# International Trade

International trade is the exchange of goods and services between countries. This type of trade gives rise to a world economy, in which prices, or supply and demand, affect and are affected by global events.

Trading globally gives consumers and countries the opportunity to be exposed to goods and services not available in their own countries. 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

International trade not only results in increased efficiency but also allows countries to participate in a global economy, encouraging the opportunity of foreign direct investment (FDI), which is the amount of money that individuals invest into foreign companies and other assets. In theory, economies can therefore grow more efficiently and can more easily become competitive economic participants.

For the receiving government, FDI is a means by which foreign currency and expertise can enter the country. These raise employment levels, and, theoretically, lead to a growth in the gross domestic product. For the investor, FDI offers company expansion and growth, which means higher revenues.

**Foreign Exchange Reserves**

Reserves are generally maintained by countries for meeting their international payment obligations — both short and long terms, including sovereign and commercial debts, financing of imports, for intervention in the foreign currency markets during periods of volatility, besides helping to boost the confidence of the market in the ability of a country to meet its external obligations and to absorb any unforeseen external shocks.

**India’s Foreign Exchange Reserves**

India’s Forex reserves as on 22/7/2016 (in billion rupees)

| | |
|---|---:|
| 1 Total Reserves | 24,234.1 |
| 1.1 Foreign Currency Assets | 22,584.1 |
| 1.2 Gold | 1,391.3 |
| 1.3 SDRs | 99.1 |
| 1.4 Reserve Position in the IMF | 159.6 |

The **Foreign exchange reserves of India** are mainly composed of US dollar in the forms of US government bonds and institutional bonds. Foreign-exchange reserves are assets held by RBI, usually in various reserve currencies, mostly the United States dollar, and to a lesser extent the euro, the pound sterling, the Japanese yen.

A **gold reserve** is the gold held by a RBI, intended as a store of value and as a guarantee to redeem promises to pay depositors, note holders (e.g. paper money), or trading peers, or to secure a currency. India currently holds 557.7 tonnes of gold, making up 9.9 percent of the country’s total forex reserve.

The Special Drawing Right (SDR) is an international reserve asset, created by the IMF in 1969 to supplement the existing official reserves of member countries. Countries can exchange SDRs for hard currency at the IMF. The SDR also serves as the unit of account of the IMF and some other international organisations. Its value is based on a basket of key international currencies.

**Reserve Position in the IMF -** Reserve tranche position (RTP) in the International Monetary Fund (IMF): The proportion of the required quota of currency that each International Monetary Fund (IMF) member country must provide to the IMF, but can designate for its own use. The reserve tranche portion of the quota can be accessed by the member nation at any time, whereas the rest of the member's quota is typically cannot be accessed.

**The International Monetary Fund**

The IMF was first conceived at a UN conference in 1944, among the 44 attending countries, before it was officially created in 1945. These countries wanted to globally stabilize exchange rates and financial communication between countries, especially following the disastrous Great Depression and World War II. Goals included international cooperation and trade, the reduction of poverty and financial crises, and economic growth. Although the Fund has evolved over the years to become what it is today and adapt to changing times, it still operates around the same guiding principles.

The IMF played a large role in the economic restructuring of the post-World War II world. After the war, some countries were in economic distress, and others were reluctant to trade with certain countries after the fighting. The Fund helped smooth over the economic post-war transition period and restabilize the global economy so it could move toward prosperity, using systems such as fixed exchange rates.

Currently, there are 188 member countries in the IMF, which is based out of Washington, D.C. Each country or region is represented by a member on the Fund's Executive Board and numerous staff members. The ratio of board members from each country is based on the country's global financial position, so that the most powerful countries in the global economy have the heaviest representation. The United States has the highest voting power, followed by Asian countries such as Japan and China and Western European countries like Britain, Germany, France and Italy.

**World Bank**

The World Bank was established in December 1945 at the United Nations Monetary and Financial Conference in Bretton Woods, New Hampshire. It opened for business in June 1946 and helped in the reconstruction of nations devastated by World War II. Since 1960s the World Bank has shifted its focus from the advanced industrialized nations to developing third-world countries.

