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Chapter 1 : The Ricardian Law of Comparative Advantage | Mises Institute

Readings in the Theory of International Trade American Economic Association, Howard Sylvester Ellis Snippet view - Readings in the theory of international trade: selected by a committee of.

In emphasizing the great importance of the voluntary interplay of the international division of labor, free traders of the 18th century, including Adam Smith, based their doctrines on the law of "absolute advantage. This is a relatively easy case to argue. It takes little persuasion to realize that the United States should not bother to grow bananas or, rather, to put it in basic micro terms, that individuals and firms in the United States should not bother to do so , but rather produce something else e. There are, after all, precious few banana growers in the US demanding a protective tariff. But what if the case is not that clear-cut, and American steel or semi-conductor firms are demanding such protection? The law of comparative advantage tackles such hard cases, and is therefore indispensable to the case for free trade. It shows that even if, for example, Country A is more efficient than Country B at producing both commodities X and Y, it will pay the citizens of Country A to specialize in producing X, which it is most best at producing, and buy all of commodity Y from Country B, which it is better at producing but does not have as great a comparative advantage as in making commodity X. In other words, each country should produce not just what it has an absolute advantage in making, but what it is most best at, or even least worst at, i. If, then, the government of Country A imposes a protective tariff on imports of commodity Y, and it forcibly maintains an industry producing that commodity, this special privilege will injure the consumers in Country A as well as obviously injuring the people in Country B. For Country A, as well as the rest of the world, loses the advantage of specializing in the production of what it is most best at, since many of its scarce resources are compulsorily and inefficiently tied up in the production of commodity Y. The law of comparative advantage highlights the important fact that a protective tariff in Country A wreaks injury on the efficient industries in that country, and the consumers in that country, as well as on Country B and the rest of the world. Another implication of the law of comparative advantage is that no country or region of the earth is going to be left out of the international division of labor under free trade. For the law means that even if a country is in such poor shape that it has no absolute advantage in producing anything, it still pays for its trading partners, the people of other countries, to allow it to produce what it is least worst at. In this way, the citizens of every country benefit from international trade. No country is too poor or inefficient to be left out of international trade, and everyone benefits from countries specializing in what they are most best or least bad at â€" in other words, in whatever they have a comparative advantage. Until recently, it has been universally believed by historians of economic thought that David Ricardo first set forth the law of comparative advantage in his Principles of Political Economy in Recent researches by Professor Thweatt, however, have demonstrated, not only that Ricardo did not originate this law, but that he did not understand and had little interest in the law, and that it played virtually no part in his system. Ricardo devoted only a few paragraphs to the law in his Principles, the discussion was meager, and it was unrelated to the rest of his work and to the rest of his discussion of international trade. The discovery of the law of comparative advantage came considerably earlier. The problem of international trade sprang into public consciousness in Britain when Napoleon imposed his Berlin decrees in , ordering the blockade of his enemy England from all trade with the continent of Europe. Immediately, young William Spence â€" , an English Physiocrat and underconsumptionist who detested industry, published his Britain Independent of Commerce in , advising Englishmen not to worry about the blockade, since only agriculture was economically important; and if English landlords would only spend all their incomes on consumption all would be well. For, first, James Mill had a far better presentation of the law â€" though scarcely a complete one â€" in his Commerce Defended than did Torrens later the same year. Moreover, in his treatment, Torrens, and not Mill, committed several egregious errors. First, he claimed that trade yields greater benefits to a nation that imports durable goods and necessities as against perishables or luxuries. Second, he claimed also that advantages of home trade are more permanent than those of foreign trade, and also that all advantages of domestic trade remain at home, whereas part of the advantages of foreign trade are siphoned off for the benefit of foreigners. And finally, following Smith, and anticipating Marx and Lenin, Torrens asserted that foreign trade, by extending the division of labor, creates a surplus over domestic requirements that must then be "vented" in foreign exports. Six years later, James Mill led Robert Torrens again in presenting the rudiments of the law of comparative advantage. Mill pointed out that labor at home will, by engaging in foreign trade, procure more by buying imports than by producing all goods themselves. Meanwhile, at the very time when this comparative cost ferment was taking place among his friends and colleagues, David Ricardo displayed no interest whatever in this important line of thought. In fact, Ricardo