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17 January 2009

Online at <https://mpra.ub.uni-muenchen.de/18570/>  
MPRA Paper No. 18570, posted 12 Nov 2009 16:46 UTC

# ECONOMIC THEORIES OF FOREIGN TRADE TRANSACTIONS

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## Abstract

*The international experience/practice shows that inside foreign trade relations has sought to lay the ground to uniform rules and to base an orderly development of international trade, so that economic operators engaged in foreign trade can trade with each other in conditions of fair and unmarked competition.*

*The extent and implications of international trade on other areas of social life has increased considerably over the last five centuries, and today's volume has grown as fast.*

*Also, deepening and diversification of economic interlinkings of the world countries, especially after the Second World War were brought to the fore the issue of international economic relations, both for specialists and for the general public. These changes have reactivated the interest of specialists for theories about international trade and hence the history of theoretical controversies regarding this issue.*

*Taking into account the fact that foreign trade transactions is a key factor in sustainable the economic development of national economies, a fact recognized both by classical economists as well as modern ones, but also demonstrated by the economic reality, in this article I addressed/approached the economic theories of international trade.*

## 1. Introduction

The extent and implications of international trade on other areas of social life has increased considerably over the last five centuries, and today's volume has grown fast.

Also, deepen and diversify of links between countries, especially after the Second World War, have brought the issue of international economic relations in the foreground, both for specialists and for the general public.

These changes have reactivated the interest of specialists for theories about international trade and hence the history of theoretical controversies regarding this issue.

Against the background of the increasing impact of modern mass communication on contemporary public opinion and in connection with the growing importance of international economic relations, are more frequently put questions

such as: which are the criteria specialization in manufacturing of various countries, which are the advantages and disadvantages of external trade for partners involved in international trade, which are the long-term results of this work for different categories of countries etc.

The answers given by different authors to these questions vary greatly, depending on the historical context in which they approached problems, and optical and interests pursued by each thinker.

Taking into account these issues, further we approached the economic theories on international trade, since foreign trade transactions is a key factor in sustainable economic development of national economies, a fact recognized both by classical economists as well as modern ones, but also demonstrated by the economic reality.

## 2. Economic theories of foreign trade transactions

Foreign trade has fulfilled in time, a decisive role in the development of certain countries or regions, contribution that can be observed from the middle Ages.

Some cities such as Genoa, Amalfi, Venice have experienced an economic evolution oscillatory, depending on the commercial performance.

It is recognized that international trade was a crucial element in the process of industrialization, being known, same time, the effects of commercial protectionism on international trade.

If we look at the beginnings and evolution of economic thought in the world during before modern period observe that, depending on the quality of economic ideas, there *are two periods*<sup>1</sup>:

<sup>1</sup> Cerchez, O., *Economic efficiency of external trade*, Logos Publishing House, Bucharest, 2007, page 11

- *Before scientific period of economic thinking* – since the mankind beginnings until the second half of the XVIII th century;
- *Scientific period* – since the second half of the XVIII th century until nowadays.

In the first period there were no works of proper economic character, the ideas were widespread in economic works with legal, historical, religious character etc.

With the development of capitalism, there are many *economic thinking currents*, with distinct theories of foreign trade, such as: *mercantile, physic, liberalism, protectionism*.

**a) Mercantils** went on the hypothesis that the world's wealth, in gold, is constant. Starting from this hypothesis was considered that when the trade takes place between individuals, winning one is certainly another loss.

By translating this reasoning to the trade between nations can be concluded that any increase in wealth and economic power of one nation is based on the expense of another.

The national wealth, for mercantils, was not defined as a sum of individual wealth. They were interested in increased national wealth encouraging simultaneously, production, exports and reducing internal consumption in order to increase the quantity of gold in the country.

According to this thinking, a country should encourage exports and discourage imports with tariffs, quotas, taxes used as means of influencing economic, resulting thus a favorable trade balance (favorable trade balance). The production will be stimulated by government intervention in the domestic economy, thereby adjusting the foreign trade.

