International Economics

Books:
1. charles P. kindleberger
2. Francis cherunillam
3. D.M. mithani
4. M.L. Jhingan
5. M.C. Vaish

3. Difference between Internal Trade and International Trade

(or)

Domestic Trade Vs. International Trade.

S.No	Internal Trade	International Trade.
1.	Trade between within the country	Trade between two (or) more countries.
2.	Domestic output within the country market.	countries output in the International market
3.	Buying and selling between nation only their own currency	Each country have to used different currency i.e, dollar, Rupee, pounds, Euro
4	knowledge of other countries cannot be exacted.	Difference in culture, language and religion stand between different countries
5	Transport and insurance are within the country	The cost of transports and insurance also check free. Greater distance greater the costs.

UNIT-I

International Economics - Content

Internal Trade: The trade take place between two individuals (or) firms or institutions in the same country called 'domestic' or Internal Trade.

International Trade: When Exchange of goods and services between two countries (or) more than two countries called 'International Trade'.

Importance:
1. Make use of abundant Raw metrials
2. Comparative Advantage
3. Greater choice of consumer
4. Specialisation and Economics of Scale
5. Greater Efficiency
6. Service Sector Trade
7. Global growth and Economic Development

Need for International Trade
1. Price
2. Quality
3. Availability
4. Demand

Advantages:
1. comparative Advantage
2. Economics of Scale
3. competition
4. Transfer of Technology
5. Job Creation
6. Consumption at cheaper cost
7. ↓ Trade fluctation
8. Utilisation of surplus Produce
9. Peace and goodwill

Disadvantages

① over - dependence
② unfair to new companies
③ A Threat of national Security
④ Pressure of Natural Resources

II. Theories of International Trade:

(Classical Theory)

1. Comparative cost:

(A) Absolute cost comparision

The Father of Economics - Adam Smith thought basis of International called "Absolute cost Advantage".

→ trade between two countries mutually beneficial - one country produce one commodity and another country produce another commodity

(Eg)

	India	USA.
No. of units wheat per unit of Labour	10	4
No. of units cloth per unit of Labour	3	7

→ USA Spcialise in wheat and UK Specialise in cloth production, Exchange these product one country to another country obtain mutual Benefits

→ Specialisation depends on size of market.

→ Smith pointed out : ① Productive gain
② Absolute cost gain
③ venture for surplus.

2 × 2 Theory (or)

(b) **Comparative cost Theory. This theory was developed by David Ricardo (1817)**

⇒ This theory states that "each country would produce that commodity in which it has comparative advantages leaving other commodities to be produced by other countries".

Assumption:

1. Only two countries i.e., A & B
2. They produced the same two commodities like 'x' and 'y'.
3. Taste are similar in both countries
4. Labour is the only factors of production.
5. All Labour units are homogenous
6. The supply of Labour unchanged
7. price are determined by Labour cost.
8. Trade based on 'barter System'
9. Technical knowledge unchanged
10. factors of production are perfectly mobile
11. free Trade between two countries
12. No Transport cost.

Explanation:

Country	No. of units of Labour per unit of 'x' commodity	No. of unit of Labour per unit of 'y' commodity	Exchange Ratio between 'x' & 'y'
'A'	100	120	1y : 1.2x
'B'	90	80	1y : 0.88x

→ On the otherhand, productivity of one unit of Linen is lower in Germany than America i.e., $0.66 in Germany as against $ 0.75 in America.

So Germany will export Linen to America

Modern Theory of International Trade

(or)

factor - Endowment Theory

(or)

2x2x2 Theory

Introduction:

Heckscher - Ohlin theory States that a country will spealize in the production and Export of the goods when production requires a relatively large countries of factor with which the country is relatively endowed with capital only. If the ratio of capital to other factors is higher than in other countries.

for example:

