MODULE - I

An Overview on Foreign Trade

MODULE 1

An Overview on Foreign Trade

Module Description

Indian population of the 21st century is younger than most of the other countries across the world. Indians are confident and aspirational. Having witnessed positive change, savoured a better life and exposed to wider opportunities, Indians in the present day demand more. India's challenge is to meet their expectations. One of the ways to move in that direction is to expand our foreign trade. This century belongs to India. And to make it a reality we need to learn more about expanding our presence in the global arena.

The goal of studying an overview on foreign trade is to understand basics of foreign trade. This module elucidates the features of foreign trade and describe its nature. The module also focuses on the nuances of Foreign Trade – its nature; its features; how it differs from international business; foreign trade in reference to India; the various modes of entry into international business; comparison of the process of internationalisation and its managerial implications.

Today the entire world is a market for business. To serve the entire globe, we need to have an awareness about foreign markets and how the foreign trade works. This module gives an excellent introduction and a brief history about foreign trade.

By the end of this module, students will be able to explain about the origin and importance of foreign trade, they will also be able to list the nature of foreign trade, differentiate between international business and foreign trade and identify the trends in India's foreign trade.

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Introduction to Foreign Trade

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Chapter 1.1

Introduction to Foreign Trade

Aim

To equip you with the basics of foreign trade, the history, state and direction of foreign trade in India

Instructional Objectives

After completing this chapter, you should be able to:

- Explain the concept of Foreign Trade
- Discuss International Business and Foreign Trade
- Explain India's Foreign Trade

Learning Outcomes

At the end of this chapter, you are expected to:

- List the nature of Foreign Trade
- Differentiate between International Business and Foreign Trade
- Identify the trends in India's Foreign Trade

1.1.1 Foreign Trade

"*Make in India is also about Make for India. It's Make in India, both for India and for exports. India is the only major economy in the world which is growing at over 7% annually. The Chinese are no longer that economical in manufacturing because wage costs have gone up significantly there. In general, their cost of production has risen and, therefore, some manufacturers are said to be keen on getting out of China. So the fact that we can draw them to India is definitely an issue which all of us are seized of.*"

- Nirmala Sitharaman, India Commerce and Industry Minister

International Trade, External Trade or Foreign Trade has only increased in scope and impact in the world today.

(i) Meaning of Foreign Trade

Trade is the lifeline of a nation. What does the term Foreign Trade mean? It is simply the trade carried on between two or more countries. It is an exchange of capital, goods and services across international borders. This kind of trade can be undertaken by an individual or by the Government of a country.

Need and Importance of Foreign Trade:

What is the need for countries to trade among each other? The answer is the diversity that exists in the world making no country self-sufficient in every need. No matter what the natural resources, human resources or industrialisation of a country are, there are goods or services or even the need for capital to develop on existing resources for which a country needs to trade with another.

Through foreign trade a country can attract lot of foreign direct investment (FDI). FDI is a critical driver of economic growth and a major source of non-debt financial resource for the economic development in India. Multinational companies invest in India to take advantage of relatively lower wages, special investment privileges such as tax exemptions by some states.

Allowing or attracting foreign investments will help a country to get technical know-how and generating employment immensely. In recent years the Indian government's favourable policy regime and robust business environment have ensured that foreign capital keeps flowing into the country without many restrictions. Through relaxing FDI norms across sectors such as defence, PSU oil refineries, telecom, power exchanges and stock exchanges, among others in India.

On the same lines it is also true that a country may have an excess of some goods or services which some other country lacks thus creating an opportunity to offload the excess at a profit.

In order to successfully navigate the international trade arena, India's new Government will be tasked with leveraging India's growing role within the international trading system to achieve both its domestic and international objectives. As the geo-economic landscape has seen a shift in recent years, emerging economies have increasingly begun to play a more pronounced role in a number of global economic issues and as the world's fourth largest economy (PPP-Purchasing Power Parity), India's role in this system has become more prominent.

Need for Foreign Trade

The major factors that necessitate Foreign Trade are:

