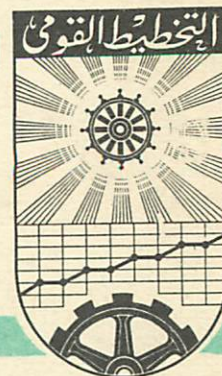


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Comparative Advantages
in
Foreign Trade

By

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Comparative Advantages in Foreign Trade

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.⁽¹⁾ 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⁽²⁾.

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,

(1) See: H.Hesse "Foreign Trade-Determinants", Hand-Dictionary of Economic Sciences, Gustav Fischer Publishers, Stuttgart and New York, 1977.page366.

(2) See: G. Kohlmey"Comments on the theory of comparative advantage in foreign trade", in International Economicsand 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 19th 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.⁽⁶⁾

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:

seHEME 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
Ecgland	120	100	220
	200	190	390

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

(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, including 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 19th century in connection with elaborating this theory was a progressive action at that time. There are some rational elements in the theory of comparative advantage to be recognized in any case (8) :

(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. ⁽⁹⁾ 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).

(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).

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