



UNILATERAL FREE TRADE VERSUS RECIPROCITY IN *THE WEALTH OF NATIONS*

BY
EDWIN G. WEST

I. INTRODUCTION

In Chapter 2, Book IV, of *The Wealth of Nations*, Adam Smith assesses the appropriateness of the policy of tariff retaliation or reciprocity. His deliberations are prefaced by a discussion of two rather innocuous cases that turn out to have very little to do with the main topic. In the first case it is advantageous “to lay some burden upon foreign, for the encouragement of domestic industry” (*WN*, p. 463) when that particular industry is necessary for the defence of the country. Smith’s second case refers to the situation when some domestic tax is being imposed on a good produced at home. In this situation Smith believed it reasonable that an equal tax should be imposed on the same good when it was imported (*WN*, p. 465).¹

From these two cases, Smith proceeds to others that he classifies as situations in which “it may sometimes be a matter of deliberation” (*WN*, p. 467) whether or not to impose tariffs or prohibitions. The case for or against serious or “combative” trade retaliation is one of these. The subject was, of course, a fact of life in Smith’s world. Nations “seldom fail to retaliate,” he observes, when others restrict the imports of their goods (*WN*, p. 467). Indeed Smith immediately supports this observation with an historical account. The story was not encouraging. The French and English, for example, “began mutually to oppress each other’s industry” with retaliatory prohibitions and duties as early as the 1670s, and they continued for a century right down to the period Smith was writing (*WN*, p. 467).²

After his own reflections, Smith concludes that retaliations could be good

Carleton University, Ottawa, Canada. I am grateful to James Ahikpor and two referees for helpful comments.

¹ A more sophisticated version of this argument is found in Musgrave (1969).

² Trade retaliation is of course being practised today throughout the world and on an increasing scale. Now described by some as the “crowbar theory” (Powell 1990), the reasoning predicts simply that foreign markets can be forced to reopen if only we are willing to close our markets to foreigners, or at least to threaten such action. The best known “crowbar activity” meanwhile is probably that which features world-wide attempts to limit agricultural subsidies, a problem that G.A.T.T. and its successor the World Trade Organization (WTO) have so far failed to resolve.

policy only when there is a reasonable probability that they will succeed in “procuring the repeal of the high duties or prohibitions complained of” (*WN*, p. 468). Meanwhile, the costs of trade retaliation in the transition could possibly be so high as to outweigh the gains from “the recovery of a great market” (*WN*, p. 468). The important question arises, therefore, as to who in practice would be left to assess both the costs and the benefits? Smith’s answer is striking:

To judge whether such retaliations are likely to produce such an effect, does not, perhaps, belong so much to the science of a legislator, whose deliberations ought to be governed by general principles which are always the same, as to the skill of that insidious and crafty animal, vulgarly called a statesman or politician, whose councils are directed by the momentary fluctuations of affairs (*WN*, p. 468).

This passage could mean that, as another fact of life, evaluations of proposals for retaliation *belong* (Smith’s word) in practice to the “crafty” politicians. Smith is not necessarily approving their actions. His *scientific* legislator’s actions in the above quotation are something else. They are ideally “governed by general principles which are always the same.” One question is whether Smith himself wanted to eschew entirely the role of politician, in preference to pursuing exclusively purely the judgement of his “scientific legislator?” In other words, it is not obvious at first sight whether Smith is stating that the politicians *should* make the key judgements on trade retaliation, or simply that, as a fact of life, they “belong” in their territory. Of the two “actors” (or decision-makers) to choose from: let us call Smith’s scientific legislator individual (a) and denote his crafty politician caught up in “the momentary fluctuations of affairs” as individual (b). Smith obviously associated himself with (a). For him to have given intellectual support for both (a) and (b), however, would have appeared conflicting, at least to some of his readers. Did Smith avoid this position? Attempts at an answer will be shown to provide new insights on the overall political economy in *WN*, especially since they endeavor to determine exactly who Smith wanted (ideally) to be “in charge.” Section II searches the literature for a consensus on this issue, while Section III focuses on Smith’s general treatment of politics, politicians, and statesmen; Section IV provides several conjectures from *WN* on economics of reciprocity that possibly lay behind Smith’s general coolness toward it. As an example of the scientific legislator’s preoccupation with “general principles which are always the same,” Section V deals with perhaps the strongest principle in Smith’s whole work, namely the division of labor. Section VI examines Smith’s two concepts of “system”: The Newtonian system, and his “man of system.” Section VII offers the main conclusions.

