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FUNDAMENTALS OF INTERNATIONAL ECONOMICS

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International economics deals with the economic activities of various countries and their consequences.

In other words, international economics is a field concerned with economic interactions of countries and effect of international issues on the world economic activity.

It studies economic and political issues related to international trade and finance.

- International trade involves the exchange of goods or services and other factors of production, such as labor and capital, across international borders.

- On the other hand, international finance studies the flow of financial assets or investment across borders. International trade and finance became possible across nations only due to the emergence of globalization.

- Globalization can be defined as an integration of economics all over the world. It involves an exchange of technological, economic, and political factors across nations due to advancement in communication, transportation, and infrastructure systems.

- With the advent of globalization, there is a rapid increase in the free flow of goods and services, capital, labor and finance between nations. The consequences of globalization can be negative or positive.

- For example, globalization has led to increase in employment opportunities and standardization of international economic laws and policies. In addition, it has also resulted in reduction in trade barriers, such as tariffs and quotas.

However, globalization has marked an increase in international competition, which results in decrease in the market share of organizations.

Therefore, the repercussions of globalization are important for organizations, irrespective of whether they are indulged in international trade or not.

Apart from this, it describes the functioning of different international economic institutions, such as World Trade Organization (WTO), International Monetary Fund (IMF), and United Nations Conference on Trade and Development (UNCTAD).

- International economics refers to a study of international forces that influence the domestic conditions of an economy and shape the economic relationship between countries. In other words, it studies the economic interdependence between countries and its effects on economy.

- The scope of international economics is wide as it includes various concepts, such as globalization, gains from trade, pattern of trade, balance of payments, and FDI. Apart from this, international economics describes production, trade, and investment between countries.

- International economics has emerged as one of the most essential concepts for countries. Over the years, the field of international economics has developed drastically with various theoretical, empirical, and descriptive contributions.

- Generally, the economic activities between nations differ from activities within nations. For example, the factors of production are less mobile between countries due to various restrictions imposed by governments.

- The impact of various government restrictions on production, trade, consumption, and distribution of income are covered in the study of internal economics. Thus, it is important to study the international economics as a special field of economics.

- International economics is divided into two parts, namely, theoretical and descriptive.

Role or Importance of Foreign Trade:

Foreign trade enlarges the market for a country’s output.
Exports may lead to increase in national output and may become an engine of growth.
Expansion of a country’s foreign trade may energise an otherwise stagnant economy and may lead it onto the path of economic growth and prosperity.

Increased foreign demand may lead to large production and economies of scale with lower unit costs.

Increased exports may also lead to greater utilisation of existing capacities and thus reduce costs, which may lead to a further increase in exports.

Expanding exports may provide greater employment opportunities. The possibilities of increasing exports may also reveal the underlying investment in a particular country and thus assist in its economic growth.

- The primary function of foreign trade is to explore means of procuring imports of capital goods, without which no process of development can start;

- ii. Trade provides for flow of technology, which allows for increases in productivity, and also result in short-term multiplier effect;

- iii. Foreign trade generates pressure for dynamic change through (a) competitive pressure from imports, (b) pressure of competing export markets,- and (c) a better allocation of resources;

- iv. Exports allow fuller utilisation of capacity resulting in achievement of economies of scale, separates production pattern from domestic demand, increases familiarity with absorption of new technologies;

- v. Foreign trade increases most workers' welfare. It does so at least in four ways: (a) Larger exports translate into higher wages; (b) because workers are also consumers, trade brings them immediate gains through products of imports; (c) it enables workers to become more productive as the goods they produce increase in value; and (d) trade increases technology transfers from industrial to developing countries resulting in demand for more skilled labour in the recipient countries.

- vi. Increased openness to trade has been strongly associated with reduction in poverty in most developing countries. As the historian Arnold Toynbee said ‘civilisation’ has been spread though ‘mimesis’, i.e. emulation or simply copying.

