International Trade

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قسم الاقتصاد

الخطة الدراسية لمقرر تجاره خارجيه

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رئيس القسم	القائم بالتدريس	أقدم أعضاء القسم بالشعبة
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بيانات المقرر

اسم المادة : تجارة خارجية

الفرقة : الثانية

الكلية : التجارة

Introduction:

Trade is one of the important economic activities in human life and known from ancient times to mankind. Trade contributed to enhancing the exchange of goods or services, or both, between two or more parties, and with the developments witnessed by human civilization, trade developed gradually. As its scope extended to become between two or more countries, and it became known as the concept of international trade.

The exchange of goods and services will always be a clear and necessary reality. Because each country produces what other countries do not produce. Countries like individuals cannot produce all the goods and services they need, and then they must specialize in producing the goods that their natural and acquired resources qualify for them, and then export their surplus production of these goods. To other countries that cannot produce it within their borders. Or they can,

but with high expenses, to import what they need from it or from others.

Thus, there are countries specializing in the production of primary commodities and other countries specializing in the production of final goods. Provided that foreign trade is established between these countries, so that the exchange of these products will take place.

Therefore, we say to the student of economic knowledge that your study of foreign trade is an important stage, and a turning point for a deeper and broader understanding of what you studied of measures of the performance of the local economy at home.

After that, we ask God that we have succeeded in preparing these notes, hoping that our students will benefit from them, and that you will increase them with knowledge and knowledge.

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Chapter 1

foreign trade

The concept & importance

Chapter 1
foreign trade
The concept & importance

The issue of international economic relations occupies a distinguished position in economic thought, due to the volume of reciprocal transactions that arise between countries within the framework of foreign trade, the latter which has attracted the attention of economists, and research in the stages of its development and the explanation of the reason for those trade relations

The country relies on foreign trade to get out of isolation and search for a way to dispose of its products, and to benefit from price differences, which was called by "Adam Smith", "David Ricardo" and "John Stuart Mill" through trade openness. The other side

of trade is that it is used to close and not allow foreign products to enter inside.

What is foreign trade

Foreign trade is considered one of the most important economic activities that countries rely on, given the economic need necessitates exchange of goods and services and the transfer of production elements, especially as it was the only solution for all countries to get out of the state of isolation, despite the different in political, economic and legal systems of these countries

However, it was an ideal solution for countries that were producing some goods but not others. It was necessary for each country to specialize in the production of goods and services that it produces more efficiently and at lower cost, then exchange its products with other countries that could not produce them efficiently due to their high cost, thus foreign

trade became based on the principle of specialization and division of labor between countries.

The concept of foreign trade

We can say that there is a divergence in the concept of the term foreign trade as a result of the great divergence of opinion about the scope of the content of this term and the images that compose it. In general, a distinction can be made between the term "foreign trade in a narrow sense" and the term "foreign trade in its broad sense." Where the term "foreign trade" in its narrow sense includes both the visible and invisible exports and imports, while the term foreign trade in the broad sense includes the following:

- **Visible exports and imports**
- **Unforeseen exports and imports**

- **International migration, that is, the movement of individuals between countries of the world**
- **International movements, that is, the movement of commodities and capital between different countries of the world.**
-

Faced with this divergence in concepts, some writers have resorted to using the term foreign trade to denote its narrow scope.

The Basises of foreign trade and its impact on the economy

In this component, we will address the basis for the establishment of foreign trade between countries, and the main factors affecting the establishment and formation of the structure of international specialization.

International assignment as a basis for the establishment of international exchange

The exchange is based mainly on the principle of international allocation, whereby each country specializes in producing a commodity or a group of commodities and exchanges them with other countries, just as each individual specializes in a specific craft, so countries specialize in the production of a certain commodity or commodities. No country can produce all the commodities it needs, but rather it is required to specialize in

Producing the goods that their natural and economic conditions qualify for their production, then exchanging them for the products of other countries that they cannot produce within their borders or that they can, but at a high cost, and thus it can be said that specialization between countries is the strong basis for the establishment of international exchange, as it will lead to an increase in the national income of the countries participating in this The exchange thus increases the

income of individuals and the rise Their level of economic well-being.

Factors of establishing and shaping the structure of international specialization:

1- Variation in natural resources

The country varies widely in its natural resources, and this leads to the difference in specialization from one country to another according to this disparity in the natural resources. There are countries that have agricultural lands, which makes them specialize in producing some agricultural crops, and there are countries that have oil fields that specialize in oil production. And so with the rest of the countries.

2- The disparity in human power

The abundance of manpower in some densely populated countries may lead to an increase in the supply of labor and thus lower wages, and this leads to the superiority of these countries in the production of some

goods with a high density of labor and that do not require great technical skill, while other countries suffer from a shortage in the supply of power. The worker and thus higher wages, she will specialize in the production of goods with high capital intensity.

3- The discrepancy in the size of capital

The acquisition by some countries of a huge stock of capital will lead to their specialization in the production of capital-intensive goods as long as the other components of these industries are available to them. As for countries that suffer from a relative scarcity of capital, they will specialize in some simple labor-intensive industries, despite the importance of capital in the field of international specialization, it has become possible to overcome the scarcity of capital through foreign investments. Therefore, countries suffering from a deficit in capital

seek to bring it from abroad and exploit it in development projects.

4- Transportation expenses (transportation cost)

Transport expenditures play an important role in international trade, as they are one of the factors affecting the international localization of industries. Settlement takes place either near raw materials, near markets, or near fuels or electrical power. Transportation has helped the international specialization to expand the market circle in front of the products of different countries, and some countries can specialize in the production of certain commodities, but the high cost of transporting these goods to the outside world makes them lose the advantage of this specialization.

5- Price differences

The difference in production expenditures (cost of factors of production) directly affects commodity prices, whether in the internal or external market. Therefore, the primary basis for establishing foreign trade is almost confined to the price differences between locally produced goods and imported goods from abroad. The rational consumer seeks to buy from the cheapest markets in order to be able to achieve the maximum possible satisfaction. As for the producer, he wishes to sell his products in the most expensive markets.

Chapter 2
Foreign trade theories

Chapter 2
Foreign trade Theories

The theory of Absolute Advantage

What Is Absolute Advantage?

Absolute advantage is the ability of an individual, company, region, or country to produce a greater quantity of a good or service with the same quantity of inputs per unit of time, or to produce the same quantity of a good or service per unit of time using a lesser quantity of inputs, than another entity that produces the same good or service.

An entity with an absolute advantage can produce a product or service at a lower absolute cost per unit using a smaller number of inputs or a more efficient process than another entity producing the same good or service.

Understanding Absolute Advantage

The concept of absolute advantage was developed by Adam Smith in his book "Wealth of Nations" to show how countries can gain from trade by specializing in producing and exporting the goods that they can produce more efficiently than other countries.

Countries with an absolute advantage can decide to specialize in producing and selling a specific good or service and use the funds that good or service generates to purchase goods and services from other countries.

By Smith’s argument, specializing in the products that they each have an absolute advantage in and then trading the products, can make all countries better off, as long as they each have at least one product for which they hold an absolute advantage over other nations.

Absolute Advantage vs. Comparative Advantage

Absolute advantage can be contrasted to comparative advantage, which is when a producer has a lower opportunity cost to produce a good or service than another producer.

Absolute advantage leads to unambiguous gains from specialization and trade only in cases where each producer has an absolute advantage in producing some good. If a producer lacks any absolute advantage then Adam Smith's argument would not necessarily apply.

However, the producer and its trading partners might still be able to realize gains from trade if they can specialize based on their respective comparative advantages instead.

Example of Absolute Advantage

Consider two hypothetical countries, Atlantica and Krasnovia, with equivalent populations and resource endowments, with each producing two products: guns and bacon. Each year, Atlantica can produce either 12 guns or six slabs of bacon, while Krasnovia can produce either six guns or 12 slabs of bacon.

Each country needs a minimum of four guns and four slabs of bacon to survive. In a state of autarky, producing solely on their own for their own needs, Atlantica can spend one-third of the year making guns and two-thirds of the year making bacon, for a total of four guns and four slabs of bacon.

Krasnovia can spend one-third of the year making bacon and two-thirds making guns to produce the same: four guns and four slabs of bacon. This leaves each country at the brink of survival, with barely enough guns and bacon to go around. However, note that Atlantica has an absolute advantage in

producing guns and Krasnovia has an absolute advantage in producing bacon.

Absolute advantage also explains why it makes sense for individuals, businesses, and countries to trade. Since each has advantages in producing certain goods and services, both entities can benefit from trade.

If each country were to specialize in their absolute advantage, Atlantica could make 12 guns and no bacon in a year, while Krasnovia makes no guns and 12 slabs of bacon. By specializing, the two countries divide the tasks of their labor between them.

If they then trade six guns for six slabs of bacon, each country would then have six of each. Both countries would now be better off than before, because each would have six guns and six slabs of bacon, as opposed to four of each good which they could produce on their own.

This mutual gain from trade forms the basis of Adam Smith’s argument that

specialization, the division of labor, and subsequent trade leads to an overall increase of wealth from which all can benefit. This, Smith believed, was the root cause of the eponymous "Wealth of Nations."

Frequently Asked Questions

How Can Absolute Advantage Benefit a Nation?

The concept of absolute advantage was developed by Adam Smith in his book "Wealth of Nations" to show how countries can gain from trade by specializing in producing and exporting the goods that they produce more efficiently than other countries and importing goods other countries produce more efficiently. By specializing in the products that they each have an absolute advantage in and then trading the products can benefit both countries as long as they

each have at least one product for which they hold an absolute advantage over the other.

