

Papers, unpub. ?
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1996

HENRY GEORGE AND THE QUEST FOR AN OPEN ECONOMY

Henry George became interested in the free trade question at the time when Great Britain had established an open trade regime and the United States was moving towards protectionism. His fundamental concern is the persistence of poverty in the midst of plenty in modern times. It is due to his concern for the plight of the vast majority of the people that he looks at the issue of free trade. Thus, he seeks to explore: How will free trade affect the working class? Is free trade in the interest of the lowest strata in society? Does free trade ameliorate poverty?

George argues that because free trade increases total wealth and reduces cost it is a necessary but not a sufficient condition for the improvement of the position of the working class. Without the elimination of land monopoly and a land value tax (or land user tax/fee), the benefits of free trade do not "trickle down" to the workers. He believes that the cardinal weakness of free trade is its inability to directly improve the quality of the life of the working class. Nevertheless, he fully endorses the free trade movement because a fully free trade regime removes all forms of restrictions to the operation of a "spontaneous" market system. He is not merely concerned about pragmatic issues but also the moral case for free trade.

The theoretical justification for free trade is widely known and is generally accepted among neoclassical economists. Yet the clamor for protection persists on the ground for "fair trade." Protectionism and other modes of trade restrictions are rationalized on the basis of universal human rights; varying

environmental regulations; trade sanctions; national security; and so forth.

In this paper, George's arguments in favor of free trade, as articulated in his book Protection or Free Trade (1886), will be examined. The relevance of his arguments to contemporary debates will be shown. Furthermore, it will be argued that George is correct in his conviction that abolishing land monopoly is essential to obtain the full benefits of free trade.

Section I: The Case for Free Trade

Adam Smith¹ advocated free trade. He showed that, with free trade, each nation specializes in the production and export of the commodity in which it has an absolute advantage, and imports the commodity in which it has an absolute disadvantage. The international specialization of production and the global division of labor increases world output.

David Ricardo² argued that, even if a nation had an absolute disadvantage in the production of both commodities with the respect to the other nation, trade is mutually beneficial. A nation should specialize in the production and export of the commodity of its least disadvantage in order to import the commodity in which its disadvantage is the greatest.

As long as there are differences in comparative costs in the production of commodities, a basis for international trade exists among nations. If the pre-trade relative commodity price differs among nations, then there is a basis for beneficial trade among nations. With trade, a nation can specialize in the production of

the commodity in which it has comparative advantage and end up consuming more valued goods than without trade. A nation is better off with trade than in autarky because it can consume more goods and/or more valued goods. The benefit of trade can be classified into two categories: (i) gains from exchange; and, (ii) gains from specialization in production.

Neoclassical economists argue that the differences in relative factor endowments as captured by different relative factor prices between nations are the most important determinants of trade. Each nation will export the commodity intensive in its relatively abundant and cheap factor of production and import the commodity intensive in its relatively scarce and expensive factor of production.³ Furthermore, international trade will lead to the elimination, or reduction, in the pre-trade differences in relative and absolute homogeneous factor prices between nations.⁴

Even if countries have the same factor endowments, if tastes among them vary, there would be a basis for mutually beneficial trade. Even if nations are identical in taste and factor endowments, there is still a basis for trade from the increase in total output resulting from economies of scale. Moreover, there can be intra-industry trade among nations in differentiated products.

Besides the "static" factors mentioned above, dynamic factors are also responsible for increasing global trade among nations. Changing tastes, the "creation" of demand, the demonstration effect, technology, economic growth, and other factors contribute

to increased international trade. The scope for trade among nations is enlarged because high-technology nations will first introduce and export new products and processes. But later, upon standardization and mass marketing, production can be carried out in labor-intensive nations. Thus, the labor-intensive nations will produce and then export the same commodity to high-technology nations.⁵

The literature on economic integration⁶ also offers compelling arguments for free trade due to the following reasons: (i) increased competition; (ii) economies of scale; (iii) stimulus to investment; (iv) benefits from the elimination of restrictions and regulations; and so forth. Moreover, monetary union reduces the amount of resources devoted to hedging foreign exchange risks, unproductive speculation, and currency diversification.

What are the problems with a regime of trade protection? The imposition of an import tariff by a small nation has the following features: (i) world prices are unaffected; (ii) domestic price of the importable commodity rises by the amount of the tariff; (iii) domestic production of the commodity rises but domestic consumption and imports fall; (iv) government collects tariff; and, most importantly, (v) the welfare of the nation declines. In the small nation, tariff causes inefficiencies known as protection costs. The protection cost is a net loss because it represents the difference between producer surplus (the difference between the market price and the price a firm is willing to supply) and consumer surplus (the difference between the market

price and the price a buyer is willing to pay) that is not transferred to other sector of the economy.

