

International Trade: Mainstream and Heterodox Perspectives

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Trade and Gender

1. Standard trade theory

- Both nations gain from trade
- Trade is automatically balanced for both
- Full employment is maintained in both
- Patterns of trade are determined by comparative advantage

Trade and Gender

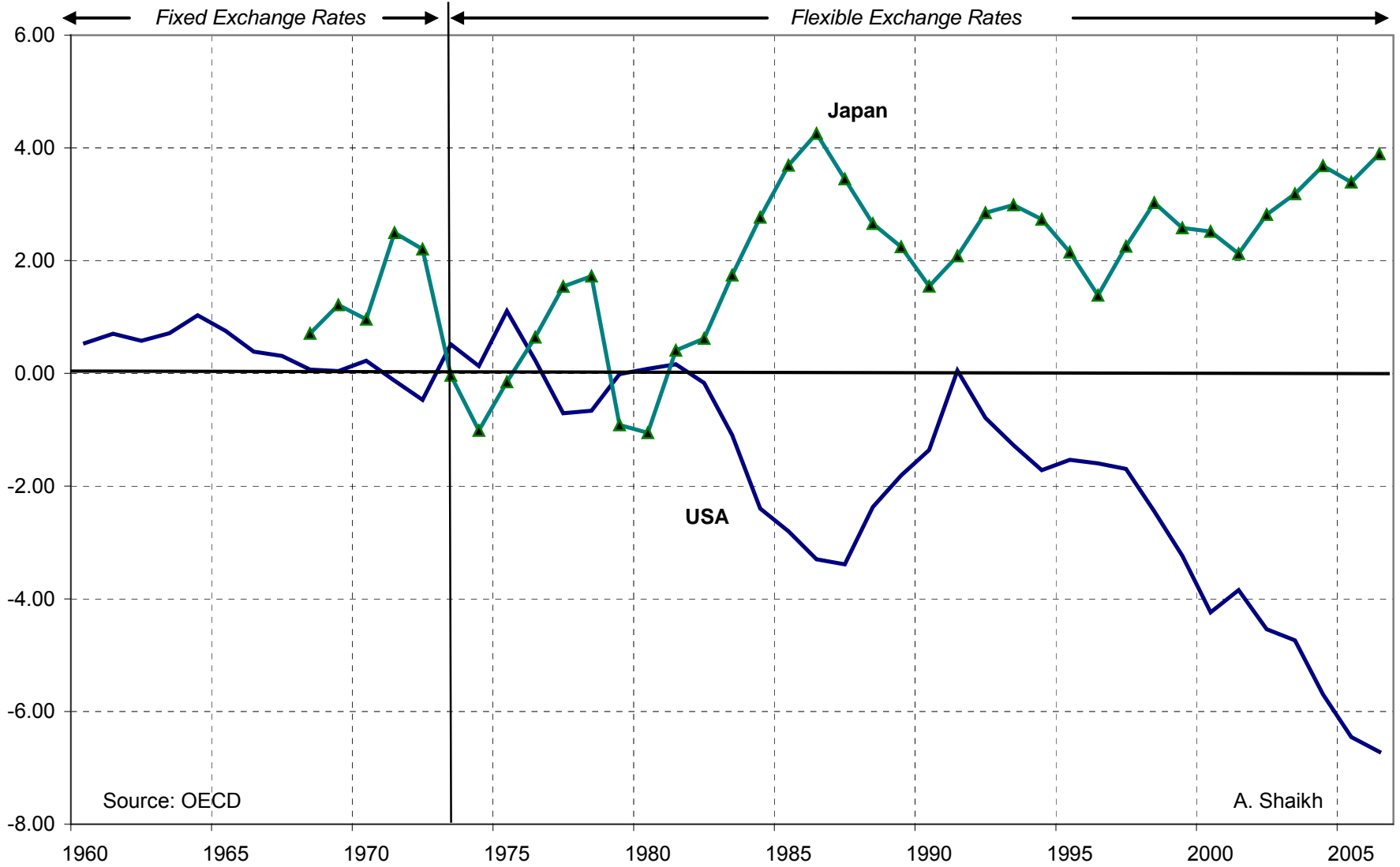
- If the developing country has a comparative advantage in unskilled labor activities, and if women are relatively concentrated in unskilled activities, then:
 - Trade will expand relative employment of women, and raise their wage relative to that of skilled labor (Bhagwati 2004, Elson 2007).

