

## CH-9 INTERNATIONAL TRADE

Date: \_\_\_\_\_

## Unit 1:- Theories of international trade

## ① INTRO:-

## Trade:

→ International trade is the exchange of Goods & serv as well as resources between countries.

→

BENEFITSDEMERITS

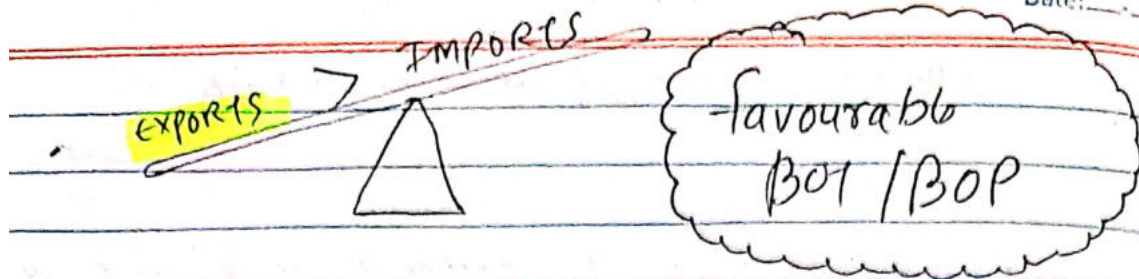
- |  |   |
|--|---|
| <ul style="list-style-type: none"> <li>• <u>Economic efficiency</u> and contributes to <u>economic growth</u> &amp; <u>rising incomes</u>.</li> <li>• Greater efficiency in use of natural, human, industrial and financial resources ensures "<u>productivity gains</u>".</li> <li>• Access to <u>new market</u> and <u>new materials</u>.</li> <li>• stimulates <u>innovation</u>.</li> <li>• Improvement in <u>quality of goods &amp; services</u>.</li> <li>• Contribute to human resource development.</li> <li>• <u>Strengthen Bonds</u> b/w countries.</li> </ul> | <ul style="list-style-type: none"> <li>• Often not equally beneficial to all nations.</li> <li>• <u>Economic exploitat<sup>n</sup></u> of underdeveloped nations.</li> <li>• Substantial <u>environmental damage</u>.</li> <li>• Exhaustion of <u>Natural Resources</u>.</li> <li>• Trade cycles are also likely to get transmitted rapidly to other countries.</li> <li>• Dependence of underdeveloped countries on foreign nations.</li> <li>- There is often <u>lack of transparency</u>.</li> <li>• Too much of <u>export orientation</u>.</li> </ul> |
|--|---|

## ② IMPORTANT THEORIES

ci) The Merchantilists' view of International Trade.

derived from  
mercantile

→ "trade and commercial affairs".



Acc to Microsoft Encarta Dictionary (2009), mercantilism is the economic policy trending in Europe from 16<sup>th</sup> to 18<sup>th</sup> century, where the govt used power to control industry & trade with the belief that national power is achieved and sustained by having **constant large quantities of exports over imports.**

2021

Theory of **Absolute** advantage → Adam Smith

In this theory, Adam Smith assumed: ✓

Trade b/w two countries

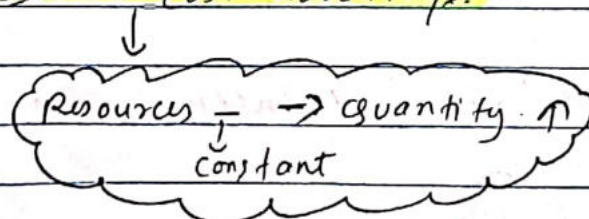
Two commodity

No transportation cost

Labour was mobile within country but immobile b/w countries

He assumed that any trade b/w the two countries considered would take place if each of the two countries had an **absolutely lower cost** in the production of one of the commodities.

Adam Smith thought that Basis of Int. Trade was **Absolute cost advantage.**



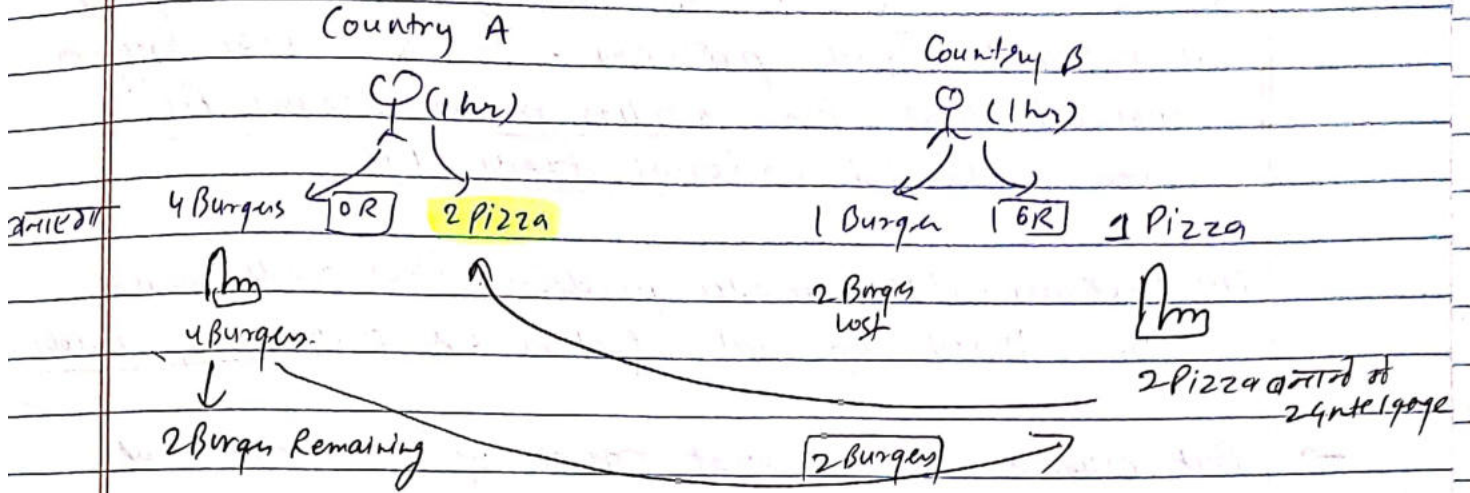
simple comparison of labour productivity.