Country-A - America

Supply of Labour = 20 units
Supply of Capital = 25 units

Labour / capital Ratio = 0.80

Country-B - India

Supply of Labour = 15 units
Supply of capital = 12 units

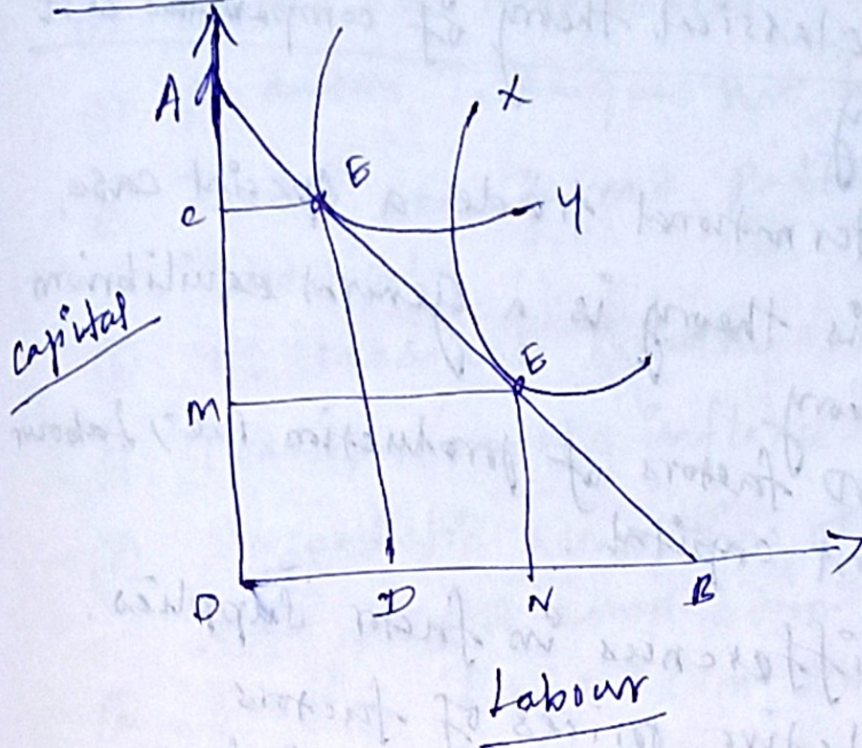
Labour / capital Ratio = 1.25

Country-A is more capital in absolute terms, country-B is more richly endowed with capital because the ratio of capital to labour in country-A (0.80) is lower than in country-B (1.25).

Assumptions:

1. It is a two by two by two model
2. There is a perfect competition in commodity as well as factor markets.

Explaination



Here, capital is more aboundent in America (country-A) and Labour is more aboundent in India (country-B). Therefore, country A will export the capital intensive goods and country B will export the Labour intensive goods.

The Heckster-Ohiln theorem that the capital abundant country will export the relatively cheap capital intensive commodities and Labour abundant country will export relatively cheap Labour-intensive commodity.

Haberler's Theory of opportunity costs

Introduction:

The opportunity costs theory says that if a country can produce either commodity X (or) Y, the opportunity cost of commodity X is the amount of the other commodity "Y" that must be given up in order to get one additional unit of commodity 'X'. Thus, the exchange ratio between the two commodities is expressed interms of their opportunity costs.

Assumptions:

1. There are only two countries i.e, A and B.
2. Each country possesses two factors of production i.e, Labour and capital.
3. Each country produced two commodities namely 'X' and 'Y'.
4. Perfect competition both factor and commodity markets.
5. The price of each commodity equal its marginal money costs.

(6) The price of each factor equal its marginal value productivity.

(7) The supply of each factor is fixed.

(8) There is full emplment in each country.

(9) There is no change in technology.

(10) factors are immobile between two countries.

(11) factors are completely mobile with in countries.

(12) Trade between the two countries is completely free and unrestricted.

Explanation: This theory explained under

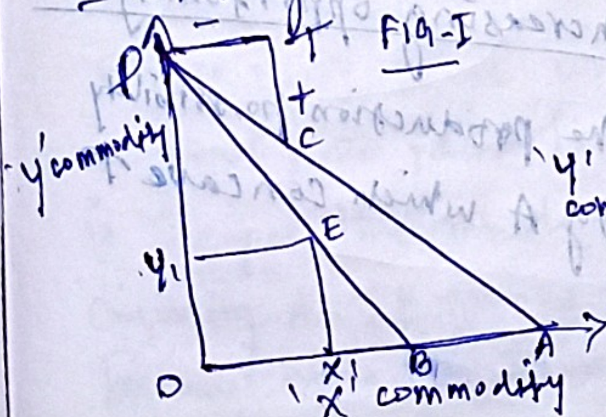
(1) Trade under constant opportunity costs.

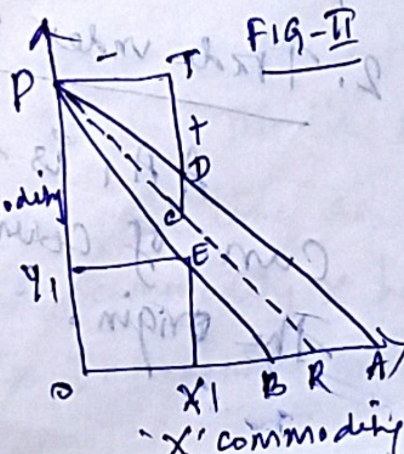
(2) Trade under Increasing opportunity costs.

(3) Trade under Decreasing opportunity costs.

(1) Trade under constant opportunity costs.

The production possibility curve is a straight line.

