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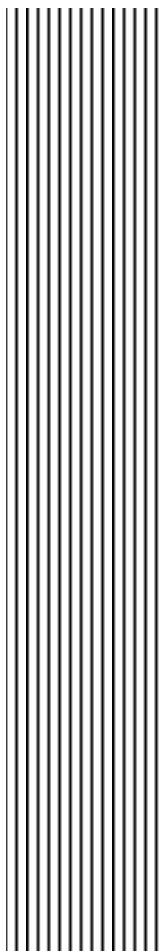
**Lectures on:
Financing International Trade**

**A publication Directed to third-year Bachelor's and first-year Master's
students Specialization: Finance and International Trade**

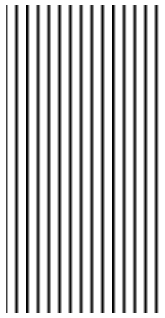
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◆ General Introduction



Foreign trade is a branch of economics that focuses on the exchange of goods, services, and capital between different countries worldwide. Over the past three decades, interest in foreign trade has increased with the rise of globalization and market economies.

Foreign trade is based on a set of theories that analyze the principles and foundations governing the exchange of goods, services, and financial transactions. It also examines the mechanisms for growth through foreign exchange markets and their potential impact on the balance of payments and exchange rate fluctuations.

Foreign trade has gained importance due to increased economic cooperation between nations and the emergence of international financial institutions, such as the International Monetary Fund (IMF). Additionally, developing countries face significant challenges related to international trade and their internal obligations.

In this chapter, we will discuss the concept of international trade and its theories. This chapter is divided into four main sections:

- **First:** General aspects of foreign trade policy.
- **Second:** Theories of foreign trade.
- **Third:** Economic policy instruments.

First chapter: General Aspects of Foreign Trade Policy

It is an undeniable fact in today's world that, regardless of the different political systems across countries, no nation can pursue a policy of complete self-sufficiency for an extended period. Adopting such a policy would require a country to produce all its needs, even when its economic and geographical conditions do not allow for it. No matter how much a country aims for self-sufficiency, it cannot isolate itself from other nations¹.

The term "foreign trade," like many other concepts in social sciences, is subject to varying interpretations regarding its scope and components. In this context, a distinction can be made between "foreign trade in its narrow sense" and "foreign trade in its broad sense."

- **Foreign trade in the narrow sense** covers both visible and invisible exports and imports.
- **Foreign trade in the broad sense** includes:
 - Visible (goods-based) exports and imports;
 - Invisible (services-based) exports and imports;
 - International migration, meaning the movement of individuals between different countries;
 - International capital movements, referring to the transfer of capital between nations.

Due to these conceptual differences, some scholars have used the term "foreign trade" to refer to its broader scope, while others have employed the term "international trade" to represent foreign trade in its wider sense².

1. Definition of Foreign Trade

Foreign trade focuses on studying all aspects of economic activity conducted between countries subject to different political authorities. In other words, foreign trade examines economic relations between different countries worldwide. These relations consist of the movement of people, represented by international migration, as well as the movement of goods, services, and capital. Such mutual relations between countries are referred to as international economic transactions.

International economic transactions are divided into international movements of goods and services and international movements of capital. This means that foreign trade primarily concerns the exchange of goods and services between different countries³.

¹ Choukairi Nouri Moussa et al., International Finance and Theories of Foreign Trade, Dar Al-Masirah for Publishing, Distribution, and Printing, Amman - Jordan, 2015, p. 13.

² Sami Afifi Hatem, Foreign Trade Between Theory and Regulation, First Book, The Egyptian Lebanese House, Cairo, 2nd edition, 1993, pp. 36-37.

Trade exchange between nations is an undeniable reality in today's world. No country, whether developed or developing, can be entirely self-sufficient in its economy without interacting with the rest of the world. Each country's national economy is based on various economic activities that complement one another in a way that ensures mutual influence. Trade acts as a link between these activities domestically, through internal trade, and internationally, through foreign trade. Consequently, foreign trade constitutes a crucial branch of the national economy and serves as a mirror reflecting the economic status of each country.

In this chapter, before delving into foreign trade policy, we will define foreign trade and explore its most important theories in economic thought, starting from classical theory to modern approaches, along with the key instruments of economic policy*.

1. The Concept of Foreign Trade

1.1. Definition and Importance of Foreign Trade

The term "foreign trade" was first used during the period when the free trade theory prevailed, as industrialized countries sought external markets for their products and sources of raw materials in colonies or foreign countries.

Foreign trade plays a central role in international relations. In the past, it was one of the causes of wars, whereas today, it is a key factor in fostering closer ties between nations. It enables countries to consume more than they produce with their own resources while also expanding distribution channels for selling their products⁴.

Foreign trade is defined as *"the process of commercial exchange of goods, services, and other factors of production between multiple countries with the aim of achieving mutual benefits for the trading parties"*⁵.

It can also be defined as *"a set of legal rules governing commercial activities based on financial, material, and service flows exchanged between countries. Exports represent the productive capacity of an economy that can be transferred to other nations, while imports reflect the shortfall in the national economy's ability to meet total demand. In summary, foreign trade consists of both visible and invisible exports and imports. In other words, it involves trade transactions between countries through import and export operations, where goods, services, and financial resources move from one country to another according to administrative and financial procedures."*

³ Mohamed Ahmed El-Sareiti, Foreign Trade, University House, Alexandria-Egypt, 2009, p. 8.

* Trade policy is considered one of the tools of economic policy, regardless of other tools such as monetary policy, fiscal policy, investment policy, etc.

⁴ LASARY. Le commerce international à la portée de tous. Ouvrage imprimé à compte d'auteur, 2005, p. 12.

⁵ Hamdi Abdel Azim, International Trade Economics, Zahraa Al-Sharq Library, Egypt, 1996, p. 13.

In addition to the previous definitions, foreign trade can also be described as *"various international trade exchange operations, whether in the form of goods, individuals, or capital, conducted between individuals residing in different political entities to meet the greatest possible number of needs. It consists of two main elements: exports, both visible and invisible."*^{*}

As for the concept of international trade versus foreign trade, some consider them to be "two sides of the same coin." However, others argue that if we examine the term "international trade" to distinguish it from "foreign trade," we find that the difference is significant. The latter—foreign trade—is merely a subset of the broader concept of international trade.

International trade moves beyond the narrow classical understanding of foreign trade and incorporates all forms of commercial exchange that exist in today's world, including:

- **International trade in goods**, which corresponds to the classical concept of foreign trade (visible trade);
- **International trade in services**, which represents foreign trade in its intangible form (invisible trade);
- **International migration**, referring to the movement of labor between countries;
- **International capital flows**, involving the movement of capital across different countries;
- **Environmental compatibility**, one of the achievements of the eighth round of multilateral trade negotiations—the "Uruguay Round"—launched on January 1, 2002. During this round, the term "international trade liberalization" officially replaced "foreign trade," marking a shift in global trade terminology⁶.

International trade is thus defined as *"foreign trade in the sense that today's world, like the past, requires the exchange of goods and services beyond national borders in areas such as migration, tourism, technology, and capital flows, just as it needs trade itself. Trade—whether domestic or international—is ultimately the result of specialization and the division of labor."*⁷

Many economists who discuss foreign trade tend to emphasize the differences between it and domestic trade based on one or more of the following distinctions⁸:

^{*}□ Exports and imports represent goods, while invisible exports and imports refer to services.

⁶ Sami Afifi Hatem, *Modern Trends in International Economics and Trade: Contemporary Issues in International Trade*, Book Three, Egyptian Lebanese House, Cairo, 2nd edition, 2005, p. 32.

⁷ Adel Ahmed Hashish, *Fundamentals of International Economics*, New University House, Alexandria, Egypt, 2002, p. 12.

⁸ Hamdi Abdel Azim, *Economics of International Trade*, previously cited reference, p. 14.

- **Geographical Scope:** Domestic trade occurs within a country's geographical or political borders, whereas foreign trade takes place on a global scale.
- **Currency Differences:** Domestic trade is conducted using a single national currency, while foreign trade involves multiple currencies.
- **Economic and Political Systems:** Foreign trade operates between different economic and political systems, whereas domestic trade occurs within a unified economic framework.
- **Regulatory Barriers:** Foreign trade is subject to various obstacles, restrictions, regulations, and laws that differ from those governing domestic trade.

International trade is fundamentally based on the principles of export and import. While a country may import more than it exports or vice versa, it is rare—if not impossible—for a country to exist outside this cycle⁹.

International trade has emerged as a solution to the inability of countries to achieve self-sufficiency in goods and services on their own. This challenge arises due to several factors, such as the nature of certain goods, the lack of capital, advanced technologies, or modern management practices required by some countries to produce these goods at a lower cost.

Foreign trade is crucial because it plays a significant role in most economies. It provides access to essential goods and services unavailable locally through imports, while also allowing surplus goods and services to be exported. These import and export activities influence physical commodity markets (such as production, income, and employment) as well as financial and monetary markets (such as money markets and foreign exchange markets)¹⁰.

Over the past five decades, international and regional trade liberalization agreements have strengthened global interconnectedness and significantly increased the flow of goods and capital between nations. As a result, trade has had an amplified impact on the economies of various countries.

1.2. Differences Between Domestic and Foreign (International) Trade

Both domestic and foreign trade result from specialization and the division of labor, which naturally lead to exchange. However, there are several key differences between domestic and foreign trade¹¹:

1-2-1. Scientific Traditions in Studying International Trade

⁹ Naïmi Fawzi, Ghassan Abdel Hakim, *International Trade, Lessons in International Business Law, Part One*, no publisher or place of publication mentioned, 1999, p. 31.

¹⁰ Taleb Mohammed Awad, *International Trade: Theories and Policies*, Wael Publishing House, Jordan, 2004, p. 14.

¹¹ Chikri Nouri Moussa et al., *International Finance and Theories of Foreign Trade*, previously cited reference, p. 17

Scientific traditions have established foreign (international) trade as an independent branch of economic studies due to its unique foundations and technical concepts that are not shared with domestic trade. Economists such as **Adam Smith** and **David Ricardo** dedicated separate studies to foreign trade, distinct from domestic trade. However, **Bertil Ohlin**, a contemporary economist, argued that there is no significant difference between them. Despite this view, the historical development of economics suggests a clear distinction between the two. The statistical data that formed the basis of economic science—such as data from local markets in cities and villages and customs statistics detailing exports and imports between countries—were fundamentally different. Since the sources of data differed, it is only natural that the resulting economic theories would also be distinct.

1-2-2. Differences in the Nature of Economic Problems Domestically and Internationally

Although foreign and domestic trade share some fundamental principles, they differ in the nature of the economic challenges they face.

Issues related to money, banking, wages, and prices, for example, have both an international and a domestic dimension, meaning that solutions in an international context differ from those applied locally.

- **Monetary and Banking Issues:** International monetary and banking problems are fundamentally different from domestic ones. For instance, within a country, traders can easily buy goods from any province or city, but they face significant challenges when purchasing from foreign countries due to currency exchange, trade regulations, and tariffs.
- **Wage Determination:** In a **capitalist system**, domestic wages are primarily determined by the supply and demand of labor. However, in an international context, wages are influenced by **international migration**, as workers tend to move from low-wage countries to high-wage countries in search of better opportunities.
- **Pricing Challenges:** The determination of commodity prices has both local and international aspects. While it is possible to enforce a **regulated pricing system** within a country, it is nearly impossible to impose a similar system globally due to differences in economic policies, trade agreements, and market dynamics.

1-2-3. The Mobility of Factors of Production

Classical economists believe that factors of production can move relatively easily within a single country, whereas their movement across international political borders is much more difficult. As a result, returns on factors of production tend to equalize within a country but not at the international level.

Within a country, if wage differences (labor returns) exist between two regions or industries, workers tend to migrate from lower-wage areas or sectors to higher-wage

ones. This movement, driven by **arbitrage**, eventually leads to wage equalization between the two regions or industries.

The same principle applies to **capital**, which flows from areas with lower interest rates to those with higher interest rates until an equilibrium is reached. Even **land**, despite being physically immobile, can be reallocated by changing its economic use¹².

This classical view on factor mobility within a country has been challenged by many economic studies, which argue that production factors do not move as freely as assumed. Evidence for this includes disparities in **unemployment rates and economic stagnation** across different regions within the same country, as well as the economic gap between the **developed North and underdeveloped South** in some nations. This suggests that even within national borders, factors of production are not perfectly mobile.

At the **international level**, numerous barriers limit or entirely prevent the free movement of factors of production between countries. These barriers include:

- **Legal Barriers:** Restrictions on the migration of labor and capital across borders.
- **Economic Barriers:** Risks that capital faces in a foreign country but not in its home country.
- **Cultural Barriers:** Differences in language, customs, and traditions that hinder labor mobility.
- **Informational Barriers:** Difficulty in obtaining accurate information about economic conditions and opportunities in foreign countries.

These differences in factor mobility between domestic and international trade—regardless of the extent of variation economists attribute to them—serve as further evidence that **domestic and foreign trade are distinct from each other**.

1-2-4. Differences in Monetary Systems

It is well known that individuals residing within the same country can conduct transactions using a **single currency** without restrictions or controls on the movement of money between different regions of the country.

However, in international transactions, the situation is different. Each country has its own distinct monetary system and national currency. As a result, many of these currencies are not universally accepted for valuing goods and services or settling **obligations** outside the borders of their respective countries.

1-2-5. Other Factors

Some additional key factors distinguishing domestic from international trade include:

¹² Chikri Nouri Moussa et al., International Finance and Theories of Foreign Trade, previously cited reference, pp. 17–19.

A. Differences in National Policies

Legal systems, economic regulations, taxation policies, and social frameworks vary significantly from one country to another. Consequently, a state may establish specific regulations for foreign transactions that differ from those applied domestically.

For example, customs duties, quota systems, foreign exchange controls, and other trade restrictions are imposed on international transactions but not on domestic trade¹³.

B. Market Segmentation

Various barriers contribute to the segmentation of international markets, including:

- **Transportation difficulties,**
- **Trade restrictions** imposed by governments,
- **Cultural differences,** such as **language, tastes, customs, and traditions.**

While technological advancements in communication and transportation have reduced market segmentation to some extent, significant differences remain. For example, traditional or culturally specific clothing reflects varying consumer preferences across different nations.

C. Differences in Monetary Authorities

Citizens of the same country operate under a single political authority, share a common historical heritage, and often have a sense of national unity and solidarity that may not exist in international trade relations.

This distinction arises because domestic trade involves transactions among individuals within the same national framework, whereas international trade includes individuals and groups residing in separate political entities¹⁴.

From here, we can summarize the key differences between domestic and international trade. There are many differences between them, some of which are formal, while others are fundamental and structural, creating a significant gap between internal and external exchanges. These differences include¹⁵:

- **Differences in Political Units:** Domestic trade takes place between individuals and entities within the same political borders, meaning they are subject to the same laws, customs, traditions, and trade regulations. In contrast, international trade occurs between individuals and entities belonging to different countries, each with its own legal system, traditions, and trade regulations.

¹³ Chikri Nouri Moussa et al., *International Finance and Theories of Foreign Trade*, previously cited reference, pp. 19–20.

¹⁴ Chikri Nouri Moussa et al., *International Finance and Theories of Foreign Trade*, previously cited reference, p21

¹⁵ Souhail Hussein Al-Fatlawi, *The World Trade Organization*, Dar Al-Thaqafa, Amman, 2009, p. 25

- **Differences in Monetary and Banking Units:** The monetary unit used in transactions differs between domestic and international trade. In domestic trade, a single currency is used and is automatically accepted by all parties. However, in international trade, multiple currencies are involved—each corresponding to a different country—which necessitates agreements on exchange rates for import and export operations, leading to foreign exchange transactions.
In addition to currency differences, banking systems also vary between countries, affecting money issuance, deposits, and credit policies. Differences in credit conditions from one country to another significantly impact the distinction between domestic and international trade.
- **Differences in Economic Policies and National Orientations:** Legal systems, economic and tax regulations, and social policies vary from one country to another. As a result, states may impose specific regulations for international transactions that differ from domestic ones. These include customs duties, quota systems, foreign exchange controls, and other restrictions that regulate external transactions. In contrast, such regulations do not typically exist in domestic exchanges between individuals or regions within the same country.
- **Differences in Market Characteristics:** The nature of markets varies between countries, significantly influencing international trade. This variation stems from differences in consumer preferences, habits, and environments, leading to diverse demands for goods and services.
- **Differences in Natural Resources:** Countries differ in the availability of natural resources, which leads them to specialize in producing goods based on their available resources. They then trade these goods for others that require resources they lack.
- **Differences in the Mobility of Production Factors:** Within a country, production factors such as labor, capital, and natural resources shift between industries based on profitability, ensuring market equilibrium and aligning product prices with consumer needs and resource availability. However, at the international level, production factors exhibit relative immobility across borders. This immobility results in price differences for various goods—even for the same product—from one country to another. Unlike the ease with which production factors move within a single country, their cross-border movement is more restricted, leading to price disparities in international trade.

2. Reasons for International Trade

International trade allows for greater production of goods and better satisfaction of human needs than if a country attempted to produce everything it required within its own borders. The primary reason for international trade among countries is the economic problem, commonly known as the issue of relative scarcity, which has multiple causes. The majority of international trade occurs between developed industrial nations, as the

higher income levels in these countries enable people to purchase large quantities of goods, and because these nations possess most of the specialized industries.

The main reasons for international trade can be summarized as follows¹⁶:

- **Inability to achieve self-sufficiency**
- **Existence of production surpluses**
- **Profit generation**
- **Improvement of living standards**
- **International specialization:** No country can fully rely on itself to meet the needs of its population due to the unequal distribution of natural resources across the world.
- **Differences in production costs and local prices:** Variations in production costs between countries drive trade, particularly in nations that benefit from economies of scale. These economies reduce the average total cost per unit compared to another country producing at lower volumes, where production costs remain higher. This gives the first country a comparative advantage in production.
- **Differences in technological levels between countries:** Production methods and technical expertise vary across nations, significantly affecting the types of goods each country produces. Developed nations typically have a diverse range of production, whereas developing countries tend to specialize in goods that rely on raw materials, such as oil, minerals, and cotton, due to technological limitations.
- **Differences in Production Conditions:** Some regions are suitable for growing coffee and tea, so they should specialize in these agricultural products while importing other goods they do not produce, such as oil, which is abundant in desert-climate countries like the Gulf states.
- **Differences in Preferences and Tastes:** Local consumers often prefer foreign products even when domestic alternatives are available. This factor becomes more significant as individual income levels rise¹⁷.

Second: The Importance and Objectives of International Trade

International trade is a vital sector in any society, whether developed or developing. It connects countries and communities while also expanding marketing opportunities by opening new markets for domestic products. Additionally, it enhances national well-being by

¹⁶ [URL] http://www.kibs.edu.kw/upload/Edaat_Jul_2016_Foreign_Trade_1312.pdf, accessed on January 15, 2019, at 15:30.

¹⁷ Hamdi Abdel Azim, Economics of International Trade, previously cited reference, p. 16.

broadening choices in consumption and investment, as well as optimizing the allocation of productive resources¹⁸.

International trade holds great significance as an indicator of a country's productive and competitive capabilities, its ability to attract foreign currency, and its impact on the trade balance. As a result, it has become a key component of national economic strategies, helping countries meet local market demands, protect domestic industries from imports, and export surpluses. Consequently, it exerts a dual influence—both externally on global markets and internally on the national economy.

1. The Importance of International Trade

International trade plays a crucial role in economic, social, and political life. It helps shape a country's political landscape and define its relationships with other nations. Its importance can be seen in the following areas:

1.1. Economic Significance

International trade contributes to achieving the following economic objectives:

- Serving as an outlet for surplus production that exceeds domestic market demand, thereby strengthening the foreign exchange reserves.
- Enabling access to a wider range of goods and services at lower costs due to the principle of international specialization¹⁹.
- Encouraging exports, which generate foreign capital essential for increasing investment, building factories, and developing infrastructure—particularly in developing countries—thus promoting economic growth.
- Acting as an indicator of a country's production and competitiveness in global markets, reflecting its export capabilities, income levels, and import potential, all of which influence its foreign transactions balance²⁰.
- Facilitating the transfer of technology and essential knowledge that supports the development of emerging economies.
- Maintaining market equilibrium by balancing supply and demand within the domestic economy²¹.

1.2. Social Significance

¹⁸ Khaled Mohammed Al-Sawa'i, *Trade and Development*, Dar Al-Manahij for Publishing and Distribution, Amman, 1st edition, 2006, p. 38.

¹⁹ Abdel Muttalib Abdel Hamid, *Economic Theory*, Al-Dar Al-Jami'iyya for Printing and Publishing, Egypt, 2000, p. 373.

²⁰ Rachad Al-Attar et al., *Foreign Trade*, Dar Al-Maseera for Publishing and Distribution, Jordan, 2000, p. 16.

²¹ Raad Hassan Al-Surn, *Fundamentals of Contemporary International Trade*, Part One, Dar Al-Rida for Publishing, Syria, 2000, p. 57.

International trade contributes to social development by achieving the following:

- Enhancing individual well-being by expanding consumer choices²².
- Bringing about necessary social changes resulting from economic transformations.
- Improving tastes, fulfilling various needs and desires, and satisfying consumer demands.
- Providing access to the latest scientific and technological advancements at relatively low prices.
- Increasing the influence of international trade on daily life.

1.3. Political Significance

In the political sphere, international trade aims to achieve the following:

- Strengthening national defense infrastructure by importing the latest advancements in science and technology.
- Establishing friendly relations and fostering diplomatic ties with trading partner countries.
- Promoting political globalization by reducing borders and shortening distances, striving to make the world a global village by leveraging modern technology and cross-border trade networks²³.

