



9th
Revised &
Enlarged
Edition

INTERNATIONAL ECONOMICS

D.M. Mithani



Himalaya Publishing House

ISO 9001:2015 CERTIFIED

INTERNATIONAL ECONOMICS

D. M. MITHANI

M.A., Ph.D.,

*Professor Emeritus,
L.J. Institute of Business Management (MBA),
Ahmedabad, India.*

*Adjunct Professor,
Oriental Institute of Management,
Vashi, Navi Mumbai.*

*Former Professor, OYA Graduate School of Business,
Universiti Utara Malaysia (UUM), Malaysia.*

*Former Reader,
Department of Commerce, University of Mumbai,
Mumbai, India.*

*Former Head of Economics Department,
Maharashtra College of Arts, Science and Commerce,
Mumbai.*



Himalaya Publishing House

ISO 9001:2015 CERTIFIED

© **AUTHOR**

No part of this publication shall be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording and/or otherwise without the prior written permission of the author and the publisher.

First Edition	: 1992	Reprint	: 2006
Reprint	: 1994	Fifth Revised Edition	: 2007
Second Revised Edition	: 1996	Reprint	: 2008
Reprint	: 1997	Reprint	: 2009
Third Revised and Enlarged Edition	: 1998	Sixth Revised and Enlarged Edition	: 2010
Reprint	: 2000	Reprint	: 2012
Reprint	: 2001	Seventh Revised and Enlarged Edition	: 2015
Fourth Revised and Enlarged Edition	: 2003	Eighth Revised and Enlarged Edition	: 2017
Reprint	: 2004	Ninth Revised and Enlarged Edition	: 2018
Reprint	: 2005		

Published by	:	Mrs. Meena Pandey for Himalaya Publishing House Pvt. Ltd. , “Ramdoot”, Dr. Bhalerao Marg, Girgaon, Mumbai - 400 004. Phones: 022-23860170, 23863863; Fax: 022-23877178 E-mail: himpub@vsnl.com; Website: www.himpub.com
Branch Offices	:	
New Delhi	:	“Pooja Apartments”, 4-B, Murari Lal Street, Ansari Road, Darya Ganj, New Delhi - 110 002. Phones: 011-23270392, 23278631; Fax: 011-23256286
Nagpur	:	Kundanlal Chandak Industrial Estate, Ghat Road, Nagpur - 440 018. Phones: 0712-2738731, 3296733; Telefax: 0712-2721216
Bengaluru	:	Plot No. 91-33, 2nd Main Road, Seshadripuram, Behind Nataraja Theatre, Bengaluru - 560 020. Phone: 080-41138821; Mobile: 09379847017, 09379847005
Hyderabad	:	No. 3-4-184, Lingampally, Besides Raghavendra Swamy Matham, Kachiguda, Hyderabad - 500 027. Phone: 040-27560041, 27550139
Chennai	:	New No. 48/2, Old No. 28/2, Ground Floor, Sarangapani Street, T. Nagar, Chennai - 600 012. Mobile: 09380460419
Pune	:	“Laksha” Apartment, First Floor, No. 527, Mehunpura, Shaniwarpeth (Near Prabhat Theatre), Pune - 411 030. Phones: 020-24496323, 24496333; Mobile: 09370579333
Lucknow	:	House No. 731, Shekhupura Colony, Near B.D. Convent School, Aliganj, Lucknow - 226 022. Phone: 0522-4012353; Mobile: 09307501549
Ahmedabad	:	114, “SHAIL”, 1st Floor, Opp. Madhu Sudan House, C.G. Road, Navrang Pura, Ahmedabad - 380 009. Phone: 079-26560126; Mobile: 09377088847
Ernakulam	:	39/176 (New No. 60/251), 1st Floor, Karikkamuri Road, Ernakulam, Kochi - 682 011. Phones: 0484-2378012, 2378016; Mobile: 09387122121
Bhubaneswar	:	Plot No. 214/1342, Budheswari Colony, Behind Durga Mandap, Bhubaneswar - 751 006. Phone: 0674-2575129; Mobile: 09338746007
Kolkata	:	108/4, Beliaghata Main Road, Near ID Hospital, Opp. SBI Bank, Kolkata - 700 010. Phone: 033-32449649; Mobile: 07439040301
DTP by	:	Sudhakar Shetty
Printed at	:	M/s. Aditya Offset Process (I) Pvt. Ltd., Hyderabad. On behalf of HPH.

