Readings

Freedom to Trade

Against the Tide: An Intellectual History of Free Trade
by Douglas Irwin
(Princeton University Press, 1996) 265 pp.

Reviewed by Stuart Anderson

Anyone who has debated a colleague, cab driver, or congressperson on trade will immediately recognize from Douglas Irwin's book that the arguments against free trade have not changed a great deal over the past two hundred years.

Rather than chronicle the trench warfare over trade, Irwin focuses on the debate among economists in books, pamphlets, and academic journals throughout history. The hero of Irwin's story is Adam Smith who in 1776, Irwin stresses, did not present "new" information on trade in the *Wealth of Nations*. According to Irwin, Smith "achieved what others before him had failed to do: present a systematic, coherent framework for thinking about the economics of trade policy."

The most intriguing chapter in *Against the Tide* is "Mill and the Infant Industry Argument." Therein Irwin describes how John Stuart Mill, one of the world's greatest economists, committed an error that seriously hampered the free movement of goods. German economist Friedrich List argued in favor of government protection and support of "infant industries." List's case for protectionism was popular in the mid-nineteenth century; however, "The infant industry doctrine did not gain formal acceptance in classical trade theory until 1848, when John Stuart Mill published the first edition of his *Principles of Political Economy*." Mill supported the theory by writing that import protection could be defended in cases when, "It cannot be expected that individuals should, at their own risk, or rather to their certain loss, introduce a new manufacture. . . ." Irwin writes:

> Mill's standing and reputation among economists gave intellectual credibility to the infant industry argument for the first time. Economists and others who viewed free trade as the best policy for all countries regardless of the circumstances were dismayed by the respectability Mill lent to protection. Richard Cobden, the great free trade activist in mid-nineteenth century Britain, reportedly lamented on his deathbed that 'I believe that the harm which Mill has done to the world by the passage in his book on *Political Economy* in which he favors the principle of protection in young communities has outweighed all the good which may have been caused by his other writings.'

Even though List primarily advocated temporary protective measures to help an industry in a country with a developing economy, industrial policy advocates in fully developed economies have seen fit to protect favored industries—and rarely on a temporary basis. In later editions of *Political Economy*, John Stuart Mill retracted his support for protecting infant industries. Mill saw how U.S., Canadian, and Australian protectionists had used his work to justify higher tariffs on imports.

While reading Irwin's book, it may be reassuring for some to note that Adam Smith also was exasperated by the political focus on the balance of trade—known in modern America as the "trade deficit." Writing on the balance of trade in 1776, Smith criticized government attempts to use deficit figures as a pretext to intervene in trade:

> There is no commercial country in Europe of which the approaching ruin has not frequently been foretold by the pretended doctors of

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> this system, from an unfavorable balance of trade. After all the anxiety, however, which they have excited about this, after all the vain attempts of almost all trading nations to turn that balance in their own favor and against their neighbors, it does not appear that any one nation in Europe has been in any respect impoverished by this cause. . . . Every town and country, on the contrary, in proportion as they have opened their ports to all nations; instead of being ruined by this free trade, as the principles of the commercial system would lead us to expect, have been enriched by it.

Irwin's book is a valuable edition to the literature on international trade particularly in today's political climate. With many political leaders saying they favor "free trade but...", the term "free trade" has been largely co-opted. Thus, Irwin's historical perspective is also valuable for its short history of trade theory prior to Adam Smith. The author points out that the term "free trade" may have emerged as early as the end of the sixteenth century. However, the more precise term was "freedom to trade." Irwin notes, "This movement was geared exclusively toward freeing trade from medieval controls and establishing the right to carry on trade without official permission or approval." With the resurgence of economic sanctions as a tool of foreign policy, the U.S. government is preventing—or trying to prevent—an increasing number of American companies from doing business in an increasing number of countries. Perhaps the free traders during the Middle Ages had it right when they emphasized "freedom to trade" rather than the politicized catchword "free trade."

Slick Regulating

Oil, Gas & Government: The U.S. Experience
by Robert L. Bradley Jr.
(Lanham: Rowman & Littlefield, 1997) 281 pp.

Reviewed by Richard L. Gordon

In *Oil, Gas & Government* Robert Bradley provides an unusual, comprehensive review of regulations affecting the U.S. oil and gas industry. In this thirty-one chapter work sponsored by the Cato Institute, Bradley criticizes every intervention affecting the U.S. petroleum industry through about 1980. Despite the title, oil is the predominant topic; only two chapters focus on gas. As Bradley recognizes, few would be interested in every issue treated, but many will benefit from examining key parts.

