International Trade PYQ 2017

Q1 Explain critically the classical theory of International trade.

Ans. The classical theory of international trade is based on the assumption that countries differ in their relative factor endowments, such as labor, capital, and natural resources, and that trade between these countries can lead to mutual gains. This theory is also known as the theory of comparative advantage, and was first articulated by Adam Smith in his seminal work, "The Wealth of Nations".

According to the classical theory of international trade, each country should specialize in the production of goods and services in which it has a comparative advantage, and trade with other countries to obtain goods and services in which it has a comparative disadvantage. This specialization and trade can lead to greater efficiency, lower costs, and increased economic welfare for all countries involved.

However, the classical theory of international trade has been criticized on several grounds. One of the main criticisms is that it assumes that factors of production are perfectly mobile within a country, but immobile across countries. This assumption does not hold in reality, as factors of production can move across borders, leading to competition and changes in relative factor endowments.

Another criticism of the classical theory is that it does not take into account the impact of government policies, such as tariffs, subsidies, and regulations, on trade patterns and economic welfare. These policies can distort trade patterns and create winners and losers, rather than leading to mutual gains.

Moreover, the classical theory assumes that there is no market imperfection, such as monopolies, externalities, or imperfect information. In reality, these market imperfections can lead to sub-optimal outcomes and may require government intervention to correct.

In conclusion, the classical theory of international trade is an important theoretical framework that provides insights into the potential gains from trade. However, it has limitations and does not capture the complexity and diversity of real-world trade patterns and policies.

Q2 What are offer curves? Explain the determination of trust with help of offer curves

Ans. Offer curves are graphical representations that show the amount of one good a country is willing to exchange for another good at different relative prices. In other words, offer curves depict the quantity of one good that a country is willing to offer for a given quantity of another good at various exchange ratios. Offer curves can be used to analyze the determination of terms of trade, which is the ratio of export prices to import prices.

To understand the determination of trust with the help of offer curves, we need to consider the situation where two countries, A and B, are trading two goods, X and Y, with each other. Let's assume that country A is relatively more efficient in producing good X, while country B is relatively more efficient in producing good Y. This means that the opportunity cost of producing good X is lower in country A than in country B, while the opportunity cost of producing good Y is lower in country B than in country A.

When the two countries start trading, the relative prices of the two goods will be determined by the intersection of their offer curves. Country A's offer curve for good Y will be downward sloping, while its offer curve for good X will be upward sloping. Country B's offer curve for good X will be downward sloping, while its offer curve for good Y will be upward sloping. The point where the two offer curves intersect is the terms of trade ratio.

If the terms of trade are favorable to country A, meaning that it can obtain more units of good Y in exchange for a unit of good X than its domestic exchange ratio, it will increase its exports of good X and decrease its imports of good Y. Conversely, country B will increase its exports of good Y and decrease its imports of good X. This will lead to an improvement in the terms of trade for country A and a deterioration in the terms of trade for country B.

In conclusion, offer curves are a useful tool for analyzing the determination of terms of trade in international trade. They can help us understand how countries decide to allocate their resources and specialize in the production of certain goods based on their relative efficiencies. The intersection of offer curves determines the terms of trade ratio, which can have significant implications for the welfare of trading countries.

Q3 Discuss the H-O theory of international trade. To which extent it is superior to the classical theory of international trade ?

Ans. The Heckscher-Ohlin (H-O) theory of international trade is a modern extension of the classical theory of international trade. The H-O theory explains why countries engage in trade and predicts the pattern of trade based on differences in relative factor endowments. According to the H-O theory, a country will specialize in the production of goods that use its abundant factor intensively and will import goods that use its scarce factor intensively.

The H-O theory assumes that there are two countries and two factors of production, capital and labor, which are not perfectly mobile between countries. The theory also assumes that production technology is identical between countries, meaning that the same amount of capital and labor are required to produce a given output in both countries. The theory then predicts that the country that has relatively more capital will specialize in the production of capital-intensive goods, while the country that has relatively more labor will specialize in the production of labor-intensive goods.

