

In 1817, Ricardo published, *The Principles of Political Economy and Taxation*, which detailed the Theory of Comparative Advantage. This theory states that it is not absolute costs differences but comparative costs differences which gives rise to trade. Even if one nation is less efficient than the other nation in the production of both commodities, there is still a basis for mutually beneficial trade. The less efficient nation should specialize in and export the good in which it is relatively less inefficient (where its absolute disadvantage is least). The more efficient nation should specialize in and export the good in which it is relatively more efficient (where its absolute advantage is greatest).

Free trade based on comparative advantage results in most efficient allocation of world's resources and maximization of world production. Adam Smith stated the basis of trade to be the absolute superiority of one nation over another in a particular product whereas David Ricardo emphasized on differences in labor productivity which gives comparative cost advantage to nations in producing particular goods. Basic prediction of Ricardo that countries will tend to export goods in which they have relatively high productivity has been confirmed by a number of studies.