

**PHILOSOPHY, THE LAW AND ECONOMICS
MOVEMENT, AND FREE TRADE**

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PHILOSOPHY, THE LAW AND ECONOMICS MOVEMENT, AND FREE TRADE

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I. Introduction

The brilliance, breath of learning, and insights of Law and Economics scholars is an undeniable fact. Equally undeniable is the appropriateness of applying the social sciences to legal thought. However, when reading Law and Economics literature, often one has the feeling that something is not quite right or at least out of place. The constant focus on efficiency, welfare maximization, and consumer preferences seems not exactly to fit with the lofty legal concepts that once made law appear so noble and attractive -- justice, truth, fairness, exactitude, compassion, dignity. Although the vague uneasiness has prompted several to criticize this or that aspect of Law and Economics, the nature of the criticism is often piecemeal and not always convincing nor satisfying. What this paper proposes to do is to argue that the Law and Economics movement is partially based on erroneous, but unarticulated, philosophical assumptions -- difficult to identify and so the cause of a vague uneasiness. By identifying these assumptions, one has a tool not only to counter and to present more effectively economic evidence in a particular case, but also to contribute to the movement by readjusting it onto firmer philosophical ground.

The application of economics to law, in itself, is a good thing. However, economics

is a relatively new science¹, a science taking the philosophy of the Enlightenment largely as a given. As such, many of the assumptions of economics have not been fully tested or explored -- especially its philosophical assumptions. With only a summary exploration of the philosophical underpinnings of the Enlightenment as applied to economics, this paper seeks to argue mainly by practical example that elements of economic analysis are quite vulnerable to philosophical criticism. This paper takes one conclusion of economic analysis -- that free trade produces great benefits for all -- and briefly explains the unspoken philosophical assumptions upon which it is based; then, this paper demonstrates how attacking these assumptions weakens the economic evidence considerably. If the reader will bear with a few pages of philosophy at the outset, he or she will better see the use of economic evidence in perspective as well as obtain an effective tool for countering economic evidence in particular instances.

II. Philosophy

A. Philosophical Assumptions

Significantly, much of the science of economics developed after the Enlightenment and is based on Enlightenment philosophy. But in the field of philosophy, Enlightenment philosophy is more and more seen as containing fundamental errors. Philosophers tell us we are in the post-modern era,

¹ Mark Blaug, *The Methodology of Economics; or, How Economists Explain* 47 (Cambridge: Cambridge University Press 1980) (All social sciences including economics are immature as compared to hard sciences such as physics.)

meaning that Enlightenment philosophy has collapsed². The implications for the law and economics movement is that certain erroneous assumptions of economics are being uncritically applied to the movement.

Philosophy can be divided into two fundamental branches (or answers to the question: what is the nature of existence?) although they have been called various names: the classical answer and the Enlightenment answer, the common-sense-based-answer and the contrived answer, the communal answer and the individualistic answer, the metaphysical answer and the materialistic answer. The old answer -- the answer advocated by the best of thinkers for millennia, the answer of Socrates, Plato, Aristotle, Cicero, Aquinas -- was that our senses are trustworthy so that having objective knowledge of reality we can also perceive and derive basic abstract principles governing existence. A key assumption or mode of thought flows from this premise: Any relationship is governed by abstract principles beyond merely mechanical relationships. (As we shall see shortly, this view is in utter contrast with modernist philosophers -- especially Immanuel Kant -- who deny our ability to even know that the material world exists.)

Based largely on common sense, the fundamental mind set is that I can come to some understanding of how things work and that to understand anything

² Positivism as the philosophy of science including social sciences is dead and presently replaced by the growth-of-knowledge philosophy of science. Bruce Caldwell, *Beyond Positivism: Economic Methodology in the Twentieth Century* 93 (London and Boston: Allen and Unwin 1982).

fully I cannot limit myself to physical measurements; I must take into account nonphysical, abstract principles as well. Aristotle taught that every corporeal thing consists of two basic metaphysical conceptions: its essence and its act of existing (also called potency and act). Thus, the human mind can grasp and essence that has no act of existing -- a particular unicorn or the idea of unicorns in general for example. This is the beginning of abstract thought. With these two first conceptions of metaphysics, one has risen above the material world to explore the principles of existence. The mind is open to a much wider perception of reality. The study of these nonphysical, abstract principles is called metaphysics, meaning “after the physical” from the title of Aristotle’s book studying the physical, “physical, ” and the very next book studying the abstract, “metaphysics.”

René Descartes (1596-1650) is the name most associated with the initial abandonment of this view. He did not start from the premise that I can discover truths about the material world and then ask about the nature of existence. Instead he started by asking what do I know for sure, concluding with the answer that the only thing I know for certain is that I am thinking, “I think therefore I am.” He excluded the entire material world from the realm of the knowable because, he reasoned, my senses sometimes make errors; consequently, and most significantly, if there is an abstract reality beyond the physical, I know next to nothing of it and so might as well ignore it. Thus, to Descartes and his followers (the European Enlightenment and almost all

branches of modern philosophy)³, there is no common-sense-based first principles on which I can base a philosophical outlook.

Note his dramatic departure from common sense, which says that just because my senses sometimes fail me does not mean that what they usually tell me is inaccurate. Of the two ways to answer the question: what is the nature of existence? Enlightenment philosophy took the less reasonable path. For to deny the basic trustworthiness of the senses is illogical: To declare one perception false is necessarily declaring another true. Having denied universal first principles, from now on, all philosophical schools will be based on the personal *a priori* postulates of a particular philosopher -- Kantian, Comptian, Hegelian, etc. -- rather than universal, common-sense-based metaphysical principles.

According to Immanuel Kant (1724-1804), the preeminent name in modern philosophy, we can never know the thing as such only the phenomenon as our mind perceives it so that mathematical science is still valid, but not much else. Denying their ability to perceive reality and thus the existence of metaphysical principles, modernists are trapped in the narrow confines of material things, of that perceivable by the senses. Kant and his followers reason that the material world is the only thing that I can sense and say something about, so I will treat it as the only practical reality. However, I will treat my understanding of it

³ Certain strains of phenomenology are the most notable exception to the modern denial of common-sense-based first principles.

with great skepticism because I am really not sure of much of anything. The hallmark of Enlightenment thought, then, is skepticism.

As we shall see, this skepticism means that any science built upon the Enlightenment -- even a social sciences such as economics -- will limit itself to the material world and only those aspects of the material that are the most quantifiable and measurable. The only relationships, then, are mathematical ones. Thus, the Enlightenment is referred to as empiricism, scientism, sensism or simply materialism; and, since modernity itself is of the Enlightenment, we are materialists. All the philosophers of the Enlightenment, the ones we rely on and quote as providing the basis for economics -- Kant, Hobbes, Mill, Locke, Hume, Comte, etc. -- start from this materialistic premise.

Little attention will be given to metaphysical thought. The laws of nature seen by the Enlightenment are purely mechanical: Since the material is the only reality worth discussing, the laws are limited to mathematical relationships of quantifiable phenomenon. Limiting understanding to the quantifiable world is referred to as positivism in philosophy. The outlook is quite narrow. This narrowness of outlook will prove to be for us, as this paper develops, quite a goldmine of attacks on economic analysis.

Thus we stand at the parting of the ways. Here at this juncture, one either

denies our ability to perceive and so our ability at abstract thought thus limiting our outlook to sense perceptions; or one trusts the senses that material reality exists; we can perceive it fairly accurately and, with a handful of intuitive rules of reason, derive abstract principles about it, thus raising our thoughts with Aristotle to the metaphysical.

The laws of nature seen by classical philosophy, the metaphysical view, are quite different from the materialistic, positivistic view, a view limited to mathematical relationships. As we use our intellect to derive abstract principles from the material, we rise above the material to the metaphysical, we see these principles and laws of nature as possessing some logical order. The outlook is quite broad. One result is that the traditional thinker did not see himself as someone able to manipulate nature based on his own subjective whims, thoughts, desires, will. He was limited to acting within objective boundaries of metaphysical principles.