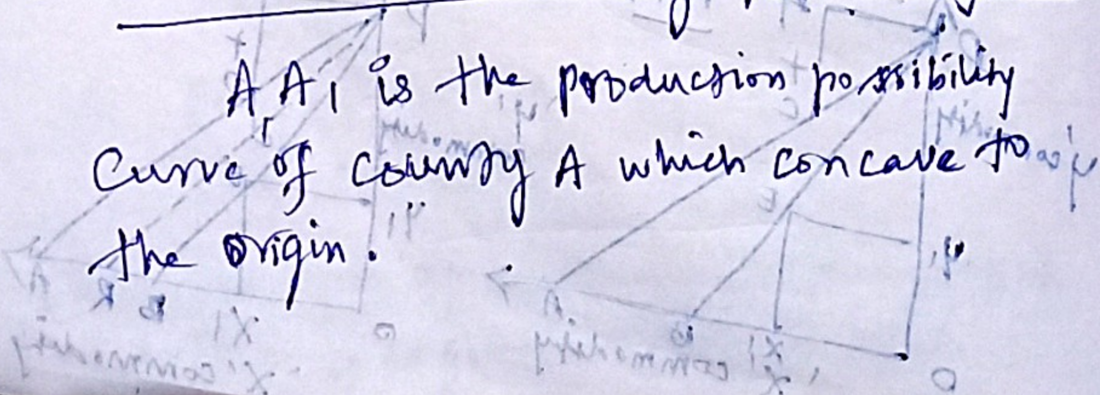


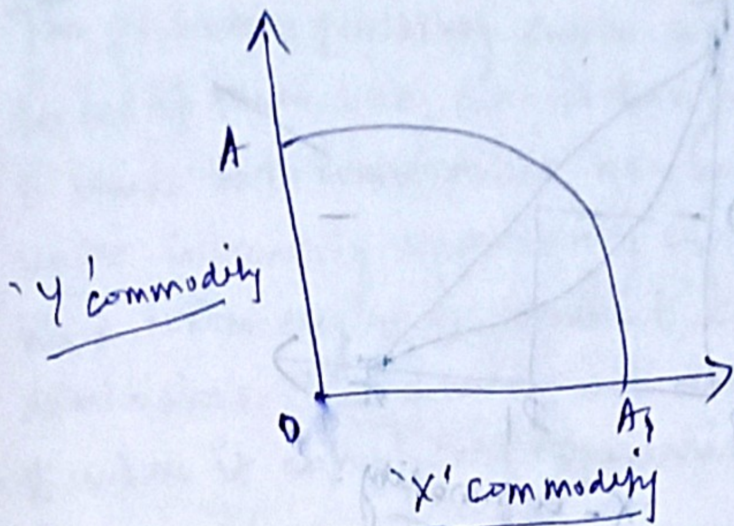


In figure-1, PA is the production possibility curve of country A and PB of country B. The pre-trade and post-trade situation of country B is now shown in fig-II where PR is the new international price line. Before trade, it was consuming and producing both the commodities at point E. After trade, it specialises exclusively in the production of 'Y' at point P, and it's consumption level shifts up from point 'E' to 'C' on the International price ratio PR. It will now export TC of Y to country A in exchange for PT of X. In this situation, Country B will not gain as much as but country 'A' will definitely share the gains from international Trade.

2. Trade under Increasing opportunity costs

AA_1 is the production possibility curve of country A which concave to the origin.

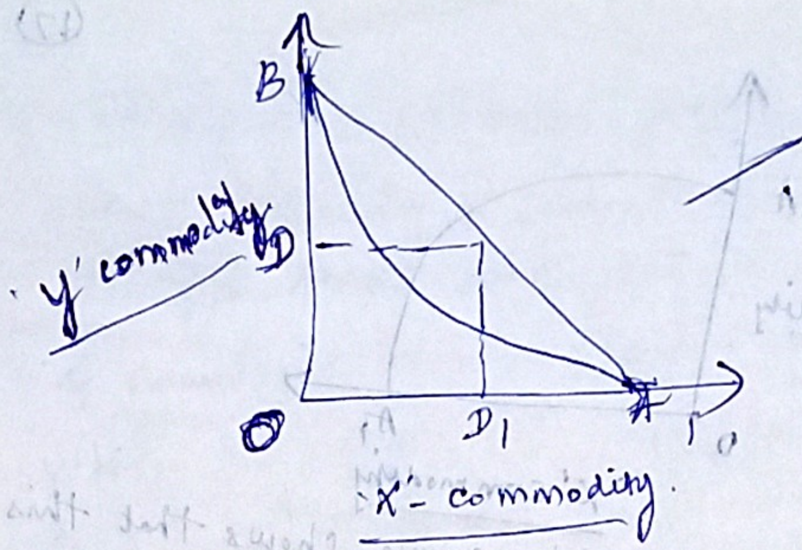




The slope of this curve shows that this country will specialise in the production of commodity 'x'. Move from point A to A_1, country A will give Larger and larger units of commodity 'y' in order to have additional units of commodity 'x'". Thus, the country faces increasing opportunity costs as it produces each additional unit of commodities 'x' in which it specialises.

(3) Trade under Decreasing opportunity costs.

Where AA_1 is the production possibility curve of country. A and BB_1 is country B. Entre in to trade with each other the inter-national price ratio line in BA_1. This line BA_1 is Steeper than the domestic price line aa of Country A. It means that commodity x has become more expensive in International market.



Thus country A will completely specialise in the production of x at point A_1 and country B will completely specialise in the production of y at B. Now each will move along the International price Line.

Trade under Decreasing and Increasing opportunity costs:-