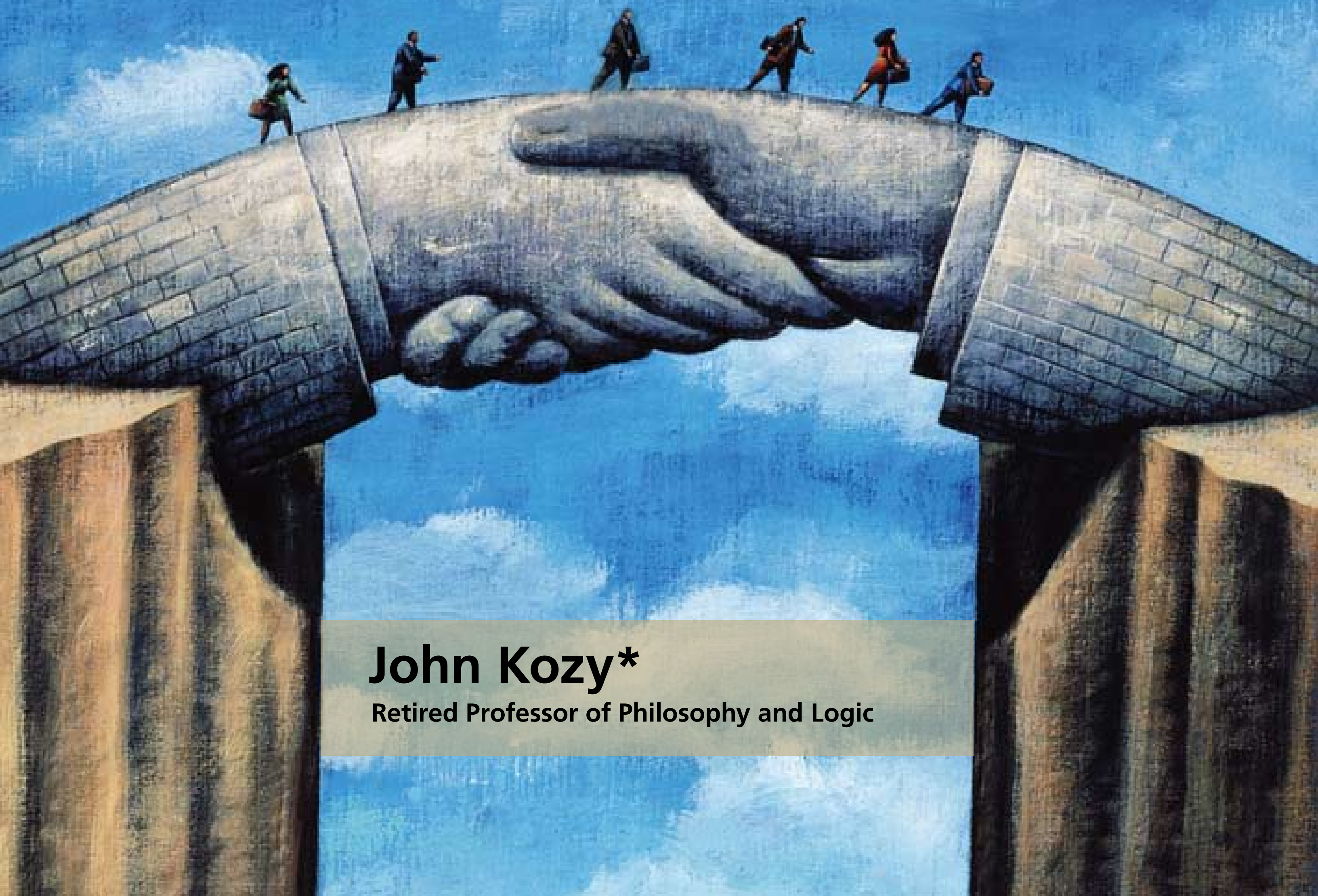
Murky Economics—Comparative Advantage & Free Trade Theory



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Economics is adrift in a sea of murky concepts, one of which is free trade. This murkiness arises from two practices common to economists—commission of what I call the fallacy of excessive generalization and imprecisely defined terms.