displayed no interest in free trade in general, or in the arguments for it; his reasoning was solely devoted to the importance of lowering or abolishing the tariff on corn. This conclusion, as we have noted, was deduced from the distinctive Ricardian system, which was to be fully set forth two years later in his Principles. For Ricardo the key to the stifling of economic growth in any country, and especially in developed Britain, was the "land shortage," the contention that poorer and poorer lands were necessarily being pressed into use in Britain. In consequence, the cost of subsistence kept increasing, and hence the prevailing which must be the subsistence money wage kept increasing as well. But this inevitable secular increase of wages must lower profits in agriculture, which in turn brings down all profits. In that way, capital accumulation is increasingly dampened, finally to disappear altogether. Lowering or abolishing the tariff on corn or other food was, for Ricardo, an ideal way of postponing the inevitable doom. By importing corn from abroad, diminishing fertility from corn land is deferred. The cost of corn, and therefore of subsistence, will fall sharply, and therefore money wage rates will fall pari passu, thereby raising profits and stimulating capital investment and economic growth. There is no hint in any of this discussion of the doctrine of comparative cost or anything like it. But how about the mature Ricardo, the Ricardo of the Principles! Once again, except for the three paragraphs on comparative advantage, Ricardo displays no interest in it, and he instead repeats the Ricardian system argument for repeal of the Corn Laws. Indeed, his discussion in the rest of the chapter on international trade is couched in terms of the Smithian theory of absolute advantage rather than of the comparative advantage found in Torrens and especially in Mill. The three paragraphs on comparative advantage, furthermore, were not only carelessly worded and confused; they were the only account, brief as they were, that Ricardo would ever write on comparative advantage. Indeed, this was his only mention at any time of this doctrine. If Ricardo had no interest in the theory of comparative advantage, and never wrote about it except in this single passage in the Principles, what was it doing in the Principles at all? We know also that Mill prodded Ricardo on including a discussion of comparative cost ratios. As we have seen, Mill originated the doctrine of comparative cost, and led in developing it eight years later. Once again, Robert Torrens tailed after Mill, repeating his discussion with no additional insights in , in the fourth edition of his Essay on the External Corn Trade. And so, once again, James Mill, by the force of his mind as well as his personal charisma, was able to foist an original analysis of his own on to the "Ricardian system. It seems possible that Mill, the inveterate disciple and Number 2 man, was Number 1 man far more often than anyone has suspected. Torrens served in the Royal Marines from to Torrens, furthermore, was scarcely in a position to take the leadership of the free trade forces, since he had abandoned his previously radical defense of unilateral free trade on behalf of reciprocal trade agreements between countries.

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Alternatively, it could be assumed that various resources are required but that they can be represented and measured by means of a "composite resource". Because of comparatively i. The concept of comparative advantage has to be distinguished from that of absolute advantage, which indicates that the country in question uses in absolute terms fewer resources in the production of the given commodity. Thus, in our example, the United States has an absolute advantage in the production of both chips and sugar and a comparative advantage in the production of chips only. The basic tenet of the comparative cost theory is that the gains from trade arise from the existence of a comparative cost advantage and not of an absolute cost advantage. Comparative advantage may need to be created Third, the theory is static. It explains trade and trade gains on the basis of comparative advantage at a certain point in time. It may be the case that comparative advantages change and can be acquired over time through, inter alia, policy action. In that case, having a comparative advantage in one good would not necessarily imply that a country should specialize in the production of that good at the expense of other lines of production. In fact, new industries so-called infant industries may not have a comparative advantage when they are being established and, as we will see below, may need to be protected until they achieve the size required to benefit from economies of scale. Thus, in our example, Brazil would not necessarily commit itself to the production of sugar, totally forgetting about computer chips, if it felt it had the basis for developing a viable chip industry in the longer term. This kind of reasoning in fact led Brazil to put trade barriers to the import of computer equipment with the intention to develop over time some advantage in the domestic production of computers. Note, of course, that trade policy may not be the most effective way of developing an indigenous industrial capacity if more direct industrial policies are available. Countries may also lose comparative advantage in certain types of production as technology evolves abroad the so-called sunset industries issue. Some qualifications on the theory of comparative costs The theory assumes that resources are fully utilized, i. Thus, if there are idle resources, there is no need to decrease the production of sugar to increase that of chips or vice versa. It