How Does Absolute Advantage Differ from Comparative Advantage?

Absolute advantage is the ability of an entity to produce a product or service at a lower absolute cost per unit using a smaller number of inputs or a more efficient process than another entity producing the same good or service. Comparative advantage refers to the ability to produce goods and services at a lower opportunity cost, not necessarily at a greater volume or quality.

What Are Examples of Nations with an Absolute Advantage?

A clear example of a nation with an absolute advantage is Saudi Arabia, The ease with which oil is extracted which greatly reduces the cost of extraction is its absolute advantage over other nations. Other examples

include Colombia and its climate ideally suited to growing coffee, or Zambia being blessed with some of the world's richest copper mines. For Saudi Arabia to try and grow coffee and Colombia to drill for oil would be an extremely costly and, likely, unproductive undertaking.

- Absolute advantage is when a producer can produce a good or service in greater quantity for the same cost, or the same quantity at a lower cost, than other producers.
- Absolute advantage can be the basis for large gains from trade between producers of different goods with different absolute advantages.
- By specialization, division of labor, and trade, producers with different absolute advantages can always gain more than producing in isolation.

- Absolute advantage is related to comparative advantage, which can open up even more widespread opportunities for the division of labor and gains from trade.

Example1:

Figure 1		
Hours of work necessary to produce one unit		
Country	**timber**	**copper**
UK	80	100
Portugal	120	90

According to Figure 1, the UK commits 80 hours of labor to produce one unit of timber, which is fewer than Portugal's hours of work necessary to produce one unit of timber. The UK is able to produce one unit of timber with fewer hours of labor, therefore the UK has an absolute advantage in the production of timber. On the other hand, Portugal commits 90 hours to produce one unit of copper, which is fewer than the UK's hours of work necessary to produce one unit

of copper. Therefore, Portugal has an absolute advantage in the production of copper.

If the two countries specialize in producing the good for which they have the absolute advantage, and if they exchange part of the good with each other, both of the two countries can end up with more of each good than they would have in the absence of trade. In the absence of trade, each country produces one unit of timber and one unit of copper, i.e. a combined total production of 2 units of timber and 2 units of copper. Here.

Figure 2

Hours of work to commit after the specialization		
Country	**timber**	**timber**
UK	80 + 100	0
Portugal	0	90 + 120

if England commits all of its labor (80+100) for the production of timber for which England has the absolute advantage , England produces :

(80+100)÷80=2.25 units of timber

On the other hand, if Portugal commits all of its labor (90+120) for the production of copper, Portugal produces (90+120)÷90=2.33... units of copper . The combined total production in this case is 2.25 units of timber and 2.33 units of wine which is greater than the total production of each good had there been no specialization. Assuming free trade this will lead to cheaper prices for both goods for both countries.

Example 2 :

Both Egypt and France produce iron and Cloth. If the total hours of work available to each country and the number of hours needed to produce a unit of each commodity in each country are shown in the following table:

Country	Hourly cost of goods production	
	Iron	Clothes
Egypt	4	3
France	2	6

Requirement:

1 - On what basis the trade is based؟

2 - Determine the countries of specialization and the equitable exchange rate

3 - Calculate the gains for both countries after Specialization

The Answer

It is noticed from the previous table that each of the two countries can produce one of the two commodities at an absolute cost less

than the other country, as Egypt has an absolute advantage in Clothes production as the unit produces only 3 hours, while France produces the unit with 6 hours, and also France has an absolute advantage in Iron production, where the unit produces it at an absolute cost of only 2 hours, while Egypt produces the unit with 4 hours.

1 - The trade exchange between the countries is based here as a result of the difference in absolute advantages in the production of the two commodities between them

2 - It would be in the interest of Egypt to specialize in the production of Clothes, and it would be in the interest of France to specialize in the production of iron.

The equitable exchange rate becomes as follows:

The price of iron in France / the price of Clothes in Egypt = 2/3

3 - Upon the establishment of trade, both countries benefit as Egypt specializes in the

production of Clothes and exports the unit of Clothes to France in exchange for an iron unit that cost 4 hours of work, and consequently it achieves a gain of one hour of work.

Whereas France specializes in iron production and exports the iron unit to Egypt in exchange for a Cloth unit that cost 6 hours of work, and thus it achieves a gain of 4 working hours.

The theory of Comparative Advantage

What Is Comparative Advantage?

The law of comparative advantage describes how, under free trade, an agent will produce more of and consume less of a good for which they have a comparative advantage.

In an economic model, agents have a com-parative advantage over others in producing a particular good if they can produce that good at a lower relative opportunity cost or autarky price, i.e.at a lower relative marginal cost prior to trade.

Comparative Advantage Describes the economic reality of the work gains from trade for individuals firms or nations, which arise from differences in their factor endowments or technolo-gical progress.

(One should not compare the monetary costs of production or even the resource costs

(labor needed per unit of output) of production. Instead, one must compare the opportunity costs of producing goods across countries).

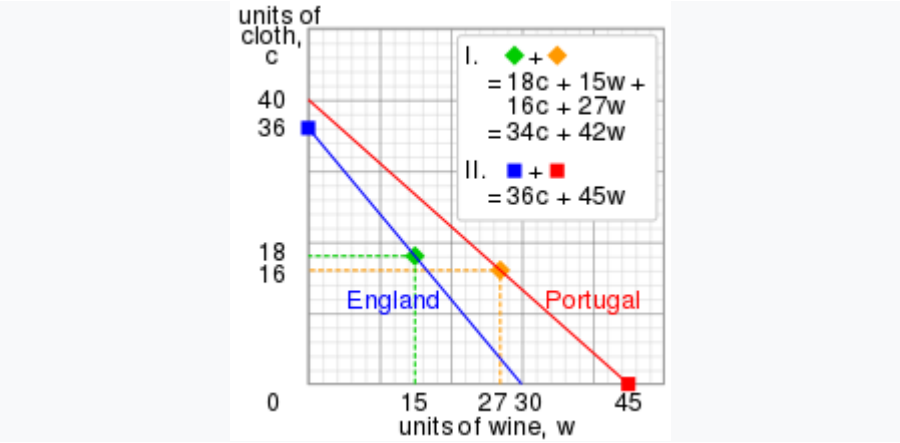
David Ricardo developed the classical theory of comparative advantage in 1817 to explain why countries engage in international trade even when one country's workers are more efficient at producing every single good than workers in other countries. He demonstrated that if two countries capable of producing two commodities engage in the free market, then each country will increase its overall consumption by exporting the good for which it has a comparative advantage while importing the other good, provided that there exist differences in labor productivity between both countries.

Widely regarded as one of the most powerful yet counter-intuitive insights in econo-mics, Ricardo's theory implies that comparative advantage rather than absolute

advantage is res-ponsible for much of international trade

In 1817, David Ricardo published what has since become known as the theory of comparative advantage in his book On the Principles of Political Economy and Taxation.

Ricardo's example[



Graph illustrating Ricardo's example: In case I (diamonds), each country spends 3600 hours to produce a mixture of cloth and wine.

In case II (squares), each country specializes in its comparative advantage, resulting in greater total output.

In a famous example, Ricardo considers a world economy consisting of two countries Portugal and England, each producing two goods of identical quality. In Portugal, the a priori more efficient country it is possible to produce wine and cloth with less labor than it would take to produce the same quantities in England. However, the relative costs or ranking of cost of producing those two goods differ between the countries.

Hours of work necessary to produce one unit		
Produce / Country	Cloth	Wine
England	100	120
Portugal	90	80

Example 2 :

Both Egypt and France produce iron and Cloth. If the total hours of work available to each country and the number of hours needed to produce a unit of each commodity in each country are shown in the following table:

Country	Hourly cost of goods production	
	Iron	Clothes
Egypt	120	100
France	80	90

Requirement:

1 - On what basis the trade is based؟

2 - Determine the countries of specialization and the equitable exchange rate

3 - Calculate the gains for both countries after Specialization

The Answer

It is noticed from the previous table that France can produce both commodities at an absolute cost less than Egypt. France has an

absolute advantage in iron production as the unit produces from it at an absolute cost of only 80 hours, while Egypt produces a unit of 120 hours. France also has an absolute advantage in textile production. As one of them is produced at a cost of 90 hours of work, in Egypt, a unit production of textiles costs 100 hours of work.

Therefore :

1 -Trade exchange between the two countries will take place here as a result of the difference in the comparative advantages in the production of the two commodities between them

2 - Specialization can be determined between the two countries according to the calculation of comparative advantages in several ways. We are satisfied with using the vertical method as follows:

A - The expense of textile production in Egypt to the expense of its production in France is:

100/90 = 1.11 Whereas the expense of iron production in Egypt to the expense of its production in France is: 120/80 = 1.5, and accordingly, for Egypt, we find that its relative expense to France in textile production is less than that of iron in the case of iron. 1.1 <1.5. Therefore, it would be in Egypt's interest to specialize in the production of textiles in which it has a comparative advantage, while France specializes in iron production.

Here the equitable exchange rate becomes as follows:

The price of iron in France / the price of textiles in Egypt = 80/100 = 0.8

3 - Upon the establishment of trade, both countries benefit as Egypt specializes in the production of textiles and exports a unit of textiles at a cost of 100 work hours to France in exchange for an iron unit that cost 120 hours of work, and accordingly, it achieves a gain of 20 working hours. Whereas France

specializes in iron production and exports to Egypt the iron unit, which costs 80 hours of work, in exchange for a textile unit that cost 90 hours of work, and thus it achieves a gain of 10 working hours.