The metaphysical thinker sees the world as infinitely more complex than the materialist. While the materialist sees himself as grasping, building, and manipulating material reality, the metaphysics sees himself surrounded by mystery, although the metaphysics trusts his senses, he does not see only with the senses but with his metaphysical reasoning power as well, he sees reality as such a complex array of interactions and interrelationships that he must rely on the entire body of learning and past experiences of mankind, something we

can call tradition. Just as materialistic thought can be characterized by skepticism, the metaphysical outlook can be characterized by respect for tradition. Thus, in the social sciences, we see him chary of accepting a new analysis or system that departs from tradition, especially ones focused on only a handful of observations (a tendency which at times has been a well known weakness of some metaphysical thinkers). The metaphysis sees the materialistic outlook as a hopelessly fractured, subjective array of claims, experiences and opinions.

B. Philosophy Applied to Economics

Two salient features of Enlightenment philosophy applied to economics are positivism and individualism. Positivism means that our understanding of anything is limited to what we can count, measure, weigh, or otherwise quantify in some way. Positivism is seen equally in the two main currents of economics -- empirical research and theoretical modeling. Both purport to explain through a handful of quantifiable factors and results -- factors and results linked by mathematical relationships alone. Economists are aware that this is their methodology.⁴ In fact, John Stuart Mill, considered to be both a

⁴ In a most influential writing on the philosophy of economic methodology, Milton Friedman states:

A theory or its “assumptions” cannot possibly be thoroughly “realistic” in the immediate descriptive sense so often assigned to this term. A completely “realistic” theory of the wheat market would have to include not only the conditions directly underlying the supply and demand for wheat but also the kind of coins or credit instruments used to make exchanges; the personal characteristics of wheat-traders. . . . Any attempt to move very far in achieving this kind of “realism” is certain to render a theory utterly useless.

Milton Friedman, “The Methodology of Positive Economics,” appearing in his *Essays in Positive Economics* 3, 32 (Chicago: University of Chicago Press 1953). See also pages 14-15. The similarity between this methodology and the hard sciences is no accident. “Economics since Samuelson’s Foundations of Economic Philosophy, The Law & Economic Movement, & Free Trade—Page 10

leading philosopher of positivism and a classical economist, explicitly stated positivism to be the methodology of economics in 1836!⁵

Contrast the positivistic view with economics as seen through metaphysics. The underlying assumption is that what we can empirically measure and quantify is only a small part of the total picture; every phenomenon has more meaning than apparent from the physical; economic life is part of a larger set of relationships and principles. Merely manipulating the physical world, economics cannot be reduced to, since empirical measurements are seen as one part of a wider reality.

The most profound and easily grasped example of a metaphysical principle applied to economics is the distinction between labor and capital. Laissez-faire thought tends not to see any inherent distinction between labor and capital. Both are mere factors of production, as such the costs of each are positivistically measured, quantified and tallied into economic models with a minimum of distinction, often with no distinction at all. When capitalism was first developing, this laissez-faire outlook resulted in great abuses of labor.

Analysis has looked on nineteenth-century physics as its model. Donald N. McCloskey, *The Rhetoric of Economics* 62 (Madison: The University of Wisconsin Press 1985).

⁵ He said:

What is now commonly understood by the term “Political Economy” . . . makes entire abstraction of every other human passion or motive; except those which may be regarded as perpetually antagonizing principles to the desire of wealth. . . . Not that any political economist was ever so absurd as to suppose that mankind are really thus constituted, but because this is the mode in which science must necessarily proceed.

The obvious failure of positivistic economics in this area resulted in many changes -- child labor laws and the like. However, not going to the underlying philosophy of positivism and in fact inconsistent with it, the changes were ad hoc -- as seen in the present ambivalence toward such laws by laissez-faire market advocates. Since the underlying positivistic philosophy remains intact, capitalistic philosophy has never come to terms with such obvious manifestations of the wider reality (thus such misadjustment could easily reoccur). We see this failure in the almost hopelessly fractured panoply of claims and proposals for the proper role of government in regulating free enterprise. Many are those who can articulate a reasonable justification for government intervention or laissez-faire policy in a particular instance, but rare are those able to propose a coherent philosophy covering the full range of market activities -- except for the extremes of socialism and anarchy.

(However, the idea of treating labor as just another material factor originally resulted not from this theoretical positivism, but from a practical focus on the material. When the industrial revolution first began, man was often so captivated by the material benefits of industrial production that he lost sight of the primacy of man over capital. Theoretical positivism developed later.

Even today, much of positivistic analysis is driven more by the practical than

John Stuart Mill, *On the Definition of Political Economy* 312, 317-18 (1836), quoted in Mark Blaug, *The Methodology of Economics; or, How Economists Explain* 55 (Cambridge: Cambridge University Press 1980).
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the theoretical.)

A metaphysical approach sees capital and labor as inherently quite different. Seeing the inherent uniqueness of man based in part on his intelligence, creativity, and ability to form the material world, it sees him as above the material. He is the “subject” of work, not an “object.” Therefore, any metaphysical economic system will grant him prerogatives far above what the materialists would. Vast are the implications. For example, in such an approach, treating labor commensurate with its status as subject of work, employers normally would grant some degree of partnership status to employees.

It must be noted that classical philosophy, metaphysics, is often dismissed out of hand as something rigid and obsolete, a view explained by both a widespread misconception of metaphysics and the existence of bad metaphysics -- a metaphysics which would not much resemble the above description and application to economics. Philosophers of science and of economics tend to fall in the category of those who misconceive it for they do mention metaphysics from time-to-time but then dismiss the notion in a sentence or two.⁶

⁶ For example, Baug would describe a metaphysical application to economics as an attempt to define the essence of an entire economy or economic relationship. Then he finds such a system unworkable since how an essence is defined is arbitrary, especially when defining such a broad concept. Mark Blaug, *The Methodology of Economics; or, How Economists Explain* 108-09 (Cambridge: Cambridge University Press 1980). This is an erroneous understanding of metaphysical principles. First, metaphysics does not proceed to *Philosophy, The Law & Economic Movement, & Free Trade—Page 13*

Besides positivism, the other great characteristic of the branch of modern philosophy which dominates economics is individualism. It is in fact a necessary corollary of positivism: Since only the world of sensory objects exists and since their only relationship is that found in mathematical principles, the world is an amorphous mass of these objects differentiated only by mathematical description. An atomistic philosopher sees the landscape of society as a flat expanse of individuals relating to each other by contract, an array of thousands of contracts and ultimately the “social contract.”

Associations such as the family are seen in purely contractual terms, contracts entered into because they provide the maximum quantity of various services and goods. Individualism, like positivism, permeates modern thought in ways we are often not aware.⁷

The metaphysical vision is that of society inherently made up of various social institutions: the family, small communities, trade associations, partnerships. Man is by nature social -- a metaphysical concept. The classical philosopher gives priority to the maintenance of these institutions over -- and often to the detriment of -- the positivistic preoccupation with achieving maximum

define the essences of such giant institutions as an economy in such a confining way. Second, as well as defining the essence of more discrete objects, it provides general principles governing the relationship between things. These principles, then, are developed into economic theorems and models.

⁷ Economic analysis itself is often individualistic: “The expression ‘methodological individualism’ was apparently invented by Schumpeter as early as 1908 . . . prescribing a mode of economic analysis that always begins with the behavior of individuals . . .” Blaug, *supra* note 5, at 45.

production, efficiency, and social welfare.

