CHAPTER 12

The Gains from Trade and Refusal to Trade

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Abstract

Purpose − Instances of refusal to trade stand in contrast to the theorems on the gains from trade. Two paradigms, second-best and political economy, have been used to explain refusal to trade. Murray Kemp (1962) provided a foundation for the political economy paradigm when he noted that, in the absence of lump-sum redistribution, the theorems on the gains from trade are "true but irrelevant". This chapter takes Murray Kemp's observation as a point of departure for a consideration of the relation between individual and group gains from trade. Paradigms in explaining refusal to trade are distinguished.

Methodology/Approach − This chapter examines ideas underlying explanations for refusal to participate in international trade.

Findings − Two different approaches are identified in modeling and explaining why the gains from trade are compromised by refusal of governments to allow free trade. The second-best approach suggests a justification for refusal to trade while the political economy approach with public-choice foundations proposes an explanation.

Practical implications − Ideology expressed in how governments are viewed can influence economic analysis.

Keywords: Gains from trade, political economy, second-best, Murray Kemp

Paper type: Research paper

1. Introduction

In the classical liberal paradigm, no individual can gain by arbitrarily refusing to trade.[1] In international trade theory, the issue is however not whether an individual chooses to live a Robinson Crusoe type existence and refuses to trade with others. The issue is rather *with whom* trade takes place. Trade might be limited to domestic markets. Preferential trading agreements might permit trade in selected foreign markets. Or trade might be allowed with anyone anywhere willing to trade. The trade that is permitted may also be restricted.

Two paradigms, second-best and political economy, have explained refusal to allow free trade in face of the gains from trade. The second-best paradigm demonstrates societal or collective gains from refusal to trade. Policies are at the same time suggested whereby market intervention can improve social welfare.[2] The political economy paradigm acknowledges societal or collective gains from free trade and bases refusal to allow free trade on inability to transform the collective or aggregate gains from trade into the individual gains that would ensure a free-trade consensus.

To accept the second-best paradigm, one has to believe that closing of economies to trade or trade intervention can increase aggregate or societal welfare. We additionally have to believe that socially benevolent governments choose policies of refusal to allow free trade with the objective of achieving second-best efficiency gains. To accept the political economy paradigm, one has to believe that the realization of societal gains from trade can be compromised by majority voting or through political influence of self-interested groups on trade policies.

A point of beginning for the political economy paradigm is the observation by Murray Kemp (1962) that, in the absence of lump-sum taxes and transfers, the theorems on the gains from trade are "true but irrelevant". In the absence of lump-sum taxes and transfers, the efficiency losses from domestic redistribution aimed at providing all individuals in a population with personal gains from trade could in principle outweigh the societal efficiency gains from trade. Without lump-sum redistribution, there need then not be consensus support among voters for free trade. Insurance and asset markets are possible alternatives to compensating payments for achieving a free-trade consensus. When achieving consensus on free trade is not feasible, we are in the domain of the political economy

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[1] The rule of law and the private property rights that facilitate trade are in the background of the liberal paradigm, since people cannot sell what they do not own and will not be prepared to receive in exchange that which they cannot be assured will after payment belong to them. The paradigm also includes the role of the state, as intervening or assisting where necessary when public goods, externalities, natural monopoly, and social justice require. See Mueller (2003), Hillman (2003).

[2] The second-best encompasses the classical exceptions of optimum tariffs and infant industries.

paradigm and refusal to allow free trade can follow from majority voting under direct democracy (Mayer, 1984) or from the more common political decisions of representative democracy (Hillman, 1982, 1989b; Grossman and Helpman, 1994, 2002).

