International Business

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Lecture – 07
Pattern of International Trade, Trade Theories, Export-Import

Welcome friends to the class of International Business. In a time when the Indian stock market is going downhill and the companies most of the companies are in the red right! Still there is a good news that, Amazon is trying to double its stores in the next coming 4 years in India right! So, this is a case of an international example of an international business how companies are trying to invest more in India.

And similarly, we are trying to also go overseas. In this lecture today we are going to discuss about we will be carrying on from the last class; where we talked about you know the new economic policy, the challenges of internationalization and globalization and its impact, privatization and how it all started in the year 1991, under the leadership of then prime minister Narasimha Rao and the finance minister Dr. Manmohan Singh right!

So, India has been going through some interesting time right! So, there has been in the past we saw lot of difficulties, but then there has been substantial growth in an Indian economy and India has become one of the most powerful economies in the world. So, in today's lecture we will be discussing about the theoretical foundations of international trade right!

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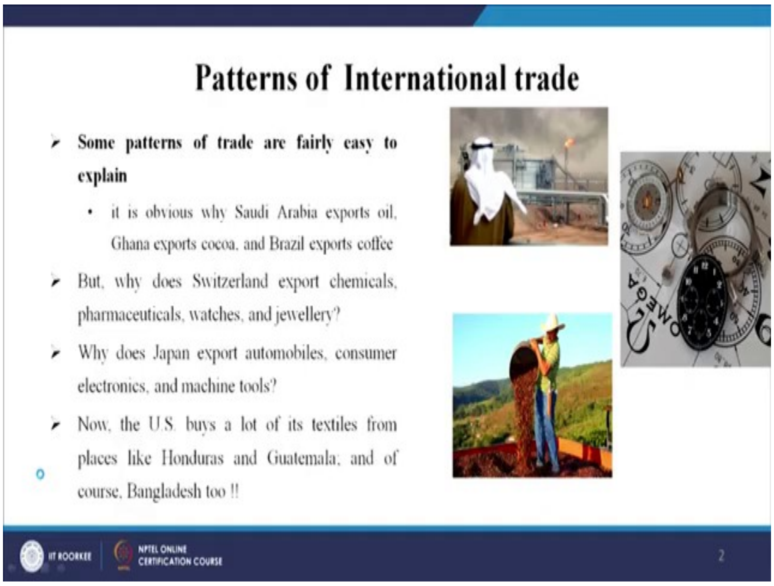

Let us see this if you can connect with these photos that is visible to you, the patterns of international trade. Now, if you can see some patterns of trade are very fairly easy to understand right! Now let us look at this.

It is obvious why Saudi Arabia exports oil right! Because its it has lot of oil reserves, no doubt about it. Ghana exports cocoa, Brazil exports coffee, Sri Lanka exports spices right! So, these are the countries which are blessed with certain kind of resources; and they are thus exporting them. But the question is why does Switzerland export chemicals, pharmaceuticals, watches and jewellery?

Why does japan export at automobiles, consumer electronics, and machine tools? And why does the U.S. buy a lot of textiles from places like Honduras and Guatemala and of course, textiles from Bangladesh? So, how these things are happening? So, today's lecture we will be discussing about the patterns of international trade, the theories behind the international trade, how do these decisions happen? And how these decisions are taken? Right!. So, what are trade theories basically? Trade theories are basically, those theories that help managers and policymakers to focus on a few questions.

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What are these questions? The questions are from this cue if you can see, what, with whom and how much? What products should you we import and export? Should we only export? Should we only import? Should we both export and import? If yes then, how much should we export? And how much should we import? How much should we trade with which country? What is the proportion of trade we should have? Right! With whom should we trade?

So, which countries are more favorable, right!? So, we should have a good relationship, economic relationship, trade relationship with them. So, these are some of the things that trade theories help us to understand.

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The question is why? What are the reasons for the international trade? So, first let us understand these reasons right! So, to start with we will go to the first point which is the differences in technology.

