Gujarat Board Textbook Solutions Class 12 Economics Chapter 9 Foreign Trade

1. Choose the correct option for the following questions :

Question 1. What happens owing to trade?
(A) The mobility of factors of production decline
(B) The number of industries decline
(C) Production process slows down
(D) Diversification in production occurs
Answer:
(D) Diversification in production occurs

Question 2. Which factor of production is least mobile in international trade?
(A) Capital
(B) Labour
(C) Entrepreneurship
(D) Land
Answer:
(D) Land

Question 3. Which significant change has occurred in India's foreign trade after 2005?
(A) The size of trade has increased and India's rank in world trade has risen
(B) The size of trade has increased but India's rank in world has fallen
(C) India's balance of payments has continuously recorded a deficit
(D) The share of traditional exports in trade has increased.
Answer:
(A) The size of trade has increased and India's rank in world trade has risen

Question 4. Which countries can be included in the list of India's traditional trade partners?
(A) England and Russia
(B) Japan and China
(C) Countries of Central Asia
(D) Australia
Answer:
(A) England and Russia

Question 5. What is balance of trade?
(A) Balance of current account
(B) Balance of capital account
(C) Balance of merchandise (visible) trade
(D) Balance of service (invisible) trade

Answer:
(C) Balance of merchandise (visible) trade

Question 6. What is meant by devaluation of rupee?
(A) Government announces increased price of $1 in terms of rupees
(B) A market situation which increases the price of $1 in terms of rupees
(C) Government announce decrease in the price of $1 in terms of rupees
(D) A market situation which decreases the price of $1 in terms of rupees
Answer:
(C) Government announce decrease in the price of $1 in terms of rupees

2. Answer the following questions in one line :

Question 1. What is meant by international trade?
Answer:
The activity of exchanging goods, services, technology etc. by a country from outside the geographical boundary is called international trade.

Question 2. What is meant by size of international trade?
Answer:
Size of foreign trade means, the total value and volume of merchandise imports and exports.

Question 3. What is meant by nature of international trade?
Answer:
Nature of imports and exports means composition of trade, that is, the types/ items of merchandise imports and exports of a country.

Question 4. What is meant by direction of international trade?
Answer:
Direction of foreign trade means the trade relations of a nation with various countries in different regions of the world.

Question 5. What is meant by exchange rate?
Answer:
The rate at which the currency of one . country can be converted into currency of another country is called exchange rate. It is the price of a foreign currency in terms of domestic currency.

3. Answer the following questions in brief :

Question 1. Give an understanding of balance of trade.

Answer:

Trade in merchandise goods (tangible goods):

- The difference in values of imports and exports of a country is known as balance of trade.
- When a country's import exceeds its export it is called negative balance of trade. If a country's export exceeds its imports it is called positive balance of trade.

Balance of trade in Balance of payment:

- While writing accounts for Balance of Payments, receipts obtained by exporting items of trade are recorded as credit entry (i.e. a'+' entry). Payments made for items imported are recorded as debit entry (i.e. a '-' entry).
- The sum total on this section of current account (i.e. the sum of credit'+' entry and debit'-' entry; or say the difference of import and export) is called the balance of trade or simply trade balance.
- If the payments for merchandise imports (i.e.'-' entries) are greater than the receipts from merchandise exports (i.e.'+' entries) then there is a deficit in the balance of trade. The vice versa situation is called surplus on the balance of trade.

Question 2. Explain the term 'size of international trade'.

Answer:

- The total value and volume of merchandise (goods) and services that a country imports and exports is known as size of foreign trade or say size of international trade.
- Every successive year, if the payments made towards imports and revenues generated from exports rise as well as the percentage of trade value rises in national income and the share of a country's trade in world trade rises , then it can be concluded that the size the county's foreign trade has increased.

Question 3. Give an understanding of balance of payments.

Answer:

Balance of Payments:

An accounting statement that shows the value of imports and exports of tangible (visible) and intangible (invisible) goods during a year is called Balance of Payments (BoP).

- Tangible or visible goods means goods which have a physical existence i.e. they can be touched and seen. Intangible or invisible goods means services such as software development, banking, logistics, etc.

