PERIYAR UNIVERSITY

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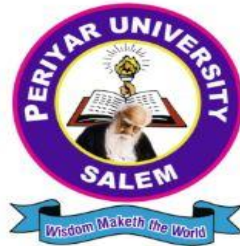
SALEM - 636 011, Tamil Nadu, India.

CENTRE FOR DISTANCE AND ONLINE EDUCATION (CDOE)

BACHELOR OF BUSINESS ADMINISTRATION
SEMESTER - II



CORE COURSE: INTERNATIONAL BUSINESS
(Candidates admitted from 2024 onwards)

PERIYAR UNIVERSITY

CENTRE FOR DISTANCE AND ONLINE EDUCATION (CDOE)

B.B.A. 2024 admission onwards

CORE COURSE - II
International Business

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LIST OF CONTENTS

UNIT	CONTENTS	PAGE
1	Introduction to International Business: Importance, nature and scope of international business- Internationalization process and Approaches - Modes of entry- Multinational Corporations and their involvement in International Business- Advantage and problems of MNCs.	10-54
2	Introduction of Trade theories – Mercantilism - Absolute Advantage - Comparative Advantage Heckscher - Ohlin Theory - The New Trade Theory - Porter's Diamond Competitive Advantage Theory.	55-98
3	Foreign Investments-Pattern, Foreign exchange rates and their impact on trade and investment flows- Functions of Foreign Exchange Market- Foreign Direct Investments - Factors influencing FDI - Modes of FDI entry - Horizontal and Vertical Foreign Direct Investment - Advantages of Host and Home Countries.	99-151
4	Drivers in Globalization - Globalization of Markets, production, investments and Technology. World trade in goods and services -	152-196

	Major trends and developments- World trade and protectionism - Tariff and non-tariff barriers.	
5	Regional Economic Groupings in Practice - Levels of Regional Economic Integration Regionalism vs. Multilateralism- Important Regional Economic Groupings in the World. Contemporary Issues in International Business- Institutional support to international business-like BREXIT, IMF, World Bank, ILO and WTO.	197-245

Section	Topic	Page No.
	UNIT 1	
1.1	International Business - An Introduction	10
1.1.1	Meaning and Definition of International business	10
1.1.2	Why is international business important?	11
1.1.3	Need for International Business	11
1.1.4	Features of International Business	12
	Summary	13
	Check Your Progress	13
1.2	Importance, nature and scope of international business	14
1.2.1	Importance of International Business	14
1.2.2	Nature of International Business	16
1.2.3	Scope of International Business	19
	Summary	21
	Check Your Progress	21
1.3	Internationalization process and Approaches	22
1.3.1	Stages of Internationalization	22
1.3.2	Approaches to International Business	24
	Summary	26
	Check Your Progress	27
1.4	Modes of entry	28
1.4.1	Exporting	28
1.4.1.1	Types of Direct Exporting	28
1.4.1.2	Types of Indirect Exporting	29
1.4.2	Licensing	31
1.4.3	Franchising	32
1.4.4	Turnkey Projects	33
1.4.5	Wholly Owned Subsidiaries (WOS)	33
1.4.6	Joint Venture	35

1.4.7	Strategic Alliance	35
	Summary	38
	Check Your Progress	38
1.5	Multinational Corporations and their involvement in International Business	39
	Summary	42
1.6	Advantage and problems of MNCs.	42
1.6.1	Advantages of MNCs	42
1.6.2	Disadvantages of MNCs	44
1.6.3	Problems of MNCs	45
	Summary	46
	Check Your Progress	47
1.7	Unit Summary	48
1.8	Glossary	48
1.9	Self- Assessment Questions	49
1.10	Activities / Exercises / Case Studies	50
1.11	Answers for Check your Progress	52
1.12	Suggested Readings	53
1.13	Open Source E-Content Links	53
1.14	References	53
	UNIT 2	
2.1	Introduction of Trade theories	55
2.1.1	Introduction	55
2.1.2	Basis of International Trade	55
2.1.3	Criticisms of Traditional (neoclassical) trade theories	56
2.1.4	List of Classical country-based theories and Modern firm-based theories	58
	Summary	58
	Check Your Progress	59
2.2	Mercantilism	60
2.2.1	Introduction	60

2.2.2	Effects of Mercantilism	61
2.2.3	Theory of Neo-Mercantilism	62
	Summary	63
	Check Your Progress	63
2.3	Absolute Advantage	64
2.3.1	Assumptions of the Theory	65
2.3.2	Implications of Absolute Cost Advantage Theory	65
	Summary	66
	Check Your Progress	66
2.4	Comparative Advantage	67
2.4.1	Assumptions	68
2.4.2	Implications	68
	Summary	69
	Check Your Progress	69
2.5	Heckscher - Ohlin Theory	70
2.5.1	Four Main Theorems in the H-O Model	72
	Summary	77
	Check Your Progress	78
2.6	The New Trade Theory	79
2.6.1	Salient Features of New Theories of Trade	79
2.6.2	Broad Categories of New Theories	80
2.6.3	Various aspects of New Trade Theory (NTT)	84
	Summary	85
	Check Your Progress	86
2.7	Porter's Diamond Competitive Advantage Theory or Porter Diamond model	87
	Summary	90
	Check Your Progress	90
2.8	Unit Summary	91
2.9	Glossary	92

2.10	Self- Assessment Questions	92
2.11	Activities / Exercises / Case Studies	93
2.12	Answers for Check your Progress	96
2.13	Suggested Readings	97
2.14	Open Source E-Content Links	97
2.15	References	98
	UNIT 3	
3.1	Foreign Investments	99
3.1.1	Introduction	99
3.1.2	Role of Foreign Investment	100
	Summary	104
	Check Your Progress	104
3.2	Foreign Exchange Rates	105
3.2.1	Introduction	105
3.2.2	Nature of foreign exchange	106
3.2.3	Types of Foreign Exchange Transactions	106
3.2.4	Impact on trade and investment flows	107
3.2.5	Global Impact of Currencies: Examples	109
	Summary	110
	Check Your Progress	111
3.3	Functions of foreign exchange market	112
	Summary	112
	Check Your Progress	113
3.4	Foreign Direct Investments	114
3.4.1	Nature of Foreign Direct Investments	114
3.4.2	Function of Foreign Direct Investments	115
3.4.3	Benefits of FDI	119
3.4.4	Regulatory framework of FDI in India	122
3.4.5	Impact of FDI on Indian Economy	123

3.4.6	Trends in Foreign Direct Investment	124
	Summary	129
	Check Your Progress	129
3.5	Factors influencing FDI	130
	Summary	133
	Check Your Progress	133
3.6	Mode of FDI entry	134
3.6.1	Types of FDI in India	135
	Summary	136
	Check Your Progress	136
3.7	Horizontal and Vertical Foreign Direct Investment	137
	Summary	138
	Check Your Progress	139
3.8	Costs and Benefits of FDI to Home and Host Countries	140
	Summary	142
	Check Your Progress	143
3.9	Unit Summary	144
3.10	Glossary	144
3.11	Self- Assessment Questions	145
3.12	Activities / Exercises / Case Studies	146
3.13	Answers for Check your Progress	148
3.14	Suggested Readings	151
3.15	Open Source E-Content Links	151
3.16	References	151
	UNIT 4	
4.1	Drivers in Globalization	152
4.1.1	Introduction	152
4.1.2	Causes of Globalization	152
4.1.3	Types of Globalization	153

4.1.4	Different types of drivers in Globalization	154
4.1.5	Advantages of Globalization	156
4.1.6	Disadvantages of Globalization	157
4.1.7	Effects of globalization	158
	Summary	159
	Check Your Progress	160
4.2	Globalization of markets, production, investments and technology	161
4.2.1	Globalization of markets	161
4.2.2	Globalization of production	164
4.2.3	Globalization of investments	167
4.2.4	Globalization of technology	170
	Summary	173
	Check Your Progress	174
4.3	World Trade in Goods and Services	175
4.3.1	Factors influencing trade in goods	175
4.3.2	Factors influencing trade in services	176
4.3.3	Importance of World Trade in Goods and Services	176
4.3.4	Challenges in world trade	177
	Summary	177
	Check Your Progress	177
4.4	Major Trends and Developments	178
	Summary	180
	Check Your Progress	181
4.5	World Trade and Protectionism	182
	Summary	184
	Check Your Progress	184
4.6	Tariff and Non-Tariff Barriers	185
4.6.1	Tariff Barriers	186
4.6.2	Types of Tariff Barriers	186

4.6.3	Non-Tariff Barriers	186
4.6.4	Differences between Tariff and Non-tariff barriers	187
	Summary	189
	Check Your Progress	189
4.7	Unit Summary	190
4.8	Glossary	190
4.9	Self- Assessment Questions	191
4.10	Activities / Exercises / Case Studies	192
4.11	Answers for Check your Progress	194
4.12	Suggested Readings	195
4.13	Open Source E-Content Links	195
4.14	References	195
	UNIT 5	
5.1	Regional Economic Groupings	197
5.1.1	Regional Economic Groupings – Meaning	197
5.1.2	Factors contributing to regional groupings	197
	Summary	198
	Check your progress	199
5.2	Regional Economic Integration	200
5.2.1	Introduction	200
5.2.2	Levels of Regional Economic Integration	200
5.2.3	Objectives of Regional Economic Integration	201
5.2.4	Effects of Regional Economic Integration	201
5.2.5	Advantages and Disadvantages of Regional Economic Integration	202
5.2.6	Impact of Regional Economic Integration	204
5.2.7	Limitations of Regional Economic Integration	205
	Summary	205
	Check your progress	206
5.3	Regionalism vs. Multilateralism	207

