SYLLABUS
B. Com - III Year
Subject – International Business

UNIT NO.	TOPICS
1	**Introduction to International Business:** Concept, Need, and Importance of International Business. Globalization and it's importance in world economy international business vs. domestic business, Complexities of international business. Modes of entry into international business. International Business Environment: National and foreign environments and their components economic, cultural political and legal environments.
2	**Theories of international trade-** Absolute advantage theory, Comparative advantage theory, Factor proportion theory and Leontief paradox, Product life cycle theory, National competitive advantage theory. Tariff and Non-Tariff Barriers. Balance of payment account and its components.
3	**International Financial Environment:** Foreign exchange market, Spot market, spot rate quotations, bid-ask spreads, trading in spot markets, cross exchange rates, forward markets, forward rate, long and short forward positions, forwards premium and discount. Arbitrage, Hedging and Speculation Types of exchange rate systems- fixed and floating, soft peg, crawling peg, free float, managed flot. Foreign exchange risk and exposure. Exchange rate Determinations: Types of Exchange rates, factors affecting exchange rate relative inflation rates, interest rates, relative interest rates, relative income levels, government controls and expectations.
4	**Foreign Trade Promotion measures and Organization in India.** Special economic zones (SEZ) and export-oriented units (with 100% export-oriented units) foreign investment-concept, type and flow, Foreign investment in Indian perspective. Financing of foreign trade and payment terms sources of trade finance (Banks, factoring forfeiting Banker's Acceptance and Corporate Guarantee) and forms of payment (Cash in advance, Letter of Credit. Documentary Collection. Open Account).
5	**Regional Economic Integration:** Forms of regional integration: Integration efforts amongst countries in Europe, North America and Asia . EU, NAFTA, SAARC and ASEAN. International Economic Organisations: WTO, UNCTAD, World Bank and IMF.

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Unit I

Introduction to International business

Concept Need and Importance of International business

- Refers to the business activities or transactions carried out beyond the national borders of a country. It is a much wider term comprising of all the commercial transactions taking place between two countries. International business can occur in different modes which can be exporting, licensing, contract, manufacturing, foreign assembly foreign production, joint venturing, and others.The nature and extent of economic interdependence among countries.
- Countries depend on each other for a variety of economic transactions that is transactions and goods and services and capital being a part of world economy.
- No Country can live in economic isolation or referred to keep out of a global economy no country is self-sufficient in regard to its requirement nor can it consume all that it produces.
- In other words, interdependence of countries is reflected in the whole range of international transactions.
- Therefore, international business is a **combination of all commercial transactions either private or government between two or more countries it is the exchange of capital goods and services across the international borders or territories.**
- These transactions are **conducted at the global level & across national borders**. International businesses are very large in size as they are performed at a global level.
- Their scales of operation are vast in size. International businesses provide employment to a large number of peoples. It is served as an important source for earning foreign exchange for the country. All payments in these businesses are done in foreign currencies of different countries.
- These businesses **help in improving the standard of living of people** in different countries **by supplying high-quality goods.**
- International businesses provide employment to a large number of peoples. It is served as an important source for earning foreign exchange for the country. All payments in these businesses are done in foreign currencies of different countries.

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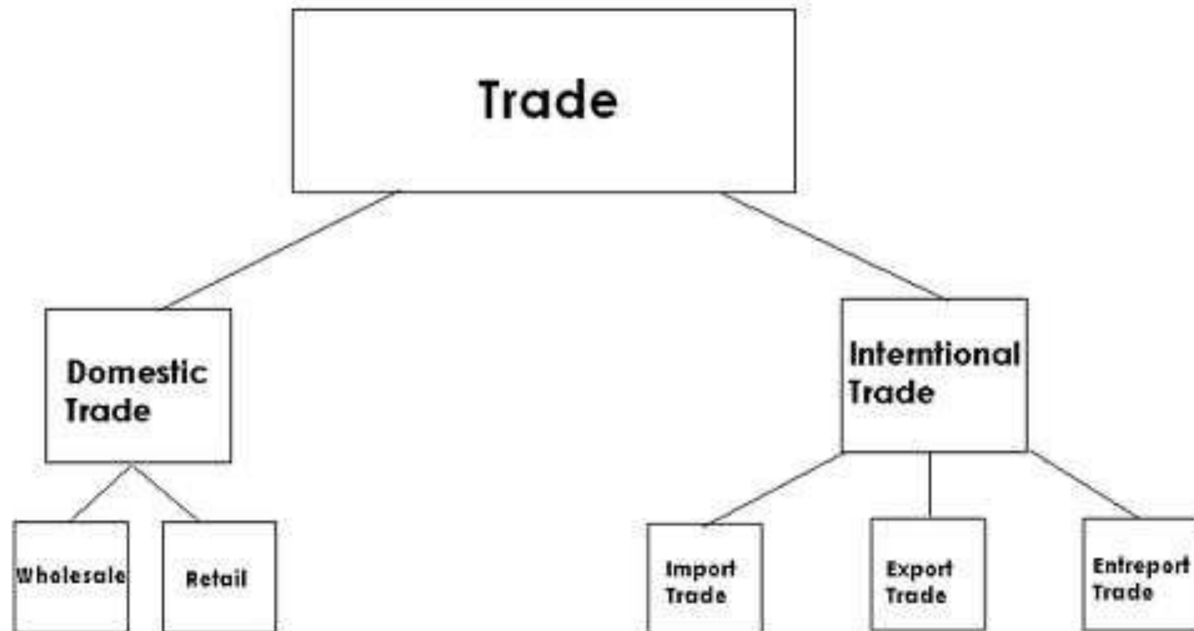

- **It is of three types:**
- **Export Trade** –It is selling of goods and services to foreign countries.
- **Import Trade –** It is buying goods and services from other countries.
- **Entreport Trade –** It is import of goods and services for re-export to other countries.

Definition of Domestic Business

The business transaction that occurs within the geographical limits of the country is known as domestic business. It is a business entity whose commercial activities are performed within a nation. Alternately known as internal business or sometimes as home trade.

The producer and customers of the firm both reside in the country. In a domestic trade, the buyer and seller belong to the same country and so the trade agreement is based on the practices, laws and customs that are followed in the country.

There are many privileges which a domestic business enjoys like low transaction cost, less period between production and sale of goods, low transportation cost, encourages small-scale enterprises, etc.

Definition of International Business

International Business is one whose manufacturing and trade occur beyond the borders of the home country. All the economic activities indulged in cross- border transactions comes under international or external business. It includes all the commercial activities like sales, investment, logistics, etc., in which two or more countries are involved.

The company conducting international business is known as a multinational or transnational company. These companies enjoy a large customer base from different countries, and it does not have to depend on a single country for resources.Further, the international business expands the trade and investment amongst countries.

Differences Between Domestic and International business are classified as under:

Domestic Business is defined as the business whose economic transaction is conducted within the geographical limits of the country. International Business refers to a business which is not restricted to a single country, i.e. a business which is engaged in the economic transaction with several countries in the world.

- The area of operation of the domestic business is limited, which is the home country. On the other hand, the area of operation of an international business is vast, i.e. it serves many countries at the same time.
- The quality standards of products and services provided by a domestic business is relatively low. Conversely, the quality standards of international business are very high which are set according to global standards.
- Domestic business deals in the currency of the country in which it operates. On the contrary, the international business deals in the multiple currencies.
- Domestic Business requires comparatively less capital investment as compared to international business.
- Domestic Business has few restrictions, as it is subject to rules, law taxation of a single country. As against this, international business is subject to rules, law taxation, tariff and quotas of many countries and therefore, it has to face many restrictions which are barriers in the international business.
- The nature of customers of a domestic business is more or less same. Unlike, international business wherein the nature of customers of every country it serves is different.
- Business Research can be conducted easily, in domestic business. As against this, in the case of international research, it is difficult to conduct business research as it is expensive and research reliability varies from country to country.
- In domestic business, factors of production are mobile whereas, in international business, the mobility of factors of production are restricted.

International Business – Meaning and Definitions

International business refers to those business activities that take place beyond the geographical limits of a country. **"International business consists of transactions that are devised and carried out across national borders to satisfy the objectives of the individuals, companies and organisations. These transactions take on various forms which are often interrelated**." **– Michael R. Czinkota**

"International business involves commercial activities that cross national frontiers" – **Roger Bennett**

- Thus, it involves not only the international movement of goods and services, but also of capital, personnel, technology and intellectual property like patents, trademarks, knowhow and copyrights etc.It is a business which takes place outside the boundaries of a country, i.e., between two countries.It includes the international movements of goods and services, capital, personnel, technology and intellectual property rights like patents, trademarks and knowhow.It refers to the purchase and sale of goods and services beyond the geographical limits of a country.

<u>Features of International Business:</u>

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- **Large scale operations**: In international business, all the operations are conducted on a very huge scale. Production and marketing activities are conducted on a large scale. It first sells its goods in the local market. Then the surplus goods are exported.
- **Integration of economies** : International business integrates (combines) the economies of many countries. This is because it uses finance from one country, labour from another country, and infrastructure from another country. It designs the product in one country, produces its parts in many different countries and assembles the product in another country. It sells the product in many countries, i.e. in the international market.
- **Dominated by developed countries and MNCs** : International business is dominated by developed countries and their multinational corporations (MNCs). They also have the best technology and research and development (R & D). They have highly skilled employees and managers because they give very high salaries and other benefits. Therefore, they produce good quality goods and services at low prices. This helps them to capture and dominate the world market.

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- **Benefits to participating countries** : International business gives benefits to all participating countries. However, the developed countries get the maximum benefits. The developing countries also get benefits. They get foreign capital and technology. They get rapid industrial development. They get more employment opportunities. All this results in economic development of the developing countries. Therefore, developing countries open up their economies through liberal economic policies.

- **Keen competition** : International business has to face keen competition in the world market. The competition is between unequal partners i.e. developed and developing countries. In this keen competition, developed countries and their MNCs are in a favourable position because they produce superior quality goods and services at very low prices. Developed countries also have many contacts in the world market. So, developing countries find it very difficult to face competition from developed countries.

- **Special role of science and technology** : International business gives a lot of importance to science and technology. Science and Technology (S & T) help the business to have large-scale production. Developed countries use high technologies. Therefore, they dominate global business. International business helps them to transfer such top high-end technologies to the developing countries.

- **International restrictions** : International business faces many restrictions on the inflow and outflow of capital, technology and goods. Many governments do not allow international businesses to enter their countries. They have many trade blocks, tariff barriers, foreign exchange restrictions, etc. All this is harmful to international business.

- **Sensitive nature** : The international business is very sensitive in nature. Any changes in the economic policies, technology, political environment, etc. has a huge impact on it. Therefore, international business must conduct marketing research to find out and study these changes. They must adjust their business activities and adapt accordingly to survive changes.

Importance of International Business

1. Earn Foreign Exchange
2. Optimum Utilisation of Resources
3. Achieve its Objectives
4. To Spread Business Risks
5. Improve Organisation Efficiency
6. To Get Benefits from Government
7. Expand and Diversify

- **Earn foreign exchange**: International business exports its goods and services all over the world. This helps to earn valuable foreign exchange. This foreign exchange is used to pay for imports. Foreign exchange helps to make the business more profitable and to strengthen the economy of its country.
- **Optimum utilisation of resources**: International business makes optimum utilisation of resources. This is because it produces goods on a very large scale for the international market. International business utilises resources from all over the world. It uses the finance and technology of rich countries and the raw materials and labour of the poor countries.

