Trade: Introduction, Meaning and Types

Trade is a basic economic concept involving the buying and selling of goods and services, with compensation paid by a buyer to a seller, or the exchange of goods or services between parties. Trade can take place within an economy between producers and consumers. International trade allows countries to expand markets for both goods and services that otherwise may not have been available to it. It is the reason why an American consumer can pick between a Japanese, German, or American car. As a result of international trade, the market contains greater competition and therefore, more competitive prices, which brings a cheaper product home to the consumer.

Trade broadly refers to transactions ranging in complexity from the exchange of baseball cards between collectors to multinational policies setting protocols for imports and exports between countries. Regardless of the complexity of the transaction, trading is facilitated through three primary types of exchanges.

Trading globally between nations allows consumers and countries 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.

A trade deficit is a situation where a country spends more on aggregate imports from abroad than it earns from its aggregate exports. A trade deficit represents an outflow of domestic currency to foreign markets. This may also be referred to as a negative balance of trade (BOT).

Types of Trade

Home Trade (Internal Trade)

Internal trade is also known as Home trade. It is conducted within the political and geographical boundaries of a country. It can be at local level, regional level or national level. Hence trade carried on among traders of Delhi, Mumbai, etc. is called home trade.

Internal trade can be further sub-divided into two groups, viz.,

(i) Wholesale Trade

It involves buying in large quantities from producers or manufacturers and selling in lots to retailers for resale to consumers. The wholesaler is a link between manufacturer and retailer. A wholesaler occupies prominent position since manufacturers as well as retailers both are dependent upon him. Wholesaler act as a intermediary between producers and retailers.

(ii) Retail Trade

It involves buying in smaller lots from the wholesalers and selling in very small quantities to the consumers for personal use. The retailer is the last link in the chain of distribution. He establishes a link between wholesalers and consumers. There are different types of retailers small as well as large. Small scale retailers includes hawkers, pedlars, general shops, etc.

Foreign Trade

External trade also called as Foreign trade. It refers to buying and selling between two or more countries. For instance, If Mr. X who is a trader from Mumbai, sells his goods to Mr. Y another trader from New York then this is an example of foreign trade.

External trade can be further sub-divided into three groups, viz.,

(i) Export Trade

When a trader from home country sells his goods to a trader located in another country, it is called export trade. For e.g. a trader from India sells his goods to a trader located in China.

(ii) Import Trade

When a trader in home country obtains or purchase goods from a trader located in another country, it is called import trade. For e.g. a trader from India purchase goods from a trader located in China.

(iii) Entrepot Trade

When goods are imported from one country and then re-exported after doing some processing, it is called entrepot trade. In brief, it can be also called as re-export of processed imported goods. For e.g. an indian trader (from India) purchase some raw material or spare parts from a japanese trader (from Japan), then assembles it i.e. convert into finished goods and then re-export to an american trader (in U.S.A).

Importance of Trade

(i) Growth of the Economy

Trade Provide growth to the economy because when trade started in any country it brings new opportunities to people. Which also brings money in public. So, trade is the most important pilar for growth of any economy.

(ii) Provide Global Presence

When a country started trading in the domestic and International market. Global reach started automatically because the people of other countries started buying the product. So, trade provides global presence to the economy.

(iii) Helps in Civilizations

When trade started in any country it helps in improving personal growth of the people because trade run in a systematic way. So, when trade starts it does not only give to the people it also teach them administrations.

(iv) Provide High Quality Products

When trade starts it brings high compositions as well. when the compositions it remove monopoly of the products. In last when trade started it provide high quality products to the consumers.

(v) Trade improves financial performance

Once trade brings it started providing tax to the goverments. This allows them to augment the returns they achieve on their investments into research and development.

ADVANTAGES OF TRADE

(i) Maximum utilization of natural resources

Trade helps each country to utilize their natural resources in effective ways to produces high-quality products at the cheapest rate. Wastage of resources automatically reduced because once trade starts it brings high skilled employees.

(ii) Trade encourages market competition

When more brands come in the market competitions increase that gives more options and quality to the consumers at a low price and remove monopoly. Example; In India there are a lot mobiles brands has came that is providing more options and quality to the custumers.

