Industrial-Economics-Module-5-Important-Topics

For more notes visit

https://rtpnotes.vercel.app

1. Theories of International Trade (Absolute, Comparative and H O Theory)

Absolute advantage theory

- According to adam smith, the basis of international trade is absolute cost advantage
- Suppose there are two commodities and two countries which produce these commodities
  - One country is efficient in the production of one commodity and thus it has an absolute advantage in the production of this commodity
  - Other country has an absolute advantage over the production of the other commodity
  - Then the countries will specialize and produce the commodify upon which they have absolute advantage

Example

	USA	UK
Number of units of wheat per unit of Labour	10	5
Number of units of cloth per unit of Labour	3	8

- In the above example, USA has an absolute advantage over the production of wheat over UK
  - Because it can produce 10 units of wheat with one unit of labour
  - But UK can only produce 5 units
- UK has absolute advantage over the production of cloth
  - Hence US will produce and export wheat to the UK and UK will produce and export the cloth to US.

  - Both countries will gain from international trade

Comparative advantage theory

- Comparative cost advantage theory was developed by David Ricardo
- Even in the case of a country for which there is no absolute advantage for both the commodities, it can gain from international trade.
- In this situation, the country should specialize in the production and export of the commodity in which its absolute disadvantage is smaller and import the commodity in which its absolute disadvantage is greater

Assumptions

- There are only two countries and two commodities
- There are no barriers in international trade
- There is no transport cost
- Labour is the only component of cost of production
- There is perfect competition and full employment

Example

Country	No of units of labour per unit of cloth	No of units of labour per unit of wine	Exchange ratio
England	100	120	1 wine = 1.2 cloth
Portugal	90	80	1 wine = 0.88 cloth

- The above example shows portugal has an absolute advantage in the production of both commodities
- Ratio of wine and cloth production shows that
  - Portugal has advantage in wine, so it will specialise in wine production and produce wine
  - England will similarly produce cloth
  -

Heckscher - Ohlin theory

- The factor endowment theory was developed by Eli Heckscher in 1919, later in 1935 it was refined by his student Bertil Ohlin.
- Its a two country two commodity model

Assumptions of the model

- There is perfect competition in the factor market and product market
- There is full employment
- There is free trade between countries
- There is no transport cost
- Technology remains same in both countries

Theorem

The differences in comparative advantage among nations is mainly due to differences in relative factor abondance or factor endowments

In other words, Relatively labour abundant country will export the relatively labour intensive commodity and import the relatively capital intensive commodity

2. Advantages and Disadvantages of International trade

Advantages

- Optimal use of natural resources
- Availability of all types of goods
- Specialisation
- Advantages of large scale production
- Stability in prices
- Establishment of new industries
- Increase in efficiency
- Development of means of transport and communication
- International cooperation and understanding
- Discouragement to monopolies
- Better employment opportunities

Disadvantages

- A threat to domestic industries
- Economic dependence
- Misuse of natural resources
- Endangers independence
- Import of harmful goods
- Evil effects of dumping
- Against national defence

3. Balance of Payment

- Balance of payments is a systematic record of all economic transactions of a nation with the rest of the world for a specific period of time.
- Usually time period is taken as one year
- The main purpose of balance of payments is to inform the governments regarding international currency position of the nation and to help in the formulation of policies accordingly

Components

Current Account

- Consists of two major items, merchandise and invisible
  - Merchandise exports and imports
    - Merchandise exports, that is sale of goods abroad are credit items, and merchandise imports, purchase of goods abroad are debit items
  - Invisible exports and imports
    - Invisible exports are credit entries
      - Sale of services like transport, insurance etc
    - Imports are debit entries
      - Purchase of services like transport and insurance

Capital account

- The capital account includes short term and long term capital transaction.
- Capital inflows are coming as credit entries and outflows as debit entries
- For example
  - Japanese firm invest 100 million on india
  - There will be entry under credit for india and entry under debt for japan

Unilateral transfers account

- Unilateral transfer means one way transfer of an item from one person to another
- Such one way transfers are without any expectations of anything in return

The official reserve account

- The official reserve account is a subdivision of the capital account. Its the foreign currency and securities held by the government, usually by central bank.

---

4. Free trade and Protection (tariff and nontariff barriers)

Free trade versus protection

- Free trade is a trade policy that does not restrict imports or exports
- It refers to trade that is free from all artificial barriers to trade like tariffs, quota restrictions, exchange controls etc.
- Protection on the other hand is the policy of protecting domestic industries against foreign competitions by means of tariffs, subsidies, import quotas etc

Arguments for free trade

- Better utilisation of resources
- Division of labour and specialization
- Efficiency
- Dampen monopoly practices
- Wide variety of goods
- Economic growth

Arguments Against free trade

- Threat to domestic industries
- Harmful commodities
- Job outsourcing leads to unemployment
- Poor working conditions

Arguments in favour of protection

- Infant industry argument
- Strategic and key industry argument
- National defence
- Anti dumping
- Keeping money at home

Arguments against protection

- Discourages compeition and compromises efficiency
- Uneconomic utilization of worlds resources
- Protection may lead to trade wars

Trade Barriers

- Trade barriers refer to the government policies and measures which restrict the free flow of goods between counties.
- They are divided to two groups, tariff barriers and non tariff barriers

Tariff Barriers

- Tariff barriers are duties or taxes imposed by the government on its import and export
- Categories (Origin and destination)
  - Export duties
  - Import duties
  - Transit duties
- Categories(Quantification of tariffs)
  - Specific duties
    - Fixed duties on each type of commodity exported or imported
  - Ad-valorem duties

        - Duties levied as a fixed percentage of commodity imported or exported
    - Compound duties
        - When specific and ad valorem duties are imposed on a commodity its known as compound duties
- Categories (Application of tariffs)
    - Single column tariff
        - uniform tariffs are imposed
    - Double column tariffs
        - 2 rates are imposed
    - Triple column tariffs
        - 3 rates, general, intermediate, and preferential
- Categories(Purpose)
    - Revenue tariff
    - Protective tariff
    - Countervailing and anti dumping tariffs

Effects of tariffs

- Protective tariff
    - Imports will become costly, demand of domestic goods will increase
- Revenue effect
    - Increase revenue of govt
- Income and employment
- Improves balance of payments

Non tariff barriers

- There are different types of NTB
    - Hardcore NTBs
        - Voluntary export restraints
        - Variable levies
        - Multi fibre agreement
        - non automatic licencing
    - Technical barriers
    - Minimum pricing

- Regulation and price survellience

5. Devaluation

- Devaluation means a deliberate reduction of the value of the domestic currency in terms of foreign currency

Success conditions of devaluation

- Success depends of reaction of other counties, if they retaliate by devaluing their currencies, devaluation will not be successful
- Depends on elasticities of demand for export
- If prices in domestic country increases at the same rate or at a higher rate of devaluation. It will not increase or decrease export

6. Marshall Lerner condition

- Devaluation will improve the balance of payments of a country if sum elasticities of demand for countries exports and its demand for imports is greater than one.