Policy Framework Agreement is the agreement reached between GOI + RBI on maximum tolerable inflation rate that RBI should target to achieve price stability.

Announcement of an official target range for inflation is known as inflation targeting

Urjit Patel

Report 2014 → RBI abondon the multiple indicator approach and make inflation targeting the primary objective of its monetary policy.

→ The Central Government has notified 4% Consumer Price Index (CPI) Inflation as target

→ FAILURE

- Average Inflation > upper tolerance level for 3 consecutive Quarters
- Average Inflation < lower tolerance level for 3 consecutive Quarters

→ RBI is mandated to publish a Monetary Policy Report every 6 months

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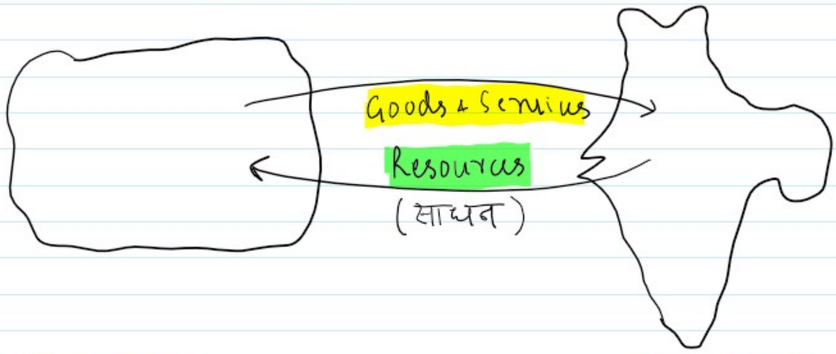
CH 9:- INTERNATIONAL TRADE (8-10 Marks)

Unit 1:- Theories of International Trade

1 INTRODUCTION

→ International Trade is the exchange of goods + services

→ International Trade is the exchange of goods & services as well as resources between countries



→

Benefits	Demerits
• Economic efficiency and contributes to economic growth & rising incomes	• Often not equally beneficial to all nations
• Greater efficiency in use of natural, human, industrial and financial resources ensures "productivity gains"	• Economic exploitation of underdeveloped nations
• Access to new markets and new materials	• Substantial envionmental damage
• Stimulates Innovation	• Exhaustion of natural resources
• Improvement in Quality of goods & services	• Trade cycles are also likely to get transmitted rapidly to other countries 
• Contribute to human resource development.	• Dependence of underdeveloped countries on foreign nations
• Strengthen bonds between countries	• There is often lack of transparency
etc etc etc.	• Too much of export orientation
	etc etc etc etc etc

(2) "IMPORTANT THEORIES"

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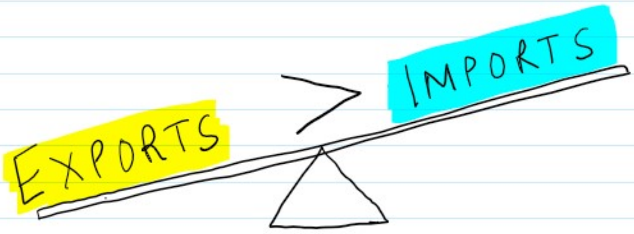
(i) The Mercantilists' view of International Trade

derived from Mercantile → "trade & commercial affairs"

Key Point :-



Favourable BOT/BOP

→ According to Microsoft Encarta Dictionary (2009), Mercantilism is the economic policy trending in Europe from 16th to 18th century where the government used power to control industry and trade with the belief that national power is achieved and sustained by having constant large quantities of exports over imports.

(ii) Theory of Absolute Advantage (Adam Smith)

