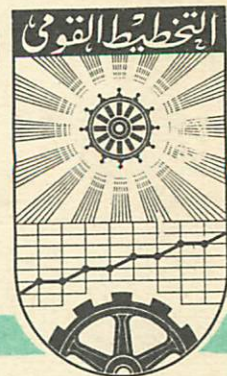


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Comparative Advantages  
in  
Foreign Trade

By

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## Comparative Advantages in Foreign Trade

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### Introduction

The world economy, since the early fifties, has been characterized, among other things, by an increasing role of the international division of Labour. Resulting from the growing internationalization of the economic life growth rates of foreign trade in most countries have exceeded by far the growth rates of industrial and agricultural production as well as of the national income. This phenomenon can be observed in the countries or regional blocs of the capitalist as well as of the socialist world economic system with substantial differences as regards the bases and aims of these processes and the methods being applied. Thus, research work in the field of the determinants of foreign trade should deal with this problem in general, taking into consideration the prevailing different socio-economic conditions.

As to the foreign trade of the countries of the Third world, their specific role in the world economy after gaining political independence has to be considered. Practical experiences of these countries during the past years have proved that unlike all classical or neoclassical assumptions and contrary to many statements at international forums trade per se, following the law of comparative advantage, does not lead more or less automatically to a mutually advantageous international division of labour and to an equal distribution of its benefits.

Obviously, the development of volume and structure of export and import and their effects on the national economy as a whole are influenced to a high degree by such factors as the following ones:



- The still existing strong economic ties to former metropolitan centres;
- Unfavourable commodity structures of export and import, resulting from the general economic backwardness as one of the heritages of colonialism;
- The role of transnational corporations in international economic relations.

The present straggle of the developing countries for establishing a New International Economic Order (NIEO) is an important attempt to overcome the negative effects of the past and the present type of international division of labour within the world capitalist economy. Embedded in this comprehensive task, the problem of determining the volume, structure and efficiency of foreign trade aiming at achieving optimal results as to the economic development of these countries as a whole should be of special importance.

Within the system of determinants of foreign trade, comparative advantages ( or comparative cost differences) play a decisive role above all as a part of the pure theory of foreign trade in western economics. <sup>(1)</sup> But also in theory and practice of foreigntrade of socialist countries the issue of comparative advantages accotding to Ricardo's famous theorem is of some importance and there exists different views on its role among the economists of these countries <sup>(2)</sup>.

This paper aims at investigating and giving a critical view on the role of comparative advantages in theory and practice of foreign trade under different political and socio- economic systems or conditions. Based on a short, <sup>(1)</sup> See: H.Hesse "Foreign Trade-Determinants", Hand-Dictionary of Economic Sciences, Gustav Fischer Publishers, Stuttgart and New York, 1977.page366.

<sup>(2)</sup> See: G. Kohlmeier "Comments on the theory of comparative advantage in foreign trade", in International Economics and Growth, Academy Publishers, Berlin/ GDR, 1968, Page 77.

concentrated presentation and evaluation of Ricardo's theorem (chapter 1) the following chapters II-IV will deal with some selected aspects of this theorem as part of the foreign trade theory in western economics and its role in international trade including economic relations between developed capitalist countries and the countries of the third world.

In chapter V the role of comparative advantages as one of the factors determining the development of the volume and structure of foreign trade of socialist countries will be discussed.



1. Ricardo's classic theorem of comparative advantage in foreign trade;

(3) When Ricardo's famous theorem was published for the first time in 1817, the struggle between the British middle classes striving for free international trade against the landlords defending their feudal privileges in general and high corn duties in particular was on a peak. (4) In conformity with the capitalist development of this country and the role of England in the world economy at that time the development of the theorem of comparative advantage in foreign trade was part of the comprehensive struggle for free trade in some European countries at the beginning of the 19<sup>th</sup> century. Hence it follows that the role of the theory (including the various modifications and complements up to now) for determining the volume and structure of foreign trade of a certain country should in any case be examined under the respective internal and external conditions of this country in the historical period concerned. (5) But first of all, let us have a look on the main ideas of this theorem.

The essence of Ricardo's theorem

Unlike his predecessors in foreign trade theory Ricardo found out that also in the case of absolute disadvantages in production costs countries can gain comparative advantages through foreign trade. J. Viner described the previous views as follows: " In the beginning of free trade doctrine in the eighteenth century the usual economic arguments for free trade were based on

(3) Notwithstanding the fact that R. Torrens mentioned this problem already in 1815 in his "Essay on the External corn trade" We hold the view that Ricardo founded this theorem.

(4) D. Ricardo "Principles of political Economy and Taxes," London, 1817.

(5) See in detail chapter 3, 4 and 5.



the advantage to a country of importing, in exchange for native products, those commodities, which either could not be produced at home at all or could be produced at home only at costs absolutely greater than of which they could be produced abroad. Under free trade, it was argued or implied, all products, abstracting from transportation costs, would be produced in those countries where their real costs were lowest. The case for free trade as presented by Adam Smith did not advance beyond this point.<sup>(6)</sup>

Based on the Methuen Treaty of 1703 between Portugal and England, the historical background for his analysis, Ricardo formulated his famous doctrine of comparative advantage in foreign trade which can be illustrated as follows: scheme 1: The impact of comparative advantages on the international division of labour

A : Situation before international division of labour and foreign trade.

country	Wine	Cloths	
Portugal	80	90	170
England	120	100	220
	200	190	390

Figures express working hours. Portugal has absolute advantages over England in the production of both commodities.

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(6) J. Viner "Studies in the theory of International Trade", London 1964, PP. 439/440.



B : Situation after international division of labour and foreign trade

Country	Wine	Cloths		A-B
Portugal	160	-	160	10
England	-	200	200	20
	160	200	390	30
A - B	40	-10	30	

By concentrating on the respective comparatively more advantageous production and international exchange of goods both countries reduced the costs of production and the system as a whole as well as the partners involved achieved welfare effects:-

Ricardo himself gave an evaluation of the main ideas and major recommendations as regards this theorem as follows :-

"Under a system of perfectly free commerce, each country naturally devotes its capital and labour to such employments as are most beneficial to each. This pursuit of individual advantage is admirably connected with the universal good of the whole. By stimulating industry, by rewarding ingenuity, and by using most efficaciously the peculiar powers bestowed by nature, it distributes labour most effectively and most economically; while, by increasing the general mass of productions, it diffuses general benefit, and binds together, by one common tie of interest and intercourse, the universal society of nations throughout the civilized world. It is this principle which determines that wine will be made in France and Portugal, that corn shall be grown in America and Poland and that hardware and other goods shall be manufactured in England" (7).

(7) D. Ricardo "The principles of political Economy and Taxation"  
J.M. Dent and sons, Ltd., London P. 81.



Summarizing, we may describe Ricardo's main ideas as follows:-

1. The principle of comparative advantage is the general law determining international specialization of production and the flow of foreign trade between various countries.
2. Foreign trade, under a system of perfectly free trade, and based on the afore mentioned principle, increases the wealth of the international community as a whole.

All participating nations benefit by this kind of international division of labour.

#### A valuation of Ricardo's theorem in principle

In the following chapters we shall deal with some aspects of the principle of comparative advantage in foreign trade under different historical and socio-economic conditions. Notwithstanding these analyses still being outstanding we shall try to draw some general conclusions as a starting point for more detailed investigations.

First of all we appreciate the theoretical results of Ricardo's work on this subject matter. As compared with his predecessors, included Adam Smith, he was the first one to recognize the possibility of achieving comparative (and not only absolute) advantages through foreign trade. His struggle for free trade in England at the beginning of the 19<sup>th</sup> century in connection with elaborating this theory was a progressive action at that time. There are some rational elements in the theory of comparative in foreign trade to be recognized in any case (8) :

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(8) See : G. Kohlmey "Comments on the theory of comparative advantage in foreign trade, op. cit. P. 87.



- 1- International division of labour can be used as a growth factor improving the productivity or efficiency of the national economy.
- 2- Also in the case of absolute disadvantages in labour productivity as compared with the international level a country can gain comparative advantages through foreign trade.
- 3- The national income can be increased through foreign trade also in the case of equilibrium in the trade balance or balance of payments.
- 4- Positive (or negative) effects of foreign trade on the national economy of a country can be calculated only by investigating exports and imports in their totality.

