8.2 MEANING

"The balance of payments of a country is a systematic record of all economic transactions between the residents of the reporting country and residents of foreign countries during a given period of time". The term 'residents' is broadly interpreted as all individuals, businesses and governments and their agencies. International organisations are classified as foreign residents. Economic transactions which enter into the balance of payments record, involve transfer of goods and assets, or rendering services from residents of one country to the residents of the rest of the world.

The balance of payments record is maintained in a standard double-entry book-keeping method. International transactions enter into the record as credit or debit. The payments received from foreign countries enter as credit and payments made to other countries as debit.

This record is prepared to measure the various components of a country's external economic transactions. The aim is to present an account of all receipts and payments arising from all economic transactions between the residents of a country and the residents of the rest of the world. The main purpose of keeping this record is to know the international economic position of a country which helps the government in making monetary and fiscal policy decisions on the one hand, and trade and balance of payments policies on the other.

8.3 STRUCTURE OF BALANCE OF PAYMENTS

Table 8.1 : BALANCE OF PAYMENTS ACCOUNT

Receipts (Credits)	**Payments (Debits)**
1) Exports of goods	1) Imports of goods
Trade Account Balance [= 1 + 1]	
2) Exports of services	2) Imports of services
3) Interest, profits, dividends received and private transfers	3) Interest, profits, dividends paid and private transfers
4) Unilateral receipts	4) Unilateral payments
5) **Current Account Balance [(1 + 2 + 3 + 4)]**	
6) Foreign investments	6) Investments abroad
7) Short term borrowing	7) Short term lending
8) Medium and long term borrowing	8) Medium and long term lending
9) **Capital Account Balance [(6 + 7 + 8)]**	
10) **Statistical Discrepancy (Errors and Omissions)**	
11) **Overall Balance = Current Account Balance + Capital Account Balance + Statistical Discrepancy** (= 5 + 9 + 10)	
12) Change in reserves (–)	12) Change in reserves (+)
Total Receipts = Total Payments	

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Total Receipts = Total Payments	

The balance of payments account is traditionally divided into (i) trade account (ii) current account and (iii) capital account. However it can be vertically divided into many components as per the requirements.

The structure of balance of payments is explained below in detail.

1. TRADE ACCOUNT BALANCE

It is the difference between exports and imports of goods, usually referred as visible or tangible items. Till recently goods dominated

international trade. Trade account balance tells as whether a country enjoys a surplus or deficit on that account. During a given period of time, if the exports and imports are exactly equal, the balance of trade is said to be in **balance**. If the value of exports exceeds the value of imports, the country is said to have **surplus** in the balance of trade. On the other hand, if the value of imports exceeds the value of exports, we have a **deficit** in the balance of trade.

The balance of trade is also referred as the balance of **Visible trade** or balance of **Merchandise trade.**

2. CURRENT ACCOUNT BALANCE

Current account includes Nos. 1, 2, 3 and 4 in table no 8.1. They comprise :

(i) **Export and import of goods** which are traditionally referred as visible or tangible exports and imports,

(ii) **Export and import of services,** also known as invisibles. Services include insurance, transport, banking, income from tourism, etc.

(iii) **Income received and paid** in the form of interest, profits and dividends for lending or investing in other countries,

(iv) Remittance from citizens working abroad and foreigners working in the reporting country.

(v) **Unilateral receipts or payments** which are also referred as transfer payments include gifts, donations, private remittances etc. received by the residents or paid to residents of other countries. Such receipts and payments do not have any counter obligation i.e. they are received free.

In Table 8.1, item numbers 1 to 4 on both side are included in **current account balance.** Within the current account, export and import of services have become more important than merchandise trade.

Current account shows a country's earning and payments position in foreign exchange. It can be compared to a person's or a firm's earnings and expenditure. A surplus on this account strengthens that country's international financial position. It could use the surplus for further development of its economy. A deficit on the other hand creates problems.

Usually a benchmark of 1 to 3 percent of GDP is set for current account deficit. Beyond this point it is considered as a difficult situation for an economy as it requires to bridge this gap either through capital account receipts by resorting to borrowing when non-debt receipts are not sufficient or drawing from foreign exchange reserves.

3. CAPITAL ACCOUNT BALANCE

The capital account records all receipts and payments that involve the residents of a country changing either their assets or liabilities to residents of other countries. The transactions under this title involve direct investment, portfolio investment and borrowings and lendings from and to other countries.

Foreign Investments: They are divided into direct and portfolio investment.

Foreign Direct investment is undertaken mostly by multinationals. They set up plant and factories on their own or in collaboration with the Indian Companies. There may be a few individuals who acquire some assets mainly in the form of houses in some foreign country.

Portfolio investment refers to the acquisition of financial assets in foreign countries. Purchase of shares of a foreign company, bonds issued by a foreign government are some examples. Under portfolio investment foreign institutional investor's purchase of shares and bonds of Indian Companies are included.

External assistance : Capital account also includes inflow and outflow under external assistance.

Short Term Borrowing : To cover up deficit in current account, countries resort to borrowing. They borrow short term which is usually a period of five years or less. They are mainly commercial borrowings from the foreign commercial banks.

Medium and Long Term Borrowings : These borrowings are from the Governments of other countries or international financial institutions like IMF. Such borrowings are preferred as they usually

bear low rate of interest and easy repayment terms. **IMF transactions are usually shown separately under monetary movement.**

Acquiring of assets through direct or portfolio investment appear as a negative item in the capital account of the balance of payments record of the reporting country since they involve payments and as a positive item in the capital account of the other country because they involve receipts. All capital outflows (investments or lendings) appear as negative (payments or debits) items as the money goes out of the economy. Similarly all capital inflows (foreign investments or borrowings from other countries) are positive items though some of them may increase the liabilities of the receiving country. To avoid any confusion it should be kept in mind that all capital inflows are recorded as credit and outflows as debit.

Financial Accounts : The IMF and some countries, record foreign direct investment, portfolio investment and foreign exchange reserves as financial account. Within the financial account direct foreign investment and portfolio investment are treated as **private financial account**. Foreign exchange reserves are shown as **official financial account**.

Capital account balance: It is equal to receipts from foreign investments and short term and long term borrowings minus payments on investments abroad and short term and long term lending. Thus, based on Table 8.1 Capital account balance = [(6 + 7 + 8)]. If the receipts from items 6, 7 and 8 are greater than the payments capital account will be surplus. On the other hand, if the payments are greater than receipts the capital account will be deficit.

4. STATISTICAL DISCREPANCY (ERRORS AND OMISSIONS)

Statistical discrepancy (errors and omissions) reflects transactions that have not been recorded for various reasons and so cannot be entered under a standard heading but must appear since the full balance of payments account must sum to zero. It also reflects the difficulties involved in recording accurately numerous transactions that take place during a given period.

