29/04/24

9. International Trade

Unit - 1 Theories of International Trade

International trade is the exchange of goods, services, capital between countries.

Advantages	Disadvantages
1. Economic Efficiency {Less COP} • Economic Growth • Economies of Large Scale Production	1. Negative for labour market {Tech ↑ Labour ↓}
2. Access to new markets	2. May not always be beneficial to both
3. Technological Innovation {R&D}	3. Stress on exports by which natural resources are exploited
4. Increased Employment, Standard of Living ↑	4. -ve effect on domestic market.
5. Utilisation of Resources	5. May create Rivalry among countries
6. Trade strengthens bonds	

Important Theories of International trade.

1. Mercantilist's View
2. Absolute Advantage
3. Comparative Advantage
4. Heckscher-Ohlin Theory
5. New Trade Theory

1. Mercantilist's View :- {old view}

→ Policy of Western European Countries based on premise that National Wealth & Power are best served by increasing exports and collecting precious metals in return.

→ More metals {Gold & Silver}, richer the country is
species

→ Exports ↑ Imports ↓

→ This view argues that trade is a zero(0) sum game.

2. Absolute Advantage Theory :- {Adam Smith} → Labour

Commodity	Country A	Country B
Wheat [Bushels / hour]	6	1
Cloth [yards / hour]	4	5

★ Export your strength, import your weakness!

→ According to Adam Smith, International trade is not a zero(0) sum game. It states that a country will specialise in production & export of a Commodity in which it has absolute advantage.

→ In other words, exchange of goods between 2 countries will take place only if each of two can produce one commodity at an absolute low production cost than other.

Advantage	Disadvantage
1. Gains to both countries	1. Too simple {considered only labour}
2. Consider importance of division of labour.	2. Labour is considered as only factor input.
3. Global output is maximised	

Major Assumptions :

-> No Transportation Cost

-> Labour is mobile

-> Talks about 2 countries.

3. Theory of Comparative Advantage :- {Labour} * opportunity costs

Commodity		Country A	Country B
Wheat	{Bushels /hour}	6	1
Cloth	{yards /hour}	4	2

Here Country A has adv. in both commodities } 6 : 1 {Wheat}
" " B " dis adv " " " 2 : 1 {Cloth}

Comparatively Wheat has higher absolut adv. so export wheat import yard

-> David Ricardo :- 1817, "Principles of Poltical Economy & Taxation"

-> As per this theory, both nations can gain if Country A exports wheat and imports cloth from B.

{Douglas Irwin (2002)} = Glad News

4. Hecksher - Ohlin Theory of Trade

-> Eli Heckscher, Bertil - Ohlin

-> Modern theory of Trade / Factor Endowmen Theory

-> Labour & Capital {focuses on}

Labour Abundant Country	Capital Abundant Country
-> Cheaper to produce Labour Intensive Goods.	-> Cheaper to produce Capital Intensive Goods
-> Export LG & Import CG	-> Export CG & Import LG

5. New International Trade Theory : {Krugman}

-> Theory of 1970's
-> Supported by Krugman
-> 2 benefits from NTT

(a) Economies of Scale {Supply Side} Production ↑ COP ↓
(b) Network Effect {Demand Side} Bandwagon Effect = Dekha dekhi

* It mainly says that this is a practical theory, no country produces only labour or only capital. A country gets less than optimum only.

Pare to optimum -> best for all

Unit: 2 → Instruments of Trade Policy

Tariffs: Also known as custom duties are taxes (or) duties imposed on goods & services which are imported (or) exported

Types of Import Tariffs:

- Based on calculation
- Based on Intension of levy
- Based on Response to Trade practices
- Based on Arrangements & Agreements

I **Based on Calculation** ~~Steel~~ ↑ ~~Expense~~ ↓

1. **Specific Tariff:** Fixed Amount of Tax per unit. Eg:- ₹4,000/bicycle

2. **Ad-Valorem Tariff:**- Fixed as a percentage. Eg:- 10%/bicycle

[or]

3. **Mixed Tariff:**- Eg:- Taxes will be 20% of value (or) ₹5,000 whichever is ~~less~~, higher
{Either expressed as % (or) expressed as value that benefits nation}

[and]

4. **Compound Tariff:**- Both specific & Ad-Valorem
[Taxes will be 20% of value and ₹5000]

5. **Technical Tariff / other Tariff:**- Calculated on basis of specifics contents of the imported goods.

