SHOULD TRADE'S 'LOSERS' BE COMPENSATED?: AN EXPLORATION OF THE WELFARE ECONOMICS OF THE LOSSES AND COSTS OF ECONOMIC CHANGE

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> *The law evidently cannot prohibit all actions which may harm others, not only because no one can foresee all the effects of any action, but also because most changes of plans which new circumstances suggest to some are likely to be to the disadvantage of some others. The protection against disappointment of expectation which the law can give in an ever-changing society will always be only the protection of some expectations but not of all.*[1]
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> *- F.A. Hayek*

I. INTRODUCTION

Economists as a group famously support free trade and do so overwhelmingly.[2] This support is not determined by party lines.[3] Surveys of economists' opinions on trade policy typically find that around four in five economists endorse a policy of free trade.[4] Such support is perhaps at least partly explained by the fact that modern economics was launched with the publication of a book that featured at its core a veritable disembowelment of mercantilism and all of its protectionist fallacies. That book, of course, is the second of only two written by Adam Smith, his 1776 *An Inquiry Into the Nature and Causes of the Wealth of Nations*.

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Research for this writing was funded by a grant from the Law & Economics Center. The opinions expressed here are mine alone and do not represent the official position of the Law & Economics Center, of George Mason University, or of any other organization. I thank for their helpful comments Veronique de Rugy, Richard Epstein, Elisa Philip Gentry, Andrew Morriss, Paulo Saguato, John Yun, and participants in the Law & Economics Center's September 2021 Research Roundtable on Capitalism and the Rule of Law. Despite this immensely productive feedback, errors and weaknesses remain, which are all my fault.

1 1 F. A. HAYEK, *Rules and Order*, *in* LAW, LEGISLATION AND LIBERTY 101–02 (1973).

2 *See* Gregory N. Mankiw, *Economists Actually Agree on This: The Wisdom of Free Trade*, N.Y. TIMES (Apr. 24, 2015), https://www.nytimes.com/2015/04/26/upshot/economists-actually-agree-on-this-point-the-wisdom-of-free-trade.html.

3 *See id.*

4 *See* Robert Whaples, *The Policy Views of American Economic Association Members: The Results of a New Survey*, 6 ECON J. WATCH 337, 340, 343 (2009).

Although nearly all of the arguments that Smith marshaled in support of free trade had been offered earlier by a variety of writers, never before were the arguments against protectionism assembled in one place, presented so systematically, and delivered with such an arresting combination of power and eloquence. Support for a policy of unilateral free trade, largely without conditions, has ever since been hard wired into the DNA of economic science.[5]

Some economists, alas, have mutant genes. Among the most scholarly of these today is Harvard's Dani Rodrik, a prominent trade skeptic. In his 2018 book, *Straight Talk On Trade*, Rodrik explains that the typical academic economist, when asked by a reporter about trade policy, "will be enthusiastic in his support of free trade."[6] But, continues Rodrik, if the reporter were to sneak into this economist's classroom, that person would encounter a quite different message:

> The professor would then launch into a long and tortured exegesis that will ultimately culminate in a heavily hedged statement: "So if the long list of conditions I have just described are satisfied, and assuming we can tax the beneficiaries to compensate the losers, freer trade has the potential to increase everyone's well-being."[7]

Rodrik is correct that when we academic economists do trade theory for fellow economists, and when we teach it to our students, we consider a broad range of theoretical possibilities that we seldom mention in public-policy discussions with non-economists. And it is true that any one of these exceptions, were it to occur regularly in the real world, would indeed render reckless all professions of unqualified support for a policy of unilateral free trade. But Rodrik is mistaken to conclude that economists who advocate enthusiastically for a policy of unilateral free trade are being untrue to their professional learning or reckless in conveying its implications for public policy. The theoretical exceptions to the finding that a policy of unilateral free trade will maximize material living standards in the home country are just that: theoretical exceptions.

The standard response of pro-free-traders to Rodrik and others who argue against a policy of unilateral free trade is to point out that, in the real world, policy is designed and applied by fallible human beings. These policymakers and enforcers typically have no reliable way of knowing when theoretical exceptions arise in reality. Nor do these government officials have access to the detailed knowledge that is necessary to ensure that these

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[5] Adam Smith was no free-trade absolutist. In *The Wealth of Nations* he explicitly identified four exceptions to the case for a policy of unilateral free trade. Yet both the substance and tenor of his work make clear that, for Smith, the burden of persuasion is squarely on those who would impose protectionist policies. On the nature and reach of Smith's exceptions to the case for free trade see Donald J. Boudreaux, *Today's Relevance of Adam Smith's Wealth of Nations*, 24 INDEP. REV. 487, 491, 493–95 (2020).

[6] DANI RODRIK, STRAIGHT TALK ON TRADE: IDEAS FOR A SANE WORLD ECONOMY 119 (2018).

[7] *Id.*

exceptions are addressed in ways that do not make matters worse. In addition, policymakers and enforcers are subject to often-perverse political incentives.[8] And such perverse incentives, as amply documented by Douglas Irwin, have for all of American history played a prominent role in the setting of U.S. trade policy.[9]

All of the theoretical exceptions to a policy of free trade are built, if usually only implicitly, on the presumption that policymakers and enforcers possess both the knowledge and the motivation of gods. Strip away one or the other—or, especially, both—of these presumptions and the wisdom of the *rule* of a policy of unilateral free trade becomes evident. Ordinary human beings simply have neither the capacity nor the political courage to be trusted with the discretion to intervene in trade in ways that make the theoretical exceptions relevant in reality.

Although this response to free-trade skeptics is commonplace[10], repeating it is nevertheless important. The reason is that even more commonplace is the habit of ignoring these features of real-world policymaking.

