UNIT 6 BASICS OF INTERNATIONAL TRADE

Structure

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6.0 OBJECTIVES

Trading is one of the oldest acts which have been followed for many centuries. The present Unit aims to introduce the basics and limitations of international trade. After studying this Unit, you should be able to:

- Differentiate between trade and international trade.
- Explain the history of trade and contemporary trade practices.
- Discuss the basics of international trade and the different benefits which can be obtained by the traders while practicing international trade.
- Identify different factors which have a profound impact on international trade and the ways to overcome those limitations.

6.1 INTRODUCTION

Dating back to the oldest centuries textile industry can be seen as the most varied and vibrant industry, with great employment opportunities. With the colonization of countries within one another, trading started to fall into place by providing countries to enlarge their market space. Countries depend on each other for trade, and earlier, most developed countries used to dominate the market, But nowadays, most of the skilled countries dominate the textiles and apparel market.

6.2 TRADE

Trade is one of the most crucial concepts in the field of economics. As observed by Ricardo, trade is driven by comparative cost rather than the total cost of producing goods. For example, one country might be more productive

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than others in making goods because it can produce a good using fewer inputs in terms of capital and labour than other countries require to produce the same amount of good. Thus countries benefit from trading according to their comparative advantage.

The two main terms related to trade are tariff and import quotas. A tariff is an excise paid on the sale of imported goods. Tariffs were placed on imported goods to discourage imports and to protect the domestic producers forming a source of government revenue. In simpler terms, tariffs are the price raise received by the domestic producers, which the domestic consumers of the importing countries pay. Apart from tariffs, import quotas were placed, which suggest or limit (legally) the quantity of the goods that are being imported into the countries. Generally, these quotas are administered using licensing agreements.

6.3 HISTORY OF TRADE

A barter system or exchanging goods and services among people is an old age practice. As political thinkers have started to examine the nature and function of trade with other countries, new theories have emerged. The British capitalists from the late 1600s were inspired by the fine cotton fabrics from India and pursued ways to produce goods beyond the household industries. Thus Indian fabrics were banned by England from developing mechanized weaving and spinning, which resulted in Industrial Revolution. This revolution has provided the groundwork for transforming the western world into an international economy.

However, Eli Whitney's cotton gin and Samuel Slater's inventions transformed the industry in the years followed by the emergence of several mill towns, factories, employment opportunities for women outside the home, and industrial reforms. One of the major turns in the process was that the British imposed restrictions as soon as the industry began to develop in the states. By the 1700s, congress has imposed tariffs and embargoes on foreign cotton goods to protect Native American cotton production. These barriers to textile imports later led the way to the trade policies for fair trade.

The nineteenth century was a crucial period for the US as the cotton industry emerged as one of the country's leading manufacturers before the Civil war. The trades were more substantial and expanded. The international economic interdependence developed in many folds. The twentieth century has bridged the gaps between the continents by creating the global textile and apparel markets to flourish in the twenty-first century.

Globalization and contemporary trade

Globalization can be considered the market expansion or exchange at a scale beyond regions of the nations. Some forms of globalization included are as follows:

- **Mercantilism**

  It is a type of trading system where a nation tries to impose a positive

trade balance, which means more exports than imports in terms of value, favoring and accumulation of the nation's wealth. This type of trading system leads to the monopolization of trade. In mercantilism, the trading system is controlled so that only one partner benefits at the expense of the others. Still, this type of mercantilism has been established as the basis of the global trading system.

- **Neomercantilism**

  This form of mercantilism can be seen in more recent trading. This trading system aims to establish a positive trade balance to meet the economically structured cost system through developmental goals. In neomercantilism, the government provides subsidy systems such as free trade zones, which thus encourage export-oriented strategies. The outcome of these trading systems is that tariff and non-tariff measures are regulated, thus protecting national commercial sectors. Therefore, this type of strategy can be considered controversial.