Apart from these rational elements we hold the view that there are some fundamental theses which are to be rejected with regard to Ricardo's theorem in principle and to its interpretation in contemporary western foreign trade theory in particular.<sup>(9)</sup> Our critical comments are concentrated above all on the following problems:

- 1- According to Ricardo, it is this principle which determines the kind of international division of labour between the various countries, i.e. the structure of production, export and import will be determined more or less automatically or spontaneously by the requirements of the theorem of comparative advantage. But practical experiences show that the flow of foreign trade as an integral part of the national economy is governed in any case by the same economic laws or aims determining the development of the national economy as a whole (e.g. profit maximizing in a capitalist society).

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(9) As to the polemic against the contemporary theory and practice see in detail chapter 11-IV.



In addition to it, we have to take into consideration the different conditions and aims according to the socio- economic relations and the actual historical stage of development (see in detail chapter 11, Iv and v) .

- 2- In compliance with Ricardo's own words perfectly free trade is a necessary prerequisite for this principle being effective. But neither in the past nor at present free trade in this strong sense had become a reality. There is still another question as to the problem under which conditions a system of perfectly free trade may be favourable at all for a certain country depending upon the actual internal and external conditions (see in detail chapter 111).
- 3- Ricardo's theorem implies that all participating countries will gain from this kind of international specialization of production and foreign trade. On the one hand, the theorem of comparative advantage in its original version did not include such necessary categories like "international value" or "world market price" at all, leaving the inclusion of these components into the foreign trade theory to Ricardo's successors, On the other hand, the fundamental problem of an equal or unequal distribution of welfare effects resulting from foreign trade, which is of utmost importance especially for developing countries, is overlooked in this theorem (see in detail chapter Iv).
- 4- The theorem of comparative advantage is by its very nature of a static character. Calculations following this principle are based in general on the existing production structure or economic concerned. Thus this theorem can be used to prove a pretended advantage of the antiquated division of labour between developing countries and developed capitalist countries and



to advocate adequate economic policies aiming at maintaining this unjust specialization of production and structure of foreign trade ( see in detail chapter Iv).

In addition to these objections to Ricardo's theorem in principle we should mention some special conditions or simplifications in the original theorem, affecting its application for practical analyses. The most important of these conditions are the following ones:

- 1- Production expenditures are expressed in working time instead of monetary terms ( costs, prices).
- 2- production factors ( land, labour, capital) can move within the country concerned, but not internationally.
- 3- Differences between the products concerned with regard to the share and the availability or the scarcity of production factors are neglected.
- 4- Effects of international specialization on the production costs (e.g. by larger size of production changeover) are neglected as well as costs of transportation.
- 5- The model includes only two commodities and two countries. Effects by interrelations between exports or imports and other branches of the national economy are not taken into consideration.
- 6- Problems arising from changing demands and from the size of the countries or markets involved are neglected.

We shall see in chapter 11 that the research work of many economists engaged in foreign trade theory since the middle of the 19 th century has aimed at overcoming these deficiencies by developing further and "modernizing" the theorem of comperative advantage or comparative cost differences.



11. The role of comparative cost differences within the system of determinants of foreign trade in contemporary western economics.

During the past 160 years Ricardo's theorem was completed, improved and to some extent changed by a lot of economists, some of the simplifications of the original model were liquidated. This development includes above all:

- the replacement of the labour value of the commodified concerned according to Ricardo by "opportunity costs";
- introducing of more commodities and countries into the model;
- taking into consideration the category of the demand and of different conditions in the countries or markets (e.g. the size of the country, the volume of export/import);
- making comparative advantages as to the endowment with production factors as the focal point of determining the structure of foreign trade;
- improving the methods and instruments used by the theorem of comparative advantage in foreign trade (indifference curves, elasticities, terms of trade, foreign trade multiplier etc).

Let us have a look on how some leading economists complemented or improved the original theorem of Ricardo;

J. St. Mill introduced demand and supply elasticities into Ricardo's theorem and described the reciprocal demand of countries participating in foreign trade as the law of international exchange of goods (10).

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(10) J. St. Mill "Principles of Political Economy", London, 1848, P. 179.



He initiated the term "comparative cost differences" instead of "comparative advantage" which is used in western economics since that time<sup>(11)</sup>.

J. Haberler and W. Leontief perfected these ideas by establishing the theory of the world economic equilibrium, understood as an equilibrium of international demand and based on opportunity costs of the commodities concerned. The following quotation may prove our thesis that all these completions, improvements and rectifications did not aim at changing the original theorem of Ricardo in principle. "Without trying to make a point against the spirit of the theory of comparative costs, it may be interesting to observe that two countries with costs of production which are equal not only comparatively, but even absolutely, will share an exchange of their products if their system of indifference lines, i.e. their relative demands are different."<sup>(12)</sup>

Of special importance as regards our topic seems to be the so-called "factor-proportion theorem" or "Heckscher-Ohlin-theorem" which can be expressed as follows:

Each country will export those goods at the production of which that factor (e.g. land, capital or labour) is used relatively intensive, the country concerned is endowed with relatively rich (and vice versa in the case of imports).<sup>(13)</sup>

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(11) J. St. Mill "Essays on some Unsettled Questions of political Economy" London, 1844, P.2.

(12) W. Leontief "The use of Indifference Curves in the Analysis of Foreign trade" Quarterly Journal of Economics, 1933, P. 234.

(13) B. Ohlin "Interregional and International trade" Cambridge (USA) 1933. Analysing the well-known "Leontief paradox" Kindleberger comes to the conclusion that the Heckscher-Ohlin Theorem is wrong. "When goods change their factor intensities from country to country depending on factor endowments and factor prices, the H.O. theorem falls to the ground" =



Though Heckscher and Ohlin refused Ricardo's theorem of comparative advantage, above all on the grounds that it is bound to the international immobility factors, I agree with those economists, (like J. Viner) who argue that the different endowment with production factors as the focal point of the H.O. model is included in Ricardo's theorem and that this new approach is not in contradiction to the fundamental thesis of Ricardo.

Hence it follows that in spite of all these and some more complements or improvements of the original theory comparative advantages or cost differences are still regarded as the main factors determining the flow and the structure of foreign trade. The following scheme may illustrate the role of comparative cost differences within a comprehensive system of determinants as part of the so-called "pure foreign trade theory" in contemporary western economics.

(14)

Scheme 2: Determinants of foreign trade.

Differences from country to country as to the commodity structure of exports and imports are caused by:

- 1- Lacking supply possibilities in the import country. They exist:
  - 1.1 permanent because of natural conditions, (resources, climate etc).
  - 1.2 medium -or long-term because of:
    - 1.2.1. different national economic development levels.
    - 1.2.2. different innovatory activities resulting in the invention of different products.

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= Ch, p Kindleberger, "Foreign trade and the National Economy: New Haven and London, Yale University press, 1962. P. 76.

(14) This scheme was published in a similar form by H.Hesse in "Determinants of foreign trade" Hand Dictionary. of Economics, Gustav Fisher publishers). stuttgart/New York 1977, P. 366.



- 1.3. Short-term because of unique or quickly changing events like
  - 1.3.1. cyclical disparities
  - 1.3.2. bad harvests, strikes etc.
2. relative price differences, being attributed to:
  - 2.1. relative differences of demands;
  - 2.2. comparative cost differences, based on
    - 2.2.1. relative differences as to the endowment of the countries with production factors according to
      - 2.2.1.1. the classical division into labour, capital, land (the so-called or thodox factor-proportion-theorem).
      - 2.2.1.2. different groups of workers as regards their education or qualification.
    - 2.2.2. relative productivity differences attributed to:
      - 2.2.2.1. quality differences of the production factors being based on
        - 2.2.2.1.1. natural conditions (e.g. as regards land)
        - 2.2.2.1.2. more favourable technologies
        - 2.2.2.1.3. different human abilities
      - 2.2.2.2. scale economies
3. Market overlappings between internal and foreign suppliers in the case of heterogeneous competition. They are:
  - 3.1. rendered possible by multiple preferences of the demanders and a respective product differentiation.
  - 3.2. determined as to their intensity by market strategical decisions of the producers.



