International Business Management

BBA 6th Semester

UNIT- I

Introduction

Nature and Scope of International Business

International Business is the process of focusing on the resources of the globe and objectives of the organizations on global business opportunities and threats.

International business defined as global trade of goods/services or investment. More comprehensive view does not focus on the "firm" but on the exchange process Free Trade occurs when a government does not attempt to influence, through quotas or duties, what its citizens can buy from another country or what they can produce and sell to another country.

The Benefits of Trade allow a country to specialize in the manufacture and export of products that can be produced most efficiently in that country. The Pattern of International Trade displays patterns that are easy to understand (Saudi Arabia/oil or Mexico/labor intensive goods). Others are not so easy to understand (Japan and cars).

Nature of International Business

1. Accurate Information
2. Information not only accurate but should be timely
3. The size of the international business should be large
4. Market segmentation based on geographic segmentation
5. International markets have more potential than domestic markets

Scope of International Business

1. International Marketing
2. International Finance and Investments
3. Global HR
4. Foreign Exchange

Need for International Business

1. To achieve higher rate of profits
2. Expanding the production capacity beyond the demand of the domestic country
3. Severe competition in the home country
4. Limited home market
5. Political conditions
6. Availability of technology and managerial competence
7. Cost of manpower, transportation
8. Nearness to raw material
9. Liberalization, Privatization and Globalization (LPG)
10. To increase the market share

11. Increase in cross border business is due to falling trade barriers (WTO), decreasing costs in telecommunications and transportation; and freer capital markets

Reasons for Recent International Business Growth

1. Expansion of technology
2. Business is becoming more global because
3. Transportation is quicker
4. Communications enable control from afar
5. Transportation and communications costs are more conducive for international operations
6. Liberalization of cross-border movements.
7. Lower Governmental barriers to the movement of goods, services, and resources enable Companies to take better advantage of international opportunities

Problems in International Business

1. Political factors
2. High foreign investments and high cost
3. Exchange instability
4. Entry requirement
5. Tariffs, quota etc.
6. Corruption and bureaucracy
7. Technological policy

Driving and Restraining forces of International Business

Driving factors

The important forces driving globalisation are as follows:

1. **Liberalisation:** One of the most important factors which have given a great forward thrust to globalisation since the 1980's is the formation of universal economic policy resulting in liberalisation of economy in many countries. The immediate result of liberalisation in globalisation of business. Now many business firms can involve themselves is international trade as the restrictions imposed by various countries is highly restricted under GATT/WTO.
2. **MNC's:** The companies which have taken a complete advantage of trade liberalisation caused under GATT/WTO are MNC's (Multi – National Companies). Sony, Philips, Coco Cola, Pepsi, Procter & Gamble, etc are some famous examples for MNC's. These companies combine their resources and objectives to achieve profit in globel market. According to the world Investment Report 1997, there were about 44,500 MNC's in the world with nearly 2.77 lakhs foregin collaborations. Hence MNC's is an important factor inducing Globalisation.
3. **Technology:** Technology in a powerful driving force of Globalisation. Once a Technology is developed, it soon becomes available every where in the world. (for example) A hospital in the USA performs the required diagnostics on patients say an X – ray or MRI or C.T Scan. These diagnostic tests represent technology in medical field. In the next three minutes, a radiologists in Bangolore, India receives the scanned images from USA. He then sends his report to USA. This is called as teleradiology. The entire process, from the time the patient was admitted, has taken Just 20 minutes. The cost of this work is 30% lower in India compared to the USA. In short, long distance on – line services made possible by the technological developments have given a forward thrust to globalisation.

4. **Transportation and Communication revolutions:** Technological revolution in several spheres, like transport and Communication, has given a great impetus to globalisation. The Microprocessor in computers has created the flow of information from one part of the globe to another not only fast but also cost effective. It has played a pivotal role in reducing space and time. It has made world in to a global village. Microprocessors coupled with satellite, optical fibre, wireless technologies, world wide web have made this 'World in to a global village. The consumers/ customers has become more global. By sitting in front of the computer and logging on to world wide web the consumer can download any type of information from any part of the world. Flow of information is business. It determines profit. Hence technology is a strong driving force for Globalisation.
5. **Product development and efforts:** The immediate impact of increase of Technology is the growth of new products due to innovation. The fast technology hastens product obsolescence. This has made many firms to invest heavily on R&D activities with cross – border alliances . These companies have to stay in business and survive competition. In order to achieve this, many companies have crossed their borders and have tie – ups to update their products through research and development with foreign companies. This causes globalisation.
6. **Rising aspirations and wants:** Because of the increasing levels of education and exposure to the media, aspirations of people around the world are rising. They aspire for everything that can make life more comfortable and satisfying. If domestic firms are not able to meet the wants, they would naturally turn to the foreign firms to satisfy their aspirations. This promotes Globalisation.
7. **World economic trends:** The world economic conditions are changing fast. There, is a great difference in the growth rates of economies/ markets between developing nations and developed nations. In developed nations the economies have become stagnant, due to saturation on the otherhand, the developing nations are experiencing tremendous growth rate in various business sector. Cheap labour, high investment in research and development, improvements in technology are some of the factors which have driven the developing nations towards achieving high growth rate in business. Hence it is very common for the developing nations to have a strong international trade links with developed nations. Thus difference in world economies between nation causes gobalisation.
8. **Regional Integration:** Nowadays many countries are joining hands together to promote free and fair international trade across the borders. They are forming separate trade blocks. European Union and North American Free Trade Agreements are two such classical examples. This promotes globalisation.
9. **Leverages:** Leverage is simply some type of advantage that a company enjoys by conducting business in more than one country. A global company can experience three important types of leverages.
10. **Experience transfers:** The experience that a company gains by doing business in one country can be effectively transferred to some other country if the particular company does business on global scale. This is called experience transfer (For example) Cocacola first developed a strong marketing strategy to tap tea and coffee market in India. In 2002 it became a success. From this experience, it then joined hands with Mc Donald's for marketing hot beverages. The Georgia Gold brand was thus born and it was first launched in Delhi and Mumbai. This brand is now available in all Mc Donald's outlets throughout the country. The success of this business in hot beverages with Mc Donald's promoted Coca-cola to enter into ice-tea and cold coffee Marketing business in 2003.

    Another classical example of experience transfer is provided by Hindustan Lever Limited.(HLL). The occurrence of Iodine Deficiency Diseases (IDD) is very common in

developing countries. This disease can be easily prevented by taking micro quantities of iodine along with salt. The salt thus produced is called as iodised Salt. This new concept of iodised salt was produced by HLL in India. HLL has now successfully introduced the concept of iodised salt to other countries like Kenya and Tanzania. The experience gained by HLL in marketing iodised salt in India has made the company to successfully market the same product in other African countries.

11. Scale economies: The art of cutting down the cost of production is called as scale economies. One major cause for scale economies is technology breakthroughs. Many companies are now heavily infesting in R&D in an attempt to reduce the cost of production. They are attempting to produce cheaper and more reliable products. (For example). The replacement of vaccum tubes by transistors and subsequent development of printed circuit boards greatly reduced the labour cost required to assemble radios, T.V'S and tape recorders. By these technological changes the cost of production of T.V sets greatly reduced and production of TV sets greatly increased. Philips are producing more than 3 billion TV sets now in order to stay in business. So to market such huge volume of production of T.V sets, Philips needs global application of business.

12. Resource Utilisation: Another strength of global company is its resource utilisation. It can now successfully outsource its resources globally thereby making better utilisation of resources.

Restraining forces On Globalisation

There are also several factors which restrain Globalisation trend. They are

1. External Factors
2. Internal Factors

External Factors: These are government policies and controls which prevents cross-border business.

Internal Factors: These are collection of factors that exists within the organisation that prevents Globalisation. One such factor is called as management myopia or near sightedness. The company with an aim to make immediate profit engage itself in short-term plan and target local markets for business. This is called as management myopia. This acts against Globalisation of business.

Comparative Cost Theory

Eminent economists have said that the comparative cost theory is the basis of international business.

It explains that: **"it pays countries to specialise in the production of those goods in which they possess greater comparative advantage or the least comparative dis-advantage."**

In the words of Cairnes—"The difference in the comparative cost of producing the commodities exchanged is essential to, and sufficient for, the existence of international business". This is the fundamental basis of international business."

When this theory is applied to international business, the theory states that a country tends to specialise in the production of those articles in which it enjoys greater comparative advantage. What is more important is not the cost of commodity in country A and its cost in country B but the ratio between the costs of the commodities in the two countries.

A Paradox Indeed:

One will surprise to find a country importing a particular commodity from another country even when she can herself produce it at a lower cost. Why so? This can be explained by giving suitable and proper example—we find that Great Britain can produce both dairy products and machinery chapter than Denmark, yet she imports dairy products from Denmark and export machinery. Why so? This paradox can be explained in this manner.

Take this point-a Professor can polish and black his own shoes better than his servant and can of course teach and lecture far better. But his time is more profitably used with his books than with brush and polish. Similarly, a doctor may be a better dispenser than his assistant, but it pays him to examine patients and leave dispensing to his compounder.

In the same way Great Britain imports cheese and butter because she gains more by producing machinery. This is not a matter of surprise because every nation uses its resources in such channels which will yield the best results. This is the main basis of all international business.

Criticism of the Comparative Cost Theory:

1. This Theory is Based on Wrong Assumptions:

The comparative cost theory is based on some such assumptions which do not hold good in real life.

Some of these assumptions are:

(i) Static assumptions of fixed costs,

(ii) The unit costs remain the same,

(iii) It assumes that there are no transport costs,

(iv) Fixed supplies of the factors of production etc.,

(v) Further it assumes that there are no other costs except labour costs, and

(vi) It assumes perfect mobility of factors inside and perfect immobility outside the country. Economists do not believe over all these assumptions.

