



HOW NEW TRADE THEORY SHAPES OUR ECONOMY: INSIGHTS AND BENEFITS FOR EVERYONE

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Introduction

In order to explain international commerce, a contemporary economic theory known as "new trade theory" (NTT) uses first-mover advantage, network effects, and economies of scale.

It helps identify the main force for globalisation and the increased trade between similar economies. It also creates the framework for government involvement in a country's industrialisation.

Paul Krugman developed the new trade theory, an economic theory that explains globalisation and international trade through the use of first-mover advantage, network effects, and economies of scale.

The main areas of disagreement between the two trade theories have been the returns of scale, fixed technology, and perfect competition—all of which the old theory acknowledges and the new theory denies.

"New trade theory of international trade" is a term used to describe a group of several economic models that primarily focus on how network effects, first-mover advantage, and returns on scale affect international trade. For instance, Paul Krugman's new trade theory is founded on his theories that examine trade patterns according to the location of trade activity; in

2008, he was awarded the Nobel Prize in Economics for these theories.

Historical Background

New trade theory was given by Paul Krugman in 1970. Krugman's work extended Ricardo's assertion that every country has some degree of comparative advantage. Every country was always in a better position than its competitors to manufacture a particular good or service because of this comparative advantage. However, Ricardo's model fell short in elucidating the calculation of comparative advantage. The concept of a comparative advantage from the new trade theory is incorporated into the model.

Principal Elements

Therefore, the following are the key components of new trade theory:

1. Economies of Scale

In this way, the cost of an item decreases as it is produced in huge quantities.

IT technologies, cars, and large-scale production equipment all help it. It is not used by domestic companies because of limited demand, but economies of scale lower the cost of production per unit as the demand for goods from overseas countries increases. Every nation has a particular industry with this capacity, and by broadening the range of products offered, production costs can be reduced.

2. Advantage of Being First

It is explained by the idea that a company gains a larger tactical and financial advantage over late entrants the earlier it begins manufacturing a given good. It occurs as a result of the low-cost structures of early entrants growing into enormous companies like NOKIA.

3. Impact of Networks

It claims that as more people use the products, the more valuable they become. The internet is one example.

Assumptions

This idea was developed by economist Paul Krugman under several presumptions. The following are the underlying presumptions of the new trade theory:

- Businesses that specialize enjoy greater economies of scale
- Productivity gains from learning by doing are outstanding.
- The benefit of first mover advantage lets in new rivals.
- The function of the government in industrialization grows in importance.
- Economies of scale play a crucial role in preventing new competitors and monopolizing businesses.
- As a company grows, product specialization and uniqueness become crucial.

Examples

The first example is to the enormous mobile phone maker NOKIA. Finland is where it began producing its mobile devices. The corporation that manufactured electrical and electronic equipment served as its foundation. In the 1990s, the NOKIA brand became the pioneer to enter the mobile and related parts

manufacturing market. It adopted economies of scale in the production of mobile phones as a result of its solid financial standing. The government of Finland backed its endeavour to manufacture mobile devices as well.

As a result, it held a monopoly on the production of mobile phones for nearly 15 years. But as time went on, more and more people began utilising NOKIA, turning it into a significant mobile corporation. As a result, it was the clear leader in mobile phones for more than ten years thanks to government assistance, economies of scale, network effects, and first-mover advantages.

Advantages of New Trade Theory (NTT)

1. More grounded assumptions: NTT modifies traditional trade theories' implausible presumptions, like perfect competition and steady returns to scale.
2. Describes intra-industry trade: One important aspect of contemporary trade patterns is the prediction of trade inside industries by NTT.
3. Firm-level analysis: NTT examines variations at the firm level to shed light on the competitiveness and heterogeneity of firms.

Disadvantages of New Trade Theory (NTT)

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Implications of New Trade Theory (NTT)

Policy Implications

1. Trade liberalisation: NTT is in favour of trade liberalisation, but firm-level competitiveness should be the main priority.
2. NTT provides guidance to industrial policy, emphasising the significance of firm-level support.
3. Competition policy: NTT highlights the necessity of addressing firm-level market strength through competition policy.

Business Implications

1. Firm-level strategy: NTT places a strong emphasis on the competitiveness and firm-level strategy.
2. Innovation and R&D: NTT emphasises that in order to increase firm-level productivity, innovation and R&D are essential.
3. Importing and exporting: NTT advises businesses to take advantage of firm-level advantages by importing and exporting.

Economic Consequences

- Trading between industries: NTT anticipates an increase in trading within industries as well as changes to trade patterns.
- Firm-level Productivity: NTT emphasises the significance of firm-level productivity for economic growth.

Economic geography: NTT informs economic geography by highlighting the significance of firm-level clustering.

Conclusion

New Trade Theory makes it easier to comprehend the complexities of globalisation and international trade. Having a solid

understanding of NTT's principles and implications can help firms and policymakers make informed decisions that will improve economic growth, competitiveness, and sustainable development.

The New Trade Theory (NTT) transforms how we think about globalisation and international trade. Through the integration of network effects, first-mover advantage, and economies of scale, NTT offers a more thorough and realistic framework for examining trade patterns.