Consider the principle of comparative advantage. The number of problems with this "principle" is legion, and numerous economists have attempted to amend and extend it. All the problems and emendations have been discussed extensively in economic literature. One writer, Steven M. Suranovic [*http://internationalecon.com/Trade/Tch40/T40-0.php*], has reduced comparative advantage to an almost useless hypothetical claim about merely possible results:

"The usual way of stating the Ricardian model results is to say that countries will specialize in their comparative advantage good and trade them to the other country such that everyone in both countries benefit. Stated this way it is easy to imagine how it would not hold true in the complex real world.

A better way to state the results is as follows. The Ricardian model shows that if we want to maximize total output in the world then, first, fully employ all resources worldwide; second, allocate those resources within countries to each country's comparative advantage industries; and third, allow the countries to trade freely thereafter.

Subjunctive expressions would at least be honest, as they would imply that economists were unsure of validity

In this way we might raise the wellbeing of all individuals despite differences in relative productivities. In this description, we do not predict that a result will carry over to the complex real world. Instead we carry the logic of comparative advantage to the real world and ask how things would have to look to achieve a certain result (maximum output and benefits). In the end, we should not say that the model of comparative advantage tells us anything about what will happen when two countries begin to trade; instead we should say that the theory tells us some things that can happen."

Yes, I know. Mr. Suranovic is just one economist, perhaps not even a good one. But that's the point. There is no precisely defined Principle of Comparative Advantage that all economists point to; it has been propounded, amended, extended, revised, and even adorned. Attempts to refute it can be likened to shooting at shadows. But the principle has two features that appear to be universal.

First, to determine that one country has a comparative advantage over another in the production of a specific product, a comparison of its costs of production in both nations is required. Look at what Ricardo writes:

"England may be so circumstanced, that to produce the cloth may require the labour of 100 men for one year; and if she attempted to make the wine, it might require the labour of 120 men for the same time. England would therefore find it her interest to import wine, and to purchase it by the exportation of cloth.

To produce the wine in Portugal, might require only the labour of 80 men for one year, and to produce the cloth in the same country, might require the labour of 90 men for the same time. It would therefore be advantageous for her to export wine in exchange for cloth."

Notice that Ricardo has no idea of how much labor of how many men is required to produce anything anywhere. Count the modal verbs. Three 'mights' and one 'may' which grammatically should have been another 'might.' The two paragraphs are couched in the subjunctive mood which, in English, implies unreality, doubt, and uncertainty. Now "how much labor of how many men" is, in principle, a simple calculation. It merely requires some counting. But even today, can anyone say with certainty how much labor of how many men is required to produce rice in any nation?

Perhaps all economists should express their principles in the subjunctive mood just as Ricardo does. Such subjunctive expressions would at least be honest, since they would imply that economists were uncertain of the validity of their models. But even Ricardo isn't consistent. When he writes, "England may be so circumstanced, that to produce the cloth may require the labour of 100 men for one year; and if she attempted to make the wine, it might require the labour of 120 men for the same time," he should have concluded that England might therefore find it her interest to import wine, rather than England would therefore find it her interest. But "might find it in her interest" is a weaker conclusion than "would find it in her interest." Could free trade be sold to

people by claiming it might lower prices?

Someone is sure to point out that the passage can be rewritten with conditional sentences that eliminate the modal verbs. True. Consider these:

"If producing cloth in England requires the labour of 100 men for one year, and if producing wine requires the labour of 120 men for the same time, it is in England's interest to import wine and to purchase it by exporting cloth.

If producing wine in Portugal requires only the labour of 80 men for one year, and producing cloth requires the labour of 90 men for the same time, it is in Portugal's interest to import cloth and to purchase it by exporting wine."

The advantage is derived from the increased production of cloth when the labor of the 120 men spent on producing wine is transferred to producing cloth. The argument implies nothing about how much the imported wine will cost. What lowers the price? Applying the law of supply and demand, which requires a number of assumptions.

One of the most difficult aspects of economic analysis is how to interpret the conclusions of models and frameworks

One is that Portugal reciprocates in this arrangement and devotes its cloth making resources to wine making, and another is that the demand for wine stays relatively constant. If Portugal chooses not to move its cloth-making resources to winemaking, the supply of wine doesn't increase. What if Portugal simply can't increase its production of wine? Wine, after all, is made from grapes which don't grow well everywhere. Then the added English demand for Portuguese wine increases the demand while the supply remains constant which raises prices.