Dedicated as a token of Love and Respect to



Prof. Y.K. Bhushan

**Senior Advisor and Campus Head
ICFAI, Business School (IBI), Mumbai
The Legend of Management Education
in India and an Iconic Institution builder
having completed
Sixty Glorious Years of his Career in Teaching**



PREFACE TO THE NINTH REVISED EDITION

This volume on International Economics is revised in seeking to explore the economic analysis incisively applied to examine the global economic events and the exciting dynamism of new economic order of the foreign trade and finance in the fast changing world of the 21st Century. In the globalising process of the world economy today, foreign trade and investments are growing faster than the production along with rising capital flows in these days of revolutionary information and communication technology. There is an increasing trend of national economic integration and interdependence, projects and policies tied together in achieving the common goals in the gamut of shifts from competition to contacts and collaboration.

In this edition, the book has been thoroughly revised and recast to incorporate a broader range of events and analysis more rigorously in an updated manner to facilitate the reader to have a better comprehension and improved ability to understand the development in the global economic fields. It is more data-oriented and research-based in its synthesization of ideas and analysis. This edition also incorporates several relevant case studies for the benefit of the reader and purposeful classroom discussions and pragmatic courses at the graduate and undergraduate levels of studies in India and abroad.

Towards acceleration of India's Development Journey Ahead.

"Those who resist change will become irrelevant in the 21st century."

— **Shri Narendra Modi**

(Prime Minister of India)

D. M. MITHANI

ACKNOWLEDGEMENTS

I take this opportunity to express my deepest thanks to Prof. Dr. Mohamad Mustafa Ishak, Vice Chancellor, Universiti Utara Malaysia, Malaysia, Prof. Y. K. Bhushan, Advisor, Indian Business School (IBS), Mumbai and Vice Chancellor, ICFAI University, Assam, and Prof. Javed Khan, President, H.K. Institute of Management, Mumbai as well as Prof. Manish Shah, Vice President, L.J. Education Foundation, Ahmedabad, India for their constant inspiration and encouragement.

I am also grateful to Dr. A.A. Munshi, Ex-Principal of Maharashtra College of Arts, Science & Commerce, Mumbai, Prof. G. S. Gupta, Professor of Economics, Indian Institute of Management (IIM), Ahmedabad, and Javed Syed, Vice President — Marketing, ASTEC, Mumbai for their valuable suggestions.

I am also grateful to Ravi Prakash Khanna and Ved Prakash Arora, Gulam Husain Chaudhary, Firoz Yusuf Khan, Mansoor Ali Moosa Sayed, Shirin Zakir Shaikh and Nilofar Shaikh from the business community in India for their valuable discussion regarding business in practice, especially in Delhi, Dubai and Mumbai.

I am equally grateful to several of my students of MBA and DBA courses at Mumbai and at the UUM (Malaysia) for their interactions that has given me a better insight for the students' needs in the study of this intricate subject. Aafreen Firoz Khan [Mumbai], Abdullah Al-Swidi [Yemen], Arfan Shahzad [Multan, Pakistan] and Sally [Malaysia] deserve special mention.

Ramzan Idd + Maharana Pratap Jayanti
16th June, 2018

D. M. MITHANI

CONTENTS

1. Importance of International Economics	1 – 7
1. Internal and International Trade	
2. Is There a Need for a Separate Theory of International Trade?	
3. Distinct Features of International Transactions	
4. Pure and Monetary Theory of International Trade	
5. International Business	
6. A Measure of International Trade Concentration	
7. Calculation of Growth Rate	
8. Concluding Remarks	
2. The Classical Theory of International Trade	8 – 23
1. Introduction	
2. Adam Smith: The Law of Absolute Cost Advantage	
3. Ricardo: The Doctrine of Comparative Costs	
4. Assumptions Underlying the Ricardian Doctrine	
5. The Theoretical Implication of the Doctrine	
6. Comparative Costs Doctrine Expressed in Terms of Money	
7. A Critical Evaluation of Ricardo's Doctrine	
8. Doctrine of Comparative Costs and Less Developed Countries	
9. The Ricardian Doctrine in Modern Times	
10. Labour Cost Competitiveness	
11. Concluding Remarks: Summing Up	
3. Generalised Ricardian Trade Theory	24 – 30
1. The Theory of Comparative Costs Applied to More than Two Goods	
2. Comparative Cost Doctrine Applied to More than Two Countries	
3. Empirical Studies in the Doctrine of Comparative Cost	
4. Opportunity-Cost Version of Comparative Advantage Principle	31 – 50
1. Introduction	
2. Opportunity Cost Curves	
3. Community Indifference Curves	
4. Equilibrium in Community Consumption and Output	
5. International Trade Under Conditions of Constant Costs	
6. Phenomenon of Trade Under Increasing Costs	
7. International Trade Under Conditions of Decreasing Costs	
8. Region of Mutually Beneficial Trade	

