

FOREIGN TRADE AND THE LAW OF VALUE:
PART I*

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I. Introduction

IN MARX'S ANALYSIS OF CAPITALISM the law of value appears as the fundamental basis for the laws of motion of capitalism. It is on this basis that Marx develops the laws of money, of prices, of profits, of accumulation, of reproduction, and of crisis. Not only the struggle of worker against capitalist, but also the pitting of worker against worker, and of capitalist against capitalist, appear as conditioned and limited by the structure and operations of the system itself: the historical development of these struggles is therefore analyzed by Marx against the backdrop of the historical development of these conditioning and limiting relations, that is, against the backdrop of the working of the law of value.

In spite of the extent to which the workings of the law of value are developed in the three volumes of *Capital*, we know of course that many topics remain incomplete, while others are hardly treated at all. It was Marx's original intention, for instance, to extend the analysis to be presented in the three volumes of *Capital* to the treatment of the state, of foreign trade, and of the world market and crisis — each to be dealt with in a separate volume.¹ But this never happened. Instead, even Volumes II and III of *Capital* had to be assembled by Engels after

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¹ R. Rosdolsky, *The Making of Marx's "Capital"* (London, 1977), Chapter 2, p. 23.

Marx's death, from a mass of papers varying from reasonably polished drafts to mere notes about points to be further developed.' To this day, certain of Marx's manuscripts — on money and on foreign exchange rates — have never been published.³

It is the aim of this paper to begin filling out one of the three main areas outlined above: namely, the extension of the law of value to the question of foreign trade.

But before we begin this task, it is first necessary to establish that it has not already been accomplished — either before Marx, by authors such as David Ricardo, or after Marx, by the many Marxists writing on the questions of international trade, imperialism, unequal exchange, and so on. In what follows, therefore, we will first trace the manner in which Ricardo's labor theory of value gives rise to the famous principle of comparative costs, for it is on this principle that authors as diverse as Ricardo, Ohlin, Samuelson, and Emmanuel base their analyses of commodity trade and the resulting international division of labor. We will examine not only what specific mechanisms are supposed to give rise to this curious law, but also the manner in which it becomes incorporated into both orthodox and Marxist theories of foreign trade. Only then will it be possible to return to the main task, and to develop the Marxian laws of international exchange in contradiction to their Ricardian counterparts.

Because of the extent of this undertaking, this paper will be published in two parts. Part I focuses on the derivation of the law of comparative costs, its subsequent adoption by orthodox theory, and its explicit or implicit presence in modern Marxist theories of foreign trade. In Part II, Marx's critique of the Ricardian theory of value is used to overturn the principle of comparative costs, and Marx's own presentation of the law of value is extended to foreign trade. On this basis we will be able to develop the phenomena deriving from the flows of commodity, financial, and productive capital respectively. Finally, we will be able to treat the various transfers of value associated with these flows, and use these results to develop a critique of unequal exchange.

² K. Marx, *Capital* (New York, 1967). Volume III. Preface by Engels, pp. 1-8.

³ K. Marx, *Grundrisse*, M. Nicolaus, editor (New York, 1973). Foreword, p. 12.

II. Ricardo's Derivation of the Law of Comparative Costs

Ricardo held that the principal problem facing political economy in his day was the determination of the laws which regulate the distribution of the product of (capitalist) society among the three great classes: that is, the laws which determine "the natural course of rent, profit, and wages."⁴

But very soon in the course of his work Ricardo realized that his analysis could not proceed without a theory of value. And this theory of value, as he soon came to realize, required both a theory of relative price and a theory of money:

Before my readers can understand the proof I mean to offer, they must understand the theory of currency and of price. . . . If I could overcome the obstacle in the way of giving a clear insight into the origin and law of relative or exchangeable value I should have gained half the battle."

I. The Theory of Price

The first problem Ricardo set himself was the determination of the laws which regulate relative price. Of course he was well aware that the immediate regulators of market prices were supply and demand; but like Adam Smith before him he was equally well aware that over the course of time the ceaselessly fluctuating interplay of supply and demand was itself regulated by a more fundamental principle: equal profitability. Thus, if as a result of market conditions a particular sector's rate of profit rose above the average-rate, then the flow of capital would tend to be biased towards that sector, causing it to grow more rapidly than demand, and driving down its market price to a level consistent with average profitability. Conversely, the sector with low profitability would tend to grow less rapidly than demand, causing its prices and profitability to rise.

The classical economists were thus able to demonstrate that behind the continuously varying constellation of market prices there lay another set of more fundamental prices, acting as centers of gravity for market prices and embodying more or less

⁴ D. Ricardo, *The Principles of Political Economy and Taxation*. Vol. I of the *Collected Works and Correspondence of David Ricardo*, P. Sraffa, editor (Cambridge, 1962), p. 5.

⁵ *Ibid.*, pp. xiv-xv.

equal rates of profit. The name given to these regulating prices in classical political economy was "natural prices," what Marx later was to call "prices of production."