Now, if you can see there are various technologies coming up; every day the in fact, the largest change is happening, because of the change in technology or rapid expansion in technology, as a time was there when the number of semiconductors would double every 18 months was said by Robert Moore right! So, this time has changed and expansion of technology is everywhere.

So, you can see the world has become a machinized world. And because of rapid expansion in technology things have become much much faster, in comparison to the old days when we were doing most of the things in a manual manner. Apple is highly dependent on key Japanese manufacturers and even Chinese right! More than half of the components of an iPhone are from Japan and China which I have missed here.

So, Japan and China and other countries also are suppliers, but most of the products comes from Japan and China, I think I have shown you in the last to last class about the configuration of the different parts of Apple and who are the suppliers from which countries. So, first point is because technology is differing and somebody is having an advantage in that. So, he would build more products, generate more products and can export it to others right!

So, this is the first difference first reason. The second is the difference in the resource endowments now what are endowments? Resource endowments are basically the factors of endowment which are basically land, labor, capital and entrepreneurship right! So, because there is a difference in this some countries would have an advantage in something and others would have an advantage in something else ok.

So, now because of these differences, because these differences exist, that is why somebody would like to export what he is good at and try to import what he does not have right! So, example you see United State imports textiles from Bangladesh right! since the efficient production of textiles requires a relatively cheap labor force and Bangladesh has it right!

Saudi Arabia's oil and gas industry is very efficiently working, because the reason simple reason is there is a lot of natural resource in the Saudi the in the Gulf countries. Silicon Valley, the place where you know most of the companies the software company, tech companies are have opened their shop. You will see in the Silicon Valley there are huge concentration of programmers drawn to the presence of massive because of the massive technical technology firms like Apple and Google.

So, this is about for example, labor this is about the natural resource, land and so these are the we are talking about the factors endowment right! the land, labor, capital and the spirit of entrepreneurship right! Then there is a difference in demand. So, because of the differences in the endowment and differences in the resources, so, there are differences in demand also, as per the you know consumer needs.

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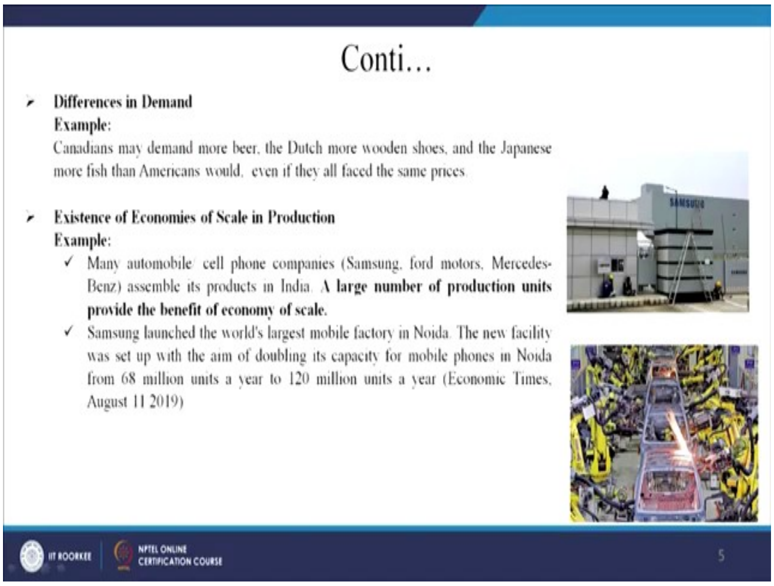

So, what it says for example, Canadians may demand more beer right! the Dutch more wooden shoes, the Japanese more fish than Americans would; even if they are all face the same prices and conditions.

Similarly, if you look at the Indian market, the Indian market has been seeing a sea change in the last many years right! So, what has been the change Indians are demanding more and more of the Western products and the high priced goods, the premium goods and even if you see, the latest technology's, cars, automobiles are today present in India right!

