Trade

Business Concepts and Economic Impact

1. Business Practices

Subcontracting

- **Definition**: A business (subcontractor) hiring an external company (subcontractee) to handle specific tasks within a larger project. A contract is signed between the 2 parties.
- **Example**: A construction company hiring a plumbing company to install pipes.
- **Key Point**: Subcontractors execute tasks based on the main company's ideas
- **Advantages**:
  - Access to specialized expertise.
  - Saves time and resources.
  - Cost-effective → don't have to hire a huge team, subcontractee already have.
- **Disadvantages:**
  - The subcontractee may do something wrong
  - Miscommunication can lead to mistakes
  - Quality issues if not professional
- **Difference from Licensing**:
  - In subcontracting, the company has no control over the product.
  - In licensing, there is some level of control over how the product is used.

Licensing

Licensing is a legal arrangement where the owner of a product, service, or intellectual property (the **licensor**) grants permission to another party (the **licensee**) to use, produce, or sell the product, service, or intellectual property under agreed-upon terms and conditions. Licensing is commonly used for intellectual property like patents, trademarks, copyrights, and trade secrets.

There are two main types of licensing:

- **Technology or Patent Licensing:** A company or individual who holds a patent (e.g., for a new invention) allows another company to manufacture or use the patented technology, often in exchange for a royalty fee or a lump sum payment.
- **Brand or Trademark Licensing:** A business might allow another company to use its brand name or trademark on products. For example, a clothing brand might license its name to a manufacturer of accessories like bags or shoes.

Key Features of Licensing:

- **Royalty Payments:** In many cases, the licensee pays the licensor a fee based on sales, usage, or a fixed amount (royalty).
- **Territory and Duration:** Licensing agreements typically specify the geographic area where the licensee can operate and the time period for which the agreement is valid.
- **Control and Restrictions:** The licensor may impose conditions on how the intellectual property is used, such as quality control standards or limits on the scope of use.

Benefits of Licensing:

- **For the Licensor:** It can generate additional revenue without having to directly produce or distribute products. It also allows for broader market reach through the licensee's resources.
- **For the Licensee:** It provides access to established intellectual property, such as brand names or technology, without having to invest in developing them from scratch.

Arm's Length Transaction

- **Definition: It means a fair deal between two people or companies who don't have any close relationship (like family or friends), so neither side gets special treatment.**
- **Example: A customer purchasing a used car from a dealership at market value.**
- **This also removes price discrimination, promoting fair trade**