Example 3 :

Complete the following table

Countries	Exchange rat	Commodity X(textiles)			Commodity Y (machines)		
		Produce	consumption	exports & imports	Produce	consumption	exports & imports
Before the trade Egypt	4X = 5 Y	400			280		
France	4X = 2 Y					200	
world							
After the trade Egypt				+ 270			
France							+ 360
world							
Gain Egypt							
France							
world					180		

The Answer

From the previous table we note that

1 - Before the trade

Egypt's consumption of textiles = its production = 400 and there are no exports or imports

Likewise for machines. Egypt's consumption of machinery = its production = 280

The same applies to France in its machinery production.

France's consumption of machinery = its production = 200

Thus, the part before the trade is:

Countries	Exchange rat	Commodity X (textiles)			Commodity Y (machines)		
		Produce	consumption	exports & imports	Produce	consumption	exports & imports
Before the trade	4X = 5 Y						0
Egypt		400	400	0	280	280	
France	4X = 2 Y			0	200	200	0
world				0	480	480	0

2- Through the exchange rates, we find that Egypt has a comparative advantage in textile production.

As producing five units of (X) textiles costs four units of machines in Egypt

While the same cost is given to only two units of textiles in France

Hence: Egypt specializes in producing textiles and exports them to France, and France

specializes in producing machinery and exports them to Egypt.

3 - After the trade

A - Textiles

Egypt's textile production = its textile production before trade + its machinery production before trade multiplied by (5 / 4)

That is, **= 400 + 280 (5 ÷ 4) = 400 + 350 = 750**

Egypt's consumption of textiles = its production - its exports **= 750 - 270 = 480**

France's consumption of textiles after trade = its imports from it = 270 and it produces nothing

The world's textile production = Egypt's production = 750 = its consumption

B - Machines

Egypt's consumption of machinery = its imports from it = 360 and nothing is produced from it

C - World exchange rate

World Exchange Rate = Textile Exchange ÷ Machinery Exchange

= 270 ÷ 360

Hence, we find that 3 X = 4 Y and it is the same rate of exchange in the two countries.

D - France's production of machinery

First: After the trade

Because the world's gain from production in machinery = 180

So the world's production of machinery after trade = its old production + gains = its consumption

= 480 + 180 = 660 =

France's production is trade

Thus, France’s consumption of machinery after trade = its new production - its exports of it

= 660 - 360 = 300

Thus, the part before the trade is:

Countries	Exchange rat	Commodity X (textiles)			Commodity Y (machines)		
		Produce	consumption	exports & imports	Produce	consumption	exports & imports
After the trade							
Egypt		750	480	+270	0	360	-360
France		0	270	-270	660	300	+360
world		750	750	0	660	660	0

France's textile production before trade

Because the rate of internal exchange before trade is 2 X = 4 Y, the Its production of Y after trade =

Its production of Y before + its production of X before time (4 ÷ 2)

That is:،

660 = 200 + its X production before trade (4 ÷2)

So : its X production before trade = (660 – 200) / 2

= 460 / 2 =
230

Hence its equal its consumption of X before trade

the world's textile production before trade

= Egyptian production + France production

400 + 230 = 630

which is equal to the world's pretrade textile consumption

Thus, the first part before trade is:

Countries	Exchange rat	Commodity X(textiles)			Commodity Y (machines)		
		Produce	consumption	exports & imports	Produce	consumption	exports & imports
Before the trade Egypt	4X = 5 Y	400	400	0	280	280	0
France	4X = 2 Y	230	230	0	200	200	0
world		630	630	0	480	480	0

- The world's gains from production:

- Textiles

Production gains = the world's X production after trade - its production before trade = 750 - 630 = 120

Consumption gain

Egypt's gains from X consumption = Egypt's new consumption - its old consumption = 480 - 400 = 80

France’s gains from X consumption = what was imported from textiles - its old consumption

= France's new consumption - its old consumption

= 270 - 230 = 40

The world's gains from X consumption

= Egypt's gains + France's gains

= 80 + 40 = 120 = His output

- **Machines**

World production gain = 180 **given in the exercise**

Consumption gain

Egypt's gains from Y consumption = Egypt's new consumption - its old consumption

= What was imported from Y - its old consumption

= 360 - 280 = 80

France's gains from Y consumption

=France’s New Consumption- Its Old Consumption

= 300 - 200 = 100

The world's gains from machine consumption = Egypt's gains + France's gains

= 80 + 100 = 180 = his gains from Y production

Accordingly, the table in its complete form is as follows:

Countries	Exchange rat	Commodity X(textiles)			Commodity Y (machines)		
		Produce	consumption	exports & imports	Produce	consumption	exports & imports
Before the trade	4X = 5 Y						0
Egypt		400	400	0	280	280	
France	4X = 2 Y	230	230	0	200	200	0
world		630	630	0	480	480	0
After the trade							
Egypt		750	480	+ 270	0	360	- 360
France		0	270	- 270	660	300	+ 360
world		750	750	0	660	660	0
Gain							
Egypt		350	80		- 280	80	
France		- 230	40		460	100	
world		120	120		180	180	

Exercise

Complete the following table

Countries	Exchange rat	Commodity x(textiles)			Commodity Y (machines)		
		Produce	consumption	exports & imports	Produce	consumption	exports & imports
Before the trade Egypt	4X = 5 Y	200	200	0	250	250	0
France	8X =6 Y	80	80	0	182	180	0
world		280	280	0	430	430	0
After the trade Egypt							
France				+ 220			
world	11X =10 Y						
Gain Egypt							
France							
world							

country	Exchange rate	Commodity (X)			Commodity (Y)		
		Product	Consumption	Ex , IM	Product	Consumption	Ex , IM
Before trade							
Egypt	**5 X = 4 Y**	**300**	**300**	**0**	**380**	**380**	**0**
U S A	**2 X = 5 Y**	**200**	**200**	**0**	**100**	**100**	**0**
WORLD		**500**	**500**	**0**	**480**	**480**	**0**
After trade							
Egypt		**775**	**475**	**300 +**	**0**	**450**	**450 -**
U S A		**0**	**300**	**300 -**	**600**	**150**	**450 +**
WORLD	**X = 1.5 Y**	**775**	**775**	**0**	**600**	**0**	**0**
Gains							
Egypt		**475**	**175**	**-**	**380 -**	**70**	**-**
U S A		**200 -**	**100**	**-**	**500**	**50**	**-**
WORLD		**275**	**275**	**-**	**120**	**120**	**-**

Chapter 3
Foreign trade
&
domestic trade

Chapter 3
foreign trade
&
domestic trade

Although the exchange of goods and services between different national economies is similar to their exchange within the same national economy, especially in terms of the joint effect of increasing production and thus increasing the satisfaction of needs due to the division of labor and specialization between individuals and between geographical regions, In fact, there are several factors that distinguish international economic relations from economic relations within the national economy, which are represented in the following:

The exchange of goods and services between countries and across borders is referred to as international trade. Domestic trade happens when this business is conducted inside of a country's borders. There are many

differences in international and domestic trade, but the basic principals are the same.

One of the main differences is cost. The cost of trading internationally is considerably higher than trading domestically. This is true for many reasons. One reason is time. The time that it takes to transport goods across oceans can cost businesses money. There can be time wasted at borders, tariffs must be paid, and customs inspections can be cumbersome. However, with today's ocean shipping logistics and advances in ocean freight transport, many of these problems are disappearing.

Modern cargo ships can carry a lot of freight, reducing the cost of shipping for everyone. Global standardization aspects of shipping containers have made the process of shipping from one country to another much easier. When the equipment and cargo match from country to country, there is no need to repack or transfer goods to new containers. This also has increased the security of shipping overseas.

It may seem that importing and exporting goods could have a negative effect on a country producing and transporting their own goods inside of their own borders, but that is not necessarily true. Many countries benefit from importing the materials needed to drive their own production industry. Even technologies and services shared across borders can benefit a country's production. Additionally, international trade motivates countries to work together, empowering each country to benefit from the other.

International trade has directly contributed to the industrialization of many countries. Ocean shipping advances have made it possible for corporations to do business all over the world. The standardization of practices is recognized worldwide. This helps countries to overcome problems that used to be associated with international business.

Take, for instance, the path that a standardized container can take. Goods that are produced in the United States can be loaded directly into the container of a semi-

trailer truck. It can be taken and moved directly to a train car and then can be transported by rail. From there, it can be unloaded at the dock and put directly on an ocean freight or cargo ship. It travels across the ocean where it is met with the same standardized equipment that can move it from the ship, to a barge, truck or train.

In the past, international shipping was a lengthy, expensive, and sometimes unpredictable endeavor. With modern tracking and standards put into place by industry leaders worldwide, international trade is a reliable, beneficial and profitable way to do business. Advancements in logistics have changed the face of global economics, industrialization, and international trade.

Similarities Between Inter Regional and International Trade

Bertil Ohlin shows that there is little difference between inter-regional and

international trade. International values are, therefore, determined in the same way as they are determined in internal trade. According to him, "International trade is but a special case of inter-local or inter-regional trade." Therefore, he does not find any justification for a separate theory of international trade. He adduces a number of arguments in support of his answer.

Ohlin does not accept the classical argument that labour and capital are freely mobile within a country but immobile internationally. He argues that labor and capital are also immobile inter-regionally within a country. This is apparent from the fact that wage rates differ not only in different trades but also in the same trades in different regions within the same country. Similarly, interest rates vary for different purposes in different regions.

