

THE SUBJECT MATTER OF INTERNATIONAL ECONOMICS

International Economics deals with international trade theory, international trade policy, balance of payments and foreign exchange markets and open-economy macro economics.

- International trade theory analyzes the basis and gains from trade.
- International trade policy examines the reasons for and effects of trade restrictions and new protectionism.
- The balance of payments measures a nation's total receipts from and the total payments to the rest of the world.

- Foreign exchange markets are the institutional framework for the exchange of one national currency for others.
- Finally, open-economy macro economics deals with the mechanisms of adjustment in balance of payments disequilibria.

CURRENT INTERNATIONAL ECONOMIC PROBLEMS

- **TRADE PROTECTIONISM IN INDUSTRIAL COUNTRIES**
- **EXCESSIVE FLUCTUATIONS AND LARGE DISEQUILIBRIA IN EXCHANGE RATES**
- **FINANCIAL CRISIS IN EMERGING MARKET ECONOMIES**
- **HIGH STRUCTURAL UNEMPLOYMENT AND SLOW GROWTH IN EUROPE**
- **JOB INSECURITY FROM RESTRUCTURING AND DOWNSIZING IN US**
- **DEEP POVERTY IN MANY DEVELOPING NATIONS**

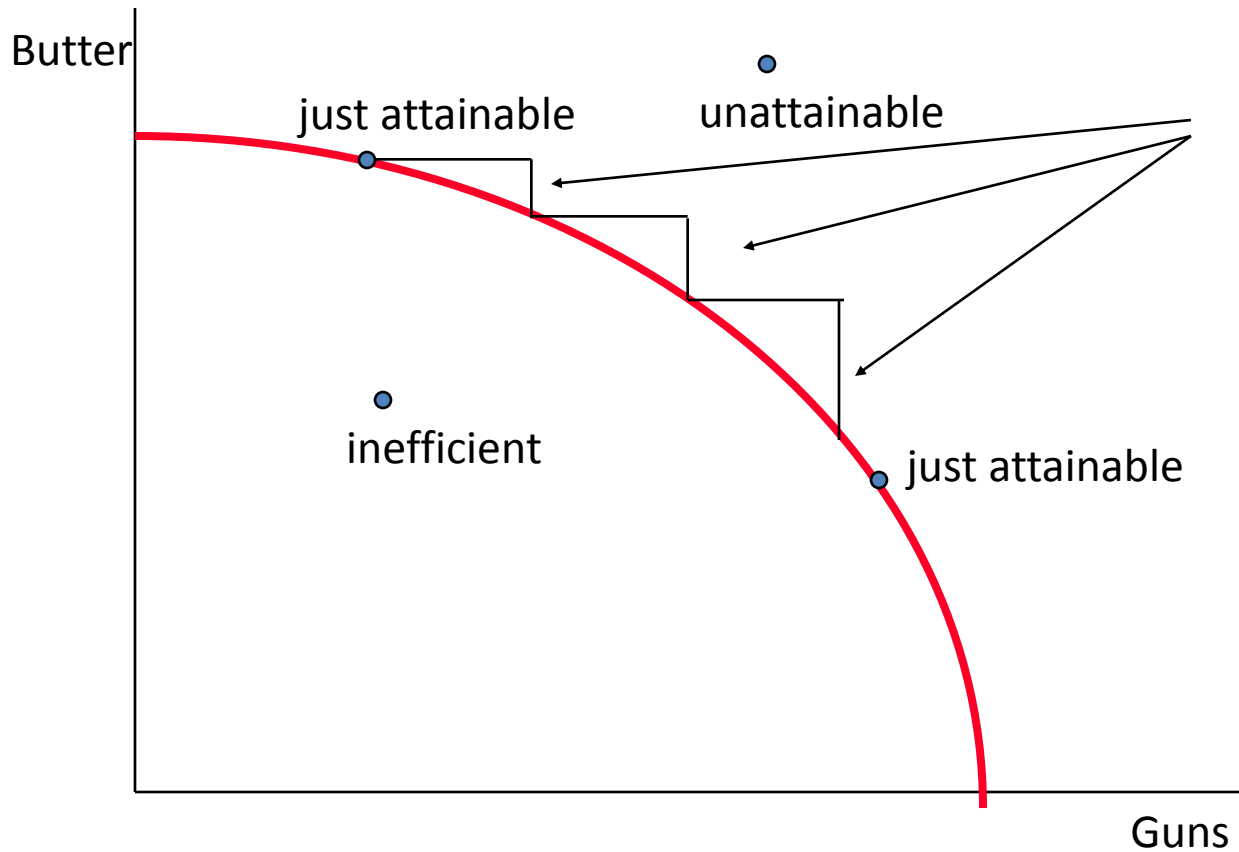
The Production Possibility Frontier - What Is It?