5. OVERALL BALANCE

Overall balance is obtained by adding up current account, capital account balances and statistical discrepancies. If the sum of current account, capital account and statistical discrepancies is positive, the overall balance is surplus. On the other hand, if the sum of the above three are negative, the overall balance is said to be deficit.

If current account is negative and capital account is positive, the overall balance may be negative or positive depending on the size of each balance. Most of the countries, as is the case with India have a deficit in current account but usually a positive balance in capital account resulting in a positive overall balance.

6. FOREIGN EXCHANGE RESERVES

Foreign exchange reserves in Item no. 12 show the reserves which are held in the form of foreign currencies usually in hard currencies like dollar, pound etc., gold and Special Drawing Rights (SDRs). Foreign exchange reserves increase when the country has a surplus in the transactions and decrease when the country has a deficit. When a country enjoys a net surplus in current and capital accounts combined, it results in an increase in foreign exchange reserves. Whenever current account deficit exceeds the inflow in capital account, foreign exchange from the reserve account is used to meet the deficit. If a country's foreign exchange reserves increase in that year, it is shown as minus in that country's balance of payments accounts.

Foreign exchange reserves (forex) are used to meet the deficit in balance of payments. The entry is in the receipt side as we receive the forex for that particular year by reducing the balance from the reserves. When surplus is transferred to the foreign exchange reserves, it is shown as minus in that particular year's balance of payment account. The minus sign (-) indicates an increase in forex and a plus sign (+) shows the borrowing of foreign exchange from the forex account (decline in forex) to meet the deficit.

Official Settlement : Foreign exchange reserves are used for adjusting surplus or deficit in balance of payment. A surplus or deficit in current and capital account combined is settled by transferring to or from the reserve account. Hence it is called official settlement.

7. THE BASIC BALANCE

The basic balance is the sum of the current account and capital account, when the two sides of the current and capital accounts are equal i.e. when the difference between the two is equal to zero, the basic balance is achieved. An increase in deficit or reduction in surplus or a move from surplus to deficit is considered worsening of the basic balance. Basic balance as Bo Sodersten points out, need not necessarily be a happy state of affairs. A basic balance achieved through long term borrowing from abroad may lead to future problems at the time of repayment. Similarly an outflow of capital may indicate a deficit currently but may earn profits and dividends in the future which will help improve the current account balance.

8. EQUILIBRIUM AND DISEQUILIBRIUM

The balance of payments always balances in a technical or accounting sense (in a double entry record). In an accounting sense, the total receipts of a country are bound to be equal to the total payments of the country, if we include all the receipts and all the payments of the country in the account. It can be seen from Table 8.1 the total receipts are equal to total payments. Thus, if we include all items in the country's balance of payments, the account must balance; there can be no 'deficit' or 'surplus'. The balance in the balance of payments implies that a net credit in any one of the items must have a counter part net debit in another. ***When the total credits and debits of all accounts balance, we say the balance of payments balances.*** A balance in balance of payments is achieved when overall balance is zero, that is a current account deficit or surplus is matched by a surplus or deficit in capital account.

A clear picture of deficit or surplus is revealed when we examine the balance of payments statement splitting it vertically into current account and capital account. It is in the current account that the surplus or deficit becomes more evident. A current account surplus is achieved when the exports of goods and services, income received and unilateral receipts are greater than the imports of goods and services, income payments and transfer payments. A reverse situation results in deficit in current account. Capital account taken by itself may also have either surplus or deficit.

The balance of payments disequilibrium is shown by classifying the items into autonomous and accommodating transactions. Thus, if the autonomous receipts are less than autonomous payments, the balance of payments is said to be in deficit. It is in surplus when such receipts are more than the payments. This is explained in the next section.

(f)	Sell
(g)	Arbitrary exchange rate

(b), (5) - (d), (6) - (f)

12.1 INTRODUCTION

International trade requires exchange of currencies between multiple trading partners. In order have a better understanding of international trade, it is necessary to be familiar with the international payments system. What should be the value of one currency in terms of another has always been a challenging question for economists and policymakers.

A country's currency is used not only by its residents but also by foreign residents who wish to purchase the country's goods and services. This brings us to the concept of **exchange rate** between different currencies. ***The rate of exchange of a currency is its price in***

terms of another currency, or a group of other currencies. The rate of exchange of a currency is a measure of its external value that measures its purchasing power in terms of foreign goods and services. It is an important variable through which a country's interdependence with the global economy can be measured and evaluated.

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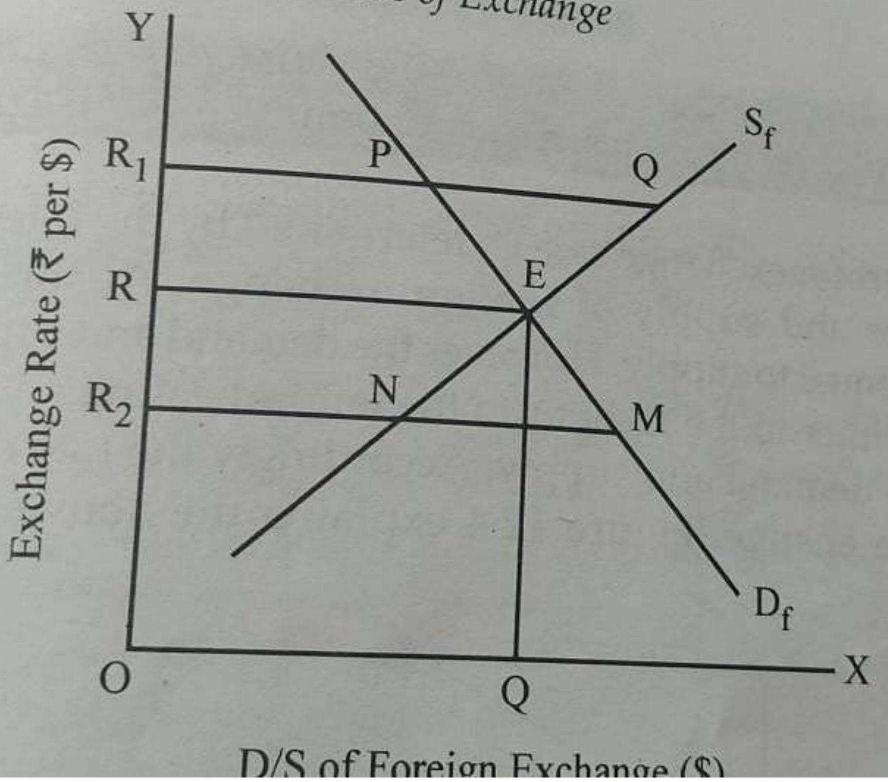

Y
Exchange Rate (₹ per $)
R_1
R
R_2
P
Q
S_f
E
N
M
D_f
O
Q
X
D/S of Foreign Exchange ($)

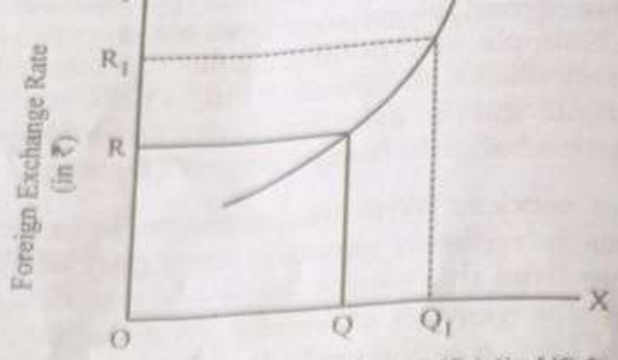


Fig. 12.2

ly from all these sources add up to the aggregate supply of n exchange. The total supply, like the supply of any other odity, is directly related to the price i.e. the foreign exchange . The diagram above shows the relationship between rate of foreign exchange and its supply. The supply curve of foreign exchange like any other supply curve, slopes upwards.

