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Ricardo`s Effect: From Idea to Implementation

Tome Nenovski

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Abstract

In international trade, countries should use their relative comparative advantages. They should specialize in production and export of goods and services that compete with a lower relative cost of production in other countries and to exchange those products for other products for which home manufacturing would be more expensive. That is the theory of David Ricardo, one of the founders of classical political economy. Although it is set back in 1817, today that theory forms the basis for explaining the benefits of international trade, i.e. the incentives and motives of national economies to trade with each other. At its core lies the model of perfect competition. This model is the basis for today's advocacy for free trade within the EU, trade with no tariffs and no other restrictions.

The end result of the Ricardo model of comparative advantage leads to a gradual flattening of product prices which are traded between economies based on comparative advantages. If there is free trade between foreign countries, it is clear that the products will move from areas with lower prices, to areas with higher prices. The realization of such a theory today is a plan within the EU. However, the practice opposes these fundamental values of Ricardo's theory because:

- The model of perfect competition, to which EU aspires, practically does not exist today because today in the EU market structures that restrict competition prevail;

- The model does not explain how countries that trade with each other will establish a balance in the trading price;

- The model does not explain how to overcome the problem of different tastes of consumers in different countries;

- The model does not explain how to reduce transport costs as barriers to foreign trade.

Eliminating such weaknesses will upgrade Ricardo's theory and make it valid in current economic conditions. That way it could really be effective in realizing the vision of a "Europe without borders".

Introduction

In mutual trade, countries should use their comparative advantages. They need to specialize in production and trade of goods that have a relative comparative advantage, i.e. goods that are produced with lower cost in comparison to other countries; and to share them with other countries as well. It is the basis of free trade or trade without restrictions on export and import by the government. In addition, the encouragement of free trade depends on the economy of scale, competition, diversity and number of offered products, efficient allocation of resources and international cooperation.

This is the theory of David Ricardo, one of the founders of classical political economy. Although it was established back in 1817, today that theory forms the basis for explaining the benefits of international trade, i.e. the incentives and motives of national economies to trade with each other. This model on comparative advantages is a model for today's advocacy for free trade. If there is free trade between foreign countries, it is clear that the products will move from areas with lower prices to areas with higher prices. However, the realization of such a theory today does not function in the EU.

The fundamental values of the theory of Ricardo are opposed due to numerous limitations and weaknesses in the implementation of this law of comparative advantages. Therefore a question is raised: is the theory of Ricardo valid under the current economic conditions? The opinion on this matter varies with different economists. Most of them think that with some improvements this theory can give the effects that were introduced by great Ricardo two centuries ago.

Terms of Trade

Theoretically, a closed (autarkic) economy does not communicate with other economies in the world. It is self-sufficient and does not depend on import and export of goods and services. Today, there is no economy with such features and the economies of all countries are open.

Open economy is an economy that freely communicates with other economies in the world. Mutual economic relationships of the modern

economies are established in two ways: by buying/selling various goods and services on the world markets and by buying/selling of capital goods on those markets.

The countries export goods and services mainly for two reasons. First, in some cases the domestic market is unable to absorb (to buy) the entire production of certain goods and services. Companies are trying to sell the surplus of those goods and services on the foreign markets where there is inadequacy of such goods and services or there is high demand for them, i.e. a specific country cannot cater to their domestic production. Secondly, domestic enterprises can evaluate foreign markets that provide better conditions (prices) for the sale of their products and thus can achieve higher earnings. In that case, the conditions for exchange (trading) are favorable for them. This process is known as the microeconomic aspect of monitoring and analyzing the terms of trade (commerce) with foreign countries.

Macroeconomic aspects in terms of international exchange, of course, are wider. They refer to the conditions under which the total national economy trades internationally. Moreover, it is always analyzed under the following terms; whether the country exports more than it imports, what is the structure of the export and import, what is the coverage of import by export and, finally, what is the cost-effectiveness of foreign trade to the national economy.