There is, however, at least one particular prong of the trade-skeptics' case that warrants a response that is more foundational. This prong is the one that, as Rodrik says in the above quotation, insists that the theoretically sound case for free trade rests on the assumption that "we can tax the beneficiaries to compensate the losers."[11] Because in the real world the "losers" from free trade are not compensated with tax revenues paid by the "winners," free trade in reality is missing a key pillar on which rests the theoretical case for free trade. Or such is the argument of Rodrik and many other trade skeptics.[12]

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8 These often-perverse political incentives, and their consequences, are most consistently revealed and studied by scholars working in the public-choice tradition. Classic works in public choice include ANTHONY DOWNS, AN ECONOMIC THEORY OF DEMOCRACY (1st ed. 1957); JAMES M. BUCHANAN & GORDON TULLOCK, THE CALCULUS OF CONSENT (1st ed. 1962); WILLIAM H. RIKER, THE THEORY OF POLITICAL COALITIONS (1st ed. 1962); MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS (1st ed. 1965); WILLIAM A. NISKANEN, BUREAUCRACY & REPRESENTATIVE GOVERNMENT (1st ed. 1971); GEORGE J. STIGLER, THE CITIZEN AND THE STATE: ESSAYS ON REGULATION (1st ed. 1975); JAMES M. BUCHANAN & RICHARD E. WAGNER, DEMOCRACY IN DEFICIT: THE POLITICAL LEGACY OF LORD KEYNES (1st ed. 1977); BRYAN CAPLAN, THE MYTH OF THE RATIONAL VOTER: WHY DEMOCRACIES CHOOSE BAD POLICIES (1st ed. 2007). An accessible introduction is GORDON TULLOCK & GORDON L. BRADY, GOVERNMENT: WHOSE OBEDIENT SERVANT? A PRIMER IN PUBLIC CHOICE (2000). On the relevance of public choice to the study of law, see MAXWELL L. STEARNS, TODD J. ZYWICKI & THOMAS J. MICELI, LAW AND ECONOMICS: PRIVATE AND PUBLIC (1st ed. 2018).

9 *See generally* DOUGLAS A. IRWIN, CLASHING OVER COMMERCE: A HISTORY OF US TRADE POLICY (1st ed. 2017).

10 *See, e.g.*, Boudreaux, *supra* note 5, at 496–97 (quoting ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 456 (Liberty Fund 1981) (1776).

11 RODRIK, *supra* note 6.

12 Rodrik is not alone. Another famous trade economist who insists that the case for free trade is valid only if trade's 'winners' compensate trade's 'losers' is Nobel laureate Paul Krugman:

> the conventional case for trade liberalization relies on the assertion that the government could redistribute income to ensure that everyone wins - but we now have an ideology utterly opposed

My purpose in this paper is to explain that even the theoretical case for free trade does not, in practice or even in principle, require that trade's "winners" compensate trade's "losers." Nor does it require even that trade's "winners" be *capable* of compensating "losers" such that at least one person is left better off with no one made worse off.

On this particular point, economists themselves – including many unapologetic pro-free-trade economists – have unwittingly contributed to the confusion. By misapplying to trade the Pareto and Kaldor-Hicks welfare criteria, economists have made the case for a policy of free trade appear more tentative than it really is.

II. THE WELFARE CRITERIA

Economists' core criterion for assessing the welfare effects of policies and economic activities is the Pareto criterion, named for the Italian economist Vilfredo Pareto. Adoption of a policy or the undertaking of some activity satisfies the Pareto criterion if that policy or activity makes at least one person better off without making anyone worse off. This Pareto criterion is simultaneously quite weak and impossibly strong.

The Pareto criterion is weak in the sense that few people with modern, liberal sensibilities would find any policy or activity that satisfies it to be objectionable. Accepting the Pareto criterion obviously involves a value judgment, but one that is almost universally shared in modern society.[13]

But the Pareto criterion is (nearly) impossibly strong in the sense that it is extremely difficult in reality to identify a policy or action that does not cause at least one or a handful of people to be made worse off. If satisfaction of the Pareto criterion were required for any real-world action to be taken, very few actions would be taken in the real world. Ironically, *everyone* over time would be made immeasurably worse off as the resulting inactivity would bring on humanity's extinction. Obviously, a welfare criterion of such stringency is not merely impractical; it is apparently severely flawed.

Actually, though, what is flawed is not the criterion *per se* but the domain in which it is often carelessly applied. As James Buchanan argued in 1962, the relevance of the Pareto criterion applies not at the level of actions

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> to such redistribution in full control of one party, and with blocking power against anything but a minor move in that direction by the other.
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> So the elite case for ever-freer trade is largely a scam….

Paul Krugman, *A Protectionist Moment?*, N.Y. TIMES: THE CONSCIENCE OF A LIBERAL (Mar. 9, 2016, 4:32 PM), https://archive.nytimes.com/krugman.blogs.nytimes.com/2016/03/09/a-protectionist-moment/.

13 *See* David Gordon, *The Pareto Criterion and Ethics*, ORG. & MKTS. (Sep. 22, 2006, 7:31 PM), https://organizationsandmarkets.com/2006/09/22/the-pareto-criterion-and-ethics/*; but see* Pareto Concepts Handout from Ethan Bueno de Mesquita, Sydney Stein Professor & Deputy Dean, Harris Sch. of Pub. Pol'y, Univ. of Chi. 43 (2019) (https://home.uchicago.edu/bdm/pepp/pareto_handout.pdf).

but, instead, at the level of rules.[14] Not only to thrive, but even to survive, the rules prevailing in society must leave each to individual a great deal of freedom to act in ways that take account of local knowledge, which frequently changes. Such freedom will very often result in the taking of actions that, examined in isolation, make some persons better off while making other persons worse off. The relevance of the Pareto criterion, therefore, is found not in the assessment of individual actions but, instead, in the assessment of the *rules* under which actions are taken.[15] A change in rules that makes at least one person better off without harming anyone else not only satisfies that criterion but is far more likely to exist in reality than is any individual *action* that satisfies the criterion.

Fifty thousand years ago a rabbit unexpectedly appears in the brush. If the person who spots it must, before taking action to capture the creature, confirm that his capturing it will not make anyone else worse off – say, a hungry neighbor who would have spotted the uncaptured rabbit a few moments later – the rabbit will hop merrily away, never to be captured by a human being. We can be sure that any human ancestors who insisted on governing their band or tribe by applying the Pareto criterion to each and every action were long ago out-competed by humans who followed more realistic strategies.