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- **Improve organisation's efficiency**: International business has very high
- organisation efficiency. This is because without efficiency, they will not be able to face the competition in the international market. So, they use all the modern management techniques to improve their efficiency. They hire the
- most qualified and experienced employees and managers. These people are trained regularly. They are highly motivated with very high salaries and other benefits such as international transfers, promotions, etc. All this results in high organisational efficiency, i.e. low costs and high returns.
- **Get benefits from Government**: International business brings a lot of foreign exchange for the country. Therefore, it gets many benefits, facilities and concessions from the government. It gets many financial and tax benefits from the government.
- **Expand and diversify**: International business can expand and diversify its activities. This is because it earns very high profits. It also gets financial help from the government.
- **Increase competitive capacity**: International business produces high-quality goods at low cost. It spends a lot of money on advertising all over the world. It uses superior technology, management techniques, marketing techniques, etc.All this makes it more competitive. So, it can fight competition from foreign companies.

Economies Of Scale:

These business are able to enjoy economies of scale due to their large scale production. International businesses produce large amount of goods for selling in different countries. With the increase in amount of production, per unit cost of producing goods goes down which helps them in earning large profits.

Cost Advantage: International business takes cost advantage over its competitors by producing goods in one country and exporting them in another country. They carry on their production in a country where factors of production are easily and cheaply available. This helps in minimizing the cost of product and earn huge profits by selling them at better prices in other countries.

Provide Employment Opportunities: International business employs large number of people for carrying out its operations across the globe. They perform large scale operations in many countries for which they require large amount of human resource.

Scope of International Business

- **Foreign Investments:** Foreign investment is an important part of international business. **Foreign investment contain investments of funds from the abroad in exchange for financial return**. Foreign investment is done through investment in foreign countries through international business. Foreign investments are two types which are **direct investment** and **portfolio investment.**
- **Exports And Imports Of Merchandise:** Merchandise are the **goods which are tangible**. (those goods which can be **seen and touched**.) Merchandise export means sending the home country's goods to other countries, which are tangible and merchandise imports means bringing tangible goods to the home country.
- **Licensing And Franchising:** Franchising means giving permission to the new party of the foreign country in order to produce and sell goods under your trademarks, patents or copyrights in exchange of some fee is also the way to enter into the international business. Licensing system refers to the companies like Pepsi and Coca-Cola which are produced and sold by local bottlers in foreign countries.
- **Service Exports And Imports:** Services exports and imports consist of the intangible items which cannot be seen and touched. The trade between the countries of the services is also known as invisible trade. There is a variety of services like tourism, travel, boarding, lodging, constructing, training, educational, financial services etc. Tourism and travel are major components of world trade in services.
- **Growth Opportunities:** There are lots of growth opportunities for both of the countries, developing and under-developing countries by trading with each other at a global level.

The imports and exports of the countries grow their profits and help them to grow at a global level.

- **Benefiting From Currency Exchange:** International business also plays an important role while the currency exchange rate as one can take advantage of the currency fluctuations.
- **Limitations Of The Domestic Market:** If the domestic market of a country is small then the international business is a good option for the growth of the business in the host country. Depression of domestic market firms will force to explore foreign markets.

<u>What is Globalisation</u>

The meaning of Globalisation is usually interpreted to indicate the integration of the economy of the nation with the world economy, it is a multi faceted aspect.It is a result of the collection of multiple strategies that are directed at transforming the world towards greater interdependence and integration.It includes the creation of networks and pursuits transforming social, economic and geographical barriers. Globalisation tries to build links in such a way that the events in India can be determined by events happening distances away.In other words, Globalisation is the method of interaction and union among people, corporations and governments universally.

- **Accordingly, the term globalisation has four parameters:**

❖ Permitting **free flow of goods** by removing or reducing trade barriers between the countries,

❖ Creating environment for **flow of capital** between the countries,

❖ Allowing **free flow in technology transfer** and

❖ Creating environment for **free movement of labour** between the countries of the world.

Thus taking the entire world as global village, all the four components are equally important for attaining a smooth path for globalisation.

Features of Globlization:

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FEATURES OF GLOBALIASTION

- Rapid expansion of international trade
- Internationalization of products and services by large firms
- Growing importance of multinational corporations
- Increase in capital transfers across national borders
- Globalization of technology
- Shifts in production from country to country
- Increased freedom and capacity and firms to undertake economic transactions across national boundaries
- Fusing of national markets
- Economic integration
- Global economic interdependence

Advantages of Globalisation

- **Advantages of globalisation**

  a developing country like India:

1. Globalization helps to boost the long run average growth rate of the economy of the country through:
   - (a) Improvement in the allocative efficiency of resources;
   - (b) Increase in labour productivity; and
   - (c) Reduction in capital-output ratio.
2. Globalisation paves the way for removing inefficiency in production system. Prolonged protective scenario in the absence of globalisation makes the production system careless about cost effectiveness which can be attained by following the policy of globalisation.

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3. Globalisation attracts **entry of foreign capital along with foreign updated technology which improves the quality of production.**
4. Globalisation usually restructure production and trade pattern favouringlabour-intensive goods and labour-intensive techniques as well as expansion of trade in services.

trade

Global trade
- Imports and exports
- Trade with many countries
- Trade agreements help exporters
- More demand for goods and services as living standards improve
- Lower business costs

Global migration
- People moving to other countries
- People working overseas
- International tourism
- Cheaper flights and transport

culture

migration

Global culture
- Products from many countries
- Cultural exchange and understanding
- Cultural exports
- Global advertising
- Global organisations

Global communication
- Cheaper, faster communication
- Internet access
- Global media networks
- New technologies
- Increased awareness of international issues

communication

Why should companies expand internationally?

- A truly multinational company is one which has a globalized supply chain spread across different parts of the world. While a global supply chain has its own vulnerabilities, which are usually beyond the control of the company (for example: the Tsunami in Japan), there are many reasons why a company would want to enter into international markets.
- The primary reasons that companies opt to expand into foreign markets are to:

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- **1. Explore markets with better profitability:** This is an obvious reason for a lot of local companies to enter into an international markets. An international market could have a higher purchasing power and, therefore, the same products can earn better profits in that market. This is obviously minus the initial go-to-market cost of breaking into that international market.

- **2. Achieve economies of scale with a larger customer base:** Some goods and commodities provide the company with great economies of scale opportunities. The effects of economies of scale can be magnified when a larger base of customers come into the business. This is pretty relevant to tech-based companies who can be easily classified as 'born-global' companies. This companies can offer their technology products to a new customer, any where in the world, at no additional costs. Hence, making more money on the buck.

- **3. Reduce over dependence on any one market:** Each business should be diversified across products and also across the market segments that it targets. This protects the business from uncertainties. This is another reason why a company should expand internationally. Usually, it would stabilize the product portfolio as well as customer portfolio to make the business robust against seasonality and the uncertainties.

- **5. Service customers who are abroad:** There could be tech companies who already serve customers around the world despite being centered at only their home country. When the company has enough number of big ticket customers in some part of the world, they can think about setting up an office there and further expand their customer base. This is done better when the company serves the international market with personalized and culturally relevant market.

Modes of Entry into International Business

- There are various ways in which a company can enter into international business.

- **Exporting and Importing:** Exporting refers to selling of goods and services by a firm of home country to a firm of foreign country. For example, sale of sweets by Haldiram to WalMart Store in USA.Importing refers to buying of goods and services by a firm of home country from a firm of foreign country. For example, purchase of toys by an Indian toy dealer from a Chinese firm.

- **Two Important Ways to Export and Import:**

  Direct Exporting/Importing – The firm deals directly with the overseas buyers or suppliers and carries out all formalities related to shipment and financing of goods and services.

Indirect Exporting/Importing – The firm employs a middleman (such as export houses or buying offices of overseas customers), who deals with the overseas buyers or suppliers and carries out all the formalities. The firm's participation is minimum.

- **Tangible vs. Intangible Exports and Imports: The exports and imports can be**

of two types:

- 1. **Merchandise exports and imports** – Merchandise means goods that are tangible, i.e., which can be seen and touched. The trade in merchandise is also known as 'Visible Trade'. Merchandise exports involves sending tangible goods abroad, while merchandise imports means bringing tangible goods from a foreign country to the home country.
- 2. **Service exports and imports** – It involves trade in intangibles, i.e., which cannot be seen and touched. The trade in services is also known as 'Invisible Trade'. It includes trading in wide variety of services, such as tourism, entertainment, transportation, communication, banking, etc.

Advantages of Exporting and Importing:

- 1. Easy Mode – As compared to other modes of international business, it is the

easiest way to get entry into international market.

- 2. Less Investment – It does not require heavy investment as needed in case of other modes of entry. Moreover, firm is not required to invest much of its time in business operations.
- 3. Less Risk – It is less risky due to negligible or low foreign investment as compared to other modes of entry.

Advantages of Import and Export

- It is one of the simplest routes of entering into the global trade and import and export generate huge employment opportunities.
- Requires less investment in terms of time and money when contrasted with other methods of entering into the global trade.
- Is comparatively less risky when compared with different routes of entering in international business.
- As no nation can be 100% self-sufficient, import and export are very

crucial for the functioning and growth of that nation.

- Can help Countries to access the best technologies available and

best products and services in the world.

- It gives better control over the trade than setting up a market and the

risk is considerably low.

Contract Manufacturing:

- Contract manufacturing is a type of international business, in which a firm enters into a contract with another firm in foreign country to manufacture certain components or goods as per its specifications. For example, international companies such as Nike, Reebok, Levis, etc. get their products or components produced in the developing countries under contract manufacturing. Contract manufacturing is also known as outsourcing.

Contract manufacturing can be done in three ways:

- Production of certain components to be used in producing final products – For example, giving contract to manufacture car accessories (like door handles, rear mirror) so that they can be used in manufacturing the final product (i.e. car).
- Assembly of components into final products – For example, assembly of

processor, mother board, hard disk, RAM, etc. into a computer.

- Manufacture of the complete product – The contract may also be given to manufacture the complete product. For example, companies like Sony, Samsung get most of the products manufactured as per their specifications.

Advantages of Contract Manufacturing:

- Contract manufacturing offers several advantages to both the international company and local producers in the foreign countries.
- 1. No need to set Production Facilities – It allows the international firms to get the goods produced on a large-scale without requiring investment in setting up production facilities.
- 2. Low Investment Risk – The investment risk is almost negligible due to no/ little investment in the foreign countries.
- 3. Lower Cost of Production – It benefits the international company to get the products manufactured or assembled at lower costs. For example, many foreign firms get their goods manufactured in India due to cheap labour.
- 4. Better utilisation of idle capacity – Local producers in foreign countries also gain as contract manufacturing ensures better utilisation of their production capacity. For example, Godrej group has been benefitted by using its excess soap manufacturing capacity in manufacturing Dettol soap for foreign company, Reckitt and Colman.

