But that a productive factor is paid

But this restriction on mobility of land did not make any fundamental difference to the classical reasoning. In contrast, no factor was allowed any type of international mobility on account of several restrictions including physical, legal, and institutional and others.

Competitive Markets:

The classical model of international trade assumes that, apart from perfect factor mobility within a country, markets are also competitive. It means that a productive factor is paid higher in that employment where its marginal productivity is higher. This process continues till each factor of production has the same marginal productivity in all alternative employments throughout the country. In the long run, therefore, each product comes to acquire a uniform cost-price level throughout the country.

Mobility of Goods as a Substitute for Factor Mobility:

In contrast, if the price of a product is higher in one country and lower in another, and even when there are corresponding differences in the rates at which factors of production are paid, no factor can move from one country to the other. Instead, only commodities are traded.

They are exported by lower cost-price countries and imported by higher cost-price ones. In other words, international trade in goods takes the place of international movement of factors of production. As international trade expands, each trading country shifts its productive resources from where they are les& productive to where they are more productive. Each country tends to concentrate on the production of those commodities in which it has

a comparative advantage. This process may continue till there is a complete specialisation.

Incomplete Truth:

However, the classical assumption of factor mobility is only partly true. Even within a country, factor mobility faces several restrictions. For example, a shift in land use is subject to several determining factors like climate, soil fertility, topography, and the like, but mines cannot be shifted from one location to the other.

Labour mobility is often restricted by considerations of language, climate, living conditions, training and skill, and so on. Mobility of capital is reduced when it is converted into specialised machines and buildings. In contrast, international mobility of capital, technology, and labour is on the increase. In the final analysis, therefore, the argument of factor mobility is becoming weaker day by day. The emergence of the Internet as a means of enabling exports of ‘ weightless* goods e.

g. software, and the creation of cyberspace, has further blurred the definition of mobility itself. For now, restrictions on international factor physical mobility play a dominant role in the volume and direction of inter-country trade. How long they can be expected to remain important, in the light of rapid technological changes, remains to be seen. 2. Distance: Some analysts used to claim that international trade involves longer distances between trading points and therefore laws of internal trade do not apply to it. It is easy to see that this argument is patently false.

Firstly, distance itself does not alter the fundamental working of market forces. Secondly, in many cases, distance between two international trading points is shorter than the distance between two trading points within a country. For example, distances of trading points located in West Bengal and Bangladesh are shorter than-they are between West Bengal and Kerala. But while trade between West Bengal and Bangladesh is international, that between West Bengal and Kerala is not. 3.

Currency Differences:

Currency Differences as such:

It was argued that when trading countries have different currencies, we cannot apply economic laws of internal trade to explain international trade. In itself it is a false argument. Traders face a number of uncertainties which they count towards additional cost of trading. It is a fact that importers and exporters have to consider uncertainties arising out of possible changes in exchange rate of the domestic currency.

But this uncertainty is just one of the several factors in their decision-making process. By itself, it does not alter the basic application of demand and supply forces. Moreover, there was a time when leading trading countries of the world were on gold standard under which exchange rate risk is reduced to a negligible level. Similarly, after Second World War, under the supervision of the International Monetary Fund, a regime of fixed exchange rates was in operation for more than two decades.

But the need to have a separate theory of international trade was still accepted.

Real Risk Variables:

However, there are situations in which currency differences can influence international trade patterns and financial flows in a significant manner. This happens when: (a) Currencies of trading countries are on paper standard, and when (b) Only a few leading currencies of the world are used for financing international trade and capital flows. In such a situation, every country wants to own sufficient balances of these leading currencies as " foreign exchange reserves" and some individual countries can easily develop serious balance of payments problems. Some countries have experienced even " bankruptcies", that is to say, they have been unable to meet their international payments obligations on schedule due to insufficient balances of the concerned foreign currency (ies).

The possibility of a serious disruption in the flow of international payments gathers further strength if, instead of a regime of fixed exchange rates, we have that of a regime of floating ones. Every country tries to accumulate balances of those currencies which are expected to have " firm" exchange rates in future. At the same time, they aim at getting rid of those currency balances which, in their judgement, are likely to depreciate. In addition, there may be a sudden loss of confidence in some currencies and speculative forces may also come into play. Consequently some currencies may rapidly become worthless in international markets. Such like problems can be solved only through active intervention by the authorities of the country in question (often assisted by some other countries and international institutions).

The risks associated with such eventualities amply justify treating International Economics as an independent branch of economics. 4. Factor Endowment: It is a fact that countries do not have identical factor endowment, and this necessitates trade in at least some items. In addition, differences in factor endowments result in unequal cost advantage in the production of even similar goods. Given this fact, it pays each country to concentrate upon the production of those goods in which it has a comparative cost advantage. It may be noted that if production of traded goods is subject to the law of diminishing returns to scale, an expansion in trade and concentration of each trading country on those goods which it can produce comparatively cheaper, would eventually narrow cost advantages (at the margin) to zero. At this stage further expansion of international trade would stop.