Book Review

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Ricardo's Gauntlet – Economic Fiction and the Flawed Case for Free Trade
by: Vishaal Kishore
Published 2014
by Anthem Press
75-76 Blackfriars Road, London SE1-8HA, UK, 222pp
ISBN: 9781783082995 (paperback)

Vishaal Kishore's book on free trade is well worth a look. Today more than ever, international trade theory is being critically examined as its predicted gains are scrutinised by citizens as well as international policy makers.

The book contains six rather dense chapters, addressed to economists, and policy makers with a theoretical background. Although Kishore presents his case well, he ignores three previous studies in the literature (Yu, 2009; Fletcher, 2011; Schumacher, 2013) which made some of his same points.

The first chapter summarises contemporary critiques of the theory of comparative advantage, under which most contemporary trade issues are framed. Kishore plays the devil's advocate, first explaining the benefits of free trade and then demonstrating how it fails on its own merits. He notes that none of these free trade critiques (although see above) have challenged assumptions or the application of comparative advantage, and promises to do so in his book.

Chapter 2 presents the theory of comparative advantage. Kishore builds on Ricardo's argument that a nation will focus on producing what it can produce more efficiently relative to other nations. This implies, of course, that all other goods are produced elsewhere. Mutual benefits result as long as opportunity costs differ, countries specialise according to comparative advantages, and goods trade at some intermediate exchange ratio. According to Ricardo, as *Kishore points out*, the following four points result:

1 In free trade, the direction and pattern of trade and specialisation will be driven by comparative advantage.

2 Specialisation on the basis of comparative advantage and trade will lead to gains.

3 Gains from trade can potentially make each country better off as a whole.

4 Therefore, a policy of free trade should be adopted.

After attacking *Paul Krugman's version of international economics* – which heavily builds on comparative advantage and then fails to properly deal with the fact that increasing returns to scale impugn the whole theory – Kishore devotes the four remaining chapters to discussing each of the above points. Chapter 3 discusses specialisation, argued on both empirical and theoretical grounds, with most neoclassical economists following the latter. So, under free trade, how do countries specialise according to comparative advantage? How is it ensured that England and Portugal, for example, do not end up with a trade deficit in one country and a surplus in the other? How can we prevent both countries from not trading at all? Those familiar with Ricardo's model understand that by looking at the opportunity costs of cloth and wine (Ricardo's model only assumes two goods in two countries) in both Portugal and England, comparative advantages are revealed. But by which mechanism does industry (or agriculture) chose one line of production over the other? And do not individuals and firms trade with each other rather than nations? (Yu, 2009) And, they certainly do not trade on the basis of comparative advantage.

In his model, Ricardo used David Hume's specie-flow mechanism, but the empirical evidence was not able to confirm the mechanism was actually at work. Lacking exchange rates, wages and prices, Kishore argues that Ricardo's model is built on sand, or better yet, gold dust. Trade accounts are never balanced in the short run, so assuming that balanced trade closes the model, is not based on economic law but on pure belief. Also, the existence of an exchange rate in today's world implies financial flows. The problem is, as Kishore correctly points out, that these are explicitly ruled out in the theory of comparative advantage. He concludes that the theory cannot establish that countries will specialise according to comparative instead of absolute advantage under free trade. There is no 'invisible hand' to help countries focus their production according to the predicted theory.

The next chapter critiques the claim that specialisation, given comparative advantage and then trade, will lead to mutual gains. Starting with a juicy quote from Karl Marx, Kishore asks (fundamentally): where does comparative advantage come from? According to established *neoclassical theory*, it is determined by natural or technical constraints. The neoclassical Heckscher-Ohlin-Samuelson model is introduced. Kishore argues that the assumption of a shared level of technology across all countries is flawed. Even if one would accept it, the idea of capital and returns to capital driving production contravenes logic. As the Cambridge – Cambridge Capital Controversy has shown, the return to capital is not (and cannot be) independent of the quantity of capital; and that the value of that capital depends on its return – a Catch 22 that has yet to be solved. Kishore points out that the economy is not merely a universe of commodities, but also a universe of human relations. While he does not mention it, the 'varieties of capitalism' approach comes to mind, which is richer in terms of socioeconomic causes of comparative advantage.

Kishore presents an alternative account in which production is determined by rights, power, and group relations. He stresses external industries of scale, which are constructed as opposed to being pre-determined. If, however, the socio-economic is crucial when it comes to comparative advantage, then the role of the state must be stressed as its influence cannot be neglected. As Kishore writes: "The state is *always* involved in trade." Hence, it does not make sense to speak about 'free trade' when states drive education, ensure 'tradability' through enforcement of property rights and so on. Free trade is a fiction.

Chapter 5 critiques the argument that trade can potentially make each country better off. Kishore grants that according to theory, real income increases in both countries. He then identifies three crucial issues: how countries share the gains, what happens over time, and how gains are shared inside the countries. The first issue is discussed in the terms of trade framework, the second with reference to the infant industry argument, and the third within the context of welfare economics.

Kishore, well-versed in each field, makes good arguments and his discussions are illuminating. Each of the three issues is based on neoclassical trade theory, which, however, constricts the discussion. Kishore points out that welfare economics is part of "the ongoing economic project of attempting to show the essentially beneficent channelling role of markets." The focus has shifted from wealth generation and distribution between classes to the maximisation of human satisfaction. Kishore sees welfare economics as the culmination "to which the entire edifice of neoclassical microeconomics points." This is not without costs as the whole socioeconomic perspective, which Kishore holds dear, is lost.

In the concluding chapter, Kishore wraps up his case against the theory of comparative advantage. He notes that it has been sold as an explanation of actual trade and as an ideal to follow; therefore, it is ideology. It is a reason for not regulating markets in the pursuit of 'free trade'. Kishore has shown successfully that the theory of comparative advantage is "unnecessarily and dangerously limiting our understanding of what is right, and what is wrong, with current international and domestic policy and socioeconomic arrangements." This has led to real world consequences, since wrong or bad policy has resulted. Kishore's quote of Blecker[1] is so impressive against the backdrop of the last US presidential elections that it is worth repeating, "Although the US economy has been running large trade deficits that represent net losses of jobs in tradeable industry, US-based corporations have no such large deficit and have profited immensely from their foreign operations." (one wishes for another quote with respect to the George W. Bush administration's tax cuts going to the wealthy). Anyway, Kishore forcefully makes the point that the theory of comparative advantage obscures the policy makers' and the electorate's view on international trade issues. As a result, there are false choices and hidden alternatives. Now the next question is: "If not free trade, then what?" While the answers to this question will take economists and perhaps other scientists longer to answer, it must be addressed.

Vishaal Kishore's book is well written and theoretically sound. I strongly recommend it to anyone teaching international trade theory. Since the issue is so central in economics, other academics and policy makers should also gain a lot from reading the book. For the layperson, it seems a tad too dense, even though Kishore adeptly gets at the issues and presents them in readable English. In my view, the book deserves a lot of attention. Rebuilding international economics could start here.

References

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Yu, F-L.T. (2009) 'A human agency approach to the economics of international trade', *International Journal of Pluralism and Economics Education*, Vol. 1, Nos. 1/2, pp.22–36.

Notes

1 For the original Blecker quote, please see [online] http://www.peri.umass.edu/fileadmin/pdf/financial/fin_Blecker.pdf (accessed 14 May 2019).