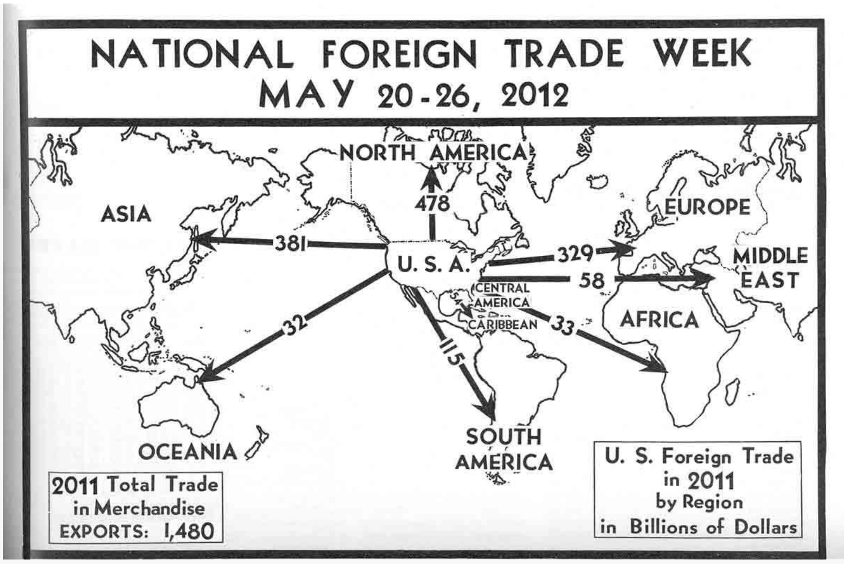
International Trade

International trade is referred to as the exchange or trade of goods and services between different nations. This kind of trade contributes and increases the world economy. The most commonly traded commodities are television sets, clothes, machinery, capital goods, food, and raw material, etc.,

International trade has increased exceptionally that includes services such as foreign transportation, travel and tourism, banking, warehousing, communication, advertising, and distribution and advertising. Other equally important developments are the increase in foreign investments and production of foreign goods and services in an international country. This foreign investments and production will help companies to come closer to their international customers and therefore serve them with goods and services at a very low rate.

All the activities mentioned are a part of international business. It can be concluded by saying that international trade and production are two aspects of international business, growing day by day across the globe.

Foreign trade is exchange of capital, goods, and services across international borders or territories. In most countries, it represents a significant share of gross domestic product (GDP). While international trade has been present throughout much of history, its economic, social, and political importance has been on the rise in recent centuries.



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According to Wasserman and Haltman, "International trade consists of transaction between residents of different countries".

According to Anatol Marad, "International trade is a trade between nations".

According to Eugeworth, "International trade means trade between nations".

Difference between Trade and Commerce

BASIS	TRADE	COMMERCE
Meaning	The possession of goods or services is given from one person to the another in payment of cash or cash equivalents. Trade can be performed between 2 parties or more than 2 parties.	Commerce involves all the activities that aid in promoting the exchange of goods and services from the manufacturer to the last customers. Primarily, the activities are banking, transportation, advertising, warehousing, insurance, etc.,
Scope	Narrow	Broad
Type of Activity	Social	Economic
Association	Between the buyer and seller	Between the manufacturer and customer
Capital requirement	More	Less
Frequency of Transactions	Isolated	Regular

- ## Classification of International Trade:

(a) Import Trade:

It refers to purchase of goods from a foreign country. Countries import goods which are not produced by them either because of cost disadvantage or because of physical difficulties or even those goods which are not produced in sufficient quantities so as to meet their requirements.

(b) Export Trade:

It means the sale of goods to a foreign country. In this trade the goods are sent outside the country.

(c) Entrepot Trade:

When goods are imported from one country and are exported to another country, it is called entrepot trade. Here, the goods are imported not for consumption or sale in the country but for re- exporting to a third country. So importing of foreign goods for export purposes is known as entrepot trade.

- ## Characteristics of International Trade:

(i) Separation of Buyers and Producers:
In inland trade producers and buyers are from the same country but in foreign trade they belong to different countries.

(ii) Foreign Currency:
Foreign trade involves payments in foreign currency. Different foreign currencies are involved while trading with other countries.

(iii) Restrictions:
Imports and exports involve a number of restrictions but by different countries. Normally, imports face many import duties and restrictions imposed by importing country. Similarly, various rules and regulations are to be followed while sending goods outside the country.

(iv) Need for Middlemen:
The rules, regulations and procedures involved in foreign trade are so complicated that there is a need to take the help of middle men. They render their services for smooth conduct of trade.

(v) Risk Element:
The risk involved in foreign trade is much higher since the goods are taken to long distances and even cross the oceans.

(vi) Law of Comparative Cost:
A country will specialise in the production of those goods in which it has cost advantage. Such goods are exported to other countries. On the other hand, it will import those goods which have cost disadvantage or it has no specific advantage.