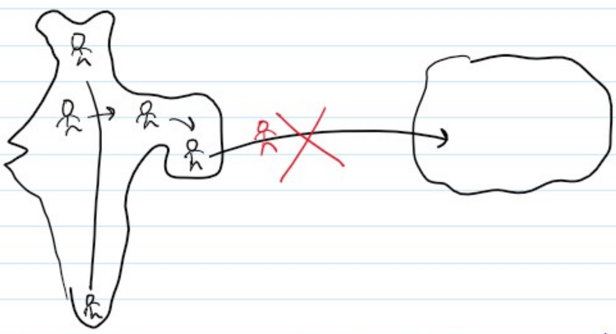
→ In this theory, Adam Smith assumed :-

(a) Trade between two countries

(b) Two commodity

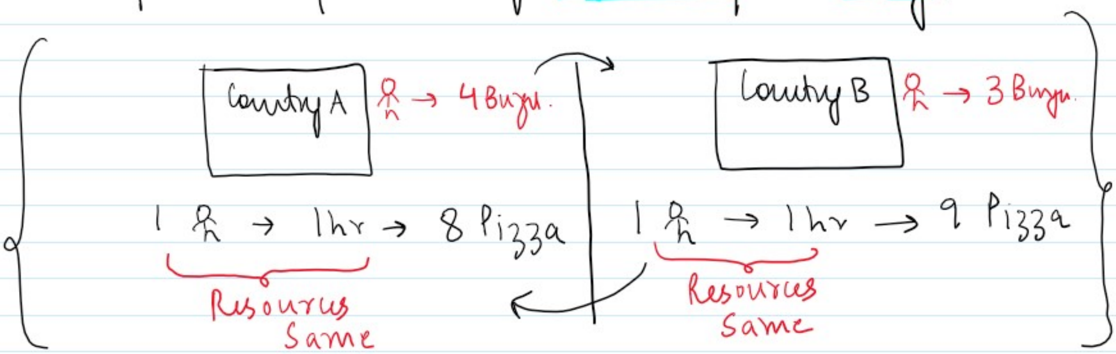
(c) No transporation cost

(d) Labour was mobile within country but Immobile between countries



(e) He assumed that any trade between 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 the basis of International Trade was **Absolute COST advantage**. The Principle of Absolute advantage refers to the ability of a party to produce greater quantity of a good, using the same amount of resources.
(Simple comparison of **Labour productivity**)



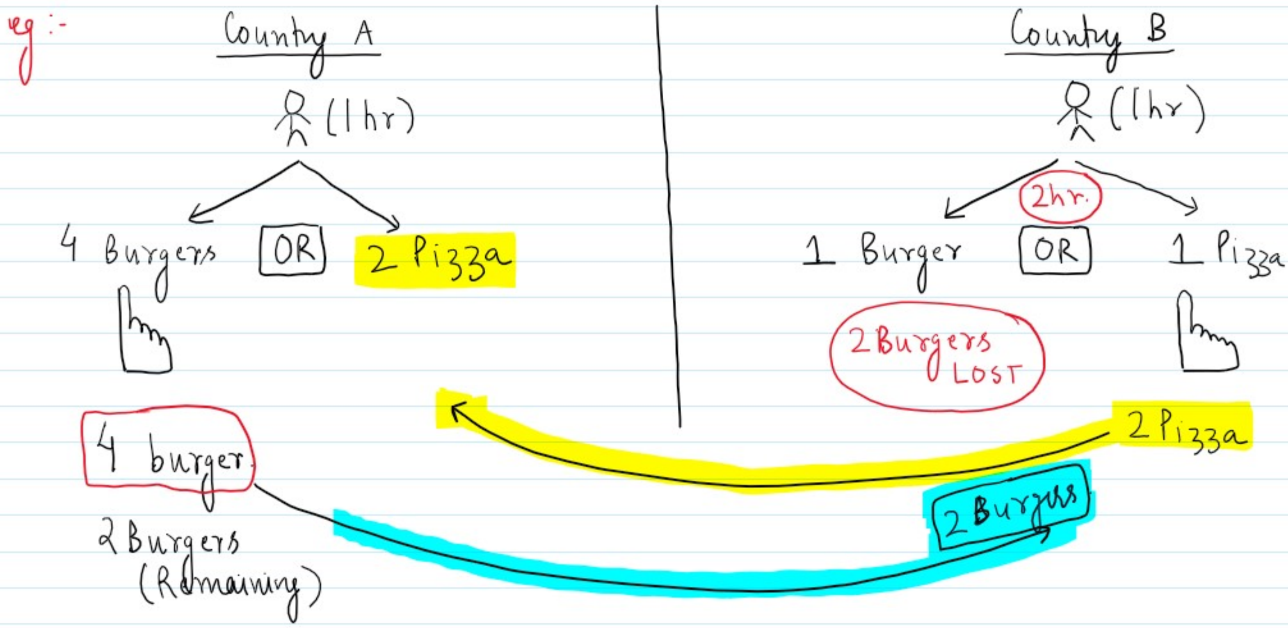
(iii) Theory of **Comparative** Advantage

→ One of the most important concepts in economics is given by **DAVID RICARDO**.

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

→ Ricardo's insight was that such a country would still benefit from trading according to **comparative advantage** - exporting products in which absolute advantage was greatest and importing products in which absolute advantage was comparatively less.