Therefore, this theory is not applicable to real life. Thus, the international business does not follow the law of comparative cost.

2. This Theory Implies Specialisation:

But in real life complete specialisation is not possible nor always desirable so far as countries are concerned.

3. International Business Arises Owing to Differences in Relative Factor Prices:

But international business also tends to narrow down these differences. Hence, business should come to end if we accept comparative cost theory.

4. This Theory has been Considered as One Sided:

As it ignores the demand and concentrates only on the supply side. This theory does not speak as to what prices the goods will be demanded.

5. It is not an Adequate Explanation:

The comparative cost theory does not furnish an adequate explanation of international business.

Critical Appraisal of Comparative Cost Theory:

Theory of comparative cost which is the important doctrine of classical economics is still valid and widely acclaimed as the correct explanation of international trade.

Most of the criticisms that have been leveled against this doctrine relate to the Ricardian version of comparative cost theory based on labour-theory of value. Haberler and others broke away from this labour-cost version and reformulated the comparative cost theory in terms of opportunity costs which takes into consideration all factors.

The basic contention of the theory that a country will specialise in the production of a commodity and export it for which it has a lower comparative cost and import a commodity which can be produced at a lower comparative cost by others, is based on a sound logic. The theory correctly explains the gain from trade accruing to the participating countries if they specialise according to their comparative costs.

These merits of the theory have led Professor Samuelson to remark, “If theories, like girls, could win beauty contents, comparative advantage would certainly rate high in that it is an elegantly logical structure.” He further writes, “the theory of comparative advantage has in it a most important glimpse of truth…. A nation that neglects comparative advantage may have to pay a heavy price in terms of living standards and potential rates of growth.”

Despite the sound logical structure and vivid explanation of gains from trade, the comparative cost theory, especially the Ricardian version based on labour theory of value has been criticized.

The following criticisms have been leveled against this theory:

1. In the first place, Ricardian version of comparative cost theory has been attacked on the ground that being based on labour theory of value, it considers only labour cost to measure the comparative costs of various goods.

   It has been pointed out that labour is not the only factor needed for the production of commodities, other factors such as capital, raw materials, land also contribute to production. Therefore, it is the total money costs incurred on labour as well as other factors that should be considered for assessing comparative costs of various commodities.

   Taussig tried to defend Ricardo by pointing out that even if labour theory of value was defective and even if other factors made important contributions to the production of goods, comparative costs could still be based on labour cost alone, if it is assumed that the trading countries are at the same stage of technological development.

   This is because, he argued that given the same technological development, the proportions in which other factors could be combined with labour would be the same. In view of this he asserted that other factors could be validly ignored and for purpose of comparative costs relative efficiency of labour alone of different countries could be considered.

   However, Taussig's defense of Ricardian version of comparative cost theory is poor and invalid. The various trading partners are not at the same stage of technological development and therefore the factor proportions used for the production of commodities in different countries are vastly different. Hence, it is quite unrealistic and improper to consider relative efficiency of labour alone.

   However, as stated earlier, Haberler rescued the comparative cost theory from labour theory of value and reformulated it in terms of opportunity cost which covers all factors.

2. The comparative cost theory explained that different countries would specialise in the production of goods on the basis of comparative costs and that they would gain from trade if they export those goods in which they have comparative advantage and import those goods from abroad in respect of which other countries enjoyed comparative advantage.

   But it could not provide a satisfactory explanation of why comparative costs of producing commodities in various countries differ. Ricardo thought comparative costs of producing commodities in various countries differed due to the differences in efficiency of labour. But this begs the question why labour efficiency is different in various countries.

   Factors for Variation in Comparative Costs of Different Commodities:
   The credit of providing an adequate and valid answer to this question goes to Heckscher and Ohlin who explained that comparative costs of different commodities in the two countries vary because of the following factors:

1. The various countries differ in respect of factor endowments suited for the production of different commodities.
2. The different commodities require different factor proportions for their production.

Thus Heckscher and Ohlin supplemented the comparative costs theory by providing valid reasons for differences in comparative costs in various countries.

3. Against the Ricardian doctrine of comparative cost it has also been said that it is based on the constant cost of production in the two trading countries. This assumption of constant costs leads them to conclude that different countries would completely specialise in the production of a single product on the basis of their comparative costs.

   Thus, of the two commodities cloth and wheat, if India has a comparative advantage in the production of cloth, it will produce all cloth and no wheat. On the other hand, if U.S.A. has a comparative advantage in the production of wheat, it will produce all wheat and no cloth. But the pattern of international trade shows that this is far from reality.

   As a matter of fact, a stage comes when it is no longer advantageous for India to import wheat from U.S.A. (because of increasing costs in producing wheat). Further, in the real world it is found that countries do not have complete specialisation. Indeed, a country produces a certain commodity and also imports a part of it.

   However, it may be noted that even if the phenomenon of increasing costs is taken into account, foreign trade can still be explained in terms of differences in comparative costs. Only in the situation of increasing costs, countries would not have complete specialisation. Opportunity cost version of comparative costs theory does consider the case of increasing costs.

4. The Ricardian theory of comparative costs, has also been criticized for its not going into the question what determines the terms of trade between the countries. Voicing this criticism Elseworth remarks, "the comparative costs theorem, the way in which Ricardo set up his illustration, tended to obscure the problem of the terms of trade."

   Ricardian theory of comparative costs explains what commodity a country will export and what commodity it will import but it does not investigate at what rate it will exchange its exports for imports (i.e. terms of trade). However, the fixation of terms of trade is a vital issue, for on it a country's share of gains from trade depends.

   It is worthwhile to note that J.S. Mill, another noted classical economist, removed this shortcoming of the comparative cost theory by supplementing it with Reciprocal Demand Theory which explains the determination of terms of trade.

5. Ohlin attacked the comparative cost theory for its assumption that factors of production were perfectly mobile within a country but immobile between countries. He pointed out that immobility of factors between countries could not serve as a basis for international trade, since immobility of factors is not peculiar the relations between countries but is also present between different regions of the same country.

   He further expressed the view that comparative cost doctrine applied not only to international trade but also to inter-regional trade. Indeed, according to him, international trade is only a special case of inter-regional trade. He further criticized the classical theory of comparative cost for its emphasis on supply conditions as an explanation of international trade and its neglect of the importance of demand conditions in determining the pattern of international trade.

He writes, “The comparative cost reasoning alone explains very little about international trade. It is indeed nothing more than an abbreviated account of the condition of supply”. According to him, prices of different goods and their quantities produced and consumed depend on both supply and demand conditions. He therefore, propounded a new theory of international trade based on general equilibrium theory of value.

It may be mentioned here that Ohlin’s criticisms do not invalidate comparative cost theory. Indeed, he only refined and modified it. Even in his theory, popularly known as factor-proportions theory of international trade, comparative costs serve as a basis of international trade.

His contribution lies in his inquiring into the question why comparative costs of commodities in different countries differ and offering a satisfactory explanation of it in terms of different factor-proportions required for the production of various goods.

He further improved the comparative cost theory by incorporating in his analysis the demand aspect as be based his international trade theory on the general equilibrium theory of value.

6. It is alleged that comparative cost theory is static in character as it is based on fixed supplies of factors of production, the given technology, and the fixed and identical production functions in the trading countries. Its conclusions cannot therefore be applied in the context of a dynamic economy, especially in the present-day developing countries where resources are being developed, technology is being improved, production functions are undergoing a change.

   Indeed, structural changes are being brought about in these economies. In view of the changes in factor supplies and technology in developing countries, comparative costs of producing different commodities are also changing. In this dynamic context, a developing economy may have a comparative disadvantage in producing a certain commodity but may attain a comparative advantage after a certain stage of its development.

   Note that this criticism about the static character of the comparative cost theory does not invalidate it. It only pinpoints the need for reformulating and refining it so as to make it applicable to the dynamic conditions of the developing countries.

Conclusion:
To sum up, bereft of the labour theory of value and expressed in terms of opportunity costs comparative cost theory is still a valid explanation of international trade. It highlights the need for removal of artificial restrictions in the form of tariffs and other means on foreign trade so that various countries specialise on the basis of their comparative costs and derive mutual benefits from trade.

This theory has been a victim of undue criticisms such as that it assumes the absence of transport costs, the existence of perfect competition and full employment, and further that it considers two commodities, two countries model. These are only simplifying assumptions and do not invalidate its conclusions in a substantial way.

Indeed, every theory makes some such simplifying assumptions in order to bring out the economic forces that have an important bearing on the subject under investigation.

Factor Proportion Theory

The factor endowment theory holds that countries are likely to be abundant in different types of resources. In economic reasoning, the simplest case for this distribution is the idea that countries will have different ratios of capital to labor. Factor endowment theory is used to determine comparative advantage. The Hechsher-Olin Theory holds that a country will have a comparative advantage in the good that uses the factor with which it is heavily endowed. When calculating comparative advantage, it is essential to remember that it is the ratios of factors that matter; a country could be heavily endowed with both labor and capital, but it proportionally may have more of one than another than would another country. If a country has a comparative advantage in a good that uses the factor with which it is heavily endowed, it should focus it's production on that good. Because it is heavily endowed with that factor, it will be most efficient at producing the good that requires that factor for production. For example, a country with a high ration of capital to labor will be more efficient at producing computers than it would corn. If that country instead focused on producing corn, it would have to divert capital which is not meant for corn production into an area where it is inefficiently used.

