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# CHAPTER- 9 International Trade

## UNIT-1 : Theories of International Trade

(1) The 'Mercantilists' view of International Trade

Export over Import MCQ

- Derived From Mercantile
- Acc to Microsoft Encarta Dis ctionary (2009), merchantile is the economic policy trending in Europe from 16th to 18th Century
- Where Govt used belief that National power is achieved by larger Quantity of Export over Import.

(2) The Theory of Absolute Advantage (Productive Capacity Adv)



- 'Adam Smith' though that absolute Cost Adv was the base of International Trade.
- Trade will be mutually beneficial when one country has absolute adv over other. & vice versa
- No absolute adv means No Trade with Nation.
- Cost of Commodities were computed in hours of Labour MCQ

| | India | China |
|---|---|---|
| wheat | 100kg/h Adv | 80kg/h |
| Rice | 50/h | 70/h Adv |

MCQ & Produce at lower opportunity cost

Labour Theory of value

* Based on hours of Labour

(3) Theory of Comparative Advantage

- David Ricardo, Trade was driven by Comparative (relative) rather than absolute,
- One Country may be productive in all the goods than other.
- Country Can still Trade by Exporting product in which Absolute Adv was greatest.
- It is not a 'Zero Sum Game', it gives mutual Benefits
- It is "Good News" for Economic Development

(4) The Heckscher - ohlin Theory of Trade (Modern Theory)

MCQ

- Above, identified the role of Labour & Capital, (Factor endowment), as an advantage.
- Country should Export the Product, whose Production is done through Factor that is abundant in economy.
- Based on 'Money Cost'

'Competition for Market share' is a Zero Sum Game

## (5) Globalization & New International Trade Theory (NTT)

- Acc to NTT, two key concept give $\boxed{\text{Adv}}$ to countries while Trade

1) Economies of Scale ÷ More Production, Lower Per UNIT Cost.

2) Network effect ÷ ('Bandwagon Effect' Value for Goods & Service for one is affected by other consumer.)



| Theory of Trade | New Theory of Trade |
|---|---|
| Based on labour & Cap | Not Based on labour |

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## UNIT - 2 Instruments of Trade Policy

- Trade Policy Encompasses all instruments that Govt may use to Promote or Restrict import & Export.

- Instrument used by Govt to Restrict Import & Encourage Export is Price related Measures

Price related Measures → Tarrif, Non Tarrif (NTM)

Price Related Measures → Tariffs

Non Tarrif

### Forms of Import Tariff

1) Specific Tariff ÷ Fixed Amount of Money (or Currency, Per unit of good), Per Unit or according to weight or Measurement.

unit

* Since the Value of Commodity is not Involved

2) Ad Valorem Tariff ÷ Fixed Percentage of the Value

### Other Types

a) Mixed Tariff ÷ Specific or Ad Valorem, Any One which Generate More Income To Govt.

b) Compound Tariff ÷ Specific and Ad Valorem

b) Technical/other ÷ On the basis of Specific Contents, its Component or related items.

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Fixing Limit

c) Tariff Rate Quotas ÷ Combine two instrument, quotas + Tarrif.
Importing under Quota, Low Tarrif & Vice Versa

* d) Most Favoured Nation Tarrif ÷ Highest / Maximum / Most Restrictive Rate a Member of WTO charge to each other.

Highest Limit

e) Variable Tariff ÷ Duty fixed to Support Domestic Price for Commodity.

To Save Domestic Commodity

f) Preferential Tarrif ÷ Charging Lower Tariff from the country, which is given Preferential Treatment. Ex - NAFTA

g) Bound Tariff ÷ Legal Commitment of WTO Member not to raise tarrif a rate above a certain Limit.

Promise to not raise rate above a certain Limit

h) Applied Tariff ÷ Tarriff amount less than Bound Tarrif Rate.

RMC

i) Escalated Tariff ÷ Rate on Manufactured Goods are higher than the Rate on Raw Material.

RM M Higher

j) Prohibilitve ÷ Set So high, that no imports can enter.

k) Import Subsidy ÷ i.e. Negative Import Tariff

l) Tariff as Response to $\boxed{\text{Trade Distortions}}$ ÷ Duty imposed to $\boxed{\text{offset}}$ the distortion

Dumping and Export Subsidy

m) Anti Dumping Duties ÷ Tarif To Avoid Dumping Practices

Surplus Production Dump to Another Country

or

Charging Lower Price in other Country for Domestic Product

n) Countervailing Duties ÷ It is equal to Subsidy, allowed by Exporting Govt to Exporter.

