



# CLASSICAL COUNTRY-BASED TRADE THEORIES

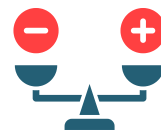


The first theories of international trade developed with the rise of the great European nation-states during the sixteenth century. Not surprisingly, these early theories focused on the individual country in examining patterns of exports and imports.

These country-based theories are particularly useful for describing trade in commodities—standardized, undifferentiated goods such as oil, sugar, or lumber that are typically bought on the basis of price rather than brand name.

## 1 MERCANTILISM

A sixteenth-century economic philosophy that maintains that a country's wealth is measured by its holdings of gold and silver. According to mercantilists, a country's goal should be to enlarge these holdings by promoting exports and discouraging imports.



Popular with manufacturers + workers; limits imports while stimulating sales.

Does require the government to subsidize exports (to stimulate sales) and that is typically passed through to tax payers. Restrictions on imports also allow manufacturers to increase prices.



**Adam Smith**

*An Inquiry into the Nature and Causes of the  
Wealth of Nations*  
1776

## 2 ABSOLUTE ADVANTAGE

A country should export those goods and services for which it is more productive than other countries are and import those goods and services for which other countries are more productive than it is.

## 3 COMPARATIVE ADVANTAGE

A country should produce and export those goods and services for which it is relatively more productive than other countries are and import those goods and services for which other countries are relatively more productive than it is.



### What if there is no disparity?

Absolute advantage looks at absolute productivity differences; comparative advantage looks at relative productivity differences. The distinction occurs because comparative advantage incorporates the concept of opportunity cost.



## 4 THE LESSON

You are better off specializing in what you do relatively best. Produce (and export) those goods and services you are relatively best able to produce, and buy other goods and services from people who are relatively better at producing them than you are.

## 5 RELATIVE FACTOR ENDOWMENTS

What determines the products for which a country will have a comparative advantage? To answer this question, two Swedish economists, Eli Heckscher and Bertil Ohlin, developed the theory of relative factor endowments, now often referred to as the Heckscher-Ohlin theory.

1. Factor endowments (resources) vary
2. Goods differ according to the factors used to produce them



A country should export those goods that intensively use those factors of production that are relatively abundant in the country.