assumes that resources can easily be reallocated to those activities in which a country has comparative advantage. In the real world, there are a number of constraints which may make it difficult to reallocate resources. Thus there are potentially high adjustment costs in moving from one line of production to another, e. The capital used in sugar factories cannot be used for chocolate production and workers have to be trained to use a different technology. In the classical model, investment resources are not internationally mobile only commodities can move and investment decisions are taken on a national basis. Furthermore, the decision-making framework for a growing part of world investment is international and not national. A large investment fund or a transnational corporation are not restricted by national boundaries; they search for profit opportunities anywhere in the world - a concept closer to that of absolute than to comparative advantage. Factors determining investment location, and therefore trade flows, are lower labour costs, availability of natural resources and distance to raw material and major markets, as well as opportunities for establishing an efficient marketing and distribution set-up. The theory of comparative advantage is mostly concerned with the efficient use of resources for producing a limited number of very homogenous commodities. Today, the quality and the volume that can be delivered by a particular supplier is often more important than the cost. In a sense, the capacity to sell is becoming more important than the capacity to produce. Trade has important distributional effects Fourth, the theory shows that countries as a whole gain from trade but makes no reference to whether and how different groups within each country benefit or lose from trade. As we will see below, trade can have important impacts on income distribution and this adds a social dimension to the trade issue. Economies of scale Trade allows scale economies to be achieved Another reason why trade can increase efficiency is because it allows an expansion of the market for a certain industry beyond the limits of the domestic economy. There are two ways in which economies of scale may occur at the industry level, which will normally operate in conjunction. One is through technological indivisibilities in the firms that make up the industry, for instance, the use of robots in car manufacturing. This happens when there are cost saving technologies that can only be introduced after a certain level of output is reached. In this case, economists talk of economies of scale internal to the firms in the industry. The other is through the existence of cost savings that take place through the sheer expansion of the industry, mostly because of an improvement in the services supplied to the industry by third parties or the technical or commercial environment in which it operates - what economists call external effects. In this case the economies of scale are external to the firm but internal to the industry. Examples of these are the development of a skilled labour force, specialized suppliers of inputs, a competitive atmosphere and a shared technological know-how, all of which will reduce costs. An interesting thing about economies of scale is that, if they are significant, countries with few differences in resources or in technology, and hence in production costs, will gain from specializing in different products and trading them. With specialization, the two countries can reap the economies of scale in the commodity in which they specialize, lowering the cost of production. Economies of scale, combined with product differentiation see below explain the phenomenon of intra-industry trade in which countries trade similar, but differentiated, products with each other, e. Competition through trade Trade ensures the benefits of competition One more way in which international trade can raise efficiency is through the enhancement of competition. By opening their frontiers to trade, countries force their industries to compete with goods and services produced abroad, and hence to struggle to become competitive and pass on cost reductions to consumers in the form of lower prices. In industries which tend to be monopolistic or oligopolistic because of the nature of the production process e. The car and telecommunication industries are examples of this. Trade may be a good way to bring competition and raise efficiency in these industries. This advantage of trade is not very relevant in agriculture since, because there are many farms producing very similar commodities, the farm sector is hardly a concentrated industry. However, farmers may benefit from the increased efficiency of input supply industries or food processing industries brought about through trade. Since these include consumer goods as well as capital goods and inputs, trade favours both domestic consumers and the development of the domestic production capacity. Diversity refers to the availability of goods that cannot be produced in the country or could only be produced under very special and expensive conditions e. It also refers to different types or brands of goods actually produced in the country e. Through product differentiation countries do not need to either fully specialize in industries where they have a comparative advantage or totally abandon industries where they do not; they can specialize in industrial niches e. Intra-industry trade of this kind is common in consumer goods industries, but is less characteristic of trade in agricultural products because of the importance of natural resource endowments and their greater homogeneity. Trade may also serve to smooth out transitory excess demand or excess supply situations in domestic markets, thus avoiding or