2x2x2 key word - comparative adv.

(निम्न) 314 312) एत एत export area निम्न Data: एत import करत

iii) Theory of Comparative advantage → DAVID RICARDO

→ Ricardo observed that trade was driven by comparative rather than absolute cost.



civ) Theory of HECKSHER - Ohlin 2x2x2.

→ also known as factor endowment theory or modern theory.

→ It states that comparative adv. in cost of products is exclusively by the differences in factor endowment.

→ A country

In exports - वित्त वृद्धि उत्पादन ए (abundant Resources)

In Imports - वित्त - अभाव ए (scarce Resources)

→ Capital abundant theory will produce & export capital intensive goods.

→ Labour abundant eco. will produce & export labour intensive Goods.

\* Theory of Comp. cost - Ricardo

- Based on labour theory of value.
- Considered labour as a sole factor

• Normative is nature. should be

वृद्धि वृद्धि - modern theory

→ Based on money cost which is more realistic.

→ Considered labour & Capital Both

→ positive in nature what is

Globalisation and new international Trade theories.

American economist & journalist Paul Krugman received 2008 Nobel Prize for economics for his work in economic geography & in identifying international Trade problems. In late 1970s, Krugman noticed that the earlier model did not fit into the international trade data.

The Heckscher-Ohlin model predicted that trade would be based on such factors as Ratio of Capital to Labour.

But Krugman noticed that most of the international trade takes place b/w countries with roughly the same ratio of Capital to Labour.

Krugman defended free trade ✓

eg: "In Praise of Cheap Labour" published in Slate in 1997.

↓ cheap labour  
को outsourcing कर

Paul A. Samuelson → The factor price equalisation theorem  
सा देखी copy.

NTT (New Trade Theory) gave two advantages to the countries that import goods to compete with domestic goods: electronics, car, IT, etc.  
Economies of scale → scale of prod (D) Cost (↓)

Network effect (Bandwagon effect) → whatsapp or Microsoft word

bandwagon effect → stylish. = phone  
fashionable. =



When GDP Gap is positive the Actual GDP > Potential GDP

limit on tax ↓  
ATST

5) Tariff Rate Quotas (TRQ) - combines two policy instruments  
Quotas & Tariff

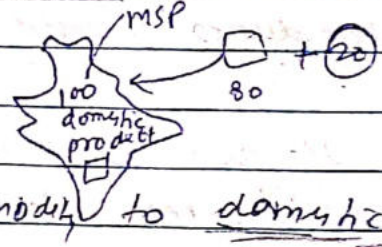
- Imports entering "under the specific quota" part are usually charged lower tariff and imports above the threshold usually charged higher tariff

6) Most favoured Nation Tariff (MFN)

- countries promise to impose on imports from other member of WTO.

- MFN Rates are the highest that WTO members charge each other.

7) Variable Tariff -



price of imported commodity to domestic support price.

8) Preferential tariff - nearly all countries are part of atleast one preferential trade agreement, under which they promise to give other country's product lower tariff than MFN rate (GSP).

9) Bound Tariff - binds itself with legal commitments not to raise tariff above certain level.

10) Applied Tariff - Actually charged tariff on MFN basis  
31st 15%  
31st highest 20%.

11) Escalated Tariff - Nominal tariff rate on import of manufactured goods > nominal rate on intermediate inputs (Raw material) discriminatory.

- (12) Prohibitive Tariff - tariff tariff set so high that no imports can tax.
- (13) Import subsidies - "payment" per unit or % of value of goods imported. Negative Import Tariff.
- (14) Tariff as Response to trade "distortion" - disturbs the tariff  
The effected importing countries upon confirmation of distortion, respond quickly by measures in form of tariff response. (Also known trigger price mechanism)
- (15) Anti-Dumping Duty - It is a protectionist tariff that govt. imposes on foreign imports that it believes are priced below fair market value.  
China 2017 → color coated steel product
- (16) Countervailing duties - Tariffs that aim to offset the ~~artificially~~ artificially low prices charged by exporters who enjoys export subsidies.

"ASEAN" → Association of South East Asian Nations.

2016 → 12.5% Tax.

### \* Effects of Tariff

- It creates obstacles to trade
- Imported goods become expensive.
- Tariff encourages production & consumption of domestically produced goods.
- Producers importing goods may charge higher prices which may lead to inc. in their profits.
- tariff also increases govt. Revenue.

## II NON TARIFF MEASURES.

→ NTMs consist of mandatory requirement rules, or regulations that are legally set up <sup>by the</sup> govt. of the exporting, importing, or the transit country.

→ NTMs are not the same as non tariff barriers.

[NTM ≠ NTB]

NTB is subset of NTM T or F.

### (i) Technical Measures

(a) sanitary & Phytosanitary (SPS) measures - to protect animal, human or plant life from risks arising from pests, toxins, contaminants etc & to protect Biodiversity.  
e.g. Prohibition of poultry from countries affected by flu.