- In short, trade promotes growth enhancing economic welfare by stimulating more efficient utilisation of factor endowments of different regions and by enabling people to obtain goods from efficient sources of supply.

ROLE OR IMPORTANCE

The Role and importance of international trade are as follows:

- Division of labor and specialization
- Optimum allocation and utilization of resources
- Raises Standard of Living of the people
- Generate employment opportunities
- Equality of prices
- Ensures quality and standard goods
- Facilitate economic development
- To improve quality of local products
- Availability of multiple choices

Scope of International Marketing

- **Imports**
- Exports
- **Contractual Agreements (**in terms of licensing or co-production or even of technical assistance)
- **Joint Venturing (** collaborative association of two brands for a reasonable period of time)
- **Contract Manufacturing**
- **Fully Owned Manufacturing**
- **Strategic Alliances(**enemy of your enemy can be your friend)
- **Management Contracts**

The scope of international economy

- The scope of international economics is wide as it includes various concepts:
- globalization
- gains from trade
- pattern of trade
- balance of payments
- FDI
- Apart from this, international economics describes production, trade, and investment between countries

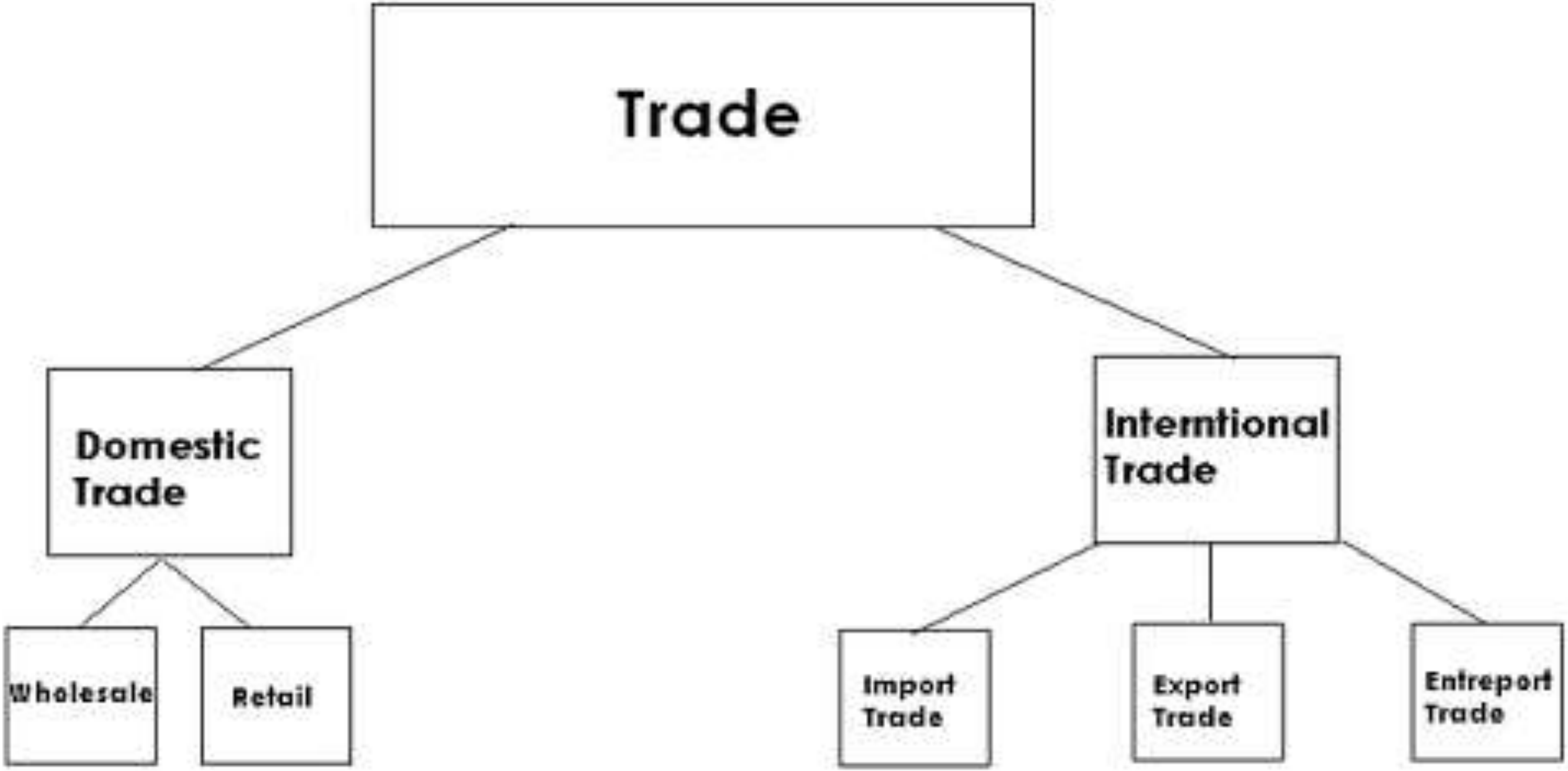
Scope of International Business

- Foreign Investments
- Exports and Imports of Merchandise
- Licensing and Franchising
- Service Exports and Imports
- Growth Opportunities
- Benefiting from Currency Exchange
- Limitations of the Domestic Market

Two parts of International Economics:

- (a) Theoretical International Economics:
- Deals with the explanation of international economic transactions

as they take place in the institutional environment.


Trade
Domestic Trade
Intermtional Trade
Wholesale
Retail
Import Trade
Export Trade
Entreport Trade

Difference B/w Domestic and International

Difference Point	Domestic Marketing	International Marketing
Operation Conditions	One nation language & culture	Many Nations, Languages & Culture
Transportation cost	Major extent	Some Extent
Currency	One	Multiple
Political	Same	Differ
