“A critical appraisal of comparative advantage theory under free market crony capitalism”

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A critical appraisal of comparative advantage theory under free market crony capitalism

Abstract

This paper investigates comparative advantage theory and principle which is suggested that price of factors and commodities determined by the supply and the demand forces in free market conditions, the market forces automatically allocate resources efficiently that have the property that someone can be made better off without someone being made worse off, it means equally redistributed incomes. The paper identifies the root causes of the problems of inequality among people and between nations, and find the problem of world-wide inequality is the final outcome/product of free market and crony capitalism. The study explores theoretically, conceptually, and empirically through surveying literatures both primary and secondary sources. Finally, various policies and recommendations are highlighted.

Keywords: comparative advantage, free market competition, crony capitalism.
JEL Classification: F10.

Introduction

The economic systems; both a state-led "Soviet Socialist Model" and, a complete free market based on the US-led "Capitalist Model" had collapsed. For the purpose of capital formation and capital accumulation mostly developing countries, followed a "market-oriented growth model" under the urban business leaders, neglecting the vast rural areas where huge population lives in the last five to six decades, followed an urban-centered development model, and encouraged migration of surplus agricultural workforce from rural to urban to supply for urban based private corporate industries. In other words, the private corporate-led "metropolitan-centered development model" of progress, the current "capitalist mode of production systems" promotes free competition based marketization world-wide. Service sector dominated "neo-liberal policies" through attracting foreign direct investment with hi-tech (a jobless growth), and through public loans (as an extra burden put on country), which is focusing only on "how to increase GDP", where vast populated agricultural based rural areas have been neglected since independent era. As a result, it creates environmental degradation (through de-forestation and creating all types of pollution), corruption, unemployment, regional imbalances and income inequality among people and between nations. This condition creates widespread poverty and malnutrition, as it is the output of a modern world historical product, the outcome of five centuries of global capitalist expansion under relations of imperialism. International finance capital led to imperialist dominated globalization, technological change, corporate restructuring – and a strong support of neo-liberal state to provide them with the knowledge and skills to cope with new technologies, where work practices are responsible factors for all types of economic disorder.

1. Literature review

The classical, neo-classical, modern economic theories based on international division of labor/international specialization. Theories of absolute advantage, comparative advantage, vent for surplus, the 18th century rule, and Heckscher and Ohlin, the benefit from trade were influenced by Smith, Mill, and Ricardo. Comparative advantage theory suggests that the demand and the supply forces determine prices of commodities and resources, allocated to produce quantity of commodities, that will reach automatically at equilibrium point with a perfect competition under free market conditions on the basis of "laissez-fair" and "international division of labor" principles. Where no technological change, no transportation cost, and no change in prices of commodities are assumed. All nations should specialize in which resources they are abundant, which firms can produce commodities at cheapest, and export to other countries. So, all firms or nations can gain from international trade.

However, under perfect competition trade creates new industries with higher productivity. Although, international trade theories failed to address that if firms or nations suppose to be benefited in a laissez-faire environment, not all the participants, how they will distribute the increased wealth/profits among people. While resources are efficiently utilized, the theories, however, neglect to consider whether such trading is fair and equitable.

The world has witnessed for rising global inequalities over periods of both growth and slump. There is a

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need to address an old question: whether rising income inequality is an inevitable outcome – or a necessary factors – of economic development; or whether it is possible, and even desirable, to reduce income inequality, in order to achieve more inclusive development as well as to overcome the present economic challenges and create the conditions necessary for a more sustainable in long run. The issue of equal distribution of wealth, economic theories failed to address it. All economists share the error of examining surplus-value not as such, in its pure form, but in the particular forms of profit, rent and interest. But workers do not receive the equal amount whatever they have produced and added an additional value of commodities that is surplus-value directly going to the owner's pocket.

2. The debate on chrony capitalism

In the real world, it is a general business practice that only those firms or corporations have good connections with the ruling gangs, such firms/corporations would be winners. It is called "crony capitalism". The successful business depends on close relationships between business leaders and the ruling gangs through favoritism in the distribution of legal permits, public grants, and tax-relief. In other words, crony capitalism is an economy that is nominally free-market, but allows for preferential regulation and other favorable government intervention based on personal relationships. Individuals commence public projects: mining, coal, power sector, petroleum, oil, gas, and infrastructure sectors: roads, railways, bridges; human development projects on health and education to establish managerial and training institutions, real estate, dam, and telecom etc. The government treats them (private corporate sectors) as new business leaders, provides natural resources: a dirty cheap land on rent or lease basis, almost free electricity, and tax relaxation. The corporate and financial aristocracy has benefited from a massive redistribution of wealth, aided and abetted by the major capitalist states and central banks. It is not just that enormous wealth stands side by side with enormous poverty, but the one is the direct product of the other.