Solar	Converter
10%	5,000

→ Battery

~~Quota = Qty Restriction~~

6. **Tariff Rate Quotas** Combines Tariff & Quota. These Imports under specified Portions or upto specific units of inputs are charged at lower rate and above that tax is increased.

II Based on intension of levy:

1. Variable Tariffs:- A duty fixed to bring the price of an imported commodity upto domestic support price.

USA → 100
India → 150
Ind Govt. will impose ₹50 on USA
So that local producers are safe

2. Escalated Tariffs:-
System where in tariff rates on imports of manufactured goods are higher that tariff rates on raw material.
Eg:- 4% Tax on iron ore, 12% Tax on steel.

3. Prohibitive Tariffs:- Tariffs are set way to high to restrict imports.

III Based on Response to Trade Distortions:-

1. Anti-dumping duty:- Dumping occurs when manufacturers sell goods in foreign country @ less than the CP in their domestic market.
To save domestic producers, Anti-dumping duty is levied.

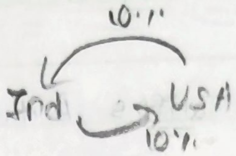
2. Countervailing Duties:- Tariffs that aim to offset the artificially low prices charged by exporters who enjoy export subsidies & tax concessions

A ← Exports at very cheap rate ← B
Ind — USA ↺ Gives subsidy to Export
↓
levy tariffs to cancel subsidy

3. Safe guard Duties:- Duty levied to avoid import of increased quantities
If 1 & 2 aren't enough then 3 is levied

IV Based on Arrangements & Agreements

1. **Most favoured Nation Tariff :-**



Who is MFN? → Every country which is a member of WTO

It is the highest rate that WTO members can charge on each other.

2. **Preferential Tariff :-** Here a low tariff arrangement is mutually decided between 2 or more countries.

3. **Bound Tariff :-** A tariff which a WTO member binds itself with a legal commitment, not to raise it above a certain level.
Eg:- In WTO it is decided that India can't charge >20%.

4. **Applied Tariff :-** The tariff actually charged which is below bound tariff is applied tariff.

5. **Import subsidies :-** = -ve import tariff i.e giving subsidies on imports in case of highly essential commodity.

Effects of Tariffs

1. It creates barriers which reduces imports
2. It makes importing goods more expensive
3. It increases govt. revenue (of importing country) till value of Total tariff.

* Non-Tariff Measures (NTM)

Anything other than tariff that effects imports (or) exports it is NTM.

NTM

- Technical
  - Technical barriers to Trade [TBT]
  - Sanitary & Phytosanitary [SPS] Measures
- Non-Technical
  - Quotas
  - Govt. Policies
  - TRIM
  - Post sales services Restrictions
  - Distribution Restrictions

Technical ~~Barriers~~ Measures

1. Sanitary & Phytosanitary Measures :- Prohibiting certain goods like poultry hens because it might cause flew in country, (or) setting limits for pesticides in foods. These measures protect humans, animals, plants.

2. Technical Barriers to Trade :- It refers to "Mandatory Technical Regulations" that define the characteristics of a product should have.

   Eg:- Size, packing, design.

   (They set standards and the product must comply with them)

Non - Technical Measures :-

1. Import Quotas :- Maximum Quantity which is to be imported is fixed

(i) Absolute Quota :- Max. Qty is fixed (unconditional)
(ii) Tariff - Rate Quota :- Can import only certain Qty . or else tariffs.

2. Price Control Measures :- These are known as para-tariff measures where the lower prices of imported goods are made higher so that local goods can compete.