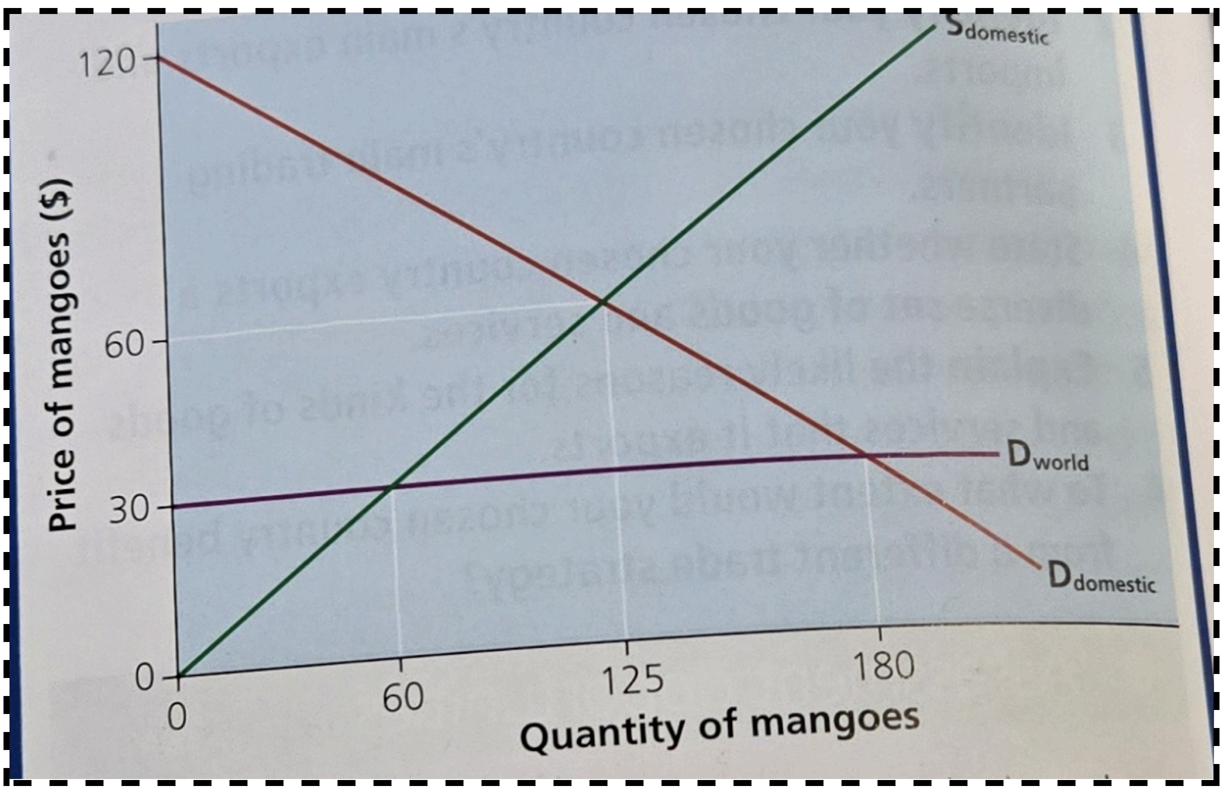
2. Public vs. Private Sector

Feature	Public Sector	Private Sector
Ownership	Government	Individuals
Purpose	Community welfare	Profit maximization
Funding	Taxes	Investments, retained profit
Risk	Lower, as backed by government	Higher, dependent on market conditions
Example	Public transport	Retail companies

3. Trade

Impact of Free Trade

Supply and Demand Curve



Abdullah:

