

INTERNATIONAL AGRICULTURAL TRADE POLICY

■ INTRODUCTION

Following Marshall, conventional to break study of international economics into two parts:

- ☞ real analysis *or pure trade theory* (MICRO)
- ☞ *monetary analysis or international finance* (MACRO)

■ Pure Trade Theory:

Essentially this is application of theories of *value* and *welfare* to issues in international economics (Bhagwati, 1964)

Pure trade theory studies:

- ☞ the reasons trade takes place
- ☞ the implications for commodity and factor prices of changes in variables such as the stock of capital
- ☞ the benefits that accrue from international trade
- ☞ the effects of trade restrictions such as tariffs and quotas on the welfare of an economy

Pure trade theory ignores problems of macroeconomic disequilibrium by assuming existence of full employment and an aggregate trade balance

■ **Monetary Analysis:**

Concerned with issues such as determination of exchange rates, and international transmission of unemployment and inflation

■ **This course fits into the field of pure trade theory, and, as is conventional, the analysis breaks down into 2 broad areas:**

- ☞ **questions of “positive” analysis, i.e. what determines the *structure* of trade; how do trade *instruments* affect market prices; what factors influence a country’s *terms of trade*?**
- ☞ **questions of “normative” analysis, i.e. in what sense does free trade maximize world income; is it ever optimal to use trade instruments; how do different trade instruments differ in terms of welfare effects?**

- **Part 1** of the course, focusing on trade and trade policy with respect to agricultural commodities, draws very much on the *neoclassical*, pure theory of trade

This is based on the standard assumptions of perfect competition, constant returns to scale, and homogeneous goods

- Should be recognized that several of the assumptions of the neoclassical model do not fit the *stylized facts* relating to either the structure of international trade in manufactured goods or the nature of international markets

☞ Much of the post-war growth in world trade has been of an *intra-industry* nature, i.e. the simultaneous export and import of products that are close substitutes for one another

This runs counter to the Heckscher-Ohlin model which predicts *inter-industry* trade, based on differing factor endowments

- ☞ **Casual observation suggests that many firms operate with increasing returns in less than perfectly competitive markets, very often selling highly differentiated products**

- **Over the past 20 years, much of pure trade theory has focused on incorporating these observations into analysis of international markets**

- **There has been a synthesis of theories from international trade and industrial organization. Helpman and Krugman (1989) suggest:**

“International trade theory has gone through a quiet but fundamental revolution in which a new approach has supplemented and, in some cases, supplanted the traditional analysis.”

- **Essentially, the new literature follows the split between positive and normative aspects of analysis:**
 - ☞ **first, and least controversial, economies of scale and imperfect competition have been incorporated into models explaining the structure of trade**

➤ **second, and a good deal more controversial, a body of theory has been developed that focuses on trade policy when markets are imperfectly competitive**

It is controversial in that it appears to undermine the orthodox prediction that free trade is always best

■ **These recent developments provide the analytical framework for Part 2 of the course where the so-called “new trade theory” is analyzed and applied to trade and trade policy in manufactured goods**