Keeping Poor Countries Poor: The Absurdity of Comparative Advantage

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Theme: Global Economy

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One of the worst economic theories that has been forced upon poor countries, and economics students, is known as comparative advantage. This means that each country should specialise in what it can make, grow or do 'best'(1) and this will benefit everyone. If a country has the right climate then it should focus on growing crops that require that climate. If it has low wages, then it should focus on labor-intensive tasks, such as sewing clothes. This theory is propaganda. There are three main flaws with it.

Firstly, the main advantage that most poor countries have is cheap labour. This means that large numbers of people in poor countries have little choice but to do extremely simple, repetitive tasks like making clothes for export. They end up competing against each other to offer the cheapest labor. Corporations can play them off against each other and pay them almost nothing. (This is discussed further in a later post on sweatshops).

The second flaw is that many poor countries have been encouraged to focus on growing one crop for export, such as coffee or cotton, only to find that the price drops considerably.(2) Some of the poorest countries in Africa get much of their export earnings from selling cotton, but as cotton prices are consistently low, they do not have enough income to survive.(3) Tanzania and Mozambique were dependent on exports of cashew nuts, but the price collapsed in the year 2000. A World Bank report recognised these problems in 2005 when it noted that:

> "a development strategy based on agricultural commodity exports is likely to be impoverishing".(4)

The focus on growing crops for export leads to a decrease in farming of food for domestic consumption. The world now produces more food than ever before, easily enough to feed everyone, but malnutrition is still widespread. Indonesia was once self-sufficient in rice but now they grow more profitable palm oil for export and malnutrition has increased.(5)

Price drops also happen with goods that are not farmed. Chile was dependent on copper exports, but the price collapsed in 1996. Venezuela relies on oil exports so when the price drops their income decreases dramatically. Commodity prices of oil, iron ore, copper and other raw materials crashed in 2015.(6) There have been price collapses in almost every traded product at different times. These price collapses do not just lead to lower incomes. They lead to malnutrition, starvation and death.

The third, and perhaps most important, flaw is that comparative advantage is based upon what each country is capable of doing now. The theory ignores the evidence that with the right forms of teaching, training, investment and long-term planning, countries can develop the capacity to do more sophisticated tasks in future. One of the best writers on this topic, the Cambridge economist Ha-Joon Chang, has written:

> "If they want to leave poverty behind, they have to defy the market and do the more difficult things that bring them higher incomes."(7)

If poor countries want to become advanced nations, by definition they have to invest in more advanced technologies. They have to develop new industries (this is known as industrialisation) and protect them early on.

The Coffee Trade – A glaring example of exploitation

Coffee is one of the most important exports for many developing countries. Every detailed analysis of the supply chain for coffee shows that the growers only receive a small amount, but everyone else in the chain, the processors, the distributors, the shippers, the transport companies, the financiers, the insurers and the retailers (mostly supermarkets and coffee shops) make big profits. The big coffee companies make extremely large profits from processing and packaging the coffee. This is known as 'adding value'. The coffee growers merely sell the raw coffee beans.

The campaign organisation, Oxfam, found that from 1990-2000 total coffee sales worldwide increased from $30 billion to $60 billion but the revenues of countries that grow the coffee beans decreased from $10 billion to $6 billion. The growers received only a tiny fraction of that amount. The same pattern has continued. In 2019, demand for coffee was greater than ever, but prices paid to growers were the lowest for 13 years.(8) For coffee that costs a few dollars in the shops, the grower gets just 1 cent.(9) If growers received ten times as much, their lives could be transformed, but consumers in rich countries would barely notice the difference. For many growers, the cost of growing coffee is often greater than the amount they can earn. The problem became so bad at one point that growers in Ethiopia stopped growing coffee and turned instead to growing drugs.(10)

There was an association of coffee-producing countries who worked together to make sure that growers earned a reasonable living. Unfortunately, international lenders like the World Bank helped Vietnam start growing coffee in the 1990s. This meant that there was too much coffee being produced. The excess coffee was not needed, so it became difficult to keep paying everyone a reasonable wage for coffee that no one would buy. This led to the collapse of the association in 2001(11) and growers have been receiving poverty-level earnings ever since.

The coffee trade highlights the issue of individual countries trying to decide how to trade within one big inter-connected world. It takes three years for coffee plants to produce their first crop. In that time, other countries might have started growing coffee, so prices might change. If we were genuinely trying to get poor people out of poverty, we would not be encouraging them to grow even more coffee. Leaving development to the whims of global markets is unlikely to provide steady, and growing, incomes for large numbers of poor people.

If coffee were traded in the same way as French wine, coffee farmers would be able to process and package the coffee themselves and make much more profit. However, the trade rules of rich countries, particularly Europe, deliberately penalise poor countries if they try to add value.(12) Leaders from advanced nations deliberately maintain the international trade system in such a way that most of the profit ends up in the pockets of their companies.

FairTrade – Better, But Not The Solution

Fairtrade is a system of trading that is supposed to ensure that producers in poor countries get a fair deal. This means a fair price for their goods, and long-term contracts to provide security.(13) The economic debates about the pros and cons of Fairtrade are surprisingly complicated, but the general principle that we should not exploit workers in poor countries is one that most people would agree with. Fairtrade companies do guarantee higher income for growers and better working conditions.

However, fairtrade is only a partial solution to the problems of poor countries. The amount that growers are paid is still low. In a genuinely fair world, it would not be possible for corporations to exploit workers. Everyone involved in the supply chain for goods sold in any advanced nation should be employed under reasonable conditions. If these countries are ever to escape poverty, we must have a trade system that guarantees poor people a good income for basic items like coffee and clothes. If they want to become advanced nations, they will still have to industrialise.

Extremely Unfair Trade

The concept of fairtrade highlights the amount of goods in advanced nations that are traded unfairly. For most goods, someone in the supply chain has been treated badly somewhere in the world. If the garment worker who made your clothes was not working in a sweatshop, the farm labourer who picked the cotton was probably paid a pittance. If tech workers in China are now better paid than in the past, the people dismantling your computer in India at the end of its working life are still being poisoned, and the mineworkers who extract raw materials are in danger of being shot if they form a union. The dominant business model is extremely unfair trade.

We saw in earlier posts that one reason why the US overthrows foreign governments is to put leaders in power who will run their country using economic policies that benefit the US. We also saw that the economic system is rigged to enable the rich to extract wealth from everyone else. When rich countries buy goods from poor countries, they pay much less than they are worth. People in poor countries are simply not paid as much as they should be for their exports.(14) Wages in poor countries have been kept artificially low for generations.

Global Minimum Wage

Some people and organisations are now pushing for a global minimum wage, to try to ensure that every worker can receive a reasonable wage for their work. This has the potential to rapidly transform the living standards of many of the world's poorest people.(15) When minimum wages were introduced in rich countries, many rich and powerful people objected.(16) Think tanks have already started doing propaganda to mislead us about a global minimum wage, but whilst there are complex issues about how we determine the correct amount and how we enforce it, there really aren't any good arguments against the idea.

The Continuation of Colonialism

Commentators in rich countries have known for hundreds of years that the best way to be successful at trade is for a country to import raw materials, which are usually cheap, and export manufactured goods, which are usually more expensive and more profitable. At the moment we are encouraging poor countries to do the opposite. The policies being recommended are the same policies that colonial powers enforced during the colonial era.(17) Files that were kept secret at the time, but have now been declassified, show that the aim was to keep poor countries poor. Rich countries recommend these policies because they enable rich people to get richer. By encouraging poor countries to focus on the most basic industries, we guarantee that they will not industrialise and will remain poor.

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Notes

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