All this was well known before Ricardo's time. What he himself sought to do was to get behind prices of production themselves, to discover what in turn regulated them. In particular, it was his argument that changes in these relative prices of production were **by and large** a consequence of changes in the relative magnitude of the total labor requirements of the commodities involved⁶ — each total labor requirement being defined as the sum of the direct labor time required to produce a commodity, plus the indirect labor times required in the production of its various means of production, plus the means of production of these means of production, and so on. Having made the argument for this law of price changes, Ricardo proceeds to assume in subsequent chapters that relative prices of production are more or less equal to relative quantities of total labor requirements.⁷ Both the analysis of money and of foreign trade are conducted on this basis.

It is not possible here to trace the logic behind Ricardo's argument.⁸ For our purposes, it is sufficient to note that in Marxian terms we may say that, subsequent to Chapter 1 of his *Principles*, Ricardo's analysis is predicated on the assumption that prices of production are more or less proportional to (labor) values.

2. The Theory of Money

Having arrived at a law of relative price, Ricardo then proceeds to the causes of variations in the *level* of money prices.

We will follow Ricardo in assuming that gold is the money commodity. Then the money price of a commodity is its rate of

⁶ *Ibid.* p. 36.

⁷ Ricardo argues that *changes in the ratios of prices are, over a given period of time, roughly proportional to changes in the ratios of the corresponding total labor requirements.* Rough proportionality of the *ratios of prices* to the ratio of the corresponding labor requirements is thus a sufficient but not necessary condition for Ricardo's main proposition.

⁸ For a fuller development of this issue, see Anwar Shaikh, "On the Laws of International Exchange," forthcoming in *Growth, Profits and Property: Essays in the Revival of Political Economy*, F. J. Nell, editor (Oxford, expected publication date 1979).

exchange with gold. **But** if commodities exchange more or less in proportion to (labor) values, then the money price of any commodity is its labor value divided by the labor value of a unit, say an ounce, of gold. This represents the amount of gold money required to purchase a unit of the commodity: the money price of the commodity equals so many ounces of gold. Of course, whenever there is a money commodity **there arise special names** for specific weights of it. In England around Ricardo's time, for instance, roughly 1/4 ounce of gold was known as a "pound" (£). A commodity exchanging for 1 ounce of gold would therefore be said to have a money price of £4.

During any given year, the same gold coin may change hands several times, being received by one person through the sale of a commodity and then being paid over to someone else when it is used to purchase some other commodity. In this way the same gold coin can function as medium of circulation more than once in any given year. Let us say that on the average a coin changes hands five times a year; then its velocity of circulation = 5.

Imagine now that the total labor-time required for all the commodities produced in a given year is 40 million worker-hours, and that the total labor-time required to produce £1 (1/4 oz.) of gold is 1/2 worker-hour. Then the money price of the society's yearly output will be 80 million. If the velocity of circulation of £-coins is indeed five, this means that only 16 million gold coins, each weighing 1/4 oz. will be required as money in that year.

Of course the laws discussed so far apply only to prices of production. We know from the laws of market prices, however, that if a commodity's supply exceeds its demand, then the market price of the commodity will fall — i.e., it will exchange for less of other commodities. If this law is also applied to money it leads straightaway to the proposition that when the quantity of gold coin exceeds the requirements of circulation (the so-called "demand" for coin), the "price" of gold will fall. Now, since gold is money, it can not have a money price; however, since it can be used to purchase any commodity on the market, it can be said to have literally thousands of "commodity prices," these being the quantities of the various commodities one can buy with £1 (1/4 oz.)

of gold. The classical quantity theory of money therefore asserts that when the quantity of gold coin exceeds the requirements of circulation, all the "commodity prices" of gold will fall; since this means that gold will purchase less of each commodity, it is equivalent to asserting that *all* money prices will rise.

The discussion so far has been in terms of gold-money. But Ricardo rapidly generalizes the argument to cover all types of money: other things being equal, an increase in the supply of money will raise all money prices, and a decrease will lower all money prices. This theory of money, as we shall see shortly, plays a critical role in Ricardo's theory of foreign trade,

3. The Ricardian Law of Comparative Cost

We noted earlier that Ricardo's theory of value comprises a theory of relative prices and a theory of money. In what follows we shall see why Ricardo's theory of value necessarily gives rise to his famous law of comparative costs. In this regard it is important to recognize that the critical element in Ricardo's derivation of the laws of foreign trade turns out to be his use of the quantity theory of money, for *it is this theory which provides the mechanism* necessary for Ricardo's results. Neo-classical theory, as we shall see in the next section, violently rejects Ricardo's labor theory of price, but nonetheless continues to embrace various theories of the money price level which are (as far as this issue is concerned) functionally similar to Ricardo's. Not surprisingly, therefore, neo-classical theory too bases its analysis of foreign trade on the principle of comparative costs.

Let us begin the Ricardian analysis of foreign trade by considering two commodities, cloth and wine, produced in England; cloth requires 100 worker-hours to produce, and wine 120 worker-hours. If, as in our previous examples, £1 ($\frac{1}{4}$ oz) of gold required $\frac{1}{2}$ worker-hour to produce, then from Ricardo's law of prices the prices of production of cloth and wine would be more or less equal to their respective labor-time relative to that of gold. Cloth would sell at about £200, and wine at about £240, domestically.