The importance of international trade can be summarized as follows:

International trade allows countries to specialize in producing goods that align with their available resources. It benefits nations by enabling them to produce goods at a lower cost while purchasing cheaper products from other countries. Its significance is reflected in the following factors:

- Indicator of a country's productive and competitive strength in international markets.
- Impact on foreign currency reserves and trade balance.
- Connecting different countries through economic exchange.
- Disposing of surplus domestic production.
- Generating profits by obtaining goods at a lower cost than producing them locally.
- Increasing national income.
- Facilitating technological transfer.
- Maintaining market balance.

²² Rachad Al-Attar et al., Foreign Trade, previously cited reference, p. 13.

²³ Raad Hassan Al-Surn, Fundamentals of Contemporary International Trade, previously cited reference, p. 58

- Meeting consumer demands, satisfying preferences, and enhancing tastes.
- Expanding marketing potential by opening new markets for national products.
- Improving national welfare by broadening investment and trade opportunities²⁴.
- Serving as a key indicator of a country's ability to produce, export, and import, impacting foreign currency reserves and trade balance.
- Establishing a link between international trade and economic development, as national income growth influences trade volume and patterns, while changes in international trade conditions directly impact income composition and levels.
- Facilitating the transfer of essential technologies and knowledge that strengthen economies and promote comprehensive development.

2. Key Objectives of International Trade

The main objectives of international trade can be highlighted as follows:

- Maximizing the benefits of surplus production: Exporting leads to an increase in national output, positively affecting employment levels and ensuring the availability of essential goods. Conversely, weak exports result in national income losses, increased unemployment, and a decline in living standards.
- Importing essential goods that cannot be produced locally: For example, importing necessary machinery and equipment for building a textile factory can create numerous job opportunities, contribute to exports, and boost national income and output.
- Import substitution: This depends on cost factors. If goods can be produced locally at reasonable costs, it may help promote trade policies and encourage exports. However, if local production is more expensive than imports, government policies play a significant role—this is often the case in developing countries.
- Transferring technology and expertise to build and restructure national infrastructure.
- Utilizing information technology as a key pathway for developing nations to bridge the gap with advanced countries, as seen in India's successful software exports.
- Analyzing countries' balance of payments, exchange rate systems, and addressing economic imbalances.
- Examining trade policies such as protectionism or free trade to understand their impact on international commerce.
- Studying international relations within economic blocs and their distinguishing features²⁵.

²⁴ Financial and Banking Insights. Foreign Trade, Institute of Banking Studies, Kuwait, Issue No. 12, Eighth Series, 2016.

3. Stages of the Evolution of International Trade

International trade has gone through several phases, outlined as follows:

First Phase (1488–1763)

This period emerged during the age of geographical discoveries and European expansion into new continents. The opening of trade routes to India and other regions played a crucial role in breaking the isolation between continents.

Second Phase (1763–1883)

In the latter part of the 18th century, England became the center of the global economy. Its abundant production allowed it to export goods to its colonies, leading to a division of trade between European nations and their colonies, giving rise to what became known as reciprocal trade.

Third Phase (1883–1980)

This phase saw the emergence of the first multinational corporations and was marked by the dominance of the capitalist system, led by the United States.

Fourth Phase (1980–Present)

This phase is characterized by the continued rise of multinational corporations and the economic restructuring linking developing countries with the International Monetary Fund (IMF). It is also associated with the rise of globalization, which integrates markets for goods and production factors. Additionally, this period has seen an increase in the diversity of exported goods, along with negative environmental impacts²⁶.

4. Indicators of International Trade

Both geographers and economists analyze international trade by studying trade flows through various indicators and metrics that help assess the current state of production structures and economic development levels. These indicators also shed light on political decisions made by governments to address economic challenges.

4.1. Trade Balance

The trade balance represents the difference between the total value of exports and total value of imports of a country.

- Trade Deficit: When imports exceed exports, the trade balance is in deficit (common among developing countries).

²⁵ Chikri Nouri Moussa et al., *International Finance and Theories of Foreign Trade*, previously cited reference, pp. 21–22.

²⁶ Fouad Mohammed Al-Saqqar, *Geography of International Trade*, Monsha'at Al-Ma'arif, Alexandria, 3rd edition, 1997, p. 19.

- Trade Surplus: When exports exceed imports, the trade balance is in surplus (typical for industrially advanced nations).

There are two main types of trade balances:

A. General (National) Trade Balance

This reflects a country's total trade exchanges (exports and imports) with all nations and global economic blocs. It can be either positive or negative depending on the trade performance.

B. Partial Trade Balance

This reflects a country's trade exchanges with a specific country or group of countries. A nation may have a trade surplus with some partners while still maintaining an overall trade deficit, a phenomenon observed in many countries, including developing nations.

Studying the characteristics of a country's trade balance provides insight into the strength of its national economy and the level of development it has achieved²⁷.

4.2. Degree of Economic Openness

This indicator reflects the importance of foreign trade within a country's national economy and is calculated using the following formula:

$$\text{Economic Openness Ratio} = \frac{\text{Total Exports} + \text{Total Imports}}{\text{Gross Domestic Product (GDP)}}$$

Although a high economic openness ratio does not necessarily indicate economic dependence on foreign markets—especially in developed countries like the United Kingdom and France—it does suggest a greater exposure to external influences.

This is particularly true for developing countries that rely heavily on the export of a limited number of raw materials. A high openness ratio in these economies means they are more vulnerable to fluctuations in global commodity markets²⁸.

4.3. Terms of Trade (ToT) Ratio

This indicator measures the relative relationship between a country's exports and imports. The most common metric used for this is the value-based terms of trade ratio, which is calculated as follows:

²⁷ Abdel Raouf Rahban, *Geography of International Trade*, available at: almejara.com/reading.php?idm47513, accessed on June 16, 2019, at 16:25.

²⁸ Abdel Wahab Hamid Rashid, *Foreign Trade and the Worsening of Arab Dependency*, Arab Development Institute, Beirut, 1984, p. 32.

$$\text{Terms of Trade Ratio} = \frac{\text{Export Price Index}}{\text{Import Price Index}} \times 100$$

- If the ratio exceeds 100%, it indicates an improvement in the country's trade conditions.
- If the ratio falls below 100%, it signals deterioration in trade performance²⁹.

The terms of trade fluctuate based on factors affecting both exports and imports.

For example:

- Currency depreciation makes a country's exports cheaper, reducing their value relative to imports.
- Lower production costs for export goods (without a similar reduction in imported goods) can drive down export prices, leading to a decline in the terms of trade.

It is important to note that:

- Industrialized nations generally experience an improving terms of trade over time.
- Countries that rely on raw material exports tend to see a deterioration in their terms of trade due to price volatility in global markets.

The trade terms ratio alone is not sufficient to measure the gains a country derives from its foreign trade. It must be calculated over different periods to analyze its evolution over time. Therefore, it is essential to separately estimate the price indices for both exports and imports.

The terms of trade ratio typically exceeds 100 in the following cases³⁰:

- When export values remain unchanged while import values decline.
- When export values increase while import values remain the same.
- When both export and import values increase, but the increase in export values is greater than the increase in import values.
- When both export and import values decline, but the decline in export values is **less severe** than the decline in import values.

4.4. Export Structure and Geographic Distribution

This indicator consists of two components:

1. Commodity Composition of Exports
2. Geographic Distribution of Exports (Markets)

The first component reflects the structural composition of the national economy.

²⁹ Abdel Wahab Hamid Rashid, Ibid., p. 33.

³⁰ Hassan Abdel Qader Saleh, Introduction to the Geography of Industry, Dar Al-Sharq, Amman, 1985, p. 203.

- The greater the diversity of exported goods and the more evenly distributed their relative importance, the more advanced the production structure appears to be. This also reduces risks associated with securing foreign revenue.
- Conversely, a lower number of export goods with high concentration in a few products suggests an underdeveloped production structure.

The degree of export concentration is calculated using the following formula:

$$\text{Export Concentration Index} = \sum \left(\frac{\text{Export value of each good}}{\text{Total export value}} \right)^2$$

A high index value indicates that a country is highly vulnerable to external decisions and global market fluctuations.

- Countries with a high concentration index often prioritize good relations with their major trading partners to maintain stability.
- Alternatively, they may diversify export markets by seeking new trading partners to reduce dependence on a limited number of buyers.

4.5. Import Structure and Geographic Distribution

The analysis of import composition is typically based on:

- The sectoral classification of imported goods (e.g., agriculture, industry, services, etc.).
- The categorization of imports into essential goods vs. luxury goods.
- The division of imports into capital goods vs. consumer goods.

By analyzing imported goods, whether based on the first or second criterion, it is possible to assess the level of national economic development by identifying the goods that the economy requires to continue its progress and development. It is observed that the largest portion of imports in industrially advanced countries consists of raw materials and energy sources, in addition to manufactured goods intended for consumption and luxury purposes.

In contrast, in developing countries, the primary imports include goods such as machinery, transportation equipment, and food products. Similarly, examining the geographical distribution of imports helps in understanding a country's foreign relations and political orientations by identifying its main sources of imports.

Studying the evolution of the structure and geographical distribution of exports and imports provides insight into changes in their composition over a specific period. This allows for an understanding of major economic developments within a country and their impact on the global economy across all sectors.

Moreover, the study of international trade geography helps in understanding the nature of economic relations between different geographical regions, between developed and developing countries, and among various economic blocs, as well as within a single economic bloc. Modern geographical studies and research on international trade emphasize the importance of identifying different production and consumption regions worldwide, as well as analyzing the mutual interactions between humans and their level of advancement and control on one hand, and the geographical environment on the other, which directly affects the movement of international trade exchanges.

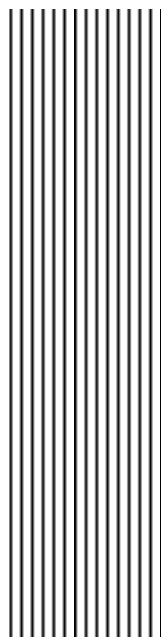
Geographers rely on statistical bulletins issued by national statistical centers, foreign trade statistics published by countries, and international statistics provided by the United Nations and its affiliated organizations. They also gather field data from ports, airports, railway stations, and border customs points.

Thus, trade statistics serve as the most crucial tool for research in the geography of trade. The geographer's role then involves classifying and analyzing these statistical data to create tables, geometric figures, or graphical representations that illustrate the evolution of trade exchanges for a given country over a certain period. These analyses also help in making comparisons to determine the extent of countries' participation in international trade exchanges³¹.

In conducting such studies, geographers employ all methods and approaches used in economic geography, including the regional approach, the commodity approach, the fundamental approach, and the functional approach. However, depending on the nature of the study or research, they primarily focus on the regional and commodity approaches. In the study of international trade, geographical research particularly emphasizes statistical methods, as they provide the greatest flexibility in achieving study objectives and are the most effective in presenting results and making comparisons.

The researcher begins by presenting statistical data dialectically, leveraging the flexibility of tables to organize, select, and integrate data. The next step involves graphical representation using various geometric figures, charts, and curves that best illustrate the findings and make them easily understandable for the reader. Finally, geographic maps play a crucial role, as geographers frequently use them to visually present information and results. Maps offer significant advantages, including the ability to display numerous phenomena of different natures and facilitate immediate comparisons.

³¹ Oussama Kaddour, *Geography of International Trade*, Al-Ittihad Printing Press, Damascus, 1989, p. 8.



Economic thought related to international trade has been divided into several perspectives, with some supporting the independence of international trade theory from general economic theory and others opposing this independence³².

To highlight these different orientations, we will first present some classical and neoclassical theories.

1. Classical Theories

The classical economists were not the first to present theories on international trade; they were preceded by the mercantilists. However, the views of classical thinkers varied, and the most significant theories can be summarized as follows:

Absolute Advantage Theory

Adam Smith (1723–1790) was among the first economists to emphasize the importance of free international trade for all participating countries through his theory of absolute advantage.

According to this theory, if a country can produce a particular good at a lower cost than other countries, it should specialize in producing that good and exchange it for another good that it produces at a higher cost. This specialization leads to an increase in total production, higher consumption levels, and greater international economic welfare.

Unlike the mercantilists, Adam Smith believed that a nation's wealth does not lie in accumulating gold but in increasing the production of final goods and services. Therefore, a country's goal should not be to hoard gold but to develop production through the division of labor and cooperation. Moreover, Smith argued that production growth requires conditions that grant producers complete freedom in choosing the type of economic activity they wish to engage in—an approach known as the "laissez-faire" policy³³.

For example, Canada, due to its climatic conditions, can efficiently produce wheat but cannot grow bananas without using greenhouses to simulate the necessary environment. On the other hand, Nicaragua is well-suited for banana cultivation but not for wheat production. Thus, Canada has an absolute advantage in wheat production compared to Nicaragua, while Nicaragua has an absolute advantage in banana production³⁴.

³² Sami Afifi Hatem, *Foreign Trade Between Theory and Regulation*, previously cited reference, p. 46.

³³ Faiza Kashi, *International Economics: Movement of Goods and Production Factors*, Dar Al-Adib Publications, Oran, Algeria, p. 13.

³⁴ Dominick Salvatore, *International Economics*, 10th edition, John Wiley and Sons, Singapore, 2011, pp. 35–36.

Under these conditions, both countries benefit from specializing in their respective products and engaging in trade, leading to mutual economic gains.

To better understand Adam Smith's Absolute Advantage Theory, we present the following examples:

Example 1:

Let's assume there are two countries, Algeria and Germany, both producing two types of goods: trucks and cars. The production cost per unit of each good differs between the two countries, as shown in **Table (1.01)**:

Country	Cars	Trucks
Germany	1 unit	3 units
Algeria	4 units	2 units

Source: Kaachi Faiza, *International Economics: Goods Movement and Factors of Production*, Dar Al-Adib Publications, Oran, Algeria, p. 13.

From the table, we observe that Germany has an absolute advantage in car production, as it only requires one unit of resources per car compared to four units in Algeria.

Meanwhile, Algeria has an absolute advantage in truck production, requiring only two units of resources per truck compared to three units in Germany.

According to the Absolute Advantage Theory, the pattern of international specialization should be as follows:

- Germany specializes in car production and exports cars to Algeria.
- Algeria specializes in truck production and exports trucks to Germany.

Example 2: Absolute Advantage Theory and Total Production Increase

Now, let's assume there are two other countries, Egypt and the United States, producing cotton and wheat. The resource costs per one ton of wheat and one ton of cotton are given in Table (1.02):

Each country has 100 resource units available. Before trade, both countries allocate half of their resources to wheat production and the other half to cotton. However, after engaging in trade, each country specializes only in the good in which it has an absolute advantage.

This specialization allows for increased overall production, as each country focuses on the good it can produce at the lowest cost, leading to greater efficiency and maximizing global output³⁵.

Table (1-02):

Production Costs per Ton of Each Commodity

Country	Cotton	Wheat
Egypt	4 units	10 units
United States	20 units	5 units

Source: Kaachi Faiza, *International Economics: Goods Movement and Factors of Production*, Dar Al-Adib Publications, Oran, Algeria, p. 14.

According to the data, before trade, Egypt allocates half of its available resources (50 units) to producing the first good (cotton) and the other half to the second good (wheat). This allocation allows it to produce 5 tons of wheat and 12.5 tons of cotton. Similarly, the United States, following the same principle, produces 2.5 tons of cotton and 10 tons of wheat, resulting in a total combined production of 15 tons of cotton and 15 tons of wheat for both countries.

However, after engaging in trade and specializing in the good in which they have an absolute advantage, total production increases, in line with Adam Smith's theory. If each country directs all its available resources to the good it produces at the lowest cost, then:

- Egypt will produce 25 tons of cotton.
- The United States will produce 20 tons of wheat.

This specialization results in a net gain of 10 additional tons of cotton and 5 additional tons of wheat compared to pre-trade production.

Example 3: Absolute Advantage and Trade Gains

We have the following information for Country A and Country B:

Table (1-03):

Production per Hour of Labor per Worker

Country	Wheat (tons/hour/worker)	Textiles (tons/hour/worker)
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³⁵ Faiza Kashi, *International Economics: Movement of Goods and Production Factors*, previously cited reference, p. 14.

Country	Wheat (tons/hour/worker)	Textiles (tons/hour/worker)
Country A	6	1
Country B	1	3

Source: Kaachi Faiza, *International Economics: Goods Movement and Factors of Production*, Dar Al-Adib Publications, Oran, Algeria, p. 15.

Let's assume both countries trade 6 tons of wheat for 3 tons of textiles. What are the expected trade gains?

- **Country A:**
 - By trading 6 tons of wheat for 3 tons of textiles, it gains 2 extra tons of textiles.
 - This trade saves 2 hours of labor, which allows it to produce 12 tons of wheat instead of just 6 tons when sacrificing 1 ton of textiles domestically.
- **Country B:**
 - By trading 6 tons of wheat for 3 tons of textiles, it gains 5 extra tons of wheat.
 - This trade saves 5 hours of labor, enabling it to produce 12 tons of textiles instead of just 1 ton of wheat when sacrificing 3 tons of textiles domestically.

Thus, by specializing in their absolute advantages and engaging in trade, both countries increase their overall output and achieve greater economic efficiency³⁶.

Example 4: Absolute Advantage and the Production Possibility Curve

Let's assume that with one unit of production factors:

- The United States can produce either 3 computers or 3,000 cartons of milk.
- France can produce either 1 computer or 5,000 cartons of milk.

Since the Production Possibility Curve (PPC) represents all the different combinations of two goods that can be produced using all available production factors, we assume:

- The maximum number of computers that the United States can produce in the absence of trade is 1,000 units.
- The maximum amount of milk that France can produce without trade is 2 million cartons.

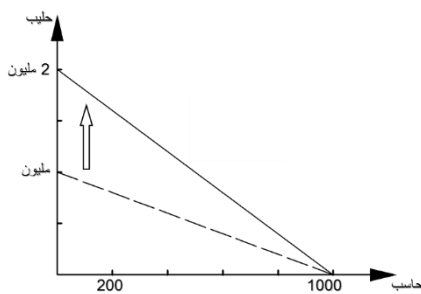
Thus, the PPC of the United States and the PPC of France appear as dashed straight lines, as illustrated in Figures (1.01) for France and (1.02) for the U.S.

Key Observations from the Graphs:

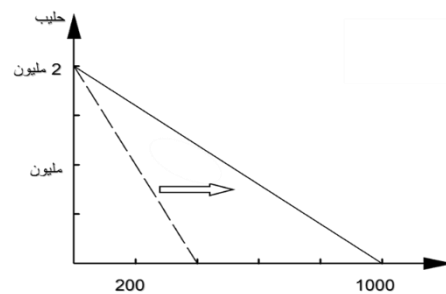
³⁶ Kaachi Faiza, *International Economics: Goods Movement and Factors of Production*, Dar Al-Adib Publications, Oran, Algeria, p. 15

- If the **United States** utilizes all its available resources, it can produce 1 million cartons of milk or 1,000 computers.
- If France fully utilizes its resources, it can produce 2 million cartons of milk or 400 computers.
- The points along the dashed lines represent alternative production combinations, where resources are divided between milk and computer production.
- Points below the PPC of the U.S. and to the left of the PPC of France indicate underutilization of resources—these quantities can be produced, but the economy is not fully using its production capacity.
- Points above the PPC of the U.S. and to the right of the PPC of France represent unattainable production levels, as there are insufficient resources to reach these quantities.

Figure (1.02)
Production Possibility Curve of the U.S.



(1.1) Figure
Production Possibility Curve of France



Source: Kaachi Faiza, *International Economics: Goods Movement and Factors of Production*, Dar Al-Adib Publications, Oran, Algeria, p. 15.

According to these figures, it is evident that if the United States utilizes all the units at its disposal, it can produce either one million milk cartons or 1,000 computers. Meanwhile, if France fully utilizes its available units, it can produce two million milk cartons or 400 computers. The points forming the dotted lines represent the possible alternative quantities that can be produced by allocating resources between milk and computer production. The points below the U.S. curve and to the left of the French curve indicate quantities that can be produced, but in this case, the available production units are not fully utilized. On the other hand, the points above the U.S. curve and to the right of the French curve represent quantities that cannot be produced due to insufficient production factors.

If the United States specializes in producing the good in which it has an absolute advantage—computers—and sells them to France in exchange for milk at a rate of 1

computer = 2,000 milk cartons, and if France also specializes in producing the good in which it has an absolute advantage—milk—and sells it to the U.S. at the same rate, the U.S. production possibilities curve will shift upward, while France's curve will shift to the right. This represents an increase in total production and domestic consumption for both countries³⁷.

Adam Smith's absolute advantage theory, introduced in 1776, is based on several assumptions, the most important of which are:

- Two goods and two countries;
- Trade is conducted through barter;
- Labor is the sole production factor and is homogeneous;
- The labor theory of value: the value of a good is derived from the labor required to produce it;
- Production factors move freely within a country but do not move between countries;
- Transportation and insurance costs are negligible;
- Production costs remain constant, and their reduction leads to increased demand for the product;
- International trade is unrestricted;
- Full employment exists—i.e., all labor resources are fully utilized in production;
- Consumer preferences and tastes are similar;
- Perfect competition exists.

Adam Smith's theory has both strengths and weaknesses. One of its key strengths is its reliance on the labor theory of value, as well as its detailed explanation of the benefits of labor division, not only at the local level but also internationally. However, its main weakness is its failure to answer the following question: Why does trade and specialization occur even in cases where a country does not have an absolute advantage?³⁸

2. David Ricardo's Theory of Comparative Advantage

To understand Ricardo's theory of international trade, we must first examine his theory of value. According to Ricardo's value theory, the value of any commodity depends on the

³⁷ Kaachi Faiza, *International Economics: Goods Movement and Factors of Production*, Dar Al-Adib Publications, Oran, Algeria, p. 15

³⁸ Kaachi Faiza, *International Economics: Goods Movement and Factors of Production*, Dar Al-Adib Publications, Oran, Algeria, p. 16-17

labor costs incurred in its production—i.e., the number of labor hours required to produce one unit of the commodity³⁹.