The answer to these questions gives the conditions under which the international trade is executed. The terms of trade with foreign countries refers to the quantity of imported goods that a country can get (pay) for the price of the unit export good. They can improve or deteriorate depending on the prices of goods and services exported and/or imported. If prices of imported goods rise and prices of export goods remain unchanged or, perhaps, fall, the trade conditions of the particular economy deteriorate. In such situations the country needs to export more in order to buy the same quantity of import goods and vice versa. The events on the world markets in the period 2007-2008 and in early 2011 testify to the significance of the conditions and changes in the terms of trade. Namely, developing countries have been major exporters of primary products for many years, and are faced with adverse terms of trade. The reason for that was the long-term economic stagnation and decline in prices of primary products. That happened with agricultural and food products. This situation reduced the earnings from export and the developing countries needed to export more in order to import products with a high degree of finalization. These countries have faced poor conditions of international exchange for a long period of time.

However, in 2007-2008 and in early 2011 the conditions changed. Due to various reasons, the demand for certain agricultural and food products (wheat, corn, sugar, etc.) sharply increased. The prices of these products reached extremely high values. Suddenly the countries that produce agricultural products were in a much more favorable situation than in the previous decades. Indexes of their export prices became much higher than the indexes of their import prices (Eurostat, 2011). Their terms of trade were significantly improved.

Generally, there are factors that enhance and factors that exacerbate the conditions of trade. They can strongly influence the scope and pace of exporting goods and services in some countries. According to Mankiw (2009, p. 692-693), the most important factors are the following:

- Tastes and preferences of consumers for domestic or foreign goods and services;
- Domestic and foreign prices of goods and services;
- Exchange rate of national currency;
- Domestic and foreign income of consumers;
- Cost of transporting goods from one country to another;
- The foreign policy of the government.

These variables change over time. Therefore, the conditions in international trade change as well. The previously described developments in the prices of agricultural and food products convincingly confirm this conclusion.

Comparative Advantage in International Trade

In order to exploit the benefits of the terms of trade, a country needs to offer goods and services on the world market in which it is specialized or which can benefit the country. In other words, in order to be a competitive athlete on the world market, the country should offer products that can be sold at competitive prices on the world markets. Simultaneously, the country will participate on the world market by buying at lower prices and selling the products on the domestic market by higher price.

There are differences in the availability of raw materials and other factors of production internationally. This leads to the existence of differences between countries in terms of production costs of individual goods and services. Therefore, countries should produce goods and services with the

available resources (that they have in large quantities and at low price) and thus the final products can be sold cheaply (more competitively) on the world markets. To accomplish this, they should at least temporarily sacrifice the production of goods and services which are available to be produced, but have no competitive advantage.

The previous observations lead us to the term 'opportunity cost' of producing a product or supplying a service. Opportunity cost of producing a product or supplying a service is the quantity of other goods and services that are sacrificed (not produced) in order to produce an additional unit of that specific product or service (Fiti, 2006, p. 456). We can take for instance an economy which is closed and which with the given resources can produce only shirts and shoes. The more resources are used to produce the shirts, fewer resources will be used for the manufacturing of shoes. The opportunity cost of the shirts is the amount of shoes that are sacrificed (not produced) in order to produce shirts.

This legitimacy stems from the limitations (rarity) of resources. However, from it, the foundations (structure) of the international trade arise. Namely, if an economy can produce certain goods and services for a shorter period of time and with less expense of other factors of production, it can specialize and concentrate just on the production of those goods and services. Specialization itself will act on reducing the production costs of those goods and services. It will enable the (specialized) country to produce those goods and services in large batches and to realize economy of scale (production of large quantities of a product using the available resources and other factors of production). The economy of scale reduces fixed costs per unit of a product. As a result of specialization and economy of scale, the country is able to produce large quantities of certain goods and services with lower prices and to exchange them for other goods and services which, if produced at home, will cost more. Thus, the opportunity cost for the production of goods and services in the specialized country significantly decreases.