Crony capitalism is greatly responsible for all types of economic ills because majority people are not only alienated but out from all economic and commercial activities. This condition is responsible for economic recession. It creates poverty, unemployment, inequality, that includes gender inequality, malnutrition, and illiteracy etc. If the wealth or assets fairly distribute for community development then of course the broader community will be benefitted. Two basic principles of capitalism namely; man is able to control the behavior of markets, was totally wrong, and second, prices of commodities and factors/resources are determined by the market forces; such as demand and supply forces, were also wrong.

The powerful big bourgeoisie (including finance, military, industrial, and oil bourgeoisie) given a cosmopolitan character to production and consumption in every country, displaced by new industries through adopting "Hi-Tech", of course, produce goods and commodities faster in terms of both quality and quantity but technology cannot consume goods and commodities. It creates wealth but also creates wide inequality gap both between nations and among people, because of overproduction with lower consumption.

3. The debate on inequality

Since 1990, the heated debate on the increasing income inequality has been going on. Eventually, there was a wide consensus that trade had played a relatively modest role in depressing the relative wages of less-skilled workers in those countries and that therefore it was not the dominant or even an important factor for explaining the increase in income inequality. Rather, this increase in inequality was attributed mainly to skill-biased technological progress (see, Anderson, 2005; Goldberg and Pavenik, 2007; and Harrison, McLaren and McMillan, 2011). The debate discounted international trade as an explanation for two main reasons: first, empirical studies of developed countries (e.g. Lawrence and Slaughter, 1993; Berman, Bound and Griliches, 1994) found that the bulk of the changes in the prices of goods and increases in the skill premiums resulted from shifts within industrial sectors, rather than between sectors, contrary to what is predicted by standard trade theory. Second, empirical studies for developing countries (e.g. Berman, Bound and Machin, 1998; Desjonqueres, Machin and van Reenen, 1999) noted that the shift toward higher pay for skilled workers that had been observed for developed countries also occurred in developing countries; yet according to standard trade theory, wages in developing countries should have moved in the opposite direction to those in developed countries.

4. Wrong developmental strategies

Since 1950s, the newly independent Asian and African nations have been adopted 'a wrong developmental strategies'. These developing nations have often focused on rapid industrialization, where service industries particularly stock market, banking and insurance sectors, and military-led manufacturing industries, and real estate based finance capital increase at the expense of agriculture and rural development where around 60-80 percent engaged with agriculture and its allied activities, were neglected. For example, please see Table 1.

Table 1. GDP composition by sectors (2013 est.)

Country	Agriculture (in %)	Industry (in %)	Service sector (in %)
USA	1.1	19.5	79.4
China	10	43.9	46.1
India	17.4	25.8	56.9

Source: CIA World Factbook – unless otherwise noted, information in this page is accurate as of August 23, 2014.

5. With the greater wealth, greater poverty & inequality: an empirical investigation

World's wealth has reached a record USD263 trillion in mid-2014 (which is USD20.1 trillion more wealth, as increased with 8.3 percent ratio when compared to mid-2013). It is almost doubled than 2000. The top richest one percent people accumulated more wealth than 3.5 billion people who just survive with one percent wealth. The 500 richest people currently own $1.54 trillion, which is more than the entire GDP of Africa.

The OXFAM International predicted that the wealth of one percent of the richest people in the world amounts to USD 110 trillion, and if this trend continues then they can control more wealth than 99 percent people in 2016. The world's 85 richest people have more assets with the same value as those owned by the poorer half of the world's population, or 3.5 billion people (Global Inequality, 2014).

In other words; it is 65 times the total wealth of the bottom half of the world's population 3.5 billion people who just survive with one percent wealth, resulting over 75 percent of the world population lives in underdevelopment, and extreme poverty has already reached 1.2 billion people in the third world, as showing international organizations' reports including, UN, World Bank, Forbes, Oxfam etc. Unemployment continues at a high level of 8.4 per cent in the developed capitalist countries, according to the World Economic Studies and Prospects of the United Nations.

The Organization for Economic Cooperation and Development (OECD) report (2014) says, "In the US, the average income of the richest 10 per cent is 16 times as large as the poorest ten per cent. The US has 481 billionaires, followed by China with 358 billionaires. The US and China now have half of all billionaires on the planet. The UK, Japan, Switzerland, India and Russia are growing fast in terms of billionaires".

However, Forbes claims that each of the 67 is on average worth the same as 52 million people from the bottom of the world's wealth pyramid. Bill Gates, the world's richest man, with a net worth of $76 billion, is worth the same as 156 million people from the bottom. Who are the 67? The biggest group – 28 billionaires, or 42 percent of them – is from the United States. No other country comes close. Five British families enjoyed with 1.7 trillion dollars where world's half population have one percent of the world's total resources or wealth.