12.5 DETERMINATION OF EXCHANGE RATE

In figure 12.3 the exchange rate is determined at E, where demand and supply curves for foreign exchange intersect. OR is the **equilibrium exchange rate** when demand for the foreign exchange is equal to its supply. OR_1 and OR_2 are not the equilibrium exchange rates. At OR_2, D > S i.e. $R_2M > R_2N$. Similarly at OR_1, S > D i.e. $R_1Q > R_1P$. Exchange rate R_1 and R_2 are not stable or equilibrium exchange rates. At the R_1 and R_2 exchange rates there will be pressure on the prevailing rate to move towards the equilibrium exchange rate i.e. towards point E.

to restrict exportable surplus leaving the country and causing shortage of such commodities in the domestic market.

Countries at different stages of their development adopt trade policies that they consider are best suited to them at that point of time. After gaining independence from a foreign power in 1947, India adopted a protectionist trade policy with very high import duties, import quotas and exchange controls. The reason for adopting this inward looking trade policy was to protect the new domestic industries, conserve foreign exchange reserves and become self sufficient. Though proponents of free trade may criticize the Indian policy makers for following protectionist trade policy, the policy makers felt justified in restricting imports and foreign investments since the country's resources had been drained by a foreign power that initially came to trade and then became political rulers. The restrictive trade policy did help the country to be self sufficient in many areas but at the same time, resulted in shortages, high cost and inefficient use of resources. As India economically developed, it was expected that the government would reduce the trade barriers as they were proving to harm the economy. But the government continued to follow restrictive trade policy till almost 1991, when it faced a severe balance of payments and foreign exchange crisis. It was only then that the policymakers decided to open up trade and invite foreign investments and moved towards free trade policy, with some restrictions.

Countries use trade barriers either as a policy decision to follow protectionism, or use them whenever the situation demands, while following a free trade policy. Let us discuss some of the tariff and non-tariff barriers to trade.

6.2 TARIFFS

A tariff is a tax imposed on commodities that are traded across the national border of a country. Tariffs can be imposed on **both imports and exports**. They are also referred to as **import or export duties** or **customs duties**. A tariff adds to the cost of importing a product, which is passed on to the final consumer in the form of **higher price of imports**. Thus, tariffs are imposed to **make imports costlier than**

domestically produced goods. Though, generally tariffs are imposed on imports, they can also be imposed on exports in order to discourage exports of scarce commodities and manage prices within the country.

Advocates of free trade argue that **tariffs have adverse effects in the long run** on the world economy as well as on the economies that impose tariffs.

The following are the objectives of tariffs:

i) To raise government's revenue.

ii) To protect and support domestic industries.

iii) To conserve foreign exchange reserves.

iv) To make domestic prices competitive with import prices.

v) To reduce the dependence on other countries and become self sufficient.

vi) To generate employment within the country.

vii) To prevent shortages in the domestic market by imposing export tariffs.

A. Types of Tariffs

Tariffs can be classified on the following basis:

I. Classification on the basis of imposition:

1. **Specific tariffs:** Specific tariffs are imposed on the physical weight, measurement or unit of a commodity that is imported or exported. They are usually imposed on agricultural commodities, cement, fertilizers, minerals etc. They are easy to administer, but since the value of the commodities are not taken into consideration while imposing tariff, there may be an element of arbitrariness in specific tariffs. Commodities of high value but low physical volume may be imposed lower tariff than commodities of high volume and low value. Specific tariffs may not always bring in equity.

2. **Ad valorem tariffs:** Ad valorem means 'on the value'. Such tariffs are levied at a percentage rate of the value of the imported or exported commodities. They are usually levied on commodities whose values are proportionately higher than their physical characteristics like weight or length. These tariffs are more equitable than specific tariffs as more expensive goods that are consumed by the rich will attract higher tariff, while cheaper goods, consumed by low income groups, will be levied lower tariffs.

3. **Mixed tariffs:** These are expressed as either a specific or an ad valorem rate, depending on whichever generates more revenue. For example, tariff on a type of textile may be 10% ad valorem or ₹ 60 per square meter, whichever is higher.

4. **Compound tariffs:** Compound tariff is a combination of both specific and ad valorem tariffs. Compound tariffs include specific tariff on a unit of the commodity plus a percentage of ad valorem tariff. This type of tariff brings greater elasticity in revenue collection and is more effective in protecting domestic industries.

5. **Tariff rate quotas:** These are made up of low tariff rates on an initial quantity of import that is within the quota limit, and a very high tariff rate on imports above that initial amount.

   Generally, non-ad valorem tariffs are less transparent and distort prices of traded commodities more than ad valorem tariffs.

II. Classification of the basis of purpose:

1. **Revenue tariffs:** Tariffs that are imposed primarily to generate revenue for the government are termed as revenue tariffs. Generally, developing countries have to rely on indirect taxes for revenue collection because people's capacity to pay direct taxes is limited in such countries. Import and export tariffs become an important source of revenue to the government in such economies. However, even if tariffs are imposed to raise revenue, this cannot be the only effect of tariffs. Any tariff on imports will always have protective effect.

2. **Protective tariffs:** When tariffs are imposed with the primary objective to protect domestic industries by making imports more expensive, they are termed as protective tariffs. Higher the tariff rate, greater is the protective effect on domestic industries. However, if the domestic demand for imported commodities is strong, then even high rates of import tariffs may not be able to provide much protection to domestic industries because the demand for imports will not be much affected by high price. High rate of protective tariffs on raw materials and intermediate goods will raise the cost of production and give rise to inflation. Therefore, in the long run, such tariffs harm the economy. The USA, has recently imposed higher rates of tariffs on several imports in order to protect their domestic industries.

III. Classification on the basis of source of imports:

1. **Non-discriminatory tariffs:** Such tariffs do not discriminate between the countries from where the imports originate. A uniform rate is levied on imports of a particular commodity irrespective of which country it is being imported from. This type of tariff is also called **single column tariff**. Such tariffs are easy to administer but they are not elastic enough to adjust according to the changing needs of particular industries.