reducing price fluctuations and eventual supply shortages. Agricultural products may benefit especially in this respect from foreign trade, since agricultural markets tend to be particularly unstable as a consequence of supply rigidities it takes time for agricultural production to respond to market signals , exogenous factors affecting production such as weather and pest conditions and the fact that the demand for food tends to vary little when prices go up or down it is inelastic. A country largely self-sufficient in food and agricultural products may have agricultural surpluses in good years, which will place strong downward pressure on farm prices. The international market may serve to dispose of these surpluses with minimum disruption of domestic prices and incomes. The opposite will happen in poor agricultural years. Thus, if a country is highly specialized in the production of some export commodities and depends largely on imports of other commodities, it will be very exposed to international price fluctuations. These fluctuations are also felt in tradable goods which are only marginally exported or imported, in the absence of policy instruments designed to isolate domestic prices from world price fluctuations. Agriculture has traditionally been the main sector where these instruments have been applied, with varying effects. Will everybody win or at least not lose? Two issues can be distinguished here; one is the impact of trade on different economic or social groups within a country, the other is whether the gains from trade are fairly distributed between trading countries. These issues are examined separately below. Contrariwise, the owners of factors engaged in industries which have to compete with products imported from abroad, i. The distribution of the gains and losses arising from trade among the owners of productive factors will depend on the situation in the respective markets. In general, however, factors which are intensively used in an industry, for instance labour in textile industries or land in extensive farming, will stand to gain or lose more than those not intensively used. Similarly, owners of factors that are rather specific to the industry and hence relatively immobile, for instance workers skilled in some agricultural operations e. If no domestic industries produce the imported good or close substitutes , consumers or the producers that use it as an input will benefit from trade, without anyone losing. Intra-industry trade, where differentiated products from the same industry are traded, will in general have less negative impact on the domestic import-competing industry than trade based on specialization, where the import-competing industry may risk being totally swept away. Farmers are vulnerable to trade changes because of the lack of alternative opportunities Since, in comparison with other industries, factor mobility and product differentiation are rather limited in agriculture, the farming sector is particularly vulnerable to the impact of trade. Thus, it is difficult for agricultural land to change its use to urban or recreational use in response to import competition, or for agricultural labour to find another type of employment since this normally requires reskilling and will often imply migration. It is possible for farmers to change crops to adjust to international competition, but weather, soils, technical know-how and other factors that may restrict or jeopardize possible changes will often come into play. Shifting from plantation or livestock farming to other type of agriculture will be particularly expensive and take a long time. These rigidities, typical of the farm sector, are one of the reasons why governments have traditionally tended to protect farmers from the effects of international competition. An issue that has received much attention from trade welfare theorists is whether those who benefit from the opening of trade can compensate those who lose, so that the opposition of the latter to a free trade regime can be overcome and the gains from trade are better distributed. This may be possible in principle, but it is extremely complex in practice. The reason is the difficulty of agreeing on the exact amount of gains and losses and the identification of the groups involved, as well as that of establishing a mechanism to carry out direct payments from one group to the other. Governments may try to collect part of the gains, for instance, through export taxation. This is a highly contentious subject surrounded by controversy and contrasting points of view. We cannot survey them all here but we will summarize some of the most representative ones. The "mainstream economics" view Mainstream theories emphasize the role of demand in explaining the distribution of trade gains between countries The first view we have called "mainstream economics" to emphasize a theoretical tradition that is at the core of conventional Western academic economic thinking on international trade issues. While "mainstream economics" has much to say on the benefits deriving from trade and the welfare implications of protectionist policies and regional trade agreements, it does not offer much by way of predictions with respect to the intercountry distribution of trade gains. As mentioned before, under the comparative cost theory the distribution of benefits is inversely related to the closeness of the international terms of trade to the domestic price ratio. However, in the original formulation of the theory by David Ricardo there was no explanation of how close the terms of trade would be to either of the domestic price ratios. Later economists, such as John Stuart Mill, stressed the role of demand factors in the determination of the terms of trade. Thus, if in our example, United