Nature of market	Relatively homogenous	Diverse & Heterogeneous
Change control & Tariffs	No Problems	Obstacles
Data Availability	Accurate	Formidable, But doubted
Government interferences	Relative free	Influences
Environmental Effects	Little effect	Distortion by large companies
Business Environment	Stable	Unstable
Climate & Nature of Business	Uniform & Understood	Varies & Unclear

Difference Between Domestic and International Business

- Culture difference
- Political difference
- Other political risks
- Differences in taking bribery
- The global legal environment also differs from the domestic environment
- The infrastructure of each nation also varies considerably
- Business practice also differs in the global environment
- Firms also face a variety of financial and currency problems it must not be ignored

- Theoretical international economics is grouped into two categories, which are as follows:
- (i) Pure Theory of International Economics:
- Involves microeconomic part of international economics. The pure theory of international economics deals with trade patterns, impact of trade on production, rate of consumption, and income distribution. Apart from this, it also involves the study of effects of trade on prices of goods and services and rate of economic growth.

- (ii) Monetary Theory of International Economics:

- Involves macroeconomic part of international economics. The monetary theory of international economics is concerned with issues related to balance of payments and international monetary system. It studies causes of disequilibrium between payments and international monetary system and international liquidity.

- (b) Descriptive International Economics:

- Deals with institutional environment in which international transactions take place between countries. Descriptive international economics also studies issues related to international flow of goods and services and financial and other resources. In addition, it covers the study of various international economic institutions, such as IMF, WTO, World Bank, and UNCTAD.

- Among aforementioned concepts, such as globalization, gains from trade, pattern of trade, balance of payments, and FDI, globalization forms the major part to be learned in international economics.