## Non-Tariff Measures NTM's

Rokna Influence Control

- It is invisible measure interfere with free Trade
- Non Tariff Measure (NTM) is Diff from $\boxed{\text{NTB (Barrier)}}$
- NTB is subset of NTM
- NTB is 'Protectionist or Discriminatory Intent'
- NTM is broader set of Measure

NTM < Technical / Non-Technical

- Technical ÷ Product specific Property, ensuring Quality, Food Safety, Protection of Biodiversity.
- Non-Technical ÷ Trade Requirements.
  Ex- Shipping, Custom formalities

## Technical Measures

1) Sanitary & Phytosanitary (SPS) ÷ (Only for food) Ban on import of certain Food items that doesn't fulfill the requirements.
   * It Protect Biodiversity

2) Technical Barrier to Trade (TBT) ÷ Both Food & Non Food product.
   Mandatory 'Standard & Technical Regulations'.



## Non Technical

1) Import Quotas ÷ → Binding Quota ÷ Set below Free Trade level
   → Non Binding Quota ÷ Set above Free trade level & had a little effect on Trade.

Types < Absolute [Limiting Quantity & Time] / Tarrif Rate

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☆ Govt Rec No Revenue from Quota, Profit is Rec from the holder of such Import license.

☆ ii) Price Control Measure ÷ 'Minimum Import Price' to Support Domestic product.

Also Known as 'Para-Tariff'.

☆ MCQ

iii) Licensing & Prohibitions

iv) Financial Measures ÷ Define the term of Payment or Advance Payment.

☆ v) Measures Affecting Competition ÷ Govt Imposed, Special Import channels

Intermediaries of Govt

☆ vi) Government Procurement Policy ÷ Govt Specified % of Purchase must be from domestic Firms.

☆ vii) Trade Related Investment ÷ 'Minimum Req of local Content / Local Raw Material Requirement.

viii) Distribution Restrictions ÷ Addition Licence or Certificate Requirement.

ix) Restriction on Post Sale Service – Apple product Service in India is restricted

x) Administrative Procedure ÷ legal Procedure

xi) Rules of Origin ÷ Importer Can give Certificate of origin to get Tax Rebate

xii) Safeguard Measures ÷ Restrict Import to Safeguard Country

xiii) Embargos ÷ Total Ban imposed by govt to Particular Country or region. Due to Political or any other reason.

## Export Related Measures

1) Ban on Exports ÷ During Period of Shortage

2) Export Taxes ÷ Specific or ad valorem

3) Export Subsidy & Incentive

4) Voluntary Export Restraints ÷ Quota limit of Export

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# UNIT-3 Trade Negotiations

RTA — GATT — WTO

* India become Part of 19 such Aggrements & also negotiating more than $\boxed{2}$ dozens of such Proposals.

RTA is the grouping of coun

* Taxonomy of Regional Trade Agreements (RTA's)

Grouping of countries, formed with the objective of Reducing barriers to Trade.

⊛ 1 Feb 2021, 339 RTA's were in Force.

— Trade Negotiation Result in many types of Agreements Like:-



## Types of RTA's

one sided

1) Unilateral Trade Agreement :- Importing country offer incentive to Exporting Country

2) Bilateral Agreements :- Btw two Countries, two Blocs or a Blocs and a country.

3) Regional Preferential Trade Agreement :- Reduce Barriers for member of group

4) Trading $\boxed{\text{Bloc}}$ :- Free Trade for Member of Group & $\boxed{\text{may}}$ Apply a Common External Tariff to other Country.

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5) Free Trade area ÷ Free Trade but Different External Tariff.

Common Tariff 6) A Custom Union ÷ Free Trade & Must Maintain a Common External Tariff

7) Common market ÷ Free Trade & Common External Tariff + Free Flow of Factor of Production.

8) Economic & Monetary Union ÷ Common Market + Common Currency.

MCC market currency common

* The General Agreement on Tariff & Trade (GATT)

- Covers Trade only in Goods
- working of GATT is responsibility of Goods Council
- GATT has 10 Committes
- GATT Lost its Relevance by 1980's

- GATT efforts at liberalizing agriculture was not successful.
- It was not a Treaty

* The Uruguary Round and Establishment of WTO.