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- 5. Benefits of Export Incentives – The local manufacturers can get benefits of export incentives if the produced goods are to be delivered to a foreign country (as per requirements of the international firm).

Licensing and Franchising:

- **Licensing:**
- Licensing is a contractual arrangement in which one firm grants access to its patents, trade secrets or technology to another firm in a foreign country for a fee called royalty. For example, Pepsi and Coca Cola are produced and sold all over the world by local bottlers in foreign countries under the licensing system.
- The firm that grants such permission is known as 'Licensor' and the other firm in the foreign country that acquires such rights are known as 'Licensee'. When there is mutual exchange of knowledge, technology and/or patents between the firms, it is known as 'Cross-licensing'.
- It may be mentioned here that it is not only technology that is licensed. For example, in the fashion industry, designers license the use of their names.

Franchising:

- Franchising is a contractual agreement which involves grant of rights by one party to another for use of technology, trademark and patents in return of the agreed payment for a certain period of time. The company that grants the rights (i.e. parent company) is known as 'Franchiser' and the other company (which acquires the rights) is known as 'Franchisee'.

International Business Environment

- The (IBE) International Business Environment is **multidimensional including the political risks, cultural differences, exchange risks, legal & taxation issues.** Therefore, (IBE) **International Business Environment** comprises the political, economic, regulatory, tax, social & cultural, legal, & technological environments.
- **An international business environment is the surrounding in which international companies run their businesses.**
- Thus, it is mandatory for the people at the managerial level to work on the factors that make an International Business Environment.
- International business is an exchange of goods and services that conducts its operations across national borders, between two or more countries. International business is also known as Globalization whereas, a Business Environment is the surrounding in which the international companies operate.

Advantages of International Business Environment

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- Helps in expanding the business,
- Exposure to more customers
- Helps in the proper management of the product life cycle and
- Helps in mutual growth

Political Environment

- The political environment refers to the **type of the government, the government relationship with a business, & the political risk in the country.** Doing business internationally, therefore, implies dealing with a different type of government, relationships, & levels of risk.
- There are many different types of political systems, for example, multi-party democracies, one party states, constitutional monarchies dictatorships (military &Therefore, in analyzing the political-legal environment, an organization maybroadly consider the following aspects:
- The Political system of the business;
- Approaches to the Government towards business i.e. Restrictive or facilitating;
- Facilities & incentives offered by the Government;
- Legal restrictions for instance licensing requirement, reservation to a specific sector like the public sector, private or small-scale sector;
- The Restrictions on importing technical know-how, capital goods &
- raw materials;
- The Restrictions on exporting products & services;
- Restrictions on pricing & distribution of goods;
- Procedural formalities required in setting the business

Economic Environment

- The economic environment relates to all the factors that contribute to

a country's attractiveness for foreign businesses.

- The economic environment can be very different from one nation to another. Countries are often divided into three main categories: **the more developed or industrialized**, the **less developed** or third world, &**the newly industrializing or emerging economies.**
- Clearly, the level of economic activity combined with education, infrastructure, & so on, as well as the degree of government control of the economy, affect virtually all facets of doing business, & a firm needs to recognize this environment if it is to operate successfully internationally. While analyzing the economic environment, the organization intending to enter a particular business sector may consider the following aspects:
- An Economic system to enter the business sector.
- Stage of economic growth & the pace of growth.
- Level of national & per capita income.
- Incidents of taxes, **both direct & indirect tax.**
- Infrastructure facilities available & the difficulties thereof.
- Availability of raw materials & components & the cost thereof.
- Sources of financial resources & their costs.
- Availability of manpower-managerial, technical & workers available & their salary & wage structures.
- Within each category, there are major variations, but overall the more developed countries are the rich countries, the less developed the poor ones, & the newly industrializing (those moving from poorer to richer).
- These distinctions are generally made on the basis of the gross domestic product per capita (GDP/capita). Better education, infrastructure, & technology, healthcare, & so on are also often associated with higher levels of economic development.

Technological Environment

- The technological environment comprises factorsrelated to the materials & machines used in manufacturing goods & services.
- Receptivity of organizations to new technology & adoption of new technology by consumers influence decisions made in an organization.
- As firms do not have any control over the external environment, their success depends on how well they adapt to the external environment.
- An important aspect of the international business environment is the level, & acceptance, of technological innovation in different countries.

- Technology often is seen as giving firms a competitive advantage; hence, firms compete for access to the newest in technology, & international firms transfer technology to be globally competitive.
- In analyzing the technological environment, the organization may

consider the following aspects:

- Level of technological development in the country as a whole & specific business sector.
- The pace of technological changes & technological obsolescence.
- Sources of technology.
- Restrictions & facilities for technology transfer & time taken for the absorption of technology.

Cultural Environment

- The cultural environment is one of the critical components of the international business environment This is because the cultural environment is essentially unseen; it has been described as a shared, commonly held body of general beliefs & values that determine what is right for one group,
- National culture is described as the body of general beliefs & the values that are shared by the nation. Beliefs & the values are generally seen as formed by factors such as the history, language, religion, geographic location, government, & education; thus firms begin a cultural analysis by seeking to understand these factors. The most well-known is that developed by Hofstede in1980.
- His model proposes four dimensions of cultural values including individualism, uncertainty avoidance, power distance & masculinity.
- Individualism is the degree to which a nation values & encourages individual action & decision making.
- Uncertainty avoidance is the degree to which a nation is willing to accept & deal with uncertainty.
- Power distance is the degree to which a national accepts & sanctions differences in power.
- Masculinity comes with the distinct gender roles, assertive, and concentrated on material achievements and wealth-building.
- This model of cultural values has been used extensively because it provides data for a wide array of countries. Many academics & the managers found that this model helpful in exploring management approaches that would be appropriate in different cultures.

- **For example,** in a nation that is high on individualism one expects individual goals, individual tasks, & individual reward systems to be effective, whereas the reverse would be the case in a nation that is low on individualism.
- While analyzing social & cultural factors, the organization may consider the following aspects:
- Approaches to society towards business in general & in specific areas;
- Influence of social, cultural & religious factors on the acceptability of the product;
- The lifestyle of people & the products used for them;
- Level of acceptance of, or resistance to change;
- Values attached to a particular product i.e. the possessive value or the functional value of the product;
- Demand for the specific products for specific occasions;
- The propensity to consume & to save.

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Unit III

Theories Of International Trade

Absolute Advantage Theory

Absolute Advantage Theory

The Absolute Advantage theory is an economic concept that was first introduced by the Scottish economist Adam Smith in his seminal work, "An Inquiry into the Nature and Causes of the Wealth of Nations" (1776). This theory serves as one of the foundational principles in classical economics and international trade. The key idea behind the Absolute Advantage theory is relatively straightforward:

- Definition of Absolute Advantage:

Absolute advantage refers to the ability of a country, individual, or economic entity to produce a good or service more efficiently and with fewer resources than another country or entity.

Labor Productivity and Efficiency:

The theory is primarily based on differences in labor productivity and efficiency between nations. Smith argued that nations should specialize in the production of goods and services in which they have an absolute advantage.

Specialization and Trade:

According to the theory, if each country specializes in producing the goods or services in which it has an absolute advantage, and then engages in trade with other nations, overall global economic welfare can be maximized.

Mutual Benefit:

The core premise is that even if one country has an absolute advantage in the production of all goods over another country, both countries can still benefit from trading with each other. By focusing on what they can produce most efficiently, countries can achieve higher overall productivity and a better allocation of resources.

Critique and Assumptions:

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The theory makes several assumptions, including the assumption of full employment, constant returns to scale, and the absence of transportation costs. Critics argue that these assumptions limit the real-world applicability of the theory.

Example to Illustrate Absolute Advantage:

Consider two countries, Country A and Country B, and two goods, Apples and Bananas.

Country A:

It takes 10 hours to produce 1 ton of Apples.

It takes 20 hours to produce 1 ton of Bananas.

Country B:

It takes 5 hours to produce 1 ton of Apples.

It takes 15 hours to produce 1 ton of Bananas.

In this example, Country A has an absolute advantage in the production of Bananas because it can produce them with fewer hours of labor. However, Country B has an absolute advantage in the production of Apples. According to the Absolute Advantage theory, both countries could benefit by specializing in the production of the good in which they have an absolute advantage and then trading with each other.

Limitations and Criticisms:

Assumptions Unrealistic: The theory relies on assumptions that may not always hold in the real world, such as full employment, constant returns to scale, and the absence of transportation costs.

Neglects Comparative Advantage: The theory does not consider the concept of comparative advantage, which takes into account opportunity costs. Comparative advantage, introduced later by David Ricardo, is often considered a more nuanced and realistic view of international trade.

Static View: The theory provides a static view and does not account for changes in technology, resource availability, or other dynamic factors that can impact comparative advantage over time.

Despite its limitations, the Absolute Advantage theory laid the groundwork for subsequent theories of international trade and remains an important historical contribution to economic thought.

Comparative Advantage Theory:

The Absolute Advantage theory is an economic concept that was first introduced by the Scottish economist Adam Smith in his seminal work, "An Inquiry into the Nature and Causes of the Wealth of Nations" (1776). This theory serves as one of the foundational principles in classical economics and international trade. The key idea behind the Absolute Advantage theory is relatively straightforward:

Key Points of Absolute Advantage Theory:
Definition of Absolute Advantage:

Absolute advantage refers to the ability of a country, individual, or economic entity to produce a good or service more efficiently and with fewer resources than another country or entity.
Labor Productivity and Efficiency:

The theory is primarily based on differences in labor productivity and efficiency between nations. Smith argued that nations should specialize in the production of goods and services in which they have an absolute advantage.
Specialization and Trade:

According to the theory, if each country specializes in producing the goods or services in which it has an absolute advantage, and then engages in trade with other nations, overall global economic welfare can be maximized.
Mutual Benefit:

The core premise is that even if one country has an absolute advantage in the production of all goods over another country, both countries can still benefit from trading with each other. By focusing on what they can produce most efficiently, countries can achieve higher overall productivity and a better allocation of resources.
Critique and Assumptions:

The theory makes several assumptions, including the assumption of full employment, constant returns to scale, and the absence of transportation costs. Critics argue that these assumptions limit the real-world applicability of the theory.

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Comparative Advantage Theory

The Comparative Advantage theory is a fundamental concept in economics, especially in the context of international trade. It was developed by the British economist David Ricardo in the early 19th century. Comparative Advantage builds upon the earlier concept of Absolute Advantage proposed by Adam Smith and provides a more nuanced understanding of trade patterns and specialization among countries. Key aspects of the Comparative Advantage theory include:

1. Definition of Comparative Advantage:

Comparative Advantage refers to a situation in which one country can produce a good or service at a lower opportunity cost than another country. Opportunity cost is the value of the next best alternative forgone when a choice is made.

2. Opportunity Cost and Trade:

The theory focuses on the opportunity cost of producing goods and services. If a country has a lower opportunity cost for producing a particular good, it is said to have a comparative advantage in the production of that good.

3. Specialization and Mutual Benefit:

Comparative Advantage argues that even if one country has an absolute advantage in the production of all goods, there are still potential gains from trade if each country specializes in the production of the good in which it has a comparative advantage.