Critiques of the Factor Endowment Theory

The factor endowment theory, while used to explain overarching notions of comparative advantage, in reality only accounts for a small percentage of world trade. At one time, there were big disparities between labor and capital in the US and East Asia. East Asia began to grow much faster than the US, however trade increased as the two countries became more similar, even though the factor endowment theory would predict that trade should have lessened. This suggests that there must be something other than factor endowments motivating international trade. The assumptions that drive the factor endowment theory may be flawed. It first assumes the same technology, and also assumes arbitrary borders. However, factors like borders play a large role in how much trade occurs; Seattle, for instance, conducts more trade with Boston than it does with Vancouver. Branding also plays a large role in trade; France has been very successful in differentiating its product, wine, from that of other countries, so regardless of factor endowments France will likely continue to specialize in wine and the rest of the world will likely keep buying it from them.

UNIT- II

Economic Institute in International Business

World Trade Organization (WTO)

During great depression of 1930s the international trade was badly affected and various countries imposed import restriction for safeguarding their economies. This resulted in a sharp decline in the world trade in 1945. USA put forward many proposals for extending international trade and employment. On October 30, 1947, 23 countries at Geneva, signed an agreement related to tariffs imposed on trade.

This agreement is known as General Agreement on Tariffs and Trade (GATT). It came into force on January 1, 1948. Initially GATT was established in the form of a temporary arrangement but later on it took the shape of a permanent agreement. GATT's headquarter was in Geneva. On December 12, 1995, GATT was abolished and replaced by World Trade Organisation (WTO), which came into existence on January 1, 1995.

The WTO was established on January 1, 1995. The WTO is the embodiment of the Uruguay Round results and the successor to GATT. 76 Governments became members of the WTO on its first day. As of September 1999, there are 134 members of the WTO and 34 countries have an observer status. There is a waiting list of 31 members. They account for more than 90 percent of the world trade.

Functions of WTO:

i) The WTO shall facilitate the implementation, administration and operation, and further the objectives of the Multilateral Trade Agreements, and shall also provide the framework for the implementation, administration and operation of Plurilateral Trade Agreements.

ii) The WTO shall provide the forum for negotiations among its members concerning their multilateral trade relations in matters dealt with under the Agreements.

iii) The WTO shall administer the 'Understanding on Rules and Procedures Governing the Settlement of Disputes'.

iv) The WTO shall administer the 'Trade Review Mechanism'.

v) With a view to achieve greater coherence in global economic policy making, the WTO shall co-operate, as appropriate, with the IMF and IBRD and its affiliated agencies.

The General Council will serve four main functions:

i) To supervise on a regular basis the operation of the revised agreements and ministerial declarations relating to: Goods, services, and TRIPs.

ii) To act as a Dispute Settlement Body,

iii) To serve as a Trade Review Mechanism,

iv) To establish Goods Council, Services Council and TRIPs Council, as subsidiary bodies.

The WTO is a more powerful body with enlarged functions than the GATT and is envisaged to play a major role in the world economic affairs. To become a member of the WTO, a country must completely accept the results of the Uruguay Round

World Bank

The World Bank is an international financial institution that provides loans to developing countries for capital programs. It comprises two institutions: **the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA)**. The World Bank is a component of the World Bank Group, and a member of the United Nations Development Group.

The World Bank's official goal is the reduction of poverty. According to its Articles of Agreement, all its decisions must be guided by a commitment to the promotion of foreign investment and international trade and to the facilitation of Capital investment.

During World War II, in the year 1944, a decision for the establishment of two institutions was taken in a Conference held at Bretton Woods in America. The institutions to be established were

(1) International Monetary Fund and

(2) International Bank for Reconstruction and Development or World Bank.

The objective of IMF was to stabilize exchange rates by removing temporary balance of payments deficits. On the other hand, the objective of the International Bank for Reconstruction and Development (IBRD) or the World Bank was the reconstruction of war-ravaged economies and provision of necessary capital for the economic development of underdeveloped countries. The bank was established in 1945 and started its function in June 1945. The World Bank is an inter-governmental institution and corporate in form. Its capital is wholly owned by its member countries.

Objectives of the World Bank

The main objectives of the World Bank are:

(1) Reconstruction and Development

The main objective of the bank is to reconstruct the war devastated economies like Britain, France, Holland etc. and to provide economic assistance to underdeveloped countries like India, Pakistan, Sri Lanka, Burma etc.

(2) Encouragement to Capital Investment

An other important objective of the Bank is to encourage private investors to invest capital underdeveloped countries, by means of guarantee of participation in loans and other investment made by private investors and when private capital is not available on reasonable terms, to supplement private investment by providing on suitable conditions finance for productive purposes out of its own capital, funds raised by it and its other resources.

(3) Encouragement to International Trade

The third objective of the bank is to encourage international trade. It aims at promoting long-range growth of international trade and maintenance of equilibrium in member's international balance of payments, so that standard of living of the people of member-countries is raised.

(4) Establishment of Peace Time Economy

The fourth objective of the Bank is to help the member-countries changeover from war-time economy to peace-time economy.

(5) Environmental Protection

Global environmental protection is also an objective of Bank. To this end, World Bank gives substantial financial assistance to those underdeveloped countries which are engaged in the task of environmental protection.

(6) Maintenance of equilibrium in balance of payment

To promote long term balanced growth of international trade and the maintenance of equilibrium in balance of payments of member countries by encouraging long term international investment so as to develop productive resources of members and thereby raising its productivity, the standard of living and labor conditions.

Capital of the World Bank

Initially, the authorized capital of the World Bank was to the tune of $ 10,000 million, which was divided into 1,00,000 shares of $ 1,00,000 each. All these shares were made available to member countries only. As per the system of the Bank, out of each share.

(a) 2 per cent in payable in gold or U.S. dollars;

(b) 18 per cent of the subscription is to be paid in terms of member's own currency;

(c) The remaining 80 per cent of the subscription is not immediately collected from the members but can be called up by the Bank as a Callabh fund whenever it requires to meet its obligation. Thus it is observed that only 20 per cent of the total capital is called by the Bank and the same is available for its lending purposes.

The capital of the World Bank has also been increased time to time with the consent of its members. After the admission of new members, the authorized capital of the Bank has been

increased to $ 171 billion. In its annual meeting held in September 1983, the World Bank decided to go in for a selective capital increase of 8.4 billion dollars and accordingly the share holding of different member countries were suitably adjusted.

Achievements

The following are the major achievements of World Bank:

(i) Membership

The total membership of the Bank has increased from a mere 30 countries initially to 68 countries in 1960 and then to 151 countries in 1988.

(ii) Increase in Working Capital

The bank has been increasing its Working Capital from time to time. Accordingly, it has raised its capital by selling its securities and bonds at different times to different countries like USA, UK etc. Accordingly, its capital has trebled during the past 40 years. In September, 1987, the Bank approved on increase in general of 74.8 billion dollars in its capital and thereby raised its lendable resources to 170 billion dollars.

(iii) Increase in Subscribed Capital

The Bank has also raised its subscribed capital from $ 10,000 million initially to $ 19,300 million in 1960 and then to $ 91,436 million in 1988. As a result of following such process, the lending capacity of the Bank has expanded.

(iv) Loan Approval

The amount of approval of loan to the member countries has been increasing and accordingly the amount increased from $ 659 million in 1960 to $ 14,762 million in 1988.

(v) Loan Disbursement

The volume of loan disbursement by the Bank among its members has also been increasing and accordingly the volume of loan disbursement has increased from $ 544 million in 1960 to $ 11,636 million in 1988.

(vi) Total Loan

The World Bank has advanced a significant amount of loan to its member countries. During the past 40 years of its existence since inception (up to June, 1989) the Bank had lent to the extent of $ 1,36,596 million to 115 member countries for various developmental projects.

(vii) Loans for Productive Purposes

The World Bank is granting loans to member countries for productive purposes, especially for the development of agriculture, irrigation, electricity and transportation projects. Economic development of a country depends on the basic infrastructure. Therefore, the Bank is lending for these aforesaid projects for this rapid economic development.

(viii) Technical Assistance

As per provisions of the Bank, the World Bank has been sending technical missions to member countries for collecting necessary information regarding the functioning of their economies. The Bank has been giving technical assistance to its member countries in order to solve their complicated economic problems and for assessing economic resources of the country and setting up of priorities for development programmes.

(ix) New Loan Strategy

In recent years, the Bank has introduced new loan strategy for giving more emphasis of financing different schemes for influencing the well being of the poor masses of member developing countries, especially for the purpose of agricultural marketing, forestry, fishery, development of feeder roads in rural areas, rural electrification, spread of education in rural areas etc. In respect of industry, the Bank made provision for direct lending to industries, more emphasis on heavy industries, fertilizer industry, labour intensive small scale industry etc.

(x) Assistance to Underdeveloped Countries

(a) Financial assistance for the promotion of development;

(b) Developing 'third window' to advance loan at lower rate of interest to the underdeveloped countries;

(c) Providing technical assistance;

(d) Organizing meetings of creditor countries for providing loan to developing countries such as Aid India Club etc.;

(e) Setting up of subsidiary financial institutions like International Finance Corporation (IFC), International Development Association (IDA) for providing soft and concessional finance to developing countries etc.

(xi) Settlement of Disputes

The World Bank has been playing an important role in the settlement of international disputes successfully for the promotion of world peace. Accordingly it has resolved Indus river water dispute between India and Pakistan and Suez Canal dispute between England and Egypt.

Characteristics and Role of MNCs

Characteristics of a Multinational Corporation

Not all businesses can be called a multinational corporation. There are certain features that must be met for them to be named as such. The following are the characteristics of multinational corporations:

1. **Very high assets and turnover**

To become a multinational corporation, the business must be large and must own a huge amount of assets, both physical and financial. The company's targets are so high that they are also able to make substantial profits.

2. **Network of branches**

Multinational companies keep production and marketing operations in different countries. In each country, the business oversees more than one office that functions through several branches and subsidiaries.

3. **Control**

In relation to the previous point, the management of the offices in other countries is controlled by one head office located in the home country. Therefore, the source of command is found in the home country.