C. **Philosophy Applied To The Law And Economics Movement**

Therefore, the Law and Economics Movement is in error to apply an economic analysis that is based on erroneous philosophy. Literature, both academic and popular, points to the failure of modern, mechanistic economics in three ways. First, popular and political literature especially criticizes economics' utter failure to propose a coherent framework of how the government and the free market should interact. This problem was discussed in the above section. Second, the philosophy of science literature is more and more explaining to economists the inadequacies, nay the bankruptcy, of the philosophical underpinnings of economics.⁸ Using mathematics as philosophy is proving to be the enormous error that it is. For example, one philosopher of mathematics has said:

Mathematics deals with the simplest concepts and phenomena of the physical world. It does not deal with man but with inanimate matter. The behavior of matter is repetitive and mathematics can describe it. But in economics, political theory, psychology, as well as biology, mathematics is far less useful. Even in the physical realm, mathematics deals with simplifications which

⁸ Professor Caldwell, himself an economist, states it this way, "Positivism in its many variants has been in decline within the philosophy of science for the last twenty years or so, and that knowledge is now filtering down into the special sciences. . . ." Bruce Caldwell, *Beyond Positivism: Economic Methodology in the Twentieth Century* 4 (London and Boston: Allen and Unwin 1982).

merely touch reality as a tangent touches a curve at one point.”⁹

Third, Law and Economics scholars are aware of the extreme narrowness of economic analysis.¹⁰ Judge Posner, for one, is certainly aware of the problem.¹¹ And some have begun the task of establishing a methodology of transcending this narrowness.¹² (Something this paper strives to do.) Several scholars, in accord with this paper, identify economics’ tendency to over abstract as a fundamental error of Law and Economics.¹³ These scholars then

⁹ Morris Kline, *Mathematics: The Loss of Certainty* 350 (New York: Oxford University Press 1980).

¹⁰ Richard A. Posner, *Economic Analysis of Law* 14 & 27 (Little, Brown & Company, Boston 4th ed. 1992).

¹¹ In the introduction to his textbook on Law and Economics, Judge Posner states:

Since economics does not answer the question whether the existing distribution of income and wealth is good or bad, just or unjust . . . , neither does it answer the ultimate question whether an efficient allocation of resources would be socially or ethically desirable. Nor can the economist tell us . . . whether consumer satisfaction should be the dominant value of society. Thus, *the economist’s competence in a discussion of the legal system is limited.*

Id. at 14 (emphasis added).

¹² Linda A. Schwartzstein, Austrian Economics and the Current Debate Between Critical Legal Studies and Law and Economics, 20 Hofstra L. Rev. 1105 (1992).

¹³ Professor Schwartzstein observes:

Unfortunately, economics is vulnerable to this type of attack, since after stating that considerations such as equality, happiness, and other people’s welfare may enter into people’s determination of their self-interest, these considerations tend not to be given much attention since they cannot be qualified. Rather, the simplifying assumption is made that all costs and benefits can be measured in dollars. It is not made clear in either the Economics or the Law and Economics literature how these more social concerns impact on the outcomes posited.

Id. at 1118 (footnote omitted). And a Law and Economics critic has put it this way: Law and Economic’s obsession “with proving welfare maximizes best from ‘efficiencies’ of discrete economic transactions of particular self-interested parties -- dismisses everything that doesn’t fit -- all other interests, all other possible orders of welfare, the rest of life, which may be all that really *is* life.” Leonard R. Jaffee, *The Troubles with Law and Economics*, 20 Hofstra L. Rev. 777, 847-48 (1992). And yet another critic has put it this way:

A moderate Laneckian [Law and Economics advocate] might . . . [say] that, although dollars cannot measure the true utilities in a case, at least it provides a quantifiable tool that can help guide the judge. . . . But the dollars should be kept in perspective; there are many other values which may be more important even if they are softer.

begin to assemble alternative methodologies for Law and Economics, none however, are consistent with the methodology offered by this paper. The point of such critiques -- sometimes missed by defenders of Law and Economics -- is not that the fundamental philosophical assumptions render the movement worthless¹⁴ but that freeing the movement from these errors would render its insights all the more valuable.

III. A Positivistic Analysis of Free Trade

Let us now attempt to apply this positivistic-metaphysical distinction to a particular area of economics -- international trade theory. It will give us the opportunity to develop our thesis. Substantially all arguments in favor of laissez-faire free trade stem from the free market philosophy, which in turn is based on positivism. This laissez-faire, free market philosophy can be stated as the belief that markets, free from as much interference as possible, are the best means to order economic activity; the most productive have the incentive to produce as much as they can. The market develops man's inherent initiative and abilities all the while coordinating a myriad of factors to establish a price -- without any bureaucracy of any kind. As an extension of this philosophy, many argue that even the world economy should be free of interference, including tariffs.¹⁵

Anthony D'Amato, Post-Revolutionary Law and Economics: A Foreword to the Symposium, 20 Hofstra L. Rev. 757, 760 (1992).

¹⁴ For example, Edmund W. Kitch, *The Intellectual Foundations of 'Law and Economics,'* 33 J. Of Legal Education 184, 187 (June 1983), seems to believe that criticizing the philosophical underpinnings is equivalent to arguing that Law and Economics is without value.

¹⁵ A smaller number argue that laissez-faire is always the best free trade policy. For a discussion of the distinction between the free market and laissez-faire philosophies, see Patricia Dillon, James Lehman, & Thomas D. Willett, *Assessing the Usefulness of International Trade Theory for Policy Analysis, in*

Positivistic economics has identified two laws (of course, laws of a purely materialistic, mechanical nature) to explain why a world-wide free market economy works best, why even more goods will be produced. Both are based on the fact that, by specializing, production is often made more efficient. The first law is called that of absolute advantages. This means that more will be produced if a country that can produce a particular item most efficiently does so and then trades with others; all are better off. The second law is the law of comparative advantages (since refined into the Heckscher-Ohlin-Samuelson factor endowment model). In short, this means that benefits accrue from specializing in what a country is best at producing internally and then trading with other countries, even if the foreign country still has an absolute advantage. The economic literature governing these laws is highly developed and the logic is undeniable -- within certain assumptions, however.

Two types of gains cause this welfare benefit. The first gain is the consumption gain, the benefit to consumers from lower prices. We will use a general example to illustrate. Let us say that of two goods, wheat and steel, the United States has an absolute advantage in producing both over Japan. However, the United States has a comparative advantage in wheat -- it is even better at producing wheat than steel.

While Japan has a comparative advantage in steel production -- it is better at producing steel than wheat. To continue with our example then, before trade the U.S.

International Trade Policies: Gains from Exchange between Economics and Political Science 21, 24 (Ann Arbor: The University of Michigan Press, John S. Odell & Thomas D. Willett eds. 1990) and Peter H. Gray, *Free Trade or Protection? A Pragmatic Analysis* 15 (New York: St. Martin's Press 1986).

price for steel was 110 bushels of wheat for 100 tons of steel or 110/90 (\$1.1). After trade the price U.S. consumers had to pay for steel would go down to the world price of \$1.

The second gain is the production gain "aris[ing] from the allocation of resources away from the direct production of importables in higher-cost home production to the specialization in the lower-cost production of exportables,"¹⁶ For example, the production of one unit of U.S. average factor endowments would only produced \$200 worth of goods at the world price (\$110 of wheat and \$90 of steel). After the U.S. specialized, it produced \$220 worth of wheat with one unit of average factor endowments, an increase of \$20. In fact, quite a volume of literature revolves around measuring production and consumption gains -- part of the empirical branch of economics as opposed to the modeling branch.

IV. A Metaphysical Analysis of Free Trade

A. In Theory

How could a lawyer counter such economic evidence? Let us proceed using this free trade example. (Perhaps the lawyer is arguing that the existence and size of welfare benefits derived from a particular tariff reduction is vastly overstated.) In general, the answer is to begin with the basic outlook of modernist philosophy, that is, recall that the assumption of positivistic economic analysis is that only the material exists. No abstract relationship between things exists. While, in the metaphysical analysis, we look beyond

¹⁶ Gerald M. Meier, *International Economics: The Theory of Policy* 62 (New York: Oxford University Press 1980).

the material to the abstract principles, the inherent relationship between things.

