INTRODUCTION TO GLOBALIZATION AND TRADE FROM A PLURALISTIC PERSPECTIVE

CHAPTER OBJECTIVES

In this chapter, you will learn about:

- Review the Orthodox Economics Comparative Advantage and Trade Story.
- Examine Critiques of Orthodox Free Trade Story.
- Identify an Alternative Approach for Evaluating the Impact of International Trade.

In Ch. 20: Globalization and Protectionism several concerns associated with free trade are tackled and, presumably, debunked. In 20.2 International Trade and Its Effects on Jobs, Wages, and Working Conditions, three issues are raised.

1. Fewer Jobs?
2. Trade and Wages
3. Labor Standards and Working Conditions

In 20.3 Arguments in Support of Restricting Imports, another five issues are tackled.

1. Infant Industry Argument
2. Anti-Dumping
3. Environmental Protection
4. Low Foreign Wages
5. National Interest Argument

But, are these issues really non-starters? Does orthodox economics effectively minimize the above outlined issues? From the standpoint of heterodox economists, the answer to both of these questions is no. There is a significant body of research available, within the context of a more pluralistic traditions in economics, that point to other interpretations of international trade in which the standard orthodox economic free trade story has very real weaknesses.

The intention of this section is to provide a counter-perspective to that of the orthodox comparative advantage story. The critique is directed toward the orthodox presentation of its theoretical ideas, specifically how orthodox theory promotes the merits and benefits of free trade. The critique will take two forms. The first and primary criticism will focus on the wide array of ways in the orthodox theoretical story fails as both a technical and functional theoretical presentation. The second element of criticism will, in periodic instances, include references to history as well as empirical evidence to document instances in which the orthodox comparative advantage story appears to not fulfill its claims.

28. 1 THE ORTHODOX STORY OF TRADE: A SYNOPSIS

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- Define the term comparative advantage.
- Explain the terms and conditions of trade from an orthodox economic perspective.

If ever there was a sacrosanct idea within orthodox economic thought, it is the belief, faith even, that orthodox economists have regarding the merits and benefits of economic actors being free to trade. The basis for the orthodox economists' faith has much to do with the theoretical explanation orthodox economists utilize to explain how trade works and why it is beneficial. Consider the ideas presented in the chapter entitled **International Trade**.

As presented, orthodox economics organizes its free trade story around several assumptions. The assumptions are designed to constrain the scope of the analysis so as to simplify the story. In the typical introductory textbook presentation, orthodox economists utilize production possibilities frontiers to depict their story.

In support of the production possibilities frontier presentation, orthodox economists apply eight assumptions. The following represents the eight, most common, assumptions.

1. Two producers
2. Two products
3. Fixed resources.
4. Fixed technology.
5. Full resource utilization.
6. Zero transactions costs
7. No external costs or benefits
8. Autarky

Let's take a moment to reflect upon these assumptions and what they mean. For starters, it is typically to assume that the two producers in the model will be countries. Within the two countries, only two products will be produced. Each country will have a fixed number of resources available to produce those products. Limited resources will subsequently limit the amount of production of the two products that is possible within the two countries. Additionally, the fixed technology assumption further limits the extent of possible production. Given the limits to production, all resources and technology are assumed to be used, fully utilized, meaning that production will take place at some point on the production possibilities frontier. Once products are produced, if the two countries seek to trade with one another, there will be no transactions costs associated with trade. Transactions costs are costs such as the legal costs of creating contracts or the transportation costs associated with shipping a product from one part of the world to another. In addition to no transactions costs, external costs or benefits are assumed to be absent. As a reminder, external costs or benefits are the possible spillover effects that occur as a result of economic activity such as production or consumption. As one can imagine, because trade requires transportation, the social costs associated with the wastes generated by transportation are very real. However, for the sake of simplicity, the model assumes the costs and/or benefits of externalities are zero. Finally, autarky means that each producer is self-sufficient. Self-sufficient producers do not require trade in order to survive. If trade is a luxury rather than a necessity, then when trade occurs it is voluntary trade and only to the benefit of the trading partners.

Given the model's assumptions, the orthodox free trade story then showcases three essential components to the trade story. First, the initial step in facilitating trade is for producers to identify their comparative advantage. Recall, comparative advantage means that producers are capable of producing some product(s) at a lower opportunity cost than another producer is capable of producing the same product(s). As a producer, regardless of whether the producer is an individual, firm, or nation, as long as the producer is producing the product at a lower opportunity cost than the other producer, the producer with the lower opportunity cost has a comparative advantage. The second step in the trade story is the specialization of production. Upon identifying its comparative advantage, orthodox economics argues that a producer should specialize in the production of the product that which it has a comparative advantage. Specialization means that a producer should direct their available resources toward the production of a specific product. The third component of the trade story is, trade. Specialized producers, producing a product of which they have a comparative advantage, should now seek to identify trading partners that are also specialized producers of desirable products.