2. **Discriminatory tariffs:** Tariffs rates differ according to the countries from where the imports originate. The products originating from countries with whom the importing country may have an agreement, will have much lower tariffs than tariffs imposed of products originating from other countries. Discriminatory tariffs are termed as **double or multiple column tariffs.** In case of double column tariff there may be two different rates of tariff for all or some commodities, one rate for those imports from the favoured nations and the other rate for countries that are not favoured nations. Similarly, there can be a general **multiple column tariff** consists of three different rates, a general rate, an international rate and a preferential rate.

3. **Maximum and minimum tariffs:** A country may have maximum and minimum tariff rates for every commodity imported. The minimum rates apply to products from the Most

Favoured Nations (MFNs). MFN tariffs are what WTO member countries promise to impose on imports from other WTO member countries, unless the country is a part of a preferential trade agreement like a free trade area or a customs union. The maximum rates are applied for the purpose of trade negotiations with some countries in order to improve the tariff imposing country's bargaining position in trade.

4. **Preferential tariffs:** These rates are imposed on imports from countries that are a part of a preferential trade agreement, like a free trade area, example NAFTA or a customs union like the EU. These rates are lower than the general tariff rates imposed on imports from countries outside the FTA or the customs union.

IV. Classification of the basis of retaliation:

1. **Retaliatory tariffs:** Tariffs may be imposed as retaliation by a trading partner on a country that initially imposes tariffs on imports, to counter the effect of the tariff. Such retaliatory tariffs will impact the exports of both the trading partners. Retaliatory tariffs result in trade wars and are harmful to international trade. In response to the tariff rates raised by the USA on Chinese goods, China has recently imposed retaliatory tariffs on $ 60 billion worth of American goods.

2. **Countervailing tariffs:** These are duties levied on imported goods to neutralize the effects of subsidies given to the producers in the exporting country. These tariffs are meant to provide a level playing field between domestic producers and producers of the same products in the exporting countries. As the producers of the exporting countries enjoy subsidies, they can sell their products at a lower price and capture foreign markets easily. For example, India may impose a countervailing duty on wheat imported from an EU country to offset the effects of the high subsidies that wheat farmers get in that country. This will make the imported wheat more expensive and there will be fair competition between imported and domestically produced wheat. Usually developed countries give large subsidies to their farmers which the developing countries

cannot give. As a result, in the international market, the farm products from developed countries have an advantage over those from developing countries. Hence, developing countries impose countervailing tariffs on farm imports from developed countries.

3. **Anti-dumping tariffs:** Dumping is a practice by an exporter of selling products in a foreign market at a price lower than what is charged for the product in the domestic market. The practice of dumping goes against the principle of fair trade. Therefore, an anti-dumping tariff, a type of protective tariff, may be imposed by the government on imports that it believes are priced below the fair market price by the exporter. This is primarily done to protect the interest of local producers. India has imposed anti dumping duties of certain products imported from China. For example, in October 2018, India imposed anti-dumping duties on certain varieties of Chinese steel to protect domestic producers.

B. Effects of Tariffs

Tariffs have wide ranging economic effects. According to Charles P. Kindleberger,[1] there are eight effects of tariffs:

(i) Protective effect

(ii) Revenue effect

(iii) Consumption effect

(iv) Distribution effect

(v) Terms of trade effect

(vi) Competitive effect

(vii) Income effect

(viii) Balance of payments effect

1. C. P. Kindleberger, *International Economics.*

The analysis of effects of tariffs is based on the following assumptions:

(a) There is one country A.

(b) A imports commodity X and exports commodity Y.

(c) The effects of the tariff are confined to the tariff imposing country.

(d) The effects of the tariff on other countries are not considered.

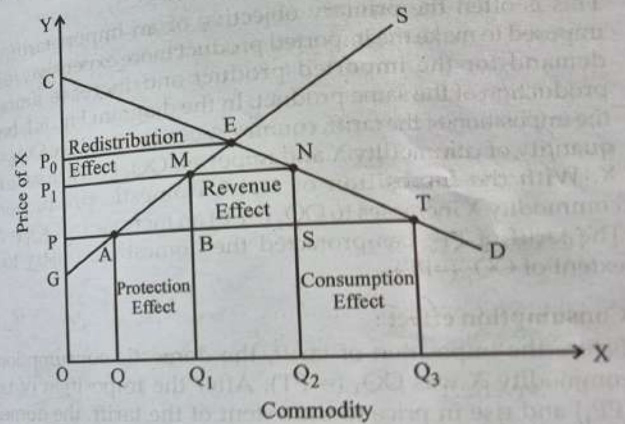


Fig. 6.1 : Effects of a Tariff

The market demand and supply curves for commodity X in country A are given by curves CD and GS respectively as shown in Fig. 6.1. The **equilibrium price** of the product, in the absence of international trade is determined by the intersection of the demand and supply curves at point E. The domestic price before import is OP_0. At this price, **consumer's surplus** is ΔCEP_0 and **producer's surplus** is ΔGEP_0.

When the country imports the product, it has to do so at the international price, which is lower than the domestic equilibrium price. The **international price** of commodity X is OP. At this international price, the country A produces OQ quantity of the commodity. The demand for X in country A at this price is OQ_3.

6.3 NON-TARIFF BARRIERS

Non-tariff barriers (NTBs) are means of restricting imports through measures other than tariffs. They include measures like import quotas, import licenses, voluntary export restrictions, product standards and testing requirements etc. With the establishment of the World Trade Organisation and promotion of free trade, tariff barriers have been coming down. Therefore, countries are increasingly resorting to non-tariff barriers.

NTBs can be broadly classified into the following:

1. NTBs that have **direct impact on the price of the imported goods.**
2. NTBs that **influence the quantity of goods imported.**

The following are some of the non-tariff barriers:

A. Import Quotas

Import quotas are the **maximum quantity of imports of commodities that are fixed by the government**. They are government imposed import restrictions that limit the volume or money value of goods that a country can import during a particular period. Import quotas are imposed to restrict imports and boost domestic production of the restricted goods. As quotas directly reduce the quantity imported, they are more effective in reducing balance of payments deficit than tariffs.

TYPES OF IMPORT QUOTAS :

Following are the types of import quotas:

1. **Tariff quotas:** Under the tariff quota system, import of a commodity up to a specified quantity is allowed, either without any duty or at a low rate of tariff. But imports in excess of the quota limit are imposed a high tariff rate.
2. **Unilateral quotas:** When a country imposes a quota on the import of a commodity without prior negotiations with the

concerned exporting country, it is known as unilateral quota. Unilateral quotas may be **global** or **allocated**. Under global quota, the commodity may be imported from any country up to the full amount of the quota limit. Under allocated quota system, the total quota limit is distributed among specified exporting countries. Unilateral quotas may face retaliatory quotas that will affect the exports of the quota imposing country.