However, in international trade, the principle of labor costs does not determine exchange value. As Ricardo states, "The same rules that govern the relative values of goods within a country do not govern the relative values at which goods are exchanged between two or more countries. The quantity of wine that Portugal exports in exchange for textiles from England is not determined by the amount of labor allocated to producing each of these goods—as it would be if both goods were produced in England or Portugal."⁴⁰

One may wonder why there is such a noticeable difference between the rules of international trade and those of domestic trade. Ricardo answered this by stating that the difference arises from the difficulty of moving capital from one country to another. Within a single country, capital moves freely to the most productive and profitable locations, but internationally, this movement is highly constrained. In the previous example, it would be in the best interest of capital owners in England and consumers in both countries for wine and textiles to be produced in Portugal. The labor and capital dedicated to textile production in England should ideally move to Portugal.

Ricardo explained that experience has shown that capital movement between countries is difficult due to concerns about security. It is not easy for individuals to leave their homeland, which they have grown up in, and move to another country with different customs, traditions, and language, as well as different government laws and regulations. These factors make labor and capital migration challenging. As a result, capital remains in its home country even at a lower rate of return, rather than seeking more profitable opportunities abroad.

In summary, the immobility of production factors—labor, capital, and management—prevents goods from being produced in the countries with the lowest production costs. Therefore, production location across different countries depends on the principle of comparative costs. Each country specializes in producing the goods for which labor costs are relatively lower.

³⁹ Sami Khalil, *International Economics*, Cairo, Egypt, Dar Al-Nahda Al-Arabiya, 2002, p. 102.

⁴⁰ Sami Khalil, *International Economics*, Cairo, Egypt, Dar Al-Nahda Al-Arabiya, p. 103.

This is essentially an extension of the division of labor principle. Generally, both countries and individuals tend to specialize in tasks where their skills and efficiency are highest. Ricardo illustrated this with an example of two workers who can make both shoes and hats. Suppose one worker is better at both tasks but is 20% better at making hats and 33% better at making shoes. Clearly, both would benefit if the more skilled worker specialized in shoe production, where he has a comparative advantage, and left hat-making to the other worker.

Ricardo's comparative cost theory represents a significant advancement over Adam Smith's absolute cost theory. Ricardo's theory is more general—it explains cases that Smith's theory does not address. In fact, Smith's theory is a special case of Ricardo's, where a country's comparative advantage also happens to be its absolute advantage.

Although Ricardo's theory convincingly explains the benefits of trade, it does not specify the exact terms at which goods are exchanged between countries, i.e., the international exchange rate, known as the terms of trade⁴¹.

**Table No. (1.04):
Comparison of Wine and Textile Production in Portugal and England**

Countries	Portugal	England
10 days of labor produce (gallons of wine, W)	20	10
10 days of labor produce (yards of textiles, C)	20	15

Source: Sami Khalil, *International Economics*, Cairo – Egypt, Dar Al-Nahda Al-Arabiya, 2002, p. 102.

From the table above, it is evident that Portugal has an absolute advantage in producing both wine (W) and textiles (C), as it outperforms England in the production of both goods. The same amount of labor in both countries results in a greater output of wine in Portugal (10W < 20W) and a greater output of textiles as well (15C < 20C).

However, Portugal's advantage in wine production is greater than its advantage in textile production compared to England. This is evident as Portugal produces twice as much wine as England with the same labor input, whereas in textiles, it produces only 1½ times more than England. This indicates that Portugal has a comparative advantage in wine production, leading to its specialization in producing and exporting wine to England while importing textiles from England.

⁴¹ Sami Khalil, *International Economics*, previously cited reference, pp. 104–106.

On the other hand, England has an absolute disadvantage in producing both wine and textiles compared to Portugal. With the same amount of labor, England produces less wine ($20W > 10W$) and fewer textiles ($20C > 15C$). However, England's disadvantage in textile production is less severe than its disadvantage in wine production.

This means that England has a comparative advantage in textile production, which encourages it to specialize in producing and exporting textiles to Portugal while importing wine from Portugal.

We can also use the same example that was used to explain Adam Smith's absolute advantage, but with Ricardo's perspective in mind. According to Ricardo, the United States would have an absolute advantage in producing both wheat and textiles. However, it has a comparative advantage in wheat production. On the other hand, the United Kingdom is absolutely disadvantaged in producing both goods, but it has a comparative advantage in textile production. The following table illustrates this:

Table No. (1.5):

Comparison of Wheat and Textile Production in the United States and the United Kingdom

Countries	United States	United Kingdom
Wheat (bushels per hour/worker)	6	1
Textiles (yards per hour/worker)	4	3

Source: Sami Khalil, *International Economics*, Cairo – Egypt, Dar Al-Nahda Al-Arabiya, 2002, p. 105.

From this table, it is evident that the United States has an absolute advantage in both goods, as it produces more wheat ($6 \text{ bushels} > 1 \text{ bushel}$) and more textiles ($4 \text{ yards} > 3 \text{ yards}$) than the United Kingdom. Consequently, the United Kingdom is at an absolute disadvantage in both goods.

However, the United States has a comparative advantage in wheat production, since:

$$6 > 1 \frac{6}{4} > \frac{1}{3} 4 > 3$$

Thus, the United States should specialize in wheat production and export it.

Likewise, the United Kingdom has a comparative advantage in textile production, since:

$$3 > 4 \frac{3}{1} > \frac{4}{6} 13 > 64$$

Thus, the United Kingdom should specialize in textile production and export it.

If trade occurs between the two countries and 6 bushels of wheat are exchanged for 6 yards of textiles, the United States gains because it receives 6 yards of textiles in exchange for 6 bushels of wheat, whereas before trade, 6 bushels of wheat could only get 4 yards of textiles domestically. Thus, the U.S. gains 2 additional yards of textiles or saves half an hour of labor.

Meanwhile, the United Kingdom also benefits. If it were to produce 6 bushels of wheat domestically, it would require 6 hours of labor, but by allocating those 6 hours to textile production, it produces 18 yards of textiles. After trading 6 yards with the United States, the UK keeps 12 yards of textiles, effectively saving 4 hours of labor.

Ricardo did not take the next step of determining the exact rate of international exchange between the two countries, as he was primarily focused on proving that differences in comparative, rather than absolute, costs were sufficient for international trade to take place⁴².

3- Mercantilist Theory:

The Mercantilist doctrine emerged in the 17th century with the rise of the modern state and national unity in countries such as England, Spain, France, Portugal, Belgium, and the Netherlands. A group of thinkers, known as mercantilists, began writing essays on international trade, advocating for an economic philosophy known as mercantilism.

The core objective of mercantilism was to accumulate precious metals (gold and silver), which were considered the foundation of a nation's wealth and power. These metals could be obtained from two primary sources:

1. **Gold and silver mines**, which were only found in specific countries.
2. **Foreign trade**, which became the main focus of mercantilist policies.

Based on this principle, mercantilists recommended government intervention in economic affairs. They encouraged exports and restricted imports, particularly luxury goods, to create a trade surplus and attract gold and silver into the country.

Since all nations could not simultaneously maintain a trade surplus—given that the total amount of gold and silver was fixed at any given time—mercantilism led to the idea that some nations gained wealth at the expense of others. This reflected the nationalist nature of mercantilism, emphasizing the importance of state support in economic matters.

Thus, mercantilists measured a nation's wealth by the amount of gold and silver it possessed, whereas in the modern era, we measure national wealth by the availability of goods and services that satisfy human needs.

Mercantilism remained dominant until the emergence of the Physiocrats, who advocated for economic freedom based on natural laws, promoting the well-known principle: "Laissez-faire, laissez-passer" (Let it work, let it pass).

⁴² Sami Khalil, *International Economics*, previously cited reference, pp. 104–106.

This shift encouraged individuals and businesses to engage in economic activities without state restrictions, leading to the rise of classical economic thought, championed by Adam Smith, David Ricardo, and John Stuart Mill. These economists criticized all forms of protectionism, government intervention, and trade restrictions⁴³.

2. The Modern Neoclassical Theory of International Trade

From our study of specialization and international trade, we observe that classical theory primarily analyzed the phenomenon by emphasizing that differences in natural relative costs lead to international trade, whereas equal costs result in no trade.

However, this classical analysis—developed under Ricardo's comparative cost theory and Haberler's opportunity cost theory—remains a simplified interpretation of the law of relative costs in its natural aspect. It does not delve into the factors responsible for these cost differences.

In general, it can be said that this result reflects the shortcomings of the analysis we have presented so far regarding the classical theory of international trade and its inability to encompass both natural and acquired sources of differences in relative costs. This refers to variations in the quantitative availability of factors of production, meaning differences in the relative abundance of production factors. As for the acquired sources of differences in relative costs, they relate to the following phenomena⁴⁴:

- The relative abundance or scarcity of human capital, also known as skilled labor.
- Economies of scale, both internal and external, which are linked to the analysis of increasing returns that arise when the scale of a firm changes. The key characteristic here is not the change in the proportion of production factor quantities, as observed in the analysis of natural sources of differences in relative costs, but rather the increase in the quantities of production factors used in a firm due to its higher production efficiency. This results from the firm's expansion and its ability to benefit from large-scale production.
- Technology and the innovations it generates, which allow some countries to acquire a temporary comparative advantage. They retain this advantage for a limited period until the underlying factors disappear, thereby facilitating international trade in technology-intensive goods, commonly known as product-cycle goods.

Given this distinction between natural and acquired sources of differences in relative costs, a corresponding differentiation emerged between natural comparative advantages and acquired comparative advantages. Within this framework, it is essential to distinguish between:

- The law of natural relative costs, formulated by Ricardo in his theory of relative costs, which was later reformulated by Haberler in his theory of opportunity cost or alternative

⁴³ Ali Abdel Fattah Abu Sharar, *International Economics*, Dar Al-Maseera, 1st edition, 2015, pp. 33–34.

⁴⁴ Sami Afifi Hatem, *Foreign Trade Between Theory and Regulation*, The Egyptian Lebanese House, 2nd edition, 1993, Cairo, pp. 135–136.

cost.

- The law of acquired relative costs, which was developed in light of new theoretical approaches that sought to refine classical international trade theory. These approaches aimed to identify new sources of differences in relative costs beyond those emphasized by the Heckscher-Ohlin model of international trade—sources that we have termed "acquired sources of differences in relative costs."

As a result, if we attempt to define classical international trade theory, we can say that it is the theory that takes the law of natural relative costs as the basis for explaining trade patterns and conditions, as well as for determining the gains derived from international trade, which benefit the countries engaged in global exchange. Within this theory, the following contributions were made to refine and formulate this law:

- The theoretical contribution of Ricardo's theory of relative costs, which relied on the criterion of geographical variation to define the concept of relative cost for internationally traded goods.
- The theoretical contribution of John Stuart Mill's theory of international values, which aimed to fill the gap in Ricardo's analysis of the law of natural relative costs. This contribution consisted of precisely determining the international equilibrium rate, rather than presenting an entire range—Ricardo's range—where all points within it represented possible or potential international equilibrium rates after the establishment of international trade⁴⁵.
- The theoretical contribution of the marginalist school in international trade, led by the renowned economist Haberler. This contribution took the form of a reformulation of the law of relative costs in its Ricardian sense, offering a clearer definition by using the criterion of commodity variation to determine the concept of relative cost for internationally traded goods. This approach led to the development of the opportunity cost theory, which replaced the labor theory of value as a method for determining the values of internationally traded goods.
- The theoretical contribution of the Heckscher-Ohlin model, which focused on factor proportions in determining the sources of differences in relative costs. This contribution deepened the classical analysis of relative costs, moving beyond the simplified formulations of previous theories. Although this model primarily addressed the phenomenon of relative differences—considered a natural rather than an acquired factor—it explained the relative abundance or scarcity of production factors as a natural source of comparative advantage between countries in the context of international trade. Consequently, this theory is classified among the neoclassical theories of international trade.

⁴⁵ Sami Afifi Hatem, *Foreign Trade Between Theory and Regulation*, The Egyptian Lebanese House, 2nd edition, 1993, Cairo, pp. 135–136.

Thus, the Heckscher-Ohlin theory of factor endowments is regarded as an attempt to provide a modern interpretation of a well-established classical concept: the natural differences in relative costs. This interpretation had not been deeply analyzed by classical economists before Eli Heckscher and Bertil Ohlin.

Based on this analysis, a clear definition of the Heckscher-Ohlin model in international trade can be established: it is an attempt to provide a modern interpretation of a classical concept, explaining the phenomenon of differences in relative costs for internationally traded goods through natural sources—specifically, the relative differences in the abundance or scarcity of production factors.

From this, it is also evident that this theoretical model provides a limited analysis of the sources of differences in relative costs, as it ignores—due to the assumptions it is based on—all acquired sources of variation in relative costs. This means that the Heckscher-Ohlin theory offers an analysis of the natural aspect of the law of relative costs, relying on the relative abundance or scarcity of production factors while leaving the acquired aspect of this law—i.e., the law of acquired relative costs—to be addressed by other theoretical contributions. These contributions have emerged from various theoretical approaches that sought to refine this theory by adapting its assumptions to make them more logical, closer to practical reality, and more consistent with the realities of the global economy⁴⁶.

1- The Factor Price Equalization Theory (Samuelson):

This theory is closely linked to the Heckscher-Ohlin theory. The Heckscher-Ohlin model contains certain price relationships between factors of production. In 1917, Heckscher pointed out that the equalization of absolute factor prices was one of the key consequences of trade, which could not be denied.

On the other hand, in 1933, Ohlin emphasized the impact of free trade on income distribution among nations. He argued that trade would lead to a tendency toward the equalization of relative factor prices among participating countries with similar production technologies.

In 1948, Samuelson developed what economists later called the Heckscher-Ohlin-Samuelson Theory of factor price equalization. According to this theory, which is based on the idea of factor abundance, international trade leads to the equalization of both relative and absolute prices of homogeneous production factors between countries.

Samuelson demonstrated this using the two-country, two-commodity, two-factor model, under the assumption that there is no factor intensity reversal. This implies that international trade plays the same role as would be expected if the free movement of production factors between countries were allowed. Additionally, it contributes to the redistribution of income within individual countries.

⁴⁶ Sami Afifi Hatem, *Foreign Trade Between Theory and Regulation*, The Egyptian Lebanese House, 2nd edition, 1993, Cairo, pp. 138–139.

This theory has sparked numerous questions, some of which can be addressed when discussing international trade and economic welfare. For instance, if trade leads to lower wages for workers in labor-scarce countries, why don't labor unions oppose trade liberalization? Moreover, if international trade affects income distribution, does this theory suggest that trade can achieve the optimal distribution of income across nations?

And will free trade lead to the equalization of per capita income across all countries?⁴⁷

2- Rybczynski's Theory:

Presented in 1955, Rybczynski's theory examines the impact of an increase in the supply of production factors. It is analyzed within the framework of comparative static analysis and considers a single country producing two goods using two factors of production. The country has not yet reached full specialization in either of the two goods. If the prices of these goods remain constant and production factors can move freely between industries, the theory demonstrates that an increase in the supply of one production factor will lead to an increase in the output of the good that intensively uses the factor whose supply has increased. At the same time, the output of the other good, which relies heavily on the second production factor whose supply remains unchanged, will decrease.

Rybczynski arrived at the following conclusion:

The rate of increase in the production of the first good will be greater than the rate of increase in the supply of the production factor, despite assuming constant returns to scale and unchanged production techniques. The reasons for this outcome are as follows:

1. The assumption of constant prices for the two goods necessarily implies stable factor prices.
2. Factor prices can only remain constant if their productivity in producing both goods remains unchanged.
3. The productivity of each factor of production can only remain constant if the ratio of the other factor used in both industries remains fixed.

Thus, the only way to absorb the increase in the supply of one production factor is by shifting resources from the other factor in the second industry, maintaining a stable input ratio in both sectors. This shift leads to a decline in output in the second industry.

It is worth noting that this theory is closely linked to the Heckscher-Ohlin model, as it fundamentally acknowledges the concept of factor abundance and the principle of comparative advantage. Some economists have managed to generalize this theory to apply to a scenario involving two countries, two goods, and two production factors.⁴⁸

3- John Hicks' Theory:

⁴⁷ Chikri Nouri Moussa et al., *International Finance*, Dar Al-Maseera, 2nd edition, 2015, pp. 103–104.

⁴⁸ Chikri Nouri Moussa et al., *International Finance*, previously cited reference, pp. 105–106.

In 1953, John Hicks studied the impact of technological progress on international trade. He examined a scenario involving two countries, where the economy of the first country is growing while the second remains stagnant. Hicks concluded that technological progress in a developing economy could harm its terms of trade, particularly if the progress occurs in its export industries. Conversely, technological progress could improve a country's terms of trade if it benefits import-competing industries.

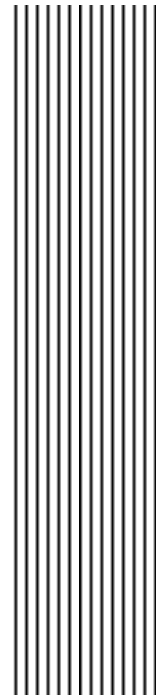
Hicks distinguished between three types of technological progress:

1. Capital-using technological progress
2. Labor-using technological progress
3. Neutral technological progress

Hicks introduced a restrictive assumption that ensures the ratio of production factor combinations remains unchanged before and after technological change, making technological progress neutral according to the previously mentioned criteria. Based on this assumption, Hicks arrived at the following conclusion:

*"If technological progress is specific to one of the two produced goods while their relative prices remain constant, the absolute output of the other good must decrease."*⁴⁹

⁴⁹ Chikri Nouri Moussa et al., International Finance, previously cited reference, pp. 106–107.



1. The Concept of Economic Policy

The term policy⁵⁰ in Arabic derives from the verb *sasasa-yasusu* and has various meanings, all revolving around managing and regulating affairs in an optimal manner.

⁵⁰ El-Sayed Atiya Abdel Wahid, *The Role of Fiscal Policy in Achieving Economic Development (Normal Income Distribution in Economic Development, Inflation Control)*, Dar Al-Nahda Al-Arabiya, no edition mentioned, Cairo, 1993, pp. 15–16.

As the state's role in economic activity expands to address economic instability, it becomes necessary for the government to possess a set of economic instruments that influence both internal and external economic balances. These instruments aim to achieve a range of economic objectives.

1- Definitions of Economic Policy

Economic policy generally refers to all decisions related to choosing among various means available to a society to achieve specific economic and social objectives, as well as the search for the best methods to reach these goals⁵¹. Some define it as:

*"A set of government measures that shape the economic environment within which economic units operate."*⁵²

Others describe it as:

*"A collection of economic tools, objectives, and the interrelationships between them."*⁵³

The state is responsible for formulating and implementing economic policy. It is also defined as a set of directives guiding all public actions that have economic implications, such as government spending policy and monetary policy. Economic policy represents the general actions of public authorities in the economic domain, including production, trade, consumption, and capital formation⁵⁴.

Economic policy aims to achieve short-term and long-term economic objectives. Based on these definitions, economic policy consists of measures and procedures undertaken by the state to achieve economic and social goals. Therefore, the economic policy adopted by a state must efficiently utilize available resources to maximize outcomes—meaning achieving the greatest objectives with the least resources⁵⁵.

However, this efficiency depends on two key factors⁵⁶:

- **Ensuring the state's financial balance** by coordinating public revenue and government expenditures.
- **Increasing domestic savings** to boost investment levels⁵⁷.

⁵¹ Deraoussi Massoud, Fiscal Policy and Its Role in Achieving Economic Balance: The Case of Algeria (1990–2004), unpublished doctoral dissertation, Department of Economic Sciences, University of Algiers, Class of 2005, p. 43.

⁵² Ne'mat Allah Najib et al., Introduction to Economics, Al-Dar Al-Jami'iyya, no edition mentioned, Beirut, 1990, p. 141.

⁵³ Reda Al-Adl, Macroeconomic Analysis, Ain Shams Library, no edition mentioned, Egypt, 1996, p. 325.

⁵⁴ Abdelmadjid Kadi, Introduction to Macroeconomic Policies: An Analytical and Evaluative Study, University Publications Office, no edition mentioned, Algeria, 2006, pp. 13–14.

⁵⁵ Jaque Muller, Economie: Manuel d'application, Édition Dound, Paris, 2002, p. 188

⁵⁶ Ne'mat Allah Najib et al., Introduction to Economics, previously cited reference, p. 441.

⁵⁷ Deraoussi Massoud, Fiscal Policy and Its Role in Achieving Economic Balance: The Case of Algeria (1990–2004), previously cited reference, p. 43.

In the long run, economic policy seeks to achieve several key goals, including national solidarity, social justice, reducing inequality, and improving citizens' living standards.

It is important to distinguish between goals and objectives in economic policy. Objectives serve as intermediate steps toward achieving broader goals, while tools are the means used to reach these objectives. Additionally, a country's economic policy can be understood as the combination of its economic goals, instruments, and their interrelationships over a specified timeframe⁵⁸.

Objectives + Tools + Time (4)

2. Types of Economic Policy:

Economic policy can be classified into several types based on the timeframe. There is conjunctural economic policy and structural economic policy. The conjunctural policy aims to restore short-term macroeconomic and financial balances, while structural policies seek to change the structure and composition of the economy in the long term. Generally, the main differences between these two types of economic policy can be summarized in the following table:

Table No. (1.06)

Comparison between Conjunctural and Structural Economic Policy

	Structural Policy	Conjunctural Policy
Duration	Long-term	Short-term
Objective	Adapting structures	Restoring macroeconomic balances
Effects	Qualitative	Quantitative

Source: Jaque Muller, *Economie Manuel d'application*, Édition Dound, Paris, 2002, p. 188.