States consumers are much more eager demanders of sugar than of chips compared to their Brazilian counterparts, the terms of trade will favour Brazil 2 , which will obtain most of the gains. In more modern forms of the theory, the terms of trade continue to depend on the relative strength of the respective demands. The main prediction arising from this reformulation is a dynamic one stating that export-biased growth, i. The opposite would happen with import-biased growth. The reason is straightforward: The opposite is the case with import-biased growth. The above effects only take place, however, if the participation in world trade of the country in question is sufficiently large for a reduction in the domestic production cost to influence the international price of the commodity. The structuralist view Structuralists argue that the periphery is disadvantaged relative to core countries In the s and s, the distribution of trade gains between developed countries the "centre" of the world economy and less developed countries the "periphery" became an issue of intense debate, due in no small part to the intellectual influence of Raul Prebisch, the Argentinean economist who was for many years at the head of the UN Economic Commission for Latin America and one of the fathers of the Latin American structuralist school. The argument is based on the assumption of trade specialization between centre and periphery, with the centre specializing in exporting manufactured industrial products and the periphery primary commodities. The decline was viewed not as a transitory phenomenon due to a specific set of circumstances but as something embedded in the structural features of central and peripheral economies and in the nature of the development process. In a nutshell, the declining trend in the terms of trade for countries in the periphery 4 was explained by three reasons. The income elasticity of the demand for imports is lower at the centre than in the periphery due to the different type of the goods imported by both sets of countries - primary commodities in one case, industrial products in the other 5. Asymmetries are postulated in the impact of technological change at the centre and in the periphery. In central countries, it is argued that technological progress tends to decrease the demand for periphery country exports many of which are substituted by synthetic products.

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Chapter 3 : Economic Theories: Theory of International Trade and Comparative Advantage

Recent writings of American and European authorities, chosen by Howard S. Ellis and Lloyd A. Metzler acting as a Committee of the American Economic Association.

Kojima argued that Western multinationals were monopolies that distorted the international allocation of resources rather than improved it. Cantwell later espoused an evolutionary resource-based view of multinationals, while simultaneously also contributing to the eclectic paradigm. Canadian economist Alan M. Parry, visiting in ; and Masahiko Itaki in the late s. In the business historian Geoffrey Jones academic [17] joined the economics department, and Reading School thinking began to influence business and economic history Jones left in and is now Professor of Business History at Harvard Business School. Sarianna Lundan, a Ph. Lundan, along with Dunning late in his career, continued to extend the Reading School approach to multinational enterprise. Major contributions have been made in this area by Robert Pearce, whose book was one of the first systematic analyses of the behaviour of the research and development activities of subsidiaries of multinational enterprise. Originally developed by Peter Buckley and John Dunning , this takes a macro-view of the interaction of multinational enterprise on structural change in countries. The first published paper by John Dunning [22] proposed a framework that has become known as the investment development path. This proposed that there was a systematic relationship between development and the inward and outward activities of multinational enterprises. This was later extended by a number of collaborative contributions by Rajneesh Narula and John Dunning on FDI and government, [23] and more recently on development and the multinational enterprise. One of the core insights has been to better understand how learning by firms is motivated by the way in which foreign investors and domestic actors interact, and builds upon internalization theory and the eclectic paradigm. This theme is especially relevant to developing and transition economies, and has inspired a number of important policy studies. Policy Influence[edit] The influence of the Reading School extends beyond its contributions to academic research, and into policy-making at the highest levels. This report has become one of the most important UN reports on multinational enterprise and development, and has become a primary reference point for most governments now published by UNCTAD. Other members of the Reading School have been engaged in advisory and consultancy roles in writing these reports and preparing background materials, including Mark Casson , Rajneesh Narula and Robert Pearce. Palgrave Macmillan, 25th Anniversary ed. Casson The Multinational Enterprise Revisited: Casson The internalization theory of the multinational enterprise: A review of the progress of a research agenda after 30 years, Journal of International Business Studies, 40, â€"80, doi. Essays in honour of John Dunning, Aldershot: The Selected Essays of John H. Lundan Multinational Enterprises and the Global Economy, 2nd. Patterns of Geographical and Industrial Diversification, Aldershot: Croom Helm [Basingstoke, Hants: Catalysts for Economic Restructuring, Routledge, London, pp.