4. Mutual Gains from Trade:

By specializing in the production of goods for which they have a comparative advantage and trading with each other, countries can achieve mutual gains from trade. Both countries can end up with more of both goods than if they tried to be self-sufficient.

5. Example to Illustrate Comparative Advantage:

Consider two countries, A and B, and two goods, Cars and Computers.

Opportunity Costs:

Country A: 1 Car = 10 Computers

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Country B: 1 Car = 5 Computers

Comparative Advantage:

Country B has a lower opportunity cost for producing Cars (giving up fewer Computers), so it has a comparative advantage in Car production.

Country A has a lower opportunity cost for producing Computers, so it has a comparative advantage in Computer production.

6. Dynamic Nature:

Comparative Advantage recognizes that comparative advantage can change over time due to shifts in factors like technology, resources, or policies.

7. Efficient Allocation of Resources:

By allowing each country to specialize in the production of goods for which it has a comparative advantage, resources are allocated more efficiently, leading to increased overall production.

8. Critiques and Considerations:

While Comparative Advantage provides a powerful framework for understanding trade patterns, critics note that it assumes constant opportunity costs and does not consider factors like transportation costs, imperfect competition, and other real-world complexities.

9. Applications Beyond Goods:

The theory can be applied beyond goods to services, labor markets, and other economic activities where opportunity costs play a role.

Comparative Advantage is considered a key insight in international economics and has played a crucial role in shaping trade policies and agreements. It highlights the benefits of specialization, efficiency gains, and the potential for mutually beneficial trade relationships among countries.

Factor Proportion theory and Leontief Paradox

Factor Proportion Theory, also known as the Heckscher-Ohlin model, is an economic theory that explains international trade patterns based on the relative abundance of factors of production in different countries. The theory was developed by economists Eli Heckscher and Bertil Ohlin in the early 20th century. The main idea behind the theory is that countries will export goods that intensively use their abundant factors of production and import goods that intensively use their scarce factors of production.

The factors of production are typically classified into two main categories:

- Labor-intensive goods: Countries with an abundance of labor relative to other factors (like capital) will specialize in and export goods that require a lot of labor.
- Capital-intensive goods: Countries with an abundance of capital relative to other factors (like labor) will specialize in and export goods that require a lot of capital.

This theory suggests that trade occurs because of differences in factor endowments between countries, and it leads to mutual benefits as countries can specialize in producing goods that make the most efficient use of their available resources.

Now, the Leontief Paradox challenges the predictions of the Factor Proportion Theory. Wassily Leontief, an economist, conducted an empirical study in the 1950s that compared the factor intensities of U.S. exports and imports. According to the Factor Proportion Theory, the U.S., being a capital-abundant country, should export capital-intensive goods and import labor-intensive goods. However, Leontief found that the U.S. was exporting more labor-intensive goods and importing more capital-intensive goods.

The Leontief Paradox raised questions about the applicability of the Factor Proportion Theory in the real world. Various explanations have been proposed for the paradox, including differences in the quality of factors of production, technological factors, and the assumption of homogeneity in the factors. It also highlighted the limitations of the model and the need to consider other factors beyond just the abundance of labor and capital in explaining international trade patterns.

Product Life Cycle Theory

The Product Life Cycle (PLC) Theory is an economic theory developed by economist Raymond Vernon in the 1960s. The theory seeks to explain the international trade patterns of certain products over their life cycle. The life cycle of a product typically consists of four stages: introduction, growth, maturity, and decline. The key elements of the Product Life Cycle Theory include the following:

- Introduction Stage:

The product is introduced into the market, and there is typically limited competition.

The innovation is often developed by a single country, usually the one where the company is headquartered.

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- Growth Stage:

The product gains popularity, and demand starts to increase.
Other countries begin to recognize the market potential and start producing the product to meet the growing demand.

- **Maturity Stage:**

The market becomes saturated, and competition intensifies.As production becomes more standardized, firms may start to relocate production to countries with lower production costs.

- **Decline Stage:**

Demand starts to decline as the market becomes saturated, and the product becomes obsolete.Production may be further relocated to countries with lower production costs to maintain profitability.

The key assumptions of the Product Life Cycle Theory are as follows:
Innovation Origin: The initial innovation and production of a new product occur in the country where the firm is headquartered.

Technology Transfer: As the product moves through its life cycle, production technology becomes more accessible to other countries, leading to increased global production.

Costs and Prices: Production costs initially start high but decrease over time due to economies of scale and improved production techniques. As a result, prices decline during the maturity stage.

Trade Patterns: In the introduction and growth stages, the innovating country is a net exporter of the product. In the maturity stage, other countries enter the market, and the innovating country may become a net importer.
It's important to note that while the Product Life Cycle Theory has been influential in understanding the dynamics of international trade, it has also faced criticism. Critics argue that the globalization of markets and the rapid pace of technological change can lead to shorter product life cycles and

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undermine the theory's applicability in today's dynamic business environment. Additionally, the theory assumes a linear progression through the stages, which may not always hold true in reality.

National Competitive Advantage Theory

The National Competitive Advantage Theory, also known as the Diamond Model, was developed by economist Michael Porter in his book "The Competitive Advantage of Nations" published in 1990. This theory seeks to explain why certain nations achieve international success in particular industries. Porter argues that the competitiveness of a nation in a specific industry depends on four interlinked determinants, forming a diamond-shaped framework:

Factor Conditions:
Refers to the nation's endowments in terms of factors of production, such as skilled labor, natural resources, infrastructure, and capital.
The quality, quantity, and efficiency of these factors impact a nation's competitive advantage.
Demand Conditions:
Describes the nature of home demand for the products or services of a particular industry.Strong and sophisticated domestic demand can drive innovation and competitiveness.

Related and Supporting Industries:
Examines the presence or absence of supplier industries and related industries that support the focal industry.A strong local base of supporting industries and suppliers can enhance competitiveness.
Firm Strategy, Structure, and Rivalry:

Refers to the conditions governing how companies are created, organized, and managed, as well as the nature of domestic competition.
Intense domestic competition can drive firms to become more efficient and innovative.
In addition to these four components, Porter added two additional elements to the model in later works:
Government's Role:
Governments can influence national competitive advantage by acting as a catalyst or hindrance. Effective government policies, institutions, and regulations can support competitiveness.

Chance:

Refers to events and circumstances beyond a nation's control that can influence competitiveness. These may include technological breakthroughs, economic shocks, or natural disasters.

According to the Diamond Model, these six factors interact with each other, creating a mutually reinforcing system that determines a nation's ability to achieve a competitive advantage in a particular industry.

The National Competitive Advantage Theory has been influential in shaping discussions on economic development and competitiveness at the national level. It emphasizes the importance of a holistic approach to understanding a nation's competitive position and stresses the interconnectedness of various factors. However, like any theoretical framework, it has been subject to criticism and debate, and its application to different contexts may vary.

Tariff and Non Tarrif Barries:

Tariffs and non-tariff barriers are two types of trade barriers that countries use to regulate international trade and protect domestic industries. They can be employed for various economic, political, or strategic reasons.

Tariffs:

Definition: Tariffs are taxes or duties imposed on imported goods and services. They increase the cost of foreign products, making them less competitive compared to domestically produced goods.

Types:

Ad Valorem Tariffs: Imposed as a percentage of the value of the imported goods.

Specific Tariffs: Set as a specific amount per unit of the imported goods.

Compound Tariffs: A combination of ad valorem and specific tariffs.

Purpose:

Protecting domestic industries by making imported goods more expensive. Generating revenue for the government.

Effects:

Can lead to higher prices for consumers on imported goods.May protect domestic industries from foreign competition.Can result in retaliatory measures from trading partners.

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Non-Tariff Barriers (NTBs):

Definition: Non-tariff barriers refer to various measures, other than tariffs, that countries use to restrict or control the flow of goods and services across borders.

Types:

Quotas: Limit the quantity or value of goods that can be imported.

Licensing and Quota Systems: Require foreign producers to obtain licenses or permits to export goods.

Technical Barriers to Trade (TBT): Standards and regulations related to product quality, safety, and technical specifications.

Sanitary and Phytosanitary Measures (SPS): Regulations related to health and safety standards for food and agricultural products.

Purpose:

Protecting domestic industries from foreign competition.Ensuring product safety and quality standards.Addressing health and environmental concerns.

Effects:

Can limit the quantity of imported goods.May increase the cost of compliance for foreign producers.Can be used for protectionist purposes.

Governments often use a combination of tariffs and non-tariff barriers to achieve their trade policy objectives. While tariffs involve direct taxes on imports, non-tariff barriers can be more diverse and include various regulatory measures. International trade negotiations, agreements, and organizations (e.g., the World Trade Organization) aim to reduce or eliminate these barriers to foster more open and fair trade practices.

Balance Of Payament

The balance of payments (BOP), also known as the balance of international payments, is a statement of all transactions made between entities in one country and the rest of the world over a defined period, such as a quarter or a year.

The balance of payments (BOP) is a systematic record of all economic transactions between residents of one country and the rest of the world over a specific time period. It provides a

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comprehensive summary of a country's economic interactions with other nations, including both financial and economic transactions.

The balance of payments is typically divided into three main components:

- Current Account: These account records transactions related to the country's trade in goods and services, income from abroad, and unilateral transfers. The major sub-components of the current account include:

Trade Balance (or Merchandise Balance): The difference between a country's exports and imports of goods.

Services Balance: Includes transactions related to services such as transportation, tourism, and financial services.

Income Balance: Reflects earnings from foreign investments and payments to foreign investors.

- Current Transfers: Unilateral transfers, such as foreign aid, grants, and remittances.
- Capital Account: This account captures transactions in financial assets and liabilities, including direct investments, portfolio investments, and other capital flows. It also includes debt forgiveness and the transfer of ownership of fixed assets.

- Financial Account: This account documents changes in ownership of financial assets and liabilities. It includes foreign direct investment, portfolio investment, changes in reserve assets, and other investments.

The balance of payments obeys the fundamental accounting principle that the sum of the current account, capital account, and financial account balances must be zero. In other words, if a country has a surplus in one account, it must have a corresponding deficit in another.

A positive balance in the current account suggests that a country is exporting more than it is importing, while a negative balance indicates the opposite. Similarly, a surplus in the financial account implies that a country is receiving more capital inflows than outflows.

Governments, policymakers, and economists use the balance of payments to assess a country's economic health, understand its international financial position, and formulate appropriate economic policies. Monitoring the balance of payments is crucial for maintaining economic stability and addressing potential vulnerabilities in a nation's external sector.

The Balance of Payments (BOP) is divided into three main components, each representing different types of economic transactions with the rest of the world.

These components are:-

- Current Account,
- Capital Account,
- Financial Account.

Current Account:

The Current Account captures the flow of goods, services, income, and current transfers between a country and the rest of the world. It is further divided into the following sub-accounts:

Trade Balance (or Merchandise Balance): This accounts for the difference between the value of a country's exports and imports of goods.

Services Balance: Includes transactions related to services, such as tourism, transportation, and financial services.

Income Balance: Records earnings from foreign investments and payments to foreign investors.

Current Transfers: Encompasses unilateral transfers, including foreign aid, grants, and remittances.