But we can be equally sure that our long-ago ancestors used *some* welfare criterion for choosing (or settling upon) the *rules* by which they lived. The human bands that chose (or stumbled upon) better rules – rules that better promoted the survival of members of the bands – outcompeted bands that chose (or stumbled upon) worse rules. 'Survival' here implies rules that at least discourage actions that diminish the bands' access to resources. The rule, for example, that prohibits the spotter of the rabbit from capturing the animal until and unless the spotter first confirms that his capturing the rabbit will harm no one else in the band is a rule that would reduce the band's access to resources. So, for the band to survive the spotter must be allowed to capture the rabbit without first having to consult anyone else.

III. THE RANGE OF PROPERTY RIGHTS

Central among the rules used by all successful societies are those that can be classified under the label "private property rights" (or "several property rights").[16] While the concrete details of the law of property vary across

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14 *See* James M. Buchanan, *The Relevance of Pareto Optimality*, 6 J. CONFLICT RESOL. 341, 341 (1962).

15 *Id.*

16 *See, e.g.*, Armen A. Alchian, *Property Rights*, ECONLIB, https://www.econlib.org/library/Enc/PropertyRights.html (last visited on Oct. 3, 2022); TOM BETHELL, THE NOBLEST TRIUMPH: PROPERTY AND PROSPERITY THROUGH THE AGES 10-11 (1998); RICHARD PIPES, PROPERTY AND FREEDOM, 3–63 (1999).

time and countries, a feature of all such law is the distinction between actions that are permissible and those that are impermissible.[17] In Anglo-American common law, property owners are generally permitted to use their properties in ways that do not interfere with other property-owners' abilities to *physically* use their properties.[18] But the law does not protect property-owners' market values in their properties.[19]

This feature of the law does not reflect some arbitrary choice. Even less does it reflect any 'pro-capitalist' bias. Instead, this feature of the law reflects nothing more – or less – than the law's cognizance of reality. Because material facts of the world change in unexpected ways, as do individuals' subjective tastes and preferences, protecting property owners against diminutions in the values of their properties is impossible.

Begin by noting that the law cannot simultaneously protect the physical integrity of individuals' properties and the market values of those properties. To allow individuals to physically use their properties as they wish—on condition that these uses do not interfere with other property-owners' physical uses—necessarily is to allow property owners to act in ways that will change the market values both of their own properties and that of other persons' properties.

To allow Smith to erect a new residential-apartment building on his land is to allow Smith to change his land's market value. If his new building is a success – as determined by the eagerness of tenants to rent space in it – the market value of his property rises. If the building is a failure, the market value of his property falls. More importantly for our discussion, to allow Smith to erect a new apartment building on his land is to allow him to change the market values also of *other people's* properties. If Smith's building is a success, the market values of nearby apartment buildings might fall as owners of these other buildings must lower their rents or increase their maintenance expenses in order to compete for tenants.[20] Implicit in – indeed, inseparable from – the law's 'decision' to protect people's physical uses of property is the law's 'decision' *not* to protect properties' market values.[21]

The law's 'choice' between protecting physical integrity and uses or protecting market values is not a toss-up. It is not the case that the law could as easily, or almost as easily, have 'chosen' instead to protect market values while not protecting owner's physical uses of property. This truth is difficult to see if focus is limited to any one instance considered in isolation, such as Smith and the apartment building. It appears obvious that the existing value

17 *See* STEARNS ET AL., *supra* note 8, at 222.

18 *Id.*

19 *See* Alchian, *supra* note 16.

20 Smith's new building might also cause the market values of nearby apartment buildings to *rise*. In this paper, however, I ignore this possibility in order to focus on the negative impacts that economic change nearly always has on some particular market values. People complain chiefly about negative impacts, seldom about positive ones.

21 *See generally* U.S. CONST. amend. V (protecting private property from being taken and only compensating for taking such property rights). *See also* Alchian, *supra* note 16.

of Smith's own land, as well as the values of nearby apartment buildings, can be protected by prohibiting Smith from physically changing the uses to which he puts his land.

But appearances here are deceiving. To protect the market values of all of these pieces of land requires far more than restrictions on what Smith and other existing landowners may do with their properties. Such protection of market values would require, in addition, an unfathomably large number of other physical restrictions. Tenants must be prohibited from moving out of their spaces (or at least from failing to continue to pay their monthly rents). Yet because tenants cannot be prohibited from dying, government must have the power to somehow ensure that all units once occupied by now-deceased tenants are immediately rented by others.

How would government achieve this outcome? Several different schemes are imaginable, but none that does not involve a high probability of bringing about precisely what the law aims to avoid, namely, reductions in the market values of some people's properties. The law could, for example, compel residents of other neighborhoods to move into apartments that are vacated due to death. But this move would reduce the market value of apartment buildings in these other neighborhoods. Alternatively, government could simply take over responsibility for paying the rents previously paid by tenants now dead. This scheme would reduce the real incomes of those who are taxed to supply the necessary funds, and this reduction in real incomes reduces the market values of those assets, including human capital, owned by the affected taxpayers.

We need not extend the example further. Sober consideration of what the law would have to do in a determined pursuit of the goal of protecting market values rather than protecting physical uses quickly reveals the goal of protecting market values to be impossible. In happy contrast, the goal of protecting physical uses is not only possible, but one that better ensures that real market values of assets *generally* rise over time. That is, the protection of physical uses rather than of market values, while resulting in many specific instances in decreases in the market values of particular assets, enables individuals to use their assets in ways that, over time, have the best prospect of ensuring the highest possible value of these assets.