So, the demand from the Indian consumers has been tremendously increasing then, the scope of economies of scale in production. Now, first let us understand what is economies of scale. So, economies of scale means that, when a company tends to produce more and more of a product, the cost of production goes down; that means, it is inverse relationship as the number of units goes up, the cost of producing a unit goes down because why, what is the reason? Because you become an expert in the handling of the raw material you buy the raw material maybe with a in a with a through a good negotiation so, at a lower price.

And, there is a very little wastage of time, there is a high hardly any switching cost involved. So, because of these economies of scale is a very important factor right! You can see many automobile cell phone companies mobile phone companies assemble its products in India right! The reason being is that first of all India itself is a huge market.

So, the demand in this market is so large that, companies are finding it good and justifiable, more rational to have their operations in India; because one the Indian market is large, second there is a cheap labor force in India right! and the English speaking people right! So, all these advantages are supporting India in the Indian market and thus many companies who to achieve such scales of economy, they are trying to have their plants in India, operations in India right!

So, this is a recent case Samsung launched the world's largest mobile factory in Noida. Noida is around is Delhi; so, the capital of India. So, the new facility was set up with the aim of doubling its capacity for mobile phones from 68 million units a year to 120 million units a year. This is taken from the economic times August 11 2019 right! So, you can understand that the demand is changing and there is a scope for achieving economies in the production.

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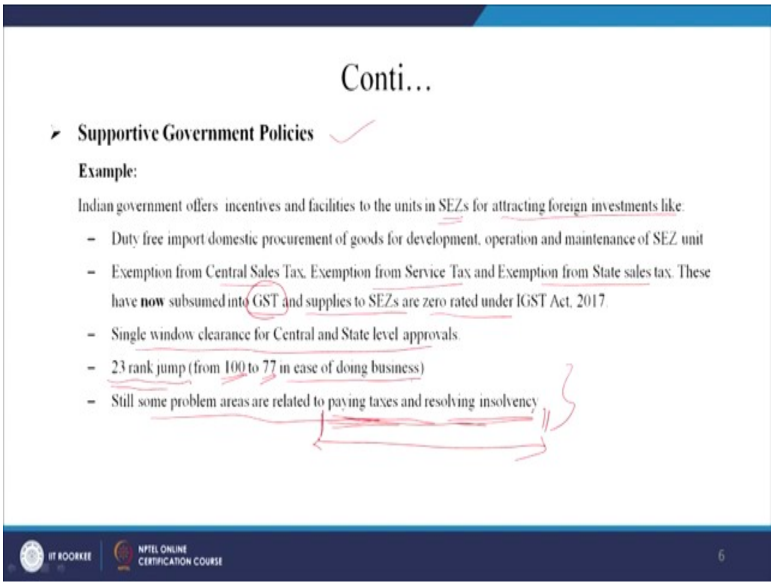

Next point is why there is international trade is growing? The supportive government policies. Now, when there is a government when there is a new government; there are change in policies right! So, these policies may be highly supportive and sometime they might not be supportive, looking at the orientation of the government. For example, when the Americans had the democrat and then they had the republic republican form.

So, there was a change in the policy right! So, people were more scared that now the maybe the Indians would have a tough time to settle in America right!

Because of the large number of programmers and other people who are going to work in America, they thought it would be tough because the republicans might not encourage; so, many people to stay in America. But, during the democrat time it was not that, there was this fear was not there during Obama time for example. Indian government for example, you see offers incentives and facilities to the units in the special economic zones for attracting foreign investments right!

Duty free import, domestic procurement of goods for development, operation and maintenance of the SEZ unit for example right! So, the government is offering incentives, Exemption from Central Sales Tax, Exemption from Service Tax; Exemption from States sales tax these have now subsumed to into GST, the Goods and Services Tax right! and supplies to SEZs are zero rated.

So, these changes has helped the companies to have more faith and trust in the Indian market and the Indian government through the for the Indian government. Now the present government, the NDA government is now talking about, single window clearance for Central and State level proposals right! the approvals and proposals.

