Business Studies form 3

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Chapter 1

Foreign Trade

1.1 Introduction

Trade is the exchange of **goods** and **services** with the main aim of making **profits**. The exchange of goods and services may take place within a country or across countries. This gives rise to two main types of trade:

1. **Domestic Trade**
2. **Foreign Trade**

1.2 Domestic Trade

Domestic Trade is the exchange of goods and services between individuals or organisations within the same country. It is mostly characterised by the use of the **local currency**. This type of trade is also called **Home Trade** or **Local Trade**.

1.2.1 Types of Domestic Trade

It is divided into two main types:

Wholesale Trade

- Involves buying goods in large quantities from producers or manufacturers and selling them in smaller quantities to retailers.
- Wholesalers act as a link between producers and retailers.

Functions of Wholesalers:

- Buy in bulk from manufacturers.
- Break bulk into smaller lots for retailers.
- Provide storage for goods.
- Sometimes offer credit facilities to retailers. *Example*: A wholesaler buys 1,000 bags of sugar from Illovo Sugar Company and resells them to small shop owners across Malawi.

Retail Trade

- Involves buying goods in small quantities from wholesalers (or sometimes directly from producers) and selling them to final consumers.

- Retailers are the last link in the chain of distribution. *Example*: A shop in Lilongwe buys sugar from a wholesalers and sells it households.

1.3 Foreign Trade

1.3.1 Meaning of Foreign Trade

Foreign Trade is the exchange of goods, services, and capital across the boundaries of a country. It may involve governments, individuals, or organisations in different countries. For example, Malawi sells tobacco to Japan and America, and imports cars and cellphones from China and India. Since countries use different currencies, transactions in Foreign Trade are often conducted using common currencies such as the US Dollar ($) or the South African Rand (R).

1.3.2 Basis of Foreign Trade

Foreign Trade exists because different countries have different resource **endowments**. For example:

- China produces cars and cellphones that Malawi cannot produce.

- Malawi produces tobacco in large quantities, which China cannot.

These differences make countries **specialise** in producing certain commodities, and then trade with others to obtain goods they cannot produce themselves.

Types of Foreign Trade:

- **Bilateral Trade**: Trade between two countries only.

- **Multilateral Trade**: Trade involving more than two countries.

1.3.3 Divisions of Foreign Trade

Foreign trade can be divided into three main categories:

1. **Import Trade**: Buying goods and services from other countries. Example: Malawi imports *cars* from Japan and *cellphones* from China.

2. **Export Trade**: Selling domestic goods and services to other countries. Example: Malawi exports *tobacco, tea, and sugar.*

3. **Entrepot Trade**: Re-exporting goods. Example: Singapore imports crude oil, refines it, and then re-exports petroleum products.

1.3.4 Major Imports and Exports of Malawi

Major Exports:

- Tobacco
- Tea
- Sugar
- Coffee
- Groundnuts

Major Imports:

- Motor vehicles and spare parts
- Petroleum and petroleum products
- Machinery and equipment
- Fertilisers
- Pharmaceuticals

1.4 Difference between Domestic and Foreign Trade

1. **Mobility of Factors**: Labour and capital move freely in Domestic Trade, but are restricted in Foreign Trade.
2. **Currency**: Domestic Trade uses local currency; Foreign Trade uses foreign currencies.
3. **Movement of Goods**: Goods move easily within a country, but cross-border trade faces restrictions and customs procedures.
4. **Market Size**: Domestic Trade is limited to the local population; Foreign Trade widens the market internationally.
5. **Transport Costs**: Higher in Foreign Trade due to long distances and border charges.

1.5 Advantages of Foreign Trade

1. Provides goods and services not produced locally.
2. Expands markets for Malawian products.
3. Encourages **specialisation** and efficient resource use.
4. Gives access to advanced technology.
5. Strengthens international cooperation.
6. Creates employment in export industries.
7. Increases consumer choice.

1.6 Disadvantages of Foreign Trade

1. Over-dependence on imports weakens local industries.
2. Trade imbalances can harm the economy.
3. Price fluctuations on world markets affect Malawi's exports.
4. Local industries face stiff competition from foreign firms.
5. Reliance on a few crops (like tobacco) is risky.
6. Political conflicts or sanctions can disrupt trade.
7. Foreign goods may weaken local culture.

