

## Ricardo's Model of Trade

- Portugal can produce all the cloth it needs with 90 laborers, and all the wine it needs with 90 laborers
- Britain can produce equivalent amounts of cloth with 100 laborers, and equivalent amounts of wine with 110 laborers.
- Can Portugal benefit from trading with Britain?
- Yes. If they put all their labor into wine and traded the surplus to Britain for cloth. They could obtain more cloth than they could produce on their own
- Portugal has an absolute advantage - they can produce both goods more cheaply/efficiently than the other country
- But a country will gain from trade as long as it has a comparative advantage in at least one good - it can produce that good more cheaply/efficiently than other goods
- If every country specializes in the goods where it has a comparative advantage and trades for everything else, the total amount of goods produced in the world will be higher than if every country was self-sufficient

## Criticisms of Ricardo's Models

- Ricardo-Weiner-Stolper-Samuelson Theorem: trade benefits a country as a whole, but within the country benefits go disproportionately to workers in industries w/ comparative advantage, while workers in other industries may be made worse-off
- May not be compatible with incentives to improve technology
- What if too many countries have the same comparative advantage?

## Winners and Losers of Trade

- Winners
  - o Winners/owners in areas of comparative advantage
  - o Consumers - prices lower, more choices
  - o Investors - more opportunities, including in areas with better opportunity for growth
  - o Government - bigger tax base
- Losers
  - o Workers/owners in areas of comparative disadvantage

- o People located geographically near industries at competitive disadvantage - ripple effects
- o In some cases, environmental protection
- o In some cases, labor protection

### The Economic North and South

- Most of the wealthiest states are in the northern hemisphere
- Developing states tend to be south of them
- Since Cold War, North-South gap has often replaced East-West as the strongest division in world politics

### Other Facts

- 80% of world lives on less than \$10 a day
- The richest 20% account for 75% of global income, 76% of consumption
- Roughly 1 billion people are illiterate
- 2.6 billion lack basic sanitation
- Nearly half of all children in the world live in poverty
- 1.6 billion people have no electricity
- In 1820 the wealth of the richest countries outnumbered the wealth of the poorest by 3 to 1. Today it is 72 to 1.
- 790 million people are consistently undernourished
- Everyone on Earth could be provided with clean water for \$9 billion, roughly the amount the US spends on cosmetics each year

### Explanations for the Gap - Colonial Legacies

- Economies in South historically designed to extract resources, grow crops and send them back to Europe for refinement
- This arrangement largely persists today
- South dependent on other states for finished goods
- Finished goods generally much more expensive than raw goods
- Raw goods often fluctuate wildly in price

### Explanations for the Gap - Political Institutions

- Little incentive to work hard or invest if policies are bad
- Examples
  - o High taxes, and revenues aren't returned back into economy
  - o Government seizes private property
  - o Private property destroyed in civil war or protests

- Institutions that extract wealth from population associated with lower growth

#### Explanations for the Gap - Geography

- Highest levels of development occur in areas suited to large-scale agricultures - allows for specialization and trade within society
  - Eurasia historically best region for grain and livestock
- Tropical climates support wider variety of diseases
- Many of the poorest countries today are landlocked

#### Explanation for the Gap - Modernization Theory

- At various times empires in Middle East, North Africa, China, India, Central America were more advanced than Europe
- The West just happened to be at leading edge of current wave of development
- The rest of the world is just at an earlier stage in the same process

#### Explanations for the Gap - Trade, Money and Debt

- When developing countries import goods, they usually have to pay in the currency of the exporter
- Need to export enough to that country to get enough currency to pay for the imports
- Otherwise, must borrow to pay for it
- Leads to a vicious circle as some money must be diverted to paying off loans