spouse." A subsidy, "calibrated to the correct size," would supposedly internalize this "eternal productivity."

Such a scheme ignores all that we have learned from the public-choice school of political economy about government failure and from F.A. Hayek about the division of knowledge. Every government subsidy comes with increased government regulation. Just what is an "eligible job"? Who are the "qualified employers"? Is there to be yet another division of the Department of Labor charged with certifying jobs and employers? Phelps claims his plan would pay for itself through savings on welfare and crime. However, once such a scheme is put into place, interest groups like labor unions would advocate expansion of the subsidies, just as they have successfully done with the minimum-wage law. The subsidies would inevitably become just another increasingly costly feature of the welfare/transfer society.

Moreover, how can government calibrate the "correct" size of the subsidy for each worker in every job? Phelps's arbitrary sliding scale of subsidies would apply to all workers at all times and places irrespective of their unique circumstances. When we recognize that decisions will be based on politics, not economics, there is nothing left of the Phelps subsidies to recommend.

But there is much more to criticize about this book. For example, Phelps writes: "In acting through the government to pull up the rewards and thus to stimulate the participation and employment of low-wage workers, the more fortunate members of the labor force would be removing a source of some embarrassment. The more advantaged in society would gain pride and self-respect from having met their end of the social contract—of having acted justly. If so, they will be willing to pay something to achieve this satisfaction in the form of higher taxes."

He apparently believes successful people are merely lucky. In fact, of course, most successful people earned every penny they have by perfectly honorable means—voluntary exchange. They did well for themselves by providing opportunities to others. I can think of no better grounds for self-respect. It is apparently necessary to say one more time that if successful people really thought that they should help less successful people, they would do so. They don't need to wait for taxation to act.

Phelps also asserts that his subsidy scheme "fits the founders' conception of our government." He says that Jefferson's assertion in the Declaration of Independence of an inalienable right to the pursuit of happiness necessarily implies a right to a rewarding job. This is preposterous. To the founders, "rights" referred to a freedom of peaceful action that is prior to, and independent of, government. The founders' rights impose only a negative obligation on others to abstain from interfering. Government's principal job is to enforce those rights. Phelps's subsidies are positive "rights." They impose burdens on some to provide for others. The rights of those forced to pay conflict with the "rights" of those who are privileged to receive.

Perhaps the silliest claim in the book is Phelps's assertion that Keynes, along with Adam Smith and John Stuart Mill, was a "classical economic liberal." That says it all. □

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How Nations Grow Rich: The Case for Free Trade

by Melvyn Krauss

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Reviewed by Daniel T. Griswold

Ever since the modern nation state emerged half a millennium ago, the question of how nations grow rich has been bound up with international trade. The battle line in the debate, from the time of the mercantilists and Adam Smith to the controversies today about GATT and NAFTA, has been whether nations grow rich by restricting free trade or by engaging in it.

Professor Melvyn Krauss's new book, *How Nations Grow Rich: The Case for Free Trade*, won't end the debate, but it does provide a readable and well-argued defense of free trade on just about every point of current contention. As an emeritus professor of economics at New York University and the author of previous books on protectionism, foreign aid, and NATO, Krauss brings a deft hand to the task. Throughout his latest book, the author illuminates everything he surveys with clear writing and sound economic thinking.

Krauss begins at the beginning, by explaining the nearly two-century-old theory of comparative advantage in layman's language. The fundamental economic argument for free trade is that it allocates resources more efficiently by allowing people and nations to specialize in what they do best.

We don't trade with people in other nations to create more jobs. We trade to make ourselves better off. "Free trade does not create jobs—it creates income by reallocating or transferring jobs from the lower productivity to the higher productivity sectors of the economy. The argument for free trade—at least in the standard theory—is an efficient allocation of resources argument. Such reallocation increases income by increasing the average productivity of the nation's stock of productive resources," Krauss writes.

After his opening footwork, Krauss delivers a roundhouse right to the Clinton administration for its "managed trade" philosophy, followed by a series of quick jabs against the false arguments for protection. Among them is the assertion that free trade is only valid if it is "fair trade." "This argument—that equity demands the United States protect its producers when foreign countries protect theirs—has a certain appeal but is nonetheless fallacious. Free trade is fair trade to those whom it counts the most to be fair to—the domestic consumer," he writes. Other protectionist "tricks" Krauss exposes are the infant-industry argument, the "cheap labor" fallacy, and anti-dumping laws.

One of the most insightful sections of the book is Krauss's analysis of how the modern welfare state has corroded support for free trade. The tax bite and labor-market rigidity of the welfare state have created the high unemployment we see today in Western Europe, which in turn foments domestic pressure to curb imports in a misguided effort to save jobs. The welfare state's web of environmental and labor regulations that burden domestic producers invites further protection against rival industries in less regulated, and typically poorer, countries. Adding to the protectionist pressure are domestic subsidies to farming and other sectors, which then demand protection to maintain artificially high prices.

Krauss doubts that the welfare state and free trade can co-exist indefinitely. "The dilemma posed by this development is clear. Because of its evolving protectionism, the growth of the welfare state now threatens the very specialization and interdependence that is the basis for Western prosperity in the first place. The manner in which the Western industrial states resolve this dilemma to a large extent will determine their continued prosperity," he warns.

In the United States, the tension between domestic intervention and free trade can be seen in the effort to "export" our environmental regulations to other countries. Among the lobbying groups opposed to NAFTA and other trade initiatives are environmental groups who worry that competition with less developed nations will put downward pressure on U.S. environmental standards in a regulatory "race to the bottom." To placate the eco-protectionists, the Clinton administration wants to make the "harmonization" of regulations a part of any new trade agreements. Krauss argues that free trade need not lead to a lowering of environmental standards, but rather to a specialization of standards, with the more regulated countries expanding their low-polluting industries and other, less regulated countries expanding production of goods that produce relatively more pollution.

In the final three chapters, Krauss examines the wreckage of America's foreign aid programs, the demise of socialist planning, and the rise of regional trade agreements, including a critique of the European Union's drive for a single currency.

My only real complaint about *How Nations Grow Rich* is that Krauss did not write more