II. TESTIMONY OF THE LITERATURE

There has been no clear consensus on Smith’s attitude toward reciprocity. Marshall believed that he judged retaliatory duties (tariffs) to be “theoretically defensible” and also actually prudent in some circumstances. Thus: “He [Smith] admits that the policy of retaliatory duties is not only defensible theoretically,

but may occasionally be prudent, even when account is taken of all the complications which it involves" (Marshall 1919, p. 747). In our terms, Marshall interprets Smith as supporting both individuals (a) and (b) and apparently sees no conflict. His support for (b) is justified by his apparent prudence and by his ability to estimate "all the complications involved." Mark Blaug (1997, p. 57), quoting the perspective of Viner, concludes simply that in *WN* (Book IV, Chapter 2), retaliations against foreign tariffs are justified. In this case, decision-maker types (a) and (b) are again implicitly both approved of.

D.P. O'Brien (1978, p. 190), in contrast, is of the firm opinion that, following the leadership of Smith, the classical economists were free traders and, moreover, that they believed that free trade "should be adopted on a unilateral basis ... Protection was either useless or distorting." O'Brien, therefore implicitly sides exclusively with individual (a), the scientific legislator. Douglas Irwin (1996), meanwhile, maintains that Smith essentially states that reciprocity (temporary retaliation to reduce foreign trade restrictions) is a noneconomic question. Ultimately, however, Irwin appears to agree with O'Brien's conclusion that the classicals prescribed the adoption of free trade as a *unilateral* action. "The fundamental principle was clear: free trade should be pursued independently of other countries' policies" (Irwin 1996, p. 82). Again, this conclusion appears clearly to champion individual (a) and, at best, to make the actions of (b) superfluous. The implication is that a country should keep open its markets regardless of tariffs on its exports imposed by others. It will be argued here that this interpretation appears consistent with Smith adopting primarily the position of (a), his "scientific legislator," who is "governed by general principles which are always the same" (*WN*, p. 468). If, however, it is agreed that Smith did see the reciprocity issue in the context of some fundamental and steady principle, the question arises why did he not confine himself to it. Why did he believe it to be necessary to "deviate," however briefly, into the realm of "insidious politicians" who attempt to judge whether retaliation will or will not pay off?

One way this question might be resolved is by presenting Smith as declaring that uncompromising free trade is the only desirable or "scientific" position, but recognising that in the real world decisions to deviate from it in many circumstances typically, and unfortunately, fall into the hands of conventional politicians. These less worthy individuals often brazenly believe they have information on outcome probabilities sufficient to win the "game" of reciprocity. One outstanding indication that Smith was dubious about their abilities (or desire) to win the game is his observation that the French and the English had been "mutually oppressing" each other with retaliatory prohibitions and duties for a whole century and without any satisfactory resolution of the problem (*WN*, p. 467).

Donald Winch (1983) recognizes the importance of the Smithian distinction between the scientific legislator and the "crafty" politician. In many circumstances, he suggests, Smith was maintaining that it was the duty of the philosopher "to encourage the development of the public spirited attitudes of the legislator at the expense of those of the politician by enunciating general principles. And the philosopher was more likely to succeed in this task if he appealed to those aesthetic instincts of system and order which underlies all

philosophy or science, rather than by resorting to exhortation ..." (Winch 1983, p. 503).

Again, in the strict context of trade retaliation, this approach would seem to place Winch with O'Brien and Irwin; all three would appear to view Smith's scientific legislator as preferring unilateral free trade and rejecting the "crafty" politicians' proposals for reciprocity.

