

International Trade

UNIT - I

Internal and International Trade:

By internal or domestic trade are meant transactions taking place within the geographical boundaries of a nation or region. It is also known as intra-regional or home trade. International trade, on the other hand, is trade among different countries or trade across political frontiers.

International trade, thus, refers to the exchange of goods and services between one country or region and another. It is also sometimes known as “inter-regional” or “foreign” trade. Briefly, trade between one nation and another is called “international” trade, and trade within the territory (political boundary) of a nation “internal” trade.

For all practical purposes, trade or exchange of goods between two or more countries is called “international” or “foreign” trade.

International trade takes place on account of many reasons such as:

1. Human wants and countries' resources do not totally coincide. Hence, there tends to be interdependence on a large scale.
2. Factor endowments in different countries differ.
3. Technological advancement of different countries differs. Thus, some countries are better placed in one kind of production and some others superior in some other kind of production.
4. Labour and entrepreneurial skills differ in different countries.
5. Factors of production are highly immobile between countries.

In short, international trade is the outcome of territorial division of labour and specialisation in the countries of the world.

Salient Features of International Trade:

The following are the distinguishing features of international trade:

(1) Immobility of Factors:

The degree of immobility of factors like labour and capital is generally greater between countries than within a country. Immigration laws, citizenship, qualifications, etc. often restrict the international mobility of labour.

International capital flows are prohibited or severely limited by different governments. Consequently, the economic significance of such mobility of factors tends to equality within but not between countries. For instance, wages may be equal in Mumbai and Pune but not in Bombay and London.

According to Harrod, it thus follows that domestic trade consists largely of exchange of goods between producers who enjoy similar standards of life, whereas international trade consists of exchange of goods between producers enjoying widely differing standards. Evidently, the principles which determine the course and nature of internal and international trade are bound to be different in some respects at least.

In this context, it may be pointed out that the price of a commodity in the country where it is produced tends to equal its cost of production.

The reason is that if in an industry the price is higher than its cost, resources will flow into it from other industries, output will increase and the price will fall until it is equal to the cost of production. Conversely, resources will flow out of the industry, output will decline, the price will go up and ultimately equal the cost of production. But, as among different countries, resources are comparatively immobile; hence, there is no automatic influence equalising price and costs. Therefore, there may be permanent difference between the cost of production of a commodity.

In one country and the price obtained in a different country for it. For instance, the price of tea in India must, in the long run, be equal to its cost of production in India. But in the U.K., the price of Indian tea may be permanently higher than its cost of production in India. In this way, international trade differs from home trade.

(2) Heterogeneous Markets:

In the international economy, world markets lack homogeneity on account of differences in climate, language, preferences, habit, customs, weights and measures, etc. The behaviour of international buyers in each case would, therefore, be different.

(3) Different National Groups:

International trade takes place between differently cohered groups. The socio-economic environment differs greatly among different nations.

(4) Different Political Units:

International trade is a phenomenon which occurs amongst different political units.

(5) Different National Policies and Government Intervention:

Economic and political policies differ from one country to another. Policies pertaining to trade, commerce, export and import, taxation, etc., also differ widely among countries though they are more or less uniform within the country. Tariff policy, import quota system, subsidies and other controls adopted by governments interfere with the course of normal trade between one country and another.

(6) Different Currencies:

Another notable feature of international trade is that it involves the use of different types of currencies. So, each country has its own policy in regard to exchange rates and foreign exchange.

For the sake of brevity, features of international trade are mentioned in Chart 1.

Chart I



Differences between Internal Trade and International Trade:

Characteristically, there are marked differences between internal and international trade as stated below:

1. Specific Terms:

Exports and Imports. Internal trade is the exchange of domestic output within the political boundaries of a nation, while international trade is the trade between two or more nations. Thus, unlike internal trade, the terms “export” and “import” are used in foreign trade. To export means to sell goods to a foreign country. To import goods means to buy goods from a foreign country.

2. Heterogeneous Group:

An obvious difference between home trade and foreign trade is that trade within a country is trade among the same group of people, whereas trade between countries takes place between differently cohered groups. The socio-economic environment differs greatly between nations, while it is more or less uniform within a country.

Frederick List, therefore, put that: “Domestic trade is among us, international trade is between us and them.”

3. Political Differences:

International trade occurs between different political units, while domestic trade occurs within the same political unit. The government in each country is keen about the welfare of its own nationals against that of the people of other countries. Hence, in international trade policy, each government tries to see its own interest at the cost of the other country.

