Iii. the features of competitive and non-competitive markets.

iii. The restrictive nature of the assumptions made by the theory, such as absence of trading costs and non-price competition, etc. Let us have a brief look at these limitations. 1.

Labour Theory of Value: Ricardian theory of international trade assumes the application of labour theory of value which is not able to provide a satisfactory explanation of the determination of either commodity prices or factor prices in a modern economy. It is because labour theory itself is based upon highly unrealistic assumptions. For example, we have noted above that for it to be valid, labour should be a homogeneous productive factor.

Moreover, it should be the only factor of production, or its proportionate share in total cost should be equal in all products. 2. Cost Differences: The classical theory does not explain the causes of differences in efficiency of productive resources. Consequently, it is also unable to explain the phenomenon of changes in productive efficiency of an economy. These days, a host of causes (including technological, educational, institutional, political, quality of governance, economic incentives, and others) of differences in efficiency of productive resources have been identified. There is also a general agreement about the changing nature of these causes.

3. Competitive Markets: In conformity with the then prevailing trend, the classical theory also assumes that the trading countries have competitive markets. Factually, however, this is not so. Modern economies are characterised by an ever-changing mixture of the features of competitive and non-competitive markets. For example, there is a simultaneous development towards free trade and economic groupings. Also, trade

barriers, including a variety of quantitative restrictions, have become integral ingredients of international economic relations. Economists are trying for restructure trade theory and bring it nearer reality by incorporating these facts. 4.

Factor Endowment, Technology and Constant Returns: These assumptions of the classical may be alright for static economies. But they do not represent the working of ever-changing and growing economies. Some critics maintain that the Ricardian theory does not take specific note of the fact that differences in resource endowments of different countries can themselves be the cause of international trade. 5.

Economies of Scale: Ricardian theory ignores the possibility that even nations endowed with similar productive resources can trade provided there are economies of scale and they take advantage of that—each country producing large quantities of selected goods.