Consumer expenditure

Price x quantity demanded

Producer revenue

Price x quantity supplied

Tax collected

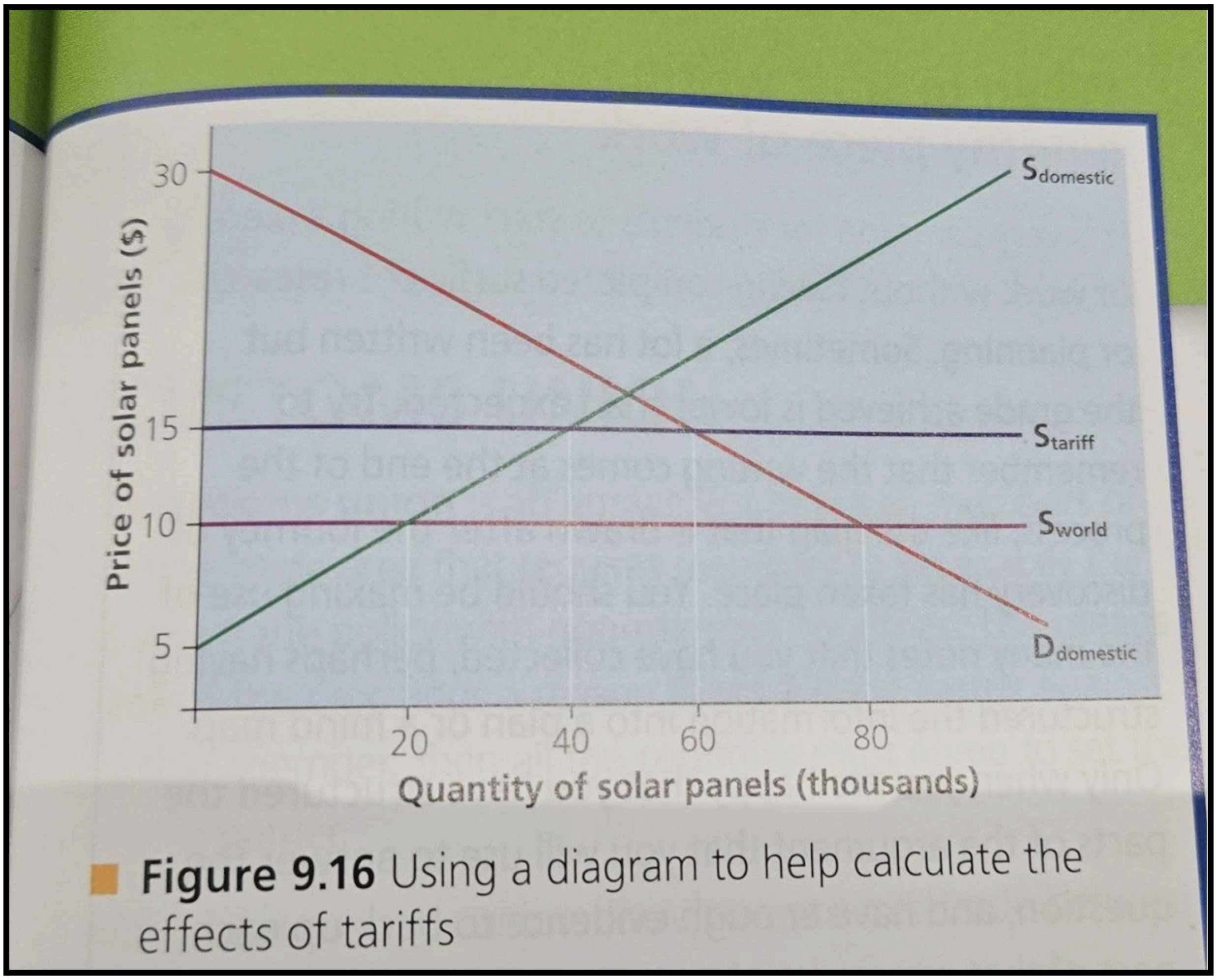
Before Free Trade

- **Consumer Expenditure** = Price × Quantity Demanded = 60 × 125 = **7,500**
- **Producer Expenditure** = Price × Quantity Supplied = 60 × 125 = **7,500**
- **Consumer Surplus**: Area above equilibrium and below demand.
- **Producer Surplus**: Area below equilibrium and above supply.

After Free Trade

- **Consumer Expenditure** = 30 × 180 = **5,400**
- **Producer Expenditure** = 30 × 60 = **1,800**
- **Impact**:
    - **Consumer surplus increases** (lower prices, higher demand).
    - **Producer surplus decreases** (domestic producers face competition).

Tariffs and Imports Practice



Formula

C.E = Price × Quantity Demanded

P.R = Price × Quantity Supplied

Tax = (New Price - Old Price) × (Qd - Qs)

Q) Calculate the following value before and after tariff (10)

1) Consumer expenditure

2) Producer revenue
3) Consumer Surplus
4) Producer Surplus
5) Tax collected by the government

Consumer expenditure
C.E = quantity demanded x price

Before tariff:
C.E = 80,000 x 10 = $800,000

After tariff
C.E = 60,000 x 15 = $900,000

Producer Revenue
P.R = quantity supplied x price

Before tariff:
P.R = 20,000 x 10 = $200,000

After tariff
P.R = 40,000 x 15 = $600,000

Consumer Surplus

Before tariff:
y(10-30) x(0-80) above the equilibrium below the demand

After tariff:
y(15-30) x(0-60) above the equilibrium below the demand

Producer surplus:

Before tariff:
y(5-10) x(0-20) below the equilibrium above the supply

After tariff:
y(5-15) x(0-40) below the equilibrium above the supply

Tax collected by the government
Tax = Tariff amount x number of imports

Before tariff:
$0

After tariff:
Tariff amount = 15-10 = 5
Num. of imports = quantity demanded - quantity supplied
Num. of imports = 60,000 - 40,000 = 20,000 units
5 x 20,000 = $100,000 tax collected

Impact of Trade on Producers

Advantages	**Disadvantages**
Larger markets	Pressure from global competitors
More profit opportunities	Lower prices (to stay competitive) can hurt local producers
Access to cheaper raw materials	May lead to **exploitation**

Impact of Trade on Consumers

Advantages	**Disadvantages**
Greater variety of goods	Job losses in uncompetitive sectors

Lower prices due to competition	Dependency on imports
Access to global innovations	Ethical concerns (sweatshops, environmental harm)

Why Trade is Limited by the Government

Countries restrict trade for several reasons, often based on economic, political, social, and security considerations. Here are the main factors behind trade restrictions:

1. Protecting Domestic Industries

- **Help Small Businesses** → less competition → grow easier
- **Job Protection** → more imports = more competition → hard to grow and pay workers → leads to job dismissals due to budget cuts → this stops that

2. National Security Concerns

- **Critical Industries** → don't want national security to be reliant on imported goods → can be exploited
- **Preventing Export of Sensitive Technologies** → prevent them from falling into the hands of adversaries or being used for harmful purposes.

3. Economic Stability

- **Balance of Payments** → less imports = better balance of payments = stronger economy
- **Exchange Rate Control** → less imports = stronger currency

4. Protecting Local Culture and Values

- **Cultural Preservation**: Countries may restrict imports of certain goods or services to protect their local culture, traditions, and social values. This could involve limiting foreign media, entertainment, or consumer goods that may overpower local products and cultural identity.

- **Environmental Standards**: Restrictions on imports of products that don't meet the country's environmental standards can help protect natural resources and maintain sustainability.

5. Retaliation or Diplomacy

- **Trade Wars** → angry at other countries → add huge tariffs to affect their economy.
- **Political Leverage** → basically say to another country that you will add tariffs on goods if they don't do something.

6. Economic Sanctions

- **Punishing Unfriendly States**

7. Health and Safety Concerns

- **Protecting Public Health** → add limits on goods which don't meet safety standard
- **Preventing Spread of Disease** → in times of disease less trade = less spread.

4. Currency

Currency Depreciation vs. Appreciation

- **Appreciation**: Currency gains value → Increases purchasing power → Imports become cheaper, but exports decline.
- **Depreciation**: Currency loses value → Increases cost of imports, makes exports more competitive.

Currency Exchange & Economic Activity

Exchange Rate: the value of a currency relative to other currencies

- **Exports - Imports = Balance of Trade**
- **Effects of Imports vs. Exports:**
  - More imports → More money paid to foreign countries → More tax → Higher prices → Depreciation of currency.
  - More exports → More economic activity → Improved **balance of trade** → Appreciation of currency.

- **Factors Affecting Currency Value:**
  - **Interest rates** (higher rates attract foreign investment, appreciating the currency).
  - **Government spending** (e.g., infrastructure projects increase economic activity and stabilize currency).

Government Economic Policies

Monetary Policy (External Focus)

- **Tools**: Interest rates, investments.
- **Higher Interest Rates** → Foreign investments increase → Currency appreciates.
- **Lower Interest Rates** → Encourages borrowing → More economic activity.

2 types:

1) **Increase interest rates**. Encourages foreign investment as investors will be able to get higher returns, thus increasing demand for the currency making it appreciate. Also done to discourage excessive borrowing.
2) **Decrease interest rates**. Encourages borrowing during times where economic activity is less so that people buy more.

Fiscal Policy (Internal Focus)

- **Tools**: Government spending, taxation.
- **Government Spending**: Creates long-term economic stability (e.g., infrastructure projects).
- **Taxes**: Maintains financial sustainability.