3. **Bilateral quotas:** When quotas are fixed through negotiations between the importing and exporting countries they are called bilateral quotas. They are decided through mutual consent and therefore will not face retaliation. They are less arbitrary.

4. **Mixing quotas:** It is a type of import restriction that makes it mandatory for producers to use certain proportion of domestic raw materials, along with imported raw materials and components, to produce finished products domestically. Its main objective is to limit the use of foreign resources and promote the use of domestic resources. Such quotas are criticized on the grounds that they result in inefficient utilization of world resources and raise domestic cost of production.

5. **Import licensing:** Licensing is a measure used to administer and implement import quotas. Under this system, importers are required to obtain a license from the government authorities permitting them to import commodities within the quota limit. Through import licensing, the government can effectively implement quotas and keep imports under control. It also helps to reduce speculative activities in the international trade. Most countries today have eliminated licensing systems as they lead to corruption among government officials, create monopoly among importers, lead to shortages of goods in the country and raise domestic prices.

EFFECTS OF IMPORT QUOTAS

Like tariffs, quotas also have multiple effects. We assume open competition between domestic and foreign products. Let us suppose there a country A and a commodity X. Fig. 6.2 shows the effect of import quota imposed by country A on imports of commodity X.

10 WORLD TRADE ORGANISATION

10.1 INTRODUCTION

India is a founder member of both G.A.T.T. (1947) and successor organisation, World Trade Organisation (WTO). WTO came into existence on January 1, 1995 replacing GATT (General Agreement on Tariffs and Trade). India became a founder member of WTO by ratifying the WTO Agreement on 30, December 1994. It incorporates Arthur Dunkel's Proposals, i.e. Dunkel Draft in respect of international trade and trade related matters. The Dunkel draft was made in December 1991 by Arthur Dunkel who was the Director General of GATT.

The successful conclusion of the Uruguay Round marked the beginning of a new era in the functioning of the global trading system. Before the completion of the Uruguay Round negotiations, the future shape of the global trading environment was far from encouraging. Failure of WTO agreement, world trade could have fragmented into exclusive regional trading blocs, with the prospect of countries resorting to unilateral action to settle disputes.

The Uruguay Round Agreement has ensured the continuation of an open world trading system, based on nondiscrimination and settlement of disputes within a multilateral framework. The new trading rules cover sectors previously excluded from multilateral negotiations and disciplines, such as textiles and clothing, and agriculture. WTO has been given the mandate to negotiate multilateral rules in new areas including services, intellectual property, and trade related investment measures. Over time, these rules may be extended to the broader aspects of foreign investment, competition policy, and trade related environmental measures.

10.2 WORLD TRADE ORGANISATION (WTO)

The World Trade Organisation (WTO) came into existence on January 1, 1995 replacing GATT, with a membership of 81 countries. The membership has since increased to 164 countries.

Principles of WTO

The important principles governing the WTO are the following :

1. **Non-discrimination:** The principle of non-discrimination has two dimensions, that is, the most favoured nation (MFN) and the national treatment.

   (a) **Most-favoured Nation (MFN): It means treating other people equally.** The essence of WTO is a commitment on the part of each signatory to give all other signatories the MFN status. MFN means that each member should treat all the other members equally as the most favoured trading partner. Thus, product made in members' own countries are treated no less favourably than goods originating from any other country. The MFN rule forbids discrimination between the national or other member.

   (b) **National Treatment: It refers to treating foreigners and locals equally.** The national treatment clause forbids discrimination between a member's own nationals and the nationals of other members. Each member should accord to the nationals of other members treatment no less favourable than that it gives to its own nationals with respect to copyrights, patents, trademarks, etc. The foreign products should not be treated less favourably than identical domestic products. Thus, it becomes very difficult for a contracting party to prevent foreign products from competing with domestic products.

2. **Freer Trade:** Lowering trade barriers is one of the most important means of encouraging trade. The WTO agreements allow countries to introduce changes gradually, through **"progressive liberalisation"**. Developing countries are usually given longer time to fulfil their obligations.

3. **Predictability:** The multilateral trading system is an attempt by governments to make the business environment stable and predictable. The predictability is achieved through **binding** and **transparency**. In the WTO, when countries agree to open their markets for goods and services, they "bind" their commitments. For goods, these bindings amount to ceilings on customs tariff rates. A country can change its bindings but only after negotiating with its trading partners, which could mean compensating them for loss of trade.

   The system tries to improve predictability and stability by discouraging the use of quotas and other measures used to set limits on quantities of imports, and also by making countries' trading rules as clear and transparent (public) as possible.

4. **Promoting Fair Competition:** The WTO is sometimes described as a "free trade" institutions, but that is not entirely accurate. The system does allow tariffs and, in limited circumstances, other forms of protection. More accurately, WTO is a system of rules dedicated to open, fair and undistorted competition.

5. **Encouraging Development and Economic Reforms:** WTO system contributes to development and economic reform in the developing countries. The WTO agreements themselves inherit the earlier provisions of GATT that allow for special assistance and trade concessions for developing countries. The WTO has special concern for developing countries, especially least

About Foreign Trade Policy (FTP)

Basics about FTP	• Central Government issues FTP with powers from the Foreign Trade (Development & Regulation) Act, 1992 [FT (D&R) Act]. • FTP is governed by Union Ministry of Commerce and Industry of India. • FTP is updated every year. • FTP is given effect through issue of notification so actual benefits depend upon language of notifications.
Director General of Foreign Trade (DGFT)	• FTP is formulated, controlled and supervised by the office of Director General of Foreign Trade (DGFT) along with co-ordination from RBI, CBIC, State GST departments etc. • Decision of DGFT is final and binding in respect of interpretation of FTP. • DGFT issues various authorisations and Importer Exporter Code (IEC) for import and export.
Various Committees under DGFT	• Policy Interpretation Committee (PIC): To aid and advice the DGFT. • Norms Committee: Fixation or change of input output norms. • Policy Relaxation Committee: For all other issues.
Importer Exporter Code (IEC)	• IEC is a 10 Digit code (PAN No.) which is mandatory for import and export.

