SECTION-A

1. Critically discuss the Ricardian theory of Comparative Advantage. How is it different from Adam Smith’s theory of Absolute Advantage?

Ans: Meaning of Comparative Advantage

Comparative advantage refers to the ability of a country to produce particular goods or services at lower opportunity cost as compared to the others in the field. Due to differences in geographical situations, efficiency of labour, climate and natural resources, a country may have the ability to produce a commodity at a lower cost as compared to the other.

In such cases, every country specializes in producing the commodity in which its comparative productions cost is the least. Therefore, all the entities can mutually benefit from voluntary trade and cooperation. This economic law was recognized by a political economist, David Ricardo in his book, ‘Principles of Political Economy and Taxation’ in 1817.

After understanding the meaning of comparative advantage, let us have a look at the assumptions of this theory.

Assumptions of Comparative Advantage

The following are the assumptions of the Ricardian doctrine of comparative advantage:

1. There are only two countries, assume A and B.
2. Both of them produce the same two commodities, X and Y.
3. Labour is the only factor of production.
4. The supply of labour is unchanged.
5. All labour units are homogeneous.
6. Tastes are similar in both countries.
7. The labour cost determines the price of the two commodities.
8. The production of commodities is done under the law of constant costs or returns.
9. The two countries trade on the barter system.
10. Technological knowledge is unchanged.
11. Factors of production are perfectly mobile within each country. However, they are immobile between the two countries.
12. Free trade is undertaken between the two countries. Trade barriers and restrictions in the movement of commodities are absent.
13. Transport costs are not incurred in carrying trade between the two countries.
14. Factors of production are fully employed in both the countries.
15. The exchange ratio for the two commodities is the same.

Criticisms of Comparative Advantage

The following are the criticisms of the Ricardian doctrine of comparative advantage:

1. The theory only considers labour costs and neglects all non-labour costs involved in the production of the commodities.
2. The theory considers all labour to be homogenous. However, in reality, labour is heterogeneous due to different grades and kinds.
3. The theory assumes similar tastes for all. However, the tastes differ with the growth of economies and income brackets.
4. The theory assumes that a fixed proportion of labour is used in the production of all commodities. However, in reality, utilization of the proportion of labour depends on the type of commodity being produced.
5. The theory has an unrealistic assumption of constant costs. However, large-scale productions lead to cost reduction and thereby increase the comparative advantage.
6. Transport costs play an essential role in determining the pattern of trade. But the Ricardo theory neglects this independent factor of production.
7. The assumption of the factors of production being mobile internally is unrealistic. The factors do not move freely from one region to another or one industry to another. The greater the degree of specializations in an industry, the more immobile the factor will be.
8. The assumption of the theory of having only two countries and two commodities is unrealistic as international trade takes place among countries trading numerous commodities.
9. Every country implements restrictions on the movement of goods to and from the countries. Thus, tariffs and trade restrictions play a role in world imports and exports. However, the theory assumes free and perfect world trade.
10. The theory assumes full employment. However, every economy has an existence of underemployment.