5.3.1	Regionalism - Meaning	207
5.3.2	Reasons for Growth of Regionalism	207
5.3.3	Multilateralism - Meaning	208
5.3.4	Reasons for Growth of Multilateralism	209
	Summary	209
	Check your progress	210
5.4	Important regional economic groupings in the world	211
	Summary	216
	Check your progress	216
5.5	Contemporary Issues in International Business	217
	Summary	220
	Check your progress	220
5.6	Institutional Support to International Business-Like BREXIT, IMF, WORLD BANK, ILO AND WTO	222
5.6.1	BREXIT	222
5.6.2	IMF – International Monetary Fund	224
5.6.3	World Bank	227
5.6.4	International Labour Organization (ILO)	230
5.6.5	World Trade Organization (WTO)	232
	Summary	236
	Check your progress	236
5.7	Unit Summary	237
5.8	Glossary	238
5.9	Self- Assessment Questions	239
5.10	Activities / Exercises / Case Studies	239
5.11	Answers for Check your Progress	242
5.12	Suggested Readings	244
5.13	Open Source E-Content Links	244
5.14	References	244

UNIT 1 - Introduction of International Business

Introduction to International Business: Importance, nature and scope of international business - Internationalization process and Approaches - Modes of entry - Multinational Corporations and their involvement in International Business- Advantage and problems of MNCs.

In this unit, learners will have a comprehensive understanding of importance, nature and scope of international business, mode of entry but also about the Multinational Corporations and their involvement in International Business, Advantage and problems faced MNCs.

SECTION 1.1: INTERNATIONAL BUSINESS - AN INTRODUCTION

International business refers to the trade and investment activities conducted across national borders. This can involve everything from exporting and importing goods and services to establishing operations or joint ventures in foreign countries. Companies engage in international business to expand their markets, source cheaper inputs, diversify risks, and capitalize on growth opportunities that are not available domestically.

1.1.1 – Meaning and Definition of International business

International business includes any type of business activity that crosses national borders. Though a number of definitions in the business literature can be found but no simple or universally accepted definition exists for the term international business.

International business is defined as organization that buys and/or sells goods and services across two or more national boundaries, even if management is located in a single country.

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.

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

Roger Bennett defined as "International business involves commercial activities that cross-national frontiers".

1.1.2 Why is international business important?

- **Economic Interdependence:** Nations are increasingly dependent on each other for goods, services, technology, and capital. Understanding international business helps in grasping how economies are interconnected and how decisions in one country can have global repercussions.
- **Cultural Exchange:** International business fosters cultural exchange, enhancing understanding and cooperation between different cultures. This is essential for successful global operations and partnerships.
- **Career Opportunities:** Knowledge of international business opens up diverse career opportunities. Whether you aspire to work for multinational corporations, non-profits, or start your own global enterprise, this field equips you with the skills needed to navigate the global market.
- **Innovation and Growth:** Engaging in international business can lead to innovation and economic growth by allowing companies to access new technologies, ideas, and best practices from around the world.

1.1.3 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

1.1.4 Features of International Business

1. **Large Scale Operations**:

In International business, all the operations are conducted on a very huge scale. Production and marketing activities are conducted on a very large scale. It first sells its goods in the local market and then the surplus goods are exported.

2. **Integration of Economies**:

International Business integrates (combines) the economies of many countries. This is because it uses finance from one country, labour from other country and infrastructure from another country. It designs the product in one country, produces its parts in many different countries and assembles in another country and sells in many countries.

3. Dominated by developed countries and MNC's

International Business is dominated by developed countries and their multinational companies. Europe and Japan dominate the foreign trade, this is because they have high financial and other resources.

4. **Benefits to Participating countries:**

International Business gives benefits to all participating countries. However, the developed countries get the maximum benefits, the developing countries also get benefits. They get foreign capital and technology. They get rapid industrial development. They get more employment opportunities.

5. Competition:

International Business has to face competition in the world market. The competition is between unequal partners. In this situation, the developed countries are in favorable position as they produce the superior quality goods and services, but developing countries find difficulty to face competition.

6. Special role of science and technology:

International Business gives a lot of importance to science and technology. Science and Technology helps the business to have a large-scale production. Developed countries use high technology. International business helps them to transfer top-end technology to the developing countries.

7. International Restrictions:

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

8. Sensitive Nature:

The International Business is very sensitive in nature. Any changes in the economic policies, technology, political environment has a huge impact. Therefore, it must conduct marketing research to find out and study these changes. They must adjust their business activities and adopt accordingly to survive changes.

Let's sum up

Learners in this section we have seen that International business refers to the trade and investment activities conducted across national borders. This can involve everything from exporting and importing goods and services to establishing operations or joint ventures in foreign countries. Also the need and features of international business in detail.

Check your progress

1. The trade and investment activities conducted across national borders refers to

A. Trade
B. National trade
C. International business
D. Domestic trade

2. Engaging in international business lead to

A. Mutual fund
B. Innovation and economic growth
C. Demand
D. Supply

3. Which of the following is essential for successful global operations and partnerships.

A. Goods exchange
B. Competition
C. Cultural exchange
D. Financial risk

4. Which of the following is NOT the feature of international business

A. Large scale operations
B. Competition
C. International restrictions
D. Small scale operations

5. Which of the following define International business?

A. Global trade of goods/services or investment.
B. Implementation of financial institutions
C. Setting up of industries
D. Leasing

SECTION 1.2: Importance, nature and scope of international business

1.2.1 Importance of International Business

1. **Earn foreign exchange:** International business exports its goods and services all over the world. This helps to earn valuable foreign exchange. This foreign exchange is used to pay for imports. Foreign exchange helps to make the business more profitable and to strengthen the economy of its country.
2. **Optimum utilisation of resources:** International business makes optimum utilisation of resources. This is because it produces goods on a very large scale for the international market. International business utilises resources from all over the world. It uses the finance and technology of rich countries and the raw materials and labour of the poor countries**.**
3. **Achieve its objectives:** International business achieves its objectives easily and quickly. The main objective of an international business is to earn high profits. This objective is achieved easily. This it because it uses the best technology. It has the best employees and managers. It produces high-quality goods. It sells these goods all over the world. All this results in high profits for the international business.
4. **To spread business risks:** International business spreads its business risk. This is because it does business all over the world. So, a loss in one country can be balanced by a profit in another country. The surplus goods in one country can be exported to another country. The surplus resources can also be transferred to other countries. All this helps to minimise the business risks.
5. **Improve organisation's efficiency:** International business has very high organisation efficiency. This is because without efficiency, they will not be able to face the competition in the international market. So, they use all the modern management techniques to improve their efficiency. They hire the most qualified and experienced employees and managers. These people are trained regularly. They are highly motivated with very high salaries and other benefits such as international transfers, promotions, etc. All this results in high organisational efficiency, i.e. low costs and high returns.
6. **Benefits from Government**: International business brings a lot of foreign exchange for the country. Therefore, it gets many benefits, facilities and

concessions from the government. It gets many financial and tax benefits from the government.

7. **Expand and diversify**: International business can expand and diversify its activities. This is because it earns very high profits. It also gets financial help from the government.
8. **Increase competitive capacity:** International business produces high quality goods at low cost. It spends a lot of money on advertising all over the world. It uses superior technology, management techniques, marketing techniques, etc. All this makes it more competitive. So, it can fight competition from foreign companies.
9. **Economies of Scale:** These businesses are able to enjoy economies of scale due to their large-scale production. International businesses produce large amount of goods for selling in different countries. With the increase in amount of production, per unit cost of producing goods goes down which helps them in earning large profits.
10. **Cost Advantage:** International business takes cost advantage over its competitors by producing goods in one country and exporting them in another country. They carry on their production in a country where factors of production are easily and cheaply available. This helps in minimizing the cost of product and earn huge profits by selling them at better prices in other countries.
11. **Provide Employment Opportunities**: International business employs large number of people for carrying out its operations across the globe. They perform large scale operations in many countries for which they require large amount of human resource.

1.2.2 Nature of International Business

The nature of international business encompasses a broad array of activities, interactions, and dynamics that define how businesses operate across national borders. Understanding the nature of international business involves examining several key characteristics:

1. **Cross-Border Transactions:**

   International business involves transactions that cross-national boundaries, including trade in goods and services, capital investment, and technology transfer.

2. **Multinational Enterprises (MNEs):**

   These are firms that own or control production or service facilities outside the country in which they are based. MNEs are a central component of international business.

3. **Diverse Environments:**

   International business operates in varied legal, political, economic, social, and cultural environments. Firms must navigate differences in regulations, economic systems, cultural norms, and business practices.

4. **Global Supply Chains**:

   Firms often source materials and components from multiple countries, assemble products in various locations, and sell in global markets, creating complex, interdependent supply chains.

