2D) INTERNATIONAL BUSINESS or TRADE ENVIRONMENT

International trade is the exchange of capital, goods, and services across international borders or territories, which could involve the activities of the government and individual. In most countries, such trade represents a significant share of gross domestic product (GDP). While international trade has been present throughout much of history, its economic, social, and political importance has been on the rise in recent centuries. It is the presupposition of international trade that a sufficient level of geopolitical peace and stability are prevailing in order to allow for the peaceful exchange of trade and commerce to take place between nations.

Trading globally gives consumers and countries the opportunity to be exposed to new markets and products. Almost every kind of product can be found on the international market: food, clothes, spare parts, oil, jewelry, wine, stocks, currencies and water. Services are also traded: tourism, banking, consulting and transportation. A product that is sold to the global market is an export, and a product that is bought from the global market is an import. Imports and exports are accounted for in a country's current account in the balance of payments.

Industrialization, advanced technology, including transportation, globalization, multinational corporations, and outsourcing are all having a major impact on the international trade system. Increasing international trade is crucial to the continuance of globalization. Without international trade, nations would be limited to the goods and services produced within their own borders. International trade is, in principle, not different from domestic trade as the motivation and the behavior of parties involved in a trade do not change fundamentally regardless of whether trade is across a border or not. The main difference is that international trade is typically more costly than domestic trade. The reason is that a border typically imposes additional costs such as tariffs, time costs due to border delays and costs associated with country differences such as language, the legal system or culture.

Another difference between Domestic and International trade is that factors of production such as capital and labour are typically more mobile within a country than across countries. Thus international trade is mostly restricted to trade in goods and services, and only to a lesser extent to trade in capital, labor or other factors of production. Trade in goods and services can serve as a substitute for trade in factors of production. Instead of importing a factor of production, a country can import goods that make intensive use of that factor of production and thus embody it. An example is the import of labor-intensive goods by the United States from China. Instead of importing Chinese labor, the United States imports goods that were produced with Chinese labor. One report in 2010 suggested that international trade was increased when a country hosted a network of immigrants, but the trade effect was weakened when the immigrants became assimilated into their new country.

International trade is also a branch of economics, which, together with international finance, forms the larger branch called international economics. Trading is a value-added function: it is the economic process by which a product finds its market, in which specific risks are to be borne by the trader.

The history of international trade chronicles notable events that have affected the trade between various countries.
In the era before the rise of the nation state, the term 'international' trade cannot be literally applied, but simply means trade over long distances; the sort of movement in goods which would represent international trade in the modern world.

In the 21st century, the European Union, United States and China are the three largest trading markets in the world.

The following are noted models of international trade.
A*dam Smith's model* **:** Adam Smith displays trade taking place on the basis of countries exercising absolute advantage over one another.

The ***R****icardian model* focuses on comparative advantage, which arises due to differences in technology or natural resources. The Ricardian model does not directly consider factor endowments, such as the relative amounts of labor and capital within a country.
The Ricardian model is based on the following assumptions:Labour is the only primary input to production
The relative ratios of labour at which the production of one good can be traded off for another differ between countries and governments.

H*eckscher-Ohlin model* **:** In the early 1900s, a theory of international trade was developed by two Swedish economists, Eli Heckscher and Bertil Ohlin. This theory has subsequently been known as the Heckscher-Ohlin model (H-O model). The results of the H-O model are that countries will produce and export goods that require resources (factors) which are relatively abundant and import goods that require resources which are in relatively short supply.

In the Heckscher-Ohlin model the pattern of international trade is determined by differences in factor endowments. It predicts that countries will export those goods that make intensive use of locally abundant factors and will import goods that make intensive use of factors that are locally scarce. Empirical problems with the H-O model, such as the Leontief paradox, were noted in empirical tests by

Wassily Leontief who found that the United States tended to export labour-intensive goods despite having an abundance of capital.
The H-O model makes the following core assumptions:
Labor and capital flow freely between sectors
The amount of labour and capital in two countries differ (difference in endowments)
Technology is the same among countries (a long-term assumption)
Tastes are the same

***A**pplicability* **:** In 1953, Wassily Leontief published a study in which he tested the validity of the Heckscher-Ohlin theory. The study showed that the United States was more abundant in capital compared to other countries, therefore the United States would export capital-intensive goods and import labor-intensive goods. Leontief found out that the United States' exports were less capital intensive than its imports.