Specialization of certain goods and services for the particular country means getting a comparative advantage in international commerce (Law on comparative advantage). It may occur in the form of absolute or relative form of advantage for the production of certain goods and services. Both benefits have been established and elaborated by the founders of classical political economy, Adam Smith and David Ricardo. Over time, the two theories have evolved (changed) in certain parts, but remained (especially the theory of

Ricardo of relative comparative advantages) as economic laws by which countries should act in the international trade in order to get greater benefit. The theory of Ricardo of comparative advantages is one of the basic tenets of the foundation of the single European market - the European Union (EU).

Smith's Theory of Absolute Advantage as a Basis for International Trade

The theory of absolute advantages was founded by the Scottish economist Adam Smith (1723-1790) in his legendary work "The Wealth of Nations". According to him, an elementary rule of good family maintenance is that one family should not produce something that can be bought on the market at a lower price. It is the same for the economy; it is profitable not to produce goods that can be bought from abroad cheaply. Or, if a foreign country can supply the domestic country with a certain commodity cheaper than we can produce it. Therefore, it is better to buy it with a certain part of our products that are used in a way that we can achieve some advantage (Smith, 1904).

How does the theory of absolute advantages work in practice? Suppose that countries X and Y produce shirts and shoes and that they trade with each other. Country X has greater labor productivity in the production of shirts, and the Y has greater labor productivity in the production of shoes. According to the usual definition, labor productivity shows the effect of labor per unit of time, i.e. the number of shirts and/or shoes produced for one day.

In accordance with the theory of Smith, X for the same time can produce more shirts compared to Y (which means a higher labor productivity), therefore X has an absolute advantage in producing shirts. Conversely, Y produces for one day more shoes than country X and Y has an absolute advantage in producing shoes. The two countries are paying to specialize in the manufacturing of the product they have absolute advantage of. So, X will specialize in the manufacturing of shirts and it will exchange the shirts for shoes from country Y. The country Y will specialize in the manufacturing of shoes and it will exchange the shoes for shirts with country X. Both countries would benefit from such exchanges, or from the international trade.

Why is this so? The answer can be found in Table No. 1.

Table 1: Absolute advantages

Products	Country X - Number of products per one working day	Country Y - Number of products per one working day
Shirts	550	400
Shoes	350	450

If the countries do not specialize in producing products which they have an absolute advantage of, the total number of shoes produced will be 800 units, and the total number of shirts produced 950 units. However, if countries specialize according to the principle of absolute advantage, the total number of shoes produced will be 900 units (100 units more than the situation before specialization), and the total number of shirts produced will be 1.100 units (150 units more than before specialization).

This theory however, is not giving answer to the question what would happen if one country has absolute advantage in producing both products. Is there a benefit from the international trade in that case? This dilemma is resolved with the theory of relative comparative advantages.

The Theory of Ricardo of Relative Advantages as a Basis for International Trade

The theory of relative advantages in foreign trade was founded by the English economist David Ricardo in 1817. According to this theory, countries are specializing in production and export of goods and services that are produced with lower cost in comparison to other countries. Ricardo proves that the countries can benefit from trade between them even when a country has absolute advantages in the production of two or more products. For Ricardo, the relative comparative advantages are more relevant.

The theory of Ricardo is presented with a hypothetical example in Table No. 2. Ricardo gives the example when England and Portugal produce wine and canvas and Portugal has absolute advantage in producing both products.

Table2: Relative advantages

Product / Country	England	Portugal
Canvas	100 working days	90 working days
Wine	120 working days	80 working days
Total:	220 working days	170 working days

According to the theory of absolute advantages, these two countries can not trade with each other, because Portugal has absolute advantage in producing canvas and wine production. However, Portugal has a relative comparative advantage in producing wine within the borders of the country, because the wine is produced in 80 working days, and the canvas requires 90 working days. When Portugal would not trade with England, 170 working days will be needed to produce two products.