Capital Account: The Capital Account documents capital transfers and the acquisition or disposal of non-financial assets. It includes:

Capital Transfers: Involves the transfer of ownership of fixed assets.

Acquisition or Disposal of Non-Financial Assets: Includes transactions like patents, copyrights, and other non-financial assets.

Financial Account:The Financial Account tracks transactions involving financial assets and liabilities. It is further classified into sub-accounts, including:

Direct Investment: Reflects investments in physical assets and lasting interests in enterprises.

Portfolio Investment: Involves transactions in financial assets like stocks and bonds.

Other Investment: Encompasses items like loans and currency reserves.

The fundamental accounting principle of the Balance of Payments is that these three accounts must sum to zero. If a country has a surplus in one account, there must be a corresponding deficit in another. For example, if a country has a trade surplus (excess of exports over imports) in the Current Account, it might experience a capital outflow or an increase in foreign assets in the Financial Account.

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III Unit

International Financial Environment

Foreign Exchange Market

The foreign exchange market often referred to as the forex market or FX market is a global decentralized marketplace for trading currencies. It is the largest and most liquid financial market in the world, where participants engage in the buying and selling of currencies based on exchange rates. The primary purpose of the foreign exchange market is to facilitate international trade and investment by allowing businesses, governments, financial institutions, and individual traders to convert one currency into another.

Key features of the foreign exchange market include:

Decentralization: The forex market operates without a centralized exchange. Instead, it consists of a network of banks, financial institutions, corporations, governments, and individual traders who conduct transactions directly with each other or through electronic trading platforms.

Currency Pairs: Currencies are traded in pairs, where one currency is exchanged for another. Each currency pair is quoted with an exchange rate, representing the relative value of one currency to the other. The first currency in the pair is the base currency, and the second is the quote currency.

Major, Minor, and Exotic Pairs: Major currency pairs involve the most widely traded currencies, such as the U.S. Dollar (USD), Euro (EUR), Japanese Yen (JPY), British Pound (GBP),

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and Swiss Franc (CHF). Minor pairs include currencies from smaller economies, while exotic pairs involve one major currency and one from a developing or smaller economy.

Participants: The major participants in the forex market include central banks, commercial banks, hedge funds, multinational corporations, and individual retail traders.

24-Hour Market: The forex market operates 24 hours a day, five days a week, due to the global nature of currency trading and the involvement of major financial centers in different time zones, including London, New York, Tokyo, and Sydney.

Leverage: Participants in the forex market often use leverage, which allows them to control a larger position with a smaller amount of capital. While leverage can amplify profits, it also increases the risk of significant losses.

Speculation and Hedging: Market participants engage in forex trading for various reasons. Some participate in speculation, seeking to profit from changes in exchange rates. Others, such as multinational corporations, use the forex market to hedge against the risk of currency fluctuations affecting their international transactions.

The foreign exchange market plays a crucial role in the global economy by facilitating international trade and investment, providing a mechanism for price discovery, and allowing participants to manage currency risk. Traders use various tools and analysis techniques to make informed decisions in the dynamic and highly liquid forex market.

Spot market and Spot Rate Quotations

The spot market refers to a financial market where financial instruments, such as currencies, commodities, or securities, are traded for immediate delivery and settlement. In the context of foreign exchange (forex), the spot market involves the buying and selling of currencies with delivery and settlement occurring on the spot or within a short period, typically two business days.

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Here are some key characteristics of the spot market in the context of foreign exchange:

Immediate Transactions: In the spot market, transactions are settled "on the spot," meaning the exchange of currencies happens almost immediately after the trade is agreed upon. This is in contrast to futures or forward contracts, which involve the agreement to exchange currencies at a future date.

Two-Day Settlement: While the actual exchange of currencies may occur instantly, settlement in the spot market usually takes two business days. This is known as the "spot date." The two-day settlement period allows time for the involved parties to complete the necessary paperwork and ensure the smooth transfer of funds.

Liquidity: The spot forex market is highly liquid due to its nature of immediate transactions. Major currency pairs, such as EUR/USD, USD/JPY, and GBP/USD, are traded in large volumes, making it easy for market participants to buy or sell currencies without significantly affecting exchange rates.

No Fixed Exchange Rate: Unlike some fixed exchange rate systems, the spot market operates under a floating exchange rate system. Exchange rates are determined by supply and demand factors in the market.

Spot Rate Quotations:

The spot rate is the current exchange rate at which a currency pair can be bought or sold in the spot market. Spot rate quotations provide information on the current market value of one currency in terms of another. The spot rate is influenced by various factors, including economic indicators, geopolitical events, interest rates, and market sentiment.

In a spot rate quotation, two currencies are involved, and the exchange rate indicates how much of the quote currency is needed to purchase one unit of the base currency. For example:

EUR/USD = 1.1500

This quotation means that 1 Euro can be exchanged for 1.15 U.S. Dollars.

USD/JPY = 110.50

This quotation means that 1 U.S. Dollar can be exchanged for 110.50 Japanese Yen.

Spot rate quotations are commonly used by businesses engaged in international trade, investors, and financial institutions for real-time pricing information and executing immediate currency transactions in the spot market.

Cross Exchange Rate

A cross exchange rate refers to the exchange rate between two currencies that do not involve the official currency of the country in which the exchange rate is quoted. In other words, it is the rate at which one currency can be exchanged for another currency, both of which are not the domestic currency.

For example, if an exchange rate is quoted for the direct conversion between the Euro (EUR) and the Japanese Yen (JPY), it is considered a cross exchange rate for someone located in the United States. This is because neither the Euro nor the Yen is the official currency of the United States. In this case, the exchange rate would indicate the value of one currency in terms of the other, without involving the U.S. Dollar (USD).

Here's an example of how a cross exchange rate might be quoted:

EUR/JPY = 130.00

This means that 1 Euro can be exchanged for 130 Japanese Yen.

In this example, if someone in the United States wanted to know the exchange rate between the Euro and the Yen without involving the U.S. Dollar, they could refer to the cross exchange rate directly.

Cross exchange rates are often used in situations where a direct exchange rate is not readily available. Traders and investors may use cross rates to calculate the implied exchange rate between two currencies by considering their respective exchange rates with a common third currency.

It's important to note that cross exchange rates are derived from the exchange rates of the currencies involved and are not always quoted directly in the market. Traders and financial institutions may calculate cross rates based on the prevailing exchange rates for the currencies in question.

Forward Markets & Forward Rates

Forward markets and forward rates are concepts related to financial markets, particularly in the context of foreign exchange. Let's explore these concepts:

Forward Markets:

Definition:

The forward market is a financial market where participants enter into contracts to buy or sell an asset at a future date for a price agreed upon today. It allows parties to hedge against potential future price movements, manage risks, and establish future transaction terms.

Features:

- Contracts: Forward contracts in the forward market are customized agreements between two parties to exchange a specific amount of an asset at a future date.
- Private Agreements: Forward contracts are typically private and traded over-the-counter (OTC), meaning they are not standardized and are negotiated directly between the two parties involved.
- Customization: Participants have flexibility in customizing the terms of the forward contract, such as the asset, quantity, price, and maturity date.

Usage:

- Hedging: Businesses and investors use forward contracts to hedge against adverse movements in prices, especially in the context of foreign exchange, interest rates, or commodities.
- Speculation: Traders may enter into forward contracts to speculate on future price movements and potentially gain from favorable market conditions.

Forward Rates:

Definition:

The forward rate is the agreed-upon exchange rate in a forward contract, determining the rate at which one currency can be exchanged for another at a future date.

Calculation:

Forward rates are influenced by the current spot rate, interest rate differentials between the two currencies, and the time to maturity. The formula for calculating the forward rate is often based on interest rate parity.

Types:

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Forward Premium: If the forward rate is higher than the current spot rate, there is a forward premium. This suggests that the market expects the currency to appreciate.

Forward Discount: If the forward rate is lower than the current spot rate, there is a forward discount. This implies an expectation of currency depreciation.

Usage:

Forecasting: Traders and businesses use forward rates to make predictions about future exchange rates and to plan for potential currency movements.

Arbitrage: In some cases, traders may engage in arbitrage activities to take advantage of discrepancies between the spot and forward rates.

In summary, the forward market provides a mechanism for parties to enter into customized contracts for future asset transactions, and the forward rate is the agreed-upon exchange rate in a forward contract. Both are important tools for managing risk and making strategic financial decisions in various markets, including foreign exchange.

Arbitrage, Hedging and Speculation

Arbitrage, hedging, and speculation are three distinct financial strategies that participants in financial markets use to achieve different objectives.

1. Arbitrage:

Definition:

Arbitrage is the process of exploiting price differences of the same or similar financial instruments in different markets to make a risk-free profit.Arbitrage opportunities arise when there is a discrepancy in the prices of identical or similar assets in different markets.Traders engaging in arbitrage will buy the underpriced asset in one market and sell it at a higher price in another market, capitalizing on the price difference.Arbitrage activities help align prices across markets and contribute to market efficiency.

2. Hedging:

Definition:

Hedging is a risk management strategy that involves taking an offsetting position to minimize the impact of adverse price movements in an asset or liability.Hedging is used to protect against potential losses due to unfavorable market conditions.Participants hedge to reduce or eliminate exposure to price volatility, interest rate fluctuations, or currency exchange rate movements.Common hedging

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instruments include futures contracts, options, and forward contracts.While hedging reduces risk, it also limits the potential for gains.

3. Speculation:

Definition:

Speculation is the act of taking on risk in the hope of achieving a profit from future price movements in financial instruments.Speculators take positions in the market with the expectation that the value of the asset will change in their favor.Unlike hedging, speculation involves taking on risk for the purpose of capitalizing on market opportunities and making a profit.Speculators often use tools like futures contracts, options, and leveraged positions to amplify potential returns (but also risks).Speculation contributes to market liquidity and helps in the discovery of market prices.

Summary:

Arbitrage: Exploiting price differences to make risk-free profits by buying low in one market and selling high in another.

Hedging: Minimizing risk by taking offsetting positions to protect against adverse price movements or other financial risks.

Speculation: Taking on risk with the expectation of making a profit from future price movements.

Market participants often use a combination of these strategies based on their financial goals, risk tolerance, and market conditions. It's important to note that while these strategies serve different purposes, they collectively contribute to the efficiency and functioning of financial markets.

Types of Exchange Rate System: Fixed and Floating

Exchange rate systems refer to the mechanisms by which the value of one country's currency is determined in relation to other currencies. The two main types of exchange rate systems are fixed (pegged) and floating. Here's an overview of each:

1. **Fixed Exchange Rate System**:

In a fixed exchange rate system, the value of a country's currency is set and maintained at a fixed rate relative to another major currency, a basket of currencies, or sometimes to gold.
Centralized Authority: The government or central bank actively intervenes in the foreign exchange market to buy or sell its currency to maintain the fixed rate.
Stability: Fixed exchange rate systems are designed to provide stability and predictability for international trade and investment.
Limited Flexibility: The currency's value does not fluctuate freely based on market forces; instead, it remains fixed until a deliberate decision is made to adjust it.
Advantages and Disadvantages:

Advantages: Reduced currency volatility, which can be beneficial for international trade and investment.
Disadvantages: May lead to economic imbalances, loss of monetary policy independence, and the need for significant foreign exchange reserves.
2. **Floating Exchange Rate System:**

In a floating exchange rate system, the value of a currency is determined by market forces of supply and demand in the foreign exchange market without direct government or central bank intervention.