After the appearance of Leontief's paradox, many researchers tried to save the Heckscher-Ohlin theory, either by new methods of measurement, or by new interpretations. Leamer emphasized that Leontief did not interpret H-O theory properly and claimed that with a right interpretation, the paradox did not occur. Brecher and Choudri found that, if Leamer was right, the American workers' consumption per head should be lower than the workers' world average consumption. Many textbook writers, including Krugman and Obstfeld and Bowen, Hollander and Viane, are negative about the validity of H-O model. After examining the long history of empirical research, Bowen, Hollander and Viane concluded: "Recent tests of the factor abundance theory [H-O theory and its developed form into many-commodity and many-factor case] that directly examine the H-O-V equations also indicate the rejection of the theory. In the specific factors model, labor mobility among industries is possible while capital is assumed to be immobile in the short run. Thus, this model can be interpreted as a short-run version of the Heckscher-Ohlin model. The "specific factors" name refers to the assumption that in the short run, specific factors of production such as physical capital are not easily transferable between industries. The theory suggests that if there is an increase in the price of a good, the owners of the factor of production specific to that good will profit in real terms.
Example: Finland produces ocean cruisers and leather products such as reindeer fur, mink and fox coats. Lapland, the northern part of Finland, is sparsely inhabited by mostly Indians who hunt these wild animals. This cold climate or forest is a factor specific in the leather goods industry.

In the urban areas Finns are also engaged in cruise ship building and Finland exports cruisers to European countries. In addition to well educated workers, the ship building industry requires a large amount of capital, which is specific to that industry in that it cannot be used in the leather goods industry. Finnish workers are mobile between the two industries.

Additionally, owners of opposing specific factors of production (i.e., labour and capital) are likely to have opposing agendas when lobbying for controls over immigration of labor. Conversely, both owners of capital and labor profit in real terms from an increase in the capital endowment. This model is ideal for understanding income distribution but awkward for discussing the pattern of trade.

***N**ew Trade Theory* **:** It tries to explain empirical elements of trade that comparative advantage-based models above have difficulty with. These include the fact that most trade is between countries with similar factor endowment and productivity levels, and the large amount of multinational production (i.e., foreign direct investment) that exists. New Trade theories are often based on assumptions such as monopolistic competition and increasing returns to scale. One result of these theories is the home-market effect, which asserts that, if an industry tends to cluster in one location because of returns to scale and if that industry faces high transportation costs, the industry will be located in the country with most of its demand, in order to minimize cost.

Although new trade theory can explain the growing trend of trade volumes of intermediate goods, Krugman's explanation depends too much on the strict assumption that all firms are symmetrical, meaning that they all have the same production coefficients. Shiozawa, based on much more general model, succeeded in giving a new explanation on why the traded volume increases for intermediate goods when the transport cost decreases.

***G**ravity model* **:** The Gravity model of trade presents a more empirical analysis of trading patterns. The gravity model, in its basic form, predicts trade based on the distance between countries and the interaction of the countries' economic sizes. The model mimics the Newtonian law of gravity which also considers distance and physical size between two objects. The model has been proven to be empirically strong through econometric analysis.

***R**icardian theory of international trade (modern development)* **:** The Ricardian theory of comparative advantage became a basic constituent of neoclassical trade theory. Any undergraduate course in trade theory includes a presentation of Ricardo's example of a two-commodity, two-country model. A common representation of this model is made using an Edgeworth Box.

This model has been expanded to many-country and many-commodity cases. Major general results were obtained by McKenzie and Jones, including his famous formula. It is a theorem about the possible trade pattern for N-country N-commodity cases.