The mercantil economic thinking was concerned about finding ways of permanently extending the sources of enrichment.

*The main common ideas of the mercantile doctrine* concerns:

- the enrichment is a laudable goal, not blameworthy;
- personal interest is a stimulus that leads to the general prosperity;
- the main form of wealth is the money from precious metals, as a result of

functions performed in the market economy;

- the role of population in increasing the wealth;
- money was a factor of production with the same title as the land.

*Thomas Man (1571-1641)*, representative of commercial mercantilism, practiced mainly in England, believes that the iron rule of trade balance is an active balance as high.

To do this, it was preferable for the export of manufactured products and import of raw materials, practice on widely scale the transit trade and the brokering exchanges between countries.

*Dimitrie Cantemir* displays, in 1716, the mercantilist doctrine in the paper: "Description of Moldova". Of such doctrines stemming its focus on economic and political problems of a small feudal state, situated at the crossroads of two worlds, the East and the West and the interests of three mighty powers: Russia, Turkey and Austria.

The Mercantile current was challenged and criticized by the promoters of classical liberalism and neo-classical because of the support of state intervention in the economy, the intervention was considered an obstacle to the affirmation of free economic initiative and functioning of market economy.

**b) The physiocrat current** developed in the XVIII century, especially in France, with the main objective of the macroeconomic process of development. Followers of this current have focused not on money but on the real forces that lead to economic development.

In reaction to the mercantile it stated that wealth was created in the exchange process, they have studied the physical creation of value and have concluded that the origin of wealth is in agriculture (or kind). They also concluded that free competition leads to the best price and thus the company will benefit if individuals are pursuing their own interest.

The physiocrat<sup>2</sup> theory has a large field of involving, thus:

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<sup>2</sup> Cerchez, O., op. cit, page 12

- theorization of agriculture importance in the lives of people, societies and states in different times and places;
- explain and theoretical prepare of shift from economics to the natural exchange of feudal agriculture to the farmers, capitalist;
- the pleading and support for the modernization of agriculture and its classification in the organic economy and industries of economy.

Important people such as *Vaulean, Bruyere, Montesquieu, Quesnay, Mirabeau, Turgat* and others have founded, developed and supported the physiocrat school.

In the Romanian countries the representative of physiocrat school was Nicolae Balcescu, which in the paper: "Economic issues in the Romanian Principalities" focuses its considerations on the development status of fact and then destiny of our country.

Knowledge and economic thinking are systematic concerns of a school-based on concept of systemic natural order which reigns in the economy, similar to the nature.

The physiocrat and mercantile prepared and paved the ground of economic thinking release of classical liberalism.

**c) The theory of classical liberalism** was based as parent of *Adam Smith* (1723-1790) that took off the most valuable ideas of precursors

The increased importance of foreign markets, with the increasing forces of capitalist production, resulted in the theory of Adam Smith attempting to explain the way in which international trade can provide a economy of national social work, thus contributing to increased labor productivity and the deepening division of labor.

Adam Smith believes that the merchandism exchange is governed by the law of value based on work, both in internal and international trade.

Adam Smith lays down *the principle of absolute advantage*, that the saving of national works, the international specialization of a country which should follow the production of goods with the

lowest costs by achieving export in other countries, the goods whose production costs might have been highest in the respective country.

The absolute advantage – otherwise is a material one including weather conditions, natural resources or the abundance of labor force, or it is acquired one, which refers to the process of manufacturing of the product - has been associated by Adam Smith to the idea of *specialization*<sup>3</sup>. Adam Smith was the first of economists who gave the theory of international trade a dynamic<sup>4</sup> vision.

He based the whole concept on the idea, opposed to mercantile current, that trade relations between nations allow all partners to specialize, thereby increasing the productivity level in each country and at the same time, the general level of production and consumption worldwide.

Liberalism is based on an individualistic conception, being located in the center the personality of individual economic agent, the state role is minimal.

For Adam Smith, the trade takes place between countries, changing production factors converted into gold (irrespective of the value theory that conceived it).

