Capital and Capital Goods in Trade Theory: A Primer

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Four and half decades ago Ian Steedman, J.S. Metcalfe, L. Mainwaring and S. Parrinello (Steedman 1979, Fundamental Issues in Trade Theory) launched a powerful critique of then dominant. Heckscher-Ohlin-Samuelsson (HOS) theory of international trade. The principal target of their criticism was the treatment of capital in HOS theory. Specifically, they showed that treating capital as an exogenously given endowment leads to severe logical difficulties. On the contrary if capital is treated explicitly in both senses i.e. as physical quantities of produced means of production and as the value (quantities multiplied by prices) of these means of production. The propositions of HOS theory lose their validity. Unfortunately, neither Steedman et.al. nor subsequent literature have built upon their critique and used it to revise and reformulate trade theory. This paper articulates trade model that explicitly recognize the distinction between physical capital goods which are themselves produced and the value of the capital stock on which basis profits are earned and represents them in the equations of those models. The resulting trade model sharply different from the HOS theory in its composition and its inference. It also differs from later developments in trade theory including a) new trade theory and b) the modern revival of Ricardian trade theory in which commodities are produced directly by means of labour alone and capital is absent. The proposed trade model accommodates trade in both capital and consumption goods.