### (b) Technical Barriers to trade (TBT)

- It covers <sup>both</sup> food & non food traded products refer to mandatory "standards and Technical Regulation" that define the specific characteristics that product should have.  
e.g.:- food laws, labelling, quality standard.

(ii) NON TECHNICAL MEASURES → It relates to trade req. like shipping req, custom formalities, trade rules, taxation policies etc.

Hard Measures

Threat measures

Other measures

Price & Quantity control

(Anti dumping & safeguards)

FINANCES Investment

100 → Non binding @ Date: \_\_\_\_\_

80 → binding

Final Imp

(1) Import Quotas → Import Quota is direct "restrict" which specifies that only a certain physical amt. of the good will be allowed into the country during a given period of time. (Generally 1 year)

(2) Price control measures → Step taken to control or influences the prices of imported goods in order to support the domestic prices of certain products.

eg - min. import price established for sulphur.

↳ Para - Tariff Measures.

(3) Non automatic licensing and prohibitions. -

- These measures are normally aimed at limiting the quantity of goods that can be imported, regardless of whether they originate from diff. sources or from one particular supplies.

for eg. textile may be allowed only on discretionary license by the importing country.

(4) Financial measures - objective to increase the import cost.

(5) Measures affecting competition - aims at granting exclusive or special preferences / privileges to one or more few limited group of economic operators.

eg. wheat import tariff at 10% or 15% or 20%

(6) Govt. ~~procurement~~ <sup>उपकरण</sup> Procurement policies → Govt may give preference to the local tenders rather than foreign tenders.

(7) Trade related investment measures -

→ Req → to use min level of locally made components.

→ Restricting the level of imported components.

→ Limiting the purchase / use of imported products.

20/04/2024

Distributors' restrictions. - These are limitations imposed on distributors of goods in the importing country involving additional license or certification req.  
e.g. fruit imported with Refrigerator or air conditioner etc. India

Restriction on post sale services. - After sales services.  
Administrative procedures - Any kind of particular procedure and formalities. Administrative delay.

Rules of origin - Import procedural obstacle occurs in the home country for making available certifications regarding origin of certificated goods.

Safeguard measures - Restrict imports of a product temporarily.

Embargoes - It is a total Ban imposed by govt. on import/export of particular product for indefinite period: fixed time.

## EXPORT RELATED MEASURES

Ban on exports. - During the period of shortage export of agricultural products may be prohibited to make them available for domestic consumption.

Export taxes - Export tax is a tax collected on exported goods may be specific or ad valorem.

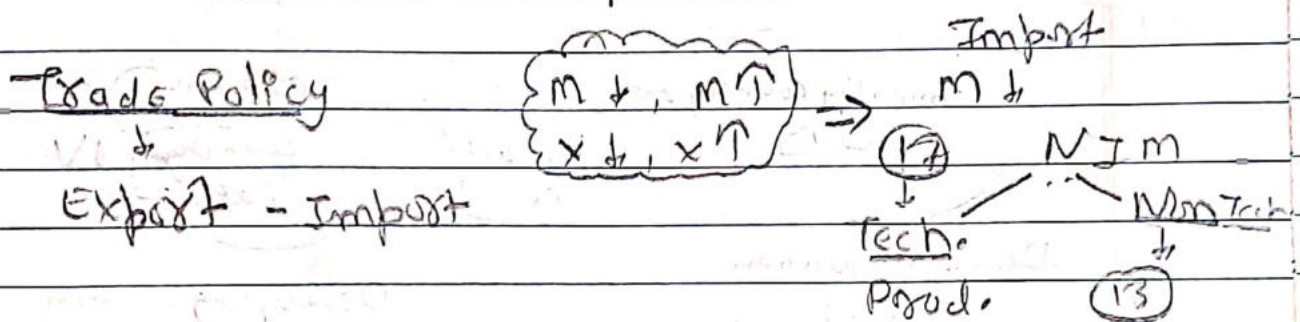
Export subsidies and incentives - like duty drawback, duty free access to imported components etc. Financial contribution

clv) Voluntary Export Restraints - VER is type of informal quota administered by exporting country voluntarily restraining the quantity of goods that can be exported out of the country during a specific period of time.

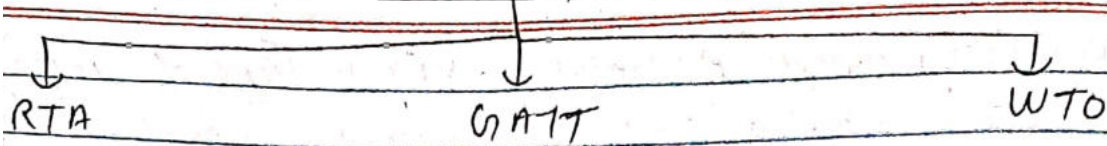
### \* Recent Developments

- free trade agreement with Mauritius on 1 April 2021
- 18 feb 2022, Comprehensive economic partnership agreement (CEPA) with UAE
- Economic Cooprat & Trade Agreement (ECTA) with Australia on 2<sup>nd</sup> April 2022

VERs cause domestic price to rise and cause loss of domestic consumer surplus.