2.1 Conjunctural Economic Policy:

As mentioned earlier, this policy aims to restore macroeconomic balances in the short term. There are several conjunctural policies that authorities use to achieve this goal, including:

2.1.1. Stabilization Policy:

This policy aims to curb economic activity and, consequently, control price and wage levels by implementing contractionary fiscal and monetary policies. Stabilization policies focus on

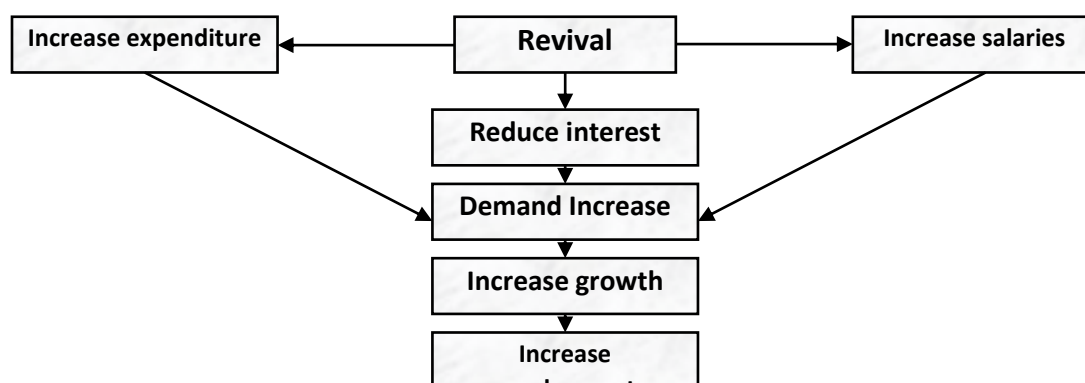
⁵⁸ Walid Abdelhamid Aayeb, *The Macroeconomic Effects of Government Spending Policy (An Applied Study of Economic Development Models)*, Hassan Al-Asriya Library, 1st edition, Beirut, Lebanon, 2010, pp. 74–75.

combating and reducing inflation. In a broader sense, they refer to a set of measures designed to maintain the economic system in its normal state by reducing social pressures⁵⁹.

2.1.2 Expansionary Policy:

This policy aims to stimulate economic activity by increasing production and employment. It is inspired by Keynesian thought (*). In some cases, the state distinguishes between stimulus through consumption and stimulus through investment. The following diagram illustrates this concept:

Figure (1-03): Illustrative Diagram of Expansionary Policy



Source: Walid Abdelhamid Ayeb, *The Macroeconomic Effects of Government Spending Policy (An Empirical Study of Economic Development Models)*, Hassan Al-Asriya Library, 1st Edition, Beirut, Lebanon, 2010, p. 79.

2.1.3 Contractionary Policy:

This policy aims to curb rising prices through traditional measures such as mandatory deductions, wage freezes, and money supply control. It results in a reduction of economic activity⁶⁰.

Figure (1-04): Illustrative Diagram of Contractionary Policy

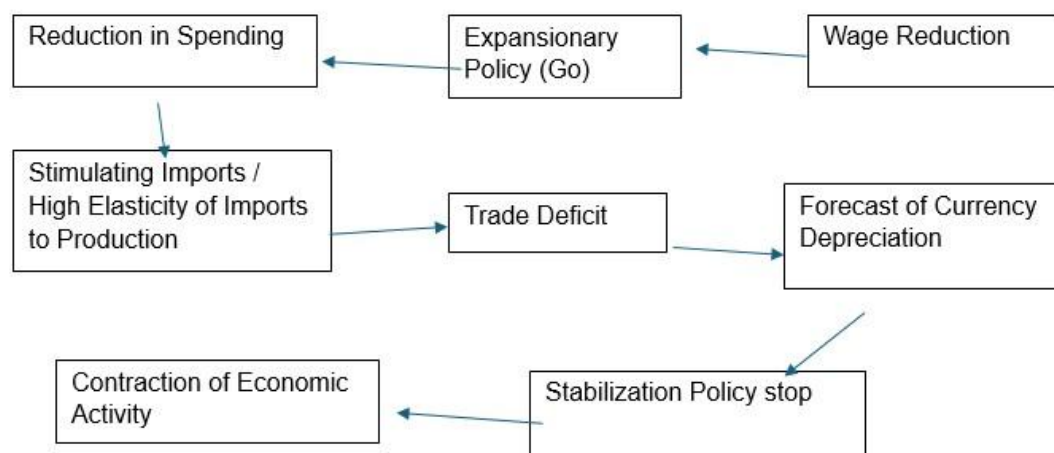
⁵⁹ Abdelmadjid Kadi, Introduction to Macroeconomic Policies, previously cited reference, p. 31.

* By Keynesian analysis, we refer to the contributions of John Maynard Keynes (1883–1946), the author of *The General Theory of Employment, Interest, and Money* (1936), along with a group of economists who were either his contemporaries or came after him. These economists based their analyses and interpretations of economic variables on Keynes' theories, thereby forming what became known as the Keynesian School. Among the most notable figures in this school are: R.F. Kahin, E.A.G. Robinson, P. Sraffa, C.H.P. Gifford, A.F.W. Plumptre, A. Hansen, J.E. Meade, P. Samuelson, and J. Hicks.

⁶⁰ Walid Abdelhamid Ayeb, *The Macroeconomic Effects of Government Spending Policy (An Empirical Study of Economic Development Models)*, Hassan Al-Asriya Library, 1st Edition, Beirut, Lebanon, 2010, pp. 33, 70.

Figure (03)

Illustrative Diagram of the Stop-Go Policy



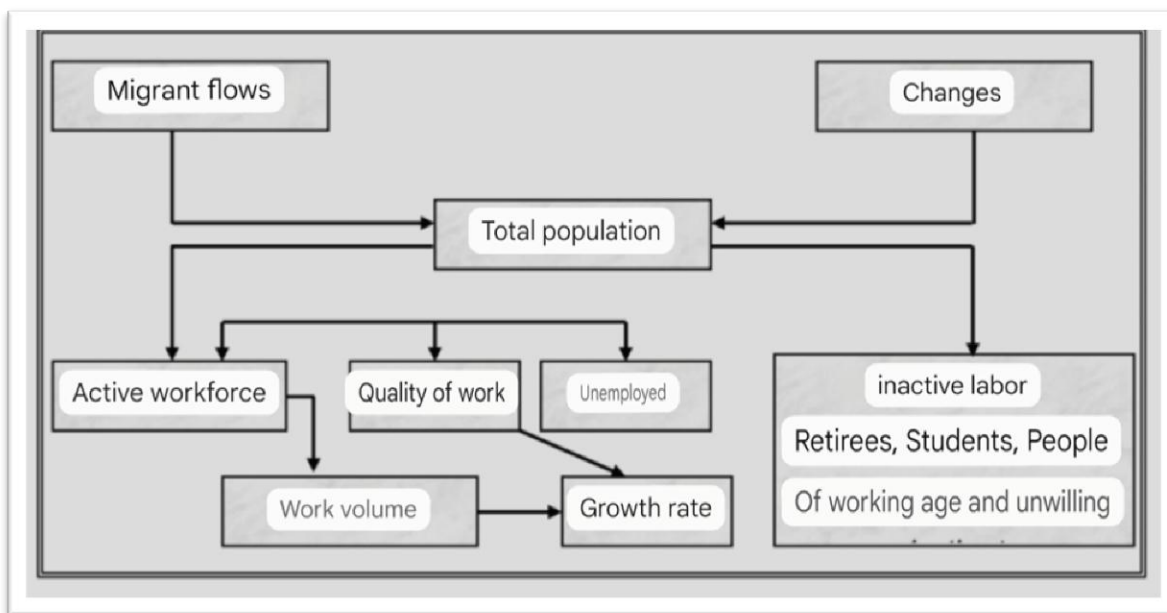
Source: Walid Abdelhamid Ayeb, *The Macroeconomic Effects of Government Spending Policy (An Empirical Study of Economic Development Models)*, Hassan Al-Asriya Library, 1st Edition, Beirut, Lebanon, 2010, p. 79.

2.1.4. Stop-and-Go Policy:

This policy was adopted in the United Kingdom and is characterized by the sequential alternation between expansionary and contractionary policies based on a classical mechanism. The following diagram illustrates this process⁶¹:

Figure (1-05): Illustrative Diagram of the Stop-and-Go Policy

⁶¹ Walid Abdelhamid Ayeb, *The Macroeconomic Effects of Government Spending Policy*, previously cited reference, p. 70.



Source: Walid Abdelhamid Ayeb, *The Macroeconomic Effects of Government Spending Policy (An Empirical Study of Economic Development Models)*, Hassan Al-Asriya Library, 1st Edition, Beirut, Lebanon, 2010, p. 33.

2.2. Structural Economic Policy:

Structural economic policy aims to adapt the national economy to changes in the international environment. It affects all economic sectors. State intervention can be preemptive, by structuring market mechanisms, promoting privatization, and upholding competition law. Alternatively, state intervention can be reactive, through supporting research and development and fostering training initiatives. These are the main pillars of economic policy in developed countries.

In contrast, developing countries, most of which have entered into economic reform programs with international financial and monetary institutions, have structured their economic policy into stabilization policies and structural adjustment policies, as previously mentioned. It is observed that these policies often conflict with stimulation policies, which rely on extensive state intervention in economic activity and increased government spending⁶².

3. Objectives of Economic Policy

⁶² Abdallah Ballounas, *The Algerian Economist, Transition from Planning to Market and the Achievement of Economic Policy Objectives*, previously cited reference, p. 205.

The objectives of economic policy are flexible, with the ultimate goal of achieving general welfare. However, these objectives are commonly summarized into four key goals, known as Kaldor's Magic Square (*), which include:

- Achieving a high economic growth rate;
- Combating unemployment and ensuring job creation;
- Achieving external balance;
- Fighting inflation.

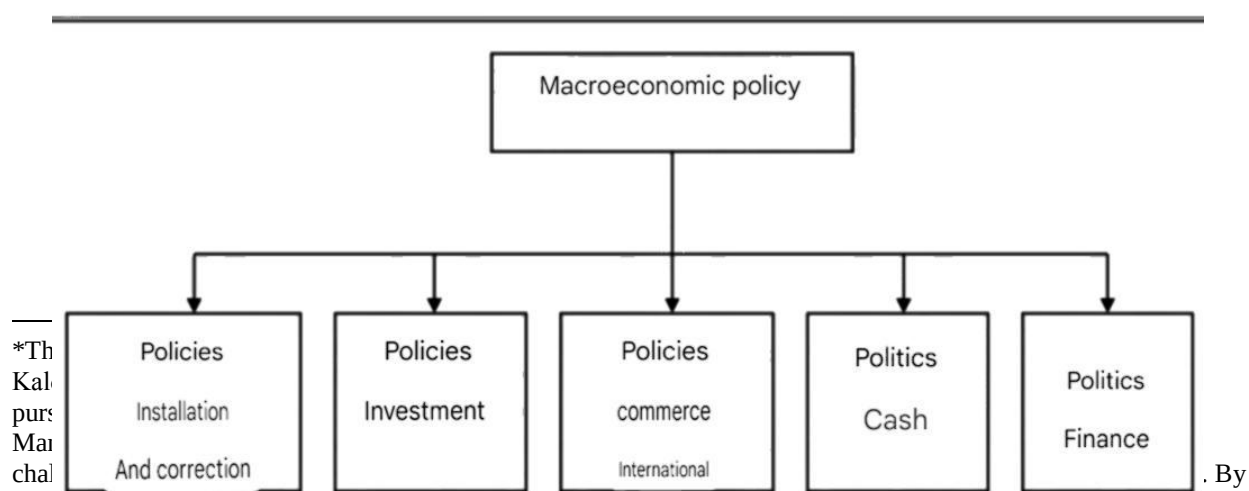
4. Economic Policy Instruments

Economic policy instruments refer to the means that, while not objectives in themselves, are used to achieve the ultimate goals of economic policy. These instruments must be clearly defined to help all economic agents make more efficient decisions.

Macroeconomic policy instruments generally involve both quantitative and qualitative measures, which must remain flexible enough to adapt to future changes. Moreover, economic policy is based on a set of principles and considerations, including the necessity of balancing the number of policy objectives with the available instruments. Policymakers must also address conflicts between objectives whenever possible. One way to manage this conflict is to increase the number of economic policy instruments simultaneously⁶³.

The structure of economic policy encompasses all its components, forming a comprehensive package of economic policies aimed at achieving the final objectives of economic policy. This is illustrated in the following diagram:

Figure (1.06) Illustrates the Structure of Economic Policy



*The
Kaldor's
Magic
Square

. By adopting an economic policy aligned with their interests and future priorities, these countries aim to achieve general welfare in the long run. / Researcher

⁶³ Abdelmutalib Abdelhamid, Economic Policies (Macroeconomic Analysis at the National Level), previously cited reference, pp. 222, 227.

Source: Abdelhamid Abdelmutalib, *Economic Policies: Micro and Macro Analysis*, Zahraa Al-Sharq, no edition, Cairo, 2007, p. 229.

The available economic policy instruments can be divided into two main categories:

- Monetary policy instruments
- Fiscal policy instruments

It is worth noting that, in its broad sense, economic policy encompasses all the rules and regulations governing public authorities when intervening in economic affairs. However, in its narrow sense, it specifically includes fiscal policy and monetary policy, which directly regulate key national economic variables⁶⁴.

1. Fiscal Policy

Fiscal policy holds a significant position among other economic policies, as it plays a crucial role in achieving the multiple objectives sought by the national economy. Due to its diverse functions, fiscal policy is considered one of the most essential tools of economic management, contributing to economic development and addressing obstacles to economic stability in both developed and developing countries. Through this policy (alongside other policies), a country can achieve its economic goals, such as growth, stability, and employment.

Thus, we aim to explore the nature of fiscal policy and its instruments.

1.1 Definition of Fiscal Policy

The term fiscal policy originates from the French word "Fisc", meaning treasury or public purse (*). Financial thought presents various definitions of fiscal policy. Some define it as:

- "A set of policies related to public revenues and government spending aimed at achieving specific objectives."
- Others define it as "The use of public finance tools, including government spending programs and public revenues, to influence macroeconomic variables."⁶⁵

Fiscal policy consists of measures through which public finances are managed, enhancing the positive effects of public spending. It encompasses all financial mechanisms through which the

⁶⁴ Ahmed Jami', *Macroeconomic Analysis*, University Culture House, no edition, Cairo, 1990, p. 241.

⁶⁵ Tariq Al-Haj, *Public Finance*, Al-Safa Publishing and Distribution, no edition, Amman, 1999, p. 201.

government intervenes to influence aggregate demand, national employment levels, and national income⁶⁶.

From these definitions, it is evident that fiscal policy serves as the primary tool for state intervention in economic activities, aiming to achieve economic, social, and political objectives. In other words, fiscal policy refers to the measures implemented by the government to ensure overall financial balance, using financial instruments to influence macroeconomic variables and achieve the state's economic policy objectives⁶⁷.

1.2 Fiscal Policy Instruments

The state can intervene in economic activities and directly influence economic variables, extending its impact to determinants of overall equilibrium through fiscal policy.

It is important to note that fiscal policy primarily concerns the measures and capabilities used by financial authorities to regulate public finance activities. It also includes tools that enable government intervention in economic activities and define the extent of its impact on all economic variables.

From the above discussion, it is clear that fiscal policy involves the government's use of taxation, public spending, and the national budget to achieve economic stability and social justice. These objectives are pursued within the broader framework of economic and social development goals.

From this, two key points emerge⁶⁸:

1. There are three main fiscal policy instruments:
 - Public expenditure
 - Public revenues
 - The national budget

These instruments are utilized as follows:

- Increasing or decreasing taxes;
- Increasing or decreasing public spending;
- Creating a surplus or deficit in the state's general budget.

b. The Primary Financial Objective

The primary financial objective is to achieve economic stability, meaning combating inflation and recession. Since public expenditures, public revenues, and the general budget are the three

⁶⁶ Mohammed Hussein Al-Wadi, Public Finance, Al-Maysarah Publishing, no edition, Amman, 2000, p. 182

⁶⁷ Ali Kanaan, Monetary Economics and Fiscal and Monetary Policies, Al-Hussein Publications, 1st edition, Syria, 1997, p. 19.

⁶⁸ Abdelmajid Qadi, Introduction to Macroeconomic Policies, previously cited reference, p. 179.

main elements of the state's economic and financial activities, they simultaneously serve as the primary tools for formulating and implementing the state's financial policy.

1-2-1. Public Expenditures

Public expenditures reflect the role and evolution of the state. As the state's role has developed from a watchdog state to an interventionist state and then to a productive state, public expenditures have expanded in volume, diversified in types, and become a key tool of financial and economic policy.

With the shift in public policy from neutral financial policy to an active financial policy, the study of public expenditures has evolved and gained prominence in financial theory⁶⁹.

The study of public expenditures aims to understand their economic and social impact on citizens' lives and to use this impact as a guideline for establishing key rules that govern public spending policies in a way that achieves the state's economic policy objectives.

a. The Concept of Public Expenditures (Government Spending)

Public expenditure can be defined as an amount of money disbursed from the state's financial resources to meet a public need⁷⁰.

Government spending can also be used as a criterion to measure the extent of the state's involvement in economic activity⁷¹.

From this definition, public expenditure consists of three elements, which form its essential pillars:

1. **Monetary nature** – Public expenditure involves a financial outlay.
2. **Public entity involvement** – It originates from the state or another public body.
3. **Public benefit objective** – It aims to achieve a general benefit⁷².

Now, let us discuss these three elements (pillars) of public expenditure to further clarify its concept.

b. Public Expenditure as a Monetary Amount

The state spends monetary amounts to acquire the goods and services necessary for its activities. This includes all state expenditures, whether for obtaining goods and services needed for the operation of public facilities, purchasing capital goods required for productive operations, or

⁶⁹ **Souzy Adly Nashed**, *Public Finance: Public Expenditures, Public Revenues, General Budget*, Halabi Publications, no edition, Lebanon, 2006, p. 26.

⁷⁰ Mohamed Baher Atlam, *Public Finance and Its Technical Tools and Economic Effects*, Al-Adab Library, no edition, Egypt, 1998, p. 71.

⁷¹ Abdelmadjid Kadi, *Introduction to Macroeconomic Policies*, previously cited reference, p. 179.

⁷² Souzy Adly Nashed, *Public Finance: Public Expenditures, Public Revenues, General Budget*, previously cited reference, p. 27.

providing subsidies and financial aid in various forms. These expenditures must take a monetary form to be classified as public expenditures.

Based on this principle, non-monetary means used by the state to obtain its necessities—such as forced labor and requisitioning (*), or paying a minimal amount while granting certain in-kind benefits, like providing free housing to some of its employees in state-owned buildings—do not fall under public expenditures.

Requiring public expenditures to take a monetary form has resulted from several factors throughout economic development, the most important of which are:

- The transition to a monetary economy, where money has become the sole medium of transactions, replacing the barter system.
- The spread of democratic ideas and the state's abandonment of coercive measures (such as forced labor and compulsory requisitioning).
- The pursuit of social justice by redistributing income among society members.
- Facilitating oversight of expenditures to ensure they fulfill their designated objectives, as monitoring non-monetary expenditures is significantly more challenging.

c. Expenditures Issued by the State or One of Its Organizations

For an expenditure to be considered public, it must originate from a public entity—whether the state itself or one of its organizations. Public expenditures include those undertaken by legal public entities, such as the state, national public bodies, and public institutions. Public projects also fall under this category, even if they operate under commercial management and aim for profitability. Despite their commercial approach, these entities remain part of the state's institutional framework, engaging in specific activities to achieve economic and social objectives.

Thus, the sole entity responsible for public expenditure is the state, which carries out spending through its various agencies in accordance with the laws in force and those approved by parliament⁷³.

d. The Purpose of Public Expenditure: Achieving Public Benefit

Public expenditures must aim to satisfy public needs and, consequently, serve the public interest. Expenditures that seek to fulfill private needs or generate individual benefits do not qualify as public expenditures⁷⁴.

The justification for this condition is based on two reasons:

⁷³ Maurice Duverger, *Finances publiques*, P.U.F, Paris, 1971, pp. 34-39.

⁷⁴ Souzy Adly Nashed, *The Essentials of Public Finance*, New University Publishing House, no edition, Alexandria, 2000, p. 33.

- The sole justification for public expenditures is the existence of public needs that the state or public institutions and organizations seek to fulfill in order to achieve the public benefit.
- If an expenditure is aimed at private benefit, it no longer qualifies as public expenditure, as it contradicts the principles of equality and justice in sharing public burdens, such as taxes. Since all individuals equally share the burden of public expenses, they must also equally benefit from the state's public expenditures⁷⁵.

Public expenditures are classified according to the following criteria:

- Based on their impact on national income, i.e., purchasing power (**real expenditures and transfer expenditures**).
- Based on their recurrence and periodicity (**ordinary and extraordinary expenditures**).
- Based on their functional classification (**according to the functions of the state**)⁷⁶.

1-2-2. Public Revenues

For the state to undertake public expenditures, it must have the necessary resources. These financial means constitute the state's income and are referred to as public revenues.

To perform its functions, the state must utilize some of the human and non-human resources available within society. This involves reallocating a portion of resources so that individuals do not exclusively use them, as well as deducting part of the purchasing power from individuals. Additionally, the state can create new purchasing power, as the issuance of money is an exclusive authority of the government.

From the above, it is clear that the state obtains public revenue through the processes of transferring and creating purchasing power, whether domestically or internationally. While public revenue varies in terms of its source and form, it can generally be categorized based on the element of compulsion involved in obtaining it⁷⁷.