The H-O theory is considered to be superior to the classical theory of international trade because it offers a more realistic explanation for the pattern of trade. The classical theory assumed that trade was based on differences in technology between countries, while the H-O theory takes into account differences in factor endowments. The H-O theory also offers a more robust prediction of the direction of trade flows, as it predicts that countries will export the goods that use their abundant factors intensively and import the goods that use their scarce factors intensively.

However, the H-O theory has some limitations. One limitation is that it assumes that factors of production are perfectly immobile between countries, which may not be the case in reality. Another limitation is that it assumes that the same technology is available in both countries, which may not be true in practice. Additionally, the H-O theory does not account for other factors that may affect trade, such as transportation costs, tariffs, and non-tariff barriers.

In conclusion, the H-O theory of international trade is a modern extension of the classical theory of international trade that takes into account differences in factor endowments between countries. While the theory offers a more realistic explanation for the pattern of trade, it has some limitations and does not account for all factors that may affect trade.

Q4 Show with the help of the partial equilibrium diagram price, production, consumption and revenue effects of tariff.

Ans. A tariff is a tax on imports, which raises the price of imported goods and reduces the quantity demanded of those goods. In this answer, we will use a partial equilibrium diagram to illustrate the effects of a tariff on the market for a particular imported good.

The following diagram shows the market for an imported good before and after a tariff is imposed:

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The original equilibrium is at point A, where the world price of the good (PW) intersects with the domestic demand curve (DD) and the domestic supply curve (DS). At this equilibrium, the quantity of the good consumed domestically is QC and the quantity imported is QM.

When a tariff is imposed, the price of the imported good rises by the amount of the tariff (t). The new equilibrium is at point B, where the new price of the good (PWT) intersects with the domestic demand curve (DD) and the domestic supply curve (DS+t). At this equilibrium, the quantity of the good consumed domestically is QCT and the quantity imported is QMT.

The effects of the tariff can be analyzed as follows:

Price effect: The tariff raises the price of the imported good from PW to PWT. This increases the price received by domestic producers, but also raises the price paid by domestic consumers.

Production effect: The higher price received by domestic producers encourages them to increase production, while the higher price paid by domestic consumers discourages them from buying the good. The result is a decrease in the quantity imported and an increase in domestic production.

Consumption effect: The higher price paid by domestic consumers reduces the quantity demanded of the imported good. This is shown by the movement along the demand curve from point A to point B.

Revenue effect: The tariff raises revenue for the government equal to the tariff rate multiplied by the quantity imported (t x QM).

Overall, the tariff reduces the quantity of the imported good consumed domestically and raises the price received by domestic producers. However, it also raises the price paid by domestic consumers and reduces the overall welfare of consumers in the economy. The magnitude of these effects depends on the elasticities of demand and supply for the imported good.

Q5 Discuss the concept of Factor-Price Equalization and income distribution.

Ans. The Factor-Price Equalization (FPE) theorem is a central idea in international trade theory, which suggests that under certain conditions, the free flow of goods and factors of production (such as labor and capital) between countries will lead to equalization of factor prices (such as wages and rental rates) across countries. This means that the relative prices of goods and services produced in different countries will reflect the relative costs of the factors of production used in their production.

According to the **FPE theorem**, when two countries are similar in terms of their technology and resource endowments, and there are no trade barriers or restrictions on the mobility of factors of production, the wage rate and rental rate of capital should be equalized across the two countries. This is because capital and labor will migrate from the country where their price is relatively low to the country where it is relatively high, causing the prices to converge over time.

However, the FPE theorem has important implications for income distribution within and between countries. When factor prices are equalized, wages and rental rates will tend to be higher in countries with a relative scarcity of capital and lower in countries with a relative abundance of capital. This means that workers in capital-scarce countries will see their wages increase, while workers in capital-abundant countries will see their wages decrease.

Furthermore, FPE may also have distributional consequences within countries. For example, in a country where the labor force is divided between skilled and unskilled workers, the increased demand for skilled labor that comes with globalization and increased trade may lead to a widening income gap between skilled and unskilled workers. This is because the increased demand for skilled labor will raise the relative price of skilled labor, leading to higher wages for skilled workers and lower wages for unskilled workers.

