

Lesson 1.- **INTERNATIONAL TRADE**

International Trade Overview

Early trade was conducted via over-land routes. Human and geographic barriers affected the relative of size of markets and trade. However, trading exists because it is beneficial to all involved. Why do countries trade? What are the social and economic advantages of trading?



Historically, the role of the merchant trade has been held in low regard, merchant traders seen as intruders who produce nothing of value. Experience has shown, however, that merchant traders provide a very important service to their communities.

World War II devastated the economies of Europe. Post WWII reconstruction created increased trade between Europe & the USA. The depression caused countries to protect markets leading to worldwide problems. WWII disrupted trade but lifted others out of the worldwide depression. After the war, colonial powers declined and many newly independent countries created new markets.

In 1947, the General Agreement on Tariffs and Trade (GATT) was negotiated as a voluntary agreement. Member countries were voluntary associates in the promotion of exchanging ideas to facilitate trade and prevent protectionism. The agreement was aimed at encouraging trade and reducing tariffs and other restrictive market practices.

The increasement of international trade caused local production advantages. This is the result of capital availability, specialization of labour, abundance of natural resources, skilled labour and management. Specialization leads to increased standard of living by allowing the fullest

possible use of local advantages and the use of resources at the highest level of productivity.

What is International Trade?

International trade is the exchange of goods and services across international boundaries or territories. In most countries, it represents a significant share of Gross Domestic Product. It is a major source of economic revenue for any nation, without it, nations would be limited to the goods found within their own borders.



International trade can be defined as either the buying (importing) or selling (exporting) of goods or services on a global basis. This is when countries exchange goods and services with one another. Usually each country will use money to pay for the goods or services from the other country. Goods can be things like clothes, food, machine spare parts, or even furniture and services are tasks or jobs that one country does for another.

When goods are moved from one country to another, two processes take place; goods coming into a country are called **imports**. And goods going out of a country are called **exports**. Sometimes a country imports more goods than it exports, this is called a **trade deficit**, on the other hand, a country exports more goods than it imports, this is called a **trade surplus**.

Advantages and Disadvantages of International Trade

Advantages to consider:

- Enhance your domestic competitiveness
- Increase sales and profits
- Gain your global market share
- Reduce dependence on existing markets
- Exploit international trade technology
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- Exploit international trade technology
- Extend sales potential of existing products
- Stabilize seasonal market fluctuations
- Enhance potential for expansion of your business
- Sell excess production capacity
- Maintain cost competitiveness in your domestic market



Disadvantages to keep in mind:

- You may need to wait for long-term gains
- Hire staff to launch international trading
- Modify your product or packaging
- Develop new promotional material
- Incur added administrative costs
- Dedicate personnel for traveling
- Wait long for payments
- Apply for additional financing
- Deal with special licenses and regulations

Balance of Payments

Balance of payment is a measure of the extent of trade among countries. It tells about the trade situation in a country at a specific point in time. With trade money moves in and out of the country (imports, exports, investments, payments, aid, unilateral transfers). The balance of payments is the accounting system that records a nation's international financial transactions.

The balance of payment is a double entry accounting system that records transactions between residents and persons in the rest of the world for a specified period. It is a record, not a determinant of trade conditions.

The balance of payment represents the difference between receipts (inflows) and payments (outflows). If payments are greater than receipts a deficit results. In assessing the balance of payments consider the three major accounts:

Balance of payment affects trade policies, monetary value and domestic economic policies to include wages, employment, investments and the value of the local currency and nation's ability to acquire foreign currency.

Balance of Trade

The **balance of trade** can be favourable or unfavourable. It focuses on the relationship between imports and exports. A negative balance of trade means that imports exceed exports. This can lead to negative balance of payments. As a country's wealth declines standard of living is reduced.

Why does Trade take place?

The theory of absolute advantage states that one nation can produce a product more efficiently than another country. The notion of an absolute advantage indicates that goods can be produced more efficiently (cheaply) in one place than in another.

Comparative advantage suggests that even if one country can produce goods more cheaply than another, both countries would be better if they each produce and trade the goods in which they each have an advantage (rather than trying to produce everything themselves).

With **comparative advantage** gains come from concentrating production effort (specializing) on what one can do best. This leads to the production of a surplus (of better quality) which can then be traded.

WHY NATIONS TRADE

The sale of goods and services is not restricted to local, regional or national markets; it often takes place on an international basis. Nations import goods that they lack or cannot produce as efficiently as other nations, and they export goods that they can produce more efficiently. This **exchange of goods and services in the world, or global market is known as international trade**. There are three main benefits to be gained from this type of exchange.

First, international trade **makes scarce goods available to nations that need or desire them**. When a nation lacks the resources needed to produce goods domestically, it may import them from another country. For example, Saudi Arabia imports automobiles; the United States, bananas and Mexico, computers.

Second, **international trade allows a nation to specialize in production of those goods for which it is particularly suited**. This often

results in increased output, decreased costs, and a higher national standard of living.

There are two economic principles that help explain how and when specialization is advantageous. According to the theory of absolute advantage, a nation ought to specialize in the goods that it can produce more cheaply than its competitors or in the goods that no other nation is able to produce. According to the theory of comparative advantage, a nation ought to concentrate on the products that it can produce most efficiently and profitably.