4. **Continued growth**

Multinational corporations keep growing. Even as they operate in other countries, they strive to grow their economic size by constantly upgrading and even doing mergers and acquisitions.

5. **Sophisticated technology**

When a company goes global, they need to make sure that their investment will grow substantially. In order to do achieve substantial growth, they need to make use of capital-intensive technology, especially in their production and marketing.

6. Right skills

Multinational companies employ only the best managers who are capable of handling huge funds, using advanced technology, managing workers, and running a huge business entity.

7. Forceful marketing and advertising

One of the most effective survival strategies of multinational corporations is spending a huge amount of money on marketing and advertising. It is how they are able to sell every product or brand they make.

8. **Good quality products**

Because they use capital-intensive technology, they are able to produce top-of-the-line products.

Role of MNCs

1. **Promotion Foreign Investment:**

In the recent years, external assistance to developing countries has been declining. This is because the donor developed countries have not been willing to part with a larger proportion of their GDP as assistance to developing countries. MNCs can bridge the gap between the requirements of foreign capital for increasing foreign investment in India.

The liberalized foreign investment pursued since 1991, allows MNCs to make investment in India subject to different ceilings fixed for different industries or projects. However, in some industries 100 per cent export-oriented units (EOUs) can be set up. It may be noted, like domestic investment, foreign investment has also a multiplier effect on income and employment in a country.

For example, the effect of Suzuki firm's investment in Maruti Udyog manufacturing cars is not confined to income and employment for the workers and employees of Maruti Udyog but goes beyond that. Many workers are employed in dealer firms who sell Maruti cars.

Moreover, many intermediate goods are supplied by Indian suppliers to Maruti Udyog and for this many workers are employed by them to manufacture various parts and components used in Maruti cars. Thus their incomes also go up by investment by a Japanese multinational in Maruti Udyog Limited in India.

2. **Non-Debt Creating Capital inflows:**

In pre-reform period in India when foreign direct investment by MNCs was discouraged, we relied heavily on external commercial borrowing (ECB) which was of debt-creating capital inflows. This raised the burden of external debt and debt service payments reached the alarming figure of 35 per cent of our current account receipts. This created doubts about our ability to fulfill our debt obligations and there was a flight of capital from

India and this resulted in balance of payments crisis in 1991. As direct foreign investment by multinational corporations represents non-debt creating capital inflows we can avoid the liability of debt-servicing payments. Moreover, the advantage of investment by MNCs lies in the fact that servicing of non-debt capital begins only when the MNC firm reaches the stage of making profits to repatriate Thus, MNCs can play an important role in reducing stress strains and on India's balance of payments (BOP).

3. **Technology Transfer:**

Another important role of multinational corporations is that they transfer high sophisticated technology to developing countries which are essential for raising productivity of working class and enable us to start new productive ventures requiring high technology. Whenever, multinational firms set up their subsidiary production units or joint-venture units, they not only import new equipment and machinery embodying new technology but also skills and technical know-how to use the new equipment and machinery.

As a result, the Indian workers and engineers come to know of new superior technology and the way to use it. In India, the corporate sector spends only few resources on Research and Development (R&D). It is the giant multinational corporate firms (MNCs) which spend a lot on the development of new technologies can greatly benefit the developing countries by transferring the new technology developed by them. Therefore, MNCs can play an important role in the technological up-gradation of the Indian economy.

4. **Promotion of Exports:**

With extensive links all over the world and producing products efficiently and therefore with lower costs multinationals can play a significant role in promoting exports of a country in which they invest. For example, the rapid expansion in China's exports in recent years is due to the large investment made by multinationals in various fields of Chinese industry.

Historically in India, multinationals made large investment in plantations whose products they exported. In recent years, Japanese automobile company Suzuki made a large investment in Maruti Udyog with a joint collaboration with Government of India. Maruti cars are not only being sold in the Indian domestic market but are exported in a large number to the foreign countries.

As a matter of fact until recently, when giving permission to a multinational firm for investment in India, Government granted the permission subject to the condition that the concerned multinational company would export the product so as to earn foreign exchange for India.

However, in case of Pepsi, a famous cold -drink multinational company, while for getting a product license in 1961 to produce Pepsi Cola in India it agreed to export a certain proportion of its product, but later it expressed its inability to do so. Instead, it ultimately agreed to export things other than what it produced such as tea.

5. **Investment in Infrastructure:**

With a large command over financial resources and their superior ability to raise resources both globally and inside India it is said that multinational corporations could invest in infrastructure such as power projects, modernisation of airports and posts, telecommunication.

The investment in infrastructure will give a boost to industrial growth and help in creating income and employment in the India economy. The external economies generated by investment in infrastructure by MNCs will therefore crowd in investment by the indigenous private sector and will therefore stimulate economic growth.

In view of above, even Common Minimum Programme of the present UPA government provides that foreign direct investment (FDI) will be encouraged and actively sought, especially in areas of:

(a) Infrastructure

(b) High technology

(c) Exports

(d) Where domestic assets and employment are created on a significant scale.

UNIT – III

Foreign Trade in India

Foreign Trade & Economic growth

Foreign trade enlarges the market for a country's output. Exports may lead to increase in national output and may become an engine of growth. Expansion of a country's foreign trade may energise an otherwise stagnant economy and may lead it onto the path of economic growth and prosperity.

Due to Increased foreign demand may lead to large production and economies of scale with lower unit costs. Increased exports may also lead to greater utilisation of existing capacities and thus reduce costs, which may lead to a further increase in exports.

Expanding exports may provide the great employment opportunities. The possibilities of increasing exports may also reveal the underlying investment in a particular country and thus assist in its economic growth.

The foreign trade contributes to economic growth are as follows:

1. **Foreign trade generates pressure for dynamic change through**

   (a) Competitive pressure from imports

   (b) Pressure of competing export markets

   (c) A better allocation of resources;

2. **The primary function** of foreign trade is to explore means of procuring imports of capital goods, without which no process of development can start;
3. **Trade provides** for flow of technology, which allows for increases in productivity, and also result in short-term multiplier effect;
4. **Foreign trade** increases most workers' welfare. It does so at least in four ways:

   (a) Larger exports translate into higher wages

Supply Factor

1. **Factor endowments:**

   Most of today's developing countries are much less endowed with natural resources (except for petroleum- exporting countries) than were the western countries during the 19th century.

2. **Population growth:**

   Most of today's developing countries are overpopulated. This means that the major portion of any increase in their output of food and raw materials is absorbed domestically, leaving, very little, if any, export surplus.

3. **Factor mobility:**

   There is much less flow of capital in developing countries today than was observed in the 19th century. At the same time there is outflow of skilled labour from such countries on a fairly large scale.

4. **Neglect of agriculture:**

   Finally, until recently, developing nations have somewhat neglected their agriculture in favour of more rapid industrialisation. This has hampered their export growth in particular and development prospects in general.

   (b) Because workers are also consumers, trade brings them immediate gains through products of imports

   (c) It enables workers to become more productive as the goods they produce increase in value

   (d) Trade increases technology transfers from industrial to developing countries resulting in demand for more skilled labour in the recipient countries.

5. Exports allow fuller utilisation of capacity resulting in achievement of economies of scale, separates production pattern from domestic demand, increases familiarity with absorption of new technologies;
6. Increased openness to trade has been strongly associated with reduction in poverty in most developing countries. As the historian Arnold Toynbee said 'civilisation' has been spread though 'mimesis', i.e. emulation or simply copying.

In short, trade promotes growth enhancing economic welfare by stimulating more efficient utilisation of factor endowments of different regions and by enabling people to obtain goods from efficient sources of supply.

Tariffs and Non-Tariffs Barriers in International Trade

Trade barriers are restrictions imposed on movement of goods between countries. Trade barriers are imposed not only on imports but also on exports. The trade barriers can be broadly divided into two broad groups: (a) Tariff Barriers, and (b) Non-tariff Barriers.

TARIFF BARRIERS

Tariff is a customs duty or a tax on products that move across borders. The most important of tariff barriers is the customs duty imposed by the importing country. A tax may also be imposed by the exporting country on its exports. However, governments rarely impose tariff on exports, because, countries want to sell as much as possible to other countries. The main important tariff barriers are as follows:

(1) Specific Duty: Specific duty is based on the physical characteristics of goods. When a fixed sum of money, keeping in view the weight or measurement of a commodity, is levied as tariff, it is known as specific duty.

For instance, a fixed sum of import duty may be levied on the import of every barrel of oil, irrespective of quality and value. It discourages cheap imports. Specific duties are easy to administer as they do not involve the problem of determining the value of imported goods. However, a specific duty cannot be levied on certain articles like works of art. For instance, a painting cannot be taxed on the basis of its weight and size.

(2) Ad valorem Duty: These duties are imposed "according to value." When a fixed percent of value of a commodity is added as a tariff it is known as ad valorem duty. It ignores the consideration of weight, size or volume of commodity.

The imposition of ad valorem duty is more justified in case of those goods whose values cannot be determined on the basis of their physical and chemical characteristics, such as costly works of art, rare manuscripts, etc. In practice, this type of duty is mostly levied on majority of items.

(3) Combined or Compound Duty: It is a combination of the specific duty and ad valorem duty on a single product. For instance, there can be a combined duty when 10% of value (ad valorem) and Re 1/- on every meter of cloth is charged as duty. Thus, in this case, both duties are charged together.

(4) Sliding Scale Duty: The import duties which vary with the prices of commodities are called sliding scale duties. Historically, these duties are confined to agricultural products, as their prices frequently vary, mostly due to natural factors. These are also called as seasonal duties.

(5) Countervailing Duty: It is imposed on certain imports where products are subsidised by exporting governments. As a result of government subsidy, imports become more cheaper than domestic goods. To nullify the effect of subsidy, this duty is imposed in addition to normal duties.

