Scholar's Digest- Journal of Multidisciplinary Studies
Volume 4, Issue 2, February 2025
ISSN (E): 2949-8856
Scholarsdigest.org

THEORIES OF INTERNATIONAL TRADE: EMERGING KNOWLEDGE

Maxwell Nwinye
Department on Management, Faculty of Management Sciences
University of Port Harcourt

Abstract
Trade is a business relationship that involves exchanging goods and services between two people or entities. International trade entails the concept of exchanging skills, technology, weapons, goods and services across national frontiers or between two countries. The factors that enhance trade are complex, and economists throughout the centuries have attempted to interpret the inclinations and factors through the evolution of trade theories. No country likes to trade with its enemy but countries engage in international business to promote world peace and exploitation of new technology. This study examined roles of theories of international trade. The study revealed that understanding the theories of international trade may help consumers or countries to penetrate foreign markers. The concept of theories of international trade especially technology gap theory and absolute advantage theory assist countries that do not produce a specific product to benefit from it through import.

Keywords: Mercantilism theory, absolute advantage theory, comparative advantage theory.

Introduction

The conflict and war between two countries were primarily for economic reasons rather than bitterness in politics, cultural or social differences. For examples, Britan established their colonies through trade, America also invaded Iraq and Libya mainly for economic reasons. Africa was colonized for trade and commerce as well as the case of Latin America. There was a fabulous amount of trade between countries even on opposite sides of the world. For instance, individuals in England, habitually ate lamb and mutton raised in New Zealand. Although, globalized economy worn-out between World War I and World War II, as restrictions and wars made trade dangerous. Ordinarily, people generally believe that most of wars were fought for trade-related reasons. Theories of international trade and its applications assisted in understanding the remote causes and aims behind such wars explaining trade pattern and the benefits that flow from trade. International trade is the exchange of goods and services between people or entities in two different countries (Krueger, 2020). International trade refers to the exchange of goods, capital, and services across national territories. International trade requires the activities of individual and government which represents a significant share of gross domestic product (GDP). Theory of international trade enables people to understand the effects of trade on the domestic economy (Suranovic, 2010). International trade theory affords consumers and countries the opportunities to penetrate new markets and products.

Literature Review

International trade entails the movement of goods, services, across national boundaries (Krugman et al., 2018). International trade is a global business that involves exchange of skills, technology, products, and services between two countries. Most countries are endowed with different natural, human, and capital resources. Each country differs from each other in combining these resources land, labour, and capital. In a globalized setting each country may not be efficient in producing the goods and services that their residents demand. They have to trade off their decisions to produce any good or service based on opportunity cost. The production decision of the country will be dependent on country that is more efficient to produce the goods and services with the lower opportunity cost. (Krugman, 1988). The difference between domestic or home trade and international trade is that the former is a trade that exists within a country while the latter exist across countries. International trade attracts more cost than the domestic trade. It is important to mention that in 21st century the three largest trading markets in the world are European Union, United State and China (Hill, 2007). Theories of international trade include mercantilism theory, absolute advantage theory, comparative advantage theory, Heckscher- Ohlin theory, Leontief paradox theory, country similarity theory, product life cycle theory, and technology gap theory (Feenstra, 2003).

Mercantilism Theory

The trade revolution gave room for a new economic concept identified as mercantilism. In mercantilism theory, agriculture practices have a very limited impact on a country's economic development because agriculture appears to be unproductive after a certain period of time. However, economic development through the use of industries has no boundaries. The mercantilists, primarily European countries such as Germany, France, and England assumed that a nation's power depends on its wealth, which grew by increasing gold and silver reserves. Heckscher (1935) claimed that mercantilism theory was founded in sixteenth century with the aid of Thomas Mun, mercantilism theory states that a country's wealth is determined by the amount of gold and silver the country has or is holding. The theory provides that the method for which a country could increase its gold and silver is by encouraging export and reduce import. This reveals that if a country exports more goods than import, the country may accumulate wealth. The objective of this theory is for a country to have trade surplus instead of trade deficit. This means where the exports exceed the imports it leads to trade surplus or favourable balance of payment, and if import is greater than the export it becomes trade deficit which generates unfavorable balance of payment. Ordinarily, another way a country can increase export and trade is by imposing restrictive on imports. This is otherwise called protectionist law that includes import duties, quota, import license, import monopoly embargo, and dualization of currency. Feenstra (2003) narrated that the essence of these laws is to protect infant or domestic industries to attain growth and sustainability.

