Export Import Management

Basics of International Trade & Transportation

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Dr. Premkumar Balaraman

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PREFACE

This Book on Export Import Management is a Masterpiece in its own way with more information and Mentoring material on the basics as well as the intricate phenomena of Export Import Business. The chapters are organized in the order of knowing the basic protocols and procedures of Export Import Business. Especially understanding of the Global scenario on Business and Logistics trends is very essential. Also the impact of Globalization process, Role of International Bodies like The World Trade Organization – WTO is no exception in the learning process on Export Import Business. The chapters in the beginning focus on Trends & Theoretical Foundations of International Trade, Significance of International Bodies and Trade Agreements, Scanning of the Export Potential, Market Assessment, Product Identification, Setting up of Business Forms.

The chapters in the middle focus on fundamentals of Export Contracts, Methods of Payment in International Trade, International Trade Documentation & Procedures, International Transportation & Value Chains and Containerization Basics. Intermodal Transport has become a global phenomenon as mechanized handling and Containerization have reduced handling costs between modes and promoted their efficiency. There are special chapters included exclusively for clarity on Export Import Documentation requirements and Payment Process intricacies. Also there is a separate chapter on Containerization, especially with more focus on Container Dimensions and Codes specified by ISO 6346.

The later part of the book covers the basics of logistics and transportation modes that are highly pertaining to Export Import Business. Sea Borne Transportation is the primary and major goods mover in International arena especially in bulk cargo, but for faster delivery it is Air Transportation. The basics and trends in these lines of support processes of Export Import Business are discussed in-depth. The Classification of Air Cargo Containers is depicted with detailed Information on dimensions and usage. Also Ports have become elements in global commodity chains controlled by logistics companies, maritime shipping lines, freight forwarders and transport operators, all of which are explained in depth for understanding, in the chapter on Ocean Freight and Shipping Operations. INCOTERMS is the master dictionary on Export Import documentation and is discussed as a separate chapter for practitioners and academic audience. There is also extra information in the form of Country Specific Case Studies on Export Import Procedures, Assistance and Promotion covering the major Continents.

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TRENDS IN INTERNATIONAL TRADE

The globalization of production systems & technologies goes hand in hand with the globalization of trade as one cannot function without the other. Compared to the volume of trade that was existing during the famous and ancient trade route regimes like Silk route, the recent trade volumes in last six hundred years is found to be manifolds and plays a major role in economies of many countries. The scale, volume and efficiency of Trade in International Scenario, have all kept on expanding since the 1970s. The Space and Time convergence due to the impact of various technologies and transport developments has made possible a more extensive market coverage that could be accessed with a lower amount of time. Further, the division and the fragmentation of production has also added to these processes and expanded trade, contributing to lower manufacturing costs.

International trade aids to maintain standard of living of nations smaller in size and which are unable to meet the various product needs from domestic sources. Global trade allows for an enormous variety of resources – from West Asia, South America, China, Africa, India, etc. to be made more widely accessible. It also facilitates the distribution of a wide range of manufactured goods that are produced in different parts of the world to global markets.

Regional specialization of economic activities has contributed to increased wealth and by this mode it has resulted in lowered production costs, thereby also increasing productivity and surpluses are generated, which can be transferred or traded for commodities that would be too expensive to produce domestically or would simply not be available. This implies that international trade decreases the overall costs of production worldwide. Consumers can buy more goods from the wages they earn, and standards of living should, in theory, increase. International trade demonstrates the extent of globalization with increased spatial interdependencies between elements of the global economy and their level of integration. These interdependencies

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imply numerous relationships where flows of capital, goods, raw materials and services are established between regions of the world.

1.1 THEORETICAL FOUNDATIONS OF INTERNATIONAL TRADE

Global Trade, also known as ***International Trade,*** *is simply the import and export of goods and services across international boundaries. Goods and services that enter into a country for sale are called* ***Imports.*** *Goods and services that leave a country for sale in another country are called* ***Exports.*** For example, a country may import rice because it doesn't have much cultivable land, but export oil because it has oil in abundance. A fundamental concept underlying global trade is the concept of comparative advantage, developed by David Ricardo in the 19th century. A condensed understanding of the doctrine of comparative advantage portrays that a country can produce some goods or services more cheaply than other countries. In technical terms, the country is able to produce a specific good or service at a lower opportunity cost than others. *An* ***opportunity cost*** *is the benefit one gives up in making an economic choice.* The classic example is guns and butter - domestic investment over defense spending. The more guns you produce, the fewer funds are available to invest in public schools and infrastructure. For example, the more you invest in the domestic economy, the less you can spend on defense.