2 types:

1) **Increase government spending, reduce tax on consumers**. Done during recessions, to boost economic activity (less tax encourages people to buy more, government spending increases economic growth.
2) **Reduce government spending, increase tax.** Done to reduce inflation as people would buy less due to higher tax rates, so demand will decrease and people will lower prices.

Reducing Imports

1. **Impose tariffs** → Increases cost of foreign goods → Lowers demand for imports.
2. **Subsidize local businesses** → Encourages local production → Reduces dependence on imports.
3. **Apply Import Quotas** → Limit to how much can be imported → less imports

Disadvantages of Tariff

1) Consumer **surplus** will decrease.
2) Local businesses will stop being as **competitive** as the demand for the imported goods would have gone down, reducing innovation and creativity.
3) Foreign country which we are importing from will not be happy, **ruining relationships**.
4) **Black markets** may form.

Economic Injections & Withdrawals

Injection → money coming into the country, better for the economy
Withdrawal → money going out of the country, worsens the economy

Injections	Withdrawals
Investments	Tax collection
Exports	Imports
Government spending	Savings

Factors of Exchange Rate

1. Interest Rates

When a country's central bank changes interest rates, it impacts the currency value. Higher interest rates attract **foreign capital inflows**, increasing **demand** for that currency, which can lead to an **appreciation**. Conversely, lower interest rates tend to decrease currency demand, leading to depreciation.

2. Inflation Rates

A country with lower inflation rates than others will generally see an appreciation of its currency. Lower inflation rates maintain **purchasing power**, which boosts **investor confidence** and **demand** for that currency.

3. Economic Indicators

Economic growth, employment rates, consumer spending, and GDP growth all play a role in determining exchange rates. A **strong economy attracts foreign investment**, which increases **demand** for the country's currency.

4. Political Stability and Economic Performance

Countries with stable governments and robust economic performance tend to have stronger currencies. Political **instability** or **uncertain** economic conditions can cause **depreciation**, as **investors avoid uncertainty**.

5. Market Sentiment and Speculation

The perceptions of investors about a country's future economic performance or geopolitical events can lead to changes in the exchange rate. **Speculation** on the future direction of a currency can also drive **short-term fluctuations**.

6. Trade Balances (Exports vs. Imports)

A country with a **trade surplus** (exports > imports) typically sees its currency **appreciate**, as foreign buyers need to purchase the country's currency to pay for its goods. Conversely, a **trade deficit** (imports > exports) tends to **weaken** a currency due to increased demand for foreign currencies.

7. Government Debt

Countries with high levels of debt are less likely to attract foreign investment, which can lead to depreciation. **High** debt levels can lead to **concerns** about the country's ability to **service its debt**, **potentially causing inflation** and reducing the currency's value.

8. Foreign Exchange Reserves

A country with high levels of foreign exchange reserves can stabilize or control the value of its currency by intervening in the foreign exchange markets. A country with low reserves may struggle to maintain its currency's value.

9. Central Bank Interventions

Central banks sometimes directly intervene in currency markets by buying or selling currencies to influence their value. This can stabilize or manipulate the exchange rate in the short term.

10. Commodity Prices

For countries that are **major exporters of commodities (e.g., oil, gold, etc.),** the prices of these commodities can affect their currency. Rising commodity prices tend to strengthen the currency of the exporting country, while falling prices can lead to depreciation.

11. Geopolitical Events

Events such as wars, natural disasters, and political upheavals can cause significant fluctuations in currency values, as they affect investor confidence and economic stability.

1) Interest Rates
2) Inflation Rates
3) Economic Strength
4) Political stability
5) Speculation
6) Balance of payments
7) Government Debt
8) Foreign Reserves
9) Commodity prices
10) Natural Disasters

5. Hyper Globalists

Globalization → transformative force → changes the world in terms of politics and economy

Key Beliefs of Hyper-Globalists:

1. **Global Economy Dominance –** Free trade, technology, and multinational corporations drive economic growth.
2. **Decline of Nation-States –** Global governance and economic interdependence reduce national sovereignty.
3. **Optimism About Progress –** Globalization fosters economic development, cultural exchange, and cooperation.
4. **Interconnected World –** Innovation, improved living standards, and democratic values spread globally.