- Balance of Payments has a credit entry and a debit entry. All receipts by the home country from foreigners are recorded in the credit entry side and all payments by the home country to foreigners are recorded in the debit entry side.

Types of Balance of Payments:
Balance of Payments can be either:

1. Balanced or
2. Unbalanced.

1. Balanced Balance of Payment:
When the value of entries on credit side equals that on the debit side, Balance of Payments is said to be balanced.

2. Unbalanced Balance of Payment:
When the /aiuS wf entries on the credit side is not equal to entries on the debit side, Balance of Payments is said to be unbalanced.

An unbalanced Balance of Payments can be further classified as follows:

1. **Deficit Balance of Payments:**
   In the statement of Balance of Payments, if payments are more than receipts i.e. the value of credit side entries is lesser than the values of debit side entries, then there is a deficit in the Balance of Payments.
2. **Surplus Balance of Payments:**
   - In the statement of Balance of Payments, if receipts are more than payments i.e. the value of credit side entries is greater than the value of debit side entries, then there is a surplus in the Balance of Payments.
   - According to the double entry book keeping system, a balance of payments always balances. However, in reality there can be a deficit or a surplus in the balance of payments.

4. Give answers to the point for the following questions :

Question 1. State the present condition of world trade.
Answer:
- Historian Agnus – Maddison in the World Trade Report, 2013 states that since the mid-1800s, the world's population has grown roughly 6 times, world production has grown 60 times, and world trade has grown over 140 times.
- According to this report, phenomenal reduction in transport and communication costs is the driving force behind today's global trading system on such a huge scale.
- The report also says that strong relations between nations have also boosted world trade.

- In the last 30 years, world merchandise and commercial services trade have increased by about 7 percent per year on average.
- Between 1980 and 2011, developing economies could raise their share in world exports from 34% to 47% and their share in world imports from 29% to 42%. Asia is playing an increasing role in world trade.
- Since decades the world trade has grown nearly twice as compared to world production. This clearly states that world trade is rising quite fast. This also reflects that international supply chains and logistics are playing a very important role in delivering goods across the world at a much faster rate.

Average annual growth of world trade during different time periods

Time period	Growth in world trade
1950-1973	7.88%
1973-1985	3.65%
1985-1996	6.55%
1996-2000	6.89%
2000-2011	5.00%
2015-2016	2.8%

Question 2. Elucidate the differences between the balance of trade and balance of payments.

Answer:

Basis of comparison	Balance of Trade	Balance of Payments
Meaning	Balance of trade is a statement that keeps record of country's export and import of goods with the remaining world.	Balance of Payment is a statement that keeps track of all economic transactions done by the country with the remaining world.
Records	Transactions related to goods only	Transaction related to both goods and services
Which is better?	It gives a partial view of the country's economic status.	It gives a clear view of the economic position of the country.
Accounts	There are no accounts in balance of trade	Two accounts namely, Current Account and Capital Account are maintained.
Result	It can be either favorable or unfavorable or balanced	Both the receipts and payment side gets tallied or say balanced
Component	It is a component of Current Account of Balance of Payment.	It consists Current Account and Capital Account

Question 3. Write a note on exchange rate.

Answer:

Exchange rate:

- "The rate at which the currency of one country can be converted into currency of another country is called exchange rate".
- "Exchange rate is the price of a foreign currency in terms of domestic currency".

Example:

- Suppose, exchange rate of US $ 1 = ₹ 60. This means that in order to buy 1 US dollar, an Indian will have to pay ₹ 60. This also means that if an American comes to India, his 1 dollar will fetch him 60 rupees.
- A rise in the exchange rate for India means that the value of Indian currency has declined in the international market.
- This means that India will have to pay more Indian rupees to buy one unit of foreign currency. This also means that the foreign currency has become expensive and hence value of Indian rupees has fallen.
- Suppose, the exchange rate is US $ 1 = ₹ 60
- When exchange rate rises for India, US $ 1 = ₹ 65. When exchange rate falls for India, US $ 1 = ₹ 57.
- It should be noted that in reality, the actual analysis of rise or fall in the value of a currency, the time gap between the rise or fall in value of the currency, prices of goods in the various countries, etc. are taken into consideration for deciding the exchange rate.

Impact of exchange rate:
Rise or fall in exchange rate has a major impact on our import and export trade.