2. The individual and gains from trade

An individual gains from trade compared to personal autarky.[3] We summarize this in a proposition that underlies the benefits from market exchange. In a population of n individuals, denote by U_i^a individual i's utility in personal autarky and by U_i^e individual i's utility from any set of opportunities to engage in personal exchange (reflected in offer curves that confront the individual or market-determined prices). Then

PROPOSITION 1A. *For any individual* i, $U_i^e > U_i^a$, $i = 1, ..., n$; *that is, all individuals gain from accepting trade offers (or cannot lose) relative to circumstances of personal autarky.*

Proposition 1A excludes presence of externalities: for example, Proposition 1A may be compromised if a ship that brings or takes goods also brings risk of disease or if we object to child labor used in production abroad. Proposition 1A assumes that transactions costs of exchange are not excessive; transportation costs could exceed the personal benefits from exchange. We can associate Proposition 1A with classical liberal thought, including Adam Smith who viewed scale economies or division of labor as a benefit of market organization and exchange, in recognition that goods may be less costly to produce when individuals produce for many others. An implication of Proposition 1A is:

PROPOSITION 1B. *If individuals vote between remaining in personal isolation and being presented with opportunities of exchange with others, they by consensus vote for opportunities for exchange.*

The consensus reflects the personal Pareto-improvement of Proposition 1A.

For convenience, we use a Benthamite social welfare function to aggregate personal utilities. Then:

PROPOSITION 1C. *For a population of n individuals, trade results in* $\sum_i U_i^e > \sum_i U_i^a$.

This proposition describes aggregate gains from trade. All n individuals are first placed in isolation where each has utility U_i^a, $i = 1, ..., n$. Then they are allowed to trade with one another in a competitive market where

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[3] I shall omit reference to cases where individuals are indifferent between trading and not trading.

they achieve utilities U_i^e $i = 1, \ldots, n$. Proposition 1C follows by aggregation from Proposition 1A.

3. Domestic and foreign trade

To introduce foreign or international trade, we note the complexity that is hidden in proposition 1C that the choice may not be between free trade *with everybody* and no personal trade at all. We subdivide the population of n individuals into h "fellow citizens" and z "foreigners". Restrictions on trade with the h fellow citizens are not allowed. In a closed economy, the domestic population of h individuals initially engages in "domestic" exchange among themselves, with the consequence of Proposition 1A. Individuals achieve levels of utility U_i^d, $i = 1, \ldots, h$ from domestic exchange. Utility from exchange that includes free trade with the z foreigners is U_i^f, $i = 1, \ldots, h$.

There can be further partitions of the population z through preferential trading. Free trade or less restrictive trade with some sub-segment of the foreign population may be allowed. Analogs can now be stated to Propositions 1A, 1B, and 1C. We shall presently consider if the analog propositions hold.

PROPOSITION 2A. *For any individual i, $U_i^f > U_i^d$; that is, all individuals gain from foreign trade relative to only domestic trade amongst themselves.*

PROPOSITION 2B. *A vote to allow international trade has consensus support.*

PROPOSITION 2C. *For the entire population of n individuals, $\sum U_i^e > \sum U_i^a$; that is, the population collectively gains from international trade relative to domestic trade.*

4. A Ricardian economy

We consider these propositions first in a Ricardian economy. Suppose that workers in a Ricardian economy have the same productive capabilities and the same consumption preferences, and that workers abroad have different production capabilities. There are aggregate and personal gains from foreign trade compared to domestic trade (2A and 2C) and all workers in the Ricardian model would vote to allow international trade (2B). Individuals have a comparative advantage in international trade but their homogeneity provides them with no source of comparative advantage in domestic exchange. For domestic trade, Proposition 1A does not hold. The only source of gains from trade is therefore foreign trade.

5. A more general model with asymmetric income sources

In a more general model, individuals have asymmetric income sources through differing productivities or personal skill endowments

(or human-capital investments). Proposition 1A then holds for domestic trade.

Paul Samuelson (1939) showed that Proposition 2C is true.[4] Samuelson (1939) compared the binary choice of free trade at given terms of trade with domestic trade (or national autarky). Murray Kemp (1962) showed that collective or aggregate gains from international trade in Proposition 2C apply when choice is not restricted to being binary between free trade and no trade, but includes any restricted trading opportunity relative to no trade, and when terms of trade are not necessarily fixed but depend upon trading offers.[5] Kemp thus showed that any opportunity to engage in international trade, even subject to artificial and arbitrary restrictions, is *collectively* preferable to the outcome achievable through domestic trade alone. However, this does not imply Proposition 2A, which requires a distribution of the collective benefit to allow all individuals to personally benefit.

