COMPARATIVE ADVANTAGE AND TRADE POLICY

Bharat R. Hazari
Professor of Economics, School of Economics, Deakin University, Melbourne, Australia

Pasquale M. Sgro
Professor of Economics, School of Economics, Deakin University, Melbourne, Australia

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Contents

Summary

The theory of comparative advantage suggests that voluntary trade between nations takes place because it is mutually beneficial, and that the pattern of trade is determined by differences in comparative advantage. Despite the undeniable gains free trade produces, throughout history countries have applied both tariff and non-tariff barriers to restrict trade. The concepts of consumer and producer surplus are often used to measure both the welfare benefits of free trade and the welfare costs of imposing tariffs. Both economic and non-economic reasons have been used justify the restriction of trade.

1. Introduction

Nations trade with each other because they consider it to be mutually beneficial. The gains occur in at least two ways. First, nations can specialize in the production of those goods at which they are more efficient in production. In this way, total world output is increased. Second, consumers are able to choose from a wider variety of goods for consumption purposes.

The meaning of the expression "more efficient in production" has evolved over time. It was introduced by Ricardo in his *Principles of Political Economy* (1817), which presented a simple model to show that absolute cost advantages are not a necessary condition for two countries to gain from trade with each other. Rather, trade and welfare depend on differences in comparative costs, or, put another way, in comparative advantage. The concepts of "absolute advantage" and "comparative advantage" will be defined shortly.

The beneficial effects of free trade, from both national and global perspectives, are documented and well-known. Nevertheless, there has almost always been some push for protectionist policies in most countries. There have also been periods in history, for example between the early 1930s and World War II, when almost all countries used tariffs and other barriers to restrict trade. The costs and benefits from tariffs and other forms of trade restriction can be identified and quantitatively estimated.

2. Comparative Advantage

There are two celebrated theories of comparative advantage: the Ricardian and the Heckscher-Ohlin (henceforth HO). These theories are primarily concerned to explain the pattern of trade among nations, that is, what commodities are exported and imported by each country. As well as explaining the trade pattern, both theories also demonstrate that voluntary exchange (free trade) is beneficial to each country. We now proceed to describe and discuss these theories.

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Biographical Sketches

Bharat Hazari is Professor of Economics at Deakin University, Melbourne, Australia. He has held numerous continuing and visiting positions at institutions in Australia and overseas: Visiting Professor of the Department of Economics, University of Venice, Italy; Visiting Ford Professor of Economics, Thammasat University, Bangkok, Thailand; Honorary Visiting Fellow, Harvard University; and Visiting Associate Professor University of British Columbia, Vancouver, Canada. His research interests include pure theory of international trade, theory of development and trade, distortion theory, legal and illegal migration, and growth theory. Professor Hazari is the co-founding editor of the *Journal of International Trade and Economic Development* and is on the Editorial Council of the *Pacific Economic Review*.

Pasquale M. Sgro is Professor of Economics at Deakin University, Melbourne, Australia. He has held numerous teaching and research positions at universities and research institutions in Australia and overseas. His research interests are in the areas of international trade and economic development, on which he has published a number of books and numerous journal articles. He is founding co-editor of the Journal of International Trade and Economic Development, published by Routledge (UK).