Impact on import:
When the exchange rate rises for India, the value of Indian rupee (₹) falls. So, India has to pay more rupees to purchase foreign goods i.e. importing becomes costlier. As a result, the demand for imported goods decline.

Impact on export:
In terms of export, when the exchange rate rises for India, India can export more quantity of goods in lesser amounts. This boosts export trade.

- For example, if earlier by spending US $ 1, a foreign trader could purchase goods worth ₹ 60, then now he can buy goods worth ₹ 65. Hence, export ₹ from India tend to rise.
- The reverse happens when exchange rate for India falls.

Question 4. Explain reasons for trade in short.
Answer:
Reasons for international trade:
1. Different countries are endowed with different factors:

- Different countries are endowed or say blessed with different factors of production in different proportions.
- All the countries do not have all the necessary factors of production to meet their demands. Hence, the countries trade with other.countries for resources, factors of production and technology to fulfill their requirements.

2. Cost of production:

- Since the factors of production and resources are distributed unequally in the world, the cost of production of goods and services also varies in different countries.
- For example, if a factor of production is scarce in a country, the cost of production for some goods or services may be more. In such situation the country will procure those goods from other countries.

3. Technological progress:

- All countries do not achieve the same level of technological progress. Some countries have expertise in some type of technology while others possess greater ability in another type of technology.
- The difference in technologies becomes a reason for entering into international trade for purchasing or selling goods or services that require specific technological expertise.

4. Division of labour and specialization:

- Availability of labour, their productivity and skills varies from country to country. Moreover, entrepreneurial skills and efficiency also varies from person to person.
- So, some countries will have better man-management and production skills Where as some may have lesser.
- This difference wiH give rise to trade between countries for producing and selling goods and services.
- The country whose labour has lesser skills will purchase goods/services from countries which possess specialization.

Question 5. Specify the difference between current account and capital account of balance of payments.
Answer:

Basis of comparison	Current Account	Capital Account
Meaning	An account which records the export and import of merchandise and unilateral transfers done during the year by a nation are known as Current Account.	An account which records the trading of foreign assets and liabilities during the year by a country is known as Capital Account.
Reflects	It reflects net income of the country.	It reflects net change in the ownership of national assets.
Components	Trade in goods and services, investment income, unrequited transfers.	It includes Foreign Direct Investment, portfolio investment, government loans, etc.

5. Answer the following questions in detail :

Question 1. State in detail the changes that have occurred in the nature of India's foreign trade over years.
Answer:

- Direction of foreign trade means the relations of a nation with various countries of the world.
- In order to develop trade relation with other countries ¡n various directions a country needs to fulfill following requirements:
- The country should have capability to undertake production of large variety of goods.

- Develop good political and diplomatic relations with many countries.
- Readiness to undertake several diplomatic engagements with other nations.
- Ability and technology for setting up proper sales facilities and trade mechanisms.
- Produce surplus quantities which can be exported.

(A) Pattern (direction) of import:

1. Our trade relations with England developed quite strong after the British started ruling India. This tradition continued even after independence. In 1960-61, 19% of our total merchandise imports were from England. However, the situation changed 2007 wherein India imported less than 2% things from England. '

2. After independence, we were quite dependent on America for our imports. In 1960-61, our imports from USA constituted 29% of our total merchandise imports. This fell to less than 8% after 2007.

3. With time, Indian industries started developing. So, we were in heavy need of petroleum based products. As a result, our merchandise imports from OPEC i.e. Organization of Petroleum Exporting Countries increased.

4. India had friendly relations with Russia and our imports from Russia were high after independence. This declined since 1980s after the economic crisis in Russia.

5. Over, time our trade with traditional partners started declining gradually and started increasing with other developing countries, especially with developing countries of East Asia, Central Asia and Africa. •

6. Our imports from other developing countries were about 11.8% of our total merchandise imports in 1960-61. This increased to 32% in 2007-08 and further to 59% in 2014-15.

(B) Pattern (direction) of export:

1. In the same pattern in 1960-61, India's exports to England constituted 26.8% of the total merchandise exports which reduced to as low as 4% after 2007-08.

2. During the same period, India's exports to USA declined from 16% of the total merchandise exports to 12.7% and that to Russia from 4.5% to 0.6%.