Further, labour and capital are not immobile between countries. Rather, labour and capital have moved from one country to the other. The rapid development of the USA, Australia, New Zealand, Canada and the Latin

American Countries in the 19th and early 20th centuries has been due to the movement of labour and capital from England and Europe.

According to Ohlin, the basis of international trade is not much different from inter-regional trade. In both, space factor is important and goods move from places of abundant supplies to places where they are scarce. Transport costs are involved in both. Trade is carried on by firms for the purpose of maximising profits both in international and inter-regional trade.

So far as currency differences in international trade are concerned, they do not necessitate a separate theory. The rate of exchange between two countries is connected together on the basis of the purchasing power of the two currencies. Since the currency of one country is convertible into the currency of another country, there is no basic difference between international trade and inter-regional trade.

Last but not the least Ohlin argues that the theory of comparative costs is not applicable to international trade alone but to

all trade within a country. It is inherent in the principle of specialisation that an individual will devote his abilities to those pursuits for which he is best suited. For example, the manager of a firm may be able to repair his motorcar more cheaply and efficiently than a mechanic at a garage, but he does not do so because his time and energy can be more profitably employed in attending to his business.

As put by Ohlin:

"Regions and nations specialise and trade with each other for the same reasons that individuals specialise and trade. Some are better fitted by temperament for one work rather than another; one is a better gardener, the other a better teacher, while the third proves an excellent doctor. The gardener would prove a poor teacher and teacher a poor doctor, and so on. Thus, the gain from specialisation is clear. Even if every individual were equally alike in ability it would pay to specialise." This fundamental principle of specialisation which permeates all walks of life, applies in exactly the same way

and with the same force, to international trade. Thus, the application of the principle of comparative costs to international trade is unnecessary because it is the basis of all trade. Ohlin emphasises in this connection, "As nations are certainly the most significant of all regions, so that theory of international trade represents the chief application of the general theory of inter-regional trade."

He, therefore, believes that there is no need for a separate theory of international trade and regards international trade as "a special case of inter-local or inter-regional trade." Prices of internationally traded goods are determined in the same way as the prices of goods are determined inter-regionally.

The basis of determination of prices in inter-regional trade is the general equilibrium of demand and supply which is also applicable to international trade without substantial changes. Differences existing between countries, as are based on tariff barriers, currency differences, differences of language, customs, habits, tastes, etc. are differences of degree and not differences of

kind. As a matter of fact, they do not obstruct the free flow of goods and services internationally. Hence, there is practically little difference between international trade and interregional trade.

Conclusion:

But we do not agree with Prof. Ohlin that there is no intrinsic difference between international and inter-regional trade. In reality, there are sharp differences between international trade and inter-regional trade. Every country has its own currency in which its nationals can buy and sell goods freely within the country. But it is not possible to buy goods from foreign countries and to sell them because of the various restrictions imposed by each country on them.

Foreign currencies are neither available freely nor convertible easily. In inter-regional trade the problem of exchange rates, balance of payments and of tariffs does not arise at all, whereas they are part and parcel of international trade. It is to solve the problems arising from the international trade that the IMF, the GATT, and the UNCTAD have been

created which have no concern with inter-regional trade.

Not only this, innumerable theories and models dealing with micro and macro parts of international trade have been formulated by Hecksher, Ohlin, Samuelson, Leontief, Johnson, Bhagwati and others which are quite distinct from the theories dealing with internal trade.

This proves that international trade needs a separate study and is in no way similar to inter-regional trade. As aptly put by Kindleberger, "International trade is treated as a distinct subject because of tradition, because of the urgent and important problems presented by international economic questions in the real world, because it follows different laws from domestic trade, and because its study illuminates and enriches our understanding of economics as a whole."

Free trading

Free trade means the state's adoption of liberal trade policies, whereby the state refrains from adopting any measures that would impede its foreign trade, and most - if not - all countries strive to liberalize their foreign trade, and the reason for this is due to a set of justifications, They can be addressed as Justification for Free trade .

Justification for Free trade

1- Benefiting from technological development

Countries that have liberalized their foreign trade benefit from the technological development occurring in the developed countries than in a specific industry, especially when they import capital goods, and thus they have benefited from the technological progress that occurred outside their borders.

2 - Take advantage of specialization and labor transfer

Freedom of trade helps each country in the world to specialize in the production of a specific commodity or group of commodities in which it is distinguished (whether with a relative or absolute advantage) and that it exports them in exchange for importing other goods, and accordingly, the international specialization will increase the employment rate. , And reduce unemployment

3- Production for the world market supports the benefit from the advantages of large-scale production

International specialization works as a result of free trade to increase production of goods and services, as well as the development of exports, which increases the

volume of foreign trade and thus achieving a significant reduction in production costs, in addition to the quality of production as a result of specialization and division of labor, which ultimately works on Increase the rate of economic well-being.

4 - Determine the real price of the local currency

vis-à-vis foreign currencies

As a result of specialization and international division of labor, depending on the freedom of trade, subsidies are canceled for all commodities produced, and consequently the commodities are valued at their real prices in the global markets, and each country becomes clear about the true value of its local currency in exchange for foreign currencies.

5 - To benefit from foreign investments

Freedom of trade works to make the whole world in the form of a single large market, which allows the freedom to transfer investments to and from countries within each

other, so most countries benefit through the influx of foreign capital into them, because of the absorption of unemployment and the achievement of foreign currencies in addition to these investments. Transfer of expertise and technology.

6- Achieving efficiency in the use of resources

Freedom of trade helps in the end to the optimal and efficient utilization of productive resources available in the world as a whole, and not only at the individual level for each country separately. Freedom of trade facilitates for consumers in different parts of the world to obtain the goods and services they need at low prices, so global demand increases. On these products, which helps to achieve more profits for the producers, which helps them to do more research and studies that work to increase the quality of use and consumption, and thus the efficiency in allocating resources.

Trade protection

Contrary to free trade doctrine, Another group of economists advocates the need for the state to impose customs restrictions on its foreign trade, in order to achieve a set of economic and non-economic goals. Supporters of this thought have based on a set of considerations or justifications that can be addressed as Commercial protection justification .

Commercial protection justification.

1 - Reliance on self-financing (achieving finan-cial revenues for the state)

Many countries - especially in political and military circumstances - need to rely on self-financing so that they do not fall under the weight of other countries, and the purpose of imposing customs protection on the state's imports may be to develop its financial revenues, and the rationale in this case is to increase the state's revenues. Financial duties from customs duties, the more imports it

imports from abroad, or the higher the customs tax rate

2 - Moving away from dependency

Some countries resort to restricting foreign trade with them in order to preserve the values and culture of society. Some countries may resort to imposing high tariffs on spirits and alcoholic beverages to preserve the religious traditions of society, and not to follow foreign cultures in this regard, as it may be. The reason is to protect some strategic industries such as petroleum and energy.

3 - Anti-dumping

Dumping generally means that the state sells the commodity in the foreign market at a price lower than the price at which this commodity is sold in the domestic market or at a price lower than its cost in this market.

Exporting countries that undertake dumping aim to control the foreign market in the long run even if they make losses in the short period. Consequently, most countries impose anti-dumping duties whenever they feel that from one of the countries.

4 - Establishing modern industries and changing

the country's economic structure

It has already been said that protection increases the financial revenues of the state, enabling it to establish new industrial projects, and consequently increase the financial revenues of the state more and more, and consequently work more of these industrial projects, which may eventually lead to a change in the structure of the economy within these countries for transformation. From commercial or agricultural countries to industrialized countries.

5- Treatment of unemployment

If the country that performs the protection is able to achieve a surplus in its financial revenues and directs this surplus to the establishment of new industrial projects, as mentioned in the previous paragraph, then it works to create new job opportunities, which leads to eliminating - or limiting - The unemployment .

6 - Protection of nascent industries

most important arguments for protectionists. This argument is based on the premise that any industry at its beginning is weak, has a high cost, and is not able to compete with similar industries in developed countries, and from here it is incumbent upon the state to provide the necessary protection for that industry in order to be able to reach the stage Advanced maturity and growth enable it to compete with similar commodities.

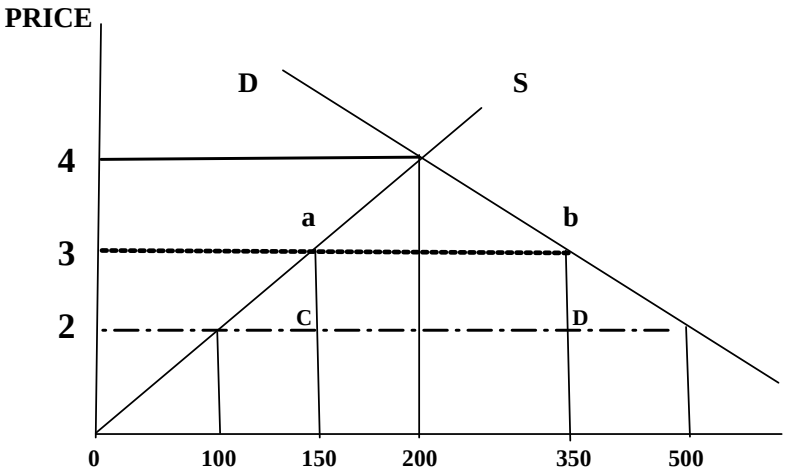
7 - Protection from imported inflation

Imported inflation is defined as the continuous rise in the prices of imported final goods and services, which is reflected in the high prices of these goods and services in the local markets.

