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TOPIC:- HECKSCHER-OHLIN THEORY OF INTERNATIONAL TRADE

The classical theory of international trade which was formulated by Prof. David Ricardo stated that other things being equal, a country tends to specialise in and export those commodities in the production of which it has maximum comparative cost advantage or minimum comparative disadvantage.

Prof. Bertil Ohlin objects to the theory of comparative costs as an explanation of international trade. He regarded the classical theory of international trade as a clumsy and dangerous tool of analysis. According to Prof. Ohlin, the classical theory is unrealistic as it considers only a two-country, two-commodity phenomenon based on the labour theory of value. Hence, Ohlin propounded a new theory of international trade based on the general theory of value.

Prof. Ohlin drawn his ideas of this theory from Prof. Eli Heckscher's analysis of general equilibrium, so, it is popularly known as 'Heckscher-Ohlin theory of international trade'. Prof. Heckscher pointed out first that when trade among countries arises the mutual interdependence theory of pricing comes into action. Prof. Ohlin accepted this view and more scientifically developed a theory of international trade based on general equilibrium analysis.

Prof. Ohlin states that trade results on account of the different relative price

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of different goods in different countries. The relative price commodity difference is the result of relative costs and factor price differences in different countries. Differences in factor prices are due to differences in factor endowments in different countries. Hence, this theory boils down the fact that trade occurs because different countries have different factor endowments. Ohlin's theory is, therefore, also known as the factor endowment theory or the factor proportions analysis. Ohlin's theory is usually expounded in terms of a two-factor model with labour and capital as the two factors of endowments. Therefore, the Heckscher Ohlin theory conclusively remarks that countries which are rich in labour will export labour intensive goods and countries which have plenty of capital will export capital-intensive products.

Features or assumptions of Heckscher-Ohlin Theory :-

Following are the features or assumptions of Heckscher-Ohlin theory:-

(I) It is assumed that there are two countries A and B.

(II) There are two factors, labour and capital.

(III) It is assumed that there are two goods: X and Y of which X is labour-intensive and Y is capital-intensive.

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(IV) Country A is labour-abundant, country B is Capital-rich.
(V) There is Perfect Competition in both the Commodity and factor markets.
(VI) All Production functions are homogeneous of the first degree. Therefore, there are constant returns to scale.
(VII) There are no transports costs or other impediments to trade.
(VIII) Demand Conditions are identical in both the countries.

Limitations of Heckscher-Ohlin theory :-

Following are the limitations of Heckscher-Ohlin theory :-
(1) There are qualitative differences of factors in different regions, no qualitative differences.
(2) Production functions of different Products are different, requiring different Proportions of different factors in Producing different goods.
(3) There is Perfect Competition in the Commodity markets as well as in the factor markets in all the regions.
(4) There are no restrictions on trade, that is, free trade Policy is followed by all the countries.
(5) The Consumer's Preferences as well as the demand Patterns and Positions are unchanged.

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(6) There are stable and fiscal Policies in the Participating nations.
(7) The transport cost element is ignored.
(8) Technological Progress in different regions is identical.
(9) There are constant returns to scale in each region.
(10) There is Perfect mobility of factors.
(11) There is tendency towards complete specialisation.

Differences between classical theory and Heckscher-Ohlin theory of International Trade

(I) classical theory Presents a seperate theory of international trade where Ohlin theory Presents general theory of value.
(II) classical theory is based on labour theory of value where Ohlin theory Presents general equilibrium theory of value analysis.
(III) classical theory model is one-factor model where Ohlin's model is two-factor model.
(IV) classical theory establishes normative or welfare Propositions of foreign trade, where Ohlin theory contributes to positive economics by explaining the structure of foreign trade.

(V) classical theory stresses on the quality differences of labour in two countries, where Ohlin emphasises on the differences in factor endowments.