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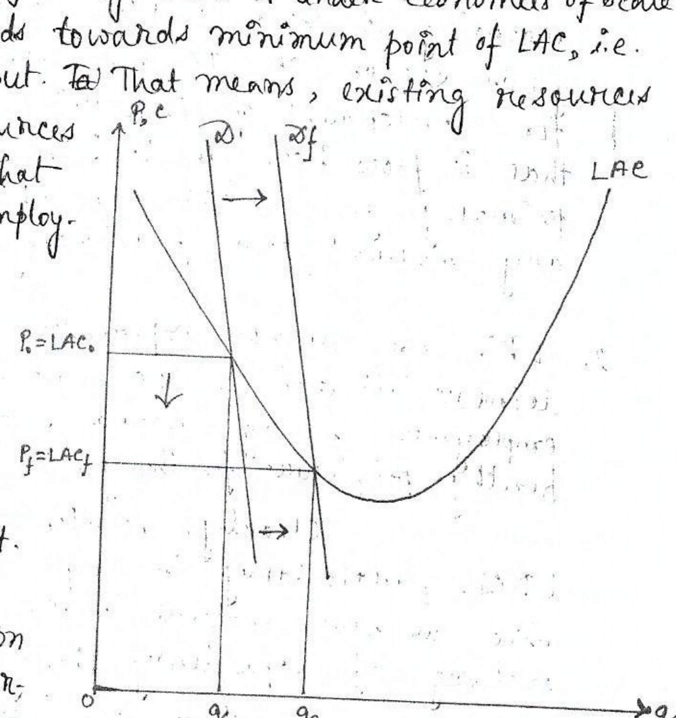
TRADE AS AN ENGINE OF GROWTH : P-S HYPOTHESIS

INTRODUCTION : Traditional classical trade theory argues that international trade encourage development process & hence international trade can be viewed as an engine of the growth. This proposition runs in terms of the Vent For surplus (VFS) theory of Adam Smith. Now we analyse this in the following way.

VFS theory starts with an assumption that there is some under utilised natural resources, excess capacity in absence of trade & when trade opens up then

1. it provides larger market. So producer will induce to produce more by using the under utilised resources & excess capacity & thereby output & employment will go up over time. Hence, we have balanced growth of all sectors as sectors are interdependent. This is not possible in absence of trade.

2. Since trade provides larger market, so larger output can be produced & hence economies of scale (if any) can be utilised to the larger extent so that economy can produce larger output at a lower AC (since after opening up of trade demand curve shifts rightward & under economies of scale LAC is falling) & economy tends towards minimum point of LAC, i.e. towards optimal or ideal output. ~~To~~ That means, existing resources as well as underutilised resources are utilised more efficiently that will encourage the growth & employment over time.



Above two effects of trade encourage the growth process through demand side effect. But trade also encourage growth process through supply side effect.

3. Trade provides large competition among the firms. Hence, to survive into the market, existing firms utilise their resources more efficiently & thereby output & employment increase. Alternatively, due to larger no. of firms monopoly power of the firm decreases by which we have larger output at a lower price & we have a larger social welfare.

4. In presence of trade country can import superior technology & thereby experience a technological ~~process~~ progress. So country can produce