In any case, public revenues can be classified into three main types:

- Economic revenues
- Sovereign revenues
- Credit revenues

Accordingly, we will explore the topic of public revenues in the following points.

⁷⁵ Souzy Adly Nashed, *Same reference*, p. 27.

⁷⁶ Rifaat El-Mahgoub, *Public Finance*, Al-Nahda Al-Arabiya Library, Cairo, 1990, p. 92.

⁷⁷ Ibrahim Ali Abdullah, Anwar Al-Ajarma, *Principles of Public Finance*, Al-Safaa Printing House, no edition, Amman, 2000, pp. 120, 124.

- Economic revenues (State properties)
- Sovereign revenues (Taxes and fees)
- Credit revenues (Public loans)

a. Economic Revenues

These are revenues that the state earns in its capacity as a legal entity owning wealth and providing public services. Such revenues include income from leasing state-owned properties, interest from loans, and profits from public enterprises. In this context, state revenues from its assets can be categorized into two main types: the public domain and public pricing.

b. Sovereign Revenues

These are revenues that the state collects compulsorily from individuals by virtue of its sovereign authority. They include taxes, fees, financial penalties imposed by courts and allocated to the state treasury, and compensations paid to the state for damages suffered, whether domestically or from another country. Additionally, sovereign revenues include compulsory loans that the state is obliged to repay in the future, whether interest-bearing or not, as well as betterment levies⁷⁸.

c. Credit Revenues (Loans)⁷⁹

In many cases, the state may need to spend large amounts on public expenditures that cannot be covered by regular, periodic revenues. In such situations, the state resorts to borrowing the necessary funds. This enables the state to secure the required financial resources without depleting the revenues of the fiscal year in which the expenditures occur.

The state turns to this type of revenue in two cases:

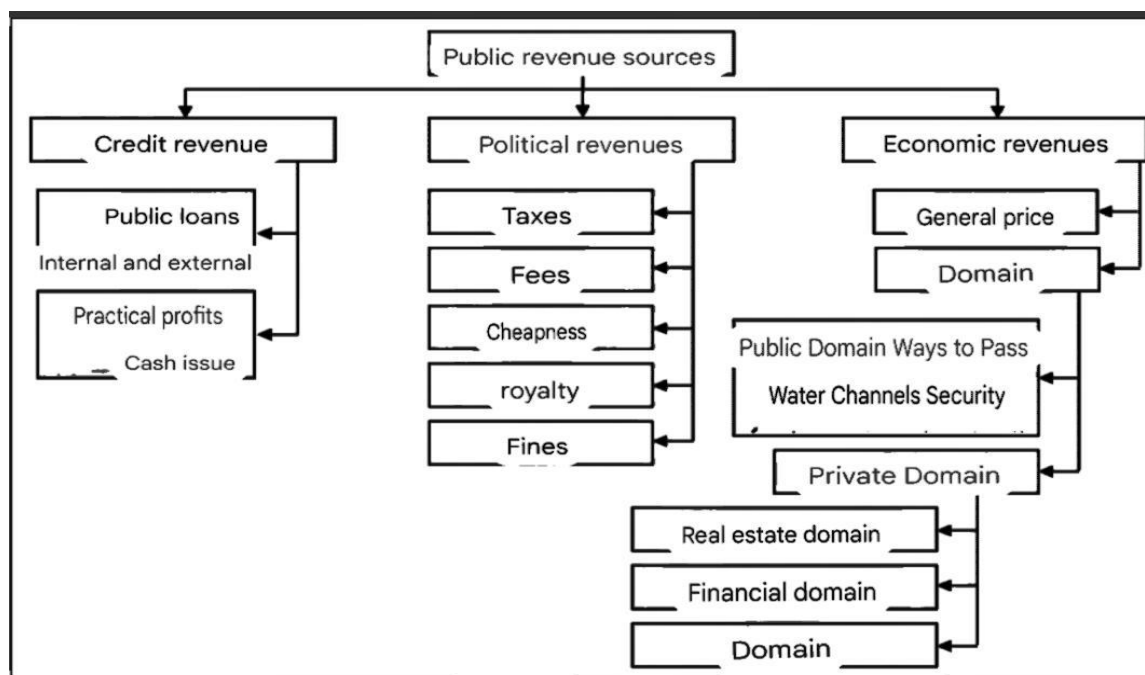
1. When taxation has reached its maximum limit, meaning that tax rates have hit their peak.
2. When taxation provokes strong resistance from taxpayers, making further tax increases politically or economically unfeasible.

The overall structure of public revenues can be summarized in the following diagram:

**Figure (1.07):
Illustrating the Sources of Public Revenues.**

⁷⁸ Zeinab Hassan Awadallah, *Principles of Public Finance*, University Publishing House, no edition, Beirut, 1994, p. 95.

⁷⁹ Mohamed Abdel Moneim Afer, Ahmed Farid Mostafa, *Islamic and Conventional Financial Economics: Theory and Application*, previously cited reference, pp. 262, 272



Source: Draoussi Massoud, *Fiscal Policy and Its Role in Achieving Economic Balance: The Case of Algeria (1990-2004)*, Unpublished Doctoral Thesis, Department of Economic Sciences, University of Algiers, Class of 2005, p. 194.

It can be said that the state, by utilizing any of the aforementioned types of revenues, can achieve various and numerous objectives.

1-2-3. The General Budget⁸⁰:

Before addressing the topic of the general budget, it is essential to establish precise terminology. Misuse of terms can lead to misunderstandings. Therefore, we must use the term "budget" in its proper sense, meaning "*Budget*", rather than "balance sheet", which corresponds to "*Bilan*".

While some scholars in financial sciences use the term "State Balance Sheet" instead of "State Budget", this imprecise usage can cause confusion. It mistakenly equates the future financial outlook of the public sector (budget) with the past financial statements of the private sector (balance sheet).

After briefly discussing the tools of fiscal policy, namely public expenditures and revenues, it is natural to move on to studying the general budget of the state, as it represents the framework where public expenditures are matched with public revenues.

The French law, specifically the French decree issued on June 19, 1956, defines the budget as:

⁸⁰ Fawzi Atoui, *Public Finance (Tax Systems and State Budget)*, Halabi Legal Publications, no edition, Lebanon, 2003, p. 320.

"The statutory framework through which the state's expenditures and revenues are estimated, authorized, and approved by the parliament in the budget law, which reflects the government's economic and financial objectives."

The general budget is the fundamental document for analyzing the public finances of any country. It outlines public expenditure items and how the state's resources are distributed across various services provided to its citizens. Additionally, it illustrates how the state generates different public revenues to finance these expenditures⁸¹.

The budget is an estimated statement of the state's expenditures and revenues for a future period, usually one year. It requires approval from the legislative authority and serves as a key tool of fiscal policy aimed at achieving the government's economic and social objectives⁸².

Thus, the general state budget is essentially a financial plan on which decisions regarding public expenditures and revenues are based for an upcoming period. In other words, it is a financial program that outlines fiscal policies and objectives the state seeks to achieve.

To summarize, the general budget is a forecast and authorization of the state's expenditures and revenues for an upcoming period, typically a year. Therefore, the state budget relies on two fundamental elements:

1. Estimation
2. Approval

2- Monetary Policy

There are differing perspectives on this subject. Monetarists argue that monetary policy is the most effective tool for achieving macroeconomic stability. According to their view, a controlled growth in the money supply is essential for the growth of national income. However, many believe that fiscal policy also plays a significant role in influencing economic activity.

In either case, there must be coordination between fiscal and monetary policies to ensure overall economic stability.

Monetary policy is one of the most important economic policy instruments used by the state. It focuses on monetary variables to achieve various economic objectives. Therefore, in this section, we will examine the concept of monetary policy, its objectives, and its tools.

2-1. Definitions and Objectives of Monetary Policy

In recent times, the goal of economic policy, which includes a set of policies such as fiscal policy, monetary policy, trade policy, and exchange rate policy, has generally been to achieve

⁸¹ Magdy Mohamed Shehab, *Financial Economics*, New University Publishing House, no edition, Alexandria, Egypt, 1999, p. 261.

⁸² Mahmoud Hussein Al-Wadi, Zakaria Ahmed Azzam, *Public Finance and the Financial System in Islam*, Al-Maysarah Publishing and Distribution, no edition, Amman, 2000, p. 131.

economic balance at the level of full employment without an accompanying rise in the general price level.

Of course, this cannot be achieved without deliberate and stimulative policies. These policies may take the form of fiscal policy, monetary policy, trade policy, or a combination of them.

There is no doubt that fiscal policy primarily affects the production market, with its main tools being government spending and taxation.

On the other hand, monetary policy impacts the money market, and its main tools include the discount rate, legal reserve requirements, and open market operations.

Both monetary and fiscal policies hold significant importance within the framework of economic policy. Given that fiscal policy supports monetary policy, they together form the fundamental pillars of a state's economic policy.

Monetary policy is one of the most important economic policy instruments adopted by the state, as it focuses on monetary variables to achieve various economic objectives. Therefore, in this section, we will examine the concept of monetary policy through its definition, objectives, and tools⁸³.

2-1-1. Definition of Monetary Policy

The concept of monetary policy has been defined in multiple ways, each reflecting the perspective of the economist or researcher regarding economic, monetary, and financial issues, as well as the relationships between them within the broader economic framework.

Despite the differences in definitions, they all agree that monetary policy is closely linked to money, the banking system (especially credit policy), and the part of government fiscal policy related to public debt and the monetary position of the state.

Monetary policy is defined as:

*"The set of programs and measures adopted by monetary authorities to regulate money in society, aiming to achieve desired objectives. In most countries, these measures are carried out by the central bank."*⁸⁴

Additionally, monetary policy can be described as:

*"A set of measures and actions taken by the monetary authority—typically represented by the central bank or the Ministry of Finance—to influence bank credit in order to achieve economic and monetary objectives, primarily economic growth and monetary stability."*⁸⁵

⁸³ Christine Ammer & Dean S. Ammer, *Dictionary of Business and Economy*, Macmillan Publishing, New York, 1977, p. 269.

⁸⁴ For more details on monetary policy, see:

Carle Walsh, *Monetary and Policy*, 3rd edition, Massachusetts Institute of Technology, 2010, pp. 453-509.

⁸⁵ Nazem Mahmoud Nour Al-Shammari, Mohamed Moussa Al-Sharouf, *Economics*, Zahran Publishing, 1st edition, Amman, 2010, p. 353.

Monetary policy refers to "the central bank's actions to increase or decrease the money supply in society by influencing the volume of credit and interest rates, using its tools to impact investment and, consequently, economic activity in the society."⁸⁶

It is also defined as "the guiding framework adopted by monetary authorities." Additionally, it can be described as "the regulation of the money supply in society to achieve the objectives of economic policy."⁸⁷

Monetary policy includes "all monetary decisions and actions, regardless of whether their objectives are monetary or non-monetary, as well as all non-monetary measures aimed at influencing the monetary system."⁸⁸

In essence, monetary policy is the set of policies related to money and the banking system, or those that control the money supply and, consequently, the purchasing power of a country. Thus, monetary policy comprises a set of laws enacted by monetary authorities to ensure the smooth and efficient circulation of money, allowing it to fulfill its economic functions effectively.

Ultimately, monetary policy consists of measures and regulations adopted by the state through the central bank to achieve economic stability and prevent economic crises.

2-1-2. Objectives of Monetary Policy

Monetary policy is a fundamental component of economic policy, as it contributes to achieving the broader objectives of economic policy while also recognizing the significant influence of money on other economic variables.

Monetary policy aims to achieve several objectives across different areas, with the most important being:

- Stabilizing the general price level, ensuring both internal and external monetary stability.⁸⁹
- Promoting economic development, by guiding the strategic and economic policies of the state, as it controls the availability of payment instruments, credit volume, interest rates, and ultimately, investment and its growth.⁹⁰
- Strengthening the independence of the central bank and developing financial and banking institutions.

⁸⁶ Abdel Moneim Radi, *Money and Banking*, Ain Shams Library, no edition, Cairo, 1998, pp. 290-291.

⁸⁷ Ahmed Farid & Sohair Mohamed, *Monetary Policy*, University Youth Encyclopedia, no edition, Alexandria, 2000, pp. 39-40.

⁸⁸ Jamal Ben Daas, *Monetary Policy in Islamic and Conventional Systems (Comparative Study)*, Al-Khaldounia Publishing House, 1st edition, Algeria, 2007, p. 86.

⁸⁹ Moufied Abdel Laoui, *Lectures in Monetary Economics and Monetary Policies*, Mazouar Printing, no edition, El Oued, 2007, p. 63.

⁹⁰ Al-Abadi Abdel Nasser, *Principles of Macroeconomics*, previously cited reference, p. 196.

- By enhancing the position of monetary policy, the authority of monetary institutions is reinforced, allowing for decision-making independently of any other authority. One of the key objectives of monetary authorities is to strengthen the central bank and ensure its independence.
- Balancing the balance of payments—monetary policy addresses any deficits or surpluses that may arise by adjusting interest rates, especially in developing countries where surplus conditions exist.
- Contributing to reducing unemployment—monetary policy works alongside fiscal policy by increasing the money supply during periods of unemployment and economic recession, stimulating effective demand, which in turn boosts investment and employment within the national economy⁹¹.
- Ensuring stability in financial markets by regulating relationships between financial and monetary institutions and encouraging savings and their transformation into productive investments. This is one of the most critical goals of monetary policy, which is implemented by the central bank, as financial markets reflect the real state of economic activity across various sectors.⁹²
- Maintaining stable interest rates without fluctuations to support long-term economic planning.
- It is evident that all these objectives form an integrated framework, offering various options for monetary authorities (the central bank) to achieve their targets.

2-2. Monetary Policy Instruments

The state indirectly intervenes in economic activities through monetary policy measures. One of the most crucial aspects of monetary policy is its ability to control the supply of money in the economy—either by absorbing excess liquidity or by injecting new reserves to support economic transactions.

The central bank implements monetary policy by influencing the volume and nature of banking credit through a set of tools and instruments. These instruments vary based on economic conditions and are legally permitted for use. They allow the central bank to regulate banking activities and influence national economic trends. These instruments are collectively known as monetary policy tools.

Achieving monetary policy objectives requires relying on various tools and instruments, though not all of them can fully achieve every goal. These tools vary from one economy to another, depending on the structure of the banking system and the strength and stability of the economy. The main instruments of monetary control are:

1. Quantitative control tools
2. Qualitative control tools

⁹¹ Abdel Muttalib Abdel Hamid, *Economic Policies at the National Economy Level (Macroeconomic Analysis)*, previously cited reference, p. 97.

⁹² Mohamed Rifaat Taqa et al., *Fundamentals of Economics (Micro and Macro)*, Ithraa Publishing, 2nd edition, Amman, Jordan, 2009, p. 357.

3. Direct control tools

2-2-1. Quantitative Control Tools⁹³:

A. Quantitative Control

Quantitative control refers to the central bank's regulation of the volume of banking credit. The central bank influences credit availability through its monetary policy instruments, which include:

- Discount Rate Policy:

The discount rate is the interest rate charged by the central bank when it refinances commercial paper or provides short-term loans to commercial banks facing liquidity shortages.

Under this policy, the central bank raises the discount rate to restrict commercial banks' ability to expand credit, aiming to curb inflationary pressures. Conversely, by lowering the discount rate, the central bank can stimulate credit expansion.

The central bank employs two approaches to affect bank reserves:

- Setting conditions for the types of financial instruments that it accepts for rediscounting, thereby limiting banks' ability to increase their reserves.
- Adjusting the discount rate to alter borrowing costs for commercial banks, which in turn influences market interest rates and credit volume.

However, many economists question the effectiveness of this tool in achieving both contractionary and expansionary objectives. Milton Friedman, for instance, was one of the strongest critics of using this instrument⁹⁴.

- Open Market Operations (OMO):

Open market operations refer to the central bank's direct intervention in financial markets by buying or selling securities, primarily government bonds with varying maturities.

Additionally, it may trade in foreign currencies or gold in certain situations.

Friedman considered OMO one of the most effective instruments, especially for developed economies, in influencing money supply.⁹⁵

Open market operations are a key tool used by central banks⁹⁶ to regulate credit volume and deposit money creation⁹⁷. By buying or selling securities, the central bank increases or decreases the reserves available to commercial banks, impacting lending capacity. The decision to buy or sell securities depends on the prevailing economic conditions, whether the economy is experiencing recession or inflation⁹⁸.

During inflationary periods, the central bank sells bonds to commercial banks, effectively absorbing part of their loanable reserves—an amount equivalent to what commercial banks pay

⁹³ Nazem Mohamed Nouri Al-Shammari, *Introduction to Economics*, Zahran Publishing and Distribution, no edition, Amman, 2010, p. 355.

⁹⁴ Belazouz Ben Ali, *Lectures on Monetary Theories and Policies*, University Publications Office, 2nd edition, Algeria, 2006, p. 122.

⁹⁵ Jamal Ben Daas, *Monetary Policy in Islamic and Conventional Systems (Comparative Study)*, previously cited reference, p. 174.

⁹⁶ Nazem Mohamed Nour Al-Shammari, Mohamed Moussa Al-Sharouf, previously cited reference, p. 356.

⁹⁷ Belazouz Ben Ali, *Lectures on Monetary Theories and Policies*, previously cited reference, p. 125.

⁹⁸ Belazouz Ben Ali, *Lectures on Monetary Theories and Policies*, previously cited reference, p. 357.

to purchase these financial instruments. This reduces their ability to grant credit, which is precisely what the central bank aims for during inflation.

Conversely, during economic recessions, the central bank repurchases the securities it previously sold to commercial banks. By doing so, it adds to their available reserves, thereby encouraging credit expansion and stimulating economic recovery.

• **Changing the Legal Reserve Requirement:**

This is one of the key monetary policy tools used to regulate credit availability, directly influencing the money supply. The central bank imposes a mandatory reserve ratio on demand and time deposits, which may reach 30%, depending on the economic conditions of a given country.

Commercial banks must hold this reserve in cash at the central bank, earning no interest. Adjusting the reserve requirement directly affects how much of each deposit remains available for lending, thereby influencing liquidity and credit expansion in the national economy.

The central bank utilizes this policy to achieve monetary balance:

- During inflation, it raises the reserve requirement, restricting banks' lending capacity⁹⁹.
- During recession, it lowers the reserve requirement, allowing banks to expand credit issuance¹⁰⁰.

2-2-2. Qualitative (Selective) and Direct Control Tools:

Selective control tools aim to influence economic activity by regulating the type of credit issued by banks based on the priority, importance, and economic condition of various sectors (whether inflationary or deflationary).¹⁰¹

Monetary authorities encourage the flow of financial resources toward strategic economic sectors that struggle with insufficient funding, while restricting the movement of capital to less productive areas, such as consumer-driven sectors and speculative markets.¹⁰²

Some of the most important tools include:

- **Credit Ceilings:** This policy limits the total expansion of financing and ensures it remains within planned levels. A maximum credit ceiling is imposed on commercial banks, and any bank that exceeds this limit must deposit an equivalent amount with the central bank or pay a penalty determined by monetary authorities.

⁹⁹ Mohamed Rifaat Taqa et al., *Fundamentals of Economics (Micro and Macro)*, previously cited reference, p. 359.

¹⁰⁰ Belazouz Ben Ali, *Lectures on Monetary Theories and Policies*, previously cited reference, p. 128.

¹⁰¹ Yousra Mahdi Al-Samarrai, Zakaria Mutlaq Al-Douri, *Central Banking and Monetary Policy*, Editar Printing, no edition, Italy, no publication year, p. 250.

¹⁰² □ Ghazi Inaya, *Financial Inflation*, Al-Shehab Publishing, 2nd edition, Batna, 1986, p. 140.

□ Belazouz Ben Ali, *Lectures on Monetary Theories and Policies*, previously cited reference, pp. 129-130.

□ Jamal Ben Daas, *Monetary Policy in Islamic and Conventional Systems (Comparative Study)*, previously cited reference, pp. 185-186.

- Regulation of Consumer Loans: The central bank imposes a maximum cap on the amount of funds that commercial banks can allocate for consumer goods purchases. It may also set a maximum repayment period for deferred sales, reducing the number of installments while increasing the value of each payment to curb excessive borrowing.
- Directed Credit Allocation: The central bank ensures that loaned funds are strategically distributed to align with government priorities. This includes channeling credit into high-priority sectors such as agriculture and industry, rather than speculative or non-productive sectors.
- Moral Suasion: In this approach, the central bank persuades commercial banks to follow a particular monetary policy without issuing formal directives. The effectiveness of this tool depends on the central bank's credibility, influence, and the level of trust commercial banks have in its policies¹⁰³.
- Directives and Orders: The central bank issues direct instructions to commercial banks and financial institutions to guide them toward the desired monetary policy objectives. This includes controlling credit volume and allocation, such as:
 - Requiring banks to invest a portion of their assets in government bonds or long-term investment projects.
 - Restricting loans for consumer industries or excessive spending activities.

For example, in 1953, the United Kingdom implemented this tool by ordering commercial banks to halt loans for installment purchase financing and to reduce other types of lending¹⁰⁴.

The central bank can also set the required ratio between capital, reserves, and total assets that banks must maintain. It may impose a ceiling on the total amount of bank loans and investments, limit the rate of increase in loans and investments over a given period, or prohibit certain types of investments that commercial banks can engage in. Additionally, it can set maximum limits on loans and investments for specific types of credit and investment categories.¹⁰⁵

Media and Public Awareness

The central bank can use various media channels to educate the public about economic realities. This helps support monetary policy reforms and achieve economic policy objectives. Media outreach targets individuals, businesses, and government sectors alike.