1	→	**2**	→	**3**
Producer Identifies its Comparative Advantage		Producer Specializes in the Production of the Comparatively Advantageous Product		Trade with other Producers of other Products

THE BENEFITS OF TRADE

Orthodox economics sees the outcomes of trade as having predominantly positive impacts for the economic well-being of those people participating in the trade. Trade is deemed beneficial for several reasons. Orthodox economics concludes that trade will not only stimulate economic growth, increase efficiency, and enhance economic development, but that trade is also the best path toward pursuing those goals.

The story of growth is relatively straightforward. The economic growth, when examined more specifically, such as in the case of international trade as producers get access to consumers beyond their domestic borders, the number of available consumers should grow. In the face of a larger potential consumer market place, domestic producers will seek to expand their productive capacities, otherwise known as growth, in order to produce more in an effort to take advantage of having more potential consumers.

The story of efficiency is less obvious, but is still relatively straightforward, particularly if viewed through the lens of international trade. In an international trade environment, producers that may have otherwise been subject to their own country's domestic competition, are now confronted by international competition. Given more competition, producers are forced to seek ever more efficient ways to produce products or risk being driven out of business. More trade equates to more competition and, through the eyes of an orthodox economist,

Finally, in the case of the economic development story, the relationship between trade and development is a bit murky but still evident. By focusing on the specialized production product(s) that producers are comparatively good at producing, the total amount of available products should grow. As two or more parties trade, each producer's relative abundance of production becomes available to more people to be consumed. Essentially, with the growth of products comes an increased ability to meet people's wants. As more wants are met, facilitated by trade, the sum total of utility grows for all and everyone is made better off. In this case, economic development is being defined as raised living standards by virtue of access to consumer products.

28. 2 A CRITICAL EXAMINATION OF THE ORTHODOX DEPICTION OF FREE TRADE

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- Explain ways in which the Orthodox Economic Trade story is limited as a technique for analyzing trade.
- Define the different types of technical critiques of the orthodox free trade model
- Explain that critiques of the orthodox free trade model are of differing severity.
- Analyze applied examples of the limitations of the orthodox economic model.

Within the discipline of economics not all economists agree with the rather rosy picture presented by orthodox economists in their defense of free trade. Critiques of the orthodox free trade story tend to focus on two areas. Some heterodox economists emphasize what they see as the theoretical failures of the orthodox story, namely its disassociation with the "real world." Other heterodox economists focus their criticisms toward the orthodoxy's depiction of the outcomes of trade, particularly the orthodoxy's conclusion that trade stimulates economic growth and economic development

Upon examination it can be argued that both paths of criticism really represent the two different sides of the same coin. For example, if the theoretical model presented by orthodox economics is, in fact, inaccurate because it is in some way divorced of "real world" context, then the theoretical conclusions drawn by the theory will likely also be flawed. Looked at the other way, if "real world" evidence points to outcomes different from the outcomes predicted or perceived by orthodox economics, then it stands to reason that the theoretical model utilized to predict outcomes is failing in some capacity.

In the following sub-sections each of the two critical paths will be explored. The careful reader will note that the two paths frequently intersect.

28. 2.1 TECHNICAL CRITIQUES: THE ORTHODOX MODEL IS POORLY CONSTRUCTED

In this section of the chapter we will explore the model imperfections approach to critiquing the orthodox presentation of free trade. The model imperfections critique is, essentially, a failure of the techniques employed by orthodox economists. There are two main types of model imperfections.

1. Type One – Mild

2. Type Two – More Severe to Very Severe

For Type I critics of the orthodox economic free trade story, the shortcomings associated with the orthodox economic presentation of free trade is strictly the result of a failure of technique, but not necessarily a failure of the overall theory. In other words, the theory does generalize to the real world, but due to model imperfections such as the model's choice of assumptions being overly simplified, the model is unable to fully capture actual real world circumstances. The degree of seriousness associated with these critiques can be classified as mild.

For Type II critics, the model imperfections critique represents a much more serious indictment of the standard orthodox free trade story. In this case, comparative advantage, specialization, and trade does not actually generalize well to the real world. The socially positive results that are depicted in the orthodox theoretical presentation, when these imperfections are accounted for, will not emerge. In other words, because the real world will, and does, contain imperfections that do not conform to the orthodox economic model, the orthodox theoretical presentation will often deviate from actual events in the real world causing the model to blatantly misrepresent the benefits of trade. Importantly, with modifications designed to correct the imperfections, the model can be corrected enough so as to reflect conditions in the real world.