So, what does it mean? They want that businessmen should not feel the heat, they should not feel disturbed and they should not be harassed and they should be able to start their business very early, very fast right! It should not be unnecessary, lot of obstacles should not be there.

So, all this has resulted you see that, there has been a 23 rank jump right! in the ease of doing business, India has moved from 100 rank to 77 right! recently. So, that is a very good achievement. But still that is not all, because you cannot be happy we cannot be happy, when we are a 7th economy powerful economy and in we are 77 in ease of doing business; that means, there is a lot and lot of opportunity to grow right! Where the problems still lying in the taxes and resolving insolvency.

So, these are the 2 areas there are many other areas, but the bright! the 2 important areas are which have a very high impact in welcoming the foreign investors is to resolve the taxation problem and the insolvency problem. If India can achieve, solve these two problems and make it as minimal as possible these problems then India's rank I am sure would go would be much better right! in the times to come.

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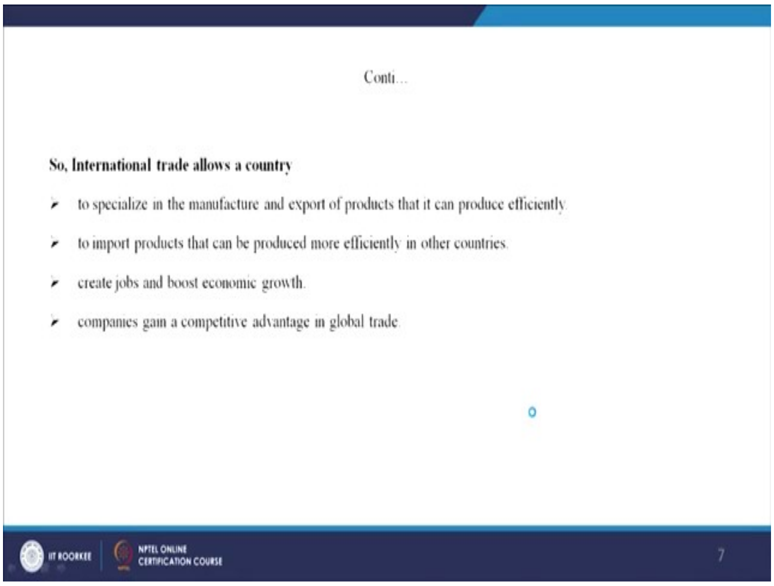

So, what international trade allows a country? So, it says international trade allows a country to specialize now that is very interesting, specialize in the manufacture and export of products that it can produce efficiently. So, what it says international trade helps one country to export something that it is doing best right!

So, if Indians are very good at textiles for example, then we would like to export more of textiles because we have an expertise in that right! To import products that can be produced more efficiently in other countries.

For example, in many of the machine tools or let us say the technology driven things, India would like to import because, still we are not as good as some of our counterparts like Germany, Sweden and you know like countries and so, we would like to import some of the technology for our own growth right! International trade helps in creating jobs and boost the economic growth; obviously, when companies like Ford, when Samsung are coming into India and setting up their offices and their operations.

Obviously, it is creating jobs for the local people right! Companies gain a competitive advantage in global trade, we will explain that; the countries and the companies in these countries they tend to have a competitive advantage. So, in comparison when it is there is a comparison they might be better off in one thing and. So, they would tend to do more of that so, right!

So, there is a competitive advantage in doing certain things for example, India has a competitive advantage because of its English speaking people as I said, large demography and huge population that is and then the people are well educated the skill sets are also growing with time. So, this is all creating a competitive advantage for India.