3. Contrary of this, our merchandise exports to OPEC constituted 4.1% of our total merchandise exports in 1960-61 which gradually increased over years. After 2007-08 it increased to over 16% and during the same period merchandise exports to developing countries increased from 14.8% to 42.6% of the total merchandise exports.

4. From our total merchandise exports, those to Asian countries were countries were almost 50% in 2014-15.

5. Thus, India has made several successful attempts to diversify her trade with different countries that too in different directions.

Question 2. Explain the difference between domestic (internal) trade and international trade.

Answer:

The nature of international trade is quite different from that of domestic trade and it involves several hurdles and challenges.

The basic differences between the two forms of trade are summarized below:

1. Based on the scale:

The scale of international trade is much larger than that of domestic trade as it involves more countries, more variety of goods, more procedures, more and stricter rules, etc.

2. Based on currencies and modes of payment:

- In domestic trade, financial transactions take place only in domestic currency and payment is transferred from one bank to another in the same country.
- On the other hand, international trade involves several currencies and exchange rates. It also involves converting the currency at a determined exchange rate into an internationally acceptable currency.
- Payment is also to be made in internationally acceptable currency.
- Moreover, in international trade, the procedures are more rigorous and they involve several permissions, clearances and duties. Buyers have to obtain letter of credit from their respective banks for assurance of payment to sellers.

3. Based on language, culture and society:

'Transactions in domestic trade take place within a familiar social, cultural and language set-up whereas in international trade these are very different.

Hence traders have to be more careful so that they do not fall into ' controversies or hurt sentiments and even to avoid legal offences.

4. Based on transport cost:

- The transport cost in international trade is much higher than the transport cost in domestic trade.
- Moreover, taxes are to be paid for each country that the goods cross. This is not the case in domestic trade and so international trade is costlier.

5. Based on degree of competition:

- Although in domestic market there are many producers but the nature of factors of production and technology in a country are more or less same. Hence, the producers cannot produce goods with a very wide range and distinction.
- In international trade, producers/traders use products and processes of their own countries which are quite different from one another. As a result, we can see a wide range of products that too quite different from each other.
- The producers of various countries compete against each other in international market.
- For example, when the production and sale of foreign cars was not allowed in India, the competition among Indian car manufacturers was not very high as compared to today. Today, various manufactures belonging to several countries compete with Indian companies in terms of their car models, finishing, features, price, etc.
- Foreign car makers make continuous efforts to increase their share in the Indian car market.
- Thus, there is lesser competition in domestic trade as compared to international trade.

6. Based on consumer satisfaction:

- It is not very difficult to satisfy consumers in domestic market because the trader is more or less aware about the social set-up, level of awareness and education, information, preferences, values, tolerance level, etc. of the people. Moreover, these conditions are quite similar within the country.
- 'This helps the producer to produce as per the demand of consumers and meet their expectations.
- In international trade, these aspects are different in different countries of the world. Hence, it is quite difficult to predict requirements of customers at international level and satisfy them.

7. Based on administrative and legal systems:

- In domestic'trade, the traders very well know the administrative and legal systems and procedures and so they face relatively lesser difficulties in undertaking trading activity.
- In case of international trade all these things are quite different. These things create several problems for the traders to trade.
- It is almost impossible for a trader to trade without understanding the tax system, the system of obtaining licenses', permissions as well as the-legal systems of various countries of the world. Moreover, all these processes are quite expensive too.

Question 3. State in detail the changes that have occurred in the size of India's foreign trade over years.
Answer:
Size of India's foreign trade:
1. The total value and volume of merchandise (goods) and services that a country imports and exports is known as size of foreign trade.

2. Every successive year if the payments made towards imports and revenues generated from exports rise as well as the percentage of trade value rises in national income and the share of a country's trade in world trade rises then it can be concluded that the size the county's foreign trade has increased.

3. Between the period 1951 and 2016, the size of India's imports and exports, their percentage share in national income as well as their share in world trade has increased. However, the down side is that the size and growth rate of imports has been higher than that of exports in most years.

4. It is very important to note that if the value of imports or exports rises in successive years just because prices have increased then such a rise in value does not signify an increase in size of trade.