(vii) Governmental Control:
In every country, government controls the foreign trade. It gives permission for imports and exports may influence the decision about the countries with which trade is to take place.

- **Need for International Trade:**

In today's world, economic life has become more complex and diversified. No country can live in isolation and claim to be self-sufficient. Even countries with different ideologies, culture, and political, social and economic structure have trade relations with each other. Thus, trade relations of U.S.A. with U.S.S.R. and China with Japan are examples. The aim of international trade is to increase production and to raise the standard of living of the people. International trade helps citizens of one nation to consume and enjoy the possession of goods produced in some other nation.

- ## Reasons of International Trade:

1- Reduced dependence on your local market

Your home market may be struggling due to economic pressures, but if you go global, you will have immediate access to a practically unlimited range of customers in areas where there is more money available to spend, and because different cultures have different wants and needs, you can diversify your product range to take advantage of these differences.

2- Increased chances of success

Unless you’ve got your pricing wrong, the higher the volume of products you sell, the more profit you make, and overseas trade is an obvious way to increase sales. In support of this, UK Trade and Investment (UKTI) claim that companies who go global are 12% more likely to survive and excel than those who choose not to export.

3- Increased efficiency

Benefit from the economies of scale that the export of your goods can bring – go global and profitably use up any excess capacity in your business, smoothing the load and avoiding the seasonal peaks and troughs that are the bane of the production manager’s life.

4- Increased productivity

Statistics from UK Trade and Investment (UKTI) state that companies involved in overseas trade can improve their productivity by 34% – imagine that, over a third more with no increase in plant.

5- Economic advantage

Take advantage of currency fluctuations – export when the value of the pound sterling is low against other currencies, and reap the very real benefits. Words of warning though; watch out for import tariffs in the country you are exporting to, and keep an eye on the value of sterling. You don’t want to be caught out by any sudden upsurge in the value of the pound, or you could lose all the profit you have worked so hard to gain.

6- Innovation

Because you are exporting to a wider range of customers, you will also gain a wider range of feedback about your products, and this can lead to real benefits. In fact, UKTI statistics show that businesses believe that exporting leads to innovation – increases in break-through product development to solve problems and meet the needs of the wider customer base. 53% of businesses they spoke to said that a new product or service has evolved because of their overseas trade.

7- Growth

The holy grail for any business, and something that has been lacking for a long time in our manufacturing industries – more overseas trade = increased growth opportunities, to benefit both your business and our economy as a whole.

8. **Uneven Distribution of Natural Resources:**
Natural resources of the world are not evenly divided among the nations of the world. Different countries of the world have different amount of natural resources and they differ with each other in regard to climate, minerals and other factors.

Some countries can produce more of sugar like Cuba, some can produce more of cotton like Egypt, while there are some others which can produce more of wheat like Argentina. But all these countries need sugar, cotton and wheat. So they have to depend upon one another for the exchange of their surpluses with the goods that are in short supply in their country and hence the need for international trade is natural.

9. Division of Labour and Specialisation:
Due to uneven distribution of natural resources, some countries are more suitably placed to produce some goods more economically than other countries. But they are geographically at a disadvantageous position to produce other goods. They specialise in the production of such goods in which they have some natural advantage in the form of availability of raw material, labour, technical know-how, climatic conditions, etc. and get other goods in exchange for these goods from other countries.

10. Differences in Economic Growth Rate:
There are many differences in the economic growth rate of different countries. Some countries are developed some are developing, while there are some other countries which are under-developed: these under-developed and developing countries have to depend upon developed ones for financial help, which ultimately encourages international trade.

- ## Advantages and Disadvantages of International Trade

- ## Advantages of International Trade:

(i) Optimal use of natural resources:
International trade helps each country to make optimum use of its natural resources. Each country can concentrate on production of those goods for which its resources are best suited. Wastage of resources is avoided.

(ii) Availability of all types of goods:
It enables a country to obtain goods which it cannot produce or which it is not producing due to higher costs, by importing from other countries at lower costs.

(iii) Specialisation:

Foreign trade leads to specialisation and encourages production of different goods in different countries. Goods can be produced at a comparatively low cost due to advantages of division of labour.

(iv) Advantages of large-scale production:
Due to international trade, goods are produced not only for home consumption but for export to other countries also. Nations of the world can dispose of goods which they have in surplus in the international markets. This leads to production at large scale and the advantages of large scale production can be obtained by all the countries of the world.

(v) Stability in prices:
International trade irons out wild fluctuations in prices. It equalizes the prices of goods throughout the world (ignoring cost of transportation, etc.)

(vi) Exchange of technical know-how and establishment of new industries:
Underdeveloped countries can establish and develop new industries with the machinery, equipment and technical know-how imported from developed countries. This helps in the development of these countries and the economy of the world at large.

(vii) Increase in efficiency:
Due to international competition, the producers in a country attempt to produce better quality goods and at the minimum possible cost. This increases the efficiency and benefits to the consumers all over the world.

(viii) Development of the means of transport and communication:
International trade requires the best means of transport and communication. For the advantages of international trade, development in the means of transport and communication is also made possible.

