CHAPTER 1
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INTRODUCTION

This study is an attempt to contribute to the theory of intra-industry trade, that is, simultaneous exports and imports of commodities that belong to the same industry. The term 'intra-industry trade' has been conceptualized for the purpose of our study to mean (I) trade between inputs and final products, and (II) trade between final products within any reasonably well-defined concept of industry. The reasons why we find it interesting to extend international trade theory to cover intra-industry trade are the following:

(1) Almost the entire theoretical literature of international trade assumes that trade always leads to inter-industry specialization, i.e. a country either exports or imports a commodity from any given industry. Similarly, the assumption of a 'vertically integrated' industry explicitly recognizes trade only in final commodities. Consequently, intra-industry trade of any type has, by assumption, been assumed away. If the results of this theorizing are attributable to the specific nature of the models used, one should not, then, attach much significance to them. If, by contrast, it can be shown that the principal
features of trade theory carry over to alternative models that take into considerations of intra-industry trade, then the confidence with which we apply the theory to real world should be strengthened.

(2) On the other hand, if it is found to be inexplicable, then any observed intra-industry trade would simply negate the validity of such theory. It also would then be enough justification to modify the theory by relaxing some of its assumptions so that more meaningful theoretical proposition could be derived that has immediate relevance to the reality.

It may be useful to point out why we wish to make a distinction between the two types of intra-industry trade. It is necessary from the viewpoint of analytical rigour since (I) implies movement of factors and commodities, while (II) is restricted to trade in final commodities only. Therefore, we shall analyse the two issues separately.