Dr. Babasaheb Ambedkar
Open University
(Established by Government of Gujarat)

MBA
SEMESTER - 4
MBA04C401

International Business

Message for the Students

Dr. Babasaheb Ambedkar Open (University is the only state Open University, established by the Government of Gujarat by the Act No. 14 of 1994 passed by the Gujarat State Legislature; in the memory of the creator of Indian Constitution and Bharat Ratna Dr. Babasaheb Ambedkar. We Stand at the seventh position in terms of establishment of the Open Universities in the country. The University provides as many as 54 courses including various Certificate, Diploma, UG, PG as well as Doctoral to strengthen Higher Education across the state.

On the occasion of the birth anniversary of Babasaheb Ambedkar, the Gujarat government secured a quiet place with the latest convenience for University, and created a building with all the modern amenities named 'Jyotirmay' Parisar. The Board of Management of the University has greatly contributed to the making of the University and will continue to this by all the means.

Education is the perceived capital investment. Education can contribute more to improving the quality of the people. Here I remember the educational philosophy laid down by Shri Swami Vivekananda:

> ***"We want the education by which the character is formed, strength of mind is Increased, the intellect is expand and by which one can stand on one's own feet".***

In order to provide students with qualitative, skill and life oriented education at their threshold. Dr. Babaasaheb Ambedkar Open University is dedicated to this very manifestation of education. The university is incessantly working to provide higher education to the wider mass across the state of Gujarat and prepare them to face day to day challenges and lead their lives with all the capacity for the upliftment of the society in general and the nation in particular.

The university following the core motto 'स्वाध्यायः परमं तपः does believe in offering

enriched curriculum to the student. The university has come up with lucid material for the better understanding of the students in their concerned subject. With this, the university has widened scope for those students who

are not able to continue with their education in regular/conventional mode. In every subject a dedicated term for Self Learning Material comprising of Programme advisory committee members, content writers and content and language reviewers has been formed to cater the needs of the students.

Matching with the pace of the digital world, the university has its own digital platform Omkar-e to provide education through ICT. Very soon, the University going to offer new online Certificate and Diploma programme on various subjects like Yoga, Naturopathy, and Indian Classical Dance etc. would be available as elective also.

With all these efforts, Dr. Babasaheb Ambedkar Open University is in the process of being core centre of Knowledge and Education and we invite you to join hands to this pious *Yajna* and bring the dreams of Dr. Babasaheb Ambedkar of Harmonious Society come true.

Prof. Ami Upadhyay
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MBA
SEMESTER-4 CORE
INTERNATIONAL BUSINESS
BLOCK: 1

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Publisher's Name: Dr. Ajaysinh Jadeja,
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'Jyotirmay Parisar', Opp. Shri Balaji Temple, Chharodi,
Ahmedabad, 382481, Gujarat, India.

Edition: 1st

ISBN: 978-93-5598-645-0

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International Business

BLOCK-1

BLOCK-2

UNIT-1 INTRODUCTION TO INTERNATIONAL BUSINESS

1.1 Introduction

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.

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 people. 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.

International business involves trading goods and services across borders, expanding into global markets, and managing operations internationally. It includes adapting to different cultures, navigating international regulations, and leveraging global opportunities for growth and innovation.

International business involves transactions and exchanges of goods, services, or resources between individuals, organizations, or governments in different countries. It encompasses various activities, including international trade, investment, finance, marketing, and management. Companies engage in international business to expand their customer base, increase revenue, access new markets, acquire resources, or gain a competitive advantage. Various factors shape international business, including government policies, cultural differences, economic conditions, legal systems, and technological advancements. To succeed in international business, companies must navigate these complex and dynamic factors and adapt their strategies to meet the needs of diverse markets and stakeholders.

1.2 Definition of International Business

"International business consists of transactions that are devised and carried out across national borders to satisfy the objectives of the individuals, companies and organizations. These transactions take on various forms which are often interrelated." – Michael R. Czinkota

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

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 come 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.

1.3 Score Of International Business

The **score of international business** could refer to various things depending on the context, such as:

1. Success and Growth

When we refer to the **success and growth** of international business, we are essentially discussing the performance of a company or a country's international business activities in a global context. A "high score" in international business indicates that a company or country has effectively achieved growth and success in the international arena. This success can manifest in several ways:

- **Global Expansion**: A company's ability to enter new markets and establish a strong presence in international regions. This could involve establishing new offices, production facilities, or distribution channels worldwide.
- **Building Strong Partnerships**: Success can also be measured by the partnerships a company has formed globally. These could include strategic alliances, joint ventures, licensing agreements, or franchises with local businesses, helping the company penetrate foreign markets and expand its network.
- **Revenue from International Markets**: Another significant indicator of success is the revenue generated from foreign markets. Companies with a high level of international sales often have a more diversified and resilient business model, as they are less dependent on one specific market.

2. Economic Impact

The **economic impact** of international business is a key factor in measuring how global commerce affects a country's economy. The "score" here refers to how significant international business is in contributing to the economic wellbeing of a nation. Several factors influence this score:

- **Exports**: A country's level of exports is a primary indicator. Higher exports mean the country is successfully selling its goods and services abroad, which drives economic growth, job creation, and increases foreign exchange earnings.
- **Foreign Direct Investment (FDI)**: The amount of FDI a country receives indicates its attractiveness to foreign investors. A high score in FDI reflects a strong business environment, attractive economic policies, and political stability that encourage international companies to invest.
- **Global Competitiveness**: A nation's competitiveness on the global stage, which depends on factors like infrastructure, education, innovation, and labour productivity, contributes significantly to its economic performance. Countries that score high in global competitiveness are seen as favourable destinations for international business.
- **Trade Balance**: The difference between a country's imports and exports, known as the trade balance, is another crucial factor. A positive trade balance (surplus) means that the country is exporting more than it imports, indicating healthy international business activity and economic growth.

3. International Business Ranking

Countries and businesses are often ranked based on their performance in international business activities. These rankings provide valuable insights into how different nations and companies perform globally and how they compare with others. Some of the most recognized rankings include:

- **Ease of Doing Business**: This ranking, often provided by the World Bank, measures how conducive a country's environment is for starting and operating a business. Factors like the simplicity of regulatory processes, access to credit, taxation, and protection of investors influence this score. Countries with a higher ease of doing business ranking attract more foreign companies and investments.
- **Global Competitiveness Index (GCI)**: Published by the World Economic Forum (WEF), the Global Competitiveness Index assesses the overall competitiveness of economies. The GCI considers factors like infrastructure, macroeconomic stability, health, education, innovation capability, and business dynamism. Countries with a high GCI score are seen as favourable places for international business, as they have the necessary conditions for sustained economic growth.
- **Trade and Investment Scores**: These metrics assess a country's performance in international trade and its ability to attract investments. High scores typically indicate robust trade relationships with other countries, strong international investment flows, and favourable policies that make the country an attractive destination for global commerce.

4. Business Evaluation

In a more detailed, **granular context**, businesses themselves may be evaluated or "scored" based on their international strategies and overall global performance. This evaluation often includes several critical factors:

- **Market Entry Methods**: How businesses enter foreign markets—whether through exporting, franchising, joint ventures, or direct investment—can significantly affect their international success. The choice of entry strategy can influence a company's risk exposure, control, and profitability.
- **Trade Policies**: A company's ability to navigate and adapt to different trade regulations, tariffs, and customs in international markets is critical. Businesses that can efficiently handle international trade policies and manage compliance tend to perform better globally.
- **Expansion Efforts**: Companies are often evaluated based on how successfully they scale their operations in international markets. Factors include the speed of market penetration, local adaptation of products, and the ability to establish a sustainable presence in new regions.
- **Market Share and Profitability**: A key evaluation metric is a company's market share in foreign markets and its profitability from these markets. Companies with strong international market shares and consistent profitability are considered to be excelling in international business.
- **Cultural Adaptability**: Cultural intelligence is crucial for international success. Companies that adapt to the local culture, customs, and business practices of foreign markets are more likely to succeed. Businesses with high cultural adaptability are better positioned to form long-term relationships with international partners and customers.
- **International Reach**: This evaluates the global footprint of a company, including how many countries it operates in, the diversity of its markets, and its ability to manage a global supply chain. A business with extensive international reach demonstrates a robust ability to operate globally and manage complex international operations.

In conclusion, business evaluations in international business measure a company's overall ability to thrive globally, including how it navigates market entry, trade regulations, profitability, and cultural challenges.

These four key aspects—**success and growth**, **economic impact**, **international business rankings**, and **business evaluation**—are essential in assessing the overall performance and influence of international business. They offer valuable insights into how well companies and countries are competing in the global marketplace and the factors that contribute to their success.

1.3 Importance Of International Business

International business is crucial because it helps countries access products and services they may not produce locally, benefiting both businesses and consumers. It creates jobs, drives economic growth, and encourages exchanging ideas and cultures across borders. By expanding into new markets, companies can also grow and compete globally.

1. Increase Revenue and Brand Awareness

Due to its international expansion, your company will be able to explore new markets and draw in new clients, increasing its sales and revenue and the visibility of its brand internationally. Your business can grow sales by entering a new market and extending the shelf life of its goods and services. Going to a new market where certain goods and services are not offered, and customers cannot purchase them gives you access to fresh and enthusiastic customers who are prepared to acquire your goods and services.

2. Minimizing Reliance on the Current Market

The chance to lessen reliance on the present market where you are already established exists when a store expands worldwide. Right now, many other businesses in the market are very competitive. You are unable to profit from this market and raise sales. Moving your company abroad would now be one of the best solutions. You can split the resources to create money without being overly dependent on one particular market instead of concentrating on just one plan or putting all your eggs in one basket.

3. Collaborate with Skilled Individuals and Utilize the External Resource

Another significant benefit of expanding your firm internationally is the ability to utilize the other country's resources, such as technology, skill, and understanding in a certain industry. This enables you to employ better technologies and discover better work practices, ultimately enhancing your company's operations and revenue. Additionally, you will collaborate with skilled individuals who are experts in your field. You can benefit from their knowledge and experience by working together to comprehend how a new country you have recently expanded to operates.

4. Get a First-Mover Advantage

The desire to outperform rivals is one of the main drivers behind many businesses seeking to go global. They will benefit greatly from being the pioneers. Customers will be familiar with your brand before those of your rivals. Additionally, changing their habits and thinking maybe challenging when buyers have specific brands in mind. They will visit yours rather than your competitors.

1.4 Benefits of international business:

1. **Earning of Foreign Exchange:** International Business helps a country to collect and earn foreign currency from the investment offered by a foreign firm in the domestic market. Foreign currency helps in meeting imports of any country from foreign countries.
2. **More Efficient Use of Resources:** International business allows firms to use the resources present in different countries more efficiently. Firms can bring the newest technologies from which the resources can be utilized more efficiently.

3. **Improving Growth Prospects and Employment Potentials:** By setting up new industries and businesses in different countries, the international business helps in improving the economic growth and employment potential in those countries. Larger scale production contributes to the GDP as well as generates employment.

4. **Increased Standard of Living:** In the presence of an international business, people of any country can consume goods and services produced in some other countries. It helps in improving the standard of living of those people and the country in general.

5. **Prospects for Higher Profits:** International business gives scope to firms a whole new market to target. Firms can sell their products in markets where prices are relatively high and earn more profits.

6. **Increased Capacity Utilization:** The products produced by a firm more than the demand in the domestic market can be sold to a foreign market with the help of international business. The capacity to produce more can be utilized with an expansion in the market.

7. **Prospects for Growth:** Firms can improve the prospects of their growth by getting into the international market. The demand for a certain product in the domestic market is limited but in the international market, firms can reach new highs.

8. **Way Out to Intense Competition in Domestic Market:** When the competition in the domestic market increases, firms can move out of the domestic boundaries to find a new market. By this, they can counter the intense competition in the domestic market.

9. **Improved Business Visions**: Every firm's vision is to grow, become more competitive, diversify and gain strategic advantage over its competitors. The international business allows firms to grow and build themselves with greater prospects.

1.5 Types of International Business

Common forms of international business include imports and exports, franchising, licensing, foreign direct investment, and strategic partnerships like joint ventures. Let's explore each in detail.

1. Import and Export

Importing and **exporting** are among the simplest and most common forms of international business.

- **Import**: This refers to the purchase and bringing of products or services from one country to another for sale or use. Companies involved in importing typically buy products that are not readily available or are cheaper to produce in other countries.

- **Export**: Conversely, exporting is when a business in one country sells products or services made or sourced in that country to customers in another country. Exporting is often the first step for companies looking to expand internationally, as it allows them to test foreign markets without significant capital investment.

Why it matters: Importing and exporting are typically the easiest ways for companies to enter international markets and begin building their global footprint. They require less initial investment compared to other forms of international business, making them a popular choice for many small and medium-sized enterprises (SMEs).

2. Franchise

Franchising is a business model where a parent company (the **franchisor**) grants permission to other businesses (the **franchisees**) to operate under its brand and sell its products or services in a specific region.

- In a **franchise** agreement, the franchisee is granted the right to use the franchisor's brand, trademark, operational model, and products/services in exchange for an initial fee and ongoing royalties.
- **Franchising vs. Licensing**: While both franchising and licensing allow one business to use the intellectual property of another, franchising typically involves a more structured and controlled relationship. Franchisees follow more detailed operational guidelines, including how to run the business, whereas licensing tends to be more flexible.

Common industries: Franchising is widely used in industries such as fast food, hotels, and car rental services, where uniformity and consistency across locations are important.

3. Licensing

Licensing allows a company (the **licensor**) to grant permission to another business (the **licensee**) to use its intellectual property—such as patents, trademarks, or copyrights—in exchange for a fee or royalty. Licensing can be a cost-effective way to expand into international markets without significant investment.

- **Types of licenses**: These can include licensing of patents (e.g., technology), trademarks (e.g., branding), or copyrights (e.g., music, movies, books). For example, a film studio may license its movies to distributors in other countries.
- **Why it's used**: Licensing allows companies to expand their reach and generate income from international markets without directly managing operations abroad. It's a low-risk method for growing the business globally while leveraging existing assets.

Industries: Licensing is commonly used in entertainment, fashion, and technology, where brands, patents, or intellectual property are central to the business.

4. Foreign Direct Investment (FDI)

Foreign Direct Investment (FDI) is when individuals or companies invest capital into businesses located in foreign countries. This is often a more involved and long-term strategy compared to exporting or licensing, as it requires setting up operations or acquiring businesses abroad.

- FDI can take various forms, such as:
    - **Mergers and Acquisitions (M&A)**: Acquiring an existing foreign company or merging with a local company.
    - **Greenfield Investments**: Establishing a new operation from the ground up, such as a new manufacturing plant.
    - **Joint Ventures**: Collaborating with a local company to form a new business entity in the foreign market.
- **Benefits**: FDI allows companies to gain a stronger foothold in international markets, access local resources, and control their operations in foreign countries. It can also help reduce tariffs and take advantage of local tax incentives.

5. Strategic Partnerships and Joint Ventures

A **strategic partnership** is a cooperative relationship between two or more companies across different countries for mutual benefit. These partnerships allow businesses to share resources, expertise, and technology, enabling them to leverage each other's strengths to enter new markets or improve business operations.

- **Strategic Alliances**: These partnerships are often non-equity-based and don't require creating a new business entity. They are more flexible and can be focused on specific goals, such as research and development, marketing, or distribution.
- **Joint Ventures (JVs)**: A joint venture is a specific type of strategic partnership where two or more companies come together to form a new, separate entity. In a joint venture, the partners typically share ownership, control, and profits. This model is commonly used when companies want to enter a new market or industry but lack the local knowledge, resources, or infrastructure to do so independently.

Advantages: Strategic partnerships and joint ventures allow businesses to reduce risk by sharing costs and resources, while also combining expertise. Joint ventures are particularly useful in entering complex or regulated foreign markets.

In conclusion, each form of international business offers unique opportunities for growth and market expansion. Companies typically select their method based on factors like the level of investment they are willing to make, the degree of control they want over operations, and the type of product or service they are offering.

UNIT-2 INTERNATIONAL MONETARY & FINANCIAL SYSTEM

2.1 Introduction

International monetary system refers to a system that forms rules and standards for facilitating international trade among the nations and helps in relocating the capital and investment from one nation to another. The international monetary system gives the set for global trade and financial trade among nations. It aims to boost the orderly exchange of goods, services, and investments across borders. At its core, the system consists of currencies and exchange rates that help trade among nations. Moreover, it is the worldwide network of the government and financial institutions that determine the exchange rate per currency. It is amazing how the monetary system has evolved from centuries ago where gold coins were used as a way of currency, and where people had to barter products or goods to receive something in exchange.

Although volatile exchange rate increase risk, they also create profit opportunities for firms and investors, given a proper understanding of exchange risk management. In order to manage foreign exchange risk, however, management must first understand how the international monetary system functions. The international monetary system is the structure within which foreign exchange rates are determined, international trade and capital flows are accommodated, and balance-of-payments (BoP) adjustments made. All of the instruments, institutions, and agreements that link together the world's currency, money markets, securities, real estate, and commodity markets are also encompassed within that term.

The International monetary system gives the set for global trade and financial trade among nations. It aims to boost the orderly exchange of goods, services, and investments across borders. At its core, the system consists of currencies and exchange rates that help trade among nations.

Each nation's currency acts as a mode of exchange in global trade. The exchange rate among currencies defines how much one currency is worth in terms of another.

Central banks play a vital role by working monetary policies and exchange rates within their distinct economies. They work to maintain price stability and a healthy financial system. Global institutions like the IMF and World Bank foster international monetary system and financially assist nations when ought.

2.2 Terminologies

- **Exchange rate:**

An exchange rate is a relative price of one currency expressed in terms of another currency (or group of currencies). Exchange Rate, or the rate of exchange, is the price of the currency of a nation in terms of another currency i.e. the price at which one currency can be traded for another.

The rate of exchange of a currency with respect to another currency reflects the relative demand of the two currencies. For example, if the US Dollar is stronger than the Indian Rupee, it implies that value of the US Dollar is higher with respect to the Indian Rupee). This, in turn, shows that the demand for US Dollars (by those holding Indian Rupees) is more than the demand for Indian Rupees (by those holding US Dollars). The relative demands of the two currencies depend on the relative demand for the goods & services of the two countries.

- **Spot exchange rate:**

A spot exchange rate is the current market price at which one currency can be exchanged for another, for immediate settlement, typically within two business days. The rate at which the foreign currency is bought and sold is called the **spot exchange rate**. A market wherein the purchase and sale of foreign currency are settled within 2 days of the deal is called spot market.

- **Forward exchange rate:**

A forward exchange rate is a predetermined rate at which two currencies will be exchanged at a specific future date, helping businesses and investors hedge against currency fluctuations. It refers to that market, which deals in the sale and purchase of foreign currency at some future date at a pre-settled rate of exchange, called **forward exchange rate**. When sellers and buyers enter an agreement to sell and buy a foreign currency after 90 days of the deal, it is called a forward transaction.

2.3 History of International Exchange Rate

The international monetary system has gone through four stages in its evolution: (1) the gold standard (1880–1914); (2) the gold-exchange standard (1925–

1933); (3) the Bretton Woods system (1944–1971); and (4) the Jamaica system, also known as the floating exchange rate system (1976–present). Over the ages, currencies have been defined in terms of gold and other items of value, and the international monetary system has been the subject of a variety of international agreements. A review of these systems provides a useful perspective from which to understand today's system and to evaluate weakness and proposed changes in the present system.

- **The Gold Standard, 1876-1913:**

Since the days of the Pharaohs (about 3000 B.C.), gold has served as a medium of exchange and a store of value. the Greeks and Romans used gold coins and passed on this through the mercantile era to the nineteenth century. The great increase in trade during the free-trade period of the late nineteenth century led to a need for a more formalized system for settling international trade balances. One country after another set a par value for its currency in terms of gold and then tried to adhere to the so-called "rules of the game". This later came to be known as the classical gold standard. The gold standard as an international monetary system gained acceptance in Western Europe in the 1870s.

- **Inter-war years and world war ii, 1914 – 1944:**

After World War I, in twenties, the exchange rates were allowed to fluctuate. This was the result of large fluctuations in currency values. Consequently, the trade could not develop. Once a currency became weak, it was further weakened because of speculative expectations. The reverse happened with strong currencies, because of these unwarranted fluctuations in exchange rates, the trade volumes did not grow in proportion to the growth in GNP.

- **Bretton Woods And The International Monetary Fund (Imf), 1944-1973**

At the 1944 meeting in Bretton Woods was the prevention of another breakdown of the international financial order, such as the one, which followed the peace after the First World War. From 1918 until well into the 1920s the world had witnessed a rise in protectionism on a grand scale to protect jobs for those returning the war, competitive devaluations designed for the same effect, and massive hyperinflation as the inability to raise conventional taxes led to use of the hidden tax of inflation: inflation shifts buying power from the holders of money, whose holdings buy less to the issuers of money, the central banks.

- **Exchange rate regime 1973-85:**

In the wake of the collapse of the Bretton Woods exchange rate system, the IMF appointed the Committee of Twenty that suggested for various options for exchange rate arrangement. Those suggestions were approved at Jamaica during February 1976 and were formally incorporated into the text of the Second Amendment to the Articles of Agreement that came into force from April 1978. The options were broadly:

1. Floating-independence and managed

2. Pegging of currency

3. Crawling peg

4. Target-zone arrangement

Floating Rate System: In a floating-rate system, it is the market forces that determine the exchange rate between two currencies. The advocates of the floating-rate system put forth two major arguments. One is that the exchange rate varies automatically according to the changes in the macro-economic variables. As a result, there does not appear any gap between the real exchange rate and the nominal exchange rate.

Pegging of Currency: Normally, a developing country pegs its currency to a strong currency or to a currency with which it has a very large part of its trade. Pegging involves fixed exchange rate with the result that the trade payments are stable. But in case of trading with other countries, stability cannot be guaranteed. This is why pegging to a single currency is not advised if the country's trade is diversified. In such cases, pegging to a basket of currency is advised. But if the basket is very large, multi-currency intervention may prove costly. Pegging to SDR is not different insofar as the value of SDR itself is pegged to a basket of five currencies.

Crawling Peg: Again, a few countries have a system of crawling peg. Under this system, they allow the peg to change gradually over time to catch up with the changes in the market-determined rates. It is a hybrid of fixed-rate and flexible-rate systems. So, this system avoids too much of instability and too much of rigidity. Elwards (1983) confirms this advantage in case of a sample of some developing countries. In some of the countries opting for the crawling peg, crawling bands are maintained within which the value of currency is maintained.

Target-zone Arrangement: In a target-zone arrangement, the intra-zone exchange rates are fixed. An opposite example of such an arrangement is the European Monetary Union (EMU) which was earlier known as the European Monetary System (EMS). There are cases where the member countries of a currency union do not have their own currency, rather they have a common currency.

2.5 Current international financial system

A financial system is a network of institutions, markets, and instruments that facilitate the exchange of funds between lenders, investors, and borrowers, enabling efficient allocation of capital and promoting economic growth.

International financial system is everywhere today. It is proved with the following facts. (a) the dollar is still the principal currency used in international transactions but its unchallenged dominance as an economic and financial force: and (c) Bretton Woods is dead but its child, the IMF, has evolved with the times and is more important than ever as watchdog and arbiter of balance of payments disequilibrium.

Concept of international monetary and financial system:

The International Monetary System (IMS) constitutes an integrated set of money flows and related governance institutions that establish the quantities of money, the means for supporting currency requirements and the basis for exchange among currencies in order to meet payments obligations within and across countries. Central banks, international financial institutions, commercial banks and various types of money market funds — along with open markets for currency and, depending on institutional structure, government bonds — are all part of the international monetary system.

The International Financial System (IFS) constitutes the full range of interest- and return-bearing assets, bank and nonbank financial institutions, financial markets that trade and determine the prices of these assets, and the nonmarket activities (e.g., private equity transactions, private equity/hedge fund joint ventures, leverage buyouts whether bank financed or not, etc.) through which the exchange of financial assets can take place. The IFS lies at the heart of the global credit creation and allocation process.

The international monetary system clearly needs to evolve. However, this evolution should be predicated on the need for stable trade, related financial and payments requirements and self-regulating imbalances in global trade and capital accounts as well as take into account the special needs of the payments systems during financial crisis events. International finance, sometimes known as international macroeconomics, is the study of monetary interactions between two or more countries, focusing on areas such as foreign direct investment and currency exchange rates.

- **Importance of international financial system:**

The international financial system is crucial for global economic stability and growth, facilitating international trade, investment, and capital flows, while also enabling businesses to access global markets and manage risks. International finance plays a critical role in international trade and inter-economy exchange of goods and services. It is important for a number of reasons; the most notable ones are listed here −

- International finance is an important tool to find the exchange rates, compare inflation rates, get an idea about investing in international debt securities, ascertain the economic status of other countries and judge the foreign markets.
- Exchange rates are very important in international finance, as they let us determine the relative values of currencies. International finance helps in calculating these rates.
- Various economic factors help in making international investment decisions. Economic factors of economies help in determining whether or not investors' money is safe with foreign debt securities.
- Utilizing IFRS is an important factor for many stages of international finance. Financial statements made by the countries that have adopted IFRS are similar. It helps many countries to follow similar reporting systems.
- IFRS system, which is a part of international finance, also helps in saving money by following the rules of reporting on a single accounting standard.
- International finance has grown in stature due to globalization. It helps understand the basics of all international organizations and keeps the balance intact among them.

- An international finance system maintains peace among the nations. Without a solid finance measure, all nations would work for their self-interest. International finance helps in keeping that issue at bay.
- International finance organizations, such as IMF, the World Bank, etc., provide a mediators' role in managing international finance disputes.

The very existence of an international financial system means that there are possibilities of international financial crises. This is where the study of international finance becomes very important. To know about the international financial crises, we have to understand the nature of the international financial system.

Greater comparability

Companies that use the same standards to prepare their financial statements can be compared to each other more accurately. This is especially important when comparing companies located in different countries, as they might otherwise be using different rules and methodologies to prepare their statements. This increase in comparability has helped investors better determine where their investment dollars should go.

2.6 International Monetary Fund (IMF)

One of the most important players in the current international financial system, the IMF was created to administer a code of fair exchange practices and provide compensatory financial assistance to member countries with balance of payments difficulties.

1. To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions that hamper the growth of world trade
2. To provide international monetary cooperation through a permanent institution that provides the machinery for consultation and collaboration on international monetary problems.
3. To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
4. To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

- **Fixed Vs Flexible Exchange Rates**

The choice between fixed and flexible rates may change over time as priorities change. At the risk of over-generalizing, the following points partly explain why countries pursue certain exchange rate regimes. They are based on the premise that, other things being equal, countries would prefer fixed exchanges rates.

- Fixed rates provide stability in international prices for the conduct of trade. Stable prices aid in the growth of international trade lessens risks for all businesses.

- Fixed exchange rates are inherently anti-inflationary, requiring the country to follow restrictive monetary and fiscal policies. This restrictiveness, however, can often be a burden to a country wishing to pursue policies that alleviate continuing internal economic problems, such as high unemployment or slow economic growth.

2.7 Determination Of Exchange Rate

The most common type of foreign transaction involves the payment and receipt of the foreign exchange within two business days after the day the transaction is agreed upon. The two-day period gives adequate time for the parties to send instructions to debit and credit the appropriate bank accounts at home and abroad and complete requirements under the forex regulations.

This type of transactions is called a spot transaction, and the exchange rate at which the transaction takes place is called the spot rate. Besides spot transaction, there are forward transactions. A forward transaction involves an agreement today to buy or sell a specified amount of a foreign currency at a specified future date at a rate agreed upon today (the forward rate).

The typical forward contact is for one month; three months; or six months, with three months being most common. Forward contracts for longer periods are not as common because of the great uncertainties involved. However, forward contract can be renegotiated for one or more periods when they become due.

2.8 The World Bank

The International Bank for Reconstruction and Development (IBRD), better known as the World Bank, was established at the same time as the International Monetary Fund (IMF) to tackle the problem of international investment.

Since the IMF was designed to provide temporary assistance in correcting the balance of payments difficulties, an institution was also needed to assist long-term investment purposes.

Thus, IBRD was established for promoting long-term investment loans on reasonable terms. The World Bank (IBRD) is an inter-governmental institution, corporate in form, whose capital stock is entirely owned by its member governments. Initially, only nations that were members of the IMF could be members of the World Bank; this restriction on membership was subsequently relaxed.

2.9 Functions Of World Bank

International Business Finance The principal functions of the IBRD are set forth in Article 1 of the agreement as follows:

1. To promote private foreign investment by means of guarantee of participation in loans and other investments made by private investors and when private capital is not available on reasonable terms, to make loans for productive purposes out of its own resources or from funds borrowed by it.

2. To promote the long-term balanced growth of international trade and the maintenance of equilibrium in balances of payments by encouraging international investment for the development of the productive resources of members.
3. To assist in the reconstruction and development of the territories of its members by facilitating the investment of capital for productive purposes.

2.10 European Monetary System

The 15 members of the European Union are also members of the European Monetary System (EMS). This group has tried to form an island of fixed exchange rates among themselves in a sea of major floating currencies.

2.11 Objectives of the European Monetary System

The primary objective of the EMS is to promote and enhance monetary stability in the European Community. Its other objectives include working towards the improvement of the general and economic situation of the countries of the European Union in terms of growth, full employment, standard of living, reduction of regional disparities, etc. Above all, it also aims at bringing about a stabilizing effect on international economic and monetary relations.

2.12 Characteristics of the EMS:

The following are the major characteristics of the EMS:

1. There is a single uniform monetary unit of the European Union, namely, the European Currency Unit (ECU);
2. A stable but adjustable exchange rate has emerged.

2.13 Foreign Exchange Markets

The foreign Exchange Market is the market in which currencies are bought and sold against each other. It is the largest market in the world. In this market where financial paper with a relatively short maturity is traded. However, the financial paper traded in the foreign exchange market is not all denominated in the same currency. In the foreign exchange market, paper denominated in a given currency is always traded against paper denominated in another currency.

One justification for the existence of this market is that nations have decided to keep their sovereign right to have and control their own currencies. Unlike the money market and capital markets, the foreign exchange market deals not in credit but in means of payment. This brings one to a fundamental point. While foreign exchange deals frequently take place between residents of different countries, the money being traded never actually leaves the country of the currency. The main participants in the foreign exchange market are commercial banks. Indeed, one say that it is the commercial banks that "make a market" in foreign exchange. Next in importance are the large corporations with foreign trade activities. Finally, central banks are present in the foreign exchange market.