Consider now the same two commodities in Portugal. The unit of money in Portugal we take to be an escudo (e.), roughly $\frac{1}{6}$ of an ounce of gold; assuming the same labor-time for gold

in all countries, one escudo ($\frac{1}{6}$ oz) of gold would then require $\frac{1}{3}$ worker-hours to produce. If then in Portugal cloth took 90 worker-hours, and wine 80 worker-hours, their domestic prices of production would be roughly 270 e. and 240 e., respectively.

But note that both £'s and e.'s are merely different national money names for quantities of gold. If England's payment to foreigners exceeded its receipts from them, i.e., if it ran a balance of payments deficit, gold bullion would eventually have to be used to make up the difference.⁹ Since both currency units are actually quantities of gold, and the international means of payment is in fact gold bullion, we can considerably simplify the exposition by expressing all prices directly in ounces of gold. Given that an ounce of gold requires two hours of labor-time, we have the following Ricardian tableau for England and Portugal:

TABLE I

	ENGLAND	PORTUGAL
Cloth:	100 hrs → 50 oz. gold	45 oz. gold → 90 hrs :Cloth
Wine:	120 hrs → 60 oz. gold	40 oz. gold → 80 hrs :Wine

Clearly, in this initial situation Portugal's greater efficiency in production translates directly into a generalized *absolute advantage* in trade. If transportation costs are not prohibitive, Portuguese capitalists will export both commodities. England will experience a continuing balance of trade deficit which will have to be made up by shipping gold to Portugal.

According to Ricardo's logic it is at this point that the quantity theory of money becomes crucial.¹⁰ The outflow of gold from England is a decrease in its domestic supply of money, so

⁹ In actual fact, the gold standard operated with exchange rates which could vary within certain limits. These limits, called gold-points, determined whether it was cheaper to change local currency into foreign currency via the exchange-rate, or buy gold with the local currency and spend the gold abroad. The basic determinant of the "gold-points" was the cost of transporting gold bullion from one country to another.

¹⁰ The example in Table I is used by Ricardo to argue for the benefits of trade according to comparative advantage. His derivations of the *mechanisms* by which this specialization is brought about are slightly different from mine, but the logic is identical. He initially supposes England to have an absolute advantage in cloth and Portugal to have an absolute advantage in wine, so that here absolute advantage and comparative

that according to the quantity theory the gold prices of *all* English commodities will begin to fall. Conversely, the inflow of gold into Portugal will raise all prices there. As this happens, Portugal's competitive edge in international markets will gradually be eroded away, even though it will of course have just as great an advantage in terms of efficiency as it did before. It is just that **this greater efficiency will be increasingly offset by the rise in Portuguese prices relative to those in England.**

Sooner or later in this process one of the two English commodities will become just competitive with its Portuguese counterpart. But which one? Well, in terms of efficiency, England always has an absolute disadvantage relative to Portugal in both commodities. But as all English prices fall and all Portuguese prices rise, the English commodity with the *smallest* disadvantage will be the first to overtake its Portuguese rival. If we examine the Ricardian tableau in Figure 1 above, we find that English wine production is only 66 2/3% as efficient as its Portuguese rival (since Portuguese wine takes 80 hours and English wine takes 120 hours), whereas English cloth production is 90% as efficient as Portuguese. England's smallest disadvantage, its *relative* advantage, lies in cloth, and as English prices drop relative to Portuguese, it is English cloth which first becomes competitive. By the same token, it is clear that if England has an equal disadvantage in both sectors of production then both English commodities would become competitive at exactly the same point. Though trade could still take place under these circumstances, there would be no fixed basis for specialization. Only if England had different disadvantages in the two commodities, i.e., only if it has a relative advantage in one, can Ricardian trade take place.¹¹

¹¹ advantage are the same, and specialization according to either implies the same patterns. He then allows England to catch up to Portugal in wine production, so that it now continues to export cloth but ceases to import wine. Trade is thus one way only, and gold flows out from Portugal and into England, raising *all* prices in the latter and lowering all prices in the former (Ricardo, op. cit. pp. 139-140). The logic of this mechanism justifies his earlier example (the one depicted in Table I), as well as his statement that the relative prices of internationally traded commodities are not regulated in the same way as commodities exchanged within a country (ibid. p. 133). Instead of following through on the logic of his presentation, Ricardo at this point switches to the implications of his analysis for international differences in price levels (ibid., p. 141).

¹¹ In neo-classical presentations, the comparison is between price ratios of cloth and

Once England can compete in cloth, two-way trade will begin. This will improve England's trade picture, but it will probably not eliminate the deficit; price level movements will therefore continue to take place, strengthening England's international position and weakening Portugal's — until finally at some point trade will more or less balance, with each country exporting the one commodity in which it *now* has a relative advantage. If for some reason the adjustment process goes too far, to the point where even English wine undersells Portuguese, then the ensuing gold flows would reverse the price level movements until once again relative advantage reigned.