For instance:

¹⁰³ Mohamed Zaki El-Shafei, Introduction to Money and Banking, Dar Al-Nahda Al-Arabiya, 7th edition, Beirut, no date, p. 315.

¹⁰⁴ Ghazi Anaya, Financial Inflation, previously cited reference, p. 157.

¹⁰⁵ Yusra Mahdi Al-Samarrai, Zakaria Mutlaq Al-Douri, Central Banking and Monetary Policy, previously cited reference, p. 254.

(□) Considering that inflation, from the monetarist perspective, is a monetary phenomenon. /The researcher

() Abdel Muttalib Abdel Hamid, Economic Policies at the National Economy Level (Macroeconomic Analysis), previously cited reference, p. 112. For more details, see: Belazouz Ben Ali, previously cited reference, pp. 157-159.

- The Bundesbank (Germany's central bank) and Sweden's central bank regularly publish reports explaining their monetary policies for credit monitoring.
- The Governor of the Bank of England issues official periodic bulletins outlining the country's credit policies.¹⁰⁶

Punitive Measures

If banks fail to comply with monetary policy guidelines, the central bank may impose penalties. These may include:

- Refusing to discount commercial banks' financial papers.
- Denying access to liquidity reserves if banks exceed their maximum allowable lending limits. ()

2-3. Monetary Policy for Controlling Inflation and Deflation

Monetarists argue that the primary goal of any monetary policy is to address inflation or deflation (the opposite of inflation). Since inflation occurs more frequently, monetary policy is typically designed to manage price stability and control inflationary pressures.

2-3-1. Monetary Policy and Inflation Control¹⁰⁷

To combat inflation, central banks sell government securities to commercial banks and individuals. As a result:

- Commercial banks owe more debt to the central bank, reducing their reserves and limiting their ability to extend new credit.
- Money creation declines, leading to a decrease in money supply.
- As a result, inflation rates drop, and the general price level stabilizes.

The central bank may also use other measures:

- Raising the required reserve ratio for banks to limit lending capacity.
- Increasing the discount rate, which discourages banks from borrowing, further reducing the money supply.

Ultimately, these actions contribute to lowering inflation, stabilizing the general price level, and ensuring a sustainable growth rate of money supply (also known as monetary aggregates).

Thus, the goal of monetary policy in addressing inflation is to limit the creation of new monetary instruments, meaning restricting money supply growth. This leads to a reduction in consumer and institutional spending on goods and services.

¹⁰⁶

¹⁰⁷ Yusra Mahdi Al-Samarrai, Zakaria Mutlaq Al-Douri, Central Banking and Monetary Policy, previously cited reference, p. 254..

At the same time, as the money supply is reduced through credit restrictions, interest rates rise, which typically results in lower inflation rates.

Some experts argue that a successful monetary policy should not first cause inflation and then attempt to correct it. Instead, an effective monetary policy maintains a stable growth rate of money supply. This ensures price stability, as money supply is the primary determinant of price levels, national output, and employment.

Monetarists also believe that a gradual reduction in the growth rate of money supply will lower inflation while minimizing the costs associated with reducing inflation rates.

2-3-2. Monetary Policy and Deflation Control¹⁰⁸

To counteract deflation, central banks purchase government securities from commercial banks and individuals. As a result:

- Commercial banks' debts to the central bank decrease, increasing their reserves.
- Banks gain more liquidity, allowing them to expand lending and credit creation.
- This increases the money supply, ending the deflationary cycle and boosting economic activity.

Other tools include:

- Lowering the reserve requirement ratio, enabling banks to lend more.
- Reducing the discount rate, making borrowing cheaper and increasing the money supply.

Thus, the goal of monetary policy in deflationary periods is to increase the money supply and stimulate demand for goods and services. Expanding the money supply helps counteract economic contraction and ensures sustained national output growth while preventing severe price fluctuations.

3. Investment Policy

3-1. Definition and Objectives of Investment Policies

Investment policies refer to a set of rules, strategies, procedures, and measures implemented by the government to achieve specific economic objectives. These policies aim to:

- Maximize national productive capacity.
- Distribute investments across different sectors, industries, and regions.

¹⁰⁸ Considering that inflation, from the monetarist perspective, is a monetary phenomenon. /The researcher

- Achieve the highest possible economic growth rate over a specific period.

On the other hand, investment policies at the national level can be seen as a set of general rules, principles, and central guidelines governing the investment process in the national economy. These policies define the size, priorities, sectoral and regional distribution of investments, as well as the nationality, ownership, production strategy, pattern, and sources of financing over a given period.

From these definitions, several key observations emerge:

1. **Government-Led Policies:** The rules, methods, procedures, and measures are set by the government and must be clear, stable, and consistent.
2. **Defined Objectives:** Investment policies aim to achieve specific economic goals and include evaluation criteria to assess the social and economic feasibility of executed investments.¹⁰⁹
3. **Investment Climate:** The success of investment policies depends on the investment climate, which consists of various indicators and tools influencing the effectiveness of policies.
4. **Types of Investment Policies:** As investment policies govern the investment process, they encompass various dimensions, such as:
 - Investment volume and priorities
 - Sectoral and regional distribution
 - Investment nationality and ownership
 - Production strategy, investment pattern, and financing sources
5. **Policy Adaptability:** Investment policies can change over time based on shifting priorities and objectives.
6. **Incentive-Based Approach:** Effective investment policies should be incentive-driven, encouraging investors and savers to channel their funds into sectors and activities that align with economic objectives.
7. **The Need for Efficient National Investment Policies:**
There is a necessity for national investment policies that are efficient in achieving the desired economic objectives. These policies should distribute investments effectively across sectors, activities, and regions to maximize economic growth. The importance of efficient investment policies is heightened by their broad societal impact—any flaws in policy design affect the entire economy. For example, if investment policies fail to

¹⁰⁹ () Abdel Muttalib Abdel Hamid, *Economic Policies at the National Economy Level (Macroeconomic Analysis)*, previously cited reference, p. 112. For more details, see: Belazouz Ben Ali, previously cited reference, pp. 157-159

achieve the employment target, unemployment issues arise, bringing widespread economic and social consequences.

8. Objectives of Investment Policies:

Investment policies primarily aim to:

- Achieve the highest possible economic growth rate
- Ensure full employment
- Increase national value-added (GDP growth)
- Support balance of payments stability
- Strengthen the national currency
- Address secondary economic goals depending on the economic context.

3-2. Determinants of Investment Value and Patterns

It is essential to recognize that several factors influence investment value and patterns at the national level. Policymakers must carefully consider these factors when designing and implementing investment policies. The key determinants include:

1. The Existing Production Structure:
 - The current sectoral distribution of production
 - The growth rates of different sectors
2. National Savings and Influencing Factors¹¹⁰:
 - Wage and income structure and expected changes
 - Price structure and anticipated fluctuations
 - Fiscal policies, including changes in taxation and public spending
 - Consumption patterns and consumption rates
 - Savings behavior, social values, and cultural influences
 - The national economic condition (recession, boom, optimism, or pessimism)
 - Targeted growth and development rates
 - Planned production structure and sectoral distribution of production growth
 - Planned capital structure and its allocation across sectors

3-3. Investment Theories and Policies

In addition to all this, investment policy makers must study the factors explaining the investment function, commonly known as investment theories. There are several theories in this field that can be briefly mentioned without delving into details as follows¹¹¹:

1. **The Keynesian Theory**, which suggests that investment is a function of the interest rate and, consequently, the marginal efficiency of investment. However, empirical studies later demonstrated that investment is relatively less sensitive to changes in interest rates.
2. **The Accelerator Theory of Investment**, which posits that changes in investment are a function of changes in output—if output increases, investment increases. Here,

¹¹⁰ Yusra Mahdi Al-Samarrai, Zakaria Mutlaq Al-Douri, *Central Banking and Monetary Policy*, Editar Press, no edition, Italy, no publication year, p. 250.

¹¹¹ Belazouz Ben Ali, *Lectures on Monetary Theories and Policies*, previously cited reference, pp. 129-130

investment refers to net investment, which equals gross investment minus depreciation allowances. One major criticism of this theory is that it explains net investment rather than gross investment, which is more relevant for purposes such as aggregate demand. Moreover, the theory assumes a fixed capital-output ratio, despite the possibility of labor substituting capital¹¹².

3. **The Internal Funds Theory of Investment**, which argues that investment depends on the level of profits. According to this theory, investment stems from retained earnings and depreciation allowances.
4. **The Modern Classical Investment Theory**, which suggests that investment is determined by the prices of capital services relative to output prices. The cost of capital services, in turn, depends on capital goods prices, interest rates, and corporate tax treatment. Thus, changes in output or in capital service prices relative to output prices affect the required level of investment. This theory, unlike the accelerator and internal funds theories, emphasizes that interest rates play a crucial role in determining investment.

The relationship between investment theories and investment policies becomes evident through the analysis above. Based on the key factors highlighted by each theory, investment policies are formulated accordingly. Notably:

- Given that the accelerator and internal funds theories differ in their determinants of investment, they also diverge in terms of investment policies and directions. Suppose investment policymakers aim to design programs to boost investment. According to the internal funds theory, policies that directly increase profits are likely to be more effective. Such policies include reductions in corporate income tax rates and tax incentives for investment loans, which help lower business tax obligations. In contrast, increases in government spending or reductions in personal income tax rates would not directly affect profits and, therefore, would not directly impact investment. However, to the extent that output increases in response to higher government spending or lower taxes, profits may rise, leading to an indirect effect on investment.
- Conversely, under the Accelerator Theory, policies designed to directly influence investment based on internal funds theory would be ineffective. For example, reducing corporate tax rates would have little to no impact on investment, as investment under this theory depends on output rather than available internal funds. On the other hand, increases in government spending or reductions in personal income tax rates would successfully stimulate investment by influencing aggregate demand and, consequently, output.

¹¹² Jamal Ben Daas, *Monetary Policy in Islamic and Conventional Systems (A Comparative Study)*, previously cited reference, pp. 185-186.

- Since Modern Classical Investment Theory integrates key determinants of investment from previous theories while incorporating additional variables, investment policies based on this theory may vary accordingly¹¹³.

As in the case of the Accelerator Theory, output is one of the key determinants of investment. Therefore, an increase in government spending or a reduction in personal income tax rates stimulates investment by influencing aggregate demand and, consequently, output. Similarly, as in the Internal Funds Theory, the tax treatment of business income is considered important. However, according to the Modern Classical Investment Theory, business taxes are significant because of their effect on the cost of capital services rather than their impact on available internal financial resources. Consequently, policies aimed at altering the tax treatment of business income directly influence investment.

Unlike the Accelerator and Internal Funds theories, interest rates are again considered a key determinant of investment. This means that monetary policy, through its influence on interest rates, has the ability to alter investment levels—something that was not the case in the Accelerator and Internal Funds theories.

This analysis suggests that the Modern Classical Model is a suitable framework for explaining investment behavior and changes in the investment function. It includes both output and the cost of capital services as key determinants of investment. Additionally, investment policies should also be based on empirical studies that assess other investment theories, as these studies might highlight the significance of other determinants or introduce new factors such as external financing variables. Based on these findings, investment policies can be designed accordingly.

3-4 The Relationship Between Investment Policy Objectives and Investment Evaluation Criteria at the National Level

Investment policymakers must establish a clear relationship between investment policy objectives and investment evaluation criteria at the national economic level, commonly referred to as social profitability criteria. The alignment between investment policy goals and these criteria helps determine the feasibility of proposed investments. This linkage is achieved through "indicative planning", which involves providing direct and indirect incentives and advantages to projects that align with the overall societal objectives pursued by investment policies.

It is important to note that if the objectives of investment policies (or the economic goals of any society) focus on:

- Increasing national income at accelerating rates,
- Enhancing national value-added,

¹¹³ () Mohamed Zaki El-Shafei, *Introduction to Money and Banking*, Dar Al-Nahda Al-Arabiya, 7th edition, Beirut, no date, p. 315.

- Achieving full employment and reducing unemployment by creating more job opportunities,
- Strengthening the balance of payments and ensuring external economic stability,
- Maintaining the value of the national currency, and other macroeconomic targets,

then investment policies must be designed to support these goals while also ensuring that investment evaluation criteria are aligned with them¹¹⁴.

Investment evaluation at the national level, using social profitability criteria, is fundamentally an attempt to determine how much a proposed project or investment contributes to achieving national economic objectives. The relative weight of each objective varies, meaning that each criterion has a different level of priority depending on the country's economy and even within the same national economy at different stages of development.

It is important to note that this does not imply disregarding investment evaluation criteria at the project level, which have been previously discussed. Rather, the idea is that individual investors have their own criteria aligned with their project's goals, while national investment policymakers must balance private interests with public economic interests. This is done by assigning specific weights to investment evaluation criteria from a societal perspective and using appropriate tools—such as direct and indirect incentives and advantages—to attract investment toward achieving the overall societal objectives, as revealed by the application of investment criteria at the national level.

To clarify the relationship between investment policy objectives and national-level investment evaluation criteria (from the perspective of society and the national economy), the following analysis explains the application of three key criteria:

4-1 Value-Added Criterion

This criterion measures the extent to which a project or investment contributes to a significant increase in national income. It is calculated by determining the ratio of the project's value-added over its lifespan to the total value-added (GDP) of the economy over the same period.

Value-added is calculated based on economic or national accounting methods, using one of the following approaches:

1. **Factor Income Approach:**

- The total value of all earnings received by the factors of production within the project.
- **Formula:** Value-Added=Wages+Rent+Interest+Profit

2. **Output Approach:**

¹¹⁴ Ghazi Anaya, *Financial Inflation*, previously cited reference, p. 157.

- Measures value-added as the difference between the market value of output and the cost of production inputs.

- Formula:

$$\text{Value-Added} = \text{Market Price of Output} - \text{Production Inputs}$$

- A more detailed version of this formula includes additional components:

$$\text{Value-Added} = (\text{Market Price of Output} - \text{Production Inputs}) + \text{Depreciation} + \text{Taxes} - \text{Subsidies}$$

○

Once the value-added for the project is determined, it is then compared to the total national value-added (GDP) to assess its relative contribution to the economy.

Value-Added Criterion =

$$\left(\frac{\text{Project's Value-Added (in each year of its lifespan)}}{\text{Total Value-Added (GDP)}} \right) \times 100\%$$

The higher the percentage, the greater the project's contribution to the total value-added, helping achieve the goal of maximizing GDP—that is, increasing the Gross Domestic Product (GDP). Conversely, a lower percentage indicates a smaller contribution to GDP growth.

4-2 Employment Criterion

This criterion evaluates the number of national workers employed by the project and their proportion relative to the total workforce of the project. It also considers the average wage of national workers compared to that of foreign workers employed by the project.

To apply this criterion, the following data must be available:

- Total number of employees in the project
- Number of national workers in the project
- Number of foreign workers in the project
- Total wages paid to all employees in the project per year

From this data, we can estimate:

- The percentage of national workers relative to the total workforce
- The percentage of foreign workers relative to the total workforce
- The average wage per national worker per year
- The average wage per foreign worker per year

A project is considered to be contributing to employment objectives when:

- The percentage of national workers in the total workforce increases

- The average share of national workers in total wages paid by the project rises annually throughout its lifespan

4-3 Balance of Payments Support Criterion

This criterion measures the impact of the investment project on the balance of payments and its contribution to achieving a balanced trade and financial position. It is applied using the following formula:

Impact of the Project on Balance of Payments Equilibrium =

Commodity (Service) Exports + Foreign Exchange Receipts – Commodity (Service) Imports – Foreign Exchange Payments

If the result is negative, the investment project has a negative impact on the balance of payments equilibrium.

If the result is positive, the investment project has a positive impact on achieving balance of payments equilibrium.

It is important to note that this criterion may be applied partially in countries suffering from chronic trade deficits, which cause structural imbalances in the balance of payments. Since investment policies aim to address these deficits due to their negative structural effects, the impact can be analyzed as follows:

- If the result is negative, the project worsens the structural imbalance in the balance of payments.
- If the result is positive, the project contributes positively to achieving balance of payments equilibrium and helps correct the structural imbalance.

5- Trade Policy

Trade policy refers to the set of measures implemented by sovereign authorities to regulate foreign trade. The main objectives of trade policy include:

- Generating financial resources for the state treasury
- Balancing the balance of payments
- Protecting domestic production from foreign competition

Trade policy employs various tools, including:

- Foreign exchange controls
- Trade agreements
- Quota systems

- Customs duties (tariffs)¹¹⁵

A more detailed discussion of trade policies will be covered in the next section.

Trade policy aims to utilize a set of tools and means, either to encourage and attract investment or to implement protectionist policies. These are strategic options available to countries that determine their relationships with the external world. This is achieved through the enactment of legislation, as well as the adoption of decisions and measures for their implementation.

In this section, we attempt to clarify the essence of trade policy, its instruments, and its role in addressing balance of payments deficits.

1. The Essence, Types, and Objectives of Trade Policy

Throughout the 19th century, the world witnessed significant developments due to the expansion of free trade, labor mobility, and capital flows. At that time, there were no restrictions on international trade, allowing individuals to obtain goods from their natural sources. Likewise, capital flowed to regions where demand was high. However, since 1914, these policies have changed. Export trade became subject to various measures and restrictions depending on the nature of the goods and each country's trade policy. Migration and capital flows, including the amounts individuals could transfer across borders, also became regulated as part of national trade policies designed to manage trade exchanges, labor movements, and capital flows. These policies oscillated between free trade and protectionism, the latter being aimed at safeguarding domestic production.

In the 16th century*, mercantilist thought promoted the protection of international trade. Later, Adam Smith and his successors advocated for free trade**, economic liberalism, and market mechanisms. However, after World War I, protectionist trade policies resurged, with each country adopting protective measures to manage its international economic relations and

maximize the benefits of global trade. As protectionism and trade restrictions increased, several countries recognized that boosting international trade required reducing trade barriers and liberalizing markets.

This led to the establishment of the General Agreement on Tariffs and Trade (GATT) in Havana in 1947. Under this framework, eight negotiation rounds were held to restore free trade policies, culminating in the Uruguay Round, which concluded in Marrakech in 1994. This agreement paved the way for the creation of the World Trade Organization (WTO) in January 1995. At that time, approximately 117 countries expressed readiness to shift toward free trade, with developing countries given a transition period of 10 years and other countries a period of 6 years¹¹⁶.

However, it is important to note that the shift toward free trade is relative. In practice, most countries adopt a hybrid approach that combines elements of free trade and protectionist policies. Therefore, this section will define trade policy, explore its types, objectives, and instruments.

1- Definition of Trade Policy:

"Trade policy in the field of international economics refers to the set of measures adopted by a state in its dealings with the external world to achieve specific objectives." The primary goal that every country seeks through trade policy is to promote national economic activity. In reality, trade policy is just one of several economic policies that a state employs to achieve its established economic objectives¹¹⁷. Therefore, countries strive to coordinate these policies to ensure they complement rather than contradict one another. Trade policies vary from one country to another depending on their economic systems; the policies adopted by developed countries differ from those of developing or less-developed nations. Each country has specific economic goals and employs distinct strategies to achieve them.

Trade policy is also defined as the economic policy applied in the field of foreign trade, meaning "a set of measures implemented by sovereign authorities in the realm of international trade to achieve specific objectives."¹¹⁸

Additionally, it can be described as "a collection of rules, methods, tools, and measures adopted by a state in international trade to maximize the benefits of its interactions with other countries,

*This school of thought believed that the supreme national interest lay in accumulating gold within the country. The way to achieve this was by increasing exports over imports, requiring the government to take all necessary measures to boost exports and limit imports, essentially adopting protectionist measures. /Researcher

**The interest in free trade policy dates back to the era of the Physiocratic school of economics, which advocated for economic freedom in general, allowing economic activities and trade to take place without state intervention, leaving individuals free to act as they wish. /Researcher

¹¹⁶ Abdel Muttalib Abdel Hamid, *Economic Policies at the National Economy Level (Macroeconomic Analysis)*, previously cited reference, p. 123.

¹¹⁷ Faiza Kashi, *International Economics: Movement of Goods and Factors of Production*, previously cited reference, p. 74.

¹¹⁸ Adel Ahmed Hashish, Magdy Mahmoud Shehab, *Fundamentals of International Economics*, Al-Halabi Legal Publications, Beirut, Lebanon, 2003, p. 229.

aiming to achieve external balance within the broader framework of economic objectives over a specified period."¹¹⁹

Thus, in the context of international economic relations, trade policy refers to the set of instruments a state employs in its foreign trade to attain particular goals.

The primary objective of trade policy is to contribute to economic development, in addition to implicit goals such as eliminating unemployment, achieving self-sufficiency in certain products, stabilizing exchange rates, and balancing the balance of payments.

In reality, foreign trade policy is merely one component of a coherent and integrated framework of other fiscal and monetary policies aimed at achieving overall economic welfare.¹²⁰

Due to differences in political and economic systems, foreign trade policies vary between countries with centralized decision-making and industrially advanced nations. They also differ in content and objectives among developing countries.

2. Types of Trade Policies:

Most economists agree that there are two main types of trade policies: free trade policy and trade protection policy.

2.1 Free Trade Policy:

Free trade policy refers to a trade system in which the state does not use its authority to influence the direction or volume of exchanges, allowing them to develop naturally through free market forces of supply and demand.

This policy is also known as a liberal trade policy or trade liberalization. It first emerged during the era of the Physiocratic school of economics and gained prominence with the ideas of Adam Smith, Ricardo, and others who advocated for economic freedom. They emphasized minimal government intervention in economic activities, allowing individuals and institutions to engage in economic and trade activities as they wished.