Mercantilism theory succeeded in some countries due to the exports were made to the colonies. For examples, the British Colonial Empire colonized Nigeria and other countries. Nigeria imports goods from Britain and that increases the treasure and wealth of Britain. Export may as well be encouraged through subsidies. Similarly, Britain tends to increase its wealth by using raw materials from countries such as America, India, France, and Netherlands but countries like China, Singapore, Germany, Taiwan and Japan promote export and discouraged mercantilism in which the countries encourage import restrictions or protectionist policies and domestic industries subsidies. Wilson (1963) disclosed critical limitations of mercantilism theory which include: there is the possibility of trade surplus in the short run. But in the long run, it may decrease due to the inflow or outflow of gold and silver between the trading countries. Mercantilism theory viewed trade as a zero-sum game or lopsided policy that means with export a country benefits than imports. Adam Smith had a contrary view and argued that trade has a positive some game where all trading countries could gain even if some have advantage over others.

Absolute Advantage Theory

Smith (1776) used his book the wealth of the Nations to challenge the mercantilism theory and demonstrated that even if countries have inequality in distribution of resources, they differ in their ability to produce goods efficiently. He therefore, introduced a new trade called absolute advantage theory. Adam Smith advocated the theory of absolute cost advantage. This theory signifies that a country shall have the ability to produce a good more efficiently than another country. If two countries are involved in producing two different products one country should specialize in producing one good in which it has absolute advantage over another country. The theory assumes that a country should focus on the production of a product in which it could produce cheaper, faster, and more efficient than another nation. Smith (1776) suggested that trade should flow naturally, according to market forces. It is not proper for a country to produce goods at home when it can buy such goods from another country at lower cost. For example, if Britain is efficient in production of textile than France and France can produce Wine cheaper than Britain. This means that Britain has an absolute advantage in the production of textile while France has absolute advantage over Britain in production of wine. Similarly, Cuba produces sugar cheaper than Canada and Canada produces wheat cheaper and more efficient than Cuba. It signifies that Canada has an absolute advantage over Cuba in production of wheat while it is economical for Cuba to produce sugar. It is obvious that the two countries will benefit by engaging in trade. Sen (2010) noted that when trading countries have increased efficiencies, people in both countries may benefit and trade should be encouraged. The theory of absolute advantage suggests that a nation's wealth shouldn't be adjudicated by how much gold and silver it had but by the living standards of its people.

Comparative Advantage Theory

David Ricardo formulated comparative advantage theory or comparative cost theory. This theory states that if a country produces two commodities, it should concentrate on the production of the goods in which it can produce more efficient and with least inefficiency. The country has to compare the two goods in terms of cost of labour and other resources used in producing the goods in which it has relative comparative advantage over the other goods (Ricardo, 1817). The theory specializes in doing what they could do relatively better, for example, if Emeka Nkem has two different skills as a teacher and plumber. Thus, he is paid

$500 per hour for his teaching service and $40 per hour for repairing taps and toilet fittings. Apart from the fact that Emeka Nkem has absolute advantage in both skills, he has to concentrate on teaching which gives him more income and hirer plumber in which he has comparative disadvantage. Furthermore, Bernhofen and John (2004) emphasized that comparative cost advantage states that countries should concentrate on the production of those goods in which they have the greatest comparative real cost advantage or least disadvantage, exporting them, and importing in exchange goods for which they have least advantage or greatest disadvantage. The difference between comparative advantage theory and absolute advantage theory is that the former focuses on the relative productivity differences while the latter deals on the absolute productivity. However, Ricardo (1817) highlighted on the failures of comparative advantage theory, and suggested that comparative cost theory assumed that labour is the only factor in production. There are other relevant factors of production like capital, land, and entrepreneur. Labour is not the only factor of production. Restriction of cost of production to only labour is absolutely defective and it makes the theory to be out of order.

Heckscher- Ohlin Theory or Factor Proportions Theory

The founders of this theory criticized absolute advantage and comparative advantage theory on the ground that the two theories relied heavily on labour as the factor of production. Apparently, two Swedish economists known as Eli Heckscher and Bertil Ohlin founded Heckscher-Ohlin theory. This theory states that a country should export commodities with abundant factors and import commodities with scarce factors (Ohlin & Bertil, 1967). Different countries have diverse factor endowments, which the differences in factor endowments facilitate trade between trading partners. The theory is also based on the assumption that there are trade barriers and that goods and factor markets are perfectly competitive (Helpman & Krugman, 1985). The theory arises from differences in national factor endowment such as land, capital and labour. It states that countries should produce and export goods that make use of locally abundant factors and import goods that make use of factors that are locally scarce. Similarly, the theory is based on countries production factor which provide the funds for investment in plants and equipment. Therefore, the theory provides that countries that are rich in capital should export capital intensive goods and countries that have much labour are to export labour intensive goods. However, Leontief paradox theory disagreed with the Heckscher Ohlin theory which states that, a country with abundant capital should export capital intensive goods. Countries that have abundant labour should export labour intensive goods. This was proved wrong by Leontief paradox theory that used United States as an example, and indicated that United States is abundant in capital but export labour intensive goods and import capital intensive goods (Ohlin & Bertil, 1967).