ROLE OF FOREIGN TRADE IN INDIA'S ECONOMIC DEVELOPMENT:

- i. The primary function of foreign trade is to explore means of procuring imports of capital goods, without which no process of development can start;
- ii. Trade provides for flow of technology, which allows for increases in productivity, and also result in short-term multiplier effect;
- iii. Foreign trade generates pressure for dynamic change through (a) competitive pressure from imports, (b) pressure of competing export markets,- and (c) a better allocation of resources;

- iv. Exports allow fuller utilisation of capacity resulting in achievement of economies of scale, separates production pattern from domestic demand, increases familiarity with absorption of new technologies;
- v. Foreign trade increases most workers' welfare. It does so at least in four ways: (a) Larger exports translate into higher wages; (b) because workers are also consumers, trade brings them immediate gains through products of imports; (c) it enables workers to become more productive as the goods they produce increase in value; and (d) trade increases technology transfers from industrial to developing countries resulting in demand for more skilled labour in the recipient countries.
- vi. Increased openness to trade has been strongly associated with reduction in poverty in most developing countries. As the historian Arnold Toynbee said 'civilisation' has been spread though 'mimesis', i.e. emulation or simply copying.

- In short, trade promotes growth enhancing economic welfare by stimulating more efficient utilisation of factor endowments of different regions and by enabling people to obtain goods from efficient sources of supply.

Importance of Foreign Trade

- Development of the Economy
- Meeting the shortages
- Imports for better living standard
- Improving quality of production

IMPORTS

- Growth of the Economy- Production; Employment; Expansion; Demand of other goods; utilization of resources
- Source of Foreign Exchange

NEED OF FOREIGN TRADE

The Difference between Inter Regional and International Trade

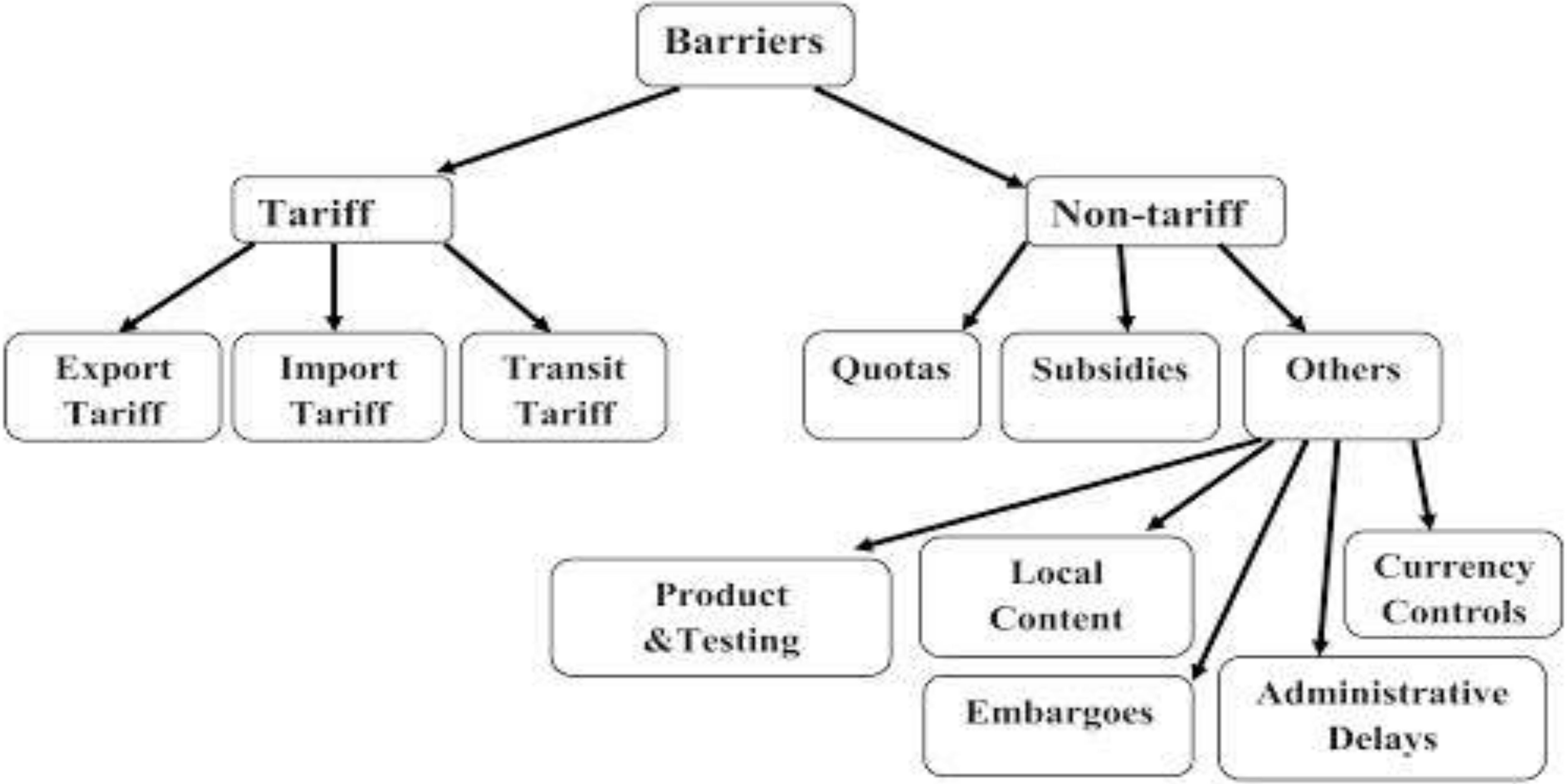
1. Factor Immobility
2. Differences in Natural Resources
3. Geographical and Climatic Differences
4. Different Markets
5. Mobility of Goods
6. Different Currencies
7. Problem of Balance of Payments
8. Different Transport Costs
9. Different Economic Environment
10. Different Political Groups
11. Different National Policies