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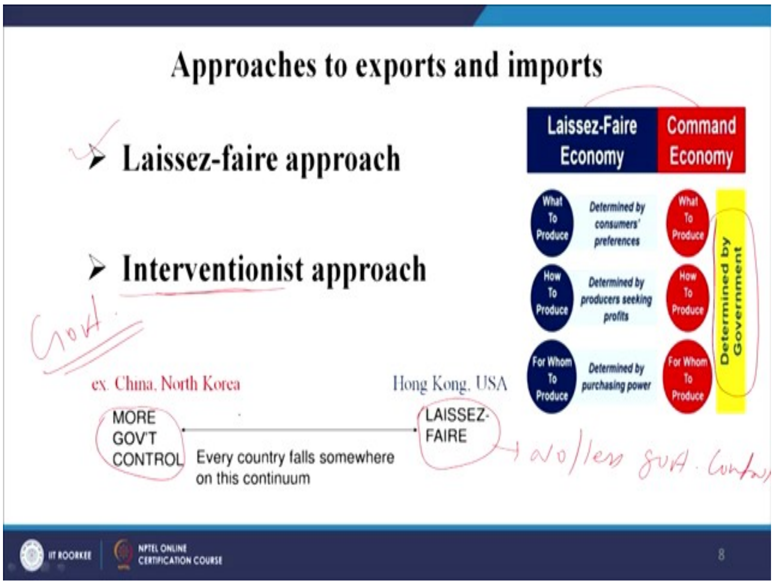

What is the approach to exports and imports? Now let us see basically there are 2 approaches. Now, if you seen one is called the laissez faire approach. Now what is this laissez faire approach? Let us see, if you look at this diagram, now laissez faire versus the command economy which is interventionist right! that means, there is an intervention somebody is interfering now who is that somebody? That somebody is not nobody, but the government here in this case.

So, the government intervenes ok! So, when you compare a laissez faire versus a command economy, what is happening? Now in the laissez faire economy if you see, what to produce is determined by the consumer’s preferences. How to produce is determined by the producers seeking profits. Now how much profit will it make. So, that will decide how to produce that. For whom to produce? So, that will be determined by the purchasing power of the people.

So, is there a demand? Demand means something which is backed by paying power. So, if there is a demand only they will make the product then only it is profitable. On the contrary if you see in the command economy or in when there is an intervention what to produce? How to produce? And for whom to produce? These things are determined by the government.

So, this is in you know spectrum where you can see through if you look at this diagram. So, where there is more government control, and there is a extreme end is the laissez faire. So, there is no government control you can understand this is as a low or very less government control no or less government control.

So, every country falls somewhere. So, India also must be somewhere what you can do is you can think where India should fall if this is an extreme government control and this is a no government control or less government control you can understand. For example, North Korea to some extent China, to a large extent why some extent large extent China, but North Korea is an at perfect example; where the government control is extremely high, extremely high right!

China is not as high as North Korea in terms of government control, but still it is still you know largely controlled by the government. Hong Kong, USA other site other laissez faire government's right! or the government is more free right! So, they did not want to have controls. So, they want the market mechanism to work.

If you have listened to the prime minister of India Mr. Narendra Modi in the August 15 speech he spoke about this point where he said about the point where he said. The government has no role to play in the running of companies.

So, the government should only be like you know stand as a savior or a facilitator to support, but not interfere in the businesses. So, that is a statement which shows that the prime minister of this country is now thinking towards moving towards a model which is more market driven, what are the approaches?

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So, we said the first is the laissez faire approach, it says one that allows the market forces to determine the relations because some countries believe government programs lead to inefficiency it is not wrong also. If you see many of the opinion holds true in India, many of the public sector units you see are today running highly inefficiently.

And whatever the reasons may be, but the end result is they are inefficient and almost many of them have become sick and these some of them are in the verge of getting closed down. So, there are several problems. So, it is thought that the government should not be running the business that is not a very great idea, it restricts the government intervention in the economy.

So, laissez-faire approach says less of government intervention in the economy. The only role of government is to prevent any coercion against individuals. So, that means, for example, if the companies that forming a cartel and trying to control the prices for example, or you know any kind of coercion that is happens right! So, in such cases the government would intervene. So, that is what you know the Prime Minister Narendra Modi said in his Independence Day speech and he said the government should only stay as a supporter, support system and not interfere.