(ix) International co-operation and understanding:
The people of different countries come in contact with each other. Commercial intercourse amongst nations of the world encourages exchange of ideas and culture. It creates co-operation, understanding, cordial relations amongst various nations.

(x) Ability to face natural calamities:
Natural calamities such as drought, floods, famine, earthquake etc., affect the production of a country adversely. Deficiency in the supply of goods at the time of such natural calamities can be met by imports from other countries.

(xi) Other advantages:
International trade helps in many other ways such as benefits to consumers, international peace and better standard of living.

➢ Disadvantages of International Trade:

Though foreign trade has many advantages, its dangers or disadvantages should not be ignored.

(i) Impediment in the Development of Home Industries:

International trade has an adverse effect on the development of home industries. It poses a threat to the survival of infant industries at home. Due to foreign competition and unrestricted imports, the upcoming industries in the country may collapse.

(ii) Economic Dependence:

The underdeveloped countries have to depend upon the developed ones for their economic development. Such reliance often leads to economic exploitation. For instance, most of the underdeveloped countries in Africa and Asia have been exploited by European countries.

(iii) Political Dependence:

International trade often encourages subjugation and slavery. It impairs economic independence which endangers political dependence. For example, the Britishers came to India as traders and ultimately ruled over India for a very long time.

(iv) Mis-utilisation of Natural Resources:

Excessive exports may exhaust the natural resources of a country in a shorter span of time than it would have been otherwise. This will cause economic downfall of the country in the long run.

(v) Import of Harmful Goods:

Import of spurious drugs, luxury articles, etc. adversely affects the economy and well-being of the people.

(vi) Storage of Goods:

Sometimes the essential commodities required in a country and in short supply are also exported to earn foreign exchange. This results in shortage of these goods at home and causes inflation. For example, India has been exporting sugar to earn foreign trade exchange; hence the exalting prices of sugar in the country.

(vii) Danger to International Peace:

International trade gives an opportunity to foreign agents to settle down in the country which ultimately endangers its internal peace.

(viii) World Wars:

International trade breeds rivalries amongst nations due to competition in the foreign markets. This may eventually lead to wars and disturb world peace.

(ix) Hardships in times of War:

International trade promotes lopsided development of a country as only those goods which have comparative cost advantage are produced in a country. During wars or when good relations do not prevail between nations, many hardships may follow.

- **Theory of Comparative Advantage of International Trade: by David Ricardo**

The classical theory of international trade is popularly known as the Theory of Comparative Costs or Advantage. It was formulated by David Ricardo in 1815.The classical approach, in terms of comparative cost advantage, as presented by Ricardo, basically seeks to explain how and why countries gain by trading.The idea of comparative costs advantage is drawn in view of deficiencies observed by Ricardo in Adam Smith's principles of absolute cost advantage in explaining territorial specialisation as a basis for international trade.Being dissatisfied with the application of classical labour theory of value in the case of foreign trade,Ricardo developed a theory of comparative cost advantage to explain the basis of international trade as under:

Ricardo's Theorem:
Ricardo stated a theorem that, other things being equal, a country tends to specialise in and export those commodities in the production of which it has maximum comparative cost advantage or minimum comparative disadvantage. Similarly, the country's imports will be of goods having relatively less comparative cost advantage or greater disadvantage.

The Ricardian Model:
To explain his theory of comparative cost advantage, Ricardo constructed a two-country, two-commodity, but one-factor model with the following assumptions:
1. Labour is the only productive factor.
2. Costs of production are measured in terms of the labour units involved.
3. Labour is perfectly mobile within a country but immobile internationally.
4. Labour is homogeneous.
5. There is unrestricted or free trade
6. There are constant returns to scale.
7. There is full employment equilibrium.
8. There is perfect competition.

Under these assumptions, let us assume that there are two countries A and B and two goods X and Y to be produced.
Now, to illustrate and elucidate comparative cost difference, let us take some hypothetical data and examine them as follows.

Absolute Cost Difference:
As Adam Smith pointed out, if there is an absolute cost difference, a country will specialise in the production of a commodity having an absolute advantage (see Table 1).

Table 1 Cost of Production in Labour Units:

	Country A	Country B	Comparative Cost Ratio
Commodity X	10	20	10/20 = 0.5
Commodity Y	20	10	20/10 = 2
ADVERTISEMENTS: Domestic Exchange Ratio:	1 X = 1/2 Y	1 X = 2 Y	

It follows that country A has an absolute advantage over B in the production of X while B has an absolute advantage in producing Y. As such, when trade takes place, A specialises in X and exports its surplus to B and B specialises in У and exports its surplus to A.

Equal Cost Difference:

Ricardo argues that if there is equal cost difference, it is not advantageous for trade and specialisation for any country in consideration (see Table 2).