Overall, while FPE can lead to increased efficiency and welfare gains for countries as a whole, it can also have distributional consequences that may create winners and losers within and between countries. It is therefore important for policymakers to consider these effects when designing policies related to international trade and factor mobility.

Q6 What are Non-Tariff barriers ? Discuss the various types of non-tariff barriers.

Ans. Non-tariff barriers (NTBs) refer to various government-imposed measures that restrict or impede international trade, other than traditional tariffs (taxes on imports or exports). NTBs can take various forms and include a wide range of policies, regulations, and administrative procedures that can make it more difficult, time-consuming, or expensive for foreign goods or services to enter a market.

The following are the various types of non-tariff barriers:

Quotas: A quota is a limit on the quantity of a particular product that can be imported into a country during a specific period. Quotas are often used to protect domestic industries from foreign competition by limiting the amount of imports that can enter the market.

Import licenses: An import license is a permit required by some countries before a particular product can be imported. The license is usually granted only after certain conditions are met, such as the payment of fees, the submission of documentation, or compliance with technical regulations.

Technical barriers to trade: Technical barriers to trade (TBT) refer to measures such as product standards, labeling requirements, and testing and certification procedures that can make it more difficult for foreign goods to enter a market. TBTs are often used to protect domestic producers from foreign competition by requiring imported products to meet certain technical standards.

Sanitary and phytosanitary measures: Sanitary and phytosanitary (SPS) measures are regulations designed to protect human, animal, or plant health. SPS measures can include import restrictions on products that do not meet certain health or safety standards.

Subsidies: A subsidy is a financial assistance provided by a government to a particular industry or firm. Subsidies can distort trade by giving an unfair advantage to domestic producers, allowing them to sell products at lower prices than their foreign competitors.

Government procurement policies: Government procurement policies are rules that require government agencies to purchase goods and services from domestic producers rather than foreign suppliers.

Intellectual property rights protection: Intellectual property rights (IPR) protection refers to laws and regulations that protect the rights of creators of intellectual property such as patents, copyrights, and trademarks. Strong IPR protection can be used to restrict imports of products that violate these rights.

Overall, non-tariff barriers can have a significant impact on international trade, as they can increase the cost of imported goods or restrict access to certain markets. It is important for policymakers to consider the potential effects of NTBs when designing trade policies, as they can have both intended and unintended consequences.

Q7 Discuss the functioning of the World Trade Organization. Justify the membership of it for India.

Ans. The World Trade Organization (WTO) is an international organization that aims to promote free and fair trade among its member countries. The WTO was established in 1995 and currently has 164 member countries. The functioning of the WTO can be described as follows:

Negotiations: The WTO conducts negotiations among its member countries to reduce trade barriers, including tariffs and non-tariff barriers, and to liberalize trade in goods and services.

Dispute Settlement: The WTO has a dispute settlement mechanism that helps to resolve disputes between member countries related to trade. This mechanism ensures that countries comply with their obligations under WTO agreements.

Monitoring: The WTO monitors the trade policies of its member countries and provides a forum for discussing trade-related issues.

Technical Assistance and Training: The WTO provides technical assistance and training to its member countries to help them implement and comply with WTO agreements.

India is a founding member of the WTO and has been a member since 1995. India's membership in the WTO provides several benefits, including:

Access to Global Markets: As a member of the WTO, India has access to markets of other member countries on preferential terms. This helps India to expand its exports and earn foreign exchange.

Protection of Indian Interests: India can use the WTO's dispute settlement mechanism to protect its interests in case of any trade disputes with other member countries.

Economic Reforms: India's membership in the WTO has encouraged economic reforms in the country, including liberalization of trade and investment policies.

Technical Assistance: India can benefit from the technical assistance and training provided by the WTO to help it implement WTO agreements and improve its trade-related policies.

In conclusion, the WTO plays an important role in promoting free and fair trade among its member countries. India's membership in the WTO provides several benefits, including access to global markets, protection of its interests, encouragement of economic reforms, and technical assistance.

