[Academic Script]
[Heckscher-Ohlin Theory & General Equilibrium Framework of International Trade]

Subject:	Business Economics
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Lecture No. & Title:	1: Heckscher-Ohlin Theory & General Equilibrium Framework of International Trade

Frequently Asked Questions

(1) Which approach has been adopted by Ohlin in theory of international trade?

A.The general equilibrium approach has been adopted by Ohlin in theory of international trade.

(2) What is the main reason of international trade according to Heckscher-Ohlin?

A. The main reason of international trade is difference in factor endowments.

(3) Why the prices of commodities differ in different nations?

A. The prices of commodities differ because factor endowments in different nations are different.

(4) How can we say that commodity X is labor-intensive and commodity Y is capital intensive?

A. If K/L ratio of X is smaller than the K-L ratio of Y, we can say that commodity X is labor-intensive and commodity Y is capital intensive.

(5) Explain the assumptions of H-O theory.

The assumptions of comparative cost difference theory are as follows:

(a) There are only two countries, two goods and two factors of production. This model is known as **2x2x2 model.**

There is a **perfect competition in goods market** which means that price is determined by the industry and producers and consumers cannot affect the market price.

(b) There is a **perfect competition in factor market** which means that neither labor nor capital has the power to affect prices or factor rewards.

(c) There is a **full employment** in both nations.

(d) There is a **constant return to scale (CRS).** It exhibits that doubling the inputs (labor and capital), output will increase by twofold. We can say that production function is homogenous of degree one. If we double the amount of labor and keep capital constant, output will increase less than the increase in the amount of labor. It shows the diminishing returns to labor. Similarly, there are is diminishing returns to capital also.

(e) We can know the abundance of goods. One cannot change the abundance of the goods.

(f) There is **free trade** between two nations. There are no restrictions like tariffs, quota etc.

(g) The **factors of production** completely **mobile within the nation**. But they cannot move from one nation to another. Therefore, **international mobility does not exist.** We can say that one labor can move from Mumbai to Ahmedabad but he or she cannot move from Mumbai to New York.

(h) **The production function of two goods is different but they are same in both nations.** It means that production function of good X is same in both nations and production function of good Y is same in both nations. But production functions of X and Y are different in both nations.

(i) The factors affecting demand like tastes, preferences and income are assumed to be constant.

(j) The stock of the factors of production in both nations is constant. They are homogeneous.

(6) What is the definition of H-O theory?

A. A nation exports goods which use relatively a greater proportion of its relatively abundant and thus cheap factor of production and imports goods which use relatively a greater proportion of its relatively scarce and thus expensive factor of production.

It means that a nation will export the commodity whose production requires the intensive use of nation’s relatively abundant factor and import the commodity whose production requires intensive use of nation’s relatively scarce factor. In other words, capital-rich nation exports capital-intensive commodity and imports labor-intensive commodity. Similarly, labor-rich nation exports labor-intensive commodity and imports capital intensive commodity.