- **Absolute advantages**

  This trade consists of a mechanism mainly relying on the nation's resources, *i.e.,* when a country can effectively produce goods using fewer resources, such as capital and labour than other potential competitors. In this trade, the nation mainly focuses on its advantage by trading its surplus and importing the goods it lacks. One of the main drawbacks of this perspective is that the countries lacking absolute advantages trades are not allowed, thus, they gaining little from their trade. Absolute advantage tends to be an enduring characteristic; as long as the resources are available or have a potential market, trade may continue, or else the trade loses its efficiency, making nations vulnerable.

- **Comparative advantage**

  When nations have an absolute advantage, they can focus on the absolute advantage over a wide array of economic sectors with the highest comparative advantages (difference between the competitors and their production cost). This type of trading system increases productivity as nations that do not have an absolute advantage can gain productivity significantly. One of the drawbacks to the competitive advantage is that it is a temporary characteristic that is subjected to change according to labour costs and technological advancements.

- **Factor endowments**

  It is an expanded version of the comparative advantage by underlining that trade is a related factor that starts with essential endowments like capital, land, and labour. The nation will export goods with notable factor endowments and import goods with scarce factor endowments. For example, countries with low labour costs focus on labour-intensive tasks, whereas nations with high capital endowments focus on capital-intensive activities. This type of endowment is subjected to improvements through investing in capital and human resources.

Intext Activity1

Explore different international trade laws which are being implemented in different countries and their impact on trades carried out in 500 words.

6.4 INTERNATIONAL TRADE

International trade can be defined as the trade where capital, goods, and services are exchanged across international borders or amongst territories because of a specific need for the specific goods or services. In other words, international trades are economic transactions that are made between countries. This trade allows countries to expand their existing markets and access goods and services that are otherwise difficult to avail in the domestic markets. Some of the commonly traded items among consumer goods are clothing, machinery, raw materials, etc. Increase in globalization has increased competitive pricing, thus bringing a cheaper product to the consumer's home. International trade has existed throughout history including Silk Road, Uttarapatha, Amber Road, Salt Roads, Scramble for Africa, etc.

Imports and exports are two terms related to the global market, where an import is brought from the global market, and an export is a product sold to the global market. Countries are endowed with foreign assets and natural resources (land, labour, capital, technology, etc.). International trade allows countries to produce goods more efficiently, quickly, and at a lower cost. In most countries, trade represents a significant share of Gross Domestic Product (GDP).

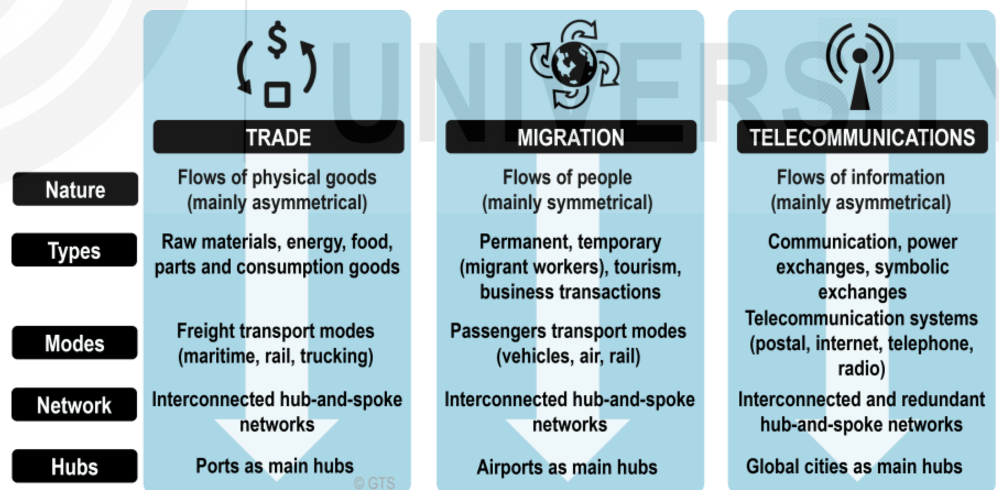

Figure 6.1 The Flows of Globalization

(Source: The Geography of Transport System (The spatial organization of transportation and mobility))

Factors affecting International trade

Understanding international trade can be a complex process compared to the trade process, as this type of trading process can significantly affect the nation's economy; thus it is essential to identify factors that will influence trade.