2.14 International Financial Markets

The financial markets of the world consist of sources of finance, and uses for finance, in a number of different countries. Each of these is a capital market on its own. On the other hand, national capital markets are partially linked and partially segmented. National capital markets are of very different stages of development and size and depth, they have very different prices and availability of capital. Hence, the international financier has great opportunities for arbitrage– finding the cheapest source of funds, and the highest return, without adding to risk. It is because markets are imperfectly linked, the means and channels by which foreigners enter domestic capital markets and domestic sources or users of funds go abroad, are the essence of this aspect of international financial management.

❖ Exercise:

- **Explain the following terms:**

1. Exchange rate
2. Spot exchange rate
3. Forward exchange rate
4. Crawling peg
5. Characteristics of EMS

- **Answer the following questions in detail:**

1. Explain the history of international exchange rate.
2. Explain exchange rate regime in detail.
3. Explain current international financial system.
4. Write down the difference between fixed and flexible rate.
5. Write a note on world bank.

UNIT-3 BALANCE OF PAYMENT

3.1 Introduction:

The Balance of Payments (BOP) is a comprehensive record of a country's economic transactions with the rest of the world over a specific period, typically a year. It serves as a vital indicator of a nation's financial stability and its position in the global economy. The BOP is divided into two main components: the current account and the capital and financial account. The current account tracks trade in goods and services, primary income, and transfer payments, while the capital and financial account records capital transfers and cross-border investments.

A balanced BOP is critical for a country's economic health, reflecting equilibrium between inflows and outflows of money. Persistent deficits or surpluses in the BOP can have significant implications, influencing exchange rates, foreign reserves, and economic policy decisions. By analysing the BOP, policymakers, economists, and investors can assess a nation's trade performance, external debt sustainability, and overall financial well-being.

3.2 Balance of Payment

3.2.1 Concept:

The Balance of Payments (BOP) is a detailed financial statement that tracks all monetary transactions between a country and the global economy during a particular time frame. It captures the country's exports and imports, investments and transfer payments involving foreign parties. The purpose of the BOP is to maintain equilibrium, ensuring that the total credits (inflows) match the total debits (outflows).

3.2.2 Definition:

Definitions of Balance of Payments (BOP)

1. **International Monetary Fund (IMF)**:

   "The Balance of Payments is a statistical statement that summarizes economic transactions between residents of a country and the rest of the world during a specific period."

2. **Kindleberger**:

   "The Balance of Payments of a country is a systematic record of all economic transactions between the residents of the reporting country and residents of foreign countries."

3. **Components of balance of payment**:

The Balance of Payments (BOP) consists of three main components: the **current account**, the **capital account**, and the **financial account**. Each component captures different aspects of a country's economic transactions with the rest of the world.

A. Current Account:

The current account records the flow of goods, services, income, and transfer payments between a country and other nations. It is further divided into:

- **Trade in Goods**: Includes exports and imports of tangible items such as machinery, vehicles, and food.
- **Trade in Services**: Covers intangible exchanges like tourism, transportation, and financial services.
- **Primary Income**: Consists of income earned from foreign investments (such as dividends or interest) and payments made to foreign investors.
- **Secondary Income**: Includes unilateral transfers like foreign aid, remittances, and gifts.

A surplus in the current account indicates that a country is exporting more than it imports, while a deficit means the opposite.

B. Capital Account:

The capital account tracks capital transfers and the acquisition or disposal of non-produced, non-financial assets. This includes transactions like:

- Debt forgiveness.
- Transfer of ownership of fixed assets.

- Sales or purchases of intangible assets like patents, trademarks, or copyrights.

The capital account is typically smaller in scale compared to the current and financial accounts.

C. Financial Account:

The financial account records cross-border investments and financial flows. It includes:

- **Foreign Direct Investment (FDI)**: Long-term investments in physical assets like factories or businesses in another country.
- **Portfolio Investment**: Investments in foreign financial assets such as stocks and bonds.
- **Reserve Assets**: Changes in a country's foreign exchange reserves managed by its central bank.
- **Other Investments**: Short-term financial transactions, including loans, bank deposits, and trade credits.

The financial account reflects the country's ability to attract foreign capital and manage its external financial obligations.

D. Errors and Omissions:

This component adjusts for any discrepancies or unrecorded transactions to ensure that the BOP balances.

The components of the BOP provide a complete picture of a nation's economic relationship with the rest of the world. Understanding these components helps evaluate trade performance, capital flows, and overall economic stability.

3.4 Open-Economy Macroeconomics

Open-economy macroeconomics focuses on the study of how economies interact with one another in a globally interconnected environment. Unlike closed economies which operate independently without external trade or financial exchanges, open economies engage in international trade investment and capital flow. This field examines the macroeconomic principles that govern such interactions and their implications for economic growth, policy-making and global stability.

❖ **Key Features of an Open Economy:**

1. **International Trade**:

   Open economies engage in the exchange of goods and services across borders, which influences domestic production, consumption, and trade balances.

2. **Capital Mobility**:

   Open economies allow for the movement of capital such as foreign investments and loans across countries. This enhances economic opportunities but also introduces vulnerabilities to global financial conditions.

3. **Exchange Rates**:

   The value of a country's currency relative to others plays a crucial role in determining trade competitiveness and capital flows. Exchange rates can be fixed floating or managed.

4. **Global Integration**:

   An open economy integrates with the global market, meaning external factors like global demand, trade policies and international financial conditions significantly influence domestic outcomes.

❖ **Key Concepts in Open-Economy Macroeconomics:**

1. **Balance of Payments (BOP)**:

   The BOP tracks a country's financial and trade transactions with other nations. It consists of the current account, capital account and financial account reflecting a country's global economic position.

2. **Exchange Rate Dynamics**:

   The exchange rate system (fixed or flexible) determines how a country's currency adjusts to changes in trade and capital flows. Exchange rates affect export and import competitiveness and influence inflation.

3. **Trade Policies**:

   Policies like tariffs, quotas, and subsidies affect the flow of goods and services. Open economies must balance protection of domestic industries with the benefits of free trade.

4. **Capital Flow Management**:

   Open economies attract foreign investments in the form of foreign direct investment (FDI) and portfolio investments. Proper management of these flows is necessary to avoid financial crises.

❖ **Advantages of an Open Economy:**

- Economic Growth: Access to global markets provides opportunities for higher production and trade.

- Technological Exchange: Openness encourages the flow of technology and innovation across borders.

- Investment Opportunities: Foreign capital can support domestic growth and infrastructure development.

❖ **Challenges of an Open Economy:**

- Economic Vulnerability: Dependence on foreign markets can lead to economic instability due to global shocks.

- Exchange Rate Volatility: Fluctuations in exchange rates can disrupt trade and investment.

- Trade Deficits: Excessive imports compared to exports may result in imbalances and debt accumulation.

Open-economy macroeconomics provides critical insights into the functioning of economies in a globalized world. It highlights the importance of balancing domestic policies with international integration to achieve sustainable economic growth and stability.

3.5 Current Account

The current account is a key component of a country's Balance of Payments (BOP). It records all transactions involving the exchange of goods, services, income, and transfers between residents of a country and the rest of the world. The current account provides insights into a nation's economic health, trade performance, and its relationship with other countries in terms of trade and financial flows. The current account is often seen as a measure of a country's external economic performance, and it consists of four main subcomponents: **trade in goods**, **trade in services**, **primary income**, and **secondary income**.

❖ **Components of the Current Account:**

1. Trade in Goods:

This includes the import and export of tangible goods, such as machinery, electronics, agricultural products, and raw materials.

Exports: Represent the goods sold to other countries and bring foreign exchange into the domestic economy.

Imports: Represent the goods purchased from other countries, leading to an outflow of domestic currency.

The difference between exports and imports of goods is referred to as the **trade balance**.

Trade Surplus: When exports exceed imports.

- **Trade Deficit**: When imports exceed exports.

2. Trade in Services:

This involves the exchange of intangible goods, such as financial services, insurance, tourism, and transportation.

- Countries with well-developed service sectors often have a surplus in this component.
- For example, nations like India benefit from exporting IT and software services, while countries like Switzerland gain from financial services.

3. Primary Income:

Primary income records earnings on investments and compensation for labour. It includes:

- **Investment Income:** Earnings from foreign investments, such as dividends, interest, and profits from multinational companies.
- **Labor Income**: Wages and salaries earned by residents working abroad.

This component reflects the financial relationships between countries, especially in terms of capital ownership.

4. Secondary Income:

Secondary income includes unilateral transfers of money or goods where no direct economic transaction occurs in return. Examples include:

- **Remittances**: Money sent by foreign workers to their families in their home countries.
- **Aid and Grants**: Financial assistance provided by one country to another, either for humanitarian or developmental purposes.
- **Gifts and Donations**: Transfers without a direct exchange.

❖ **Key Features of the Current Account:**

1. **Net Balance**:

   The current account balance is the sum of its four components. A positive balance indicates a surplus, while a negative balance reflects a deficit.

2. **Interconnectedness with Trade and Investment**:

   The current account reflects how a country interacts with the global economy through trade and investments.

3. **Sustainability**:

   Persistent deficits in the current account can lead to external debt accumulation, while consistent surpluses might indicate underutilization of domestic resources.

❖ **Significance of the Current Account:**

1. **Indicator of Economic Health**:
   The current account provides a snapshot of a country's economic performance in relation to the rest of the world.

   - A **surplus** suggests strong export performance or high investment income.
   - A **deficit** may indicate reliance on foreign goods and capital or imbalances in domestic savings and investments.

2. **Impact on Currency Exchange Rates**:

   A current account surplus typically strengthens a country's currency, while a deficit may lead to currency depreciation.

3. **Policy Implications**:

   Governments and central banks monitor the current account to implement policies that stabilize trade and financial flows. For instance, a large deficit may prompt measures to boost exports or reduce import dependence.

4. **Global Competitiveness**:

   It reflects a country's ability to compete in the global market. Strong performance in goods and services exports showcases competitiveness.

Factors Affecting the Current Account:

1. **Exchange Rates:**

   A weaker currency makes exports cheaper and imports costlier, potentially improving the trade balance.

2. **Domestic Economic Growth:**

   Rapid economic growth may lead to increased imports due to higher demand for goods and services.

3. **Global Demand:**

   Economic conditions in trading partner countries influence exports and investment income.

4. **Trade Policies**:

   Tariffs, quotas, and trade agreements significantly impact the flow of goods and services.

❖ **Challenges of Current Account Deficits and Surpluses:**

Deficits*:*

- A current account deficit implies that a country imports more than it exports.
- **Risks**:
  - Increased reliance on foreign borrowing or investments to finance the deficit.
  - Potential currency depreciation, leading to inflation.
  - Vulnerability to external economic shocks.

Surpluses:

- A surplus indicates that a country exports more than it imports.
- **Concerns**:
- Over-reliance on exports, which might expose the economy to global demand fluctuations.
- Insufficient domestic investment or consumption.

3.6 Capital Account

The **capital account** is one of the main components of a country's Balance of Payments (BOP). It records the movement of capital between a nation and the rest of the world, primarily focusing on capital transfers and transactions involving non-produced, non-financial assets. While the capital account is generally smaller in scale compared to the current account and the financial account, it plays a critical role in understanding a country's economic transactions.

The capital account provides insights into the economic exchanges related to ownership changes, debt forgiveness, and the transfer of intangible assets. It reflects how resources are allocated across borders to support investment, development, and financial obligations.

❖ **Components of the Capital Account:**

1. Capital Transfers:

Capital transfers refer to transactions where ownership of assets is changed, or liabilities are canceled without corresponding economic benefits being exchanged. These include:

- **Debt Forgiveness**: When a country’s external debt is waived by another country or international institution.
- **Grants and Donations for Capital Projects**: Funds provided to finance infrastructure or development projects, such as building roads, schools, or hospitals.

- **Transfer of Ownership of Fixed Assets**: Movement of ownership rights of tangible assets like land and equipment between countries.

2. Transactions Involving Non-Produced, Non-Financial Assets:

This component tracks the acquisition or disposal of non-produced and intangible assets, including:

- **Natural Resources**: Transactions involving the rights to use or exploit natural resources, such as oil reserves, forests, or mining rights.

- **Intellectual Property Rights**: Sales or purchases of patents, copyrights, trademarks, and franchises.

❖ **Features of the Capital Account:**

1. **Small but Significant Role**:

   The capital account is relatively smaller in volume compared to other components of the BOP, but it holds significance in specific cases like debt restructuring or international aid.

2. **Focus on Long-Term Impact**:

   Unlike the financial account, which deals with short-term capital flows, the capital account often involves transfers with long-term economic implications, such as infrastructure development.

3. **Relationship with the Current Account**:

   While the capital account deals with transfers of capital and non-financial assets, it complements the current account by supporting transactions that involve long-term benefits.

❖ **Importance of the Capital Account:**

1. **Debt Relief**:

   Capital transfers like debt forgiveness can help countries reduce financial burdens and allocate resources toward economic development.

2. **Infrastructure Development**:

   Grants or donations for capital projects contribute to building the physical and institutional foundation of a country, enabling long-term growth.

3. **Facilitates Resource Allocation**:

   The capital account ensures the efficient allocation of resources across borders, allowing countries to utilize natural and intangible assets effectively.

4. **Stabilizes External Accounts**:

By accounting for one-time transfers and ownership changes, the capital account helps balance the overall BOP.

Factors Affecting the Capital Account

1. **Debt Restructuring Agreements**:

   International arrangements to forgive or restructure a country's debt significantly impact the capital account.

2. **Development Assistance**:

   Aid and grants provided for capital projects, especially in developing countries, influence the flow of resources in the capital account.

3. **Global Market Trends**:

   Transactions involving intellectual property rights or natural resource use depend on global demand and economic conditions.

4. **International Relations and Policies**:

   Bilateral or multilateral agreements often determine the flow of capital transfers, particularly in the case of aid or resource-sharing arrangements.

❖ **Challenges in Managing the Capital Account**

1. **Dependency on External Support**:

   Countries relying heavily on grants or debt forgiveness may face difficulties in achieving economic independence.

2. **Mismanagement of Funds**:

   Misuse of capital transfers intended for development projects can hinder economic growth and lead to inefficiencies.

3. **Valuation Issues**:

   Accurately valuing non-produced, non-financial assets, such as intellectual property rights or natural resources, can be complex and subject to disputes.

4. **One-Time Nature**:

   Capital account transactions are typically one-time events and do not provide ongoing financial flows, making their impact temporary in nature.

3.7 Financial account:

The **financial account** is a crucial component of a country's Balance of Payments (BOP). It tracks the flow of financial capital between a country and the rest of the world. Unlike the current account, which focuses on the exchange of goods, services, and transfers, the financial account deals with investments, capital movements, and ownership of assets. It reflects a country's ability to attract or provide financial resources internationally.

The financial account provides insights into how a country manages its financial interactions with the global economy, including foreign investments, loans, and changes in foreign reserves.

- **Components of the Financial Account:**

The financial account is divided into the following key components:

1. Foreign Direct Investment (FDI)

Definition: FDI refers to long-term investments made by foreign entities in a country's businesses, infrastructure, or other productive assets. It typically involves ownership of at least 10% of a company.

Examples: Building factories, acquiring companies, or establishing joint ventures.

Importance: FDI reflects confidence in a country's economic potential and contributes to employment, technology transfer, and industrial growth.

2. Portfolio Investment:

Definition: Portfolio investment involves short-term financial investments in a country's securities, such as stocks, bonds, or mutual funds, without taking control of the underlying assets.

Examples: Foreign investors purchasing government bonds or shares in a company listed on the stock exchange.

Volatility: Portfolio investments are more volatile than FDI because they can be withdrawn quickly, affecting financial stability.

3. Reserve Assets:

Definition: Reserve assets are foreign currency reserves, gold holdings, and special drawing rights (SDRs) managed by a country's central bank. These are used to stabilize the exchange rate, settle international debts, and intervene in foreign exchange markets.

Examples: Central banks selling foreign currency reserves to defend the domestic currency against depreciation.

Significance: Reserve assets indicate a country's ability to manage external shocks and maintain liquidity.

4. Other Investments:

Definition: This category includes cross-border loans, trade credits, bank deposits, and other financial flows that do not fall under FDI or portfolio investment.

Examples: Short-term loans provided by foreign banks, trade financing, or cross-border deposits.

Flexibility: These transactions are often short-term and reflect the liquidity needs of businesses or governments.

5. Financial Derivatives:

Definition: Transactions involving financial derivatives, such as options, futures, and swaps, are also part of the financial account. These instruments are used for hedging risks or speculative purposes.

- **Features of the Financial Account:**

Reflects Capital Movements: The financial account captures the movement of financial capital, highlighting whether a country is a net borrower or lender to the rest of the world.

Double-Entry System: Transactions are recorded as both inflows (credits) and outflows (debits), ensuring the account balances with other components of the BOP.

Focus on Ownership Changes: The financial account tracks changes in ownership of financial assets and liabilities between residents and non-residents.

Interaction with Other Accounts: A surplus or deficit in the current account often corresponds to opposite trends in the financial account, reflecting the flow of funds needed to finance trade imbalances.

- **Significance of the Financial Account:**

Indicator of Investor Confidence: High levels of foreign direct investment (FDI) or portfolio inflows indicate global confidence in a country's economic prospects.

Capital for Development: Financial inflows provide resources for infrastructure, industrial expansion, and technological advancement.

Management of External Shocks: Reserve assets allow central banks to intervene in foreign exchange markets, helping to manage currency volatility and economic shocks.

Policy Formulation: Governments use data from the financial account to assess financial stability, formulate policies, and attract foreign investments.

- **Factors Affecting the Financial Account:**

Economic Stability: Stable economies with predictable policies attract more FDI and portfolio investments.

Interest Rates: Higher domestic interest rates compared to global rates attract foreign investments in bonds and other securities.

Exchange Rate Policies: A competitive exchange rate can make investments in a country more attractive.

Global Financial Conditions: Worldwide economic conditions, such as recessions or booms, significantly affect capital flows.

Political Climate: Political stability and transparent governance foster investor confidence, encouraging inflows into the financial account.

- **Challenges of Managing the Financial Account:**

Volatility of Portfolio Investments: Portfolio investments are prone to sudden reversals, leading to financial instability during global market shocks.

Over-Reliance on Foreign Capital: Excessive dependence on foreign investments can lead to vulnerabilities, particularly if external conditions change abruptly.

Currency Risks: Large financial inflows can lead to currency appreciation, which may reduce export competitiveness.

Debt Accumulation: If financial inflows are primarily in the form of loans, it can lead to unsustainable debt levels.

- **Financial Account vs. Capital Account:**

While the **capital account** records one-time transactions like debt forgiveness and ownership transfers, the financial account focuses on ongoing investments and capital flows. The two accounts complement each other to provide a comprehensive picture of a country's external financial interactions.

3.8. Why is balance of payment important?

The Balance of Payments (BOP) is a critical economic indicator that records all transactions between a country and the rest of the world over a specific period. It provides a comprehensive overview of a nation's economic interactions, encompassing trade, investments, and financial flows. The importance of the BOP lies in its ability to reflect a country's economic stability, competitiveness, and global integration. Below are the key reasons why the BOP is vital:

1. Indicator of Economic Health:

- The BOP helps policymakers, economists, and businesses assess the economic health of a country.
- A **current account surplus** indicates strong export performance, while a **deficit** may signal over-reliance on imports or external debt.

2. Exchange Rate Stability:

- The BOP influences a country's exchange rate. A surplus can strengthen the currency, while a deficit may lead to depreciation.
- Monitoring the BOP helps central banks manage foreign exchange reserves and implement measures to stabilize currency fluctuations.

3. Basis for Economic Policy

- Governments use the BOP to formulate trade, fiscal, and monetary policies.

- For example:
    - A persistent trade deficit may prompt policies to encourage exports or reduce import dependence.
    - Large capital inflows could lead to regulations to manage foreign investments.

4. Reflection of Global Competitiveness

- The BOP shows how competitive a country is in the global market.
- A strong export sector and balanced capital inflows indicate an economy capable of sustaining growth in a competitive environment.

5. Attracting Foreign Investments

- A stable and favourable BOP can attract foreign direct investment (FDI) and portfolio investments by demonstrating the country’s economic potential and stability.
- Countries with balanced or surplus BOPs are often seen as safer investment destinations.

6. Understanding External Dependencies

- The BOP highlights a country’s dependence on foreign markets for trade, capital, or resources.
- High levels of external debt or dependence on imports for essential goods (e.g., energy or food) can signal economic vulnerabilities.

7. Early Warning System for Crises:

- Persistent deficits in the BOP, especially in the financial or current account, can indicate potential economic challenges, such as:
    - Risk of currency crises.
    - Unsustainable levels of external debt.
    - Vulnerability to global shocks.
- Monitoring BOP trends helps policymakers implement corrective measures in advance.

8. Role in Global Economic Relations:

- The BOP facilitates a better understanding of a country's economic relationships with its trading and investment partners.
- It helps nations negotiate trade agreements, resolve disputes, and collaborate on international economic policies.

9. Management of Foreign Exchange Reserves:

- The BOP guides central banks in managing foreign exchange reserves.
- For instance:
    - Surpluses add to reserves, strengthening a country's ability to handle external shocks.
    - Deficits deplete reserves, prompting the need for financing through loans or other measures.

10. Supports Sustainable Growth:

- By analysing the BOP, countries can identify areas of economic imbalance and work toward sustainable growth.
- For example:
    - A trade deficit might prompt investment in domestic industries to boost exports.
    - High capital inflows may lead to infrastructure development and long-term growth.

❖ **Conclusion:**

The Balance of Payments is more than just a record of transactions; it is a vital tool for understanding a nation's economic position in the global landscape. By offering insights into trade performance, financial flows, and external dependencies, the BOP helps governments, businesses, and international institutions make informed decisions. Proper management of the BOP ensures economic stability, fosters growth, and enhances a country's integration into the global economy.

3. 9 Keywords

1. Balance of Payments (BOP)

A systematic record of all economic transactions between a country and the rest of the world over a specific period.

2. Current Account

A part of the BOP that records transactions of goods, services, income, and unilateral transfers like remittances and foreign aid.

3. Capital Account

The section of the BOP that tracks capital transfers and transactions involving non-produced, non-financial assets like patents and land.

4. Financial Account

Records investments and financial flows, including Foreign Direct Investment (FDI), portfolio investments, and changes in reserve assets.

5. Trade Balance

The difference between a country's exports and imports of goods and services.

6. Exports

Goods and services sold by a country to other countries, contributing to foreign exchange earnings.

7. Imports

Goods and services purchased by a country from other countries, leading to foreign exchange outflows.

8. Goods and Services

Physical items (goods) and intangible offerings (services) traded internationally, forming the backbone of the current account.

9. Net Income

Income from investments abroad minus payments to foreign investors in the home country.

10. Unilateral Transfers

Transfers of money or goods between countries without any return, such as remittances or foreign aid.

11. Foreign Direct Investment (FDI)

Long-term investments made by foreign entities in domestic businesses or infrastructure, showing confidence in the economy.

12. Portfolio Investment

Short-term investments in financial securities like stocks or bonds, which are more volatile than FDI.

13. Reserve Assets

Foreign currency reserves, gold holdings, and Special Drawing Rights (SDRs) held by a country's central bank to stabilize the economy.

14. Surplus

A situation where inflows exceed outflows in the BOP, indicating more money entering the country than leaving.

15. Deficit

Occurs when outflows exceed inflows, signaling more money leaving the country than entering.

16. Exchange Rate

The value of a country's currency compared to another currency, influenced by BOP trends.

17. Foreign Exchange Reserves

Funds held by a central bank to manage currency stability and respond to economic crises.

18. Global Competitiveness

A country's ability to compete effectively in the global market, influenced by its trade performance.

19. Debt Forgiveness

When a country's external debt is written off by creditors, recorded under the capital account.

20. Capital Transfers

Movements of capital, such as grants for infrastructure development or debt restructuring.

21. Non-Produced Assets

Intangible assets like patents, copyrights, and natural resource rights exchanged internationally.

22. Trade Deficit

When imports exceed exports, indicating a negative trade balance.

23. Trade Surplus

When exports exceed imports, indicating a positive trade balance.

24. External Debt

Debt owed by a country to foreign creditors, which can impact the financial account.

25. Economic Stability

A state where a country maintains steady growth, low inflation, and manageable debt levels, often linked to a balanced BOP.

26. Currency Depreciation

A fall in the value of a country's currency, often triggered by a BOP deficit.

27. Currency Appreciation

An increase in the value of a country's currency, often associated with a BOP surplus.

28. Economic Policy

Strategies like monetary and fiscal policies adopted by governments to influence BOP outcomes.

29. International Trade

The exchange of goods and services across borders, forming the core of the current account.

30. Monetary Policy

Central bank actions, such as interest rate adjustments, that impact foreign investment and exchange rates.

31. Fiscal Policy

Government spending and taxation policies that influence trade balances and foreign investments.

32. Foreign Investments

Investments from foreign entities in domestic businesses, projects, or financial securities.

33. Economic Integration

Collaboration between countries through trade agreements, shared markets, or financial ties that impact BOP.

34. Economic Indicators

Metrics like trade balances, FDI levels, and current account deficits used to assess a country's economic performance.

35. Global Market Trends

Shifts in global trade, investment flows, and commodity prices that affect the BOP.

36. Economic Dependence

Reliance on foreign trade or investments for economic stability, which can be risky if imbalanced.

37. Economic Growth

A sustained increase in a country's production and income levels, supported by strong BOP performance.

38. Economic Vulnerability

Exposure to external shocks, such as global recessions or trade disruptions, as reflected in the BOP.

39. International Financial Flows

Movement of money across borders through investments, loans, or aid, recorded in the financial account.

40. Current Account Deficit

When a country spends more on imports and transfers than it earns from exports and investments.

41. Trade Imbalances

Disparities between imports and exports that can lead to BOP deficits or surpluses.

42. Macroeconomic Stability

Overall stability in an economy, achieved through balanced trade, investments, and financial flows.

43. Intellectual Property Rights

Ownership rights for intangible assets like patents or copyrights, often exchanged internationally.

44. Natural Resources

Assets like oil, minerals, or forests traded or transferred across countries, affecting the BOP.

45. Debt Restructuring

Negotiating changes in debt repayment terms, often recorded in the capital account.

46. Infrastructure Development

Capital investments in projects like roads, bridges, or energy plants, supported by foreign aid or FDI.

❖ EXERCISE:

A. Fill in the Blanks (10 Questions):

1. The Balance of Payments (BOP) records all ___________ between a country and the rest of the world.
2. The ___________ account includes transactions related to goods, services, income, and unilateral transfers.
3. The ___________ account tracks one-time transfers like debt forgiveness and ownership of non-produced assets.
4. Foreign Direct Investment (FDI) is recorded in the ___________ account.
5. The trade balance is the difference between ___________ and ___________.
6. A ___________ occurs when the inflows in the BOP exceed the outflows.
7. Portfolio investment is considered ___________ term compared to FDI.
8. ___________ reserves are managed by central banks to stabilize exchange rates and handle external shocks.
9. A persistent ___________ in the current account may lead to external borrowing or depletion of reserves.
10. The financial account reflects the ___________ of ownership of financial assets and liabilities between countries.

Answer:

1. Economic transactions
2. Current
3. Capital
4. Financial
5. Exports, Imports
6. Surplus
7. Short
8. Foreign exchange
9. Deficit
10. Transfer

B. Multiple Choice Questions (MCQs) (10 Questions):

1. The Balance of Payments is recorded over:
   a) A decade
   b) A specific period (month, quarter, year)
   c) A financial quarter only
   d) None of the above
   Answer: b) A specific period (month, quarter, year)

2. Which of the following is NOT part of the current account?
   a) Export of goods
   b) Import of services
   c) Debt forgiveness
   d) Income from foreign investments
   Answer: c) Debt forgiveness

3. The capital account primarily records:
   a) Long-term investments
   b) Trade in goods and services
   c) Capital transfers and non-produced assets
   d) Portfolio investments
   Answer: c) Capital transfers and non-produced assets

4. Foreign Direct Investment (FDI) is an example of:
   a) Current account transaction
   b) Capital account transaction
   c) Financial account transaction
   d) None of the above
   Answer: c) Financial account transaction

5. A country's trade balance is in surplus when:
   a) Imports exceed exports
   b) Exports exceed imports
   c) There is no trade
   d) None of the above
   Answer: b) Exports exceed imports

6. Reserve assets are typically managed by:
   a) Commercial banks
   b) The central bank
   c) Private investors
   d) Multinational corporations
   Answer: b) The central bank

7. A persistent deficit in the Balance of Payments may lead to:
   a) Currency appreciation
   b) Increased foreign exchange reserves
   c) Currency depreciation
   d) Economic independence
   Answer: c) Currency depreciation

8. Which account captures the transfer of patents, copyrights, and natural resource rights?
   a) Current account
   b) Capital account
   c) Financial account
   d) Trade account
   Answer: b) Capital account

9. Portfolio investments are characterized as:
   a) Ownership of physical assets

b) Long-term investments in businesses
c) Short-term financial investments
d) Transfers of foreign aid
Answer: c) Short-term financial investments

10. The Balance of Payments is recorded using a __________ system.
a) Single-entry
b) Double-entry
c) Triple-entry
d) None of the above
Answer: b) Double-entry

C. Descriptive Type Questions (20 Questions):

1. Define the Balance of Payments (BOP) and explain its components.
2. Describe the significance of the current account and its subcategories.
3. Explain the role of the capital account in the Balance of Payments.
4. Discuss the financial account and its importance in tracking international financial flows.
5. How do foreign direct investments (FDI) and portfolio investments differ?
6. What is a trade balance? How does it affect a country's economy?
7. Explain the role of foreign exchange reserves in managing a country's economy.
8. Discuss the importance of a surplus or deficit in the Balance of Payments.
9. How does the Balance of Payments influence exchange rate stability?
10. Explain the role of reserve assets in the financial account.
11. Discuss how globalization has impacted the Balance of Payments for developing countries.
12. What are unilateral transfers, and how do they affect the current account?
13. How can a persistent current account deficit affect a country's economy?
14. Describe the relationship between the current account and financial account in the Balance of Payments.
15. What measures can a government take to correct a Balance of Payments deficit?
16. Explain the concept of currency depreciation and how it relates to the Balance of Payments.
17. Discuss the challenges associated with managing a country's Balance of Payments.

18. What is the significance of the Balance of Payments as an economic indicator?

19. How do external shocks impact a country's Balance of Payments? Provide examples.

20. Explain the double-entry accounting system used in the Balance of Payments and its importance.

UNIT-4 FOREIGN EXCHANGE MARKET

4.1 Introduction

Foreign exchange trading has a long history, with evidence of currency trading dating back to ancient civilizations. However, modern forex trading as we know it today began in the 1970s when the Bretton Woods system of fixed exchange rates collapsed, leading to the adoption of floating exchange rates. The emergence of electronic trading platforms and the internet in the 1990s transformed the forex market, making it more accessible and providing greater opportunities for individual traders. Today, the forex market is the largest financial market in the world, with trillions of dollars traded daily.