Trade and Gender

Historical Roots of Standard Trade Theory

- The key to the preceding predictions of standard trade theory lies in the theory of comparative costs
- Ricardo's derivation of comparative costs
 - International trade regulated by international competition among profit-seeking firms
 - Initial competitive disadvantages give way to final comparative advantages
- Neoclassical theory adds Full Employment
 - HOS assumes common production conditions

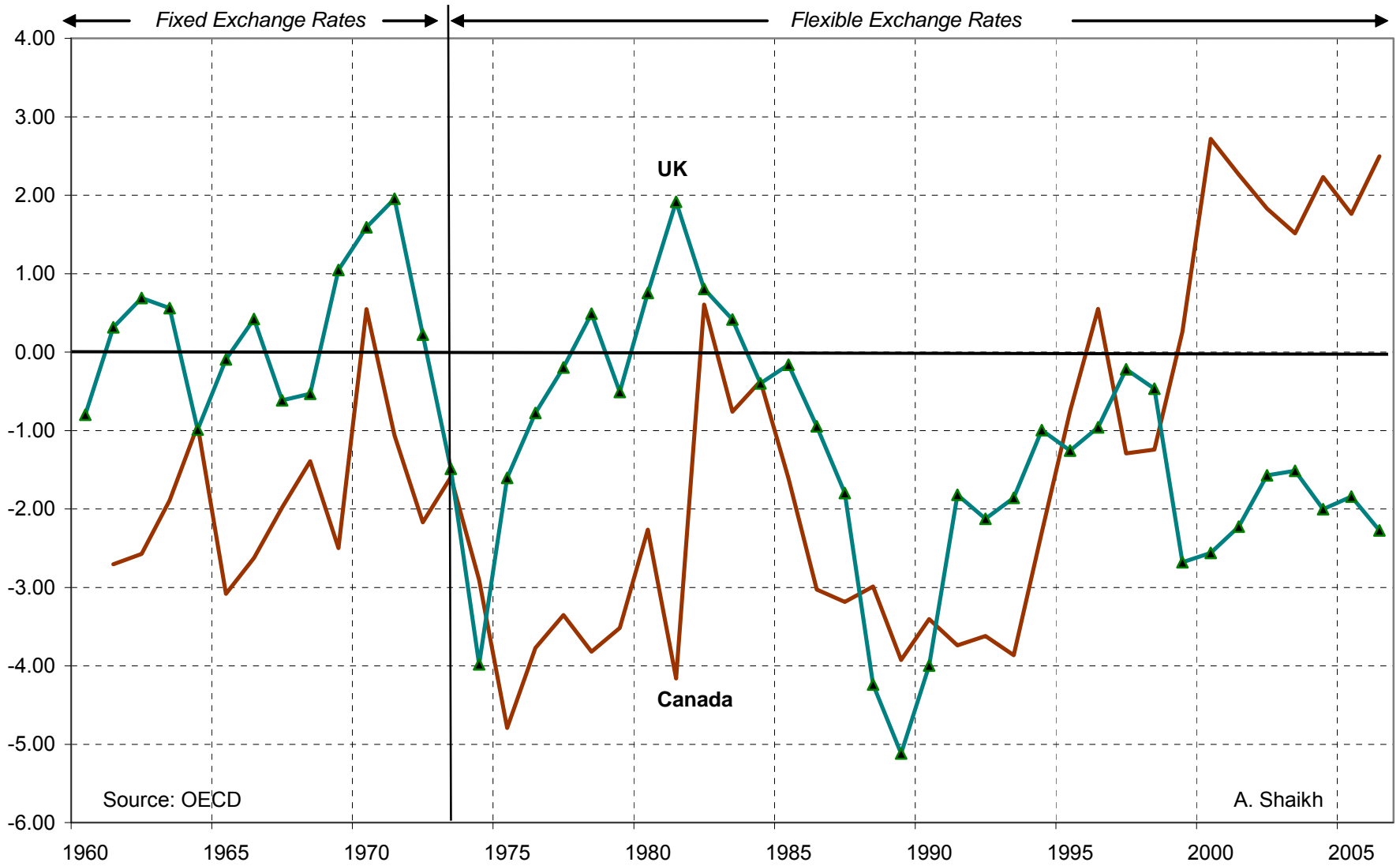
Balance of Trade as a Percentage of GDP



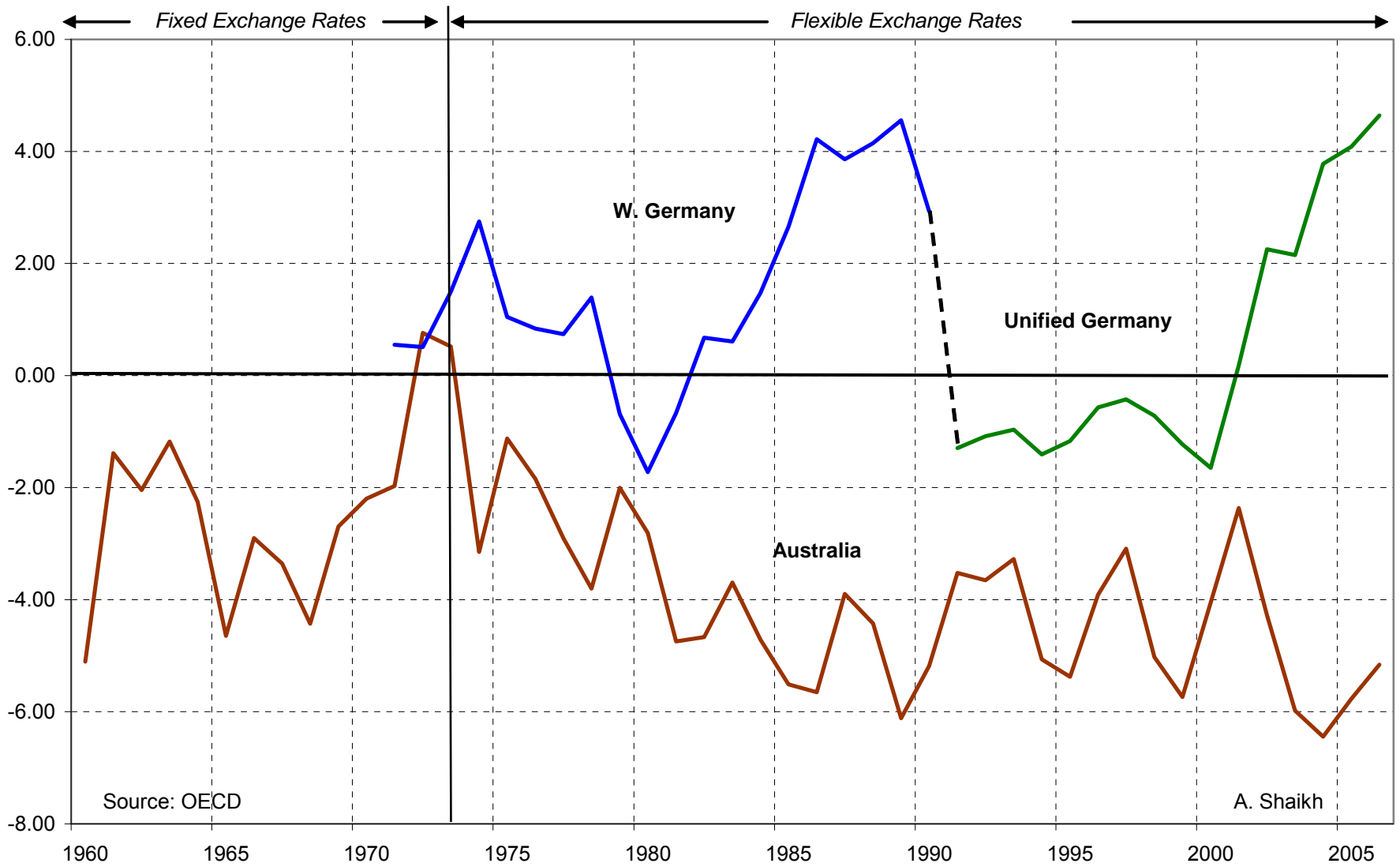
Source: OECD

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Balance of Trade as a Percentage of GDP



Balance of Trade as a Percentage of GDP



Source: OECD

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Note 1: Country A's prices in £'s are converted via the exchange rate into international currency (\$), while country B's are already in \$'s

Note 2: Hence in international currency (\$), Country A's prices are $p_{a1} = £10 * e$, $p_{a2} = £20 * e$, while Country B's prices are $p_{b1} = \$20$, $p_{b2} = \$30$.

Note 3: At the opening of trade at the initial exchange rate ($e = .5$), Country A has the lower international prices in both goods.

- i. According to Ricardo, the BOT surplus in Country A means that its exchange rate (e) appreciates
- ii. As the exchange rate (e) appreciates, the \$-equivalent of Country A's prices rise. But since country B's prices are already in \$, they do not change

Note 4: **The international regulating price in either sector (1 or 2) is the lower of the two country prices.** Switchover points are at the highlighted exchange rates.