III. SMITH'S ATTITUDE TOWARD POLITICIANS AND STATESMEN

It seems difficult to deny that Smith often looked with disdain on politics and politicians, and there seems no reason to believe that his adjectives "crafty" and "insidious" were any less derogatory in 1776 than today. Thus to both Pope and Johnson, the word "insidious" meant sly, crafty, wily, or even treacherous. As for politics, Smith's attitude is revealed in his search for an appropriate constitution. He warns, therein, that when the judicial is united to the executive power it is hardly possible that "justice should not frequently be sacrificed to, what is vulgarly called, politics" (*WN*, p. 722). So presumably if justice could thus be sacrificed to politics, economic welfare could similarly be sacrificed to politicians. Many of them, after all, are seen by Smith as short-term maximizers of their personal incomes who were willing to play the game of trading reciprocity at the expense of their countrymen (*WN*, p. 467). Another indication that Smith believed that day-to-day politics was usually and typically an arena of self-interest and ambition is revealed in his treatment of the contemporary American call for "no taxation without representation." Instead of "peddling for the little prizes" from the paltry raffle of colony faction, the leading men in the colonies could be given the opportunity to win the great prizes which "sometimes come from the wheel of the great state lottery of British politicks" (*WN*, pp. 622–23).

The term "statesman" similarly receives much derogatory description and on page 468 of *WN* it shares with the word a "politician" the adjectives of "insidious" and "crafty." It is in Book IV of *WN*, however, that we find the most haughty disdain. With regard to the best method of allocating his own separate capital, Smith insists:

every individual, can, in his local situation, judge much better than any statesman ... can do for him. The statesman who should attempt to direct private people in what manner they ought to employ their capitals would ... assume an authority which could safely be trusted, not only to no single person, but to no council or senate whatever, and which would nowhere be so dangerous as in the hands of a man who had folly and presumption enough to fancy himself fit to exercise it (*WN*, p. 456).

It is an easy step to suggest that it is this same statesman that reappears in connection with Smith's consideration of the policy of reciprocity. Statesmen are not only crafty and insidious, but some of them presume to know the ideal allocation of resources. Suppose country B starts a trade war by imposing a tariff on good *m* produced in A. If country A's statesmen respond with a retaliatory

tariff on commodity *q* produced in country B, they must demonstrate why they choose *q* instead of *n*, or *o*, or *p*. But this ultimately calls for an omnipotence in general that Smith was vigorously challenging. And he would suspect that the statesmen had personal interests in the domestic industry producing product *q*, an industry that would now be protected.

We come next to another important aspect of our analysis: In some contexts Smith reverses his attitude on politicians and statesmen and reveals support, if not admiration, of them. Referring for instance to the American revolutionaries of 1776 he observes: "From shopkeepers, tradesmen, and attorneys they are become statesmen and legislators ..." (*WN*, p. 623). As for conditions in the "barbarous" state or stage, the wide variety of necessary occupations obliges every man to fully exert his capacity. Each individual is, among other things, a warrior. But in addition, "Every man too is in some measure a statesman, and can form a tolerable judgment concerning the interest of the society, and the conduct of those who govern it" (*WN*, p. 783).

Consider also the question of the correct way to give up Britain's exclusive trade to the colonies. Smith recommends a policy of gradualism. He concedes that sudden losses could trigger such great disorders that the timing of the new changes was such a delicate and complex issue that it warranted handling by the wisest of citizens: Thus "... in what manner the natural system of perfect liberty and justice ought gradually to be restored, we must leave to the wisdom of future statesmen and legislators to determine" (*WN*, p. 606). After such demonstration that Smith was sometimes for and sometimes against politicians and statesmen, the question arises whether an element of contradiction is involved.³ An answer (in the negative), however, seems easily available. Returning to Smith's quotation using the phrase "insidious and crafty animal" (*WN*, p. 468), this description is intended to fit only a *sub-group* of the whole class of people called politicians (or statesmen). Thus the full quotation refers only to those statesmen or politicians, *whose councils are directed by the momentary fluctuations of affairs* (*WN*, p. 468, emphasis added). This position, of course, leaves room for the rest of the class of politicians and statesmen as individuals who are prompted, not by "momentary fluctuations or affairs," but are instead more long-term in their outlook. This would obviously explain Smith's "statesmen" who could be trusted, for instance, with the gradualist task of relinquishing Britain's colonial monopoly.