## UNIT 3 Trade Negotiations



### RTA (Regional Trade Agreement)

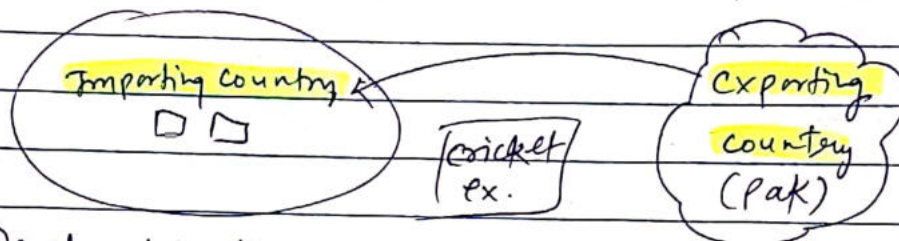
RTAs are defined as grouping of two countries which are formed with objective of reducing barriers to trade b/w member countries.

(As on 1<sup>st</sup> Feb 2021, 339 RTAs were in force)

### Types of RTA.

Unilateral Trade Agreement - under this an importing country offers trade incentives in order to ~~emou~~ encourage the exporting country.

(eg. Generalised system of preferences)



Developed Nation  
(US)

Developing Nation

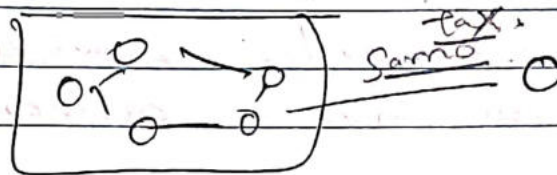
① GSP → It promotes economic dev. By eliminating duties on various products limited.

Bilateral Trade Agr. - agreements that set rules of trade b/w two countries, two blocs or a bloc and a country (eg. ASEAN-India free Trade Area)

group of countries

③ Regional Preferential Trade Agreements - Agreements among a group of countries to reduce trade barrier on a reciprocal & preferential basis only for the members of group (~~eg -~~) (eg - GSTP) → Global system of Trade preferences.

④ Trading Bloc → A group of countries that have Free trade agreements b/w themselves & may apply a common external tariff to other countries.  
Eg - Arab League (AL), European free trade Association (EFTA)



⑤ Free Trade Area → Group of countries that eliminate all tariff and quota barrier on trade with objective of increasing exchange of goods among themselves. (eg - ASEAN - India free Trade area)

⑥ A customs union - group of countries that eliminate all tariffs on trade among themselves, but maintain a common external tariff on trade with other countries. European Union etc.  
(It is technically violat<sup>n</sup> of MFN)

⑦ Common market → A common market deepens a custom union by providing for free flow of output and of factors of products by reducing or eliminating internal tariff and by creating common external tariff.  
(eg - EU, ASEAN)

② Economic & Monetary union - free transit of goods through the borders (eg. EU)  
 Common currency [single currency]

## II GATT (General agreements on Tariffs & Trade)

- GATT covers international trade in goods \*
- The workings of GATT agreements are the responsibility of the council for trade in goods (Goods council)
- The Goods council has 10 committees \* these committees consist of all member countries.
- The GATT lost its relevance by 1980s because
  - a) intellectual property rights and trade in services were not covered.
  - b) Ambiguities in multilateral system.
    - ↳ confusion
    - ↳ Goods & Trade ↑
  - c) World merchandise trade increased a lot & it was beyond the scope of GATT.
  - d) efforts at liberalizing agriculture ② were not successful.
  - e) Inadequacies in "dispute settlement system."
  - f) It was "not a treaty"

## \* URUGUAY ROUND \*

- It brought about the biggest reform of the world's trading system. Members established 15 groups to work on limiting restriction.
- The Round started in Punta del Este in Uruguay in Sept 1986. In Dec 1993, the Uruguay round (8<sup>th</sup>) was the most ambitious & largest ever round with 123 countries participated was completed.
- The agreement was signed by most countries on 15 Apr 1994, and with effect from 1 July 1995 marked ~~with~~ the Birth of WTO.

## 3) WORLD WTO

→ Six key objectives :-

- (1) To set and enforce rules for international trade.
- (2) To provide <sup>the</sup> forum for negotiations.
- (3) to resolve disputes
- (4) to increase transparency
- (5) To involve in global economic management
- (6) To help developing nations.

### ⇒ STRUCTURE OF WTO

WTO activities are supported by a Secretariat located in GENEVA by Director General.

It has three tier system of decision making

Top  
↓  
middle  
↓  
...

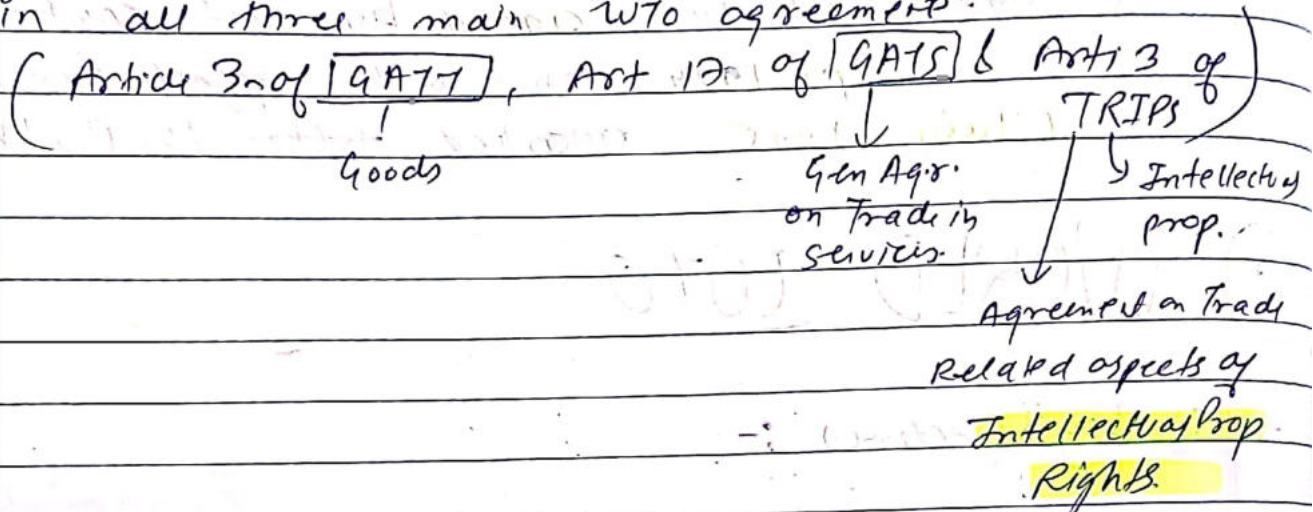
WTO accounts for almost 95% of world trades and currently having 164 member countries (of which 117 are developing countries)