5. Size of trade is said to increase only if the value increases due to increase in volume of imports and exports.

6. Hence, the value of a country's imports and exports is measured at constant prices or in US dollars. When value of imports and exports is measured in US dollars, the changes in prices of import goods and exports goods in successive years are adjusted in the exchange rate mechanism and thus we can obtain size of trade in real terms.

India's foreign trade after 1991 (in million US $)

	1991-92	1998-99	2014-15
Merchandise exports	17.9	33.2	310.5
Merchandise imports	19.4	42.4	448.0
Balance of trade	**–1.5**	**–9.2**	**–137.5**

Source: Economic Survey of India, 2015-16

- The difference in values of imports and exports of a country is known as balance of trade.
- When a country's import exceeds its export it is called negative balance of trade.
- As can be seen in table, although India's foreign trade has increased over years but India's exports have never exceeded its imports. Hence, our balance of trade has always remained negative.

Reason for negative balance of trade:

- In the initial years of independence, India was an underdeveloped country. So, it imported more and exported less. This resulted, in negative balance of trade.
- After 1980, India started developing more. So, people started demanding more goods from the industries. Hence, it became necessary to import more and more goods to sustain, maintain and expand the large industries established in India.
- Moreover, the industries could barely meet the domestic demands so there was no surplus production that could be exported. So, again our balance of trade remained negative.
- After 1991, India's exports increased significantly. To sustain in international competition, Indian industries started importing technology, petroleum, etc. in large quantity. Again our exports remained high compared to imports.
- Hence, since indepehdence our balance of trade has always remained negative.

Question 4. State in detail the changes that have occurred in the direction India's foreign trade over years.
Answer:
Composition (nature) of India's merchandise imports and exports:
Composition of trade means the items that India imports and exports. In 1951, India was a less developed economy. It progressed to become a developing economy by 1980. After 2000, it progressed still further to gain identity of a fast-developing and emerging economy.

(I) Foreign trade around the decade of 1950-60:
A less developed economy imports things quite frequently that too in high volume in all the sectors.

- Between 1950 and 1960, India's agriculture sector was quite weak and so ' it imported food grain quite frequently. During that period it also imported machines and spare parts, capital assets, technological know-how, etc. in very high quantity.
- In terms of exports, the less developed economies like India mainly exports goods belonging to agriculture or say primary sector. So, in the past, India mainly exported tea, coffee, jute, mineral ore, and minerals, etc. It did not export industrial goods in much quantity.

(II) Foreign trade around the decade of 1970-80:

- When a country starts developing, the proportion import of food grains tends to fall. The share of primary sector goods in total exports tends to fall and that of industrial goods tends to rise. India saw such trends in the decades of 1970 and 1980.
- When the country further develops its export trade increases. To maintain and increase the export i.e. to keep on producing items of export the country's import for raw material, technology, spare parts, petroleum, etc. increases. These imports are

necessary for the industries that produce goods for export. So, as India developed its export as well as import also increased.

(III) Foreign trade after 1991:

(A) Change in import structure:

1. After 1991, the nature of trade changed significantly in India. The import of food grains and other agricultural goods and capital goods declined.

2. The share of traditional exports like tea, coffee, jute etc. in total exports declined while that of industrial goods and non-traditional items increased. For example, India started exporting software.
In 1961, the share of food imports in India's total merchandise imports was 19.1% which declined to just 3.9% in 2014-15. This shows that India attained self-reliance in producing grains and other food items.

3. As India developed, it started generating more more capital and capital intensive goods. So, India's import of such items decreased significantly. In 1960-61, the share of capital intensive goods in India's merchandise imports was as high as 31.7% which declined to 9.8% in 2014-15.

4. In 1960-61, the import of new items was only 2.2% of the total merchandise. This increased to 46.5% in 2014-15. This shows that as India developed in a variety of sectors it needed more and more new types of items and so India's imports of new types of items increased.

(B) Change in export structure:

1. As India developed, the nature of export also changed.

2. In 1960-61, the primary sector export consisted of 44.2% of total export. It reduced to as low as 12.3% in 2014-15. In this, the share of tea and coffee exports declined from 19.3% to 0.2% and that of jute export declined from 21% to 0.2%.

