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International Trade Theories

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Lecture - 3

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Topic covered

- **Heckscher-Ohlin Model**
- **Criticism of Factor Endowment Theory**
- **Leontief Paradox**

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FACTOR ENDOWMENT THEORY

One of the main drawbacks of Ricardian theory of comparative cost was that it did not provided the reasons for the differences in comparative costs.

Factor Endowments lie at the center of Heckscher – Ohlin theory. Heckscher (1919) and Bertil Ohlin (1933) developed a theory to explain the reasons for differences in relative commodity prices and competitive advantage between two nations.

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FACTOR ENDOWMENT THEORY

According to this theory, a nation will export the commodity whose production requires intensive use of nation's relatively abundant and cheap factors and import the commodity whose production requires intensive use of nation's scarce and expensive factors.

It suggests that the patterns of trade are determined by factor endowment rather than productivity.



FACTOR ENDOWMENT THEORY

The theory suggests three types of relationships viz.,

- Labour-Labour Relationship,
- Labour Capital Relationship,
- Technological Complexities.

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FACTOR ENDOWMENT THEORY

Labour – Labour Relationship : A country would specialize in production of labour intensive goods if labour is in abundance as compared to the cost of land.

Labour-Capital Relationship : In countries where the capital is abundantly viable and labour is relatively scarce, there would be tendency to achieve competitiveness in the production of goods requiring large capital investments.

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FACTOR ENDOWMENT THEORY

Technological Complexities : As the same product can be produced by adopting various methods of technologies of production, its cost competitiveness, one has to examine the optimum way of production in view of technological capabilities and constraints of a country.

accepts comparative advantage as the cause of international trade and explains the reasons behind the differences in comparative cost.

One of the limitations of H-O theory is that it is based on static model of given factor endowments and given technology.

Criticism of Factor Endowment Theory

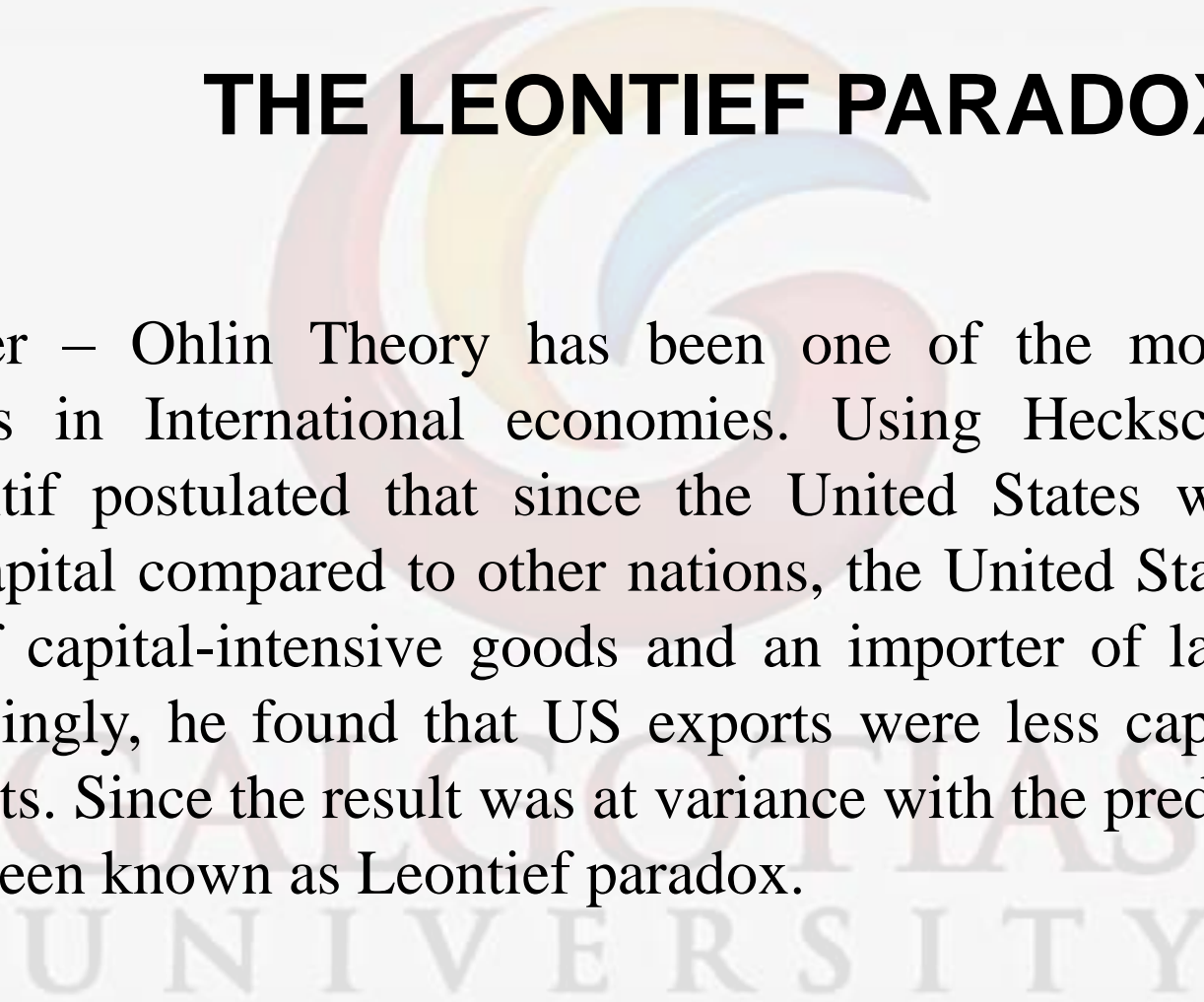
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THE LEONTIEF PARADOX

The Heckscher – Ohlin Theory has been one of the most influential heretical ideas in International economies. Using Heckscher – Ohlin Theory, Leonitif postulated that since the United States was relatively abundant in capital compared to other nations, the United States would be an exporter of capital-intensive goods and an importer of labor-intensive goods. Surprisingly, he found that US exports were less capital intensive than US imports. Since the result was at variance with the predictions of the theory, it has been known as Leontief paradox.



REFERENCES

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Thank You

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