It is helpful at this point to return to Winch's (1983) discussion of the relationship between the scientific legislator and the less "pure" politician:

But since Smith was nothing if not a realist, the legislator takes on the character of an ideal type in a world in which affairs are chiefly conducted by politicians. In such a world, however, it remained the duty of the philosopher to encourage the development of the public-spirited attitudes of the legislator at the expense of those of the politician by enunciating general principles (Winch 1983, p. 503).

³ I have previously detected contradiction in Smith on (a) the issue of the cultural effects of the division of labor (West 1996), and (b) his position on the Bank of England monopoly (West 1997).

Winch continues by quoting the following from Smith's *Theory of Moral Sentiments (TMS)*:

You will be more likely to persuade, if you describe the great system of public police ... , if you explain the connexions and dependencies of its several parts, their mutual subordination to one another, and their general subserviency to the happiness of society; if you show how this system might be introduced into his own country, what it is that hinders it from taking place there at present (*TMS*, p. 186).

It is interesting next to attempt to apply the above Smithian advice to our context of trade wars. In advising on how his system might be introduced into one's country, he, presumably, is referring to his system of natural liberty buttressed by a constitution that respected property rights and the rule of law. If we now follow the interpretations of O'Brien, Irwin, and Winch, Smith's unilateral adoption of free international trade was fully compatible with this general or comprehensive system of free enterprise in *all* areas. But if Smith's superior legislator was to proceed by gentle persuasion, he would surely not succeed by aggressively calling his listeners "crafty" and "insidious." It might therefore be a useful task to try to construct a more patient attempt by Smith's philosopher to show how his general (and constant) principles pertained to the issue of trade reciprocity; in Smith's words, how he would "explain the connexions and dependencies of its several parts."

IV. THE FULL ECONOMIC COMPLEXITIES

It is reasonable to conjecture that Smith's *patient* philosopher would be prompted to slowly explain a series of substantial but somewhat concealed costs associated with trade retaliation. The adjective "concealed" is intended to refer to further dimensions of thought that are spread throughout *WN* and must be "brought to the surface" so as to bear appropriately on the present topic. We estimate that there are six such Smithian costs of trade retaliation. They are summarized in Table 1.

Table 1: Smith's concealed costs of trade retaliation:

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1. Time costs in terms of reduced capital accumulation under fixed technology
 2. Time costs in terms of foregone opportunities to improve technology
 3. Costs of rent seeking
 4. Costs of non-productive government growth via tariff revenues
 5. Excessive costs of enlarged customs house administrations
 6. Costs of consumption distortions
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With regard to item 1 in the table, Smith is always concerned with the time-consuming costs of trade retaliation even if it is of a much shorter duration than a century. A parallel example of these costs relates to his discussion of infant industry proposals. Advocates for giving a subsidy (or negative tariff) to a given

infant industry typically argue that, after the manufacture eventually takes root, it can stand on its own and the protection can be withdrawn. Smith concedes that it is certainly possible to set up an industry sooner than it could have been otherwise and that, indeed, eventually its products will be as cheap or cheaper than in the foreign country. It does not follow, however, that the total national income will increase by such an arrangement since there are important costs that remain relatively hidden. They relate to the pace of growth of national income, which, Smith observes, depends upon the accumulation of capital, that in turn results from savings. The higher the national income, the higher the possible savings. But the immediate effect of infant industry regulation is to diminish national income and, therefore, to reduce capital accumulation. In other words, because consumers are obliged in the transition (while the infant is growing) to purchase products at a higher price domestically, their ability to save is diminished. This total opportunity cost must be considered in any comprehensive reckoning, Smith insists. Conversely, if no such regulation is made society will have a greater immediate national income and a greater potential for savings than would be the case with the infant industry subsidy. In that scenario, there will be more immediate capital accumulation, and growth will occur, although with a different pattern of output. The onus is, therefore, clearly on the infant industry advocates to demonstrate that their growth rates will be superior:

Though for want of such regulations the society should never acquire the proposed manufacture, it would not, upon that account, necessarily be poorer in any one period of its duration. In every period of its duration its whole capital and industry might still have been employed, although upon different objects, in the manner that was most advantageous at the time. In every period its revenue might have been augmented with the greatest possible rapidity (*WN*, p. 458).