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Chapter 4 : The Reading School of International Business - Wikipedia

"Using International and Japanese Regional Data to Determine When the Factor Abundance Theory of Trade Works." (PDF - MB) American Economic Review 87, no. 3 (): Davis, and Weinstein.

By doing so Cotton Land will eliminate its furniture industry. However, it can trade the surplus cloth for furniture. Similarly, Wood Land can direct all its resources to the production of furniture and produce 16 pieces of furniture. Although its cloth industry will suffer it can trade the surplus pieces of furniture for cloth bales. Through specialization and trade, the supply of goods in both economies increases, which brings the prices down, making them more affordable. Law of Comparative Advantage: Even if a country can produce everything more efficiently than another country, there is still scope for trade. A country can maximize its wealth by putting its resources into its most competitive industries, regardless of whether other countries are more competitive in those industries. This is called the law of comparative advantage. Suppose Cotton Land produces both cloth and furniture better than Wood Land. However to achieve greater wealth, each country should specialize in the item in which it enjoys greatest advantage among all the products it produces. In terms of opportunity cost, or the cost of not transferring resources, Cotton Land is twice efficient in producing cloth as furniture. Whereas, Wood Land should concentrate on furniture and trade it for cloth with Cloth Land. Channeling resources into the most productive enterprise in each country will result in more products to trade. Even though it makes economic sense to allocate resources to the most productive industries, no country wants to rely on only a few products. This makes the country vulnerable to changes in the world economy, such as recession, new trade laws and treaties, and new technologies. A country that relies too heavily on one product is especially susceptible to market forces. If demand suddenly drops or if a cheaper alternative becomes available, the economy of that country could be damaged. Many Middle East countries that are largely dependent on their oil exports see their economic fortunes rise and fall in tandem with the oil market. It is most advantageous to have declining import prices compared with the prices of exports. Exchange rates and productivity differences affect the terms of trade more than any other factors. By developing a diversified economy, a country can make sure that even if some industries are suffering, other, more competitive industries will keep the economy relatively healthy. Competitiveness is used to describe the relative productivity of companies and industries. If one company can produce better products at lower prices than another, it is said to be more competitive. This is a matter of concern for governments, since it is difficult for uncompetitive industries to survive. In the long run, competitive depends on: The ability of a society to do this effectively determines whether it can remain competitive in the global economy. The law of comparative advantage says that a country can become more competitive by directing its resources to its most efficient industries. Such lower-cost goods are more in demand in international markets. Certain industries that require heavy research and development or capital expenditures cannot be competitive unless they can spread the costs over many units. If a sophisticated weapons industry knows that it has access to foreign markets and could export, it may increase the scale of its manufacturing operations and become more efficient and competitiveness in the international markets. All governments regulate foreign trade. The extent to which they do so is a matter of great controversy and debate. The news is full of reports of various groups protesting about: New trade agreements Adverse effects of trade on domestic industry, and Dilution of the environmental and labour standards, especially in the developing economies. Free trade proponents stand for an open trading system with few limitations and little government involvement. Advocates of Protectionism believe that governments must take action to regulate trade and subsidize industries to protect their domestic economy. Although the amount of government involvement in trade varies from country to country and product to product, overall barriers to trade have been lowered since World War II. All governments practice protectionism to some extent. There are many arguments forwarded by advocates of protectionism. The following are some of them. Less developed countries have a natural cost advantage, as labour costs in those economies are low. They can produce goods less expensively than developed economies and their goods are more competitive in international markets. Protectionists argue that infant, or new, industries must be protected to give them time to grow and become strong enough to compete internationally, especially industries that may provide a firm foundation for future growth, e. However, critics point out that some of these infant industries never "grow up". Any industry crucial to national security, such as producers of military hardware, should be protected. That way the nation will not have to depend on outside suppliers during political or military crisis. Diversification of the