This comprehensive system of factors determining the structure of foreign trade with many interrelations and overlappings between the single elements is obviously much more realistic than the original assumption of Ricardo or some of his predecessors over-estimating the exclusive role of comparative advantages of cost differences. But nevertheless we can learn from this scheme that comparative cost differences (see point 2.2) play also at present the central and the decisive role in this system of determinants and in modern pure theory of foreign trade as a whole. Moreover, there exists up to now no comprehensive theoretical system, connecting the new factors with the elements of the traditional theory of comparative cost differences as regards their respective priorities, effects etc. (15)

Summarizing, we come to the conclusion that our principal objections against the main theses of Ricardo's theorem of comparative advantage at the end of chapter 1 remain unchanged with regard to the role of comparative cost differences as the central part of the system of determinants of foreign trade in contemporary Western economics. In the following two chapters we are going to investigate this problem with regard to two selected topics, namely the role of free trade and the distribution of welfare effects of foreign trade.

111. Perfectly free trade as a basic condition of the theorem of comparative advantage.

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(15) K. Rose "Foreign Trade" *ibid*, p. 363.



As we have seen before, perfectly free trade is a postulate of the Ricardian theorem<sup>(16)</sup>. This means that according to this principle comparative advantages or cost differences can play their role as the most important or decisive determinants of foreign trade in a world capitalist system only under these specific conditions.

When studying modern textbooks on economics in western countries in general and on foreign trade in particular we find a more or less ambiguous treatment of this problem. On the one hand, most of the leading economists over and above all other arguments use the theory of comparative cost differences to explain why export or import trade is transacted at all, and the circumstances in which the various countries export or import certain commodities, without mentioning that perfectly free trade is a necessary precondition for this theory. For instance Haberler, one of the high authorities in this field. Places this theory at the head of his theoretical work as a whole<sup>(17)</sup>.

On the other hand, the same economists know quite well that ever since Ricardo's days free trade had never become a reality. We may quote Haberler again, who wrote: "The drift towards protectionist and autarchic policies of the past sixty or seventy years has been sharply accentuated by each recession"<sup>(18)</sup>.

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(16) See Ricardo's quotation according to footnote 8.

(17) G. Haberler "The theory of International trade"  
William Hodge, London 1954.

(18) G. Haberler "Readings in the theory of international trade",  
The Blakiston co, Philadelphia, 1950, P. 531.



In addition to this obvious contradiction we can observe that in many publications on the theory of foreign trade in general and the role of comparative cost differences in particular the problem of free trade is presented in a very abstract manner, without taking into consideration the historical aspect, inequalities between the countries participating in international trade and other actual conditions in the world markets. So we shall give emphasis in the following on some selected aspects of this problem:

1. A historical view on the development of free trade since

The Publication of Ricardo's theorem in 1817 shows first that there was and there is no "perfectly free trade" any where and that already resulting from this fact we should doubt the alleged leading or even exclusive role of comparative cost differences for determining the structure of international trade. Furthermore it proves that decisions on the economic policy of a country with regard to free trade or to a certain degree of protectionism in any case have to be taken in conformity with the position of the country concerned in the world economy in an actual historical period.

As we mentioned already, Ricardo's struggle for free trade was in the interest of the British middle classes at that time, whereas the foreign economic policy of France in the 19<sup>th</sup> Century was characterized by a traditional protectionism, the situation in Germany was marked by dozens of customs barriers, and the U.S.A. adopted a protectionist policy (and adheres to it in many branches of the national economy even today). It may be of some interest also for the time being to mention that the German economist Friedrich List, who had come to the USA as a political refugee, recommended in 1830 for the US Government a policy of protective import duties, intended to protect



"infant manufactures" against England which was at that time the predominant political and economic power (19)

A critical analysis of the current situation in international trade between capitalist countries shows that in spite of all theoretical discussions on behalf of free trade, intensive negotiations in the so-called Tokyo-round of GATT and declarations on the summits of the leaders of the western world international trade is affected by increasing protectionism, through customs and non-tariff barriers. This assessment concerns trade between the industrialized countries or regional blocs (EEC) as well as trade between them and developing countries. According to GATT - calculations the share of foreign trade on the world capitalist market, which is hindered by state interventions, increased between 1974 and 1976 from 35% to 40% (20). The disillusion as regards the development of trade liberalization and connected with it of western economic theory as a whole leads the west German economist Detlef Lorenz to the statement: "Free trade models are alas as a rule, a historical- as are other models of modern economics (21)"

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(19) F. List "Outlines of American Political Economy" in Schriften, Reden, Briefe" VOL 11, Berlin, 1931. The different bias or interests of certain groups of the population in the U.K. and the U.S. during some periods of the 19th century in favour of free trade or protectionism is shown, too, by Ch.P. Kindleberger in "Foreign trade and the National Economy", op. cit., p. 77/78.

(20) Neue zuricher xritung, 25. 1.1978, p.11.

(21) D, Lorenz "On the Crisis of the "Liberalization Policy" in the Economics of Interdependence" in Inter - Economics 7/8 1978, Weltarchiv GmbH, Hamburg, P. 170.



At last let us have a look now on the results of an economic policy according to the principle of free trade or "laissez-faire" on the structure of export, import, production and consumption in a certain period of the history of the Arab world. Based on trade agreements between the Ottoman Empire and different European countries, which were first concluded in the sixteenth century, foreign merchants, especially English and french-levant companies, were given distinct priority for the conduct of their foreign trade business. According to the unequal conditions in these relations at the end of the eighteenth and the beginning of the nineteenth century, characterized all by heavy import duties on cotton yarn in France against very low import taxes on foreign goods in the ottoman Empire, by the introduction of machine spinning in England against the traditionally manufactured cotton fabrics and textiles in Arab countries and by the privileged status of foreign merchants in these countries, formerly flourishing industries in various main urban centres like Baghdad, Alepo and Damascus suffered great losses in production and exports, and the national markets of these countries were flooded by English and french goods. This kind of a "limited free trade" (there existed some-but completely inefficient-regulations for import duties) led within some decades to a devastation of local industries unemployment of highly skilled artisans and craftsmen in these areas and an increasing dependence upon foreign products of all kinds. This may be shown by the fact that the import of English cotton fabrics into the ottoman Empire increased tenfold between 1828 and 1813<sup>(22)</sup>

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(22) See": in detail: A,B, zahlan "Established patterns of technology Acquisition in the arab world" presented to the conference on technology transfer and change in the Arab World, Beirut, organized by U.N. ECWA, October 1977.



2. Another question concerns the relation between comparative cost differences and other factors within the comprehensive system of determinants of foreign trade (see scheme 2) under the current conditions of "trade liberalization" (the modern version of free trade) in the western world. For this purpose we shall refer to an analysis of the Oxford economist, Sir Douglas Mac Dougall, on the alleged impact of comparative cost differences on foreign trade relations between the United States and the United Kingdom, using the calculations made by L. Rostas on the exchange of some selected goods between these two countries in 1937<sup>(23)</sup>.

Based on comparative calculations between the productivity of the individual industries and the wage level of the two countries the author wanted to prove that according to the principle of comparative cost differences, within the two-country model each country would have to export that commodity to the market of the other country for which the productivity advantage was greater than the difference in the wage level. Mr. Dougall believed that the comparison of the twenty five products examined fully confirmed the principle of comparative cost differences, for in spheres where U.S. productivity was more than twice the U.K. productivity (i.e. where the difference in productivity exceeded the wage differential) the United States controlled the export markets (and vice versa). However a more detailed analysis of these calculations leads us to the following conclusions<sup>(24)</sup>:

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(23) D.M. Dougall "Comparative Advantage in Practice, Readings in Economics" Mr. Graw-Hill, New York, 1958. pp 315-318. Though the calculations were made 40 years ago problems and conclusions in principle seem to be unchanged for conditions at the time being.

(24) See J. Vaida "Socialist Foreign trade and Modern Economic theories" in "The Role of Foreign trade in a Socialist Economy" Corvina Press, Budapest, 1965, p. 256-257.