- **Impact of inflation**

  Inflation can be defined as the increase in general prices for goods or services thus, the purchasing power of currency is falling. For example, when the country's inflation rate increases relatively, the countries where trade is being done are expected to fall or decrease. Consumers and corporations from countries with inflation will likely purchase goods or services overseas thus reducing the country's exports.

- **Impact of national income**

  The total income accruing to the one year’s time, the economic activities of the country is known as national income, which includes wages, interests, rents, and profits. An increase in income levels will be proportional to the rise in the consumption of goods. Every percentage growth in the consumption of goods is most likely to reflect the increase in the demand for national or foreign goods.

- **Impact of government restrictions**

  A nation's government can profoundly affect the trade balance due to several trade policies such as subsidizing exports, import restrictions, piracy control, etc. Amongst three major trade restrictions to protect domestic producers are tariffs, subsidies, and quotas. A tariff can be defined as the tax imposed by the importing country; this is to be paid when an imported good crosses its international boundary. A subsidy can be defined as a payment given by the government to domestic producers based on their production capacity. A quota can be defined as a limiting factor that limits the number of goods to be imported or exported.

- **Impact of exchange rates**

  One of the significant factors is the currency exchange rate, which is the price of one nation‘s currency in terms of the other nation's currency. In exchange rates, domestic or foreign currency can be quoted directly or indirectly. In the direct system, the price per unit of foreign currency is expressed in domestic currency rates. However, in the indirect system, the cost per unit of domestic currency is expressed in foreign currency.

- **Geographical location**

  A country's geographical location can also play a significant role in international trade with respect to climate changes, ease of transportation and presence of coastal areas. The more complex the travel routes more the transportation charges, thus raising the overall price range of the goods or services.

- **The level of economic development**

  A country's economic development can directly affect the its foreign trade and relative position in international trade. For example, developing countries' relatively underdeveloped trade systems and resource management make them relatively less likely to make strong players in the global trade market.

- **Lack of restrictions on piracy**

  Piracy is a term used for manufactured products that look almost identical to the original. Due to the lack of restrictions on piracy by several governments, international trade flow will be significantly affected by piracy, thus reducing demand for imported or exported products. In other terms, imported/ exported products were compared to piracy products, thus making them relatively costlier.

- **Competitiveness**

  With the growing competitive levels, interdependence levels between the markets are increasing several folds. Competitiveness can be defined as the relative ability of different countries to provide additional services or products at a level that is widely accepted by the population. Competitiveness has a significant role in global trade as the higher levels are attained by the most competitive countries making life difficult for underdeveloped countries.

- **Globalization**

  Globalization can be defined as the general tendency of national economies to integrate for mutual benefit. Globalization has increased international trade over the past few decades. It has been facilitated by advancements in technology, transportation and allowing companies to engage in cross- border economic activities.

Check Your Progress I

Note: Use the space provided for your answer

1. **Fill in the blanks:**
   (a) ……….. is a trade where capital, goods, and services are exchanged across international borders or amongst territories.
   (b) What are the factors which are affecting international trade ……....., ………….., …………., ……….., ……………, ……………
   (c) …………… can profoundly affect the balance of trade due to several trade policies such as subsidizing exports, restrictions on imports, piracy control, etc.

2. **Define Mercantilism.**

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6.5 BENEFITS OF INTERNATIONAL TRADE

The benefits of international trade for a business are a larger potential customer base, meaning more profits and revenues, less competition in a foreign market that has yet to be accessed, diversification, and possible benefits through foreign exchange rates.

Need for International Trade

International trade is mostly developed to allow countries to expand their potential market and access different goods and services they lack, which otherwise will be difficult to obtain or unavailable in the local market. Some common things that spur international trade are education, government policies, natural resources, labour laws, and financial opportunities.

6.5.1 Common Barriers to International Trade

The obstacle that may hinder trade between countries is the trade barriers. Trade barriers are introduced to reduce imports, favor national goods, and enhance exports. Some of the common trade barriers which were imposed by the countries include subsidies, tariffs, quotas, and non tariffs.

A subsidy can be defined as the incentives provided by the governments to their respective industrial workers or the local producers as a form of encouragement to produce more goods at a lowered cost, thus increasing the competitiveness in the global market.