- The description of the best possible combinations of two goods to produce using all of the available resources.
- Shows the trade-off between more of one good in terms of the other.
- Assumes: input endowments given, technology given, time given and efficient production.

Opportunity Cost

- The **opportunity cost** of an activity is the value of the resources used in that activity when they are measured by what they would have produced when used in their next best alternative.
- The slope of the Production Possibility Frontier measures the **marginal opportunity cost** of producing one good in terms of the amount of the other good foregone.

A Typical PPF Picture

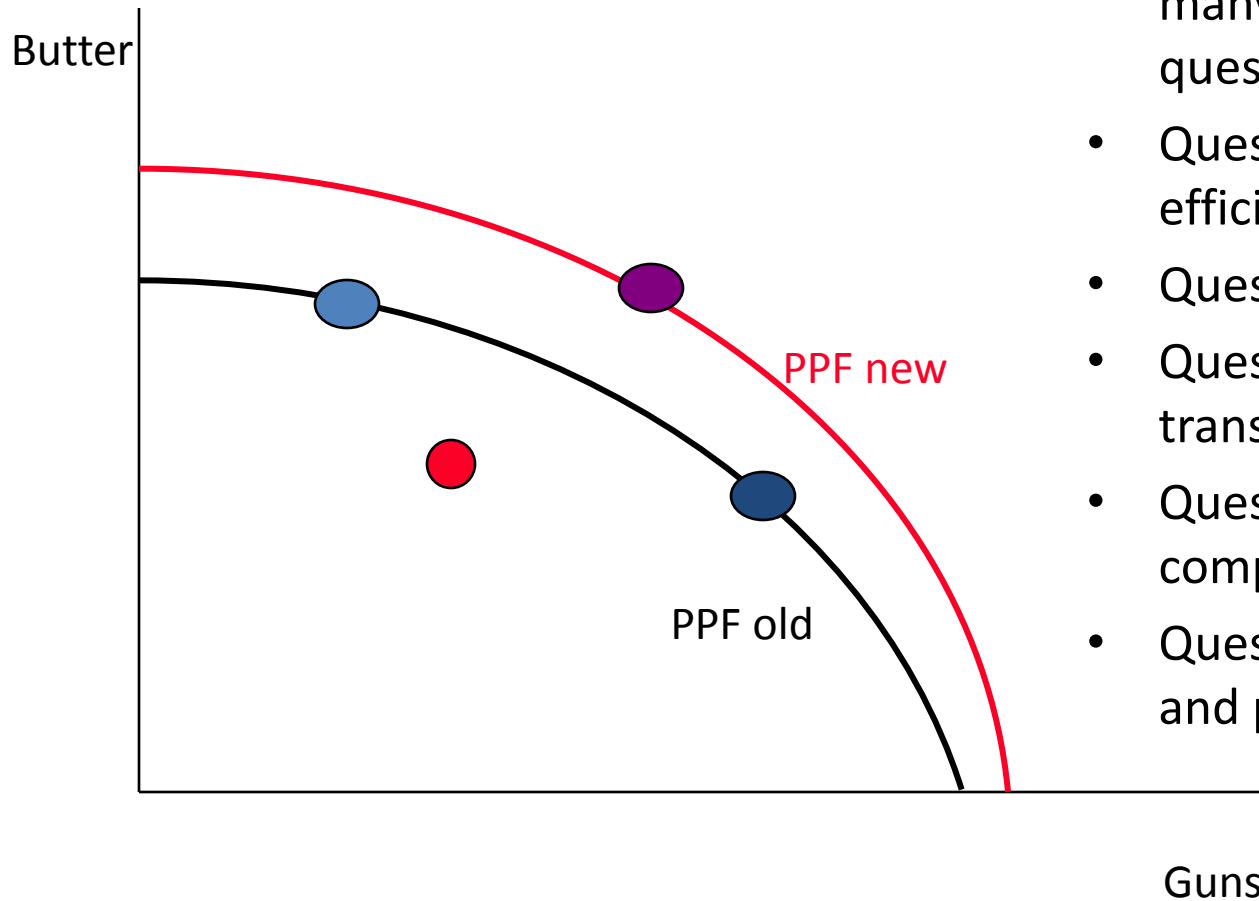


The marginal opportunity cost of guns in terms of butter is increasing as we move down the PPF!