General Export Promotion Measures

Developing Districts as Export Hubs

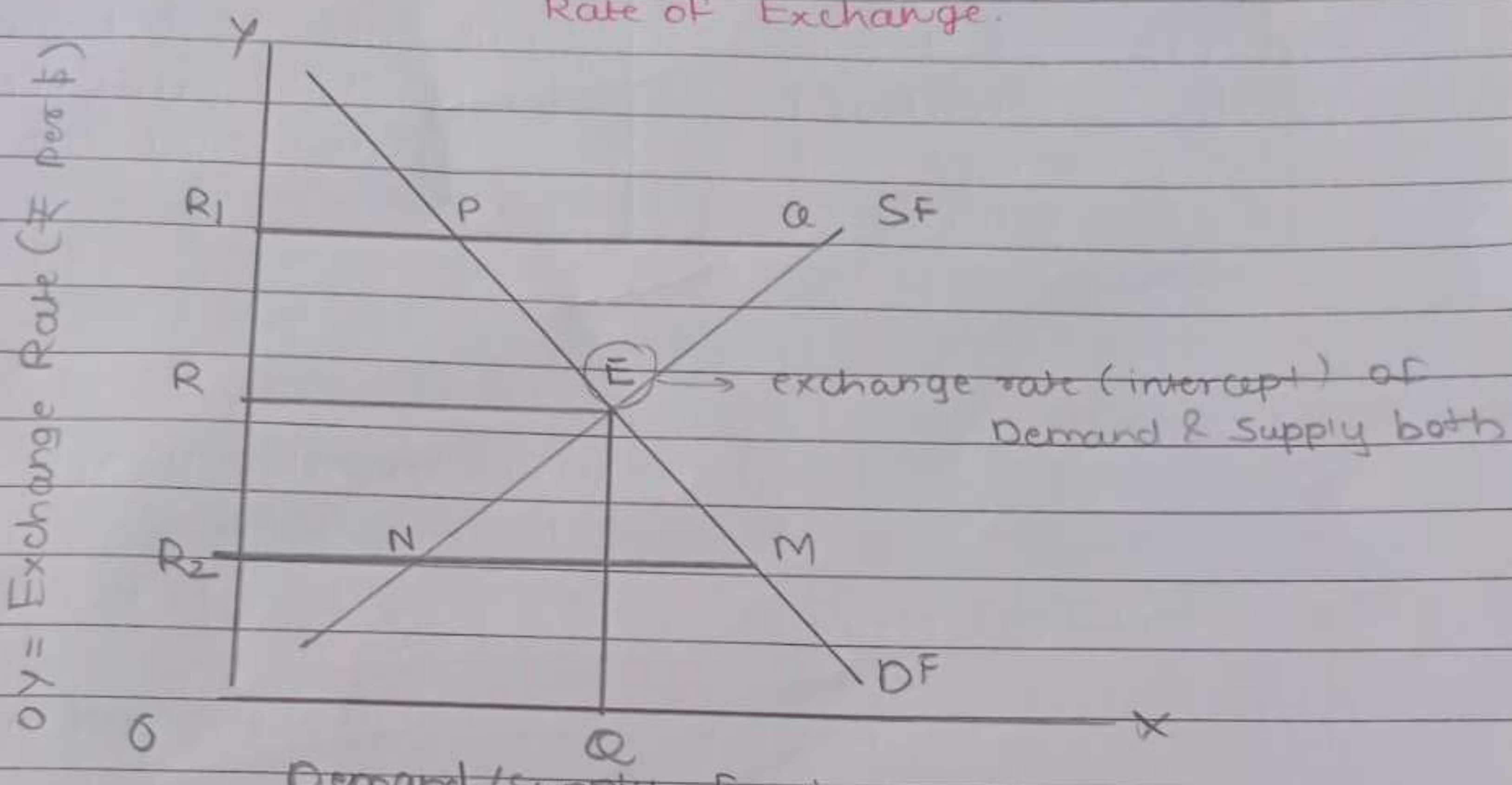
- In each district, 2-3 high potential products may be prioritized and for such products, plan for export growth may be implemented.
- Various benefits will be given to promote the export of such products from such districts i.e., help in production, marketing, exportation etc.

Status Holders

All exporters having IEC number are eligible for status based on export performance in current and preceding three financial years:

Category of Status Holder	Minimum Export Performance (In USD million) [FOB value of export earning]
1 Star Export House	3
2 Star Export House	15
3 Star Export House	50
4 Star Export House	200
5 Star Export House	800

Dig:- Determinatn of Equilibrium Rate of Exchange.



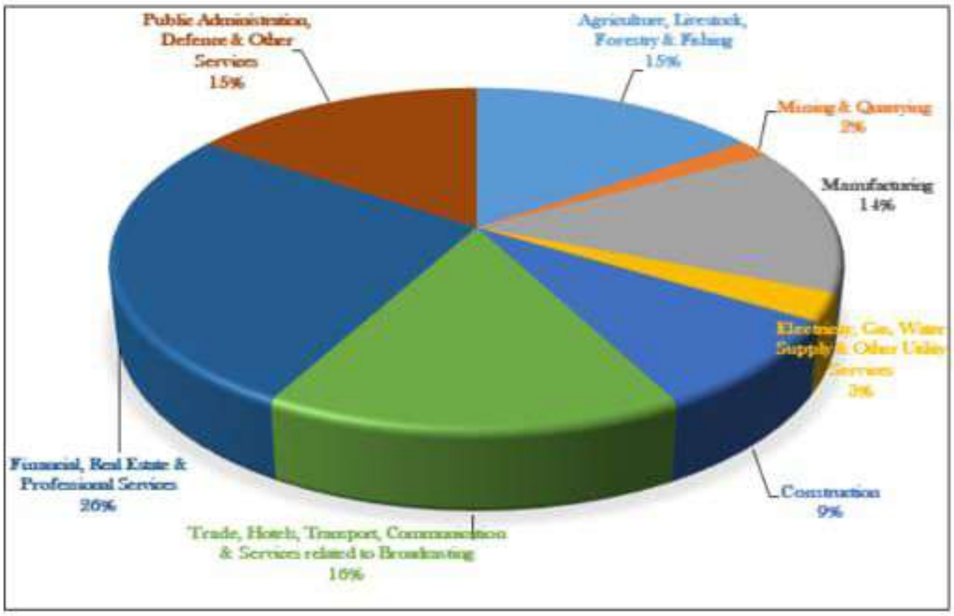
- OR - Equilibrium exchange rate. (Demand = supply)
- OR_1 - & OR_2 - Not equilibrium exchange rate (demand ≠ supply)