But what would happens if Portugal specializes in the production of wine, which has a comparative advantage in its area compared to the canvas? In that case, it will require 80 working days to produce wine for its own needs and another 80 working days to produce wine for export, or to exchange for canvas from England. So, in this case, with 160 days Portugal will have two products - wine and canvas and, in fact, will save 10 working days. Regardless of the fact that Portugal has absolute advantage in producing both commodities, it is good to specialize in the production of goods with relative comparative advantage. It allows for the country to produce two products cheaper and with less labor costs.

Using the same logic, England is better off to specialize in the production of canvas in which it has a relative comparative advantage and to share its canvas for Portuguese wine. If they so proceed, England will get two products for 200 days. Otherwise, if England does not trade with Portugal, in order to provide wine and canvass, it has to spend 220 working days or 20 days more.

It is obvious that the relatively abundant supply of a factor of production makes the expenditures relatively cheap to rent. Therefore, the goods whose productions are based on a particular factor of production will be relatively cheap. Those are the goods for which the country has comparative advantage. “States with scantily land, but with a high degree of skilled labor, usually have a greater share of industrial products in its exports, countries with land, but with few skilled workers, typically export raw materials” (Begg et al. 2000, p. 560). Therefore, countries are paid to specialize in the

manufacturing of products that have comparative advantages and to trade those products for other products that would be more expansive if they are produced domestically. The differences in relative productivity are the basis for international trade (Begg et al. 2000, p. 553).

Perfect Competition and Free Trade

David Ricardo's theory of comparative advantage today is the basis for explaining the benefits of international trade, i.e. the initiatives and motives of national economies to trade with each other. At its core lies the model of perfect competition (at the time of Ricardo, market structures were close to the model of perfect competition). This model is the basis for today's economists that are promoting free trade (with no customs and other restrictions).

The end result of Ricardo's model of comparative advantage leads to a gradual flattening of the prices of products and services in the economies that trade with each other, based on comparative advantages. Namely, if there is free trade between countries and relevant economic and political cooperation among the various nations within the EU with positive implications for their economic growth (a realistic assumption within the EU now), it is clear that the products will move from areas with lower prices to areas with higher prices. France, for instance, has an obvious comparative advantage in producing high quality cheese, and Spain has a comparative advantage in producing high quality men's shoes. Countries trade with each other within the single European market, de facto, without customs duties and non-tariff restrictions. Cheese, which is cheaper in France, may be placed on the Spanish market, and men's shoes that are manufactured in Spain may be placed on the French market. So the higher supply of high quality and relatively cheap French cheeses in Spain will cause a drop in the price of the cheeses in this country. Conversely, a rise in imports of high quality men's shoes from Spain to France, and the increased supply of men's shoes on the French market may also cause decline in the price of that product in France.

If such a trade relation between the two countries is established, the prices of the products in the markets in those countries will begin to converge and become equal. Use of trade between two countries, thanks to specialization in areas where countries have already gained comparative advantages, will have the citizens of Spain buy and consume less expensive

French cheese and citizens of France buy and consume cheaper Spanish men's shoes.

Such arguments are the basis for free or liberal trade from which all EU Member States would benefit. In fact, the validity of the theory of Ricardo of comparative advantages and the assessment of most contemporary economists that all countries participating in foreign trade will benefit if it is free are reasons for intensive exchange of goods and services between EU Member States. The mutual dependence on the economic cooperation of individual national economies within the EU economy becomes more and more important.

Trade between the EU Member States

So far, however, such conclusions are not fully realized in the mutual exchange of EU Member States. Analyses of statistical indicators show that the less developed "old" EU member states (like Portugal and Greece), and most of the countries that have joined the EU since 2004, are still far from realizing the benefits expected from the activities of the single European market. The low development of some "old" EU member states and the need to meet the Acquis communautaire, as a condition for membership of the "new" countries in the EU, are mostly aiming to remove the various customs and non-tariff barriers in relations with other Member States. That means the need for their integration into the common European market is conditional upon their increasing openness to the EU. The result of this is a growth in the size of their foreign trade within the EU, but much more of the import than of the export.

The following analysis confirms this fact. The analysis will be limited to the volume of foreign trade of 10 countries within the EU which have a detectable and significant imbalance in trade relations within the Union: Bulgaria, Czech Republic, Greece, Cyprus, Lithuania, Hungary, Poland, Portugal, Slovenia and Slovakia (hereinafter referred to as Group 10).