A caution is in order. The precise mathematical measurements and calculations of the natural sciences, inductive in nature, have brought us great technological advances. These advances have so come to dominate our lives that their methodology -- inductive reasoning -- has come to dominate our mode of thought as well. So slow, thoughtful reflection is needed to begin organizing our modern minds along non-mechanistic lines, a thinking that is deductive in nature. It is not easy. In the example at hand, begin by asking, why does man produce in the first place? He does so because of his inherent nature as master of the material world. Remember man is above the material in general and capital in particular; he is the subject not the object. The ultimate reason for the material is so that man can develop himself -- his personality, his creativity, and especially his virtue. He does this through working with the earth to govern, to form and to develop its productivity.

At the outset, it must be admitted that international trade then is a good since it has the potential of increasing production and so the welfare of man. Also, it increases solidarity between peoples and so decreases the threat of war. The only questions then are not whether but when and to what extent should international trade be practiced? The proper frame of the question, then, is when do the costs of trade outweigh the benefits? How accurate do the

narrow mechanistic considerations reflect the costs and benefits?

In attacking positivistic economic analysis, we need to look for considerations outside the scope of positivistic analysis, considerations going to the development of the person. We will be seeking to broaden the scope of consideration. We will find that, in general, there are two general attacks to all positivistic economic analysis. The first attack concerns the facts themselves.

B. First Attack -- The Materialistic Simplifications

1. Materialistic Simplifications In General

Limited to the quantifiable, the economic model -- whatever it may be -- will by necessity simplify reality. However, the world and any part of it is much more complex than any mathematical model can account for. The model is only a facsimile of reality -- and a rather rough and tenuous approximation at that. Within a range of consciousness from the conscious to the unconscious, the economists have made many, many assumptions, some without significance, some with great significance. Looking at the social sciences from a purely material point of view, the positivistic economists applies much to quickly the mathematically precise analysis of the natural sciences to the social sciences. In order to arrive at seemingly definitive mathematical answers, he or she has made quite a number of simplifications.

But as soon as the narrow confines of the formulas are left, we note that other less quantitative factors demand to be considered, the social dimension for one.¹⁷ Focusing on measurable observations of free trade -- the decrease in real consumer prices, the decrease in real production costs, the theoretical economies of scale efficiencies -- free trade analysis becomes preoccupied with such measurements. The literature grossly discounts any unmeasurable observations. Some economists are aware of this: "International economists have long known that external economies could provide an argument against free trade. Since we have little empirical evidence on the actual importance of external economies, however, it is difficult to know how important this argument really is."¹⁸

Our criticism is not with the fact of simplification -- simplification is the necessary methodology of any model -- but with taking the results as definitive. Human relations simply cannot be quantified to the extent an electrical circuit can. It is not that the economist does not recognize he is dealing with a facsimile, but that he has

¹⁷ Compare Patricia Dillon, James L. Lehman & Thomas D. Willett, *Assessing the Usefulness of International Trade Theory for Policy Analysis*, in *International Trade Policies: Gains from Exchange between Economics and Political Science* 28 (Ann Arbor: The University of Michigan Press, John S. Odell & Thomas D. Willett eds. 1990).

¹⁸ Paul R. Krugman, *The Narrow and Broad Arguments for Free Trade*, 83 *American Economic Review* 362, 363 (1993).

lost the sense of the tentative nature of his model, he has lost the sense of the metaphysical. It is not, then, that these models are not valuable, do not provide great insights, do not involve complex and brilliant high mathematics, it is their unconscious divorce from the wider reality.¹⁹ They can and easily do go astray. The proper methodology of the social science of economics is to define and discriminate, not simplify, meaning that the mathematical models are to be placed within the context of many other considerations.²⁰

Therefore, in looking to attack the results of any positivistic economic model, the first place to look is at the factual assumptions. Again, the model is necessarily a simplification of the real. Since it is based on purely material premises, the order of its simplification will tend toward emphasizing the greatest quantity. More is usually assumed better. The analysis dwells on

¹⁹ In advocating the use of Austrian Economics in Law and Economics, Professor Schwartzstein states that Austrian Economics sees markets as coordinating such an array of data and relationships -- data and relationships that are constantly changing -- that they cannot be measured so that mathematical analysis is of little use. Schwartzstein, *supra* note 11, at 20 1129-30. Professor Schwartzstein then describes how Austrian Economics offers a method of transcending the narrow confines of positivism.

²⁰ In arguing in favor of a university having a broad vision, Newman states:

I observe, then, and ask you, Gentlemen, to bear in mind, that the philosophy of an imperial intellect, for such I am considering a University to be, is based, not so much on simplification as on discrimination. Its true representative defines, rather than analyzes. He aims at no complete catalogue, or interpretation of the subjects of knowledge, but following out, as far as man can, what in its fulness is mysterious and unfathomable. Taking into his charge all sciences, methods, collections of facts, principles, doctrines, truths, which are the reflexions of the universe upon the human intellect, he admits them all, he disregards none, and, as disregarding none, he allows none to exceed or encroach.

John Henry Newman, *The Idea of a University* 346-47 (1857).

a measurable end result. The factors bringing about the end result are those easily measured. The nonmeasurable factors are at most acknowledged. Thus, the most fruitful areas to attack are the assumptions that the difficult-to-quantify factors are so small as to be largely irrelevant. Remember that because the economist is working from a positivistic philosophy, such assumptions are often made unawares.

2. Simulated Comparative Advantages (SCAs)

We have reviewed traditional comparative advantage and factor of production analysis upon which free trade theory is based. We saw that the whole theory rests on the idea of nations having comparative advantages. We emphasized that, from a philosophical point of view, free trade theory is based on the output-maximizing, mechanistic nature of free markets: The exchange of various goods between nations is in essence a giant machine that maximizes production. However, machines have no eyes. Man can easily fool a machine. Even a child can place a slug in a soda machine.

Thus, in the material simplification phase of our attack, we need to begin to look for erroneous discounting of material factors simply because those factors are less quantifiable. The obvious place to begin is to look at the comparative advantages themselves since

they are so central. This paper will argue that the extreme positivism of trade analysis has made it blind to the fact that many countries simulate comparative advantages in order to earn a greater share of the welfare benefits resulting in an overall welfare loss from trade. Substantial evidence exists that many comparative advantages of the modern world are "simulated comparative advantages" (SCAs), and theoretical trade models confirm that free trade is not beneficial when SCAs are present; despite this, international trade, empirical analysis ignores the existence of SCAs. The idea of SCAs is not new. Neither is the fact that under traditional models trade is harmful under such circumstances (something we shall see in more detail shortly). But what this paper finds is that trade analysis, both empirical studies and models, has tended to ignore the existence and importance of SCAs and other factors because they are difficult to quantify -- a far-reaching positivistic error.

In the positivistic analysis of free trade as applied to the market sphere, welfare is maximized by specializing along the lines of comparative advantage. According to this model, the country doing the exporting will reap the greatest share of the welfare gains (to be discussed in more detail below). Therefore, each country will have an incentive to increase exports, will have an incentive to

make it appear as though it has a comparative advantage. For example, in the above illustration, Japan might underpay its steelworkers in order to appear to be able to sell to the United States at a competitive price.

How free trade causes a net welfare loss to the United States and to the world under this circumstance can be found by questioning two of the assumptions of traditional trade analysis. We will find that two major assumptions are not a part of modern trade patterns. The positivistic preoccupation with highly measurable factors has made the application of an otherwise valid model blind to factors leading to a welfare loss -- even though these factors are material and somewhat quantifiable, *they are just not highly quantifiable*. Let us now concentrate on changing only one assumption. The elimination of this one assumption alone results in U.S. welfare loss from trade!

