Fundamental Theories in International Trade and Economics

Over the centuries, just as the mechanisms, logistics, markets and extent of trade have changed, a number of theories have emerged to explain the complexity, restrictions, advantages and status of international trade. In this overview, we will touch on the most important ones. These remain theories, but their credence and impact in being used as the baseline for government activity through the ages leads us to a better understanding of modern trade and economics.

Mercantilism

Developed in Europe in the 16th and 17th century the modern dependency on an international reserve currency and trade surpluses and deficits derives from this economic practice. It theorizes that a country should produce, and export more than it imports, by carefully utilizing the resources at its disposal. Gold was the foundation for this theory; export more, import less, and hoard the surplus gold to gain power. It also proposed that one country may gain advantage only at the expense of another. As a natural progression, this theory later led to governments implementing price controls and other fiscal forms of protectionism.

Liberalism and Absolute and Comparative Advantages

As protectionism stifled trade and economic growth, new theories emerged along with a movement that called for more liberal international trade, which would ultimately lead to the present proliferation of global free trade agreements. As early as 1776, in his book 'The Wealth of Nations' , the economist, Adam Smith, put forward the idea of absolute advantage; that a country should look for a good or service they can produce more efficiently and effectively than anyone else and focus all efforts on that and use that good to trade for the other goods and services as needed.

Later on, the idea of absolute advantage was challenged by English Economist, David Ricardo. He theorized that countries could have comparative advantages; being better and producing a variety of goods than others, even of the same kind. The core idea here is that the focus should be on what goods each country is better at producing, and then concentrating labour and resources on those; improving productivity and efficiency, later trading the surplus in exchange for other goods or gold (i.e., reserve currency). We see large parts of this theory remain in place today.

Modern Theories

Other theories also exist, such as country similarity theory, product life cycle theory and global strategic rivalry theory, all seeking to explain international trade from a modern perspective.

For example, country similarity proposes that those countries with similar levels of economic development will be more likely to trade with each other. It is useful in understanding trade where brand reputation is important to customers. Product lifecycle theory explains that a product will be developed and built in the home country, mature and then through standardization, result in being manufactured in places where it is cost competitive to do so, as we see with electronic goods. A prime example is the Apple iPhone, created and licensed in the USA, made in China.

Trade Finance: A Constant

Regardless of which theory of international trade you get behind, one thing has been constant through the ages. The need for financial products to facilitate trusted international movement of goods and services. At Euro Exim Bank, we are proud to be pioneers in a new era of digitalized trade finance and international trade settlement. Powered by cutting edge technologies in our trade platform, incorporating blockchain, we provide a full range of trade finance instruments and enable instant global settlements through our Exim Wave platform in over 150 currencies.