The case of repeated games in the context of trade protection and tariff retaliation illustrates similar time costs. Consider Smith's example of Colbert's French tariff of 1667 which "imposed very high duties upon a great number of foreign manufacturers" (*WN*, p. 467). After a presumably lengthy period where pressure was brought upon the French government by the Dutch, "they, in 1671 *prohibited* the importation of the wines, brandies, and manufactures of France" (*WN*, p. 467) (author's emphasis). Thus the reply to French *duties* by Dutch *prohibitions* shows that this trade war was stepped up with escalating force.

This whole series of events, meanwhile, took eleven years—the French even then being forced only to "moderate" [Smith's word] *some* of their duties in favor of the Dutch. We must conjecture therefore that Smith's skepticism about infant industry proposals would have been similarly applicable to the French/Dutch trade war. The fact that Smith is averse to any significant "waiting time" during such conflicts is, of course, also connected with his recognition of the probability of continuously increasing returns through time and the technological improvements that accompany them (see item 2 in Table 1). Smith's is an endogenous growth model wherein increased divisions of labor result simultaneously in continued improvement in worker productivity and new technical

invention.⁴ Accumulation of “stock,” Smith observes, “naturally leads to this improvement” (*WN*, p. 277). But trade wars involve serious time costs that force the participants’ national products to be lower than under non-participation. This in turn implies not only a reduced ability to save and invest under constant technology but also a lower rate of technological improvement.

Another relatively concealed cost concerns the precise distribution of the immediate domestic beneficiaries of tariff impositions (see item 3 in Table 1). With regard to trade retaliation in France, Smith states that the leader, Colbert, “seems in this case to have been imposed upon by the sophistry of merchants and manufacturers, who are always demanding a monopoly against their countrymen” (*WN*, p. 467). Smith was aware that different industries and occupations faced different costs of political organization and lobbying. Since only some of the rent seekers could possibly succeed, there would have been serious costs of resource misallocation. This would be in addition to what we now call the costs of rent seeking in the sense of loss of resources when they are devoted to competitive lobbying for non-productive legislation.

Smith’s position, moreover, is one that does not accept the concept of a country’s “objective function” in terms exclusively of physical output. He was concerned instead with welfare maximization of the country’s citizens individually. The existence of the sophistry of merchants and manufacturers that gave them “a monopoly against their countrymen” would render ambiguous the term “a country’s objective function.” The presence of such influential rent seekers can result in gains to them that could well be much less than the losses from trade retaliation suffered by other members of society. In Smith’s words, trade retaliation “seems a bad method of compensating the injury done to certain classes of our people, to do another injury ourselves, not only to those classes, but to almost all other classes of them” (*WN*, p. 468). Smith observes that when our neighbor prohibits some manufacture of ours, we retaliate by restricting not only the imports of the same manufacture into our country, but also some of the neighbor’s other manufactures. Workmen who suffered from the neighbor’s original prohibition will thus not be benefited from that imposed by their own country. “Every such law therefore, imposes a real tax upon the whole country, not in favour of that particular class of workmen who were injured by our neighbour’s prohibition, but of some other class” (*WN*, p. 468).

A further, relatively concealed cost relates to another immediate beneficiary of tariff imposition: the government (item 4 in Table 1). In the eighteenth century indirect taxes were the only ones practicable, and the tariff was a leading example. But besides personal enrichment, to what purpose would government officials put an increased flow of revenues following retaliatory tariff imposition? The primary one would be armaments (new warships, guns, etc.) since relative military strength was another mercantilist method of “beggaring one’s neighbor.” Where revenues (from tariffs and other tax instruments) became insufficient for these purposes, the government had to borrow. Meanwhile, the personal enrichment (from tariffs) of the rent seekers and administrators enabled

⁴ See Reid (1987) and Buchanan and Yoon (1994).

them to purchase the increasing quantities of government bonds. Without such facility of borrowing, Smith contended, “wars would in general be more speedily concluded, and less wantonly undertaken” (*WN*, p. 926).

