INTERNATIONAL TRADE

UNIT-1

Meaning of International Trade

International trade is referred to as the exchange or trade of goods and services between different nations. This kind of trade contributes and increases the world economy. The most commonly traded commodities are television sets, clothes, machinery, capital goods, food, raw material, etc.

International trade has exceptionally increased, which includes services such as foreign transportation, travel and tourism, banking, warehousing, communication, distribution, and advertising. Other equally important developments are the increase in foreign investments and production of foreign goods and services in an international country.

These foreign investments and productions help companies to come closer to their international customers, thus serving them with goods and services at a very low rate.

All the mentioned activities are parts of international business. It can be concluded by saying that international trade and production are two aspects of international business, which is growing day by day across the globe.

Reasons for International Trade

(1) Production

It is not possible for every single country to produce equally at a cheap cost.

That is why international trade is taken into account.

(2) Factors of production

Factors of production include labour, capital, and raw material for producing goods and services that are available at different rates in different countries.

(3) Cost of production

Each country finds it advantageous to produce only those goods and services that can be produced efficiently.

The rest of the activities are assigned to other countries at a lower cost.

(4) Resource distribution

Many times, companies face problems due to the limitation of natural resources.

There is an unequal distribution of the resources in the country.

(5) Examples

Different countries are specialised in different sectors like in India, Maharashtra is involved in textiles, West Bengal in jute products, Haryana and Punjab in food products, Kerala in spices, etc.

Same is categorised for other countries.

Importance of International Trade

International trade between various nations is an essential factor that is responsible for the increase in the standard of living, creating employment, and empowering consumers to enjoy different kinds of goods.

Countries have to produce certain commodities and exchange them with other commodities produced by others. Each country produces those in which it has comparative cost advantage and exchanges them with those in which it has a comparative disadvantage. Few other important factors that are influenced by international trade are:

- **Differences in climate and soils**: Different agricultural products thrive better under certain soils and climatic conditions. For example, cocoa grows well in the tropical climate and soil.
- **Differences in natural resource endowment**: Some countries are endowed with mineral resources that are not found in other areas, crude oil is produced in large quantities in **Saudi Arabia** and **United Arab Emirates** but is not found in commercial quantities in many other **European** and **West African** countries.
- **Variations in available capital stock**: Some countries possess adequate stocks of capital while others do not have adequate capital for exploiting the available resources. Those with less capital stock borrow capital or import goods that they do not produce.
- **Variations in levels of industrial development**: The industrialized countries export their surplus commodities to the less industrialized ones.
- **Variations in level of technical skills**: Countries with advanced technical skills in the production of certain commodities are able to produce certain goods at cheaper rates e.g. **Switzerland** for watches, **France** for wines.
- **The need to satisfy certain wants**: A country has to engage in trade with another because certain goods (especially if they are strategic) are not produced in sufficient quantities at home. It therefore imports what it does not produce in sufficient quantities or what it does not produce at all, but is required for the survival of the economy.
- **Utilisation of raw materials:** Some countries are naturally blessed with an abundance of raw materials, like Qatar is for oil, Iceland for metals and fish, etc. Without international trade, these countries would never benefit from their natural resources or raw materials.
- **Greater choice for consumers:** More international trade results in more choices of products.
- **Specialisation and economies of scale – greater efficiency:** This means that it does not matter what a country is specialised in, and the essential thing is to pursue a specialisation that allows companies to make a profit that outweighs most of the other factors.

- **Global growth and economic development:** International trade influences the economic growth of a country. This increase also leads to the reduction of poverty levels.

Scope of International Business

(1) Exports and Imports

They include merchandise (tangible or having physical existence) of goods.

Export merchandise means sending goods to other nations.

Import merchandise means receiving goods from other nations.

They include the trade of services.

(2) Service trade

It is also known as invisible trade.

It includes the trade of services (intangible or no physical existence).

There is both export and import of services.

It includes services like tourism, hotel, transportation, training, research, etc.

(3) Licensing and Franchising

Under this, permission is given to the organisations of other countries.

It includes selling the product of a particular company.

Under its trademark, patents are given in return of some fees. *Example: Pepsi and Coca Cola are produced and sold through different sellers abroad.*

Franchising is similar to licensing, but franchising is associated with services. *Example:* Dominos, Burger King, etc.

(4) Foreign investment

It includes the investment of available funds in foreign companies to get returns. It can be of two types:

(1) Direct investment means investing funds in plant and machinery for marketing and production, also known as a foreign direct investment (FDI). Sometimes, these investments are done jointly and are known as joint ventures.