9.	Concluding Remarks	
10.	Specialisation Indicators	
11.	Revealed Comparative Advantage	
5.	Heckscher-Ohlin Theorem: Modern Theory of International Trade	51 – 69
1.	Introduction	
2.	Heckscher-Ohlin Theorem	
3.	Assumptions and Elucidation of the Heckscher-Ohlin Theorem	
4.	Summary of Ohlin's Theory	
5.	Critical Evaluation of Heckscher-Ohlin Theory	
6.	Case Study: H-O Hypothesis and China	
6.	Factor Endowments Theory: Revisited	70 – 97
1.	A Verification of Ohlin's Theorem (Interpreted in Terms of Price Criterion)	
2.	A Geometric Treatment of the Heckscher-Ohlin Model (Interpreted in Terms of Physical Criterion)	
3.	Differing Factor Endowments and Geographical Specialisation	
4.	Graphical Demonstration of Complete Factor-Price Equalisation	
5.	Lerner's Illustration of Factor-Price Equalisation	
6.	Kindleberger's Illustration of Factor-Price Equalisation	
7.	Empirical Test of Factor Endowment Theory: Leontief Paradox	
8.	Intra-industry Trade	
9.	A Case Study	
10.	Case Study: India	
11.	Global Trade	
7.	Recent Development in Theories of International Trade: An Overview	98 – 112
1.	The Availability Doctrine	
2.	The Stolper-Samuelson Theorem	
3.	Heckscher-Ohlin-Samuelson (H-O-S) Theorem	
4.	The Rybczynski Theorem	
5.	The Vent-For-Surplus Approach	
6.	The Product Cycle Hypothesis	
7.	Porter's Theory of Competitive Advantage of Nations	
8.	Concluding Remarks	
8.	The Gravity Model	113 – 120
1.	The Gravity Model of Trade	
2.	Practical Applications	
3.	Trade Gravity	
4.	Extended Gravity Model	
5.	A Case Study: South Africa	

6.	Case Study: Application of Gravity Model in Bangladesh's Trade	
7.	Concluding Remarks	
9.	Gains from International Trade	121 – 129
1.	The Nature of Gains	
2.	Sources of Gain	
3.	Factors Determining Size of Gain	
4.	Equalisation of Potential and Actual Gains	
5.	Criteria of Measuring Gains from International Trade	
6.	The Size of Country and the Gains from Foreign Trade	
10.	Terms of Trade	130 – 154
1.	Terms of Trade	
2.	Theory of Reciprocal Demand	
3.	Marshall-Edgeworth Offer Curves	
4.	Critical Appraisal	
5.	Factors Affecting Terms of Trade of a Country	
6.	Effects of Shifts in Demand on the Terms of Trade	
7.	Effects of Tariffs on the Terms of Trade	
8.	Effect of Devaluation on the Terms of Trade	
9.	Effect of Economic Development on the Terms of Trade	
10.	Terms of Trade and Economic Development	
11.	Reasons for the Unfavourable Terms of Trade of Underdeveloped Countries	
11.	Technical Progress and International Trade	155 – 160
1.	Introduction	
2.	Forms of Technical Progress	
3.	Technical Progress and Terms of Trades	
12.	The Rate of Exchange	161 – 193
1.	Foreign Exchange and Its Instruments	
2.	Foreign Exchange Market	
3.	Rate of Exchange	
4.	Changes in Exchange Rate	
5.	Speculation in Currency Trading	
6.	Market Rate and Equilibrium Rate of Exchange	
7.	Mint Parity Theory	
8.	Purchasing Power Parity Theory	
9.	Balance of Payments Theory	
10.	Causes of Fluctuations in Exchange Rate	
11.	Fixed and Flexible Exchange Rate	
12.	Case for Fixed Exchange Rates	

13. Case for Flexible Exchange Rates
14. Optimum Currency Areas
15. Influence of Monetary and Fiscal Policies on Exchange Rate
16. Futures and Options

13. The Real Exchange Rate **194 – 199**

1. Introduction
2. Nominal versus Real Exchange Rate
3. Determinants of the RER
4. Real Effective Exchange Rate
5. Misalignments
6. A Case Study of China

14. The Balance of Payments **200 – 235**

1. The Balance of Payments Account
2. Importance of Balance of Payments
3. The Structure of Balance of Payments
4. Balance of Trade and Balance of Payments
5. Balance of Payments Always Balances
6. Disequilibrium in the Balance of Payments
7. Kinds of Disequilibrium in Balance of Payments
8. Causes of Disequilibrium
9. Short Run and Long Run Disequilibrium
10. Measures for Correcting Disequilibrium
11. Monetary Measures
12. Non-monetary Measures
13. Foreign Trade Multiplier
14. Adjustable Peg, Crowding Peg and Wider Band Exchange Rate Systems
15. Alternative Approaches to the Balance of Payments Policy
16. Adjustment Processes to Disequilibrium in the Balance of Payments (BoP)
17. Trade-off Between Internal Balance and External Balance: Mundell and Flemming Model
18. BoT: J-Curve Effect