On the other hand, United Nations warned that approximately 805 million people are hungry in the world every day. In India, approximately 194 million India people are hungry every day. More than 46.7 percent of children are under-weight (between 5-10 years). Less than 2 years around 58 percent of children is not properly grown-up. Among children 1 child is malnutrited. 3.000 children die every day due to malnutrited diseases. 24 percent sharing India those children died less than five years. 30 percent newly born baby died in India every day. Each year die more people in India from hunger than diseases like Aids, Malaria, and TB in the world.

The stock market and finance capital are the driving forces behind the wealth of the world's billionaires. The top industry for billionaires, according to Wealth-X, is "finance, banking and investment", which accounts for close to 20 percent of the total billionaire population, followed by industrial conglomerates at 12 percent and real estate at 7 percent. More than one in six billionaires resides in the financial capitals of New York, Hong Kong, London, Mumbai, Singapore and Moscow. Crony Capitalism Index ranking listed Hong Kong, Russia, and Malaysia in the top 3 spots. All these money of bankers, shareholders, land owners and manufacturers is nothing else than accumulated unpaid for labor of the working class.

6. Worse situation for rural poor

A staggering 75 percent of the world's poor live in rural areas. Most of the rural population depends, directly and indirectly, on small-scale food crop agriculture, fishery, pastoral animal husbandry or rural wage labor associated with plantations and ranches, and ancillary activities linked to rural townships. Many rural families need to diversify their sources of income and employment in view of increasingly smaller parcels of land, low agricultural productivity, volatile weather conditions and soil erosion. Mostly developing countries' large rural communities suffer from inadequate access to food and lack of employment opportunity. The problem is compounded by the dependence on outdated and inefficient technologies leading to poor productivity and slow economic growth. According to United Nations Industrial Development Organiszation (UNIDO); agriculture-based industrial products account for half of all exports from developing countries, yet only 30 per cent of those exports involve processed goods compared to a figure of 98 per cent in the developed world.

An imbalance in development is the consequence, with detrimental effects on both rural and urban people. Hence, reducing urban-rural disparities and gender inequalities is a crucial element for any poverty reduction strategy. Mobilizing the potential productivity of rural people and particularly of women is indispensable to achieve the resilient economic growth that will pull people above the poverty line.

Conclusion

The policy and institutional framework behind this global economic system, which has been shaped in the course of the last thirty years, is rarely analyzed by mainstream economists. The false appearance of "pure" capitalism is publicly maintained to preserve the exclusive influence of well-connected individuals. Some people continue to defend trickle-down theories which assume that economic growth encouraged by a free market, will inevitably succeed in bringing about greater justice and inclusiveness in the world. This opinion, which has never been confirmed by the facts, expresses a crude and naive trust in the goodness of those wielding economic power and in the sacralized workings of the prevailing economic system. Economic science is an ideological construct which serves to camouflage and justify the New World Order. A set of dogmatic postulates serves to uphold free market capitalism by denying the existence of social inequality and the profit-driven nature of the system is denied. The role of powerful economic actors and how these actors are able to influence the workings of financial and commodity markets is not a matter of concern for the discipline's theoreticians. The powers of market manipulation which serve to appropriate vast amounts of money wealth are rarely addressed. And when they are acknowledged, they are considered to belong to the realm of sociology or political science. The focus of neoclassical economics is on equilibrium, disequilibrium and "market correction" or "adjustment" through the market mechanism, as a means to putting the economy back "onto the path of self-sustained growth".

The economists, particularly in the universities, rarely address the actual "real world" functioning of markets. Theoretical constructs centered on mathematical models serve to represent an abstract, fictional world in which individuals are equal. There is no theoretical distinction between workers, consumers or corporations, all of which are referred to as "individual traders". No single individual has the power or ability to influence the market, nor they do any conflict between workers and capitalists within this abstract world.

By failing to examine the interplay of powerful economic actors in the "real life" economy, the processes of market rigging, financial manipulation and fraud are overlooked. The concentration and centralization of economic decision-making, the role of the financial elites, the economic thinks tanks, the corporate boardrooms: none of these issues are examined in the universities' economics programs. The theoretical construct is dysfunctional; it cannot be used to provide an understanding of the economic crisis. Crony capitalism consists of collusion among market players. While perhaps lightly competing against each other, they will present a unified front (sometimes called a trade association or industry trade group) to the government in requesting subsidies or aid or regulation. Newcomers to a market may find it difficult to find loans, acquire shelf space, or receive official sanction.

Recommendations

- ♦ Comparative advantage or cost opportunity theory is no longer. It can be applied only through neutralized state and the market forces.
- ♦ Free market with perfect competition based concept became irrelevant in the past. To solve the problems of the society, there is a need to make a well-planned democratic state based on "people-oriented policies applications.
- ♦ Crony capitalism should be abolished.

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