4. Different Rules:

National rules, laws and policies relating to trade, commerce, industry, taxation, etc. are more or less uniform within a country, but differ widely between countries.

Tariff policy, import quota system, subsidies and other controls adopted by a government interfere with the course of normal trade between it and other countries. Thus, state interference causes different problems in international trade while the value of theory, in its pure form, which is laissez faire, cannot be applied in toto to the international trade theory.

5. Different Currencies:

Perhaps the principal difference between domestic and international trade is that the latter involves the use of different types of currencies and each country follows different foreign exchange policies. That is why there is the problem of exchange rates and foreign exchange. Thus, one has to study not only the factors which determine the value of each country's monetary unit, but also the divergent practices and types of exchange resorted to.

6. Heterogeneous World Markets:

In a way, home trade has a homogeneous market. In foreign trade, however, the world markets lack homogeneity on account of differences in climate, language, preferences, habits, customs, weights and measures etc.

The behaviour of international buyers in each case would, therefore, be different. For instance, Indians have right-hand drive cars, while Americans have left-hand driven cars. Hence, the markets for automobiles are effectively separated. Thus, one peculiarity of international trade is that it involves heterogeneous national markets.

7. Factor Immobility:

Another major difference between internal and international trade is the degree of immobility of factors of production like labour and capital which is generally greater between countries than within the country. Immigration laws, citizenship qualifications, etc., often restrict international mobility of labour. International capital flows are prohibited or severely limited by different governments.

Advantages of International Trade:

The following are the major gains claimed to be emerging from international trade:

(1) Optimum Allocation:

International specialisation and geographical division of labour leads to the optimum allocation of world's resources, making it possible to make the most efficient use of them.

(2) Gains of Specialisation:

Each trading country gains when the total output increases as a result of division of labour and specialisation. These gains are in the form of more aggregate production, larger number of varieties and greater diversity of qualities of goods that become available for consumption in each country as a result of international trade.

(3) Enhanced Wealth:

Increase in the exchangeable value of possessions, means of enjoyment and wealth of each trading country.

(4) Larger Output:

Enlargement of world's aggregate output.

(5) Welfare Contour:

Increase in the world's prosperity and economic welfare of each trading nation.

(6) Cultural Values:

Cultural exchange and ties among different countries develop when they enter into mutual trading.

(7) Better International Politics:

International trade relations help in harmonising international political relations.

(8) Dealing with Scarcity:

A country can easily solve its problem of scarcity of raw materials or food through imports.

(9) Advantageous Competition:

Competition from foreign goods in the domestic market tends to induce home producers to become more efficient to improve and maintain the quality of their products.

(10) Larger size of Market:

Because of foreign trade, when a country's size of market expands, domestic producers can operate on a larger scale of production which results in further economies of scale and thus can promote development. Synchronised application of investment to many industries simultaneously become possible. This helps industrialisation of the country along with balanced growth.

Disadvantages of International Trade:

1. Exhaustion of Resources:

When a country has larger and continuous exports, her essential raw materials and minerals may get exhausted, unless new resources are tapped or developed (e.g., the near-exhausting oil resources of the oil-producing countries).

2. Blow to Infant Industry:

Foreign competition may adversely affect new and developing infant industries at home.

3. Dumping:

Dumping tactics resorted to by advanced countries may harm the development of poor countries.

4. Diversification of Savings:

A high propensity to import may cause reduction in the domestic savings of a country. This may adversely affect her rate of capital formation and the process of growth.

5. Declining Domestic Employment:

Under foreign trade, when a country tends to specialize in a few products, job opportunities available to people are curtailed.

6. Over Interdependence:

Foreign trade discourages self-sufficiency and self-reliance in an economy. When countries tend to be interdependent, their economic independence is jeopardised. For instance, for these reasons, there is no free trade in the world. Each country puts some restrictions on its foreign trade under its commercial and political policies.

UNIT -III

Barriers to Trade

3. What are the barriers to international trade?

International trade is carried out by both businesses and governments—as long as no one puts up trade barriers. In general, trade barriers keep firms from selling to one another in foreign markets. The major obstacles to international trade are natural barriers, tariff barriers, and nontariff barriers.

Natural Barriers

Natural barriers to trade can be either physical or cultural. For instance, even though raising beef in the relative warmth of Argentina may cost less than raising beef in the bitter cold of Siberia, the cost of shipping the beef from South America to Siberia might drive the price too high. *Distance* is thus one of the natural barriers to international trade.

Language is another natural trade barrier. People who can't communicate effectively may not be able to negotiate trade agreements or may ship the wrong goods.