Countries sometimes resort to protecting their foreign trade in order to preserve the domestic price level from being influenced by foreign prices

Example 1 :

If you have a set of data, as shown in the following figure:



Required:

1-Determine the quantity of domestic production, domestic consumption, and import at the price 4

2-Determine the amount of local production, domestic consumption and import at the price 2

3-Determine the amount of local production, domestic consumption and import at the price 3

4-Determine the government's revenue from imposing customs tariff at price 3

5 -How do customs tariff affect GDP؟

The solution

1 - At the domestic price (4), domestic production is equal to domestic consumption by the equivalent of 200 units, and import is equal to zero in this case, i.e. it is a state of self-sufficiency.

2 - At the world price (2), the local production is 100 units, while the domestic demand is 500 units, and accordingly, the import is

500 – 100 = 400 units

3 - At price (3), domestic production is 150 units, while domestic demand is 350 units, and therefore import is

350 – 150 = 200 units

4 - At the price (3), the government revenue from customs **tariff** is :

the area of the rectangle (ABC D) = 200 x 1 = 200

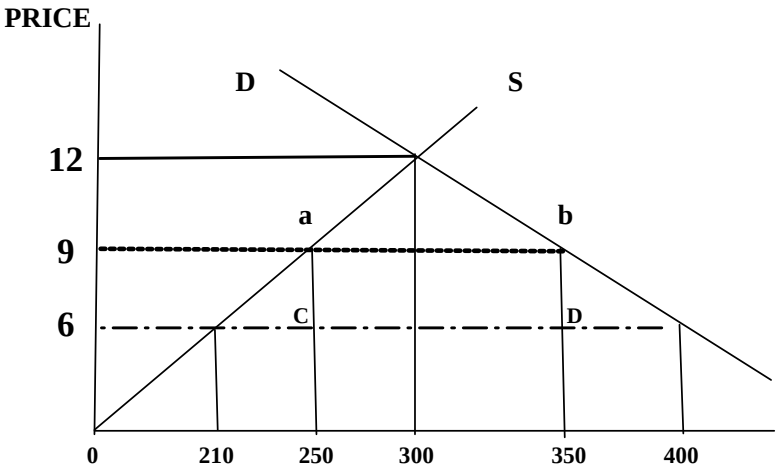
5 - Customs **tariff** help to increase local production as it led to an increase in domestic production from 100 units to 150 units, by

imposing Revenue customs duties at 50% of the world price.

It is also possible to convert the revenue customs tariff into Prohibited customs tariff that lead to raising the total domestic production from 100 units to 200 units, and that when imposing customs **tariff** of 100% of the world price.

Exercise 1 :

If you have a set of data, as shown in the following figure:



Required:

1-Determine the quantity of domestic production, domestic consumption, and import at the price 12

2-Determine the amount of local production, domestic consumption and import at the price 6

3-Determine the amount of local production, domestic consumption and import at the price 9

4-Determine the government's revenue from imposing customs tariff at price 9

5 -How do customs tariff affect GDP؟

Chapter 4
Exchange rate
and
balance of payments

Chapter 4
Exchange rate
&
balance of payments

currency exchange rates

Each official country adopts a special currency to complete its economic operations such as buying and selling, etc., and this currency is approved within the borders of the state only, and those who set foot on the land of this country must deal with this monetary unit or currency, but in the case of travel and travel or commercial dealings with other countries, this requires Use the currency of the other country. Therefore, the user or the establishment that intends to carry out these financial or commercial transactions must pay the value of the imported goods and products according to the currency adopted in the country of exporting the goods.

Objectives of the exchange rate

Resistance to inflation:

an improvement in the exchange rate leads to a decrease in the level of imported inflation and an improvement in the level of competitiveness of institutions. In the short term, the decrease in import costs will have a positive effect on lowering the level of imported inflation.

Resource allocation:

the real exchange rate leads to the transfer of resources to the international commodities sector for export, and this is what works to expand the country's commodity base so that a large number of commodities can be exported.

Income distribution:

the exchange rate plays an important role in the distribution of income between the local groups or sectors. When the competitiveness of the traditional export sector (raw materials or agricultural) increases

as a result of the decrease in the real exchange rate, this makes it more profitable, and the profit returns to the owners of capital while reducing The purchasing power of workers. And vice versa, when the nominal exchange rate falls, this leads to a rise in the purchasing power of wages.

Development of local industries:

The central bank can lower the exchange rate in order to encourage national industry, which would encourage exports. The devaluation of the currency by the central bank protects the domestic market from external competition and encourages exports.

Factors affecting the exchange rate

Relative price levels:

According to the purchasing power parity theory, when the prices of domestic commodities rise, the demand for domestic goods decreases and the price of the national currency tends to decrease as the imported

goods' can continue to be sold in a good manner, and vice versa.

Tariffs and quotas:

both customs tariffs (taxes on imported goods, for example) and quotas (restrictions on the quantity of goods that can be imported) affect the exchange rate, because that increases the demand for the local good.

Preference for foreign goods over domestic goods:

An increase in demand for a country's exports causes its currency to rise in the long run, and an increase in demand for imports causes a decline in the value of the national currency.

Productivity:

In the event that the country is more productive than other countries, it can lower the prices of local goods relative to the prices of foreign goods and still generate profits, and the result is an increase in demand for local

goods and the tendency of the local currency to rise.

How to determine exchange rates

Under the golden system (evaluating the currency in gold), the exchange rates of currencies were determined based on the relationship between the gold equivalent of the currency in comparison with other currencies.

At that time, exchange rates enjoyed a great deal of stability, and their fluctuations were confined within narrow limits, which are the entry and exit limits of gold. After the relationship between paper money and gold was severed, the gold content of the coin no longer had any role in its exchange rate.

Exchange rate and inflation

This relationship is based on the purchasing power parity theory that was initially formulated by Ricardo and then

developed by Gustave Cassel, and focuses on the simple principle that "the value of a currency is determined on the basis of its purchasing power, and hence the equilibrium exchange rate must express the equality of the real purchasing power of the two currencies in question.

This model has proven a great ability to predict exchange rates in the long run, but it is blamed for several things such as the unrealistic assumptions on which it was built such as the availability of free and complete competition in the international economy and the absence of transportation costs and customs fees.

Exchange rate and interest rate

This theory assumes that in the absence of customs barriers, the return on employment in two different countries must be equal, and this on the other hand guarantees that the difference between an economy and the rest of the economies is equal to the rate of

appreciation or depreciation of the currency in the future.

This theory led to the emergence of the concept of deferral discount and postponement bonus, and considering that the exchange rate is the best way to predict exchange rates, but that its validity does not exceed 55%.

Exchange rate and balance of payments

Balance of payments balances (foreign trade balance, current transactions balance, base balance balance) are the most important factors explaining the change in the exchange rate in the medium term, as the occurrence of a deficit in the trade balance necessarily leads to a decrease in the exchange rate. The importance of these stocks increases as they have a relationship with inflation and interest rates. A country characterized by high inflation rates finds great difficulties in exporting its products and affecting the trade balance. It is also the interest rates that govern the flow of capital in the long and short term

Balance of Payments

It is an account that reflects all payments and obligations abroad against all payments and obligations received from abroad between the various entities of a country during a specified period of time. It is a record of all financial flows in and out of the country.

Balance of payments indicates whether a country saves enough to pay for its imports. It also reveals whether the country is achieving sufficient economic production to support its development.

A deficit in the balance of payments means that the country imports more products, capital and services than it exports. Therefore, he has to borrow from other countries to pay for his imports. Short term .

In the event that it is not possible to obtain sufficient loans, countries sometimes resort to some exceptional tools to reduce or fill the deficit in the balance of payments. An example of these exceptional tools is the

imposition of customs protection. By setting customs tariffs on imports. As well as devaluing the local currency against other currencies.

However, the devaluation does not at all adequately fill the deficit in the balance of payments. Tariffs should also be efficient.

And in order to get acquainted with the mechanism of action of each of the effective customs duties or the mechanism of devaluation, we review the following examples:

Important definitions and rules

Nominal customs tariff :

It is the total of customs tariffs imposed on the commodity in its various stages. That is, it is equal to the total tariff imposed on raw materials as well as on the finished good

Nominal tariff = tariff on raw materials

+ tariff on final goods

The local price after tariff:

= Price abroad + value of customs tariff

Domestic value added = price of domestic final good

after tariff - price of domestic

raw materials after tariff

Global value added = price of the final good abroad

- price of raw materials abroad

Effective tariff =

Exercise 1:

If the commodity is sold abroad for $ 8, and the price of the raw materials involved in its production is equivalent to $ 5, then if Egypt imports the final Goods and imposes a tariff equivalent to 25% of its price, and imports the raw material and imposes a tax equivalent to 10% of its price. Its price.