15. International Capital Movements **236 – 241**

1. Meaning of Capital Movements
2. Classification of International Capital Movements
3. Factors Governing International Capital Movements
4. The Role of International Capital Movements

16. Free Trade versus Protection	242 – 253
1. Free Trade	
2. Protection	
3. Economic Arguments for Protection	
4. ‘Non-economic’ Arguments	
5. Role of Protection in Developing Countries	
6. Protective Devices	
17. Tariffs	254 – 265
1. Classification of Tariffs	
2. Effects of Tariffs	
3. The Optimum Tariff	
4. Retaliation	
5. Nominal and Effective Rates of Protection by Tariff	
18. Import Quotas	266 – 274
1. The Nature and Purpose of Quotas	
2. Types of Import Quotas	
3. Effects of Quotas	
4. Quotas versus Tariffs	
5. Concluding Remarks	
19. Exchange Control	275 – 283
1. Meaning	
2. Objectives of Exchange Control	
3. Procedure of Exchange Control	
4. Methods of Exchange Control	
5. Concluding Remarks	
6. Effects of Exchange Control	
20. Miscellaneous Protection Techniques	284 – 289
1. Price Discrimination or Dumping	
2. Subsidies	
3. International Cartels	
4. International Commodity Agreements	
21. State Trading	290 – 297
1. Meaning	
2. Forms and Scope of State Trading	
3. Objectives of State Trading	
4. Merits of State Trading	
5. Disadvantages	

6. Future of State Trading
7. State Trading Corporation of India

22. International Gold Standard **298 – 312**

1. Introduction
2. Mechanism of Gold Standard
3. Rules of the Gold Standard Game
4. Drawbacks of the International Gold Standard
5. Hawtrey Regarded the Gold Standard as a State of “Anarchy in World Credit Control”
6. Working and Collapse of Gold Standard

23. International Monetary Fund **313 – 326**

1. The Nature of IMF
2. Objectives
3. Functions
4. Organisation and Structure
5. Quotas
6. Operations
7. Role of Gold in IMF Arrangements
8. IMF’s Resemblance to Gold Standard
9. IMF — A Better Scheme than Gold Standard
10. Achievements of the IMF
11. The IMF and India
12. Shortcomings of the Fund
13. Suggested Reforms in the IMF

24. International Financial Institutions **327 – 331**

1. The World Bank (IBRD)
2. International Finance Corporation (IFC)
3. International Development Association (IDA)

25. Major Issues of The International Monetary System: The Problem of International Liquidity **332 – 352**

1. Introduction
2. Three Major Issues
3. Main Problems
4. What is International Liquidity?
5. Criteria for Adequacy of International Liquidity
6. International Liquidity Problem
7. IMF and International Liquidity
8. A Review of Suggested Reforms

9.	Special Drawing Rights: The 'Paper Gold'	
10.	Salient Features of SDRs	
11.	Critical Appraisal	
12.	The SDRs Operation	
13.	SDRs and International Liquidity: Some Observations	
26.	The Theory of Customs Union	353 – 363
1.	Forms of Economic Integration	
2.	The Pure Theory of Customs Union	
3.	Dynamic Effects of Customs Union	
4.	General Equilibrium Theorem of Customs Union	
27.	The European Economic Community (European Union)	364 – 368
1.	The Nature of EEC	
2.	Organisation	
3.	The Impact of EEC	
4.	European Free Trade Association (EFTA)	
5.	The EEC: 1992 Reforms	
28.	General Agreement on Tariffs and Trade (GATT)	369 – 384
1.	Origin of GATT	
2.	Main Objectives of GATT	
3.	Most Favoured Nation Clause	
4.	Tariff Negotiations	
5.	The Kennedy Round	
6.	Uruguay Round of the GATT	
7.	Non-tariff Barriers	
29.	The World Trade Organisation (WTO)	385 – 393
1.	Introduction	
2.	Objectives and Functions of the WTO	
3.	The WTO Code/Agreements	
4.	The WTO in Action	
5.	Appendix	
30.	United Nations Conference on Trade and Development (UNCTAD)	394 – 406
1.	Introduction	
2.	Organisation of the UNCTAD	
3.	Main Functions of UNCTAD	
4.	UNCTAD and GATT	
5.	Appraisal of Recommendations of UNCTAD-I	
6.	UNCTAD-II	
7.	UNCTAD-III	

8. UNCTAD-IV
9. UNCTAD-V
10. UNCTAD-VI
11. UNCTAD-VII and VIII
12. New International Economic Order (NIEO)

31. Euro-Dollar Market **407 – 411**

1. Prelude
2. The Meaning of Euro-Dollar
3. Euro-dollar Market
4. Benefits of the Euro-dollar Market
5. Effects of Euro-dollar Market on International Financial System
6. Shortcomings of the Euro-dollar Market
7. The Euro-dollar Multiplier (EDM)
8. European Monetary Union (EMU)