The imposition of a tariff by a large nation has the following features: (i) improvement in its terms of trade; (ii) reduction in the volume of trade; and, (iii) under certain conditions, temporary improvement in the nation's welfare. However, the improvement of the welfare comes at the expense of its trading partners. Hence, its trading partners are likely to retaliate. As a result, both the large nation and its trading partners are ultimately worse off. In essence, other things being constant, the imposition of tariff, quota, or any mode of protectionism is likely to be detrimental to a nation, irrespective of its size. Protectionism is harmful because it reduces a nation's welfare.

Section II: George on Free Trade

George⁷ argues that labor creates capital and is the ultimate producer of wealth. There is no reason for labor to fear foreign competition. He shows that the argument for protection is not any different from arguing for delaying or preventing the introduction of any new labor-saving technology and invention on the pretext that it is harmful to the interest of labor. The objective of protection is the prevention of the flow of useful and cheap commodities. But the purpose of production is consumption and the improvement of the quality of life.

George⁸ demonstrates the absurdity of the protectionist argument by showing that it implies the division of humanity into the smallest possible political unions. Protectionism assumes

that foreigners try to "dump" commodities. But one engages in trade only because one expects to be better off after trading than before trading. If one is worse off after trading then one would engage not in trading in the future. The cause of importation is consumer demand. In spite of protection, the demand for imported goods remains. He believes it is natural and mutually beneficial for people to trade and exchange goods and services.

George⁹ argues that if protectionism were beneficial, the most autarkic nations and regions would be the most developed. But nations that have accumulated capital and are wealthy are ones which trade heavily. Trade facilitates regional development, economic growth, improvement of skills, and specialization.

Often tariffs, quotas, and other obstacles to trade are defended because these are means for the state to raise revenue. Tariff is a form of indirect taxation. He finds it to be morally indefensible because it is a form of regressive taxation that hurts the poorest consumers the most. He points out that the function of tariff as maximizing state revenue and its function of offering maximum protection to domestic industry are antagonistic.¹⁰

If the objective is to provide support to various sectors of the domestic industry, direct subsidies would do a better job. Subsidies can be financed through direct taxation. It is a more transparent mode of transfer than tariff. Domestic production of a "protected" good can increase if and only if tariff causes

prices to rise. A more efficient way to encourage industry is to provide direct subsidies instead of tariff.¹¹

The construction of a tariff regime is inherently problematic because it calls for careful discrimination. The finished product of one industry is an input for another industry.¹² A consistent tariff regimes requires minute and detailed knowledge of all sectors of the economy which is virtually unattainable. The state cannot possible construct a consistent tariff regime.

Do tariffs encourage industry? Only the expectation of extra normal profits can encourage firms to enter an industry. But tariffs promote inefficiency because they draw scare capital and labor from profitable and efficient sectors. A tariff regime distorts a country's competitive advantage and deprives a nation from the benefits of participating in the global market place. George¹³ dismisses the argument that manufacturing is so fundamental that this sector should be protected. Industrialization should be left to private enterprise.

George¹⁴ examines international payments and opines that it is mistaken to hold that a nation benefits more from obtaining money for commodities than from obtaining commodities for money. Trade using money does not change the essential character of mutually beneficial international exchange. International payments can be settled with commodities, loans, investment, and reserves. International money is also a means of exchange; thus, a country is no worse off for setting a trade deficit by obtaining a capital account surplus.

Support for protectionism is often based on the belief that countries with low wages can "under sell" countries with high wages.¹⁵ But most protectionism is against countries with similar wage structure and patterns. Comparatively low wage is not necessarily an advantage: the productivity and quality of labor is far more important. The high wage of labor reflects greater productivity, better technology, and higher standard of living. Labor efficiency depends on the standard of living.¹⁶ Thus, protectionism cannot be justified on the ground that free trade equalizes returns to homogenous factors. Free trade leads to optimal use of resources and increases aggregate output.

The problem with protection is high taxation and increase in prices. Resources are wasted in securing protection. Once protectionist obstacles are created in one sector of the economy, they readily spread to other sectors.¹⁷ In this way, protectionism discourages investment, innovation, application of cost-reduction and high technology.