BREAKOUT BOX – A NOTE ON THE FAILURE OF TECHNIQUE

A failure of technique means that by making alterations to the choice of assumptions, the comparative advantage story can be modified to present theoretical outcomes that are more accurate to the real world. As a general rule the changes in assumptions are applied on an ad hoc basis, meaning that assumptions are altered from situation to situation. The goal becomes to modify assumptions in order to reflect phenomena experienced in the actual global economy. The modification of assumptions suggests that there are limits to the usefulness of the techniques utilized within orthodox economic theory to explain.

TYPE I MODEL IMPERFECTIONS

The following represent examples of instances in which the restrictive features of the assumptions do not provide a "real world" depiction, but also do not fundamentally undermine the free trade story.

EXCLUSION OF TRANSACTIONS COSTS

In constructing their theoretical presentation of international trade, orthodox economics excludes transactions costs. Transactions costs include factors such as transportation, legal, and communications costs. As one can imagine, in the actual world in which we live the trade of products will seemingly always include significant transaction costs. When transactions costs are included some trades that would have otherwise been beneficial will not be worthwhile as the costs associated with making the trade become too high to justify the trade. While this critique certainly does point to instances in which some trades will not happen as would be the case in the standard orthodox trade story, the critique is not a deal breaker as most of the orthodox trade story remains intact.

NON-LINEAR PRODUCTION POSSIBILITIES FRONTIERS

Production possibilities curves are not linear (straight line) but rather concave (bowed outward). A bowed outward PPF reflects the principle of increasing opportunity cost. Increasing opportunity cost implies that as a nation moves closer and closer to specializing in the production of one good or one type of good, the opportunity cost of specialization will rise. For example, for countries producing agricultural commodities, there tend to be land or ecology limits on their productive capacity. As a result, to specialize in an agricultural product and then expanding production in an agricultural producing sector may cause there to be an increase in the average cost of production due to declining productivity associated with the diseconomies of scale that accompanies introduction of less and less fertile land.

Since the free trade story is told on the basis of comparative advantage such that a nation produces those goods that require a low opportunity cost of production, if opportunity costs are changing (specifically, rising), then production of a good that may have a low opportunity cost at one point, may have a significantly higher opportunity cost after specialization. The following table illustrates this point.

		CANADA	
SILVER (OUNCES)	0	500,000	600,000
LUMBER (BOARD – FEET)	1,000,000	500,000	0
	1l : 1S	1l : 0.2S	
		1S : 1L	1S : 5L
		MEXICO	
SILVER (OUNCES)	0	40,000	80,000
LUMBER (BOARD – FEET)	80,000	50,000	0
	1L : 1.33S	1L : 0.8S	
		1S : 0.75L	1S : 1.25L

The ratios in red illustrate the lowest opportunity costs of production for both Canada and Mexico. For Canada, the numbers indicate that they have a comparative advantage in producing lumber because they can produce 1 unit of lumber at the expense of only 0.2 units of silver. Canada's comparative advantage outcome emerges when Canadian production changes from 0 lumber and 600,000 silver to 500,000 lumber and 500,000 silver. For Mexico, the numbers indicate that they have a comparative advantage in producing silver because they are capable of producing 1 unit of silver for 0.75 units of lumber. Mexico's comparative advantage emerges when Mexican production changes from 0 silver and 80,000 lumber to 40,000 silver and 40,000 lumber.

According to the logic of orthodox economic theory, now that the Canadian and Mexican comparative advantages have been identified, with Canada having the advantage in lumber and Mexico the advantage in silver, Mexico and Canada should then specialize and trade. Specialization means that Canada should now only produce lumber, moving their production outcome to 0 silver and 1,000,000 lumber while Mexico should now only produce silver, moving their production to 0 lumber and 80,000 silver. It is at this point that a problem appears. Once each country specializes, what was a comparative advantage dissolves into a comparative disadvantage.

Examining the table, as a result of the principle of increasing opportunity cost, the opportunity cost in silver of specializing in lumber increases as Canada moves to maximum lumber production becoming a 1 lumber to 1 silver ratio. Mexico experiences as similar problem except theirs is the problem of a rising opportunity cost associated with forgone lumber. For Mexico the ratio changes to 1 silver for 1.25 lumber (which is also 1 lumber for 0.8 silver). In fact, as is demonstrated by this table, once the country's specialize, each country now has a comparative advantage in the opposite product from what it previously had a comparative advantage. Post-specialization, Mexico is now capable of producing lumber at a lower opportunity cost than Canada and Canada is now able to produce silver at a lower opportunity cost than Mexico. Clearly the orthodox economic story does not fit this circumstance. This is not to say that free trade necessarily breaks down as a result of this scenario, but it does demonstrate that in a more realistic setting, specialization and trade are not appropriate. In fact, one thing the table clearly demonstrates is that both countries are better off producing a combination, a diversity, of products. At this point, based on a diversity of products produced, if the countries trade, then trade will allow both countries to acquire even more of the respective product that they do not have a comparative advantage in producing.