Now put a third country into the mix. Suppose Sweden finds itself in exactly the same position as England. Sweden stops making wine to produce cloth. Now the demand for Portuguese wine is even greater. There is nothing in free trade theory that makes lower prices necessary or even certain.

Subsequently, economists replaced "how much labor of how many men " by "opportunity costs." But opportunity costs are much more difficult to compute. Look at how the concept of opportunity cost is defined: the amount of one product that must be given up in order to produce one more unit of another product. But how many phone calls to an Indian call center must be given up for Indians to produce one more pound of hak? And how many pounds of hak must be given up by Americans to get one more call to an American call center? Is the example facetious? I think not. How many American made automobiles must be given up to produce one more two-story home? Who knows? Does it matter where the automobiles and homes are built? Would opportunity cost be the same in California and Connecticut or Kerala and Bihar? Would the opportunity cost be the same if the workers producing automobiles were unionized and those producing houses were not or vice versa or both? Can opportunity costs be manipulated? Economists avoid these questions merely by making more assumptions.

Opportunity costs are assumed to be constant; they never change. No limits on production exist. Full employment exists in both countries at all times. All factors of production are mobile within countries but are immobile between them. Pricing mechanisms maintain perfect competition. Can we ask whether the cloth producers in Portugal are lazier than the wine producers? No. Labor is assumed to be equally productive everywhere. All this assuming is very neat, but it's a sham. Has anyone ever seen an analysis of data that shows that the Chinese have a comparative advantage over the United States in the production of the plethora of products that Americans import from China? Why not? If the comparison of how much labor of how many men is required (or the opportunity costs) can't be carried out, the principle of comparative advantage has no applications and is entirely useless. But as useless as it is, economists venerate it. Consider this passage:

"[O]ne of the most difficult aspects of economic analysis is how to interpret the conclusions of models. Models are, by their nature, simplifications of the real world and thus all economic models contain unrealistic assumptions. Therefore, to dismiss the results of economic analysis on the basis of unrealistic assumptions means that one must dismiss all insights contained within the entire economics

discipline. Surely, this is not practical or realistic. Economic models in general and the Ricardian model in particular do contain insights that most likely carry over to the more complex real world [*http://internationalecon.com/Trade/Tch40/T40-0.php*]."

This passage, in its entirety, is a non-sequitur. Even if models are simplifications of the real world and contain unrealistic assumptions, it does not follow that one must dismiss all insights contained within them unless there are none. After developing the model, a competent model builder would then analyze it assumption by assumption, asking what happens if this assumption is false, what happens if that assumption is false, what happens if the first and second assumptions are false, and so on until s/he asks what happens when all of the assumptions are false. Only then could one see which, if any, insights are revealed by the model. Why would rejecting all insights contained within the entire economics discipline not be practical or realistic if there are no valid insights? And to conclude that the Ricardian model contains insights that most likely carry over to the real world is pure unjustified opinion. How would anyone ever determine its likelihood?

In cuisine, proof is in the pudding. In economics, the proof is in the recipe regardless of how rank the pudding tastes

Building models on assumptions that may or may not be true is one thing. Such models may apply to the real world. But building models on assumptions that can never be true is another. These models are never applicable to the real world.

Economists are a curious bunch. In cuisine, the proof is in the pudding. In economics, the proof is in the recipe regardless of how rank the pudding tastes. Paraphrasing Dani Rodrik, when economists are taken to task for ignoring real world complications, they argue that the presence of market imperfections does not change the model's logic. He's right, but they change the model's outcome, and that's what's really important. People don't care about theory, and a logical principle, named modus tollens, affirms that if the consequent of a conditional argument is false, the antecedent is false. So when economists apply a model and the predicted results don't ensue, the only logical conclusion is that the model's premises are surely false.

Second, the principle of comparative advantage relies on a generalization so extensive its generalized term has no denotation. It is a term without meaning.