This assumption is that exports must equal imports or what this paper and international trade literature calls the "general equivalency principle of trade." The general equivalency principle of trade holds that a trade imbalance can only exist in the short run. The imbalance will always be rectified through one of several mechanisms. One mechanism is the product market itself, the

amount each country sells to the other will be equal because supply will equal demand. The financial market is another mechanism -- if a country does not export as much as it imports, its currency will depreciate. When a country does not import as much as it exports, that country's currency must appreciate, and a net welfare loss to its trading partner results.²¹ Thus, welfare loss from inefficient production caused by the SCA is transferred from the exporter to the importer.

In the traditional view of welfare analysis, these mechanisms are not a factor since it is assumed that the foreign nation will always import from the United States the exact amount it exports to the United States. That is, its imports will rise to the level of U.S. imports. It is assumed Japan will use its export revenues to purchase products the United States has a comparative advantage in producing. However, if Japan wastes its export revenues by using artificially low labor costs, then it cannot buy as many U.S. products as would be expected. The undereducated, underhoused, underfed families of underpaid Japanese workers will not be in a position to buy many U.S. products.

Let us explore this example using numbers. What if Japan were

²¹ Meier, *supra* note 15, at 26. This paper does not cover the more complex case of multiparty trade, however, the same result will be had in those cases.

simulating its comparative advantage in steel production? What if its true steel production per unit of average factor endowments were \$30 less than appeared? In other words, Japan would be using more than one unit of factor endowments to produce 190 tons of steel but exporting a large quantity of steel, a quantity consistent with producing 190 tons per unit. If one average unit of factor endowments consisted of 10 workers, then it is really taking 12 to produce 190 tons of steel. Japan's internal price of steel is not 0.8 but 0.94 (75/80). It still has a comparative advantage but not nearly as large. So Japan will end up exporting much more steel than it should if world welfare were maximized.

Figure 1	
U.S. Wheat Production, Consumption, and Sales During Simulated Comparative Advantages	
220	U.S. Potential Wheat Production per Unit of Average Factor Endowments
<u>-30</u>	Decrease Production Because of Fall in Japanese Demand
190	
<u>-70</u>	Sell 70 Bushels to Japan
120	
-30	Sell 30 Bushels Elsewhere to Raise Extra \$30 for of Steel
90	Total U.S. Wheat Consumption

However, to produce each 190 tons of steel, Japan is underpaying its workers because it is using more than 10 workers to produce the 190 tons. These 12 workers must share in the same income as 10 would receive for one unit of output. So Japanese workers would not be in a position to buy as many U.S. products as expected. Japan would still produce 190 tons of steel per apparent unit and sell 100 tons at \$1 per ton. But since Japan's internal cost is \$30 more per unit than appears, it will buy \$30 less per 190 tons of steel produced, only \$70 worth of wheat. Since demand for U.S. wheat has decreased by 30 bushels, the United States will decrease wheat production by 30 bushels per unit to 190. Of the 190, it sells 70 to Japan leaving 120. It must sell 30 more somewhere else to raise the additional \$30 needed to purchase the full 100 tons of steel leaving only 90 bushels of wheat per unit of output. See **figure 1.**²²

Significantly, the United States welfare is not improved by trade with a wasteful partner; the U.S. economy is even harmed by such a trade since the wheat production industry would suffer an income

²² The welfare loss need not come about through an absolute change in demand as shown here. It may come about as the monetary exchange rate or world commodity prices change. But the welfare changes would be the same no matter which equilibrium mechanism came into play.

In addition, the precise welfare loss may vary slightly from that shown here since demand for steel in the U.S. would fall as wheat production is reduced.

decline. Eventually, U.S. wheat production would decline, so its comparative advantage would go to waste.

To the extent that foreign workers are underpaid, they will not buy U.S. products, e. g., Boeing 747s and wheat. The unemployed U.S. workers will not be able to afford many 747s or much wheat either. So these industries will shrink even more. Therefore, no production gains from trade will exist, rather a loss. Some consumption gains from trade will exist, but they will be much smaller than the estimate since U.S. consumers will not have a large enough income to take full advantage of the lower prices.

3. What Effect Would SCAs Have On Free Trade Theory?

Contrary to an intuitive view²³, a foreign manufacturer selling to the United States at below real costs harms U.S. welfare because resources are allocated inefficiently. Of the two gains from trade, the production gain deteriorates quite seriously. Not only is the production gain nonexistent but also a production loss occurs. In the U.S.-Japan example, the U.S. wheat production resources are not being used efficiently; the United States is not even using all of its wheat production resources. Even the consumption gain is partly a chimera since many consumers no longer have the income

²³ Dillon, Lehman, and Willett, *supra* note 14, at 43.

to take advantage of lower prices. These inefficiencies result because SCAs make prices meaningless.

If price is to be our guide for buying, selling and investing, then price should tell us something about efficiency. Efficiency should refer to the amount of real resources used per amount of useful product manufactured.

.....

Indeed, . . . there is an enormous disparity between the price of a product or service to an individual and the cost of that same product or service to the society as a whole.²⁴

In other words, someone is placing slugs in the soft drink machine, but the positivistic approach is unable to detect it.

Sure enough, free trade theory itself confirms that SCAs would cause a welfare loss to the importing nation. The above U.S.-Japan example is a well established part of trade theory. Both the existence of SCAs and the resultant welfare loss of trade are consistent with the existing literature.²⁵ As economists advocating

²⁴ David Morris, *Free Trade is Harmful, in Trade Opposing Viewpoints* 25, 28-29 (New York: Greenhaven Press, Inc., David L. Bender and Bruno Leone eds. 1991).

²⁵ The SCA phenomenon developed in this paper exists in economic literature under the names of interference, distortion, or market imperfection. Bharat R. Hazari, *The Pure Theory of International Trade and Distortions* 86-100 (London: Croom Helm Ltd. 1978); Ronald W. Jones & J.P. Neary, *The Positive Theory of International Trade, in International Trade: Surveys of Theory and Policy: Selections from the Handbook of International Economics*, 2, 45-53 (Amsterdam: Elsevier Science Publishers B. V., Ronald W. Jones ed. *Philosophy, The Law & Economic Movement, & Free Trade—Page 31*

free trade have stated: "Textbook treatments of the gains from trade based on simple models are . . . valuable in demonstrating the possibilities of gains and illustrating how they can come about. It is quite a different matter to take such illustrations as proof that free trade is always optimal."²⁶ In other words, trade theory is based on a mathematical model. The results of the model in turn are based upon highly stylized facts. When these stylized facts are changed, even slightly, the results of the mathematical model vary, often greatly. When a basic assumption of trade theory is altered, the result is a welfare gain for the United States turned into a loss.

Positivism is clearly at work here. Economists working with the

1986); Anne O. Krueger, *Trade Policies in Developing Countries*, in *International Trade: Surveys of Theory and Policy: Selections from the Handbook of International Economics* 131, 160-166 (Amsterdam: Elsevier Science Publishers B.V., Ronald W. Jones ed. 1986) W.M. Corden, *The Normative Theory of International Trade*, in *International Trade: Surveys of Theory and Policy: Selections from the Handbook of International Economics* 65 86-100 (Amsterdam: Elsevier Science Publishers B.V., Ronald W. Jones ed. 1986) This interference literature draws the same conclusion reached here; namely, when the normal free trade assumptions are interfered with, a welfare loss may well result from free trade. *Surprisingly, this author has not found a single critic of free trade who cites this literature!* Couched in much more technical language than used here and built upon a more sophisticated analysis, this literature is not very accessible. In addition, this literature is quite theoretical treating a welfare decline from free trade as just another of many outcomes when the assumptions of free trade are varied. That this outcome may be a significant fact of modern trade is usually dismissed based on a small range of empirical evidence only. However, this literature acknowledges that little evidence exists on the effects of interference. Krueger, *supra* at 167 - 169. Significantly, a paper devoted to demonstrating that free trade results in a welfare gain in a large number of interference cases specifically finds that "subsidies either of production . . . or of trade" do not result in such a gain. Alan V. Deardorff, *The General Validity of the Law of Comparative Advantage*, in 80 *J. of Political Economy* 941, 941 (1980)

The fact that a well-accepted branch of free trade theory acknowledges that SCAs would cause a welfare loss to the importing nation coupled with the almost total absence of understanding that this is occurring in practice strongly supports the thesis of this paper. A positivistic approach to the complexity of any of the social sciences is destined for failure. There are just too many factors, tendencies, relationships, and shadings of the above to keep track of. It is not that positivistic models are without value, but that in the social sciences they provide only a part of the picture -- a much smaller part than in the natural sciences.