32. Regional Economic Integration Among Developing Countries **412 – 429**

1. Concept of Regional Economic Integration
2. Types of Economic Integration
3. Advantages of a Regional Grouping
4. Regional Grouping in LDC
5. Asian Economic Co-operation
6. South Asian Association for Regional Co-operation (SAARC)
7. The ESCAP
8. Gulf Co-operation Council (GCC)
9. The European Economic Area
10. The Council for Mutual Economic Assistance
11. North American Free Trade Agreement (NAFTA)
12. Association of South East Asian Nations (ASEAN)
13. Concluding Remarks

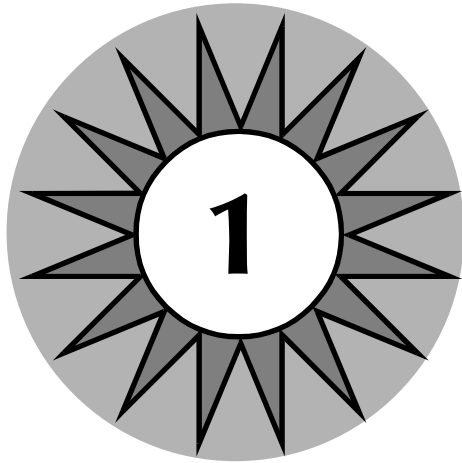
33. Regionalism versus Multilateralism **430 – 435**

1. Introduction
2. Trend Towards Regionalism versus Multilateralism
3. Case of Developing Countries
4. Global Regional Trade
5. NEO Integration
6. BRICS Current Scenario
7. Concluding Remarks

34. India's Foreign Trade	436 – 444
1. Introduction	
2. Trends of Exports and Imports of India	
3. Composition of India's Foreign Trade	
4. Direction of India's Foreign Trade	
5. Concluding Remarks	
35. India's Balance of Payments	445 – 464
1. Introduction	
2. India's Problem of BoP Deficit	
3. Causes	
4. Remedies and Suggestions	
5. India's BoP: Current Scenario	
6. Export and Import Policy: 2002-2007	
36. Multinational Corporations	465 – 472
1. Introduction	
2. Features of MNCs	
3. Emergence of MNCs in a Historical Perspective	
4. Classification of MNCs	
5. Role of MNCs in Developing Countries	
6. MNCs and Developing Countries	
7. Drawbacks of Multinational Corporations	
37. Foreign Direct Investment (FDI)	473 – 489
1. Meaning of FDI	
2. Significance of FDI	
3. FDI Statistics	
4. FDI versus Exports	
5. Determinants of FDI	
6. Host Country Economic Determinants	
7. Determinants of FDI: An Empirical Model	
8. Impact of FDI	
9. Major Theories of FDI	
10. Surge in FDI	
11. Foreign Investment Inflows in India	
38. International Debt and World Bank	490 – 496
1. Introduction	
2. Nature of Debt Problem	
3. The Baker Proposals	
4. Debt Ratios	

5. A Comparison in the Asian Setting
6. Solution Strategy
7. Lenders from South Korea
8. IMF Strategy: Structural Adjustment Policy

39. Globalisation	497 – 533
1. Introduction	
2. Indicators of Globalisation in a Nutshell	
3. Globalisation Strategy	
4. Impact of Globalisation	
5. Case of Globalisation	
6. Global Industries Classification	
7. Globalisation and Technology Transfer	
8. Constraints of Globalisation	
9. Strategy for Growth in the Global Set-up	
10. The Major Problems and Issues	
11. Global Governance	
12. Global Financial System	
13. When Going Global: Some Reflections	
14. Concluding Remarks	
15. Degree of Globalisation	
16. Globalisation: China Case	
17. Globalisation: India Case	
18. A Comparison: India versus China	
19. Global Trade Scenario Pinpoints	
20. Global Production Sharing	
40. Globalisation of Financial Markets: International Finance Hub	534 – 543
1. Introduction	
2. International Finance Hub (IFH)	
3. Degree of Concentration of Finance Activity	
4. Singapore versus Hong Kong as IFH	
5. Global Financial Crisis	
6. Lessons from Recent — (2008) Global Financial Crisis	
41. Case Study Folio	544 – 563
Appendix 1: Additional Matter	564 – 565
Appendix 2: Statistical Tables	566 – 585
References and Selected Readings	586 – 589



Importance of International Economics

1. Internal and International Trade

The term “trade” is commonly understood to mean exchanges of goods, wares or merchandise among people. It comprehends every species of exchange or dealing in goods. Trade may be internal or external. By internal or domestic trade is meant transactions taking place within the geographical boundaries of a nation or region. It is also known as intra-regional or home trade. External or international trade, on the other hand, is trade among different countries or trade across political frontiers. International trade thus, refers to the exchange of goods and services between one country or region and another. It is also sometimes known as inter-regional or foreign trade. Briefly, trade between one nation and another is called “international” trade; and trade within the territory (political boundary) of a nation “internal” trade.