This outcome is not ironic. In a world of scarce resources, changes in market values are necessary to attract resources to those particular uses in which they will be of greatest use – of greatest 'value' – to humankind and, hence, away from those particular uses that are not as useful.[22] In a world in which property owners are protected from suffering reductions in the values of their resources and assets, owners have little incentive to release their resources and assets from relatively unproductive uses, and are severely

22 *See* Alchian, *supra* note 16 ("No matter who the owner is, the use of the resource is influenced by what the rest of the public thinks is the most valuable use. The reason is that an owner who chooses some other use must forsake that highest-valued use—and the price others would pay him for the resource or for the use of it.").

restricted by law from seeking different, more-productive uses for their resources and assets. The result over time is economic stagnation. Per-capita incomes fall. Standards of living fall. And property values in the aggregate are lower than they would be in an alternative world in which the law does not protect market values.[23]

IV. COMPENSATION?

Of course, a policy in which trade's 'winners' compensate trade's 'losers' is imaginable without the law switching over entirely to the protection of all market values instead of physical uses. And if such compensation is practically possible, perhaps it is also advisable as a means of further ensuring that the rising tide of prosperity created by free trade does indeed lift all boats. At the very least we can ask: Why *shouldn't* trade's 'winners' compensate trade's 'losers'?

The short response is to ask: Why *should* trade's 'winners' compensate trade's 'losers'? More fully: Why should property owners have the values of their properties protected from one specific source of potential decline if these values are not protected from other sources of decline? Unless there is something unique about economic change fueled by commerce that crosses political borders, the case for the 'winners' from *international* trade compensating the 'losers' from *international* trade is a loser.

And there is indeed nothing about commerce that crosses political borders that differs in any essential economic respects from commerce that occurs exclusively within the confines of a country's national borders.[24] This conclusion, it can be fairly said, is a sound summary of economists' teachings about trade and trade policy since Adam Smith first put quill to parchment.[25]

There simply is nothing unique about trade that crosses political borders at creating what are called 'winners' and 'losers.' *All* economic change does so, and in a modern commercial economy it does so incessantly.[26] Implementation in California of a newly discovered lower-cost process for producing

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23 *See* BETHELL, *supra* note 16, at 10 (Observing that "Property sets up fences, but it also surrounds us with mirrors, reflecting back upon us the consequences of our own behavior. Both the prudent and the profligate will tend to experience their deserts." A system of property law that aimed to protect market values would shatter these mirrors.) *Id.* at 11 elaborates on the connection between economic prosperity and private property.

24 *See* Boudreaux, *supra* note 5, at 496–97.

25 *Id.*

26 *See* Donald J. Boudreaux, *Free Trade and How It Enriches Us*, INST. OF ECON. AFFS. 32 (2018); Daron Acemoglu, David Autor, David Dorn, Gordon H. Hanson & Brendan Price, *Import Competition and the Great US Employment Sag of the 2000s*, 34 J. OF LAB. ECON. 141, 144-45, 183 (2016). Boudreaux documents that the number of jobs typically destroyed each *month* in the United States today is not much smaller than the total number of jobs destroyed during the so-called "China Shock" period – that is, the 13-year stretch from 1999 through 2011 in which American trade with China is said to have inflicted unusually intense harm on American manufacturing workers.

aluminum will destroy some jobs in Ohio's steel factories.[27] The harms suffered by American workers who thus lose their jobs, as well as the harms suffered by American steel-company shareholders whose portfolios thus take a hit, are no less real or harsh than are the harms they would have suffered had the demand for their outputs instead been reduced by a lowering of American tariffs on steel imports from Brazil or China.[28] Therefore, to say that international trade has winners and losers – or that a lowering of trade barriers creates winners and losers – is to imply incorrectly that there is something unique about international trade at destroying jobs and businesses in the home country.

This fact alone renders unsupportable the claim, such as made above by Dani Rodrik, that the economic case for free trade rests on the assumption that trade's 'losers' be compensated by trade's 'winners.'[29] Because no one believes that every source of economic change, even those that are purely domestic, are justified only if 'winners' compensate 'losers,' to single out economic change that is manifested through international trade as alone having to satisfy this requirement is unwarranted both as a matter of economics and of ethics.[30]

Those who are reluctant to accept this conclusion might ask themselves this question: Should the lowering of legal and cultural barriers to women working in the market have been conditioned on the resulting 'winners' compensating the 'losers'?[31] After all, the entry of more women into the market certainly destroyed some particular jobs held by men and worsened the bottom lines of some particular businesses owned by other men. Everyone who would reject the assertion that the case for allowing women to work in the market is premised on the assumption that the resulting 'winners' will compensate the 'lowers' should also reject, and for the very same reasons, the assertion that allowing freer trade is premised on the requirement of paying such compensation.

27 *See* DOUGLAS A. IRWIN, FREE TRADE UNDER FIRE 203–04 (5th ed. 2020).

28 *See* DONALD J. BOUDREAUX, GLOBALIZATION 144–45 (1st ed. 2007).

29 *See* RODRIK, *supra* note 6, at 3.

30 This paper is not a primer in trade theory. So I here only summarize economists' dual conclusion that (1) foreigners buy from, and sell to, us for the very same reasons that we buy from, and sell to, each other; and (2) all positive economic benefits created by purely domestic trade are of a type created also by foreign trade, and all negative economic consequences created by foreign trade are of a type created also by purely domestic trade. Although there are inessential economic differences, such as the need to make currency exchanges, that typically distinguish foreign trade from domestic trade – and although foreign trade sometimes has *non*-economic consequences (such as ones affecting national security) that are much more rare with purely domestic trade – nothing in either economic theory or economic history reveals foreign trade to differ in any economically essential WAYS from purely domestic trade. *See* e.g., BOUDREAUX, *supra* note 26, at 57; Boudreaux *supra* note 5, at 33; Daniel Griswold, MAD ABOUT TRADE: WHY MAIN STREET AMERICA SHOULD EMBRACE GLOBALIZATION 31–32 (2009); PIERRE LEMIEUX, WHAT'S WRONG WITH PROTECTIONISM?: ANSWERING COMMON OBJECTIONS TO FREE TRADE 79 (2018); IRWIN, *supra* note 27, at 38, 42.

31 The same question might also be asked about the removal of legal and cultural barriers that resulted in more black employees working in the market.

It is no good objection to observe that the case of women entering the market, unlike the case of making trade freer, involves only fellow citizens. The 'winners' who scholars such as Rodrik believe should compensate the 'losers' are only those domestic citizens who directly gain from freer trade.[32] Although some foreigners also gain when trade at home is made freer, these foreigners are not in the pool of persons who are regarded as taxable for the purpose of compensating trade's 'losers.'[33] The pool of 'winners' whose gains should be taxed in order to get the funds necessary to compensate trade's 'losers' is believed to consist only of those domestic citizens – those domestic producers and domestic consumers – who can be identified as gaining from a freeing of trade.