The third benefit of **international trade is its political effects**. Nations that trade together develop common interests that may help them overcome political differences. Economic cooperation has been the foundation for many political alliances, such as the European Community founded in 1957, later known as European Union.

International trade has done much to improve global conditions. It enables countries to import goods they lack or cannot produce domestically. It allows countries to specialize in certain goods with increased production and decreased prices. Finally, it opens the channels of communications among nations.

International trade covers a variety of different aspects and procedures that should be understood and handled by future specialists in this area.

*** Answer these questions with your own words.**

1. What are the various markets in which the sale of goods and services takes place?

2. What is international trade?

3. What are the benefits offered by international trade to nations?
4. What resources help determine which products a nation will specialize in?

GATEWAYS TO GLOBAL MARKETS

World markets have changed enormously in the past decade. New markets have been opened with the end of cold war. New economic blocks have been formed. New trading alliances are shaping. Inevitably, a new way of thinking and approach to doing business is necessary in order to survive in the fast changing economy.

Most countries realise the advantages of international trade. Countries have developed their economies, increased production of goods, and met market demands through the increasement of international trade. A nation that exports more will grow stronger. The stronger a nation is, the more recognition and respect it will earn.

With the end of cold war, more resources worldwide are geared towards exporting. Exporting becomes more challenging with continued population growth and the addition of new exporters.

"Exports are the key to the economic survival of a nation. Exports not only help a country earn money, they help create jobs, peace, prosperity, and the power to influence."

Morris Ng

Exporting can provide growth and profit. It is a complex and demanding field, which may enhance every nation's productivity.

In order to export and import products, there needs to be a system of international monetary exchange. Most products must be paid with the legal tender of the producing country. International trade involves the exchange of one currency for another.

Most currencies are now exchanged on a floating rate basis. There are no official exchange rates. The rates fluctuate according to market forces. The exchange rate may vary greatly due to demand and therefore the price of currency is either rising or falling.

The comparative advantage which exporting countries enjoy sometimes changes. If transportation costs increase or currency exchange rates change, it may become cheaper to produce the product in the market country, especially if large amounts of exports are involved.

Trade surplus--- favourable balance of trade ---is an excess of exports over imports. **Trade deficit--- unfavourable balance of trade---**is an excess of imports over exports.

A country with a record trade surplus is often threatened with sanctions and trade barriers from a deficit importing country. A country with a record trade deficit is usually faced with the internal social disorders.

There are several reasons why governments try to control the imports and exports of a country. One reason is that a country enjoys an advantage if it exports more than it imports. Wealth accrues to the exporting country. Some countries have special programs to encourage exports. They may be programs that provide marketing information, establish trade missions, subsidise exports and provide tax benefits or incentives. Government subsidies allow companies to sell products cheaply. Sometimes these subsidised companies export their products and sell them cheaply overseas. This practise is known as **dumping**; it is selling on a foreign market at a price below the cost of production.

The imposition of trade barriers, such as **import quotas** and **higher duties**, is not the only solution to meeting the international challenge.

The remedy to beat the trade imbalance is to understand foreign cultures and business practices, and to provide competitive products and services.

On the other hand, governments impose **taxes** and **quotas** to restrict imports of certain products. Sometimes governments want to protect a domestic industry because that industry provides employment for the population. Not only the industries, but also the labour unions encourage the government to establish protectionist controls.

Protectionist measures are in the form of **duties**, which eliminates the comparative advantage, or **quotas** that restrict the import of the product altogether. There are two forms of **import tariffs: specific and ad valorem**.

A **specific tariff** is a certain amount of tax for each unit of the product. An **ad valorem** is based on the value of the product, for example 5% of its value. The imposition of the **ad valorem tax** depends upon first determining the value of the product. A **tariff** increases the price of the item, raises revenue for the government and controls consumption through market forces.

A **quota** has a different effect on the market because it limits the number of items imported. While under a quota there may be a higher price because of a limited supply, under a **tariff** is tax that creates a higher price: the supply is not limited.

Exporting enterprises sometimes set up subsidiaries in the market countries. The larger enterprise is referred to as the **parent company**. A large company that sets up production facilities in several different countries is referred to as a multinational.

Answer these questions with your own words using the information from the reading when necessary.

1. Why do governments encourage exports?
2. What do you understand as dumping?
3. Why do governments implement protectionist measures?
4. Why do governments implement protectionist measures?
5. Why do governments try to control imports and exports?
6. Why does exporting help to develop a nation's economy?

Fill in the blanks the following paragraph with the most appropriate terms from the list.

base
expands
development
involved in

operate in
vary
subsidiary
view

appreciation of
corporation
stages
relationships

During the _____ of a corporation, the organizational structures may _____ over time and pass through a number of _____. As the _____ grows, it _____ its operations. It might become _____ setting up a _____. Although the corporation has a primary or "home _____," establishment of a subsidiary allows the company to enter into new _____ with a _____ toward increasing its production and marketing capabilities.

REFERENCES

Norman, S. 1983. Weire in Business

Documents from <http://www.export911.com>

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