The foreign exchange market (also known as forex, FX, or the currencies market) is an over-the-counter (OTC) global marketplace that determines the exchange rate for currencies around the world. Participants in these markets can buy, sell, exchange, and speculate on the relative exchange rates of various currency pairs. Foreign exchange markets are made up of banks, forex dealers, commercial companies, central banks, investment management firms, hedge funds, retail forex dealers, and investors.

The foreign exchange market is the global market for exchanging currencies of different countries. It is decentralized in a sense that no one single authority, such as an international agency or government, controls it. The major players in the market are governments (usually through their central banks) and commercial banks. Firms such as manufacturers, exporters and importers, and individuals such as international travelers also participate in the market. There are a few key concepts we need to understand the market. Foreign exchange is the action of converting one currency into another. The rate that is agreed upon by the two parties in the exchange is called exchange rate, which may fluctuate widely, creating the foreign exchange risk.

The foreign exchange market was one of the original financial markets formed to bring structure to the burgeoning global economy. This asset class makes up the largest financial market in the world in terms of the value of currency units being traded. Aside from providing a venue for the buying, selling, exchanging, and speculation of currencies, the forex market also enables currency conversion for international trade settlements and investments.

There are two types of exchange rates that are commonly used in the foreign exchange market. The spot exchange rate is the exchange rate used on a direct exchange between two currencies "on the spot," with the shortest time frame such as on a particular day. For example, a traveler exchanges some Japanese yen using US dollars upon arriving at the Tokyo airport. The forward exchange rate is a rate agreed by two parties to exchange currencies for a future date, such as 6 months or 1 year from now.

Currencies are always traded in pairs, so the "value" of one of the currencies in that pair is relative to the value of the other. This determines how much of country A's currency country B can buy, and vice versa. Establishing this relationship (price) for the global markets is the main function of the foreign exchange market. This also greatly enhances liquidity in all other financial markets, which is key to overall stability.

4.2 Forex Leverage

The leverage available in the Foreign Exchange (FX) markets is among the highest that traders and investors can access in any financial market. Leverage allows traders to control larger positions in the market than they could with just their own capital. Essentially, leverage is a loan provided by a broker to a trader, enabling them to amplify the size of their trades. By using leverage, traders can potentially increase their profitability by gaining exposure to more substantial market movements with a smaller initial investment.

For instance, a trader with a $1,000 balance in their forex account might be able to trade up to $100,000 worth of currency by using a leverage ratio of 100:1. This means that for every $1 of their own capital, they are controlling $100 of the total position in the market. In this case, the broker provides the trader with the additional capital (in this example, $99,000), and the trader is only required to put down a small fraction of the total position size—this is known as the "margin" required for the trade. At a margin of 1%, the trader only needs to deposit $1,000 to control a $100,000 position.

This type of leverage can have a significant impact on a trader's potential returns. If the market moves in the trader's favour, the profits are calculated based on the full $100,000 notional value, rather than the initial $1,000 margin. For example, if the value of the currency pair increases by 1%, the trader's profit will be $1,000 (1% of $100,000), effectively doubling their initial investment.

However, with the potential for amplified profits comes the risk of amplified losses. Leverage works both ways—while it can increase profitability, it can also magnify losses if the market moves against the trader's position. In the example above, if the market moves unfavourably by just 1%, the trader will face a $1,000 loss, which would wipe out their entire initial investment of $1,000. In more extreme cases, losses can exceed the trader's initial margin if the market moves significantly against their position, leading to a margin call or the broker closing out the position to prevent further losses.

ability to use high leverage in FX trading is both a benefit and a risk. It enables traders to maximize their potential returns with a relatively small initial investment, but it also exposes them to the risk of significant losses if the market moves unpredictably. Because of this, it is crucial for traders to practice prudent risk management, including setting stop-loss orders, using position sizing strategies, and carefully considering their leverage levels relative to their risk tolerance and account size.

summary, while leverage in the FX market can significantly enhance the potential for profit, it also amplifies the risk of loss. Traders need to fully understand how leverage works and be prepared for the risks involved. Proper risk management techniques and a cautious approach are essential to avoid substantial financial losses when using leverage in forex trading.

4.3 Types of Foreign Exchange Markets

There are three main forex markets: the spot forex market, the forward forex market, and the futures forex market.

Spot Forex Market: The spot market is the immediate exchange of currencies at the current exchange on the spot. This makes up a large portion of the total forex market and involves buyers and sellers from across the entire spectrum of the financial sector, as well as those individuals exchanging currencies.

Forward Forex Market: The forward market involves an agreement between the buyer and seller to exchange currencies at an agreed-upon price at a set date in the future. No exchange of actual currencies takes place, just the value. The forward market is often used for hedging.

Futures Forex Market: The futures market is similar to the forward market, in that there is an agreed price at an agreed date. The primary difference is that the futures market is regulated and happens on an exchange. This removes the risk found in other markets. Futures are also used for hedging.

4.4 Advantages of the Foreign Exchange Market

1. **High Liquidity:** The Forex market is the largest and most liquid market in the world, with an average daily trading volume exceeding $6 trillion. This high liquidity ensures that traders can buy or sell currencies at any time during market hours without worrying about slippage or significant price deviations. Whether trading large or small positions, participants can generally execute trades quickly, which is particularly important in a market where conditions can change rapidly.

2. **Accessibility:** One of the major advantages of the Forex market is its accessibility. It operates 24 hours a day, five days a week, which allows traders from all over the world to participate at times that suit their schedules. Whether you're trading from Asia, Europe, or the Americas, the market is always open. Additionally, all you need to access the Forex market is an internet connection and a trading platform, which lowers the barriers to entry for individual traders and investors.

3. **Diverse Trading Options:** The Forex market offers a broad range of currency pairs, from major pairs like EUR/USD and GBP/USD to minor and exotic currency pairs. Traders can employ a wide variety of strategies—ranging from day trading and scalping to long-term position trading—depending on their goals, risk tolerance, and trading style. This diversity provides ample opportunities for profit, whether in trending or volatile markets.

4. **Low Transaction Costs:** Forex trading is known for its relatively low transaction costs compared to other financial markets like equities or commodities. In many cases, brokers charge no commission, relying instead on the bid-ask spread, which is often quite tight due to the market's liquidity. For retail traders, this means lower costs per trade and the potential for more frequent trading without eating into profits too significantly.

5. **Leverage:** Forex trading allows traders to use leverage, which enables them to control a larger position with a smaller amount of capital. For example, with a leverage ratio of 100:1, a trader with a $1,000 margin can control a $100,000 position. Leverage can amplify profits, giving traders the ability to benefit from relatively small price movements. However, it is important to note that while leverage can increase potential gains, it also amplifies the risks of significant losses.

6. **Global Market:** As a truly global market, the Forex market plays a vital role in international trade and finance. It allows businesses, governments, and investors to exchange currencies and manage currency risks. For example, international companies can use the Forex market to hedge against fluctuations in exchange rates, while investors can access foreign assets more easily. The global nature of the market ensures that there is always demand for currencies, providing liquidity and trading opportunities.

7. **Transparency:** The Forex market is highly transparent. Prices are determined by supply and demand in a decentralized market, with real-time price data available to all participants. Unlike some other financial markets, there is no central exchange or monopoly on price information. Forex traders can access live quotes, news feeds, and charts from various platforms, allowing them to make informed decisions and react quickly to market events.

4.5 Disadvantages of the Foreign Exchange Market

1. **Volatility:** While volatility can create opportunities for profit, it also increases the risk of significant losses. The Forex market is known for its sharp price movements, which can be driven by economic reports, political events, or other factors. A sudden news event or central bank announcement can cause dramatic shifts in currency prices, making the market unpredictable. This volatility can be challenging for inexperienced traders and can result in substantial losses if not managed properly.

2. **Risk of Leverage:** While leverage can increase potential profits, it also magnifies the risk of losses. Traders using leverage are essentially borrowing money to increase their trading positions. If the market moves against them, losses can exceed their initial investment, potentially wiping out their entire trading account. This is why it is crucial for traders to use leverage cautiously and implement sound risk management strategies to limit exposure.

3. **High Competition:** The Forex market is highly competitive, with participants ranging from retail traders to large financial institutions, hedge funds, and central banks. The sheer size of the market means that small traders often compete against institutions with vast resources, advanced technology, and access to exclusive information. This competition can make it difficult for individual traders to consistently achieve profitability without a strong understanding of the market and a well-defined trading strategy.

4. **Limited Regulation:** Unlike traditional stock markets, the Forex market is not centrally regulated. While individual countries have their own regulatory bodies overseeing brokers and institutions, there is no single global regulatory authority for the Forex market. This lack of centralized regulation can expose traders to increased risks, such as fraud, scams, or unethical practices by unscrupulous brokers. Traders must carefully choose regulated brokers to mitigate the risk of falling victim to such activities.

5. **Complex Market:** The Forex market can be quite complex, especially for beginners. Currency values are influenced by a wide range of factors, including economic data, interest rates, geopolitical events, and market sentiment. Understanding how these factors interact requires knowledge of both technical and fundamental analysis. New traders may struggle to navigate the complexities of the market, making it difficult for them to make informed decisions and avoid costly mistakes.

6. **Economic and Political Events:** The Forex market is highly sensitive to global economic and political events. Major announcements from central banks, changes in government policies, or geopolitical developments can have an immediate and dramatic impact on currency prices. For example, a change in a country's interest rate or a political crisis in a major economy can trigger volatility in currency pairs. Traders must stay informed about these events and be able to react quickly to manage risk and capitalize on opportunities.

7. **High Barriers to Entry:** While the Forex market is accessible, trading successfully requires significant knowledge, experience, and capital. New traders must learn about technical and fundamental analysis, risk management, trading psychology, and market structure before they can trade profitably. Without a strong foundation in these areas, traders may struggle to succeed. Additionally, while low transaction costs make the market attractive, inexperienced traders may still face substantial risks if they lack the necessary skills and strategies to navigate the complexities of Forex trading.

4.6 Features of the Foreign Exchange Market

The foreign exchange market, or Forex market, is unique in several ways, offering distinct features that differentiate it from other financial markets. Below are the key characteristics of the foreign exchange market:

1. Decentralized and 24-Hour Operation Across Multiple Time Zones:

Unlike stock markets, which are typically centralized and operate within specific hours in one location, the Forex market is decentralized. This means that there is no central exchange; instead, currency trading occurs directly between buyers and sellers through a global network of banks, brokers, and other financial institutions. As a result, the market operates 24 hours a day, five days a week, which allows traders to access the market at any time, regardless of their geographical location. The Forex market spans multiple time zones, with different financial centers—such as London, New York, Tokyo, and Sydney—driving activity throughout the day. This continuous nature of the market provides flexibility for traders to enter and exit positions at any time, making it ideal for both full-time and part-time traders.

2. Largest and Most Liquid Market with High Trading Volumes and Low Transaction Costs:

The Forex market is the largest and most liquid financial market in the world, with daily trading volumes exceeding $6 trillion. This immense liquidity ensures that currency transactions can be executed quickly and with minimal price slippage, even for large transactions. High liquidity also leads to narrower bid-ask spreads, reducing transaction costs for traders. This makes the Forex market particularly appealing for those looking to trade frequently, as the cost of entering and exiting trades remains relatively low compared to other markets, such as stocks or commodities. Furthermore, the market's large size and liquidity allow for efficient price discovery and help maintain orderly market conditions.

3. Influenced by Various Factors:

The Forex market is impacted by a wide array of factors that can cause fluctuations in currency values. Economic indicators, such as GDP, unemployment rates, and inflation data, often play a crucial role in shaping market sentiment and influencing currency prices. Additionally, geopolitical events, including political instability, trade tensions, or natural disasters, can lead to sudden volatility in currency markets. Central bank policies, particularly interest rate decisions and monetary policies, also have a profound effect on currency values. For instance, when a central bank raises interest rates, it typically strengthens the domestic currency as investors seek higher returns. Traders and investors must monitor these and other variables closely to anticipate market movements and adjust their strategies accordingly.

4. Opportunities for Speculation Using a Range of Trading Strategies:

The Forex market provides a multitude of opportunities for traders to speculate on the movement of currency pairs, whether through short-term trades or longer-term positions. Traders can adopt various strategies, such as scalping, day trading, swing trading, or position trading, depending on their risk tolerance and investment horizon. The market's high volatility and liquidity create frequent opportunities for profit, especially in fast-moving conditions. Additionally, traders can use technical analysis (chart patterns, indicators, etc.) or fundamental analysis (economic data, news releases, etc.) to inform their decisions. The availability of leveraged trading also allows traders to control larger positions with relatively small amounts of capital, amplifying both potential profits and risks. As a result, the Forex market is attractive to a wide range of traders, from beginners to experienced professionals, who can tailor their strategies to suit their preferences.

5. Accessible to a Wide Range of Participants:

One of the defining features of the Forex market is its accessibility. Unlike some other financial markets that may have high entry barriers due to minimum investment requirements or complex regulations, the Forex market is open to a wide range of participants. Individuals can trade currencies with relatively small amounts of capital by using leverage, and many retail brokers offer accessible platforms for online trading. In addition to individual traders, the market also attracts large financial institutions, such as banks, hedge funds, and investment firms, which play a significant role in the market’s liquidity and price discovery. Governments and central banks also participate in the Forex market to manage their currency reserves and influence exchange rates. This broad participation ensures a vibrant, dynamic market where liquidity is abundant, and opportunities for profit abound.

4.7 Importance of Foreign Exchange Market in International Business

The foreign exchange market plays a crucial role in the global economy, affecting countries in several ways:

1. International trade: Changes in currency values can affect a country's balance of trade, as exports become more expensive when a country's currency appreciates.
2. Capital flows: The forex market facilitates capital flows between countries, allowing businesses and investors to invest in foreign markets.

3. Monetary policy: The forex market can influence a country's monetary policy, as central banks may adjust interest rates or intervene in the market to maintain currency stability.

4. Economic growth: A stable currency and exchange rate can support economic growth, while currency volatility can harm business and consumer confidence, potentially leading to economic slowdowns.

❖ Exercise:

- **Explain the following in detail:**

1. What is foreign exchange market? Explain its types.
2. Explain the advantages and disadvantages of foreign exchange market.
3. Write down the features of foreign exchange market.
4. Explain the importance of foreign exchange market.

- **Write down the answers briefly:**

1. Spot Forex Market
2. Forward Forex Market
3. Future Forex Market
4. Forex Leverage
5. Spot Exchange rate

UNIT-5 INTERNATIONAL CAPITAL AND MONEY MARKET INSTRUMENTS

5.1 Introduction

Money and capital markets are fundamental to the economy, serving investors and businesses alike. Money markets deal in short-term debt instruments, usually for one year or less. It's where governments, banks, and large corporations go to manage their immediate cash needs. Capital markets involve long-term securities, such as stocks and bonds that mature in more than one year. This is where companies and governments raise funds for major projects and long-term growth.

Money markets are the lifeblood of day-to-day financial operations, while capital markets sustain long-term economic growth. They differ in three ways: the types of financial instruments traded, the duration of investments, and the level of risk. While the money market prioritizes liquidity and safety, the capital market offers the potential for higher returns with increased risk. Below, is explained each market's characteristics and how they work.

A money market refers to a market that allows for the exchange of securities. This market focuses on the supply and demand of money instead of products. Both individuals and large corporations can participate in this market by either borrowing or lending funds. This market usually consists of securities that mature within the year.

The International Money Market is a large-scale money market that allows many central banks to conduct transactions from different countries. This includes both lending and borrowing funds. It handles funds in trillions, with the main actors being central banks and major commercial banks. Transactions in the international money market practically occur 24 hours a day.

5.2 Global Depository Receipt

A Global Depository Receipt (GDR), also known as an International Depository Receipt (IDR), is a financial instrument that facilitates the trading of foreign stocks on domestic stock exchanges. It is a certificate issued by a depository bank, which purchases shares of foreign companies and holds them in custody. The depository bank then issues the GDRs, which represent the shares of the foreign company. These GDRs are made available for trading on stock exchanges outside of the company's home country, enabling investors to trade and invest in international companies without needing to navigate the complexities of cross-border transactions directly.

A GDR is a negotiable financial instrument, meaning it can be bought, sold, or transferred by investors, and it can be traded just like any other stock or security. The GDRs are typically denominated in the currency of the country where they are listed, which makes them accessible and easier for local investors to trade. For example, a U.S.-based investor may purchase GDRs for a company based in Germany, and the GDRs would be priced in U.S. dollars, not in euros, even though the shares underlying the GDR are denominated in euros.

The key advantage of GDRs is that they allow companies from different countries to raise capital from global markets. By issuing GDRs, a company can gain access to foreign investors without needing to comply with the regulatory requirements of each country where the shares are being sold. For example, a company based in Brazil could issue GDRs that trade on the New York Stock Exchange (NYSE), thereby allowing U.S. investors to buy and sell shares of the Brazilian company, even though the underlying shares are held in Brazil.

The depository bank or custodial institution is responsible for holding the underlying shares of the company on behalf of the GDR holders. These shares are kept in a secure account, and the depository bank acts as an intermediary between the investor and the foreign company. The GDR itself is essentially a claim to a specific number of shares, with the bank providing the necessary administrative services related to corporate actions (like dividend payments, voting rights, etc.) on behalf of the investors.

While the underlying shares of the international company trade as domestic shares in their home country, GDRs provide an easy way for global investors, who may be located in countries where the foreign company doesn't list its shares, to invest in those stocks. GDRs broaden the potential pool of investors, creating more liquidity and often attracting more capital to foreign companies.

Overall, GDRs are an important tool in global finance, facilitating international investment and helping companies tap into capital markets beyond their domestic borders.

5.3 Foreign currency convertible bond

A foreign currency convertible bond (FCCB) is a type of convertible bond issued in a currency different than the issuer's domestic currency. In other words, the money being raised by the issuing company is in the form of foreign currency. A convertible bond is a mix between a debt and equity instrument. It acts like a bond by making regular coupon and principal payments, but these bonds also give the bondholder the option to convert the bond into stock. A bond is a debt instrument that provides income to investors in the form of regularly scheduled interest payments called coupons. At the maturity date of the bond, the investors are repaid the full face value of the bond. Some corporate entities issue a type of bond known as convertible bonds.

A bondholder with a convertible bond has the option of converting the bond into a specified number of shares of the issuing company. Convertible bonds have a conversion rate at which the bonds will be converted to equity. However, if the stock price stays below the conversion price, the bond will not be converted. Thus, convertible bonds allow bondholders to participate in the appreciation of the issuer's underlying shares. There are various types of convertible bonds, one of which is the foreign currency convertible bond.

5.4 American depository receipts

American Depositary Receipts (ADRs) are financial instruments issued by U.S. banks that allow U.S. investors to invest in foreign companies without the complexities of dealing with foreign stock markets directly. ADRs represent a specific number of shares in a foreign company, and these underlying shares are held by a U.S. financial institution or depository bank, often through its overseas branches. By issuing ADRs, foreign companies can gain access to capital from U.S. investors, while U.S. investors can diversify their portfolios by investing in international companies, all without needing to deal with foreign currencies or markets.

ADRs are negotiable securities, meaning they can be bought, sold, or traded on U.S. stock exchanges like the New York Stock Exchange (NYSE), NASDAQ, and the American Stock Exchange (AMEX). They can also be sold over-the-counter (OTC). The key benefit of ADRs for U.S. investors is that these securities are denominated in U.S. dollars, making them more accessible since the investor does not have to deal with exchange rate fluctuations or currency conversion when buying and selling shares.

Each ADR represents a specific number of shares in a foreign company. Depending on the agreement between the foreign company and the U.S. depositary bank, one ADR could represent a fraction of a share, a full share, or multiple shares of the underlying foreign stock. This allows U.S. investors to gain exposure to international stocks even if the foreign company's shares are not listed or traded on U.S. exchanges.

When a foreign company decides to list its shares in the U.S. through ADRs, it must work with a U.S. bank that will purchase the company's shares in bulk and deposit them with a custodian bank. In return, the U.S. bank issues ADRs, which represent the foreign shares and can be traded by U.S. investors. These ADRs can also facilitate foreign companies' ability to raise capital in U.S. markets by offering a simpler, more streamlined process for investing in foreign companies.

ADRs can also pay dividends to U.S. investors in U.S. dollars. This makes it easier for U.S. investors to manage their dividend income, as they do not need to deal with foreign currency or international taxation issues. The U.S. bank responsible for issuing the ADR handles the currency exchange and transfers dividends to investors in U.S. dollars. Additionally, corporate actions, such as dividend payouts or stock splits, are adjusted and handled by the depositary bank, which manages these on behalf of the U.S. investors holding the ADRs.

ADRs are also priced and traded in U.S. dollars, which means that U.S. investors can buy and sell them just like regular U.S.-based stocks. They clear through U.S. settlement systems, allowing for smoother, more familiar transactions for U.S. investors.

In summary, American Depositary Receipts (ADRs) are a key financial instrument that facilitates the investment of U.S. capital into foreign companies. They provide U.S. investors with the opportunity to diversify their portfolios by gaining access to international stocks, all while simplifying the investment process through U.S.-denominated securities. For foreign companies, ADRs are an efficient way to tap into the U.S. capital markets, raising funds and gaining exposure to a wider pool of investors.

5.5 International capital market

A capital market is basically a system in which people, companies, and governments with an excess of funds transfer those funds to people, companies, and governments that have a shortage of funds. This transfer mechanism provides an efficient way for those who wish to borrow or invest money to do so. For example, every time someone takes out a loan to buy a car or a house, they are accessing the capital markets. Capital markets carry out the desirable economic function of directing capital to productive uses.

International capital markets are the same mechanism but in the global sphere, in which governments, companies, and people borrow and invest across national boundaries.

5.6 Benefits of international capital market

1. **Higher returns and cheaper borrowing costs:** These allow companies and governments to tap into foreign markets and access new sources of funds. Many domestic markets are too small or too costly for companies to borrow in. By using the international capital markets, companies, governments, and even individuals can borrow or invest in other countries for either higher rates of return or lower borrowing costs.

2. **Diversifying risk**: The international capital markets allow individuals, companies, and governments to access more opportunities in different countries to borrow or invest, which in turn reduces risk. The theory is that not all markets will experience contractions at the same time.

The structure of the capital markets falls into two components—primary and secondary. The vast majority of capital transactions take place in the secondary market. The secondary market includes stock exchanges (the New York Stock Exchange, the London Stock Exchange, and the Tokyo Nikkei), bond markets, and futures and options markets, among others. All these secondary markets deal in the trade of securities.

5.7 Components Of The International Capital Markets

❖ International Equity Markets

Companies sell their stock in the equity markets. International equity markets consists of all the stock traded outside the issuing company's home country. Many large global companies seek to take advantage of the global financial centers and issue stock in major markets to support local and regional operations.

❖ International Bond Markets

Bonds are the most common form of debt instrument, which is basically a loan from the holder to the issuer of the bond. The international bond market consists of all the bonds sold by an issuing company, government, or entity outside their home country. Companies that do not want to issue more equity shares and dilute the ownership interests of existing shareholders prefer using bonds or debt to raise capital (i.e., money). Companies might access the international bond markets for a variety of reasons, including funding a new production facility or expanding its operations in one or more countries.

There are several types of international bonds, which are detailed in the next sections.

- **Foreign Bond**

  A foreign bond is a bond sold by a company, government, or entity in another country and issued in the currency of the country in which it is being sold. There is foreign exchange, economic, and political risks associated with foreign bonds, and many sophisticated buyers and issuers of these bonds use complex hedging strategies to reduce the risks.

  For example, the bonds issued by global companies in Japan denominated in yen are called *samurai bonds*.

  Foreign bonds sold in the United States and denominated in US dollars are called *Yankee bonds*. In the United Kingdom, these foreign bonds are called *bulldog bonds*.

  Foreign bonds issued and traded throughout Asia except Japan, are called *dragon bonds*, which are typically denominated in US dollars.

- **Eurobond**

  A Eurobond is a bond issued outside the country in whose currency it is denominated. Eurobonds are not regulated by the governments of the countries in which they are sold, and as a result, Eurobonds are the most popular form of international bond. A bond issued by a Japanese company, denominated in US dollars, and sold only in the United Kingdom and France is an example of a Eurobond.

- **Global Bond**

  A global bond is a bond that is sold simultaneously in several global financial centers. It is denominated in one currency, usually US dollars or Euros. By offering the bond in several markets at the same time, the company can reduce its issuing costs. This option is usually reserved for higher rated, creditworthy, and typically very large firms.

- **Eurocurrency Market**

  Eurodollar are nothing but US dollars deposited in European banks. Over the years, banks in other countries, including Japan and Canada, also began to hold US dollar deposits and now Eurodollars are any dollar deposits in a bank outside the United States. (The prefix *Euro-* is now only a historical reference to its early days.) An extension of the Eurodollar is the Eurocurrency, which is a currency on deposit outside its country of issue. While Eurocurrencies can be in any denominations, almost half of world deposits are in the form of Eurodollars.

5.8 International money market:

The international money market is a market where international currency transactions between numerous central banks of countries are carried on. The International Monetary Market (IMM) was introduced in December 1971 and formally implemented in May 1972, although its roots can be traced to the end of Bretton Woods through the 1971.

The primary purpose of the International Monetary Market is to trade currency futures, a relatively new product previously studied by academics as a way to open a freely traded exchange market to facilitate trade among nations. The International Money Market is a division of the Chicago Mercantile Exchange (CME) that deals with the trading of currency and interest rate futures and options.

5.9 Limitations of The International Monetary Market

While the international monetary market, particularly in trading financial futures, offers the potential for significant financial rewards, it also comes with a set of risks and limitations that can impact both individual traders and institutions. These risks are highlighted by exchanges such as the Chicago Mercantile Exchange (CME) to ensure that market participants are aware of the challenges they may face. The following outlines some of the key limitations and risks associated with trading in this segment of the financial markets:

1. Economic, Political, and Geopolitical Market Conditions

Economic, political, and geopolitical factors have a profound impact on the international monetary market. Global economic performance, the stability of financial systems, and the overall confidence of investors can greatly affect the prices of financial instruments, including futures contracts. Political decisions—such as changes in government, trade policies, or diplomatic relations—can cause fluctuations in currency values, interest rates, and commodity prices. Geopolitical events like wars, regional conflicts, or natural disasters may disrupt supply chains and influence market sentiment, leading to increased market volatility or significant price movements that can either create opportunities or expose traders to substantial losses.

2. Legislative and Regulatory Changes

The international monetary market is subject to ongoing changes in laws and regulations, both at the national and international levels. Legislative reforms or changes in regulatory frameworks can significantly alter the way financial markets operate. New regulations can impact how futures contracts are traded, how much leverage is allowed, and how financial institutions or market participants must comply with risk management standards. Furthermore, regulatory bodies in different countries may impose restrictions on cross-border transactions or enforce stricter reporting and transparency requirements. These regulatory changes can introduce uncertainty and affect the strategies used by market participants, especially those involved in international trading.

3. Broad or Quick Changes in the Industry and Financial Markets

The financial industry is constantly evolving, and rapid technological advancements, new financial instruments, or shifts in market behaviour can affect how futures markets operate. For instance, new algorithmic trading strategies, automated systems, or the rise of digital currencies can all have a significant influence on market dynamics. These changes may lead to shifts in liquidity, trade volumes, and the overall market structure. Additionally, broad market movements, such as those driven by economic cycles or large-scale financial crises, can quickly change the landscape of the international monetary market. Traders must be adaptable to these shifts and be prepared for volatility or sudden changes in market conditions that could impact their positions.

4. Shifts in Price Levels, Contract Volumes, and/or Volatility in the Derivatives Markets

Derivatives markets, including futures contracts on foreign exchange, equities, interest rates, and commodities, are highly sensitive to shifts in underlying market conditions. A sudden change in price levels, whether through economic data releases, central bank policy changes, or market sentiment shifts, can lead to rapid fluctuations in futures contract prices. These price movements can be amplified by changes in trading volumes, with higher or lower volumes of contracts traded potentially increasing volatility. For instance, a surge in demand for a particular futures contract can drive prices up, while a sharp decline in demand can have the opposite effect. As these futures markets are linked to the broader markets in equities, foreign exchange, interest rates, and commodities, traders must remain vigilant to potential price shifts that can trigger significant gains or losses.

5. Changes in Global or Regional Demand or Supply for Commodities

Commodity markets, which are a vital part of the international monetary market, are heavily influenced by supply and demand factors. Changes in global or regional demand for commodities such as oil, gold, agricultural products, and metals can lead to significant fluctuations in commodity futures prices. For instance, shifts in industrial demand, changes in production levels, weather conditions, or disruptions in supply chains can all have a direct impact on commodity prices. Additionally, changes in government policies regarding commodity exports or tariffs can affect the availability of commodities and alter global market dynamics. Traders must be able to assess these supply and demand factors accurately to make informed decisions, as any misjudgement could lead to financial losses due to volatile price swings.

5.10 The Drawbacks of Currency Futures

The challenging aspects were how to connect values of IMM foreign exchange contracts to the interbank market—the dominant means of currency trading in the 1970s—and how to allow the IMM to be the free-floating exchange envisioned by academics. Clearing member firms were incorporated to act as arbitrageurs between banks and the IMM to facilitate orderly markets between bid and ask spreads. The Continental Bank of Chicago was later hired as a delivery agent for contracts. These successes raised an unforeseen level of competition for new futures products.

The CBOE options Exchange competed and received the right to trade U.S. 30-year bond futures while the IMM secured the right to trade Eurodollar contracts, a 90-day interest rate contract settled in cash rather than physical delivery. Eurodollars came to be known as the "eurocurrency market," which is used mainly by the Organization of the Petroleum Exporting Countries (OPEC), which always required payment for oil in U.S. dollars. This cash settlement aspect would later pave the way for index futures such as world stock market indexes and the IMM Index. Cash settlement would also allow the IMM to later become known as a "cash market" because of its trade in short-term, interest-rate-sensitive instruments.

❖ **A System For Transactions**

With new competition, a transaction system was desperately needed. The CME and Reuters Holdings created the Post Market Trade (PMT) to allow a global electronic automated transaction system to act as a single clearing entity and link the world's financial centers like Tokyo and London. This Post Market Trade (PMT) is known as Globex, which facilitates not only clearing but electronic trading for traders around the world. In 1975, U.S. T-bills were born and began trading on the IMM in January 1976. T-bill futures began trading in April 1986 with approval from the Commodities Futures Trading Commission (CFTC).

❖ Financial Crises And Liquidity

In financial crisis situations, central bankers must provide liquidity to stabilize markets because risk may trade at premiums to a bank's target rates, called money rates, that central bankers can't control. Central bankers then provide liquidity to banks that trade and control rates. These are called repo rates, and they are traded through the IMM. Repo markets allow participants to undertake rapid refinancing in the interbank market independent of credit limits to stabilize the system. A borrower pledges securitized assets such as stocks in exchange for cash to allow its operations to continue.

