- The idea of a wealthy society was to have exports exceed imports (trade surplus) so that the king's treasure chests could be filled with money.
- Exports created inflows of gold and silver while import created outflows of gold and silver

David Hume-1752

- David Hume showed the inconsistency of X>I in the long run by explaining inflation.
- Increased exports leads to inflation and higher prices
- Increased imports lead to lower prices
- Result: Country A sells because of high prices and Country B sells more because of lower prices.
- In the long run, no one can keep a trade surplus.

Absolute Advantage

- Adam Smith argued that countries differed in their ability to produce goods efficiently, and should specialize in the production of the goods they can produce the most efficiently. Division of labor.

- If Britain were to specialize in textile production, and Spain in wine production, Smith argued that both Britain and Spain could consume more textiles and wine than if each only produced for their own consumption. Thus trade is a positive sum game.

Comparative Advantage

David Ricardo asked what might happen when one country has an absolute advantage in the production of all goods. Ricardo's theory of comparative advantage suggests that countries should specialize in the production of those goods they produce most efficiently and buy goods that they produce less efficiently from other countries, even if this means buying goods from other countries that they could produce more efficiently at home.

Heckscher-Olin Theory

The Heckscher-Ohlin theory predicts that countries will export those goods that make intensive use of factors of production which are locally abundant, while importing goods that make intensive use of factors that are locally scarce. It focuses on differences in relative factor endowments rather than differences in relative productivity.

The Leontief Paradox

- Wassily Leontief theorized that since the U.S. was relatively abundant in capital compared to other nations, the U.S. would be an exporter of capital intensive goods and an importer of labor-intensive goods.
- However, he found that U.S. exports were less capital intensive than U.S. imports

The Product Life Cycle

- Raymond Vernon suggested that as products mature, both the location of sales and the optimal production location will change, affecting the direction and flow of imports and exports. Globalization weakens this theory.
- Over time, demand for the new product would grow in other advanced countries making it worthwhile for foreign producers to begin producing for their home markets