Table No. 3 shows that the share of intra export and import of goods and services in the Gross Domestic Product (GDP) of Group 10 has been continually increasing in the period 2005 - 2008 (period before the beginning of the World Economic crisis). During that period some of those countries (Bulgaria, Czech Republic, Lithuania, Poland, Slovenia, Slovakia) recorded very high dynamic of growth of their trade in intra EU trade.

Table 3

Share of intra EU import and export of goods and services in GDP of EU Member States						
		% of GDP				INDEX
	GEO/TIME	2005	2006	2007	2008	2008/2005
1	European Union (27 countries)	30.66	32.90	33.02	34.25	126.08
2	Belgium	91.70	95.26	97.78	99.14	123.17
3	Bulgaria	43.92	49.56	56.23	56.40	195.65
4	Czech Republic	65.01	69.72	73.34	72.41	164.40
5	Denmark	31.82	32.60	31.68	32.70	115.70
6	Germany	32.27	35.39	36.85	36.90	126.55
7	Estonia	60.80	58.26	51.09	50.50	119.65
8	Ireland	45.95	41.26	39.41	39.38	95.02
9	Greece	13.79	15.24	15.25	16.27	143.53
10	Spain	21.48	22.47	22.39	22.94	127.88
11	France	21.32	21.68	21.52	21.62	114.49
12	Italy	21.62	23.74	24.58	24.91	126.32
13	Cyprus	17.78	16.87	16.83	17.89	127.35
14	Latvia	37.69	35.58	32.76	32.21	151.33
15	Lithuania	54.12	53.85	48.08	57.82	165.29
16	Luxembourg	60.59	66.55	52.76	52.34	113.09
17	Hungary	64.39	73.54	75.69	76.35	142.41
18	Malta	35.87	42.61	36.96	30.01	102.61
19	Netherlands	79.58	84.97	86.23	91.79	133.96
20	Austria	37.87	39.17	40.90	41.18	126.35
21	Poland	31.37	35.64	36.32	35.84	169.72
22	Portugal	23.45	24.75	25.31	25.70	122.59
23	Romania	34.65	33.86	28.86	29.39	148.55
24	Slovenia	48.38	54.52	61.54	61.75	165.59
25	Slovakia	74.12	84.93	87.94	84.89	192.13
26	Finland	29.01	33.29	32.70	32.69	132.26
27	Sweden	29.74	31.94	31.87	33.07	124.22
28	United Kingdom	19.50	21.94	19.10	20.88	106.00

Source: Eurostat, 2011 Available at:
http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database

Insufficient development of some of the “old” EU members and the growing openness of the newly admitted EU members led to a high dynamic of growth of their import from other EU member states. The accelerated pace of their imports from the EU caused increase the participation of Group 10 in the total import on

the level of the EU from 8,35 percent in 2005 to 10,99 percent in 2008, which indicates an increase of 31,6 percents (see Table No. 4).