You see, only winos (alcoholics) drink wine! The rest of us drink Asti, Beaujolais, Bordeaux, Burgundy, Cabernet Sauvignon, Chablis, Champagne, Chardonnay, Chianti, Fynbos, Jerez, Kalecik Karası, Luján de Cuyo, Madeira, Merlot, Moselle, Pinot Gris, Port, Pouilly Fuisse, Riesling, Sake, Sangiovese, Sauternes, Sherry, Tempranillo, Valpolicella, Vinhos Verdes and scores of others. Why Ricardo chose wine is a mystery. Perhaps he was a wino and really didn't care about flavor, aroma, dryness, and body. Or perhaps he chose wine because the English were and still are not very good at making wine. Would the French be willing to give up Beaujolais for Port or the Japanese be willing to swap Sake for Vinhos Verdes?

Someone will say it's just an example. But generalize on any product. Automobiles, tomatoes, potatoes, chairs, whatever. The only products made worldwide that are identical are factory produced according to precisely defined specifications and sometimes even those vary. These products can be made just as easily in Chad as in China. There is no reason to believe that people in Bongor are any less dexterous than people in Beijing.

Statements like the following are often found in the literature:

"The magic of comparative advantage is that everyone has a comparative advantage at producing something. The upshot is quite extraordinary: Everyone stands to gain from trade. Even those who are disadvantaged at every task still have something valuable to offer. Those who have natural or learned absolute advantages can do even better for themselves by focusing on those skills and buying other goods and services from those who produce them at comparatively low cost. [*http://www.econlib.org/library/Topics/Details/comparativeadvantage.html*]"

Now, just ask, how could anyone know the first sentence's claim? Is it simply impossible that someone somewhere can't do anything at all? How can anyone justify a claim that such an impossibility exists? And how does everyone stand to gain from trade just because they can buy things at

comparatively (compared to what) low cost? If just one person loses his income or his life because of trade policy, the statement about everyone is false. The sentence isn't even true if the word 'gain' is modified by 'financial.'

So if it cannot be shown with certainty that one nation has a comparative advantage over another in the production of some product, then no one can be certain that any predicted benefits from basing trade on a comparative advantage will ensue. If free trade can't be based on comparative advantage, it must be based on some other kind of real, contrived, assumed, or imagined advantage, not comparative advantage.

Free trade, when reduced to its simplest form, means nothing but trade not restricted by protectionist practices. But "protectionist practices" is another ill-defined, murky concept. Consider these scenarios:

Two countries, Us and Them, each produce a product named a domock. Us is a highly developed nation that has implemented many economic regulations to protect its people from injury, exploitation, and fraud. Them is an underdeveloped nation with no economic regulations. Manufacturers in Them can export domocks to Us and sell them for one curr each. Manufacturers in Us can sell domocks for two currs each. So what can Us do?

Leaving aside the possibility that Us might simply allow its manufacturers of domocks to go out of business, only three unique alternatives exist: Us can impose a tariff of one or more currs on each domock imported (a protectionist practice), can subsidize its domock-manufacturers so they can reduce the price to one curr (another protectionist practice), or eliminate the protective regulations that cause the price of domocks to be two currs. Free trade advocates do not consider this last alternative protectionist, and it is the alternative they advocate.

But why is the third alternative not just as protectionist as the first two? All three are done for the same reason and produce the same result. How can anyone justify calling the first two protectionist and the third not?

Only one answer to the question exists, and it is trivial. Free trade is often defined as a trade policy that allows traders to act without having to deal with governmentally imposed regulations. Since the first two alternatives involve regulations and the third does not, the first two are protectionist and the third is not by definition alone. But logically, a thing is what it is and not another thing. If some horticulturalists decide to define orchids as adornments and not flowers, would orchids no longer be flowers? A name does not make something what it is; its attributes do. Remember the adage, if it looks like a duck, squawks like a duck, and walks like a duck? But if all three alternatives are essentially the same, free trade theory collapses into utter nonsense.

In 1913, V. I. Lenin published an article in Pravda titled, Who Stands to Gain? Regardless of opinions of Lenin or Leninist-Marxism, this question is a useful analytical tool when evaluating policy proposals and was stated long before Lenin by the Romans (cui prodest?). Unfortunately, it is asked far too infrequently. If free trade policy were implemented worldwide and all protective regulations were eliminated, who would stand to gain? Merchants certainly. But what about the rest of us?

If free trade policy were implemented worldwide and all protective regulations were over, who would stand to gain?