Table 2 Cost of Production in Labour Units:

	Country A	Country B	Comparative Cost Ratio
Commodity X Commodity Y	10 20	15 30	10 /15 = 0.66 20/30 = 0.66
Domestic Exchange Ratio:	1 X = 1/2 Y	1 X = 1/2 Y	

On account of equal cost difference, the comparative cost ratio is the same for both the countries, so there is no reason for undertaking specialisation. Hence, the trade between two countries will not take place.

Comparative Cost Difference:

Ricardo emphasised that under all conditions, it, is the comparative cost advantage which lies at the root of specialisation and trade (see Table 3).

Table 3 Cost of Production in Labour Units:

	Country A	Country B	Comparative Cost

			Ratio
Commodity X	10	15	10/ 15 = 0.66
Commodity Y	20	25	20/25 = 0.80 25
Domestic Exchange Ratio	IX = 0.5Y	IX = 0.6Y	

It will be seen that country A has an absolute cost advantage in both the commodities X and Y. However, A possesses a comparative cost advantage in producing X. For, comparatively, country A’s labour cost involved in producing 1 unit of X is only 66 per cent of B’s labour cost involved in producing X, as against that of 80 per cent in the case of Y.

On the other hand, country B has least comparative disadvantage in production of Y, though she has absolute cost disadvantage in both X and Y.

It should be noted that, to know the comparative advantage, we have to compare the ratio of the costs of production of one commodity in both countries (i.e., 10/15 in the case of X in our example) with the ratio of the cost of producing the other commodity in both countries (i.e., 20/25 in the case of У in our example). To state in algebraic terms:

If in country A, the labour cost of commodity X is Xa and that of У is Ya, and in B, it is Xb and Yb respectively, then absolute differences in cost can be expressed as:

$Xa/Xb < 1 < Ya/Yb$

(Which means that country A has an absolute advantage over country B in commodity X and country B has over A in commodity У). And, comparative differences in costs are expressed as:

$Xa/Xb < Ya/Yb < 1$

(Which implies that country A possesses an absolute advantage over B in both X and (Y, but it has more comparative advantage in X than in Y). If, however, there is an equal cost difference, i.e., $Xa/Xb = Ya/Yb$ will be no international trade between the two countries.

In our illustration, since country A has comparative cost advantage in commodity X, as per Ricardo s theorem, this country should tend to specialise in X and export its surplus to country B in exchange for У (i.e., import of У from B). Correspondingly, since country B has least cost disadvantage in producing У, she should specialise in У and export its surplus to A and import X.

Gain Attributes of International Trade:

It further follows that when countries A and B enter into trade, both will gain. In the absence of trade, domestically in country A, IX = 0.5У. Now, if after trade, assuming the terms of trade to be IX — 1Y, country A gains 0.5 unit more. Similarly, in country B, IX = 0.6 У domestically, after trade, its gain is 0.4Y.

In short, "each country can consume more by trading than in isolation with a given amount of resources. Indeed, the relative gains of the two countries will be conditioned by the terms of trade and one is likely to gain proportionately more than the other but it is definite that both will gain.

In fact, the principle of comparative costs shows that it is possible for both the countries to gain from trade, even if one of them is more efficient than the other in all lines of production.

The theory implies that comparative costs are different in different countries because the abundance of factors which may be necessary for the production of each commodity does not bear the same relation to the demand for each commodity in different countries.

Thus, specialisation based on comparative cost advantage clearly represents a gain to the trading countries in so far as it enables more of each variety of goods to be produced cheaply by utilising the abundant factors fully in the country concerned and to obtain relatively cheaper goods through mutual international exchange.

Ricardo's theory pleads the case for free trade. He stresses that free-trade is the pre-requisite of gains and improvement of world's welfare. Free trade "by increasing the general mass of production diffuses general benefit and binds together by one common tie of interest and intercourse, the universal society of nations throughout the civilised world."

To sum up, what goods will be exchanged in international trade is the main question solved by Ricardo's theory of comparative costs. The theory is lucidly summarised by Kindle-Berger as follows:

"The basis for trade, so far as supply is concerned, is found in differences in comparative costs. One country may be more efficient than another, as measured by factor inputs per unit of output, in the production of every possible commodity, but so long as it is not equally more efficient in every commodity, a basis for trade exists. It will pay the country to produce more of those goods in which it is relatively more efficient and to export these in return for goods in which its absolute advantage is least."

▪ Trade as an Engine of Economic Growth

Although the rate of economic growth and the space and pattern of economic development depends primarily on internal conditions in developing countries, international trade can make significant contribution to economic development. The traditional theories of trade examine how growth in production capabilities can affect international trade.

Clearly, growth can have a major impact on international trade. There is also likely to be an impact in the other direction—from trade to growth. Exposure to international trade can have an impact on how fast a country's economy can grow and how fast its production facilities are growing over time.

The classical economists like Adam Smith and David Ricardo first found interest in the role of trade in economic development. They have sang the praise of free trade based on comparative advantage. The principle of comparative advantage holds that each country will benefit if it specialises in the production and export of those goods that it can produce at relatively low cost. Conversely, each country will benefit if it imports those goods which it produces at relatively high cost.