Conclusion:

Therefore, the classical economists asserted on the basis of the above arguments that international trade was fundamentally different from domestic or inter-regional trade. Hence, they evolved a separate theory for international trade based on the principle of comparative cost differences.

FREE TRADE Vs PROTECTION

Barriers to Trade



- FREE TRADE VS PROTECTION

What is free trade?

- Free trade is said to take place between countries when there are no barriers to trade put in place by governments or international organizations.
- Goods are able to move freely between countries.

What is Protectionism?

- Any measured designed to give local producers of good or service an advantage over a foreign competitor.

ARGUMENTS FOR PROTECTION

There are many arguments for protecting local producers and industries. These include:

- **Protecting Domestic Employment**
- **Protecting The Economy from Low-Cost Labour**
- **Protecting an infant (sunrise) Industry.**
- **To Avoid the Risks of Over-Specialization**
- **Strategic Reasons**
- **To Prevent Dumping**

ARGUMENTS FOR PROTECTION

Protecting the Economy from low-cost labour

- It is often argued that the main reason for declining domestic industries is the low cost of labour in exporting countries.
- The economy should be protected from imports that are produced in countries where the cost of labour is very low.

ARGUMENTS FOR PROTECTION

Protecting the Economy from low-cost labour

<u>Manufacturing Industries</u>

- While trade may create many benefits for an economy as a whole, the cost in terms of job looses may be concentrated in particular industries.
- There is much greater job insecurity among manufacturing workers in developed countries who fear they will lose their jobs to workers in emerging markets such as China & India.
- Workers and their trade unions may lobby vigorously for protection against imported goods.

ARGUMENTS FOR PROTECTION

Protecting the Economy from low-cost labour

<u>Counter Argument for Free Trade</u>

- If we protect the economy from low-cost labour, it will mean that consumers pay higher prices than they should.
- Production in a protected economy would take place at an inefficient level.
- The country wishing to export would lose trade and their economy would suffer.