Samuelson (1939) had stated the gains from trade in terms of potential compensation: "if an unanimous decision were required in order for trade to be permitted, it would always be possible for those who desired trade to buy off those who opposed trade, with the result that all could be made better off" (p. 204). Murray Kemp observed that lump-sum taxes and transfers were required if the redistribution were to be consistent with retaining the gains from trade. The efficiency losses from non-lump-sum compensation could in principle outweigh the gains from trade. Without lump-sum compensation, Propositions 2A and 2B could therefore not be assured. Kemp pointed out that: "If the only types of taxes or subsidies that are available are those that carry with them a deadweight loss of allocative inefficiency, then *the theorems are true but irrelevant*" (p. 819).

This was a prescient observation at a time when the political economy paradigm was far from mainstream thought in the study of international trade. Kemp was stating that it was true that replacing domestic trade with free trade or any restricted form of foreign trade could increase aggregate welfare or national income. However, we should not necessarily expect to see foreign trade realized if income-distribution impediments to foreign trade could not be overcome and actual compensation could not take place.

The impediments to free trade are the efficiency losses when redistribution occurs. If redistribution cannot take place to ensure Propositions 2A

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[4] That is, for any group of individuals taken together, the consumption opportunities for the group available through foreign trade dominate the consumption opportunities available through domestic trade.

[5] On the foreign offer curve and aggregate domestic consumption possibilities, see also Samuelson (1962), which accompanies Murray Kemp's paper, and previously Baldwin (1948). On further extension of the proofs of the gains from trade, see Ohyama (1972).

and 2B, we may observe a collective decision of refusal to trade, notwithstanding the aggregate gains from trade (Proposition 2C).[6]

6. The feasibility of free-trade consensus

Traditional models of international trade describe economies where tax bases allow lump-sum taxes. The tax bases are assured by an assumption that factors of production are inelastically supplied.[7] Factor rewards however in general influence factor supply.[8] Still, even if in practice feasible, lump-sum taxation and income transfers are not policy instruments that governments use. Lump-sum taxes if uniform are regressive. If not uniform, lump-sum taxes become arbitrary and may be intentionally or inadvertently discriminatory.

Lump-sum taxation is therefore *politically not feasible*. In the absence of lump-sum taxation, there is no assurance that a tax base will exist to allow the gains from international trade to increase utility for all individuals in a population.[9] We can envisage a case where trade liberalization occurs and the gainers from trade who are to be taxed to finance compensating transfers to losers have preferences such that utility from income and leisure are almost perfect substitutes over the range of market factor prices where taxes are levied. The tax base can then sufficiently contract when taxes are levied so that tax revenue required to make any required compensating transfers cannot be collected. That is, income redistribution is constrained by the Laffer curve. The tax base may also contract because the factor of production that is to be taxed is internationally mobile.[10]

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[6] In the companion piece to Murray Kemp's paper, Paul Samuelson writes: "Practical men and economic theorists have always known that trade may help some people and hurt others. Our problem is to show that trade lovers are theoretically able to compensate trade haters for the harm done to them, thereby making everyone better off" (1962, p.823). Samuelson drew a distinction between economic enquiry concerned only with achieving efficiency and political economy. As Murray Kemp inferred, however, compensation in principle is not sufficient to move self-interested voters to support free trade.

[7] This is quite as Marx and Engels would have had it: in these models people contribute according to ability and not according to reward.

[8] On variable factor supply in models of international trade, see Kemp and Jones (1962).

[9] Regressive income taxes can decrease the magnitudes of the substitution responses that contract tax bases but are not in general politically feasible. See Hillman (2003, chapter 7).

[10] Dixit and Norman (1980, 1986) proposed a means of compensatory transfers whereby the production gains from trade could be assured and then the surplus consumption over autarky consumption or part thereof could be provided to consumers through market prices that were distorted by commodity taxes and subsidies. The production gains from trade are achieved and the taxes and subsidies distribute the increased output. The problem is to find the market means of redistribution that result in the required compensation. See also Kemp and Wan (1986) for exposition of some special cases comparing lump-sum and non-lum- sum distribution of the gains from trade.