For companies, the global financial, including the currency, markets (1) provide stability and predictability, (2) help reduce risk, and (3) provide access to more resources. One of the fundamental purposes of the capital markets, both domestic and international, is the concept of liquidity, which basically means being able to convert a noncash asset into cash without losing any of the principal value. In the case of global capital markets, liquidity refers to the ease and speed by which shareholders and bondholders can buy and sell their securities and convert their investment into cash when necessary. Liquidity is also essential for foreign exchange, as companies don't want their profits locked into an illiquid currency.

❖ Exercises

- **Answer the following questions:**

1. Write a note on GDR.
2. Write a note on ADR.
3. Write a note on Foreign Currency Convertible Bond.
4. What is international capital market? Explain the benefits of it.
5. Explain the components of international capital market.
6. Explain international money market in detail.

- **Answer the following questions briefly:**

1. Full form of ADR
2. Full form of GDR
3. Full form of FCCB
4. Yankee bonds
5. Dragon bonds
6. Euro bonds
7. Global bond

MBA

SEMESTER-4 CORE

INTERNATIONAL BUSINESS

BLOCK: 2

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Publisher's Name: Dr. Ajaysinh Jadeja,
Registrar,
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'Jyotirmay Parisar', Opp. Shri Balaji Temple, Chharodi, Ahmedabad, 382481, Gujarat, India.

Edition: 1st

ISBN: 978-93-5598-685-6

UNIT-6 FOREIGN TRADE POLICY

6.1 Introduction and meaning

India is known as one of the most important and emerging players in the global economy. Its foreign trade policies and government reforms have made it a significant destination for foreign investments around the world. Also, technological and infrastructural developments being carried out all over the country enable efficient trade and economic practices. For the successful economic development of a country, a vigorous foreign trade policy is of great importance. Therefore, India adopted a foreign trade policy known as the EXIM Policy or the Export-Import policy.

Regulation of international trade supposes purposeful influence of the state on trade relations with other countries. The main goals of foreign trade policy are as follows:

The volume change of exports and import

- Changes in the structure of foreign trade
- Providing the country with the necessary resources
- The change in the ratio of export and import prices

There are three main approaches to the regulation of international trade which are as follows:

- A system of unilateral measures, in which the instruments of state control used by the government unilaterally and not coordinated with the trading partner;
- The undertaking of bilateral agreements, in which trade policy measures agreed between trading partners;

- The undertaking of multilateral agreements, in which trade policy is coordinated and regulated by the participating countries (the General Agreement on Tariffs and Trade, which is included in the system of the WTO agreements, agreements on trade of EU member states)

The state can use each of approaches in any combination. The basic line of government control of international trade is the application of two different types of foreign trade policy in combination: liberalization (free trade policy) and protectionism. The free trade policy is understood as the minimum of state interference in foreign trade, which developed on the basis of free market forces of supply and demand, and the protectionism is understood as - the state policy, which provides the protecting of the domestic market from foreign competition through the use of tariff and non-tariff trade policy instruments. These two types of trade policy characterize the measure of state intervention into international trade. If under the conditions of liberalization policy, a basic regulator of foreign trade is a market, then the protectionism practically excludes the operation of free market forces. It is assumed that economic potential and competitiveness at the world market of separate countries is different. Therefore, a free action of market forces can be unprofitable for the less developed countries. Unlimited competition from more powerful states can result to economic stagnation and the formation of inefficient economic structure in less-developed countries. The protectionism policy contributes to the development of certain industries in the country and often is a necessary condition for industrialization of agrarian countries and unemployment reduction. However, the removal of foreign competition reduces the interest of domestic producers in the implementation of scientific and technological progress, improving the efficiency of production. The forms of protectionism are as follows:

a. selective protectionism, directed against some countries or some commodities
b. industrial protectionism, which protects certain industries
c. collective protectionism: countries, which belong to economic integration organizations conduct this form to countries, which do not belong to a union
d. hidden protectionism, which is carried out by methods of domestic economic policy

Every country has economic, social. and political arguments, protecting interests of protectionism. The main arguments for restrictions on foreign trade can be essentiality for défense, providing, increase of domestic employment, diversification for the sake of stability, protection of infant industries, protection from dumping, cheap foreign labour force. So, the art of trading policy is to find the point of balance between two trends: free trade and protectionism. Each policy has its own advantages and disadvantages, depending on the circumstances, time, and place of its applying. The instruments of state regulation of international trade include tariff methods and non-tariff methods. Tariff methods that regulate mostly the imports and protect domestic producers from foreign competition. They make foreign goods less competitive; while nontariff methods, regulating both imports and exports (they help to bring more domestic products on the world market, making them more competitive).

6.1.1 History of Foreign Trade Policy in India

India's foreign trade policy has evolved. Initially, it aimed at self-sufficiency by limiting imports through high tariffs and restrictions. However, reforms in the 1980s and 1990s brought about significant changes, reducing tariffs and opening up to foreign investment. Post-liberalisation, India has continued simplifying trade procedures and focusing on key sectors like IT and manufacturing. Joining regional and global trade agreements has further connected India to the world economy. Recent efforts have focused on making trade easier and boosting India's global trade share, aiming to establish it as a top manufacturing and export destination.

The Foreign Trade Policy 2015-20 looked upon the agenda for transforming India as an emerging and important player in world trade. This shall overcome many barriers of trade and develop improved export performance. It is described under the following headings:

- ✓ **Merchandise Exports from India Scheme (MEIS):** This scheme was brought in to negate the infrastructural inefficiencies and cost incurred while exporting the goods.
- ✓ **Services Exports from India Scheme (SEIS):** This scheme aimed to encourage the export of services. The scheme offered duty credit scrips to eligible service providers.
- ✓ **Niryat Bandhu Scheme:** This scheme was developed for mentoring first-time exporters to be full-fledged exporters through every phase of export.
- ✓ **Trade Facilitation and E-governance:** It encompasses reducing transaction costs and time through IT-enabled platforms and services.

EXIM Policy (Export-Import Policy) brought a comprehensive approach to trade. It reduced tariffs and restrictions, making importing goods easier and attracting foreign investment. The policy also aimed to boost exports by offering incentives and simplifying procedures.

The new foreign trade policy approach changes India's trade strategy. It aims to ensure continuity and responsiveness, with revisions scheduled as needed based on feedback from trade and industry sectors. This new foreign trade policy focuses on tax remission over incentives and emphasises greater trade facilitation through technology and collaboration among exporters, states, and districts. It also targets emerging areas like e-commerce exports and streamlines Special Chemicals, Organisms, Materials, Equipment and Technologies (SCOMET) policies, reflecting a comprehensive approach to India's foreign trade.

❖ Impact of Foreign Trade Policy on Import

FTP 2023 streamlines import documentation requirements, reducing processing times through the use of digital technologies and making customs clearance more efficient. It reduces the cargo release time. However, there are certain exceptions, such as prohibiting importing gifts through post or courier, including those purchased from e-commerce portals, unless these are life-saving drugs or medicines and *rakhi*.

The foreign trade policy 2023 lays the groundwork for increased trade chances. It values innovation, teamwork, and easing tasks. By refining procedures and introducing specific benefits, the policy's goal is to boost exporters, stir up economic progress, and strengthen India's global marketplace stance.

❖ **Technology Transfer**

The process of distributing commercial technology is known as technology transfer. This will take the form of a technology transfer transaction, which may or may not be a legally binding contract but will involve the transferor communicating the relevant knowledge to the recipient. Non-commercial technology transfers, such as those found in international cooperation agreements between industrialized and developing countries, are also included. These agreements could cover infrastructure or agricultural development, as well as international cooperation in domains including research, education, employment, and transportation. International trade in itself is vital to a country's economy, as it contributes significantly to GDP (GDP). Therefore, the emerging trends in the foreign trade are responsible for facilitating global growth and development that is not restricted to a single country. The introduction of new technology, increased communication, and enhanced infrastructure have made it easier to take advantage of the opportunities of international trade.

6.1.2 Nature of Foreign Trade

To indicate the nature of trade policy, the following two indicators are used:

1. The average level of customs tariff: It is calculated as the average rate of import duties, according to the value of imported goods, to which the rate is applied. This indicator is defined only for the goods whose imports are imposed by duties.
2. The average level of nontariff barriers: It is calculated as the value share of the imports or exports, which are subject to the restrictions.
3. Mode of implemented restrictions for each of the indicators is considered as open one if its level is less than 10%, the moderate one if less than 10-15%, the limited one is over 25% and the restrictive one if 40-100%.

6.2 Foreign Trade Policy in India

Foreign trade policy needs amendments every five years and aims at developing export capability, improving export performance and structure, encouraging foreign trade, and creating a suitable balance of payments position. It is updated every year on the 31st of March, and the modifications, improvements, and new schemes become effective from 1st April each year.

India in 1991, after liberalization, totally lifted all sorts of restrictions from trade for the purpose of improvement in the balance of payment position. A strong need was felt for Indian markets to work globally, and the economy was set free. But in a developing economy, it is not possible to develop industries without the protection of policies. Therefore, later, it was necessary for India to impose a restriction on its economy through trade policies to regulate import and export. The Foreign Trade Policy is a comprehensive framework evolved by the Government of India for regulation and promotion in international trade. It outlines policies, guidelines, and incentives for the exporter and the importer towards an improvement in the trade performance of the country. It enhances global competitiveness and achieves sustainable economic growth. The FTP encompasses various schemes, procedural norms, and institutional measures. These aid in promoting exports, facilitating the importation of necessary goods, and attracting foreign investment. Thus, it will ensure the protection of the country's economic interests.

Trade enables economic growth and national development. The main aim is not the mere earning of foreign exchange, but encouraging greater economic activity. India's foreign trade policy, or FTP, is an essential set of rules on how India does business with the world**.** The Directorate General of Foreign Trade (DGFT) takes charge of it. The main goals of India's FTP are to boost exports, create favourable conditions for trade, and support steady economic growth.

The goal of the foreign trade policy FTP is to combine India with the world markets smoothly. It aims to showcase India as a trustworthy trade partner globally. Shifting from incentives, India's foreign trade policy strives to build an environment that supports businesses, in line with the principles of „*Atma Nirbhar Bharat'* and 'Local goes Global.' It is about gearing India up to face future challenges, focusing on making it one of the top exporting nations, especially during the anticipated 'Amrit Kaal' period. Recognising the importance of local efforts, the policy encourages partnerships with state governments to promote exports at the grassroots level.

6.4 Foreign Trade Policy 2023

The Foreign Trade Policy 2023 shall carry forward the success of the previous policies. It shall attempt to tackle the new challenges thrown up by the changing global trade environment. This policy shall attempt to take up emerging opportunities and enhance the export potential of several sectors. It will also help facilitate ease of doing business for both exporters and importers. This policy is in tune with the vision of the government to make India a $5 trillion economy by 2025. It integrates insights from various stakeholders to create a conducive environment for international trade. The present foreign trade policy in India is FTP 2023 that has been aimed at enhancing exports, diversification of markets, the enhancement of service exports, and improvement in general trade infrastructure as well as the ease of doing business.

❖ Objectives of the Foreign Trade Policy in India

The Foreign Trade Policy 2023 has several key objectives. These are aimed at promoting sustainable economic growth and enhancing India's position in the global market are as follows:

- Export incentives, logistics and access to market.
- Diversify away from traditional markets; the new markets must be sought to expand the base.
- Enhance sectors of IT, health, education, and tourism services; enhance infrastructures, reduce cost; further the processes of all these must be streamlined so that Indian goods can compete internationally.
- It will further cement the domestic production and value addition for higher growth of exports
- Facilitate more jobs under the overall structure by strengthening export of MSME and startup products and services.

- To enable substantial growth in exports from India and import to India to boost the economy. The growth of that will be environment friendly and people-centric.
- To increase at least, up to double the percentage share of global merchandise trade conducted within the next five years.
- To improve the balance of payment and trade.
- To act as an effective instrument of economic growth by creating employment opportunities for the citizens; the larger the expansion of trade activities, the more the workforce required.
- To provide for sustainable growth by giving access to essential raw materials for production and other components, consumables, and capital goods required for increasing production and providing efficient services.
- To raise the technological capacity for production and cost-effectiveness of industry and services, thereby improving their competitive strength in comparison to other countries, and to encourage the accomplishment of internationally accepted standards of quality.
- To provide buyers or clients with high-quality goods and services at globally competitive rates and quality. „Canalization"- an important feature of Foreign Trade Policy under which specific class of goods can be imported only by designated agencies.
- Creation of opportunities by engaging in good and ethical practices.
- Accelerating the economy from low-level economic activities to high-level economic activities by making it a globally oriented and vibrant economy.
- To derive maximum benefits from expanding the global market and seizing the best opportunities available.
- Making policies that favour ease of doing business and e-governance and allow for hassle-free transactions for both import and export. Reducing the interference between the exporters and Directorate General of Foreign Trade by reducing the number of export documents.
- To allow the import of technology and equipment which can help in achieving better international standards of quality and reduce the cost of production.
- Establishing the Advance Licensing System for imported goods needed for manufacturing various goods for export. An Advance License is issued by the Directorate General of Foreign Trade to allow duty-free import of inputs, which are physically integrated with the export product (making normal allowance for wastage).
- To allow the import of certain goods as listed in the Open General License; a kind of export license which is issued by the Government to domestic suppliers.

6.6 Salient Features of the Foreign Trade Policy 2023

Many salient features for addressing current situations have been published in the FTP 2023. The detailed features of these are elaborated in the policy statements.

❖ **Export Promotion Schemes**

➢ **Remission of Duties and Taxes on Exported Products (RODTEP):** It is a scheme under which many other differential indirect embedded taxes and duties not refunded via other schemes get refunded. There is a hope that

Indian products would turn out to be more competitive in the international markets. It will be a guarantee that there will not be any hindrances from taxes.

- **Export Promotion Capital Goods (EPCG) Scheme:** This is an export promotion scheme. Here the capital goods can be imported with full or reduced customs duty. It goes on to give various benefits to the exporters. It fulfils the given export obligations, thus upgrading the technologies and quality of exports.
- **Merchandise Exports from India Scheme (MEIS):** MEIS scheme is classified country-wise and product-wise by providing duty credit scripts to exporters so as to negate infrastructural inefficiencies and hence associated costs too.

- **Improvement of Infrastructure and Logistics**
  - **Trade Infrastructure for Export Scheme (TIES):** The TIES is an effort towards narrowing the gaps that exist in infrastructure for the country's export logistics. The same offers finance support to projects in enhancing export infrastructure, like:
    - upgrading ports,
    - creating warehouse facilities, and
    - other container freight stations.
  - **E-commerce Initiatives:** The policy, having recognized the burgeoning importance of digital trade, the government also took initiatives on e-commerce exports with incentives and ease of doing business along with developing such logistic zones.

- **Sectoral Focus and Diversification**
  - **Agricultural and Food Exports:** It is an emphasis on value-added agriculture products and food processing industries. These are the schemes under the Agriculture Export Policy to double the income of farmers by diversifying export markets and developing infrastructure.
  - **Service Sector Exports:** Focus areas are IT and IT-enabled services (ITES), healthcare, education, and tourism sectors with vast growth potential and foreign exchange earnings.

- **Ease of Doing Business**
  - **Streamlining of procedures:** The focus is on minimizing bureaucratic hurdles that decrease the import-export procedure hurdles, reduce documentary requirements, and provide end-to-end IT-enabling for processes of trade.
  - **Promoting Start-up Ecosystem:** A focused dedication towards start-up support in exports by the avenues like SEZs, EOUs, and requisite hand-holding and counselling.

- **Sustainability and Compliance**
  - **Green and Circular Economy:** This involves sustainable integration through the motivational usage of green energy, reduced carbon footprint, and the embracement of circular economy principles in trade practice.
  - **Compliance and Standards:** Compliance with international standards and compliance requirements in the Indian export so that its acceptability improves in the world market. In addition, there is a need for certifications, testing facilities, and improvement in quality.

6.7 Impact of the New Foreign Trade Policy 2023 on Exports

The new policy would have manifold effects on the export landscape of India. A few of those are as follows:

- **Increased competitiveness:** Indian products, through the schemes of refunding embedded taxes, such as RoDTEP, become more internationally competitive. Remission of Duties and Taxes on Exported Products (RoDTEP) is a new scheme launched by the government to replace the existing MEIS scheme for exports of goods from India.
- **Higher export volumes:** With incentives and easier procedures, it would lead to an overall increase in export volumes, leading to greater foreign exchange earnings.
- **Market Diversification:** It is likely to reduce the reliance on the conventional markets and penetration of new markets in order to reduce the risk and open up new revenue streams.
- **Sectoral Growth:** This will throw all rounded growth in various segments of the economy like agriculture, manufacturing, IT, and services sectors.

6.8 Four Pillars of Foreign Trade Policy

The policy is founded on four key pillars: Incentive to Remission, Export Promotion through Collaboration, Ease of Doing Business and Reduction in Transaction Cost, and Emerging Areas. The Four Pillars of India's Foreign Trade Policy 2023 are as follows:

1. Incentive to Remission:

FTP 2023 introduces various incentive schemes and remissions for businesses to promote exports. The Remission of Duties and Taxes on Exported Products (RoDTEP) scheme replaces existing rebate schemes, offering a comprehensive and streamlined approach for exporters to receive timely and adequate support.

2. Export Promotion through Collaboration:

The policy emphasizes collaboration among stakeholders, including central and state governments, industry associations, export promotion councils, and Indian

Missions, to create a conducive environment for exports. This coordinated effort will enable India to identify new opportunities, explore untapped markets, and diversify its export basket.

3. Ease of Doing Business and Reduction in Transaction Cost:

FTP 2023 prioritizes the ease of doing business for exporters by simplifying processes, reducing transaction costs, and implementing IT-based systems. The policy introduces measures such as the one-time Amnesty Scheme for pending authorizations and streamlining export promotion schemes like EPCG and Advance Authorization.

4. Emerging Areas:

FTP 2023 focuses on emerging sectors like E-commerce exports, Districts as Export Hubs (DEH) initiatives, and streamlining the SCOMET policy. The policy aims to integrate courier and postal exports with ICEGATE and raise the consignment cap, fostering grassroots trade ecosystems and partnering with State governments. By focusing on the four key pillars, the policy lays a solid foundation for a vibrant and competitive export sector that can drive India's economic growth and global standing. What will be interesting to study is the roles Indian Entrepreneurs play to modernize education, services, and technology to sustain and accentuate the growth in Indian Exports.

6.9 Liberalisation of Foreign Trade and Foreign Investment Policy

Liberalization of foreign trade and investment policies has been the main driver of India's economic reforms since early 1990. The policies aim to reduce the trade barriers of India. They open it up to foreign investments as a step to integrate India into the world economy. Some of the policies adopted towards this objective are:

- **Reduction of Import Duties:** Huge cuts in the import duties so that the import price and import competitiveness is reduced.
- **De-licensing of Industries:** Simplified licensing norms are removed so that it becomes easy to enter for companies.
- **Promotion of Foreign Direct Investment (FDI):** Policies have been altered to attract FDI in various industries by allowing higher equity participation and smoothening entry norms.
- **Special Economic Zones (SEZs):** Building of SEZs with first-world infrastructure, in addition to granting special incentives on tax terms so that they would become magnets of exports and investment.

6.10 Export Policy for MSMEs

E-Commerce is widely considered as a medium to reduce costs related to penetration and sustainability of exporters in international markets. Indian MSMEs stand to benefit from the enhanced visibility provided by e-commerce platforms. Improved infrastructure, competitive pricing and reduced costs associated with marketing and outreach of products over a digital platform contribute to promoting online sales.

Government of India has taken several measures to enhance the exports by Micro, Small and Medium Enterprises (MSMEs). These include efforts made under Make in India Programme, Promotion of Ease of Doing Business, improved availability of credit through MUDRA, Stand up India.

Further, Ministry of MSME has established 52 Export Facilitation Centers (EFCs) across the country with an aim to provide requisite mentoring and handholding support to MSEs in exporting their products and services to the foreign market; and 102 Enterprise Development Centers (EDCs) have been setup with the aim to build a network of entrepreneurial leaders by providing professional mentoring and handholding support services to existing as well as aspiring MSMEs with special focus on rural enterprises on continuous basis. These EDCs act as "One-stop-shop" and provide services under components including Awareness, Incubation, Enterprise Facilitation etc.

In addition to these, Ministry is also implementing International Cooperation Scheme for enhancing the marketability of products and services in the MSME sector by facilitating visit /participation of MSMEs in international exhibitions /trade fairs/buyer-seller meet etc. abroad and also holding International conferences/seminars/workshops in India, for technology infusion, exploring business opportunities, joint ventures etc. Also, Cluster Development Programme is being implemented by Office of Development Commissioner(MSME) for enhancing the productivity and competitiveness as well as capacity building of Micro and Small Enterprises (MSEs) to increase demand of domestic products in global markets.

Ministry of Micro, Small & Medium Enterprises (MSME) has taken multiple initiatives for enhancing participation of MSMEs in e-commerce, which includes the following;

- **Procurement and Marketing Support (PMS) Scheme:** Under this Scheme, the sub-component of "Adoption of e-Commerce by Micro Enterprises" has been introduced. This new component includes providing financial assistance for selling products or services by Micro Enterprises (up to 10 new products) through e-commerce portals.

- **Portal of National Small Industries Corporation (NSIC):** NSIC, a PSU under the Ministry of MSME has launched MSME Global Mart Portal **(www.msmemart.com) -** a B2B e-commerce marketing platform for Micro, Small and Medium Enterprises (MSMEs), which provides Global Trade Leads, Tender Information, Franchise Opportunities, Data on Used Machineries, etc.

- **E-commerce portal of Khadi and Village Industries Commission (KVIC):** KVIC a statutory body under the Ministry of Micro, Small and Medium Enterprises has also launched a portal **ekhadiindia.com** for B2C outreach, which enables all businesses to have a global reach with Interactivity, Immediacy and Ease of Adaptation.

6.11 Categories of Product under FTP

The FTP provides for most of the goods/services to be „freely‟ exported and Imported, except when regulated by way of „restriction‟, „prohibition‟ or „exclusive trading through State Trading Enterprises (STEs)‟ as laid down in Indian Trade Classification (Harmonized System).

I. **Free:** Products categorized as free can be exported or imported without any permission from DGFT subject to the conditions, if any, mentioned against the product in the ITC (HS) Book and any other law of the country governing their exports or imports.

II. **Restricted:** Any goods/service categorised as „Restricted‟, may be exported or imported only in accordance with an Authorisation / Permission or in accordance with the procedures prescribed in a Notification / Public Notice issued in this regard.

III. **Prohibited Goods:** These are the items that cannot be exported at all. The majority of these include wild animals, and animal articles or those prohibited for trading through an International Convention.

IV. **State Trading Enterprise (STE):** Certain items can be exported only through designated STEs. The export of such items is subject to the conditions specified in the ITC (HS) Book.

❖ Exercises:

Q-1 Long Questions:

1) Write the meaning of Foreign Trade.
2) Write History of Foreign Trade.
3) Describe Nature of Foreign Trade.
4) Write a note on Foreign Trade Policy in India.
5) Explain Objectives of the Foreign Trade Policy in India.
6) Short note: Foreign Trade Policy 2023
7) Write Salient features of Foreign Trade Policy
8) What is the Impact of New Foreign Trade Policy 2023 on exports?
9) Explain Four Pillars of Foreign Trade Policy.
10) Explain Liberalisation of Foreign Trade and Foreign Investment Policy

Q-2 MCQ:

1) Name the two schemes introduced under the new foreign trade policy?
   a) Merchandise Export from India Scheme & Services Export from India Scheme
   b) Services Export from India Scheme & Services Import from India Scheme
   c) Services Import from India Scheme & Merchandise Export from India Scheme
   d) Merchandise Import from India Scheme & Services Export from India Scheme

2) The Indian Government unveiled the new Foreign Trade Policy 2015-20 on _____.
   a) 30th Mar 2015
   b) 31st Mar 2015
   c) 1st April 2015
   d) 30th April 2015

3) The main aim of India‟s foreign policy is____________________

a) To secure her national interest
b) To become more powerful country
c) To be the permanent member of UN Security Council
d) To promote international peace and security

4) The foreign trade policy of india Updated every ____________year.

a) 2 year
b) 3 year
c) 4 year
d) 5 year

5) India is a member of ____________ global trade organisation.

a) WTO
b) IMF
c) WORLD BANK
d) NONE OF THESE

6) Which Policy aims to make india a global manufacturing hub?

a) Make in india
b) Digital india
c) Skill india
d) Start up india

UNIT-7 MNES AND FDI

7.1 Introduction to MNEs (Multinational Enterprises)

In the increasingly interconnected global economy, **Multinational Enterprises (MNEs)** have become fundamental players. These companies have the ability to operate in multiple countries, manage complex supply chains, and influence markets across borders. The presence and activities of MNEs have a significant impact not only on their home countries but also on the host countries where they invest, operate, and contribute to economic development.

❖ **What Are MNEs?**

A **Multinational Enterprise (MNE)** is any business entity that manages production or delivers services in more than one country. These companies typically establish a network of affiliates, subsidiaries, branches, or joint ventures in different parts of the world. The defining characteristic of an MNE is its ability to operate in more than one country, often with the intent to access new markets, reduce production costs, or obtain resources not available in the home country.

While MNEs may vary significantly in terms of size, sector, and operations, they all share a common ability to leverage the benefits of globalization. They engage in international trade, cross-border investments, and contribute to the integration of the global economy.

7.1.1 Characteristics of MNEs

1. **International Operations**:

   MNEs have operations that span multiple countries. They may own and operate subsidiaries, joint ventures, or partnerships across various geographic regions. These operations may include manufacturing, assembly, sales, research and development (R&D), and more.

2. **Ownership and Control**:

   MNEs typically retain a significant level of control over their foreign operations. This control may come from owning the majority of shares in foreign subsidiaries or having a strong influence through management and operational decisions. They seek to manage resources, production, and marketing strategies on a global scale, which allows them to exploit efficiencies in their operations.

3. **Diversified Activities**:

   MNEs often diversify their activities to mitigate risks associated with dependence on one market or product. This can include diversifying into new industries, product lines, or geographic regions. Diversification helps them maintain stability and respond to the fluctuations of different markets.

4. **Advanced Technology and Expertise**:

   One of the key advantages MNEs have over local firms in host countries is their access to advanced technology, managerial expertise, and capital. MNEs often bring cutting-edge technology, modern business practices, and managerial skills to host countries, which can drive productivity and innovation.

5. **Global Integration**:

   MNEs aim to create integrated global operations. This often involves centralized decision-making from the home country (or headquarters), with local subsidiaries or branches adapting strategies to suit their specific market conditions. Despite local customization, the core values and strategic direction of the company remain aligned across all regions.

7.1.2 Role and Importance of MNEs in the Global Economy

1. Economic Growth and Job Creation:

One of the most significant contributions of MNEs is the creation of jobs and the stimulation of economic growth. By establishing operations in host countries, MNEs often provide employment opportunities, which can improve local living standards. Their presence can lead to the development of local industries, supply chains, and infrastructure.

Moreover, MNEs often invest in R&D, contributing to technological advancements and innovation. This, in turn, supports the economic development of not just the host country, but also the broader region, helping to raise productivity and competitiveness.

2. Technology Transfer and Knowledge Sharing:

MNEs are often at the forefront of technological innovation. When they establish operations in foreign countries, they can transfer new technologies, managerial practices, and technical expertise to the host country. This is especially important for developing economies that may not have access to such knowledge. The impact can be seen in improved efficiency, better product quality, and enhanced industrial capabilities in the local economy.

3. Global Trade and Investment:

MNEs are key drivers of global trade. Their operations across multiple countries involve cross-border transactions of goods, services, and capital. This results in the exchange of resources and creates global supply chains, allowing for the efficient allocation of resources and the maximization of comparative advantage. Furthermore, through Foreign Direct Investment (FDI), MNEs promote capital flows between countries, which can be vital for economic development.

4. Market Expansion:

MNEs typically enter foreign markets in search of growth opportunities, often targeting emerging markets where demand is rising. By entering new markets, they can benefit from the increasing purchasing power of consumers in those regions. At the same time, they may reduce their exposure to market fluctuations in their home countries.

5. Influence on International Business Practices:

The widespread reach of MNEs has led to the global standardization of business practices. These firms set benchmarks for quality, efficiency, and management. In doing so, they can influence consumer preferences and drive the adoption of international norms in various industries.

7.2 Introduction to FDI (Foreign Direct Investment)

Foreign Direct Investment (FDI) is a crucial aspect of the global economy, representing the flow of capital and resources from one country to another. FDI occurs when a company or individual from one country makes an investment into a business or real assets in another country. Unlike portfolio investment, which involves purchasing financial assets such as stocks and bonds, FDI involves a long-term interest and significant control or influence over the foreign enterprise. FDI is considered one of the most effective ways for companies to expand their operations internationally and for countries to access capital, technology, and expertise.

What is FDI?

FDI is defined as an investment made by a person, company, or country into assets or business operations in another country. It typically involves the investor acquiring a significant ownership stake—usually at least 10%—in a foreign company, which grants them a level of control or influence over the company's decisions. This is different from Foreign Portfolio Investment (FPI), which involves buying stocks or bonds without significant control over the company.

7.3 Multinational Firms & Foreign Direct Investment (FDI)

In the context of globalization and international business, **multinational firms** and **foreign direct investment (FDI)** are two crucial concepts that are deeply intertwined. Multinational firms are key players in the global economy, and they use FDI as one of their primary strategies to expand operations, access new markets, and increase profitability across borders. To understand how these two concepts work together, it is important to first explore what multinational firms and FDI are, and then how they relate to each other.

7.3.1 Multinational Firms (MNEs)

A **multinational firm** (also known as a **multinational corporation**, or MNC) is a company that has operations in more than one country. These firms can range from large corporations, such as **Apple**, **Toyota**, and **Unilever**, to smaller companies that expand beyond their national borders.

Key characteristics of multinational firms include:

1. **Global Operations**:

   Multinational firms conduct business in several countries. They own or control assets, such as production plants, subsidiaries, or joint ventures in foreign markets.

2. **Cross-Border Business Activities**:

   These firms engage in various business activities across different countries, including manufacturing, research and development (R&D), marketing, sales, and service operations. They may have a central headquarters in one country, with various branches or subsidiaries worldwide.

3. **Strategic Decision-Making**:

   While multinational firms operate internationally, they typically maintain a centralized control system where strategic decisions—such as overall company direction, major investments, and research priorities—are made at the headquarters. However, subsidiaries often have some level of autonomy in adapting to local market conditions.

