Who Gains from Global Trade?
Student Handout

The issue of trade, who gains, and whether the poorer countries of the world can ever trade their way to a better economic position is a topical and hotly contested one. Next week the trade negotiators of the world's countries and trading blocs meet for negotiations to try to agree the basis on which they exchange goods and services.

Peter Mandelsohn, who is negotiating on behalf of the European Union, argues that a new trade deal will help the poor countries to trade their way out of poverty:

'It could give Least Developed Countries a new foothold in the booming markets of the rapidly growing economies. We should never forget that a 1% increase in African global market share would be worth many times more than what you currently receive in aid.'
Speech to African leaders on 29 February 2008

But former US President Bill Clinton is concerned about the effect of global free trade (especially from China) on the US economy. According to the news agency Reuters (10 March 2008):

Clinton, with strong backing from U.S. organised labour, has advocated a 'time out' in trade liberalisation and questioned whether the theory of comparative advantage that underpins free trade still applies in the 21st century.
Reuters, 10 March 2008

What is the Theory of Comparative Advantage?

So what does Clinton mean by 'the theory of comparative advantage'? The conventional economic defence of free trade is based on the Theory of Comparative Advantage, first written down by David Ricardo in 1817. It was made in contrast to Adam Smith's theory of absolute advantage, which suggests that if a country can produce one good more efficiently than another country it would gain economically if it concentrated its efforts on its best good and trade it with the other country for goods that country produced more efficiently. This is intuitively reasonable. The next step is to argue that, even if one country produces everything less efficiently than its neighbour, it is still best placed to concentrate on the good it, itself, produces most efficiently and trade for other goods with its neighbours.

As with all economic theories the Theory of Comparative Advantage is based on a series of assumptions. We will discuss in the session how many of these are still—or ever were—realistic.

Assumptions:

- Labour is the only 'factor of production' included in the model
- Labour is identical within the country but always different across countries
- Labour be reallocated costlessly but cannot move between countries
- Labour is always fully employed, i.e. there is no unemployment
- Goods are assumed to be interchangeable, i.e. one country's computers are as good as another's

- Goods can be transported costlessly
- There are technological differences between countries

Additional flaws include:

- The model cannot account for the far higher volume of trade and speed of transport of the modern economy
- The model is based on only two countries
- The impact of climate change and peak oil are not considered

Whose Advantage is it Really?

Colin Hines argues that, in the contemporary world, there are three major reasons why the theory no longer holds—he calls these the 'three Cs'. They are competition, control and climate change.

Competition: In reality the free trade regime has led to what is sometimes called the 'race to the bottom'. The poorer countries compete with each other to reduce the prices of their goods, which they achieve by having lower wages and lower environmental standards. Sri Lanka has lost out in the garment competition with Vietnam and China and has had to develop tourism instead. The removal of mangrove swamps to create tourist beaches was part of the explanation for the devastation the Boxing Day tsunami caused there.

Control: Because the wealthy nations control the trade game, the poorer countries do not get richer in spite of exporting more: an increase of more than 40 per cent in the quantities they exported between 1997/8 and 2004/6 brought virtually no increase in what they could buy with the proceeds. This is the result of the international trade game, where countries that control reserve currencies and have military and diplomatic power control the trade negotiations and benefit increasingly from the growing volume of trade. Those who export commodities come under ever more pressure.

Changes in the Terms of Trade of some Country Groups, 1980-2 to 2001-3

Group	*Annual average 1980-2*	*Annual average 2001-3*	*% change*
Developed economies	95.7	103.3	+7.9
Developing economies	117.3	97.7	-16.7
Developing economics: Africa	131.7	100.0	-24.1
Least developed countries	144.0	93.3	-35.2
Landlocked countries	114.7	96.3	-16.0
Sub-Saharan Africa	124.0	98.3	-20.7

Source: Data from UNCTAD; calculations in Lines, 2008.

Climate change: The era of globalisation has come as a result of cheap oil—this era is coming to an end. In addition, the transport of goods across the world at virtual no economic cost has created a vast environmental cost in terms of carbon dioxide emissions. The price of creating those emissions is going to increase, meaning that trade cannot continue in the same volumes.

Even when countries gain from trade the gains are not equally shared. A report from the UN trade body showed that in nine out of ten countries in Latin America the pay gap between skilled and unskilled workers increased as a result of freer trade. In fact, the least skilled workers actually ended up poorer. An ILO study of 30 poorer countries found that in two-thirds of them real wages fell when there economies engaged more in global trade, and with the unskilled wages falling most.

What About the Politics?