3. Non-automatic Licensing and Prohibitions :- For certain commodities Govt may impose the condition of mandatory license in order to reduce imports. Eg :- Alcohol, Arms etc.

4. Finance Measures :- Make advance payment to imported country or else no import

5. Measures Affecting Competition :- Only selective people are given import rights.

6. Govt. Procurement Policies :- Govt. may give preference to local tenders rather than foreign ones.

7. Trade Related Investment Measures (TRIMs) :- Mandating that certain portion (or) fraction of a commodity must be produced domestically.

8. Distribution Restrictions :- You can import but the places of selling will be restricted.

9. Restriction on Post-sale Services :- You can import but post-sale services will be provided by India.

S-3

10. Embargo :- Completly banning a commodity. [Most Extreme form of Trade barrier]

Export Related Measures : Things that export country will apply.

-> To reduce exports, exporting country may ban exports. This is done in case of shortage in exporting country.

-> Export Taxes :- Intends to reduce exports and increase domestic supply and hence there is a reduction in price.

-> Export Subsidies & Incentives :- Exporting country's Govt. is happy about exports and allow subsidies so that they can earn foreign exchange.
Duty drawback -> When we are uncertain about the buyer of exporting goods Govt. charges taxes but when sold, these taxes are returned back.

-> Voluntary Export Restraints :- Temporary Restriction [Quota]
It prescribes max. Qty that can be exported which is generally based on Political Considerations.

Ex:- Any Export to Maldives from India for next 5 years limited to 100 units and if exceeded then Tariff.

Unit - 3 Trade Negotiations

RTA -> Regional Trade Agreement

-> Grouping of countries formed with the objective of reducing barriers to trade with them.

Types of Trade Agreements:

1. Uni-lateral Trade Agreements :- Importing country gives incentives (+ve measures) to exporting country to export so that their economy strengthens.
   Eg:- During Russia-Ukraine war, India promoted oil purchase from Russia

2. Bi-lateral Agreements :- Agreement which sets rules of trade between two countries. Eg:- EU-SA Free Trade Agreement
   EU -> European Union & SA -> South Africa

3. Regional Preferential Trade Agreement :- Reduce trade barriers between countries for only members' of the group (or) specific region.
   Eg:- SAARC -> South Asian Association for Regional Cooperation
   GSTP -> Global System of Trade Preferences

4. Trading Bloc :- Group of countries that have free trade agreement between themselves and may apply a common tariff on other countries. (India)
   Eg:- EFTA -> European Free Trade Association

5. Free Trade Area :- Group of countries that have free trade agreement between themselves and apply independent tariff rates on non-member countries.
   NAFTA -> North American Free Trade Area
   AIFTA -> ASEAN - India Free Trade Area
   ASEAN -> Association of SouthEast Asian Nations.

6. Customs Union :- Group of countries that eliminate all tariff on trade among themselves but maintain a common ~~seal~~ external tariff on trade with ~~ot~~ countries outside India. Eg :- GCC -> Gulf Cooperation Council.

7. Common Market :- Allowing free output of factors of production of group of countries and eliminating tariffs between them. Also, they set common ~~se~~ external tariffs for non-members.

8. Economic & Monetary Union :- Common currency between Countries.
Eg :- EU -> European Union

GATT -> General Agreement on Tariffs & Trade

-> 1948 - 1994 (operative form)
-> Its responsibility was Council for Trade in goods -> 10 committees
-> It lost its relevance in 1980's because :-

Treaty -> binds international laws

Agreement -> follows specific conduct (domestic)

- Fast evolving economies due to globalisation
- Expansion of International investments.
- Service sector wasn't covered by GATT
- It wasn't such organisation to deal with many no. of issues
- Agricultural trade liberalisation wasn't successful.

WTO → World Trade Organisation

→ Outcome of Uruguay Round
→ 1st July 1995 (DOB)
→ Initially → 123 countries (members)
→ Now → 164 countries (members)

Objectives of WTO

→ Raise standard of living
→ Ensuring full employment and rise in aggregate demand or Effective Demand.
→ Expanding production, trade in goods & services.

