

Theories of International trade

1. Introduction

The exchange of goods and services as well as resources between countries. It involves transaction between residents of different countries.

Compared to internal trade, international trade has greater complexity as it involves

- i. Heterogeneity of customers and currencies.
- ii. Differences in legal system.
- iii. More elaborate documentation
- iv. Diverse restrictions in the form of taxes
- v. Regulations
- vi. Duties
- vii. Tariffs
- viii. Quota
- ix. Trade barriers
- x. Standards
- xi. Issues related to shipping and transportation

2. Arguments in the support and against of the international trade

Arguments in the support

- i. Prevent undue fall in domestic prices due to Overproduction.
- ii. Reduction in domestic Monopoly
- iii. Economic Growth and rising income
- iv. Enhance the scope of Mechanization and Specialization.
- v. Inputs (raw material) at competitive prices (Chemicals use in textile sector)
- vi. Supply of goods during Natural Calamities (flood, earthquake)
- vii. Generating Employment & raising standards of livelihood
- viii. Strengthen the bonds between two nations
- ix. Enhanced Efficiency and Probability

Arguments in Against

- i. Revelry on Account of severe competition
- ii. Exhaustion of Natural Resources

- iii. Threat to the survival of domestic industries (Walls, hyperstar)
- iv. Loss of cultural identity
- v. Risk of trade Embargoes (sections apply any time)
- vi. Harmful imports will damage Environment and Health
- vii. Depressed demand on unskilled and semi-skilled workers (machines take the position of labors)

3. The mercantilist view of International Trade

- Collect precious metals to become rich (gold, diamonds)
- Maximize Exports and minimize Imports
- Trade is a Zero-sum Game (if one win than other loose)

4. The Theory of Absolute Advantage

- Adam Smith tell that International trade is not a Zero-sum game.
- Exchange of goods between two countries will take place only if each of the two countries can produce one commodity at an absolutely lower production cost than the other country.

5. The theory Comparative Advantage

- Developed by David Ricardo in his book principles of Economy and taxation (1817).
- Comparative Costing

6. Modern Theory of Trade

- This theory is developed by Eli Heckscher and his student Bertil Ohlin
- Comparative theory is based on one factor (Labor)
- They tell Trade is based on Factor Endowment (factor of productions)
- The country which have more factor endowment are financially better
- Labor intensive good and capital intensive good
- Example of Cloths and computer
- Either a country is labor abundant (pak) or capital abundant (USA)

7. Difference between comparative cost and modern theory

	Theory of competitive cost	Modern theory
Basis of difference	The basis of the difference between countries is comparative cost	Explain the causes of difference as comparative costs as difference in factor endowment
Based on	Based on single factor (Labor)	Based on labor and capital
International trade	Treats international trade is quite different from domestic trade	All the world is single market Global village
Difference in comparative advantage	All the credit goes to “productive efficiency of workers”.	Credit goes to all Factor endowments.

8. New trade theory

- This theory is developed by Paul Krugmar in 1970s
- Anything you can import and export (fabrics, food chain)
- Healthy competition
- It creates Monopolistic competition

Economies of scale

Network effects

- The value of a product or service is enhanced as the number of individual using it increases. This is also referred as “**bandwagon effect.**”