(6) Revenue Tariff: A tariff which is designed to provide revenue to the home government is called revenue tariff. Generally, a tariff is imposed with a view of earning revenue by imposing duty on consumer goods, particularly, on luxury goods whose demand from the rich is inelastic.

(7) Anti-dumping Duty: At times, exporters attempt to capture foreign markets by selling goods at rock-bottom prices, such practice is called dumping. As a result of dumping, domestic industries find it difficult to compete with imported goods. To offset anti-dumping effects, duties are levied in addition to normal duties.

(8) Protective Tariff: In order to protect domestic industries from stiff competition of imported goods, protective tariff is levied on imports. Normally, a very high duty is imposed, so as to either discourage imports or to make the imports more expensive as that of domestic products.

Note: Tariffs can be also levied on the basis of international relations. This includes single column duty, double column duty and triple column duty.

NON-TARIFF BARRIERS

A non tariff barrier is any barrier other than a tariff, that raises an obstacle to free flow of goods in overseas markets. Non-tariff barriers, do not affect the price of the imported goods, but only the quantity of imports. Some of the important non-tariff barriers are as follows:

(1) Quota System: Under this system, a country may fix in advance, the limit of import quantity of a commodity that would be permitted for import from various countries during a given period. The quota system can be divided into the following categories:

(a) Tariff/Customs Quota (b) Unilateral Quota

(c) Bilateral Quota (d) Multilateral Quota

- **Tariff/Customs Quota:** Certain specified quantity of imports is allowed at duty free or at a reduced rate of import duty. Additional imports beyond the specified quantity are permitted only at increased rate of duty. A tariff quota, therefore, combines the features of a tariff and an import quota.
- **Unilateral Quota:** The total import quantity is fixed without prior consultations with the exporting countries.
- **Bilateral Quota:** In this case, quotas are fixed after negotiations between the quota fixing importing country and the exporting country.
- **Multilateral Quota:** A group of countries can come together and fix quotas for exports as well as imports for each country.

(2) Product Standards: Most developed countries impose product standards for imported items. If the imported items do not conform to established standards, the imports are not allowed. For instance, the pharmaceutical products must conform to pharmacopoeia standards.

(3) Domestic Content Requirements: Governments impose domestic content requirements to boost domestic production. For instance, in the US bailout package (to bailout General Motors and other organisations), the US Govt. introduced 'Buy American Clause' which means the US firms that receive bailout package must purchase domestic content rather than import from elsewhere.

(4) Product Labelling: Certain nations insist on specific labeling of the products. For instance, the European Union insists on product labeling in major languages spoken in EU. Such formalities create problems for exporters.

(5) Packaging Requirements: Certain nations insist on particular type of packaging materials. For instance, EU insists on recyclable packing materials, otherwise, the imported goods may be rejected.

(6) Consular Formalities: A number of importing countries demand that the shipping documents should include consular invoice certified by their consulate stationed in the exporting country.

(7) State Trading: In some countries like India, certain items are imported or exported only through canalising agencies like MMTC. Individual importers or exporters are not allowed to import or export canalised items directly on their own.

(8) Preferential Arrangements: Some nations form trading groups for preferential arrangements in respect of trade amongst themselves. Imports from member countries are given preferences, whereas, those from other countries are subject to various tariffs and other regulations.

(9) Foreign Exchange Regulations: The importer has to ensure that adequate foreign exchange is available for import of goods by obtaining a clearance from exchange control authorities prior to the concluding of contract with the supplier.

(10) Other Non-Tariff Barriers: There are a number of other non – tariff barriers such as health and safety regulations, technical formalities, environmental regulations, embargoes, etc.

Advertisements

Role of Export Promotion and Import Substitution

Import Substitution Strategy:

For various reasons, many LDCs have ignored primary-exports-led growth strategies in favour of import substitution (IS) development strategies. These policies seek to promote rapid industrialisation and, therefore, development by erecting high barriers to foreign goods in order to encourage domestic production. A package of policies, called import substitution (IS), consists of a broad range of control, restriction and prohibitions such as import quotas and high tariffs on imports.

The trade restrictions are intended to **"protect"** domestic industries so that they can gain comparative advantage and substitute domestic goods for formerly imported goods. IS policies are largely based on the belief that economic growth can be accelerated by actively directing economic activity away from traditional agriculture and resource-based sectors of the economy towards manufacturing.

The broad range of tariffs, quotas and outright prohibitions on imports that are part of IS policies are clearly not a form of infant industry protection. The infant-industry argument states that sectors and industries that can reasonably be expected to gain comparative advantage, after some learning period, should be protected.

But the broad protection under IS policies usually protect all industries indiscriminately, whether they generate technological externalities or have any chance of achieving competitive efficiency.

IS policies were advocated due to a very sharp decline in the prices of commodities and raw materials exported by many LDCs. Prebisch and Singer convincingly argued that low-income elasticity of demand for primary products implied that, in the long run, the terms of trade of primary product exporters would deteriorate.

In short, the IS approach to development applies the strategic argument for protection to one or more targeted industries in the LDCs. That is, the government determines those sectors best suited for local industrialisation, erects barriers to trade on the products produced in these sectors in order to encourage local investment and then lowers the barriers over time as the industrialisation process gains momentum.

If the government has targeted the correct sectors, the industries will continue to thrive even as protection comes down. In practice, however, the trade barriers are rarely removed. In the end, countries that follow IS strategies tend to be characterised by high barriers to trade that grow over time.

PROBLEMS OF IMPORT-SUBSTITUTION IN INDIA

Following are the main problems of import substitution in India:

(1) High Production Cost at Initial Stage: Besides the raw material, certain other cost like interest rates, higher price of importable and non-traded inputs, technological factors and low product,civil,y contribute to the high cost, of production in India Therefore, commodities produced in the country have high prices in comparison to the imported goods and consumers show, no interest in buying the goods produced for the intention of import-substitution.

(2) Poor Quality of Production: Poor quality and inadequacy of inputs, technology and facilities affect the product quality. Policy of import substitution proves unsuccessful due to poor quality products.

(3) Ignorance of Consumers: Generally, people believe that imported goods are better than the home products. This view attract them towards the imported goods and they do not take interest in buying goods produced in the country. Policy of

(4) Lack of Essential Resources import-substitution becomes impractical due to lack of resources essential for production. Inadequacy of capital and raw material, backwardness of technology create hinderane in the way of import substitution.

(5) Dampens Innovation: Critics observe that such subsidised import substitution generally limits competition, dampens innovation and productivity growth, and keeps the country’s real income low.

(6) Ignores Specialisation: This approach ignores the benefits of specialisation and comparative advantage. The consumers and the entire economy might be better off if the emphasis on import substitution were replaced by an emphasis on outward orientation.

(7) Discriminates Against Agriculture: Import substitution discriminated against agriculture and favoured industry. It led to stagnation and impoverishment in rural This, in turn, led to migration to the cities, necessitating the 'unproductive' type of investments.

MEANING OF EXPORT PROMOTION

Export promotion comprises all those government and non-government efforts, rules, procedures, courses of action and techniques which are adopted to boost our exports in terms of value as well as in volume. Thus all those measures, schemes, policies, procedures and methods which are adopted for increasing export are known as export promotion measures. In order to attain the objective of self-reliance every country is keenly interested to expand its exports.

CRITICAL EVALUATION OF THE POLICY OF IMPORT SUBSTITUTION AND EXPORT PROMOTION

The goal of self-reliance in vital sectors has been a long term objective of India since the beginning of the planning. The goal can be attained through foreign trade policy in two ways as given under :

1. Import substitution policy, 2. Export promotion policy.

The two broad objectives of the programme of import substitution in India were : (a) to Save scarce foreign exchange for the import of more important goods, and (b) to achieve self-reliance in the production of as many goods as possible. The policy in India has gone through various phases. Broadly speaking, we can discern three distinct phases

(i) in the earlier phase, import substitution mostly took the form of domestic production of Consumer goods;

(ii) in the second phase, emphasis shifted to the replacement of the import of capital goods and

(iii) in the third phase emphasis was on reducing the dependence on imported technology by developing and encouraging the use of indigenous techniques. As a result of the policy of import substitution, the structure of imports has undergone significant changes. Many items which were previously imported are now being produced in the country itself. As a result of this policy, the country has been able to increase the production of many industrial products like iron and steel, automobiles, railway wagons, machine tools, diesel engines, power transformers, etc. and in the case of many other products has achieved a stage of self-sufficiency. As stated earlier, import substitution enabled the country to achieve diversification and depth so necessary for further growth• However, many economists have argued that the indiscriminate extension of import substitution to a wide range of sectors in India without regard to costs, was not the 'best', or the 'most efficient' policy. In this context Jaleel Ahmed states, "Valuable resources could have been saved if the process of import

substitution had been more selective with a limited number of strategically chosen sectors and industries, where a concentration of effort and resources could have maximised the gains in efficiency. In the heavy industry sector, in particular, simultaneous development of a plethora of manufacturing activities may have deprived the economy of the advantages of large-scale production and of meeting the minimum critical thresholds. In short, the policy of import substitution was followed during sixties and up to early seventies whereas the export promotion policy was followed since early seventies. In order to succeed government of India has changed her EXIM policy from time to time to attain export promotion policy. In the year 1973, OPEC countries raised the prices of crude oil about four times. India has shifted her policy from import substitution to export promotion so that she could meet the challenge of sharp hike in oil •prices by the OPEC. Export promotion and import substitution are the two important measures for narrowing down and ultimately wiping out the balance of payments deficit. Infact, Import-substitution and Export Promotion are the two aspects of the coin."