With the tax base present, the efficiency losses from non-lump-sum redistribution can in principle exceed the societal gains from trade.

There are other practical impediments to redistribution. Moral hazard may be encountered if the intention is that compensating payments persist as long as individuals have not adjusted to new employment (although unemployment is not present in the usual trade models).[11] If the compensation is the present value of individual losses incurred, capital markets are required to allow the compensatory transfers to be financed from the future income of the gainers from trade liberalization. Again there is a prospective moral hazard problem. Borrowing against future income requires collateral other than human capital.

7. *The evolutionary case for free trade*

If gains from trade cannot be assured for all individuals through compensating transfers, can other means ensure consensus support for free trade? Following on from and adapting the propositions of Friedrich von Hayek and others, an evolutionary case can be made in the face of uncertainty about future comparative advantage and the terms of trade. Let

$$x_{1t}, x_{2t}, \ldots, x_{mt}, \quad t = 0, 1, \ldots, T$$

denote the goods available at time t from present time 0 up to a time horizon T and let relative prices determined through a suitable numéraire be

$$p_{1t}, p_{2t}, \ldots, p_{mt}, \quad t = 0, 1, \ldots, T.$$

The attributes and identity of the goods and relative prices in the future are subject to uncertainty at time 0. Future comparative advantage therefore is not known with certainty. Nor are the goods that will be traded known, nor substitutability with other goods. The uncertainty affects individuals' expected utilities and leads risk-adverse individuals to seek insurance. For well-known reasons relating to asymmetric information, the sought insurance may not be offered in private markets.[12] An alternative to insurance markets for personal incomes is self-insurance through income diversification in asset markets. In a limiting case under appropriate conditions, Propositions 2A and 2B can hold in the presence of non-diversifiable human capital. Inability to diversify human

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[11] In experience with "structural adjustment programs", a finding is that the programs often subsidize firms that release and then re-hire the same labor.

[12] In principle, people with incomes tied to traded goods' prices could enter into contract whereby protection would serve as the instrument of income insurance contingent on realization of comparative advantage and terms of trade. On the feasibility of such insurance in a specific-factors model, see Cassing *et al.* (1986).

capital because of moral hazard can however impede achievement of a free trade consensus through asset markets.[13]

Personal gains from free trade cannot be assured because of limitations on compensatory payments through government. If neither insurance nor asset markets allow individuals to resolve personal income uncertainty, we are left with the evolutionary case for free trade. That is, over the course of human history, only free markets have persistently sustained benefits for the broad population.[14]

8. Political economy and refusal to allow free trade

The evolutionary case for the market is based on societal benefits with personal gains and losses averaging out over time. A shorter time horizon is involved when collective decisions and political influence lead to refusal to allow free trade. The political economy paradigm then predicts refusal to trade because neither *ex post* lump-sum or other compensating transfers nor *ex ante* means of resolving income uncertainty through insurance are available to establish consensus for free trade.

For each individual, there exists a subset of a population with whom trade maximizes personal utility in competitive markets. Individuals with common interests cannot however use the political process to implement refusal to trade with any arbitrarily sought group. Institutions and transactions costs favor collective and political decisions to exclude or restrict trade with foreigners. The political economy paradigm thereby in particular applies to foreign trade.[15]

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[13] Whether a free trade consensus is feasible depends on whether individuals with personal endowments of physical and human capital can restructure sources of personal income through asset markets to end personal interest in protectionist policies (Feeney and Hillman, 2004).

[14] A related case, also associated with Hayek, is that free markets and the accompanying rule of law that protect private property rights preserve individual freedom. For a summary of Hayek's case for the market, see Hillman (2003, Chapter 1, Section 3).