The classicists advocated the doctrine of laissez-faire (non-interference by the government) even in international trade (and not just in domestic matters). Such adherence to completely free trade, they thought, would promote the maximisation of welfare for the world and the member countries in the world trading system.

Notwithstanding its limitations, the theory of comparative advantage is one of the deepest in all types of economies. Those countries which disregard comparative advantage ultimately have to pay a heavy price in terms of their living standards and economic growth.

As P. A. Samuelson and W. D. Nordhaus convincingly argue:
"Free trade promotes a mutually beneficial division of labour among nations; free and open trade allows each nation to expand its production and consumption possibilities, raising the world's living standard. Protectionism prevents the forces of comparative advantage from to maximum advantage."

However, there is dissatisfaction among LDCs as to the virtue of completely free trade and most such countries feel that it is not the ideal policy for them. They feel that they are partners in global trade since the gains from trade are not equally shared by developed and developing countries.

This very feeling gets reflected in the North-South conflict which has created the demand for a new international economic order. Given their level of poverty and some special problems which they have been facing over the years, developing countries often treat the laissez-faire prescription as inappropriate.

So, any discussion of the role of international trade in promoting economic development must take into account the special problems faced by the developing countries in international trade and the policy constraints they face in tackling them.

Trade, undoubtedly, has several benefits. It promotes growth and enhances economic welfare by stimulating more efficient utilisation of factor endowments of different regions and by enabling people to obtain goods from efficient sources of supply. Trade also makes available to people goods which cannot be produced in their country due to various reasons.

The role of trade in enhancing consumer's choice (even delight) is tremendous. The foreign trade multiplier, shows how an injection of income arising out of trade can lead to economic expansion.

According to A.C. Cairn cross:
"As often as not, it is trade that gives birth to the urge to develop, the knowledge and experience that make development possible, and the means to accomplish it."

An Overview of the Developing Countries:
It may be noted at the outset that LDCs are not a homogeneous group. There are many differences in levels of income, types of industrial structure, degree of participation in international trade (or the degree of economic openness) and types of problems faced in the world economy.

In spite of the diversity among LDCs, a list of Characterizations of these countries is useful for emphasizing that they are very different from the industrialised countries. In general, the LDCs are characterised as having low per capita incomes and a relatively low per cent of their population in urban areas.

In addition, population growth rate, the share of agriculture in GDP, and infant mortality rates are higher and life expectancy is shorter than those in high- income countries. Finally, the share of manufactured exports in total exports tends to be lower in developing countries than in high-income countries.

E. Haberler lists the following benefits of trade to stress the importance of trade to development of the less developed countries:
1. Trade provides material means (capital goods, machinery, and raw and semi-finished material) indispensable for economic development.

2. Trade is the means and vehicle for the dissemination of technological knowledge, the transmission of ideas, for the importation of know-how, skills, managerial talents and entrepreneurship.

3. Trade is also the vehicle for the international movement of capital, especially from the developed to the underdeveloped countries.

4. Free international trade is the best anti-monopoly policy and the best guarantee for the maintenance of a healthy-degree of free competition.

The Role of Trade in Economic Development:

In discussing the role of trade in fostering economic development, we have to examine various different issues, viz, the static effects of trade, the dynamic effects of trade and export pessimism or secular deterioration of the terms of trade of LDCs. In this context, we have access to discuss trade policies of the developing countries.

1. The Static Effect of Trade on Economic Development:

International trade enables an LDC to get beyond its PPC and improve its welfare. It can consume more than what it is capable of producing through specialisation and exchange. An LDC can improve its well-being by specialising in and exporting the relatively less expensive domestic goods and importing goods which are relatively more expensive. Even if a country's production does not change at all, there are still gains from exchange if there is a difference between internal relative prices in autarky and those which can be obtained internationally.

In addition, the characteristics of the imported goods either in terms of quantity for customers or productivity in the case of capital and intermediate imports, may improve the economy 's ability to meet consumer desires for better quality goods or larger volume of goods made available by improved technology. Imports may also help remove bottlenecks and enable the economy to operate closer to its PPC—that is to say, more efficiency on a consistent basis.

i. Employment Generation:

Due to specialisation there is a relative expansion of the sectors using relatively more intensively an LDCs abundant factor—which is labour. For most LDCs, specialisation according to comparative advantage helps to expand labour-intensive production instead of more modern, capital-intensive production.