So, whenever the role is required they will jump into right! The next point is free trade theories. So, there are 2 points in this, one is the absolute advantage theory and the comparative advantage theory we will do it in detail; which prescribes that the government should not intervene directly to affect trade. So, these 2 theories one given by Adam Smith, the other given by David Ricardo. They said these are the free trade theory which says, the minimum the governments intervention is there in any economy or in any business setup it is better for the companies and the economy at large.

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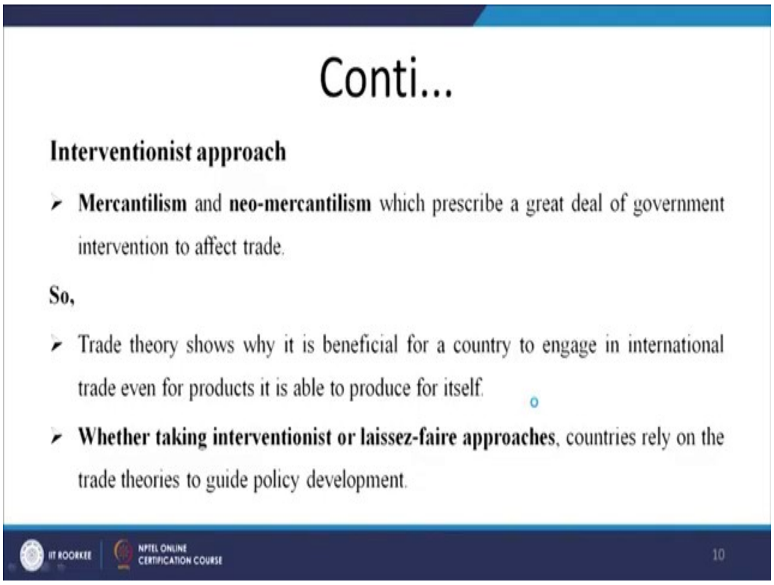

Now, what is this interventionist approach? Ok. So, we can understand it from two point of view. So, one is called the mercantilism and the neo-mercantilism which prescribe a great deal of government intervention to affect trade. Now what is that? Let us see. Trade theories shows why it is beneficial for a country to engage in international trade even for products it is able to produce for itself. That means, suppose country A let us say India is good at something right! is good at something still it should be in a trade relationship with another country to get the maybe to import or export the same item which it is doing still good.

Suppose, we are a good producer of rice or good producer of spices or good producer of textiles, but that does not mean that India should not involve in trade relationship with other countries in these 3 items ok! Whether taking interventionists or laissez-faire approach countries rely on the trade theories to guide policy development. So, how are the countries economic policies developed? They are developed on basis of these approaches, looking at these approaches.

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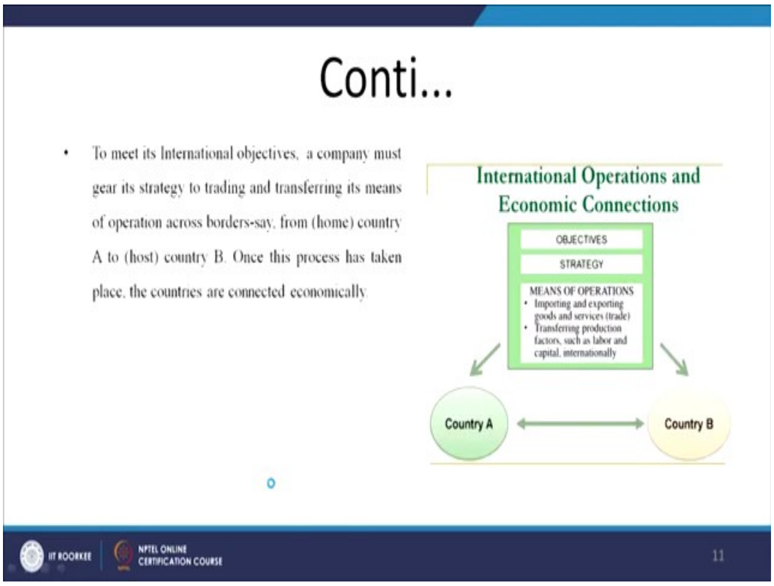

To meet its international objective, a company must gear its strategy to trading and transferring its means of operations across borders; say from home country to host country. once this process has taken place the countries are current economically. So, for example, you see today in today's time you can see India versus Pakistan for example, the trade relationship has become has been severed very badly right! it has been severed; it has affected very badly.

