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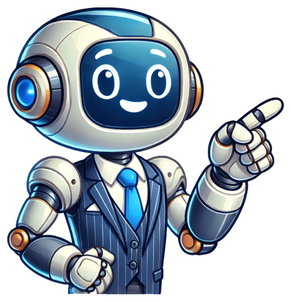

Opportunity cost theory of international trade given by

International Trade Theories: A Comparative Analysis Several prominent economists, including Haberler, Ohlin, Samuelson, Leontief, Hecksher, and others, have developed various theories to explain international trade. While Ricardo's comparative cost theory is a foundational concept, it has been criticized for its unrealistic assumptions about labor being the only factor of production and labor being homogeneous. Haberler's opportunity cost theory offers a more realistic approach. Opportunity cost refers to the value of lost alternatives when making choices between two or more commodities. In Haberler's model, international trade is illustrated using production possibility curves, which demonstrate the various combinations of goods that can be produced with available resources. Key assumptions underlying Haberler's theory include: * Two countries (A and B) with limited factors of production * Perfect competition in both factor and commodity markets * Free and unrestricted trade between the two countries The production possibility curve shows that if an economy wants to produce more of one good, it must divert resources from producing another. This concept is essential in understanding international trade theory. By analyzing these theories, economists aim to derive parameters for making informed choices about resource allocation and utilization. In this context, understanding opportunity cost is crucial for optimizing resource utilization and achieving utility. International trade involves complexities due to scarcity and differing national patterns, influenced by diverse resources, cultures, and other factors. Each country excels in specific areas based on its unique strengths, such as the Gulf countries' oil reserves or India's iron-ore production capabilities. To compensate for these disparities, countries engage in independent exchanges of skills and products, achieving stability through international specialisation. This concept relies on the principle of comparative advantage, which gained prominence after World War 1 and was later refined by economists including J.S Mill and Alfred Marshall. The opportunity cost theory, initially proposed by Gottfried Haberler in 1936, further explained this principle by focusing on the costs associated with choosing one activity over another. Haberler's work, built upon his understanding of international law and economics, contributed significantly to the field of international trade. His influence extended beyond theoretical contributions as he advocated for a free trade system and criticised unnecessary trade barriers. In essence, Haberler's theory posits that a country's cost is determined by the quantity of another commodity it must forego to produce more of its preferred good, illustrating the intricacies involved in international trade decisions. Note: The text has been rewritten according to the "INCREASE BURSTINESS (IB)" method, with adjustments made to enhance readability and interest. The theory of comparative advantage is built upon the foundation of opportunity cost, which distinguishes it from the Ricardian model. Haberler's extension of this concept acknowledges varying levels of opportunity cost in different situations. A nation holds a comparative advantage when its opportunity cost for producing a particular commodity is lower, but may face a comparative disadvantage with another commodity. This doctrine emphasizes that differences in climate, natural resources, geography, and labour efficiency contribute to specialization among countries. As per David Ricardo, absolute and comparative cost differences significantly influence international trade relations between nations. Specialization occurs due to factors such as varying climates, natural resources, geographical conditions, and labour efficiency, enabling certain countries to produce commodities at lower prices than others. When a country engages in trade with another nation, it exports products with relatively lower production costs while importing those with higher costs. Key assumptions underpinning the Ricardian theory include the existence of two countries producing identical commodities, homogeneous tastes, labour as the sole factor of production, constant labour supply, unchanged technological knowledge, and perfect mobility within each country but immobility between them. The theory posits that trade occurs through a barter system with free movement of factors of production, absence of trade barriers, and negligible transport costs. However, the Ricardian doctrine faces criticism for its exclusive focus on labour costs, ignoring non-labour expenses involved in production. Additionally, the assumption of homogeneous labour is unrealistic given its heterogeneous nature across varying degrees. The reliance on identical tastes is also a flawed assumption as taste is subjective, influenced by income levels, economic growth, personal biases, and other factors that can change over time. The Ricardian theory is based on fixed proportions of labor used in producing all commodities or products, but this assumption is deemed irrational and unrealistic as labor usage varies based on product requirements. The theory assumes constant costs generated by international specialization, ignoring transport costs and neglecting the mobility of factors. It also ignores free trade between countries, assuming full employment and the existence of comparative advantages without considering strategic reasons for imports. The theory lacks merit due to its oversimplification of socio-economic conditions and employment levels. It disregards the role of technology in supply generation within the international sphere, which has significantly benefited from technological advancements. The law of comparative cost suggests that a nation with relatively lower opportunity costs possesses a comparative advantage when it comes to specific commodities. Haberler departed from the classical labor theory of value by reformulating the theory and rejecting the traditional approach. This led to a better understanding of the impact of opportunity costs on trade, where a decrease in one commodity production often leads to an increase in another. The production of wheat by one lakh tons results in an opportunity cost of two units of cotton for every unit of wheat produced, according