The Round was started in Punta del Este in Uruguary in Sept 1986 and was schedule to be completed in 1990 december.

It was Delayed due to, Heated Controversies over,

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agriculture ✯

Finally in Dec $\boxed{1993}$, Uruguay Round, ~~ea~~ $\boxed{8th}$ and most largest round ever of Multilateral trade negotiation in which $\boxed{123}$ country participated was completed after 7 years.

Signed on April 15, $\boxed{1994}$
Took effect on July 1, 1995)

It also marked the Birth of WTO.

## ✱ WTO WORLD TRADE ORGANISATION

– Structure of WTO



WTO Activities are supported by secretariat located in Geneva, headed by director General.

$\boxed{\text{Three Tier System}}$ of Decision Making

1) Ministerial Conference ÷ can take decision on all Matters and meet once every 2 year.

2) General Council ÷ Meets several times a year in Geneva. It acts to review trade policy & Dispute settlement body.

3) Goods Council, Service, Intellectual property (TRIPS) council ÷ report to General Council.

75%

$\boxed{\text{164 Members of WTO}}$, $\boxed{117}$ are Developing Countries.

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* The Guiding Principles of WTO

1) Trade without Discrimination

- Most Favoured Nation [Also has Exception]
- National Treatment [Treating Local Produce & Imported goods equally]

2) Free Trade: Gradually, through negotiation

[Progressive Liberalisation]

3) Predictability: through Binding & Transparency

[Through Bind Tariff & rules convey publically]

4) Promoting Fair Competition

- ~~Subsi~~ - Dumping
  - Export Subsidies [stopping these 2 things through Policies]

5) Encouraging Development & Economic Reforms

* The Doha Round

- It is the 9th Round Since 2nd world war.
- It was launched at WTO's Fourth Ministerial Conference in Doha Qatar, in Nov 2001

- This Negotiation include 20 area's of Trade mainly Agriculture, Services, Non-Agricultural Product,

and intellectual property.
- The most Controversial Topic was Agriculture. *

## * G-20 : Faciliatating Trade

G-20 Economies introduce $\boxed{66}$ New Trade Facilities & $\boxed{47}$ Trade Restrictive Measures.

66 - 47

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# UNIT-4 Exchange Rate & its Economic Effects

* The Exchange Rate Regimes How to Fix

1) Floating or Free or Flexible Exchange Rate System

- Exchange Rate is purely set by Private Market Forces, Thus Demand & Supply

- No Role of Govt & RBI
- Market has the advantage of Self Regulating
- Market has the ability to prevent itself from External shock, By Self Regulation

2) Managed Float System



- Exchange rates are still free to float but, Govt try to influene the rate, if to goes beyond a certain level.

(Ceilling) Highest Rate - 70
(Floor) Lower Rate - 61
[Example, if Rate goes beyond these limit then Govt will enter]

3) Fixed Exchange Rate

- Rate is set by the Govt

1 unit of our currency for other (Direct quote)  __/__/__

## * Nominal v/s Real Exchange Rate

currency to currency

**Nominal** ÷ It is the Rate at which a person can trade the currency of one country for the currency of other.

Ex - 1 dollar = 83 ₹ Thus, $\frac{1}{83}$

Goods & Service

**Real** ÷ It is the rate at which a person can trade goods & services of one country for Goods & Services of other.

2 Bread ₹ of India, 1 Bread of Australia

* Real Rate is the key determinant of Net Exports.



Real Exchange Rate = Nominal Exchange Rate × $\frac{\text{Domestic Price in ₹}}{\text{foreign Price in ₹}}$

Nominal ×

Ex = $\frac{1}{83}$

## * The Foreign Exchange Market

Forex Participants < Commercial Bank, Brokerage houses

Actively influence Price Formation Process. So they are called Market Makers

Types of Transaction in Foreign Market

i) Current or Spot
ii) Future

iii) Forward Exchang Rate ÷ Delivery in Future at Future Rate

• Forward Premium ÷ Forward Exchange Rate > Spot Rate

" Discount ÷ " " " < " "

Currency Futures ÷ Similar as Currency Forward but Differ in nature & Details of settlement & Delivery.