Adam Smith, another classical economist, with the use of ***Principle of Absolute Advantage*** *demonstrated that a country could benefit from trade, if it has the least absolute cost of production of goods, i.e. per unit input yields a higher volume of output.* The production of goods and services in countries that need to trade is based on two fundamental principles, first analyzed by Adam Smith in the late 18th Century (in The Wealth of Nations, 1776), these being the division of labor and specialization.

The international trade accounts for a good part of a country's gross domestic product. It is also one of important sources of revenue for a developing country. With the help of modern production techniques, highly advanced transportation systems, transnational corporations, outsourcing of manufacturing and services, and rapid industrialization, the international trade system is growing and spreading very fast. International trade among different countries is not a new a concept. History suggests that in the past there where several instances of international trade. Traders used to transport silk, and spices through the Silk Route in the 14th and 15th century. In the 1700s fast sailing ships called Clippers, with special crew, used to transport tea from China, and spices from Dutch East Indies to different European countries.

A country's balance of payments basically tracks the financial flows between trading partners. The ***Balance of Payments*** includes the payments made for imports and exports, as well as financial transfers. Exports create

a positive entry, while imports are a negative. That said, a balance of payments must always balance out at zero – a trade deficit (more imports than exports) must be balanced with foreign investments, declines in reserves, or increased debt; likewise, a trade surplus will be balanced out with financial outflows or increased reserves.

1.1.1 CLASSICAL COUNTRY BASED THEORIES

Mercantilism: A trade system where a nation tried to impose a positive trade balance (more exports than imports, particularly value-wise) on other nations to favor the accumulation of wealth. This system was prevalent during the colonial era and often undertaken by charter companies receiving a monopoly on trade (Pincus, 2012). Mercantilism represents the antithesis of free trade since trade relations are controlled and aligned to benefit one partner at the expense of the other (McDermott, 1999). Still, mercantilism established the foundations of a global trading system, albeit an unequal one.

Neomercantilism: A more recent trade system, which like mercantilism leans on establishing a positive trade balance to meet economic development goals. Export-oriented strategies can be considered a form of neomercantilism (Veebel, 2015), particularly if a government establish an incentive and subsidy system (e.g. free trade zones), which confers additional advantages to the factors of production. Neomercantilism can also be a response by some governments to the competitive and disruptive consequences of free trade, particularly if the trade partners are engaged in neomercantilist strategies. The outcome is tariff and non-tariff measures regulating trade and protecting national commercial sectors that are perceived to be subject to unfair competition.

Absolute Advantages: Based on a nation (or a firm) able to produce more effectively in an economic sector while using less resources (e.g. capital, labor) than any other potential competitors (Schumacher, 2012) and therefore has an absolute advantage. Global efficiency can thus be improved with trade as a nation can focus on its absolute advantages, trade its surplus and import what it lacks (Seretis & Tsaliki, 2016). Adam Smith (1776), who is regarded as the father of modern economics, countered mercantilist ideas by developing the concept of absolute advantage. The drawback of this perspective is that in theory nations having no absolute advantages should not be involved in trade since they may have little to gain from it. Absolute advantages tend to be an enduring characteristic, particularly for resources.

Comparative Advantages: Even if a nation (or a firm) has absolute advantages over a wide array of economic sectors, it can focus on the sectors it has the highest comparative advantages (the difference of its production costs and those of its competitors) and import goods in sectors it has less comparative advantages (Brecher, Chen & Choudhri, 2002). David Ricardo

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(1817) was concerned with the static resource allocation problem when he defined the concept of comparative advantage, which is determined not by absolute values of labor productivity but by labor productivity ratios. The comparative productivity increases the total production level since that even if a nation (or a firm) has no absolute advantages, it can focus on sectors where the total productivity gains are the most significant. Comparative advantages tend to be a temporary characteristic, that can change with the evolution of labor costs.

Factor Endowments: It expands the comparative advantages perspective by underlining that trade is related to the factors endowments of a nation. The most basic endowments are capital, land and labor. A nation will export goods to which it has notable factor endowments and imports goods in which it has scarce factor endowments (Reeve, 2006). As such, nations that have low cost labor available will focus in labor intensive activities while nations having high capital endowments will focus in capital intensive activities. Factor endowments can be improved through capital and human resources investments. This theory namely **Heckscher-Ohlin Theory (Factor Proportions Theory)** based on factor endowments came in the early 1900s and was put forth by two Swedish economists, Eli Heckscher and Bertil Ohlin and focused their attention on how a country could gain comparative advantage by producing products that utilized factors that were in abundance in the country. Their theory is based on a country's production factors—land, labor, and capital, which provide the funds for investment in plants and equipment.