5. **Foreign Direct Investment (FDI):**

   FDI involves establishing operations or acquiring assets in another country, such as building factories, opening retail outlets, or acquiring local companies.

6. **Trade and Export:**

   Exporting goods and services to foreign markets is a fundamental aspect of international business. This includes direct exporting (selling directly to customers) and indirect exporting (using intermediaries).

7. **Strategic Alliances and Joint Ventures:**

   Firms often enter into partnerships with foreign companies to share resources, knowledge, and risks. Joint ventures involve creating a new entity jointly owned by the partners.

8. **Licensing and Franchising:**

   Licensing allows a foreign company to produce and sell products under the licensing company's brand. Franchising involves a franchisor granting a franchisee the right to operate a business using the franchisor's business model and brand.

9. **Global Marketing and Branding:**

International business requires adapting marketing strategies to different cultural contexts and consumer preferences while maintaining a coherent global brand image.

10. **Currency and Exchange Rates:**

Operating internationally involves dealing with multiple currencies and fluctuating exchange rates, which can impact profitability and pricing strategies.

11. **Regulatory Compliance:**

Firms must comply with the legal and regulatory frameworks of each country they operate in, including trade laws, labor laws, environmental regulations, and intellectual property protections.

12. **Risk Management:**

International business entails various risks, including political risk, economic risk, and currency risk. Companies must develop strategies to mitigate these risks.

13. **Cultural Sensitivity and Adaptation**:

Success in international markets often requires understanding and respecting cultural differences, adapting products and services to local tastes, and employing culturally sensitive communication strategies.

14. **Logistics and Distribution**:

Efficiently managing the logistics of moving goods across borders, including transportation, warehousing, and customs clearance, is critical for international business.

15. **Innovation and Technology Transfer**:

International business often involves the transfer of technology and innovation between countries, fostering global technological advancement and innovation.

16. **Ethical Considerations**:

Firms must navigate ethical issues such as labor practices, environmental sustainability, and corporate social responsibility in different international contexts.

The nature of international business is dynamic and multifaceted, requiring companies to be adaptable, resourceful, and strategic in managing their global operations. Success in international business depends on understanding and effectively managing the complexities and opportunities presented by operating in a globalized economy.

1.2.3 Scope of International Business

The scope of international business is broad and encompasses a wide range of activities that involve cross-border transactions and operations. Here are the primary areas that define the scope of international business:

1. International Trade:

Exporting and Importing: Selling goods and services to foreign markets (exporting) and purchasing goods and services from foreign markets (importing).

Trade Agreements: Understanding and leveraging bilateral and multilateral trade agreements to facilitate smoother and more advantageous trade relations.

2. Foreign Direct Investment (FDI):

Greenfield Investments: Establishing new operations or facilities in a foreign country.

Mergers and Acquisitions: Acquiring or merging with existing foreign companies.

Joint Ventures and Strategic Alliances: Partnering with foreign firms to share resources, knowledge, and risks.

3. Global Supply Chain Management:

- Sourcing and Procurement: Identifying and procuring raw materials and components from different countries.
- Logistics and Distribution: Managing the transportation, warehousing, and distribution of goods across borders.
- Supply Chain Optimization: Streamlining operations to reduce costs and increase efficiency on a global scale.

4. International Marketing and Sales:

- Market Research: Conducting research to understand foreign markets, including consumer behavior, market demand, and competitive landscape.
- Product Adaptation: Modifying products to meet the preferences, regulations, and standards of different markets.
- Branding and Promotion: Developing and implementing marketing strategies to build brand recognition and loyalty in international markets.

5. International Finance and Accounting:

- Currency Exchange Management: Managing the risks and opportunities associated with fluctuating exchange rates.
- International Taxation: Navigating different tax systems and regulations to optimize tax liabilities.
- Financial Reporting: Adhering to international accounting standards and reporting requirements.

6. Cross-Cultural Management:

- Cultural Sensitivity and Adaptation: Understanding and adapting to cultural differences in business practices, communication, and management styles.
- International Human Resource Management: Recruiting, training, and managing a global workforce, including expatriates and local employees.

7. Legal and Regulatory Compliance:

- International Trade Laws: Complying with laws and regulations governing international trade, including tariffs, quotas, and trade restrictions.
- Intellectual Property Protection: Protecting intellectual property rights across different jurisdictions.
- Compliance with Local Regulations: Ensuring adherence to local laws and regulations in areas such as labor, environmental standards, and corporate governance.

8. International Risk Management:

- Political Risk: Assessing and mitigating risks associated with political instability, government changes, and regulatory shifts.
- Economic Risk: Managing risks related to economic fluctuations, inflation, and changes in interest rates.
- Operational Risk: Addressing risks related to disruptions in the supply chain, logistics, and production processes.

9. Technology and Innovation:

- Technology Transfer: Facilitating the transfer of technology and innovation between countries to enhance competitive advantage.

- Digital Transformation: Leveraging digital technologies to streamline operations, improve customer experiences, and drive global growth.

10. Corporate Social Responsibility (CSR) and Sustainability:

- Ethical Business Practices: Implementing ethical practices and standards in international operations.
- Sustainability Initiatives: Promoting environmental sustainability and social responsibility in global business activities.

11. International Economic and Political Relations:

- Diplomacy and Trade Relations: Engaging with governments and international organizations to foster favourable business environments.
- Economic Development: Contributing to the economic development of host countries through investment, job creation, and knowledge transfer.

Let's sum up

Learners in this section we have seen the importance, nature and scope of international business. Some of the importance are Earn foreign exchange, Optimum utilization of resources, to spread business risks etc. The nature of international business encompasses a broad array of activities, interactions, and dynamics that define how businesses operate across national borders. The scope of international business is broad and encompasses a wide range of activities that involve cross-border transactions and operations.

Check your progress

1. Which involves establishing operations or acquiring assets in another country

A. Trade
B. Export
C. Import
D. FDI

2. Which involves a franchisor granting a franchisee the right to operate a business using the franchisor's business model and brand.

A. Joint venture

B. Franchising
C. Leasing
D. Hire purchase

3. which of the following is Establishing new operations or facilities in a foreign country.

A. Acquisitions
B. Greenfield Investments
C. Mergers
D. Strategic Alliances

4. International business makes optimum utilization of ___________.

A. Resources
B. Efficiency
C. Benefits from Government
D. Supply chains

5. which of the following is a fundamental aspect of international business.

A. Global marketing
B. Risk management
C. Exporting goods and services to foreign markets
D. Competition

SECTION 1.3: INTERNATIONALIZATION PROCESS AND APPROACHES

1.3.1 Stages of Internationalization

Every company in the International Business will pass through the 5 different stages of Internationalization. They are:

- Domestic Company
- International Company
- Multi-National Company

- Global Company
- Transnational Company

Stage – 1: Domestic Company

Domestic Company limits its operations, mission and vision to the national boundaries. This company focus its view on the domestic market opportunities, supplies and customers. These companies analyse the national environment of the country, formulate the strategies to exploit the opportunities offered by environment. They never think of growing globally. They believe in saying, “if it is not happening in home country, it is not happening”.

Stage – 2: International Company

Domestic companies which grows beyond their production capacities, think of internationalizing their operation. Those companies which decide to exploit the opportunities outside the domestic country are stage – 2 companies. These companies believe that the practices the people and products of domestic business are superior to those of other countries. The focus of these companies is domestic but
extends the wings to the foreign countries. These companies select the strategy of locating a branch in foreign markets and extend same domestic operations into foreign markets.

Stage – 3: Multi-National Company

International companies turn into the Multi-National companies when they start responding to the specific needs of different country market regarding product, price and promotion. This stage is also referred as Multi-Domestic companies. These companies formulate different strategies for different markets. They operate like a domestic market of country concerned in each of their market.

Stage – 4: Global Company

A global company is the one, which has either global strategy. Global Company either produces in home country or in a single country and focuses on marketing these products globally or produces globally and focuses on marketing these products domestically.

Stage – 5: Transnational Company

It produces, markets, invests and operates across the world. It is an integrated global enterprise that links global resources with global markets at profits. There is no pure Transnational company.

1.3.2 Approaches to International Business

The most challenging task a company may face while entering the international market is the degree of standardization or customization in its operations. The question of standardization or adaptation or customization will be affecting all business operations and marketing mix decisions. However, in the era of globalization, where consumers have access to all the products and services and have their own taste and preferences, scope of customization has increased. Whether a company chooses standardization or customization of its operations depends upon its attitude towards different cultures and environments. The attitude towards standardization or customization can be explained with the EPRG Framework of international marketing. EPRG framework is based upon four approaches of a company towards international marketing. Douglas Wind and Pelmutter advocated four approaches of International Business. They are:

1. Ethnocentric Approach
2. Polycentric Approach
3. Regiocentric Approach
4. Geocentric Approach

Ethnocentric Approach:

Ethnocentric approach or home country orientation is the approach where a company simply markets its product or services internationally in the same manner as they do domestically. Companies believe that consumer's needs and market conditions are more or less homogeneous in international markets. Companies prefer an ethnocentric approach in order to avoid the expense of developing new marketing techniques to serve foreign consumers. All functions are planned and carried out from home base only with little or almost no difference in product formulation or specifications. The domestic companies normally formulate their strategies, their product design and their operations towards the national markets, customers and competitors. The company exports the same products designed for domestic markets to foreign countries. Thus, maintenance of domestic approach towards International business is Ethnocentric Approach.