- a- Contrary to the two-country model generally employed, the bulk of the exports examined goes to third markets and not to the other country (U.S. or U.K.).
- b- In all cases of comparative advantages of the U.K. the U.S. tariffs overcompensate these advantages, except for some bulk goods like cement and coke where the transport charges are very high. This means that U.S. customs barriers of protectionism are stronger than comparative advantages.
- c- In the sphere of machinery, motor cars and other goods, where the U.S. has comparative advantages and the relatively low British tariffs do not compensate them, imports from the U.S. account for only 2.5 to 8 per cent of the domestic consumption in the U.K. with a continuing high share of internal production of these goods.
- d- The high exports of U.K. cotton goods as compared with those of the U.S. (with favourable climatic and soil conditions for cultivation of cotton) prove that under conditions of modern industry in many instances the advantages arising from physical potentialities are overshadowed by other, more important factors.

Summarizing this analysis underlines our principal theses that on the one hand there exists in practice no "perfectly free trade" as a prerequisite for the governing role of comparative advantages or cost differences on the structure of foreign trade and that on the other hand a lot of other factors are determining the flow of international trade. In addition to those ones mentioned above or presented in our scheme 2 on determinants of foreign trade we should note the strong influence of the international monetary system,



(25)  
especially the instability of exchange rates, the impact of economic integration policy (above all in the case of EEC) on "trade creation" and "trade diversion" and, last not least, the overwhelming role of transnational or multinational corporations on the world capitalist market.

3- According to the object of this paper and the topic of this chapter we should investigate now the specific impact of the "multi-nationals" on perfectly free trade in connection with the role of comparative cost differences as a determinant of foreign trade (26). First of all, let us have a look on the impact of these big corporations on the world capitalist economy in general and on international trade in particular. In the early seventies, some 7.000 international monopolies with their tens of thousands of foreign branches controlled about 50% of international production, more than 60% exports and some 20% of the gross national product (GNP) in the world capitalist system. The book value of the capital invested as direct investments in the developing countries alone amounted to over 69 billion dollars in 1975, and for 1974 and 1975 the transfer of profits from subsidiaries in developing countries to the parent companies in the respective metropolises is (27) numbered at 39.000 million dollars. It is estimated that about 20-30% of international trade on the world capitalist market is intragroup trade between

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(25) D. Lorens " On the crisis ... op, cit, p. 171.

(26) We shall concentrate here on these aspects and do not attempt to deal with the role of the multi-nationals on the world capitalist economy as a whole. Moreover, in chapter IV some other aspects as regards the role of multi-nationals will be investigated.

(27) N.A. Razzak, acting secretary-general of AAPS<sup>10</sup>, his speech at the International conference on the Role of transnational corporations and the strategies of Economic development, Paris, 25-27 April 1979, published in Development and Socio-Economic Progress 2) 1979, Cairo, 60-62.



parent companies and subsidiaries (or between subsidiaries) in various countries and that the multi-national's share of the total exports and imports of developing countries amounts to more than 33% .

This unprecedented power of some big corporations on the world capitalist economy influences to a high extent the flow of international trade as regards its volume, commodity and regional structure and prices. This new situation is far from the conditions of "free competition" on internal and external markets as a basic assumption in the framework of classical or neo-classical foreign trade theory. As to the topic of this chapter our first conclusion is that the activities of multinationals are a strong argument against a more or less functioning model of a "perfectly free trade". Secondly we hold the view that these specific conditions worsen furthermore the role of comparative advantages or cost differences for determining the structure of foreign trade between various countries. Instead, comparative cost differences may play a certain role for determining the structure of production, exports and imports among the various enterprises or subsidiaries of a multinational group as part of the strategy of profit maximising within this international economic empire.

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(28) P. Richter " Are the Developing countries in Reality "Exporters of capital. " Inter - Economics 4/1979, Hamburg P. 176.



IV. Comparative advantages and the distribution of welfare effects of foreign trade.

According to the classical theory of comparative advantage (or cost differences) the international exchange of goods based on this principle will lead to a common price relation the reciprocal value of which marks the "terms of trade". Both participating countries will achieve welfare effects under the assumption that the common price relation lies between the two cost relations concerned ( in our example of scheme 1 it must be between the cost relations of cloths to wine of 9:8 (Portugal) and 5:6 (England). As Ricardo did not mention international values or prices, he was not able to evaluate the amount of welfare effects as a whole and its distribution among the countries concerned.

Since the middle of the nineteenth century a lot of efforts were exerted for solving the latter problem (above all by J.ST. Mill, Marshall, Taussig, Viner). Different types of "terms of trade" were introduced, aimed at measuring the effects of international division of labour on the national economy of the countries involved (29).

Notwithstanding different views as regards fundamental theoretical questions as well as the usefulness of some instruments or models for purposes of measuring welfare effects of foreign trade, there seems to be conformity in principle as to the following theses:

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(29) See in detail: H.R. Hemmer, "Foreign trade-terms of Trade" and J.Schumann "Foreign trade-Welfare Effects" in Hand Dictionary of Economic Sciences, op. cit, p. 388-426.



- 1) Foreign trade based on comparative cost differences does not lead automatically to an equal or just distribution of welfare effects among the participating countries. There are three possible variants:
  - a) equal distribution among the partners;
  - b) unequal distribution (obviously the most probable and most numerous cases);
  - c) One partner gains, the other one loses.
- 2) All the coefficients resulting from calculations according to the various types of terms of trade <sup>(30)</sup> are reflecting certain aspects of changes as regards the effects of foreign trade on the national income or on the trade balance in a fixed period against a previous period. They give no answer as to the absolute amount of these effects including the direct and indirect effects of foreign trade on production, consumption or economic growth of the country concerned.

There are different or controversial opinions on the factors causing or influencing the distribution of these effects, concentrating above all on the following problems:

- Socio-economic conditions within the countries and the type of international division of labour.
- differences between the partner countries as to labour productivity, size and/or economic power, natural factors (land, climate, mineral resources), modern technology etc.

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(30) See: e.g. the commodity- income-, single factorial double factorial-, real cost- and utility terms of trade *ibid*, p. 395-398.



- Commodity structure of export and import,
- Colonial or neo-colonial dependencies,
- activities of multi-national cooperations.

It is common sense that foreign trade between the industrialized metropolises on the one hand and colonies or dependent countries on the other hand led, contrary to Ricardo's assumption, not to an international division of labour "most beneficial to each" and "admirably connected with the universal good of the whole"<sup>(31)</sup>. Instead, the unequal distribution of welfare effects of foreign trade between the countries was and is still one of the factors<sup>(32)</sup> having led to the economic backwardness of the countries of the third world. Therefore the struggle of the developing countries for a new international economic order is an attempt to overcome the detrimental effects of the existing international division of labour on their economics.

In connection with this problem it seems to me that the great emphasis given since some years on research and publications on "Economics of Interdependence" aims to a high extent at ignoring or refusing the negative effects of unequal distribution of the gains from international economic relations on the economies of the "periphery" of the world capitalist market. I agree in this respect with "Bartschi:

"It should also be borne in mind that the renaissance of politico-economic interdependence as a topic of research ... also had an ideological function: the American generated interdependence approach explicitly responded to the latin

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(31) See footnote 7

(32) We refer to the well known writings of Myrdal and Prebisch and the report to the club of Rome "Reshaping the International order."



American generated dependence approach by rightly trying to generalize it and by wrongly trying to ignore the inequality of mutual interdependence, i.e. the asymmetry of international economic relationships<sup>(33)</sup>.

Starting from this general view we are now going to discuss some selected aspects of the topic of this chapter giving special reference to the problems of developing countries.

1. A first problem shall be devoted to the role of natural resources of the countries for using comparative advantages in foreign trade. According to Haberler the argument runs as follows: "Each country will produce those goods for the production of which it is specially suited on account of its climate, of the qualities of its soil, of its other natural resources, of the innate and acquired capacities of its people, and - this must be given special emphasis - of the real capital which it possesses as a heritage from its past, such as buildings, plant and equipment, and means of transport. It will concentrate upon the production of such goods producing more of them than it requires for its own needs, and exchanging the surplus with other countries against goods which it is less suited to produce or which it cannot produce at all<sup>(34)</sup>."