### "GUIDING PRINCIPLE OF WTO"

**most favourable nation (MFN)** - treating other people equally.

**National treatment** - treating foreigners & locals equally

This principle of national treatment is also found in all three main WTO agreements.



**free trade** - WTO allows "progressive liberalisation"

एक एक बर्रिअर उतरा  
करे

**Predictability** - In WTO, when countries agree to open their markets for goods or services they "bind their commitments". Countries should make trade rules as clear as possible (transparent).

5. Promoting fair competition - WTO promotes fair competition in agriculture, intellectual prop., services etc.

6. Encouraging development and economic reform - Developed countries have started to allow duty free and quota free imports for almost all products from least developed countries.

→ WTO AGREEMENTS →

Geneva

1986-1994

Agreement on agriculture

\_\_\_\_\_ applicability of SPS measures

\_\_\_\_\_ textile & clothing replaced the multi-fibre agreement (MFA) since 1994.

\_\_\_\_\_ TBT (Technical Barriers to Trade)

\_\_\_\_\_ TRIMS (Trade related investment measures)

\_\_\_\_\_ relating to anti-dumping

\_\_\_\_\_ relating to custom valuation agreements

\_\_\_\_\_ relating to pre-shipment Inspection (PSI)

\_\_\_\_\_ on ~~rules~~ rules of origin

\_\_\_\_\_ on import licensing procedure

\_\_\_\_\_ on subsidies & countervailing measures

\_\_\_\_\_ GATS & TRIPS.

\_\_\_\_\_ trade policy review mechanism (TPRM)

★. Plural lateral agreements → It involves several countries with common int but do not involve all WTO countries.

★

DOHA ROUND (9th Round) y.

- Qatar in 2001 Nov.

- Talks about negotiation 20 ~~area~~ areas of trade.

★ - Most controversial topic was "agriculture trade"

→ 86] Road.  
120

Group of 20 " is the premier forum for int. economic cooperation. India holds the presidency of G20 from 1 Dec 2022 to 30 Nov 2023.

G20 was formed in 1999 after the Asian financial crisis.

Since Beginning of COVID-19 trade related measures were implemented by G20 and 61% measures were "trade facilitating".

(39% measures were "trade Restrictive")

By Oct 2022, 77% of export restrictions has been repealed — 29th Oct 17.

→ X ————— X ————— X  
52 Food Restriction  
27  
44% OF The Export

Floating → Flexible Exchange.  
 Fixed :- Govt

Unit 4

## ① Intro

- A foreign currency transaction that is denominated in or requires settlement in foreign exchange.
- Exchange rate is the rate at which the currency of one country is exchanged for the currency of another country.
- A direct quote (European currency quotation) is the no. of units of local currency exchangeable for one unit of foreign currency.  
 $\text{₹ } 80 / \$$  foreign currency to local currency
- An indirect quote (American currency quotation) is the no. of units of foreign currency exchangeable for one unit of local currency.  
 $0.0125 \$ / ₹$   
 2 unit of local currency to 1 unit of foreign currency

② EXCHANGE RATE REGIMES. (3 Regimes)

- ci) Free floating exchange rate system. (clean floating)
- Rate determined by market forces of demand & supply.
  - No govt. intervention.
  - self regulating 😊
  - No need to maintain foreign currency reserves. 😊
  - less stability 😞
  - speculation 😞
  - international trade are riskier

- ③ Managed floating system. (dirty floating)
- Govt. and central banks often seek to increase or decrease their exchange rate by buying & selling their own currencies.

Such ~~interacti~~ intervention is likely to have only a small impact.

fixed Exchange Rate System pegged

set by Govt.

stability 😊

Less speculation 😊

Avoids currency fluctuation 😊

Govt. has to keep huge foreign currency reserves 😊

It enhances international trade & investment 😊

Basically, free floating system exchange Rate system is efficient and transparent.

It allows central bank to pursue its own independent monetary policy.

## NOMINAL AND REAL EXCHANGE RATES.

Nominal exchange rate is expressed in units of one currency per unit of other currency.

A real exchange rate adjusts this for changes in price levels.