(iii) Trade develops sympathies

Trade develops sympathies and creates common interests between trading country. It also exchange the ideas traditions, customs. This promotes international understanding and peace among the people. if war starts it can be remove by people love and understanding.

(iv) Advantages of large-scale production

When the trade started it does not only use home country but also export to other countries. This leads to larger production of the product and advantages of large production can be a benefit to all the countries.

(v) Increase in efficiency

Trade helps to country to increase their productivity because trade brings high productivity machine and best technology to the host country. This increases the efficiency and benefits to the consumers all over the world.

DISADVANTAGES OF TRADE

(i) Economic Dependence on Developed Economies

The developing economies have to depends on the developed economies because developed economies provide funds, technologies machines etc. to developing nations for trades, most of the undeveloped economy in Asia and Africa are directly depend on European countries.

(ii) Political Dependence

Most of the time trade encourages slavery. Trade affects the political decisions of the country because they become a big pillar of country of their financial support. So, it starts occupying the country's decisions. Basically it happens in backward economies.

(iii) Creates Monopoly

When big companies come in developing nations they invest money and manpower in huge quantity. So, it affects local business and creates a monopoly in the industry. Example When Amazon came to India it has effect a lot of local business.

(iv) Fear of loosing jobs

Loosing jobs is also a big fear for local skilled and educated employees.because when a big company leaves the country it fired employees in huge quantity. which creates crisis in economy.

Difference between Internal and International Trade

Trade is an economic concept that deals with buying and selling of goods. Trade is conducted between two or more parties (individuals or business entities).

Internal trade is the trade that takes place between two parties within the geographical boundaries of a nation. It is also known as domestic trade or home trade.

International trade is the trade where two or more individuals from two different countries are involved or two different countries are involved in the trade. It is also known as foreign trade.

Let us look at some of the points of difference between the internal and international trade.

Internal Trade

International Trade

Definition

Internal trade is trade that involves buying and selling taking place between two parties which are located within the political and geographical boundaries of a country

International trade is referred to as a trade that involves buying and selling of goods between two individuals or businesses located in two different countries or it can be trade between two different countries

Currency exchange

There is no exchange of currency as trade takes place within the boundaries of the nation

Exchange of currency is there between the two countries/individuals/businesses involved in the trade

Trade Restrictions

No trade restrictions for internal trade

International trade has different restrictions as the two countries involved in trade have different policies with regards to trade

Transportation Cost

Transportation cost is less when trade is taking place within the borders of a country

Comparatively higher transportation costs as goods need to be transported across the world

Goods traded

Only those goods and services are traded that are available in the country

Helps countries to trade goods that are produced in surplus or purchase goods that are scarcely available

Foreign reserve

Does not generate any foreign reserve

International trade generates foreign reserves for the two trading countries

Theories of International Trade

International trade allows countries to expand their markets for both goods and services that otherwise may not have been available domestically. As a result of international trade, the market contains greater competition, and therefore more competitive prices, which brings a cheaper product home to the consumer.

International trade gives rise to a world economy, in which supply and demand, and therefore prices, both affect and are affected by global events. Political change in Asia, for example, could result in an increase in the cost of labor, thereby increasing the manufacturing costs for an American sneaker company based in Malaysia, which would then result in an increase in the price charged at your local mall. A decrease in the cost of labor, on the other hand, would likely result in you having to pay less for your new shoes.

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Theories of International Trade

Classical Country- Based Theories

Modern Firm-Based Theories

MercantilismCountry SimilarityAbsolute AdvantagesProduct lifecyclesComparative AdvantageGlobal Strategic RivalryHeckscher-OhlinPorter's National Competitive Advantages

Mercantilism

According to Wild, 2000, the trade theory that state that nations ought to accumulate money wealth, typically within the style of gold, by encouraging exports and discouraging imports is termed mercantilism. In line with this theory different measures of countries' well being, like living standards or human development, area unit tangential mainly Great britain, France, Holland, Portuguese Republic and Spain used mercantilism throughout the 1500s to the late 1700s.

Mercantilistic countries experienced the alleged game, that meant that world wealth was restricted which countries solely may increase their share at expense of their neighbours. The economic development was prevented once the mercantilistic countries paid the colonies very little for export and charged them high value for import. The most downside with mercantilism is that every one country engaged in export however was restricted from import, another hindrance from growth of international trade.

Absolute Advantage

The Scottish social scientist Smith developed the trade theory of absolute advantage in 1776. A rustic that has associate absolute advantage produces larger output of a decent or service than different countries mistreatment an equivalent quantity of resources. Smith declared that tariffs and quotas mustn't limit international trade it ought to be allowed to flow in step with economic process. Contrary to mercantilism Smith argued that a rustic ought to focus on production of products within which it holds associate absolute advantage. No country then ought to turn out all the products it consumed. The speculation of absolute advantage destroys the mercantilistic concept that international trade could be a game. In step with absolutely the advantage theory, international trade could be a positive-sum game, as a result of there are gains for each countries to associate exchange. In contrast to mercantilism this theory measures the nation's wealth by the living standards of its folks and not by gold and silver.

There's a possible drawback with absolute advantage. If there's one country that doesn't have associate absolute advantage within the production of any product, can there still be profit to trade, and can trade even occur. The solution is also found within the extension of absolute advantage, the speculation of comparative advantage.

Comparative Advantage

The most basic idea within the whole of international trade theory is that the principle of comparative advantage, first introduced by economist David Ricardo in 1817. It remains a serious influence on a lot of international foreign policy and is thus necessary in understanding the fashionable international economy. The principle of comparative advantage states that a rustic ought to specialize in manufacturing and exportation those merchandise during which is includes a comparative, or relative price, advantage compared with different countries and will import those merchandise during which it's a comparative disadvantage. Out of such specialization, it's argued, can accrue larger profit for all.

During this theory there square measure many assumptions that limit the real-world application. The idea that countries square measure driven solely by the maximization of production and consumption and not by problems out of concern for employees or customers may be a mistake.

Heckscher-Ohlin theory

In the early decade a world trade theory referred to as issue proportions theory emerged by two Swedish economists, Eli Heckscher and Bertil Ohlin. This theory is additionally referred to as the Heckscher-Ohlin theory. The Heckscher-Ohlin theory stress that countries ought to turn out and export merchandise that need resources that area unit well endowed and import merchandise that need resources in brief provide. This theory differs from the theories of comparative advantage and absolute advantage since these theory focuses on the production of the assembly method for a selected smart. On the contrary, the Heckscher-Ohlin theory states that a rustic ought to specialize production and export victimization the factors that area unit most well endowed, and so the most cost effective. Not turn out, as earlier theories declared, the products it produces most expeditiously.

The Heckscher-Ohlin theory is most well-liked to the Ricardo theory by several economists, as a result of it makes fewer simplifying assumptions. In 1953, economic expert revealed a study, wherever he tested the validity of the Heckscher-Ohlin theory. The study showed that the U.S was additional well endowed in capital compared to alternative countries, thus the U.S would export capital- intensive merchandise and import labor-intensive merchandise. Wassily Leontief observed that the U.S's export was less capital intensive than import.

Modern or Firm-Based Trade Theories

In contrast to classical, country-based trade theories, the category of modern, firm-based theories emerged after World War II and was developed in large part by business school professors, not economists. The firm-based theories evolved with the growth of the multinational company (MNC). The country-based theories couldn't adequately address the expansion of either MNCs or intraindustry trade, which refers to trade between two countries of goods produced in the same industry. For example, Japan exports Toyota vehicles to Germany and imports Mercedes-Benz automobiles from Germany.

Unlike the country-based theories, firm-based theories incorporate other product and service factors, including brand and customer loyalty, technology, and quality, into the understanding of trade flows.

(i) Country Similarity Theory

Swedish economist Steffan Linder developed the country similarity theory in 1961, as he tried to explain the concept of intraindustry trade. Linder's theory proposed that consumers in countries that are in the same or similar stage of development would have similar preferences. In this firm-based theory, Linder suggested that companies first produce for domestic consumption. When they explore exporting, the companies often find that markets that look similar to their domestic one, in terms of customer preferences, offer the most potential for success. Linder's country similarity theory then states that most trade in manufactured goods will be between countries with similar per capita incomes, and intraindustry trade will be common. This theory is often most useful in understanding trade in goods where brand names and product reputations are important factors in the buyers' decision-making and purchasing processes.