There is no doubt that comparative advantages resulting from the endowment with natural resources of the countries concerned play an essential role in using the possibilities of international division of labour

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(33) W. Bartschi "Dependencies and Interdependencies," Inter-Economics 9/10 1978, Hamburg, P. 248.

(34) G. Haberler "the theory of International trade," William Hodge, London 1954, P. 125.



for the benefit of the national economy as a whole. The privileged position of some countries as to the production and export of crude oil or of Egypt in the field of extra long staple cottons underlines this thesis. But at the same time, the one-sided and more or less exclusive orientation on the already existing natural resources in determining the structure of production and export is obviously one of the decisive factors having caused and still being influencing the present economic backwardness of Third world countries and the inequality in international trade. The following aspects should be given special emphasis:

- a) Whereas Ricardo speaks of "most efficaciously" exploitable resources provided by nature, according to Haberler the international division of labour is above all determined by factors which a people have inherited from its past. Following this static approach of the theorem of comparative advantage would justify and declare eternal the inequality between underdeveloped and industrialized countries in the world economy and would favour assumptions or proposals aiming at preserving the existing commodity structure in foreign trade between these two groups of countries unchanged in principle. In full conformity with this version some modern economists in western countries hold the view that for the majority of third world countries the complementary trade (i.e. exchange of raw materials and agricultural products against finished products) would remain the most favourable variant in their economic relations with industrialized capitalist countries (35)

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(35) J. Beyfuss "The trade with developing Countries - its potentialities and limitations", Inter - Economics 11./12-1978, Hamburg, P.287.



b) We should discuss more in detail the term a "national resources" in connection with their role for achieving comparative advantages in foreign trade. Kindleberger mentions for instance that natural resources cannot be considered or evaluated "per se" but in any case in relation to a given technology and the available capital of the country concerned in a certain period<sup>(36)</sup>. Furthermore he polemizes against extreme opinions as regards the role of such resources. "On the one hand, there is the belief that abundant resources are necessary to a high standard of living like that of the United States. This is not so. Look at Britain, or Switzerland or even Western Germany ... On the other hand, it is frequently claimed that specialization in resource products is ruinous. This is not true. Regard Canada, not to mention Australia, New Zealand, Denmark, most of which are transforming themselves into industrial countries by means of the wealth produced from resources"<sup>(37)</sup>.

I agree with him in general. But as to the latter example, he ignores apparently the socio-economic and historical conditions under which certain countries may gain comparative advantages as to the production and export of raw materials or agricultural products. Contrary to the present situation in most of the developing countries, the afore mentioned countries were already characterized by a relatively high economic level (skilled labour, infrastructure, capital). Thus it will not be justified to generalize these examples to third world countries.

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(36) Ch. G. Kindleberger Foreign trade ... op. cit. p. 28.

(37) *ibid*, p. 46.



c) At last let us have a look on the relation between natural resources and other factors connected above all with the scientific technical progress, in using comparative advantages in foreign trade. We should avoid extreme opinions as to this problem <sup>(38)</sup>, either by overestimating the rôle of natural resources or by neglecting their importance in principle. In the first case we might support the unequal exchange between countries as exporters of primary goods or finished products, in the latter one we could prevent a country from successfully using still existing comparative advantages in this field.

At the same time, the special conditions in different spheres of the national economy have to be taken into consideration. Vajda writes:

"In agricultural production the great variety and wide range of comparative advantages did, in fact, exist in the age of Ricardo, and moreover continue to do so even in the future ..... Still, in most branches of modern industrial production, and in particular in those where breath - taking progress is being made, the range of comparative advantages determined by physical potentialities, or largely controlled by them, is negligible, une quantité négligeable. Today comparative advantages are born or pass away as a result of circumstances created by social and ownership relations, produced and reproduced by man" <sup>(39)</sup>. I agree with this idea in principle. But we should avoid this too

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(38) See: e.g. the different views between G. Kohlmey and E. T. Aoshner in "Foreign Economics and growth", Academy Publishers, Berlin GDR/1968, pp. 92 and 141.

(39) J. Vajda "Socialist Foreign trade and Modern Economic theories" op. cit, p. 253.



trading: however, the more productive nation gains more than the less productive one"<sup>(40)</sup>.

This thesis is in full conformity with practical results in the history of international trade between the centres and the former colonies or dependent countries and with investigations of other economists (e.g. G. Myrdal, R. Prebisch, H. Myint, H.W. Singer) on this subject. I agree with it in principle, but two comments should be noted. Firstly, the socio-economic conditions within the countries concerned and the type of international economic relations have to be taken into consideration in any case, when dealing with the afore mentioned theorem. Experiences of the past 30 years proved that under conditions of a world socialist economy international trade among CMEA countries did not lead to a widening gap between them as to their economic levels but to evening out the existing differences in this respect (see in detail chapter v).

Secondly, the problem of unequal exchange is going far beyond the "pure foreign trade theory". As the real life on the world capitalist market is far from any abstract model of free competition or perfectly free trade, the impact of other factors like political conditions, capital and technology transfer, activities of transnational corporations etc has to be included in respective investigations on this subject.

Let us have a look now on some selected aspects of the commodity structure of foreign trade in connection with the theorem of comparative advantage and the problem of distribution of welfare effects. We shall deal

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(40) W. Bartschi "Dependencies and Interdependencies-a Theoretical comment", Inter-Economics 9/10 - 1978, Hamburg, p. 247.



absolute confrontation between agriculture and industry and give more emphasis to the comprehensive role of science and technology penetrating all branches of the national economy including agriculture (see e.g. the high level of productivity in the U.S. agricultural production at present time).

2. The afore mentioned problem is connected closely with the question of the impact of differences existing in the degree of general economic development of the level of productivity among the individual countries on the distribution of welfare effects of foreign trade. Obviously, this question is not only of special importance for the theory of foreign trade but it plays a fundamental role in the present struggle of developing countries for establishing a new international economic order.

It is far beyond the possibilities of this paper, to deal with this problem in its full complexity. So we shall concentrate on some selected questions, especially on some aspects of distribution effects of fundamental differences as regards the commodity structure of export and import resulting from the different levels of economic development in various countries. But first of all we want to discuss shortly some ideas of the "theorem of unequal exchange."

Based on the well known thesis of Karl Marx that there exists exploitation too in international economic relations and that the more productive nation exploits the less productive one, some Western economists elaborated and introduced a theorem of unequal exchange in foreign trade. It aims at providing an explanation for the distribution of gains from trade. Bartschi writes: "Combined with the theorem of comparative advantage, the positive conclusion is that both countries involved in international trade gain by



with these questions especially from the point of view of developing countries.

Analyzing the statistics on the development of the commodity structure in international trade between developing countries and industrialized capitalist countries since the end of the second World War, we can ratify the two following main trends:

- a) a continuously prevailing exchange of raw materials and raw material - intensive semi-finished products from developing countries against industrial manufactures from Western countries. The export structure of many developing countries is still characterized by the predominance of one or two goods like coffee, copper, cocoa, cotton, crude oil etc.
- b) an increasing share of labour - intensive finished products like textiles, toys, selected electrotechnical and precision engineering products in the total exports of some developing countries (e.g. South-Korea, Taiwan, Hongkong, Singapore).

This trend in the international division of labour is accompanied by structural changes in the industry of Western countries in a reverse direction in favour of branches with capital intensive and highly sophisticated products, and exports.

Both tendencies are in full conformity with the classic principle of comparative cost advantage (complementary trade) or the Heckscher-Ohlin factor proportion theorem using the existing enormous wage cost differences (substitution trade). Some Western economists hold the view that this development is most favourable for industrialized capitalist countries as well as for



developing countries and they recommend a continuation of this kind of international division of labour for the long run <sup>(41)</sup>. Activities of multinational corporations are also characterized to a high extent by putting these theoretical ideas into practice <sup>(42)</sup>.