Ricardo based his argument on two goods in which the UK and Portugal obviously have absolute advantages—wine and woollen cloth. During a recent trip to Lisbon I realised why he used these examples and thereby began to understand the true meaning of the theory. My helpful guidebook informed me that the reason there was free trade between these two countries is that it was bought some 50 years early at the barrel of a gun, or rather to allow Portugal to avoid the barrels of Spain's guns. Britain offered military protection under the Methuen Treaty but in exchange Portugal had to agree to the import of subsidized UK cloth, undercutting domestic production and putting thousands of textile workers out of jobs. So Ricardo's example in fact makes clear that trade is always about politics rather than free markets—a reality that remains true today.

The theory of comparative advantage is counter-intuitive, and the reason is that it contains several crucial theoretical flaws, although it can be made convincing when demonstrated using a specific numerical example, as was done by Ricardo and repeated in countless economic textbooks since his day. The textbook examples always rely on a fixed numerical terms of trade, say 10 barrels of oil for 1 tonne of grain, whereas in reality it is precisely these terms which are not fixed; rather they are negotiated in a political arena within which the two countries negotiating are not equal in power.

So What Alternatives are There?

1. *Renegotiate the terms of trade*

From a development economics perspective and in a book with a strong focus on poverty alleviation, Tom Lines argues the case for a fundamental restructuring of commodities markets. He also suggests informal co-operation between poorer countries dependent on commodities to earn foreign exchange to increase their market power:

> For example, in May 2005 a new government in Ecuador (which exports more bananas than any other country) signed a degree to regulate the volume of bananas leaving the country. Two months later, Malaysia and Indonesia announced a bilateral plan to cooperate on the palm oil, rubber, cocoa, timber and other markets in order to ensure price stability and eliminate the undercutting of their position by others. . . . On the world tea market, discussions have been reported involving all four leading tea producers, China, India, Kenya and Sri Lanka.
>
> Tom Lines, 2008

This may be considered ‘unfair trade’ as it represents effective cartels in the markets for different commodities but it is a response to the unfairness of the negotiations in those very markets, which have been dominated by the rich Western nations to the detriment of the South for centuries.

2. *A new global agreement or GAST—General Agreement on Sustainable Trade*

The ‘national treatment’ rules of the WTO, which prohibit the promotion of domestic above imported goods, might be changed under GAST to a provision permitting trade controls ‘that increase local employment with decent wages, enhance protection of the environment, ensure adequate competition and consumer protection, and otherwise improve the quality of life . . . States are urged to give favourable treatment to domestic products and services which best further these goals.’

Box 8.3. *Key Provisions of the General Agreement on Sustainable Trade*

Support the local	*Provisions preventing governments from giving favourable conditions to domestic producers will be abolished*
Favouring certain partners	States will be allowed to choose to give preferential trade terms to goods and services from other states which respect human rights, treat workers fairly, and protect the environment
Performance requirements	States may impose requirements on corporations opening production facilities in their territories based on: a minimum level of domestic input to the production process; a minimum level of local equity investment; a minimum level of local staff; minimum environmental standards
Standstill and rollback	No state party to GAST can pass laws or adopt regulations that diminish local control of industry and services
Dispute resolution	Citizen groups and community institutions should be able to sue companies for violations of this trade code, under a transparent and public process.

3. *Trade subsidiarity*

A system where you begin with local supplies first, and only move outwards when you cannot meet your needs locally.

Our consideration of different goods might look like this:

		Raw materials	
		Local	Global
Labour	Non-intensive	Farmers’ markets; self-build; domestic textiles	Fair trade; replace WTO with GAST
	Intensive	Support of local craft workers	Mending to replace obsolescence; end to intellectual property laws

Molly Scott Cato
July 2008

Lesson plan

Presentation: Introduction to the Theory of Comparative Advantage (10 minutes)

Students question and critique the theory (10 minutes)

Discussion: what other approaches might there be to organizing world trade (10 minutes)

Role-play: approaches to trade of differently favoured nations (20 minutes)

Presentation: three alternatives (10 minutes)

Unions between nations to negotiate better terms
Renegotiate at the global level – a General Agreement on Sustainable Trade
Trade subsidiarity and localization – begin with the local

Further Reading

Andrew Simms, 'Collision Course - free trade's free ride on the global climate', a report from 2000 focusing on the environmental costs of trade, available for download from the New Economics Foundation website.
Schmelzer, M. 'Fair Trade: In or Against the Market?', Is Fair Trade a neoliberal solution to market failures or a practical challenge to neoliberal trade and the free market regime in general? (an exploration of the issues in conventional economics concepts): http://www.threefolding.org/essays/2007-01-001.html
Oxfam, Rigged rules and double standards (an argument that freeing up world trade will help the world's poor): http://www.oxfam.org.uk/resources/papers/downloads/trade_report.pdf
Colin Hines's critical response, using his 'three Cs' argument: http://www.gaianeconomics.org/pdf/jekyll_hyde.pdf
Trade Susidiarity from a Planetary Perspective (my paper arguing for a balancing of trade with self-sufficient production): http://www.gaianeconomics.org/pdf/tradesub.pdf

And if you have more time and this is a particular interest:

Rowbotham, M. (2000), *Goodbye America! Globalisation, Debt and the Dollar Empire* (Charlbury: Jon Carpenter).
Woodin, M. and Lucas, C. (2004), *Green Alternatives to Globalisation: A Manifesto* (London: Pluto).