***C**ontemporary theories* **:** Ricardo's idea was even expanded to the case of continuum of goods by Dornbusch, Fischer, and Samuelson. This formulation is employed for example by Matsuyama and others. These theories use a special property that is applicable only for the two-country case.

***N**eo-Ricardian trade theory* **:** Inspired by Piero Sraffa, a new strand of trade theory emerged and was named neo-Ricardian trade theory. The main contributors include Ian Steedman (1941–) and Stanley Metcalfe (1946–). They have criticized neoclassical international trade theory, namely the Heckscher-Ohlin model on the basis that the notion of capital as primary factor has no method of measuring it before the determination of profit rate (thus trapped in a logical vicious circle). This was a second round of the Cambridge capital controversy, this time in the field of international trade.

The merit of neo-Ricardian trade theory is that input goods are explicitly included. This is in accordance with Sraffa's idea that any commodity is a product made by means of commodities. The limitation of their theory is that the analysis is restricted to small-country cases.

***T**raded intermediate goods* **:** Ricardian trade theory ordinarily assumes that the labor is the unique input. This is a great deficiency as trade theory, for intermediate goods occupy the major part of the world international trade. Yeats found that 30% of world trade in manufacturing involves intermediate inputs. Bardhan and Jafee found that intermediate inputs occupy 37 to 38% of U.S. imports for the years 1992 and 1997, whereas the percentage of intra-firm trade grew from 43% in 1992 to 52% in 1997.

McKenzie and Jones emphasized the necessity to expand the Ricardian theory to the cases of traded inputs. In a famous comment McKenzie pointed that "A moment's consideration will convince one that Lancashire would be unlikely to produce cotton cloth if the cotton had to be grown in England." Paul Samuelson coined a term *Sraffa bonus* to name the gains from trade of inputs.

***R**icardo-Sraffa trade theory* **:** Economist John S. Chipman observed in his survey that McKenzie stumbled upon the questions of intermediate products and postulated that "introduction of trade in intermediate product necessitates a fundamental alteration in classical analysis". It took many years until Shiozawa succeeded in removing this deficiency. The Ricardian trade theory was now constructed in a form to include intermediate input trade for the most general case of many countries and many goods. Chipman called this the Ricardo-Sraffa trade theory.

Based on an idea of Takahiro Fujimoto, who is a specialist in automobile industry and a philosopher of the international competitiveness, Fujimoto and Shiozawa developed a discussion in which how the factories of the same multi-national firms compete between them across borders.[32] International *intra-firm competition* reflects a really new aspect of international competition in the age of so-called *global competition*.

***I**nternational production fragmentation trade theory* **:** In his chapter entitled *Li & Fung, Ltd.: An agent of global production* (2001), Cheng used Li & Fung Ltd as a case study in the international production fragmentation trade theory through which producers in different countries are allocated a specialized slice or segment of the value chain of the global production. Allocations are determined based on "technical feasibility" and the ability to keep the lowest final price possible for each product. Fragmentation widens the scope for "application of Ricardian comparative advantage". An example of fragmentation theory in international trade is Li and Fung's garment sector network with yarn purchased in South Korea, woven and dyed in Taiwan, the fabric cut in Bangladesh, pieces assembled in Thailand and the final product sold in the United States and Europe to major brands.

In 1995 Li & Fung Ltd purchased Inchcape Buying Services, an established British trading company and widely expanded production in Asia. Li & Fung supplies dozens of major retailers, including Wal-Mart Stores, Inc., branded as Walmart.

***F**ree-Trade Theories* **:** In fact, many countries following mercantilist policy tried to become as self-sufficient as possible. We discuss two theories supporting free trade: absolute advantage and comparative advantage. Both theories hold that nations should neither artificially limit imports nor promote exports. The market will determine which producers survive as consumers buy those products that best serve their needs. Both free trade theories imply specialization. Just as individuals and families produce some things that they exchange for things that others produce, national specialization means producing some things for domestic consumption and export while using the export earnings to buy imports of products and services produced abroad.