²⁶ Dillon, Lehman, and Willett, *supra* note 14, at 26.

theory of free trade see the possibility of SCAs and then work out what the effects would be on the model, finding a net welfare loss would be created. However, this small line of the purely theoretical literature is entirely lost when the theory is applied through empirical studies. The difficult to quantify factors producing SCAs can find no place in the stylized economic analysis, the type of analysis especially relied upon in political debates.

4. The Two Assumptions Of Free Trade

In reality, two assumptions of trade theory are not consistent with modern trade patterns. The elimination of both these assumptions results in a loss from SCA based trade and transfers the loss to the importing country. Eliminating the second assumption, immobile factors of production, makes SCAs more likely; virtually all free traders admit that capital is mobile. But they argue that SCA based trade causes a loss to the exporting country and a gain to the importing country. However, when we drop the first assumption, exports equal imports, the welfare loss is transferred to the importing nation, as we just saw. After exploring the theoretical framework, we will go on to look at some empirical evidence of modern trade patterns.

The second unrealistic assumption is that factors of production are immobile. For example, if a firm in the United States started

producing wheat more efficiently through the use of chemical pesticides, then the traditional theory starts with the assumption that the chemical pesticide technology would not be transferred to other countries, Japan in the example. Thus the comparative prices within each country are held constant. If the chemical pesticide technology were transferred to Japan, then the United States may well lose its comparative advantage in wheat production rendering the precise welfare calculations far off the mark.

If such technological factors of production were transferable, then a U.S. welfare loss would be the more likely outcome.

Technological factors of production being mobile, a technology based comparative advantage would be difficult to maintain.²⁷ So as far as manufactured products are concerned, comparative advantages would depend upon only a few relatively immobile factors of production, most notably, labor, the environment²⁸, and government. Thus, the pressures on a country to simulate a comparative advantage in one of these three areas would be great.

5. The Three Immobile Factors of Production

Having stated that most production factors are now quite mobile so that the most significant immobile factors -- labor, environment,

²⁷ Meier, *supra* note 15, at 42; Robert H. Heller, *International Trade: Theory and Empirical Evidence* 6 (Englewood Cliffs, New Jersey: Prentice-Hall, Inc. 1968).

²⁸ William McGaughey, Jr., *A U.S.-Mexico-Canada Free-Trade Agreement: Do We Just Say No?* 37 (Minneapolis: Thistlerose Publications. 1992).

and governmental -- are particularly susceptible to simulation, let us explore what they entail for their nature is indeed an important oversight of positive economics. Then, in the next section, we will go on to look for empirical evidence of simulation. Others have already ably started the analysis so that only the main points should be made here.

Let us begin with artificially low wages. Is it possible to define a simulated low wage? Some may argue that wages are simply a product of supply and demand, so no wage is too high or too low. Theoretically, a simulated low wage exists and is defined as any wage below a subsistence wage.²⁹ A subsistence wage is that needed to feed, cloth, educate, and house a family at a reasonably acceptable level. By a reasonably acceptable level, reference is made to the particular society. For example, a sixth grade education may be acceptable in one society while a high school education, in another. So even if all economies were paying a living wage, some economies would still have a real comparative advantage in certain types of low-skill labor costs or in the availability of high-skill labor.

With environmental costs, in most instances, real comparative advantages would be quite small since pollution has basically the

²⁹ Gray, *supra* note 14, at 11.

same effects everywhere. As far as creating a SCA by disregarding environmental costs of production, based on the estimated large costs of such regulations³⁰, production advantages resulting from ignoring environmental costs would also be great. As far as environmental based costs, many have documented large costs of environmental laws.³¹

That governments may create SCAs is well established. International trade treaties address the problem, even the GATT and World Trade Organization. United States antidumping and countervailing duty laws were established in large part to counteract governmental aid to export industries. Such aid may take the form of a direct subsidy or it may be in a nuanced form, for example, granting tax breaks to industries which happen to export most of their production. Legitimate government based comparative advantages do, however, exist. That a particular government is better able to promote solid industrial infrastructure is a real comparative advantage.³²

³⁰ U. S. Environmental Protection Agency, *Final Report: The Cost of Clean Air and Water: Report to Congress 1984* (Washington, D.C. 1984); Michael Hazilla & Raymond J. Kopp, *Social Cost of Environmental Quality Regulations: A General Equilibrium Analysis*, 98 *J. of Political Economy* 853 (1990).

³¹ U.S. Environmental Protection Agency, *supra* note 29; Hazilla & Kopp, *supra* note 29.

³² The effectiveness of governmental SCA policy can be seen in one of free traders' own arguments. A line of free trade analysis points to the added welfare benefits of free trade resulting from free trade's tendency to promote capital formation. "If a liberalization raises the return of capital, it will induce capital formation and thereby raise output more than static effects alone would predict." Richard E. Baldwin, *Measurable Dynamic Gains from Trade*, 100 *J. of Political Economy* 162, 162-63 (1992). So Governments have all the more incentive to promote SCA based trade. However, since this capital formation gain results from the growth in

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6. Evidence of SCA in Modern Trade Patterns

Let us leave the theoretical framework of free trade and look at modern trade patterns to determine whether SCAs are in fact a player. We will review three major aspects of present day trade as they relate to the two major assumptions of traditional trade theory questioned above. We will find substantial evidence, often positivistic, that much of the growth in international trade is SCA driven and so producing welfare losses. The inability of trade economists to perceive such evidence -- positivistic and so perceptible by them -- confirms the flawed outlook of Enlightenment economics -- it is so oriented toward finding end results that intermediate considerations, no matter how significant, are only cursorily considered.

a. Evidence of Factor Mobility

The first assumption questioned was that production factors were immobile across country borders. The evidence is overwhelming that many factors of production are highly mobile, at least between countries with an already substantial production infrastructure.³³ The factors of even

exports, it will be a net loss for the importing country (the United States in the examples) since production decreases. The fast rise of newly industrialized country industries and the equally fast decline of U.S. industry may be partially explained by this effect of exporting.

³³ Tim Lang & Colin Hines, *The New Protectionism: Protecting the Future against Free Trade* 22 (New York: The New Press 1993); Morris, *supra* note 23, at 29 - 30.

high technology production proved surprisingly mobile. Production of items initially developed in the United States move overseas often. Such items include computers, semiconductors, telecommunications equipment, and analytic equipment.³⁴

b. Evidence of The "General Equivalency Principle of Trade" -- The Monetary Exchange Rate

The monetary evidence at first seems to contradict the thesis of this paper. The "general equivalency principle of trade" holds that if a country does not export as much as it imports, its currency will depreciate.³⁵ So, the lack of demand for U.S. exports should show up by a substantial decline in the U.S. dollar since 1973. To a large extent, no such decline has occurred. The evidence is deceptive. To begin with, the U.S. dollar has depreciated against major trading partners such as

³⁴ Committee for Economic Development, *The Trade Deficit Harms the U.S. Economy*, in *Trade: Opposing Viewpoints*, 175, 179 (New York: Greenhaven Press, Inc., David L. Bender and Bruno Leone eds., reprinted from *Toll of the Twin Deficits* (New York: Committee for Economic Development 1987).