In this context, international free trade policy can be defined as "a set of rules, procedures, and measures aimed at removing or reducing direct and indirect trade restrictions—both quantitative and non-quantitative, tariff and non-tariff—to facilitate the flow of international trade across national borders in pursuit of specific economic objectives."¹²¹

It is expected that this century will witness the dominance of free trade policies, especially with the expiration of the ten-year transition period granted by GATT and the World Trade

¹¹⁹ Abdel Muttalib Abdel Hamid, *Economic Policies at the National Economy Level (Macroeconomic Analysis)*, previously cited reference, p. 124.

¹²⁰ Youssef Beïbi, *The Economic Policy of Trade Liberalization within the Framework of the World Trade Organization with Reference to the Algerian Case*, unpublished doctoral thesis in economic sciences, 2006-2007, p. 34.

¹²¹ Abd El-Muttalib Abd El-Hamid, *Economic Policies (Macroeconomic Analysis at the National Economy Level)*, previously cited reference, p. 133.

Organization (WTO) to developing countries to adjust their trade environments and complete economic reform programs. These efforts aim to fully liberalize international trade, allowing the world to operate under a free trade system.

Supporters of free trade policy present several arguments in favor of their position, among which the most significant are:

1. **International free trade** allows each country to specialize in producing goods in which it has a comparative advantage due to its natural conditions and the abundance of suitable production factors. Moreover, the production of goods with a competitive advantage—based on quality, price, and low costs—ensures the benefits of international specialization. This guarantees that each country gains from trade when exchanging goods, a benefit that would not be possible if all countries produced the same goods. The extent of these benefits depends on the expansion of the international market.
2. **Countries can only fully enjoy the benefits of production** within an international exchange system that allows nations with a comparative and competitive advantage in producing certain goods to expand their production beyond domestic needs. They can then exchange their surplus for other goods they struggle to produce efficiently due to relative deficiencies.
3. **Achieving the optimal scale of production** results from market expansion, enabling large-scale enterprises to reach their optimal operational levels. Free trade policies facilitate this by allowing businesses to increase production, export goods, and reduce costs as long as the market demand is sufficient.
4. **Preventing monopolies** is another key argument in favor of free trade. In a protected environment, inefficient enterprises may dominate the market, enabling them to raise prices, limit production, and sell low-quality goods to consumers without competition. This leads to excessive resource consumption, consumer exploitation, and negative impacts on both national economic growth and overall economic welfare.
5. **Adopting a free trade policy stimulates international trade** among countries, as it expands market access for exports and products in which each country has a comparative and competitive advantage. In contrast, protectionist policies lead to a decline in international trade.¹²²
6. **Encouraging international competition** drives maximum production efficiency at the lowest possible cost. This pushes producers to reduce production costs to lower prices, maximize profits, and increase output further.

Imposing restrictions on imports while encouraging exports may lead other countries to adopt similar protectionist measures, ultimately reducing the volume of global trade.

¹²² Abd El-Muttalib Abd El-Hamid, *Economic Policies (Macroeconomic Analysis at the National Economy Level)*, previously cited reference, pp. 134-135.

7. **Adopting a free trade policy leads to an increase in national income** for all parties involved in international trade, bringing greater prosperity to the global economy compared to protectionist policies.
8. **Free trade enhances the optimal allocation of economic resources** and increases employment levels in the national economy of each country.
9. **It reduces unemployment rates more effectively than protectionist policies** by ensuring better utilization of available production factors across different countries.
10. **Free trade policies help maximize exports** by following an export-oriented production strategy, leading to a better achievement of external balance compared to protectionist policies.

The Shift Toward Free Trade

Given these arguments and others, free trade policies have increasingly gained prominence in today's global economy. Many nations have recognized that liberalizing international trade is key to boosting global trade exchange, increasing national income, and enhancing economic welfare.

Governments are encouraged to reduce restrictions and promote trade liberalization, shifting away from protectionist measures such as tariffs and non-tariff barriers. This transformation is driven by the General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO), which have facilitated global trade by promoting competitive international economies based on comparative and competitive advantages. The transition toward free trade was expected to be fully implemented starting in 2004.¹²³

2.2 Protectionist Trade Policy

Protectionist trade policy refers to a government's strategy to shield its domestic market from foreign competition by imposing tariff and non-tariff barriers.

For centuries, economists and policymakers have debated whether protectionist policies, which support national industries, or free trade policies, which compare domestic and international production costs, are more effective.¹²⁴

Historical studies on trade policies over different periods reveal that trade policies have fluctuated between protectionism and free trade rather than being applied in absolute forms. For example, during the 1950s and 1960s, economies transitioned from protectionism to free trade. However, in the early 1970s, protectionist measures resurfaced to shield domestic markets from foreign competition.

¹²³ Abd El-Muttalib Abd El-Hamid, *Economic Policies (Macroeconomic Analysis at the National Economy Level)*, previously cited reference, pp. 135-136.

¹²⁴ Faïza Kachi, *International Economics: The Movement of Goods and Factors of Production*, previously cited reference, p. 74.

Types of Trade Protectionism

Over the past decades, different forms of trade protection have emerged:

- Selective protectionism: Targeted protection measures against specific countries.
- Sectoral protectionism: Protection policies focused on specific economic sectors, such as agriculture or the automotive industry.
- Collective protectionism: Trade barriers imposed by a group of countries within a regional bloc against non-member nations.

Arguments in Favor of Protectionist Policies

Many economists argue that protectionist policies are necessary to safeguard national economies and ensure an optimal level of welfare for the majority of society.

Several theoretical arguments support the case for protectionism, including:

1- The Argument of Terms of Trade¹²⁵

This argument is based on a cost-benefit analysis. In the case of a large country with a significant impact on global prices, imposing tariffs on imports can reduce their levels, allowing the country to improve its terms of trade. This is only beneficial if the economic gains outweigh the distortions caused by the tariff-induced price changes.

For large economies with a strong international presence, the benefits of improved trade terms often exceed the costs of tariffs borne by local consumers.¹²⁶

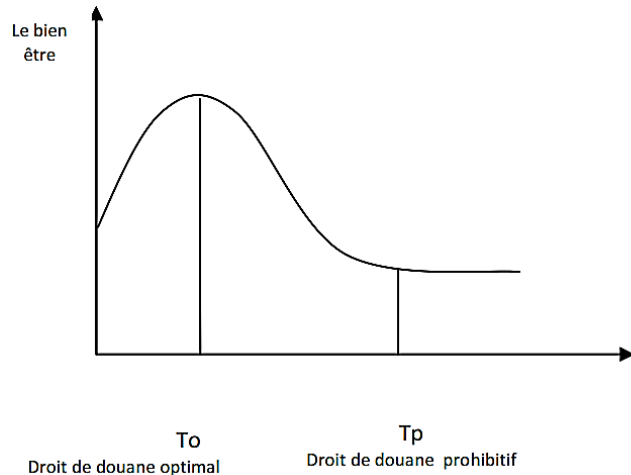
However, raising tariffs too high can lead to negative consequences that outweigh the positive effects of improved trade terms. If tariffs are set at a prohibitive level, they can completely block international trade.

If a tariff level of T_p is reached, imports will be entirely restricted, and the country will lose all the benefits of international trade. This is illustrated in the following diagram:

Figure 1.08: The Optimal Tariff Rate

¹²⁵ Paul Krugman and Maurice Obstfeld, *International Economics*, 7th edition, Pearson Education-France, 2008, pp. 217-218.

¹²⁶ Faïza Kachi, *International Economics: The Movement of Goods and Factors of Production*, previously cited reference, p. 75.



Source: Paul Krugman & Maurice Obstfeld, *Économie internationale*, 7th edition, Pearson Éducation-France, 2006, p. 217.

As shown in the figure, the relationship between tariff levels and economic welfare is initially positive—welfare increases as tariffs rise until reaching a specific level (T_o), known as the optimal tariff rate (le droit de douane optimal), which maximizes welfare.

Beyond this point, the relationship becomes negative—meaning higher tariffs reduce welfare but do not entirely eliminate imports—until reaching a prohibitive tariff level (le droit de douane prohibitif), which blocks all imports.

For large economies, the optimal tariff rate (T_o) is always greater than zero but lower than the prohibitive tariff rate (T_p), which completely eliminates imports if applied.¹²⁷

In Exporting Cases

If we consider that subsidizing exports and exporters distorts trade terms and negatively impacts welfare, then the ideal policy would be to impose export taxes, known as a negative subsidy. Just like the optimal import tariff, the optimal export tax is always positive (greater than zero) for large economies but lower than the prohibitive tax, which would entirely prevent local exports from integrating into the global economy.

This policy, known as "l'impôt optimal" (the optimal tax), is widely applied by many oil-exporting countries that dominate the global market, aiming to raise oil prices in international markets.¹²⁸

2- Economic Stability and Employment Growth

Adopting a protectionist policy allows a country to produce various industrial goods, even without a comparative advantage, thereby diversifying its production structure. This diversification reduces the relative importance of any single product in influencing national

¹²⁷ Faïza Kachi, *International Economics: The Movement of Goods and Factors of Production*, previously cited reference, p. 75.

¹²⁸ Mohamed Ahmed El-Sariti, *Foreign Trade*, previously cited reference, p. 162.

income, exports, or employment. Consequently, if a negative shock affects one product, its overall impact on key economic variables remains limited, and it may be offset by a positive fluctuation in another sector, ensuring a degree of national economic stability.¹²⁹

Furthermore, protectionist policies encourage local industries to expand by shielding them from foreign competition. This results in greater employment opportunities, particularly in developing countries. Additionally, these policies attract multinational corporations to invest domestically, as they offer a competitive advantage for their products in local markets.

3- Objectives of International Trade Policies

The previously mentioned definitions indicate that the ultimate goal of a country's trade policies is to maximize its benefits from global trade and achieve external balance—which is a key objective of economic policy and international trade strategies.

The external balance objective is often quantitatively reflected in the balance of payments, determining whether a country experiences equilibrium, a surplus, or a deficit.

International trade policy objectives are categorized into three main groups:

1. Economic Objectives
2. Social Objectives
3. Strategic Objectives¹³⁰

3.1- Economic Objectives:

- Generating revenue for the public treasury
- Achieving balance in the balance of payments
- Protecting domestic production from foreign competition
- Shielding the national economy from the risks of dumping
- Supporting infant industries
- Safeguarding the economy from external fluctuations

3.2- Social Objectives:

The social objectives of trade policy include:

¹²⁹ Sayed Mohamed Ahmed El-Sarbenti, Foreign Trade, previously cited reference, p. 162.

¹³⁰ See further details:

Gawda Abdel Khaleq, International Economics: From Comparative Advantage to Unequal Exchange, 4th edition, Dar Al-Nahda Al-Arabiya, Cairo, 1992, pp. 155-158.

Abd El-Muttalib Abd El-Hamid, Economic Policies at the National Economy Level (Macroeconomic Analysis), previously cited reference, pp. 126-130.

Adel Ahmed Hashish, Magdy Mahmoud Shehab, Fundamentals of International Economics, previously cited reference, pp. 233-240.

- Protecting the interests of specific social groups, such as farmers, producers of certain goods, or workers in specific industries.
- Redistributing national income, where the state aims to balance income distribution among different social classes or groups.¹³¹

3.3- Political and Strategic Objectives:

- Ensuring greater independence and security in economic, food, and military aspects.
- Securing the state's needs for energy sources and other strategic goods, particularly during crises and wars.
- Achieving self-sufficiency, especially in food security.¹³²

4- Trade Policy Instruments

Trade policy instruments refer to all the means used to influence a country's international trade, whether directly or indirectly. These tools are classified into two main categories:

- 1. Protectionist trade policy instruments**
- 2. Free trade policy instruments**

4.1- Protectionist Trade Policy Instruments:

It is essential to distinguish between the tools used in a protectionist trade policy and those applied under a liberal trade policy or free trade system. Below are the main protectionist trade policy instruments:

- **Tariff System: ()** A form of indirect taxation on consumption and trade, imposed on goods crossing customs borders, whether entering or leaving a country.
- **Foreign Exchange Control and Fixed Exchange Rate:** The state monopolizes the purchase and sale of foreign currency, imposing restrictions on foreign exchange transactions. This system ensures that the government controls the foreign exchange market, meaning that only the central bank can supply foreign currency, and individuals or corporations cannot trade foreign currency outside official channels.
- **Export Subsidies and Dumping: (*)** Export subsidies are a key trade regulation tool, consisting of financial assistance provided to exporters to boost exports and enhance their competitiveness in global markets. On the other hand, dumping refers to the practice of

¹³¹ Adel Ahmed Hashish, Magdy Mahmoud Shehab, *Fundamentals of International Economics*, previously cited reference, pp. 238-239.

¹³² Fayçal Lousif, *The Impact of Foreign Trade Policies on Sustainable Economic Development in Algeria during the Period 1970-2012*, unpublished master's thesis, University of Sétif, 2014, p. 17.

selling goods in foreign markets at a price lower than their domestic market price under similar conditions.¹³³

- **Trade and Payment Agreements:** These agreements emerged after the Great Depression due to gold and foreign currency shortages. They operate under a clearing system, where trade debts between two countries are settled against each other, allowing international trade transactions to continue despite currency constraints.
- **State Trading:** This policy aims to regulate the marketing of major export commodities, whether raw materials or manufactured goods, by controlling export quantities to stabilize or raise prices in international markets. In terms of imports, state trading ensures the country meets its essential needs for consumer, capital, and production goods, aiming to maintain balance in the balance of payments.¹³⁴
- **Embargo or Prohibition:** Embargoes involve banning the import or export of specific goods, either permanently or temporarily. The reasons for embargoes may be:
 - **Economic:** Protecting public interest by banning harmful or luxury products (e.g., narcotics, privately traded weapons, or goods that threaten local industries).
 - **Political:** Countries may boycott trade with certain nations due to political disagreements or ideological differences.
- **Prohibition is not considered a protectionist measure but rather a complete abstention from international trade, particularly when it concerns goods and services that are not globally banned. In this sense, prohibition poses a threat to international trade. ()**
- **Quota System and Import Licenses:** This refers to placing restrictions on the import and export of specific goods. The quota system sets a maximum limit on the quantity of a particular imported good. While it can also be applied to exports, it is more commonly used for imports.¹³⁵

4.2- Free Trade Policy Instruments:¹³⁶

Under GATT (General Agreement on Tariffs and Trade) and the World Trade Organization (WTO), most countries have shifted towards a free trade policy. Many nations have implemented economic reform programs that emphasize trade liberalization. As a result, trade policies today rely on different tools from those used under the protectionist system.

¹³³ Adel Ahmed Hashish, Magdy Mahmoud Shehab, *Fundamentals of International Economics*, previously cited reference, p. 245.

¹³⁴ Faiza Kachi, *International Economics: The Movement of Goods and Factors of Production*, previously cited reference, p. 108.

¹³⁵ Abd El-Muttalib Abd El-Hamid, *Economic Policies at the National Economy Level (Macroeconomic Analysis)*, previously cited reference, p. 146.

¹³⁶ Magdy Mahmoud Shehab, *International Economics*, Dar Al-Maaref Al-Jami'iya, no edition, Alexandria, 1999, p. 128.

- **Eliminating Direct Quantitative Restrictions:** The transition to free trade policies has led to the removal of quotas, import bans, and other direct quantitative restrictions. This shift is evident in trade liberalization programs under agreements with the International Monetary Fund (IMF) and within GATT and WTO frameworks. Consequently, customs duties (tariff restrictions) remain the only available trade policy tool, while direct quantitative restrictions are being eliminated worldwide.
- **Export Incentives:** This tool replaces export subsidies, which were common in the past but are now considered undesirable. Instead, a range of export incentives has been introduced to promote exports under free trade policies. These incentives may include:
 - Temporary tax exemptions
 - Liberalizing and stabilizing exchange rates
 - Reducing or eliminating tariffs on imported inputs to enhance export price competitiveness
 - Lowering export financing costs
- **Establishing Free Trade Zones:** Free trade zones are a crucial tool in free trade policies. These zones are part of a country's territory but are treated as foreign areas in terms of international trade, currency regulations, and customs. Unless specified otherwise by law, customs procedures do not apply within these zones. As a result, free trade zones operate with complete trade freedom and are directly linked to international markets.¹³⁷

5- Key Technical Methods for Regulating Foreign Trade

When a country adopts a specific trade policy, it primarily relies on a set of technical methods and tools to regulate its foreign trade. These methods can be summarized as follows:

5.1 - Taxes and Customs Duties

Customs duties are taxes imposed by a country on goods crossing its borders, whether imports or exports. These duties can be classified based on how they are assessed or their intended purpose¹³⁸:

A. Based on Assessment Method:

There are four main types of customs duties under this classification:

1. **Ad Valorem Duties:** These are percentage-based tariffs applied to the value of imports. They can either:
 - Be imposed at a fixed rate on all imported goods without discrimination, affecting the overall volume of imports (quantitative impact).

¹³⁷ Ahmed El-Adly, *International Trade*, Tiba Publishing and Distribution, no edition, Cairo, 2006, pp. 121-122.

¹³⁸ Abd El-Muttalib Abd El-Hamid, *Economic Policies at the National Economy Level (Macroeconomic Analysis)*, previously cited reference, p. 150.

- Be selectively applied to certain imports, impacting both the volume and composition of imported goods.
2. **Specific Duties:** These are imposed based on the number, weight, or volume of imported goods. They can be converted into a monetary value.
 - However, these duties face challenges, such as:
 - Determining the actual value of goods (Should it be based on market value? Production cost? If so, at what point in time?)
 - Differences in quality grades of the same product (A fixed duty might be burdensome for low-quality goods but negligible for high-end goods).
 - Difficulty applying these duties to technologically advanced goods with varying intrinsic values.
 3. **Compound Duties:** These include a combination of ad valorem and specific duties to differentiate between different types of the same product.
 4. **Nominal Duties:** These are used to keep prices stable. If international prices rise, the duty is lowered, and if prices drop, the duty is increased to maintain a steady domestic price level.

B. Based on Purpose:

Customs duties can also be classified into:

- **Fiscal Duties:** Imposed to generate government revenue
- **Protective Duties:** Used as a tool to limit foreign competition.

It is often difficult to draw a clear distinction between these two types because both contribute to government revenue and protect domestic markets. However:

- A duty is considered fiscal if the country produces the same goods locally and imposes an equivalent tax on domestic production or if there is no local industry producing such goods.
- Otherwise, the duty is considered protective.

However, financial and economic objectives can sometimes conflict, especially when high tariffs reduce import volumes and lower government revenue, particularly if the demand for the taxed goods is elastic.

5.2 - Subsidies and Support

Subsidies refer to all forms of assistance provided by the government to local producers to enhance their competitiveness in international markets. These subsidies can be either monetary or in-kind. They are especially common in developing or emerging economies seeking to support their domestic industries, despite potential negative impacts on other countries.

However, under the World Trade Organization (WTO) agreements, certain subsidies—such as artificially low domestic prices for resources like fuel—are not permitted. Additionally, WTO prohibits export subsidies, except for economically weaker nations where annual per capita income does not exceed \$1,000.¹³⁹

Subsidies can be classified into¹⁴⁰:

1. Direct Subsidies

These involve monetary assistance provided to local producers, such as:

- Selling production inputs at highly discounted prices far below market rates.
- Providing financial aid to support production continuity.

For example, European Union countries, particularly the UK, provide direct financial assistance to farmers and livestock producers to help them remain competitive in international markets.

2. Indirect Subsidies

These are more common and take various forms, such as:

- Reducing export duties or eliminating customs tariffs on exports.
- Providing infrastructure (such as water, roads, and electricity) to producers at low costs.
- Offering low-interest credit to businesses.
- Organizing international trade fairs to promote local products abroad.

Such indirect subsidies help boost international competitiveness of local industries without violating trade regulations outright.

5.3 - Quota Systems and Import Licensing

One of the quantitative trade barriers is the quota system, under which the government sets a fixed limit on the quantity or value of goods that can be imported or exported. This system is more commonly applied to imports, though some countries also use it for exports¹⁴¹.

There are three main reasons why a country might adopt import quotas:

1. Greater control compared to price-based restrictions:
 - Unlike tariffs, quotas set a clear and predictable limit on imports.

¹³⁹ Abd El-Muttalib Abd El-Hamid, *Economic Policies at the National Economy Level (Macroeconomic Analysis)*, previously cited reference, pp. 152-153.

¹⁴⁰ Abdelrachid Ben Dib, *Regulation and Development of Foreign Trade: A Case Study of Algeria*, unpublished doctoral thesis, University of Algiers, 2003, pp. 129-130.

¹⁴¹ Murray Gibbs, *Trade Policy*, United Nations, Department of Economic and Social Affairs (UNDESA), New York, 2007, p. 26.

- In contrast, price-based restrictions (tariffs) can be uncertain, as market fluctuations can influence their effectiveness.
2. Managing inelastic demand for foreign products:
 - If consumers strongly prefer imported goods, price-based restrictions may not be effective.
 - Similarly, if foreign suppliers are unwilling to adjust their supply, tariff measures might fail to curb imports.
 3. Allowing local industries to adapt to market conditions:
 - By limiting imports, domestic industries get time to adjust production strategies and align with market demands.

However, WTO strongly opposes this system as it discriminates against foreign products, restricting free trade.

5.4 - Trade Agreements

Regional trade is becoming increasingly important in the global economic landscape. Regional trade now accounts for 55% of total global trade, and the number of regional trade agreements has increased eightfold since the 1980s. Currently, these agreements control around 40% of world trade.

Trade Policy and Addressing Balance of Payments Deficit

In cases of persistent balance of payments deficits—a common issue in many developing countries—trade and economic policymakers must carefully design an effective trade policy to address the deficit both in the short and long term. In doing so, they should consider the following key aspects:

1. Distinguishing between a trade deficit (which occurs when imports exceed exports) and a balance of payments deficit, which represents the net financial position of a country in its external transactions.
2. Identifying the root causes of the balance of payments deficit, including monetary factors, and clearly defining these causes.
3. The approach to addressing the deficit depends on the trade policy adopted. The tools used to manage the deficit will vary accordingly.

