International Trade Theory

www.ashraffeps.yolasite.com

Ashraf Samir Ph.D.

Resources and Trade: The Heckscher-Ohlin Model

Introduction

❑ The Ricardian theory showed how trade can arise because of differences in **labor productivity.**

❑ The Heckscher-Ohlin theory argues that, in addition, trade also occurs due to:

differences in the availability of labor, labor skills, physical capital, or other **factors of production across countries**

Choosing the Mix of Inputs

Assumptions:

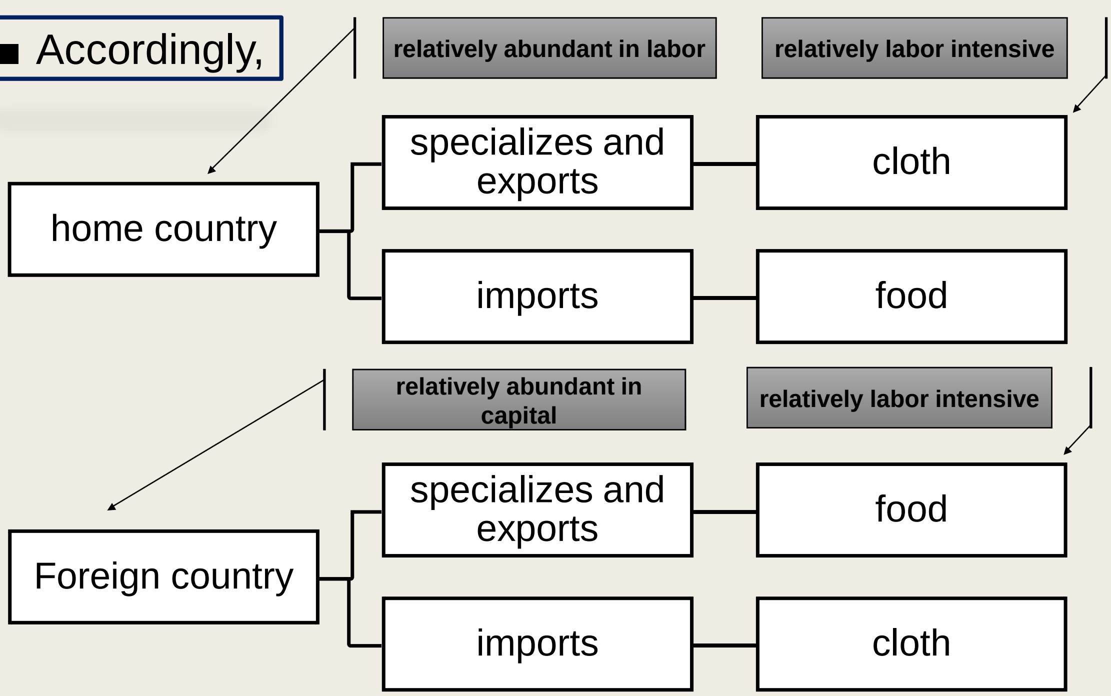
1. Two countries: home and foreign.
2. Two goods: cloth and food.
3. Two factors of production: labor and capital.
4. Home is relatively abundant in labor and Foreign is relatively abundant in capital

■ To produce a given amount of cloth (or food), a country may choose different amounts of labor and capital depending on the **wage**, *w*, paid to labor and the **rental rate**, *r*, paid when renting capital.

■ When the wage *w* increases relative to the rental rate *r*, producers use less labor and more capital in the production of both food and cloth.

- For any given values of *w* and *r*, if cloth production uses more labor relative to capital than food production uses, we can say that:
- production of cloth is **relatively labor intensive**,
- while production of food is **relatively capital intensive**.

- Accordingly,



■ If the **relative price of a good** increases, then the real wage or rental rate of the factor used intensively in the production of that good increases, while the real wage or rental rate of the other factor decreases.

■ Any change in the relative price of goods alters the distribution of income.

Thank you