An important implication of the process of adjustment is that in the end each country's international terms of trade (the quantity of imports that can be bought with a unit of its exports) will necessarily be better than its domestic. In England, for example, the cloth on the market will be English cloth; but the wine available will generally be imported from Portugal. Those whose unbounded patriotism would require them to insist on English wine will have to pay a higher price for it than they would for the imported variety. Therefore a unit of cloth, England's export commodity, will be worth more units of Portuguese wine than it will be of domestic wine simply because domestic wine costs more. Similarly, in Portugal, its export, wine, is worth more units of English cloth than it is of Portuguese cloth simply because the English cloth is cheaper.

The proposition just put forward, on the terms of trade of each country, has often been used as the basis of a proof that each nation-as-a-whole gains from trade. Thus it is said that England can get more wine for its cloth through trade than it can get domestically: trade is generally beneficial. Though Ricardo is careful to derive the laws of trade on the basis of its profitability to capitalists, when he turns to the analysis of the effects of trade he abandons the concept of classes and reverts to that of a nation-as-a-whole. Now, it is undeniable that the concept of a nation is both valid and necessary at some level of analysis; nations do exist and their interaction is a real process. But to assert that trade is beneficial to the nation-as-a-whole is simply to assert that "what's good for General Motors is good for the U.S."

wine in each country, rather than efficiency of production. But the conclusion is the same.

Trade is undertaken by capitalists because they can make more profits that way; it is they who always gain. Even if this gain for the capitalists happens to spill over to workers in either country, which is certainly not necessary from the above analysis, one can only say that in this instance trade also benefits a particular set of workers. It is not possible to reduce the fundamentally antagonistic relations of classes to the bland homogeneity of a nation-as-a-whole. Christians are not in a position to cheer for lions so long as they are both booked to play in the Coliseum.

4. *Modern Derivations of the Law*

It should be obvious from the preceding derivation how crucial the "right" sort of monetary theory is to the derivation of the law of comparative costs. Any monetary theory which translates the initial trade deficit of the backward country into falling price levels (falling relative to the price level in the advanced country) will do the trick. We need therefore to say a bit about the modern theories of the price level and their role in modern derivations of comparative costs.

In general, modern versions of the theory of foreign trade leave intact the basic principles set out by Ricardo. But they differ from Ricardo on the theory of price, and to a lesser extent on the formulation of the precise mechanisms by which specialization according to comparative costs is brought about.

As far as the theory of price is concerned, neoclassical economics replaces Ricardian total labor requirements as the regulator of price with the notion that the price of a commodity is regulated by the commodities which the nation-as-a-whole must forego, at the margin, in order to produce an extra unit of the commodity in question. Since this concept of cost-as-opportunities-foregone has no meaning unless all resources are assumed to be fully utilized at all times, neoclassical theory finds it necessary (and very convenient) to also assume full utilization of all resources. Thus, *given* some initial endowment of resources within a country, and assuming full utilization of this initial endowment, relative prices emerge as being jointly determined by the structure of technology (as exemplified by the production possibilities curve of a nation) and the structure of preference (as exemplified by the commodity indifference curves).

The trouble with this general description is that virtually any outcome can be derived by appropriate combinations of supply and demand (production possibilities and consumption preferences). Like all near tautologies, it is consistent with practically everything, and can therefore explain practically nothing. As a result, the dominant explanation of the actual patterns of foreign trade, the Heckscher Ohlin Samuelson model, is of necessity a much more specific construction, with much more determinate outcomes.

Whereas Ricardo locates the patterns of international specialization in the international differences in relative costs, the Heckscher-Ohlin-Samuelson formulation attempts to go one step further and tie these (refined) relative costs to a single dominant variable: the given national "endowments" of capital and labor. In order to do this, the model assumes that consumers in two different regions of the world are essentially alike. Even more astonishingly, it also assumes that a given commodity is produced under identical production conditions in both regions.¹²

The assumption concerning consumers eliminates differences in demand between two regions (say the developed capitalist world and the Third World), as an explanation of relative cost differences. But even more important, the assumption of identical production facilities *eliminates underdevelopment itself — and with it the problem of absolute advantages and disadvantages — as an explanation of relative cost differences and hence as an explanation of the patterns of trade.*

The only thing that remains are the differences between national "endowments" of capital and labor. Here, it is argued that regions which are relatively capital-abundant (i.e., which have a relatively higher endowment of capital to labor) will be able to produce capital-intensive commodities relatively more cheaply than the labor-abundant regions. Conversely, the labor-abundant region would of course have a comparative cost advantage in the production of labor-intensive commodities. It follows therefore that the capital-abundant region (the developed capitalist world) will, and for reasons of efficiency and good of the world-as-a-whole should, specialize in capital-intensive (manufactured) products, exporting them in return for the labor-intensive

¹² C.P. Kindleberger, *International Economics* (Homewood, Illinois, 1973), Chapter 4.