This means expanding traditional agriculture, primary products, and labour-intensive light manufactures. International trade thus stimulates employment and puts upward pressure on wages as has been suggested by the Heckscher-Ohlin (H-O) theorem. However, most LDCs are labour-surplus countries. So, an increased demand for labour is unlikely to raise the wage rate much.

ii. Export Instability:

Moreover, the relative growth in the production of traditional goods may not be desirable if such growth is at the expense of modern manufacturing. Due to low income and price elasticities of demand for such goods and the instability of supply of agricultural and primary products due to natural (weather) conditions, greater specialisation in these goods can result in a greater instability of income even in the short run.

iii. Adverse Terms of Trade:

In addition, since an LDC is a small country (in the sense that it cannot exert any influence on the prices of its exports and imports), expansion of export supply may lead to undesired terms of trade movements that will-reduce the static gains from trade. This may lead to a distribution of gains from trade in favour of the industrially developed countries.

iv. Greater Dependency:

Finally, expanding production of basic labour-intensive goods and relying on the industrialised countries for technology and skill-intensive manufactures and capital goods often leads to excessive economic dependency. It also links the economic health of the developing country to that of the industrialised country.

v. Vent for Surplus:

Both the classical (Ricardian) and the modern (H-O) theories of international trade are based on the assumption that production in each trading country takes place under conditions of full employment. But full employment does not prevail in LDCs. So, trade theories cannot be applied in such countries to predict the impact of trade on production, consumption, distribution and social welfare.

Yet, there is another potential gain from trade, as has been pointed out by Hla Myint (1958). According to Myint, due to unemployment on LDCs, actual output is less than its potential output. By utilising its manpower fully an LDC can produce more products and its supply may exceed domestic demand.

This excess supply can be disposed of in the form of export. In this sense a 'vent for surplus', i.e., a larger market that will permit a labour surplus country to increase its employment and output, as is shown by a movement from a point such as I (inefficient point), inside the PPC to a point E (efficient point) on the PPC in Fig. 1.

Myint suggests that vent for surplus convincingly explains why countries start to trade, while the theory of comparative cost helps to understand the types of commodities countries ultimately export and import. No doubt the gains in income, employment and needed imports can render considerable help to the whole process of development.

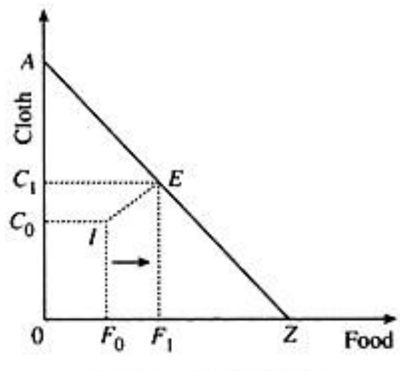

Fig. 1: Vent for Surplus

In short, the static gains from trade for an LDC originates from the traditional gains from exchange and specialisation as will follow from a vent for surplus. However, due to the lack of sufficient flexibility in traditional (largely subsistence) economies and the nature of the traditional labour-intensive exports, the relative gains from trade may be less than those from more flexible and progressive industrial economies and may be further reduced by the undesirable effects of increased economic instability and secular deterioration of the terms of trade. No doubt in the process of economic development we find changes in the economic structure and sectoral distribution of income.

This occurs in response to changes in relative prices brought about by international trade. However, the economic systems of the LDCs tend to be somewhat unresponsive to changing price incentives, at least in the short run.

So, factors of production may not move easily to the expanding low-cost sectors from the contracting higher-cost sectors. In such a situation the process of adjustment assumes the characteristics of the specific-factors model. Consequently, the gains from specialisation are reduced correspondingly.

2. The Dynamic Effects of Trade on Economic Development:

Perhaps the maximum potential impact of trade on development lies in its dynamic effects. As D. Salvatore has put' it- "While the need for a truly dynamic theory cannot be denied, comparative statics can carry us a long way forward incorporating dynamic changes in the economy into traditional trade theory. As a result, traditional trade theory, with certain qualifications, is of relevance even for developing nations and the development process."

On the positive side, the expansion of output made possible by access to the wider international markets enables the LDC to exploit economies of scale that would not be possible with a narrow domestic market.

This means that industries which are not internationally competitive in an isolated market may achieve competitiveness by way of international trade if there are potential economies of scale. If LDCs can take advantage of economies of scale, they can reduce costs of production and sell their products at low prices in international market.

Promotion of Infant Industries:

Moreover, comparative advantage is a dynamic concept. In the real world, we find changing pattern of comparative advantage over time. As a developing nation accumulates capital and improves its technology, its comparative advantage shifts away from primary products to simple manufactured goods first and then to more sophisticated ones.

Thus, with economic development, international trade can foster the development of infant industries and make them internationally competitive by providing the market size and exposure to products and processes that is unlikely to happen in closed (isolated) economy. This is why the most important argument for protection in LDCs is the infant industry argument. It is essentially an argument in favour of protection to gain comparative advantage.

This is why for protecting infant industries trade policy restraints in most LDCs are used, at least in the early stages to restrict imports or promote exports. To some extent, this has already happened in Brazil, Korea, Taiwan, Mexico and some other developing countries. However, there are various problems with using the policy in practice. Infants never grow adult in some high protected environments and there is need for continuation of protection for ever.

Other Dynamic Influences:

Perhaps the maximum possible impact of trade on development depends on its dynamic effects. Prima facie, the expansion of output brought along by access to the larger international markets permits the LDC to take advantage of economies of scale that do not arise in the limited domestic market.