But there is an even deeper reason to reject the claim that the case for free trade requires that 'winners' compensate 'losers.' It is a reason that returns us to the above discussion of the Pareto criterion for assessing the welfare consequences of actions and policies. This reason can be stated boldly: A *policy* of unilateral free trade *does* in fact satisfy the Pareto criterion. A *policy* (or a *rule*) of unilateral free trade does in fact make everyone better off without making anyone worse off.

This claim initially seems to be incurably mistaken. When a cut in tariffs prompts Mike in Michigan to buy more steel from Brazil and, hence, less steel from Ohio, Joe and Jennifer, who worked for years at an Ohio steel mill, lose their jobs. Their incomes fall. This freeing of trade clearly seems to inflict losses upon them. Joe and Jennifer appear to be among trade's losers. Workers such as these are obviously the kinds of people who Rodrik, Krugman, and others have in mind when they talk of trade's "losers."[34]

Here as earlier, appearances are deceiving. When we consider the larger, time-embedded market process in which Joe and Jennifer (and Mike) are active participants, it becomes clear that none of these Americans are losers from trade. Indeed, all are winners. Big time.

V. A (TRULY) GREAT GAME

Do the following mental experiment. Suppose you can join a special poker game in which every time a new hand is dealt the house gives each player more money with which to play. The amount of new money the house adds to your earnings is random: Sometimes you get a lot; other times you get very little. Also, sometimes the amount of new money that you get will be more than what the person sitting beside you gets, while other times it will

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32 *See* RODRIK, *supra* note 6, at 204.

33 Nonresident aliens can only be taxed for income earned from domestic sources, not economic benefits they accrue abroad. *See, e.g.*, *Taxation of Nonresident Aliens*, IRS, https://www.irs.gov/individuals/international-taxpayers/taxation-of-nonresident-aliens (June 2. 2022).

34 *See* RODRIK, *supra* note 6, at 230; Krugman, *supra* note 12.

be less. But each time you get from the house at least some additional new money.

Here, though, is what makes this poker game really special: The amount of new money that the house distributes over time to each player is so great that every player who remains in the game long enough is guaranteed to become richer over time, regardless of how well or poorly he or she plays the game. And the longer a player remains in the game, the richer that player becomes.

Keep in mind that you can also add to your earnings by playing the game well. Your skill and care at playing the game matter; they positively affect your prospects of winning at each 'play' of the game as well as your winnings over time. In each round you can bet whatever amount of your earnings you wish. If you win a particular round, you obviously grow richer – you get the table's winnings from that round *and* whatever amount of new money the house distributes to you at the conclusion of that round.

Of course, you will not win every round. Indeed, if you bet a great deal in a round that you lose, you might be poorer when that round ends than you were before that round started, despite the new house money that you received at the end of that round. But again, the house guarantees that, regardless of your fate after each round, if you play the game long enough your real wealth will grow.

In this game, therefore, there are no losers. There are, of course, individuals who suffer losses in each round. But because the house guarantees to each player that he or she will grow richer over time the longer he or she remains in the game, this game has only winners. A person who, after losing a particular round, quits this game or calls for its rules to be fundamentally altered, would be foolish.

Free trade is very much like this special poker game. The house – a policy of free trade in bourgeois society[35]—ensures that over time every participant grows richer than that person would be without free trade. But there is no guarantee that in every 'round' of economic 'play' no one suffers losses. Indeed, as explained above, because economic growth requires that people be free to use their properties in ways that cause unexpected and unwanted changes in the market values of other people's properties, in each and every economic 'round' some people will be made worse off than they were at the start of that 'round.' And so, while today some peoples' incomes do fall because of free trade, it makes no sense to describe these people as losing from

[35] *See generally* DEIRDRE N. MCCLOSKEY AND ART CARDEN, LEAVE ME ALONE AND I'LL MAKE YOU RICH: HOW THE BOURGEOIS DEAL ENRICHED THE WORLD (2020).

trade itself.[36] Their very participation in the global economy makes them – makes *everyone* in modern society– richer over time.[37]

Do I exaggerate by claiming that literally *everyone* in modern society is made better off over time by trade? No. Empirical evidence supports this conclusion. In a 2017 study, Gary Clyde Hufbauer and Zhiyao (Lucy) Lu report that "the payoff to the United States from trade expansion" from 1950 to 2016 "is roughly $2.1 trillion (measured in 2016 dollars)… US GDP per capita and GDP per household accordingly increased by $7,014 and $18,131, respectively (both measured in 2016 dollars)."[38]

Is it possible that, even though this study spans nearly two-thirds of a century and finds significant per-capita income gains, some individual Americans were nevertheless made worse off over this span of time by trade? Yes, it is possible, but only barely.

Of course, some workers who lost jobs to imports during this period never found new jobs, while some others found jobs that, over the remainder of their working lives, paid them, in inflation-adjusted dollars, less in total than these workers would have been paid had they never lost their jobs to imports. But during this time span most of even these workers gained increased access, year after year, to the fruits of global trade – fruits such as novel consumer electronics and other new goods from abroad, as well as lower prices and higher quality – because of foreign competition – of many domestically produced consumer goods.[39] These benefits accumulate over time.

Consider a hypothetical American who lost a job to imports relatively early – say, 1970 – in the period studied by Hufbauer and Lu. If he or she survived for 40 more years, that person gained access to (among other benefits) automobiles made much better by foreign competition, to cell phones and other consumer electronics that in some cases were made possible, and that in nearly all cases were made more affordable, by foreign competition, and to clothing the real prices of which fell substantially,[40] driven largely by the off-shoring of much clothing production. The fall in this worker's income in 1970 was real, but so too are the additions that trade contributed to this person's real income over the next 40 years. It is highly unlikely that, all

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36 *See* Donald J. Boudreaux, *Trade and Romance*, CAFÉ HAYEK (January 7, 2007), https://cafehayek.com/2007/01/trade_and_roman.html (analogizing to the claim that a man whose wife left him is not a 'loser' at the game of love, but instead won in the past, lost now, and might win in the future).