[15] A related question is why refusal to trade with foreigners is used when more efficient production subsidies can be expected to be available. Behavioral economics and issues of framing appear to have a role: people may believe that their government should not stand idly by as their fellow citizens or they themselves lose their jobs because foreigners are selling in their domestic markets Wolfgang Mayer and Raymond Riezman (1990) summarize various reasons why informed voters might prefer use of trade policy instruments. Voters may not be informed; "rational ignorance" or transparency is often proposed as the reason for using foreign trade policy to preserve or redistribute income domestically. Steven Magee (1988) used the term "obfuscation". See also Hillman (1989b) on the Brigden case for the Australian tariff. Tullock (1989) has pointed to the related puzzle of the non-transparent means that are sometimes used to redistribute income or to provide rents to rent seekers. With regard to whether voters are informed, the evidence is anecdotal but we can all be the source of anecdotes if our students have been surprised to learn that tariffs are not merely taxes on foreign goods but are equivalent to domestic production subsidies for protected import-competing producers in conjunction with equivalent domestic consumption taxes, and that through general equilibrium effects tariffs affect incomes throughout the economy.

9. The second-best view

An economist may believe that the theory of international trade is (or should be) exclusively normative and may have been trained to maximize social welfare or else the utility of a representative individual. Aspects of collective action and political calculation are then missing from the model that is used. The model without collective action and political calculation is consistent with a benevolent government that maximizes social welfare. The economist may then observe a government that does not allow free trade. The model in use only allows a second-best explanation for the policies of intervention of government. Minimum wages can be proposed to make a labor-abundant country look like and trade like a country where labor is a relatively scarce factor, in which case autarky is shown to be preferable to free trade. Society at large then gains from the intervention of benevolent government, which closes off trading opportunities. An efficiency justification is thus provided for refusal to trade.[16] A reversal of comparative advantage can in principle similarly occur because of externalities. The externalities are now the reason for refusal to trade. Although the case has been made in principle, no empirical evidence ever seems to have been offered that second-best circumstances have justified refusal to trade. The proposed second-best gains from refusal to trade protected the vision of benevolent government. The political economy perspective in contrast viewed government as the means for political decisions made by people who had political and self-interested objectives.

10. Strategic trade policy and rent seeking

Rent seeking remains outside of the description of government policy decisions so long as government is described as maximizing social welfare or the utility of a representative consumer. The second-best defends the government paradigm as benevolent when rents are being created and being assigned through political decisions. A government may for example be observed to be giving subsidies to a domestic industry or firm whose owners or shareholders are resident principally within its jurisdiction. Pigovian solutions to externality problems under designated legal rights could justify such subsidies. The firms receiving the subsidies compete against foreign firms in various markets. A public-choice or political economy explanation suggests that successful rent seeking has taken place to influence rent

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[16] Because of the minimum wage "distorting" the true cost of labor, the country is trading contrary to comparative advantage and is exporting in terms of factor content its relatively scarce factor capital. Eliminating the trade that is contrary to comparative advantage increases national income.

assignment. The second-best strategic trade policy explanation proposes *social benefits* from subsidies provided by governments.

11. Trade liberalization

The second-best defense of benevolent government also makes an appearance in views of trade liberalization. Through a series of multilateral negotiations, the high-income countries of the world liberalized trade among themselves. The MFN (most favoured nation) clause ensured that the liberalizations were multilateral. The multilateralism avoided opportunism in making ''concessions'' when granting ''market access'' (Ethier, 2001, 2002). Protectionist possibilities nonetheless remained because of the incomplete-contract nature of the liberalization agreements (Ethier, 2005). The economic interest of exporting industries favored trade liberalization as the exchange of market access. The conceptions there were applied were mercantilist, with presumptions of national rights to markets and exchange of rights through compromises that allowed foreigners market access. The mercantilist ideology was consistent with the interests of exporters who were the beneficiaries of the ''exchange of market access'' (Hillman and Moser, 1996). The conception of ''exchange of market access'' is outside of the paradigm of the social-welfare maximizing government. Consistent with the latter paradigm is an explanation that governments had previously imposed optimum tariffs and had now found a way to escape the Nash equilibrium, and were able to negotiate their way back to the contract curve through the liberalization agreements.