Table 4

	Share of intra import of EU member countries in total intra EU import					
		% of Intra EU import				**INDEX**
	GEO/TIME	**2005**	**2006**	**2007**	**2008**	**2008/2005**
1	European Union (27 countries)	**100**	**100**	**100**	**100**	**132.67**
2	Belgium	6.06	5.91	6.17	6.10	133.55
3	Bulgaria	0.40	0.44	0.63	0.69	232.33
4	Czech Republic	0.97	1.07	1.20	1.43	195.15
5	Denmark	1.49	1.40	1.36	1.35	119.59
6	Germany	18.81	19.37	19.01	18.72	132.01
7	Estonia	0.17	0.20	0.17	0.14	112.92
8	Ireland	1.56	1.36	1.28	1.10	93.60
9	Greece	1.55	1.60	1.64	1.75	149.64
10	Spain	7.05	7.40	7.33	7.44	140.07
11	France	11.15	9.83	9.79	9.91	117.90
12	Italy	10.63	11.06	11.01	11.07	138.12
13	Cyprus	0.13	0.13	0.14	0.15	148.28
14	Latvia	0.15	0.16	0.18	0.17	155.73
15	Lithuania	0.43	0.42	0.39	0.57	177.20
16	Luxembourg	0.41	0.46	0.37	0.35	114.09
17	Hungary	1.37	1.37	1.48	1.50	146.18
18	Malta	0.06	0.07	0.06	0.05	117.57
19	Netherlands	12.54	12.33	12.51	13.10	138.61
20	Austria	1.69	1.64	1.72	1.76	137.89
21	Poland	1.71	2.02	2.25	2.55	198.25
22	Portugal	0.98	0.96	0.98	1.03	140.45
23	Romania	1.02	1.10	1.03	1.11	143.67
24	Slovenia	0.29	0.32	0.42	0.46	214.90
25	Slovakia	0.52	0.66	0.78	0.86	218.81
26	Finland	1.33	1.47	1.50	1.51	150.64
27	Sweden	2.25	2.28	2.26	2.26	132.92
28	United Kingdom	15.28	14.98	14.35	12.85	111.54

Source: Eurostat, 2011 Available at:
http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database

The increase of imported products from other countries within the EU is understandable. It is a way to offset the range of products which are not produced at all or not produced in sufficient quantity on the domestic market and thus to meet the growing needs and demands of domestic consumers. Moreover, probably a strong factor is the higher quality of these products in

relation to the quality of the domestic products, and in many cases, lower cost of the foreign over the domestic products, previously established by the conditioned specialization and volume of these products in the exporting (developed) countries. Of course, import of goods and services from abroad has a positive effect on the growing competition in the domestic market. Thus analyzed, the value of the growing integration of Group 10 in the external trade of the EU cannot be denied. On the contrary, it should be welcomed.

A problem appears on the other side of the external trade of the Group of 10 on the European market - on the side of export. From the data in Table 6 it can be concluded that the export of these countries in the observed period has increased, but neither with similar nor with higher pace than that at which their import from other EU countries has increased.

The reasons for this are different: greater integration of the developed countries of EU in the world trade (and outside the EU), unsatisfactory quality of the products of less developed member states, the decisions of developed countries to import more intermediate goods (raw materials) from the less developed countries, goods which have low added value and thus are cheaper, but also frequent decisions of the developed countries to introduce the so-called non-tariff restrictions on imports of products from other areas of the EU to protect their own production and manufacturers of certain goods, especially those in the agricultural sector. These reasons caused the average participation of Group 10 in the total export to the EU to increase at much smaller pace than their share in total import in the EU. Thus, from 10,38 percents in 2005, export of Group 10 has increased to 12,83 percents, which signifies an increase of 23,6 percents (see Table No. 5). This leads to a conclusion that Group 10 has a low ratio of export/GDP, i.e. that those countries are still faced with some barriers in their operation within the EU, which hampers their opportunities at the expanded European market. That, ultimately, hampers those countries from increasing their exports on inter European market, which will have a favorable effect on the growth of their GDP.

Therefore, in the observed period (2005-208) the dynamic of import growth (31,6 percent) of Group 10 was considerably higher than the dynamic of growth of their export in the markets in those countries (23,6 percent). As a result, the high trade imbalance in Group 10 with the EU is obvious.

However, the conditions in the mutual exchange of goods and in the mutual exchange of services between Group 10 and the EU are quite typical.