Tariffs are levied taxes on imports. A tariff is mainly used to raise the price of imports so the consumers feel burdened to use such products, ultimately reducing the imports. In simpler terms, tariffs can be elaborated as, with the increase in the price, the consumers less favors those items. Thus, making them opt for local goods and services.

Quotas trade barriers restrict the flow of goods and services that can be imported into a particular country. Generally, these types of quotas come with an inherent licensing system suggesting proof of specific limitations and regulations.

Non-tariff barriers are the other limitations of the treads rather than the tariffs. It includes regulations, licenses, and sanctions. Some countries regularly use this to limit their commerce they undertake with other countries. Regulations regarding product content or quality are included in non-tariff barriers. A license under the non- tariff barrier allows limited companies to import goods from other countries. Sanctions as a non-tariff barrier are the government act that prohibits companies from doing business with certain countries.

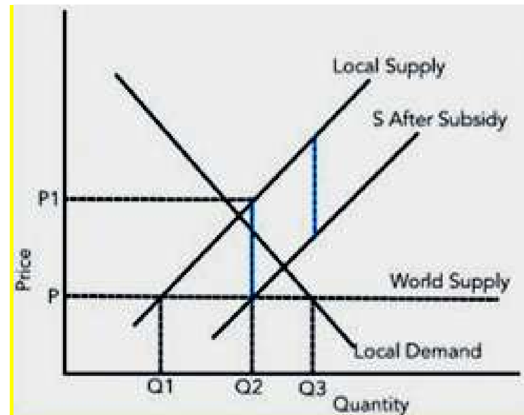

Figure 6.2 Example of the Effects of Trade Barriers
(Source:www.economicsonline.co)

Figure 6.2 can be elaborated as P is the world price, Q1 is the production from the domestic industry, Q2 is the local demand, and Q3 is the imported goods.

6.6 TRADE POLICIES

Trade policy can be defined as the goals, rules, standards, and regulations involved in trade between countries. These policies are particular to the specific country and are formed by its public officials. The trades policies the countries follows varies between the countries and regions, but there are some common policies and agreements that have significant impact on international trade in the textiles and apparel sector.

In developing nations, textile/apparel industries have been a source of economic development, thus it relying on exports to gain income. Trade barriers were imposed as intense competition has grown between the countries producing textile and apparel goods for the same markets (the United States and Western Europe). Often the highest effect was seen in the less developed countries whose exports are based on labour-intensive productions.

General Agreement on Trade and Tariffs (1947) was established to provide licensing and tariff levels which in turn help to protect the economies from the dominance of the developed countries or external competition.

In the 1960s, the policies were limited to cotton imports. With the emergence of manufactured fibers, new rules were needed to cover these fibers, thus resulting in Multifiber Arrangement (MFA). Therefore, a quota system that limits the volume of textile and apparel products, allowed into the more-developed countries.

Several arrangements and laws called upon a unified trade regulation body, thus giving rise to the WTO (World Trade Organization), which opened a new world trading system mainly for the benefit of consumers with the principles of non-discrimination and transparency with open and predictable trade. Later GATT, WTO, and MFA were replaced by the Agreement on Textiles and Clothing (ATC), whose primary need is to benefit both developing and developed countries. ATC expired on 1st January 2005, abolishing all the quotas, thus lifting the gate on 40 years of discriminatory

trade regime which restricted the textile and apparel goods from the developing countries.

In the interim, NAMA (Non-Agricultural Products Market Access) was developed under Doha multilateral goods, which directly affect the textile and clothing sector in both developed and underdeveloped countries. However, due to some challenges, the scheme was suspended on 24th July 2006. Later in the early 2007s, renegotiations started bearing new opportunities and challenges for the exporter's sector. Under NAMA, the average tariff rates were relatively lowered for industrial products thus benefiting the developing countries. On the other hand, this has relatively intensified the competition with imports. Thus, developing and lower developing countries will be constantly exposed to the challenges and opportunities the evolving international trade systems provide.