37 *See, e.g.*, The Copenhagen Consensus Centers Post 2015 Consensus, *Free Trade Could Make Everyone in the World Richer*, Global Policy (Dec. 1, 2014), https://www.globalpolicyjournal.com/blog/01/12/2014/free-trade-could-make-everyone-world-richer.

38 Gary Clyde Hufbauer and Zhiyao (Lucy) Lu, Peterson Inst. for Int'l Econ., *Globalization: A Fresh Look with a Focus on Costs to Workers* 1, PB17-16 (May 2017).

39 *See, e.g.*, The Copenhagen Consensus, *supra* note 37.

40 E-mail from Mark Perry, Senior Fellow, American Enterprise Institute. to Donald J. Boudreaux, Professor of Economics, George Mason University (Oct. 19, 2021) (on file with author) (His calculation that between 1970 and 2010 the real price of clothing in the U.S. fell by 64%).

things considered, trade inflicted on this person a net loss from the time he or she lost the job until his or her death in 2010. To classify this person as a "loser" from trade, therefore, would be a mistake.

The mistakenness of such a classification becomes even more evident when we look, not only forward, but also backwards. Looking backwards reveals that the job this hypothetical worker lost in 1970 was itself very likely the result of international trade. If the job this worker lost was, say, in a television-manufacturing plant, that job was likely created years earlier because of foreign demand for American-made television sets. Almost certainly, the wages paid to workers employed in that plant, including wages paid to the hypothetical worker whose job in 1970 was 'destroyed' by trade, were higher than these wages would have been had mid-20th-century American television manufacturers not had an export market for their outputs – an export market that would not have existed were Americans unable to import.[41]

The direct impact in earlier years of trade in creating jobs, and in raising the pay of workers who held these jobs, must be reckoned against the direct impact in later years of trade then destroying these same jobs. Workers who today, because of trade, lose jobs that were created yesterday *by* trade are not legitimately classified as "losers" from trade.

VI. COSTS ARE NOT LOSSES

Participation in the modern economy signals consent to play by the rules of the modern economy. As stated above, among the most central of these rules is that the law protects the physical integrity of people's properties but not properties' market values.[42] And so when market forces cause a fall in the market value of some property – including that which a worker has in his or her labor – that property owner is more accurately described as paying the *cost* of participating in a market economy rather than suffering a *loss*.[43] I propose that the word "loss," in economic and legal policy discussions, be reserved to describe losses of possessions or benefits to which a person is legally entitled. A thief who steals $100 from you inflicts on you a loss of $100. A trespasser inflicts on you loss of your right to control your land. Your

41 *See generally* Boudreaux, *supra* note 5, at 490 (describing how free trade benefitted US manufacturing from the 1940s to the 1970s).

42 *See, e.g.*, Alchian, *supra* note 16.

43 Such costs are the sort that are classified by Anglo-American tort law as *damnum absque injuria*—that is, damage without injury. *See Damnum Absque Injuria*, THE WOLTERS KLUWER BOUVIER LAW DICTIONARY DESK EDITION (2012), https://plus.lexis.com/ (search "damnum absque injuria" in quotation marks under "Secondary Materials" and it is the third result) ("There are cases when the act of one man may cause a damage or loss to another, and for which the latter has no remedy; he is then said to have received damnum absque injuria; as, for example, if a man should set up a school in the neighborhood of another school, and, by that means, deprive the former of its patronage; or if a man should build a mill alongside of another, and consequently reduce his custom"). For alerting me to this fact I thank Richard Epstein.

unfortunate encounter in the intersection of Main St. and Elm Blvd. with a negligent driver inflicts on you a loss of some of your property. Contract breach brings loss of a bargained-for anticipated benefit. In each of these examples, you had a legitimate expectation of being legally entitled to some property interest that was unexpectedly taken from you. For these losses, you are rightfully entitled to be made whole by compensation from the party who wronged you.

Costs differ from losses categorically. Unlike losses, costs are what choosers voluntarily sacrifice in exchange for benefits. Both losses and costs, each standing alone, are decrements from individuals' welfare. But only losses spring from a series of human interactions that decrease that welfare on net. When someone suffers a loss, that person is made worse off. In contrast, when someone incurs a cost, that person is made better off.

This odd-sounding conclusion about costs follows from the fact that costs are the inescapable consequences of choices.[44] I choose to pay $15 for a pizza because I expect that the satisfaction that I will get from the pizza exceeds the satisfaction that I would get were I to keep that $15 or to spend or invest it in some other way. Because I can get satisfaction from the pizza only by incurring the cost of sacrificing $15 for it, incurring this cost makes me better off. This reality is not changed by the fact that the net increase in my welfare would be even greater were the restaurant owner to give me the pizza free of charge. The bottom line here is that no one would call the $15 that I spend for the pizza a "loss."

Consider another example. Suppose that, in order to buy a home, I borrow $200,000 from a mortgage lender and agree to repay the loan, in monthly installments, at a certain rate of interest over the course of fifteen years. I move into the home today and commence living in it. A man from Mars, with no previous knowledge of earthly conventions, pops down to earth two years from now and observes me sending a check each month to the mortgage holder. After a few months of observation, the Martian reports to his leaders on the red planet that each month some mysterious force inflicts on me a loss in the amount of my mortgage payment. The Martian and his leaders conclude that I would be better off were I not obliged to suffer a loss each month in the form of these monthly amounts.

But no knowledgeable earthling would describe me as each month suffering a loss. When asked to describe the meaning of my mortgage payments, the earthling would instead say that I am paying the *cost* of having borrowed money to purchase a home.[45] The earthling would be correct. Of course, I

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44 *See generally,* JAMES M. BUCHANAN, COST AND CHOICE: AN INQUIRY IN ECONOMIC THEORY (1969).