DIFFICULTIES IN EXPORT PROMOTION

If we view from the world angle we shall find that in the world export, India's export have been regularly decreasing from the time of independence. India's share in the total foreign trade of the world was 11% whereas now it has greatly decreased, A brief account, of the major drawbacks of India's export sector is given below

1. **Technological Factors:** Technological problems have very seri0US effect on India's exports. The Tandon Committee and Alexander Committee have referred to the adverse 'impact of technological backwardness on India's exports through poor quality, low productivity, high costs, etc.
2. **High Costs:** In a large number of cases, high domestic costs are an inhibiting factor. This problem has been clearly stated by Abid Hussain Committee, "India is often at a disadvantage vis-a-vis competing countries because its costs of production, and hence export price, are higher than in competing countries. It is not only because of the higher prices of importable and non-traded inputs, or because of time and cost over-runs implicit in managerial inefficiency, but also because of much lower level of productivity, all of which stem from the aforesaid problems."
3. **Poor Quality Image:** India has a poor-quality image abroad. Despite the measures taken under the Exports (Quality Control and Inspection) Act and other laws, our exports continue to suffer because ofquality problems. Poor quality and inadequacy of inputs, technology and facilities affect the product quality. In several instances, carelessness or lack of commitment on the part of the exporters is also responsible. Adulteration and dumping are also not uncommon. There is a general impression that a proper export culture is lacking in India.
4. **Unreliability:** Besides quality, Indian exporters have been regarded as unreliable on certain other factors. As the Tandon Committee has observed, a very important black mark on the Indian exporters is reneging a term used in the USA to refer to going back on a contract and refusing to fulfil it on its original terms.
5. **Supply Problems:** A serious drawback of the Indian export sector is its inability to provide continuous and smooth supply in adequate quantities in respect of several products. The problem is that much of the exporting is the result of the residual approach rather than conscious effort of producing for export. The tendency for exporting what we produce rather than producing for export still continues to characterise the export behaviour.
6. **Faceless Presence Although** India is an important Supplier of several commodities in foreign markets, her presence in these markets is faceless in the sense that the consumers do not, know

that these commodities are Indian. Major export items of India like sea-foods, leather manufactures, spices, etc., have in many cases, a faceless presence in foreign markets. Although these exports may undergo further processing or repackaging in many cases. In several cases the Indian exports are sold in the foreign markets in the same condition as they are exported but under foreign brand names. It has also been found that when the product carries a foreign brand name sometimes, they fetch a much higher price than the same product with an Indian name. This is indeed a vicious circle. The poor-quality image of the Indian products, many a time apparent than real, makes it difficult to sell under Indian brand names. The faceless presence, on the other hand, perpetuates the problem. The faceless presence is the result of the failure of the exporters and- export promotion agencies in India to build up an image for Indian goods abroad. In fact, most bulk importers of Indian goods want this situation to be perpetuated as this enables them to hold control over the market while the exporters, being at the mercy of the foreign traders, lose bargaining power.

7. **Infrastructural Bottlenecks:** Infrastructural shortages such as energy shortages, inadequate and unreliable transport and communication facilities hinder growth in exports. Power shortages and breakdowns disrupt production schedules, increase cost and adversely affect timely shipments.
8. **Uncertainties**, Procedural Complexities and Institutional Rigidities: One of the defects of our trade policy regime has been the uncertainty about future policies, incentive schemes etc. The procedural complexities of the Indian trade regime have been indisputably acknowledged. There is a general feeling that not only that there are too many controls and overlapping of policies but also “the principle of Indian policy is to elaborate rule (and exceptions) to them, which are not only detailed and specific, but also subject to wide discretion.” These are vindictive of the structural weakness of the institution system in India,
9. **Inadequacy of Trade Information System:** An efficient Trade Information System is essential for success in the dynamic global market. But, “our marketing infrastructure as well as marketing techniques are neither effective nor efficient. We do not have any machinery to keep prompt track of business informati0n overseas, as done by JETRO in Japan, KOTRA in Korea, CETDC in Hong Kong and STDB in Singapore with a wide network of offices abroad. These organisations have evolved an efficient system, which help them to get information pertaining to tenders and the like much before these are released officially. In India, we get this information, at times, after the expiry date. India has, no doubt, a plethora of organisations; governmental, semi-governmental and also non-governmental engaged in this task in one way or other. Yet we do not have an easy access to market intelligence and information.

UNIT- IV

Foreign Investment

About FDI in India

Introduction

Apart from being a critical driver of economic growth, foreign direct investment (FDI) is a major source of non-debt financial resource for the economic development of India. Foreign companies invest in India to take advantage of relatively lower wages, special investment privileges such as tax exemptions, etc. For a country where foreign investments are being made, it also means achieving technical know-how and generating employment.

The Indian government's favourable policy regime and robust business environment have ensured that foreign capital keeps flowing into the country. The government has taken many initiatives in recent years such as relaxing FDI norms across sectors such as defence, PSU oil refineries, telecom, power exchanges, and stock exchanges, among others.

Market size

According to the Department for Promotion of Industry and Internal Trade (DPIIT), FDI equity inflows in India stood at US$ 456.79 billion during April 2000 to December 2019, indicating that government's effort to improve ease of doing business and relaxation in FDI norms is yielding results.

FDI equity inflows in India stood at US$ 36.79 billion during April-December 2019. Data for 2019-20 indicates that the service sector attracted the highest FDI equity inflow of US$ 6.52 billion, followed by computer software and hardware – US$ 6.34 billion, telecommunications sector - US$ 4.29 billion and trading – US$ 3.52 billion.

During 2019-20, India received the maximum FDI equity inflows from Singapore (US$ 11.65 billion), followed by Mauritius (US$ 7.45 billion), Netherlands (US$ 3.53 billion), Japan (US$ 2.80 billion) and USA (US$ 2.79 billion).

Investments/ developments

Some of the recent significant FDI announcements are as follows:

- In January 2020, Amazon India announced investment of US$ 1 billion for digitising small and medium businesses and creating one million jobs by 2025.
- In January 2020, Mastercard announced its plans to invest up to US$ 1 billion in India over next five years to double-up its research and development efforts for the Indian market.
- In October 2019, French oil and gas giant Total S.A. have acquired a 37.4 per cent stake in Adani Gas Ltd for Rs 5,662 crore (US$ 810 million) making it the largest Foreign Direct Investment (FDI) in India's city gas distribution (CGD) sector.
- In August 2019, Reliance Industries (RIL) announced one of India's biggest FDI deals, as Saudi Aramco will buy a 20 per cent stake in Reliance's oil-to-chemicals (OTC) business at an enterprise value of US$ 75 billion.
- In October 2018, VMware, a leading software innovating enterprise of US has announced investment of US$ 2 billion in India between by 2023.

- In August 2018, Bharti Airtel received approval of the Government of India for sale of 20 per cent stake in its DTH arm to an America based private equity firm, Warburg Pincus, for around $350 million.
- In June 2018, Idea's appeal for 100 per cent FDI was approved by Department of Telecommunication (DoT) followed by its Indian merger with Vodafone making Vodafone Idea the largest telecom operator in India
- In May 2018, Walmart acquired a 77 per cent stake in Flipkart for a consideration of US$ 16 billion.

Government Initiatives

In March 2020, government permitted non-resident Indians (NRIs) to acquire up to 100 per cent stake in Air India.

In December 2019, government permitted 26 per cent FDI in digital sectors.

In August 2019, government permitted 100 per cent FDI under the automatic route in coal mining for open sale (as well as in developing allied infrastructure like washeries).

In Union Budget 2019-20, the government of India proposed opening of FDI in aviation, media (animation, AVGC) and insurance sectors in consultation with all stakeholders.

100 per cent FDI is permitted for insurance intermediaries.

As of February 2019, the Government of India is working on a road map to achieve its goal of US$ 100 billion worth of FDI inflows.

In February 2019, the Government of India released the Draft National E-Commerce Policy which encourages FDI in the marketplace model of e-commerce. Further, it states that the FDI policy for e-commerce sector has been developed to ensure a level playing field for all participants.

Government of India is planning to consider 100 per cent FDI in Insurance intermediaries in India to give a boost to the sector and attracting more funds.

In December 2018, the Government of India revised FDI rules related to e-commerce. As per the rules 100 per cent FDI is allowed in the marketplace-based model of e-commerce. Also, sales of any vendor through an e-commerce marketplace entity or its group companies have been limited to 25 per cent of the total sales of such vendor.

In September 2018, the Government of India released the National Digital Communications Policy, 2018 which envisages increasing FDI inflows in the telecommunications sector to US$ 100 billion by 2022.

In January 2018, Government of India allowed foreign airlines to invest in Air India up to 49 per cent with government approval. The investment cannot exceed 49 per cent directly or indirectly.

No government approval will be required for FDI up to an extent of 100 per cent in Real Estate Broking Services.

The Government of India is in talks with stakeholders to further ease foreign direct investment (FDI) in defence under the automatic route to 51 per cent from the current 49 per cent, in order to give a boost to the Make in India initiative and to generate employment.