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The book is divided into four main sections; each devoted to a "sector" of the industry. However, as many issues cross sectorial lines, unified treatment of each policy would have been preferable. The technology that enabled extensive cross-referencing might have been better used to reorganize. Bradley pays little attention to some issues, but compensates for this shortcoming with his high-quality treatment of the most important policies. Bradley also has provided readers with an invaluable reference source.

Bradley addresses many well-known issues including state regulations on oil production and federal supporting programs, federal income tax depletion allowances, natural gas price controls, and interventions of the 1970s, particularly oil price controls. He also presents several less well-known but equally important issues including wartime planning, the *Standard Oil* case and subsequent attempts to control competition in refining and marketing, and public utility regulation of gas and oil pipelines. Bradley's treatment of the history of wartime controls, a topic which traditionally has received limited exposure in scattered publications, is a particularly valuable bonus.

Bradley thoroughly reviews state production controls, the supporting federal policies, and the disastrous regulation of oil prices in the 1970s. Some major issues warranted more attention; particularly natural gas regulation, the effort to stimulate synthetic fuel production, and crude oil stockpiles. Consequently, Bradley understates the defects of these policies. Bradley generally emphasizes the ideological implications of policies rather than offering formal, theoretical appraisals. Bradley argues that regulatory experience in the petroleum industry bolsters free market arguments, specifically the Austrian approach of Ludvig von Mises and F. A. Hayek. While a surprisingly large part of petroleum policy can be criticized conclusively with Austrian theories, some important exceptions arise. The only jarring component of the discussion is

Bradley's antagonism, similar to Mises's, to econometrics and other forms of modeling. While such techniques are flawed, they often can limit folly.

Bradley's two chapter review of state "conservation" regulation takes us significantly beyond the previous, obsolete literature. It has been long-understood that governmental mishandling of the proper assignment of property rights in the petroleum industry inspired an undesirable state production control system. As import competition increasingly threatened state practices, a horrendous oil import control program was implemented. Bradley concludes that these controls were wasteful, undesirable attempts to raise prices in an effort to shelter small producers.

Bradley also cuts through the fog about goals. He sensibly concludes that the system of output rigging to stabilize price effects had to rely on the only available guide—namely, maintaining prior prices. More critically, he argues that failure to attain coordinated management of oil fields was due more to political than economic barriers. The main shortcoming of his argument is that it does not take advantage of all available weapons. For example, Bradley could have bolstered his argument with a discussion of Ronald Coase's classic writings on social costs that analyze the problems of comparing public and private solutions in complex situations and warn against glibly preferring government solutions.

Bradley provides a strong, extensive analysis of oil price controls in the 1970s, however inconveniently scattered throughout the book. The Nixon, Ford, and Carter administrations implemented ever more intrusive, ill-advised government rules to deal with inflation in general and then rising oil prices. The intrusions included establishing oil price controls, complicating natural gas and oil pricing rules, and imposing complex taxes on U.S. production. As Bradley less adequately notes, the government also instituted oil stockpiling and attempted to promote new technologies as alternatives to oil and gas. Indeed the Carter administration embarked on an ambitious program to subsidize the commercial development of these technologies that ultimately failed.

Bradley's gem is a discussion of how reselling provided a loophole in oil price regulation. Resellers could retain fifty cents per barrel for each barrel resold; traders quickly learned that by making enough additional paper resales, they could allocate among themselves the difference between controlled refinery prices and free market levels. Regulation that was designed to protect consumers, instead, characteristically, massively, and fruitlessly transferred rents among oil market insiders.

Bradley goes beyond criticizing the inefficiencies of antitrust practices and argues that abolition is the only tenable reform. For instance, he argues that Standard Oil was an efficient competitor that was penalized for its success, and that post-Standard policies in gasoline retailing protected inefficient existing firms. Standard antitrust writings suggest that protection of retailing in gasoline was unwise and doubts about antitrust attacks on Standard Oil have increased, but so have efforts to justify the action.

Bradley's discussion of gas price control is too terse to build a solid case against the misguided policies, but the most critical points are mentioned. He does an excellent job of explaining why legal and political considerations produced and perpetuated economically indefensible intervention. Indeed, traditional public utility regulation was unnecessary and unworkable because of the existence of strong competition between firms. Bradley also recognizes the incoherence of the policy of setting "area prices" for each region of the country based on the alleged average costs of production. However, he does not go far enough in developing the theoretical and empirical justifications needed to support his criticism. In particular, he does not show that the hallowed "cost of service" principle is economic nonsense. He makes inadequate use of available literature, especially Paul W. MacAvoy's classic analysis of competition in natural gas in *Price Formation in Natural Gas Fields*.

Overall, Bradley successfully demonstrates why free market principles should guide oil and gas markets, and how regulation of the petroleum industry has produced price distortions and other undesirable consequences.