Profits can rise only if a protectionist regime provides a domestic monopoly. Protectionism does not raise wages.¹⁸ Unless the general level of wages rise in the economy, wages in protected sectors are unlikely to rise. Hence, workers will not benefit from protectionism. George urges the immediate abolishing of all tariff and obstacles to free trade.¹⁹

Section III: Criticism of New Protectionism

A liberal trade regime was established in postwar period. Income growth led to the expansion of international trade.

International trade, in turn, led to the expansion of the growth of income. The postwar years witnessed negotiated reduction of tariffs and quotas on a multilateral basis.

Since the 1970s, however, the rise of new protectionism threatens international trade.²⁰ Voluntary export restraints, countervailing duties, anti-dumping measures, health and safety regulations, and product specifications exemplify the rise of non-tariff barriers. Developments in "alternative" trade theory based on models of small group oligopoly, increasing returns to scale, imperfect markets, and strategic trade policy call to question the theoretical merit and the relevance of the free trade paradigm. In the political arena, the concern for universal human rights, intervention abroad, "fairness," environment, and high technology are used as pleas for protectionism.

Bhagwati²¹ defends free trade theoretically and empirically in light of the new protectionist debate. The postwar growth and the success of the newly industrialized countries were largely due to trade liberalization. Protectionism not only leads to conventional dead-weight loss but additional unproductive activities due to the attempt to "capture" the rents of protection.²²

Recent developments in the theory of international trade suggest that in small group oligopolies (imperfect markets) and increasing returns in high-technology, knowledge-intensive sectors, where prices do not reflect social costs, state intervention may be beneficial.²³ However, even if such

conditions obtain, policy intervention requires unattainable sector specific knowledge. There is no reason to believe that the state can successfully intervene in "managing trade."²⁴ Unilateral intervention is likely to promote foreign retaliation. Hence, in the long run, strategic trade policy will do more harm than good.

In response to the "manufacturing matters" thesis, one can note the following: (i) the productivity growth in services can be as high as in manufacturing; (ii) positive externalities are not exclusive to manufacturing; and, (iii) the service sector does not requires a manufacturing "base."²⁵

Lately, restrictive trade policy is justified on the grounds of universal human rights, labor conditions, environmental concerns, and so forth. Bhagwati²⁶ argues that the issue at hand is a problem of policy assignment. Trade policy should be aimed at securing the gains of trade. It would be inefficient to employ trade policy to secure other objectives. Other channels should be used for non-trade policy objective, such as environmental issues, worker's rights, and so on. For instance, human rights should be subject to international conventions, monitoring, and world-wide campaigns to protest the violation of human rights.

The "fairness" issue is widely debated, particularly regarding Japan. One can note the following: (i) bilateral settlements are not likely to open markets, rather such measures will only shift the burden onto weaker countries; (ii) the attempt to achieve bilateral reciprocity risks confrontation leading to punitive and

retaliatory tariffs. He argues that the fairness issues is harmful. A constructive approach would seek to extend the liberal trading framework in multilateral negotiations.²⁷

The tendency to support protectionist measures because of any state intervention abroad is mistaken.²⁸ There has to be distinction drawn between state intervention to "protect" domestic market and state intervention in response to "market failure." The latter can be justified. Moreover, different countries will have different social objectives and needs. Hence, countervailing duties or anti-dumping measures against such intervention abroad would be inappropriate. Intervention and subsidies for sectors such as high technology industry, which all states regard as key sectors, would be counter-productive because it will lead to inflammatory protectionism and retaliation.

Section IV: Free Trade and Land Monopoly

Like contemporary neoclassical economists, George finds the ideology of protectionism to be of no merit for the working class. Hence, he asks: If protectionism is harmful and free trade beneficial to growth why does protectionism persist? And why is the working class indifferent to the trade regime?

George²⁹ argues that although free trade tends to increase output, efficiency, and revitalize wealth, it does not follow that free trade in itself will benefit the working class. In this respect, free trade is similar to any other form of increase in national wealth. Under present circumstances it is possible that the removal of tariff will not improve the plight of the working

class. This, he argues, explains the apathy of workers towards free trade. Since workers cannot obtain any tangible material benefits from an open trade regime, there is no incentive for them to support such a regime. Why is labor unable to gain any benefit from the increased production potential of free trade? The present land regime, namely, the private monopoly of land ownership is responsible for the persistence of poverty in spite of increased wealth and free trade.³⁰ Since free trade increases a nation's wealth, it inevitably extends the margin of cultivation. As a result, rents increase both in volume and as ratio of total output. Free trade helps the land owner to get more rent. Although free trade in itself does not increase the inequality of distribution, due to land monopoly, the increased production of wealth resulting from free trade actually deepens poverty.³¹

George³² proposes to appropriate rent by taxing the value of land, independent of the value of land improvement. He fully endorses free trade but does not consider it to be adequate to eliminate poverty and maldistribution of wealth. A regime of authentic free trade would abolish land monopoly. He points out that the sole moral basis for property is the person's right to own the fruits of his labor. The human being is entitled to enjoy the results of his own effort.

