

# Example of essay on free trade

[Economics](#), [Trade](#)



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The evolution of international trade has occurred in a gradual manner. Developing nations are considered to be important growth markets for exports in the United States and the importance of foreign direct investment (FDI) outranks the exports as an entry point to foreign markets. But the question remains whether foreign direct investment will serve as a complement or substitute for exports

A bidirectional complementary relationship exists between the U. S. exports to foreign countries, specifically, East Asian nations, and the FDI. The FDI plays a major role in influencing exports which, in turn, affect the FDI. The U. S. exports are determined by export prices, GDP and the exchange rates. The rise in foreign GDP lead to an increase in exports in the U. S. while an increase in exchange rates results in the decrease of U. S. exports. This suggests that the value of the U. S. dollar is likely to become more expensive for consumers present in foreign nations upon appreciation to invest in goods from the U. S.

Free trade agreements have always been said to increase the international trade of members. But in spite of forty years' worth of gravity equation estimates of the impact of FTAs on the trade flows, no direct and convincing evidence is present to support the fact. This might come as a surprise to the

expansion of FTAs within the past 15 years as well as expectations for the increase in trade through agreements. But the statement is revealed to be true when basic cross-section methods used with instrumental variables and control functions are found to be unsuitable for consistent estimates of these ATEs due to the presence of over identifying restrictions tests and endogeneity and are instead substituted with panel data of unbiased average calculations of ATEs. According to the estimates, an FTA is going to undergo a rise in trade between two member countries by almost 86 percent after using for 15 years. These numbers happen to be almost six times the estimated effect when OLS is used. The impact of an FTA on trade between two members is probably determined by the economic size, the distance separating the two nations and per capita income. It is necessary to understand the significance of adjusting for endogeneity when calculating the overall effects of free trade agreements on the trade flows .

According to the theory of comparative advantage, supply varies between nations due to technological variations as well as the availability of resources. It is possible to explain the difference in technology using Ricardo's theory of comparative advantage but the endowments and resource variations are explained using the Heckscher-Ohlin model .

The Ricardian model can be used to understand which nation imports or exports without information regarding the level of demand. But, in order to determine the exact global price, it is necessary to become familiar with the demand. The models make it clear that two countries engaged in trade consumer more amount of goods under trade instead of autarky. The differences in autarky prices pinpoint the direction of the flow of trade

between two different countries but in order to determine the exact pattern of trade, it is necessary to consider trade equilibrium. The trade gains are divided into the categories of specialization and exchange. Moreover, specialization in trade results in increased output in the entire world .

Adam Smith devised an interesting theory on international trade where he compared it to the manner in which it was presented in modern texts in the form of the theory of absolute advantage. All of Smith's original ideas are not included in the theory which was mainly in favour of free trade. Though he was aware that absolute free trade was unrealistic, he tried to portray free international trade as the best option. According to Smith's ideas, if free trade turns operative, consumers will start to purchase goods from the seller with the lowest price. The producer or the nation with the least production costs will be able to sell it for the cheapest rate and undersell the competitors. So, each nation can manufacture commodities which are produced at a lower cost than other countries .

But even though comparative advantage is not applicable on the basis of commodities, on an average it can be exercised on a multi-commodity environment. In terms of the Ricardian model, comparative advantage traces its origins to the variations in technologies among different nations. But the HOS model offers another source for comparative advantage in the form of differences in factor endowments between nations. Both the sources of comparative advantage seem to be present in various settings and so the models are not considered to be mutually exclusive. But, on the other hand, both the Specific Factors model and the HOS model enable us to understand why few groups inside an existing economic framework can protest against

movements for free trade. Though the country benefits as a whole from trade, there are a few parts of the nation which suffers losses from trade in case agents draw their incomes from separate factors .

It is possible to explore the relationship between business cycles and terms-of-trade shocks through the comparison of numerical solutions derived from the competitive equilibrium of a small open economy's dynamic stochastic model with significant business cycles in order to better understand the real exchange rate, the terms of trade as well as fluctuations in the global economy without free trade .

Trade barriers are one of the most significant reasons why many countries across the world have not considered opening up to the concept of free trade. Discrepancies in tariff rates significantly affect global trade. There are countries which promote trade relationships with other countries through reduction in the tariff rates of exports. This soon leads to free trade with the member countries .

Currency fluctuation plays a major role in preventing free trade between countries since buyers might end up paying much more than the intended amount. Regulations on investment hamper the spread of free trade in different nations and even environmental restrictions have become stronger in recent times. Both countries need to comply with proper safety regulations if they wish to continue trade relationships with each other .

The Romer-Model has several implications for free trade since it enables to distinguish between free flows of ideas and free trade in goods. In developed economies, the allocation of capital between the R&D and the manufacturing industries is left untouched in every manner and so, free trade has no further

impact on the economy. Trade in goods by itself enhances the rate of growth of the economy which experiences sluggish growth and hampers the growth rate of the rapid economy .

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