We do not neglect the necessity and also the possibility of achieving gains to a certain extent by using comparative advantages in the production and export of raw materials and labour-intensive products and the import of capital - intensive modern goods as part of a comprehensive and long - term development strategy. But at the same time it is evident that these fundamental differences in the commodity structure of export and import resulting from the different economic levels of the two groups of countries led in the past and lead further to an unequal distribution of welfare effects of foreign trade to the detriment of developing countries.

The negative effects of this kind of international division of labour according to the theorem of comparative advantage, impeding the economic progress of the Third world countries, may be demonstrated above all by the following factors, being results as well as new sources for an unequal international exchange:

- a) The one-sided orientation towards the production and export of some selected raw materials is connected in most cases with continuing or even growing backwardness in the other sectors of the national economy.

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(41) J. Beyfuss "The Trade with Developing countries ...", op, cit.

(42) F. Mursi "The Multi-Nationals' Movements in the Arab Region" Development and Socio - Economic Progress, A.A.P.S.O. 2/1979, Cairo, p. 34.



Analyzing the experiences of latin-America, Prebisch proves that the foreign capital introduced modern technology only in some "enclaves" of production of raw materials as a kind of extension of the industry of capitalist countries without promoting the scientific - technical development in the rest of the economy of the Third world countries concerned. This biased development led among other things to reverse trends as regards the growth of demands for the respective raw materials in the industrialized capitalist countries and for masses of finished products to be imported by the developing countries. This permanent tendency of disequilibrium is a major factor for increasing deficits in the balance of payment of most of the developing countries<sup>(43)</sup>.

- b) The afore mentioned general problem of the exchange of raw materials against finished products, described by R.Prebisch as an anachronistic scheme of international division of labour, must be investigated in detail from different aspects. Gains from the exploitation of comparative advantages and the distribution of welfare effects between the participating countries are differing considerably, depending upon
- The role the various groups of raw materials or single commodities (e.g. crude oil or other fuels, cereals etc) in a given period of the world economy;
  - The economic level of the raw material exporting country as a whole (see e.g. the increasing role of some highly industrialized countries as exporters of selected raw materials);

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(43) See in detail: T. Prebisch "Towards a dynamic development of latin-America", Economic-scientific Informations, Berlin, Issue 38/39.



- Ownership relations in the fields of exploration, processing, trans-  
(44)  
portation and distribution of raw materials ;
- c) For the majority of Third World countries (with the exception of the big exporters of crude oil) the fundamental differences in the commodity structure between export and import led among other things to permanent deteriorating terms of trade and to a constant diminution of the share of this group of countries in the total international trade on the world  
(45)  
capitalist market .
- d) As we mentioned before, the effects of a great and further increasing share of exports and imports of developing countries are influenced directly or indirectly by activities of multinational cooperations in different forms. In many cases exports and or imports of developing countries represent in fact intragroup trade between subsidiaries or between parent companies and subsidiarien of multinational corporatopns. A recent study on the activities of multinational enterprises in Brazil  
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and Mexico, quated by UNCTAD , put the share of such exports of the  
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two countries in 1972 at 73% and 82% respectively.

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(44) See in detail: E. Toeschner "the role of natural conditions in the international division of labour-a study to the problem of raw materials" in: foreign Economics and growth, Academy Pablishers, Berlin/GDR, p. 130.

(45) ibid, p. 141, J. Beyfuss "The Trade with Developing Countries." op. cit. p. 287.

(46) UNCTAD: Dominant positions of Market Power of transnational cooperations Use of the transfer price Mechanism, RTD/B/C2/167, 1977p. 25ff.

(47) p. Richter: "Are the Developing countries in Reality Exporters of Capital?" Inter - Economics, Hamburg, 4/1979, p. 178.



Though complete and detailed statistical information about the respective activities is not available, investigations in this field furnished evidence of the fact that several channels were used for disguised profit retransfer to the detriment of developing countries. This includes price manipulation, i.e. the overpricing of imports and the underpricing of exports .<sup>(48)</sup>

It is without saying that this is another factor affecting the unequal distribution of welfare effects of foreign trade to the disadvantage of developing countries. As to the main subject of this paper, we may conclude that in the case of multinational corporations' activities in production and foreign trade of Third world countries, comparative advantages or cost differences play an essential role for exploiting and developing further the international division of labour. But the direction and the actual measures are determined under these conditions by the interests of some multinational cooperations instead of the interests of the participating countries, above all the Third world countries.

Summarizing, we come to the conclusion that under the condition of fundamental differences in the degree of general economic development the one-sided exchange of raw materials against finished products is one of the major causes for the widening economic gap between the countries of the First and the Third world. The international division of labour conducted according to the classic principle of comparative cost differences or the Heckscher-Ohlin factor proportion theorem and based on the illusion of a "perfectly free

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(48) Ibid, p. 178.



trade" is in no case a remedy for solving the problems on the present world capitalist market in favour of the developing countries. It is far beyond the aim and the possibilities of this paper to elaborate proposals or recommendations as regards changes of the economy within these countries and as to the system of international economic relations aiming at solving the above mentioned problems. Instead, I am going to present now some ideas on the role of comparative advantages in the foreign trade of socialist countries.

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V. Comparative advantages in foreign trade of socialist countries.

Under conditions of socialism, the exploitation of comparative advantages is of great importance, too, and plays an essential role in theory and practice of foreign trade. But when investigating the respective problems, we have to take into consideration in any case the specific internal and external conditions of these countries in the field of economy in general and the foreign trade in particular, differing considerably from the conditions concerned under capitalism. As to the internal conditions, we should mention above all:

- Public ownership of the most important means of production;
- Comprehensive national economic planning, characterized by the decisive role and binding force of central planning, including foreign economic relations with socialist and non-socialist countries;
- Foreign trade state monopoly.

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(49) We are concentrating in this chapter on theory and practice of foreign trade in CMEA countries and are not dealing with the situation in other socialist countries like China, Yugoslavia etc. At the same time, we shall confine ourselves above all to comparative advantages in economic relations among CMEA countries.



As regards the impact of external conditions on the role of comparative advantages in foreign trade, we might refer in the first place to:

- The new type of international economic relations on the world socialist market as laid down in the "Principles of socialist international division of labour" and the respective conclusions or recommendations of the CMEA in the course of socialist economic integration;
- A system of international cooperation in planning among CMEA countries;
- The principles of the formation of contract prices for intraarea trade and for the application of the transferable rouble as the international currency of CMEA countries<sup>(50)</sup>.

Because of these specialities there were and there are discussions among economists of socialist countries whether the doctrine of comparative advantage is at all applicable in a study of socialist foreign trade or to what extent comparative advantages exert a certain influence on the structure of production, export and import. On the one hand, an extreme opinion stating that this theorem is a reactionary one as a whole, aiming only at proving and justifying the existing international division of labour between highly industrialized countries and the less developed countries in the world capitalist economy. According to this view this theorem should be rejected in principle and might not be applied at all under socialism<sup>(51)</sup>.

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((50) See in detail: G. Grote "Economic Integration among socialist countries Memo. No 1241 at the institute of National Planning ; Cairo, 1979.

(51) Roginsky Frumkin "Is there a rational core in the bourgeois theory of international trade", "in Foreign trade, 11/1961. Moscow pp. 20-31.



On the other hand, the majority of economists in socialist countries-and I belong to this group too-holds the view that apart from its negative essence, the theorem of comparative advantage has also some rational aspects which should be recognized and taken into consideration in the implementation of socialist foreign trade. There seems to be far reaching conformity in general on the following main principles concerning the role of comparative advantages in the economy of socialist countries:

- a- Foreign trade is not determined in the first line by comparative advantages, but they play an essential role in a system of determinants.
- b- Comparative advantages in foreign trade have to be given due consideration within the framework of national economic planning.
- c- Bases for decisions on exploiting comparative advantages are not in the first line the already existing conditions within the countries concerned (as a heritage of their past <sup>(52)</sup>). But the changeable conditions seen from a dynamic point of view..

