International trade theory

International Trade Theory of the of the International Trade Theory The new theory relating to international trade originated in 1970s, and it supplanted the earlier theory of mercantilism, which was based on bullion. On account of international trade, a nation can achieve scale of economies, and it can also bring about a reduction in the cost of production. The term economies of scale, denotes a reduction in unit cost, due to large output volumes. Furthermore, economies of scale permit the distribution of fixed cost over a large volume and the capacity of the larger producers to employ specialized resources, which are more productive (Hill & Jain, 2008, p. 235).

This novel trade theory has two significant implications. First, on account of the impact of trade on economies, it can enhance the choice of goods available to consumers, while reducing their cost. Second, if the production required for achieving economies of scale is of the order of the global demand, then only a few enterprises will obtain support (Hill & Jain, 2008, p. 235). Consequently, global trade in some commodities could possibly the preserve of the firms who had initially taken the initiative.

There are a number of models that relate to international trade, and these models are dealt with in International Trade Theory. The principal objective of these theories is to explain the various ideas that pertain to the transfer of goods and services, across the world. Although, these theories have changed over time, the fundamental principle underlying international trade is more or less similar to the principle, on which domestic trade is founded (International Trade Theory and Policy). In essence, the chief purpose of trade is to maximize profits for the entities involved in the exchange of goods and services.

A number of forms are assumed by the economic integration of countries.

Some of these are preferential tariffs, customs unions, free – trade associations, common markets, economic unions and complete economic integration. Nations belonging to a specific system of preferential tariffs, levy a higher rate of duty on imports on countries that do not belong to their group. This was evident among the Commonwealth countries, which had established a system of common tariff preferences, subsequent to the year 1919 (Allais, Balassa, Bertrand, Robinson, & Wonnacott, 2011).

Unique solutions to economic problems are not possible, as long as competition and trade occur in an environment that is imperfect from the economic perspective. The result of economic endeavors becomes dependent on the behavior of the participants. The market situation is steeped in imperfection and is sub optimal, and economic integration merely results in an additional adjustment device. A complicated economic environment admits of many outcomes, and several of these may be inappropriate. This has resulted in a new model of economic integration that is essentially an amalgamation of several theoretical approaches to investment, competition and trade (Jovanović, 1998, p. xvii).

It has been declared by the various economic theories that international trade improves efficiency. In fact, international trade enhances the productive capacity of nations involved in trade. Comparative advantage plays an important role in promoting productive efficiency. This has been highlighted in the Huckster-Ohlin and Ricardo theories (Kling, 2008). Furthermore, comparative advantage based trade tends to benefit the smaller countries to a much greater extent than the larger nations.

The reason behind this can be attributed to the fact that the benefits of comparative advantage are proportional to difference between the relative prices in domestic markets where there is no trade and the relative prices in the global markets. Moreover, trade promotes innovation and dynamism in the economy. For instance, enhancements in productivity and manufacturing quality in the recent decades in the US have been attributed to competition from nations like Japan (Kling, 2008).

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