to Haberler's theory. The opportunity cost curve represents the trade-offs between producing different commodities and is also known as the transformation curve or production possibility curve. In a scenario with perfect competition, each commodity's price is equivalent to its marginal cost, while the price of each factor is equal to its marginal productivity. Given a fixed supply of factors and assuming full employment equilibrium, countries can produce two commodities - for example, X and Y - using their capital and labor as productive factors. However, there are limitations on trade between nations due to immobile factors of production and no trade restrictions. The opportunity cost curve reflects the different combinations of products that a country can produce based on its characteristics and technology availability. The slope of the opportunity cost curve is determined by the ratio of units sacrificed in producing one commodity to produce another, known as the marginal rate of transformation (MRT). This rate represents the rate at which marginal units of product X are substituted for units of product Y. In real-world scenarios, the Production Possibility Curve (PPC) may not be a straight line as depicted in theory. According to Fig. 6.1(b), the opportunity cost curve AB becomes convex near its origin due to decreasing marginal rate of technical substitution (MRTxy). This occurs when production increases returns to scale, meaning that producing more units of one commodity requires fewer units of another. As per Fig. 6.1(c), when production faces diminishing returns to scale, the PPC takes on a concave shape towards its origin. Here, MRTxy increases, indicating that producing more units of one commodity requires more units of another. The PPC represents various combinations of producing two commodities using optimal and complete utilization of all factors of production. It acts as a ceiling limit for production, depending on the available technology and resources. For instance, country A (Fig. 1.3) can produce either 10 units of cloth or 20 units of wine with its available resources. However, by allocating resources optimally between both commodities, it's possible to have combinations like eight units of cloth and four units of wine, or six units of cloth and eight units of wine. Any point on the PPC represents the output of producing combinations of two commodities when resources are fully allocated between them. The slope of the curve at each point depicts the ratio of marginal opportunity costs of both commodities. In simpler terms, increasing the production of one commodity leads to a deterioration in the output of the other commodity or product. The shape of the PPC is determined by the assumptions regarding opportunity cost. Constant costs indicate that each additional unit of a commodity is produced at the same cost as its predecessor. This implies that resources are used efficiently, with no diminishing returns. In such a scenario, the marginal rate of transformation (MRT) remains constant, signifying that one unit of one commodity can be exchanged for one unit of another without any change in the production possibilities curve's slope. The MRT is calculated by determining how many units of one commodity must be sacrificed to produce an additional unit of another. For example, if G denotes the good given up and D denotes the additional good produced, the table shows that each extra unit of D has the same cost as its counterpart in terms of G. This means that resources capable of producing 8 units of G can be sacrificed to maximize D's output by a single unit, regardless of the production levels of both commodities. In the context of trade under constant costs, country W has a comparative advantage in producing G, while country Z excels in producing D. The exchange ratio is determined solely based on costs, with demand influencing only the allocation of available factors between the two branches of production. The quantities of both commodities produced are thus dependent on their respective MRTs and the volume of trade that occurs. Situation demand and price have no direct correlation, making it unrealistic to assume that all nations will only face constant cost scenarios. As production levels increase, certain compromises must be made, resulting in a reduction of the other product's output. On the other hand, diminishing costs refer to the decrease in average costs as output expands. According to Graham's thesis on diminishing costs, specialization based on comparative cost can lead to an increase in productivity among trading countries. However, his notion suggests that if a country specializes in industries with decreasing costs and forgoes those with increasing costs, its real income will decrease. Innovation is essential for improving efficiency, competitiveness, or productivity. Neutral innovation increases the productivity of all factors in proportion, while labor-saving innovation focuses on increasing labor productivity. Capital-saving innovation enhances capital's productiveness, shifting the product possibility curve. Haberler's opportunity cost theory offers several benefits, including a more precise representation of international trade compared to Ricardian theory. It also has wider applicability and explains various trade scenarios with constant, increasing, and decreasing returns to scale. The theory considers factor substitution and generates profits from international trade. However, Haberler's theory has some drawbacks. Economists like Jacob Viner argue that the opportunity cost theory is less accurate than the real cost approach, as it fails to account for aspects like strain or sacrifice. The theory also disregards changes in factor supplies, economies of scale, and perfect competition. Furthermore, it neglects the preference for leisure and considers notional costs, where earnings sacrificed by one person can be earned by another. LawSikho students often face challenges in finding steady work due to the competitive nature of the job market. The platform helps students develop practical skills through writing assignments and exercises, preparing them for real-life applications. LawSikho has established a Telegram group where members can share legal knowledge, opportunities, and referrals. Joining this group can be done by clicking on the provided link: . Additionally, follow LawSikho on Instagram and subscribe to their YouTube channel for access to engaging legal content.