Polycentric Approach:

In Polycentric approach, companies go for customization for each foreign market. They will customize the products according to each country depending upon the consumers taste or preferences or cultural or any legal or political factors i.e. depending upon their local marketing conditions and then enter into that market. Companies

customize the marketing mix to meet the specific needs of each foreign market. The company establishes a foreign subsidiary company and decentralizes all the operations and delegates decision-making and policy making authority to its executives. In fact, company appoints executives and personnel who direct reports to managing Director of that company. Company appoints key personnel from the home country and all other vacancies are filled by people of host country.

Regiocentric Approach:

The company after operating successfully in a foreign country, thinks of exporting to the neighbouring countries of the host country. At this stage, the foreign subsidiary considers the regional environment for formulating policies. It markets more or less the same product design, under polycentric approach in other country of region with the different market strategy. In a regiocentric approach, company's target a group of countries having similar market characteristics, and then enter into the market. Once the company is established in various markets, attempts are made to form market clusters based on geographical and psychic proximity. The production and distribution of products are made to serve the whole region with an effective economy of operation, close control and coordination.

Geocentric Approach:

In geocentric approach, the company identifies the needs of consumers worldwide and then enters into the market with standard products with standardized marketing mix for all the markets it serves. Companies have to identify the similarities in consumption patterns that can be targeted. The companies coordinate their distribution network to distribute their products in various regional and national markets by establishing manufacturing and processing facilities around the world. They select the employees from entire globe and operate with a number of subsidiaries. Each subsidiary function act as an autonomous company in formulating policies, strategies, product design, etc.

Let's sum up:

In this section we have seen that every company in the International Business will pass through the 5 different stages of Internationalization. They are Domestic Company, International Company, Multi-National Company, Global Company and Transnational

Company. The attitude towards standardization or customization can be explained with the EPRG Framework of international marketing. EPRG framework is based upon four approaches of a company towards international marketing. Douglas Wind and Pelmutter advocated four approaches of International Business. They are Ethnocentric Approach, Polycentric Approach, Regiocentric Approach and Geocentric Approach

Check your progress

1**. How many stages are there in Internationalization.**

A. 4
B. 3
C. 5
D. 2

2. **Which of the following limits its operations, mission and vision to the national boundaries.**

A. Domestic Company
B. Partnership
C. Foreign company
D. Joint venture

3. **Who advocated four approaches of International Business**.

A. Wasserman
B. Douglas Wind and Pelmutter
C. Haltman
D. Eugeworth

4. **Which approach is also known as home country orientation.**

A. Ethnocentric Approach
B. Polycentric Approach
C. Regiocentric Approach
D. Geocentric Approach

5. **Which approach identifies the needs of consumers worldwide and then enters into the market with standard products.**

A. Polycentric Approach
B. Regiocentric Approach
C. Geocentric approach
D. Ethnocentric Approach

SECTION 1.4: MODES OF ENTRY

A mode of entry into an international business is the channel which organization employs to gain entry to a new international market. This section considers a number of key alternatives, but recognizes that alternatives are many and diverse. There are two major types of entry modes: equity and non-equity modes. The non-equity modes category includes export and contractual agreements. The equity modes category includes: joint venture and wholly owned subsidiaries.

1.4.1 Exporting

Exporting is the process of selling of goods and services produced in one country to other countries. There are two types of exporting: direct and indirect.

- **Direct Exports**

Direct exports represent the most basic mode of exporting, capitalizing on economies of scale in production concentrated in the home country and affording better control over distribution. Direct export works the best if the volumes are small. Large volumes of export may trigger protectionism.

1.4.1.1 Types of Direct Exporting.

Sales representatives represent foreign suppliers/manufacturers in their local markets for an established commission on sales. Provide support services to a manufacturer regarding local advertising, local sales presentations, customs clearance formalities, legal requirements. Manufacturers of highly technical services or products such as production machinery, benefit the most form sales representation.

Importing distributors purchase product in their own right and resell it in their local markets to wholesalers, retailers, or both. Importing distributors are a good market

entry strategy for products that are carried in inventory, such as toys, appliances, prepared food.

Advantages of Direct Exporting

- Control over selection of foreign markets and choice of foreign representative companies
- Good information feedback from target market
- Better protection of trademarks, patents, goodwill, and other intangible property
- Potentially greater sales than with indirect exporting.

Disadvantages of Direct Exporting

- Higher start-up costs and higher risks as opposed to indirect exporting
- Greater information requirements
- Longer time-to-market as opposed to indirect exporting.
- **Indirect exports:**
  An indirect export is the process of exporting through domestically based export intermediaries. The exporter has no control over its products in the foreign market.

1.4.1.2 Types of Indirect Exporting

- **Export Trading Companies** (ETCs) provide support services of the entire export process for one or more suppliers. Attractive to suppliers that are not familiar with exporting as ETCs usually perform all the necessary work: locate overseas trading partners, present the product, quote on specific enquiries, etc.
- **Export Management Companies** (EMCs) are similar to ETCs in the way that they usually export for producers. Unlike ETCs, they rarely take on export credit risks and carry one type of product, not representing competing ones. Usually, EMCs trade on behalf of their suppliers as their export departments.
- **Export Merchants** are wholesale companies that buy unpackaged products from suppliers/manufacturers for resale overseas under their own brand names. The

advantage of export merchants is promotion. One of the disadvantages for using export merchants result in presence of identical products under different brand names and pricing on the market, meaning that export merchant's activities may hinder manufacturer's exporting efforts.

- **Confirming Houses** are intermediate sellers that work for foreign buyers. They receive the product requirements from their clients, negotiate purchases, make delivery, and pay the suppliers/ manufacturers. An opportunity here arises in the fact that if the client likes the product it may become a trade representative. A potential disadvantage includes supplier's unawareness and lack of control over what a confirming house does with their product.
- **Nonconforming Purchasing Agents** are similar to confirming houses with the exception that they do not pay the suppliers directly – payments take place between a supplier/manufacturer and a foreign buyer.

Advantages of Indirect Exporting

- Fast market access
- Concentration of resources for production
- Little or no financial commitment. The export partner usually covers most expenses associated with international sales
- Low risk exists for those companies who consider their domestic market to be more important and for those companies that are still developing their R&D, marketing, and sales strategies.
- The management team is not distracted
- No direct handle of export processes.

Disadvantages of Indirect Exporting

- Higher risk than with direct exporting
- Little or no control over distribution, sales, marketing, etc. as opposed to direct exporting

- Inability to learn how to operate overseas
- Wrong choice of market and distributor may lead to inadequate market feedback affecting the international success of the company
- Potentially lower sales as compared to direct exporting, due to wrong choice of market and distributors by export partners.

1.4.2 Licensing

An international licensing agreement allows foreign firms, either exclusively or non-exclusively to manufacture a proprietor's product for a fixed term in a specific market.

Summarizing, in this foreign market entry mode, a licensor in the home country makes limited rights or resources available to the licensee in the host country. The rights or resources may include patents, trademarks, managerial skills, technology, and others that can make it possible for the licensee to manufacture and sell in the host country a similar product to the one the licensor has already been producing and selling in the home country without requiring the licensor to open a new operation overseas. The licensor earnings usually take forms of one time payments, technical fees and royalty payments usually calculated as a percentage of sales.

As in this mode of entry the transference of knowledge between the parental company and the licensee is strongly present, the decision of making an international license agreement depend on the respect the host government show for intellectual property and on the ability of the licensor to choose the right partners and avoid them to compete in each other market. Licensing is a relatively flexible work agreement that can be customized to fit the needs and interests of both, licensor and licensee.

Following are the main advantages and reasons to use an international licensing for expanding internationally:

- Obtain extra income for technical know-how and services
- Reach new markets not accessible by export from existing facilities
- Quickly expand without much risk and large capital investment

- Pave the way for future investments in the market
- Retain established markets closed by trade restrictions
- Political risk is minimized as the licensee is usually 100% locally owned
- Is highly attractive for companies that are new in international business.

On the other hand, international licensing is a foreign market entry mode that presents some disadvantages and reasons why companies should not use it as:

- Lower income than in other entry modes
- Loss of control of the licensee manufacture and marketing operations and practices dealing to loss of quality
- Risk of having the trademark and reputation ruined by a incompetent partner
- The foreign partner can also become a competitor by selling its production in places where the parental company is already in.

1.4.3 Franchising

The Franchising system can be defined as: "A system in which semi-independent business owners (franchisees) pay fees and royalties to a parent company (franchiser) in return for the right to become identified with its trademark, to sell its products or services, and often to use its business format and system."

Compared to licensing, franchising agreements tends to be longer and the franchisor offers a broader package of rights and resources which usually includes equipment, managerial systems, operation manual, initial trainings, site approval and all the support necessary for the franchisee to run its business in the same way it is done by the franchisor. In addition to that, while a licensing agreement involves things such as intellectual property, trade secrets and others while in franchising it is limited to trademarks and operating know-how of the business.

Advantages of the International Franchising Mode

- Low political risk
- Low cost

- Allows simultaneous expansion into different regions of the world
- Well selected partners bring financial investment as well as managerial capabilities to the operation.