So, because there is a lack of trade between these two countries are very very less of trade. In fact, now at a we are a standstill position. So, the none of the economies are going to benefit. Nobody should think that India being a larger economy it will not get affected, that is a very very wrong way of thinking.

On the other side, if say somebody says only Pakistan is going to be you know be at a loss that is also wrong, both the countries will be at loss, but it is not about always economy so, there are other issues. So, which is not my you know part of my class. So, I am not getting into it. But these are political and patriotic reasons for which we might not be able to do business with them, but economically if you say it is a loss, there is no doubt about it right!

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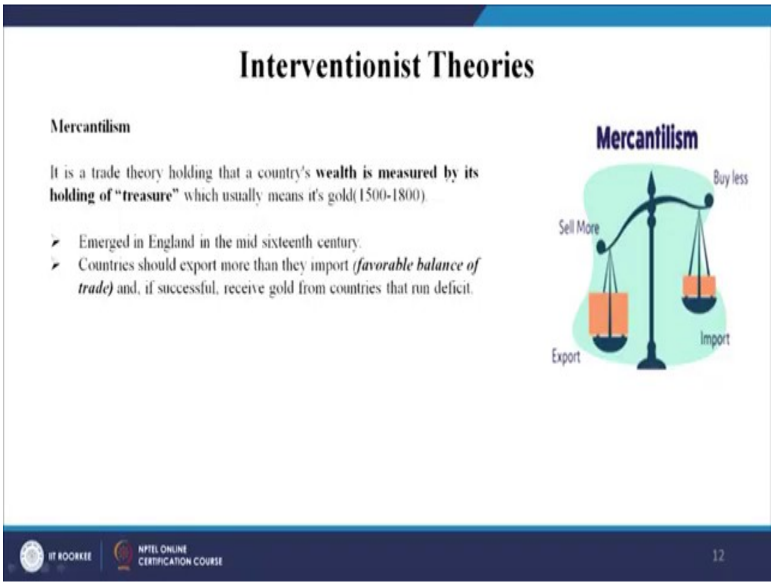

So, what is this interventionist theory? First it says the mercantilism. It is a trade theory holding that a country's wealth is measured by its holding of "treasure", now what is this treasure? Treasure is usually means gold right! it started in the it was during this 1500 to 1800 year time period, that this belief of economic thought was prevalent at that time.

So, countries thought [FL] whoever was holding more treasure; that means, in more gold simple terms was in a better position right! It emerged in England in the mid-16th century it started in 15, but it was largely prevalent in the mid-16th century. Countries should export more than they import what it said, countries should be more export oriented than import because, they felt export is positive, import is negative; you see that is why when you do more import it there is a deficit word attached right!

And they say it is a favorable balance of trade for if you export more and it said there is a deficit created when you are trying to import more right! So, if successful received gold from the country that run deficit. So, what it says? You tend to export goods and get in gold right! So, more the treasure you have the better the country's economy condition is. So, thus you can see buy less sell more.