A real exchange rate is the rate at which a person can trade the goods or services one country for the goods or services of another.

$$\text{Real exchange Rate} = \frac{\text{Nominal Exch Rate} \times \text{Domestic prices}}{\text{Foreign prices}}$$

ex - 1\$ = 1₹

US - 2\$

India 5₹

$$= 1 \times \frac{5}{2} = 2.5$$

India

$$\text{Real effective exchange Rate (REER)} = \frac{\text{Nominal exchange Rate}}{\text{Price Deflator}}$$

## ④ FOREIGN EXCHANGE MARKET

→ forex market mainly consists of commercial banks & brokerage houses (known as market makers)

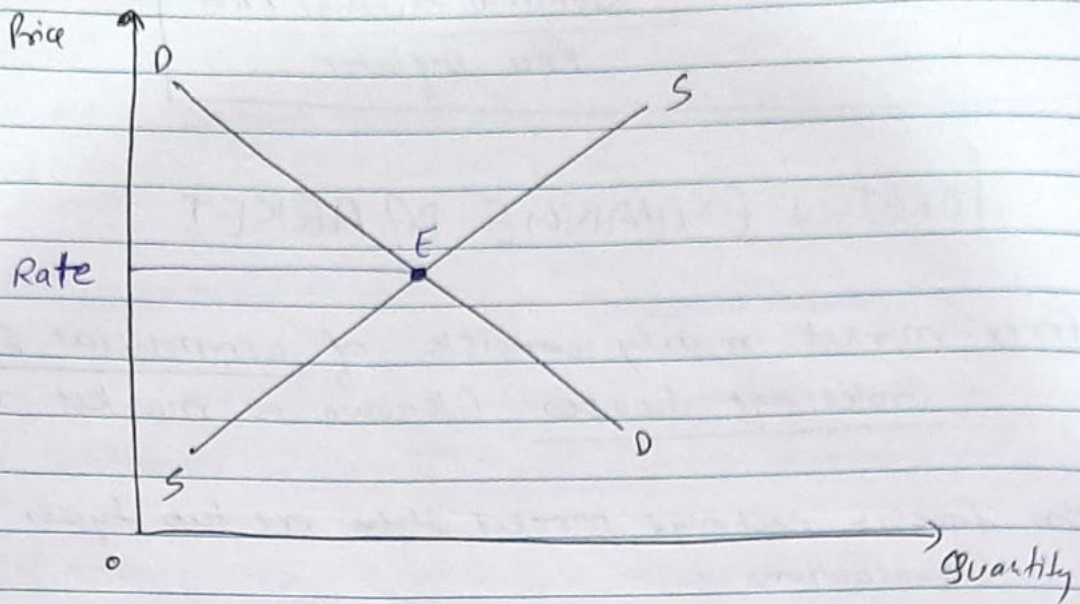
→ In foreign exchange market there are two types of transactions :-

- a) currency transactions which are carried out in the spot market and exchange involves immediate delivery.  
T+2 d.
- b) future transactions wherein contracts are agreed upon to buy and sell currencies for future delivery which are carried out in forward / future market.

\* A foreign exchange transaction can involve any two currencies, but mostly US\$ is involved (even though it is not the national currency of either of the countries) Thus, US\$ is vehicle currency.

⑤  
very Imp  
&  
max.

### Determinants of Nominal Exchange Rate



Why demand?

(Why \$ is demanded)

- To purchase goods from foreign country
- Foreign Tour ↑↑
- To send unilateral transfers
- To make investment in foreign countries
- To open foreign Bank A/c
- For speculation.

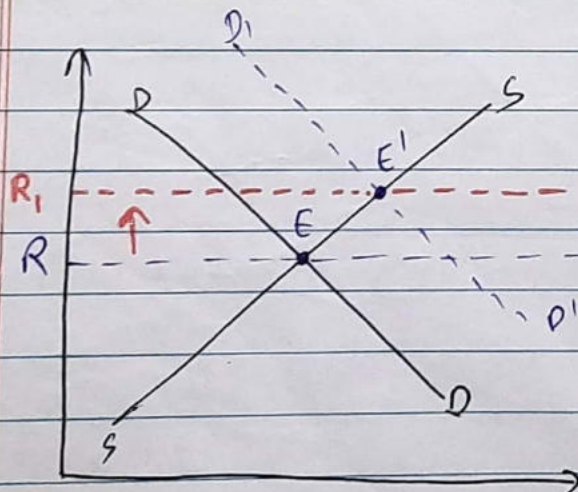
Why supply?

(Why inflow of \$)

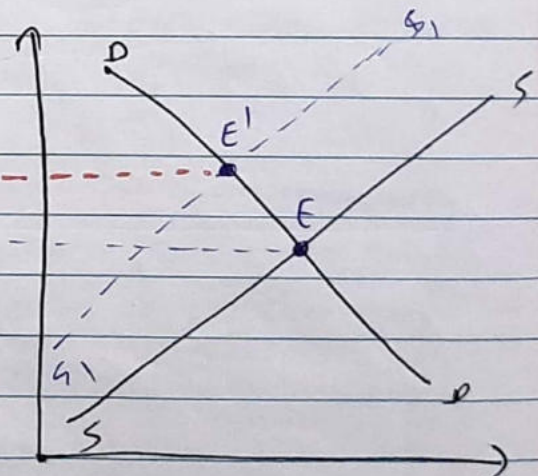
- Exports ↑↑
- investment by foreigners in our country
- Unilateral transfer received
- Foreigner visiting indts
- Speculation.
- Loans Paid bank.

\*

HOME CURRENCY DEP.