* Most Transaction involve Exchange of Foreign Currencies for the U.S Dollar even when it is not the National Currency.
So, Dollar is often Called "Vehicle Currency"

## (*) Demand For Foreign Exchange

- Purchase Goods
- Unilateral Transfer
- To make Investment
- Purchase Asset
- Open Bank Acc (Foreign Acc)
- Speculation

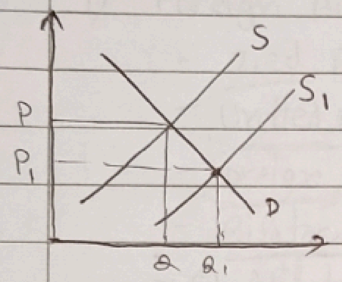
→ Supply side Also have vice verse Reasons

## * CHANGES IN EXCHANGE RATE

1) Appreciation ÷ Currency Appreciate when its value increase in respect to value of other Currency.

1$ = 70

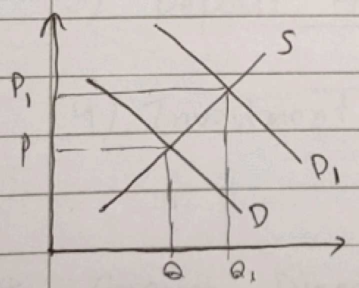
Now, 1$ = 60 / Appreciate




Supply of Foreign Currency ↑
Home Currency Appreciate

2) Depreciation ÷ Currency Depreciate when its Value decrease in respect to value of other Currency.






Demand of Foreign Currency ↑
Home Currency Depriciate

| Devaluation | Depriciation | Revaluation | Appreciation |
|---|---|---|---|
| Due to Govt | Due to Market | By Govt | By Market |
| By Fixed Exchange Rate System | By Floating | By Fixed | By Floating |

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## (*) Impact of Exchange Rate Fluctuations on Domestic Economy.

1) Currency Appreciation, Costly Export, Cheap Import

2) Depreciation, Cheap Export, Costly Import

same Exchange Rate for a given Currency ÷



) Arbitrage Ans

# UNIT-5 International Capital Movements

## * Types of Foreign Capital

- Means any flow of Capital into home Country.
- Movement of Capital & Foreign Investment are Diff thing, Investment is a part of movement of Capital.

1) Foreign Aid
   - Tied Aid ÷ Grants for Specific use
   - Untied Aid ÷ " " use that is not specified
   - Foreign Grants
   - Bilateral Inter Govt Grant
   - Multilateral - By world Bank etc



2) Borrowing

3) Deposit From NRI

4) Investment — FDI - In Industrial, real Asset
   FPI - In Bonds stocks

## * Foreign Direct Investment (FDI)

- Occurs through more than 10% of shares in Target asset.
- Three Components ÷ Equity Capital, reinvested earnings, intra Company loan.
- FDI is Real Investment

## Categories

1) Horizontal ÷ Same Type of Business in Foreign

2) Vertical ÷ Diff from Main Business, But Supplement its major Activity

3) Conglomerate ÷ ~~Unre~~ Totally Unrelated to Main Business.

4) Two way Direct Foreign Investment ÷ Reciprocal Investments
(Mai Teri Country Mai, Aur Tu Meri)

* Foreign Portfolio Investment (FPI)

- It is a flow of 'Financial Capital'
- It is done throug Capital market (stock market)

MCQ - It effects BOP or Exchange rate, rather than production

* Reasons for FDI

1) Expecting higher rate of return than home country.

2) Other General Reasons 9.75 Page

* ~~Hot~~ Host Country Economic determinants of FDI attraction

1) Market Seeking FDI

2) Resource or Asset Seeking FDI

3) Efficiency - seeking FDI

4) Policy Framework

5) Business facilitation

* Modes of Foreign Direct Investment (FDI)

- Forming Subsidiary
- Equity Injection
- Acquiring Control in Foreign Co.
- Mergers & acquisitions
- Joint Venture
- MCQ ★ Green Field Investment (Establish of fresh overseas production)
- MCQ ★ Brown Field Investmen (Make use of Existing infrastructure, ~~by merging~~ rather than new one)



* Benefits & Problems Associated with FDI

General Points ..... 9.80

Conclusion: NO assessment can be made regarding weather the benefits of FDI outweigh the cost.

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* FDI in India

1) India's FDI inflow reached record level during 2020-21. Total FDI inflow \$ 81,973 million, 10% increase then previous year.

2) Acc to world Investment Report 2022, India was 8th among the world's major FDI in 2020