4. **Access to Resources and Markets**:

   By operating in multiple countries, multinational firms can access important resources (e.g., raw materials, labour, capital) and markets (e.g., consumers) that may not be available in their home country. This helps to diversify their operations, reduce risks, and maximize profits.

7.3.2 Foreign Direct Investment (FDI)

Foreign Direct Investment (FDI) refers to investments made by a company or individual in one country into business interests located in another country. Typically, FDI involves acquiring at least 10% of the ownership of a foreign company, which allows the investor to exert a degree of control or influence over that company. FDI is often contrasted with portfolio investment, which involves purchasing stocks or bonds without acquiring significant control over the company.

FDI can take several forms:

1. **Greenfield Investment**:

   This is when a multinational firm builds new operations from the ground up in a foreign country. It could involve setting up manufacturing plants, distribution centers, or R&D facilities in a new market. Greenfield investments are capital-intensive but allow for full control over operations.

2. **Mergers and Acquisitions (M&A)**:

FDI can also take the form of a merger or acquisition, where a multinational firm buys or merges with an existing foreign company. This allows the investor to quickly access an established market presence, local customer base, and infrastructure.

3. **Joint Ventures**:

In some cases, multinational firms enter joint ventures with local companies in the foreign market. A joint venture allows the multinational firm to pool resources with the local partner, share risks, and leverage local knowledge while gaining access to new markets.

❖ **How Multinational Firms Use FDI**

For multinational firms, FDI is a key tool to expand their operations internationally. Here are several ways in which multinational firms use FDI:

1. **Market Expansion**:

One of the main reasons multinational firms engage in FDI is to enter new markets. By investing in a foreign country, these firms can gain direct access to new customers, capitalize on growing economies, and increase their global footprint. This is especially important for firms that want to grow beyond their home market, especially when domestic markets are saturated.

2. **Cost Reduction**:

Many multinational firms use FDI as a way to reduce operational costs. This can include setting up production facilities in countries where labour costs are lower or where raw materials are abundant. By reducing costs, they can offer more competitive prices in global markets while increasing profit margins.

3. **Resource Acquisition**:

FDI is also a strategy for multinational firms to secure access to important resources, such as natural resources (e.g., oil, minerals), skilled labour, or technology. For example, a technology firm might invest in a foreign country to tap into a skilled workforce, or a manufacturing company might set up operations in a country rich in specific raw materials.

4. **Technology and Knowledge Transfer**:

Multinational firms often bring advanced technology, management practices, and know-how to the host countries where they invest. In return, they gain access to local knowledge, innovations, and potentially better ways of doing business in foreign markets. This transfer of technology and expertise can benefit both the multinational firm and the host country.

5. **Strategic Positioning and Competitive Advantage**:

FDI allows multinational firms to gain a competitive advantage over local competitors and other multinational firms. By establishing operations in key markets, these firms can strengthen their position globally, improve brand recognition, and create barriers to entry for other companies.

6. **Diversification**:

For multinational firms, FDI provides a way to diversify business risks by spreading operations across various geographical regions. This reduces dependence on a single market and can protect the company from regional economic downturns or political instability.

❖ **Impact of Multinational Firms and FDI on Host Countries**

While multinational firms benefit from FDI, the host countries also experience significant economic impacts:

1. **Economic Growth**:

FDI can stimulate economic growth in host countries by bringing in capital, creating jobs, and improving productivity. Multinational firms often invest in infrastructure, technology, and training programs, which helps to develop local industries and improve overall economic conditions.

2. **Job Creation**:

The establishment of foreign operations by multinational firms can create employment opportunities in the host country. This can range from low-skilled labour in manufacturing plants to high-skilled jobs in management, R&D, and marketing.

3. **Technology Transfer**:

Multinational firms often bring new technologies and business practices to the host country, which can improve local industries and increase efficiency. This helps the host country become more competitive globally.

4. **Challenges**:

While FDI can bring significant benefits, it also presents challenges. Local firms might struggle to compete with large multinational companies that have more resources and technological advantages. Additionally, there is concern over the potential negative impact on the environment, local cultures, and the economy if foreign firms dominate certain industries

7.4 Scope of Multinational Firms (MNEs)

1. **Global Operations**:

MNEs operate in multiple countries across the world. They manage subsidiaries, affiliates, or joint ventures in various markets, which helps them expand their reach and capture international markets.

2. **Market Diversification**:

Multinational firms expand their market base by entering new geographic regions. This diversification allows them to tap into emerging markets and reduce reliance on any single market, minimizing risks associated with economic downturns or market saturation.

3. Product/Service Standardization and Adaptation:

MNEs often standardize products and services to maintain brand consistency and cost efficiency. However, they also adapt their offerings to local market conditions, cultural preferences, and legal requirements to ensure relevance and competitiveness in different regions.

4. Cross-Border Supply Chains:

MNEs typically manage extensive global supply chains, sourcing raw materials, components, and services from various countries. This allows them to optimize costs and maintain operational flexibility by leveraging the comparative advantages of different regions.

5. Resource Allocation and Control:

MNEs have the ability to allocate resources, such as capital, technology, and expertise, across borders to maximize efficiency. They maintain significant control over their foreign operations, especially in the case of wholly-owned subsidiaries or majority-owned joint ventures.

6. Access to Capital and Technology:

MNEs have greater access to financial resources and advanced technologies compared to smaller firms. This enables them to invest in research and development (R&D), innovations, and infrastructure in their foreign markets.

7. Strategic Acquisitions:

MNEs often engage in mergers and acquisitions to quickly gain market share, access local networks, or acquire strategic assets (e.g., brands, intellectual property, distribution channels) in foreign markets.

8. Influence on Local Economies:

MNEs can influence the economies of host countries by providing employment, driving technological progress, and contributing to economic growth. They may also bring new business practices, helping to raise industry standards in the host country.

9. Cultural and Social Impact:

MNEs can significantly impact local cultures by introducing new consumer goods, services, and corporate practices. While this can enhance lifestyles, it can also raise concerns over cultural homogenization or loss of local traditions.

7.5 Scope of Foreign Direct Investment (FDI)

1. Capital Inflows:

FDI brings significant capital into the host country, enabling economic development by funding new projects, businesses, and industries. This capital can be used for infrastructure development, industrial growth, and job creation.

2. **Technology and Knowledge Transfer**:

Through FDI, multinational firms often bring advanced technologies, managerial expertise, and innovative business practices to the host country, which can boost productivity and enhance local capabilities.

3. **Job Creation and Skills Development**:

FDI can create employment opportunities by establishing new businesses, factories, and operations. It also helps in skill development through training programs and exposure to new technologies and management techniques.

4. **Market Access for Local Firms**:

FDI helps local businesses expand by linking them to global supply chains and networks, which can enhance their growth prospects and introduce them to international markets.

5. **Infrastructure Development**:

Foreign investors often contribute to infrastructure development in the host country, such as building roads, ports, communication networks, and power plants, all of which can improve the overall business environment.

6. **Boosting Exports**:

FDI can lead to the establishment of export-oriented industries in the host country, which can help increase the country's exports and improve its balance of payments.

7. **Improvement in Productivity**:

The presence of multinational firms through FDI often drives productivity improvements in local firms. Local businesses may adopt better production techniques, management practices, and more efficient technologies as a result of foreign investment.

8. **Access to International Markets and Networks**:

FDI can serve as a gateway for the host country's businesses to connect to international markets, as multinational firms typically have established networks and distribution channels across different regions.

9. **Challenges of Economic Dependency**:

While FDI brings benefits, it can also create challenges. Heavy reliance on foreign investments may result in economic dependency, where local economies are vulnerable to the decisions of foreign companies or changes in global economic conditions.

10. **Impact on Local Competitiveness**:

FDI can improve the competitiveness of local industries by introducing competition and promoting innovation. However, it may also lead to the dominance of foreign firms, potentially crowding out smaller local businesses.

11. Political and Economic Risks:

FDI is subject to political and economic risks in host countries, including changes in government policies, expropriation, or political instability, which can affect the security and profitability of foreign investments.

12. Environmental and Social Concerns:

Some critics argue that FDI, particularly in certain industries, can have negative environmental and social impacts, such as exploitation of natural resources or poor working conditions. There are increasing calls for sustainable investment practices.

7.6 Features of MNC:-

1. Global Operations

One of the defining features of MNCs is their **global presence**. They operate in more than one country, usually in a significant number of international markets. These corporations often have a home country, where their headquarters is located, and they establish subsidiaries, affiliates, joint ventures, or strategic alliances in other countries to expand their reach.

For instance, companies like **Apple**, **Microsoft**, and **Toyota** have operations in dozens of countries. They may run manufacturing plants, research and development (R&D) centers, and sales offices in various parts of the world. This global footprint enables MNCs to tap into new markets, leverage local resources, and respond more quickly to global economic trends.

2. Centralized Control with Local Adaptation

Despite operating in different markets, MNCs usually maintain **centralized control** over their overall strategy and major decisions. The management decisions regarding corporate policies, marketing strategies, R&D direction, and financial management are often made at the headquarters. However, MNCs need to adapt to the **local market conditions** to ensure success in each of their operating countries.

For example, while an MNC might have a standardized product offering globally, it may adapt the product's features, pricing, or marketing strategies to cater to local tastes, regulatory requirements, and consumer preferences. **Coca-Cola**, for instance, offers different flavours and packaging sizes in different countries to match local demand. This combination of global oversight with local responsiveness allows MNCs to efficiently manage their operations while meeting the unique needs of customers in different regions.

3. Large-Scale Capital Investment

MNCs are often involved in **large-scale capital investments**, such as building manufacturing facilities, acquiring raw materials, or establishing infrastructure in various countries. The scale of these investments enables them to benefit from **economies of scale**—reducing the per-unit cost of production by increasing the volume of output.

MNCs often invest heavily in research and development (R&D) to innovate and maintain a competitive edge. These investments are not only limited to physical infrastructure but also extend to intellectual property, advanced technology, and human capital, which are necessary for driving long-term growth and staying competitive in global markets.

4. Access to Resources, Labor, and Technology

MNCs frequently seek to establish their operations in countries that offer certain competitive advantages, such as access to **cheap labour**, natural resources, or advanced technology. This access allows them to reduce operational costs and increase profitability. For example:

- **Manufacturing**: MNCs may relocate manufacturing operations to countries with lower labour costs, such as China, India, or Vietnam. This helps them lower production costs, which can be crucial for staying competitive in price-sensitive markets.
- **Natural Resources**: Many MNCs, particularly those in industries like mining, oil, and agriculture, invest in countries rich in natural resources (such as Brazil, Russia, or Canada), ensuring access to raw materials at competitive prices.
- **Technology**: MNCs also establish R&D centers in regions known for their technological prowess (e.g., Silicon Valley in the U.S. or Bangalore in India). By doing so, they can leverage innovations and advancements that may not be available in their home countries.

Through these strategies, MNCs can optimize their operations and maintain a competitive advantage in the global marketplace.

5. Cross-Border Supply Chains and Logistics

MNCs typically run complex **global supply chains** that span across multiple countries. They source raw materials, components, and finished goods from different parts of the world, taking advantage of the **comparative advantages** offered by various regions. These supply chains allow MNCs to maximize efficiency, lower costs, and ensure a steady flow of goods and services to meet the demand of international markets.

For instance, **Apple** designs its products in the U.S., sources components from various suppliers in different countries (such as semiconductors from Taiwan, screens from Japan, and assembly in China), and sells the finished products worldwide. The coordination and management of these supply chains require sophisticated logistics and technology to ensure that products are produced and delivered on time, at competitive prices.

6. International Marketing and Branding

Marketing and branding are also crucial to the success of MNCs. These corporations often have well-established global brands that are recognized and trusted by consumers worldwide. A consistent global brand image helps MNCs promote their products and services across borders, though they often make certain adjustments in their marketing strategies to align with local cultural preferences, legal requirements, and consumer behaviour.

For example, **McDonald's** follows a global brand strategy, but it tailors its menu to meet local tastes (offering **vegetarian burgers** in India and **teriyaki burgers** in Japan). Similarly, **Nike** uses global advertising campaigns while incorporating local sports figures and cultural references to connect with customers in various regions.

7. Access to Foreign Direct Investment (FDI)

MNCs often play a major role in **Foreign Direct Investment (FDI)**. As these corporations expand into international markets, they engage in activities such as setting up manufacturing plants, purchasing shares in local companies, or establishing joint ventures with local partners. FDI helps MNCs gain a foothold in foreign markets and strengthens their overall market position.

For example, **Toyota** has invested in several countries by building factories and forming partnerships with local automakers to produce vehicles suited for the regional market. This not only helps the company to cut costs but also allows it to bypass tariffs and other trade barriers in certain markets.

8. Cultural Diversity and Global Workforce

An often-overlooked feature of MNCs is their **cultural diversity**. Since MNCs operate across multiple countries, they employ people from various cultural backgrounds, with a variety of languages, customs, and work practices. This diversity can enrich the organization by bringing diverse perspectives and creative solutions to business challenges.

At the same time, managing this diverse workforce can be challenging. MNCs must navigate differences in work ethics, communication styles, and decision-making processes, and they must also adhere to varying labour laws and regulations in each country where they operate.

MNCs invest in **cross-cultural training** and **global management practices** to manage this diversity effectively and foster an inclusive work environment.

9. Risk and Regulatory Management

Operating across borders exposes MNCs to various **risks** that they must manage carefully. These risks can include **political instability**, **exchange rate fluctuations**, **legal and regulatory challenges**, and **economic crises** in foreign markets. MNCs often have specialized risk management teams to assess and mitigate such risks through strategies like **hedging**, **insurance**, and **diversification**.

Additionally, MNCs must comply with the **regulatory environment** in each country they operate in. This includes complying with local labour laws, environmental regulations, taxation policies, and corporate governance standards. To manage regulatory complexity, MNCs often establish legal and compliance teams in different countries to navigate the local legal landscape.

10. Corporate Social Responsibility (CSR) and Ethical Practices

MNCs are increasingly being held accountable for their impact on the environment, society, and the local economies in which they operate. Many multinational corporations have embraced **Corporate Social Responsibility (CSR)** programs that focus on sustainable business practices, ethical labour standards, environmental protection, and community development.

For instance, companies like **Unilever** and **Nestlé** have implemented CSR initiatives to reduce their environmental footprint, improve labour conditions, and promote fair trade practices in their supply chains

7.7 Advantages of Multinational Company

1. Economic Growth and Development

One of the most significant advantages of MNCs is their ability to contribute to the **economic growth and development** of the countries in which they operate. These companies bring substantial **foreign direct investment (FDI)**, which helps stimulate local economies. FDI plays a critical role in financing infrastructure, developing industries, and creating jobs.

MNCs often establish manufacturing plants, research centers, or regional offices in developing nations, contributing to the **diversification of the economy**. This creates a ripple effect across industries, helping to boost sectors like construction, logistics, and technology. Additionally, the presence of multinational companies often encourages the growth of local suppliers and service providers, resulting in a more robust economy.

For example, **Toyota's investment in India** has led to a thriving automotive sector, with local suppliers benefiting from its demand for parts and components. Similarly, **Apple's presence in China** has created an entire ecosystem of suppliers, manufacturers, and service providers that rely on Apple's global operations.

2. Job Creation and Employment Opportunities

MNCs create significant employment opportunities in host countries. By establishing operations in foreign countries, they provide direct jobs for the local population, often in regions where jobs are scarce or the local economy is underdeveloped. These jobs are not limited to low-skilled positions but also include managerial, technical, and highly specialized roles.

In addition to direct employment, MNCs also generate **indirect employment** by encouraging the creation of local businesses to support their operations. For example, construction companies, local suppliers, transportation companies, and other service providers often benefit from the presence of a multinational company in the area.

Moreover, MNCs tend to offer better wages, working conditions, and career growth opportunities compared to smaller local firms, attracting a skilled workforce and improving living standards. For instance, employees at **Google's operations in various countries** typically enjoy competitive salaries, health benefits, and access to advanced training programs, all of which contribute to personal and professional development.

3. Access to Technology and Innovation

MNCs are often at the forefront of technological innovation. They bring **advanced technologies**, **management practices**, and **know-how** to the host countries where they operate. This transfer of technology and expertise can greatly benefit local businesses, industries, and governments. It boosts productivity, helps improve product quality, and leads to better efficiency in various sectors.

For instance, MNCs in the **technology sector**, such as **Microsoft** and **Intel**, often introduce new technologies that raise the standards of local industries, including information technology, manufacturing, and telecommunications. The knowledge and training offered by MNCs to their local employees contribute to building a skilled workforce, that is capable of utilizing state-of-the-art tools and techniques.

Additionally, many MNCs invest heavily in **research and development (R&D)**. By doing so, they foster innovation not only within their own organizations but also in the surrounding community. The research efforts often lead to technological advancements that local businesses can adopt or adapt to their own operations, driving further innovation and competitiveness in the market.

4. Improved Infrastructure

When MNCs set up operations in a host country, they often invest in improving the **infrastructure** of the region. This can include the construction of roads, bridges, factories, and office buildings, as well as upgrades to utilities like electricity and water systems. The presence of an MNC often necessitates improvements in local infrastructure, both for the company's operations and for the surrounding community.

For example, **Microsoft** has invested in building data centres in various countries. These facilities require reliable electricity, high-speed internet, and other essential services. As a result, local infrastructure is often improved, which benefits the broader population by providing better services and contributing to the overall development of the region.

In addition, MNCs often partner with local governments to develop large infrastructure projects that benefit both the company and the local population. For example, when **Shell** operates in an oil-rich region, it may help fund or build roads, pipelines, and other infrastructure to transport resources. These projects not only benefit Shell but also facilitate trade and economic growth for the region.

5. Better Standards of Management and Corporate Governance

MNCs are generally known for implementing **best practices** in terms of corporate governance, management systems, and compliance with international standards. These companies often bring more **efficient management techniques** to host countries, raising the standards of local businesses.

Local businesses can learn from the MNC's management styles, business practices, and organizational structures, leading to an overall improvement in business efficiency. For instance, the **project management systems** implemented by companies like **Siemens** or **General Electric** can influence local firms and raise industry standards.

Moreover, many MNCs enforce **high ethical standards** and adhere to international regulations related to labour practices, environmental protection, and anti-corruption measures. This, in turn, encourages better practices in the local market and fosters a **culture of transparency** and **accountability**.

6. Access to International Markets

MNCs play a crucial role in helping local businesses access **international markets**. By working with multinational companies, smaller domestic firms can enter global supply chains, expand their reach, and tap into international consumer bases. This exposure allows local businesses to increase their revenues and improve their competitive standing in the global market.

For example, local suppliers that work with companies like **Walmart**, **Amazon**, or **Nike** can eventually expand their customer base beyond the borders of their home countries. As they align with MNCs' stringent quality standards, these suppliers improve their products and services, making them more competitive in the global marketplace.

Furthermore, the **marketing expertise** and global distribution networks that MNCs possess help boost the visibility of locally produced goods and services to an international audience. This increased exposure can be highly beneficial for local brands that want to grow and compete on the world stage.

7. Enhanced Consumer Choice and Lower Prices

MNCs introduce **variety and competition** into the local markets, enhancing consumer choice. By offering products and services from global brands, consumers benefit from a wider range of goods. They can access better-quality products that might not have been available otherwise.

Additionally, the presence of MNCs in a market often leads to **price competition**, which benefits consumers. MNCs bring economies of scale, allowing them to produce goods at lower costs, which can then be passed on to the consumer in the form of **lower prices**.

For example, **Unilever** and **Procter & Gamble** offer a wide array of products in diverse categories, from personal care to food, often at competitive prices. Consumers in countries where these MNCs operate benefit from lower prices, higher product quality, and more options compared to local-only brands.

8. Corporate Social Responsibility (CSR)

Many MNCs are highly committed to **corporate social responsibility (CSR)**, which involves efforts to contribute positively to society and the environment. MNCs engage in a variety of CSR activities, including environmental sustainability programs, community development, charity initiatives, and ethical sourcing.

For example, **Nestlé** focuses on sustainable sourcing of raw materials, improving nutrition, and supporting local communities through health education programs. Similarly, companies like **Patagonia** and **The Body Shop** have strong environmental and ethical sourcing initiatives. These CSR programs help to improve the well-being of local communities, foster sustainability, and contribute to global environmental efforts.

7.8 Importance of FDI in international business

1. Stimulates Economic Growth and Development

FDI is a key driver of **economic growth** in developing and emerging markets. When foreign firms invest in a country, they bring in capital, technology, and expertise, all of which can have a profound impact on the local economy. The capital inflows associated with FDI help fund infrastructure projects, factories, and new business ventures that create economic value and increase the overall productivity of the host country.

For instance, FDI helps in financing sectors such as **manufacturing**, **services**, and **infrastructure**, providing much-needed resources in economies that may struggle with limited domestic capital. By investing in industries that require large upfront investments (such as energy, telecommunications, and mining), FDI often helps jumpstart sectors that are crucial for long-term economic growth.

Countries that are particularly dependent on FDI, like **China**, **India**, and many countries in **Africa** and **Latin America**, often see significant improvements in their GDPs due to the inflow of foreign investment. This influx of funds can improve the country's overall standard of living, enhance social services, and build a more diverse, robust economy.

2. Technology and Knowledge Transfer

One of the most significant contributions of FDI to international business is the **transfer of technology and know-how** from foreign investors to local firms. When multinational companies invest in a host country, they often bring with them advanced technologies, production processes, and managerial skills that are not readily available in the local economy.

The transfer of technology enhances the productivity and efficiency of industries within the host country. It can include the introduction of new machinery, software, and innovative methods that improve the competitiveness of local businesses. Furthermore, foreign companies typically offer **training programs** to local workers, which helps raise skill levels and improve labour productivity.

For example, when foreign firms such as **General Electric**, **Microsoft**, or **Intel** set up operations in developing countries, they bring with them the latest technological advancements. Local workers and businesses can learn from these innovations, and over time, the local economy becomes more technologically advanced, competitive, and capable of innovating on its own.

Additionally, FDI can lead to the **establishment of research and development (R&D) hubs** in the host country, enabling local firms to become part of the global innovation network. This technology spillover is crucial for developing economies seeking to catch up with more advanced nations.

3. Creation of Jobs and Employment Opportunities

FDI plays a vital role in **job creation** in the host country. By establishing new businesses, opening manufacturing plants, or expanding service networks, foreign investors generate employment opportunities, especially in countries with high unemployment rates. The entry of multinational corporations can also create **indirect jobs** through their supply chains, including in logistics, marketing, and other supporting industries.

For example, large companies like **Toyota**, **Apple**, or **Volkswagen** often establish local production facilities in emerging markets. These companies not only create direct jobs in their factories but also generate demand for raw materials, transportation, and retail, benefiting the broader economy. This helps address issues like **unemployment**, which is a significant challenge in many developing countries.

Moreover, foreign companies often offer competitive wages, better working conditions, and benefits, contributing to the overall improvement of the labour market in the host country. In some cases, the presence of foreign firms raises local labour standards, as these firms are typically held to higher international standards for health, safety, and environmental regulations.

4. Access to International Markets

FDI provides companies with **access to international markets**. For businesses that wish to expand globally, establishing operations in foreign countries through FDI offers a strategic entry point into new markets. Rather than relying solely on exports, multinational companies can leverage **direct investment** to establish a stronger local presence, adapt their products to local tastes, and directly reach customers.

For example, companies like **Coca-Cola**, **McDonald's**, and **Nike** have established production and distribution networks in various countries through FDI. By doing so, they can avoid trade barriers such as tariffs, reduce transportation costs, and gain direct access to local consumer bases. This enables multinational corporations to compete more effectively with local companies and enhance their market share.

FDI also helps local firms gain access to global supply chains. A local supplier working with a multinational company can access broader networks of customers and suppliers across the world, thus expanding its business opportunities and enhancing its competitiveness on the global stage.

5. Increased Productivity and Competitive Advantage

FDI typically leads to **increased productivity** in the host country. When foreign companies invest in local markets, they bring more efficient production methods, managerial expertise, and innovative strategies that can lead to improved productivity. This is especially important in industries where competition is fierce, as it forces local firms to upgrade their operations and adopt more modern technologies to remain competitive.

Moreover, **foreign firms** often introduce **new competition**, challenging local businesses to innovate and improve their products and services. This **competitive pressure** can result in higher quality products, better customer service, and more competitive pricing in the local market.

An example of this can be seen in the **telecommunications** industry. When foreign firms like **Vodafone** or **T-Mobile** entered developing markets, they raised the level of competition, prompting local companies to improve their services, offer competitive pricing, and invest in better infrastructure. This has benefited consumers and spurred innovation within the industry.

6. Enhances Export Capabilities

FDI also plays a significant role in enhancing the **export capabilities** of host countries. Many foreign firms establish production plants in countries with lower labour costs to take advantage of cheaper manufacturing while still exporting finished products to global markets. As a result, FDI can lead to **increased exports** from the host country, boosting the nation’s **trade balance** and overall economic performance.

For example, many countries in **Southeast Asia** have seen a dramatic increase in exports due to the establishment of manufacturing facilities by multinational companies. These operations allow for the production of consumer goods, electronics, and machinery, which are then shipped worldwide.

FDI in manufacturing has also been particularly important for nations in **Latin America** and **Africa**, where foreign investors often produce goods for export while stimulating local economies through job creation and technology transfer.

7. Improvement in Infrastructure and Social Development

FDI is often associated with improvements in a country's **infrastructure**. When foreign companies invest in developing countries, they frequently engage in **infrastructure development projects**, such as the construction of roads, ports, airports, and power plants, to support their operations. These investments not only benefit the foreign investor but also contribute to broader economic development.

For example, multinational companies often invest in building roads, energy facilities, and telecommunications networks to support their factories and distribution networks. These infrastructure improvements can have significant positive spillover effects on local businesses, enabling them to operate more efficiently and engage in trade with other countries.

In addition, some multinational companies engage in **corporate social responsibility (CSR)** initiatives, where they invest in local communities through health, education, and environmental programs. These programs improve the social and economic conditions in the host country, particularly in rural or underdeveloped areas.

8. Increased Tax Revenue for Host Governments

FDI also contributes to **increased tax revenues** for the host country governments. Foreign companies, when operating in a host country, are subject to local tax laws, which can result in significant government revenues. These revenues can then be used to fund public services such as education, healthcare, and infrastructure development.

Governments in developing countries often rely on FDI to enhance their tax base, which can be vital for financing social programs and public investments. The **tax benefits** from FDI are especially important in countries that are looking to reduce poverty and improve social outcomes.

7.9 Types of FDI

Foreign Direct Investment (FDI) is a critical component of the global economy, allowing companies to establish or expand their presence in foreign markets. FDI involves an investment in assets, such as businesses or physical capital, by a foreign company or individual in a country other than their own. There are several types of FDI, each with distinct characteristics, motivations, and impacts. The main types of FDI are **Greenfield Investment**, **Mergers and Acquisitions (M&A)**, **Joint Ventures (JV)**, and **Horizontal, Vertical, and Conglomerate FDI**. Understanding these types of FDI can help clarify the strategies that companies employ when investing abroad.

1. Greenfield Investment

Greenfield investment refers to a type of FDI in which a foreign company builds new operations from the ground up in a foreign country. This could involve the construction of new factories, office buildings, and other physical infrastructure. A company making a Greenfield investment essentially "builds its own" presence in the host country, starting from scratch rather than acquiring or partnering with existing businesses.

❖ **Characteristics:**

- **High control and autonomy**: Since the investor is establishing new facilities or businesses, it has complete control over operations, including management, production methods, and overall strategy.
- **Long-term commitment**: Greenfield investments are usually long-term in nature, requiring significant capital investment and planning. The setup process may take several years.
- **Local employment and technology transfer**: These investments tend to generate local employment opportunities, as the foreign firm hires workers and managers. Moreover, the firm may transfer technology, business practices, and management skills to the host country.

Example:

An example of Greenfield investment is **Toyota's investment in the U.S.** in the 1980s, where the company built manufacturing plants in Kentucky and other locations to produce cars locally for the U.S. market. This allowed Toyota to benefit from lower production costs, avoid trade barriers, and ensure faster delivery to customers.

2. Mergers and Acquisitions (M&A)

Mergers and Acquisitions (M&A) are another significant form of FDI, where a foreign company either merges with or acquires a local company. Unlike Greenfield investments, M&A does not require the foreign investor to build new facilities from scratch. Instead, it involves purchasing or merging with an existing business to expand its operations, gain market share, or access new resources.

Characteristics:

- **Speed and efficiency**: M&As are usually faster to implement than Greenfield investments. By acquiring an existing company, the foreign investor gains immediate access to its resources, customer base, and established market position.
- **Access to local knowledge and networks**: M&A provides the foreign company with valuable local knowledge, market expertise, and distribution networks, which can be difficult to replicate in a new market.
- **Synergies**: The foreign company can benefit from synergies between the two firms, such as cost savings, complementary resources, or market expansion.

Example:

A well-known example of M&A is **Coca-Cola's acquisition of the British company Honest Tea**. Through this acquisition, Coca-Cola expanded its presence in the organic beverage market while leveraging Honest Tea’s established brand and local networks.

3. Joint Venture (JV)

A **Joint Venture (JV)** is a business arrangement in which two or more parties agree to combine resources, expertise, and capital to form a new business entity in a foreign market. Each partner in a joint venture, shares in the ownership, risks, and profits of the business. JVs are often seen as a way for foreign investors to enter markets where they may not be able to operate alone due to regulatory, cultural, or financial constraints.

Characteristics:

- **Shared risk and reward**: In a JV, both parties share the risks associated with the business, as well as the rewards. This reduces the financial burden on each party compared to a full acquisition or Greenfield investment.
- **Local partner expertise**: A joint venture with a local company can help the foreign investor navigate regulatory and cultural challenges, gain access to local networks, and understand consumer preferences more effectively.
- **Control and decision-making**: Control in a JV is shared between the partners, and decision-making is often more complex, as the partners need to agree on key issues.

Example:

A prime example of a joint venture is **Sony Ericsson**, which was a partnership between **Sony** (a Japanese company) and **Ericsson** (a Swedish company). The two companies combined their expertise in electronics and telecommunications to create a successful mobile phone brand. Through this JV, they gained access to each other’s strengths and market knowledge.

4. Horizontal FDI

Horizontal FDI occurs when a company invests in a foreign country by establishing or acquiring a business that produces the same or similar products or services as it does in its home country. The goal of horizontal FDI is typically to expand market share, reduce transportation costs, and overcome trade barriers such as tariffs and quotas.

Characteristics:

- **Same industry**: The investor engages in the same or similar industry in the foreign market, often to produce goods that can be sold locally or regionally.
- **Market expansion**: Horizontal FDI enables companies to increase their reach by entering new geographic markets, offering similar products or services to local customers.
- **Minimization of trade barriers**: Companies make horizontal investments to reduce or avoid tariffs and other trade restrictions by producing goods locally in the target market.