Evidently, international economics, which is the subject of the present book, is that branch of economics which is concerned with the exchange of goods and services between one country and another (foreign trade) as distinct from that trade, which is carried on within the territory of a nation (domestic trade).

The economic reason or significance of international trade is similar to that of domestic trade in a country, that is, the mutual satisfaction of wants and attainment of well-being. In fact, in the absence of international trade it would not have been possible for the world community to live a more happy and prosperous life with a high standard of living as we see today.

However, the fundamental basis of international trade lies in the fact that all countries cannot produce all things equally well or cheaply due to the unequal distribution of natural resources among them and impropriety and imperfect substitutability of their available factors of production. Moreover, for various socio-economic and political reasons, there is a lack of mobility of factors, especially labour, as between one country and another. Thus, different kinds of production which were most advantageous to them were undertaken by different countries and when the exchange of these specialised goods which took place among them gave birth to international trade. Thus, international

trade insofar as it is a result of geographical specialisation fundamentally the same as trade between two regions within the same country (*i.e.*, *domestic* trade). Each region within a country tends to specialise in the production of commodities for which it is best suited, *e.g.*, jute is manufactured in West Bengal and cotton textiles in Mumbai. The same principle of territorial division of labour is extended to the international level, too.

The difference between the two types of trade, internal and international trade (or economics) is merely an application of general economics in the particular context. From this arises questions such as: Why is international economics treated as a separate branch of economics? Are not the laws of domestic trade applicable to foreign trade? Can we not just extend the general theory of production, value, money, etc., to the problem of international trade and transactions? Why should there be a need for a separate theory?

2. Is There a Need for a Separate Theory of International Trade?

On this question, there are two views: (i) The Classical view and (ii) Ohlin's view.

The Classical View

Classical economists believed that there was a fundamental difference between home trade and foreign trade. They pointed out that, labour and capital move freely within a country but not between different countries. Thus, international immobility of factors was the basic criterion accepted by the classical economists for the emergence of international trade. Moreover, different national policies, different political units, different monetary systems, and artificial barriers like tariffs and exchange controls involved in international trade distinguish it from domestic trade. Hence, the classicists observed that the conditions which regulated the exchange of commodities within one such country did not apply to economic relations between different countries. Hence, a separate theory of international trade was necessary and justified.

Ohlin's View

Bertil Ohlin, the Swedish economist, however, challenged the traditionally accepted notion on international trade by advocating that there is no need for a separate theory of international trade. In his view "international trade is but a special case of inter-local or inter-regional trade."

He opines, that the Marshallian theory of value can be easily extended to the phenomenon of international trade by developing the "space" thesis instead of the "time" hypothesis in the Marshallian Price Theory. "Space element is vital for the international trade and should be given full consideration in the theory of pricing, through its extension from one to a number of more or less closely related markets. Such an extension can be based upon one market analysis."¹

In economic life, the concept of "space" has the following significance:

1. The factors of production are generally confined to certain localities, and
2. Free movements of goods are also prevented by the transportation costs and other inhibitory factors.

1. B. Ohlin: *Interregional and International Trade*, p. 4.

In short, from the “space” consideration, there arose the concept of mobility or immobility of the factors of production as located not in certain places but in certain “districts.” He further laid down that the concept of “district” should fulfil at least two conditions:

1. There should be significant differences between the districts, and
2. There should be little differences within a single district.

In other words, a district satisfying these two conditions may be regarded as a “region.”

Under these considerations of the space element, if we take the axiom that the factors of production are inter-regionally immobile but intra-regionally (within the region) freely mobile, then most conveniently we can extrapolate the analysis of regional or internal trade into the international sphere. Ohlin, thus, claims that, the development of the concept of one market theory can include the theory of international trade as an integral part of the general price theory, and that, therefore, there is no need for a separate theory of international trade.

Thus, on methodological grounds, Ohlin tends to reject the necessity for a separate study of international economics. We, however, cannot agree with Ohlin on this issue that a separate study of international trade is not warranted purely for methodological reasons. Apart from methodological reasons, there are various qualifications and variations within a separate branch of study which by all means render a special study quite essential. For an intensive study, a separate branch of the phenomenon is more logical and justifiable than to hold meaningless behavioural generalisations.²

We may, thus, say that, since there are specialised branches of economics like theory of value, theory of money, public finance, industrial economics, labour economics and so on, there must also be a special study of international trade separately called “international economics.”