**World Bank performs the following functions:**

1. Granting reconstruction loans to war devastated countries.
2. Granting developmental loans to underdeveloped countries.
3. Providing loans to governments for agriculture, irrigation, power, transport, water supply, educations, health, etc
4. Providing loans to private concerns for specified projects.
5. Promoting foreign investment by guaranteeing loans provided by other organisations.
6. Providing technical, economic and monetary advice to member countries for specific projects
7. Encouraging industrial development of underdeveloped countries by promoting economic reforms.

**IMF vs. World Bank**

The IMF works hand-in-hand with the World Bank, and although they are two separate entities, their interests are aligned, and they were created together. While the IMF provides only shorter-term loans that are funded by member quotas, the World Bank focuses on long-term economic solutions and the reduction of poverty and is funded by both member contributions and bonds. The IMF is more focused on economic policy solutions, while the World Bank offers assistance in such programs as building necessary public facilities and preventing disease.

**Asian Development Bank**

The ADB was founded in 1966 with the goal of eradicating poverty in the region. The Asian Development Bank (ADB) is a multilateral development finance institution whose mission is to reduce poverty in the Asia Pacific region.

**Functions:**

i. Provides loans and equity investments to its Developing Member Countries (DMCs)

ii. Provides technical assistance for the planning and execution of development projects and programs and for advisory services

iii. Promotes and facilitates investment of public and private capital for development

iv. Assists in coordinating development policies and plans of its DMCs

**Balance of Trade and Balance of payments**

In today’s world, all countries import some goods and services from other countries and also export certain other goods and services which are surplus in their country. The difference between the value of goods and services exported out of a country and the value of goods and services imported into the country is balance of trade. If a country has a balance of trade deficit, it imports more than it exports, and if it has a balance of trade surplus, it exports more than it imports.

The balance is said to be favorable when the value of the exports exceeded that of the imports (i.e. exports exceed imports), and unfavorable when the value of the imports exceeded that of the exports (i.e. imports exceed exports).

Balance of Payment is a system of recording all the economic transactions of a country, with the rest of the world over a period, say one year. Typically, the transactions included in BoP are country's exports and imports of goods, services, financial capital, and financial transfers. Thus, in nutshell we can say, the BoP accounts summarize international transactions for a specific period, usually a year, and are prepared in a single currency, typically the domestic currency for the country concerned.

**It can be concluded that:**

The balance of payments (BOP) is an accounting of a country's international transactions for a particular time period. Any transaction that causes **money to flow** into a country is a credit to its BOP account, and any transaction that causes money to flow out is a debit.

The BOP includes the *current account*, which mainly measures the flows of goods and services; the *capital account*, which consists of capital transfers and the acquisition and disposal of non-produced, non-financial assets; and the *financial account*, which records investment flows.

The BOT is typically the biggest bulk of a country's balance of payments as it makes up total imports and exports.

BOP is said to be favorable balance of payments, when more payments are coming in than going out, and will be unfavorable when less payments are coming in than what is going out.

**Difference between Balance of Trade and Balance of payments**

| Basis of Difference | Balance of Trade (BOT) | Balance of Payment (BOP) |
|---|---|---|
| 1. Definition | Balance of Trade is defined as 'difference between export and import of goods and services' | Balance of Payment is defined as the 'flow of cash between domestic country and all other foreign countries'. It includes not only import and export of goods and services but also includes financial capital transfer. |
| 2. How calculated | BOT = Net Earning on Exports - Net payment made for imports | BOP = BOT + (Net Earning on foreign investment i.e. payments made to foreign investors) + Cash Transfer + Capital Account +/- Balancing Item<br>**or**<br>BOP = Current Account + Capital Account +/- Balancing item ( Errors and omissions) |
| 3. When considered as favorable or unfavorable | If export is more than import, at that time, BOT will be favorable. If import is more than export, at that time, BOT will be unfavorable. | Balance of Payment will be favorable, if the country has surplus in current account for paying all past loans in the capital account.<br><br>Balance of payment will be unfavorable, if country has current account deficit and it took more loan from foreigners. After this, it has to pay high interest on extra loan and this will make BOP unfavorable. |
| 4. Solution to being unfavorable | To buy goods and services from domestic country. | To stop taking of loan from foreign countries. |
| 5. Factors | Main factors which affect BOT:<br>1. cost of production<br>2. availability of raw materials<br>3. Exchange rate<br>4. Prices of goods manufactured at home | Main factors which affect BOP:<br>1. Conditions of foreign lenders.<br>2. Economic policy of Govt.<br>3. all the factors of BOT |