Example:

McDonald's is a classic example of horizontal FDI. The company operates fast-food restaurants globally, expanding its market by setting up new restaurants in different countries. It produces and sells the same products (burgers, fries, drinks) that it offers in its home market, but in local stores tailored to local tastes.

5. Vertical FDI

Vertical FDI occurs when a company invests in a foreign market by establishing or acquiring businesses that are involved in different stages of the production process, either upstream or downstream from its core operations. This type of FDI helps the investor secure resources, reduce production costs, or ensure a stable supply of raw materials or distribution channels.

Characteristics:

- **Upstream FDI**: Upstream vertical FDI occurs when a company invests in a foreign country to secure access to raw materials or intermediate goods for production.
- **Downstream FDI**: Downstream vertical FDI occurs when a company invests in distribution networks, retail operations, or marketing in a foreign market.
- **Cost reduction and supply chain control**: Vertical FDI helps the foreign company control the supply chain, ensuring that it has access to key inputs or markets at lower costs.

Example:

A **vertical FDI example** is **ExxonMobil's investment in oil drilling operations in the Middle East**. ExxonMobil has upstream FDI by investing in oil exploration and drilling, and downstream FDI in refining and distribution. This integration of both ends of the production chain helps reduce costs and ensure supply chain stability.

6. Conglomerate FDI

Conglomerate FDI refers to an investment in a completely unrelated business or industry in a foreign market. In contrast to horizontal or vertical FDI, a conglomerate FDI involves entering into entirely new markets or industries that are not directly connected to the investor’s existing operations. This type of FDI is often driven by the desire for diversification and risk reduction.

Characteristics:

- **Diversification**: The primary goal is to reduce risk by spreading investments across different industries or sectors in foreign markets.
- **No direct relationship with the investor’s existing business**: The foreign investment is made into a business or industry that is unrelated to the company’s core activities.
- **Risk management**: By entering an unrelated industry, companies can balance risks across different sectors, which may be important during times of economic uncertainty.

Example:

An example of **conglomerate FDI** is **General Electric's (GE) investment in finance**. While GE is primarily known for its industrial products (such as turbines and appliances), it diversified into the financial services sector by acquiring a variety of financial institutions and insurance companies. These investments were in completely unrelated industries and helped GE reduce its overall business risk

❖ Exercise:

- **Multiple choice Questions**

1. Which of the following best defines a Multinational Enterprise (MNE)?

A) A company that operates in only one country
B) A company that owns and controls business activities in multiple countries
C) A company that only exports products abroad
D) A company with only local operations

2. What is a primary characteristic of Foreign Direct Investment (FDI)?

A) The investment made within the domestic market
B) The investment in another country by a company or individual
C) The direct investment in local stocks
D) The trade of goods and services between two countries

3. Which of the following is NOT a type of Foreign Direct Investment (FDI)?

A) Greenfield Investment
B) Mergers and Acquisitions (M&A)
C) Export-based investment
D) Joint Ventures (JV)

4. Which type of FDI involves establishing new operations in a foreign country from the ground up?

A) Mergers and Acquisitions
B) Greenfield Investment
C) Joint Venture
D) Horizontal FDI

5. A company enters a foreign market by purchasing or merging with an existing company in that market. What type of FDI is this?

A) Greenfield Investment
B) Mergers and Acquisitions
C) Joint Venture
D) Vertical FDI

6. What is the main advantage of Greenfield Investment for a multinational corporation?

A) Quicker market entry
B) Greater control over operations
C) No need for new infrastructure
D) Immediate market share

7. A Joint Venture typically involves:

A) A single company investing on its own in a foreign country
B) Two or more firms combining resources to create a new entity in a foreign market
C) Acquiring an existing company in a foreign market
D) Exporting products to a foreign country

8. Which of the following is a vertical FDI example?

A) A company buys a local hotel chain to enter the hospitality business
B) A multinational buys a local retailer to sell its products
C) A company builds a factory in a foreign country to manufacture its products
D) A multinational invests in a raw material supplier in another country

9. Horizontal FDI primarily focuses on:

A) Securing raw materials
B) Expanding into new geographic markets with similar products
C) Building new factories in foreign countries
D) Reducing financial risk

10. What is one key benefit of Mergers and Acquisitions (M&A) for foreign companies?

A) Faster market entry
B) Lower costs of production
C) Avoidance of competition
D) Total market control

11. Which of the following is an example of conglomerate FDI?

A) A technology firm buying a steel production company
B) A car manufacturer building a new factory overseas
C) A fast-food chain entering a new market with its existing brand
D) A telecommunications firm buying a cable network

12. Which type of FDI is aimed at securing a stable supply of raw materials?

A) Horizontal FDI
B) Vertical FDI (upstream)
C) Greenfield Investment
D) Conglomerate FDI

13. A company that builds factories in different countries to produce goods locally for each market is engaging in:

A) Horizontal FDI
B) Vertical FDI
C) Greenfield Investment
D) Mergers and Acquisitions

14. Which of the following would most likely result in job creation in the host country?

A) A Greenfield Investment
B) A company's exclusive export strategy

C) An increase in local tariffs
D) A domestic company's international outsourcing

15. FDI helps to transfer technology and know-how primarily through:

A) Export strategies
B) Acquisitions and mergers
C) Import restrictions
D) Direct investment in local businesses and factories

16. The primary advantage of Mergers and Acquisitions (M&A) is:

A) Creating new market demand
B) Gaining immediate access to an established market and resources
C) Developing new technologies
D) Building new production plants

17. FDI in developing countries typically leads to improvements in:

A) Local tax regulations
B) Domestic savings rates
C) Infrastructure and employment opportunities
D) Local subsidies for foreign firms

18. A key advantage of Joint Ventures is:

A) Full control over the foreign business
B) Lower risk through shared investment and knowledge
C) Avoiding any financial risk
D) No need for market adaptation

19. What is horizontal FDI primarily aimed at?

A) Controlling resources in foreign markets
B) Expanding market share by offering similar products abroad
C) Establishing local production facilities
D) Acquiring competitive advantages in unrelated industries

20. Which of the following benefits does vertical FDI offer?

A) Immediate market access
B) Better integration of supply chain and resource control
C) Fewer financial risks
D) A faster return on investment

21. A company like McDonald's expanding globally by opening new franchises in foreign countries is an example of:

A) Horizontal FDI
B) Greenfield Investment
C) Joint Venture
D) Vertical FDI

22. What type of FDI would involve a firm building its own factories abroad?

A) Greenfield Investment
B) Mergers and Acquisitions

C) Joint Venture
D) Conglomerate FDI

23. Which type of FDI involves a foreign firm entering a market by partnering with a local company to create a new business entity?

A) Greenfield Investment
B) Mergers and Acquisitions
C) Horizontal FDI
D) Joint Venture

Answer: D) Joint Venture

24. An investor builds a factory in a foreign country to produce goods locally and sell them to consumers in that country. This is an example of:

A) Horizontal FDI
B) Vertical FDI
C) Greenfield Investment
D) Conglomerate FDI

25. A major benefit of conglomerate FDI is:

A) Immediate access to raw materials
B) Risk diversification by entering unrelated industries
C) Increased operational control
D) Expedited market entry

- **Answer the Following Question:**

1. Explain MNC and FDI in detail
2. Explain the scope of Multinational firms and FDI
3. Explain briefly about the Advantages of Multinational Company.
4. Write a note on Types of FDI
5. How FDI plays important role in International Business?
6. What are the features of MNC?

UNIT-8 INTERNATIONAL TRADE AND REGIONAL ECONOMIC INTEGRATION

8.1 Introduction

Companies involved in international marketing must deal with taxes, duties, or tariffs on goods bought from or sold in other countries. Being aware of multilateral and bilateral trade agreements between the home country and other nations is essential since these agreements affect the profitability of the business. Bilateral agreements are trade pacts made between two countries. Three or more nations take part in multilateral agreements. A country can be a part of a multilateral trade agreement while also participating in bilateral trade agreements with many other countries. Several agencies help smoothen the Internal Trade. For example, The World Trade Organisation (WTO) helps to negotiate the terms of a trade agreement, and once an agreement is established, it helps enforce the agreement. Global financial institutions like the International Monetary Fund (IMF) and the World Bank also facilitate international trade.

In today's interconnected world, international integration has become an important aspect of global trade and commerce. As countries strive to expand their markets and enhance economic growth, they increasingly recognize the importance of integrating their economies with other nations through various mechanisms such as regional trade agreements (RTAs) and international organizations like WTO, IMF and so on.

International economic integration refers to the process by which countries come together to reduce trade barriers and promote investment to facilitate the flow of goods, services, and capital across international borders. It involves the harmonization of economic policies, removal of economic and non-economic barriers and the establishment of common rules of trade and investment among nations. This integration can take different forms, ranging from preferential trade agreements between two or more countries to the establishment of global economic unions.

8.2 Regional Integration in International Trade

Regional economic integration refers to the process where countries within a specific geographic region (generally neighbour countries) work together to reduce trade barriers, promote trade and commerce within the region and initiate efforts to promote economic development within the region. Regional economic integration has enabled countries to focus on issues that are relevant to their stage of development as well as encourage trade between neighbours.

Few of the common integrations in place globally are as follows:

❖ **North American Free Trade Agreement (NAFTA)**

NAFTA was established in Jan 1994. It was implemented to promote trade among the United States, Canada, and Mexico. Lately, NAFTA has been terminated and replaced by the United States-Mexico-Canada Agreement (USMCA) in 2020.

It aimed to encourage economic activity among North America's three major economic powers. Its primary focus was to open and expand trade in the agricultural, automotive, and textile industries. Some of its objectives were:

- Reduction of trade barriers among member countries
- Creation of trade rules and regulations
- Improvement of working conditions of the labour
- Establishment of a safe market for North American goods and services
- Expansion of global trade and cooperation for North American goods and services.

The full text of the trade agreement consisted of 22 chapters, divided into eight sections. Each section aimed at facilitating trade within the North American Region and eliminating trade barriers. The most important provisions are discussed below.

- **Elimination of Trade Barriers**

One of the main goals of NAFTA was to eliminate most tariffs and other restrictions on trade among the three countries. The agreement also sought to eliminate non-tariff barriers to trade such as border processing and licensing requirements.

- **Intellectual Property Protections**

NAFTA also provided increased protection for intellectual property rights such as trade secrets and computer software. These protections increased the incentives for cross-border trade because they reduced the risk of losing business secrets to an international competitor.

- **Environmental and Labour Protections**

The Clinton administration negotiated several side agreements to ensure protections for the environment and labour rights under NAFTA. NAFTA's provisions were supplemented by two other regulations. The North American Agreement on Environmental Cooperation (NAAEC) and the North American Agreement on Labor Cooperation (NAALC) intended to prevent businesses from relocating to other countries to exploit lower wages, more lenient worker health and safety laws, and looser environmental regulations.

- **Dispute Resolution**

To further facilitate cross-border trade, the agreement included a dispute resolution process for disagreements among investors, businesses, and state governments.

1. Association of South-east Asian Nations (ASEAN)

In 1967 ASEAN was established by Thailand, Indonesia, Malaysia, the Philippines, and Singapore. ASEAN is one of the developing world's most successful regional economic cooperation zones. The initial aim was to encourage regional cooperation and create a collective front against the spread of Communism in Asian countries and create a stable political environment. ASEAN's economic integration efforts began with the creation of the ASEAN Free Trade Area (AFTA) in 1992, which successfully reduced tariffs between ASEAN's first members. Brunei, Darussalam, Vietnam, and Myanmar too joined ASEAN by the end of the 1990s making ASEAN a ten-member entity. In 2020 ASEAN joined China, Japan, Australia, South Korea, and New Zealand in signing the Regional Comprehensive Economic Partnership (RCEP), the largest trade agreement in history.

Some of the objectives of ASEAN are:

- create a single market and production base for member countries
- become a highly competitive economic region.
- promote equitable economic development within the region.
- fully integrate the region into the global economy.
- Promote cooperation in the political, economic, and social areas.

In 2007, the ten members adopted the ASEAN charter, a constitutional document that provided a legal status and institutional framework to ASEAN. The charter has laid down a blueprint for the community members. ASEAN is headed by a chair- a position that rotates annually among leaders of member-states.

An important fact that makes ASEAN stand out is the diversity of its members. From Singapore (a nation with highest GDP) to Myanmar (a nation with lowest GDP) are all a part of the same entity. Demographics differ across the region too. Various ethnicities are represented by ASEAN. For example, Cambodia is a Buddhist majority nation while Indonesia is a Muslim majority nation, Singapore and Vietnam have the most diversified religious groups.

ASEAN has benefited enormously from Asia's rise as a global centre of power and wealth. By balancing relationships with the U.S., China, India, and the European Union. However, challenges like climate change and political instability have caused frequent tensions among member countries. The prolonged issue of contention among member nations has been the claims of China over the South China Sea. Members like Vietnam, Brunei, Indonesia, and the Philippines claim features in waters contested with China. China's move to build artificial islands over the South China Sea was seen as a threat to national sovereignty by member nations. The United States, which has a strong interest in preventing China from claiming the South China Sea has extended support to other ASEAN countries and has even increased its maritime presence over the disputed region.

The COVID-19 pandemic created severe economic disruption in sectors such as industrial production and tourism; nonetheless, ASEAN coordinated a regional response to align economic recovery strategies and maintain open trade routes and set an exemplary example of integration in true sense.

2. European Union (EU)

Following World War 2 European leaders felt the need to integrate their efforts to achieve peace stability and development. Winston Churchill initially proposed the formation of the European Union. The first 6 countries to join were: France, Italy, Netherlands, Belgium, West Germany, and Luxembourg. These countries were abbreviated as BREXIT. Today, the European Union is a confluence of 27 European countries. The latest addition to EU has been Croatia taking the membership number to 28. UK made an exit from EU in 2020 making the membership number again to 27. EU was established in 1993 in Maastricht. The present headquarters of EU is in Brussels. The common principles and values that underlie EU are Freedom, Democracy, Equality and Peace.

European Union seeks to achieve the following objectives.

- To enhance political co-operation among member nations
- To enhance economic integration by creating a single currency the EURO.
- Unified foreign policy among member nations.
- Common Citizenship policy and rights.
- Increased co-operation in the areas of judiciary and immigration.
- To combat social exclusion and discrimination
- To achieve sustainable development with balanced growth and price stability.
- To promote scientific and technological progress.
- To respect the rich cultural diversity of member nations.

The European Union consists of 7 important decision-making bodies as listed below.

1. European Parliament
2. European Council
3. European Commission
4. Council of European Union
5. Court of Justice of EU
6. European Central Bank
7. European Court of Auditors.

European Parliament. The European Parliament forms one-half of the EU's legislative body. The parliament consists of 751 members, who are elected by popular vote in their respective countries. The term for each member is five years.

The purpose of the parliament is to debate and amend legislation proposed by the European Commission.

European Council. The European Council provides the political leadership for the EU. The European Council meets four times per year, and each member has a representative, usually the head of its government. Collectively it functions as the EU's "Head of State".

European Commission. The European Commission provides the day-to-day leadership and initiates legislation. It's the EU's executive arm.

Council of the European Union. The Council of the European Union functions as the other half of the EU's legislative body. It is sometimes called the Council or the Council of Ministers and should not be confused with the European Council above. The Council of the European Union consists of a government minister from each member country and its representatives may change depending on the topic being discussed.

Court of Justice. The Court of Justice makes up the judicial branch of the EU. Consisting of three different courts, it reviews, interprets, and applies the treaties and laws of the EU.

EU has developed an internal single market through a standardized system of laws where members have agreed to act as one. With respect to currency, 19 countries of 27 Nations use Euro as their currency. The EU works closely with India to promote peace, boost economic growth and enhance sustainable development across the region.

In 2007 India-EU EU Bilateral Trade and Investment Agreement (BTIA) was agreed upon. With this, it was expected of India and EU to remove trade barriers and boost FDI among all member nations. EU was India's largest trading partner in 2019-20 ahead of China and US. Thus, relations between EU and India have always been cordial and have been a win-win deal for both India and EU. However, Europe's economy faces a deeper recession and a slower recovery than the United States or other parts of the world. Because the EU's $18.4 trillion economy makes up 30 percent of the world economy, its poor prospects are likely to rebound on the United States, Asia, and other regions.

❖ **Pre-requisites for Integration**.

1. Embrace Openness and Liberalization:

One fundamental aspect of maximizing benefits from international economic integration is embracing openness and liberalization. By removing barriers to trade such as tariffs, quotas, and non-tariff barriers, countries can enhance market access and foster greater competition. This leads to increased efficiency, productivity, and innovation within domestic industries. For example, the European Union's single market has allowed member states to specialize in their comparative advantages, leading to higher overall economic growth.

2. Enhance Connectivity and Infrastructure:

To fully capitalize on international economic integration, countries must invest in Infrastructure. Efficient transportation networks, reliable logistics systems, and modernized ports facilitate the movement of goods and services across borders and reduce time delays.

3. **Strengthen Institutions and Governance:**

Effective institutions and good governance are crucial for harnessing the benefits of international economic integration. Transparent and predictable regulatory frameworks, and strong and efficient dispute resolution mechanisms instil confidence in investors and ensure cross border trade. The World Trade Organization (WTO) plays a key role in providing a rules-based system for international trade, ensuring fairness and stability among member countries.

4. **Inclusive Growth:**

While international economic integration can bring about economic growth, it is essential to ensure that the benefits are shared widely and contribute to equitable social development. Governments must adopt policies that promote inclusive growth, such as investing in education and healthcare, supporting small and medium-scale enterprises (SMEs), and implementing social safety nets. For example, the Nordic countries have successfully combined economic openness with strong welfare systems, resulting in high levels of social equality.

5. **Mitigate Risks and Address Disparities:**

International economic integration also presents risks and challenges that need to be managed effectively. Countries should estimate negative impacts on vulnerable sectors or regions through targeted policies, such as retraining programs for displaced workers or regional development initiatives. It is crucial to address disparities between countries and within societies to prevent marginalization and social unrest.

6. **Engage in Sustainable Development Practices:**

As the world faces pressing environmental challenges, it is imperative to integrate sustainable development practices into international economic integration efforts. This includes promoting green technologies and preserving biodiversity. The EU's Green deal aimed at achieving Carbon Neutrality by 2050, demonstrates the commitment to sustainability within the context of economic integration.

Maximizing benefits from international economic integration requires a comprehensive approach that encompasses openness, infrastructure development, innovation, good governance, inclusivity, risk mitigation, and sustainability. By embracing these principles and implementing appropriate policies, countries can reap the full potential of international economic integration, fostering economic growth, social development, and global prosperity.

8.3 Effects of Regional Economic Integration

The Effects of Regional Economic Integration are both positive and negative.

The positive effects of Regional Economic Integration are:

1. Expanded Market Opportunities: Through economic integration, countries gain access to larger markets, both domestically and internationally. This allows business units to access a larger customer base, leading to increased sales and revenue. Moreover, it encourages competition, which drives innovation and improves product quality thus leading to a healthy market driven by consumer preferences.

2. Liberalisation of Trade and Economic policies: International economic integration often involves the reduction or elimination of trade barriers between countries such as tariffs and quotas. This facilitates the flow of goods and services across borders, promoting trade and commerce. No country can produce all goods and services. Therefore, with limited resources countries tend to focus on producing goods and services where they have comparative advantage. The rest of the goods are imported from other countries.

3. Foreign Direct Investment (FDI): Economic integration attracts foreign direct investment, as it creates a more favourable business environment where Investors are encouraged to drive financial resources to countries that offer access to larger markets, stable institutions, and transparent regulations. With FDI comes capital, technology, and expertise, boosting overall economic growth and job opportunities.

4. Economies of Scale: when countries produce all required goods and services within the boundaries of the nation, some resources will be underutilized while others may be overutilized based on the demands of goods and services. This phenomenon prevents the countries to achieve economies of scale which is achieved when resources are used optimally. Economic Integration allows for the pooling of resources and the realization of economies of scale. By combining production capacities and sharing infrastructure, countries can produce goods more efficiently and at lower costs.

5. Regional Cooperation: Economic integration often takes the form of regional trade agreements, such as free or liberal trade agreements. These agreements promote cooperation among member countries, fostering cordial relations and political stability. By working together, countries then address common challenges, such as environmental issues or security concerns, more effectively working hand in hand.

6. Knowledge and Technology: Transfer: Economic Integration facilitates the exchange of knowledge, technology, and best practices among countries. It also encourages collaborative efforts in Research and Development as well as Technology development. Shared knowledge leads to breakthrough inventions in several fields benefitting mankind at large.

7. Better Resilience: Economic integration builds better resilience among countries to withstand economic shocks. By diversifying trade partners and markets, countries reduce their dependence on a single country for the provision of smooth trade. This diversification helps mitigate the impact of economic downturns or disruptions faced by specific sectors and countries.

The negative effects involved in creating regional agreements include the following:

- **Trade diversion.** The flip side to trade creation is trade diversion. Member countries may trade more with each other than with non-member nations. This may mean increased trade with a less efficient or more expensive producer because it is in a member country. In this sense, weaker companies can be protected inadvertently with the bloc agreement acting as a trade barrier. In essence, regional agreements have formed new trade barriers with countries outside of the trading bloc.
- **Employment shifts and reductions.** Countries may move production to cheaper labour markets in member countries. Similarly, workers may move

to gain access to better jobs and wages. Sudden shifts in employment can disrupt markets.

- **Loss of national sovereignty.** With each new round of discussions and agreements within a regional bloc, nations may find that they must give up more of their political and economic rights.

8.4 Levels of Economic Integration

Levels of regional economic integration involve two or more countries agreeing to reduce trade barriers and increase economic cooperation for mutual benefit. There are different levels or stages of regional integration that countries can pursue, based on how deeply they want to integrate their economies. The concept of regional economic integration stems from the ideas of comparative advantage and mutual gains from trade. By reducing trade barriers with neighbouring countries that have complementary economies, nations can specialize in what they produce most efficiently and import what they need from regional partners. This leads to higher trade volumes, economic growth, and development opportunities. Following are the levels of Economic Integration.

- **Preferential Trading Area**: Countries agree to reduce tariffs and quotas on imports from member countries, but each country retains its own trade policies towards non-member nations. There is limited cooperation and no formal institutions are established. Examples are the ASEAN Free Trade Area and the Latin American Integration Association.
- **Free Trade Area**: Member countries eliminate all tariffs, quotas, and non-tariff barriers on trade between themselves. Each country has independent trade policies towards non-members. Common rules of origin are agreed to prevent trade deflection. A free trade agreement establishes legal and institutional frameworks. Examples are NAFTA and Mercosur.
- **Customs Union**: In addition to free trade, member countries adopt a common external tariff and have a common trade policy towards non-members. This harmonizes the members' commercial policies and allows for integrated planning of trade with outsiders. The European Coal and Steel Community (1952) evolved into the EU customs union.
- **Common Market**: Goes beyond a customs union by allowing free movement of factors of production - capital, labour, services, and technology - across borders. Common institutions regulate competition and coordinate macroeconomic policies. Examples are the EU common market and EEC.
- **Economic Union**: Members establish full economic integration through a single market with coordinated fiscal, budgetary and monetary policies. A common currency may be introduced. This allows for policies to be harmonized across the whole region. The EU aims to become a fuller economic union.
- **Complete Economic Integration**: Full economic and political union is achieved. Member countries surrender national sovereignty to supranational institutions. A permanent legal and institutional framework is established. Examples would include federal states like the US or autonomies within countries. The EU approximates this level in some ways.

In summary, the higher the level of integration, the greater the benefits but also the costs in terms of national autonomy and flexibility. Nations must weigh these trade-offs according to their needs and objectives.

8.5 Benefits of Economic and Monetary Integration

The benefits of economic integration are many and are analogous to the benefits of international trade.

1. Efficient use of resources

Economic integration leads to economies of scale, saving money and energy for all group members and improving management efficiency.

2. Beneficial for Producers as well as Consumers

It benefits producers and consumers since a more significant number of producers can sell their goods to more customers without being concerned about trade restrictions.

Traders can also earn more profits because manufacturers expand their output to cater to a broad market, which ultimately results in economies of scale. The consumers benefit as they obtain the product at a lower price. Hence, all players in the economic cycle get their fair share while monopoly breaks and healthy competition exists.

3. Job opportunities

When trade regulations are relaxed, and the economy becomes an Open Economy, labour from the member nations may find work not just in their native country but also in other countries. In a nutshell, regional and or economic integration removes barriers between nations and guarantees that people have plenty of job possibilities in the countries involved.

Countries can gain benefits such as increased trade, economic growth, and improved political relationships from economic integration.

4. Increased Trade

Economic integration can lead to a significant increase in trade between member countries. This is primarily due to the reduction or elimination of trade barriers such as tariffs and quotas. As a result, goods and services can move more freely between countries, leading to an increase in the volume of trade. This can stimulate economic growth as businesses have access to larger markets and can benefit from economies of scale. For example, the European Union, one of the most integrated economic regions, has seen a substantial increase in intra-regional trade since its formation.

5. Improved Growth Rate

Economic integration can also stimulate economic growth directly. By creating a larger, unified market, integration can attract more foreign direct investment (FDI). FDI can lead to the transfer of technology and skills, boosting productivity and economic growth. Moreover, economic integration can lead to increased competition, which can drive innovation and efficiency, further promoting economic growth.

6. Improved Political Relationships

Improved political relationships are another potential benefit of economic integration. By fostering economic interdependence, integration can reduce the likelihood of conflict between member countries. This is because the economic costs of conflict are likely to outweigh any potential benefits. Furthermore, economic integration can lead to increased cooperation on other issues, such as environmental policy or human rights, promoting regional stability and cooperation.

7. Innovation and Technology Transfer

International economic integration provides opportunities for knowledge sharing, technology transfer, and innovation diffusion. Collaborative Research projects, joint ventures, and foreign direct investment (FDI) can promote the exchange of ideas and technologies between countries. For instance, multinational corporations often establish research centres in different regions to tap into local expertise and adapt products to suit specific markets.

8.6 Economic Implications

Overall, global businesses have benefited from the regional trade agreements by having more consistent criteria for investment and trade as well as reduced barriers to entry. Companies that choose to manufacture in one country find it easier and cheaper to move goods between member countries in that trading bloc without incurring tariffs or additional regulations.

The challenges for businesses include finding themselves outside of a new trading bloc or having the "rules" for their industry change because of new trade agreements. Over the past few decades, there has been an increase in bilateral and multilateral trade agreements. It's often called a "spaghetti bowl" of global bilateral and multilateral trade agreements because the agreements are not linear strands lining up neatly; instead, they are a messy mix of crisscrossing strands, like a bowl of spaghetti, that link countries and trading blocs in self-benefiting trading alliances. Businesses must monitor and navigate these evolving trade agreements to make sure that one or more agreements do not negatively impact their businesses in key countries. This is one reason why global businesses have teams of in-house professionals monitoring the WTO as well as the regional trade alliances.

For example, American companies doing business in one of the ASEAN countries often choose to become members of the US–ASEAN Business Council, so that they can monitor and possibly influence new trade regulations as well as advance their business interests with government entities.

The US–ASEAN Business Council is the premiere advocacy organization for U.S. corporations operating within the dynamic Association of Southeast Asian Nations (ASEAN). ASEAN represents nearly 600 million people and a combined GDP of USD $1.5 trillion across Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam. The Council's members include the largest U.S. companies working in ASEAN, and range from newcomers to the region to companies that have been working in Southeast Asia for over 100 years. The Council leads major business missions to key economies; convenes multiple meetings with ASEAN heads of state and ministers; and is the only U.S. organization to be given the privilege of raising member company concerns in consultations with the ASEAN Finance and Economic Ministers, as well as with the ASEAN Customs Directors-General at their annual meetings. Having long-established personal and professional relationships with key ASEAN decision makers, the Council can arrange genuine dialogues, solve problems, facilitate opportunities in all types of market conditions, and provide market entry and exclusive advisory services.

While other countries and the EU have ongoing dialogues with ASEAN, the US–ASEAN Business Council is the most formal approach.

Thus, if implemented well regional blocs can bring equitable growth and development and benefit all member nations with liberal trade. However, it is equally important to address the challenges involved in integration such as a threat to national sovereignty, mitigation of minority interest, and the like.

❖ Keywords

Integration, Bloc, European Union, ASEAN, NAFTA, WTO, Free-trade, Co-operation, Tariffs, Agreements, Global Economy.

❖ Exercise

1. Discuss the formation of ASEAN and its economic implications.
2. How has European Union emerged as one of the most powerful blocs? Discuss this with reference to its management and features.
3. Discuss the challenges faced by ASEAN bloc with respect to China's claims over South China Sea.
4. Discuss the negative effects of the economic integration.
5. Discuss the benefits of economic integration.
6. What are the Pre-requisites for economic integration? Discuss in detail with examples.

UNIT-9 SUBSIDIES, ANTI-DUMPING, COUNTERVAILING DUTIES

9.1 Introduction

In international trade, countries employ various measures to regulate the flow of goods and services across their borders. These measures are generally categorized into tariff and non-tariff barriers.

Tariffs are taxes or duties imposed on imported goods, making them more expensive and thereby less competitive in the domestic market. This tool is commonly used to protect local industries from foreign competition, generate revenue for the government, or influence trade relationships.

On the other hand, non-tariff barriers refer to a variety of regulatory or policy measures, other than tariffs, that countries use to control the volume of trade. These can include quotas, import licensing, customs procedures, health and safety standards, and subsidies, among others. Non-tariff barriers are often seen as more subtle but equally effective in restricting trade and protecting domestic industries.

Two important measures in the realm of non-tariff barriers are subsidies and anti-dumping regulations. Subsidies involve financial assistance from the government to local businesses to make their products more competitive internationally. Anti-dumping and countervailing duties are trade defense instruments used to protect domestic industries from unfair trade practices, such as foreign goods being sold below cost (dumping) or foreign governments providing subsidies to their exporters. These measures are designed to ensure fair competition and prevent market distortion caused by unfair trade practices.

❖ Subsidies

Subsidies refer to financial assistance or benefits provided by governments to domestic industries or businesses to help improve their competitiveness, promote economic development, or achieve certain social or environmental goals. Governments provide subsidies in various forms, including direct cash grants, tax breaks, low-interest loans, and even government-provided goods and services at below-market rates. The aim of subsidies is often to lower production costs for domestic producers, making their products more competitive in both domestic and international markets.

While subsidies can support economic growth by fostering the development of new industries or enhancing the competitiveness of existing ones, they can also create trade distortions. When governments provide financial support to their domestic industries, it can lead to unfair competition in international markets, as foreign competitors may not receive similar assistance. This may result in market imbalances and can be perceived as an unfair advantage in global trade.

Example: A common example of subsidies is seen in the agricultural sector. In the United States and European Union, governments provide subsidies to local farmers in the form of direct payments or price supports. These subsidies help keep the prices of locally produced agricultural goods competitive by lowering production costs, even though the market price of these goods may not reflect the true cost of production. Such subsidies can make it difficult for farmers in developing countries to compete on the international market.