3. Distinct Features of International Transactions

There are several reasons — practical as well as pedagogic — for evolving a separate theory of international trade and consequent development of a distinctive branch of economics called “International Economics” dealing with issues and problems of the international economy. International trade follows different laws of behaviour from those of domestic trade. Therefore, a separate theory is inevitable. These reasons, in a way, tend to point out the distinguishing attributes of international transactions. Following Kindleberger,³ we may enlist the important features of international trade as under.

Immobility of Factors

The degree of immobility of factors like labour and capital is generally greater between countries than within a country. Immigration laws, citizenship requirement, etc., often restrict the international mobility of labour. International capital flows are prohibited or severely limited by different governments. Consequently, the economic significance of such mobility of factors tends to equality within but not between countries. For instance, wages may be equal in Mumbai and Pune but not in Mumbai and London. According to Harrod, it thus, follows that domestic trade consists largely of exchange of goods between producers who enjoy similar standards of life, whereas, international trade consists of

2. *Ibid.*, p. xv.

3. Kindleberger C.: *International Economics*, pp. 3-10.

exchange of goods between producers enjoying widely differing standards. Evidently, the principles which determine the course and nature of the internal and international trade are bound to be different in some respects at least.⁴

In this context, it may be pointed out that, the price of a commodity in the country where it is produced tends to equal its cost of production. The reason is that, if in an industry the price is higher than its cost, resources will flow into it from other industries, output will increase and the price will fall until it is equal to the cost of production. Conversely, resources will flow out of the industry, output will decline, the price will go up and ultimately equal the cost of production.

Therefore, among different countries, resources are comparatively immobile; hence, there is an automatic influence equalising price and costs. There may be permanent difference between the cost of production of a commodity in one country and the price obtained in a different country for it. For instance, the price of tea in India must, in the long run, be equal to its cost of production in India. But in the U.K., the price of Indian tea may be permanently higher than its cost of production in India. In this way, international trade differs from home trade.

To the extent that, there are differences in factor mobility and equality of factor returns, costs and price of goods produced and exchanged between countries as compared to those within a single country, international trade will follow different laws. A distinct set of theories will thus, be needed to analyse international transactions.

Heterogeneous Markets

In the international economy, world markets lack homogeneity on account of differences in language, preferences, customs, weights and measures, etc. The behaviour of international buyers in each case would, therefore, be different. For instance, the Indians have right-hand driven cars while Americans have left-hand driven cars. Hence, the markets for automobiles are effectively separated. Thus, one peculiarity of international trade is that, it involves heterogeneous national markets.

Different National Groups

An obvious difference between home trade and foreign trade is that trade within a country is trade among the same group of people, whereas, trade between countries runs between differently cohered groups. The socio-economic environment differs greatly between nations, while it is more or less uniform within countries. Friedrich List, therefore, put that: "Domestic trade is among us, international trade is between us and them."⁵

Different Political Units

International trade is a phenomenon which occurs between politically different units, while domestic trade occurs within the same political unit. The government in each country is keen about the welfare of its own nationals against that of the people of other countries. Hence, in international trade policy, each government tries to see its own interest at the cost of the other country. As a matter of fact national sovereignty exerts its great influence on the character of economic activity and trade.

4. Sir Roy Harrod: *International Economics*, p. 6.

5. Quoted by C. Kindleberger: *International Economics*, p. 9.

Thus, the task of international economics is to discover a common ground, if it can, for economic relationship which will satisfy the various components of a peaceful world.

Different National Policies and Government Intervention

National rules, laws and policies relating to trade, commerce, industry, taxation, etc., are more or less uniform within a country, but differ widely between countries. Tariff policy, import quota system, subsidies and other controls adopted by a government interfere with the course of normal trade between it and other countries. Thus, state interference causes different problems in international trade while the value theory in its pure form, which assumes *laissez-faire* policy, cannot be applied *in toto* to the international trade theory.

Different Currencies

Perhaps the principal difference between domestic and international trade is that, the latter involves the use of different types of currencies. That is why there is the problem of exchange rates and foreign exchange. It is a fact that different countries follow different foreign exchange policies. Thus, one has to study not only the factors which determine the value of each country's monetary unit, but also the fact of divergent practices and exchange resorted to.

Specific Problems

International economic relations give rise to certain specific problems of a peculiar nature, *e.g.*, international liquidity, international monetary co-operation, evolution of international organisations like the European Common Market, etc. Such problems can never arise in regional economics. These are to be studied separately and solved by "international economics" against the background of world movements at large.

