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Centre for Distance and Online Education

Basics of Foreign Trade

BACHELOR OF COMMERCE

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Unit I Introduction to Foreign Trade

Learning Objectives:

By the end of this unit, the learners would be able to:

- Understand the nature and scope of international business and distinguish it from domestic trade by examining interdependence among nations and global trade patterns.
- Explain the classical and modern theories of international trade, including absolute and comparative advantage, the Heckscher-Ohlin model, and the Gravity Model of Trade.
- Evaluate the gains from international trade by analysing different cost doctrines and equilibrium models, and understand how these gains benefit participating countries.
- Examine the impact of exchange rate mechanisms on international trade dynamics and how currency fluctuations influence trade flows and economic competitiveness.
- Apply strategic trade theories such as Porter's National Competitive Advantage and the Product Life Cycle Theory to assess why nations and firms gain or lose competitive strength over time.

Structure:

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1.1 INTRODUCTION

International trade has existed in one form or another since time immemorial. Indian traders crossed seven seas and ventured to Java and Sumatra long ago. International trade theories, however, were developed much later. Fundamentally, in a market system, individuals trade because they expect to gain from the exchange, *i.e.*, they expect to be better off as a result of trading. In this respect, trade occurs for the same reasons among nations as it does among regions within a given country. Thus, domestic trade occurs within the political boundaries of a nation, whereas international trade occurs across the political boundaries of different nations.

> *"International trade consists of transactions between residents of different countries."*
> ***– Wasserman and Haltman***

The principle of comparative advantage is the basis of international trade. Each nation or region specialises in the production of those goods and services in which it enjoys maximum comparative advantage and imports or purchases its other requirements from other nations. Thus, the principle of division of labour and specialisation is the basis of world trade.

1.2 NATURE OF INTERNATIONAL BUSINESS

International business refers to commercial transactions that take place across national borders and involve the exchange of goods, services, capital, technology, and knowledge. It plays a vital role in today's globalised economy by fostering economic interdependence, enhancing resource allocation, and expanding market access for businesses. Unlike domestic trade, international business operates in a diverse environment shaped by varying political systems, legal frameworks, cultural practices, and economic conditions. This diversity introduces unique challenges and opportunities that require strategic planning, adaptability, and global awareness. As companies expand beyond national boundaries, understanding the inherent nature of international business becomes essential for successful cross-border operations. The following points highlight the key characteristics that define the nature of international business.

(a) **Cross-Border Transactions:** International business involves the exchange of goods, services, capital, and information across national borders. These transactions may include exporting, importing, licensing, franchising, and foreign direct investment. Since multiple jurisdictions are involved, they are subject to different legal, economic, and political environments. This cross-border nature makes international business more complex than domestic trade.

(b) **Multiplicity of Currencies:** International business transactions are carried out in multiple currencies, introducing foreign exchange considerations. Businesses must deal with exchange rate fluctuations, convertibility, and sometimes restrictions on currency movement. Exchange rate risks can impact profitability and require hedging mechanisms. This aspect differentiates international business from domestic operations conducted in a single currency.

(c) **Legal and Political Diversity:** Different countries operate under varying legal systems, trade regulations, tax policies, and political ideologies. International business must adapt to these diverse environments, which can influence contract enforcement, investment protection, and overall ease of doing business. Political stability, diplomatic relations, and government interventions can directly affect international operations.

(d) **Cultural Sensitivity and Diversity:** Cultural differences in language, customs, traditions, and consumer behavior play a crucial role in international business success. Companies must tailor their marketing strategies, management styles, and communication approaches to align with local cultures. Failure to understand cultural nuances can lead to misunderstandings or brand rejection. Cultural intelligence is, therefore, a key competency in global business.

(e) **High Degree of Risk and Uncertainty:** International business is exposed to higher levels of risk compared to domestic trade. These risks include exchange rate volatility, geopolitical instability, trade restrictions, and sudden policy changes. Companies also face country-specific risks like expropriation, civil unrest, or import bans. Effective risk management tools are essential for sustainable international operations.

(f) **Need for International Competitiveness:** Operating in global markets demands a high level of competitiveness in terms of cost, quality, innovation, and customer service. Firms must continuously upgrade their processes, products, and technology to meet global standards. They compete not only

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with local businesses but also with international giants. Building a strong value proposition is essential to thrive in such an environment.

(g) **International Mobility of Factors of Production:** International business involves the movement of capital, labour, technology, and managerial expertise across borders. Companies invest in foreign markets through joint ventures, wholly owned subsidiaries, or strategic alliances. They also hire talent globally and transfer knowledge and technology across locations. This mobility fosters global integration and knowledge sharing.

(h) **Dependence on International Institutions:** Global trade is supported and regulated by institutions like the World Trade Organisation (WTO), International Monetary Fund (IMF), and United Nations Conference on Trade and Development (UNCTAD). These bodies set rules, mediate disputes, and support developing countries in trade capacity building. International businesses rely on such frameworks to operate smoothly and resolve conflicts.

(i) **Dynamic and Evolving Nature:** International business is constantly evolving due to changes in technology, global trade agreements, economic trends, and geopolitical developments. Businesses must stay updated with these shifts and adapt quickly to maintain their relevance. Disruptions such as pandemics, wars, or trade wars can reshape global trade patterns. Hence, agility and foresight are crucial traits for international firms.

(j) **Influence on Domestic Economies:** International business significantly impacts domestic production, employment, and investment. It opens new markets for local industries and brings in foreign capital, technology, and innovation. However, it may also expose domestic businesses to intense competition. Therefore, governments often balance openness with protectionist measures to safeguard national interests.

Check Your Progress

1. Which of the following is a distinguishing feature of international business as compared to domestic business?
   (a) Uniform legal systems
   (b) Absence of cultural differences
   (c) Involvement of multiple currencies
   (d) Single market operations
2. International business transactions are exposed to which of the following risks to a higher extent?
   (a) Operational risks only
   (b) Political and exchange rate risks
   (c) Inventory and logistics risks
   (d) Technological risks only
3. The mobility of which of the following is a characteristic of international business?
   (a) Factors of production such as capital, labour, and technology
   (b) Domestic demand
   (c) Local taxation policies
   (d) Natural resources