❖ **Anti-Dumping Measures**

Dumping is a practice where a company exports goods at a price lower than the price it charges in its domestic market, or even below its cost of production, to gain market share in the importing country. Dumping can harm domestic industries in the importing country by undercutting local producers, potentially driving them out of business or severely reducing their market share. As a result, dumping can lead to market distortions and unfair competition in international trade.

To combat this issue, governments often impose anti-dumping duties—additional tariffs on imports that are found to be dumped. These duties are designed to raise the price of dumped goods, bringing them in line with the fair market price, thereby protecting domestic industries from being unfairly undercut. Anti-dumping measures aim to restore fair competition by ensuring that imports are priced in a way that reflects their true cost of production and the competitive dynamics of the market.

Example: A well-known case of anti-dumping measures occurred between the European Union and China regarding solar panels. In 2013, the European Union imposed anti-dumping duties on Chinese solar panels, after it was determined that Chinese manufacturers were selling panels at prices much lower than their production costs in Europe. This was seen as a threat to European solar panel manufacturers, leading to the imposition of tariffs to protect the local industry.

❖ **Countervailing Duties (CVDs)**

Countervailing duties (CVDs) are tariffs that are imposed on imported goods that are found to be benefiting from subsidies in their country of origin. These duties are designed to neutralize the impact of such subsidies and ensure that the imported goods do not have an unfair price advantage in the importing country's market. CVDs are typically imposed after an investigation confirms that the subsidized goods are causing harm to domestic industries, such as by displacing local products or creating unfair price competition.

CVDs are an essential trade remedy tool used by governments to address unfair trade practices, especially when products are being sold in foreign markets at artificially low prices due to government support. By imposing CVDs, a country aims to level the playing field and protect domestic producers from the negative impacts of subsidized imports.

Example: One notable example of countervailing duties was the U.S. action against Indian steel producers. In 2016, the U.S. imposed countervailing duties on Indian steel imports after it was determined that the Indian government was providing substantial subsidies to its steel industry. The U.S. investigation found that these subsidies were allowing Indian producers to sell steel at lower prices, thus harming U.S. steel manufacturers. The U.S. imposed CVDs on Indian steel to counteract this unfair advantage and protect the domestic industry.

Together, these trade policies help maintain fair competition in global markets by preventing distortions caused by unfair pricing and government support.

❖ **Why study these? / Importance**

By studying these topics, stakeholders—including policymakers, business leaders, economists, and legal experts—can make better-informed decisions that promote fair and sustainable global trade.

1. **Ensuring Fair Trade**

   Understanding these trade measures helps in maintaining a level playing field in international markets. By addressing unfair pricing and government interventions, businesses and policymakers can ensure that competition is based on efficiency and innovation rather than artificial advantages.

2. **Protecting Domestic Industries**

   Many domestic industries suffer due to foreign competitors selling goods at artificially low prices (dumping) or benefiting from government subsidies. Studying these concepts helps in designing effective policies to shield local businesses from such unfair trade practices.

3. **Compliance with International Trade Laws**

   The World Trade Organization (WTO) and regional trade agreements have specific rules regarding subsidies, anti-dumping measures, and countervailing duties. A thorough understanding of these topics ensures compliance with global trade regulations, preventing potential trade disputes or sanctions.

4. **Economic Policy and Decision-Making**

   Governments and businesses need to make informed decisions regarding trade policies, tariffs, and market interventions. Knowledge of these concepts aids in crafting effective economic strategies that balance domestic industry support and global trade commitments.

5. **Preventing Trade Wars and Disputes**

   Unfair trade practices can lead to retaliatory measures, escalating into trade conflicts. A proper grasp of these mechanisms helps policymakers and trade negotiators resolve disputes amicably through legal frameworks rather than aggressive trade barriers.

6. **Consumer Impact and Market Stability**

   Dumping and excessive subsidies can lead to unstable markets, affecting both producers and consumers. Understanding these trade policies ensures that consumers get fair prices while preventing monopolistic or predatory pricing practices that could harm long-term market health.

7. **Global Competitiveness**

   Businesses engaged in international trade need to be aware of anti-dumping and countervailing duties to adjust their pricing and supply chain strategies. This knowledge helps firms remain competitive in foreign markets while avoiding legal and financial penalties.

9.2 Types Of Duties

Each of these duties, discussed below, plays a significant role in shaping international trade policies, protecting domestic industries, and maintaining fair competition in global markets.

1. **Basic Customs Duty (BCD)** – This is a standard tax imposed on imported goods at the time of entry into a country. It is levied to generate government revenue and protect domestic industries from excessive foreign competition. The rate of duty varies depending on the type of goods and the trade agreements between countries. For example, a country may impose a **10% customs duty** on imported automobiles to promote its local car manufacturing industry.
2. **Anti-Dumping Duty (ADD)** – This duty is applied to imported goods that are sold below their normal value, often below production costs, to eliminate competition in the importing country. It helps protect domestic industries from unfair trade practices. For instance, if China exports steel at an extremely low price, harming U.S. steel producers, the U.S. may impose an anti-dumping duty to neutralize the price advantage.
3. **Countervailing Duty (CVD)** – A countervailing duty is imposed to offset subsidies granted by a foreign government to its exporters, preventing unfair competition. It ensures that imported goods do not benefit from artificial cost reductions due to government aid. For example, if Indian textile exporters receive government subsidies, the EU may impose a CVD to bring imported textiles to a fair market value.

4. **Safeguard Duty** – This is a temporary duty imposed when a sudden increase in imports threatens the survival of domestic industries. Unlike anti-dumping duties, safeguard duties apply even if the imports are fairly priced but still cause economic harm. For instance, a country may impose a **20% safeguard duty o**n imported solar panels to help its local manufacturers adjust to the competition.
5. **Specific Duty** – A specific duty is a fixed amount charged per unit of imported goods, regardless of their price. This type of duty simplifies tax calculations and prevents undervaluation of goods for duty evasion. For example, a country may impose a **$5 per liter** duty on imported wine,

meaning that all wine imports are taxed the same amount regardless of their actual price.

6. **Ad Valorem Duty** – This is a percentage-based duty imposed on the total value of imported goods, adjusting automatically with price changes. It ensures fair taxation in proportion to the value of goods. For instance, a country may impose a **15% ad valorem duty** on imported luxury handbags, meaning that a $1,000 handbag incurs a $150 tax, while a $500 handbag incurs a $75 tax.
7. **Protective Duty** – This duty is imposed to protect domestic industries from foreign competition, usually in strategic or developing sectors. By making imported goods more expensive, it encourages local production and self-reliance. For example, India imposes a **protective duty on electronic goods** to support its domestic electronics industry under the "Make in India" initiative.
8. **Revenue Duty** – A duty imposed primarily to generate government revenue rather than to protect local industries. It is often applied to essential or widely consumed goods to ensure a steady flow of income for public services. For example, many countries impose **a duty on imported petroleum products** as a key revenue source for infrastructure and development projects.
9. **Retaliatory Duty** – This duty is imposed in response to high tariffs or trade restrictions imposed by another country. It is often used as a countermeasure in trade disputes to push for fairer trade relations. For example, if the European Union imposes tariffs on American technology products, the U.S. might impose retaliatory duties on European cars in response.
10. **Export Duty** – Unlike import duties, an export duty is imposed on goods leaving a country. It is used to control the export of critical resources, prevent shortages, or stabilize domestic prices. For instance, a country may impose an **export duty on crude oil** to ensure that more of the resource is available for domestic consumption rather than being sold abroad.
11. **Transit Duty** – This is a duty imposed on goods passing through a country en route to their final destination. It is usually applied in cases where the country incurs costs for infrastructure use or wishes to generate revenue from trade routes. For example, a country with a major shipping canal may charge a **transit duty** on goods transported through its waters.
12. **Compensatory Duty** – A duty imposed to offset tax advantages or incentives granted to exporters by their home countries. It ensures that domestic businesses do not suffer due to foreign tax breaks. For example, if a country provides a **15% tax rebate to its electronics manufacturers**, another country importing these electronics may impose a **compensatory duty** to level the playing field.

9.3 Anti-Dumping Actions

Dumping occurs when a company exports goods to another country at a price lower than their normal value, often below the cost of production or the price in the exporter’s home market. This practice can harm domestic industries by undercutting local producers and driving them out of business. To counter this, governments impose anti-dumping duties—tariffs specifically designed to neutralize the unfair pricing advantage and restore fair competition.

Anti-dumping actions are legal measures taken by governments to investigate and address instances of dumping. These actions typically involve a thorough investigation, verification of harm to domestic industries, and the imposition of duties if necessary.

❖ Legal Framework for Anti-Dumping Actions

Anti-dumping actions are governed by international trade agreements, primarily under the World Trade Organization (WTO). The WTO Anti-Dumping Agreement (ADA) provides a legal framework for identifying and responding to dumping practices. Key principles include:

- A formal investigation must be conducted before imposing anti-dumping duties.
- Proof is required that dumping is causing or threatening material injury to domestic industries.
- The duties, imposed, should not exceed the margin of dumping (the difference between the normal value and export price).
- Affected exporters have the right to present their case and seek legal recourse.

Many countries also have their own national laws and trade authorities, such as:

- U.S. International Trade Commission (ITC) and Department of Commerce (United States)
- Directorate General of Trade Remedies (DGTR) (India)
- European Commission's Trade Directorate (European Union)

❖ Process of Anti-Dumping Investigations

The process for initiating anti-dumping actions generally follows these steps:

1. Filing of Complaint

The anti-dumping process begins when domestic industries or trade associations believe that foreign competitors are selling goods at unfairly low prices, causing damage to local producers. The affected industry submits a formal complaint to the relevant government authority, such as:

- U.S. Department of Commerce (DOC) and U.S. International Trade Commission (ITC) (United States)
- Directorate General of Trade Remedies (DGTR) (India)
- European Commission's Directorate-General for Trade (EU)

❖ Requirements for a Valid Complaint:

- Proof that the export price is lower than the normal value in the exporting country.

- Evidence that the dumping is causing injury to the domestic industry.
- Industry representation: The complaint must be supported by a significant portion (at least 25-50%) of the domestic producers in the affected industry.

2. Preliminary Investigation

Once the complaint is accepted, the investigating authority examines whether there is sufficient evidence to proceed with a full investigation.

❖ Key Actions in Preliminary Investigation:

- Request for detailed pricing and production cost data from both domestic and foreign manufacturers.
- Issue questionnaires to importers, exporters, and local producers to gather trade and pricing data.
- Verify data submitted by foreign exporters to ensure accuracy.
- Conduct public hearings where stakeholders (importers, exporters, local businesses) present their views.

❖ Possible Outcomes:

- If sufficient evidence of dumping is found, a full investigation is launched.
- If evidence is weak, the case may be dismissed.

Example:

If India's DGTR finds that Chinese solar panels are being dumped but the impact on local industries is unclear, they may request more data before proceeding.

3. Determination of Dumping Margin

Once a full investigation begins, authorities calculate the dumping margin, which is the difference between the export price and the normal value of the product in the exporter's home market.

❖ Methods of Calculation:

1. Comparison with the domestic market price – If the same product is sold at a higher price in the exporter's country, the price difference is considered dumping.
2. Comparison with production costs + profit margin – If the product is sold below cost, authorities calculate what the fair price should be.
3. Third-country comparison – If reliable pricing data is unavailable in the exporter's country, a similar market is used for reference.

4. Assessment of Injury

The next step is to determine whether the dumping is causing significant harm to domestic industries.

❖ Factors Considered in Injury Assessment:

- Financial losses in the affected domestic industry.
- Declining sales and market share of local producers.
- Job losses in the domestic sector.
- Reduced investment and capacity utilization in local industries.
- Price suppression (domestic firms forced to lower their prices).

Authorities analyze trade data, financial statements, and economic indicators over the last 3-5 years to establish patterns.

Example:

If U.S. steel mills report a 20% drop in revenue and layoffs of 5,000 workers due to cheap Chinese steel imports, authorities will confirm injury.

5. Provisional Measures

If the preliminary findings indicate substantial harm, the investigating authority may impose provisional anti-dumping duties for up to six months while the investigation continues.

❖ Key Features of Provisional Measures:

- Used to prevent further injury to domestic industries while the investigation is ongoing.
- Temporary duties are based on preliminary dumping margin calculations.
- Provisional measures can be refunded if the final investigation does not confirm dumping.

Example:

If the EU suspects China is dumping electric bicycles, they may impose temporary duties of 15% for six months while completing their investigation.

6. Final Decision and Duty Imposition

After 6-12 months, the investigating authority makes a final determination. If both dumping and injury are confirmed, definitive anti-dumping duties are imposed.

❖ Final Actions:

- Impose definitive anti-dumping duties (lasting 5 years, subject to review).
- Negotiate a price undertaking, where the exporter agrees to increase prices instead of facing duties.
- Terminate the case if evidence is insufficient.

The final decision is published in government trade notices, and affected parties can challenge it in domestic courts or the WTO dispute resolution mechanism.

Example:

If India confirms that Chinese tires are being dumped at 30% below cost, it may impose a 30% anti-dumping duty for five years to protect its tire manufacturers.

- **Types of Anti-Dumping Duties**

Based on the investigation, different types of anti-dumping duties may be imposed:

- Provisional Duties – Temporary tariffs applied while investigations are ongoing.
- Definitive Duties – Long-term duties applied after a full investigation, generally lasting five years.
- Price Undertakings – Instead of duties, exporting companies may agree to increase their prices to avoid harming domestic producers.

- **Impact of Anti-Dumping Actions**

Positive Effects:

- Protects domestic industries from unfair foreign competition.
- Encourages fair trade and prevents monopolistic practices.
- Helps sustain local employment and industrial growth.

- Negative Effects:

- Can increase prices for consumers and businesses relying on imports.
- May lead to trade retaliation from affected countries.
- Investigations and legal processes can be time-consuming and costly.

Thus, Anti-dumping actions play a crucial role in maintaining fair trade and protecting domestic industries from unfair foreign competition. However, they must be implemented carefully to balance the interests of consumers, producers, and international trade relations. Proper enforcement through WTO guidelines and national laws ensures that anti-dumping measures remain a tool for fair competition rather than a means of trade protectionism.

9.4 Subsidies And Countervailing Measures

In international trade, subsidies and countervailing measures play a crucial role in shaping competitive dynamics between countries. A subsidy is financial assistance provided by a government to domestic industries to support production, exports, or specific economic activities. While subsidies can enhance economic growth and job creation, they can also distort trade by giving domestic producers an unfair advantage over foreign competitors.

To counteract the effects of subsidies that harm international competition, countervailing measures (such as countervailing duties) are imposed by importing countries to neutralize the impact of subsidized imports. These measures help restore fair competition and prevent market distortions caused by government-backed price reductions.

The World Trade Organization (WTO) regulates subsidies and countervailing measures through the Agreement on Subsidies and Countervailing Measures (SCM Agreement) to ensure that trade remains fair and non-discriminatory.

❖ Understanding Subsidies

A subsidy is any financial contribution made by a government or public body that provides an advantage to a specific industry or company. These benefits can take various forms, including direct payments, tax breaks, low-interest loans, or government-provided goods and services.

❖ Types of Subsidies

A. Direct and Indirect Subsidies

1. Direct Subsidies – These involve direct financial aid from the government, such as cash grants, to support industries.
    - Example: A government provides $500 million in direct aid to farmers to boost agricultural output.
2. Indirect Subsidies – These include benefits like tax reductions, low-interest loans, or government-provided infrastructure.
    - Example: A country offers zero-interest loans to domestic industries to lower production costs.

B. Export and Domestic Subsidies

1. Export Subsidies – Financial assistance provided specifically to boost exports, allowing companies to sell goods overseas at lower prices.
    - Example: China provides tax rebates to solar panel manufacturers to make exports more competitive.
2. Domestic Subsidies – Support given to local industries to help them compete with foreign imports without necessarily promoting exports.
    - Example: The U.S. government subsidizes corn production to keep prices stable for domestic consumers.

C. Prohibited and Actionable Subsidies (as per WTO SCM Agreement)

1. Prohibited Subsidies – These are subsidies that directly distort trade and are strictly banned by the WTO.
    - Example: A country giving a rebate on export taxes only to companies that export a certain percentage of their goods.
2. Actionable Subsidies – These subsidies are allowed but can be challenged if they harm other countries' industries.
    - Example: If a government offers low-interest loans to a local steel industry, foreign competitors can challenge it if they suffer losses.

❖ Impact of Subsidies on International Trade

Positive Effects:

- Encourages economic growth and supports industries.
- Protects employment in strategic sectors.
- Helps lower prices for consumers.

Negative Effects:

- Creates unfair trade advantages over foreign competitors.
- Leads to overproduction, which can destabilize global markets.
- May cause trade disputes and retaliation from other nations.

Example: The U.S.-China trade war partly stemmed from U.S. concerns over China's subsidies to industries like telecommunications and steel, which were seen as unfair competition.

❖ Understanding Countervailing Measures

Countervailing measures are tariffs or duties imposed by an importing country to offset the effects of foreign subsidies that harm domestic industries. These are designed to neutralize unfair competition and prevent domestic producers from being driven out of business by artificially cheap imports.

❖ Legal Framework (WTO Rules on Countervailing Measures)

Under the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement), countervailing measures can only be imposed if:

- A subsidy exists, and it is provided by a foreign government.
- The subsidy causes material injury to the domestic industry of the importing country.
- There is a clear causal link between the subsidy and the injury.

❖ Process of Imposing Countervailing Duties (CVDs)

Step 1: Filing a Complaint

- Domestic industries submit a complaint to their national trade authority, proving that foreign subsidies are causing harm.
- Example: U.S. steel manufacturers file a case claiming that subsidized Chinese steel is damaging their business.

Step 2: Preliminary Investigation

- Authorities examine whether sufficient evidence exists to justify an investigation.
- Importers and exporters are asked to submit data on pricing and production costs.

Step 3: Final Investigation and Injury Determination

- Authorities analyse financial reports, trade data, and price trends to determine if domestic industries are suffering losses.
- Example: If U.S. authorities find that domestic steel producers lost 30% of market share due to cheaper Chinese imports, injury is confirmed.

Step 4: Imposition of Countervailing Duties

- If injury is proven, countervailing duties (CVDs) are imposed, usually lasting five years.
- Example: The EU imposes a 25% countervailing duty on subsidized Chinese electric vehicles to protect European car manufacturers.

Step 5: WTO Dispute Resolution (If Challenged)

- The exporting country can challenge the CVDs at the WTO.
- If the WTO finds the duties unjustified, it can order their removal.

❖ **Examples of Countervailing Measures in Practice**

1. **U.S. vs. China (Steel Subsidies, 2018)**
    - The U.S. imposed countervailing duties up to 50% on Chinese steel products, arguing that China's government subsidies led to unfairly low prices in global markets.
2. **EU vs. India (Textile Subsidies, 2019)**
    - The EU investigated India's subsidies to textile manufacturers and imposed countervailing duties on Indian textile imports to support European producers.
3. **Canada vs. U.S. (Softwood Lumber Dispute, 2021)**
    - Canada challenged the U.S.'s countervailing duties on Canadian softwood lumber, leading to a WTO dispute over whether Canadian government subsidies were unfair.

Subsidies are powerful economic tools that governments use to support domestic industries, but they can also distort international trade if used excessively. Countervailing measures, such as countervailing duties, help level the playing field by neutralizing the advantages created by subsidies. However, they must be implemented carefully under WTO guidelines to avoid trade wars and economic retaliation.

9.5 Keywords

1. **Subsidy** – A financial benefit provided by the government to support domestic industries and enhance competitiveness.

2. **Countervailing Duties (CVDs) –** Tariffs imposed on subsidized imports to neutralize unfair trade advantages.

3. **Anti-Dumping Duty –** A tariff imposed on foreign goods sold below fair market value to prevent market distortion.

4. **Dumping Margin –** The difference between the normal value of a product and its export price, used to determine anti-dumping duties.

5. **SCM Agreement –** The WTO Agreement on Subsidies and Countervailing Measures, which regulates government subsidies and their impact on trade.

6. **Prohibited Subsidies –** Subsidies that directly distort trade, such as export-contingent financial assistance, and are banned under WTO rules.

7. **Actionable Subsidies –** Subsidies that may be challenged if they harm foreign competitors but are not outright prohibited.

8. **Preliminary Investigation –** The initial phase of an anti-dumping or countervailing duty case to determine if further inquiry is needed.

9. **Final Determination –** The conclusion of an investigation that confirms whether subsidies or dumping have caused material injury to domestic industries.

10. **WTO Dispute Resolution –** A legal process where the WTO mediates trade disputes between countries regarding unfair trade practices.

❖ Exercises

- **Fill in the blanks:**

1. A subsidy is a financial contribution provided by a __________ to domestic industries to support production, exports, or economic activities.
2. The WTO regulates subsidies and countervailing measures through the __________ Agreement.
3. __________ subsidies are strictly prohibited by the WTO as they directly distort trade.
4. Countervailing duties are imposed to offset the impact of __________ imports.
5. The process of imposing countervailing duties begins with the filing of a __________ by domestic industries.
6. A dumping margin is calculated by comparing the __________ price with the normal value.
7. Provisional anti-dumping duties can be imposed for up to __________ months during the investigation.

8. The final anti-dumping duties usually last for __________ years but are subject to review.
9. The U.S. imposed countervailing duties on Chinese __________ in 2018 due to government subsidies affecting global prices.
10. The EU imposed countervailing duties on Indian __________ exports to protect European producers.

- **Answers**

1. Government
2. SCM (subsidies and countervailing measures)
3. Prohibited
4. Subsidized
5. Complaint
6. Export
7. Six
8. Five
9. Steel
10. Textile

- **True or False Statements:**

1. The WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement) allows all types of subsidies without restrictions.
2. Countervailing duties are imposed to neutralize the effects of foreign government subsidies on imported goods.
3. Export subsidies are financial assistance provided to boost domestic consumption only.
4. Anti-dumping duties and countervailing duties serve the same purpose in international trade.
5. A preliminary investigation is conducted before imposing countervailing duties to determine if a subsidy is causing injury to domestic industries.
6. The dumping margin is calculated by comparing the export price to the normal value of the product.
7. Prohibited subsidies under the WTO are those that unfairly distort trade, such as export subsidies tied to export performance.
8. Provisional anti-dumping duties can last for up to five years before a final decision is made.

9. If a countervailing duty is found to be unjustified, the WTO can order its removal.
10. The U.S. imposed countervailing duties on Chinese steel products in 2018 due to concerns over government subsidies.

- **Answers**

1. **False** – The WTO has strict regulations on prohibited and actionable subsidies.
2. **True** – Countervailing duties aim to offset unfair advantages created by foreign subsidies.
3. **False** – Export subsidies are meant to promote exports, not domestic consumption.
4. **False** – While both deal with unfair trade practices, anti-dumping duties address **pricing below market value**, while countervailing duties address **government subsidies**.
5. **True** – A preliminary investigation is necessary before imposing countervailing duties.
6. **True** – The dumping margin is determined by comparing the export price with the normal value.
7. **True** – Prohibited subsidies include those tied to export performance or local content requirements.
8. **False** – Provisional anti-dumping duties can last **up to six months**, not five years.
9. **True** – The WTO has a dispute resolution process that can order the removal of unjustified countervailing duties.
10. **True** – The U.S. imposed countervailing duties on Chinese steel due to concerns over subsidies affecting global market prices.

- **Multiple Choice Questions (MCQs)**

1. What is the primary purpose of countervailing duties?
   a) To increase government revenue
   b) To punish exporting countries
   c) To offset the impact of foreign subsidies on domestic industries
   d) To promote free trade
2. Which organization regulates subsidies and countervailing measures globally?
   a) United Nations (UN)
   b) World Trade Organization (WTO)
   c) International Monetary Fund (IMF)
   d) World Bank

3. Which of the following is an example of a **prohibited subsidy** under the WTO rules?
   a) Government providing infrastructure to all industries
   b) Tax rebates given only to exporters based on their export performance
   c) Subsidized loans available to all domestic industries
   d) None of the above

4. What is the first step in imposing **countervailing duties**?
   a) Imposing immediate duties on foreign goods
   b) Conducting a full trade investigation
   c) Filing a complaint by domestic industries
   d) WTO issuing a ban on the product

5. How is the **dumping margin** calculated?
   a) By comparing the government subsidy with production costs
   b) By comparing the import price with the domestic industry's revenue
   c) By comparing the export price with the normal value (home market price or cost of production)
   d) By averaging global market prices

6. Which of the following is a **type of subsidy**?
   a) Export subsidy
   b) Domestic subsidy
   c) Direct subsidy
   d) All of the above

7. How long do **final anti-dumping duties** usually last?
   a) 6 months
   b) 2 years
   c) 5 years
   d) 10 years

8. Why might an importing country impose **countervailing duties** on foreign goods?
   a) To discourage imports completely
   b) To retaliate against a political dispute
   c) To neutralize unfair advantages created by foreign government subsidies
   d) To promote domestic exports

9. What happens if a countervailing duty is found to be **unjustified** under WTO rules?
   a) The affected country can impose double duties in response
   b) The WTO orders its removal
   c) The WTO ignores the issue
   d) The country must reduce its subsidies instead

10. Which of the following is an example of a **trade dispute involving countervailing duties**?
    a) The U.S. imposing duties on Chinese steel due to subsidies
    b) The WTO banning all agricultural subsidies globally
    c) The EU and U.S. signing a free trade agreement
    d) China imposing tariffs on domestic goods

- **Answers**

1. c) To offset the impact of foreign subsidies on domestic industries
2. b) World Trade Organization (WTO)
3. b) Tax rebates given only to exporters based on their export performance
4. c) Filing a complaint by domestic industries
5. c) By comparing the export price with the normal value (home market price or cost of production)
6. d) All of the above
7. c) 5 years
8. c) To neutralize unfair advantages created by foreign government subsidies
9. b) The WTO orders its removal
10. a) The U.S. imposing duties on Chinese steel due to subsidies

- **Descriptive Questions:**

1. Explain the concept of subsidies in international trade. How do they impact domestic and foreign industries?
2. What are countervailing duties (CVDs)? How do they help in maintaining fair trade practices?
3. Discuss the different types of subsidies and provide examples of each.
4. What is the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement)? How does it regulate the use of subsidies?
5. Describe the step-by-step process involved in imposing countervailing duties on subsidized imports.
6. Differentiate between anti-dumping duties and countervailing duties. In what situations is each imposed?
7. Explain the concept of a "dumping margin" and its significance in determining anti-dumping duties.
8. What are the key economic and trade implications of excessive subsidies by a country? Provide real-world examples.
9. Describe the role of the WTO in resolving trade disputes related to subsidies and countervailing measures.
10. Analyse a real-world trade dispute where countervailing duties were imposed. What was the outcome of the dispute?

UNIT-10 STRATEGIC ALLIANCE AND FOREIGN COLLABORATION AND JOINT

10.1. Introduction

Welcome to the fascinating field of global business! This chapter will discuss three important ideas that companies employ to develop, grow, and thrive in international markets: joint ventures, strategic alliances, and international collaborations.

Consider yourself a business owner who wants to expand into a new nation. Because it is like entering a foreign environment with unfamiliar regulations, customs, clients, and rivals, you could experience anxiety. However, what if you were able to overcome these obstacles with the assistance of a partner who is familiar with the local market? This is where these tactics are useful.

❖ **Strategic Alliances**

A strategic alliance is a formal agreement between two or more companies to work together toward shared goals while remaining independent. Unlike mergers or acquisitions, strategic alliances allow businesses to collaborate without giving up ownership or control.

Real-World Examples of Strategic Alliances

Starbucks & PepsiCo – A Perfect Blend of Strengths

- Starbucks wanted to sell its bottled coffee drinks worldwide but did not have the distribution network.
- PepsiCo, a global leader in beverages, had an extensive distribution system.
- They joined forces—Starbucks created the drinks, and PepsiCo handled distribution. The result? Bottled Starbucks coffee is now available in supermarkets and convenience stores across the globe!

Spotify & Uber – Music on the Go

- Uber riders often wanted a better in-car experience
- Spotify allowed riders to play their favourite music while riding.
- This partnership enhanced the Uber experience and increased Spotify's user engagement.

Apple & IBM – Bringing iPhones to Businesses

- Apple is great at making user-friendly devices, while IBM specializes in enterprise software.
- Their alliance helped create powerful business apps for iPhones and iPads, making them more useful in the corporate world.

Strategic alliances help businesses grow by leveraging each other's strengths while staying independent. Now, let's look at another way companies work together across borders.

❖ **Foreign Collaboration**

Foreign collaboration refers to partnerships between companies from different countries to share knowledge, technology, resources, or market access. It can take the form of licensing, franchising, or co-development.

Real-World Examples of Foreign Collaboration

Boeing & Tata Advanced Systems – Building Aircraft in India

- Boeing, a global aerospace leader, partnered with Tata Advanced Systems in India.
- This collaboration allows Boeing to manufacture aircraft parts in India while helping Tata develop advanced aerospace capabilities.

McDonald's & Hardcastle Restaurants – Adapting to Indian Tastes

- When McDonald's entered India, it needed to adjust its menu to suit local tastes.
- It partnered with Hardcastle Restaurants, which helped McDonald's introduce new items like the Mc-Aloo Tikki Burger.
- The result? A successful McDonald's experience tailored for India!

Hyundai & Indian Auto Parts Suppliers – Cost-Effective Manufacturing

- Hyundai sources auto parts from Indian suppliers to reduce costs while maintaining quality.
- This collaboration helps Hyundai remain competitive in the automobile industry while supporting India's manufacturing sector.

Foreign collaborations allow companies to tap into new markets while sharing expertise and resources. But what if two companies want to take their partnership a step further? That is where joint ventures come in.

❖ **Joint Ventures**

A joint venture (JV) occurs when two or more companies form a new entity to work together. Unlike strategic alliances, JVs involve shared ownership, risks, and profits.

Real-World Examples of Joint Ventures

Sony Ericsson – A Short-Lived Success in Mobile Phones

- Sony (Japan) and Ericsson (Sweden) formed a JV to manufacture mobile phones.
- Sony brought its expertise in design and entertainment, while Ericsson contributed its telecommunications knowledge.
- Though successful for a while, Sony eventually took full ownership of the company.

Maruti Suzuki – Transforming India's Car Industry

- In the 1980s, Suzuki (Japan) partnered with Maruti (India) to produce affordable, fuel-efficient cars.
- Suzuki brought cutting-edge automobile technology, while Maruti provided local market expertise.
- Today, Maruti Suzuki is the largest car manufacturer in India!