(primary) products of the labor-abundant (underdeveloped capitalist) region. In other words, acceptance of, and adaptation to, the existing differences between developed and underdeveloped capitalist regions is *efficient* from the point of view of the world-as-a-whole. Poor Ricardo dared only to claim that international inequality is best of all. It is no surprise that so wondrous a construct as this has been readily adapted to justify and celebrate other sorts of inequalities too. Gary Becker, for instance, views marriage as a "trading" contract between men and women, to be analyzed exactly in terms of the Heckscher-Ohlin-Samuelson model. The greater the general differences between men and women (i.e. the greater the extent of institutionalized sexism), the greater the gains from trade, and the stronger the bond that holds the marriage together.¹³

As a rule, modern presentations of the law of comparative costs make no reference to the actual mechanisms by which the law is to be brought about. The emphasis is almost entirely on the gains from trade that would be achieved if trade were to be based on comparative costs; nonetheless, since these models are also intended to be descriptive of actual trade patterns, "the implicit assumption is [made] that the adjustment of money wage and price levels or exchange rates required to preserve international monetary equilibrium do actually take place. . . ." ¹⁴ In this way the modern derivations of comparative costs rely on what are essentially variants of Ricardo's mechanism: in all cases, the very nature of the desired solution requires monetary variables (price levels and/or exchange rates) to adjust in such a way as to transform any existing absolute advantage into a comparative one. In all versions, therefore, given England's absolutely lower efficiency and hence initially higher costs of production, its ensu-

13 G. Becker, "A Theory of Marriage, Part I," *Journal of Political Economy*, Vol. 81, 4, July-August, 1973; "A Theory of Marriage, Part II," *Journal of Political Economy*, Vol. 82, 2, March-April 1974. Sexism is proved to be both rational and efficient: Men and women enter the marriage market with various "initial endowments" consisting of home-capital and market-capital: men being in general relatively more "endowed" with market-capital, and women with home-capital, they specialize to their mutual advantage in market and home activities respectively. The potential of this fantastic analysis is, I feel, not even approached by Becker's use of it. What about blacks and whites? Surely there is much more work still to be done.

14 H. Johnson, "International Trade: Theory," *International Encyclopedia of the Social Sciences*, David L. Sills, editor (New York, 1968), Volume 8, p. 84.

ing trade deficit must somehow result in a continuous lowering of English prices while Portugal's trade surplus must lead to a continuous raising of its prices — until at some point each country has a cost advantage in only one commodity.

The critique of comparative costs consequently requires us to contrast four basic theories of the price level: the Hume specie-flow version of the Quantity Theory (Ricardo), the cash balances version of the Quantity Theory, the Keynesian determination of prices through the level of money wages, and Marx's theory of money. In order to do this, we need a common ground of some sort.

Fortunately for us, most of the history of international trade, and hence most of its theory, has been dominated by precious metals as the standard of both domestic and international money.¹⁵ Thus, in discussions of the theories of international trade we always find a common theoretical ground — their operation under the so-called gold standard. By contrasting various theories on this basis, differences in the theories themselves may be separated from differences in institutional arrangements. And since neither the Ricardian nor the neoclassical versions of the law of comparative costs claim to be dependent on any specific monetary institutions, the gold standard is a valid common ground. So much so, in fact, that the neoclassical treatment of the adjustment mechanism under the gold standard is virtually identical to that of Ricardo:

The adjustment mechanism under the gold standard . . . was more or less automatic in the sense that central banks were expected to react to gold outflows and inflows by more restrictive and less restrictive monetary policies, respectively, which would in turn react upon price and wage levels, lowering them in the deficit countries and raising them in the surplus countries. These price changes, in turn, were expected to shift expenditure from surplus to deficit countries, thus reducing and eventually eliminating the disequilibrium. . . . [T]he theory is correct in

15 By most accounts this period dominates the history of capitalism up to at least 1914, and by some accounts up to the 1960s. In any case, the period under consideration is one in which precious metals function as the ultimate international money; this by no means excludes the phenomena associated with token money and credit money. Though I do not develop the different forms of money here, the analysis can be extended to deal with token and credit money based on a commodity money (gold, silver, etc.).

its broad outline even if its practice has been somewhat oversimplified.¹⁶

In neoclassical discussions, the gold standard is treated as being theoretically equivalent to a regime of fixed exchange rates. Consequently, at the opposite theoretical extreme from fixed exchange rates, we are told, lies the notion of purely flexible exchange rates determined solely by the relative supplies and demands of the national currencies. Here the claim is made that it is possible for each nation to have a *fully independent monetary system*.¹⁷ In this case, the price levels in each country are "insulated" from external influences, and all adjustments are brought about through the exchange rate. In a backward country a trade deficit implies a depreciation of the country's currency, which makes imports relatively more expensive to it and its exports relatively cheaper abroad. Since this process is assumed to have no limits, eventually the flexible exchange rate settles at a level which makes comparative advantage a reality.

We cannot consider the merits of these various derivations until we have examined Marx's theory of money. But it is useful to note even at this point that it is completely false to treat the existence of a gold standard as equivalent to some theoretical notion of fixed exchange rates. In its actual operation the gold standard was a system of flexible exchange rates whose movements were *bounded* by limits determined by the costs of transporting gold. This meant that insofar as the "normal" variations of trade were concerned, the gold standard operated as if it were a system of purely flexible exchange rates. On the other hand, insofar as systematic imbalances were concerned, the exchange rate soon reached one of the two limits and it became cheaper to settle debts by shipping gold directly: in this mode, therefore, it operated like a system of fixed exchange rates. The orthodox theoretical notion that there exist two independent polar extremes of fixed and flexible exchange rates thus has its origin in one-sided (and hence false) abstractions of the real process. We will return to this important point later on.