Required:

1 - Calculate the nominal tariff

2 - Calculate the Domestic price after imposing tariff on the final Goods

3 - Calculate the Domestic price after imposing tariff on raw materials

4 - Calculate the Domestic added value

5 - Calculate the global added value

6 - Calculate effective tariff

The solution

1 - Nominal tariff = 25% + 10% = 35%

2 - The Domestic price after imposing tariff on

final Goods:

= Price abroad + tariff value

= 8 + (8 x 25%)

= 8 + 2 = $ 10

Or that the Domestic price after imposing tariff

on the final Goods = 8 x 1.25 = 10

3 - The Domestic price after imposing tariff on

raw materials:

= Price abroad + tariff value

= 5 + (5 x 10%)

= 5 + 0.5 = $ 5.5

Or, the Domestic price after imposing tariff on

raw materials = 5 x 1.1

= 5.5

4- Domestic value added

= Domestic price after imposing tariff on

the finished commodity - the local price

after imposing tariff on raw materials

= 10 - 5.5 = $ 4.5

5 - Global added value:

= Price abroad of the finished good – the price of raw materials abroad

= 8 – 5 = $ 3

6 - Effective tariff =

$$\frac{\text{Domestic value added - Global added value}}{\text{Global added value}}$$

$$\textbf{Effective tariff} = \frac{4.5 - 3}{3} = 50\ \%$$

Exercise 2:

In a country suffering from a deficit in its balance of payments, where the balance of payments data was as follows:

Exports:

The price	quantity
800	20000

Imports:

The price	quantity
800	30000

If the country wanted to increase its exports and reduce its imports to remedy the deficit in its balance of payments, by reducing the currency value by 25%

Required :

1 - Calculate the value of exports and imports before the reduction

2 - Calculate the deficit in the balance of payments before the reduction
3 - Calculate the value of exports and imports after devaluation
4- Calculate the deficit in the balance of payments after the reduction
5 - Determine the percentage of the reduction in the balance of payments deficit, and the required percentage of the reduction to eliminate the deficit.

The solution

1 - Value of exports before reduction

$= 800 \times 20000 = 16000000$

The value of imports before reduction

$= 800 \times 30000 = 24000000$

2 - The value of the deficit in the balance of paym-

ents before the reduction

$$\begin{array}{rr} & 24000000 \\ - & 16000000 \\ \hline \end{array}$$

= 8000000

3 - The value of exports and imports after deva-

luation:

After devaluation, the following occurs:

A - The Exports price decrease by the same rate of

reduction and become:

Ex price after reduction = Old price (1 - discount rate)

= 800 (0.75) = 600

B - The exports quantity increases with the same

percentage reduction and become =

Old quantity (1 + reduction percentage)

= 20,000 (1.25) = 30,000

C - The import prices increase by the same rate of

reduction, then they become:

Import price after redu = Old price (1 + discount rate)

= 800 (1.25) = 1000

D - Import quantity decreases by the same rate of

reduction, then they become

Import quantity after redu = Old quantity (1 - reduction ratio)

= 30000 (0.75) = 22500

Therefore:

The value of exports after devaluation

= 600 x 30,000 = 18000000

The value of imports after devaluation

= 1000 x 22500 = 22500000

4- The value of the deficit in the balance of paym-

ents after the reduction = 22500000
– 18000000
= 7500000

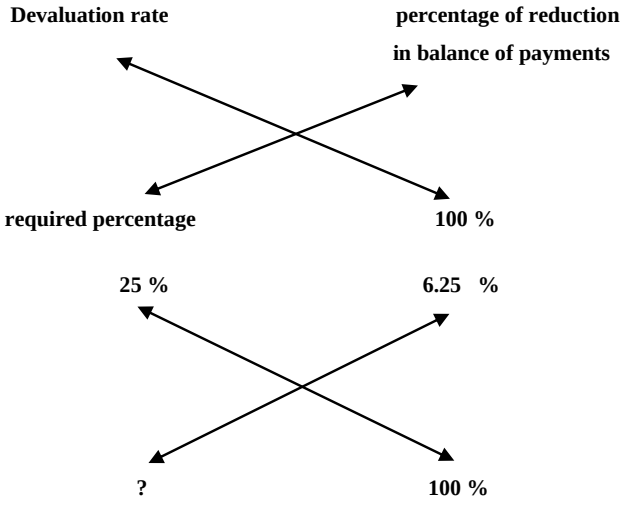
5- The value of the decrease in the balance of paym-

ents deficit = 8000000
– 7500000
= 500000

Consequently, the percentage of decrease in the balance of payments deficit is:

= 500,000 ÷ 8,000,000 = 6.25%

The required percentage of reduction to eliminate the deficit can be calculated through the following scissors form:



Therefore:

Required ratio = (25 x 100) ÷ 6.25 = 400.

Exercise 3:

In a country suffering from a deficit in its balance of payments, where the balance of payments data was as follows:

The price	quantity
95	1000

Exports:

Imports:

The price	quantity
110	1100

If the country wanted to increase its exports and reduce its imports to remedy the deficit in its balance of payments, by reducing the currency value by 25%

Required :

1 - Calculate the value of exports and imports before the reduction

2 - Calculate the deficit in the balance of payments before the reduction

3 - Calculate the value of exports and imports after devaluation

4- Calculate the deficit in the balance of payments after the reduction

5 - Determine the percentage of the reduction in the balance of payments deficit, and the required percentage of the reduction to eliminate the deficit.

The solution

1 - Value of exports before reduction

$$= 95 \times 1000 = 95000$$

4 - The value of imports before reduction

$$= 110 \times 1100 = 121000$$

3 - The value of the deficit in the balance of payments before the reduction

$$\begin{array}{rr} & 121000 \\ - & 95000 \\ \hline = & 26000 \end{array}$$

3 - The value of exports and imports after devaluation:

After devaluation, the following occurs:

A - The Exports price decrease by the same rate of

reduction and become:

Ex price after reduction = Old price (1 - discount rate)

= 95 (0.75) = 71.25

B - The exports quantity increases with the same percentage reduction and become =

Old quantity (1 + reduction percentage)

= 1000 (1.25) = 1250

C - The import prices increase by the same rate of reduction, then they become:

Import price after redu = Old price (1 + discount rate)

= 110 (1.25) = 137.5

D - Import quantity decreases by the same rate of

reduction, then they become

Import quantity after redu = Old quantity (1 - reduction ratio)

= 1100 (0.75) = 825

Therefore:

The value of exports after devaluation

= 71.25 x 1250 = 89062.5

The value of imports after devaluation

= 137.5 x 825 = 113437.5

4- The value of the deficit in the balance of payments after the reduction

= 113437.5

– 89062.5

= 24375

5- The value of the decrease in the balance of payments deficit

= 26000

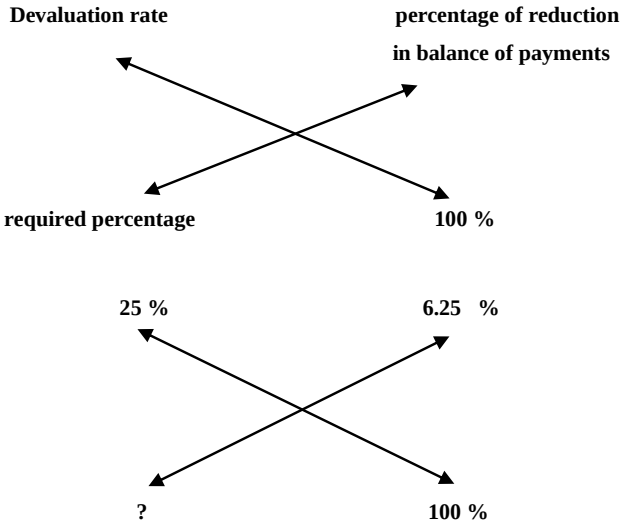
– 24375

= 1625

Consequently, the percentage of decrease in the balance of payments deficit is:

= 1625 ÷ 26000 = 6.25%

The required percentage of reduction to eliminate the deficit can be calculated through the following scissors form:



Therefore:

Required ratio = (25 x 100) ÷ 6.25 = 400.

Chapter 6
Internal and external balance

Chapter 6
Internal and external balance

We developed a model for national income in an open economy. Within this model the balance-of-payments is integrated into the national economý. , There før we discussed what is meant by balance of payment equilibrium-or external balance. We also discussed how a country can cure a deficit in the balance of payments by changing the exchange rate or by following certain fiscal policies:.

Although the question of keeping external balance in equilibrium is very important for many countries, there are other important aims of economic policy which should be taken into account in addition to the balance of payments equilibrium. As we mentioned in chapter (5) full employment and price stability (internal balance) are important aims of economic policy of a country, for example a country might achieve balance of payments equilibrium_but it also might have

unemployment or inflation. In other words, a country might realize external balance but not internal balance. Also there might be a conflict between internal and external balance. This in tur implies that both internal and external balance should be considered jointly. This is the main concern of this chapter which provides a definition of internal and external balance and
considers the main economic means (instruments which help realize internal balance and balance of payments equilibrium.

Definition of internal and external balance:

Intemal balance:

Internal balance is simply the realization of full employment and price stability. This can be achieved by realize equilibrium in both the goods and money markets. The equilibrium in the goods markets is achieved when aggregate demand (total expenditure) equals national income. In other words, the goods market will be in equilibrium when the condition for income equilibrium is satisfied as follows:

I + X=S+M……(1)

Where I and S are investment and saving, and X and M are exports and imposts. Here we assume no government (there is no tax nor government expenditure) for simplicity. If we consider oniy intemal balance equation (4.1) will be reduced to:

I=S=

.....(2)

Therefore, the equilibrium in the goods markets is achieved when investment equals saving. When investment equals saving the equilibrium level of income will be determined. In chapter (1) we saw that saving is a function of income. In other word the level of saving depends on the level of income. We also saw tha

investment is an exogenous variable which is assumed to affect the level of income. Here we will assume that the level of investment depends on internal rate. In other words the investment demand is a decreasing function of the interest rate; at high interest rates we will get low levels of investment and at low interest rates we will get high levels of investment. Since saving depends on the level

of income and investment depends on the interest rate we expect to have different levels of income and different interest rates at which saving and investment are equal. In other words, there are many combinations of national income and interest rate which keep the equality between saving and investment and hence, the equilibrium in the goods market. There many combinations of income and interest rate which equate saving and investment can be represented by a curve. This cure is called the "IS Curve" or the investment saving curve. The "IS" curve is presented in figure (1)

Figure (1) consists of three parts:

Part (1) represents the investment - demand curve. it says that when he interest rate (r) decreases the investment demand increases.