The PPF is typically bowed-out or linear.

It is not bowed-in

PPF Gymnastics



- The PPF is also useful for many other types of questions.
- Questions about efficiency.
- Questions about equity.
- Questions about tax and transfer policy.
- Questions about composition of output.
- Questions about growth and productivity.

Absolute vs. Comparative Advantage

Applied to Trade

- **Absolute advantage:** if your country uses fewer resources to produce a given unit of output than the other country.
- **Comparative advantage:** if your country can produce the output at a lower marginal cost in terms of other goods foregone than the other country.
- Every country (or person, or economy) has a comparative advantage at some activity.
- Absolute advantage is not important and may not always happen. Sometimes people or countries have the absolute advantage in nothing! Yet trade possibilities still exist.
- It's all about comparative advantage.

PPFs and Comparative Advantage

Maximum Production Rates				
Producer	Corn meal (kg/day)	Random Access Memory (k chips/day)	Relative Price of RAM (kg corn per k chips)	Relative Price of Corn Meal (k chips per kg corn meal)
Juanita	12	4	3.00	0.33
Julio	8	2	4.00	0.25

- In this example, there are two goods being produced: Corn meal and RAM.
- Juanita has an absolute advantage at both: she can produce more of each than Julio.
- Juanita has a comparative advantage at producing RAM compared to Julio: she gives up 3.00 kg/day of corn meal to make an additional 1k of chips.
- Julio has a comparative advantage at producing corn meal compared to Juanita: he gives up 0.25 k chips to make an additional kg of corn meal.

Terms of Trade

The value of a country's exports relative to that of its imports. It is calculated by dividing the value of exports by the value of imports, then multiplying the result by 100.

If a country's terms of trade (TOT) is less than 100%, there is more capital going out (to buy imports) than there is coming in. A result greater than 100% means the country is accumulating capital (more money is coming in from exports).

HIGHLIGHTS OF THE FOREIGN TRADE POLICY, INDIA: 2015-2020

- SIMPLIFICATION & MERGER OF REWARD SCHEMES
 - ✓ Merchandise Exports from India Scheme (MEIS)
 - ✓ Service Exports from India Scheme (SEIS)
 - ✓ Incentives (MEIS & SEIS) to be available for SEZs
 - ✓ Duty credit scrips to be freely transferable and usable for payment of custom duty, excise duty and service tax.

- ✓ Status Holders like The nomenclature of Export House, Star Export House, Trading House, Star Trading House, Premier Trading House certificate has been changed to One, Two, Three, Four, Five Star Export House.

➤ BOOST TO "MAKE IN INDIA"

- ✓ Reduced Export Obligation (EO) for domestic procurement under EPCG scheme:
- ✓ Higher level of rewards under MEIS for export items with high domestic content and value addition.

➤ TRADE FACILITATION & EASE OF DOING BUSINESS

- ✓ Online filing of documents/ applications and Paperless trade in 24x7 environment:
- ✓ Online inter-ministerial consultations
- ✓ Simplification of procedures/processes, digitisation and e-governance
- ✓ Forthcoming e-Governance Initiatives
- ✓ New initiatives for EOUs, EHTPs and STPs

- ✓ Facilitating & Encouraging Export of dual use items (SCOMET).
- ✓ Facilitating & Encouraging Export of Defence Exports
- ✓ e-Commerce Exports
- ✓ Duty Exemption
- ✓ Additional Ports allowed for Export and import

- ✓ Duty Free Tariff Preference (DFTP) Scheme
- ✓ Quality complaints and Trade Disputes
- ✓ Vishakhapatnam and Bhimavaram added as Towns of Export Excellence