An additional consideration for Smith was the fact that tariff administration costs were high (item 5 in Table 1) and they would be significantly increased by the introduction of retaliation. He refers to the “great number” of custom house and excise officers whose salaries and perquisites “are a real tax upon the people” (*WN*, p. 896). Furthermore, increased incentives to evade tariff restrictions by smuggling would step up the costs of monitoring. When caught, the smuggler was often subjected to such heavy penalties as to involve his complete ruin.

Modern economists would also add to the list of concealed costs the consumption distortions caused by tariffs (see item 6 in Table 1). In part, Smith already touched upon this when he discussed distortion in saving decisions. Using today’s terminology, we could call it the dynamic consumption distortion; however, there is also a static consumption distortion.

V. RECIPROCITY AND THE DIVISION OF LABOR PRINCIPLE

To reiterate, the duty of the philosopher in Smith is to enunciate to ordinary citizens, as well as to others, those general principles that emerge from the discipline of political economy. One important set of general principles yet to be addressed relates to Smith’s emphasis on the importance of the division of labor. After brief discussion of this, an attempt will be made to show its implicit connection with the debate about tariff wars.

Among the “golden rules” supporting the division of labor is the crucial provision of a legal environment that encourages, or at least does not hinder, the accumulation of capital: “... till some stock be produced there can be no division of labour, and before a division of labour takes place there can be very little accumulation of stock” (*Lectures*, p. 522). Such accumulation, however, demanded that government ensure full respect for property rights. “When people find themselves every moment in danger of being robbed of all they possess, they have no motive to be industrious. There could be very little accumulation of stock, because the indolent which would be the greatest number, would live upon the industrious, and spend whatever they produced” (*ibid.*).

Smith’s criticisms of governments for indulging in excessive taxation were similarly based on its adverse effects on the accumulation of stock. The higher the taxation, he insisted, the lower the accumulation and the smaller the chances of further division of labor. Indeed, the intensity of Smith’s condemnation of the failure of government to provide a legal framework and infrastructure appropriate to an emerging free market system appears at times to match that of his insistence on free trade generally.

One problem in several countries was the imperfection of the law with regard to contracts. Another was the absence of legislation to ensure good highways and adequate policing of land transport. Taxes on both imports and exports were further barriers to commerce. It was indeed as if the law had abandoned the merchants. “They, however, must lay the tax upon their goods, their price is

raised, fewer of them are bought, manufactures are discouraged, and the division of labour hindered" (*Lectures*, p. 529). Smith concluded accordingly that taxation "is in reality one of the causes that the progress of opulence has been so slow" (*ibid.*). The combative imposition of tariffs under the policy of reciprocity was another form of taxation, and, judged by its typical duration in Smith's time, it, too, would have seriously reduced the ability to accumulate capital.

Smith's treatment of the division of labor has the important implication of what we now call increasing returns, and this might also have some connection with the debate on reciprocity. The following possible scenario is one suggestion only because undoubtedly this subject invites much further reflection and future research.

Consider first the recent interpretation of Adam Smith's *The Wealth of Nations* that reaches back to the work of Allyn Young (1928/1994). In it, J.M. Buchanan (Buchanan and Yoon 1994) concludes that Smith's central economic proposition amounts to the statement that economic progress results from generalized (economy-wide) increasing returns. In its idealized form, Buchanan continues, it is the spread of Smith's division of labor that leads to "increasing returns to the scale of the inclusive economic nexus ..." (1994, p. 11; see also Reid 1987).