Criticism: Critics argue that hyper-globalism ignores inequalities, cultural erosion, and power imbalances.

Practice Questions

1. Explain the difference between licensing and subcontracting. Provide an example of each.

SUbcontracting is when a business hires a 3rd party business to do any sort of work for you, at a cost. For example, if a company wants to build an office, they will hire a subcontractor to do all the building work for them. However, the subcontractor must be told the details of the construction. On the other hand licensing is when someone gives another person intellectual rights to use his product, so they give a patent in exchange for royalties. For example, if a company creates a new type of bottle, a 3rd party can buy a patent for royalties in exchange for them being able to use it.

In subcontracting, a company hires a subcontractor to carry out a job for them. In licensing, a company gives intellectual rights to a 3rd party to use their product in the form of a patent, in exchange for royalties. Licensing allows for some control over the product, whereas subcontractors have no control.

2) How does free trade impact consumer and producer surplus?

Free trade greatly impacts consumer and producer surplus.

Consumer surplus is the difference between what a consumer was willing to pay and what he actually paid for a product. Free trade increases competition in the market, as it instigates a large amount of imported goods entering the country. These are usually cheaper, or of higher quality (or both), making the market more competitive for the local businesses. As a result, they have to reduce their prices to stay competitive, resulting in the consumers having to pay less, thus increasing the consumer surplus.

On the other hand, producer surplus is the difference between how much a producer was willing to sell their product for and how much they actually sold it for. Since there would be more competition in the market, producers have to reduce their prices to be able to compete with the imported goods, forcing them to decrease their profit margins. In turn, this reduces the amount they actually sold their product for, thus decreasing the producer surplus.

2. If a country's interest rates increase, how would this affect its currency and economy?

An increase in the interest rates can have adverse effects on a country's currency and economy.

In terms of the economy, since interest rates would have increased people would be less inclined to borrow money from the bank as they would have to pay back much more money, resulting in people choosing to save their money more. This results in less economic activity (a withdrawal), as consumers would take much less loans and thus would have less money to spend on products. Furthermore, businesses would have a hard time expanding, as one of the main sources of finance for them are loans. Now that they are a much less viable option, businesses would expand slowly and the economy would therefore slow down.

In terms of the currency, it would start to appreciate. This is because investors would start to invest much more money into the currency as they would receive more return from it due to higher interest rates. This would increase demand for the currency, resulting in it appreciating.

3. Describe two ways in which the government can reduce imports and support local businesses.

The first way in which the government can reduce imports and support local businesses is by adding tariffs on the imported goods. This would reduce demand for imports as they would be more costly for the consumers, which would result in the country becoming less dependent on imports (thereby reducing them) and would help local businesses grow as their customer bases would increase.

The second way in which the government can reduce imports is by providing subsidies to the local businesses to support and help them grow. These could include tax free loans, free land, cheap labor and expense coverage. This would help the local businesses grow, reducing the burden on them, thereby allowing them to provide credit facilities (such as trade credit) to the public easier. This would result in people choosing local businesses more, reducing the imported goods consumption and helping local businesses grow.

4. A government imposes a tariff on imported goods. How does this affect:
    - Domestic producers
    - Foreign producers
    - Government tax revenue
    - Consumers

If the government imposes a tax on imported goods, this will affect a variety of different entities. In terms of domestic producers, the producer surplus will increase as there will be less demand for the imported goods due to the increased prices, making the market less competitive. This will also likely result in more producer revenue as consumers will buy from the local producers more than the imported goods due to lesser prices.

In terms of government tax revenue, that will increase. Since the tariff increases the price of the imported goods, people will pay more tax on it thus increasing the tax revenue.