HeadQuarter → Geneva [Switzerland]

~~Structure of WTO~~ Structure of WTO

Level 1	Level 2	Level 3
Ministerial Conference [Any multilateral trade related discussion]	General Council [Trade Disputes]	[Goods Council, Service Council, Intellectual Property] Report to General Council & Responsible for implementing WTO rules.

TRIPS :- Trade Related Intellectual Property rights (Part of level 3)

Last level committee (working group)

→ Deal with membership application, environment related issues etc.

The DOHA Round :-

- A.K.a → Doha development Agenda
- 9th round since WW2
- November, 2001 → 4th Ministerial Conference in Doha, Qatar
- Lowering trade barriers and revise trade rules.
- Includes 20 areas of trade (including NAMA → Non-agricultural market access)
- Most controversial topic in Doha round → Agricultural trade.

The Guiding Principles of World Trade Organisations (WTO)

1. Most favoured Nation (MFN) :- Members must treat all other members equally
India gives some adv. to Bangladesh, (if both are members of WTO)
then India must give same adv. to other members as well

2. National Treatment :- Once the foreign goods are imported, Govt. cannot restrict to sell or buy only local goods. They must treat local & foreign goods equally.

* Free trade : Gradually, through negotiation
Lowering trade Barriers
Progressive liberalisation → Developing countries are given more time to fulfill their obligations.

* Predictability : through binding & transparency

Foreign companies should be confident, the trade barriers should not be raised arbitrarily (suddenly)

* **Promoting fair Competition**

WTO promotes free competition. Eg :- In India import taxes for Russia - 10%, USA - 20% } Unfair ✗

* **Encouraging development and Economic Reform**:

WTO's aim must be to convert developing economies to developed ones.

-> * There must be a transparency in decision making.
-> * Dispute Settlement Mechanism.
-> * Environment Protection to take place.

WTO Agreements

1. **Agreement on Agriculture** aims to improve agricultural trade and strengthen GATT disciplines
   -> Market Access
   -> Domestic Support
   -> Export Subsidy

2. **Agreement on Sanitary and Phytosanitary (SPs) Measures** says that govt. must prove that the products importing can cause harm. Govt. can't be unjustifiable.

3. **Agreement on Textile and Clothing** says fibre and clothing must be implemented.

4. **Agreement on Technical Barriers to Trade (TBT)** A country cannot say that particular commodity doesn't comply with its standards. That is why international standards are established.

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5. **Agreement on TRIMS** :- It must not effect foreign investment of a country.

6. **Anti-Dumping Agreement** :- Proper investigations will be made for false claims of Anti-Dumping

7. **Customs Valuation Agreement** :- The mechanism of valuing import taxes must be as per international valuation system.

8. **Agreement on Pre-Shipment Inspection (PSI)** :- There will be a inspection of goods exported in exporting country before shipment by importing country

9. **Agreement on Rules of Origin** :- Certificate of origin must be issued which contains that where the goods are made.

10. **Agreement on Import licensing Procedures** :- No much import licensing ~~are~~ should be there.

Unit - 4 Exchange Rate and Its Economic effects

It refers to money denominated in a currency other than domestic currency.

Why we need foreign currency?

- Buy assets
- Pay liabilities
- Tourism
- Other Expenses

Exchange Rate Regimes

System used for computing exchange rate. These are 3 main categories.

- Free Float Rate
- Managed Float Rate
- Fixed Float Rate

1. Free Floate Exchange Rate :- Here exchange rate is entirely decided by market forces i.e, demand & supply. {Unpredictable & Self-regulated} There is no major control by Govt./RBI.

2. Managed Float Exchange Rate :- Here Govt. fixes the intervals / limits both upper & lower for Exchange Rate. Here Exchange rate can freely fluctuate between limits and Govt. interferes only when Exchange rate crosses limits.

3. Fixed Exchange Rate :- The govt. fixes a fixed Exchange Rate (with RBI)

Advantages :

→ Lesser fluctuations.

