IV. Higher Order Thinking Skills (HOTS)

Question 1. “Foreign trade is not free from difficulties.” Comment.
Answer: Foreign trade is not free from difficulties. The following are some of the important difficulties of foreign trade:

1. It is a long distance trade and as such it becomes difficult to maintain close relationship between the buyer and the seller.
2. Each country has its own language. As foreign trade involves trade between two or more countries, there is diversity of languages. This difference in language creates problem in foreign trade,
3. Foreign trade involves preparation of a number of documents which also creates difficulties in the way of foreign trade.
4. Some restrictions are imposed on export and import of commodities. These restrictions stand on the progress of foreign trade.
5. Foreign trade involves a great deal of risks because trade takes place over a long distance. Though the risks are covered through insurance, it involves extra cost of production because insurance cost is added to cost.

Question 2. “International trade benefits both the parties involve.” Do you agree? Justify your answer:
Answer. No doubt, trade benefits both the parties involved. These gains can be categorised as static and dynamic.
Static gains from trade:

1. If a country has an absolute or relative advantage in the production of some goods, it can specialize in those goods and can trade it for others. It will increase total productivity.
2. Increase in imports will increase country’s ability to satisfy consumer needs. Imports of capital goods may also increase the economic growth rate in the initial stages. It may also shift economy closer to its production possibility curve indicating relatively fuller utilization of resources.
3. Specialization based on comparative advantage will result more efficient utilization of resources. Hence, a labour abundant country will expand those industries which use more of labour. It will stimulate employment and wage rates will go up.
4. According to Myint, international trade can provide a larger market for developing countries that will help these countries to increase their output and employment and hence, they will shift closer to PPC and real output will increase.
5. Trade brings various nations closer and interlinks the economies of the world. It helps to learn from each other’s experience and sharing of capital, technology and knowhow also increases.

Negative static effects of trade:

1. An economy which specialises in labour intensive industries at the cost of modern sector may face problems. It is so because the products of these industries have low price elasticities of demand and supply of agriculture and primary goods is quite

instable.
2. Large chunks of stock will lead to unfavorable terms of trade for the country. It may reduce the benefits expected from trade.
3. Specializing in labour intensive industries and relying on developed nations for modern machinery and commodities is not advisable on the principle of prudence.
4. Since there is huge unemployment in developing countries, increased demand for labour will not increase wage rate so much.
5. Since there are inflexibilities in traditional economies, the expected gains from trade do not get realized. Rather trade benefits developed countries more and thereby increases the inequalities of income amongst nations.
   Dynamic gains from trade:

Dynamic positive effects:

1. When economy operates at a larger scale with access to the markets of other countries, it can avail of economies of scale which otherwise will not be available.
   Economies of large scale will make these countries more competitive in international market.
2. International trade gives*an exposure to world market and international technology of production which a closed economy can not have. It helps an under developed country to grow at a fast pace and become more competitive.
3. There are many other dynamic changes that occur in the economy via trade like increased investment due to better economic environment, approach to world class technology, institutional changes, exposure to new and different products.

Dynamic negative effects:

1. Market imperfections may increase social costs. Hence, trade that considers only private costs may not be consistent with the long term development goals.
2. The overall effect of exports will vary from industry to industry; sector to sector. Some industries may get benefit more than others.
3. If increasing returns to scale are available for some commodity, it may lead to higher profits through exports rather than one in which decreasing returns to scale are expected. Hence, returns to scale may complicate the judgment whether exports are benefiting or not.
4. Existence of imperfection in markets and government policies may adversely affect the expected dynamic gains.
5. Many a time, trade benefits developed countries more than developing ones. In such a situation, it may worsen the relative economic strength of developing nations.

V. Value Based Questions

Question 1. Which mode of international business should be chosen by a small business man and why?
Answer: A small business should consider following factors in selecting mode of entering into international business.

1. Ease of entry: First and foremost factor that determines the choice of mode of entry into international business is ease of entry. A businessman wants to adopt such mode of entry into international business which is easy and less formalities requiring. Exporting, importing, licensing and franchising are better ways from this perspective.
2. Cost: Second determining factor is cost involved. For example, very less cost is involved in exporting, importing, licensing,

franchising and contract manufacturing as compared to joint ventures and setting wholly owned subsidiaries.

3. Control over production: If the foreign company or producer wants full control over production activities in local country, he will prefer franchising, wholly owned subsidiary or joint venture with majority share holding. If it is not so important, he will prefer exporting, importing, contract manufacturing licensing etc.
4. Sharing of Technology: If the company has no problem in sharing of technology then it may choose joint venture or franchising. But if it does not want to share its technology and trade secrets, it will prefer wholly owned subsidiary or exporting.
5. Risk Involved: If a firm is ready to take risk, it may choose wholly owned subsidiary or joint ventures but if it is willing to minimise its loss then it should choose exporting, licensing, franchising or contract manufacturing.
   In my opinion, being a small businessman he will prefer exporting or licensing,franchising to other modes of business as it is easy, less costly, gives greater control over production and involves lesser risk.

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