Country profiles to consider possibilities for reorganizing the global trade system: using Hines's model of the three Cs, think about an empowered trade strategy for your country.

Bangladesh	**Nigeria**
Population: 150,448,340 GDP: $222.4 bn.—ranked 48th Traditionally Bangladesh exported jute, but this was replaced by oil-based textile fabrics and the industry declined. Two-thirds of Bangladeshis are farmers. The most significant sector is textiles: 75% of export earnings from the garment manufacture. Bangladesh has suffered by the freeing up of global trade and competition with low-cost producers, especially China. Remittances sent by expatriates are also a significant contributor to the economy. Export partners: US 25%, Germany 12.6%, UK 9.8%, France 5% (2006) Import partners: China 17.7%, India 12.5%, Kuwait 7.9%, Singapore 5.5%, Hong Kong 4.1% (2006)	Population 148,000,000; GDP $191.4 billion—ranked 47th Petroleum is central to the Nigerian economy, accounting for 40% of GDP. It is the 12th largest producer of petroleum. The country also has huge deposits of natural resources that are not significantly expoited. Around 60% of the population work in the agricultural sector—in the 1960s the country grew around 98% of its own food and exported food. It is now a major importer of food. Nigeria fully paid off its external debt in April 2006. Export partners: US 48.8%, Spain 8%, Brazil 7.3%, France 4.2% (2006) Import partners: China 10.7%, US 8.4%, Netherlands 6.2%, UK 5.8%, France 5.6%, Brazil 5.1%, Germany 4.5% (2006)
Brazil	**China**
Population: 186,757,608 GDP: US$1,313 trillion—ranked 10th Brazil is the fifth largest country in area and in population. The country has recently benefited from the global boom in commodity prices including agricultural exports such as beef and soya beans; it also has oil and gas resources. Its industrial products such as cars, steel, computers, aircraft and consumer goods account for 30% of GDP. Export partners: US 17.8%, Argentina 8.5%, China 6.1%, Netherlands 4.2%, Germany 4.1% (2006) Import partners: US 16.2%, Argentina 8.8%, China 8.7%, Germany 7.1%, Nigeria 4.3%, Japan 4.2% (2006)	Population: 1,321,851,888 GDP: $3.42 trillion—ranked 3rd The fastest growing economy during this century with an annual growth rate of 10%. China is the world's largest producer of rice and also produces wheat, maize, tobacco, soybeans, peanuts and cotton. It has large deposits of natural resources and produced a huge range of consumer products for export. Export partners: US 21%, Hong Kong 16%, Japan 9.5%, South Korea 4.6%, Germany 4.2% (2006) Import partners: Japan 14.6%, South Korea 11.3%, Taiwan 10.9%, US 7.5%, Germany 4.8% (2006)

Thailand	**UK**
Population: 63,038,247; GDP $519.9 bn.—ranked 21st	Population: 60,587,300: GDP $2.772trn—ranked 5th
Thailand was one of the Asian tiger in the 1980s and 1990s, enjoying record growth. The bubble burst due to a currency crisis, leading to economy collapse towards the end of the century. Major exports include rice, textiles and footwear, fish products and cars. Thailand is the world's largest exporter of rice. Tourism contributes 5% of the GDP. In recent years Thailand has taken a route towards a self-sufficiency economy, taking a step back from export-led growth. This has resulted in impressive human development improvements.	The service sector accounts for 73% of GDP; it is dominated by financial services, especially banking and insurance. The City of London is the centre of global capital; the UK is the sixth most popular tourist destination. Manufacturing only around 16%; the strongest manufacturing sector is pharmaceuticals. The creative industries are also growing rapidly. North Sea oil and gas supply most of the UK's energy needs currently.
Export partners: US 15%, Japan 12.6%, China 9%, Singapore 6.4%, Hong Kong 5.5%, Malaysia 5.1% (2006)	Export partners: US 13.9%, Germany 10.9%, France 10.4%, Ireland 7.1%, Netherlands 6.3%, Belgium 5.2%, Spain 4.5% (2006)
Import partners: Japan 19.9%, China 10.6%, US 7.5%, Malaysia 6.6%, UAE 5.5%, Singapore 4.4% (2006)	Import partners: Germany 12.8%, US 8.9%, France 6.9%, Netherlands 6.6%, China 5.3%, Norway 4.9%, Belgium 4.5% (2006)