Note 5: At the exchange rate $e = 1.5$ (£/\$) [highlighted], $(p_{a2})e = (£20)(1.5 £/\$) = \$30 = p_{b2} = 30\$$. This is the first crossover point

Note 6: At the exchange rate $e = 2$ (£/\$), $(p_{a1})e = (£10)(2 £/\$) \$20 = = p_{b1} = 20\$$. This is second crossover point.

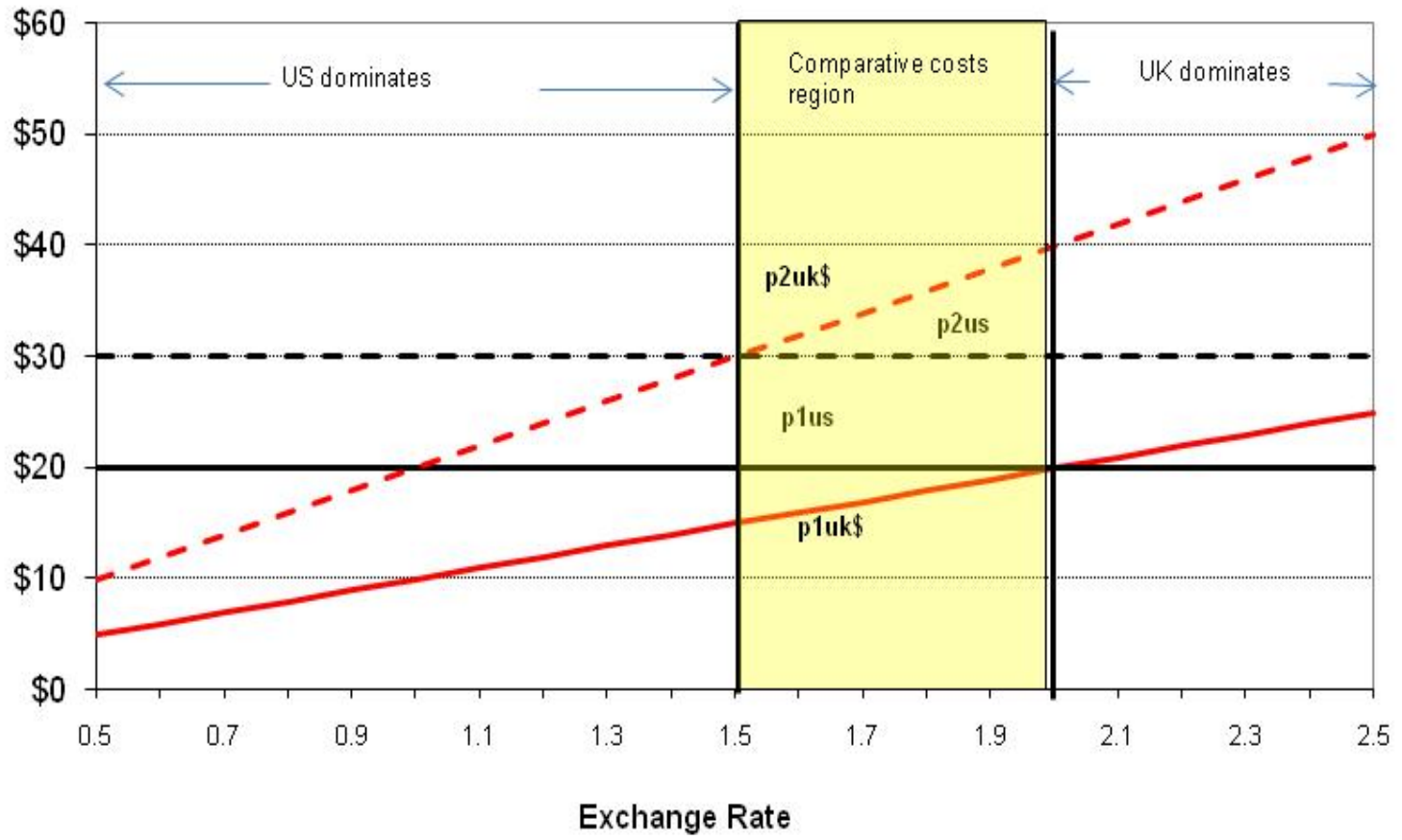
Note 7: According to Ricardo, the exchange rate will rise if a country has a BOT surplus and fall if it has a BOT deficit: hence it can only stabilize when $BOT = 0$

- i. But then the only feasible range of exchange rates is when each country has one regulating capital, so that each country can export one of the goods
- ii. The precise point within this feasible exchange rate range at which trade balances will then depend on export and import propensities in each country