Well, suppose Them allows its manufacturers to employ child labor. Us then eliminates it child-labor protections. Are the children better off just because they can now purchase domocks for one curr each? Suppose Them allows its manufacturers to use dangerous materials. Us then eliminates its restrictions on the use of dangerous materials. Are people better off being injured and poisoned just because they can now buy domocks for one curr? Suppose Them allows its manufacturers to place workers in dangerous circumstances where many are maimed and killed. Us then eliminates it regulations on unsafe workplaces. Are workers better off being injured and killed just because they can now buy domocks for one curr? Is anyone even financially better off? So who stands to gain? Just merchants?

To economists, incredibly, merchants are mostly Mr. Goodfellows. They don't lie to and cheat consumers. They don't overcharge. They never market products that don't work or that don't work as advertised. They don't market products that injure and sometimes kill and hide the fact

that these possibilities were known before the products were marketed. They don't write contracts with hidden fees buried in text that can be read only with microscopes or that coerce people into repudiating their legal rights. They never defraud clients, each other, or governments by submitting claims for work never done on governmental projects or for governmental programs. They don't profiteer in wartime. They don't corrupt public officials. In fact, most are veritable saints, and the few that aren't, those rotten apples, are plucked from the barrel of commerce by the invisible hand, because the market is self-regulating. But in reality, unregulated business exhibits all the characteristics of a criminal enterprise.

As a logician, if I were asked to prove that the market is self-regulating, the only effective proof that I could think of would be to list all the untrustworthy firms whose dishonest actions were restrained by trustworthy firms and then show that, at best, no or just a few untrustworthy firms have avoided this restraint. But no economist has ever developed such a proof, which means that either the market isn't self-regulating or that there are so few trustworthy firms that they lack the power to restrain the untrustworthy.

However, this debate on free trade is merely a diversion. The process of globalizing trade that has now gone on for several decades has nothing to do with comparative advantage or free trade theory. No nation has abandoned any industries, transferred the resources to industries making products for export, and used the exports to pay for the importation of the products previously made by the abandoned industries. The so-called "developed" nations, whose governments are controlled by commercial interests, have merely bought the idle labor and resources of "underdeveloped" nations for skimpy sums and paid for them with fiat currencies that amount to little more than promissory notes. It remains to be seen whether the nations holding these promissory notes will ever be able to redeem them for value equal to that expended on the labor and resources used to manufacture their exported products. If not, these nations will find that they have been swindled just as the residents of the United States, Great Britain, and other nations who have lost their homes and savings have. The only confirmed result of globalized trade is the greatest transfer of wealth from the least wealthy to the most wealthy in recorded history.

The real issue is independence or dependence. Free trade advocates are attempting to convince governments worldwide to relinquish their control over their economies. It is an attempt by merchants to control all markets. If it succeeds, national governments will be irrelevant.

The real question that nations must answer is whom do they want to give control of their economies to? The alternatives are national governments, which are at least in some cases and in some sense responsible to their citizens, or powerful worldwide commercial interests who have to answer to no government and no people. Nations that were once colonies of Western imperialist countries should consider this question carefully. Although the yokes of past oppression may have been lifted, the interests that propelled imperial conquest were commercial and still exist, and the agendas have not changed. Only the methods of conquest have.

The question is not trade, but how and by whom it will be controlled. Trojan horses do exist and everyone is a protectionist

Trade between nations will not cease if free market theory is completely debunked. Everyone, as I have argued above, is a protectionist; everyone seeks to protect something—people their lives, merchants their profits, consumers their protections, laborers their jobs, nations their wealth and power. The question is not trade, but how and by whom it will be controlled. So I would suggest that the world's governments should beware economists bringing promises of prosperity based on utopian theories on behalf of merchants. Trojan horses do exist. IER

(The views expressed in the article are personal. The author is a retired professor of philosophy and logic who blogs on social, political, and economic issues. After serving in the U.S. Army during the Korean War, he spent 20 years as a university professor and another 20 years working as a writer. He has published a textbook in formal logic commercially, in academic journals and a small number of commercial magazines, and has written a number of guest editorials for newspapers. His on-line pieces can be found on http://www.jkozy.com/ and he can be emailed from that site's homepage.)