16 R. A. Mundell, "Balance of Payments," *International Encyclopedia of the Social Sciences*, *op. cit.* pp. 8-9.

17 L. B. Yeager, *International Monetary Relations: Theory, History and Policy* (New York, 1966), p. 104.

5. Orthodox and Marxist Critiques

The law of comparative costs, whatever its form, has always been associated with the advocacy of free trade: Ricardo's own development of this principle was in fact part of his polemic against the Corn Laws (which were designed to prevent the free import of cheap corn into England), and from that time onward Free Traders of all kinds have based their own arguments on those of Ricardo. It is not surprising, therefore, to find that the primary thrust of critics has been to attack not so much that part of the law which argues that the pattern of trade will depend on comparative costs, as the proposition that free trade is efficient, mutually beneficial, and good for the world-as-a-whole.

We cannot discuss the orthodox critics of the law in much detail here, save for the following remarks. In general, these critics fall into three categories. First, there are those (like Graham, the Keynesians, etc.) who seek to modify one or more of the grounds of the law so as to provide theoretical counterexamples to it.¹⁸ In spite of their apparent opposition to the law, these sorts of criticisms *implicitly (and often explicitly) accept the law as being theoretically valid on its own grounds*. It is therefore not at all surprising that these criticisms are usually viewed not as refutations of comparative costs, but rather as its further development; typically, in neoclassical textbooks, the doctrine of comparative costs is presented as *the* fundamental principle underlying international trade, with the foregoing types of criticisms as extensions and concretizations of it.

Second, there are empirical studies which appear to refute the law, such as the famous studies by Leontief and by Arrow-Chenery-Minhas-Solow. Both of these studies cast serious doubt on the empirical relevance of the assumptions and predictions of the Heckscher-Ohlin-Samuelson model. But distressing as these results are to the proponents of this particular model, they have little bearing on the principle of comparative costs, for (as we have already noted) this model *begins* by assuming the Ricardian

18 The orthodox critics are discussed in greater detail in my "On the Laws of International Exchange" (see footnote 8). In addition, A. Emmanuel, in the introduction to his book, *Unequal Exchange: A Study of the Imperialism Trade* (New York, 1972), provides a useful and illuminating survey of orthodox critiques of the law of comparative costs.

pattern of specialization according to comparative costs and then attempts to link this pattern to the "factor endowments" of the nations involved. At best, therefore, the empirical and theoretical paradoxes generated by these sorts of studies merely sever the attempted link between national factor endowments and the pattern of trade. *They leave the Ricardian law untouched.*

Finally we come to those critics who attack the law as being *no longer valid* because one or more of its premises no longer hold in today's world. Here we find that the empirical criticism of the law, and particularly of the efficacy of free trade, is based on modern developments such as the loss of wage and price flexibility, the demise of the gold standard, the death of competition, and systematic interference by governments.¹⁹ For our purposes, it is sufficient to note that this historical school of orthodox criticism (which, as we shall see shortly, has its Marxist counterparts) implicitly accepts the law as valid where its premises — primarily those involving competitive capitalism — can be taken to hold. On its own ground (which in this case is taken to involve a particular historical epoch) the law is accepted as valid.

In sum, we find that so far as orthodox criticism is concerned (whether it be theoretical, empirical or historical), the basic principles of the doctrine of comparative costs emerge relatively unscathed. We turn therefore to the Marxist critiques.

Given Marx's exhaustive treatment of Ricardo's theory of value, it would seem that Marxists would have long ago extended his analysis in one way or another to deal with the Ricardian law of comparative costs. Curiously enough, this is not so: instead, the issue is seldom mentioned,²⁰ and where it is, Ricardo's attempt to determine the limits of international exchange is acknowledged only implicitly by accepting one of his central conclusions: whereas the law of value regulates exchanges within a

19 M. Barrat-Brown, *The Economics of Imperialism* (New York, 1974). In this book Barrat-Brown surveys various arguments blaming "sectionalist monopoly and obstructionist principles" (p. 32), "post-colonial nationalism and self-imposed autarchy" (p. 35), "trade union action," and the inequality of "bargaining power" between developed and underdeveloped capitalist countries (p. 233), for the historical inapplicability of free trade arguments.