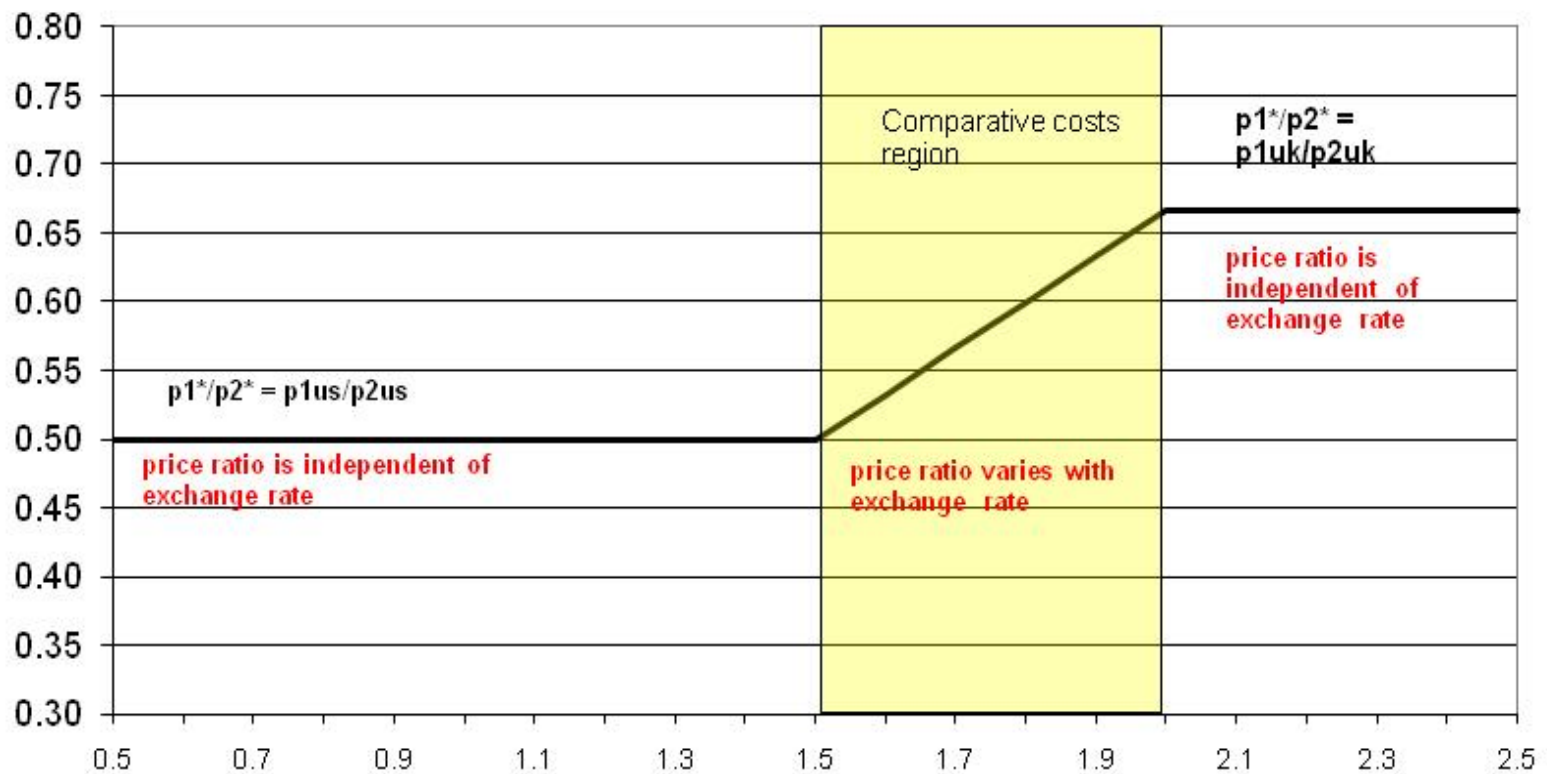
Note 8. When either country has both regulating capitals, its domestic price ratio determines the international price ratio: these are the regions of absolute cost advantage

- i. E.G. absolute cost advantage holds for Country A between for exchange rates below $1.5 £/\$$, and holds for Country B for exchange rates above $2£/\$$
- ii. However, the only feasible exchange rate range is when each country has one regulating capital
- iii. Hence in this range the international relative price is not determined by cost structures, but rather by the condition of balanced trade.
- iv. Such a range can only exist if the two countries have different initial price ratios, and within this range the trade balancing ratio will be between each country's initial price ratio
- v. Hence trade equilibrium, defined as $BOT = 0$, will always fall in the region of comparative costs

Potential International Prices at Various Exchange Rates



International Regulating Relative Price ($p1^*/p2^*$)