45 The situation would differ categorically if, owning my home outright, I am accosted by mafioso who credibly inform me that if I do not pay to them a certain sum each month they will forcibly remove me from my home. In this case my monthly payments are indeed appropriately described as losses. (Technically, I incur the full loss the moment the mafia threatens to remove me from my home if I refuse to

would be delighted, after obtaining the borrowed the funds, for the mortgage holder to then relieve me of my obligation to repay. My welfare would be raised by such relief. But I clearly would be made worse off if, as a result of the mistaken conclusion that the institution of mortgage lending imposes *losses* on borrowers, creditors had long been prohibited from demanding repayment from debtors. While in my ideal world the mortgage lender would simply give me the $200,000 with no strings attached, I am nevertheless better off in a world in which mortgage lenders can demand repayment of loans than I would be in a world in which such demands are unlawful.

Now consider an American steelworker who loses a job because fellow Americans start buying more steel from Brazil and, hence, less steel from Ohio. This worker suffers no loss. Instead, this worker is paying a cost of participating in the modern commercial global economy. It is indisputable that this worker would prefer not to have to pay this cost, just as it is indisputable that I would prefer not to have to repay my mortgage lender. But this reality does not transform the worker's (or my) cost into a loss.

Each worker in a modern commercial economy is very much like the above-mentioned mortgage holder. Each such worker voluntarily participates in this economy because of the enormous benefits he or she reaps from doing so. But these benefits are possible only because producers must compete for consumers' dollars—only because consumers are generally free to spend their incomes as they choose and are not regarded as contractually binding themselves, with their purchases, indefinitely to each producer that he or she patronizes. These benefits are possible, in other words, because the law protects the physical uses and integrity of property and not properties' market values.[46]

VII. DO WE REALLY CHOOSE TO PARTICIPATE IN THE MODERN ECONOMY?

It is fair to ask if I am correct to claim that workers in the modern commercial economy are akin to persons who take out mortgages. To take out a mortgage, after all, is a voluntary act.

But so too is participation in the modern commercial economy a voluntary act. No one is forced to participate. Each of us has the option of withdrawing from commercial society as a tiny handful of people have actually done.[47] A great deal of rural land is available for purchase.[48] Each of us is free

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send them monthly payments. Nothing essential is changed by the fact that these particular mafioso kindly allow me to endure my loss in the form of monthly installment payments.)

46 *See, e.g.*, Alchian, *supra* note 16.

47 *See* DAVID SCHMIDTZ, PERSON, POLIS, PLANET 199 (2011).

48 A majority of US land is privately owned and thus available for purchase. *See* Stacey Vanek Smith & Cardiff Garcia, *The U.S. Has Nearly 1.9 Billion Acres Of Land. Here's How It Is Used*, NPR

to buy this land on which we can scratch out a living, either literally alone or with whatever small band of individuals we persuade to accompany us.

Of course, the resulting material standard of living of economically isolated individuals would be desperately low compared to the standard of living available even to the poorest of those who participate in the modern commercial economy.[49] Indeed, the colossal difference between the maximum standard of living achievable by those who divorce themselves from modernity and the minimum standard of living available those who remain integrated into modernity is what makes my claim that it is possible to abandon commercial society seem so far-fetched.

What *is* far-fetched – in fact, what is impossible – is to divorce oneself from modernity while simultaneously maintaining a standard of living close to what we moderns today regard as minimally acceptable. Realization of the crushing material deprivation of a life detached from the modern economy is what gives people the impression that such a life is impossible. Yet such a life is not impossible; it is just extremely costly given the option of remaining in modernity.[50] The cost of freeing oneself from the consequences of the decisions of financiers in New York and London, of steel producers in China and India, of farmers in France and Florida, of entrepreneurs in California and Denmark, and of governments in Washington and Beijing is simply too high to be remotely appealing to all but the most anti-social recluses.

And so nearly everyone born into modernity *chooses* to remain in modernity. The fact that this choice is such an easy one does not make it less of a choice. Each of us who chooses to earn an income by serving strangers in the market, and to spend that income on goods and services produced by strangers and put at our disposal by the market, thereby *chooses* to play by the rules of the market. Among the most crucial of these rules is the law's protection of property-owners' physical rights to their properties but not of the market values in these properties.[51]

(July 26, 2019, 4:28 PM), https://www.npr.org/2019/07/26/745731823/the-u-s-has-nearly-1-9-billion-acres-of-land-heres-how-it-is-used. *See also* Rural Land Prices for Texas, TEXAS REAL ESTATE RESEARCH CENTER AT TEXAS A&M UNIVERSITY, https://www.recenter.tamu.edu/data/rural-land#!/state/Texas (last visited Oct. 2, 2022) (showing land sales in several states); Undeveloped Land for Sale, LANDWATCH, https://www.landwatch.com/undeveloped-land (last visited Oct. 2, 2022) (showing undeveloped land available for purchase).

49 *See* J. Paul Newell, *Rural Healthcare: The Challenges of a Changing Environment*, 47 MERCER L. REV. 979, 982 (1996) (discussing issues with healthcare services in rural communities and inadvertently showing how well off they are compared to hunter-gatherers); Allison Lacko, Shu Wen Ng & Barry Popkin, *Urban vs. Rural Socioeconomic Differences in the Nutritional Quality of Household Packaged Food Purchases by Store Type*, INT'L J. OF ENV'T RSCH. & PUB. HEALTH 39, 50 (2020) (discussing issues with food product quality in rural communities and inadvertently showing how well off they are compared to hunter-gatherers).

50 *See* Daniel Mark Schwartz, *How Much Money It Takes To Live Off The Grid | Five Hidden Costs*, OFF GRID PERMACULTURE, https://offgridpermaculture.com/Beginners/How_Much_Money_It_Takes_to_Live_Off_the_Grid_5_Hidden_Costs.html (last visited Oct. 3, 2022).

51 *See, e.g.*, Alchian, *supra* note 16.

As posed above, the choice is stark: remain in, or withdraw from, modernity. Fortunately, modernity itself supplies options along a spectrum, with divorcing from modernity being only an endpoint. Within the modern market are options for different degrees of protection from the risks of market adjustments, although nothing close to complete protection against such risk. Each of us can, without abandoning market connections completely, choose economic lives with more or less risk of being subject to market adjustments.