Economy: If a country channels all its resources into a few industries, no matter how internationally competitive those industries are, it runs the risk of becoming too dependent of them. In the rush to meet the world demand for their exports, some countries may compromise on critical environmental standards. This is particularly true for less developed countries that do not have well defined environmental protection laws in place. Tariffs are taxes on imports. Tariffs make the item more expensive for consumers, thereby reducing the demand. Governments sometimes restrict the sale of foreign goods by imposing import quotas. These limit the quantity of foreign goods that can be imported and help domestic producers by limiting the share of the market that can be taken by foreigners. Sometimes governments negotiate agreements whereby a country agrees to voluntarily limit its export of a certain product. Japan voluntarily limited its export of cars to the United States in to 1. With tariffs, it is the importing country that stands to gain through increases in the tax revenue. However, in case of quantitative restraints, the exporting country gains as the price of the imported good rises. Both import quotas and voluntary restraints thwart the functioning of the free market. The quantity of goods remains constant while the price changes, instead of demand and supply determining both quantity and price. Another way to achieve the goals of protectionism is to make the domestic industry more competitive. Subsidies, which are grants by the government to an industry, can accomplish this. Governments also ban imports of certain products to protect domestic industries. For instance, Japan bans importation of rice to protect its domestic rice industry. Health, environmental and safety standards often vary from country to country. These may act as a barrier to free trade and a tool of protectionism. For example, the European Union has very stringent health and safety standards that goods have to meet in order to be imported. Apart from the legal restrictions there may be other less formal obstacles that impede trade. Cultural factors are one such obstacle. Arguments for Free Trade: The debate about how free a trading system should be is an old one, with positions and arguments evolving over time. Free trade advocates typically argue that consumers benefit from freer trade and forward many reasons in support of their theory. Free trade and the resulting foreign competition forces US companies to keep prices low. Consumers have a large variety of goods and services to chose from in open markets. Domestic companies have to modernize plants, production techniques and technology to keep themselves competitive. Any kind of protectionist measures, like tariffs, often brings about retaliatory actions from foreign governments, which may restrict the sale of goods in their markets. This may result in inflation and unemployment in the US as the export industries suffer and prices of imports rise. An open trading system creates a better climate for investment and entrepreneurship than one in which there is fear of government cutting off access to certain markets. The cost of protection often outweighs the benefits. Balance of Payments gives a complete summary of all economic transactions that involve money flowing into or from a country. Exports are the value of goods and services sold abroad over any specific period of time. Imports are the value of goods and services purchased from foreign countries over a specific period of time. Statistics can have different interpretations: Interpretations of trade statistics sometimes can differ sharply, depending on the question being asked. The US trade deficit has been viewed as good, bad, irrelevant, overstated, understated and illusory. For example, a company that exports goods to the United States will view the deficit as a sign of a healthy US market. On the other hand, a US based trade union may consider the deficit as a sign that domestic industries are unable to compete in the world markets. In a global economy that is measured in trillions of dollars, not every transaction is going to be reported accurately. Statistics for many types of transactions rely heavily on estimates made by statisticians, and even the best estimates are sometimes incorrect. This can produce a skewed measurement of what is actually happening in the economy. Measuring Imports and Exports: Importers file tax documents with the customs service describing the type and value of imported goods. These reports are processed and tabulated to arrive at the overall level of imports. Inaccurate reports, delays in processing data, and smuggling can affect their value. There is no tax on exports and recording of data is done at the ports or other locations from where exports take place. All such individual records are totaled to arrive at the total exports in a particular year. Sometimes, it is difficult to assign a particular value to goods. To compare the exports of two countries in a given year, it is necessary to convert the figures into the same currency.

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Chapter 9 : L.A. Metzler (Editor of Readings in the Theory of International Trade)

international trade 93 2 2 ï¬•Trade policiesï¬, refers to all policies that have a direct impact on the domestic prices of tradables, that is, goods and services traded across national boundaries as imports and/or exports.