20 Cf. E. Mandel, *Marxist Economic Theory*, Vol I-II (New York, 1968), and P. Sweezy, *The Theory of Capitalist Development* (New York, 1962).

competitive capitalist economy, it does *not* do so between such economies.²¹

Why this striking silence? In part, it arises from the paucity of references in Marx to the question of foreign trade — due, no doubt, to his expressed intention to treat this issue in a separate volume subsequent to *Capital*. But this silence in Marx is only part of the explanation for the ambivalence of Marxists on this subject. Another equally important part lies in the fact that ever since the publication of Lenin's *Imperialism* it has become a Marxist commonplace to assert that capitalism has entered its monopoly stage.²² Now, in the case of monopoly it is widely accepted by Marxists and non-Marxists alike that the laws of price formation must be abandoned;²³ "the most serious aspect of monopoly from an analytic point of view, is that the discrepancies between monopoly price and value are not subject to any general rules. . . ." ²⁴ What remain therefore are the basic social relations of capitalist commodity production, and it is to the various manifestations of these that the theory of monopoly capital turns.

Of course, once the laws of price formation in general are thrown out, then the laws of international price formation necessarily follow. The focus shifts instead to the domestic and international rivalries of giant monopolies, to their political interaction with various capitalist states, and to the antagonisms and conflicts between these states themselves — in other words, to "imperialism" as an aspect of *monopoly* capitalism. The law of value, like competitive capitalism itself, fades into history.

It is beyond the scope of the present paper to attempt a proper construction of a Marxist concept of concentration and centralization (as opposed to monopoly) to confront the views mentioned above. It must be noted, however, that even an acceptance of the aforementioned views in no way puts to rest the ambivalence among Marxists with regard to Ricardo's law, **any** more than it resolves the recurring conflicts on the transformation problem, the theory of wages, etc.; instead, it merely

21 Sweezy, *op. cit.*, p. 289.

22 V. I. Lenin, *Imperialism: The Highest Stage of Capitalism* (New York, 1939).

23 Sweezy, *op. cit.*, pp. 270-271.

24 *Ibid.*, p. 54.

sidesteps them. Like their orthodox counterparts, these Marxist criticisms leave the law of comparative costs still standing — in the case of competitive capitalism, at least.

Lastly, in recent years this whole issue has been once again brought sharply into focus by Arghiri Emmanuel's challenging new work, entitled *Unequal Exchange: A Study of the Imperialism of Trade*.²⁵ In this book Emmanuel sets out to overthrow the pernicious doctrine of comparative costs by attacking what he argues is one of its fundamental assumptions — the immobility of capital between different countries and between regions of the world.

Emmanuel begins by noting that Ricardo's analysis of foreign trade is predicated on the assumption that both labor and capital are immobile between regions of the world. These are the conditions of "pure" foreign trade, so to speak, since in this case only commodities (and not capital and/or labor) flow between nations.

On these, its original grounds, Emmanuel accepts Ricardo's law? But, he argues, the world is different nowadays in that even though labor remains, by and large, immobile across regions of the world, capital today is fairly mobile.²⁷ In the modern world, therefore, while the relative immobility of labor gives rise to large and persistent differences in wages among the developed and underdeveloped regions of the capitalist-dominated world, the relative mobility of capital tends actually to equalize profit rates across these regions. It is Emmanuel's contention, therefore, that whereas the law of comparative costs *continues to determine the international patterns of trade and specialization (and hence the international division of labor)*, the modern mobility of capital gives rise to a set of entirely new and unforeseen consequences arising from this law. Specifically, since wages tend to be much lower in the underdeveloped regions, in the absence of capital mobility between regions profit rates will tend to be higher in the underdeveloped regions than they will be in the developed regions. If profit rates are now equalized through the international mobility of capital, the profit rate in the underde-

veloped regions will be lowered and that in the developed regions raised. It follows from this that profits (surplus value) are transferred from the former to the latter. Since profits are an important source of growth, the transfer of profits out of the underdeveloped regions is at the same time a reduction in their rate of growth relative to what it could have been in the absence of the intrusion of foreign capitals. This effect, which compares potential profits in the absence of capital mobility with actual profits resulting from the existing mobility of capital, is quite different from the question of whether or not the actual profits made by foreign capitals in the underdeveloped regions are then reinvested there or repatriated. To the extent that these profits are repatriated, this would of course add insult to injury. But the primary problem remains the transfer itself, which Emmanuel calls unequal exchange (in the narrow sense.)

We will not examine Emmanuel's analysis in any greater detail at this point. For our purposes, it is sufficient to note two things about this debate. First, that Emmanuel quite explicitly accepts Ricardo's law on its original grounds, and even retains it as the basis for the international division of labor in his subsequent derivation of unequal exchange. *In this sense, the Ricardian law remains the base of Emmanuel's new superstructure.* Secondly, though many of the Marxist criticisms of the problematic underlying Emmanuel's arguments are quite telling, his critics manage to neatly avoid two central questions posed by his work. First of all, at the level of abstraction that Marx maintains in his three volumes of *Capital*, is it really true (as many Marxists appear to believe) that Ricardo's law of comparative costs is the international form of Marx's law of value? Second, is it true (as Emmanuel argues) that when the export of capital becomes significant, the Marxian law of international value is transformed into Emmanuel's law of unequal exchange?

Posed in this way, these questions have exactly the same theoretical status as that of any other law developed by Marx in *Capital*. Marx lays bare the structure of capitalism on the basis of its "ideal" form, that of free competition, precisely because it is *this* form that gives the freest expression to the immanent laws of the system. It is on this basis that Marx derives exploitation, crises, concentration and centralization, and a host of other phenomena characteristic of capitalism. Is it not curious, then,

25 Emmanuel, *op. cit.*

26 *Ibid.*, pp. xxxiii-xxxiv.