3.1 - If a Protectionist Trade Policy is Adopted

A protectionist approach to international trade relies on restrictive measures such as:

- Import substitution strategies to reduce reliance on foreign exchange.
- Strict foreign exchange controls and fixed exchange rate policies.

- Imposing tariffs, trade barriers, and both justified and unjustified protectionist measures.
- Applying direct quantitative restrictions, such as import and export quota systems.
- Expanding export subsidies and engaging in dumping strategies.
- Increasing reliance on trade and payment agreements with specific countries.
- Expanding state involvement in trade activities.

3.2 - If a Free Trade or Trade Liberalization Policy is Adopted

A free trade policy approach involves reducing trade restrictions and using market-driven mechanisms. Key tools include:

- Adopting an export-oriented production strategy to maximize foreign exchange earnings.
- Liberalizing foreign exchange regulations and floating exchange rates.
- Gradually reducing tariff barriers over time.
- Eliminating most, if not all, direct quantitative restrictions, such as quotas, and gradually phasing out import bans.
- Implementing a package of export incentives that comply with WTO regulations.
- Expanding free trade zones, particularly industrial free zones, to attract export-driven investment.
- Enhancing the role of the private sector in international trade to take the lead under a free trade policy framework.

Therefore, each country must adopt a trade policy that aligns with its economic conditions. However, it is important to note that since 2004, the global trend has strongly shifted toward free trade. This has influenced national trade policies, making trade liberalization the dominant model. As a result, countries are increasingly focusing on free trade mechanisms and developing new tools to achieve external balance and a sustainable balance of payments¹⁴².

1- The Future of Trade Policy Amid Global Economic Transformations

Many questions arise about the future of international trade policy in the context of global economic transformations—particularly regarding which model will prevail, the balance between freedom and restrictions, and the extent of trade liberalization. While the relative weight of free trade is increasing worldwide, the question remains:

- What will trade policy look like in the face of other economic transformations?

¹⁴² Reda Abdel Salam, *International Economic Relations*, 2nd ed., Al-Maktaba Al-Asriya for Publishing and Distribution, Egypt, 1991, p. 22.

- How will economic blocs, international participation economies, and their requirements shape trade policy?

These factors will undoubtedly influence future trade policy directions worldwide in the coming years. Moreover, they will impact the tools and objectives of trade policies, questioning:

- The suitability of existing trade instruments, and
- The potential need for new tools to adapt to global economic changes and achieve desired objectives.

Thus, international economic policymakers must analyze, prepare, and develop mechanisms to design an efficient international trade policy that aligns with global economic transformations.

To provide a clearer picture, here is a brief overview of the key global economic transformations shaping the future of trade policy:

1. The General Agreement on Tariffs and Trade (GATT), the World Trade Organization (WTO), and the shift toward free trade.
2. Economic blocs and their evolving orientations.
3. The transition to international participation economies.
4. The shift from an import-substitution strategy to an export-oriented production strategy.¹⁴³

3- The Relationship Between Trade Policy, Economic Systems, and International Trade Trends

In this section, we will analyze how different economic systems shape trade policy, alongside recent trends in international trade. A significant factor to consider is the growing influence of multinational corporations, which now play a dominant role in international trade through their expansion and foreign direct investment (FDI).

1- The Relationship Between Trade Policy and Economic Systems

The general economic policy of any country is fundamentally shaped by its economic system and ruling ideology. This, in turn, directly affects various economic tools, including trade policy. Trade policies are essentially a reflection of the state's economic orientation.

There are three primary economic systems, each with a distinct approach to trade policy:

1.1 - The Capitalist System

¹⁴³ Emmanuel Nyahoho et Pierre Paul Proulx, *Le Commerce International - Théorie, Politique et Perspectives Industrielles*, 3rd ed., Presses de l'Université du Québec, 2006, pp. 167-168.

In capitalism, trade is seen as the backbone of economic freedom, the driver of innovation, and the catalyst for prosperity. These three factors are considered essential for:

- Individual wealth,
- Societal development, and
- Overall economic growth.

Additionally, trade fosters international connectivity and economic progress, which in turn promotes global peace. The capitalist perspective argues that¹⁴⁴:

- Countries built on strong democratic foundations do not seek wars, and
- The most prosperous nations make the best neighbors.

From this standpoint, capitalists view trade restrictions as a barrier to individual choice, societal progress, and global peace.

The liberal perspective views trade and free exchange as powerful forces in strengthening social bonds. It contributes to wealth creation and fosters complementary relationships between nations. Additionally, it promotes specialization and connects individuals and societies through shared interests.

From this viewpoint, the liberal project does not merely seek to establish a market society; rather, it sees trade as the foundation of the social contract. The success of societies that embrace this perspective serves as evidence of its effectiveness¹⁴⁵.

This model is fundamentally based on at least four key variables:

1. The right to practice and collectively contribute to institution-building.
2. The functional necessity arising from the interconnectedness created by trade.
3. A strong emphasis on political education and fostering a culture of freedom to enable active participation in economic and social development.
4. Personal development, empowerment, and ensuring fair compensation (équité) for individual contributions.

The importance of free trade in the modern world is well illustrated by Paul Samuelson in his book *Economics*, where he describes the growing interdependence of the United States and the global economy¹⁴⁶:

¹⁴⁴ Mahmoud Bibili, Policies of Regional Trade Agreements, National Center for Agricultural Policies, Damascus, Syria, April 2008, p. 1.

¹⁴⁵ Abd El-Muttalib Abd El-Hamid, Economic Theory (Micro and Macro Analysis), Al-Dar Al-Jami'iya, no edition, Alexandria, Egypt, 2007, pp. 403-405.

¹⁴⁶ Abd El-Muttalib Abd El-Hamid, Economic Theory (Micro and Macro Analysis), previously cited reference, pp. 406-407.

"In past centuries, trade had a modest impact on the overall economic performance of the United States. It was possible to ignore economic ties between nations, leaving such matters to scholars and government experts. However, rapid advances in communication and transportation, along with trade policies, have increasingly linked the economic fortunes of nations. Today, trade connections between Japan, Mexico, Canada, and the U.S. are stronger than the ties between California and New York a century ago.

The global economic cycle now deeply affects all nations. Monetary policy decisions in Washington can trigger recessions, poverty, and revolutions in South America. Political unrest in the Middle East can drive oil prices up or down, leading to periods of global prosperity or stagnation. Revolutions in Russia can disrupt global financial markets. Ignoring international trade is like watching only half of an economic football match."

1.2 - The Socialist System

The socialist system is fundamentally based on centralized decision-making, economic planning, and state control over all sectors. It emphasizes collective ownership of production means, viewing economic policymaking as an exclusive responsibility of the state. In contrast, it considers private ownership and individualism as sources of economic crises and social inequalities.

This core socialist ideology results in state dominance over all economic and commercial activities, eliminating individual ownership and private enterprise. In countries with socialist economies, the government alone dictates trade policies, with no consideration for individual preferences. The primary objective is to fulfill the state's and society's collective goals rather than individual economic ambitions¹⁴⁷.

1.3 - The Islamic Economic System

The Islamic economic system offers a unique approach by recognizing private ownership, granting individuals the right to exclusive possession, utilization, and inheritance of their assets. At the same time, it maintains a balance between private and public ownership, ensuring that both contribute equally to economic development.

In this system:

- Private and public ownership coexist without conflict, each fulfilling its role in economic growth.
- The state intervenes in economic activities when necessary, particularly when individuals are unable or unwilling to fulfill essential economic functions.
- Economic freedom is regulated, ensuring a balance between individual and collective interests, all within the framework of Islamic principles.

¹⁴⁷ Abd El-Muttalib Abd El-Hamid, Economic Theory (Micro and Macro Analysis), previously cited reference, pp. 168-174 (with modifications).

Thus, the Islamic system integrates individual economic freedom with state intervention, aiming to harmonize personal and societal benefits without violating fundamental religious principles.

Dr. Tarek Youssef Hassan Jaber defines foreign trade policy in the Islamic economy as:

"A set of procedures, means, and tools used by the Islamic state to achieve the objectives of the Islamic economic system within the framework of regulating foreign trade and all exchanges, including goods, services, and others."

He also believes that the Islamic system, as an entity and a state, seeks to establish trade relations with responsible countries that pose no risk in dealings. Since the products of different regions vary from one country to another, it is essential to address the Islamic state's needs through foreign trade. Engaging in international trade relations is necessary to generate profits that bring widespread benefits to the state. The benefits of foreign trade cannot be overlooked, as Islam views trade as a process of buying and selling, which can be conducted domestically or internationally. Islam does not isolate its state from dealings with other countries, as this is no longer feasible in the modern era, where both domestic and foreign trade are essential aspects of contemporary life¹⁴⁸.

2- International Trade and Multinational Corporations

The ability of multinational corporations to influence the structure and volume of international trade primarily stems from their ownership of production units in various parts of the world. These units generate revenues and financial flows that are reinvested.

2.1- The Position of Multinational Corporations in International Trade

According to older data from the 1970s, multinational corporations controlled a significant share of exported products from developing countries. Their exports exceeded 30% of the total exports of six newly industrialized countries and even surpassed 90% of a country's exports in cases like Singapore¹⁴⁹.

The foundation of these multinational corporations is investment in countries with low labor costs to maximize profits. In addition to this factor, developing countries have implemented policies to attract as many of these corporations as possible by establishing free trade zones. This has allowed multinational corporations to benefit from several advantages, primarily low or even zero taxation, making these locations safe havens for them. Another factor is the ability to establish production processes for goods that are not permitted in the home country, particularly due to environmental regulations.

However, in contrast, a country like the United States saw industries such as electronics, footwear, toys, and clothing begin to relocate for investment worldwide as early as the 1960s. For example, in 1970, 90% of radio sales came from exports by subsidiaries of American companies based in Southeast Asia. These imports to the U.S. sparked anger and hostility from

¹⁴⁸ Bernard Remiche et al., *Le Commerce International Entre Bi-et Multilatéralisme*, Larcier Edition, Brussels, Belgium, 2010, p. 122.

¹⁴⁹ Bernard Remiche et al., *Le Commerce International Entre Bi-et Multilatéralisme*, op. cit., p. 124.

American labor unions, which accused these companies of contributing to the decline of American industry¹⁵⁰.

2.2- Intra-Firm Trade of Multinational Corporations

One of the most significant differences between globalization at the beginning of the 20th century and what we experience today is the role that multinational corporations have come to play in the global economy. Before World War II, the number of these corporations was small, and their role in global trade was very limited.

Their expansion began after World War II, and by the 1970s, one-third of trade among developed countries consisted of exchanges between two branches of the same company operating in different countries. A notable example is Ford exporting engines manufactured in Cologne, Germany, to equip vehicles assembled at one of its branches in Belgium¹⁵¹.

One of the key strategies employed by large corporations is the establishment of multiple branches and the internal circulation of their products, particularly semi-finished goods. This creates a commercial dynamic between the branches of the parent company, which is formally classified as exports and imports since these goods cross national borders.

2.3 - Direct Export vs. Foreign Direct Investment or Licensing

Multinational corporations have driven an increase in relocation and foreign direct investment, a trend that has consistently worried labor unions and government authorities in the companies' home countries. Relocation occurs when a company transfers part or all of its operations to another country, either through one of its subsidiaries or by outsourcing the process to a foreign firm. In both cases, relocation contributes to an increase in global trade and has a direct impact on labor markets.

Before opting for direct investment, licensing, or establishing a subsidiary abroad, a company conducts a feasibility study to weigh its options. It must choose between two primary strategies: producing in the home country and exporting abroad or fully or partially relocating its operations, or granting a production license to a foreign producer.

In the book *International Economics* by Robert J. Carbaugh, an illustrative example is provided to explain the possible choices a company might make¹⁵²:

Consider, for instance, that Company AB produces a soft drink in Wisconsin, USA. Instead of making a direct investment in Canada, the company supplies the Canadian market through direct exports. The production cost remains stable at \$6 per crate when the production level reaches 300 crates.

¹⁵⁰ Paul Samuelson et al., *Economics*, translated by Hisham Abdullah, 2nd ed., Al-Ahliya Publishing and Distribution, Amman, Jordan, 2001, p. 498.

¹⁵¹ Fayçal Lousif, *The Impact of Foreign Trade Policies on Sustainable Economic Development in Algeria during the Period 1970-2012*, previously cited reference, p. 27.

¹⁵² *Ibid.*, p. 27.

First, we analyze the impact of this strategy on the company's economic balance. From an economic standpoint, the direct export strategy is the most suitable when the demand in Canada is relatively low (i.e., the market is small). In contrast, the foreign direct investment (FDI) strategy or licensing production becomes more appropriate when demand in Canada is higher.

Let's assume that Company AB expects American consumers to purchase 200 crates per year. Producing this quantity in Wisconsin allows the company to achieve significant profitability, with a production cost of \$8 per crate. Suppose that the expected demand in Canada is around 100 crates.

Since the total production volume would be 200 crates for U.S. consumers and 100 crates for Canadian consumers, the company can reduce production costs to \$6 per crate, provided that the quantity reaches 300 units.

The alternative to producing this product in the U.S. is manufacturing it in Canada. However, given that the expected demand in Canada is only 100 crates per year, the market remains very small. Additionally, the cost of producing 100 crates in Canada would be \$11 per crate.

On the other hand, if the cost of producing in Wisconsin + distribution and transportation costs is lower than the cost of producing in Canada, then AB will maximize its profits through direct exports to Canada¹⁵³.

However, if the demand in Canada exceeds 300 crates per year, it would be more beneficial for AB to either license a Canadian partner to produce the company's product or invest directly in Canada.

Now, let's assume that Canadian demand reaches 400 crates per year, while U.S. demand remains at 200 crates.

As previously mentioned, the cost remains fixed at \$6 per crate when production reaches 300 crates. This means that producing 400 units for Canada and 200 units for the U.S. will maintain the cost at \$6 per crate. However, Company AB would benefit from avoiding the transportation and distribution costs associated with exporting to Canada. Consequently, AB would increase its profits by either investing directly in Canada or granting a production license to a local Canadian partner.

Beyond transportation costs, trade restrictions (especially import tariffs) could also force the company to opt for direct investment in Canada instead of exporting from Wisconsin, particularly if the Canadian government imposes high tariffs.

Based on the above analysis, it is evident that foreign direct investment (FDI) significantly contributes to global trade due to the following factors:

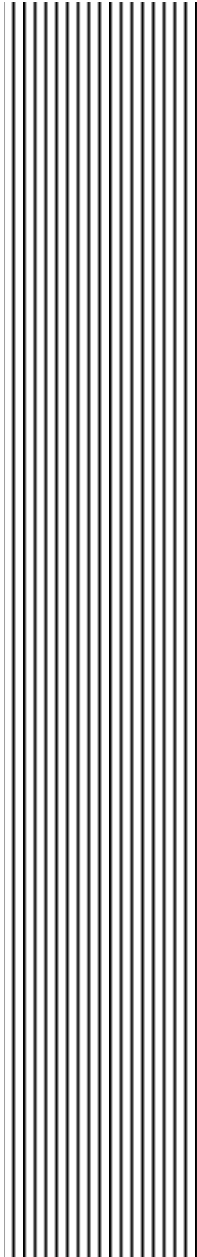
- One-third of global trade consists of exports and imports conducted by multinational corporations.

¹⁵³ Fayçal Lousif, The Impact of Foreign Trade Policies on Sustainable Economic Development in Algeria during the Period 1970-2012, previously cited reference, p. 28.

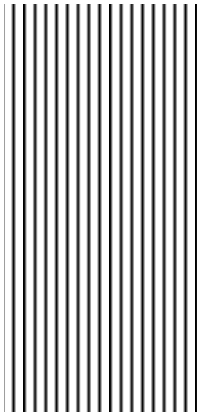
- Internal trade between parent companies and their subsidiaries accounts for one-third of total global trade value.
- Multinational corporations dominate international economic activity by holding the largest share of global direct investments.
- These corporations integrate FDI with global trade by operating through subsidiaries in developing countries and industrialized regions, facilitating export-oriented strategies.

Additionally, structural changes in the global economy play a crucial role in explaining this growing integration between foreign direct investment and international trade¹⁵⁴.

¹⁵⁴ Michael Rainelli, *Le Commerce International*, 9th ed., Éditions La Découverte, Paris, 2003, p. 103.



◆ General Conclusion



In this subject, we addressed the theoretical and conceptual framework of foreign trade policy and its various stages of development to deepen our understanding of its concept and objectives. We reviewed several key points related to international trade policy, including theories that are themselves divided into classical and modern neoclassical theories. We then attempted to present all the tools on which economic policy relies in its implementation and role, with trade policy being one of its most crucial tools, demonstrating its effectiveness in many aspects. As we progressed through this chapter, we examined trade policy, which many consider one of the most important instruments of economic policy. However, the experiences of many countries do not necessarily confirm that free trade inevitably leads to higher levels of growth, especially given the difficulty of applying the assumptions underlying foreign trade theory.

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Index

Title	Page
General Introduction	-
Chapter 1: General Overview of Foreign Trade Policy	-
First: The Concept of Foreign Trade	01
1. Concept of Foreign Trade	02
1.1. Definition and Importance of Foreign Trade	02
1.2. Difference Between Domestic and Foreign (International) Trade	05
1.2.1. Scientific Traditions in Studying International Trade	05
1.2.2. Differences in Economic Problems Domestically and Internationally	05
1.2.3. Mobility of Production Factors	06
1.2.4. Differentiation of Monetary Systems	07
1.2.5. Other Factors	08
2. Reasons for Foreign Trade	09
Second: Importance and Objectives of Foreign Trade	10
1. Importance of Foreign Trade	10
1.1. Economic Aspect	11
1.2. Social Aspect	11
1.3. Political Aspect	11
2. Main Objectives of International Trade	13
3. Stages of International Trade Development	13
4. Foreign Trade Indicators	14
4.1. Trade Balance	14
4.2. Economic Exposure Rate	15
4.3. Terms of Trade	15

4.4. Structure and Geographic Distribution of Exports	16
4.5. Structure and Geographic Distribution of Imports	17
Chapter 2: Theories of Foreign Trade	-
First: Classical Theories	19
1. Absolute Advantage Theory	19
2. Comparative (Cost) Advantage Theory - David Ricardo	24
3. Mercantilist Theory	27
Second: Modern Neoclassical Theory of Foreign Trade	28
1. Factor Price Equalization Theory (Samuelson)	30
2. Rybczynski Theory	31
3. John Hicks' Theory	32
Chapter 3: Economic Policy Instruments -	
First: Concept of Economic Policy	33
1. Definitions of Economic Policy	33
2. Types of Economic Policy	34
2.1. Conjunctural Economic Policy	35
2.1.1. Stabilization Policy	35
2.1.2. Recovery Policy	35
2.1.3. Contractionary Policy	36
2.1.4. Stop-and-Go Policy	36
2.2. Structural Economic Policy	37
3. Objectives of Economic Policy	37
Second: Economic Policy Instruments	38
1. Fiscal Policy	39
1.1. Definition of Fiscal Policy	39
1.2. Fiscal Policy Instruments	40
1.2.1. Public Expenditures	42
1.2.2. Public Revenues	44

1.2.3. General Budget	45
2. Monetary Policy	46
2.1. Definitions and Objectives of Monetary Policy	46
2.1.1. Definition of Monetary Policy	47
2.1.2. Objectives of Monetary Policy	47
2.2. Monetary Policy Instruments	49
2.2.1. Quantitative Control Instruments	49
2.2.2. Qualitative (Selective) and Direct Control Instruments	51
2.3. Monetary Policy and Inflation/Recession Control	52
2.3.1. Monetary Policy and Inflation Control	53
2.3.2. Monetary Policy and Recession Control	53
3. Investment Policy	54
3.1. Definition and Objectives of Investment Policies	54
3.2. Determining Factors of Investment Value and Pattern	56
3.3. Investment Theories and Policies	58
3.4. Relationship Between Investment Policy Objectives and National Investment Evaluation Criteria	59
4. Investment Evaluation Criteria	60
4.1. Value Added Criterion	60
4.2. Employment Criterion	61
4.3. Balance of Payments Support Criterion	61
5. Trade Policy	61
Chapter 4: Trade Policy	-
First: Nature, Types, and Objectives of Trade Policy	62
1. Definition of Trade Policy	63
2. Types of Trade Policies	64
2.1. Free Trade Policy	64
2.2. Protectionist Trade Policy	66
3. Objectives of International Trade Policies	69

3.1. Economic Objectives	69
3.2. Social Objectives	70
3.3. Political and Strategic Objectives	70
4. Trade Policy Instruments	70
4.1. Protectionist Trade Policy Instruments	70
4.2. Free Trade Policy Instruments	72
5. Key Technical Methods for Foreign Trade Regulation	73
5.1. Taxes and Customs Duties	73
5.2. Subsidies and Support	74
5.2.1. Direct Subsidies	74
5.2.2. Indirect Subsidies	75
5.3. Quota System and Import Licenses	75
5.4. Trade Agreements	76
Second: Trade Policy and Balance of Payments Deficit Control	76
1. Future of Trade Policy in Light of Global Economic Changes	77
Third: Relationship Between Trade Policy, Economic Systems, and International Trade Trends	78
1. Relationship Between Trade Policy and Economic Systems	78
1.1. Capitalist System	78
1.2. Socialist System	80
1.3. Islamic System	80
2. International Trade and Multinational Corporations	81
2.1. Role of Multinational Corporations in International Trade	81
2.2. Intra-Firm Trade of Multinational Corporations	82
2.3. Direct Export vs. Foreign Direct Investment or Licensing	82
General Conclusion	86
List of Sources and References	88
Index	96