Heckscher-Ohlin's Theory of International Trade.

* Introduction

The classical comparative cost theory did not satisfactorily explain why comparative costs of producing various commodities differ as b/w different countries.

The new theory propounded by Heckscher and Ohlin went deeper into the underlying forces which cause differences in comparative costs.

They explained that it is difference in factor endowments of different countries and different factor-proportions needed for for producing different commodities that account for differences in comparative costs. This new theory is therefore called Heckscher-Ohlin theory of International Trade.

Since, there is a wide agreement among modern Economists about the explanation of

International Trade offered by Heckscher and Ohlin. This theory is also called Modern theory of international trade. Further, Since this Theory is based on general equilibrium analysis of price determination, this is also known as general Equilibrium Theory of International Trade.

According to general equilibrium theory of value, relative prices of commodious are determined by demand for and supply for them. In the long-run equilibrium under conditions of perfect competition, Relative prices of commodities, as determined by demand and supply, are equal to average of production.

The cost of production of a commodity, as is well-known, depends upon the prices paid for the factors of production employed in the production of that commodity. factor prices in turn determine the income of factor owners and hence the demand for goods.

Ohlin pointed out more Significant factors, namely, differences in factor endowments of the

Nations and differences in factor proportions of producing different commodities, which account for differences in in comparative costs and hence from the ultimate basis of inter-regional or international trade.

According to Ohlin, the underlying forces behind differences in comparative costs are two-fold:

1. The different regions or countries have different factor endowments.

2. The different goods require different factor-proportions for their production.

It is well-known fact that various countries are differently endowed with productive factors required for production of goods. Some country posses relatively more capital, some relatively more labour and some relatively more land.

The factor which is relatively abundant in a country will tend to have a lower price and the factor which relatively scarce will tend to have a higher price. Thus ~~Accor~~ according to ohlin factor endowments and factor prices are intimately associated with each other.

Suppose K stands for the availability or Supply of capital in a country, L for that of labour and PK for price of capital and PL for the price of labour.

further, take two countries A and B. In country A, capital is relatively abundant and labour is relatively scarce, the reverse is the case in country B. Given these factor-endowments. in country A capital will be relatively cheaper. In the Symbolic term –

$$\left(\frac{K}{L}\right)_A > \left(\frac{K}{L}\right)_B \text{ and } \left(\frac{PK}{PL}\right)_A < \left(\frac{PK}{PL}\right)_B$$