27 *Ibid.*, p. xxxiv.

that whereas free and equal exchange within a capitalist nation gives rise to all of these phenomena, it appears not to do so when it takes place between capitalist nations? How is it that whereas Marx derives the unevenness of development within a capitalist nation on the basis of free competition, Marxists generally have to resort to monopoly to explain the unevenness of development between capitalist nations? These are the questions we will turn to next.

Summary and Conclusions to Part I

Perhaps the most enduring proposition in the analysis of international trade has been the so-called law of comparative costs, which, as we, have seen, has generally been accepted by orthodox economists and Marxists alike as being valid on its own grounds. In all of its various disguises, this so-called law has asserted that when it comes to international trade between capitalist nations, inherent inequalities are negated. No nation, however humble, need ever fear trade, for like bourgeois justice, it is blind to differences in station. Or so the story goes.

But it turns out that aside from the multitude of proofs about the so-called optimality of specialization according to comparative costs, the real heart of the matter lies in the assertion that the basic thrust of international trade is *actually* to bring about such specialization. And the automatic mechanism which supposedly accomplishes this, we pointed out, was the operation of the various orthodox theories of the price level.

We then went on to examine the development of the principle of comparative costs in its original (and basically unaltered) form: that of David Ricardo. Only when this was done could modern derivations of the law be presented and analyzed. It was important to show that the so-called law was a logical outcome of the conjunction of Ricardo's theory of value with his theory of money; this enabled us to establish that the locus of a critique of the law lay in its antecedents — not in the law itself.

In Part II of this paper we will focus on Marx. In his analysis of Ricardo, Marx provides us with the necessary critiques of Ricardo's theories of value and money. Moreover, in his own work he treats these subjects under the development of the law of value. We will also present Marx's own treatment of value,

price and money. This will have a double consequence: his critique of the antecedents of the so-called law of comparative costs will provide us with a basis for a critique of the law itself; and his own development of the law of value will provide us with the basis for an adequate treatment of the laws of international exchange. When this is done, the law of comparative costs will be seen to be *impossible* precisely on its own grounds. Rather than finding, as Ricardo did, that Portugal and England will each end up specializing in one of the two branches of production — in spite of Portugal's absolute superiority in the production of both — we will find that Portugal will necessarily export both. England, the underdeveloped capitalist country in this example, will end up with a persistent trade deficit balanced by gold outflows and/or short-term borrowing. Such trade must eventually collapse, other things being equal.

When this result is expressed in terms of its real content, we can say: free trade will ensure that the underdeveloped capitalist regions will either have to confine their import needs to the low levels supportable by their exports, or else they will be chronically in deficit and perpetually in debt. It is *absolute* advantage, not comparative, which rules trade.

This represents an extension of Marx's law of value (which of course subsumes a theory of money) to the realm of the international exchange of commodities. But as Marx points out, these commodities are capitalistically produced commodities, the commodity-forms of various national capitals. As such, the interchange of commodity-capitals among nations carries with it the seeds of other forms of international capital, flows such as those of financial capital (foreign borrowing/lending), and of productive capital (direct investment).

The question of direct investment is particularly important, since its analysis plays so important a role in various theories of trade. Orthodox theory, for instance, finds direct investment to be a means of closing the gap between rich and poor capitalists countries, on the grounds that it transfers savings from the developed countries to the underdeveloped ones. Marxist theories, on the other hand, have traditionally derived the major phenomena of international uneven development from the export of productive capital; Emmanuel, for example, makes the

export of capital pivotal in his theory of uneven development, since it is through the mobility of productive capital that profit rates are equalized.

But most of these analyses of direct investment are based on an acceptance of Ricardo's law of comparative costs. *This law is the base on which their super-structures are built.* Since the central argument of this paper is to overthrow this law, and subsequently to locate many of the phenomena of uneven development on a world scale — previously attributed to the export of capital — in the working of commodity trade alone, it will become imperative at that point to extend the analysis to incorporate the effects of direct investment.

Consequently, this latter question will be taken up. It will be shown that although foreign capital can provide an offset to chronic balance of trade deficits (in part because of the capital inflow and in part through the modernization and expansion of the export sectors), it can do so only at the expense of destroying native industries, blocking the development of the indigenous forces of production, undermining the terms of trade, and generating corresponding capital outflows (such as surplus value in the form of repatriated profits). Instead of negating international inequality, therefore, foreign investment will be seen to tighten the grip of the strong over the weak — not merely through monopoly or state power, but through "free" competition itself.

Lastly, the question of transfers of surplus value will be tackled. Here particular attention will be paid to the different sorts of transfer of value which international competition brings about, to their net directions and effects. It will be shown that neither their direction nor their overall effects can be simply established. Indeed, these transfers will emerge as secondary phenomena of underdevelopment itself, not as its primary cause. This knowledge will then enable us to briefly criticize the notion of unequal exchange, as developed by its main proponents.

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