1.1.2 MODERN OR FIRM-BASED TRADE THEORIES

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

Country Similarity Theory: Swedish economist Steffan Linder developed the country similarity theory in 1961, as he tried to explain the concept of intraindustry trade. Linder's theory proposed that consumers in countries that are in the same or similar stage of development would have similar preferences. In this firm-based theory, Linder suggested that companies first produce for domestic consumption. When they explore

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exporting, the companies often find that markets that look similar to their domestic one, in terms of customer preferences, offer the most potential for success. Linder's country similarity theory then states that most trade in manufactured goods will be between countries with similar per capita incomes, and intraindustry trade will be common. This theory is often most useful in understanding trade in goods where brand names and product reputations are important factors in the buyers' decision-making and purchasing processes (Linder, 1961).

Product Life Cycle Theory: Raymond Vernon, a Harvard Business School professor, developed the product life cycle theory in the 1960s. The theory, originating in the field of marketing, stated that a product life cycle has three distinct stages: (1) new product, (2) maturing product, and (3) standardized product. The theory assumed that production of the new product will occur completely in the home country of its innovation (Vernon,1966). In the 1960s this was a useful theory to explain the manufacturing success of the United States. US manufacturing was the globally dominant producer in many industries after World War II.

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

Global Strategic Rivalry Theory: Global strategic rivalry theory emerged in the 1980s and was based on the work of economists Paul Krugman and Kelvin Lancaster. Their theory focused on MNCs and their efforts to gain a competitive advantage against other global firms in their industry. Firms will encounter global competition in their industries and in order to prosper, they must develop competitive advantages (Krugman, 1984),). The critical ways that firms can obtain a sustainable competitive advantage are called the barriers to entry for that industry. The barriers to entry refer to the obstacles a new firm may face when trying to enter into an industry or new market. The barriers to entry that corporations may seek to optimize include (Lancaster & Kelvin, 1980):

(a) Research and development,

(b) The ownership of Intellectual Property Rights,

(c) Economies of Scale,

(d) Unique business processes or methods as well as extensive experience in

the industry, and

(e) The control of resources or favorable access to raw materials.

Porter's National Competitive Advantage Theory: In the continuing evolution of international trade theories, Michael Porter of Harvard Business School developed a new model to explain national competitive advantage in 1990. Porter's theory stated that a nation's competitiveness in an industry depends on the capacity of the industry to innovate and upgrade. His theory focused on explaining why some nations are more competitive in certain industries. To explain his theory, Porter identified four determinants that he linked together. The four determinants are (1) local market resources and capabilities, (2) local market demand conditions, (3) local suppliers and complementary industries, and (4) local firm characteristics (Porter, 1990).

1.2 GAINS FROM TRADE

All of the economic theories of international trade suggest that it enhances efficiency. In this regard, international trade is like a new technology. It adds to the productive capacity of all countries that engage in trade. Some of the efficiency is due to comparative advantage, as in the Ricardo and Heckscher-Ohlin theories. In addition, some efficiency comes from taking advantage of increasing returns.

Trade based on comparative advantage should tend to benefit small countries more than large countries. That is because the benefits of comparative advantage are proportional to the difference between the relative prices in world markets and the relative prices that would prevail in home markets without trade. If that difference is large, then a country earns a large advantage from trade. If that difference is small, then there is only a small advantage from trade. Small countries are more likely than large countries to find that relative prices in the world market differ significantly from what would prevail in their home markets. Another benefit from trade is that it promotes dynamism and innovation within an economy.

An economy that is closed to trade is one in which inefficient industries and laggard firms are well protected. In fact, studies suggest that barriers to trade are a major cause of extreme underdevelopment. The countries that are most closed to trade tend to be the poorest in the world. Countries that have reduced trade barriers and increased the share of imports and exports in their economies tend to be among the fastest-growing nations.

1.3 BARRIERS TO INTERNATIONAL TRADE

While free trade is generally thought of as a positive, countries will periodically put up barriers to trade. **Tariffs** are taxes on imports that make imported goods more expensive and less competitive relative to domestically-produced goods. While national governments used to obtain a significant

percentage of their receipts from tariffs, tariffs today are more commonly used to protect domestic industries and/or to prohibit other countries for perceived wrongdoing (typically subsidizing local industries to the detriment of the importing country's industries).

Subsidies are transfer payments given by governments to domestic suppliers of goods or services. The motivation to provide subsidies is to increase production and/or lower prices for a country's consumers and/or to make domestically-produced goods more competitive with imports (Leahy & Neary, 2009). **Quotas** are limits on the amount of a good that can be imported in a given period. Quotas serve a similar purpose to tariffs in that the increase the price of imported goods, but quotas can be even more severe as no additional goods are available once the quota level is reached.