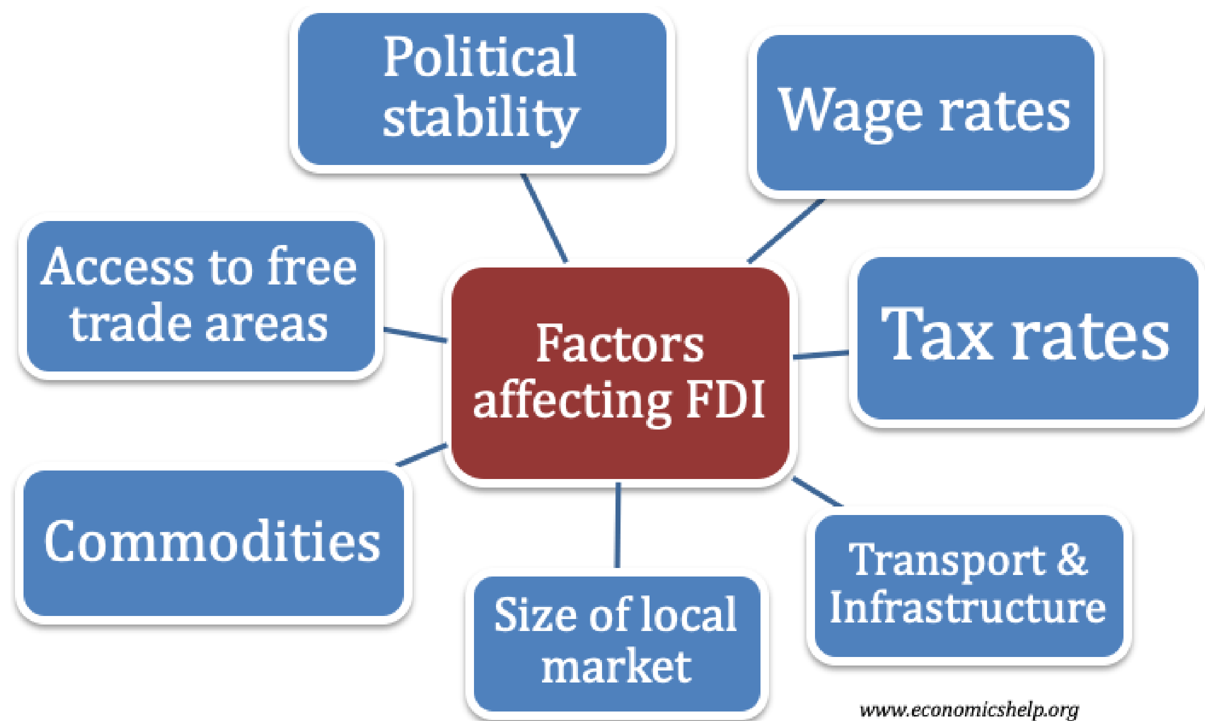
Factors that affect foreign direct investment (FDI)

Foreign direct investment (FDI) means companies purchase capital and invest in a foreign country. For example, if a US multinational, such as Nike built a factory for making trainers in Pakistan; this would count as foreign direct investment.

In summary, the main factors that affect foreign direct investment are

- Infrastructure and access to raw materials
- Communication and transport links.
- Skills and wage costs of labour

Factors affecting foreign direct investment



1. Wage rates

A major incentive for a multinational to invest abroad is to outsource labour-intensive production to countries with lower wages. If average wages in the US are $15 an hour, but $1 an hour in the Indian sub-continent, costs can be reduced by outsourcing production. This is why many Western firms have invested in clothing factories in the Indian sub-continent.

- However, wage rates alone do not determine FDI, countries with high wage rates can still attract higher tech investment. A firm may be reluctant to invest in Sub-Saharan Africa because low wages are outweighed by other drawbacks, such as lack of infrastructure and transport links.

2. Labour skills

Some industries require higher skilled labour, for example pharmaceuticals and electronics. Therefore, multinationals will invest in those countries with a combination of low wages, but high labour productivity and skills. For example, India has attracted significant investment in call centres, because a high percentage of the population speak English, but wages are low. This makes it an attractive place for outsourcing and therefore attracts investment.

3. Tax rates

Large multinationals, such as Apple, Google and Microsoft have sought to invest in countries with lower corporation tax rates. For example, Ireland has been successful in attracting investment from Google and Microsoft. In fact, it has been controversial because Google has tried to funnel all profits through Ireland, despite having operations in all European countries.

4. Transport and infrastructure
A key factor in the desirability of investment are the transport costs and levels of infrastructure. A country may have low labour costs, but if there is then high transport costs to get the goods onto the world market, this is a drawback. Countries with access to the sea are at an advantage to landlocked countries, who will have higher costs to ship goods.

5. Size of economy / potential for growth
Foreign direct investment is often targeted to selling goods directly to the country involved in attracting the investment. Therefore, the size of the population and scope for economic growth will be important for attracting investment. For example, Eastern European countries, with a large population, e.g. Poland offers scope for new markets. This may attract foreign car firms, e.g. Volkswagen, Fiat to invest and build factories in Poland to sell to the growing consumer class. Small countries may be at a disadvantage because it is not worth investing for a small population. China will be a target for foreign investment as the newly emerging Chinese middle class could have a very strong demand for the goods and services of multinationals.

6. Political stability / property rights
Foreign direct investment has an element of risk. Countries with an uncertain political situation, will be a major disincentive. Also, economic crisis can discourage investment. For example, the recent Russian economic crisis, combined with economic sanctions, will be a major factor to discourage foreign investment. This is one reason why former Communist countries in the East are keen to join the European Union. The EU is seen as a signal of political and economic stability, which encourages foreign investment.

Related to political stability is the level of corruption and trust in institutions, especially judiciary and the extent of law and order.

7. Commodities
One reason for foreign investment is the existence of commodities. This has been a major reason for the growth in FDI within Africa – often by Chinese firms looking for a secure supply of commodities.

8. Exchange rate
A weak exchange rate in the host country can attract more FDI because it will be cheaper for the multinational to purchase assets. However, exchange rate volatility could discourage investment.

9. Clustering effects
Foreign firms often are attracted to invest in similar areas to existing FDI. The reason is that they can benefit from external economies of scale – growth of service industries and transport links. Also, there will be greater confidence to invest in areas with a good track record. Therefore, some countries can create a virtuous cycle of attracting investment and then these initial investments attracting more. It is also sometimes known as an agglomeration effect.
10. Access to free trade areas.
A significant factor for firms investing in Europe is access to EU Single Market, which is a free trade area but also has very low non-tariff barriers because of harmonisation of rules,

regulations and free movement of people. For example, UK post-Brexit is likely to be less attractive to FDI, if it is outside the Single Market.

UNIT- V

Regional Trading Blocks

Regional economic integration

The modern industrial system rests upon such techniques that can be employed economically only if the production takes place on a very large scale. This requires expanding markets on the one hand and increasing purchasing power with the people on the other.

For the fullest exploitation of the production potential of the modern techniques, certain countries having small internal geographical markets, have attempted to organise themselves into regional groupings. The economic integration, in the broadest sense, means the unification of distinct economies into a single larger economy.

The tariffs and other restrictions upon trade are applied in a discriminatory manner. Such discrimination is of two forms—country- discrimination and commodity-discrimination. The economic integration, according to Salvatore, is the "commercial policy of discriminatively reducing or eliminating trade barriers only among the nations joining together."

Thus the economic integration refers to an arrangement whereby two or more countries combine into a larger economic region through the removal of discontinuities and discriminations existing along national frontiers, while following a common tariff and trade policies against the countries outside the group.

Tinbergen has defined economic integration as "the creation of the most desirable structure of international economy, removing artificial hindrances to the optimum operation and introducing deliberately all desirable elements of co-ordination and unification." Tinbergen has distinguished-between the negative and positive aspects of integration.

The negative aspects of integration involve the removal of discrimination and restrictions on the movement of goods among the member countries. The positive aspects of integration involve the adoption of such policy measures and institutional arrangements as facilitate the removal of market distortions within the given economic region.

The economic integration can be understood both as a process and as a state of affairs. As a process, it is concerned with the measures which aim at abolition of discrimination between economic units belonging to different nation states. As a state of affairs, it can be treated as an area comprised of different nation states among which there is an absence of various forms of discrimination.

There are two essential features of economic integration:

(i) Re-introduction of free trade among the member nations.

(ii) Imposition of a common external tariff policy against the non-member countries.

From these two features, it follows that economic integration is a synthesis between free trade and tariff protection.

Benefits of Economic Integration:

The economic integration between two or more countries brings the following main benefits:

(i) Economies of Scale:

The individual countries, having small internal market, have limited capacity to expand production. The economic integration provides an unrestricted access of the products produced by any member country. This gives strong inducement to expand production and exploit fully the economies of scale.

(ii) International Specialisation:

The economic integration enables the member countries to attain a greater degree of specialisation in both products and processes. Specialisation based on comparative cost advantage by a specific geographical region can cause considerably large expansion in production.

(iii) Qualitative Improvement in Output:

The regional economic co-operation among a number of countries leads to rapid technological changes and larger and easier capital movements. The member countries, in such favourable conditions, can bring about qualitative improvement in production.

(iv) Expansion of Employment:

As some countries organise themselves into regional economic groups and allow unrestricted flow of labour within the region, there can be maximisation of employment and income.

(v) Improvement in Terms of Trade:

The economic integration greatly increases the bargaining power of the member countries vis-a-vis the rest of the world. That brings about a significant improvement in their terms of trade.

(vi) Increase in Economic Efficiency:

The economic integration results in increased competition within the region. That helps in maintaining a higher level of economic efficiency of the group as a whole.

(vii) Improvement in Living Standard:

As some countries organise themselves into regional groups, there is easier availability of superior varieties of goods at competitive prices. The increase in employment opportunities and the purchasing power too contributes in improving the living standards of the people.

(viii) Increase in Factor Mobility:

The economic integration leads to dismantling of barriers upon the movement of labour and other factors among the member countries. Increased factor mobility enlarges employment; lowers factor costs; and promotes productive activity in all the member countries.

Forms of Economic Integration:

The essence of economic integration is the economic co-operation among the participating countries.