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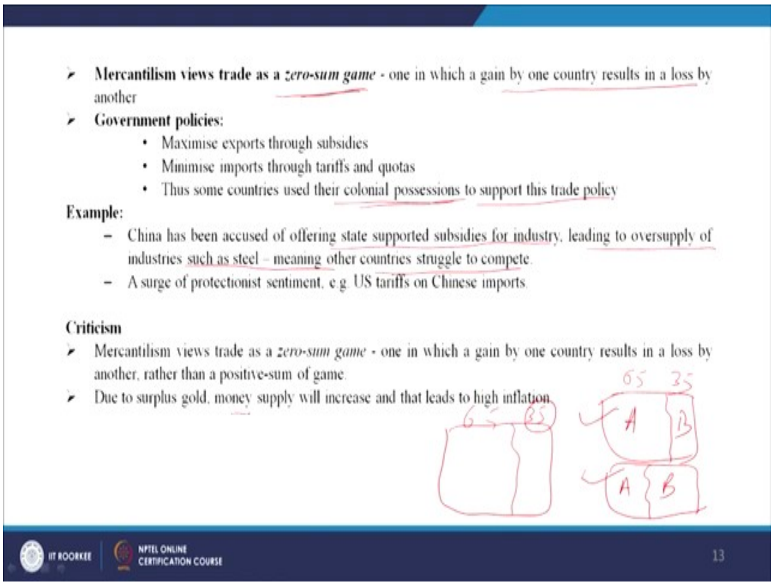

This mercantilism is viewed as a zero-sum game right! One in which the gain by one country results in a loss by another. So, what is it what is the meaning? The total let us say this is the total. Now if suppose A takes away this position. So, B is in a loss, but the total is the same. Now if you see if there is a suppose change right! if I try to make it the same point same you know suppose I make it now B has gained in comparison to these two diagrams B as gained, but A has shrinked, but the total is the remain the same. So, the total does not change right!

So, what did he saying? In which a gain by one country results in a loss by another. So, what are the government policies accordingly for such a condition? Maximize the exports through subsidies. So, to export to export more you have to give subsidies to your producers in the domestic market right! But that is a very questionable thing that we will debate later on maybe through the classes.

But the government thinks, you let us give subsidies; we Chinese economy is has this model is applied in the Chinese economy. So, when they have given lot of subsidies to improve the exports right! and minimize the imports through tariff and quotas. Now you restrict imports by increasing the tariff by putting some quotas you know some trade barriers so, that people will not try to import the raw materials; rather try to make it either in the domestic produce in the domestic market or not rely on such things.

But that is a very you know very wrong idea to me it is a very fancifully wrong idea right! Some countries used their colonial positions you know for example, India was the colony to the British right! So, British had lot of large number of colonies right! So, what they did was this countries France, Spain they had lot of Portugal, they had lot of colonies they use their colonial positions to support this trade policy.

So, what they would do? They would get in the raw materials. So, there was hardly any import duty or any cost for them and they would use this raw material for their benefit and then supply it to other countries and export high. So, that was a very free you know there was a much larger gain for these countries. Example: China has been accused of offering state supported subsidies for industry, which I was just saying. Leading to oversupply of industries such as steel and others.

For example you look at the lot and lot of industries for example, it starts from battery manufacturing to toy manufacturing to even technological components right! whatever you see China has been a you know has a large producer, the reason is because of the governments subsidies largely right!

So, now, this has led other countries to compete because the other countries have not been able to go in a way as China did. A surge of protectionist sentiments example US tariffs on Chinese imports now. Now recently also the US has you know because of the trade war which has happened between US and China.

The US has levied a huge amount of you know tariff. Now this increase in tariff has led to a decrease in the Chinese goods to get into the US market. So, now, these are the examples where the government intervenes to control this right! What is the criticism? The criticism is that mercantilism views trade as a zero-sum game - one in which a gain by one country results in a loss by another, rather than a positive some game.

So, as I said we are thinking that the total volume of this and this is same. Why cannot it happen? That the entire market can grow right! Why do not we think it that way? Let the condition remain the same. Suppose here A has 65 and B has 35 percentage let it be the same here. But if I am increasing the size of the market right! So, this 35 does not mean anymore the same 35 and the 65 does not mean the same 65.

So, the value absolute value has increased right! Due to surplus gold another problem money supply will increase because of the reserves which gold is one of the major reserves. The money supply in the market domestic market will increase and that leads to a high inflation because money becomes cheaper. So, this will lead to high inflation. So, these are the criticisms for the mercantilism view right! So, today we will wind up here. In the next lecture what we will do is we will continue from this mercantilism we will get into the other theories other ways of thinking and then we will move further right! so.

Thank you very much.