Tata Starbucks – Bringing Premium Coffee to India

- Tata Group partnered with Starbucks to open Starbucks stores in India.
- Tata helped with real estate, logistics, and local supply chains, while Starbucks contributed branding and expertise.
- This JV allowed Starbucks to expand in India without taking on the risks alone.

Thus, Strategic alliances, foreign collaborations, and joint ventures are powerful ways for businesses to expand internationally.

- Strategic alliances help companies grow by combining strengths without merging.
- Foreign collaborations allow businesses to share knowledge and technology across borders.
- Joint ventures take partnerships further by forming a new company where both partners share risks and rewards.

By using these strategies, businesses can enter new markets, innovate faster, and compete on a global scale.

10.2. Recent Trends in International Strategic Alliances

The business world is constantly changing, and in global markets, strategic alliances are now more important than ever. In order to stay ahead in a cutthroat global marketplace, businesses are coming up with new and inventive ways to collaborate. Let us examine a few of the most current developments in global strategic partnerships:

1. Focus on Innovation and Technology

In today's world, technology drives everything. Companies are forming alliances to share resources, knowledge, and expertise in areas like artificial intelligence (AI), blockchain, and renewable energy.

- For example, tech companies often team up with startups to create cutting-edge solutions faster.
- Partnerships in renewable energy projects, like solar and wind power, are also on the rise as businesses look for sustainable solutions.

2. Rise of Digital Partnerships

The transition to digital business models was expedited by the COVID-19 pandemic. In order to improve cloud technology, e-commerce platforms, and online services, businesses are now establishing digital alliances.

- Retail companies, for example, work with payment platforms to provide customers around the world with seamless digital purchasing experiences.
- Partnerships between social media businesses and content producers are also being formed in an effort to increase their user base and reach.

3. Focus on Sustainability and ESG Goals

The concepts of environmental, social, and governance, or ESG, are increasingly important in corporate strategy. In order to address global concerns such as community development, ethical sourcing, and climate change, businesses are joining together.

- For example, alliances in the fashion industry promote sustainable production and recycling practices.
- Similarly, automobile manufacturers are teaming up to develop eco-friendly vehicles like electric cars.

4. Cross-Industry Collaborations

Companies in the same business are no longer the only ones that can form strategic alliances. In order to take advantage of new prospects, cross-industry partnerships are growing in popularity.

- For example, healthcare companies team up with technology firms to develop wearable devices that monitor health.
- Automakers collaborate with software developers to create smart, self-driving cars.

5. Focus on Emerging Markets

South American, African, and Asian emerging economies are garnering interest. In order to penetrate these rapidly expanding industries and acquire new clients, businesses are forging partnerships.

- For instance, partnerships with local companies in India or Brazil help foreign businesses understand cultural preferences and regulations.

6. Increased Use of Virtual Collaboration

Advances in communication technologies have made it possible for businesses to collaborate remotely. Teams from all over the world can now collaborate easily thanks to the widespread trend of virtual strategic partnerships.

- Tools like video conferencing, cloud storage, and project management software are enabling these alliances to thrive.

7. Short-Term Alliances for Specific Goals

Many businesses are now choosing short-term collaborations cantered on certain initiatives or objectives over long-term commitments.

- For example, two companies may collaborate for a single product launch or marketing campaign and then dissolve the partnership afterward.

8. Data-Driven Alliances

Data is a valuable resource in the digital age. Businesses are joining forces to exchange and evaluate consumer information, enhance decision-making, and customize goods and services.

- For instance, streaming platforms collaborate with analytics companies to recommend movies or shows based on user preferences.

9. Alliances to Mitigate Risks

Alliances assist businesses in sharing risks and pooling resources during unpredictable times, like a global pandemic or economic downturn.

- Businesses in the travel and tourism sector, for example, formed alliances to recover from the impact of the pandemic.

10. Increased Role of Governments and Institutions

Alliances are also being promoted more actively by governments and international organizations. These partnerships seek to address global issues such as trade restrictions or public health emergencies.

- For example, public-private partnerships were instrumental in the rapid development and distribution of COVID-19 vaccines.

These patterns demonstrate how strategic partnerships are adapting to the needs of a world that is changing. Companies are collaborating not only to open up new markets but also to innovate, address global issues, and build sustainable futures. Businesses can forge solid alliances and prosper in the global marketplace by adopting these trends.

10.3 International Strategic Alliances by Region

In international business, strategic alliances are essential, and how businesses establish these partnerships frequently varies by the location in which they operate. Alliance structure is influenced by the distinct features, market demands, and business potential of each location. Let us examine how strategic alliances function in various global contexts.

1. North America

Innovation and technical breakthroughs are concentrated in North America, particularly in the US and Canada. In this area, high-tech sectors including software development, biotechnology, and e-commerce are frequently the subject of strategic alliances.

- **Key Features:**
    - Alliances often involve large corporations collaborating with startups to foster innovation.
    - Partnerships are typically project-specific and focused on developing cutting-edge technologies.
    - Heavy emphasis on intellectual property (IP) protection in agreements.

For example, tech giants like Google and smaller AI startups often partner to explore new possibilities in artificial intelligence.

2. Europe

Europe is known for its diverse markets and strict regulatory environment. Alliances in this region often revolve around sustainability, manufacturing, and cross-border collaborations.

- **Key Features:**
    - Many alliances are formed to comply with European Union (EU) regulations and standards.
    - Cross-border collaborations are common due to the single market system within the EU.
    - Partnerships often focus on environmental sustainability and renewable energy.

For instance, automobile companies from Germany and France frequently collaborate to create eco-friendly cars, such as electric and hybrid vehicles.

3. Asia-Pacific

The Asia-Pacific region is a hotspot for economic growth, with countries like China, India, Japan, and South Korea driving innovation. Strategic alliances here focus on entering new markets and leveraging local expertise.

- **Key Features:**
    - Alliances often aim to tap into the region's large consumer base.
    - Partnerships in manufacturing, technology, and telecommunications are prominent.
    - Local partnerships are essential to navigate complex regulatory systems.

An example is the collaboration between multinational tech firms and Indian IT companies to develop software solutions and outsource operations.

4. Latin America

Latin America offers opportunities in agriculture, energy, and consumer goods. Strategic alliances in this region help companies overcome challenges like political instability and infrastructure gaps.

- **Key Features:**
  - Many alliances focus on natural resources, such as oil, gas, and mining.
  - Partnerships with local companies help foreign firms understand cultural and regulatory nuances.
  - Governments often play a significant role in facilitating alliances.

For example, global energy companies collaborate with Brazilian firms to explore and develop renewable energy sources.

5. Middle East and North Africa (MENA)

The MENA region is rich in natural resources and offers significant opportunities in oil and gas, construction, and technology. Strategic alliances here often involve partnerships with government entities or local businesses.

- **Key Features:**
  - Alliances are typically long-term and involve large-scale infrastructure projects.
  - Strong focus on energy-related industries, including renewable energy initiatives.
  - Partnerships help navigate political and cultural complexities.

An example is the collaboration between international oil companies and Middle Eastern firms to develop sustainable energy solutions.

6. Sub-Saharan Africa

Sub-Saharan Africa is an emerging market with opportunities in agriculture, energy, and technology. Strategic alliances here focus on creating sustainable solutions and addressing local challenges.

- **Key Features:**
  - Alliances often target social impact, such as improving healthcare or education.
  - Partnerships are designed to adapt to the region's developing infrastructure.
  - Companies often collaborate with non-governmental organizations (NGOs) or government agencies.

For example, tech companies collaborate with African governments to expand internet connectivity and promote digital inclusion.

7. Global Trends in Strategic Alliances

While each region has its unique features, certain trends are universal:

- Digital transformation: Companies worldwide are forming alliances to develop digital solutions and enhance online services.

- Sustainability: Green energy and eco-friendly projects are a common focus across regions.
- Short-term collaborations: Many alliances are now project-specific, focusing on immediate goals rather than long-term commitments.

Understanding regional differences is essential for forming successful international strategic alliances. Each region offers unique opportunities and challenges, and businesses must adapt their strategies accordingly. By leveraging the strengths of regional partnerships, companies can expand their reach, enhance their capabilities, and achieve global success.

10.4. International Strategic Alliances by Sector

In many different businesses around the world, strategic alliances are essential. They enable businesses to pool their resources, combine their talents, and accomplish shared objectives. The area or industry in which alliances are created frequently influences how they operate. Let us examine how various industries are being shaped by strategic alliances.

1. Technology Sector

The technology sector thrives on innovation and collaboration, making it one of the most active areas for strategic alliances.

- **Key Features:**
  - Partnerships are often formed to develop new products or improve existing technologies.
  - Collaborations include sharing intellectual property (IP) and research and development (R&D) efforts.
  - Alliances help companies stay competitive in rapidly changing markets.

Real-World Examples

Samsung & Google – The Android Partnership

- Samsung, a leader in smartphone hardware, collaborates with Google, the mastermind behind Android.
- Together, they refine software-hardware integration, ensuring Samsung devices run seamlessly on Android.

Microsoft & OpenAI – The AI Revolution

- Microsoft partnered with OpenAI to accelerate AI advancements.
- This alliance led to the development of powerful AI tools like ChatGPT and Copilot.

2. Healthcare and Pharmaceuticals

The healthcare and pharmaceutical sector heavily relies on alliances to innovate and bring new treatments to market.

- **Key Features:**
  - Alliances focus on drug discovery, vaccine development, and clinical trials.
  - Partnerships are often between pharmaceutical companies, research institutions, and biotechnology firms.
  - Collaborations help reduce the costs and risks associated with R&D.

Real-World Examples

Pfizer & BioNTech – COVID-19 Vaccine Breakthrough

- This collaboration led to the rapid development of one of the world's first COVID-19 vaccines.
- Pfizer handled large-scale manufacturing, while BioNTech provided mRNA technology expertise.

Novartis & Google's Verily – Smart Contact Lenses

- Novartis partnered with Google's health division, Verily, to create smart contact lenses that can monitor glucose levels in tears.

3. Automotive Sector

The automotive industry is undergoing a transformation with the rise of electric vehicles (EVs) and autonomous driving technologies. Strategic alliances are crucial to this evolution.

- **Key Features:**
  - Companies collaborate to share expertise in EV batteries, software, and production.
  - Alliances help automakers expand into global markets and meet sustainability goals.
  - Partnerships are often between automakers, technology firms, and energy companies.

Real-World Examples

Tesla & Panasonic – Revolutionizing EV Batteries

- Tesla's electric cars need powerful batteries, and Panasonic delivers them.
- Their partnership has been crucial in making Tesla vehicles more affordable and efficient.

BMW & Toyota – Hydrogen-Powered Cars

- These rivals joined forces to develop hydrogen fuel cell technology for cleaner transportation.

4. Energy and Utilities Sector

The energy sector, especially renewable energy, is a hotspot for strategic alliances. Companies are joining forces to address global energy needs sustainably.

- Key Features:
    - Partnerships focus on solar, wind, and other renewable energy sources.
    - Collaborations often involve governments and international organizations.
    - Alliances help companies access funding and reduce project risks.

Real-World Examples

BP & Ørsted – Hydrogen Energy Partnership

- BP, a global oil giant, and Ørsted, a renewable energy leader, are working together to develop renewable hydrogen solutions.

Tesla & SolarCity – The Future of Solar Energy

- Tesla acquired SolarCity to create integrated solar panels and battery storage systems, making sustainable energy more accessible.

5. Retail and E-Commerce Sector

In the retail and e-commerce space, alliances help companies enhance customer experience and expand their reach.

- **Key Features:**
    - Companies team up to create seamless shopping experiences through technology and logistics.
    - Alliances often focus on payment systems, supply chain management, and data analytics.
    - Partnerships help businesses enter new markets more effectively.

Real-World Examples

Walmart & Flipkart – Expanding in India

- Walmart invested in Flipkart to strengthen its presence in India's booming online retail market.

Alibaba & Starbucks – Digital Coffee Ordering in China

- Alibaba partnered with Starbucks to allow customers to order coffee through its apps, boosting Starbucks' digital sales.

6. Entertainment and Media Sector

The entertainment and media industry relies on alliances to create, distribute, and promote content globally.

- **Key Features:**
    - Partnerships often involve production studios, streaming platforms, and content creators.
    - Alliances help companies share resources and reach wider audiences.

- Collaborations focus on creating original content and leveraging digital platforms.

Real-World Examples

Disney & Pixar – A Perfect Animation Match

- Pixar's animation expertise and Disney's storytelling and marketing power led to hits like *Toy Story* and *Finding Nemo*.

Netflix & Local Filmmakers – Expanding Global Content

- Netflix collaborates with filmmakers worldwide to create region-specific content, such as *Sacred Games* in India and *Money Heist* in Spain.

7. Agriculture and Food Sector

In the agriculture and food sector, strategic alliances address issues like food security, sustainability, and innovation.

- **Key Features:**
  - Collaborations focus on improving crop yields, reducing waste, and creating healthier food products.
  - Partnerships are common between Agri-tech startups, food companies, and governments.
  - Alliances help businesses adapt to climate change and meet consumer demands.

Real-World Examples

Monsanto (Bayer) & The Climate Corporation – Digital Farming

- This partnership developed data-driven farming solutions that help farmers make better decisions based on weather patterns and soil conditions.

Nestlé & Starbucks – Expanding Coffee Products

- Nestlé partnered with Starbucks to distribute Starbucks-branded coffee products in supermarkets globally.

8. Transportation and Logistics Sector

Transportation and logistics companies form alliances to improve efficiency and reduce costs.

- **Key Features:**
  - Partnerships focus on technology integration, route optimization, and sustainability.
  - Alliances help companies expand into international markets and improve last-mile delivery.
  - Collaborations are essential for global supply chain management.

Real-World Examples

DHL & Amazon – Speeding Up Deliveries

- DHL and Amazon partnered to enhance logistics and make one-day deliveries possible.

Uber & Volvo – Advancing Self-Driving Cars

- Uber teamed up with Volvo to develop self-driving cars for ride-hailing services.

9. Financial Services Sector

The financial services industry uses strategic alliances to innovate and provide better services to customers.

- **Key Features:**
    - Collaborations often involve fintech companies and traditional banks.
    - Alliances focus on digital payment systems, blockchain technology, and financial inclusion.
    - Partnerships help companies improve security and customer convenience.

Real-World Examples

Visa & PayPal – Simplifying Online Transactions

- Visa and PayPal joined forces to make digital payments more seamless, benefiting millions of online shoppers.

JP Morgan & Onyx – Blockchain in Banking

- JP Morgan partnered with Onyx to develop blockchain-based payment systems for faster international transactions.

10. Education and Training Sector

In the education sector, strategic alliances help institutions and organizations provide innovative learning solutions.

- **Key Features:**
    - Partnerships focus on developing online courses, research collaborations, and skill development programs.
    - Alliances often involve universities, tech companies, and government agencies.
    - Collaborations aim to make education accessible and industry-relevant.

Real-World Examples

Google & Universities – Digital Skills Certifications

- Google collaborates with universities to offer free and paid certifications in IT, digital marketing, and data science.

edX & Harvard/MIT – Democratizing Education

- Harvard and MIT co-founded edX to provide high-quality online courses to learners worldwide.

Each sector has unique needs and challenges, and strategic alliances help companies overcome them. By forming alliances, businesses can innovate, grow, and create value for their customers. Whether it is technology, healthcare, or agriculture, these partnerships are the backbone of success in today's interconnected world.

10.5. Driving Forces and Policy Issues in Strategic Alliances, Foreign Collaborations, and Joint Ventures

International strategic alliances, foreign collaborations, and joint ventures are powerful tools for businesses looking to expand globally. But what drives companies to form these partnerships? And what policy issues need to be considered? Let us dive in to understand these factors in simple terms.

Driving Forces Behind Strategic Alliances and Collaborations

Several factors motivate companies to form strategic alliances, collaborate with foreign firms, or create joint ventures. These driving forces can be broadly categorized into business goals, market needs, and external pressures.

1. Access to New Markets

- One of the biggest reasons for forming partnerships is to enter new markets.
- By collaborating with a local partner, companies can navigate unfamiliar regulations, cultural differences, and consumer preferences.

For example, a U.S.-based tech firm may partner with an Indian company to tap into the large and growing Indian market.

2. Sharing Costs and Risks

- International expansion, research, and development (R&D), or setting up new production units can be expensive and risky.
- Strategic alliances allow companies to share the financial burden and risks involved.

Think about two car manufacturers collaborating to develop electric vehicles (EVs). They split the costs of R&D, testing, and production.

3. Gaining Expertise and Technology

- Partnerships provide access to the skills, expertise, or technology that one company may lack.
- This exchange benefits both partners and strengthens their competitive edge.

For instance, a pharmaceutical company in Europe might partner with a U.S.-based biotech firm to use cutting-edge technology for drug development.

4. Building Global Networks

- Collaborations help businesses connect with suppliers, distributors, and other stakeholders worldwide.

- This creates a strong global network, making operations smoother and more efficient.

For example, logistics companies form alliances to streamline international shipping routes.

5. Meeting Regulatory Requirements

- In some countries, laws may require foreign companies to partner with local firms.
- Forming a joint venture or collaboration helps comply with these regulations and gain entry into the market.

For example, China often requires foreign companies to partner with local businesses to operate within its borders.

6. Competitive Pressure

- Companies often form alliances to stay ahead of their competitors.
- By joining forces, they can combine resources and deliver better products or services.

For example, two airline companies might form a partnership to offer a wider range of flight routes and better services.

Policy Issues in Strategic Alliances and Joint Ventures

While strategic alliances and collaborations can offer significant advantages, they also bring challenges. Companies must carefully address policy-related issues to ensure a smooth partnership.

1. Regulatory Compliance

- Every country has its own set of rules for foreign collaborations and joint ventures.
- Companies must comply with laws related to taxation, labour, and environmental standards.

For example, if a company plans to open a factory in another country, it must adhere to local labour laws and safety regulations.

2. Intellectual Property Rights (IPR)

- Protecting intellectual property is a critical issue in strategic alliances.
- Partners need to clearly define who owns the technology, patents, or trademarks and how they can be used.

For instance, a software company sharing its source code with a partner must ensure that it is not misused or shared with others.

3. Cultural Differences

- Differences in language, work culture, and business practices can create misunderstandings.
- Policies should address how cultural challenges will be managed.

For example, setting guidelines for communication and decision-making can help bridge cultural gaps.

4. Governance and Decision-Making

- Clear policies are needed to define how decisions will be made within the partnership.
- Issues like profit sharing, conflict resolution, and exit strategies should be outlined in the agreement.

For instance, a joint venture agreement should specify who has the final say on critical decisions.

5. Competition Law and Anti-Trust Regulations

- Some alliances might be subject to scrutiny to ensure they do not create monopolies or restrict competition.
- Companies must follow anti-trust laws to avoid legal complications.

For example, two major competitors forming an alliance may need approval from regulatory authorities.

6. Currency and Financial Issues

- Policies should address how currency fluctuations, tax rates, and profit repatriation will be handled.
- This is particularly important in countries with volatile currencies.

For example, a company operating in a country with an unstable economy might face challenges in converting profits back to its home currency.

7. Environmental and Social Responsibility

- Partners must align on policies regarding environmental sustainability and social responsibility.
- Adhering to international standards ensures long-term success and avoids reputational damage.

For instance, a manufacturing alliance should include policies on waste management and carbon emissions.

The driving forces and policy issues in international strategic alliances, foreign collaborations, and joint ventures are interconnected. Companies must balance the motivations for forming these partnerships with the challenges they present. By addressing policy issues upfront and building strong agreements, businesses can create successful alliances that benefit all parties involved.

10.6. Types and Benefits of Strategic Alliances

Strategic alliances are partnerships between companies that work together to achieve common goals while remaining independent. These alliances help businesses pool their strengths, share risks, and access new opportunities. Let us explore the different types of strategic alliances and the benefits they offer in a simple, engaging way.

Types of Strategic Alliances

Strategic alliances come in various forms, depending on the goals and the level of integration between partners. Here are the main types:

1. Joint Venture (JV)

- A joint venture is when two or more companies create a new, independent entity to pursue a specific project or business goal.
- Each partner contributes resources, shares ownership, and divides profits or losses.

Example: An automobile company partners with a battery manufacturer to create a joint venture for producing electric vehicles.

2. Equity Strategic Alliance

- In this type, one company buys equity (ownership) in another, creating a partial partnership.
- This alliance often involves a stronger financial commitment.

Example: A tech company purchasing a 25% stake in a startup to gain access to its innovative technology.

3. Non-Equity Strategic Alliance

- This is a less formal arrangement where companies collaborate without exchanging ownership stakes.
- They work together through contracts, agreements, or resource-sharing.

Example: A software firm licensing its technology to another company for use in its products.

4. Vertical Alliance

- A vertical alliance involves companies from different stages of the same supply chain.
- It helps streamline processes, reduce costs, and improve efficiency.

Example: A food processing company partnering with a farming cooperative to secure a steady supply of raw materials.

5. Horizontal Alliance

- In a horizontal alliance, companies in the same industry collaborate to expand their market reach or develop new products.
- This often happens between competitors.

Example: Two airlines partnering to offer a wider network of routes and shared loyalty programs.

6. Global Alliance

- A global alliance involves companies from different countries collaborating to access international markets.

- It helps overcome cultural, regulatory, and logistical barriers.

Example: A U.S.-based retail chain partnering with a European logistics company to establish its presence in Europe.

Benefits of Strategic Alliances

Strategic alliances offer numerous advantages that help businesses grow and succeed in competitive markets. Let us break them down:

1. Access to New Markets

- Alliances enable companies to enter markets they might not have accessed on their own.
- Local partners bring knowledge of customer preferences, regulations, and cultural nuances.

Example: A cosmetic brand forming an alliance with a local distributor to sell its products in Asia.

2. Sharing Resources and Expertise

- Partners can share technologies, research, and other resources, reducing costs and improving efficiency.
- Each partner brings unique strengths to the table.

Example: A pharmaceutical company partnering with a biotech firm to share R&D resources and accelerate drug development.

3. Reducing Risks

- International expansion and innovation involve risks.
- Sharing these risks with a partner makes it easier to manage uncertainties.

Example: Two firms co-developing a new product split the costs and risks of production.

4. Faster Market Entry

- Alliances speed up the process of entering new markets by leveraging a partner's established network.
- Companies can avoid delays caused by learning curves or regulatory hurdles.

Example: A car manufacturer partnering with a local firm in Brazil to quickly set up dealerships and service centres.

5. Increased Innovation

- Collaborations foster creativity by combining different perspectives and expertise.
- This leads to innovative products and solutions.

Example: A tech company working with a university to develop cutting-edge AI technology.

6. Competitive Advantage

- Strategic alliances create synergies that give partners a strong competitive edge.
- Combining forces help outperform rivals in the market.

Example: A beverage company forming an alliance with a packaging firm to create eco-friendly solutions that attract environmentally conscious consumers.

7. Cost Savings

- Sharing resources like infrastructure, marketing, and distribution reduces overall expenses.
- Economies of scale can be achieved.

Example: Two telecom companies collaborating to share cell tower infrastructure.

8. Strengthened Global Presence

- Partnerships help companies expand their global footprint and enhance brand visibility.
- They can also overcome challenges posed by language and cultural barriers.

Example: A U.S.-based fashion brand forming an alliance with an Asian e-commerce giant to reach millions of new customers.

Strategic alliances come in many forms, each suited to different business goals and industries. The benefits of forming alliances—such as accessing new markets, sharing resources, and boosting innovation—make them an essential strategy in today's interconnected global economy.

10.7. Joint Venture

A Joint Venture (JV) is a business arrangement where two or more companies come together to create a new entity for a specific purpose. Each partner brings resources like capital, expertise, or technology, and they share the risks, profits, and responsibilities of the venture. A joint venture allows companies to pool their strengths and achieve common goals that might be difficult to accomplish alone.

What is a Joint Venture?

Imagine you and a friend want to start a lemonade stand in your neighbourhood. You have the lemons, and your friend has the sugar and cups. Instead of working separately, you decide to join forces, sharing your resources and splitting the profits equally.

This is exactly how a joint venture works in the business world, but on a larger scale. Companies come together, contribute their strengths, and work as partners to achieve a shared objective.

Key Features of a Joint Venture

1. **Shared Ownership**
    - Each partner owns a portion of the new entity.

- Ownership is typically based on the resources and efforts contributed by each partner.

2. **Limited Scope**
    - Joint ventures are often created for a specific project, goal, or market entry.
    - Once the objective is achieved, the JV may dissolve or continue if the partners agree.
3. **Separate Entity**
    - A joint venture operates as a separate legal entity from the parent companies.
    - This means it has its own management, employees, and financial structure.
4. **Shared Risks and Rewards**
    - Partners share the costs, risks, and profits based on their agreement.
    - This reduces the financial burden on any single partner.

Types of Joint Ventures

1. **Equity-Based Joint Venture**
    - Partners contribute capital to form a new company and own shares in it.
    - Ownership and profits are divided based on the equity contribution.

Example: A multinational automobile company and a local manufacturer creating a new factory to produce cars.

2. **Contractual Joint Venture**
    - No new company is formed. Partners work together based on a contractual agreement.
    - Responsibilities, profits, and risks are shared as per the contract.

Example: A tourism company partnering with a hotel chain to offer travel packages.

Benefits of a Joint Venture

1. **Access to New Markets**
    - Joint ventures help companies enter new geographic or industry markets.
    - Local partners provide knowledge about regulations, culture, and customer preferences.

Example: A global fast-food chain forming a joint venture with a local company to set up outlets in a foreign country.

2. **Resource Sharing**
    - Companies share technology, infrastructure, and expertise.

- This reduces costs and accelerates project timelines.

Example: Two pharmaceutical companies collaborating to develop and market a new drug.

3. **Risk Mitigation**
   - By sharing risks, companies reduce the financial and operational burden on themselves.
   - This is especially helpful in high-risk industries like energy and mining.

Example: An energy company entering a joint venture to explore offshore oil reserves.

4. **Increased Innovation**
   - Partners bring unique ideas and technologies to the table, fostering creativity.
   - Joint ventures often lead to innovative solutions and products.

Example: A tech company and a university teaming up to create a research lab for artificial intelligence.

5. **Faster Market Entry**
   - A joint venture speeds up the process of establishing a presence in a new market.
   - Local partners help navigate regulations and reduce barriers.

Example: A clothing brand collaborating with a local retailer to launch its products in Asia.

Challenges of Joint Ventures

While joint ventures have many advantages, they also come with challenges. Here is what companies need to watch out for:

1. **Cultural Differences**
   - Different work cultures and management styles can create conflicts.
   - Effective communication is essential to overcome these challenges.
2. **Unequal Contribution**
   - If one partner feels they are contributing more resources or effort, tensions can arise.
   - Clear agreements help prevent misunderstandings.
3. **Decision-Making Conflicts**
   - Partners may have different priorities, leading to disagreements in decision-making.
   - Establishing a shared vision and governance structure is key.

4. **Trust Issues**
    - Lack of trust can hinder collaboration and affect the venture's success.
    - Open and transparent communication builds stronger relationships.

Real-Life Example of a Joint Venture

One of the most well-known joint ventures is Sony Ericsson.

- Sony, a Japanese electronics company, and Ericsson, a Swedish telecommunications company, formed a joint venture in 2001.
- The goal was to combine Sony's expertise in consumer electronics with Ericsson's knowledge of mobile communication to create innovative mobile phones.
- The venture was successful for many years, producing popular phones before ending in 2012 when Sony took full control.

Why Are Joint Ventures Important in International Business?

Joint ventures are vital for companies aiming to expand globally. They provide access to new opportunities, reduce risks, and foster collaboration. In today's interconnected world, joint ventures enable businesses to achieve growth while navigating complex international markets.

A joint venture is a powerful tool for businesses looking to combine strengths and achieve mutual goals. By understanding the benefits and challenges, companies can form successful partnerships that drive growth and innovation.

❖ Exercises:

1. Answer the following questions:

1. Define strategic alliances, foreign collaboration, and joint ventures.
2. Explain the recent trends in international strategic alliances. Provide examples to support your explanation.
3. Analyse the formation of international strategic alliances by regions (e.g., Asia-Pacific, Europe, and North America).
4. Discuss the major sectors benefiting from international strategic alliances.
5. Identify and elaborate on the driving forces behind the formation of strategic alliances.
6. Discuss the policy issues and challenges companies face when entering international strategic alliances.
7. List and explain the types of strategic alliances.

8. Discuss the benefits of forming strategic alliances with foreign companies.
9. Define joint ventures and describe their significance in international business.
10. Compare and contrast joint ventures with other types of strategic alliances.

2. Answer the following questions briefly:

1. Define a strategic alliance and give an example.
2. What is foreign collaboration, and why is it significant for businesses?
3. List two recent trends in international strategic alliances.
4. What are the primary sectors that benefit from international strategic alliances?
5. Name any two regions with the highest number of strategic alliances.
6. What is the role of policy in shaping international strategic alliances?
7. Differentiate between a strategic alliance and a joint venture.
8. State two benefits of strategic alliances.
9. Name any two driving forces behind strategic alliances.
10. What are the key challenges faced in joint ventures?

યુનિવર્સિટી ગીત

સ્વાધ્યાયઃ પરમં તપઃ
સ્વાધ્યાયઃ પરમં તપઃ
સ્વાધ્યાયઃ પરમં તપઃ

શિક્ષણ, સંસ્કૃતિ, સદ્‌ભાવ, દિવ્યબોધનું ધામ
ડૉ. બાબાસાહેબ આંબેડકર ઓપન યુનિવર્સિટી નામ;
સૌને સૌની પાંખ મળે, ને સૌને સૌનું આભ,
દશે દિશામાં સ્મિત વહે હો દશે દિશે શુભ-લાભ.

અભણ રહી અજ્ઞાનના શાને, અંધકારને પીવો ?
કહે બુદ્ધ આંબેડકર કહે, તું થા તારો દીવો;
શારદીય અજવાળા પહોંચ્યાં ગુર્જર ગામે ગામ
ધ્રુવ તારકની જેમ ઝળહળે એકલવ્યની શાન.

સરસ્વતીના મયૂર તમારે ફળિયે આવી ગહેકે
અંધકારને હડસેલીને ઉજાસના ફૂલ મહેંકે;
બંધન નહીં કો સ્થાન સમયના જવું ન ઘરથી દૂર
ઘર આવી મા હરે શારદા દૈન્ય તિમિરના પૂર.

સંસ્કારોની સુગંધ મહેંકે, મન મંદિરને ધામે
સુખની ટપાલ પહોંચે સૌને પોતાને સરનામે;
સમાજ કેરે દરિયે હાંકી શિક્ષણ કેરું વહાણ,
આવો કરીયે આપણ સૌ
ભવ્ય રાષ્ટ્ર નિર્માણ...
દિવ્ય રાષ્ટ્ર નિર્માણ...
ભવ્ય રાષ્ટ્ર નિર્માણ

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