The empirical evidence and declarations of intent by governments do not support the second-best descriptions. No government ever seems to have declared that the reason for not refusing to allow free trade was the intention to benefit from an optimum tariff. Indeed, governments have often appeared to fear a decline in the world price of import-competing goods. Murray Kemp, through his observations on lump-sum taxes and transfers and the gains from trade, can have the final word. The gains from the optimum tariff to the population at large require means of distributing the tariff revenue for Pareto-improvement for the population.

12. Trade diversion: The second-best within political economy

The political economy view can accommodate the second-best. Murray Kemp has written about preferential trading and has made influential contributions to our understanding of this topic.[17] In particular, together

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[17] See Kemp (1969).

Table 1. The prisoners' dilemma of trade diversion

	Person 2 ignores the new duty-free source	Person 2 buys from new duty-free source
Person 1 ignores the new duty-free source	3,3	1,4
Person 1 buys from new duty-free source	4,1	2,2

with Henry Wan, he has shown that in principle it is always possible to avoid welfare-reducing preferential trade.[18]

We might also ask why welfare reduction at all occurs since relaxing a constraint should not result in welfare loss. That is, allowing free trade where restricted trade previously was permitted should not reduce welfare, since the opportunities thereby provided, if disadvantageous, can be ignored. Yet, in the circumstances where trade diversion occurs, changed opportunities to buy from a new source reduce individuals' utility.

I have previously shown that the circumstances here are those of a multi-person prisoners' dilemma.[19] The dilemma hinges on a common pool problem for revenue from a tariff. Table 1 shows the two-person case. Each of two persons can ignore the new duty-free source for imports and thereby achieve the symmetric efficient outcome (3, 3). The personally best outcome for one person and the personally worst outcome for the other person occur at (4, 1) and (1, 4). At (4, 1), person 2 buys from the source with the lower world price and pays the tariff, so providing revenue for the government, from which person 1 benefits. Person 1 contributes no tariff revenue in having purchased from the duty-free source. The Nash equilibrium is at (2, 2) where there is no tariff revenue and trade diversion has taken place.

An enforceable contract to ignore the duty-free import source would increase utility for both persons. Mutual gain at (3, 3) relative to the Nash equilibrium (2, 2) would be ensured if each consumer were to receive back from the government the precise sum that the consumer paid in tariff revenue. However, governments do not return individually paid tariff revenue.

13. International externalities and refusal to trade

A second-best political economy can be based on Ostrogorski's paradox.[20] In Table 2, there are 4 groups of voters. Groups A, B, and C each consist of 20% of voters. Voters in these groups benefit from the protection of

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[18] Kemp and Wan (1976).
[19] See Hillman (1989a).
[20] On the Ostrogorski paradox, see Nurmi (1999) or Hillman (2003).

Table 2.   Free trade wins with either direct voting or representative democracy

	Protection for A	Protection for B	Protection for C
Group A (20%)	Yes (*F* candidate)	No (*F* candidate)	No (*P* candidate)
Group B (20%)	No (*F* candidate)	Yes (*P* candidate)	No (*F* candidate)
Group C (20%)	No (*P* candidate)	No (*F* candidate)	Yes (*F* candidate)
Group D (40%)	No (*F* candidate)	No (*F* candidate)	No (*F* candidate)

Table 3.   Free trade wins with representative democracy, protection wins with a direct vote on policy for each industry

	Protection for A	Protection for B	Protection for C
Group A (20%)	Yes (*F* candidate)	No (*F* candidate)	No (*P* candidate)
Group B (20%)	No (*F* candidate)	Yes (candidate 2)	No (*F* candidate)
Group C (20%)	No (candidate 2)	No (*F* candidate)	No (*F* candidate)
Group D (40%)	Yes (*P* candidate)	Yes (*P* candidate)	Yes (*P* candidate)

their own industry (they have industry-specific incomes) and lose from the protection of any other industry. Group D consisting of the remaining 40% of the population loses from protection provided to any industry. Under majority voting on the single issue of protection for each industry, the majority favors free trade for each industry by 80–20%. Under representative democracy, voters vote once and support the candidate closest to their own preferred position. The voters in groups A, B, and C prefer free trade to protection for all three industries. In a choice between the protectionist candidate *P* and the free-trade candidate *F*, they support the latter. The *F* candidate thus wins.

