Gains From International Trade

IEC HASS Elective 2

Classical Economists advocated free trade so that gains to all countries can be maximised.

- International Trade benefits all the participating countries.
- I t enables the country to export the surplus to other countries and there by secure a better market or it .
- Similarly it enables a country to import a commodity which it cannot produce at all or can produce only at a high cost.

Some other important gains from International Trade are:

- International Specialisation due to Division of labour
- Equalisation of prices
- Optimum allocation of scarce resources
- Exchange of technical and managerial knowledge and skill
- Maximisation of Production
- Comparative cost advantage

There is no need to be self-sufficient in every line of Production in such globally accessible economies.

- >>> Attempting to be self-sufficient would imply that the nation would have to produce everything it needs itself.
- This would mean it has to allocate its limited resources to production of every goods and services .
- This would lead to wastage to valuable resources
- It would have limited chance of product diversification.

International Trade gives gains from trade>>

- International Trade give access to diverse array of goods and services.
- It enables the nation to specialize in the production of goods that it excels in terms of possessing Comparative advantages in its production. .

So, lets define Gains From Trade:

- Gains from trade are the benefits an individual or country experiences when they engage in trade with others.
- **The two main types of gains from trade are:**

static gains and dynamic gains

What are Static and Dynamic Gains of International Trade:

- **Static gains** from trade are those that increase the social welfare of the people living in the nations. When a nation can consume beyond its production possibilities frontier after engaging in trade, it has made static gains from trade.
- **Dynamic gains** from trade are those that help the nation's economy grow and develop faster than if it had not engaged in trade. Trade increases a nation's income and production capability through specialization, which allows it to save and invest more than it could in pre-trade, making the nation better off.

Let us take an example: Gains from international Trade in the form of Production of more goods.

- Say:
- **In India,**
- 1 day’s labour produces 40 units of wheat
- 1 day’s labour produces 40 units of Cloth
- **In England:**
- 1 day’s labour produces 20 units of wheat
- 1 day’s labour produces 30 units of wheat

- **Which country has Absolute Advantage in the production of the commodities ?**

Assumptions:

- 1. each country **has 2 days of labour**
- 2. the output of the different commodities can be added up
- 3. There is Constant cost conditions in both the countries

In the Absence of Trade >>>

- >> each country produces both the commodities.

- >> 1 day's labour produces Wheat and 1 day's labour produces Cloth.

- **So what will be the Total output ??**

Answer: 130 units of Wheat and Cloth

- HOW ?

Now, under International Trade:

- Which country has comparative advantage and in which commodity ??

So >>

- India has Comparative advantage in the production of Wheat and England has Comparative advantage in the production of Cloth.

- So, each will specialise in their production.

- What will be the Total Combined Output Now ??

Answer : 140 units of Wheat and Cloth

- LETS OBSERVE THE GAINS FROM TRADE WITH A DIAGRAM

Distribution of Gains

- The extent of Gains from the Trade depends upon the differences between the domestic cost ratios of the trading countries.
- **The greater this difference, the greater will be the gains from trade**
- The Gains may be unevenly distributed between the countries, depending upon their bargaining power.
- This distribution of gains will depend upon the Terms of Trade (TOT) , i.e., the rate at which the country's exports are exchanged for imports.
- **The closer the TOT to the domestic exchange ratio of a country, the lesser will be the gains for that country and the greater will be the gains for the other country.**

Lets See this with a diagram...

- Taking the case of the 2x2 model of Comparative cost theory.

- Say there is two country -- India and England dealing with two products = Wheat and Cloth
- Let their Domestic exchange rates be :
- 1 W = 9 C in England
- and 1W = 5 C in India

Thus,

- International Trade leads to international Specialisation and this in turn leads to optimisation of resources use and maximisation of Output.