Starting from this principal assessment, we shall deal in the following with some selected problems:

1- CompARATIVE ADVANTAGES IN A system of determinants of foreign trade:

Under socialism, the development of foreign trade of a certain country as regards the volume, commodity-and regional structure is determined by a comprehensive system of determinants, including comparative advantages. But contrary to the respective system in contemporary capitalist economics (see scheme 2 in chapter 11), based on the assumption of a free-market mechanism within the countries concerned and on the international level, in foreign trade of socialist countries comparative advantages are not considered the

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(52) See the quotation of G. Haberler according to footnote 34.



decisive factor, leading more or less spontaneously and automatically to an allegedly optimal structure of production, export and import. Instead, they are subordinated to the principal social motive forces and aims of the national economic development of socialist countries, aiming at achieving "maximum satisfaction of the material and cultural needs of man" as the basic law of socialism<sup>(53)</sup>. This is in accordance with the idea of Engels that contrary to the basic economic law of capitalism that production by the many serves the interests of the few, the economy in socialism should be characterized by "the replacement of the social production anarchy by social production in accord with the needs of the community as well as every individual"<sup>(54)</sup>, Therefore the point of departure for the comprehensive system and the procedure of national economic planning in general and for the determination of the target function for the socialist economy in particular is based on consumption or value-in-use standards, i.e. on the intended end-apportionment of material values in the interests of the people of the country concerned<sup>(55)</sup>.

In conformity with and derived from the comprehensive system of planning and balancing, determining the development strategy for the national economy as a whole, there exists a sub-system of determinants of foreign trade aiming at exploiting the potential advantages of international division of labour as much as possible in favour of the general aims of the economic development plan and in full accord with political and social conditions and aims.

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(53) G. Tittel "The Economic basic law of socialism and the main task" in *wirtschafts, wissenschaft*, 12/1973, Berlin, GDR.

(54) F. Engels "Anti - Dühring", Berlin GDR. 1973.

(55) G. Soiling "Needs and Requirements as the starting point of planning" in *wirtschafts wissenschaft* 2/1973, Berlin, GDR;  
D. Schwefer "Basic needs, planning and policies", *Inter-Economics* 5/6-1979, Hamburg, p. 132.



If we consider this sub-system a linear programming model, the objective function aims in principle at maximizing the national income in a given period by determining such a commodity-and regional structure of export and import which use comparative advantages in an optimal way.

The other elements of the system of determinants are expressed by a set of constraints, covering the existing limitations both internally and no external markets, such as domestic demands, production capacities, market possibilities, obligations arising from existing agreements on international economic relations, balance of payments requirements, etc.

Thus the national economic planning system in general and the planning system of foreign trade in particular ensure that comparative advantages are used on all levels and in all branches of the national economy (see in detail the following paragraph 3), but in any case only within the targets and limitations of the national economic plan as a whole in a given period. This may include among other things limitations on the basis of political decisions by the central authorities of the state for supporting certain countries, e.g. by exporting fixed amounts of goods to these areas irrespective of aspects of efficiency<sup>(56)</sup>.

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(56) See in detail G. Grote, "Foreign trade planning" Memo no 1220 at the institute of national planning, Cairo, 1978.



2- The relation between absolute and comparative advantages and between static and dynamic aspects in foreign trade among socialist countries:

Notwithstanding some different opinions in detail, there is conformity in principle among most of the economists of socialist countries that contrary to absolute advantages or disadvantages (based on fundamental differences as to the economic development level among socialist countries) comparative advantages will be of importance for determining the international division of labour also in the future and that these comparative advantages are predominantly dynamic in nature (57).

There exists a close connection between the two afore mentioned relations. The dynamic approach as regards the exploitation of comparative advantages in intra-area foreign trade is of utmost importance for evening out the existing differences as to the economic level or labour productivity between CMEA countries, e.g. between highly industrialized countries like czechoslovakia or the G.D.R., and formerly predominantly agrarian countries like

Romania or Bulgaria and by this for the continuously-advancing reduction of the role of absolute advantages. Calculations as part of the procedure for preparing agreements on specialization and cooperation of production are not based in the first line on the already existing conditions within the countries concerned (especially as regards the production capacities, experiences in management or organization) determining the costs of production, but they take into consideration to a high extent the possible changes in the economic and social conditions. As a result, these agreements include

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(57) G. Kohlmeier "Comments on the theory of comparative advantages in foreign trade," op. cit., p. 92, J. Vajda "socialist foreign trade...", op. cit., p. 263/264.



stipulations for assistance by the more advanced countries in the fields of technology transfer, vocational training for skilled workers or specialists, continuous scientific-technical development of new products etc. Practical experiences of the past 30 years of economic cooperation and integration among the European CMEA countries prove good progress as regards the process of evening out fundamental differences in the economic development levels of the member countries (58)

Resulting from the above mentioned tendencies, absolute differences as to the economic development level and labour productivity between socialist countries as a whole will decrease constantly, reducing more and more the role of absolute differences in the costs of production of certain goods. This concerns in the first line the field of industrial production in general and of machinery in particular. But contrary to some assumption (see footnote 11) this development will not lead to neglecting the role of comparative advantages, predominantly dynamic in character, between and within the various branches of the national economies of socialist countries.

In those branches of production where physical conditions (climate, quality and fertility of the soil, better or worse potentialities in mining etc.) play a greater role, comparative advantages of a more static nature may prevail also in the future (59). Hence it follows that some basic structures in foreign trade between socialist countries as regards the exchange of mineral or agricultural products against finished products will remain also in

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(58) G. Grote "Economic Integration ... " op cit, p, 32 ff.

(59) J. Vajda "Socialist foreign trade ... "op. cit. p. 264.



the future but that the main tendency will be the growing share of the exchange of finished products between all participating countries, using comparative advantages of a dynamic nature between and within the branches of their national economies.

3- National economic planning and foreign trade state monopoly and comparative advantages in foreign trade :

In western literature we find a lot of statements saying that economic planning in socialist countries aims in general at reducing the role of foreign trade according to the principles of "self-sufficiency" or "autarchy on a national or regional level" respectively <sup>(60)</sup> and that "in a planned economy with a foreign trade monopoly the end-user industries are generally not free to choose the best or most efficient among alternative supply sources within and outside the CMEA area. <sup>(61)</sup>" According to these and other publications the system of planning and management in socialist countries is considered a major obstacle against using comparative advantages of foreign trade in an optimal way whereas the free-market mechanism of western countries creates by its very nature the best possibilities in this field.

As to the first argument, statistics on the development during the sixties and seventies show that in all European CMEA countries foreign trade was characterized by high and stable growth rates, that these growth rates exceeded those of the national income and industrial production and that in

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(60) "East-West trade, the lessons from Experiences". The conference board, U.S.A., N.Y., 1971 p. 19/20. "Soviet Economic prospects for the seventies" - compendium of papers submitted to the joint Economic Committee congress, June 27, 1973, Washington pp. 677.

(61) G. Haberler/J.P. Hardy, Discussion paper at the fourth world congress of the J.E.A. Budapest, 1974, p.4.



most of these countries the share of export in the national income. Is relatively high<sup>(62)</sup>. In addition to other factors these figures prove the high rank of international division of labour with other socialist as well as with non-socialist countries in the economic development strategies of these countries, in contradiction to any theoretical models of closed or self sufficient economies.

Before answering the second question, related to the possibilities of using comparative advantages within the framework of national economic planning and a system of foreign trade monopoly, let us have at first a short look on some aspects of the procedure of foreign trade planning which might be of special interest as regards our problem.

A first aspect is the so called "hierarchic system" in planning, i.e. the fact that there are different decision making areas on the top, medium and low levels and that there exists a continuous flow of informations from the top to the lower levels and vice versa. Concerning our problem, there are different possibilities and tasks as to include comparative advantages in the process of foreign trade planning. On the central level there is on the one hand an almost unique possibility for using differences among the various branches or groups of commodities as regards the relation between domestic costs or prices and world market prices leading to a list of priorities as one of the factors determining the export-and import structure of the country as a whole. On the other hand data on costs, prices, market conditions of

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(62) See: Current statistical yearbooks of CMEA, G. Gtrote "international Economic comparative studies". Memo. No. 604 at the Institute of National Planning, Cairo, 1978, p.117/119.



the broad variety of export and import goods in detail are limited on this level.