(2) Portfolio investment means one company invests in another company by way of investing in its securities and earning income in the form of interests and dividends.

Advantages of International Business

(1) Income: It helps in earning foreign exchange to the organisations. Forex helps in paying off the cost of imports of capital goods, technologies, fertilisers, etc., from abroad.

(2) Efficient resources: Under international trade, countries produce what they can produce efficiently and leave the other activities to nations in which they can work efficiently. This helps different nations to distribute the activities and work efficiently in their areas.

(3) Growth and employment potentials: International trade helps in faster growth of organisations as well as countries. Sometimes, organisations are not able to create employment in the market as they produce on a small scale. Initially, countries like China, Japan, and South Korea took the whole world as a single market for trade. This helped them in employment generation across the world.

(4) Standard of living: People in one country are able to enjoy goods and services of other nations. This helps them in improving the standard of living.

(5) **Increase in quantity and variety of goods and services**: with specialization and exchange, total world output and consumption increases.

(6) **Expansion of market:** A country's market is expanded by having access to other countries' markets.

(7) **Source of foreign exchange**: By exporting its goods and services, a country is able to earn foreign exchange.

(8) **Acceleration of economic development**: Trade facilitates the inflow of **foreign capital** for socio-economic development.

(9) **Increased utilization of resources**: Increased efficient utilization of resources leads to a higher level of output.

(10) **Encouragement of competition**: **Foreign** competition is introduced through trade. There is increased research in order to produce competitive quality goods for the world market and for domestic consumers.

(11) **Increased technical knowledge and gaining of ideas**: The less technically advanced countries gain technical knowledge from the advanced countries.

(12) **Creation of employment opportunities**: Many people am engaged in production for the exporting and impeding of commodities.

Difference between Domestic and International Trade

Parameters	**Domestic trade**	**International trade**
Nationality of buyers and sellers	Under this, people of one nation work in their respective domestic market.	Under this, people from different nations work in the international market.

Nationality of other stakeholders	Stakeholders like suppliers, producers, employees, middlemen, etc., are of the same nation.	Stakeholders like suppliers, producers, employees, middlemen, etc., are of different nations.
Mobility of factors of production	Factors of production like capital and labour are mobile across one nation.	Factors of production like capital and labour are mobile across the different nations.
Heterogeneous customers	Usually, customers are homogeneous in the domestic market.	Customers are not homogeneous in the international market due to different religion, caste, language, etc.
Risks	Under this, a nation is subjected to the political risks within the nation.	This may be a barrier to international trade as different nations have different political risks.
Policies	It is subjected to different policies and regulations, and laws of a single nation.	It is subjected to different policies and regulations, and laws of multiple nations.
Currency	Only one currency is involved.	There is involvement of more than one currency.

Advantages and Disadvantages of Licensing and Franchising

Advantages of licensing and franchising

(1) Nature

Under this system, a licensor/franchisor invests their own money in setting up their business

There is no cost of investing the funds abroad.

So, it is less expensive than other modes.

(2) Interventions

The whole business is owned and managed by local people.

The government interventions or takeovers do not take place.

(3) Existing contracts

Since the business under licensing or franchising is managed by local people, its existing contacts become helpful in marketing operations.

Disadvantages of licensing and franchising

(1) Competition: When the brand becomes popular after licensing or franchising, there is the threat of substitute products having a slight difference.
So, it increases the competition.

(2) Secrecy: If the business is not transacted properly, the confidential information can be leaked to competitors in the foreign market due to which the licensor can suffer stiff competition or losses.

(3) Litigations: It is of no doubt that, conflicts arise among the licensor and the licensee on the factors like maintenance of accounts, payment of royalty, etc. This can lead to costly and long litigation.

(4) **Over-dependence of countries**: Excessive specialization leads to too much dependence which is dangerous in times of crisis between countries.

(5) **Unbalanced growth and development**: Some sectors are developed at the expense of others. The tendency of third world countries to produce primary products has stifled industrial growth.

(6) **Over-production:** Excessive specialization could lead to over-production. This may discourage producers because of the lower prices received for imports. It could lead to dumping, i.e., the process whereby a commodity is sold in a foreign market at a price lower than the producers' cost of production.

(7) **Unemployment:** Excessive importation of foreign goods may stifle the growth of domestic industries and create unemployment problems.

(8) **Importation of dangerous commodities and ideas**: Dangerous commodities such as cocaine, etc. and indecent ways of dressing and behaviour may be imported. These may aggravate the rate of crime.