INTERNATIONAL TRADE

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International trade is exchange of capital, goods, and services across international borders or territories. It refers to exports of goods and services by a firm to a foreign-based buyer (importer). In most countries, it represents a significant share of gross domestic product.

International trade is in principle not different from domestic trade as the motivation and the behavior of parties involved in a trade do not change fundamentally regardless of whether trade is across a border or not. The main difference is that international trade is typically more costly than domestic trade. The reason is that a border typically imposes additional costs such as tariffs, time costs due to border delays and costs associated with country differences such as language, the legal system or culture.

International trade is also a branch of economics, which, together with international finance, forms the larger branch of international economics.

Several different models have been proposed to predict patterns of trade and to analyze the effects of trade policies such as tariffs:

1. The Ricardian model focuses on comparative advantage and is perhaps the most important concept in international trade theory. In a Ricardian model, countries specialize in producing what they produce best. Unlike other models, the Ricardian framework predicts that countries will fully specialize instead of producing a broad array of goods.

Also, the Ricardian model does not directly consider factor endowments, such as the relative amounts of labor and capital within a country. The main merit of Ricardian model is that it assumes technology differences between countries.

The Ricardian model makes the following assumptions:

- Labor is the only primary input to production.
- Constant Marginal Product of Labor.
- Limited amount of labor in the economy.
- Labor is perfectly mobile among sectors but not internationally.
- Perfect competition.

The Ricardian model measures in the short-run, therefore technology differs internationally. This supports the fact that countries follow their comparative advantage and allows for specialization.

2. The Heckscher-Ohlin theory stresses that countries should produce and export goods that require resources that are abundant and import goods that require resources in short supply. This theory differs from the theories of comparative advantage and absolute advantage since these theories focus on

the productivity of the production process for a particular good. On the contrary, the Heckscher-Ohlin theory states that a country should specialise production and export using the factors that are most abundant, and thus the cheapest. Not to produce, as earlier theories stated, the goods it produces most efficiently.

The theory argues that the pattern of international trade is determined by differences in factor endowments. It predicts that countries will export those goods that make intensive use of locally abundant factors and will import goods that make intensive use of factors that are locally scarce.

The Heckscher-Ohlin model makes the following core assumptions:

- Labor and capital flow freely between sectors.
- The production of shoes is labor intensive and computers - is capital intensive.
- The amount of labor and capital in two countries differ.
- Free trade.
- Technology is the same across countries.
- Tastes are the same.

3. In specific factors model, labor mobility between industries is possible while capital is immobile between industries in the short-run. Thus, this model can be interpreted as a 'short run' version of the Heckscher-Ohlin model. The theory suggests that if there is an increase in the price of a good, the owners of the factor of production specific to that good will profit in real terms.

4. The Gravity model of trade presents a more empirical analysis of trading patterns rather than the more theoretical models. The gravity model, in its basic form, predicts trade based on the distance between countries and the interaction of the countries' economic sizes. The model has been proven to be empirically strong through econometric analysis.

Companies doing business across international borders face many of the same risks as would normally be evident in strictly domestic transactions.

International trade also faces the risk of unfavorable exchange rate movements. International trade is a major source of economic revenue for any nation. Without international trade, nations would be limited to the goods and services produced within their own borders.

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