at OR_2 = OR_2 & R_2M - (Demand > Supply) $R_2M > R_2N$

at OR_1 - OR_1 & R_1Q - (Demand < Supply) $R_1P < R_1Q$

R_1 & R_2 - Not stable in equillibrium exchange rate

Sectoral Composition of Nominal GVA in Q1 of FY 2025-26



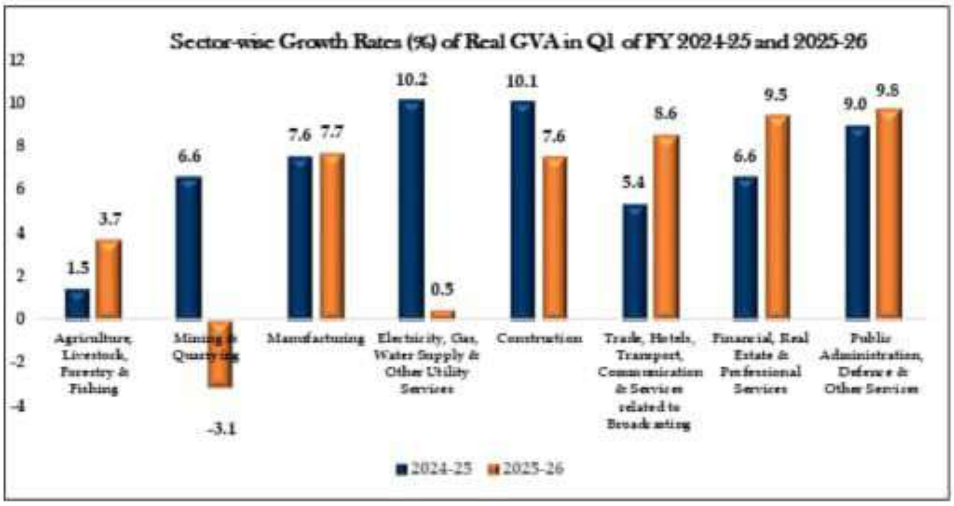
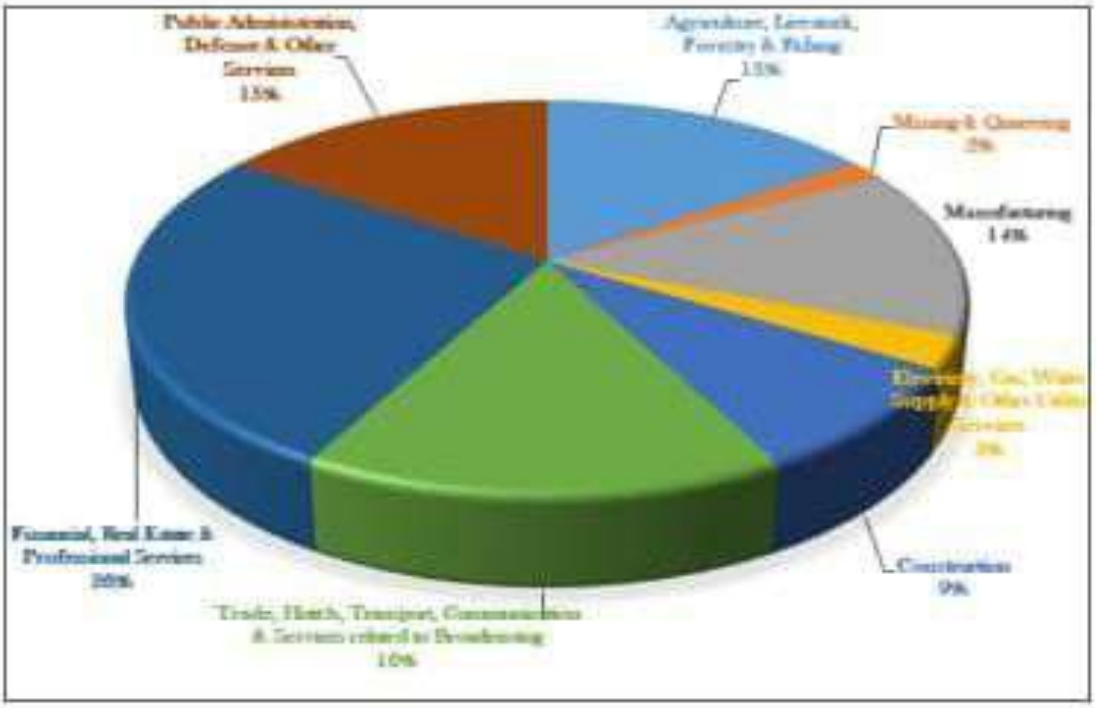


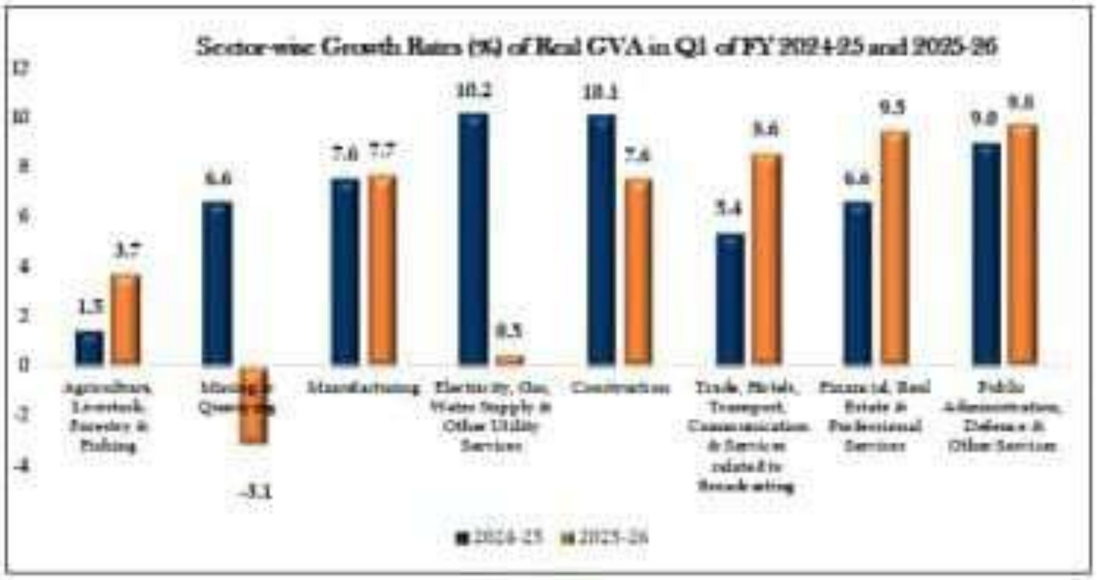
Fig. 3: Composition and Growth Rates of Quarterly GVA in Broad Sectors

Composition (%) of Nominal GVA

Fig. 2: Sectoral Composition and Growth Rates of Quarterly GVA

Sectoral Composition of Nominal GVA in Q1 of FY 2025-26





Monopoly

- One seller
- No close substitutes
- No competition
- Monopolist is a price maker

Monopolistic Competition

- Large no. of sellers.
- Differentiated products
- Close substitutes
- Non price competition
- Firm has partial control over price

⑤ Lack of uniformity :

There is a lack of uniformity among the firms in terms of their size. Some firms may be small while others may be of bigger size..

Meaning :

The term oligopoly is derived from greek word 'oligo' which means few and 'poly' which means selle

It is that market where there are few firms (sellers) in the market producing either homogenious produc or differentiated products.