A Classical Theory of the Terms of Trade

- The key to the Ricardian story is the notion that the terms of trade will adjust automatically to make trade balanced
- As Ricardo notes, this implies that while *national* relative prices are determined by competitive costs, *international* relative prices (terms of trade) are *not* cost-determined
 - Rather, international relative prices are determined by the requirements of balanced trade

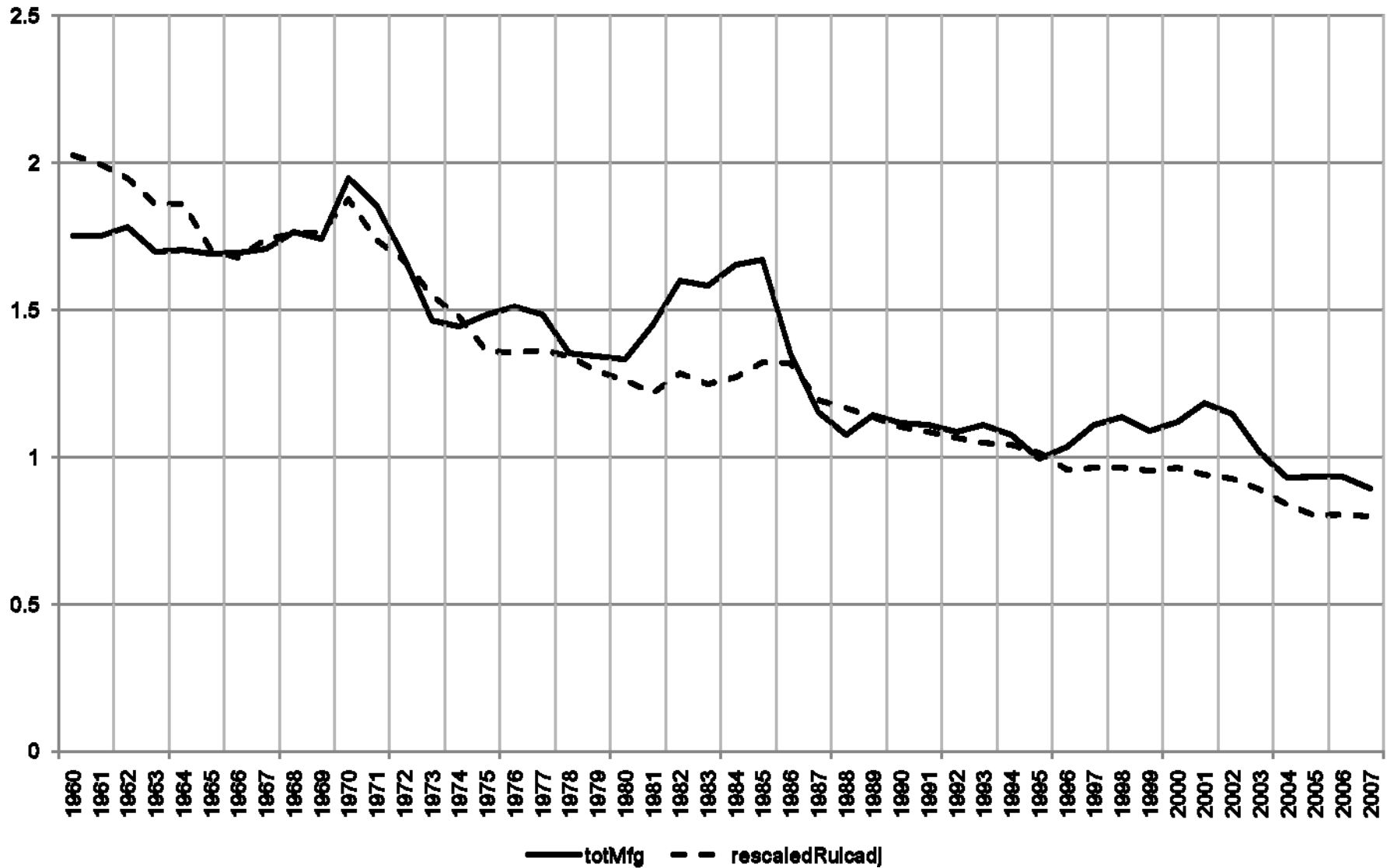
A Classical Theory of the Terms of Trade

- We have seen that the empirical evidence does not support the comparative cost theory of trade
- One reaction has been to emphasize that it is oligopoly and monopoly power that regulates trade, not competition
 - Hence a focus on imperfect competition
- But I want to argue that this is wrong: the problem lies in the how international competition is portrayed

