what constitutes a developed country has changed over time—for example, from a producer of iron and steel in the early part of the twentieth century to a producer of automobiles and planes in the middle part of the century to a producer of computer software and microchip designs in the latter decades—a failure to competitively produce the goods and services that conform to the current definition of a developed country gives rise to political concerns. Further, when international competitiveness appears to be declining, political action is often called for to restore it.

The factors that determine a nation's international competitiveness are exceedingly complex. In some cases, competitiveness is related to factors over which nations have little control—the availability of natural resources, geographical location, and climate. For the most part, however, competitiveness relates to factors over which governments can exercise some control—the skills of the labor force, higher education, the legal and commercial environment, infrastructure such as roads and ports, entrepreneurial incentives, taxes, research and development activity, the market power exercised by foreign firms, and the activities of foreign governments. Trade theories help identify the sources of competitiveness and what causes them to change.

Alternative Theories of International Trade

Trade theory has undergone a long evolution in its quest to explain competitiveness, but as yet no comprehensive theory has been developed. The insights gained along the way, however, are considerable. *Classical* theories of international trade—most closely associated with the work of Adam Smith in the eighteenth century and David Ricardo in the nineteenth (Smith 1961; Ricardo 1951)—were primarily concerned with showing that trade was beneficial to the nations that engaged in it. The two simple proofs of classical trade theory, *absolute advantage* and *comparative advantage*, still provide much of the popular intellectual underpinnings for belief in trade liberalization.

If two nations voluntarily trade, then both must gain if each country specializes in producing the good for which it has an *absolute advantage*. Advantage is defined by efficiency in resource use. The good that the country produced would then be exchanged in trade for the commodity in which it had an absolute disadvantage. This intuitive result can best be proved through a simple numeric example. In table 2.1 we