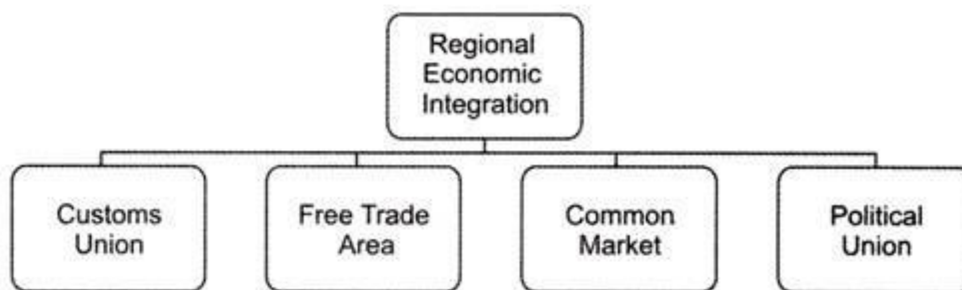


Figure-5: Trade Blocs

On the basis of the degree of cooperation, the economic integration can be of the following main forms:

(i) Preferential Trade Area or Association:

The preferential trade area or association is the most-loose form of economic integration. In this arrangement, the member countries lower tariffs on imports from each other. It means they offer preferential treatment to the member countries.

As regards the outside world, they continue to maintain their individual tariffs. The best instance of preferential trade area or association is the Commonwealth System of Preferences, established in 1932. It is headed by Britain and includes all the Commonwealth countries.

(ii) Free Trade Area:

In this form of economic integration, the member countries abolish completely both tariff and quantitative trade restrictions among themselves. However, each member country is free to maintain its own trade barriers against the non- member countries. An important example of free trade area is the European Free Trade Association (EFTA).

This association was formed in November, 1959. It included such countries as United Kingdom, Austria, Denmark, Norway, Sweden, Portugal, Switzerland and Finland as associate members. Another such association is Latin American Free Trade Association (LAFTA). It was formed in June 1961 by 10 Latin American countries.

(iii) Customs Union:

A more formal type of integration among two or more countries is the customs union. In this form of integration, the member countries abolish all tariffs and other barriers on trade among themselves. As regards the rest of the world, they adopt a common external tariff and commercial policy.

The customs unions and free trade area are similar in respect of abolition of all trade barriers for the member countries. But the customs union is distinct from the free trade area in respect of the common external tariff against the non-member countries.

In case of free trade area, the member countries retain their own tariff and other trade barriers against the non-member countries. Thus customs union is a more closely- knit form of integration than the free trade area. In a customs union, all the member countries act as a single economic unit against the non-member countries.

The customs union has been defined by GATT as the Substitution of a single customs territory for two or more customs territories, so that:

(i) Duties and other regulations of commerce…….. are eliminated with respect to substantially all trade between the constituent territories of the Union or at least with respect to substantially all the trade in products originating in such territories, and

(ii) The same, duties and other regulations of commerce are applied by each of the members of the union to the trade of territories not included in the union. J.E. Meade explained that a customs union is characterised by "complete freedom of movement of goods and services within the territories of the member countries or a common tariff applicable to all the member countries of the customs union and a common tariff adopted by all the member countries of the customs union with respect to the rest of the world."

The most important instance of a customs union is the European Economic Community formed by West Germany, France, Italy, Belgium, the Netherlands and Luxembourg in 1957.

The theory of customs union was first of all given by Jacob, Viner in 1950. According to him, customs union ensures, on the one hand, increased competition among the members and, on the other, an increased measure of protection against trade and competition from the rest of the world. Viner clearly stated that the synthesis of elements of competition and protection might or might not increase the welfare of the member nations.

Jacob Viner's pioneering work in this field was followed by the contribution made by the writers like J.E. Meade (1955), R. G. Lipsey (1957), H.G. Johnson (1962), J. Vanek (1965), Cooper and Masell (1965), Murry Kemp (1969), J. Bhagwati (1971), P.J. Lloyd (1982) and many others.

(iv) Common Market:

The common market signifies a more unified arrangement among a group of countries than the customs union. The common market involves the abolition of tariff and trade restrictions among the member countries and adoption of a common external tariff. It goes even beyond that and allows free movement of labour and capital among the member nations.

Thus in case of a common market, there is a free and integrated movement of goods and factors among the member countries. The European Common Market (ECM) called also as the European Economic Community (EEC) is the best example of the common market.

(v) Economic Union:

The most advanced form of economic integration involving the greatest degree of co-operation is the economic union. In case of an economic union, two or more countries form a common market. In addition, they proceed to harmonise and unify their fiscal, monetary, exchange rate, industrial and other socio-economic policies. The member countries attempt to have a common currency and banking system.

An example of economic union is BENELUX (including Belgium, Netherlands and Luxembourg) which was formed in 1948 initially as a customs union bat later got converted into an economic union in 1960. These countries have now joined the EU. The European Economic Community (EEC) has transformed itself into an economic union called as European Union (EU) in 1991.

An interesting recent development, based on the principles of integration, has been the duty--free zones or economic zones. Such areas have been set up in different countries or regions with the object of attracting foreign investment through duty-free imports of raw materials and intermediate products.

European Union

The European Union is a group of 28 countries that operates as a cohesive economic and political block. Nineteen of the countries use the euro as their official currency. The EU grew out of a desire to form a single European political entity to end the centuries of warfare among European countries that culminated with World War II and decimated much of the continent. **The European Single Market was established by 12 countries in 1993 to ensure the so-called four freedoms: the movement of goods, services, people and money.**

The EU began as the European Coal and Steel Community, which was founded in 1950 and had just six members: Belgium, France, Germany, Italy, Luxembourg and the Netherlands. It became the European Economic Community in 1957 under the Treaty of Rome and, subsequently, became the European Community.The early focus of the EC was a common agricultural policy as well as the elimination of customs barriers. The EC initially expanded in 1973 when Denmark, Ireland, the United Kingdom, Greece and Spain became members. A directly elected European Parliament took office in 1979.

In 1986, the Single European Act solidified the principles of foreign policy cooperation and extended the powers of the community over the members. The act also formalized the idea of a single European market. The Maastricht Treaty took effect on Nov. 1, 1993, and the European Union replaced the EC.

The Treaty created the euro, which is intended to be the single currency for the EU. The euro debuted on Jan. 1, 1999. Denmark and the United Kingdom negotiated **"opt out"** provisions that permitted them to retain their own currencies. Several newer members of the EU have not yet met the criteria for adopting the euro. In 2017, the EU's gross domestic product totaled $17.1 trillion (nominal), which was $2.9 trillion less than the United States' $20 trillion GDP.

Euro Crisis

The **EU and the European Central Bank (ECB)** have struggled with high sovereign debt and collapsing growth in Portugal, Ireland, Greece and Spain since the global financial market collapse of 2008. Greece and Ireland received financial bailouts from the community in 2009, which were accompanied by fiscal austerity. Portugal followed in 2011, along with a second Greek bailout.

Multiple rounds of interest rate cuts and economic stimulus failed to resolve the problem. Northern countries such as Germany, the United Kingdom and the Netherlands increasingly resent the financial drain from the south. Repeated rumors that Greece would be forced to withdraw from the euro failed to materialize amid disagreement as to whether the move was legally possible as it was not covered in the **Maastricht Treaty.**

UK Referendum

As the situation moved from crisis to stagnation, the U.K. government announced it would hold a referendum to determine whether it would remain a part of the EU on June 23, 2016. The nation voted to leave the EU under what's now called Brexit.

Association of South East Asian Nations (ASEAN)

The Association of Southeast Asian Nation (ASEAN) is an association of nations dedicated to economic and political co-operation in Southeast Asia countries.

ASEAN was established on 8th August 1967 in Bangkok, Thailand with the signing of the ASEAN Declaration (Bangkok Declaration) by the Founding Members of ASEAN, Indonesia, Philippines, Malaysia, Singapore and Thailand. Brunei Darussalam then joined on 7 January 1984, Vietnam on 28 July 1995, Lao PDR and Myanmar on 23 July 1997 and Cambodia on 30 April 1999 making up what is today the ten Member States of ASEAN.

The ASEAN region has a population of about 500 million, a total area of 4.5 million square kilometers, a combined gross domestic product of almost US$ 700 billion and a total trade of about US$ 850 million.

Objectives of ASEAN:

(i) To accelerate the economic growth, social progress and cultural development in the region through joint endeavors.

(ii) To promote regional peace and stability through abiding respect for justice and the rule of law.

(iii) To encourage active collaboration and mutual assistance on matters of common interest in Economic, Social, Cultural, Technical, Scientific and Administrative fields.

(iv) To provide assistance to each other in terms of training and research facilities in the educational, professional, technical and administrative areas.

(v) To work together for a greater utilization of agriculture and industries in order to expand the trade both locally and internationally.

(vi) To study the problems of international community trade, the improvement of their transportation and communications facilities and the raising of the living standards of the nations.

(vii) To promote Southeast Asian studies.

(viii) To maintain close and positive co-operation with existing international and regional organizations with similar aims and purposes.

ASEAN Free Trade Area (AFTA):

The framework of agreement on enhancing economic co-operation (1992) made a decisive move towards economic co-operation by proposing AFTA to increase ASEAN's competitive advantage as a single production unit in the world market. With this, greater economic efficiency, productivity, and competitiveness were expected to emerge out of the elimination of tariff and non-tariff barriers. Towards this objective, foreign firms were allowed to team up with the local firms by using as much as 60 per cent of the imported materials from outside the ASEAN world.

A scheme of trade liberalisation, called as the common effective preferential tariff (CEPT) Scheme, was adopted to effect a lower targeted tariff level (in the range of zero to five per cent) to be achieved within a short time-framework of ten years, i.e. by January 1, 2003. New ASEAN members were, allowed longer time to meet this deadline, e.g. Vietnam up to 2006, Laos and Myanmar up to 2008, and Cambodia up to 2010.

The CEPT also provides for the elimination of non-tariff barriers in five years' time. The implementation of CEPT is expected to facilitate:

(i) Harmonization of standards

(ii) Reciprocal recognition of tests and certification procedures

(iii) Removal of barriers to foreign investments

(iv) Macro-economic consultations

(v) Promotion of venture capital, etc.