³⁵ Meier, supra note 15, at 26.

Japan.³⁶ But most importantly, cash from non-trade based transactions flows into the United States from several sources. These flows, quite substantial, alleviate the downward pressure on the dollar. They include royalty payments made to U.S. interests³⁷, proceeds from foreign operations of U.S. based corporations, payment for services, and returns on foreign investments. But perhaps most important is the massive but immeasurable capital flight into the United States.³⁸ Internal monetary forces also served to strengthen the U.S. Dollar. "In the United States, . . . a combination of government deficit and private investment in excess of private saving strengthened interest rates and thereby attracted capital from abroad, leading to appreciation of the dollar"³⁹ Therefore, the behavior of the U.S. dollar is consistent with trade causing a welfare loss. (One

³⁶ International Monetary Fund, *International Financial Statistics* (Washington, D.C.: International Monetary Fund 1992).

³⁷ Steven Schlossstein, *Trade War: Greed, Power, and Industrial Policy on Opposite Sides of the Pacific* 120 (New York: Congdon & Weed, Inc.1984).

³⁸ Donald R. Lessard & John Williamson, *Capital Flight and Third World Debt* (Washington, D.C.: Institute for International Economics 1987); Angus Maddison, *Economic Progress and Policy in Developing Countries* 223-24 (London: Allen & Unwin 1970).

³⁹ Richard N. Cooper, *Industrial Policy and Trade Distortion: A Policy Perspective, in International Competitiveness* 115, 118 (Cambridge, Massachusetts: Ballinger Publishing Company, A. Michael Spence & Heather A. Hazard eds. 1988). Cooper argues that trade does not cause a welfare loss. However, his observation that high U.S. interest rates leads to appreciation of the dollar is in accord with this paper.

should be getting a feel for the complexity of economic phenomenon and so how inappropriate it is to limit its study to a handful of empirical factors.)

c. **U.S. Exports Not in Demand**

The absence of demand for U.S. exports is strong evidence in support of the existence of SCAs. As U.S. tariff rates declined and manufacturing technology became more defused internationally, U.S. manufacturing declined precipitously. The labor, environmental, and governmental factors which remained largely immobile proved dispositive. Production moved abroad to where these costs were lower. The cry became: the United States will concentrate production in what it has a comparative advantage in; the displaced factory workers, starting with the most intelligent and industrious ones, will find employment in these promising sectors. The high technology industry seemed an obvious place of U.S. comparative advantage. However, foreign demand did not develop. Indeed, nothing guarantees that the demand for high-wage items

will increase at the same rate high-wage U.S. jobs are displaced by foreign low-wage jobs.⁴⁰ For example, McGaughey⁴¹ points to the fact that Mexican income is so low that they cannot afford many U.S. products. This is because "holding down wages, as a means of lowering production costs, limits the size of the market"⁴² After all, how much need of Boeing 747s and American lawyers does a population making pennies per day have? How much U.S. wheat could such populations buy? Would not they manage to get by on a little locally grown rice? If the low costs of imports were based on true comparative advantages, then demand for U.S. exports would not have faltered.

C. Second Attack -- The Materialistic Boundaries

1. Smallness Philosophy

The second attack is of the materialistic boundaries of the model. Almost always the model is fundamentally true. The problem, therefore, is that the economic model makes an absolute of a

⁴⁰ Sima Lieberman, *The Economics and Political Roots of the New Protectionism* 142 (Totowa, New Jersey: Rowman & Littlefield 1988); *similar*, Gray, *supra* note 14, at 87.

⁴¹ McGaughey, *supra* note 27 at 24.

⁴² R.J. Barry Jones, *Perspectives on International Political Economy, in Perspectives on Political Economy* 173, 179 (New York: St. Martin's Press, R. J. Barry Jones ed. 1983).

relative truth. For the truth of the economic model is always relative to the full truth of the abstract reality. Besides the first attack, the process of oversimplification in a way that adduces exaggerated benefits from mechanistic models, current economics is virtually blind to the abstract truths behind relationships in society.

Again, the economist's materialistic outlook may well not be based on the theoretical materialism going back to Descartes, but on practical materialism; however, the same result attains. Practical materialism in economics means to be so mesmerized by the potential and real output of a particular market structure as to disregard both the less-quantifiable considerations and the abstract setting of the market structure. Thus, if asked, the economists may not admit to being a philosophical materialist, but he has made a practical division between the non-quantifiable realities of abstract principles and the quantifiable materialistic world (an error called dualism in philosophy).

The practical import for us is that one can always go beyond a material model to an abstract model and find deficiencies and harms in the purely physical outlook. We will now attempt to look beyond the materialistic view of trade in our search for additional arguments against free trade. Also, we will look for arguments to

counter specific contentions of free traders.

The metaphysical view of a properly structured market can be seen in terms of one central theme, the humane functionality of relatively small economies. SCAs have been presented as a serious problem so currently widespread that the costs of free trade often outweigh the benefits. We will now come to see SCAs as just one serious symptom of the error of encouraging a highly integrated world economy. Despite the shrinking of the world through communications and transportation, the metaphysical view still favors relatively autarkic countries or at least regions. Under such a system, trade would be based mostly on natural comparative advantages -- climate and natural resource differences.

The extreme specialization of regions contemplated by free trade advocates may seem logical from the positivistic approach, an approach based on mathematical formulas. However, when we return to the wider, metaphysical goals of markets -- to develop the human personality, to serve as a tool for man as he develops the earth's resources while providing him a better living -- we begin to see the extraordinary narrowness of the mathematical view, a view based on the sole goal of maximizing output. (We have already seen how the mathematical, ignoring SCAs, fails miserably at even

its stated goal.)

Let us begin by reminding ourselves of the growing signs of disfunctionality in our open economy (something free trade advocates are prone to ignore, usually because the relationship between free trade and disfunctionality is not obvious as viewed from the narrow confines of the mathematical). A society does not operate well as a mere cog in an international production scheme. The society and its members are bound to become alienated from others.⁴³ That this alienation occurs can be objectively seen in several ways. To begin with, income distribution becomes quite skewed as a country becomes oriented towards trade. Since many of the long-term benefits of free trade consist of returns on capital especially to large capital, capital holders, a small minority, benefit the most.⁴⁴ Society may cease to function under such a condition. Governments are ill-prepared to remedy the situation; the voice of the increasingly powerful minority dominates on the one hand, and the easy remedies of income redistribution and the welfare state soon show their ineffectiveness on the other.

Besides the smooth functioning of society, the humaneness of

⁴³ *Id.* at 30; Morris, *supra* note 23, at 31.

⁴⁴ Ravi Batra, *The Myth of Free Trade: A Plan for America's Economic Revival* 158 (New York: Charles Scribner's Sons 1993).

smaller economies points to another central goal of metaphysical economics: The development of the individual. As an economy becomes more and more developed and the role of the individual becomes more and more specialized, the individuals become less and less developed. Their limited range of experience coupled with their inability to understand their role in such a complex, highly-dependant society has significant negative effects on human development. To regulate such a dependent society, governments multiply the number of laws, regulations, and regulators thus restricting individual liberty. Individual autonomy with its attendant psychological and societal benefits erodes. Who can measure such effects? Asking whether anyone will ever put a number on such a phenomenon misses the point that such a factor is quite large, apparent, and real. Non-materialistic thinkers have long noted this phenomenon.⁴⁵

These unmeasurable, metaphysical goals of a market can be

⁴⁵ For example, a British writer Dr. Copelston has observed:

The more the powers of each individual are concentrated in one employment, the greater skill and quickness will he naturally display in performing it. But, while he thus contributes more effectually to the accumulation of national wealth, he becomes himself more and more degraded as a rational being. In proportion as his sphere of action is narrowed his mental powers and habits become contracted; and he resembles a subordinate part of some powerful machinery, useful in its place but insignificant and worthless out of it. . . . The advantage of the community is nearly in an inverse relation with his own.