Smith's pin factory example is obviously pertinent, but it tends to mislead because it seems to focus on one industry in isolation. Allyn Young's major contribution was to draw attention to Chapter 3 of Book I of *The Wealth of Nations* entitled: "That the Division of Labour is Limited by the Extent of the Market." It took over a century and a half before the full implications of this chapter were realized. If the division of labor depends on the size of the market, Young observes, we can ask just what constitutes a large market. It is not just population or geographic area alone. The key factor is buying power. The capacity to buy, meanwhile, depends on the capacity to produce. We should presumably not be impressed solely with the dramatic increase in the number of pins produced in Smith's famous pin factory illustration. We should take one more step and realize that the large output of pins means that they are the source of increased demand for other things offered in exchange. The division of labor in pins, therefore, extends the market for other things elsewhere and the expansion of these second areas of economic activity means they can undertake their own divisions of labor. Bear in mind also that this cumulative occurrence of specialization implies, in Smith, a corresponding surge in technological development.

Suppose now a world of two countries, A and B. Assume that eventually mercantilist rent-seekers in B successfully lobby their government to grant them strong tariff protection against imports (from A) of commodity x. Received opinion would declare such an outcome to be unambiguously and substantially injurious to the economy of A. The Smith/Young reasoning, however, contains a potential qualification to this conclusion. Country B will enjoy (a) some monopoly benefit plus (b), future benefits from a concentrated division of labor that imply increasing returns in the production of x. But this event will subsequently generate for this favored country the power of buying some other good, and this could well begin to be produced by A. Following Young's interpretation of Smith, B's initial increase in the "power of buying it" will

derive from its new ability to offer large quantities of good x in exchange. Insofar as the monopoly benefit dominates, however, country B's output will be restricted, although not to zero. A similar limitation will apply to the growth of the division of labor. But even this is a tentative conclusion because the division of labor that *will* occur will generate improvements in technology, and these could benefit both A and B. So insofar as this scenario is plausible, Smith's attitude would be that much more opposed to starting a tariff war. And this judgment would, of course, be substantially strengthened after accounting for the expected costs of reciprocity outlined in Table 1.

VI. SMITH'S TWO CONCEPTS OF "SYSTEM"

It has been suggested to us that although Smith's wise legislator/statesman is certainly guided by thinking that is systematic, he is not one who blindly follows the dictates of what Smith himself described as the "man of system." The latter character, however, seems to pertain more to politics than economics and it seems that Smith had the French Revolution in mind when discussing him (*WN*, p. 231, n. 6). "The man of system" emerges from the dangerous circumstance of growing fanaticism concerning proposed radical changes to the political constitution. Smith contrasts him with the man who has a public spirit and one who is prompted altogether by humanity and benevolence. This type of leader will content himself "with moderating, what he often cannot annihilate without great violence" (*WN*, p. 233). Winch (1978) understandably concludes that Smith recognized "that there were circumstances in which it would be wrong to expect solutions to be arrived at on anything other than a basis of pure expediency or 'interest of government.' National defense provided an example of this, *as well as retaliatory restrictions*" (*ibid.*, p. 173, our emphasis).

This is certainly an interesting setting in which to place our subject of trade retaliation. Yet two questions remain. First, Smith observes that the public-spirited leader will go along with, or temporarily tolerate, unsatisfactory situations only "when he cannot conquer the rooted prejudices of the people by reason and persuasion" (*WN*, p. 233). *The Wealth of Nations*, of course, is designed for just such a challenge. To Smith the most conspicuous "rooted prejudice" was the public's acceptance of mercantilism in most of its forms. And the trade retaliation scenario was one of them. Start with Smith's references, for instance, to the high duties on corn imports, which gave the growers of that commodity an advantage; or start with the prohibition of the imports of foreign woollens that gave a similar advantage to the mercantilist manufacturers of domestic woollens. These are only selected examples and Smith insists that "many other sorts of manufacturers have, in the same manner, obtained in Great Britain either altogether, or very nearly, a monopoly against their countrymen" (*WN*, p. 452). But these are the same words with which Smith describes trade wars and retaliation. Thus, in France such wars (connived at by Colbert) were started or conducted by merchants and manufacturers "who were always demanding a monopoly against their countrymen" (*WN*, p. 467). It seems, therefore, that if Smith was not prepared to tolerate mercantilism in terms either of practical expediency or interest of government, neither was he ready to accept

a policy of trade reciprocity, since this was just another manifestation of the same mercantilist “affliction.”