Market Forces: Currency values fluctuate based on market conditions, economic indicators, interest rates, and other factors.
Automatic Adjustments: The exchange rate adjusts naturally to maintain equilibrium in response to changing economic conditions.
Independence: Governments and central banks do not need to hold large reserves or actively manage the exchange rate.
Advantages and Disadvantages:
Advantages: Allows for automatic adjustments to economic conditions, promotes flexibility, and allows monetary policy independence.
Disadvantages: Can lead to higher volatility, which may pose challenges for international trade and investment planning.
3. **Managed Float (Dirty Float):**

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In a managed float system, the currency's value is primarily determined by market forces, but the central bank may intervene occasionally to stabilize or influence the exchange rate.
Market Forces with Intervention: The exchange rate is influenced by market conditions, but central banks may intervene to prevent excessive volatility or address economic concerns.
Advantages and Disadvantages:

Advantages: Offers a balance between the flexibility of a floating system and the stability of a fixed system.
Disadvantages: Requires central bank intervention, which may not always be successful in achieving desired outcomes.
Many countries adopt a hybrid approach or transition between fixed and floating exchange rate systems, and some use a managed float to strike a balance between flexibility and stability. The choice of exchange rate system depends on a country's economic and policy objectives.

Soft Peg, Crawling Peg free float managed float

Soft Peg:

In a soft peg or semi-fixed exchange rate system, a country allows its currency to fluctuate within a certain range or band relative to a reference currency or a basket of currencies. The central bank intervenes to maintain the currency's value within this band.

Limited Flexibility: While the currency is not fixed at a specific rate, it is allowed to fluctuate within a predetermined range.
Central Bank Intervention: The central bank intervenes in the foreign exchange market to buy or sell its currency to prevent significant deviations from the established range.
Example:

The Chinese Yuan (CNY) has been managed with a soft peg to the U.S. Dollar within a specified range.
2. Crawling Peg

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A crawling peg is a type of fixed or semi-fixed exchange rate system where a country adjusts its currency's value at a fixed rate or percentage over time. The adjustments are typically made to account for inflation differentials.

Regular Adjustments: The central bank periodically adjusts the exchange rate to accommodate changes in economic conditions, such as inflation.

Predictability: Provides a degree of predictability for businesses and investors, as the adjustments are pre-announced.

Example:

Some countries in the past, like Brazil, implemented crawling pegs to manage their exchange rates.

3. Free Float:

In a free float exchange rate system, the currency's value is determined purely by market forces of supply and demand in the foreign exchange market. There is no direct government or central bank intervention to influence the currency's value.

Market Forces: The exchange rate is determined by market dynamics, economic indicators, and other factors without artificial constraints.

Flexibility: Provides maximum flexibility for currency values to adjust based on changing market conditions.

Example:

The United States Dollar (USD) and the Euro (EUR) are examples of currencies that are freely floated.

4. Managed Float:

In a managed float exchange rate system, the currency's value is primarily determined by market forces, but the central bank may intervene occasionally to stabilize or influence the exchange rate.

Market Forces with Intervention: The exchange rate is influenced by market conditions, but central banks may intervene to prevent excessive volatility or address economic concerns.

Flexibility with Guidance: Allows for some flexibility in the exchange rate, but central banks may provide guidance or intervene when necessary.

Example:

Many major currencies, including the Japanese Yen (JPY) and the British Pound (GBP), are managed float currencies.

Countries may choose a specific exchange rate system based on their economic goals, monetary policies, and market conditions. The choice of system can have implications for economic stability, trade competitiveness, and monetary policy effectiveness.

Foreign Exchange risk and Exposure

Foreign exchange risk, also known as currency risk, refers to the potential for financial losses due to fluctuations in exchange rates between different currencies. Businesses and investors face foreign exchange risk when they engage in international trade, investment, or financial transactions involving multiple currencies. Foreign exchange exposure is the extent to which an entity is vulnerable to the impact of such exchange rate movements.

There are three main types of foreign exchange exposure:

1. **Transaction Exposure:**

Transaction exposure arises when a company has contractual cash flows, revenues, or expenses denominated in foreign currencies, and exchange rate movements can affect the actual amount received or paid.

Example:

A U.S.-based company selling goods to a European customer with payment due in euros. If the euro depreciates against the U.S. dollar before the payment is received, the U.S. company will receive fewer dollars than expected.

Risk Management:

Companies can use hedging instruments such as forward contracts or currency options to mitigate transaction exposure.

2. **Translation Exposure (Accounting Exposure):**

Translation exposure, also known as accounting exposure, arises when a multinational company consolidates financial statements that are denominated in different currencies. Changes in exchange rates can impact the reported financial results and financial position.

Example:

A U.S.-based multinational company that owns subsidiaries in Europe. If the euro depreciates against the U.S. dollar, the value of the European subsidiaries' financial results in U.S. dollars will be lower when translated.

Risk Management:

Companies may implement accounting policies, such as using hedging instruments or adjusting financial statements for currency effects, to manage translation exposure.

3. Economic Exposure (Operating Exposure):

Definition:

Economic exposure, also known as operating exposure, arises from the impact of exchange rate movements on a company's future competitive position and cash flows. It reflects the long-term impact on a company's competitiveness in the global market.

Example:

A Japanese automobile manufacturer exporting cars to the U.S. If the Japanese yen appreciates against the U.S. dollar, the cost of production in yen increases, potentially affecting the competitiveness of the company's products in the U.S. market.

Risk Management:

Strategies to manage economic exposure may include diversification of markets, adjusting pricing strategies, and entering into long-term contracts with suppliers or customers.

Managing foreign exchange risk and exposure is crucial for businesses operating in the global marketplace. Various financial instruments, such as forward contracts, futures, options, and swaps, can be utilized to hedge against adverse currency movements and mitigate the impact of exchange rate volatility on financial performance.

Exchange Rate Determinants

Types of Exchange rates

There are various types of exchange rates, reflecting different ways in which the value of one currency can be expressed in terms of another. Here are the main types of exchange rates:

1. Spot Exchange Rate:

Definition: The spot exchange rate is the current market rate at which a currency pair can be bought or sold for immediate delivery and settlement. It is the rate at which currencies are traded "on the spot."

Notation: For example, EUR/USD = 1.1500 indicates that 1 Euro can be exchanged for 1.15 U.S. Dollars.

2. Forward Exchange Rate:

Definition: The forward exchange rate is the rate at which a currency pair can be bought or sold for delivery and settlement on a future date. It allows parties to agree on an exchange rate today for a transaction that will occur in the future.

Notation: Similar to the spot rate, but with a future date. For example, EUR/USD (1-month forward) = 1.1600.

3. Nominal Exchange Rate:

Definition: The nominal exchange rate is the stated rate at which one currency can be exchanged for another. It reflects the relative value of two currencies without adjusting for differences in price levels (inflation) between the two countries.

Example: If the nominal exchange rate between the U.S. Dollar and the Euro is 1.2000, it means 1 USD is equivalent to 1.20 EUR.

4. Real Exchange Rate:

Definition: The real exchange rate adjusts the nominal exchange rate for differences in price levels (inflation) between two countries. It provides a more accurate measure of the relative purchasing power of two currencies.

Calculation: Real Exchange Rate = (Nominal Exchange Rate * Domestic Price Level) / Foreign Price Level.

5. Effective Exchange Rate:

Definition: The effective exchange rate (also known as the trade-weighted exchange rate) is a measure of the value of a country's currency against a basket of multiple foreign currencies, with each currency's weight determined by its share in the country's trade.

Calculation: Weighted average of bilateral exchange rates.

6. Cross Exchange Rate:

Definition: The cross exchange rate is the exchange rate between two currencies that do not involve the official currency of the country where the exchange rate is quoted.

Example: If you want to know the exchange rate between the Euro and the Japanese Yen without involving the U.S. Dollar, it's a cross rate.

7. Floating Exchange Rate:

Definition: In a floating exchange rate system, the value of a currency is determined by market forces of supply and demand. It is not fixed or pegged to another currency or commodity.
Example: The U.S. Dollar and the Euro in a freely floating exchange rate system.
8. Fixed Exchange Rate:
Definition: In a fixed exchange rate system, a country's currency is pegged or fixed to the value of another currency, a basket of currencies, or a commodity. The central bank intervenes to maintain this fixed rate.
Example: The historical Bretton Woods system where major currencies were pegged to the U.S. Dollar.
These various types of exchange rates play crucial roles in international trade, finance, and investment, and understanding them is essential for participants in the global economy.

Factors Affecting Exchange Rate

Exchange rates are influenced by a multitude of factors, and their values can change due to a combination of economic, political, and market forces. Here are some key factors that affect exchange rates:

1. Interest Rates:
Relationship: Generally, higher interest rates attract foreign capital seeking better returns, leading to an appreciation of the currency. Conversely, lower interest rates may lead to depreciation.
2. Inflation Rates:
Relationship: Lower inflation rates are associated with currency appreciation, while higher inflation rates can lead to depreciation. A lower inflation rate in a country makes its goods and services more attractive to foreign buyers.
3. Economic Indicators:
GDP Growth: Strong economic growth tends to attract foreign investment, leading to an appreciation of the currency.
Employment Data: Low unemployment rates and positive employment data contribute to economic stability and may strengthen the currency.

4. Political Stability and Economic Performance:

Political Stability: Countries with stable political environments are more attractive to foreign investors, leading to a stronger currency.

Economic Performance: Strong economic fundamentals, sound fiscal policies, and effective governance can enhance a currency's value.

5. Trade Balances:

Surplus vs. Deficit: Countries with trade surpluses (exports exceed imports) often experience currency appreciation, while those with trade deficits may see depreciation.

6. Foreign Exchange Reserves:

High Reserves: Countries with substantial foreign exchange reserves can intervene in currency markets to stabilize or influence their currency's value.

7. Market Sentiment:

Investor Confidence: Market sentiment and investor confidence play a significant role. Positive news or perceptions about a country's prospects can lead to currency appreciation.

8. Government Debt:

Debt Levels: High levels of government debt may lead to concerns about a country's ability to meet its financial obligations, potentially leading to currency depreciation.

9. Speculation:

Market Expectations: Anticipated future economic and political events can drive speculation, influencing currency values.

10. Central Bank Actions:

Interest Rate Policies: Central banks can impact exchange rates through decisions on interest rates. Rate hikes can strengthen a currency, while rate cuts may weaken it.

Currency Interventions: Central banks may directly buy or sell their currency in the foreign exchange market to influence its value.

11. Global Events:

Geopolitical Events: Political tensions, conflicts, or major geopolitical events can lead to currency volatility.

Natural Disasters: Unexpected events like natural disasters can impact a country's economy and currency.

12. Relative Strength of Other Currencies:

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Dollar Index: The U.S. Dollar Index, which measures the value of the U.S. Dollar against a basket of major currencies, can influence global currency movements.