Thus, industries which are not internationally competitive in a narrow and isolated domestic market may well gain competitiveness as a wider market created by international trade. Trade creates an opportunity to exploit potential economies of scale. Furthermore, comparative advantage keeps on changing over time.

Thus, as economic development takes place, international trade promotes the growth and ensures the maturity of infant industries which become internationally competitive by being able to exploit the wider market created by trade.

A wider market also exposes an LDCs products and processes in international market and creates pressure on the industries of LDCs to improve product quality and reduce product price so that these are accepted in the rest of the world. In short, international trade makes protected domestic industries internationally competitive.

Other dynamic influences of trade on economic development arise from the positive competitive effects of trade, increased investment resulting from changes in the economic environment; the increased dissemination of technology into the LDC (as has been suggested by the product life cycle model), exposure to new and improved products and changes in institutions accompany the increased exposure to different countries, cultures and products. Trade fosters domestic competition and acts as an instrument of controlling monopoly.

Openness to trade can affect the technology that a-country can use. We may now discuss the mechanism in detail. Trade policies give of country access to new and improved products. No doubt capital goods are an important type of input into production that is largely imported by LDCs at lower stages of development. Trade allows a country to import new and improved capital goods, which **"embody"** better technology that can be used in production to raise total factor productivity.

The foreign exporters can also enhance the process, for instance, by advising the importing firms on the best ways to use the new capital goods. Some empirical studies show that the gains from being able to import unique foreign imports that embody new technology can be larger than the traditional gains from trade, highlighted by the classical theory.

According to T. A. Pugel, in a more general way, openness to international activities leads the firms and people of the country to have more contact with technology developed in other countries. This greater awareness makes it possible for an LDC to gain the use of new technology—through purchase of capital goods or through licensing or initiation of the technology.

Great economic openness is likely to have a favourable effect on the incentive to innovate. Trade is likely to put additional competitive pressure on the country's firms. The pressure drives the firms to seek better technology to raise their productivity in order to achieve greater international competitiveness.

Trade also provides a larger market in which to earn returns to innovation. Its sale into foreign markets provides additional returns, then the incentive to innovate increases, and firms devote more resources to R & D activities.

Openness thus can enhance the technology that a country can use—both by facilitating the diffusion of imported technology into the country and by accelerating the indigenous development of technology. Furthermore, these increases in current technology base can be used to develop additional innovations in the future.

The current technology base becomes a potent source of increasing returns over time to ongoing innovation activities. The growth rate for the country's economy (and for the world as a whole) increases in the long run.

In short, economic openness can accelerate long-run economic growth. This indicates an additional source of gains from international trade (or from openness to international activities more generally). Empirical studies show that there is a strong positive correlation between the growth rate of a country and its international openness. This is not a proof of causation, 'but it is consistent with the theoretical analysis that suggests why openness can raise growth.

Trade as a Hindrance to Growth:

Critics, however, have pointed out that conditions in developing countries are not very different from those of industrial countries. So that the application of the static principle of comparative advantage may not be helpful in providing appropriate guidelines for trade and specialisation in a dynamic LDC environment. While trade can be beneficial to nations and the world as a whole, it can also have harmful effects on some countries and as also on the world entire.

The international trading system is biased against the developing countries, particularly the poor among them, because of factors like their weak bargaining power vis-a-vis the advanced countries, the participation gap, dependence on the developed countries for various needs, etc.:

The important harmful effects of trade are the following:

1. Trade may lead to indiscriminate exploitation of natural resource, particularly of developing nations. Trade has been resulting in the drain of resources from the developing to developed countries.

2. Trade also causes environmental problems because of the indiscriminate exploitation of resources and location/relocation of polluting and hazardous industries in the developing world for the benefit of the developed world.

3. The deterioration of the terms of trade of the developing countries causes large income transfers from the developing to the developed countries.

International trade may also give rise to demonstration effect in the developing countries. Demonstration effect, a term associated with Nurkse, refers to the tendency of poor people to imitate the life styles of the rich.

In international economics, it refers to the tendency of the people of developing countries to follow the consumption habits of the people of the advanced countries by importing luxury goods. This could have harmful social and economic effects. It could also have some favourable effect if it can encourage the development of the domestic industries of the developing countries.

Another important harmful effect of trade is what is described as the backwash effect. Some of the domestic industries of the developing countries, particularly small scale, which are unable to compete with the well-developed industries of the advanced countries, could be destroyed or damaged by unregulated imports.

India has had a paradoxical policy of reserving many items for the small scale sector but allowing the import of these items. The recent trade liberalisation is adversely affecting the agricultural, often subsistence, sector of many developing countries even as the agricultural sector is heavily protected in the developed world.

Globalisation and free trade are now adversely affecting the developed countries, too because of the edge the developing countries have over the developed ones in the production of many products. Trade also results in the introduction of pep and cola cultures to the developing countries which have important social implications.

Two main reasons for not so remarkable improvement in growth due to trade in LDCs are:

(i) Absence of perfect competition (and the consequent distortion of commodity and factor prices) and

(ii) The absence of full employment (due to existence of not only surplus labour but also surplus productive capacity).