Part (2): represents the investment saving balance (i.e I =S). any point on the 45oimplies that saving is equal to investment.

Part (3) is the saving function. It shows that savings is an increasing function of income (Y). When income (Y) increases saving (S)

also increases depending on the marginal propensity to save (see chapter 1) sf wel wavn917 jestene 18

Part (4): provides the IS curve.it represents the combinations of income (Y) and interest rate (r) which represent an equality between saving and investment. in other words, any point on the IS curve means that saving is equal to investment at the income level and interest rate at this point For example , at point 'a' on the IS curve investment = saving = 20 at income level 80, and an interest rate

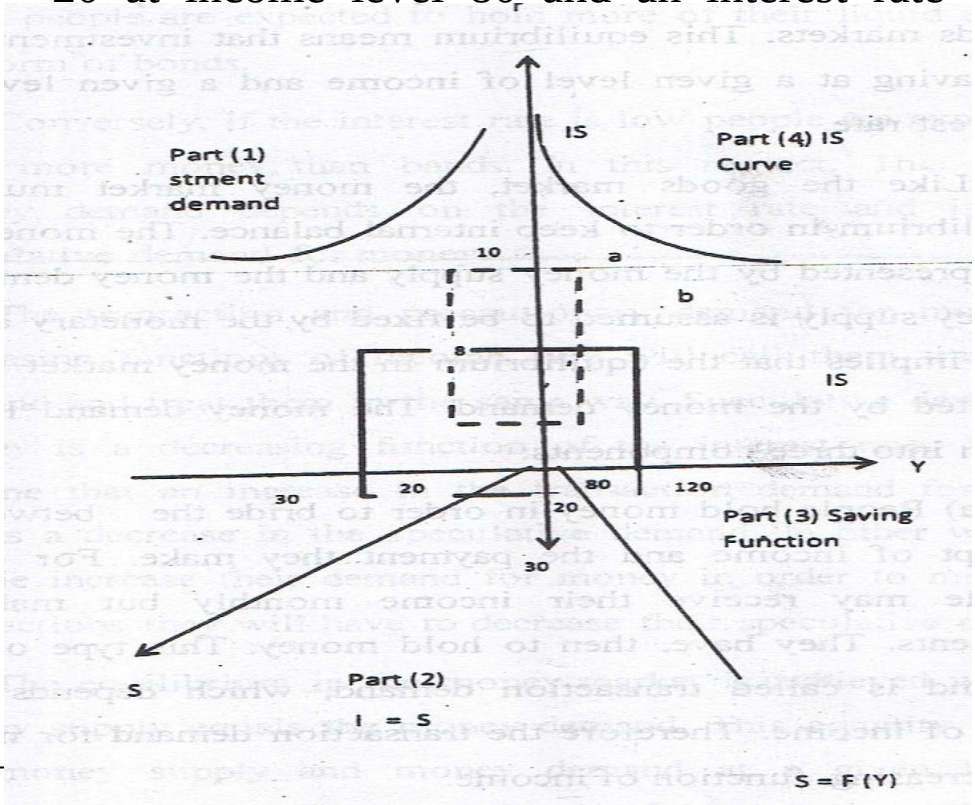


Figure (1) the derivation of the IS curve

This IS curve, therefore, represents the equilibrium in the goods markets. This equilibrium means that investment is equal to saving at a given level of income and a given level of the interest rate.

Like the goods market, the money market must be in equilibrium in order to keep internal balance. The money market is represented by the money supply and the money demand. The money supply is assumed to be fixed by the monetary authority. This implies that the equilibrium in the money market is mainly affected by the money demand. The money demand is broken down into three components:

a) People hold money in order to bride the between their receipt of income and the payment they make. For example, people may receive their income monthly but make daily payments. They have, then to hold money. This type of money demand is called transaction demand, which depends on the level of income. Therefore the transaction demand for money is an increasing function of income.

b) People may hold money in order to meet unexpected expenditure. This is called precautionary demand for money which also depends on the level of income.

(C) People may hold their liquid assets in the form of bonds or money. If the return on bonds is high (i.e. the interest rate is

represented by a curve. This curve is called LM curve , or the money demand – money supply curve. This curve is given in. figure (4.2).

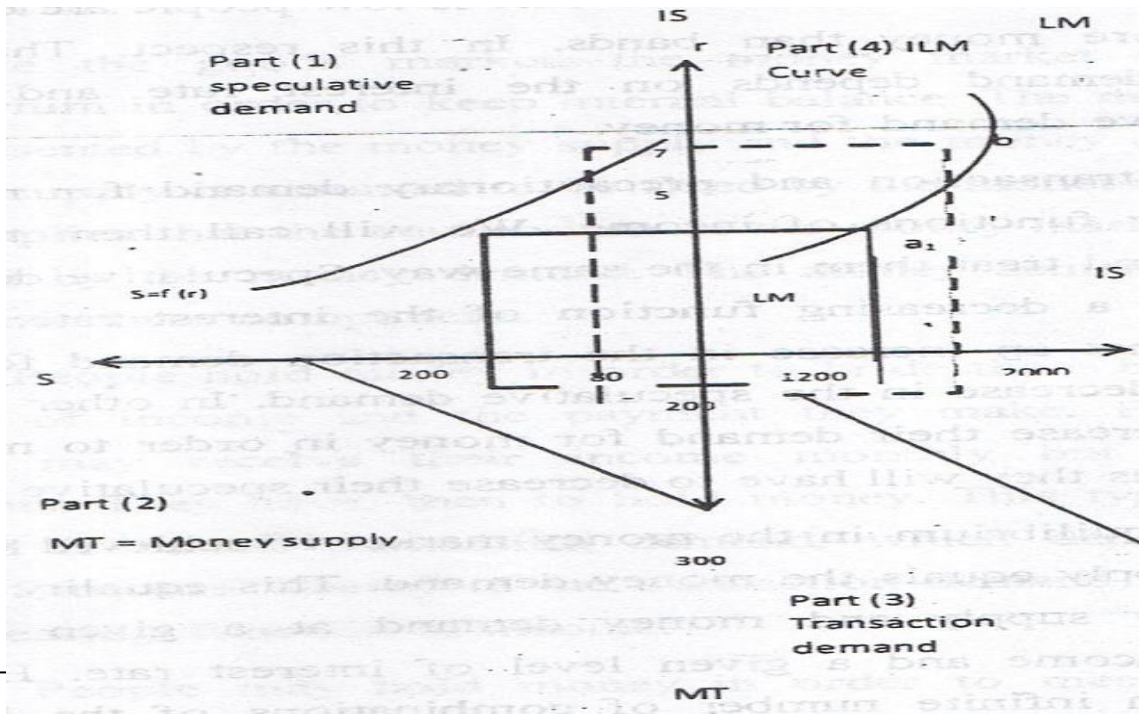


Figure (2)

The derivation of the LM curve

-Figure (2) consists of four parts:

Part (1): Given the speculative demand for money curve which shows that an increase in the interest rate will lead to a decrease in the speculative demand for money.

Part(2) Shows how the money supply is divided into , speculative demand and transaction demand for money. In this respect, if a greater amount of money supply is allocated to speculative demand, this will mean that a smaller amount of