1.7 Challenges of Foreign Trade in Malawi

1. Poor infrastructure (roads, railways, and ports).
2. Shortage of foreign exchange.
3. Over-reliance on agriculture.
4. Trade barriers (tariffs and quotas) from other countries.
5. Limited industries and exports.
6. Political instability and policy changes.

1.8 Balance of Trade

Balance of Trade (BOT) is the difference between the value of exports and imports within a year.

$$\text{Balance of Trade} = \text{Exports} - \text{Imports}$$

- **Favourable BOT**: Exports $>$ Imports (earns foreign exchange).
- **Unfavourable BOT**: Imports $>$ Exports (loss of foreign exchange).

1.9 Balance of Payments

Balance of Payments (BOP) is a record of all transactions between Malawi and the rest of the world in a year. It includes both goods and services, as well as financial flows like loans and remittances.

Components:

1. **Current Account**: Exports, imports, services, and transfers.
2. **Capital Account**: Transfers of assets, debt forgiveness.
3. **Financial Account**: Investments, loans, and changes in reserves.

1.9.1 Favourable Balance of Payment (BoP)

- Occurs when a country's inflow of **foreign exchange** is greater than its outflows.
- The nation earns more from exports of goods and services than it spends on imports and other outflows.
- It usually mean a country has a **BoP** surplus.
- **Favourable BOP**: Inflows of foreign exchange > outflows.

1.9.2 Unfavourable Balance of Payment (Bop)

- Occurs when a country's outflows of foreign exchange is greater than its inflows.
- The nation spends more on imports than it earns on exports and other foreign transactions.
- It usually means that the country has a **BoP** surplus.
- **Unfavourable BOP**: Outflows > inflows.

1.10 Terms Used in Foreign Trade

1. **Visible Trade**: Trade in goods (e.g. cars, crops).
2. **Invisible Trade**: Trade in services (e.g. banking, tourism).
3. **Tariff**: A tax on imports. The custom duty that is paid on goods entering the country. Because of the tarrifs, the prices of goods and services on the local market rises.
4. **Quota**: A limit on the quantity of imports. A country gives a limit on quantity or value of the import of particulr commodities or goods of a particular country.
5. **Exchange Rate**: Value of one currency compared to another. Example: 1 USD = MK 1,700.
6. **Free Trade** or **Trade Liberalization**: Trade without restrictions. The free flow of goods and services into or out of the country.
7. **Protectionism**: Use of trade barriers to protect local industries. A country puts restrictions or barriers on imports or sometimes export aimed at protecting local industries / businesses.
8. **Embargo**: A total ban on the importation of a particular commodity or goods from a particular country.
9. **Dumping**: Selling goods abroad at very low prices. The export of goods to countries where they are sold at a lower price than they fetch on the firm's home market. Dumping is usually done to kill competing industries of the importing country.

10. **Devaluation**: This is when the currency of the particular country falls in value against other internationally recognised currencies such as the US Dollar ($).

11. **Trade Agreements**: A situation where countries negotiate certain trade incentives in order to make trade free or partially free. These are also called **Trade Protocols**.

Summary / Revision Points

- Trade is divided into **Domestic** (within Malawi) and **Foreign** (between Malawi and other countries).
- Foreign Trade exists because countries have different resources and specialise in certain goods.
- Malawi mainly **exports**: tobacco, tea, sugar, coffee, and groundnuts.
- Malawi mainly **imports**: vehicles, fuel, fertilisers, machinery, and medicines.
- Foreign Trade can be divided into **imports, exports, and entrepot trade**.
- Advantages include access to goods, wider markets, technology, and jobs.
- Disadvantages include over-dependence, trade imbalances, and stiff competition.
- Malawi faces challenges such as poor infrastructure, lack of forex, and reliance on agriculture.
- **BOT** = Exports – Imports. Can be favourable or unfavourable.
- **BOP** is broader than BOT and includes all international transactions.
- Key terms: tariffs, quotas, exchange rate, dumping, free trade, and protectionism.

Bibliography

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