Disadvantages of the International Franchising Mode

- Franchisees may turn into future competitors
- Demand of franchisees may be scarce when starting to franchise a company, which can lead to making agreements with the wrong candidates
- A wrong franchisee may ruin the company's name and reputation in the market
- Comparing to other modes such as exporting and even licensing, international franchising requires a greater financial investment to attract prospects and support and manage franchisees.

1.4.4 Turnkey Projects

A turnkey project refers to a project in which clients pay contractors to design and construct new facilities and train personnel. A turnkey project is way for a foreign company to export its process and technology to other countries by building a plant in that country. Industrial companies that specialize in complex production technologies normally use turnkey projects as an entry strategy.

One of the major advantages of turnkey projects is the possibility for a company to establish a plant and earn profits in a foreign country especially in which foreign direct investment opportunities are limited and lack of expertise in a specific area exists.

Potential disadvantages of a turnkey project for a company include risk of revealing companies' secrets to rivals, and takeover of their plant by the host country. By entering a market with a turnkey project proves that a company has no long-term interest in the country which can become a disadvantage if the country proves to be the main market for the output of the exported process.

1.4.5 Wholly Owned Subsidiaries (WOS)

A wholly owned subsidiary includes two types of strategies: Greenfield investment and Acquisitions. Greenfield investment and Acquisition include both advantages and disadvantages. To decide which entry modes to use is depending on situations.

Greenfield investment is the establishment of a new wholly owned subsidiary. It is often complex and potentially costly, but it is able to full control to the firm and has the most potential to provide above average return. “Wholly owned subsidiaries and expatriate staff are preferred in service industries where close contact with end customers and high levels of professional skills, specialized know how, and customizations are required.” Greenfield investment is more likely preferred where physical capital-intensive plants are planned. This strategy is attractive if there are no competitors to buy or the transfer competitive advantages that consists of embedded competencies, skills, routines, and culture. Greenfield investment is high risk due to the costs of establishing a new business in a new country. A firm may need to acquire knowledge and expertise of the existing market by third parties, such consultant, competitors, or business partners. This entry strategy takes much time due to the need of establishing new operations, distribution networks, and the necessity to learn and implement appropriate marketing strategies to compete with rivals in a new market.

Acquisition has become a popular mode of entering foreign markets mainly due to its quick access. Acquisition strategy offers the fastest, and the largest, initial international expansion of any of the alternative.

Acquisition has been increasing because it is a way to achieve greater market power. The market share usually is affected by market power. Therefore, many multinational corporations apply acquisitions to achieve their greater market power require buying a competitor, a supplier, a distributor, or a business in highly related industry to allow exercise of a core competency and capture competitive advantage in the market. Acquisition is lower risk than Greenfield investment because of the outcomes of an acquisition can be estimated more easily and accurately. In overall, acquisition is attractive if there are well established firms already in operations or competitors want to enter the region.

On the other hand, there are many disadvantages and problems in achieving acquisition success.

Integrating two organizations can be quite difficult due to different organization cultures, control system, and relationships. Integration is a complex issue, but it is one of the most important things for organizations.

By applying acquisitions, some companies significantly increased their levels of debt which can have negative effects on the firms because high debt may cause bankruptcy. Too much diversification may cause problems. Even when a firm is not too over diversified, a high level of diversification can have a negative effect on the firm in the long-term performance due to a lack of management of diversification.

1.4.6 Joint Venture

There are five common objectives in a joint venture: market entry, risk/reward sharing, technology sharing and joint product development, and conforming to government regulations. Other benefits include political connections and distribution channel access that may depend on relationships. Such alliances often are favorable when:

- The partners' strategic goals converge while their competitive goals diverge
- The partners' size, market power, and resources are small compared to the Industry leaders
- Partners are able to learn from one another while limiting access to their own proprietary skills

The key issues to consider in a joint venture are ownership, control, length of agreement, pricing, technology transfer, local firm capabilities and resources, and government intentions. Potential problems include: Conflict over asymmetric new investments, Mistrust over proprietary knowledge, Lack of parent firm support, cultural clashes

1.4.7 Strategic Alliance

A strategic alliance is a term used to describe a variety of cooperative agreements between different firms, such as shared research, formal joint ventures, or

minority equity participation. The modern form of strategic alliances is becoming increasingly popular and has three distinguishing characteristics:

1. They are frequently between firms in industrialized nations
2. The focus is often on creating new products and/or technologies rather than distributing existing ones
3. They are often only created for short term durations

Advantages of a Strategic Alliance

Technology Exchange

This is a major objective for many strategic alliances. The reason for this is that many breakthroughs and major technological innovations are based on interdisciplinary and/or inter-industrial advances. Because of this, it is increasingly difficult for a single firm to possess the necessary resources or capabilities to conduct their own effective R&D efforts. This is also perpetuated by shorter product life cycles and the need for many companies to stay competitive through innovation. Some industries that have become centers for extensive cooperative agreements are:

- Telecommunications
- Electronics
- Pharmaceuticals
- Information technology
- Specialty chemicals

Global Competition

- There is a growing perception that global battles between corporations be fought between teams of players aligned in strategic partnerships. Strategic alliances will become key tools for companies if they want to remain competitive in this globalized environment, particularly in industries that have dominant leaders, such as cell phone manufactures, where smaller companies need to ally in order to remain competitive.

Industry Convergence

- As industries converge and the traditional lines between different industrial sectors blur, strategic alliances are sometimes the only way to develop the

complex skills necessary in the time frame required. Alliances become a way of shaping competition by decreasing competitive intensity, excluding potential entrants, and isolating players, and building complex value chains that can act as barriers.

Economies of Scale and Reduction of Risk

- Pooling resources can contribute greatly to economies of scale, and smaller companies especially can benefit greatly from strategic alliances in terms of cost reduction because of increased economies of scale.

- In terms on risk reduction, in strategic alliances no one firm bears the full risk, and cost of, a joint activity. This is extremely advantageous to businesses involved in high risk / cost activities such as R&D. This is also advantageous to smaller organizations which are more affected by risky activities.

Alliance as an Alternative to Merger

- Some industry sectors have constraints to cross-border mergers and acquisitions, strategic alliances prove to be an excellent alternative to bypass these constraints. Alliances often lead to full-scale integration if restrictions are lifted by one or both countries.

Disadvantages of Strategic Alliances

The risks of Competitive Collaboration

Some strategic alliances involve firms that are in fierce competition outside the specific scope of the alliance. This creates the risk that one or both partners will try to use the alliance to create an advantage over the other. The benefits of this alliance may cause unbalance between the parties, there are several factors that may cause this asymmetry:

The partnership may be forged to exchange resources and capabilities such as technology. This may cause one partner to obtain the desired technology and abandon the other partner, effectively appropriating all the benefits of the alliance.

- Using investment initiative to erode the other partners’ competitive position. This is a situation where one partner makes and keeps control of critical resources. This

creates the threat that the stronger partner may strip the other of the necessary infrastructure.

- Strengths gained by learning from one company can be used against the other. As companies learn from the other, usually by task sharing, their capabilities become strengthened, sometimes this strength exceeds the scope of the venture and a company can use it to gain a competitive advantage against the company they may be working with.

- Firms may use alliances to acquire its partner. One firm may target a firm and ally with them to use the knowledge gained and trust built in the alliance to take over the other.

Let's sum up

Learners in this section we have seen that a mode of entry into an international business is the channel which organization employs to gain entry to a new international market. This section considers a number of key alternatives, but recognizes that alternatives are many and diverse. There are two major types of entry modes: equity and non-equity modes. The non-equity modes category includes export and contractual agreements. The equity modes category includes: joint venture and wholly owned subsidiaries. An international licensing agreement allows foreign firms, either exclusively or non-exclusively to manufacture a proprietor's product for a fixed term in a specific market. The Franchising system is a system in which semi-independent business owners (franchisees) pay fees and royalties to a parent company (franchiser) in return for the right to become identified with its trademark, to sell its products or services, and often to use its business format and system.

Check your progress

1. Which of the following is the process of selling of goods and services produced in one country to other countries.

   A. Importing

B. Exporting
C. Retailing
D. Wholesaling

2. Which of the following is the process of exporting through domestically based export intermediaries.

A. Indirect export
B. Licensing
C. Franchising
D. Venture

3. Which of the following refers to a project in which clients pay contractors to design and construct new facilities and train personnel

A. Export trading company
B. Export merchants
C. Turnkey project
D. Purchasing agents

4. Which of the following is the establishment of a new wholly owned subsidiary

A. Joint venture
B. Greenfield investment
C. Whole sale
D. Retail

5. Which of the following is the major objective for many strategic alliances

A. Earn profit
B. Increase competition
C. Recruitment
D. Technology exchange

SECTION 1.5: MULTINATIONAL CORPORATIONS AND THEIR INVOLVEMENT IN INTERNATIONAL BUSINESS

Multinational corporations (MNCs) are enterprises that operate in multiple countries, managing production or delivering services in more than one country. Their involvement in international business is extensive and multifaceted, impacting global trade, investment, and economic development. Here are key aspects of MNCs' involvement in international business:

1. Market Expansion and Revenue Generation

- Global Market Access: MNCs expand their operations to tap into new markets, gaining access to larger customer bases.
- Diversification: By operating in multiple countries, MNCs reduce their dependence on a single market, spreading risk across different regions.