TYPE II MODEL IMPERFECTIONS

The following examples provide an overview of some of the Type II imperfections that appear to generate a divide between real, actual, world circumstances and the orthodox economic trade story. Each imperfection represents a more fundamental challenge to the orthodox model of trade than did the Type I imperfections. As such, the imperfections are presented from least significant to most significant in terms of their implications for the orthodox model.

SPECIALIZATION AND ECONOMIC VULNERABILITY

Any time production becomes highly specialized, the producer confronts potential risks. Here are two potential risks associated with specialization.

1. Any country that chooses to completely specialize in the production of one product runs the risk of a decline in the market for the specialized good. For example, consider a circumstance in which consumers lose interest in the product. In this case market demand declines and the country specializing in the production of this product will necessarily suffers significant economic damage.

2. Any country that specializes in the production of an agricultural good, beyond losses in consumer demand also face production risks. A change in weather or a natural disaster has the potential to completely undermine the economy of the nation(s) producing the single agricultural product and devastate an economy.

In either of the above stated situations, the orthodox economic advice of specialization and trade has the potential to cause negative, not positive effects, for the participants. Clearly there are potentially economically devastating risks associated with a program of rigid specialization.

Although the issue of risks does present a more pressing critique of the standard orthodox free trade story, because potential risks are not definite risks, absent the emergence of these events, the orthodox free trade story is still applicable. Additionally, if the above stated risks are a concern, one can argue that the orthodox model can alter its assumptions to acknowledge heightened risks and, subsequently, advocate for more diversified economies. Diversified economies can still trade and, within the orthodox economic story, these economies would still be encouraged to open their borders to the free flow of products.

SPECIALIZATION AND LESS THAN FULL EMPLOYMENT

While the orthodox economic free trade story presents the idea that trade may produce increases in available goods and services to the trading partners, as a nation or nations specializes the industries suffering from a comparative disadvantage will, ultimately, displace laborers. Because the losses in one industry may not be fully compensated in another industry or industries, more laborers may be displaced than necessarily employed, thus causing unemployment.

An example of the above situation, consider the trading situation of two countries where one country has an abundance of labor and the other country has an abundance of capital (tools, equipment, machinery). In the country that tends to have an abundance of labor the firms within that country would tend to use a lot of labor, and less capital, for their production. In the country that tends to have an abundance of capital, the firms within the capital intensive country will tend to use a lot of capital, rather than labor, in their production processes.

According to orthodox economic theory, in identifying their respective comparative advantages, the labor intensive country would determine that it has a comparative advantage in producing products that require a lot of labor while the capital intensive country would find that it has an advantage in producing products that require a lot of tools, equipment and machinery. The challenge that emerges in this situation is that not all firms in the capital intensive country will be capital intensive producers, some will be labor intensive producers. The labor intensive firms in the capital intensive country will discover that they are at a comparative disadvantage against labor intensive producers from the labor intensive country. The resulting outcome will be that the labor intensive firms, with an abundance of labor, from the capital intensive country, will begin laying off workers. At the same time, while the capital intensive firms in the capital intensive country will likely grow and expand with trade, thus hiring more laborers, it is likely that their hiring will be less than the number of layoffs from the labor intensive firms. In summary, because the firm using a lot of machines tends to use capital rather than labor for its production the number of laborers it absorbs will likely be less than the number of workers the labor intensive firm fires. The overall outcome would be a rise in unemployment in the capital intensive country.

In this instance, the increase in unemployment being described would imply that trading countries will frequently not be operating at their maximum point of productive possibilities. The notion of less than full employment is a concept that is, more often than not, the case across the entire global economy. The evidence of less than full employment is overwhelming. For example, over the last three decades (as global free trade policies and agreements have expanded, not contracted) unemployment rates across countries identified as economically advanced and developed (countries such as the United States, Canada, Japan, Germany, France, the United Kingdom, Australia, Sweden, and others), unemployment rates have ranged from between a low of 3% to as high as 25%. Additionally, in the rest of world, where the majority of the global population resides the absolute number of unemployed or underemployed laborers exceeds 1 billion people. Clearly less than full employment is the norm, not the exception.

A less than full employment outcome undermines the standard orthodox free trade story because countries at less than full employment can produce more of any two products while opportunity costs are zero. In the case of less than full employment, determine a comparative advantage is impossible because both products reflect the lowest possible opportunity cost, zero. In a circumstance such as this, the orthodox free trade story is not capable of explaining the very real world situation of trade under conditions of less than full employment. Correcting the model to account for this imperfection would require that the model assume that an action will be taken to push the economy back to full employment. Such actions could include government (public) policy measures designed to alleviate the unemployment that emerges as a result of trade. Even for many orthodox economists acknowledging the less than full employment scenario is a justification for government action to mitigate the negative consequences associated with trade.