Leontief Paradox Theory

Leontief paradox theory was formulated by a Russian born American economist called Professor Wassily Leontief. He conducted an input-output study by comparing United States economy with Heckscher Ohlin theory. Leontief paradox theory revealed an opposite situation in which the United States was importing capital-intensive goods from abroad despite being a capital-rich country and was found to be exporting labour-intensive goods (Feenstra, 2003). This theory contradicted Heckscher Ohlin theory. For example, America was importing capital-intensive goods from abroad despite being a capital-rich country and was found to be exporting labour-intensive goods. Most countries have low manpower and incomplete specialization in production (Neary & Albert, 1986). Indeed, labour in the United States was available in steady supply and more productive than other countries which encouraged it to export labour intensive goods. America has protective trade policy, the import of natural resources, and the investment in human capital which helped United States to export labour-intensive goods.

Product Life Cycle Theory

This theory was developed by a Harvard business school Professor called Raymond Vernon. The theory states that product life cycle consists of three distinct stages which are new product, maturing product, and standardized product (Hill, 2007). Companies that engage in international business pass through the stages of product life cycle. Thus, the theory assumed that before a product becomes new in the eyes of consumers, such product must be produced in the firm's home country, where it could be accepted in the domestic market. As the production of the product increases and the unit cost reduces, the product eventually becomes a major export that will penetrate foreign market. The second stage of maturing product arises when the product has gain attraction and foreign demand increases either for consumption or for further production. Accordingly, the firm may be encouraging to engage in foreign direct investment where it could open a new factory in foreign country to produce similar product. The third stage is the standardized product, which occurs when other nations begin to produce the same product that was originally produced by a company in one country. It is the stage when the firm's home country begins to import the product from other nations. Sen (2010) asserted that the theory was useful in explaining the manufacturing success of the United States which has globally dominant producer of goods in many industries after the World War II. For example, the theory illustrated how the personal computer (PC) undergoes the process of product cycle.

Country Similarity Theory

Country similarity theory was formulated by Steffan Linder a Swedish Economist. Moreover, this theory states that countries that have similar factors such as income, stage of technology, communication, consumer habits, market preferences, level of industrialization, language, number of cities, should trade together and promote intra industry trade (Krugman et al., 2018). The theory suggested that consumers in co-countries that have similar stage of development tend to enjoy the same preferences. Thus, trade between two or more countries could be possible or interesting when they have similar per capital come. The first task for the companies is to produce for domestic consumption and when there is demand from foreign countries, it may export such products to them. The theory enhances buyer's decision making in terms of products with brand names and reputations.

Technology Gap Theory

This theory is the opposite of country similarity theory because it states that a country that is inferior in technology should have trade relationship with a technologically superior country so that it can benefit from the technology. Besides, technology gap theory illustrated that it is the technological superiority of a country that gives it an advantage in securing export markets (Suranovic, 2010). This theory induced many presidents in less industrialized nations to travel abroad for the purpose of negotiating with foreign investors that will transfer technology into their countries.

Conclusion

Theories of international trade assisted various stakeholders such as government, managers, economists, businesses, organizations, and entrepreneurs to understand the tenets of international trade and how to promote, regulate, and manage it. Most countries that do not have sufficient resources benefit productively from countries with abundant resources through theories of international trade. This study revealed that when two countries have trade relationship, they are capable of transferring wealth to people in such countries and promote peace among the trading partners. It was also discovered that through theories of international trade a lot of persons have acquired knowledge about the realities that face global business.

References

1. Bernhofen, D. M. & John, C. B. (2004). A direct test of the theory of comparative advantage: The case of Japan. Journal of Political Economy, 112, 48-67.
2. Feenstra, R. C. (2003). Advanced international trade: Theory and evidence. Princeton University Press.
3. Heckscher, E. F. (1935). Mercantilism. Allen & Unwin.
4. Helpman, E. & Krugman, P. R, (1985). Market structure and foreign trade. MIT Press.
5. Hill, C. (2007). International business competing in the global marketplace (6th ed.). McGraw-Hill.
6. Krueger, A. O. (2020). International trade: What everyone needs to know OUP.
7. Krugman, P., Melitz, M., & Obstfeld, M. (2018). International trade: Theory and policy. Pearson.
8. Krugman, P. (1988). Rethinking international trade. MIT Press.
9. Ohlin & Bertil (1967). Interregional and international trade. Harvard University Press.
10. Neary, J. P. & Albert, S. (1986). Factor content functions and the theory of international trade. Review of Economic Studies, 53, 421-432.
11. Ricardo, D. (1817) The theory of comparative advantage. In P. Sraffa, & M. H. Dobb (Eds.). Principles of political economy and taxation. Cambridge University Press.
12. Sen, S. (2010). International trade theory and policy: A review of the literature. Levy Economics Institute of Bard College.
13. Smith, A. (1776). An inquiry into the nature and causes of the wealth of nations book v, chapter 2, article I: Taxes upon the Rent of House.
14. Suranovic, S. (2010). International Trade: Theory and policy. Saylor Foundation.
15. Wilson, C. (1963). Mercantilism. Routledge and Kegan Paul.