1.4 ADVANTAGES AND DISADVANTAGES OF INTERNATIONAL TRADE

Benefits of International Trade can be reaped further, if there is a considerable decrease in barriers to trade in agriculture and manufactured goods. Some important advantages of International Trade include,

i. Enhances the domestic competitiveness
ii. Takes advantage of international trade technology
iii. Increase sales and profits
iv. Extend sales potential of the existing products
v. Maintain cost competitiveness in your domestic market
vi. Enhance potential for expansion of your business
vii. Gains a global market share
viii. Reduce dependence on existing markets
ix. Stabilize seasonal market fluctuations
x. More variety of goods available for consumers.
xi. Better quality of goods.
xii. More Exchange of Technical know-how.
xiii. Increase in Local Employment

Some Disadvantages of International Trade include,

i. Local production may suffer
ii. Local industries may be overshadowed by their international competitors
iii. Rich countries may influence political matters in other countries and gain control over weaker nations.
iv. Ideological differences may emerge between nations with regard to the procedures in trade practices.

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1.5 TRADE PROJECTIONS

According to the report on World Economic Situation and Prospects (UN, 2016), the subdued performance of world trade flows persisted into 2015, with the volume of world trade projected to increase by only 2.7 per cent for the year, the lowest rate since the global financial crisis and approximately the same rate as the estimated world gross product growth for 2015 **(Figure 1.5.1).** For the second consecutive year, developed economies played the leading role in driving global trade. Among all regions, the developed economies in Europe contributed most significantly to global import growth in 2015, accounting for 70.3 per cent of the growth **(Figure 1.5.2).**

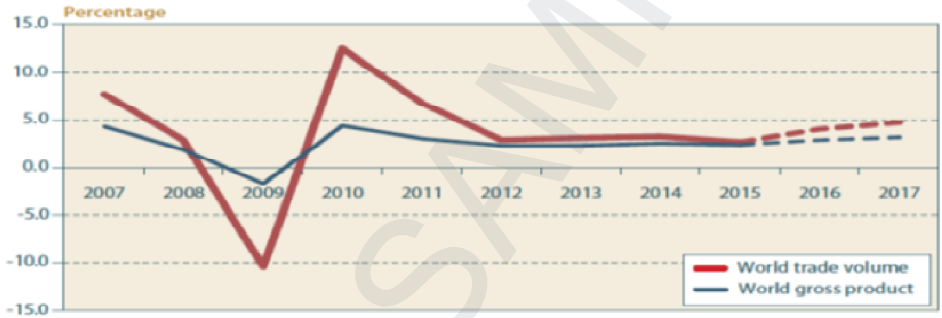


Fig 1.5.1 - Growth of world trade and world gross product, 2007-2017

Source: UNDESA, based on United Nations Statistics Division National Accounts Main Aggregates Database. a Growth rate for 2015 is partially estimated; growth rates for 2016 and 2017 are forecast. Accessed (23 Feb 2017) from: http://www.un.org/en/development/desa/policy/wesp/wesp_archive/2016wesp_ch2_en.pdf

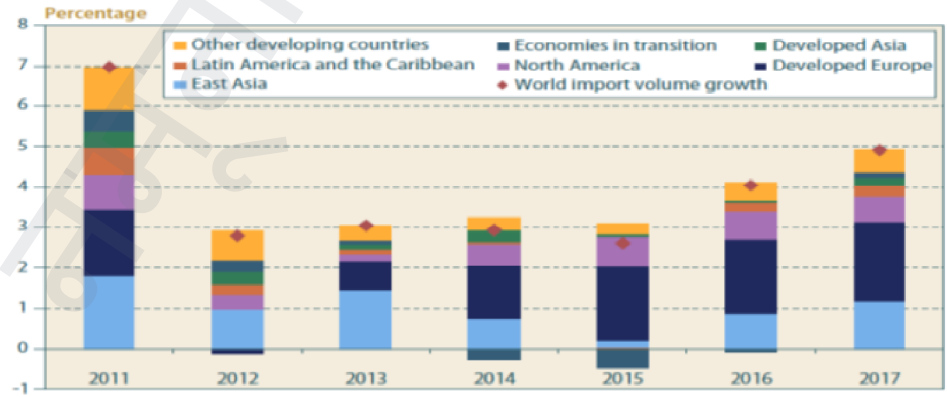


Fig 1.5.2 - Regional contribution to global import growth, 2011–2017a

Source: UNDESA, based on United Nations Statistics Division National Accounts Main Aggregates Database. Note: The "Other developing" countries includes