→ More trade & Investments

Direct Quote & Indirect Quote

	Direct Quote	Indirect Quote
1.	1 unit of foreign currency = No. of units of local currency.	1. Unit of local currency = No. of units of foreign currency.
2.	$1 = ₹80	₹1 = $0.0125
3.	Also called European Currency Quotation	Also called American Currency Quotation
4.	Foreign Currency = Base currency Domestic " = Counter "	Domestic Currency = Base currency Counter " = Foreign currency.

Peg :- Fixing of exchange rate by government.

How Govt fluctuates Exchange rate?

Maggie

1 Pckt. = ₹10 → ₹15

Create Excess demand to make ₹10–₹15

$1 = ₹50 Govt can create Excess demand for $ to make $1 = ₹80

$ = ₹80

Govt. can start selling foreign currency to increase supply to reduce $ value.

Exchange Rate

- Nominal [Doesn't consider inflation effect]
- Real [Does consider inflation effect]

Nominal Exchange Rate = $1 = ₹56
Price Index in India = 116
Price Index in USA = 112
Real Exchange Rate = ?

$$\text{Real ER} = \text{Nominal ER} \times \frac{\text{Domestic PI}}{\text{foreign PI}}$$

Real Exchange rate describes "how many units" of good (or) service in one country can be traded for 'one unit' of that good (or) service in a foreign country.

Foreign Exchange Market

The collection of markets & institutions that handle the exchange of foreign currency is foreing exchange market.

Participants :-

-> Central Banks
-> Commercial Banks
-> Govt.
-> foreign Exchange dealer
-> MNC's
-> NBFC
-> Speculators

2 types of transactions :

-> Current / spot transaction

Give ₹80 and buy $1 today

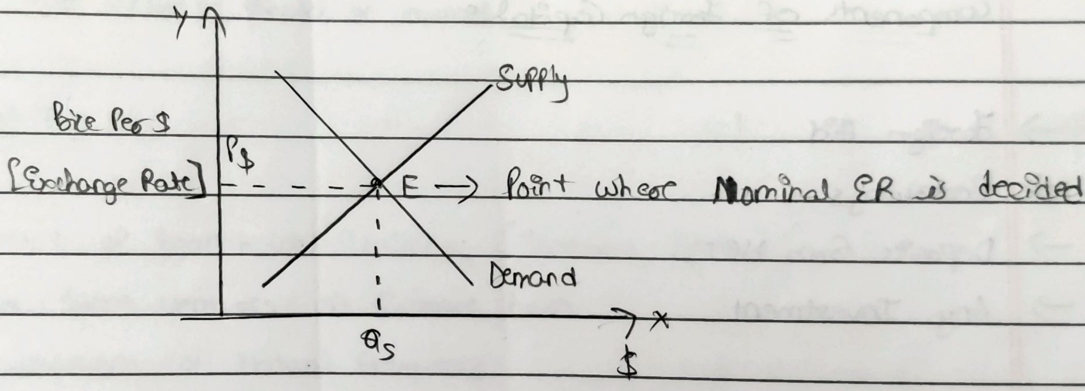
-> Forward / future transaction

Decide to fix $1 = ₹80 but buy after 3 months because of fear of inflation.

Determination of Nominal Exchange Rate

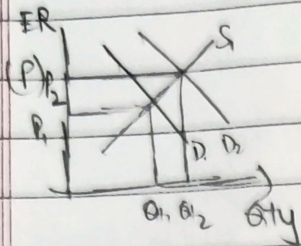
Market forces of demand & Supply

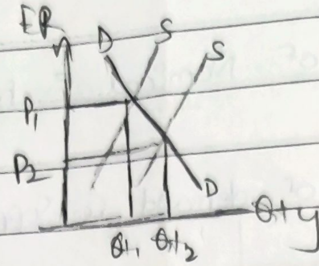
why Demand for FE	why Supply for FE
→ Purchase of goods & Services	→ Sell of goods & services
→ Gifts, Grants	→ Gifts, Grants
→ Purchase assets, Shares	→ Sell assets, shares