The absolute advantage theory says that the yearly work of any nation is the fund which always has supplied with all necessary goods.

In Adam Smith's view the goods exchange was governed, both in national trade and the international law, by the value law based on work - the principle of absolute costs or benefits.

Thus, as much a country consumes fewer factors of production to produce a product than other countries, as its products become more competitive.

This is the foundation of absolute advantage theory, Adam Smith saying that if trade between two countries is made without restriction and regularly, it is advantageous, although not always for both countries.

<sup>3</sup> Burnete, S., *International trade*, Economic Publishing House, Bucharest, 1999, page 18

<sup>4</sup> Stoenescu, V., *Nowdays theories related to international economic relationships*, Phd Thesis, ASE Bucharest, 1987, page 96

The condition to achieve the absolute advantage is absolutely foreign policy free trader.

Adam Smith laid the emphasis on broadening the market and deepening international division of labor, increasing the skill levels and economic development, being the first who gave a dynamic vision of international trade.

The progress made by Adam Smith in comparison with his forbears, the mercantile persons, lies in the reporting of trade to production and division of labor (social, manufacturing and international), in illustrating some sustainable relationships, basis of individual actions in the economy, linking the acts of selling-purchase with the value law and defining the absolute advantage in inside and outside trade, and in support of economic liberalism, as a general rule, admitting however that cases of state intervention and restrictions on foreign trade are unavoidable and therefore acceptable (especially when comes to national defence)<sup>5</sup>.

Growing scale of foreign trade of Great Britain during the industrial revolution and a permanent concern for strengthening its links with the colonies on other continents have brought public attention to issues of international trade and external best economic policies.

Forces of production is growing rapidly in England under the impetus of new capitalist relationships and manufacturing production gives gradually place to machinery and great industries.

While Adam Smith has focused the researches on capital manufacturing, *David Ricardo (1772-1823)* has made findings of the study, particularly of the agriculture problems.

David Ricardo referring to foreign trade has shown that it takes place not necessarily based on absolute advantage, but on the basis of *comparative advantage*.

David Ricardo promoted *two theories*:

- theory of comparative costs of production and / or relative advantages in international trade;
- quantitative theory of money and self-equilibrium of the balance of external payments as a result of international free flow of precious metals.

From the explanations and examples given by him result that *the relative advantage* lies in the possibility of producing a merchandise with an expenditure of time relatively less in comparison with other goods in the same country even if the goods spent more time working than other countries, and even if the absolute volume of spending time working is higher than in other countries for the same merchandise<sup>6</sup>.

David Ricardo's model is based on labor value theory, assuming free competition within each country on product markets and production factors, with complete immobility of production factors between countries.

David Ricardo make abstraction of the transport costs and trade barriers, the existence of them diminish the principle of comparative costs.

David Ricardo continues the line of thought of Adam Smith with whom he agrees in many respects, but has a greater power of abstraction and generalization, which allows him to raise the economic theory of one step higher, indicating that exchange of goods is governed of different principles depending on the level at which they are made: macroeconomic or worldeconomic.

On Adam Smith, the phrase of international division of labor is based on comparing price of same goods in different countries.

In contrast to this, Ricardo argued that even if a commodity can be produced with less labor in a country, the latter may prefer to import goods in order that it can specialize in other goods that may offer higher advantages compared.

The limit of David Ricardo's model lies in its static character, which indicates that *international specialization* maintain economic disparities, the benefits of international trade being thus unequal for partners.

<sup>5</sup> Sută, N. and collaborators, Course of international trade and commercial policy, Ceres Publishing House, Bucharest, 1992, page 417

<sup>6</sup> Ricardo, D., *Special works*, tome I, Academia Publishing House, 1959, page 123-136

*The comparative costs principle* argues that a country will export the commodity/good whose price expressed in the prices of other goods is lower than the price of one good expressed in the same way in other countries.

Accordingly to David Ricardo's theory, the partner countries can gain from trade if they specialize in producing goods that have a relatively lower price.