Relative Interest Rate and relative Income Level

Relative interest rates and relative income levels are important factors that influence exchange rates in the foreign exchange market. Here's how each of these factors can affect exchange rates:

1. Relative Interest Rates:
Positive Relationship: Generally, there is a positive relationship between interest rates and the strength of a currency.
Higher Interest Rates: Countries with higher interest rates often attract foreign capital seeking better returns. As a result, the demand for the currency of a country with higher interest rates increases, leading to an appreciation of that currency.
Carry Trade: Investors may engage in carry trades, where they borrow in a currency with a low-interest rate and invest in a currency with a higher interest rate, capitalizing on the interest rate differential.
2. Relative Income Levels:
Positive Relationship: There is typically a positive relationship between a country's income level and the strength of its currency.
Economic Growth: Countries experiencing higher economic growth and rising income levels are often viewed as more attractive to investors. Foreign capital tends to flow into countries with strong economic performance, leading to an appreciation of their currency.
Purchasing Power Parity (PPP): Over the long term, the theory of Purchasing Power Parity suggests that exchange rates should adjust to equalize the purchasing power of different currencies. Changes in relative income levels can influence this adjustment.
Interaction of Relative Interest Rates and Relative Income Levels:
Complementary Effects: In many cases, relative interest rates and relative income levels work in tandem to influence exchange rates. A country with both higher interest rates and strong economic growth is likely to experience significant demand for its currency.
Divergent Movements: There can be instances where the two factors move in opposite directions. For example, a country with lower interest rates but strong economic growth may still attract foreign capital due to favorable investment opportunities.

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Considerations:

Expectations: Exchange rates are also influenced by expectations. If investors anticipate changes in interest rates or economic conditions, they may adjust their currency positions accordingly.

Global Factors: Global economic conditions, geopolitical events, and other external factors can also impact exchange rates, sometimes overshadowing the influence of interest rates and income levels.

It's important to note that while these factors provide insights into exchange rate movements, the foreign exchange market is complex, and multiple factors simultaneously influence currency values. Traders, investors, and policymakers consider a comprehensive set of economic indicators and variables when analyzing and predicting exchange rate movements.

Unit IV

Foreign Trade Promotion Measures and Organizations in India

India employs various measures and has organizations in place to promote foreign trade. The country has been actively engaged in promoting international trade to boost economic growth and enhance

global competitiveness. Here are some of the key measures and organizations related to foreign trade promotion in India:

Measures to Promote Foreign Trade:

Export Credit and Finance:

Various financial institutions and banks provide export credit and finance to facilitate trade transactions, including pre-shipment and post-shipment credit.

Export Incentives and Subsidies:

The government offers incentives and subsidies to exporters, such as the Merchandise Exports from India Scheme (MEIS) and the Services Exports from India Scheme (SEIS), to promote and reward export activities.

Export Promotion Councils (EPCs):

EPCs are industry-specific organizations that work closely with the government to promote and facilitate exports in particular sectors. They provide support in areas like market research, product development, and resolving export-related issues.

Special Economic Zones (SEZs):

SEZs are designated areas with favorable economic policies to attract foreign investment and promote exports. Businesses operating within SEZs enjoy tax incentives and simplified export-import procedures.

Trade Facilitation Measures:

Continuous efforts are made to simplify and streamline trade procedures, reduce paperwork, and enhance the ease of doing business for exporters and importers.

Trade Agreements and Bilateral Partnerships:

India engages in bilateral and regional trade agreements to enhance market access and foster economic cooperation with other countries and trading blocs.

Quality Standards and Certifications:

Adherence to international quality standards is emphasized to enhance the competitiveness of Indian products in global markets. Various certification bodies and quality control agencies ensure compliance.

Organizations Involved in Foreign Trade Promotion:

Ministry of Commerce and Industry:

The Ministry plays a pivotal role in formulating and implementing trade policies. It oversees various departments and agencies involved in foreign trade promotion.

Directorate General of Foreign Trade (DGFT):

DGFT is the apex body responsible for formulating and implementing the foreign trade policy. It issues export-import licenses, administers trade policies, and promotes foreign trade.

Export-Import Bank of India (EXIM Bank):

EXIM Bank provides financial assistance, including loans, credits, and guarantees, to support Indian exporters and importers.

Federation of Indian Export Organisations (FIEO):

FIEO is the apex body of Indian export promotion organizations. It acts as a bridge between the government and the export community and provides various services to exporters.

Commodity Boards:

Various commodity-specific boards, such as the Tea Board, Coffee Board, Spices Board, etc., work to promote and regulate the export of specific commodities.

Indian Trade Promotion Organization (ITPO):

ITPO is responsible for promoting India's trade and organizing trade fairs and exhibitions to showcase Indian products globally.

Confederation of Indian Industry (CII) and Federation of Indian Chambers of Commerce and Industry (FICCI):

These industry associations actively participate in trade promotion activities, advocacy, and policy formulation to boost foreign trade.

Customs Department:

The Customs Department ensures smooth clearance of goods at ports and implements trade facilitation measures.

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These measures and organizations collectively contribute to the growth and development of India's foreign trade by fostering a conducive environment for exporters and importers.

Special Economic **Zones:**

special Economic Zones (SEZs) are designated geographical areas within a country that have specific economic regulations and policies to promote economic activities, trade, and investment. The primary objective of establishing SEZs is to create an environment that attracts foreign and domestic investment, enhances exports, generates employment, and stimulates economic growth. SEZs typically offer a range of incentives and benefits to businesses operating within their boundaries. Here are key features and characteristics of Special Economic Zones:

Key Features of Special Economic Zones:

Geographical Isolation:

SEZs are physically demarcated areas, often located near ports or major transportation hubs, to facilitate the movement of goods.

Economic Regulations:

SEZs have distinct economic regulations and policies that differ from the rest of the country. These regulations are designed to create a business-friendly environment.

Incentives and Benefits:

SEZs offer various incentives and benefits to businesses, including tax breaks, duty-free imports and exports, simplified customs procedures, and relaxed regulatory requirements.

Foreign Direct Investment (FDI):

SEZs aim to attract foreign direct investment by providing a favorable environment for foreign businesses to set up operations.

Export-Oriented Activities:

SEZs are typically focused on export-oriented activities. Businesses within SEZs are encouraged to produce goods and services primarily for export markets.

Infrastructure Development:

Governments often invest in developing robust infrastructure within SEZs, including transportation, utilities, and communication facilities, to support businesses and enhance their competitiveness.

Labor Regulations:

SEZs may have more flexible labor regulations compared to the broader national labor laws. This flexibility can attract businesses seeking a more adaptable workforce.

Single Window Clearance:

SEZs often provide a single-window clearance system, streamlining administrative processes and reducing bureaucratic hurdles for businesses.

Diversification of Economic Activities:

SEZs may focus on specific industries or sectors, promoting diversification and specialization in economic activities.

Benefits for Businesses Operating in SEZs:

Tax Incentives:

Businesses in SEZs may enjoy tax holidays, reduced corporate income tax rates, and exemptions from certain taxes and duties.

Duty-Free Imports and Exports:

Import and export of goods and services within SEZs are often exempt from customs duties and tariffs.

Expedited Customs Procedures:

Simplified and expedited customs procedures make it easier for businesses to import raw materials and export finished products.

Infrastructure Support:

Access to well-developed infrastructure, including roads, ports, and utilities, enhances the operational efficiency of businesses.

Flexibility in Employment Practices:

SEZs may provide flexibility in labor regulations, allowing businesses to adopt more adaptable employment practices.

Market Access:

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Businesses in SEZs often benefit from increased market access and preferential treatment in international trade agreements.

Challenges and Criticisms:

Potential for Inequity:

Critics argue that the benefits provided to businesses in SEZs may create inequities and divert resources away from the broader economy.

Environmental Concerns:

Rapid industrialization in SEZs can sometimes raise environmental concerns, leading to issues such as pollution and habitat destruction.

Dependency on Exports:

Overreliance on export-oriented activities may expose SEZs to global economic fluctuations.

Labor Issues:

Concerns may arise regarding labor conditions and workers' rights, especially if labor regulations within SEZs are significantly different from national standards.

SEZs have been implemented in various countries worldwide, each with its own set of policies and regulations. They serve as tools for governments to attract investment, stimulate economic growth, and enhance global competitiveness.

Foreign Investment-concept, type and flow

Foreign investment refers to the investment made by individuals, businesses, or governments in assets and activities located outside their own country. This type of investment involves the transfer of capital across borders to acquire or establish ownership in foreign assets. Foreign investment can take various forms, and the flow of capital can be categorized into different types based on the nature and purpose of the investment. Here's an overview of the concept, types, and flow of foreign investment:

Concept of Foreign Investment:

Foreign investment involves the allocation of capital across international borders with the goal of earning returns or obtaining ownership stakes in foreign assets. This capital can be invested in various forms, including stocks, bonds, real estate, factories, businesses, or other financial instruments. Foreign

investment plays a crucial role in global economic development, facilitating cross-border trade, technology transfer, and economic growth.

Types of Foreign Investment:

Foreign Direct Investment (FDI):

Definition: FDI occurs when an investor acquires a significant ownership stake (usually at least 10%) in a foreign company, allowing for a significant degree of control and influence over the company's operations.

Purpose: FDI is often associated with long-term investments in physical assets, technology transfer, and strategic partnerships.

Foreign Portfolio Investment (FPI):

Definition: FPI involves the purchase of financial assets such as stocks and bonds in foreign countries without obtaining significant ownership or control over the invested entities.

Purpose: FPI is typically more liquid and is often driven by the desire to earn returns on financial instruments rather than influence over the management of the invested entities.

Foreign Institutional Investment (FII):

Definition: FIIs are institutional investors, such as mutual funds, pension funds, and insurance companies, that invest in the financial markets of foreign countries.

Purpose: FIIs invest in stocks, bonds, and other financial instruments, contributing to capital flows in foreign financial markets.

Flow of Foreign Investment:

Inward Foreign Investment:

Definition: Inward foreign investment refers to capital flowing into a country from foreign entities. It includes FDI and FPI that is directed towards acquiring assets or establishing operations within the country.

Example: A foreign company establishing a subsidiary or acquiring a stake in a local company in another country.

Outward Foreign Investment:

Definition: Outward foreign investment refers to capital flowing out of a country to invest in foreign assets. It involves domestic entities making investments in assets located in other countries.

Example: A domestic company investing in a foreign market by acquiring a stake in a foreign company or establishing a subsidiary.

Balance of Payments:

Current Account and Capital Account: Foreign investment contributes to a country's balance of payments. Inward and outward foreign investment affect the current account (trade balance) and capital account of a country's balance of payments.

Global Investment Flows:

North-South and South-South Investments: Global investment flows often involve developed countries (North) investing in developing countries (South). Additionally, South-South investments refer to capital flows between developing countries.

Government Policies and Regulations:

Regulatory Framework: Governments often implement policies and regulations to attract or regulate foreign investment. These policies may include tax incentives, investment protection agreements, and measures to ensure national security.

Unit V

Regional Economic Integration

Forms of regional integration

Regional integration refers to various forms of collaboration and cooperation among countries within a specific geographic region. These efforts aim to enhance economic, political, and social ties among member states. There are several forms of regional integration, ranging from trade agreements to political unions. Here are some common forms:

1. Free Trade Area (FTA):

Definition: A Free Trade Area eliminates or reduces tariffs and other trade barriers among member countries. Each country maintains its own trade policies regarding non-member countries.