ARGUMENTS FOR PROTECTION

Protecting the Economy from low-cost labour

<u>Counter Argument:</u>

Government supports workers who lose jobs:

- There is some responsibility on governments to help those workers who have lost their jobs due to increasing competition, from low cost foreign labor.
- These supply side policies could include additional education and training so retrenched workers can enter new industries.

ARGUMENTS FOR PROTECTION

Protecting an Infant (sunrise) industry

- Many governments argue that an industry that is just developing may not have the economies of scale advantages that larger industries in other countries may enjoy.
- The domestic industry will not be competitive against foreign imports until it can gain teh cost advantages of economies of scale.
- Because of this, it is argued that industry needs to be protected against imports, until it achieves size where it is able to compete on an equal footing.

ARGUMENTS FOR PROTECTION

Protecting an Infant (sunrise) industry

- It is likely that developing countries without access to sophisticated capital markets, can use the infant industry argument to justify protectionist policies.
- However, whether have the international political power to able to impose protectionist policies, without complaints and action from developed countries is debatable.

ARGUMENTS FOR PROTECTION

To avoid the risks of over-specialization

- Governments may want to limit over-specialization, if it means the country could become over-dependent on the export sales of one or two products.
- Any change in the world markets for these products might have serious consequences for the country’s economy.
- For example, changes in technology could severely reduce the demand for a commodity, as the development of quartz crystal watches did for the Swiss wristwatch industry, harming the economy.

ARGUMENTS FOR PROTECTION
To Prevent Dumping

What is dumping?

- Dumping is the selling by a country of large quantities of a commodity, at a price lower than its production cost, in another country.
- For example, the EU may have a surplus of butter and sell this at a very low cost to a small developing country.
- Where countries can prove that their industries have been severely damaged by dumping, their governments are allowed under international trade rules to impose anti-dumping measures to reduce the damage.
- However, it is very difficult to prove whether or not a foreign industry is guilty of dumping.

ARGUMENTS FOR PROTECTION
To Prevent Dumping

Counter Argument For Free Trade

- A government that subsidizes a domestic industry may actually support dumping.
- For example, developing countries argue that when the EU exports subsidized sugar, it is actually a came of dumping because the price doesn't reflect that actual cost of the EU sugar producers. Therefore if dumping does occur, it is more likely that there will be a need for talks between governments, rather than any form of protection.

ARGUMENTS FOR PROTECTION
To Prevent Dumping

Counter Argument For Free Trade

- There is always a danger that protectionism will invite retaliatory actions by foreign governments and this reduces the benefits that can be gained by all consumers and producers in all countries.

ARGUMENTS FOR PROTECTION

To correct a balance of payments deficit

<u>**Counter Argument for Free Trade**</u>

- This will only work in the short run.
- It does not actually address the actual problem, because it does not rectify the actual causes of deficit.
- Also, if countries do this, then it is likely that other countries will retaliate with protectionist measures of their own.

ARGUMENTS AGAINST PROTECTIONISM

- All the counter arguments previously covered are great arguments for free trade.
- The arguments against protection are really related to the reasons why countries trade, as previously studied.

ARGUMENTS AGAINST PROTECTIONISM

Prices

- Protection may raise prices to consumers and producers of the imports they buy.

Choice

- Protection would lead to less choice for consumers.

ARGUMENTS AGAINST PROTECTIONISM

Competition

- Competition would diminish if foreign firms are kept out of a country, and so domestic firms may become inefficient without the incentive to minimize costs.
- Innovation may also be reduced for the same reason.

ARGUMENTS AGAINST PROTECTIONISM

<u>Comparative Advantage</u>

- Protectionism distorts comparative advantage leading to the inefficient use of the world's resources.
- Specialization is reduced and this would reduce the potential level of world's output.

ARGUMENTS AGAINST PROTECTIONISM

Economic Growth

- For all reasons listed previously, protection may hinder economic growth.