Although not explained too clear the mechanism of exchanges of the world market of the partners who differ in terms of their economic potential, David Ricardo put before economics a difficult and complex issue on which will focus many thinkers.

The theory of comparative costs is related to the quantity theory of money and the extant of equilibrium for trade balances.

Thus, Ricardo makes distinction between the value of money as merchandise and value for money as a means of circulation.

Most reactions to the theory of international trade of Ricardo (from Fr. List, Manoilescu M., J.M.Keynes) were based on the following reasons<sup>7</sup>: rejection of foreign policy of free trade by thinkers from less developed countries because they could not face competition from developed countries where the labor productivity was higher, also the challenge of mutual benefit of international trade and the harmony of interests arising following the international trade exchange.

Rejecting the conclusions of certain claims with generality character of the theory of comparative costs may not lead to ignoring the merits of this theory. Thus, it fulfills a specific progressive role in the liquidation of mercantile residues, in expanding the international trade links, with major implications in the development of productive forces of society.

Also, David Ricardo enriched the analytical instruments of economic science in the investigation of international relations

with such terms as "cost of production" (explained using working time required to produce goods), "relative cost (compared) of production "relative advantage"<sup>8</sup>.

Despite its imperfections and critics which have been brought, this theory persisted for almost two centuries in the first interest to specialists in the field of international trade.

Thus theory of Ricardo about international trade even today is accepted in a number of developed countries and despite the theoretical denial (the criticism brought in time of economists who came in particular from developing countries) and practical denial (international statistics).

Thus, the american economists P.A. Samuelson and W.D. Nordhaus, wrote in 1995 in the book of the economy: "When trade is free and each country focuses on the area in which it holds comparative advantage, everyone has gained. Workers in each region can obtain a larger quantity of consumption goods for the same workload when they specialize in areas of comparative advantage and exchange the goods they produce with others which faced with a relative disadvantage. When borders are open to international trade, the national income of each participating country in this issue is increasing"<sup>9</sup>.

If the work is the only factor of production, as assumed models of Adam Smith and David Ricardo, the absolute and comparative advantages can only derive from differences in productivity.

One of the economic theory which benefits a large audience, composed by about 200 years ago, presented in many of the creators of economic science, is that spring of welfare and progress is the labor productivity.

***The competitive advantage theory***, formulated by Michael Porter, is based on the principle that, nationally, the only significant criterion is that of national productivity.

Unlike the traditional approach, in which the national advantage has as source the

<sup>7</sup> Sută, N. col, *Internațional trade and nowadays commercial policies*, All P.H, Bucharest, 1997, page 512

<sup>8</sup> Sută, N. col, *Course of international trade and commercial policy*, Ceres P.H, Bucharest, 1992, page 423

<sup>9</sup> Samuelson, P.A., Nordhaus, W.D., *Political Economy*, Teora P.H, Bucharest, 2000, page 806

production and their costs, the competitive advantage is the result of a whole chain/string of activities that contribute to successful marketing of a product. In this chain are covered both *primary activities*, namely: production, promotion, distribution and price, and *secondary activities* (support), ie: supply, human resources, planning, finance and accounting.

The competitive advantage it holds that economy which manage to recover, as well, the whole chain of such activities.

The theory of competitive advantage consists, essentially, in stressing the fact that an important advantage in obtaining market is to identify ways in which the same products are obtained with input links below (cost advantages), or the same activities are carried out in a particular manner, original, innovator, at a higher value (quality advantage) achieving ultimately more productivity<sup>10</sup>.

*Michael Porter* has used in developing the theory of competitive advantage a system of determinants, which the author called "diamond", which creates an internal environment more or less favorable to achieve competitive advantages for national firms involved in economic life.

These determinants are related to: the endowment with internal factors, the specific of internal market, the linkages between industry and internally competitive environment.

In the first part of the XIX th century, the classical liberalism hit the first difficulties in the acceptance of his ideas by the public opinion. Thus, while the socialists utopian criticism is directed mainly to the sphere of production and distribution, the attacks coming, especially from Germany and the United States is moving towards the free trade policy envisaged by classical liberal economists.