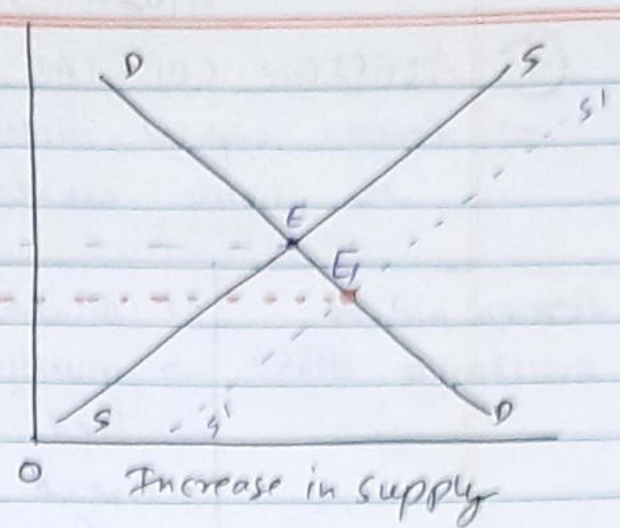
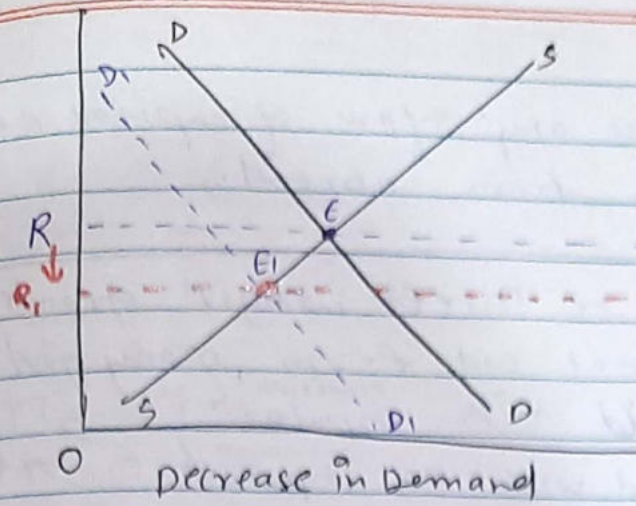


Inc in Demand



Dec in Demand

HOMG  
CURR  
APP



Effects of Currency Dep & Currency App.

Exchange Rate dep. lowers the relative price of country's exports (export rises), raises the relative price of its imports (Import falls), leads to output expansion, encourages economic activity, inc international competitiveness and imp. BOP

Curr app. raises the prices of exports, (decrease export) increases imports, adverse effect on competitiveness, causes larger deficits & worsens the trade balance.

Depreciat<sup>n</sup> (Appreciation) v/s Devaluation (Revaluation)  
 earlier 1\$ = ₹80      earlier \$ = 80₹  
 now 1\$ = 85      now \$ = 85₹

Dep → राज्यीय दमन एत अरु ← Revaluat<sup>n</sup>

It occurs due to market forces of Demand & supply.

deliberately done by govt.

## UNIT-5

① FOREIGN CAPITAL विदेशी पूँजी

→ foreign capital includes any inflow of capital into the home country from abroad.

foreign aid or assistance. (सहाय) (Help)	<ul style="list-style-type: none"> <li>→ Bilateral or direct intergovt. grants</li> <li>→ multilateral aid from many govt.</li> <li>→ Tied aid with <sup>condition</sup> stipulations</li> <li>→ untied aid with no stipulations</li> <li>→ foreign grants (voluntary) from institutions or organisations.</li> </ul>
Borrowings (Loan) <u>अति</u> <u>अंत</u>	<ul style="list-style-type: none"> <li>→ Direct intergovt. loans</li> <li>→ Loans from int. institut<sup>s</sup></li> <li>→ <u>soft loans</u> (No harsh condit<sup>ns</sup> on loan.)</li> <li>→ external comm. Borrowing</li> <li>→ Trade credit facilities</li> </ul>
Deposits from NRI	-
Investments (निवेश)	<ul style="list-style-type: none"> <li>→ foreign portfolio investment (FPI)</li> <li>→ foreign direct inv. (FDI)</li> </ul>

② FDI

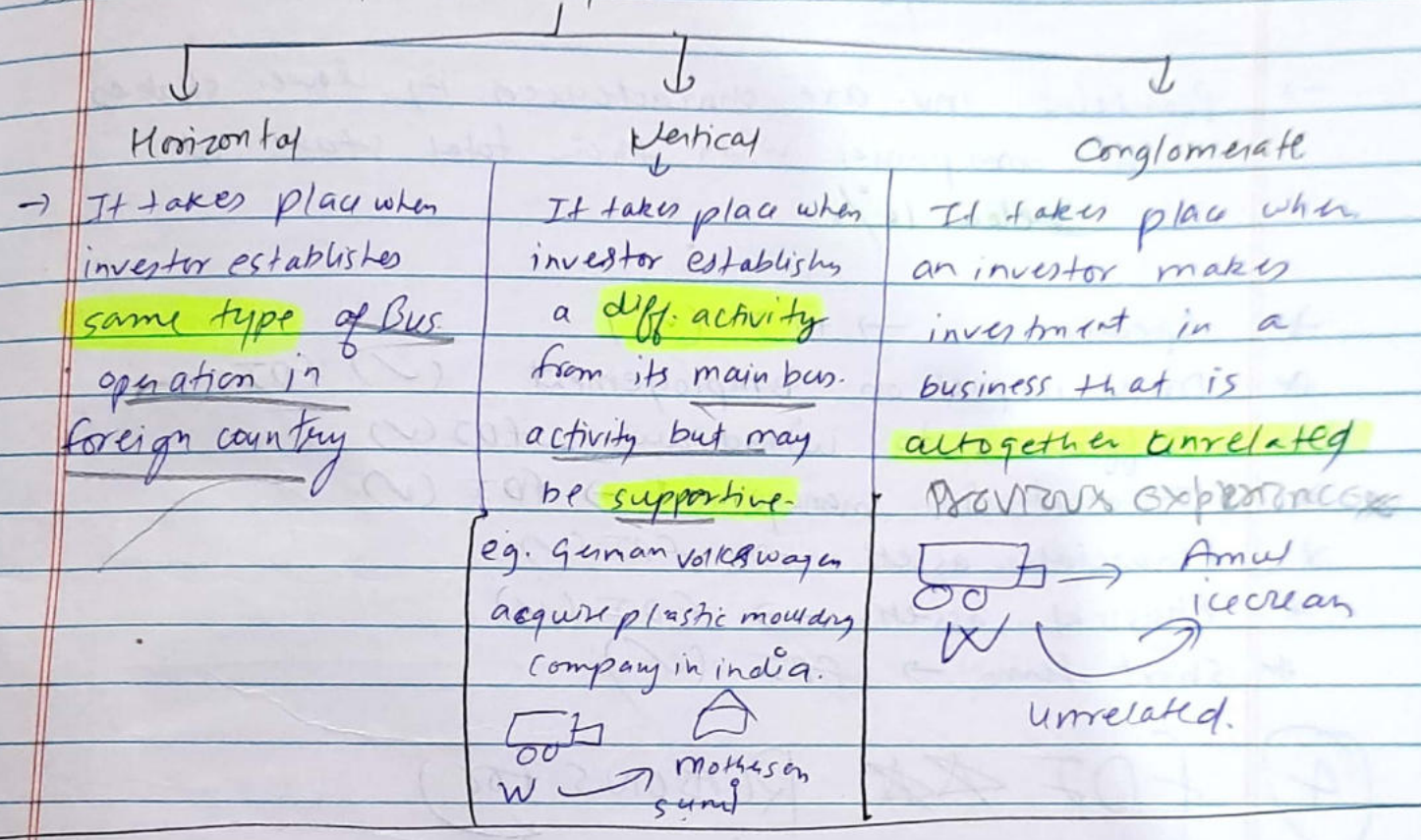
Acc to IMF (internat<sup>l</sup> monetary fund) & OECD (organisat<sup>l</sup> for economic & development), the acquisition of at least 10% of ordinary shares or voting power in a public or private enterprise by non-resident investors makes FDI