As quoted in Newman, *supra* note 19, at 127. Alexis de Tocqueville said essentially the same thing. (1957) *Democracy in America: Vol. II*. 168, chapter XX, New York: Alfred A. Knopf.

described, then, to a certain extent as the external economies of autarchy. These goals -- the development of the individual and the smooth functioning of society -- do not lend themselves to an empirical method of analysis. We need to begin to outline this metaphysical philosophy in order to emphasize its incompatibility with a purely empirical study.

The basis for the "smallness philosophy" advocated here can be described in terms of ease of communication, something enhancing the metaphysical goal of personality development, something enhancing man's ability to properly tend the earth. In a sense, all the supporting arguments emanate from the efficiency and quality of communication existing only in a small economy. The personal responsibility and accountability felt by all constituents to one another are particularly enhanced by smallness of scale.

The most obvious example is in the government. The remoteness of government decision makers from most constituents within a country or even within a political subdivision is magnified by adding an international supranational structure above the national level. Thus when a particular firm within an industry within a geographic political subdivision within a country exports based on an SCA and the negative welfare costs are paid in distant lands,

perhaps even spread minutely over many countries, then the chance of the supranational organization responding to the needs of its constituents and correcting the inefficiency is remote indeed. Not only would those directly harmed not be able to reach the distant decision makers, but also the decision makers would not be able to even detect the SCA and its harmful effects.

In the business world, the deterioration of communication is just as strong. The prime example is the link between supply and demand, a link broken by the large volume of imports and by the growing skewed income distribution. This link was the driving force behind much of U.S. economic growth for the entire history of the country.⁴⁶ Say's law ruled: supply automatically created its own demand. The link has been so clearly broken that the Keynesian method of government spending to stimulate an economy as well as the supply sider's promotion of production are ineffectual. The possibility that some type of supranational body could step in and fix the broken market mechanisms -- coordinating U.S. economic policy with every other country in the world -- is impracticable.

The delocalization of production also harms communications between related industries. Especially recently, economists have

⁴⁶ John M. Culbertson, *The Folly of Free Trade, in Free Trade Versus Protectionism* 55, 59 (New York: The H. M. Wilson Company, Donald Altschiller ed. 1988).

documented the "linking industry" phenomenon where rivals and related industries historically gravitate to one region.⁴⁷ But often even unrelated industries sprout up in proximity to established industries. They take advantage of the example, physical infrastructure, financial infrastructure, and general business know-how already present.

Man's tending of the earth's resources becomes not so much a tending as a thoughtless exploitation. The decision to use a particular production process -- made in a distant place often under the press of enormous market forces -- is made with minimal understanding of the effect on the earth. With the power of modern technology, the danger here is quite large.

The philosophical distinction between technology and science provides another explanation for the mechanistic outlook of our culture. The fact is that technology has come to dominate modern life. While science is oriented toward knowledge and truth, technology distances the user from understanding. The user of technology is concerned with that the technology should function correctly, not how it works. Hence, a technology dominated culture becomes an artificial culture, a culture oriented toward the

⁴⁷ Michael E. Porter, *The Competitive Advantage of Nations* 10, 131-154 (New York: The Free Press 1990).
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ends alone. Thus, our mind set when turned to economics is oriented toward maximum output, the bottom line. We give little thought to how the bottom line is reached, e.g., the effects of SCAs on trade patterns, the effect on our neighbors of moving production overseas, the effect on the environment.

2. Arguments In Favor Of Free Trade

Let us now take this second attack on free trade -- the metaphysical boundaries -- and apply the attack to specific arguments in favor of free trade. Such an analysis demonstrates that the metaphysical view encompasses -- as it well should -- existing trade theory and so is a far reaching synthesis of trade theory with other concerns; it is not a radical departure from existing trade theory.

When confronted with the existence of SCAs, free traders would argue as follows. Market forces would eventually eliminate any SCA on their own. Any SCA could not be carried on indefinitely. The true cost must eventually be paid so that the offending country would eventually suffer from its deception. The alternative, government interference, is too ineffective. It is beyond the means of government bureaucrats to discern and properly counter an SCA.

To present even an outline of the volumes written on both sides of
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this argument is beyond this brief paper. However, the metaphysical approach provides us with three particularly salient counter arguments. First, the human costs of such market corrections on a world economic level are too high for most to tolerate.⁴⁸ Economic misadjustments lasting even centuries and deep depressions would result from such corrections. Remember that in the metaphysical approach, providing a stable environment for our citizens to develop is one of the more abstract benefits we are seeking. The constant restructuring -- waves of layoffs, transferring production from that region or this region -- entails costs quite beyond what a mechanistic market analysis can consider. Besides few if any countries would be willing to make their political interests subservient to increasing the efficiency of the world economy. Inevitably, through government intervention, each country will encourage the highly prized manufacturing jobs.

Second, the benefits of a free market do not much exist on an international scale. Especially recently, economists have pointed to the dynamics of relatively autarkic economies, a theme developed in the above section.

Third, a government policy of encouraging small-scale domestic

⁴⁸ Gray, *supra* note 14, at 16 - 18 & 82.

production does not mean more government interference in the free market system. It means less. Any comparison of the amount of government regulation in modern laissez-faire economies to traditional economies demonstrates this. The volumes of U.S. business statutes and regulations did not begin to appear until market forces grew to large proportions. The ungainliness of mechanistic market forces is simply too harsh on society for any government to ignore and remain politically popular. To encourage small-scale production requires only a handful of general policy actions by the government. When more detailed restrictions are needed, these would be left to smaller societies -- trade associations and the like.

V. **Conclusion**

The social science called economics has become quite mechanistic, especially in the United States. By mechanistic is meant that analysis dwells on a handful of highly-quantifiable, well-definable factors, whether found in empirical studies or theoretical models. All other considerations are only vaguely acknowledged. This mechanistic view is added to and reinforced by the idea that impersonal, mechanical market mechanisms will produce the best result -- defined as the maximum output.

Although sophisticated, refined, and not without value, such analysis is inadequate. To proceed as though only one part of reality is the totality of reality means that the

better part is not considered. The analysis is myopic and somewhat hypnotic as the easily grasped and colorful images of great output and easily understood results in bottom-line-number-form draw the onlooker's attention ever more powerfully to focus on and see only these images.

To confront the weaknesses of this analysis, we must understand the twofold historical causes of this materialistic error. For the causes are not limited to economics but are a pervasive part of society. Thus not only have the eyes of economists been slowly drawn downward into a mesmerizing fixation on the material but also the eyes of our culture and society over the past several centuries. The first cause is the materialistic Enlightenment premise of economics. The second is that much of economics is such a new science that it has no historical premise other than the Enlightenment.

The range of consideration in any social science is so broad as to be worthless if cut off from the wider patrimony of thought and learning. By thinking of ourselves as autonomous persons capable of understanding and judging anything independently -- as Enlightenment individualism tells us -- we become prone to manipulation and tyranny, including the tyranny of numbers. We see little value in the vicarious experiences and many points of view offered to us by the liberal arts. "Just give me the bottom line!" becomes the motto of even professorial research.

Although requiring quite a counter-cultural effort, the lawyer wishing to counter such

narrow evidence has the tools to do so. He or she simply steps out of the Enlightenment to the wider-vision of the metaphysical view of classical philosophy. But since Enlightenment thought is so entrenched, he or she must consciously assume the role of the teacher and instruct his audience in a foreign outlook. However difficult, the rewards are great since he can effectively question even such well accepted conventional wisdom as that free trade will benefit all.

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