On the lower level e.g. in an industrial combine and the respective foreign trade enterprise, being responsible for production, export and import of a certain group of commodities, the detailed information as to comparative advantages and market conditions for a large number of single commodities will be available as a basis for decision-making as regards the commodity and regional structure of export and import in detail. But at the same time, these enterprises have to take into consideration some limitations or constraints resulting from decisions taken by central or medium - level authorities which are to be reconsidered in the light of the interests of the society of this country as a whole, including political and social factors.

Concluding, we may state that the existing hierarchic system of planning foreign trade in socialist countries provides favourable conditions or opportunities in principle for exploiting comparative advantages on all levels and in all branches of the national economy. In paragraph 4 of this chapter we shall deal with some difficult and up to now not satisfactorily solved problems in this respect.

Secondly, we should investigate the interrelation between national economic planning and international cooperation in planning, above all among CMEA countries<sup>(63)</sup>. This element of the mechanism of economic integration

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(63) See in detail: G. Grote "Economic Integration", opcit, p. 89ff. There is also some kind of cooperation in planning with non-member countries of CMEA (e.g. with Yugoslavia).



among socialist countries is of great and further increasing importance for determining the development of the international division of labour within this area and to a certain degree also between CMEA countries and non-member countries (64). As cooperation in planning and the respective international agreements embrace all elements of foreign economic relations, including scientific-technical cooperation, investments and industrial cooperation and, last not least foreign trade, these activities are of utmost importance for the exploitation of advantages within all the participating countries and from the view of this international community as a whole. At the same time, this procedure is connected with the problem of avoiding an "unequal exchange" to the detriment of the economically less developed countries of this integrating grouping (see footnote 40).

We should place special emphasis here again on the dynamic approach in the exploitation of comparative advantages in economic relations among socialist countries. Feasibility studies and calculations in the fields of scientific - technical, investments - and industrial cooperation, which are more and more the core of socialist economic integration, are based in any case on analyses and prognoses aiming at changing some existing conditions in the countries involved in a certain project (e.g. the production structure, the infra-structure, the level and structure of research and development, education or vocational training etc.). Hence it follows that factors determining the labour productivity and costs of production will change in the result of these measures of international division of labour and that comparisons based in the first line on the existing conditions within the countries

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(64) Ibid, p. 79 ff.



concerned would lead to wrong decisions with regard to social and economic progress within each of the participating countries as well as to evening out the still existing differences as to the economic development level.

In practice, the process of calculations and decision - making in projects of international cooperation and specialization is carried out in two ways. On the one hand, joint groups of specialists are preparing calculations from the point of view of the project as a whole, taking into consideration the changing, dynamic conditions in all the participating countries. On the other hand, each country prepares its own calculations and proposals, aiming at promoting the national economic development strategy as a whole including the optimal exploitation of comparative advantages in favour of maximizing the long-term growth of the national income and balancing the manifold effects of the project concerned on various branches or spheres of the national economy (65) in a comprehensive manner .

This procedure will result in most cases in different variants for solving a certain problem. Starting from these different national variants and the afore mentioned joint calculations, in an iterative process of negotiations, including necessary compromises, definite agreements will be achieved, leading to decisions in the national economic planning of the countries concerned and to commercial contracts between the responsible organizations or enterprises.

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(65) See in detail: J.F. Kormnow "Specialization and cooperation of production of CMEA countries", Die wirtschaft, Berlin GDR, 1974 p. 162 ff, G.Grote "Economic Integration and Industrialization, paper submitted to the Regional seminar of UNIDO/J.N.P. Cairo December 1978, p. 27.



Under the present conditions of the system of planning management within the CMEA countries and the mechanism of integration on the international level, such a procedure is considered the most appropriate method for connecting national and international interests in socialist economic integration, for supporting the further equalization of the level of economic development and for avoiding negative effects of a possible unequal exchange<sup>(66)</sup>.

Summarizing, we may conclude that the close connection and interrelations between national economic planning and international co-operation in planning among CMEA countries create favourable conditions and possibilities in principle for exploiting comparative advantages, predominantly dynamic in character, in favour of the individual member countries and the integrating community as a whole as well. At the same time, there exists some difficult problems connected especially with determining and measuring comparative advantages and with ensuring a just distribution of the outcoming effects according to the principle of mutual advantage in general and the equalization of the economic development level between the integrating socialist countries in particular.

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(66) As we mentioned before, this problem of "unequal exchange" goes far beyond foreign trade and is effected by various elements of international economic relations in their complexity.



4. Some specific problems connected with using comparative advantages in socialist countries.

As we mentioned before, contrary to the western theory of foreign trade, under socialism comparative advantages are not considered the decisive force determining the structure of production, export and import more or less automatically or spontaneously. Instead, they are integrated in the whole system of planning the development of the national economy in general and of foreign trade in particular. Hence it follows that the possible or probable effects of comparative advantages have to be calculated and used in balancing and optimizing within the procedure of long-medium-and short term planning and that high requirements have to be met as regards the accuracy of these calculations differing as to the level and the time horizon of planning<sup>(67)</sup>.

Apart from much progress and good results achieved up to now in this field in theory and practice of socialist countries, there are some problems, especially related to measuring the effects of foreign trade, which are not yet solved satisfactorily and are subject to respective discussions among economists.

In the following we shall deal with some selected questions:

A first problem concerns the accuracy of calculations within the countries concerned with respect to the efficiency of foreign economic relations in general and comparative advantages of foreign trade in particular. Apart

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(67) See in detail: G. Grote "Foreign trade planning" Memo. No. 1220 at the Institute of National Planning, Cairo, 1978.



from some general methodological questions connected with the procedure of project evaluation in any case, (e.g. coovering the complexity of a certain project including interrelations between some branches, assessing the development of costs, internal and external prices, in their dynamics for 8 10 years ahead etc). There exists some specific difficulties resulting from the procedure of internal price formation. Because of deviations between national values and prices according to the existing regulation of price formation, there arises certain problems with regard to comparing the efficiency of the export or import of different commodities, aiming at evaluating comparative advantages. In some CMEA countries special methods are applied for this purpose, replacing or correcting the national prices<sup>(68)</sup>.

Another question is related to the afore mentioned task of assessing variants of certain projects of international industrial cooperation from the point of view of all the countries involved. In this case the evaluations of the efficiency of such projects as a whole and of comparative advantages of the participating countries are complicated in addition to the already mentioned problem of national pricing within the individual countries by some existing methodical differences in assessing costs and prices between CMEA countries and by some up to now unsatisfactorily solved problems in the field of using the exchange rates for comparing the national currencies. In practice, special methods are applied in order to overcome these difficulties<sup>(69)</sup>.

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(68) Ibid, p. 18 ff; "Efficiency of foreign economic relations of the socialist national economy" Die wirtschaft, Berlin, GDR. 1977.

(69) J.F. Kormnow, "Specialization ..," op. cit., p. 162.



Last but not least, comparative advantages in foreign trade and the distribution of the resulting effects between the socialist countries are influenced by the level and the structure of CMEA contract prices, deviating both from the actual international prices on the world capitalist market as well as from the internal prices within the countries of this integrating community. They aim at guaranteeing mutual advantages for the partners concerned according to the principle of "equivalent exchange" and at promoting the economic integration among these countries<sup>(70)</sup>.

At the time being, the CMEA contract prices are formed on the basis of average world market prices (of a period five years) on the main commodity market concerned. They are characterized among other things by a high degree of stability and they are involved in the planning within the CMEA countries and in the international cooperation in planning. Unlike prices on the world capitalist market spontaneous, speculative and cyclical factors are eliminated. In addition to the average world market prices the conditions of producers and exporters of the CMEA countries play a certain and steadily increasing role, too. In some cases, for instance in price formation for parts and sub-assemblies in the course of specialization and cooperation of production, costs of production within the partner countries are already the decisive factor.

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(70) See in detail" G. Grote "Economic Integration ..." op. cit, p. 61-66.



From the historical point of view, the present system is a transitional one, and there is a tendency towards a growing role of the conditions of production and consumption within the CMEA member countries in the formation of prices for the intra-area trade, with adequate consequences for comparative advantages and the distribution of the effects of foreign trade between socialist countries.