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BA Economics Honours | Semester V | Calicut University

International Trade Theories

Course Code: ECO5CJ302 • Module 1

Module I: Introduction to International Trade

International trade involves the exchange of capital, goods, and services across international borders and territories. It accounts for a substantial proportion of global Gross Domestic Product (GDP), allowing sovereign economies to overcome domestic factor resource limitations, exploit scale economies, and enhance domestic consumption welfare.

Unit 1 & 2: Scope, Importance, and Analytical Concepts

The study of international trade addresses two fundamental questions: Why do nations trade? What determines the pattern, volume, and terms of international commerce?

- **Terms of Trade (ToT):** The relative price of exports in terms of imports. The Net Barter Terms of Trade (N) is formulated as:

  $$N = \frac{P_x}{P_m} \times 100$$

  where P_x is the export price index and P_m is the import price index. An increase in N represents an improvement in terms of trade, enabling a country to buy more imports for a given volume of exports.
- **Gains from Trade:** Decomposed into two distinct components:
  1. *Gains from Exchange:* Arising from reallocating consumption along the community indifference curve without altering production.
  2. *Gains from Specialization:* Arising from restructuring production toward commodities possessing comparative cost advantages.
- **Trade Indifference Curves (James Meade):** Derived by subtracting the domestic Production Possibility Frontier (PPF) from community indifference curves, representing trade offer preferences at varying international price ratios.

Unit 3, 4 & 5: Trade Policy, Balance of Payments, and Foreign Exchange

Governments regulate cross-border trade flows through commercial policies:

- **Free Trade vs. Protection:** While free trade maximizes global allocative efficiency, protectionist arguments emphasize infant industry nurturing (Hamilton-List), employment protection, anti-dumping defense, and strategic trade policy (Brander-Spencer).
- **Tariff and Non-Tariff Barriers:** Tariffs generate price, production, consumption, trade, revenue, and income redistribution effects. Non-tariff barriers include import quotas, Voluntary Export Restraints (VERs), sanitary and phytosanitary rules, and technical barriers to trade.
- **Balance of Payments (BoP):** A systematic double-entry statistical record of all economic transactions between residents of a country and the rest of the world over a financial period, divided into Current Account, Capital Account, and Official Reserves.

Advanced Theoretical Formulations and Empirical Frameworks (Analytical Division 1)

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Empirical Methodology, Identification Strategies, and Econometric Estimation

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Consider the structural estimation of policy impacts across decentralized economic agents. When evaluating macroeconomic interventions or microeconomic regulatory changes, parameters estimated from observational datasets must account for expectations formation and structural parameter stability in accordance with the Lucas Critique. Consequently, contemporary applied economics bridges micro-foundations with aggregate macroeconomic phenomena through dynamic stochastic general equilibrium (DSGE) modeling and micro-econometric panel estimations.

Comparative Institutional Analysis, Market Failures, and Policy Governance

Economic outcomes are fundamentally mediated by institutional architectures, legal property rights regimes, and regulatory governance. In emerging market economies such as India, market imperfections—including asymmetric information, transaction costs, infrastructural bottlenecks, and credit constraints—often necessitate nuanced policy interventions that differ substantially from textbook laissez-faire predictions.

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Market Efficiency	Markets clear instantaneously; price mechanism allocates resources optimally without systemic friction.	Markets are prone to structural failures, information asymmetry, and coordination coordination failures.	Targeted regulatory oversight, public investment in infrastructure, and social safety nets.
Behavioral Motivation	Hyper-rational agents maximizing expected utility with complete cognitive computational capacity.	Bounded rationality, behavioral heuristics, loss aversion, and institutional anchoring effects.	Choice architecture, behavioral nudges (NITI Aayog initiatives), and consumer financial protection mandates.
State Intervention	State role restricted to core public goods, contract enforcement, and national defense (minimalist state).	State acts as developmental catalyst, risk-absorber of last resort, and promoter of equitable distribution.	Strategic industrial policy (PLI schemes), counter-cyclical fiscal intervention, and universal public services.
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Comprehensive Empirical Analysis: The Kerala Model and Sub-National Development

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However, contemporary economic analysis also highlights structural challenges confronting this development paradigm: high educated unemployment, fiscal constraints stemming from escalating public debt servicing and pension obligations, and heavy reliance on external remittance inflows from migrant workers in the Persian Gulf. Sustaining this high-welfare equilibrium necessitates transitioning toward a knowledge-driven economy, incentivizing high-tech manufacturing, and mobilizing sustainable sub-national fiscal resources.

Policy Synthesis and Analytical Evaluation

Policy formulation in dynamic economic environments must therefore synthesize foundational deductive reasoning with robust inductive empirical inquiry. Economists must continuously evaluate the balance between market incentives and regulatory governance, ensuring that institutional frameworks promote both productive efficiency and distributive social justice.

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