Table 5

Share of intra export of EU member countries in total intra EU export						
		% of Intra EU export				INDEX
	GEO/TIME	2005	2006	2007	2008	2008/2005
1	European Union (27 countries)	100	100.00	100.00	100.00	122.57
2	Belgium	9.31	8.94	9.08	9.08	119.57
3	Bulgaria	0.25	0.29	0.34	0.34	164.67
4	Czech Republic	2.42	2.60	3.12	3.12	157.85
5	Denmark	2.18	2.10	2.04	2.04	114.29
6	Germany	22.65	22.49	22.93	22.93	124.13
7	Estonia	0.22	0.20	0.22	0.22	122.36
8	Ireland	2.54	2.20	1.98	1.98	95.49
9	Greece	0.39	0.42	0.41	0.41	130.53
10	Spain	5.06	4.85	4.90	4.90	118.84
11	France	10.68	10.36	9.81	9.81	112.60
12	Italy	8.29	8.13	8.00	8.00	118.27
13	Cyprus	0.04	0.03	0.03	0.03	89.33
14	Latvia	0.14	0.14	0.17	0.17	148.93
15	Lithuania	0.28	0.29	0.36	0.36	155.60
16	Luxembourg	0.61	0.65	0.56	0.56	112.74
17	Hungary	1.85	1.90	2.12	2.12	140.93
18	Malta	0.05	0.05	0.03	0.03	91.83
19	Netherlands	11.77	11.71	12.61	12.61	131.33
20	Austria	3.26	3.14	3.28	3.28	123.17
21	Poland	2.55	2.79	3.32	3.32	159.55
22	Portugal	1.11	1.07	1.03	1.03	114.20
23	Romania	0.70	0.73	0.88	0.88	152.31
24	Slovenia	0.48	0.51	0.58	0.58	149.84
25	Slovakia	1.01	1.16	1.52	1.52	184.75
26	Finland	1.35	1.41	1.35	1.35	122.60
27	Sweden	2.80	2.84	2.76	2.76	120.50
28	United Kingdom	8.01	9.01	6.56	6.56	100.38

Source: Eurostat, 2011 Available at:
http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database

Regarding the exchange of goods, no significant imbalances between export and import have been noted. According to Zamora (2009), EU countries are more open in that part, which indicates that the internal market provides encouraging integration of the markets of goods. In fact, statistics confirm that the internal trafficking of goods accounts for about 18 percent of the EU GDP. Moreover, Group 10 and, especially, the newly admitted EU countries, show greater openness (almost twice as big, about 35 percent of

GDP) than the "old" EU member states, which show about 17 percent of GDP in the exchange of goods on the domestic market.

Despite the high openness to trade in goods, the openness of all Member States in the exchange of services is very small (about 6 percent of GDP). Moreover, in the developed part of the EU there is a distinctive orientation towards the much larger import of services from countries outside the EU. They, in particular, demand services from the outside world in the field of financial services, information and IT services and construction services. A possible reason for this is the higher quality of the services which are obtained outside the EU. However, in various analysis (Zamora, 2009) it is stated that the main reason for such relations in exchange regarding the services are the still present high barriers that countries set for imports of services from the EU internal market. Knowing this, the European Commission in 2006 adopted Directive 2006/123/EC on services, which the Member States of the EU should have started implementing by the end of 2009. The main objective of this Directive is to remove barriers from the sharing of services among the EU members, which will be a great benefit to businesses and consumers in all EU countries.

Accordingly, in the commercial relations between Member States there are still a number of limitations that do not allow significant improvement in trading conditions and equal identification of all Member States with a single market.

Limitations

In practice these fundamental values of the validity of Ricardo's theory of comparative advantage are often challenged. Actual limitations and shortcomings can be summarized as follows:

a) The model of perfect competition within the EU today virtually does not exist. Today the prevailing market structures limit the competitiveness. For example, today there are oligopolies (more differentiated sellers who agree to act on the market). Such are, for example, clusters of cars, wine, grain, oil, etc. In some areas there are monopolies (the only manufacturer of a product). This is usually the case of phone service or computer software companies. Because of their presence neither the flexibility of prices and wages, nor the mobility of production factors (labor, capital) functions, which are the basic requirements of the model of perfect competition;

b) Although efforts are made to appropriately establish free international trade, in practice, it remains burdened by numerous restrictions. To protect the economy, many countries used protectionist measures, such as various quantitative restrictions on trade with other countries. The most illustrative examples are the various quantitative restrictions which individual Member countries use in order to protect their products from competing products from other Member countries which built powerful and competitive industries, especially based on comparative advantages arising from the relatively cheap and abundant labor.