Example: North American Free Trade Agreement (NAFTA), now replaced by the United States-Mexico-Canada Agreement (USMCA).

2. Customs Union:

Definition: In a Customs Union, member countries not only eliminate internal trade barriers but also adopt a common external trade policy. This means that member countries have a unified approach to trade with non-member nations.

Example: European Union (EU) before the Single Market.

3. Common Market:

Definition: A Common Market goes beyond a Customs Union by allowing the free movement of not only goods and services but also factors of production, such as labor and capital.

Example: European Single Market.

4. Economic Union:

Definition: An Economic Union involves a high level of economic integration, including a common currency, harmonized fiscal policies, and common monetary institutions.

Example: The Eurozone within the European Union.

5. Political Union:

Definition: Political Union represents the highest level of integration, involving not only economic and trade cooperation but also political cooperation and coordination.

Example: The European Union, where member states delegate certain political powers to common institutions.

6. Monetary Union:

Definition: A Monetary Union involves the adoption of a common currency among member countries, along with coordinated monetary policies.

Example: The Eurozone, where countries use the euro as their official currency.

7. Regional Economic Communities (RECs):

Definition: RECs are organizations that promote economic integration and cooperation within a specific region. They may include various forms of integration, from trade agreements to common markets.

Example: Economic Community of West African States (ECOWAS) in West Africa.

8. Association Agreements:

Definition: Association Agreements establish a privileged relationship between a non-EU country and the European Union. They include provisions for political cooperation, economic integration, and trade facilitation.

Example: The Association Agreements between the EU and countries like Ukraine, Moldova, and Georgia.

9. Bilateral and Multilateral Trade Agreements:

Definition: Countries may engage in bilateral or multilateral trade agreements to reduce trade barriers, promote economic cooperation, and improve market access for goods and services.

Example: The Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) is a multilateral trade agreement involving countries in the Asia-Pacific region.

10. Strategic Alliances and Partnerships:

Definition: Countries may form strategic alliances or partnerships to enhance collaboration in specific areas, such as defense, security, or technological development.

Example: The North Atlantic Treaty Organization (NATO) is a strategic alliance for mutual defense.

Considerations:

Overlap and Flexibility: Some regional integration initiatives may combine multiple forms, and countries may participate in more than one integration arrangement simultaneously.

Evolutionary Process: Regional integration is often an evolutionary process, with member states gradually deepening cooperation and integration over time.

The choice of the form of regional integration depends on the goals, priorities, and levels of commitment of the participating countries. The ultimate objective is to enhance economic efficiency, promote political stability, and foster regional cooperation.

NAFTA

NAFTA stands for the North American Free Trade Agreement. It was a trade agreement signed by Canada, Mexico, and the United States, which came into effect on January 1, 1994. NAFTA aimed to eliminate or reduce barriers to trade and investment among the three North American countries. The agreement created one of the world's largest free-trade zones and had a significant impact on the economies of the member countries.

Key features of NAFTA included the elimination of most tariffs on goods traded between the three nations, the establishment of rules for trade in services and intellectual property, and the creation of mechanisms for resolving trade disputes. NAFTA also facilitated the movement of goods and services across borders, promoting economic integration in the region.

In 2020, NAFTA was replaced by the United States-Mexico-Canada Agreement (USMCA), which was negotiated and signed by the three countries to modernize and update the terms of trade. The USMCA retained many aspects of NAFTA but introduced some new provisions and addressed various concerns raised by the participating nations.

SAARC

SAARC stands for the South Asian Association for Regional Cooperation. It is a regional intergovernmental organization and geopolitical union in South Asia, established in December 1985. The primary purpose of SAARC is to promote regional cooperation and development in South Asia, addressing issues such as economic growth, social progress, cultural development, and regional stability.

SAARC's member countries include:

Afghanistan
Bangladesh
Bhutan
India
Maldives
Nepal
Pakistan
Sri Lanka

The organization aims to enhance economic and regional integration, foster collaboration in various sectors such as agriculture, education, health, and technology, and work towards the welfare of the people in the South Asian region. SAARC holds regular summits where leaders of member countries discuss and strategize on common issues and challenges.

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However, the effectiveness of SAARC has sometimes been hampered by political differences and bilateral tensions among member countries. Despite these challenges, the organization remains an important forum for regional cooperation and dialogue in South Asia.

ASEAN

ASEAN stands for the Association of Southeast Asian Nations. It is a regional intergovernmental organization comprising ten Southeast Asian countries, which are located in Southeast Asia. ASEAN was founded on August 8, 1967, with the signing of the ASEAN Declaration (also known as the Bangkok Declaration) by its original member states.

The member countries of ASEAN are:

Brunei
Cambodia
Indonesia
Laos
Malaysia
Myanmar (Burma)
Philippines
Singapore
Thailand
Vietnam

ASEAN aims to promote regional cooperation and integration, economic growth, social progress, and stability in Southeast Asia. The organization works towards these goals through a principle of non-interference in the internal affairs of member states and a commitment to consensus-based decision-making.

Key features of ASEAN include the ASEAN Free Trade Area (AFTA), which promotes economic integration by reducing tariffs and trade barriers among member states, and the ASEAN Economic Community (AEC), which envisions the creation of a single market and production base for the free flow of goods, services, and skilled labor.

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In addition to economic cooperation, ASEAN also focuses on addressing regional political and security issues, as well as promoting cultural and social cooperation among its member states. The organization plays a crucial role in fostering dialogue and cooperation in the Southeast Asian region.

WTO

The WTO, or World Trade Organization, is an international organization that deals with the global rules of trade between nations. It was established on January 1, 1995, following the Uruguay Round of negotiations (1986–1994). The WTO is headquartered in Geneva, Switzerland.

Key functions and features of the WTO include:

Trade Negotiations: The WTO provides a forum for member countries to negotiate trade agreements and settle trade disputes. It aims to promote fair and open trade by reducing trade barriers and facilitating negotiations on various trade-related issues.

Dispute Settlement: The WTO has a dispute settlement mechanism that allows member countries to resolve trade disputes through consultations and, if necessary, through adjudication by a dispute settlement panel. This mechanism provides a structured and rules-based process for resolving conflicts.

Trade Policy Review: The WTO conducts regular reviews of the trade policies and practices of its member countries. This process helps ensure transparency and encourages adherence to agreed-upon rules.

Technical Assistance and Capacity Building: The WTO offers technical assistance and capacity-building programs to help developing countries participate effectively in the global trading system. This includes providing support for building trade-related infrastructure, improving legal frameworks, and enhancing trade-related skills.

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Monitoring and Surveillance: The WTO monitors global trade trends and economic policies that may affect trade. It also addresses emerging trade issues to ensure that the multilateral trading system remains relevant and responsive to the needs of its members.

Trade Facilitation: The WTO aims to simplify and streamline customs procedures and border controls to facilitate the smooth flow of goods across borders. The Trade Facilitation Agreement, concluded in 2013, is one example of the WTO's efforts in this area.

Principles: The WTO is based on principles such as nondiscrimination, most-favored-nation treatment (MFN), and national treatment. These principles are designed to promote fair and equitable treatment of all member countries in the global trading system.

The WTO provides a framework for negotiating and formalizing trade agreements, and it serves as a platform for dialogue and cooperation on international trade issues. While it has faced challenges and criticisms, the WTO plays a central role in fostering a rules-based global trading system.

UNCTAD

UNCTAD stands for the United Nations Conference on Trade and Development. It is a permanent intergovernmental body established by the United Nations General Assembly in 1964. UNCTAD's mandate is to promote trade, investment, development, and cooperation among nations, particularly focusing on the needs of developing countries.

Key functions and activities of UNCTAD include:

Trade and Development Research: UNCTAD conducts research and analysis on a wide range of trade and development issues, including macroeconomic trends, trade policies, investment flows, and the impact of globalization on developing countries.

Policy Analysis and Advice: UNCTAD provides policy advice to member countries, particularly those in the developing world, to help them formulate and implement effective trade and development

policies. This includes guidance on trade negotiations, investment policies, and strategies for sustainable development.

Capacity Building: UNCTAD offers technical assistance and capacity-building programs to help developing countries build the skills and knowledge necessary to participate effectively in the global economy. This includes training programs, workshops, and advisory services.

Trade Facilitation and Logistics: UNCTAD works on issues related to trade facilitation, including improving customs procedures, transportation, and logistics. The organization aims to help countries reduce trade costs and enhance their competitiveness in international markets.

Investment Promotion: UNCTAD supports efforts to attract foreign direct investment (FDI) to developing countries. It provides analysis and guidance on investment policies and works to create a favorable investment climate.

Debt Management: UNCTAD addresses issues related to external debt and debt management in developing countries. It provides analysis and policy recommendations to help countries manage their debt sustainably.

Globalization and Development Strategies: UNCTAD examines the impact of globalization on development and explores strategies for integrating developing countries into the global economy in a way that ensures inclusive and sustainable development.

Trade and Environment: UNCTAD considers the relationship between trade and environmental sustainability, aiming to find ways to reconcile economic development with environmental conservation.

UNCTAD plays a crucial role in promoting inclusive and sustainable development, particularly focusing on the needs and challenges faced by developing countries. The organization holds regular conferences and publishes reports that contribute to international discussions on trade and development issues.

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WORLD BANK & IMF

The World Bank and the International Monetary Fund (IMF) are two distinct entities, but they are both international financial institutions that play significant roles in the global economy.

World Bank:

Formation: The World Bank was established in 1944 and began operations in 1946. Its primary focus is on providing financial and technical assistance to developing countries for development projects and programs.

Purpose: The World Bank aims to reduce poverty and support sustainable economic development in member countries. It provides loans and grants for projects related to infrastructure, education, healthcare, and other sectors that contribute to economic development and poverty reduction.

Structure: The World Bank Group consists of five institutions, with the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA) being the main arms. The World Bank operates through partnerships with governments, private sector entities, and other international organizations.

International Monetary Fund (IMF):

Formation: The IMF was established in 1944 along with the World Bank. It officially began operations in 1947. Unlike the World Bank, the IMF's primary focus is on maintaining global monetary cooperation and financial stability.

Purpose: The IMF provides financial assistance to member countries facing balance of payments problems, helping them stabilize their economies. It also conducts economic surveillance, provides policy advice, and offers technical assistance to member countries.

Structure: The IMF is governed by its member countries, each of which holds voting power based on its financial contributions. It provides short-term financial assistance through its lending programs and aims to prevent financial crises by promoting sound economic policies globally.

Key differences:

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Focus: The World Bank focuses on long-term development projects and poverty reduction, while the IMF addresses short-term balance of payments and financial stability issues.

Nature of Assistance: The World Bank primarily provides loans and grants for development projects, while the IMF offers short-term financial assistance with conditions attached to ensure economic stability and reform.

Membership: Both institutions have a global membership, but the World Bank primarily serves middle-income and low-income countries, while the IMF's membership includes a broader range of countries, including advanced economies.

Together, the World Bank and the IMF collaborate to promote global economic stability and development, each with its specific areas of expertise and functions.

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