In terms of consumers, they will be negatively affected. This is because the consumer surplus decreases since the price of the imported goods have gone up. Therefore, they will have less buying power and would have to choose between buying expensive goods or lesser quality goods.

Finally, in terms of the foreign producers they will start earning less revenue. This is because since the demand for imported goods will have gone down the country will start importing less and less of them, reducing the amount of money that the local government would have to pay them.

5. Explain the impact of high imports on local businesses and the overall economy.

High imports have a huge impact on local business and the overall economy. In terms of local business, life for them would be much more difficult as imported goods are generally of higher quality so people will choose them more as opposed to the local business' goods. This will cause them to have to lower their prices to increase demand, causing them to have very low profit margins and reducing the producer revenue. As a result, many of them will go out of business and people aspiring to build their own business in their country will be discouraged from doing so.

In terms of the overall economy, that will also worsen. First of all, imports are withdrawals, which decrease the overall economic activity in the country, causing the country's economy to depreciate significantly. Second of all, since there will be high imports the balance of trade will worsen, making the economy even more unstable. Furthermore, high imports make money go out of the country, not circulate within the country, which also results in a bad economy.

6. Describe the role of fiscal and monetary policies in stabilizing an economy.

Fiscal and monetary policies are essential in stabilizing an economy, and work hand in hand.

Fiscal policies, which have an internal focus, allow the government to fund long term infrastructure or development projects in the country, allowing for long term economic stability. This is done through 2 tools, government spending and tax. The government taxes its people to spend on the country, which can help the economy as that money spent is an injection, which increases economic activity and appreciates the currency.

Monetary policies, which have an external focus, allow the government to promote foreign investors to invest into the economy, which is an injection as money will be going into the economy. This is done using interest rates. By increasing the interest rates accordingly, the government can influence foreign investors to invest into the economy as interest rates will be higher, making the trade off good for them. This will increase economic activity and significantly help in stabilizing the economy.

7. Describe increased volume of exports impact consumers, producers, government, and foreign entities.

If there is more exports, then some of the country's inventory would be going abroad. This would result in less units being available for the consumers, which could lead to stock shortages. This may lead to products becoming less accessible for them. However, exports improve the balance of payments, which then improves the country's exchange rate due to increased demand of the currency, so the buying power of the consumers would increase.

The local producers would also benefit from this. This is because they would have access to larger markets in which they can sell their products, allowing for them to be able to generate more revenue. This also increases their profit opportunities.

The government would also benefit from this greatly. The exports would improve the country's balance of payments, which would allow for the country to have a stronger currency due to increased demand for it, as well as a stronger economy overall due to this being an economic injection. Governments would also have access to another source of revenue, allowing them to implement monetary policies and invest in long-term infrastructure projects to improve the country.

In terms of the foreign producers, they would suffer from this. This is because they would face more competition from the new products that their country would be importing, forcing them to reduce either profit margins and sell cheaper products to survive. This will lead them to expand slower due to less revenue, and would make surviving much more difficult.

In terms of the foreign producers, they would be affected negatively and positively. In terms of the positives, due to increased competition prices would be lower as people would have to compete more. Moreover they would have access to a wider array of products, giving them many options to choose from. Furthermore, they would be able to buy new technology from the country that is exporting that their own country did not have. However, if any of these consumers have jobs then they could get dismissed by their employers due to budget cuts since the employers would have to reduce prices. On top of that, in ths long run the consumers' buying power would decrease as this would negatively affect the country's balance of payments.

Finally in terms of the foreign government, they would face problems and advantages. In terms of the advantages, it gives them another source of revenue as they can apply tariffs and collect more tax which they can utilise to pay off debts or for any other thing. Furthermore, the government would be able to meet up with demand if the suppliers couldn't through importing the missing goods.

However, the government may become reliant on that country for goods. On top of that, the economy would weaken imports as economic withdrawals, which would weaken the overall economic stability of the country in the long run.