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The international trading environment and cash flow planning for international trade transactions can be much more challenging than in domestic operations. This is because of the multitude of factors that can restrict the receipt of funds or lessen the value of the funds received. In particular, firms trading abroad must anticipate exchange rate fluctuations, transmission delays, exchange controls, political risks, and slower collection of accounts receivable. Exchange rate fluctuations: Exchange rate fluctuations can reduce the value of the proceeds from a sale, or can increase the value of the funds needed to pay for a transaction. Unless planned for and controlled through risk management techniques, such fluctuations can seriously undermine expected cash flows. Transmission delays: Transmission delays are an often-overlooked cost of doing business abroad, but they do affect cash flow. International shipments and the resulting payments are complex enough already; delays can slow the transmission of funds from the paying country to the receiving country by a few days to several weeks. The cash budget must take into account the possibility of technical or bureaucratic delays along the payment chain.

The delays may be the result of improperly completed documentation, or they may arise from foreign administrative procedures. New exporters may be able to plan for the types of delays experienced in their domestic business, but they can be unpleasantly surprised when international business delays are far longer than they expect. Exchange controls: Exchange controls can prevent or restrict the payment of funds by the trading parties in a particular country. Such controls result from the host government’s attempt to conserve its hard currency reserves. Often enforced by a cumbersome and lengthy system of foreign currency authorization, these regulations impose more problems for capital repatriation transactions than for payment of arm’s-length invoices. At times they can result in all payments being stopped. This can have a devastating effect on a firm’s cash flow, and it should be insured against if the amounts involved are relatively large. Political risks: Political risks can also severely affect a firm’s cash flow. For instance, the revocation of an export or import permit frustrates performance under an international trade transaction. In the meantime, the exporter may already have covered the costs of arranging for the export sales or preparing the products for shipment. Such a situation will have an obvious negative impact on cash flow. Slower collection of receivables: The slower collection of international accounts receivable can strain a firm’s cash position. To avoid this, care must be taken to select appropriate payment terms for each foreign buyer, and to factor likely delays into the cash budget. Again, if the receivables involved are substantial, the exporter should use export credit insurance or export receivables discounting facilities in order to avoid excess risk. The factors above show how conditions of international trade can undermine a company’s cash position. Companies can take measures to reduce or avoid such risks, but only if they know of the risks in advance. Cash flow planning is the way for a company to identify possible problems and defend itself against them.

The *International Monetary Fund* (IMF) is an international organization headquartered in Washington, D.C., of "189 countries working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world." Formed in 1944 at the Bretton Woods Conference primarily by the ideas of Harry Dexter White and John Maynard Keynes, it came into formal existence in 1945 with 29 member countries and the goal of reconstructing the international payment system. It now plays a central role in the management of balance of payments difficulties and international financial crises. Countries contribute funds to a pool through a quota system from which countries experiencing balance of payments problems can borrow money. As of 2016, the fund had SDR477 billion (about $668 billion).

Through the fund, and other activities such as the gathering of statistics and analysis, surveillance of its members' economies and the demand for particular policies, the IMF works to improve the economies of its member countries. The organisation's objectives stated in the Articles of Agreement are **:** to promote international monetary co-operation, international trade, high employment, exchange-rate stability, sustainable economic growth, and making resources available to member countries in financial difficulty.

The *World Bank* is an international financial institution that provides loans to countries of the world for capital programs. It comprises two institutions: the International Bank for Reconstruction and Development (IBRD), and the International Development

Association(IDA). The World Bank is a component of the World Bank Group.
The World Bank's stated official goal is the reduction of poverty. However, according to its Articles of Agreement, all its decisions must be guided by a commitment to the promotion of foreign investment and international trade and to the facilitation of capital investment.

The *Asian Development Bank* (ADB) is a regional development bank established on 19 December 1966, which is headquartered in the Ortigas Center located in Mandaluyong, Metro Manila, Philippines. The company also maintains 31 field offices around the world to promote social and economic development in Asia.