**d) The protectionism** was felt on the criticism issues of social inequality which are into conflict with the "wonderful" world picture of Adam Smith, attacking of front the concept of free trade of Adam Smith and David Ricardo.

The relationship between protectionism and free trade concerns:

- the stability of market economy in a country is related to the formation of an internal market which has support and protection from the state;
- the permanent or replacement of protectionism with economic liberalism depends on the degree of maturation of the modern national economy and the competitive power of goods belonging to that nations worldwide;
- the protectionism and liberalism, though are not totally excluded, being possible certain combinations (France).

The concept of *Friederich List* of international trade and protectionism is based on the theory of productive forces of the nation representing its entire core of economic system.

The protectionism is based on *two fundamental arguments*:

- ◆ usefulness for a nation to achieve economic autonomy;
- ◆ the need to reserve to the domestic producers the market.

*Friederich List*, an outstanding representative of protectionism, believes that it should remain a tool in the hands of the state, being necessary that gradually, as industrialization, the protectionist measures to be mitigated until removing them all.

*Friederich List* pleads with all the conviction for a protectionist policy, designed to encourage the development of young industries, defending them from foreign goods competition that came from the advanced countries economically.

The industrialization through protectionist measures should therefore have a complex development of the economy, increasing the economic potential of the nation and it participate in the growing position to world economic channel.

*List* admits that in the different levels of development of nations, free trade policies only benefit developed countries and disadvantage the poor the most, deeping the gap between them and favoring the monopoly situation for developed countries. In the opinion of *F. List*, the protectionism was the only real and positive

<sup>10</sup> Cerchez, O., op.cit., page 15

alternative for countries lagging behind economically.

Thus, the idea of educative protectionism has emerged, who will join to the most fertile world of thought in international economic relations perimeter-illustrated by *M. Manoilescu*.

At the beginning of XX th century, swedes *Eli Heckscher* and *Bertil Ohlin* were resumed the theory of comparative advantage of D. Ricardo. According to their theory, the trade is conducted on the relative prices of domestic factors of production involved in producing goods subject to international economic exchanges.

In this area an important contribution was brought by romanian economist M. Manoilescu, which deepened the analysis of the comparative advantage in foreign trade, seen through the prism of labor productivity.

**The new-liberalism in Romania**, which lasted from the end of World War I until the nationalization of the means of production in 1948, had few elements in common with those of developed capitalist countries.

***The characteristics of romanian new-liberalism***, promoted by *M. Manoilescu*, *Vintilă Brătianu*, *Mitiță Constantinescu*, *Ștefan Zeletin*, *Dimitrie Gusti* etc., are:

- engaging in actions of getting back the theoretical baggage of liberalism taking account of changes in the world and especially the demands of positive development of our country;
- promote state intervention in the economy, as a condition of maintenance and proper functioning of market economy in the contemporary period;
- theorization the need that future economy to be mixed;
- support the industrialization in the country's new space, as a prerequisite condition to restructuring the economy, strengthen the independence, raising the productivity of national work and recovery the national riches;
- promotion the theory and practice of "development by ourselves", which mean supporting the interests of the

country, the more potential for recovery of all capital and attract foreign participation only to the extent that by bringing were not adversely affected the interests of national economy;

- dismiss the idea of revolutionary leaps and struggles between classes, support the evolutionary development and changes path, suitable for social harmonies.

M. Manoilescu, the greatest theorist and most representative in the field of international trade, develops new theories on the international economic relations, international division of labor, the economic structure of the world countries, the disparities between them and the need to change the status of things for proliferation of industrialism in the work land countries.

M. Manoilescu considers the labor productivity, the level or the costs of different branches of production as the criterion most indicated by the orientation of international specialization and outside trade.

The benefits and gains from international trade are uneven and they are divided between countries, depending on several factors of production, thus labor and capital being the basic.