Tariff Barriers

A tariff is a tax imposed by a nation on imported goods. It may be a charge per unit, such as per barrel of oil or per new car; it may be a percentage of the value of the goods, such as 5 percent of a \$500,000 shipment of shoes; or it may be a combination. No matter how it is assessed, any tariff makes imported goods more costly, so they are less able to compete with domestic products.

Protective tariffs make imported products less attractive to buyers than domestic products. The United States, for instance, has protective tariffs on imported poultry, textiles, sugar, and some types of steel and clothing, and in March of 2018 the Trump administration added tariffs on steel and aluminum from most countries. On the other side of the world, Japan imposes a tariff on U.S. cigarettes that makes them cost 60 percent more than Japanese brands. U.S. tobacco firms believe they could get as much as a third of the Japanese market if there were no tariffs on cigarettes. With tariffs, they have under 2 percent of the market.

Arguments for and against Tariffs

Congress has debated the issue of tariffs since 1789. The main arguments *for* tariffs include the following:

- Tariffs protect infant industries. A tariff can give a struggling new domestic industry time to become an effective global competitor.
- Tariffs protect U.S. jobs. Unions and others say tariffs keep foreign labor from taking away U.S. jobs.
- Tariffs aid in military preparedness. Tariffs should protect industries and technology during peacetime that are vital to the military in the event of war.

Definition of Global Trade

Global trade, also known as international trade, is simply the import and export of goods and services across international boundaries.

Goods and services that enter into a country for sale are called **imports**. Goods and services that leave a country for sale in another country are called **exports**. For example, a country may import wheat because it doesn't have much arable land, but export oil because it has oil in abundance.

A fundamental concept underlying global trade is the concept of **comparative advantage**, developed by David Ricardo in the 19th century. In a nutshell, the doctrine of comparative advantage states that a country can produce some goods or services more cheaply than other countries. In technical terms, the country is able to produce a specific good or service at a lower opportunity cost than others.

An **opportunity cost** is the benefit one gives up in making an economic choice. The classic example is guns and butter - domestic investment over defense spending. The more guns you produce, the less funds are available to invest in public schools and infrastructure, for example. The more you invest in the domestic economy, the less you can spend on defense.

Advantages

Let's say that England produces more wheat per man-hour than Portugal, and Portugal produces more wine per man-hour than England. Consequently, England has a comparative advantage in producing wheat, and Portugal has a comparative advantage in producing wine. In other words, England's opportunity costs for the production of wheat is lower than for the production of wine, and Portugal's opportunity costs are lower for the production of wine than for the production of wheat. Thus, England is better off producing wheat, selling it to Portugal and buying its wine from Portugal. Portugal, on the other hand, is better off selling its wine to England and buying its wheat from England.

What can we learn from this example? Global trade allows for specialization and lower costs to consumers. Countries can focus on what they are best suited to do - engage in activities with the lowest opportunity costs for them. Focusing on their comparative advantages means they can maximize production and efficiency, which leads to greater potential for profit and economic growth.

Global trade can create economic wealth on a global scale as each country maximizes its revenue and growth by focusing on what it does best and saving money on imports that would be more costly for it to produce domestically. A country generates revenue from exporting the excess goods and services that its domestic market doesn't need to other countries that have a different comparative advantage. The money it receives from the exports can then be used to import goods and services it does not produce from the countries that have a comparative advantage in the production of those goods and services - just like England and Portugal trading wine and wheat, but on a global scale with countless products and services.

Global trade can also reduce international conflict and war. It may not make intuitive sense at first glance, but think about it for a moment. Global trade creates long-term mutually beneficial relationships or a symbiosis. If you start a war with someone who provides you needed goods, such as wheat or oil, you may have just shot yourself in the foot. In other words, global trade cultivates cooperation rather than conflict.

CPA College

UNIT - IV

Balance of payments

Maintaining a *balance of payments* with the rest of the world is a **macro-economic objective**. In simple terms, if the balance of payments *balances*, then the combined receipts from selling goods and services abroad, and from the return on investments abroad, equals the combined expenditure on imports of goods and services, and investment income going abroad.

The balance of payments is also an official account of international payments, published in a document called the **Pink Book**. Statistics on UK imports and exports have been gathered in the UK since 1687.

As an official record, the balance of payments is broken down into two basic accounts – the current account, and the capital and financial account.

The current account

The current account is made up of the following payments:

Trade in goods

These items include the import and export of finished goods, such as cars, and computers; semi-finished goods, such as parts and components for assembly, and commodities, such as oil, tea and coffee.