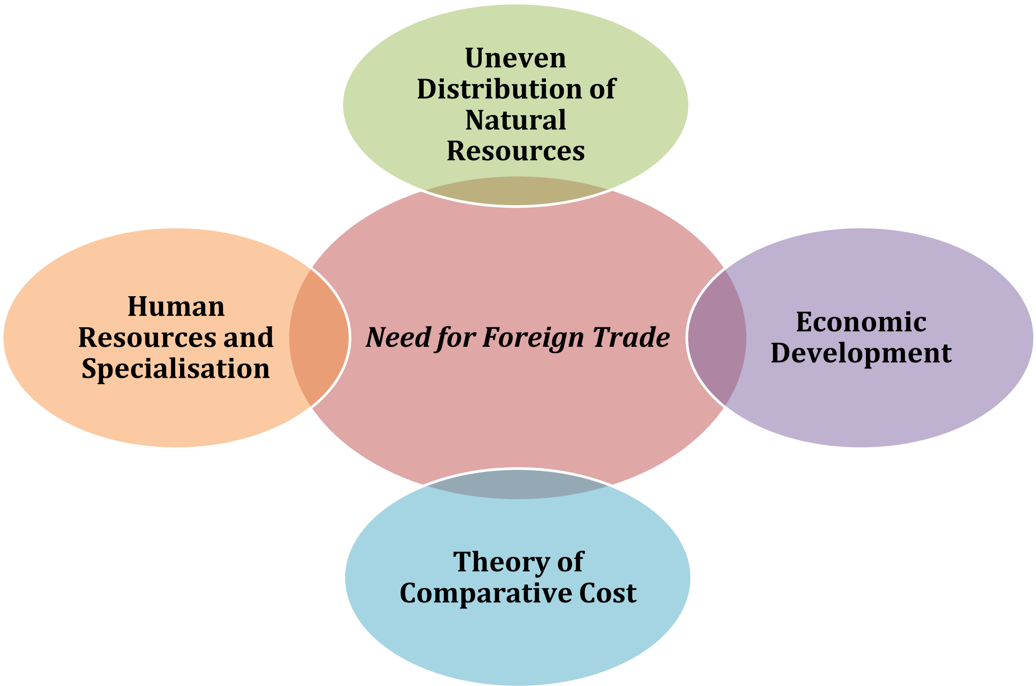

Figure 1.1.1: Need for Foreign Trade

The four major factors that necessitate Foreign Trade:

1. Uneven Distribution of Natural Resources

Every country in the world is geographically different from another. This means that because of the differences in climate, soil, minerals and other factors, some countries can grow some crops better than others. This creates a requirement for surplus home crops to be exported and deficient ones to be imported.

2. Human Resources and Specialisation

Diversity in human resources as well as natural resources makes some countries more suitable to the production of particular goods that other countries are not equipped to produce. The people, their skills – inherent and learnt, availability of raw material, climatic conditions give countries an advantage over others. This is another reason that necessitates Foreign Trade.

3. Economic Development

There is often diversity in the economic growth rate of different countries. While some countries are developed, some are underdeveloped and some others are developing. Underdeveloped and developing countries depend on for capital which further increases the need for Foreign Trade.

4. Theory of Comparative Cost

The theory of comparative cost states that a country must focus on what it can produce, depending on its natural resources, human resources and economics, at the lowest cost possible. This promotes ideal division of labour and international specialisation leading to better standard of living across countries all over the world. In this manner, the theory of comparative cost encourages Foreign Trade.

(ii) Nature of Foreign Trade

Foreign trade is the exchange of goods, service and capital across international borders and gives consumers and countries the opportunity to be exposed to new markets and products. When a product that is sold to the foreign market is an export and a when a product that is bought from the foreign market is an import. Exports and imports are accounted for in a country's current account in the balance of payments and intern impact the GDP of a country.

Also involving in international trade nations trade with each other regularly, they often establish and create a stronger, more effective trading relationship and aid to have more global peace and stability. Foreign trade will help to allow certain people, or in this case nations to specialise in certain products or services. The kind of specialisation allows companies to produce products for a lower price with a better quality than otherwise normally. When some nations have competitive advantage, these nations are able to specialise in something they are good at and trade for other things they aren't or don't have the resources to produce, then both the countries are benefited.

Take the example of India and China. China produces a great number of the goods that India consumes. China is able to mass-produce these products better than India will do. And India specialises in other products and services and trade them with China.

The three categories of Foreign Trade:

1. **Import:** When a country sources and buys goods or services from another country it is termed as import trade.

   For example, India imports electronic goods from China

2. **Export:** When a country sells its goods and services to another country thereby sending the goods and/or services from the home country to another country it is termed as export trade.

   For example, Gems and Jewelry

3. **Entrepot:** It is also known as “Re exports”. It is when a country imports goods from another country and then sells it to a different country. This involves both import and export.

   For example, India may import oil from Iraq and export some of it to Bhutan.

Import

When a country sources and buys goods or services from another country it is termed as import trade

Export

When a country sells its goods and services to another country thereby sending the goods and/or services from the home country to another country it is termed export trade

Entrepot

Entrepot also known as “Re exports” is when a country imports goods from one country and then sells it to a different country

This involves both import and export.

Figure 1.1.2: Categories of Foreign Trade

Import, Export and Entrepot are the three categories of Foreign Trade as shown in the figure 1.1.2.

Economies of the world today have come to realise the huge positive impact that Foreign Trade can have on their growth if regulated wisely. The Foreign Trade policies of a country can make or break its economy furthering or hindering its growth. The meaning of International Trade as said by renowned people is shown in the figure 1.1.3.

According to Wasserman and Haltman, "International trade consists of transaction between residents of different countries".

According to Anatol Marad, "International trade is a trade between nations".

According to Eugeworth, "International trade means trade between nations".

Figure 1.1.3: International Trade Quotes

Did you know?

India has the largest export trade with the United States of America and the largest import trade with China!

Self-assessment Questions

1) _________trade involves business between different countries.
   - a) International
   - b) Domestic
   - c) Internal
   - d) Inter state

2) What is the need for foreign trade?
   - a) Decreases Economic Development
   - b) Non standard of living
   - c) Increases Economic Development
   - d) Non division of labour

3) Trading goods from home country to another country is known as ____________.
   - a) Export Trade
   - b) Internal Trade
   - c) Import Trade
   - d) Retail Trade

4) Entrepot Trade is _____________________.
   - a) Goods exchanged within a country
   - b) Goods purchased from another country
   - c) Goods sold to another country
   - d) Goods imported from one country and re-exported after processing

Notes: