International Economics : Scope & Importance

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Unit Highlights:

® Scope of International Economisc.

® International Economisc and its Importance.

Lesson 1 : International Economics : Scope And Importance

Lesson Objectives

After this lesson, you will be able to

® see what international economics is all about;

® realize the scope of international economics and

® appreciate the importance of international economics.

Introduction

Historically speaking, international trade is said to carry a touch of romance, a sense of the unknown, and of unforeseen danger. In the tenth century, caravans crossed desert, and in the fourteenth voyages of discovery, largely motivated by trade prospects, took adventures across stormy seas to unknown continents. The British restriction on colonial trade helped to fuel American Revolution. After World War-1 the waring nations of Europe began a new chapter of peace and prosperity by concluding a peace treaty, the precursor of the present European Community.

Several facts facilitated phenomenal trade expansion in the post-war period.

The world has come a long way since World War II in freeing trade from many forms of trade restrictions through the auspices of international negotiations such as those under the GATT and, most recently, through establishment of the World Trade Organization. Competitive trade restrictions of the past have to a significant extent, been eliminated. The world volume of international commerce has grown tremendously since the last World War. Part of it is no doubt due to the cheapening of transport, revolution in communication technologies, and reductions in risk because of insurance and international trade laws. But all these could not have contributed much had it not been for revolutions in realization that trade is an engine of growth and prosperity and isolationism is anachronistic.

But there are parallel ominous developments too. Trade has also raised frustration and apprehension among large section of populations in both developed and underdeveloped countries. Among them are innocent workers who have lost their jobs from cheaper foreign goods, a price that international specialization and reallocation of factors (in the face of relative immobility of labor) must exact. Many votaries of free trade are growing skeptical about the claimed benefits of unhampered trade. Politicians, worried about the consequences of having angry job losers on the electoral rolls are raising cries for protection. Issues like large country vs. small country, rich vs. poor countries are surfacing regularly, especially with respect to the division of gains from free trade.

Should countries open up their economics? If so, how would they, especially the poor ones, cope with shocks that spill over from across the border (and for no fault of their own) ? How fast should it do so and in what sequence ? How are international financial relations to be conducted? Does a country surrender a great deal of its autonomy in the conduct of macroeconomic policies in the name (or for the sake of) global order? Can international interdependence be so ordered as to ensure its smooth functioning and fair, harmonious development ? What kind of supranational authority does such an order call for? How will its affairs be conducted ? Will it lead to some kind of a world government? If, so what will be its contours ? You can enlighten yourself about these and many other issues of international economics. But then, what is international economics?

World trade is yet to cope with many difficult issues.

International Economics And Its Importance

Specialization through international division of labour is the basis of international trade.

International economics deals basically with those economic principles which govern the exchange of goods (and services) between sovereign nations (more accurately, between their residents) and with special policy problems which arise in view of this. It must be understood, however, that these general principles are the same as those which apply to trade between groups and individuals within a given country . This is so because the gains from trade, whether national or international, arise from specialization through division of labour which increases productivity of factors. Specialization is, however, impossible without trade. Of course, mutually beneficial exchange can arise even without production, when tastes differ between trading partners. This gain from pure exchange can be substantially increased when trade makes it possible to reallocate productive resources on the basis of comparative advantage.

If so, why study international economics separately from (say) money and banking or labour economics? Each of the latter branches has specific groups of transactors. So has international economics - residents of different nations . Traditionally, two reasons are given to justify a separate study of international economics.

1. In the long run, factors of production such as labour and capital move freely within the national frontiers, while their mobility is severely restricted between nations. As a result, it is argued, factors cannot move to any location to take advantage of higher rewards (reflecting higher productivities).

Unskilled and semi-skilled labour is far less mobile than skilled labour.

But we know that factors are not completely immobile between countries. The great international migrations of the nineteenth century are instant reminders to the contrary. Nor is it entirely true that factors can move absolutely freely within a country, particularly when it is a large country with diverse culture and ethnic groups. Nevertheless, it is true that factors, especially unskilled and semi-skilled labourers, are far less mobile (generally speaking) between nations than within any given country. In view of this, it becomes interesting to ask whether and to what extent free flows of goods and services between countries can substitute for the relative immobility of factors in equalizing factor returns. In other words, can trade lead to international reallocation of factors and hence to higher levels of world real income and welfare?

2. The second point about the need for special treatment of international economics is that international trade takes place between sovereign nations, and therefore, it is possible, and indeed likely, that in pursuance of conflicting national objectives they will adopt policies which will, intentionally or not, tend to diminish trade flows. In this context, the specific task of international trade theory would be to highlight the gains from free trade and to focus on the need for, and the possibility of, harmonies and conflicts in international economic relations.

The familiar breakdown of the entire corpus of economic theory into micro and macro domains has its parallel in international economics. International economics consists of two main branches- international trade and international finance. The former corresponds to its microeconomic counterpart and employs the methods of static equilibrium theory to barter exchange with money assumed to be a veil. The theory of international finance, on the other hand, is fundamentally macroeconomic in nature and deals with international monetary relations which assumes special significance in the event of balance of payment disequilibrium and the adjustment that it calls for.

In the present day world, economic interdependence among nations is very strong, particularly in matters of macroeconomic policy. For example, if US national income grows, its trading partner may benefit from US citizen's increased imports. At the same time, domestic US policies may export inflation or unemployment abroad. The foreigners may then initiate countervailing policies. These beggar-thy-neighbour policies can be harmful for all, as history bears witness.

Trade disruptive forces need to be tamed.

As emphasized before, trade can be an engine of growth, but could be disruptive as well. For trade to be an effective instrument of growth and stability, an effective frame work of cooperation and control must be evolved. The task is often made difficult because non-economic issues tend to turn attention away from the gains that free trade and international economic cooperation entail.

Questions for Review

Multiple Choice Questions (Tick appropriate answer (√))

1. Trade flows between nations
   A. Never took place before World War II
   B. Were weaker before World War II
   C. Were stronger before World War II
   D. Were Stronger after World War II
   E. Both (B) & (D).
2. Trade may give rise to frustrations among some people within many given countries because.
   A. The country does not gain from trade.
   B. Some people gain while others lose, and the loses are not compensated.
   C. Trade benefits only the rich and so the rich.
   D. None of the above.
3. In the course of international trade
   A. Capital moves truly among nations
   B. Labour moves truly among nations
   C. Both moves truly among nations
   D. Labour moves less truly than capital.

Short Questions

1. What briefly is the principal objective of the World Trade Organization (WTO)?
2. Why are many supports of free trade also skeptical about it? Are their positions contradictory?
3. In what sense, if any, can international interdependence prove to be harmful? why?
4. Do you think harmonies are stronger than conflicts in international economic relation? why?
5. What is international finance? Is it necessary to study it separately from real trade theory?
6. Mention two reasons to justify a separate study of the issues in international exchange of goods and services.

Essay type Questions

1. Discuss the scope and importance of international economics.
2. Why is the study of international economics very important understanding the issues in international economic relations?
3. Can you imagine why international trade had grown very slowly (and was often disrupted) before World War II?
4. What are some of the contentions issues that stand in the way of trade expansion in the present day world?

Answer : 1.E, 2.B, 3.D