FDI has 3 components:-

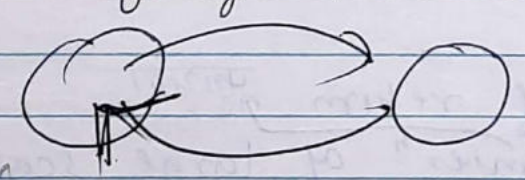
- a) Equity Capital
- b) Reinvested earnings
- c) Other direct Capital (eg. intra company loans)

→ FDI are real investments in factories, assets, land inventories etc. and involve foreign ownership of production facilities.

→ FDI may be categorised as -



Two way direct foreign investment      Reciprocal Investment



OECD :- (The organization for economic Cooperation and Development)



- (vii) By passing tariff & non tariff barriers
- (viii) Cost effective availability of inputs
- (ix) Tax Benefits.

\* FDI takes place through :-

- a) opening subsidiary company or associate > 20%
- b) equity injection → lumpsum.
- c) ~~acquiring~~ acquiring control
- d) mergers & acquisitions
- e) Joint venture
- f) Green field investment → New facility from scratch
- g) Brown field investment → existing facility

## ⑤ PROBLEMS OF FDI

- use of inappropriate capital intensive methods in labour abundant country
- Inc. in regional disparity
- Crowding out of domestic investment.
- Diversion of Capital resulting in distorted pattern of products
- Instability in BoP & exchange rates.
- Repatriation of profits.
- Anti ethical market distortions.
- Over exploitation of natural resources
- Decrease in competitiveness of domestic companies.
- Jeopardizing national security
- worsening commodity terms of trade

Harmful

$\frac{\text{Price of exports}}{\text{Price of inputs}}$

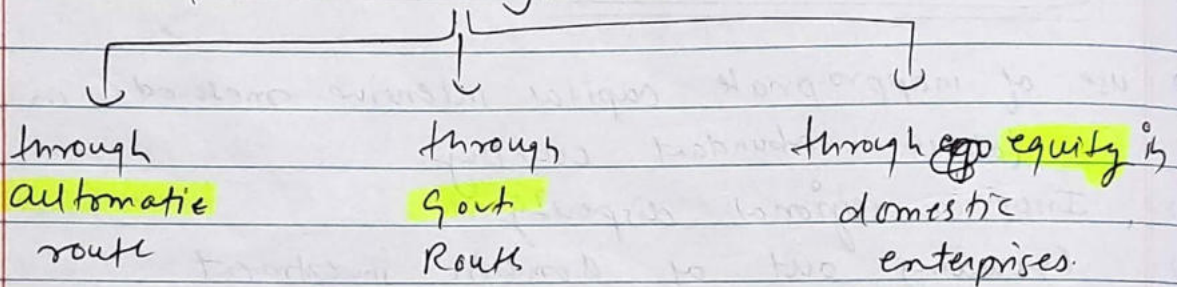
Terms of Trade =  $\frac{\text{PoF Export}}{\text{PoF Import}}$

⑥ BENEFITS OF FDI

- New innovations
- Higher efficiency
- Higher employment
- Better products
- Lower prices
- welfare for consumers
- Better access to foreign markets
- Improvement in BOP.

\* MAURITIUS is the leading country in respect of inflow of FDI to India.

\* A foreign investor may enter India :-



\* FDI is prohibited in **Chif fund & Nidhi Corp**

\* Acc to RBI, overseas direct investment stood at US \$ 1922.57 million in Sep ~~2022~~ 2022

Investment made by Indian ent. in foreign companies

\* Acc to World investment Report 2022, India was ranked **8th** among the world's major FDI recipients. (US \$ 81973 million during 20-21)