George³³ argues that under a free trade regime all restrictions (except those related to issues of public morality) are abolished. Under authentic free trade, labor will have access

to land, and land monopoly will be abolished.

George believes that the moral argument for the free trade position is based on a conception of natural justice. A just regime allows the spontaneous operation of markets and appropriates the rent from land. A just regime lets the human being retain the values created by his labor power, and ensures that socially created values belong to society. George³⁴ is convinced that free trade with a fair land regime will be the foundation for social prosperity and growth.

Section V: Free Trade without Land Value Tax?

As shown above, George believes that the principal cause of the increase of want despite the increase of wealth is land monopoly. He argues that abolishing land monopoly is a fundamental prerequisite for an authentic free trade regime. However, suppose that, for institutional reasons, land monopoly cannot be abolished. What would a be a consistent Georgist position on free trade?

Neoclassical economic theory shows that if it is impossible to attain even one condition for an optimal outcome, then a second-best optimum can be only achieved by departing from all the first-best conditions. Furthermore, if a constraint prevents the attainment of even one condition, then the attempt to achieve the rest of all first-best conditions need not increase welfare. Indeed, given a constraint, trying to promote the fulfillment of first-best conditions in other sectors may reduce welfare.

Based on the above analysis, it is clear that trying to

promote free trade without simultaneously abolishing land monopoly is futile. Given George's fundamental emphasis on the struggle against land monopoly, his intuitive grasp of the problem is not different from the analysis provided by contemporary economic theory. He understood that the land regime determines the socioeconomic and political order of a community; the possession of land is a source of power. Without a fair land regime, the gains from free trade will not serve social development and human progress. Needless to say, George's view is particularly relevant for developing nations, such as Bangladesh.

Contemporary neoclassical economists advocate free trade for its welfare effects. George, however, advocates free trade for moral reasons.³⁵ Thus, he would object to protectionism because it is fundamentally contrary to his conception of natural rights. Protectionism prevents people from freely exchanging goods and services; it is a cardinal violation of human freedom. George is not only concerned about the interest of the working class but also the general interest of humanity. Hence, it is inconceivable that George would ever support a protectionist measure even if it was shown to be economically beneficial to the working class. The moral case against protectionism is far more significant than the short-term economic interest of a particular segment of society.

Conclusion

For humanity's progress, the current land regime must be altered. Of course, vested interests will resist a land value

tax. However, the power of the vested interests should not prevent those who seek social justice from championing the cause of a fair land regime and an open economy. Authentic freedom and justice will be established the day when free trade exists without land monopoly. After all, George's fundamental quest is the establishment of an open and just economy based on freedom. In essence, George seeks to achieve no less than all the necessary and sufficient conditions for liberty and justice.

Endnotes

1. Smith, 1776.
2. Ricardo, 1817.
3. Bhagwati and Srinivasan, 1984. Pp. 30-35.
4. Sameulson, 1949. Pp. 181-97.
5. Vernon, 1966.
6. Viner, 1953.
7. George, 1886. Pp. 21-22.
8. Ibid., pp. 37-44.
9. Ibid., pp. 51-53.
10. Ibid., pp. 69-79.
11. Ibid., pp. 85-89.
12. Ibid., p. 91.
13. Ibid., pp. 153-165.
14. Ibid., pp. 123-134.
15. Ibid., p. 135.
16. Ibid., pp. 138-141.
17. Ibid., p. 168.
18. Ibid., p. 209.
19. Ibid., p. 220.
20. Bhagwati, 1991.
21. Bhagwati, 1988.
22. Ibid., pp. 103-104.
23. Krugman, 1987.
24. Bhagwati, 1989. Pp. 105-110.
25. Ibid., pp. 110-114.
26. Ibid., pp. 151-153.
27. Ibid., pp. 123-126.

28. Ibid., pp. 126-127.
29. Ibid., pp. 225-233.
30. George, 1879.
31. George, 1886. Pp. 234-275.
32. Ibid., p. 287.
33. Ibid., pp. 286-287.
34. Ibid., pp. 327-332.
35. Professor Robert Andelson made me aware of this point in private communication.

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