In Table 3 group D might support protection because foreign production takes place with child labor or with lower environmental standards than domestic production. Ideally the voters want foreign governments to change their policies and they view the second-best response as refusal to trade. Direct voting on the issue of protection for each individual industry now results in a majority favoring protection in each case, since group D forms a winning coalition with the group that benefits from protection for the industry on which the vote is taken. Under representative democracy where there is a single vote on the choice between the *F* and *P* candidates, all industry groups vote for free trade (they do not care about the foreign externality and lose from protection of all industries but one gain from free trade). The outcome is electoral success for the *P* candidate. Ostrogorski's paradox is present because the choice of the collective decision making mechanism determines the outcome. In this example, group D wants foreign societies to adhere to

the group's desired norms.[21] The collective action of refusal to trade internalizes externalities that members of this group perceive from imports purchased by anybody, and not just themselves. Individual action cannot achieve the sought objective. Left to their individual decisions, without group discipline, the persons in group D may confront a prisoners' dilemma and in the Nash equilibrium perhaps purchase the socially unacceptable good.

14. Other explanations for refusal to trade

For completeness, we should add other explanations for refusal to trade. Mercantilist ideology results in refusal to trade since the object of the ruler is to accumulate gold and silver through a trade surplus: if everybody wants only to sell and not to buy, there is no trade. Refusal to trade can also occur because of trade embargos.[22] A country confronting an embargo threat can also refuse to trade, for reasons of national defense.[23] Refusal to trade is also a consequence of the ideology of communism, which is inconsistent with market exchange with foreigners since decentralized decisions through foreign markets can contradict the intentions of central planning. Of course, absence of private property rights altogether contradicts personal exchange in markets.

15. Conclusions

The primary policy question in international trade is why refusal to trade occurs given the theorems on the gains from trade. The political economy

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[21] In the public debate and subsequent voting on NAFTA in the U.S., for example, there was a public perception that free trade with Mexico might be disadvantageous because of differing environmental standards and prospective "loss of jobs" as U.S. industry relocated or invested in Mexico. U.S. industry perceived the benefits of access to the Mexican market, but more so the advantage of free re-entry of goods produced at Mexican wages into the U.S., although as in case 2 above each industry would have, we can believe, preferred protection as an exception for itself.

[22] For example, some Arab and also other Muslim countries have maintained an embargo on trade with the state of Israel to express their opposition to the existence of Israel. There has also been a secondary boycott whereby non-Israeli firms doing business with Israel were placed on a boycott list. Often, as we would expect, self-interest results in governments ignoring ideologically based boycotts. Agence France Presse (AFP) reported on July 5, 2006 that the Damascus-based Arab League Central Boycott Office (CBO) had informed the Swiss food company Nestlé that it had been placed on the boycott list. Nestlé was given a one-year respite to cease operations in Israel. Nestlé did not comply and consumers in most Arab countries continue to buy Nestlé products. Danish products were boycotted in Muslim countries to protest cartoons in the Danish press that depicted the prophet Muhammad. The U.S. maintained an embargo against Cuba during the period of the Castro regime.

[23] See for example Mayer (1977) and Arad and Hillman (1979).

view of trade policy allows for general self-interested behavior, including political decision makers who are viewed as having political objectives. Second-best theory responds to refusal of governments to allow free trade by adopting the perspective of Dr Pangloss, who declared that any observed outcome must necessarily be the best of all possibilities chosen by a benevolent decision maker. I have presented an overview-of refusal to trade. Refusal to trade is a particularly appropriate topic for this volume because of the observation by Murray Kemp (1962) without lump-sum taxes and transfers, the theorems on societal gains from trade are "true but irrelevant". In making this observation, Murray Kemp can be regarded as having laid the foundations for the modern political economy explanation that places income distribution and political or collective decisions at the core of the explanation for refusal to trade.

Acknowledgements

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