Modern workers make current choices in the labor market with eyes to the future and, hence, many workers *do* make estimates about the risks of job loss. Nearly every young person in the developed world confronts various broad career options. Attend college or not? Major in electrical engineering, in accounting, in education, or in gender studies? Pursue an MBA, an MD, or a JD? Accept this job offer or that other job offer? Although the relevant variables for making such decisions are many, job security is certainly among these variables.[52]

It is also unrealistic to imagine that individuals have no or only inaccurate information to rely upon when assessing the security of different jobs. At one extreme, young men and women who enlist in the military know the terms of enlistment and can be confident that the option to reenlist will be available in the future.[53] At the other extreme, entrepreneurs who launch new firms selling never-before-available goods or services understand that the probability of failure is high.[54] In between these two extremes stretches a wide spectrum of different jobs and career paths, nearly every one of which is accompanied by some public knowledge about its pay, amenities, prestige, difficulty, and security.

This public knowledge does not have to be perfect for workers with different preferences for job security to sort themselves into different jobs with different degrees of security.[55] For example, public-sector employers perform fewer layoffs than private sector employers during recessions, a fact that might attract workers who put a high priority on job security.[56] Such workers also tend to choose jobs in large, long-established firms over jobs in small upstart firms funded with venture capital. These individuals are more likely

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52 A May 2017 poll conducted in the United States by Yahoo! Finance found that workers do indeed assess the job-security aspects of different employment options. Rick Newman, *Labor Shortages? Blame Corporate America*, YAHOO! NEWS (June 13, 2017), https://www.yahoo.com/news/labor-shortages-blame-corporate-america-173604463.html.

53 *See Joining the Military: What You Should Know Before Committing*, MILITARY.COM, https://www.military.com/join-armed-forces/making-commitment.html (Last visited Oct. 3, 2022).

54 *See* Bobby Chernev, *What Percentage of Small Businesses Fail?*, REVIEW42, https://review42.com/resources/what-percentage-of-small-businesses-fail/ (Feb. 1, 2022).

55 *See* Susan Adams, *Job Security A Top Priority For Global Workers*, FORBES (July 31, 2014, 10:19 AM), https://www.forbes.com/sites/susanadams/2014/07/31/job-security-a-top-priority-for-global-workers/?sh=5b5b8a581acc.

56 *See* ALICIA H. MUNNELL & REBECCA CANNON FRAENKEL, CTR. FOR RET. RSCH., PUBLIC SECTOR WORKERS AND JOB SECURITY 2–3 (2013), https://crr.bc.edu/wp-content/uploads/2013/05/SLP31_508.pdf.

to move, in search of work, away from geographical locations that are in economic decline to geographical locations that are growing and seem likely to continue to grow. People with different preferences for job security choose differently.

No less importantly, employers have incentives to discover just how strongly workers want job security. All other things equal, employers who offer greater job security can pay their workers lower money wages than are paid by employers who offer less job security.[57] Workers who do not value additional job security enough to accept lower wages will work in jobs that pay more but offer less security, while workers who have higher demands for job security will be attracted to jobs that offer greater security but pay lower wages.

Employers have every incentive to supply additional units of such security as long as the costs of supplying additional units of job security fall short of the benefits employers receive in return in the form of lower wage bills. Therefore, the greater are workers' demands for job security, the greater are the reductions in wages and fringe benefits that workers are willing to accept in exchange for increased job security – and the greater are employers' abilities and willingness to supply such security.

Given that labor markets are generally competitive, we can presume that the market supplies different optimal levels of job security for different workers. The amount of such security in any given job is not greater than it is now because the cuts in wages and fringe benefits that workers would have to accept in exchange for more security are judged by workers to be too great. But it cannot be denied that different jobs supply different degrees of job security. Nor can it be denied that many jobs, perhaps most, supply at least *some* degree of job security, even if such security does not appear as a formal term in employment contracts (clerks in a McDonald's restaurant are not laid off after one day of lower-than-expected sales volume.). If nothing else, workers form plausibly correct expectations about just how secure each job is, and wages adjust upwards or downwards to reflect these expectations.

VIII. CONCLUSION

One conclusion is straightforward. Anyone who wishes to own assets, including human capital, possessing market values must subject those assets to market-valuation processes – which is to say, to competitive markets. Those persons who intensely fear the fate of suffering any declines in the market valuation of their assets can escape that fate, but only by choosing to

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57 *See* Marios Michaelides, *A New Test of Compensating Differences: Evidence on the Importance of Unobserved Heterogeneity*, 11 J. OF SPORTS ECON. 475, 475–79 (2010); Matthew Dimick, *Compensation, Employment Security, and the Economics of Public-Sector Labor Law*, 43 U. TOL. L. REV. 533, 545–46 (2012).

divorce themselves from the market by scratching out a subsistence existence unattached to commercial society. Those persons who instead choose to remain attached to commercial society thereby choose to play by the rules of competitive markets. They choose to incur the risk of declines in the market valuations of their assets as the cost of enjoying the prospect of increases in the market valuations of their assets. Any declines in asset values caused by market processes – including those caused by changes in the pattern of international trade – are therefore not losses that in justice ought to be compensated but, instead, are costs that in justice must be paid by each person who enjoys the benefits of participating in modern commercial markets.

A second, related conclusion is warranted: Economists' concept of "pecuniary externalities"[58] is worse than useless. It is misleading. Changes in the market values of properties occur incessantly and are indeed very often caused by the activities of fellow human beings who change their commercial behaviors, consumers who change their patterns of spending, and entrepreneurs who change the availability of goods and services. These changes typically arise out of self-interested ("utility-maximizing" and "profit-maximizing") actions without the actors taking account of the consequences of their actions on the market values of other people's properties. Yet in no sense are these changes in market valuations externalities. They are a routine, expected, *and essential* feature of the competitive market process. To label them "externalities," even when such labeling is followed by an explanation of why policymakers should ignore them, is therefore inaccurate. Such labeling creates only confusion. The term should be completely jettisoned.

58 *See, e.g.*, *Pecuniary Externality*, LIQUISEARCH, https://www.liquisearch.com/pecuniary_ externality (last visited on Oct. 17, 2022).