Some of the key trade policies related to textiles and apparel industries are discussed below:

Tariffs: Tariffs are taxes imposed on imported goods. Many countries apply tariffs to textiles and apparel products to protect their domestic industries and promote local production. Tariff rates can vary widely between countries and are often higher for finished products compared to the raw material or intermediate goods.

Quotas: Quotas are quantitative restrictions on the amount of textiles and apparel products that can be imported into a country. Quotas can be imposed to limit imports and protect domestic industries from foreign competition. However, many countries have phase out quotas as result of the Agreement on Textiles and Clothing, under the World Trade organization.

Regional Trade Agreement: Regional trade Agreement is an agreement between two countries within a specific geographical region. Free trade Agreements and Customs Unions are the examples of Regional trade Agreement. These trade agreements often aim to reduce tariffs and other trade barriers between two countries.

Rules of Origin: In the textiles and apparel sector, rule of origin is very important for determining eligibility for preferential trade agreement and avoiding transshipment of trade rules.

Intellectual Property Right (IPR): This is important in textiles and apparel industry for trademarks, design protection and copyright. Trade policies related to IPR enforcement help protect the rights of designers and brand owners, and preventing counterfeiting and unauthorized use of intellectual property.

Non- Tariff Barrier: This policy includes measures other than tariffs that can restricts trade such as technical regulations, product standards, labeling requirements etc.

Hence, it is important to note that trade policies can change overtime as countries negotiate new agreements or adjust their regulation.

Check Your Progress II

Note: Use the space provided for your answer

1. Elabourate on some of the common barriers to International Trade.

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2. Define Trade Policy.

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6.7 LET US SUM UP

To sum up, the Unit "trade" can be defined as one of the important concepts of centuries. The two main terms related to trade are tariff and import quotas. Tariffs were placed on imported goods to discourage imports and to protect the domestic producers forming a source of government revenue. Import quotas were placed, which suggest or limit (legally) the quantity of the goods that are being imported into the countries. International trade is where capital, goods, and services are exchanged across international borders or amongst territories because of a specific need for particular goods or services. International trade is mainly developed to allow countries to expand their potential market and access different goods and services they lacking, which otherwise will be difficult to obtain or unavailable in the local market. Some of the common trade barriers which were imposed by the countries include subsidies, tariffs, quotas, import and export incense, and standardizations. As intense competition has grown between the countries that are producing textile and apparel goods for the same markets, trade barriers were imposed, making international trade a place for the systematic flow of goods and services.

6.8 KEYWORDS

Trade: Trade is a basic act of exchange of goods and services, in other words, trade can be termed as the buying of goods or services between people or countries.

International Trade: International trade is the exchange of capital goods and

services across international borders or territories because of a need or want of goods or services. This trade represents a significant share of the gross domestic product in most countries.

Trade Policies: Trade policy can be defined as the goals, rules, standards, and regulations involved in trade between countries. These policies are particular to the specific country and are formed by its public officials.

Globalization: Globalization is a term used to describe the growing interdependence of the world's economies, cultures, and populations, which are brought across by cross-border trade of goods and services, technology, and the flow of investment, people, and information.

Competitiveness: Competitiveness can be described as the ability of a business, a country, or a person to compete. This is also known as the ability of a business to deliver better value to customers than competitors. A key part of all business activity in which marketing plays a vital role in the search for sustainable competitive advantage.

6.9 REFERENCES AND SUGGESTED READINGS

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6.10 CHECK YOUR PROGRESS – POSSIBLE ANSWERS

Check Your Progress I

1. (a) International Trade

   (b) Inflation, National income, Exchange rate, Government restrictions, Competitiveness, Geographical conditions, etc.

   (c) Government restrictions

2. It is a type of trading system where a nation tries to impose a positive trade balance, which means more exports than imports in terms of value favoring the accumulation of the nation's wealth. This type of trading system leads to the monopolization of trade. In mercantilism, the trading system is controlled so that only one partner benefits at the expense of the others.

Check Your Progress II

1. Some of the common trade barriers which were imposed by the countries include subsidies, tariffs, quotas, import and export incense, and standardizations.

2. Trade policy can be defined as the goals, rules, standards, and regulations that are involved in trade between countries. These policies are particular to the specific country and are formed by its public officials.

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