2. Foreign Direct Investment (FDI)

- Capital Investment: MNCs invest significant capital in foreign countries, establishing subsidiaries, joint ventures, or acquiring local firms.
- Technology Transfer: Through FDI, MNCs often bring advanced technology, managerial expertise, and best practices to host countries.

3. Global Supply Chains

- Efficiency and Cost Reduction: MNCs optimize their production processes by locating different stages of production in various countries to take advantage of lower costs and efficiency gains.
- Logistics and Distribution: They manage complex logistics and distribution networks to ensure efficient movement of goods and services across borders.

4. Employment and Skill Development

- Job Creation: MNCs create employment opportunities in host countries, contributing to local economic development.
- Training and Development: They provide training and skill development to local employees, enhancing human capital in host countries.

5. Innovation and R&D

- Research and Development: MNCs invest in R&D activities, often establishing research centers in multiple countries to leverage global talent and innovation ecosystems.
- Product Innovation: They introduce new products and services to international markets, catering to diverse consumer needs and preferences.

6. Cultural Exchange and Influence

- Cultural Integration: MNCs contribute to cultural exchange by promoting diverse work environments and facilitating cross-cultural interactions.
- Global Branding: They build global brands that influence consumer behavior and preferences worldwide.

7. Regulatory and Ethical Considerations

- Compliance: MNCs must navigate complex regulatory environments, adhering to laws and regulations in different countries.
- Corporate Social Responsibility (CSR): They engage in CSR activities, addressing social, environmental, and ethical issues in the regions they operate.

8. Challenges and Criticisms

- Market Dominance: MNCs can dominate local markets, potentially stifacing competition and disadvantaging local businesses.
- Exploitation Concerns: There are concerns about labor exploitation, environmental degradation, and unfair trade practices in host countries.
- Tax Avoidance: MNCs are often scrutinized for their tax practices, with allegations of shifting profits to low-tax jurisdictions to minimize tax liabilities.

9. Geopolitical Impacts

- Economic Diplomacy: MNCs play a role in shaping economic diplomacy and trade relations between countries.
- Influence on Policy: They can influence government policies through lobbying and advocacy, impacting international trade agreements and economic policies.

Examples of MNCs

- Apple Inc: Operates in numerous countries with a complex supply chain, major R&D investments, and a strong global brand.
- Toyota: Manufactures and sells vehicles globally, known for its production efficiency and innovation in automotive technology.
- Unilever: Produces consumer goods with a significant presence in both developed and developing markets, focusing on sustainability and social responsibility.

Let's sum up

Learners we have seen that Multinational corporations (MNCs) are enterprises that operate in multiple countries, managing production or delivering services in more than one country. Their involvement in international business is extensive and multifaceted, impacting global trade, investment, and economic development. MNCs are pivotal players in the global economy, driving international trade, investment, and economic integration. While they offer numerous benefits, such as job creation and technology transfer, they also face criticism and challenges that require careful management and regulation. Understanding the dynamics of MNCs' involvement in international business is essential for policymakers, businesses, and consumers alike.

SECTION 1.6: ADVANTAGES AND PROBLEMS OF MNCs

1.6.1 Advantage of MNCs

1. High Living Standard

Customers in various countries can buy more products with the same amount of money in the International Markets. In turn, it can also enhance the living standard of the people through enhanced purchasing power and by consuming high quality products.

2. Increased Socio-Economic Welfare

International business enhances the consumption level, and economic welfare of the trading countries.

3. Wider Markets

International business widens the market and increases the market size. Therefore, the companies need not depend on the demand for the product in one single country or customer's taste and preferences.

4. Reduced effects of Business Cycle

The stages of business cycle vary from country to country. Therefore, MNC's shift from the country experiencing a recession to the country experiencing the boom conditions. Thus, international business firms can escape from the recessionary conditions.

5. Reduced Risks

Both commercial and political risks are reduced for the companies engaged in international business due to spread in different countries.

6. Large Scale Economics

MNC due to the wider and larger markets produce larger quantities, which provide the benefit of large-scale economies like reduced cost of production, availability of expertise, etc.

7. Potential Untapped Markets

International business provides the chance of exploring and exploiting the potential markets which are untapped so far. These markets provides the opportunity of selling the product at a higher price than in domestic markets.

8. Provides the opportunities for and challenge to domestic business

International Business firms provides the opportunities to the domestic companies. These opportunities include technology, management expertise, market intelligence, etc,.

9. Division of Labour and Specialisation

International business leads to division of labour and specialization. Brazil specializes in coffee, Kenya in tea, Japan in automobiles.

10. Economic Growth of the world

Specialisation, division of labour, enhancement of productivity, posing challenges, development to meet them, innovations and creations to meet the competition lead to ovrall economic growth of the world nations.

11. Optimum and proper utilization of world resources

International business provides for the flow of raw materials, natural resources and human resources from the countries where they are in excess supply to those countries which are in short supply or need most.

12. Cultural Transformation

International business benefits are not purely economic or commercial, they are even social and cultural. There is a close cultural transformation and integration.

13. Knitting the world into a closely interactive Traditional Village

International business ultimately knits the global economies, societies and countries into a closely interactive and traditional village where one is for all and all are for one.

1.6.2 Disadvantage of MNCs

1. Political Factors

Political instability is the major factor that discourages the spread of international business.

2. Huge Foreign Indebtedness

The developing countries with less purchasing power are lured into a debt trap due to the operations of MNCs in these countries.

3. Exchange Instability

Currencies of countries are depreciated due to imbalances in the balance of payments, political instability and foreign indebtedness. This, in turn, leads to instability in the exchange rates of domestic currencies in terms of foreign currencies.

4. Entry Requirements

Domestic governments impose entry requirements to multinational.

5. Tariff Quotas and Trade Barriers

Governments of various countries impose tariffs, import and export barriers in order to protect the domestic business. Further these barriers are imposed based on the political and diplomatic relations between or among various governments.

6. Corruption

Corruption has become an international phenomenon. The higher rate bribes and kickbacks discourage the foreign investors to expand their operations.

7. Bureaucratic Practices of Government

Bureaucratic attitudes and practices of government delay sanctions, grants permission and licenses to foreign companies.

8. Technological Pirating

Copying the original technology, producing imitative products, imitating other areas of business operations were common in Japan. This practices invariably alarms the foreign companies against expansion.

9. Quality maintenance

International business firms have to meticulously maintain quality of the products based on quality norms of each country. The firms have to face severe consequences, if they fail to conform to the country standards.

10. High Cost

Internationalizing the domestic business involves market survey, product improvement, quality up gradation, managerial efficiency and the like. These activities need larger investments and involve higher cost and risk. Hence, most of the business houses refrain themselves from internationalizing their business.

1.6.3 Problems of MNCs

The main problems in international business are as follows:

1. **Distance barrier**: International business is carried across the borders of the country. When the markets are far moved by distance, the transportation cost becomes high and the delivery time tends to become longer. As a result, there is an increase in the cost of a product.

2. **Differences in language**: Each country has its own language in which its traders wish to prepare their trade documents right from trade enquiry or the letter of quotation to the payment documents. This works as a serious barrier between the traders of the different countries. Moreover, the distance between the trading countries increases the cost of transportation of goods, making the price high and also creating a risk of fraud, etc. as the traders may not have face to face contact between them. An international businessman often encounters the problems arising out of differences in language. Even when the same language is used in different countries, the same words or terms may have different meanings.

3. **Cultural differences**: Cultural differences constitute one of the most important problems in international business. Many domestic markets are not free from cultural diversities.
4. **Political and legal differences**: Political and legal differences also act as a major hurdle in International business. The complexity generally increases as more countries are included in the company's portfolio.
5. **Difference in currency:** The currency varies from nation to nation. This may cause problems of exchange rate fluctuations and currency convertibility. The monetary system and regulations may also vary from nation to nation.
6. **Economic differences:** The economic environment may change from country to country which is a major hurdle in international business.
7. **Import-export restrictions:** At times many countries put certain restrictions on their foreign trade to make their Balance of Payment (BOP) favourable. They impose heavy tariffs or import duties, volume restrictions on both of their imports as well as their exports. This hampers the smooth conduct of International trade.
8. **Heavy documentation**: International Trade requires so many legal formalities and many documents, which makes the trade procedure very cumbersome as well complex. Therefore, most of the small traders trade only through third parties rather than going directly and have to pay commission to them which reduce, their profit margins, increase the cost of transactions.
9. **Lack of proper information about the foreign market**: In most of the cases new traders do not have adequate information about foreign markets whatever information is provided by different agencies are either inadequate or does not fulfil their requirements. Thus, they fail to have clarity about the opportunities available to them for exports and imports.
10. **Payment problems:** There may arise payment problem between traders of both countries as they both want to transact in their own currency and fluctuations in foreign exchange may also add on to the problem of payment and due to this risk may also arise for both the traders.