Simultaneously, in common use are the non-tariff barriers that some countries have introduced for the protection and promotion of their products in trade with other Member States. Often the more developed Member States require extremely high safety standards for imported goods or bring much bureaucracy to reduce the volume of goods entering the country. For example, unnecessary delays are introduced in the processing of import documentation or very high (often subjectively high) standards for health and safety of the population. Or, to boost exports of their products, some countries grant subsidies which can be public (for example, approving grants or performing other investment incentives), hidden (granting tax breaks for exporters) or exporters can even receive direct financial assistance to export (Nellis H. Parker, 2004, p. 318). The western parts of the EU often do;

c) The theory of comparative advantage puts the developing countries (Bulgaria, Poland, Hungary, Lithuania, Portugal, Slovenia, etc.) in a disadvantage. These countries have comparative advantages in the production of raw materials and products with a low degree of industrial processing (finalization). The prices of these products are low compared to the prices of products with a high degree of finalization of production whose comparative advantages are on the side of developed Member States. Accordingly, there is an unfavorable relationship between the prices of raw materials and commodity prices with a high degree of processing. In other words, the terms of trade are unfavorable to the less developed member states. In the past decade, terms of trade became worse in less developed countries because the prices of the products with a high degree of finalization rose faster than the dynamics of growth of prices of raw materials and products with a low degree of processing. That means that less developed countries are forced to supply larger quantities of raw materials to obtain smaller quantities of industrial products. In that case the less developed

countries lose as opposed to the claim of the theory of comparative advantages that in the international trade all countries have benefit;

d) The model does not explain how countries trade among themselves to establish a balance in the trading price;

e) The model does not explain how to overcome the different tastes of consumers in different Member States;

f) The original theory of Ricardo of comparative advantage does not explain how to reduce transport costs as barriers to foreign trade.

Conclusions: Single Market for European Identity

If the theory of Ricardo insists that foreign trade should be with strict observance of the relative comparative advantages, that means that the theory actually requires the preservation of present relations, or unchanged status (status quo), which obviously does not suit the less developed countries within the EU. This means that comparative advantages of raw materials for production are on the side of less developed countries and comparative advantages for production of industrial products are on the side of developed countries. Therefore, the theory of Ricardo should be analyzed through its dynamic aspect, i.e. to take into account that the comparative advantages are not given once and for all, but that each country, with reasonable and well-established development policy, should create relative comparative advantages in strictly selected economic sectors.

That, in reality, of course, is possible. Typical examples are the countries of Southeast Asia, which gained comparative advantages in the electronics sector, which they previously did not have. Or countries-producers of agricultural and food products, which, as previously stated, fight for higher prices of their products on the world markets, which significantly improved their terms of trade within the outside world.

In addition to being an equal field for competition for all its members, the European market should be more open than ever, and the measures which will be taken should lead to stimulation of the competition. This is possible with a greater integration of different (national) markets in a single market, and elimination, as much as possible, of the numerous restrictions which are still maintained. In fact, one cannot speak of a fully integrated market if the “economic borders” between individual Member States are not eliminated. This particularly applies to the “old” member states, which by eliminating the

remaining foreign trade barriers will contribute to improving the functioning of the internal market in the EU.

The analysis confirms that Group 10 shows a much greater willingness to trade in goods and services with other Member States. But the obvious is still present: the resistances and constraints posed by the advanced (older) member states, especially in the exchanges of various forms of services within the EU. The European economy can be considered to be fully integrated only providing that the internal market guarantees freedom of mutual exchange of services as well.

Elimination of the previously mentioned weaknesses will upgrade the theory of Ricardo and make it valid in the current economic conditions. Within the EU it is possible to have further liberalization of the trade in the Member States and further enhancement of their trade integration as a condition for establishing and fostering sustainable economic development of EU integration as a whole. In this case the theory of Ricardo could really be effective in realizing the vision of a Europe without any borders, which would mean strengthening the single market that would be equally identified by all Member States.

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