The higher they are in a country, both its net income arising from international trade is higher and vice versa.

M. Manoilescu is a defender of protectionism, his theory is taken as a reference point for promoters of a new vision of international economic order which help to reduce disparities and to support poor countries to get out the underdevelopment stage.

Based on the theme addressed by M. Manoilescu, the economist *Mitiță Constantinescu* creates a true dual industrialization theory for internal consumption and the export needs in order to purchase the required goods to the country from the international market.

The new vision takes as the starting point the macroeconomic structures that ust be achived in a rational way, by means of active economic policy, depending on the demands of complex national economy.

M. Manoilescu draws attention that more important in foreign trade, even if there is or is not balance of commercial balance, which shows that, in fact, a quantitative aspect, is the quality element of foreign trade, consisting of a advantageous export structure of export the goods, in which to predominate the goods with the highest productivity.

**The most important thesis promoted by M. Manoilescu** are:

- a country enriches if exported goods of high productivity of labor and imported goods of low labor productivity;
- a real currency is the productivity of export goods;
- those theories which, under the pretext of division of labor and specialization of production, recommended to countries to use their new forces and surplus of population in the lower economic sectors with a labor productivity lower, are theories of regression and national shame;
- in relation to intra-european trade, Manoilescu M. points out that when western Europe sells industrial goods created by an employer for agricultural goods of ten workers from Eastern Europe, this thing means exploitation.

M. Manoilescu's theory was and is an important point even for its critics, many of them recognize with objectivity the scientific value, even though they disagree with its practical implications.

At the same time with the emergence and development of micro-analysis and systems theory (cyber) has moved to a qualitatively new stage regarding the theory of foreign trade.

Following the global crisis (the 30th years) that traditional economic theory failed to cope with them, it came a new economic power, interventionist, called **the macroeconomic theory** or "**Keynes Theory**", from the name of its founder, J.M. Keynes.

As a consequence of this theory, there are different economic models such as:

- variable-objective (unemployment, inflation etc.);

- variable-economic instrument of intervention (taxes, subsidies etc.);
  - intermediate variables (prices, wages etc.).
- In most models, the customs duties (taxes and taxes in general) are considered variable-instrument.

Between capitalism the custom duties become, along with trade agreements, the main means of trade policy, serving to protect newly emerging industries, transforming the instruments of aggressive protectionist policy.

### 3. Conclusions

In the trade policy developments **in the postwar period**, is off three **main trends**:

- ◆ liberalization of international trade, accompanied by a return to protectionism;
- ◆ multiplying and widening the agreements of regional economic integration and preferential trade arrangements;
- ◆ application of a preferential regime to commercial trade with developing countries.

These trends give rise to different degrees of international specialization which reflects, in essence, the economic potential of the states.

For postwar feature is characteristic the general trend of increasing dependence of states from external market, reflected in increasing share of exports in the world.

Due to increasing of economic interdependence between countries, in current conditions, is an objective trend of reduction of duties with a strong development of international trade.

The governments have sought to intervene in the sense of orientation the economic exchanges in the direction you want them through two main means:

- trade policy development coming from the general economic policy;
- participation in the elaboration of a unified legal framework for international economic exchanges.

Turning these efforts is the emergence of the global economy, as it is defined in the literature.

Down through the history of market and the mechanisms that have gone a long way, which stresses the objectivity character, proving

the whole distance historically broad improvement and adaptation to states of very different concrete things.

*It can be concluded* that during the history of economic thought, the most representative of world economists have tried to find an answer to two fundamental questions related to international economic relations: the causes of trade and the gain from trade.

The developed methods have evolved from mercantilism, absolute advantage and comparative advantage in the classical theory,

to the resources and trade with specific factors and comparative advantage in the modern theory frame.

For Romania, a country still in transition and recent member of the European Union are particularly important to intensify participation in international trade exchange of goods and services, but also attracting foreign investments in the economy as the main opportunities for technology again the industrial sector, restructuring the national economy, in order to create and maintain sustainable competitive advantages.

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