Let’s sum up

Learners in this section we have seen the advantages and problems faced by MNCs. Advantage of MNCs are High Living Standard, Increased Socio-Economic Welfare, Wider Markets, Reduced effects of Business Cycle, Reduced Risks, Large Scale Economics, Potential Untapped Markets, Division of Labour and Specialisation and Economic Growth of the world. Disadvantages are Political Factors, Huge Foreign Indebtedness, Exchange Instability, Entry Requirements, Tariff Quotas and Trade Barriers, Corruption, Bureaucratic Practices of Government, Technological Pirating, Quality maintenance and High Cost. The main problems in international business are Distance barrier, Differences in language, Cultural differences, Political and legal differences, Difference in currency, Economic differences, Import-export restrictions, Heavy documentation, Lack of proper information about the foreign market, Payment problems

Check your progress

1.Which enterprise operate in multiple countries, managing production or delivering services in more than one country

A. Domestic company
B. Sole proprietorship
C. Multinational corporations (MNCs)
D. Partnership

2. Which of the following is the advantages of MNCs

A. High living standard
B. Large scale economics
C. Division of labour and specialization
D. All of the above

3. Which of the following is NOT the problem in MNC

A. Distance barrier
B. Cultural differences
C. Economic difference
D. None of the above

4. MNCs create employment opportunities in host countries, contributing to local ____

A. Economic development
B. Social development
C. Family development
D. Technology development

5. MNCs expand their operations to tap into ____ markets

A. Existing
B. New
C. Competitive
D. unsuccessful

1.7 Unit summary

Learners, in this first unit we have seen that International business is crucial for economic growth, market expansion, risk diversification, and accessing global resources. It involves globalization, cross-border transactions, and cultural exchange, covering trade, investment, licensing, franchising, and strategic partnerships. Firms typically internationalize through stages, adopting approaches like ethnocentric, polycentric, regiocentric, and geocentric. Entry modes include exporting, licensing, joint ventures, wholly-owned subsidiaries, and strategic alliances. Multinational corporations (MNCs) play a significant role by investing, producing, marketing, and innovating globally. While MNCs offer advantages like economic growth and technology transfer, they also pose challenges such as cultural conflicts and potential exploitation.

1.8 Glossary

Ethnocentric approach	Home country orientation is the approach where a company simply markets its product or services internationally in the same manner as they do domestically
Polycentric approach	Companies go for customization for each foreign market.

Regiocentric approach	The company after operating successfully in a foreign country, thinks of exporting to the neighboring countries of the host country
Geocentric approach	The company identifies the needs of consumers worldwide and then enters into the market with standard products with standardized marketing mix for all the markets it serves.
Exporting	The process of selling of goods and services produced in one country to other countries.
Indirect export	An indirect export is the process of exporting through domestically based export intermediaries
Export Merchants	Wholesale companies that buy unpackaged products from suppliers/manufacturers for resale overseas under their own brand names
Confirming Houses	Intermediate sellers that work for foreign buyers
Licensing	Allowing a foreign company to produce and sell products under the licensor's brand.
Franchising	Allowing a foreign entity to operate a business model developed by the franchisor.
Wholly-Owned Subsidiaries	Establishing a fully owned business operation in a foreign country, either through acquisition or greenfield investment

1.9 Self-Assessment Questions

Short Answers: (5 Marks)

1. Why is international business important?
2. Mention the scope of international business
3. What are the stages of internationalization?
4. Describe the four approaches of International Business
5. Explain the types of direct exporting

6. Describe the advantages of indirect exporting
7. Explain about licensing
8. Describe about joint venture
9. List out the advantages and disadvantages of MNCs
10. Write a brief note on problems of MNCs

Long Answers: (8 Marks)

1. Discuss the features of international business in detail.
2. Explain in detail on franchising, wholly owned subsidiaries and strategic alliance.
3. Elaborate in detail about modes of entry in international business.
4. Explain about Multinational Corporations and their involvement in International Business.

1.10 Case Study

A case study on the mode of entry in international business involves analyzing how a company expands its operations into a foreign market. This process includes several key decisions, such as choosing the appropriate entry mode, understanding market dynamics, and assessing risks and benefits. Below is a structured case study of a hypothetical company, "TechWave," entering the Indian market.

TechWave's Entry into the Indian Market

Company Background

TechWave is a U.S.-based technology company specializing in cloud computing solutions and software services. Established in 2005, the company has grown to become a significant player in North America and Europe. TechWave aims to expand its global footprint by entering the rapidly growing Indian market.

Market Analysis:

India, with its large population, increasing internet penetration, and a burgeoning IT sector, presents a lucrative opportunity for TechWave. Key factors considered include: Market Potential: India has one of the fastest-growing economies with a high demand for IT and cloud services. Competition: The market is competitive with both local and international players. Regulatory Environment: India has specific regulations

regarding data security and foreign investments. Cultural Factors: Understanding local business practices and consumer behavior is crucial.

Entry Mode Options:

TechWave considered several entry modes:

1. Exporting: Selling products directly from the U.S. to Indian customers.
2. Licensing: Allowing a local company to use TechWave's technology and brand.
3. Joint Venture: Partnering with an Indian company to establish a new entity.
4. Wholly-Owned Subsidiary: Setting up a new, fully-owned operation in India.
5. Franchising: Allowing local entrepreneurs to operate under TechWave's brand and business model.

Selected Entry Mode:

After thorough analysis, TechWave decided to enter the Indian market through a Joint Venture with an established Indian IT company, "InnoTech Solutions”.

Rationale for Choosing Joint Venture:

Local Expertise: InnoTech Solutions has extensive knowledge of the Indian market, customer base, and regulatory landscape. Resource Sharing: Combining resources, technology, and expertise can accelerate market entry and reduce costs. Risk Mitigation: Shared financial and operational risks make the venture more manageable.

Cultural Integration: Facilitates better cultural alignment and smoother operations.

Implementation Plan:

1.Partnership Agreement: Formalizing the joint venture agreement, including ownership stakes, roles, and responsibilities. 2.Market Entry Strategy: Developing a comprehensive strategy that includes marketing, sales, and customer service tailored to Indian customers. 3.Regulatory Compliance: Ensuring all operations adhere to Indian regulations and legal requirements. 4.Technology Integration: Integrating TechWave's cloud solutions with InnoTech’s local infrastructure. 5. Talent Acquisition: Hiring and training local talent to support the new venture.

Challenges and Mitigation Strategies:

Regulatory Hurdle: Navigating complex regulations and ensuring compliance through local legal expertise. Cultural Differences: Implementing cross-cultural training programs to bridge cultural gaps between U.S. and Indian employees. Competition: Differentiating

TechWave's offerings through innovation and superior customer service. Operational Integration: Streamlining integration processes to ensure seamless operations and minimize disruption.

Outcomes and Evaluation:

Six months post-entry, TechWave assessed its progress: Market Penetration: Achieved a significant customer base, particularly among SMEs and startups. Revenue Growth: Recorded a 20% increase in quarterly revenue from the Indian market. Brand Recognition: Enhanced brand visibility and reputation in the Indian tech industry. Operational Efficiency: Effective collaboration with InnoTech Solutions led to optimized operations.

Question

1. **Analyze and summarize the given case study.**

1.11 Answers for check your progress

Modules	S. No.	Answers
Module 1	1.	C. International business
	2.	B. Innovation and economic growth
	3.	C. Cultural exchange
	4.	D. Small scale operations
	5.	A. Global trade of goods/services or investment
Module 2	1.	D. FDI
	2.	B. Franchising
	3.	B. Greenfield Investments
	4.	A. Resources
	5.	C. Exporting goods and services to foreign markets
Module 3	1.	C. 5
	2.	A. Domestic company
	3.	B. Douglas Wind and Pelmutter

	4.	A. Ethnocentric Approach
	5.	C. Geocentric approach
Module 4	**1.**	B. Exporting
	2.	A. indirect export
	3.	C. Turnkey project
	4.	B. Greenfield investment
	5.	D. Technology exchange
Module 5 & 6	**1.**	C. Multinational corporations (MNCs)
	2.	D. All of the above
	3.	D. None of the above
	4.	A. Economic development
	5.	B. New

1.12 Suggested Readings

1. Manfred B. Steger (2020), Globalization: A Very Short Introduction, Oxford University Press, ISBN: 978-0198849452

2. Ravi Ramamurti (2021), The Future of Globalization: A Review of International Business Theories, Journal of International Business Studies, Springer.

1.13 Open Source E-Content Links

S.No.	Topic	E-Content Link
1.	International Business	https://www.youtube.com/watch?v=b2m2G8xMmBM https://www.youtube.com/watch?v=KS9CfrKyMI0
2.	Internationalization process and Approaches	https://www.youtube.com/watch?v=DzoGC4eWUMk

1.14 References

- International Business: Competing in the Global Marketplace by Charles W.L. Hill, G. Tomas M. Hult
- International Business: Text and Cases by P. Subba Rao
- International Business by Rakesh Mohan Joshi
- Global Business by S. K. Bhatia
- International Business: A Managerial Perspective by Ricky W. Griffin, Michael W. Pustay
- International Business: The Challenges of Globalization by John J. Wild, Kenneth L. Wild
- Investopedia

UNIT 2 - INTRODUCTION OF TRADE THEORIES

Introduction of Trade theories - Mercantilism - Absolute Advantage - Comparative Advantage - Heckscher-Ohlin Theory -The New Trade Theory - Porter's Diamond Competitive Advantage Theory

SECTION 2.1: TRADE THEORIES

2.1.1 INTRODUCTION

The reason for the emergence of international trade is that the human wants are varied and unlimited and no single country possesses the adequate resources to satisfy all these wants. Hence there arises a need for interdependence between countries in the form of international trade. So, in order to make effective utilization of the world's resources international trade is to be boosted and the problems faced by the countries should be dealt with.