A Classical Theory of the Terms of Trade

- The flaws in Ricardo's argument
- Quantity theory of money is wrong
- Feedback effect on costs is crucial

Real Exchange Rate vs. Adjusted Relative Real Unit Labor Costs
 (the two scaled to match in 1965-69, which is a BOP equilibrium: Yeager 1976, Table 27.1, p. 68)



**Table 2. Level of industrialization
(manufacturing output per capita), 1800-1913**

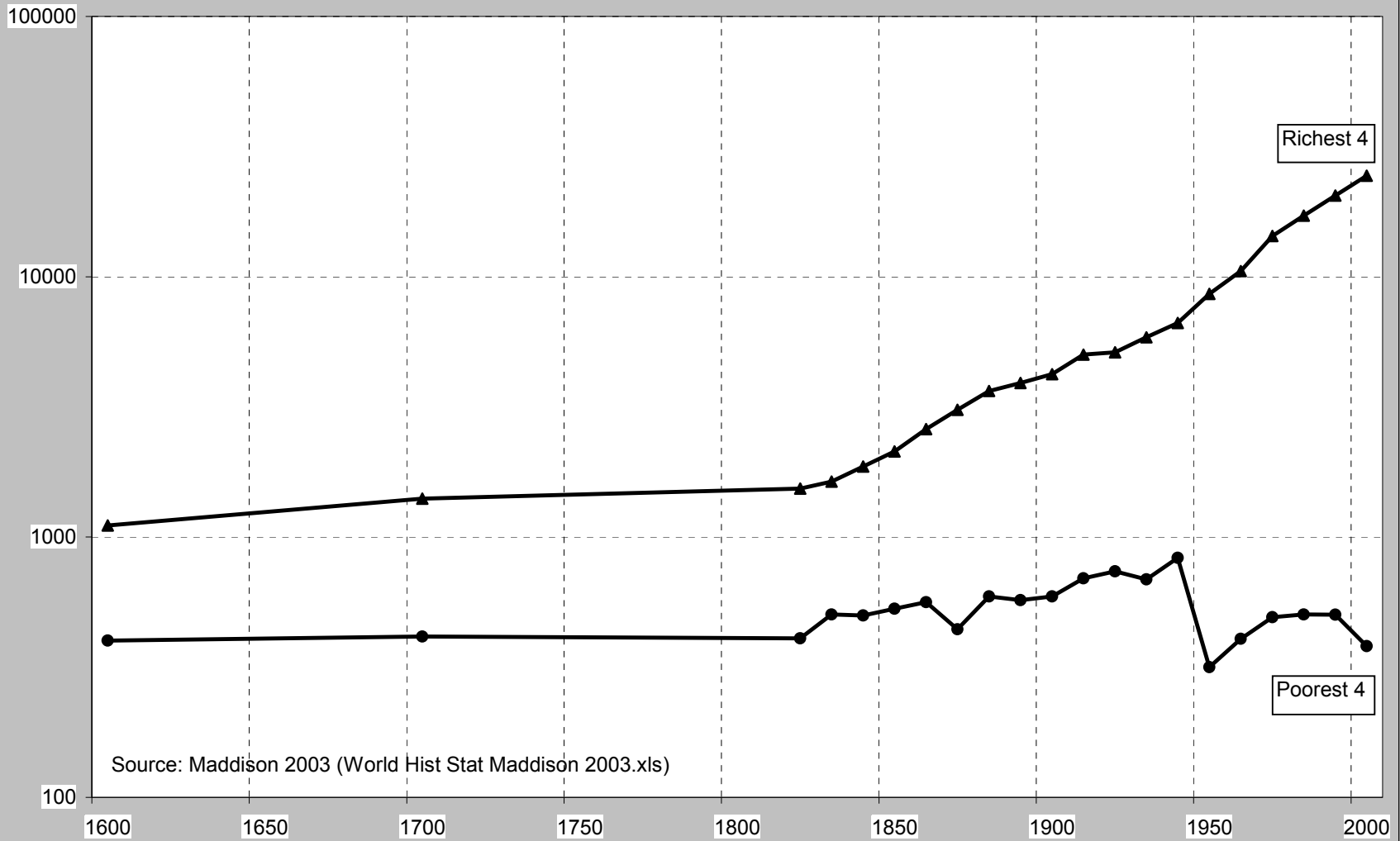
(UK 1900=100)

	1800	1830	1860	1880	1900	1913
Total developed countries	8	11	16	24	35	55
Total Third World	6	6	4	3	2	2
<u>Memo</u>						
United Kingdom	16	25	64	87	100	115
United States	9	14	21	38	69	126