The second issue remaining focuses on the argument that Smith rejected excessive attachment to system because he disliked his “man of system.” One must, however, consider simultaneously his attitude to “system” in the field of science. Central to *WN* is the search for reasoning that describes the optimum pattern of economic development. It is well known that its author had a profound admiration of the scientific principles and achievements of Sir Isaac Newton. Accordingly, *WN* endeavored throughout to formulate a “system” in the grand Newtonian scientific manner, a system based on one simple basic axiom. Where Newton’s simple axiom was the universal phenomenon of gravity, Smith’s was that of individual self-interest set in a world of what he called “natural liberty.” Smith, of course, also attempted a scientific system that could eventually inform and advise legislators and statesmen. But here there was no obvious expectation or intention of counseling such leaders in terms of “pure expediency” or “interests of government.”⁵

VII. CONCLUSION

At first sight, Adam Smith is critical of both politicians and statesmen, at least in the context of decisions about trade retaliation. An initial impression is that Smith understood that such decisions “belonged” in practice to the same politicians and statesmen despite the fact that they are described by in *WN* as crafty and insidious animals! Opposed to them, Smith seems to have offered the services of the “wise and scientific legislator” who is motivated primarily in the search for constant and general principles. A preference for the unilateral adoption of free trade over opportunistic policies of reciprocity was one example. Yet the scientific legislator’s position needed patient explanation because his duty was that of gentle persuader of politicians and others about the need to implement Smith’s “higher” system. And it was a system that envisioned a genuinely decentralized world of competition under the protection of law and respect for property rights.

It is the view of this paper that the necessary painstaking presentation by the legislator involved bringing to the surface several concealed costs associated with the uninstructed politicians’ preference for continuous pressure on uncooperative trading partners. Table I lists these hidden costs, costs that Smith recognized in several parts of *WN*, and which incorporate both static and dynamic dimensions.

Speaking of general and constant principles, Smith’s scientific legislator in *WN* produced one that seems almost to dominate all the others. Appearing initially in the first three chapters of Book I of *WN*, it is summarized under the heading of “the division of labour.” This process required an appropriate “infrastructure” that included the provision of an efficient system of legal

⁵ Griswold (1999, p. 72) is skeptical of the claim that Smith ultimately sought to follow the Newtonian method. But his reasoning appears to me to pertain predominantly to *The Theory of Moral Sentiments* rather than to *WN*.

contracting, good roads, a respect for property rights, and minimum taxation. It has been argued here that since both tariffs and counter tariffs are a form of taxation, their existence in the late eighteenth century would significantly diminish the infrastructure just mentioned—especially if they were of similar duration to those prevailing in Smith’s time.

While offering to citizens some simple explanation of the universal advantages of the division of labor, Smith’s fuller understanding of it led him to emphasize the encouragement it gave, say, to two countries in mutually affording a dynamic market for the goods and services of each (*WN*, pp. 33–34). The damage done by the imposition of a tariff by one country on the imports from another could be placed in considerable perspective following this consideration. So long as *some* trade and *some* production occurs, the division of labor principle can still be applied and the resultant improvement in technology could be utilized, albeit in different degrees, by all participants. This consideration could easily dampen the enthusiasm of policy-makers to impose reciprocal tariffs and, to reiterate, especially if they are fully aware of the many incidental, and sometimes concealed, costs of reciprocity listed in Table 1.

The above-sustained examination of the several implications of Smith’s economic analysis, supports the conclusion of O’Brien and others (see above) that classicals such as Adam Smith prescribed the adoption of free trade as a *unilateral* action. This means that a country endeavors to keep open its markets regardless of tariffs on its exports to others. Whereas this conclusion seems hitherto to have been largely intuitive, it is hoped that the above arguments provide a much firmer and more satisfactory foundation.

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