Trade in services

Trade services include financial services, tourism, and consultancy.

Income from investment and employment

Investment income refers to any income made from investing abroad, and includes profits, such as those from business activities of subsidiaries located abroad; interest received from UK financial investments and loans abroad, and dividends from owning shares in overseas firms.

Payments to individuals who are residents of a country, and are employed in another, are also included in the current account. Investment and employment income are also known as 'primary income'.

Transfers

The final section of the current account includes transfer payments (transfers) arising from gifts between residents of different countries, donations to charities abroad, and overseas aid. Transfers are also known as 'secondary' income.

The Capital and Financial Account

The Capital and Financial Account records the flows of capital and finance between the UK and the rest of the world. Types of flow include:

1. *Real foreign direct investment* (FDI), such as a UK firm establishing a manufacturing facility in China. Direct investment refers to investment in an enterprise where the owners or shareholders have some element of control of the business.
2. *Portfolio investment*, such as a UK investor buying shares in an existing business abroad. With portfolio investment, the investor has no control over the enterprise.
3. *Financial derivatives* are any financial instrument whose underlying value is based on another asset, such as a foreign currency, interest rates, commodities or indices.
4. *Reserve assets* are foreign financial assets that are controlled by monetary authorities – namely the Bank of England. These assets are used to finance deficits and deal with imbalances. Reserve assets include gold, Special Drawing Rights, and foreign exchange held by the Bank of England.

This process is often called official financing.

Net errors and omissions

In theory, the Capital and Financial Account balance should be equal and 'opposite' to the Current Account balance so that the overall Account balances, but in practice this is only achieved by the use of a balancing item called net errors and omissions. This device compensates for various errors and omissions in the balance of payments data, and which brings the final balance of payments account to zero.

Financing deficits and surpluses

The financing of a deficit is achieved by:

1. Selling gold or holdings of foreign exchange, such as US dollars, yen or euros, or:
2. Borrowing from other Central Banks or the **International Monetary Fund (IMF)**.

A surplus will be disposed of by:

1. Buying gold or currencies.
2. Paying off debts.

CPA College

UNIT -V

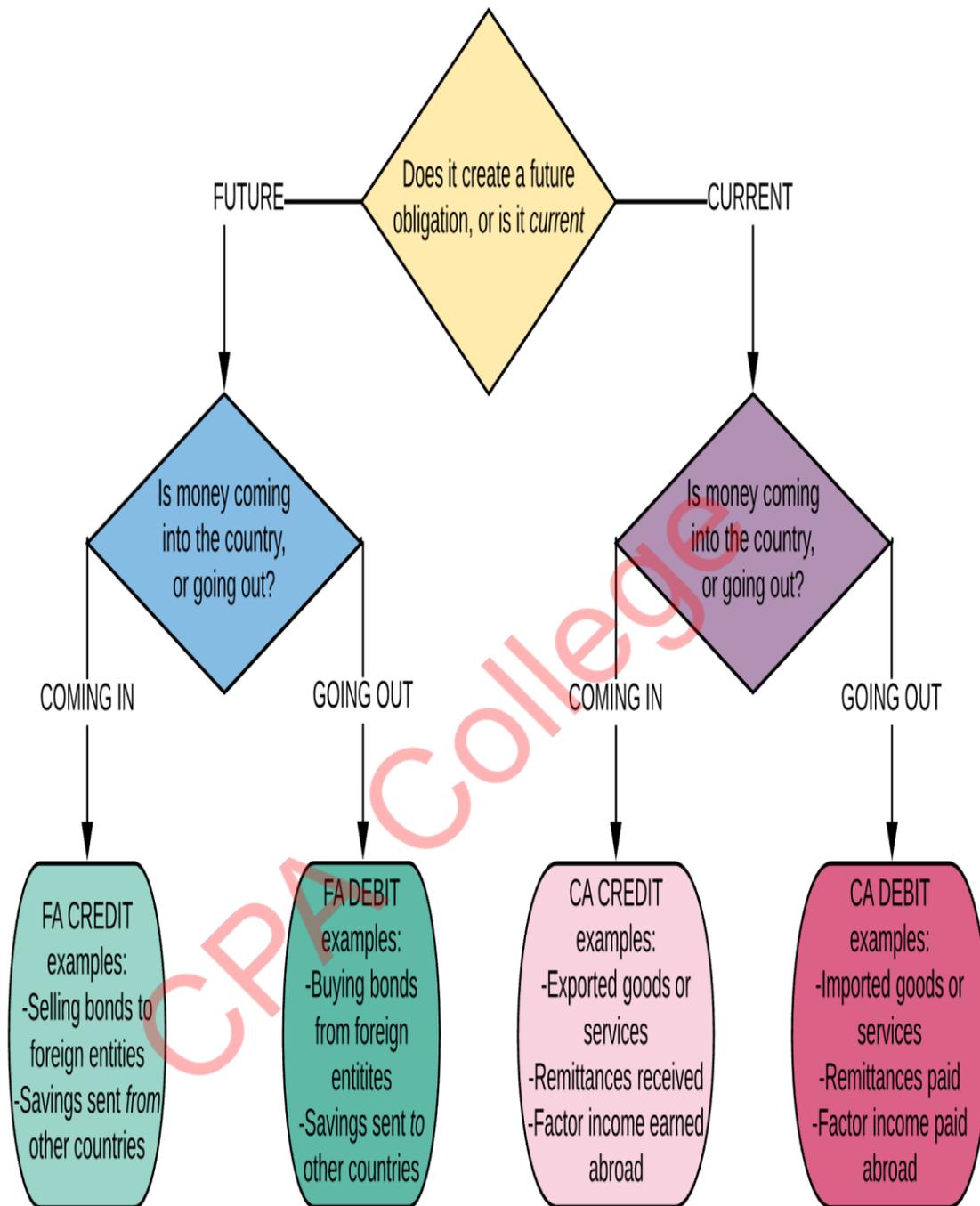
The current account (CA) and capital and financial account (CFA) records transfers and purchases between countries