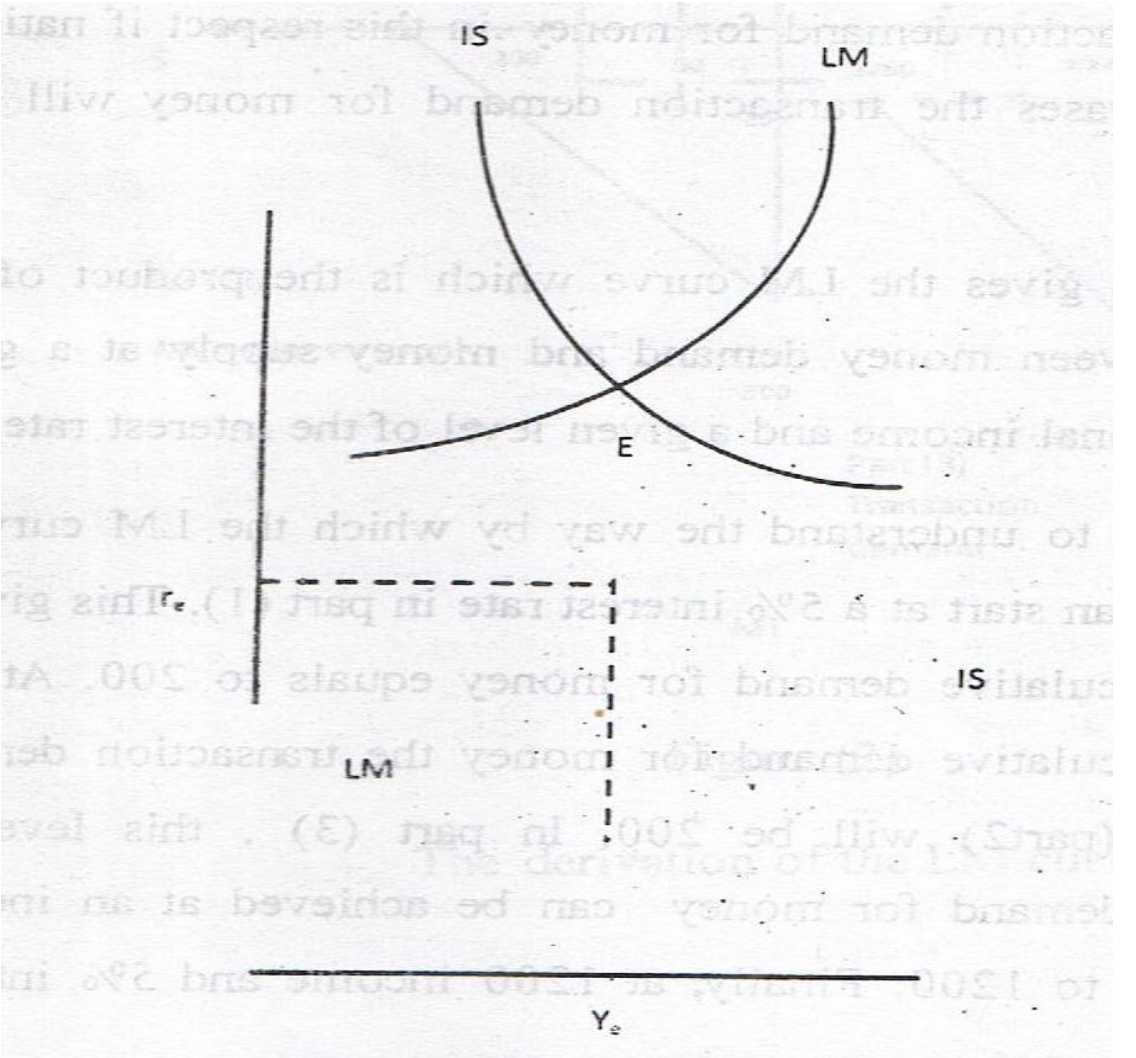
money supply will be allocated to transaction demand.

Part (3) represents the relationship between national income and the transaction demand for money in this respect if national income increases the transaction demand for money will also increase.

Part (4) gives the LM curve which is the product of the equality between money demand and money supply at a given level of national income and a given level of the interest rate.

In order to understand the way by which the LM curve is derived we can start at a 5% interest rate in part (1). This gives a level of speculative demand for money equals to 200. At this level of speculative demand for money the transaction demand for money (part2) will be 200. In part (3), this level of ransaction demand for money can be achieved at an income stel equals to 1200. Finally, at 1200 income and 5% interest
rate we have point "a" in part (4) .By repeating this process and starting at a 7% interest rate we will get point "b" in part (4) By connecting points "a" and "b" we can get the LM curve as presented in part (4) of figure (2.(
svisluoede ani di 93397995 By putting the IS and LM curves together we can get the equilibrium in both the goods and money markets. This is done in ligure (3). Point "E" in figure (3) gives the equilibrium level of national income at Ye and the equilibrium level of the interest rate at re. any point other than point "E" will represent

disequilibrium in the goods market or the money market



. -The main objective of economic policy is to keep the goods
and money markets in equilibrium. But what means can be used if the economy is not operating on point "E" in figure (3)? For example if the goods markets are not in equilibrium and the country has unemployment. What policy can be used in order to overcome this problem? Because the country has unemployment, it is expected that its economy will operate to the left of the Is curve. This means that saving exceeds investment. The right policy in this case is to increase
investment or
Because economic policy is controlled by the government, it is expected that the government will increase government expenditure or reduce tax if the economy is operating to the left of the IS curve. In this respect, government expenditure will have effects similar to the effects of investment, and tax will have effects similar to the effects of saving (see chapter) if the economy is

operating to the right of the IS curve this will mean overfull employment or potential inflation. This implies that investment is greater than saving and the correct policy is to reduce government expenditure or Increase tax.

Chapter 7
International monetary system

International monetary system

In this chapter we shall discuss many subjects around the International monetary system (its definition, components, factors, Risks, financial in stability, financial crises ... etc. as the following:

***global payment system:**

Global payment system is a term that broadly refers to the set of mechanisms by which consumers, businesses m governments & financial institutions make payments

***types of global payment system:**

There are many or several types of global payment systems are the non-electronic payment systems & electronic payment systems. We can understand this by the following table which discuss the transactions & payments flows in major National payment system as the following:-

Table no 1:

Transactions & payments flows in major National payment

System

Country /payment system	Transaction /Smillions	Value /trallions
EMU/target	66.6	420.7
Euro-1	41.0	74.5
Japan/Zen gin	5.1	88.4
BOJ-NET	16.7	569.6
UK/Chaps	29.2	61.9
USA/Fed wire	123.3	436.7

A. non electronic payment systems:

This system is available in the most of developing & developed countries. In most nations, people continue to use coins & currency for the bulk of exchange. for example , USA residents use coins & currency for more than three – fourths of the total number of exchanges transactions they make , in this system , the transaction is final at the moment that the exchange occurs . In contrast, check & debit card transactions are final only after banks transfer funds from the account of the purchaser to the seller.

-B. electronic payment systems:

This system is available in some of developing & developed countries. About 85%' of the dollar value of USA electronic payment takes place via large-value wire transfer systems. Not only USA but also EMU, UK, Japan...etc .

***payment - system Risks:**

The payment - systems face both private & public risks that are inherent in financial transactions risk increases as the size & scope of the payment system increases. For instances, when any retail outer accepts currency or coins from a customers, there is a remote possibility that the customers payment be counterfeit

There are many kinds of risks as the following:

1/Liquidity risks:

Liquidity risks is the risk of loss that may occur if a' payment is not received when due.

2/credit risks:

credit risks is the risk of loss that could take place if one party to an exchange were to fail to abide by terms under which both parties originally had agreed to make the exchange

3/systemic risks:

Systemic risks is the risk of loss that some payment intermediaries may not be able to meet the terms of payment agreements because of failures by other institutions to settle transactions that otherwise are not

4/Herat risks:

systemic risks across

Herat risk liquidity, credit, & international borders.

***financial instability:**

Financial instability when nation's financial sector is no longer able to allocate funds to the most productive projects

***financial crisis:**

Financial crisis is a situation that arises when financial instability becomes so severe that the nation's financial system is unable to function. a financial crisis typically involves a banking crisis , a country crisis & a foreign debt crisis.

Chapter 8
International Monetary Institutions

International monetary institutions:

International monetary institutions contain many basic institutions such as International monetary fund, the group of World Bank. We shall discuss these two institutions as the following:

First: International monetary fund

The International monetary fund (IMF):
Is a multinational organization that promotes International monetary cooperation, exchange arrangements k & economic growth? It provides temporary financial assistance to lations experiencing balance - of - payments difficulties 2000
The next figure (figure no 1) is a charts show the growth of MF membership since the founding of the organization in July 1944. Currently, the MF has 182 member nations
The number of member nations in the International monetary fund (IMF) is now about six times larger than it was when the organization was founded as the following figure

charts.

***International monetary fund quota subscriptions:**

The quota subscriptions of each members nation in the MF m which is denominated in special drawing rights, depends on the nation's real national income. A country's quota subscription determines its share of voting power within the IMF & howmuch it is eligible to borrow under standard "IMF credit arrangement.

***the quota subscriptions of MF:**

The quota subscriptions of MF is the funds deposited by MF member nations that together from the pool of funds that MF managers can use for loans to member nations , experiencing financial difficulties nd

***the conditionality of MF:**

.The conditionality of MF is the set of limitations on the range of allowable actions of government of a country that is a recipient of IMF loans.

bash *the Facilities of MF:

There are many financing facilities have been given by the International monetary fund

(IMF). These financing facilities are the following:

A. Regular MF facilities:

De cose 1/Stand by arrangements (SBA:(

Seizes 01 bsbrand SOFT Stand by arrangements intend to assist in situations requiring temporary or cyclical adjustments arrangements are typically for 12-18 months & are phased in on a quarterly basis, with releases of founds contingent on meeting performance criteria & periodic program reviews.

2/external fund facility (EFF):

External fund facility is designed to provide assistance for adjustment to problem arising from structural macroeconomic probleliùs for periods up to 3 years.

B. IMF concessional assistance:

1/poverty reduction & growth facility (PRGF):

OSTS It provides financial assistance to countries experiencing difficulties in repaying large bilateral & multilateral external debts.

2/heavily indebted poor countries (HIPC) initiative:

Heavily indebted poor countries (HIPC) initiative is provides financial assistance to countries experiencing difficulties in repaying large bilateral & multilateral external debts.

C. MF other financing facilities: such as the following:

1/compensatory financing facility (CFF) :

It is intended to assist members experiencing arising from temporary export declines or increased expenses in importing foodstuffs

2/supplemental reserve facility (SRF) :

It is designed to assist members experiencing sudden & disruptive adjustment problems arising from a loss of market confidence

3/contingent credit lines (CCL):

It is designed to assist members affected by contagion effects of financial crises originating elsewhere.

Second: the World Bank group (WB):

WB is the other key super national institution that provides support to nations experiencing financial problems. World Bank a sister institution to the International monetary

fund(IMF), that is more narrowly specialized in making loans to about 100 developing nations in an effort to development & Growth . This institution, which also was created during the 1944 Breton woods conference

***World Bank institutions:**

There are many institutions of WB (the World Bank group)as the following :-

l/international development association Nat i on

2/ international Bank for reconstruction & development

3/ international finance corporation

4/multinational investment guarantee agency