Monopoly - one seller
Monopolistic - large number of seller (but closely related)

→ Monopolistic competition & Monopoly
(same, same but different, eg: toothpaste has same as other competion but thodasa different}. like a feature or smth)

→ (toothpaste is same, like different companies but some company may have a different taste, colour or smell)

⟹ i] It refer to a market situation in which there are large number of firms which sells closely related but differentiated products.
eg: Toothpaste, Soap, Maggi

iske pehele conte monopoly ka

→ Monopoly has one seller wheras ~~M~~ Monopolistic has large number of sellers.

ii] Monopoly has no close substitute wheras Monopolistic has ~~closely~~ differentiated products.

iii) Monopoly has no competion wheras Monopolistic has a close substitute.

iv) Monopolist is a price maker, Monopolistic is ~~a~~ a non-price competition.

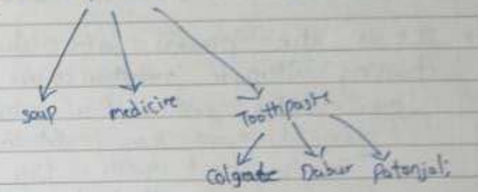
monopolistic v) ~~Mon~~ Firm has partial control over the Price

monopoly v) Monopoly has a very tough ~~entry~~. or hard entry to competition.

__/__/__

→ Draw this in exams as well

* Monopoly + Competition = Monopolestic competition.



* ~~Game Theory~~ :-

monopoly vi] Price descrimination

* Game Theory :- (Two or more rational people compete)

→ It is given by John Von Neuman and Oscar Morgenstern in 1928

→ Game theory is a body of knowledge that deals with making decisions when two or more rational and intelligent opponents (same level company) are involved under situation of conflict and competitive.

→ ~~In Game theo~~

the considerable control over the pr...
of a product.

② Interdependence :

The seller is very cautious with respect to any action taken by the competing firms. Since there are few sellers in the market.

③ Advertising :

Advertising is very powerful instrument in the hands of oligopolist. A firms under oligopoly can start an interactive and attractive advertising.

followings are the features of oligopoly

(1) few firms or sellers :

under oligopoly market, there are few firms or sellers. These few firms dominate the market and enjoys the considerable control over the price of a product.

under oligopoly can start an inter...
and attractive advertising.

④ Entry Barriers :

The firm can easily exit from the industry whenever it wants but has to face some entry barriers.

⑤ Lack of uniformity :

There is a lack of uniformity among the firms in terms of ...

What is FTA?

- A Free Trade Agreement (FTA) is a pact between two or more countries aimed at diminishing or removing obstacles to trade.

- These barriers encompass tariff barriers, such as taxes, as well as non-tariff barriers, including regulatory laws.

Perfect competition is an ideal market structure in economics where numerous buyers and sellers operate, leading to an efficient allocation of resources. In this scenario, no single buyer or seller can influence the market price, resulting in a situation where all participants are price takers.

key features of perfect competition:

1. Many Buyers and Sellers: There are a large number of participants on both sides of the market, ensuring no single entity can dominate.
2. Homogeneous Products: The goods offered by different sellers are identical, meaning consumers see no difference between products from various suppliers.
3. Free Entry and Exit: Firms can easily enter or exit the market without significant barriers, promoting competition.
4. Perfect Information: All participants have access to complete information about prices, products, and market conditions, leading to informed decision-making.
5. Price Takers: Individual firms cannot set prices; they must accept the market price determined by overall supply and demand.

nificance of FTA

- FTAs encourage specialization, imports for scarce goods, enhancing resource efficiency.
- By facilitating a blend of local production and foreign trade, FTAs contribute to economic growth.
- They also promote diversification of supply chains by simplifying and reducing the cost of cross-border business operations.

at is FTA?

- FTAs entail mutual agreements among participating nations on various obligations concerning the trade of goods and services, as well as provisions for safeguarding investors' rights and intellectual property.

y in News?

- India signed a Free Trade Agreement (FTA) with four European countries — Iceland, Liechtenstein, Norway, and Switzerland to reach $100 billion in investments in India and one million jobs within 15 years.

Significance of FTA

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- By facilitating a blend of local production and foreign trade, FTAs contribute to economic growth.
- They also promote diversification of supply chains by simplifying and reducing the cost of cross-border business operations.

- FTAs entail mutual agreements among participating nations on various obligations concerning the trade of goods and services, as well as provisions for safeguarding investors' rights and intellectual property.

- Australia, Malaysia, Sri Lanka, South Korea and Japan are few of India’s FTA partners.

followings are the features of oli

① **Few firms or Sellers :**

under oligopoly market, there are few firms or Sellers. These few firms dominate the market and enjoys the considerable control over the price of a product.

② **Interdependence :**

③ Advertising :

Advertising is very powerful instrument in the hands of oligopolist. A firm under oligopoly can start an interactive and attractive advertising.

④ Entry Barriers :

The firm can easily exit from

Game Theory

- A Game is a contest, involves two or more competitors, each of them wants to win
- Study of Decision Making under the situation of Conflicts or Competition
- In Game Theory, Competitors are referred as Players,
- Players may be individuals, Organisations etc.

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Meaning :

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It is that market where there are few firms (sellers) in the market producing either homogenious products or differentiated products

Game Theory

- The objective of the Players in Competitive situations is to
  - Maximize the Minimum Gains (Maximin)

Inflation

Causes of Inflation

Demand side

- Increase in public expenditure
- Deficit financing
- Cheap monetary policy
- Increase in disposable income
- Black Money
- Increase in Investment
- Increase in population
- Less public borrowing
- Reduction in taxes
- Increase in Exports

Supply side

- Less Production
- Artificial Scarcity
- Taxation policy of the government
- Shortage of food grains
- Industrial dispu[illegible]
- Technical changes
- Lack of Raw materials
- Natural calamitie[illegible]
- Productive Set up
- War

10:00 59%

Shorts

Subscriptions | Live | Lens

⇒ Demand Side :-

(i) Increase in Public Expenditure :- If the public expenditure in a country leads to increase then there are increase in purchasing power increased. Demand of goods and services increased but there are no increase in production of goods. As a result price begin rise.

(ii) Deficit financing :- Printing of more notes leads to increase in income of people. But production does not increase and demand increase.

(iii) Disposable income :- Demand for goods and services increase due to increase in consumer's income.

(iv) Black money :- The money which is not shown in banks or unrecorded money, is called black money. The person who holding the black money spend it on luxurious goods.

704

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Inflation,causes of inflation , Demand side ...

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(v) Increase in Investment :- When the firm think that there will be profit in near future, then it increase its investment. There is more capital formation. Price of capital goods increase due to increase in demand. So, the price of other things also increase.

(vi) Reduction in taxes :- When government reduce taxes, people's monetary income increase. Then the purchasing power of the people increase. Demand increase, price of the goods also increase.

Taxes ↓ → Monetary income ↑ → Price ↑

(vii) Increase in population :- If the population of the country is higher than the output of the country. Supply of goods is less than demand then price rise.

Population ↑ → Output ↓ → Price ↑