The balance of payments is a system of recording transactions that happen between countries. Any movement of money into, or out of, a country has to be accounted for. We can use this flowchart to figure out where a transaction should go:

Trade deficits and surpluses in the balance of payments

A trade surplus exists if a country exports more than it imports. A trade deficit exists if a country exports less than it imports. To see how each of these situations impacts the balance of payments, let's start with a simplified example of Panem's balance sheet.

- The capital that is being sent to and from countries in the capital and financial account is *financial capital*, not physical capital. Whenever you use the word capital, it's good practice to specify the kind of capital you are talking about. If you are talking about the stock of physical equipment that can lead to economic growth, say "physical capital." If you are talking about the flow of financial assets between countries, say "financial capital."
- Many people assume that a trade deficit is bad. CACAC, A deficits aren't necessarily bad because a country can consume more goods than they could produce domestically. However, deficits do create a future liability that will eventually need to be paid.



There are two categories in the BOP: the **current account (CA)** and the **capital and financial account (CFA)**. If a transaction creates a liability, like selling a bond to another country, that gets counted in the capital and

financial account. But if a transaction doesn't create a liability (like the fancy red cars), the transaction gets counted in the current account.

Anything that occurs in one account is offset by the opposite happening in the other account. For example, if the current account increases by $\$100$, the capital and financial account must decrease by $\$100$. The fact that an entry in the current account is offset by an entry in the capital and financial account creates the mathematical identity:

$$CA = -CFA$$

Economic growth and trade

In the UK, there is a strong connection between a growing economy and trade deficits. Soon after the economy went into recession in 1990, the trade deficit began to fall quickly. However, as the economy came out of recession and into a period of strong growth from 1993, the trade deficit began to rise quickly, and continued to rise through the next 15 years. It is likely that the recession that started in late 2008 will cause the deficit to fall back, as indeed the above table indicates.

Causes of a current account deficit

There are several possible causes of a persistent current account deficit, including the following:

Excessive growth

If the economy grows too quickly, and rises above its own *trend rate*, which in the UK is around 2.5%, then domestic output (AS) may not be able to cope with domestic aggregate demand.

High export prices

High export prices will occur if a country's **inflation** is higher than that of its competitors, or if its currency is over-valued which will reduce its price **competitiveness**.

Non-price factors

Non-price factors can discourage exports, such as poorly designed products, poor marketing or a worsening reputation for reliability.

Poor productivity

An economy might not be producing enough from its scarce factors of production. Labour productivity, which is defined as output per worker, plays an important role in a country's competitiveness and trade performance, and the UK has suffered from poor productivity. The *productivity gap* is the gap between the UK's relatively poor productivity performance and that of the UK's leading competitors.

Low levels of investment in real capital

This could be caused by excessive long-term interest rates, or low levels of research and development.

Low levels of investment in human capital

This involves a lack of investment in education and training, which reduce skill levels relative to competitor countries and force countries to produce low value exports.