For these reasons, if we are to get a balanced view of the effects of international trade on development we have to refer to some important disadvantages of free trade for an LDC, more so in view of the fact that these problems can have important implications for trade policy.

1. Externalities:

The static theory of comparative advantage ignores the very important fact that most markets in LDCs are imperfect. This implies departure from the Pareto optimality conditions. Market imperfections create an undesirable consequence. Private costs and benefits differ from social costs and benefits mainly due to the existence of economic externalities.

Any reliance on market prices in such an environment can lead to the emergence of a pattern of trade which, is largely inconsistent with both relative social costs-and long-term development goals of the country, e.g., if the growth of an industry does considerable damage to the physical environment.

2. Differential Impact of Trade:

In a more general way, the overall effect of growth in exports on the growth and development of the entire economy is likely to vary from commodity to commodity. The reason is easy to find out. In a broader dynamic context, the economy- wide production linkages vary among different commodities or sectors.

Industries producing certain strategic inputs like steel, coal and power or oil may act as leading sectors or ‘growth poles’ for the entire economy, while others—such as primary products—will act as the lagging sectors having little or no linkage effect outside their own sectors.

3. Variation in Returns to Scale:

Returns to scale may also vary among commodities. This means that an LDC is unlikely to have a relative cost advantage in a particular product since the domestic market is too narrow to permit cost-efficient production.

However, there might exist a comparative advantage in the same product at a higher level of output. In a like manner, a product may have a relative cost advantage at present but its production is characterised by decreasing returns to scale. So it may have very limited export potential.

4. Market Imperfections and Government Policy:

The domestic supply and demand conditions that underlie both current and future comparative advantage is likely to be influenced both by market imperfections and by restrictive, and at times unrealistic, domestic economic policies.

5. Unequal Distribution of Gains from Trade:

Finally, the operation of markets and characteristics of traded goods differ between the developing countries and the industrialised countries. Such differences result in a disproportionate share of the benefits of trade being captured by the industrialised countries.

What is worse is that such differences often lead to greater dependence of LDCs on DCs. This is a major source of potential development problems for countries like India, Pakistan and Bangladesh which have a colonial heritage and an enclave economic structure.

As D. Salvatore comments- "With developing nations specialising in primary commodities and developed nations specialising in manufactured products, all or most of the dynamic benefits of industry and trade accrue to developed nations, leaving developing nations poor, undeveloped and dependent." Two issues related to these differences are export instability and secular (long-run) deterioration of the terms of trade. In this sense, trade acts as hindrance to growth.

It is to this issue that we turn now:

Export Instability:

Exports of LDCs tend to fluctuate more sharply from year to year than are found in industrialised countries. Due to the relatively high degree of openness of many LDCs (i.e., a high ratio of foreign trade to GDP), variability in the export sector leads to fluctuations in GDP and the domestic price level. Thus, business cycles get transmitted from developed to developing countries through international trade.

This causes considerable uncertainty to producers and consumers. In addition, export instability makes it more difficult to carry out planning for development. When export earnings are high in 'good' years, new projects are started by importing necessary equipment.

But when export earnings subsequently decline, the planning process receives a severe jolt. The reason is that foreign exchange is not available to complete and to operate the projects. The end result is huge resource waste and, a serious distortion to the planning process.

Causes:

There are three main causes of export instability. There is a common link among the causes since all originate from the fact that many LDCs are relatively more engaged in the export of primary products than of manufactured goods. While the first two reasons pertain to price fluctuations, the third one focuses on variations in total export earnings.

Immeserising Growth:

J. N. Bhagwati has even pointed out that a large country actually could be made worse-off by an improvement in its ability to produce the products it exports. This is known as immeserising growth. By expanding its ability to produce food as its export good the large country increases its supply of exports (expands its willingness to trade). This reduces the relative price of food in world markets. At the same time this causes an increase of the relative price that it must pay for its imports of car.

The decline in the country's terms of trade is so bad that it outweighs the benefits of the greater ability to produce exportable goods. In short, growth that expands the country's Willingness to trade can result in such a large decline in the country's terms of trade that the country is worse off.

No doubt most of the gains from trade in the past have accrued to DCs. But this does not mean that trade is actually harmful. There are cases where a balanced trade may actually have hampered economic development. However, in most cases, it can be expected to provide invaluable assistance to the development process.

Dutch Disease:

Booming primary exports may fail to stimulate development due to deterioration of the terms of trade for a special reason, known as the Dutch Disease. This problem was first detected in Netherlands in the 1960s when major reserves of natural gas were discovered.

The ensuing export boom and the balance of payments surplus pressurized new prosperity. Instead, however, during the 1970s, the Dutch economy suffered from rising inflation, declining export of manufactures, lower rates of income growth, and rising unemployment.

Max Corden and Peter Nearly first described the strange phenomenon of the Dutch Disease, in which a country that receives higher export prices or a larger inflow of foreign capital may be worse-off than without the windfall.