3. Similarly, the share of leather products in exports declined from 4.4% in 1960-61 to 1.3%in 2014-15 and that of cloth declined from 10% to 2%.

4. In terms of exports, the less developed economies like India mainly exports goods belonging to agriculture or say primary sector. So, in the past, India mainly exported tea, coffee, jute, mineral ore, and minerals, etc. It did not export industrial goods in much quantity.

5. Against this, the export of readymade garments increased from 0.1% in 1960-61 to 5.4% in 2014-15.

6. The share of manufactured goods in total merchandize exports was 45.3% which increased to 66.7% in 2014-15.

7.In 1960-61, India exported only 1.1% of petroleum products. This increased to 18.5% in 1914-15.

Conclusion:
There is a considerable change in the foreign trade pattern since independence. India has developed significantly in all these years and hence both the volume and pattern of import and export trade have also significantly changed.

Question 5. Give the meaning, types, accounts and factors influencing balance of payments.
Answer:
Balance of Payments:
An accounting statement that shows the value of imports and exports of tangible (visible) and intangible (invisible) goods during a year is called Balance of Payments (BoP).

- Tangible or visible goods means goods which have a physical existence i.e. they can be touched and seen. Intangible or invisible goods means services such as software development, banking, logistics, etc.
- Balance of Payments has a credit entry and a debit entry. All receipts by the home country from foreigners are recorded in the credit entry side and all payments by the home country to foreigners are recorded in the debit entry side.

Types of Balance of Payments:
Balance of Payments can be either

1. Balanced or
2. Unbalanced.

1. Balanced Balance of Payment:
When the value of entries on the credit side equals that on the debit side, Balance of Payments is said to be balanced.

2. Unbalanced Balance of Payment:
When the /aiuS wf entries on the credit side is not equal to entries on the debit side, Balance of Payments is said to be unbalanced.

An unbalanced Balance of Payments can be further classified as follows:

1. **Deficit Balance of Payments:**
   In the statement of Balance of Payments, if payments are more than receipts i.e. the

value of credit side entries is lesser than the values of debit side entries, then there is a deficit in the Balance of Payments.

2. **Surplus Balance of Payments:**
    - In the statement of Balance of Payments, if receipts are more than payments i.e. the value of credit side entries is greater than the value of debit side entries, then there is a surplus in the Balance of Payments.
    - According to the double entry book keeping system, a balance of payments always balances. However, in reality there can be a deficit or a surplus in the balance of payments.

Balance of Payments (BoP) consists of two accounts. They are:

1. Current account and
2. Capital account

I. Current Account: The current account records the credit and debit entries for :
1. Trade in merchandise goods (tangible goods):

- Receipts obtained by exporting items are recorded as credit entry (i.e. a '+' entry). Payments made for items imported are recorded as debit entry (i.e. a entry).
- The sum total on this section of current account (i.e. the sum of credit'+' entry and debitentry; or say the difference of import and export) is called • the balance of trade or simply trade balance.
- If the payments for merchandise imports (i.e.entries) are greater than the receipts from merchandise exports (i.e. V entries) then there is a deficit in the balance of trade. The vice versa situation is called surplus on the balance of trade.

2. Trade in services (intangible things):

- The incomes from invisibles are recorded on credit side and payments on debit side.
- This includes banking, insurance, transportation, etc. through which transactions of import and export have occurred. '
- Current Account Balance = Trade Balance + Income Balance + Net Unilateral transfer.

II. Capital Account:

- Capital account records receipts and payments from transactions on assets such as assets like stocks, gold, capital loans, etc. and other forms of fixed capital.
- The total of Current Account and Capital Account is called the Balance of Payments.

Factors influencing Balance of Payments:

- Factors influencing balance of payments means those factors that affect imports, exports, movement of capital, movement of factors of production, investment, lending, etc. in a nation are called factors influencing Balance of Payments.

- Deficit or surplus in the Balance of Payments can arise due to such factors.
- The impact of such factors usually depends upon the level of economic development of a country.

Some of these factors are:

- Exchange rate
- Prices of tradable goods in home country and in foreign countries
- Variety and quality of tradable goods
- Inevitable imports
- Level of economic development of the country
- Legal restrictions on trade
- Trade supporting facilities and infrastructure like transport, communication, etc.