4. Pure and Monetary Theory of International Trade

International trade theories are usually classified into "pure" and "monetary" theory. The pure (or equilibrium) theory of international trade deals with "equilibrium" phenomena of trade. It seeks to analyse and expose the conditions of equilibrium in real terms. It probes into the economic causes and consequences of international trade. The monetary theory of foreign trade is confronted with the monetary mechanism of international economic transactions, including financial transactions and capital movements. It primarily deals with the determination of exchange rates and seeks to examine the methods and processes of adjustments in the balance of payments equilibrium.

The pure theory of international trade answers three sets of questions: First, why do nations enter into trade? Second, how are gains of trade shared by the trading nations? Third, how does international trade affect the allocation of resources in the domestic economy of the trading country?

A distinctive feature of pure theory of international trade is that it is part of general theory of value. It is, however, static general equilibrium theory (whether it be the classical theory of "comparative costs" or the modern "factor-proportions analysis"). At the most, "pure theory" is a rudimentary dynamic analysis. The monetary theory of international trade, on the other hand, is at least partly a perfect

dynamic theory, which is closely related to the trade cycle theory and Keynes' General Theory of Income and Employment.⁶

In economic literature so far, however, no successful attempt has been made to explain fully how these two types of theories are interlocked. Perhaps the reason for this may not be far to seek. The pure theory of international trade fundamentally deals with the shift in the economic equilibrium from one position to another on account of dynamic changes like changes in preferences, technology, economic policy, etc. It seeks to describe and analyse the features of new equilibrium. The monetary theory of international trade, on the other hand is confined to the process of adjustment leading back to equilibrium. Pure theory generally could not very successfully analyse and describe the process of adjustment. It could only figure out equilibrium positions. As such, international monetary theory has always to confront one or the other of the following problems: either (1) it is trivially simple or (2) it involves specific and sometimes unrealistic assumptions about the nature of adjustment. The latter fact, however, puts the generality aspect of the theory in doubt. Consequently, it becomes difficult to integrate monetary theory into the skeleton of pure economic theory in a rational and realistic manner.⁷

5. International Business

International business is a wider phenomenon than international trade.

When a business firm conducts or expand its business activity beyond the domestic borders of its country it engages in **international business**.

International business virtually implies a company's enlarging business activity containing production as well as sales in more than one country.

The growth and prosperity of global economy rests on the spread of international business, in modern times.

Multinational corporations (MNCs) are the pillars of expanding global economy today. International trade and investments are pivotal in this regard. Table 1.1 summarily represents the types of economies operating in the global arena.

TABLE 1.1: TYPES OF ECONOMIES COMPRISING THE GLOBAL ARENA (ILLUSTRATIONS)

Classification	Major Characteristics	Example
1. Developed Economies	<ul style="list-style-type: none"> ● Mature Economy ● High per capita income 	USA, Australia Canada, Japan
2. Developing Economies	<ul style="list-style-type: none"> ● Extensive Growth in last two decades 	Singapore, Hong Kong, Taiwan, India
3. Transition Economies	<ul style="list-style-type: none"> ● Shift from government control system to capitalism 	Indonesia, Malaysia, Thailand
4. Least developed countries (LDCs)	<ul style="list-style-type: none"> ● Poorest Nations. ● High unemployment ● Lack of skills 	Afghanistan, Cambodia, Yemen

6. Haberler G. V.: *A Survey of International Trade Theory*, p. 4.

7. Cooper R.N. (ed.): *International Finance*, pp. 7-8.

6. A Measure of International Trade Concentration

Concentration ratio (C_n) for International Trade is measured as follows:

$$C_n = (Q_n - X_n)/(Q - X + M)$$

Where

Q_n = Sales at home and abroad by the n largest domestic firms

X_n = Exports by the n largest domestic firms

Q = Total Sales

X = Total Exports

M = Total Imports

**Source:* Soumyen Sikdar (2002): *Contemporary Issues in Globalisation*, Oxford University Press, New Delhi.

7. Calculation of Growth Rate

The Compound Rate of Growth (CRG)

$$CRG = (X_a/X_b)^{1/n} - 1$$

Here,

X_n = The dollar value of international trade in the current year

X_b = The dollar value of international trade in the base year.

8. Concluding Remarks

Over the years in modern times, world economic trade has expanded dramatically with the increasing number of new participants and products in trade.

Tariffs, transportation costs and lack of adequate market access are usually regarded as major trade barriers. To this, in today's time, it is also essential to examine the following factors as the biggest barriers to trade activity of developing economies. These are:

- Contracts identification
- Understanding the customers' nature and technique in the different segments, owing to differences in cultures and eco-social environment.
- Coping with trade regulations imposed by the governments.
- Difference in legal environment.
- Building of networks and relationships.

A participant firm can overcome the contractual and cultural barriers to trade with growing experience, lowering of trade costs and enactment of bilateral trade agreements.