Source: (Bairoch 1977, volume 1, p. 404, as reproduced in Milanovic 2002, p. 12)

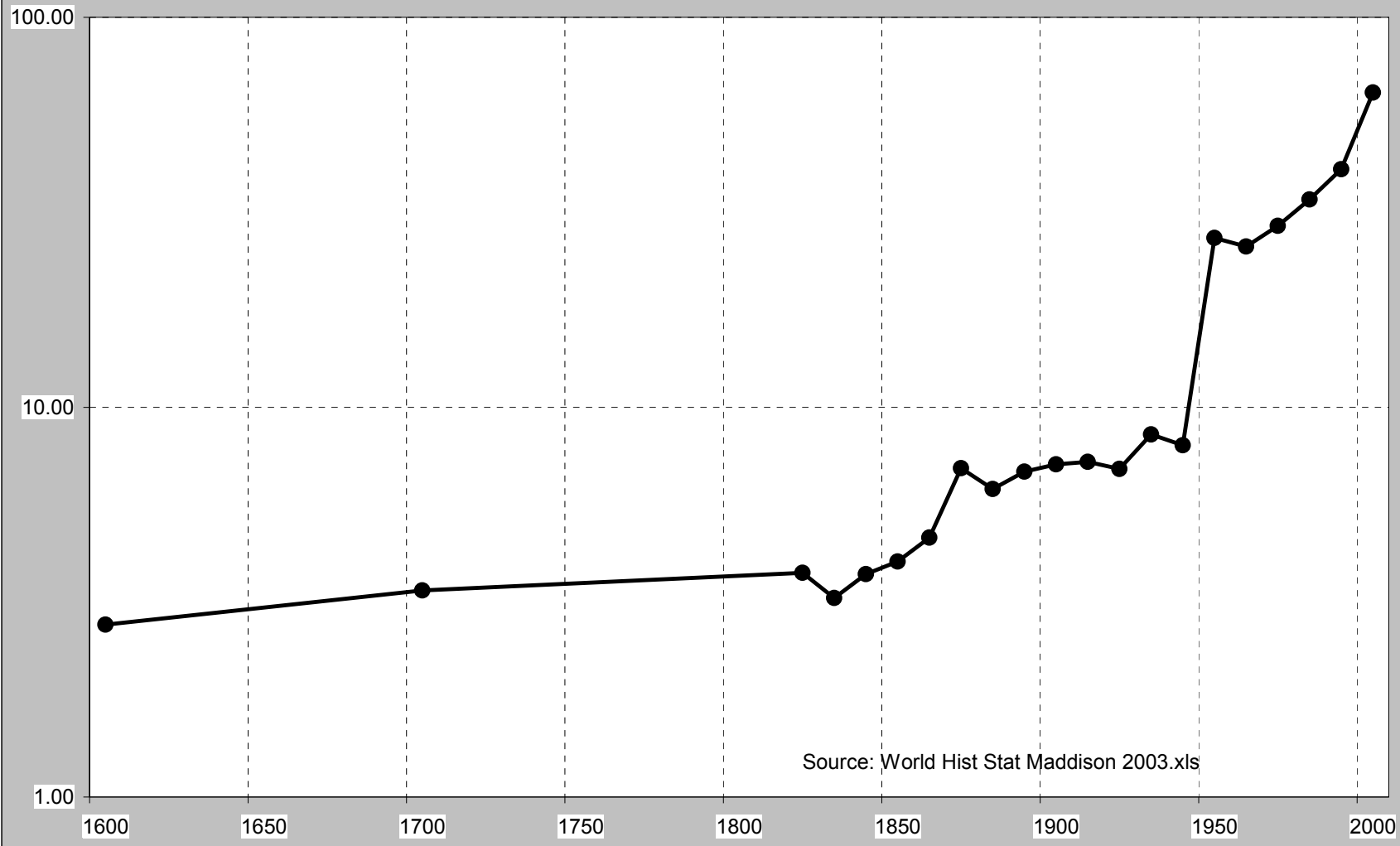
Figure 1.20a: GDP Per Capita Richest 4 and Poorest 4 Countries

1990 International Geary-Khamis dollars (log)



Source: Maddison 2003 (World Hist Stat Maddison 2003.xls)

Figure 1.21: Ratio of the GDP Per Capita of the Richest 4 Countries to the Poorest 4



Source: World Hist Stat Maddison 2003.xls

**Figure 2: VMIR (Per Capita Vast Majority Income relative to GDP) by Country
2000 or closest**