(ii) Product Life Cycle Theory

Raymond Vernon, a Harvard Business School professor, developed the product life cycle theory in the 1960s. The theory, originating in the field of marketing, stated that a product life cycle has three distinct stages: (1) new product, (2) maturing product, and (3) standardized product. The theory assumed that production of the new product will occur completely in the home country of its innovation. In the 1960s this was a useful theory to explain the manufacturing success of the United States. US manufacturing was the globally dominant producer in many industries after World War II.

It has also been used to describe how the personal computer (PC) went through its product cycle. The PC was a new product in the 1970s and developed into a mature product during the 1980s and 1990s. Today, the PC is in the standardized product stage, and the majority of manufacturing and production process is done in low-cost countries in Asia and Mexico.

The product life cycle theory has been less able to explain current trade patterns where innovation and manufacturing occur around the world. For example, global companies even conduct research and development in developing markets where highly skilled labor and facilities are usually cheaper. Even though research and development is typically associated with the first or new product stage and therefore completed in the home country, these developing or emerging-market countries, such as India and China, offer both highly skilled labor and new research facilities at a substantial cost advantage for global firms.

(iii) Global Strategic Rivalry Theory

Global strategic rivalry theory emerged in the 1980s and was based on the work of economists Paul Krugman and Kelvin Lancaster. Their theory focused on MNCs and their efforts to gain a competitive advantage against other global firms in their industry. Firms will encounter global competition in their industries and in order to prosper, they must develop competitive advantages. The critical ways that firms can obtain a sustainable competitive advantage are called the barriers to entry for that industry. The barriers to entry refer to the obstacles a new firm may face when trying to enter into an industry or new market. The barriers to entry that corporations may seek to optimize include:

Research and development,

The ownership of intellectual property rights,

Economies of scale,

Unique business processes or methods as well as extensive experience in the industry, and

The control of resources or favorable access to raw materials.

(iv) Porter's National Competitive Advantage Theory

In the continuing evolution of international trade theories, Michael Porter of Harvard Business School developed a new model to explain national competitive advantage in 1990. Porter's theory stated that a nation's competitiveness in an industry depends on the capacity of the industry to innovate and upgrade. His theory focused on explaining why some nations are more competitive in certain industries. To explain his theory, Porter identified four determinants that he linked together. The four determinants are, local market resources and capabilities, local market demand conditions, local suppliers and complementary industries, and local firm characteristics.

Local market resources and capabilities (factor conditions). Porter recognized the value of the factor proportions theory, which considers a nation's resources (e.g., natural resources and available labor) as key factors in determining what products a country will import or export. Porter added to these basic factors a new list of advanced factors, which he defined as skilled labor, investments in education, technology, and infrastructure. He perceived these advanced factors as providing a country with a sustainable competitive advantage.

Local market demand conditions. Porter believed that a sophisticated home market is critical to ensuring ongoing innovation, thereby creating a sustainable competitive advantage. Companies whose domestic markets are sophisticated, trendsetting, and demanding forces continuous innovation and the development of new products and technologies. Many sources credit the demanding US consumer with forcing US software companies to continuously innovate, thus creating a sustainable competitive advantage in software products and services.

Local suppliers and complementary industries. To remain competitive, large global firms benefit from having strong, efficient supporting and related industries to provide the inputs required by the industry. Certain industries cluster geographically, which provides efficiencies and productivity.

Local firm characteristics. Local firm characteristics include firm strategy, industry structure, and industry rivalry. Local strategy affects a firm’s competitiveness. A healthy level of rivalry between local firms will spur innovation and competitiveness.

In addition to the four determinants of the diamond, Porter also noted that government and chance play a part in the national competitiveness of industries. Governments can, by their actions and policies, increase the competitiveness of firms and occasionally entire industries.

Porter’s theory, along with the other modern, firm-based theories, offers an interesting interpretation of international trade trends. Nevertheless, they remain relatively new and minimally tested theories.