eg :-



(iv) Heckscher - Ohlin Theory

→ This theory is also known as Factor Endowment theory or Modern Theory of Trade

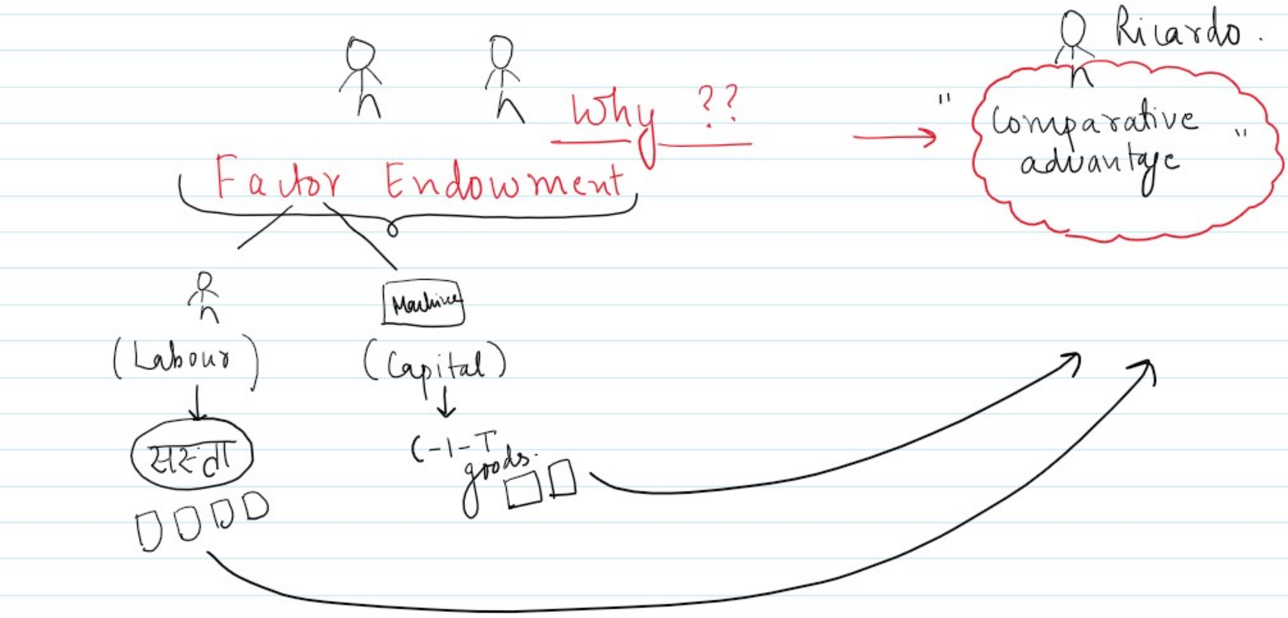
→ It states that comparative advantage in cost of production is exclusively by the differences in factor endowment

→ A country tends to specialise :-

In Exports" - whose production requires intensive use of its "abundant" resources

In Imports - whose production requires intensive use of its "scarce" resources.

→ Capital Abundant economy will produce and export capital intensive goods and labour abundant economy will produce and export labour intensive goods.



* Theory of Comparative Cost RICARDO	Modern Theory दो दोस्त
• Based on Labour theory of value	Based on money cost which is more realistic
• Considered labour as sole factor	Considered labour as well capital as important factors
• Studies only comparative costs of goods concerned.	• Considers relative prices of the factors (labour + capital)
• It is Normative in nature "Should be" "क्या होना चाहिए"	It is positive in nature What is "क्या है"

(v) Globalisation + New International Trade Theories

→ American economist + journalist **Paul Krugman** received **2008 Nobel Prize** for Economics for his work in economic geography and in identifying international Trade patterns. In late 1970s, Krugman noticed that the earlier model did not fit into noticed that the earlier model did not fit into the international trade data.

Refer(iv) { The Heckscher-Ohlin model predicted that trade would be based on such factors as
Ratio of Capital to Labour

80 : 20
or 30 : 70 } Factor endowment

But Krugman noticed that most of the international trade takes place between countries with roughly the same ratio of capital to labour.

→ Krugman defended $\boxed{\text{free trade}}$

"In Praise of Cheap Labor" published in Slate in 1997

cheap labour को
outsource करो

→ Paul A Samuelson :- The factor Price equalization theoram

international trade equalizes the factor prices between trading nations

→ NTT (New Trade Theory) gave two advantages to the countries that import goods to compete with domestic goods :-

(a) Economies of Scale

Scale of Production (↑) COST (↓)

Scale of Production (↑) COST (↓)

(b) Network effect (Bandwagon Effect)

(eg WhatsApp or Microsoft Windows)

- The way one person's value for a good or service is affected by value of that good or service to others.

The value of product or service is enhanced as the number of individuals using it increases.

x ——— x ——— x ——— x ——— x

Unit 2 — Instruments of Trade Policy

- Tariff → 16 types
- Non Tariff measures (NTM)
  - Technical → 2 types
  - Non Technical → 13 types
- Export Related Measures → 4 types

I TARIFF

→ Tariff is known as custom duties imposed on goods and services which are imported or exported.

→ In this unit, tariff would refer to import duties

* Tariff leave the world market price of the goods unaffected, while raising their prices in the domestic market