Q8 Write short notes on:

(i) Agreement on Agriculture

Ans. The Agreement on Agriculture (AoA) was signed by member countries of the World Trade Organization (WTO) in 1994. The agreement aimed to reform trade in the agricultural sector and increase market access for agricultural products. The AoA was one of the most controversial agreements during the Uruguay Round of negotiations, as it dealt with sensitive issues such as domestic support, export subsidies, and market access.

The key objectives of the AoA were to establish fair competition in the agricultural sector, reduce trade-distorting subsidies, and increase market access for agricultural products. The agreement also aimed to improve food security and ensure sustainable development.

Under the AoA, member countries were required to reduce their trade-distorting subsidies over a period of time. Developing countries were given more time to implement these reforms. The agreement also allowed member countries to impose measures to protect the environment, public health, and animal and plant life.

India is a member of the WTO and has benefited from the AoA. The agreement has allowed India to increase its agricultural exports to other countries. However, India has also faced challenges in implementing the agreement, particularly in reducing its domestic support for agriculture. The country has argued that it needs to provide support to its farmers to ensure food security and reduce poverty in rural areas.

In conclusion, the AoA has played an important role in reforming trade in the agricultural sector and increasing market access for agricultural products. However, the implementation of the agreement remains a challenge for many member countries, including India.

(ii) Export Subsidy

Ans. Export subsidy is a form of government support provided to domestic producers to encourage and promote exports of goods and services. The subsidy is usually provided in the form of cash grants, tax incentives, or other forms of financial assistance to offset the costs of production and transportation, making the export of goods more competitive in the global market.

Export subsidies are often used to promote exports of agricultural products, textiles, and other manufactured goods. They are commonly used by developing countries to enhance their export competitiveness in the global market.

While export subsidies can help boost a country's export earnings and promote economic growth, they have also been criticized for distorting international trade and creating an uneven playing field. When a country provides export subsidies, it can lower the price of its exported goods, making them more competitive than similar products from other countries. This can lead to trade disputes and retaliation from other countries that may also resort to providing export subsidies.

In addition, export subsidies can be expensive for the government and may lead to inefficiencies in domestic production. They can also lead to overproduction, which can create a surplus of goods in the domestic market and drive down prices.

Many international organizations, such as the World Trade Organization (WTO), have attempted to reduce the use of export subsidies by member countries. The WTO's Agreement on Subsidies and Countervailing Measures (SCM Agreement) allows member countries to take action against other members that provide export subsidies that cause harm to their domestic industries.

In conclusion, export subsidies are a form of government support provided to domestic producers to encourage and promote exports of goods and services. While they can help boost a country's export earnings and promote economic growth, they have also been criticized for distorting international trade and creating an uneven playing field.

(iii) Trade Related Intellectual Property Rights (TRIPS)

Ans. Trade-Related Aspects of Intellectual Property Rights (TRIPS) is an agreement that sets out the minimum standards for various forms of intellectual property (IP) regulations in trade between nations. It was established as part of the World Trade Organization (WTO) in 1995. TRIPS aims to ensure that intellectual property rights (IPRs) are respected and enforced, and to promote innovation, technology transfer, and fair competition among countries.

The TRIPS agreement covers a broad range of IP issues, including patents, trademarks, copyrights, and trade secrets. It sets out rules and procedures for the protection, enforcement, and use of IPRs in international trade. The agreement requires all WTO member countries to provide minimum levels of IP protection and enforcement, and to establish effective mechanisms for resolving IP disputes.

The TRIPS agreement has been controversial since its inception, with critics arguing that it promotes the interests of developed countries and multinational corporations at the expense of developing countries and their citizens. Supporters of TRIPS argue that it promotes innovation and technology transfer, and provides an effective means of protecting IP rights and enforcing international trade rules.

India, as a member of the WTO, is obligated to comply with the TRIPS agreement. The country has been active in negotiating and implementing TRIPS-related issues, particularly in the areas of public health and access to medicines. India has also been an advocate for the interests of developing countries in TRIPS negotiations, and has sought to ensure that the agreement does not unduly restrict access to essential medicines and other technologies in developing countries.