Depreciation	Devaluation
Decrease in currency's value due to Market forces under a "floating exchange rate" system.	It is a deliberate (wantedly) downward adjustment in value of country's currency in fixed Exchange rate system
Cause Demand FE ↑ $1 = ₹75 ⇒	$ = ₹80 Supply

Appreciation	Revaluation
Rise in value of domestic currency under floating exchange rate system	Deliberate upward adjustment under Fixed exchange rate system.
Cause Supply FE ↑ $1 = 75 ⇒	$1 = 69





Unit-5 International Capital Movements

The term foreign Capital includes any inflow of capital into the home country from abroad.

Components of foreign Capital :

- Foreign Aid
- Borrowings
- Deposits from NRI's
- Any Investment

Investments

Foreign Direct Investment [FDI]

≥ 10% Shares

Purpose of directly controlling the business administration

Foreign Portfolio Investment [FPI]

< 10% Shares

Purpose of investment in shares.

Foreign Direct Investment (FDI)

→ It is a process where the resident of one country (i.e, home country) acquires the ownership of asset in another country (i.e host country).

→ This involves ownership, control & management of asset in host country.

→ These are real investments in factories, asset, land, inventories.

Characteristics :

→ Long term relationship

→ 10% (or) more shares should be owned

Forms of FDI :-

- Establishment of branch (or) Subsidiary (Facebook India).
- Creation of Joint ventures on Contract basis.
- Joint Development of Natural Resources
- Purchase of company in the country receiving foreign capital. (Vodafone acquired Hutch)

Types of FDI :-

Horizontal FDI	Vertical FDI	Conglomerate FDI
Investor establishes same type of business operation in a foreign country as it operates in home country. Eg:- Amazon, Microsoft.	Investor establishes (or) acquires a business activity in a foreign country which is different yet supplements its major activity. Eg:- Tesla → cars ↓ Acquires Air bag Co.	Investor makes a foreign investment in a business i.e unrelated to its existing business in home country. Eg:- Tesla buying Lenskart

Foreign Portfolio Investment

FPI is the flow of 'financial capital' rather than 'real capital' and does not involve ownership (or) control by the investor.

Eg:- Purchase of shares of Reliance Industries by Elon musk

* -> Stake Ownership <10%

Mode of FPI : GDR [Global Depository Receipt]
ADR [American Depository Receipt]

	FDI	FPI
1.	Involves creation of Real Assets [Physical assets]	Involves investment in financial assets
2	Voting Share ≥ 10%	Voting share < 10%
3.	Long term interest	Short term interest

Reasons of FDI :

- Increasing interdependance among countries
- Internationalisation : When products go global in market
- To enlarge their economies by doing large scale operations
- Direct control due to production knowledge : If expert in one thing, opens
- manufacturing units in other country

Modes of FDI :-

- Opening a subsidiary (or) associate company in a foreign country
- Equity Acquiring a existing company.
- Merging {VI}
- Green field Investment :- New business setting up in foreign as well
- Brown field Investment :- Using infra of host country to set up business

Benefits of FDI :-

1. Creation of a Competitive environment } Business POV
2. New technology & Innovations
3. Variety of goods and services } Customer POV
4. Lower Prices of Goods
5. Accelerates growth & economic development } Economy POV
6. Better workculture.

Problems Associated with FDI :-

1. A large foreign firm may drive out domestic firms from industry.
2. Disturbed pattern of production {Profit motive of investors}
3. Aggressive advertising.
4. Regional disparities will arise {IT only in HYD, BGL, etc} No development.
5. Exploitation of natural resources.

FDI in India

- Outsiders invest in India due to cheap labour & resources.
- India's Max. FDI was in 2020-21. US$ 81,973 million
- 8^{th} rank in largest receipients of FDI (from 9^{th} in 2019).
- Got FDI major share in IT, Tele-comm, Automobile in 2022.