2.1.2 BASIS OF INTERNATIONAL TRADE

No country is self-sufficient in producing all the required goods and services from its own resources. This problem can be solved through international trade where the countries obtain those goods which it cannot produce or cannot produce as cheaply as possible in another country. However, this is not the only basis for doing international trade, there are other reasons also. Trade economists have laid down different theories for international trade.

Brief overview of traditional trade theory

For analytical convenience, trade theory can be classified into two categories namely, traditional theory (which has a neoclassical foundation) and new trade theories. Traditional trade theory incorporates the principles of perfect competition, homogenous goods and constant returns to scale in production. This would include the trade theories of Smith, Ricardo, Heckscher and Ohlin and the modifications or extensions of the Heckscher-Ohlin theory. The new theories of international trade on the other hand

would include theories characterised by product differentials, imperfect competition and increasing returns to scale.

Trade theories have inter alia, attempted to explain three issues:

- The pattern of trade where the emphasis has been on explaining the basis of trading relations;
- The sources of gain from trade where the emphasis has been on explaining how the gains from trade are distributed among trading partners; and
- The structure of production and returns to factors of production where the emphasis has been on explaining the implications of trade for the structure of production and returns to factors of production within each trading country.

Some of the basic assumptions underlying conventional trade theories include:

1. Trading relations are restricted to two countries each having a fixed stock of factors of production;
2. Factors of production are perfectly mobile among industries within a country but completely immobile internationally;
3. There are no transport costs in trade;
4. All traded products are final products;
5. Both factor and product markets are characterized by perfect competition with producers maximizing profits and factor returns at a level that ensures full employment of all factors;
6. Technology is such that production is characterized by constant returns to scale; and
7. Consumers everywhere have identical homothetic utility functions.

2.1.3 Criticisms of Traditional (neoclassical) trade theories

The underlying assumptions supporting conventional trade theories have been called into question. In this section these assumptions are listed and then a brief overview of the criticisms is provided.

- Resources are country specific and constant in quality and in full employment across countries. Technology is either fixed (classical model) or similar and freely available (factor endowment model) to all nations.

- Perfect competition prevails. Factors of production are perfectly mobile between different production activities.
- Governments play no role in international economic relations so that trade is strictly carried out among anonymous producers who have as their sole motive the minimization of costs and maximization of profits. International prices are the result of the interaction of supply and demand.

Some of the criticisms emanating from these assumptions are elaborated on below.

Factor resources

Conventional trade theory assumes that factor resources are fixed in quantity, constant in quality across nations, fully employed and not mobile across countries. As far as the mobility of factor resources is concerned, it is well recognised that one major phenomenon of production in the nineteenth and twentieth century relates to the mobility of factor resources. The proliferation of multi-national corporations (MNCs) over the last century has manifested itself in the transfer of capital, skilled labour and technology across nations. Trade has been one of the main determinants of unequal growth of productive resources in different nations. This is especially the case for resources such as physical capital, entrepreneurial abilities, scientific capacities and upgrading of technological skills of the labour force. Thus, factor endowments and comparative costs are subject to a state of change.

Fixed technology

Rapid technological change is an important characteristic of our modern world economy. The development of synthetic substitutes (rubber, wool, cotton, sisal, jute, hides and skins) for example, by the developed countries have had a profound effect on third world economies. Hence the strict adherence to the principle of fixed technology would mean that the third world countries would continue producing primary goods for which world demand has decreased.

Assumption of perfect competition.

Resource allocation between production activities is not instantaneous and costless as traditional theory would lead us to believe. Increasing returns to scale is a common feature of the production process. Similarly, monopolistic and oligopolistic market control of internationally traded commodities mean that large individual

corporations are able to manipulate world prices and supplies. Thus, joint producer activities and oligopolistic bargaining among giant buyers and sellers are important determinants of price and quantity on the international market.

Role of governments

It is because of the non-existence of perfect competition and instantaneous adjustment of product and factor markets that governments play an increasingly important role in international economic relations. The optimum tariff argument suggests that a country having a dominant role on the international market (in terms of manipulation of prices) may find it advantageous to impose tariffs. As pointed out earlier, unemployment may also justify government intervention. It should also be noted that the benefits of trade may not be equitably distributed. Whether trade is beneficial or not depends on the nature of the export sector, the distribution of its benefits and its linkages with the rest of the economy. Hence government intervention may not only be justified, but also necessary to secure the benefits from trade. The existence of imperfect competition (a characteristic of the modern world) necessitates an increasingly important role for government in international economic relations.

2.1.4 List of Classical country-based theories and Modern firm-based theories

Classical country-based theories	Modern firm-based theories
Mercantilism	Country Similarity
Absolute Advantage	Product Life Cycle
Comparative Advantage	Global strategic Rivalry
Heckscher-Ohlin	Porter National Competitive Advantage

Let’s sum up

Learners in this section we have seen that the reason for the emergence of international trade is that the human wants are varied and unlimited and no single country possesses the adequate resources to satisfy all these wants. No country is self-sufficient in producing all the required goods and services from its own resources. This

problem can be solved through international trade where the countries obtain those goods which it cannot produce or cannot produce as cheaply as possible in another country. Classical country-based theories are Mercantilism, Absolute Advantage, Comparative Advantage and Heckscher-Ohlin. Modern firm-based theories are Country Similarity, Product Life Cycle, Global strategic Rivalry and Porter National Competitive Advantage.

Check your progress

1. **Which trade theories do not have transport costs in trade**
   A. Conventional trade
   B. New trade
   C. Monopolistic competition
   D. Dual competition

2. **Which one of the following is the classical country-based theory**
   A. Country Similarity
   B. Product Life Cycle
   C. Mercantilism
   D. Porter National Competitive Advantage

3. **Which one of the following is not the modern firm-based theory**
   A. Comparative Advantage
   B. Global strategic Rivalry
   C. Porter National Competitive Advantage
   D. Product Life Cycle

4. **Which of the following is NOT the assumptions of conventional trade theories**
   A. Trading relations are restricted to two countries each having a fixed stock of factors of production
   B. All traded products are final products
   C. Consumers everywhere have identical homothetic utility functions
   D. Both factor and product markets are characterized by monopolistic competition

5. **Which type of trade theory incorporates the principles of perfect competition, homogenous goods and constant returns to scale in production**

A. New trade theory
B. Traditional trade theory
C. Economic theory
D. Psychological theory

SECTION 2.2: MERCANTILISM

2.2.1 Introduction

Mercantilism, economic theory and practice common in Europe from the 16th to the 18th century that promoted governmental regulation of a nation's economy for the purpose of augmenting state power at the expense of rival national powers. It was the economic counterpart of political absolutism. Its 17th-century publicists - most notably Thomas Mun in England, Jean-Baptiste Colbert in France, and Antonio Serra in Italy - never, however, used the term themselves; it was given currency by the Scottish economist Adam Smith in his Wealth of Nations (1776).

Mercantilism contained many interlocking principles. Precious metals, such as gold and silver, were deemed indispensable to a nation's wealth. If a nation did not possess mines or have access to them, precious metals should be obtained by trade. It was believed that trade balances must be "favourable," meaning an excess of exports over imports. Colonial possessions should serve as markets for exports and as suppliers of raw materials to the mother country. Manufacturing was forbidden in colonies, and all commerce between colony and mother country was held to be a monopoly of the mother country.

A strong nation, according to the theory, was to have a large population, for a large population would provide a supply of labour, a market, and soldiers. Human wants were to be minimized, especially for imported luxury goods, for they drained off precious foreign exchange. Sumptuary laws (affecting food and drugs) were to be passed to make sure that wants were held low. Thrift, saving, and even parsimony were regarded

as virtues, for only by these means could capital be created. In effect, mercantilism provided the favourable climate for the early development of capitalism, with its promises of profit.

Later, mercantilism was severely criticized. Advocates of laissez-faire argued that there was really no difference between domestic and foreign trade and that all trade was beneficial both to the trader and to the public. They also maintained that the amount of money or treasure that a state needed would be automatically adjusted and that money, like any other commodity, could exist in excess. They denied the idea that a nation could grow rich only at the expense of another and argued that trade was in reality a two-way street. Laissez-faire, like mercantilism, was challenged by other economic ideas.

2.2.2 Effects of Mercantilism

Mercantilism led to the creation of monopolistic trading companies, such as the East India Company and the French East India Company. Restrictions on where finished goods could be purchased led in many cases to burdensome high prices for those goods. Commercial rivalry tended to result in military rivalry as well, notably during the Anglo-Dutch Wars. Colonists seeking to get around the trade restrictions mandated by mercantilism resorted to widespread smuggling. The constraints of mercantilism were a cause of friction between Britain and its American colonies and were arguably among the elements that led to the American Revolution.

• Countries should export more than they import and receive the difference in gold.

• Mercantilism views trade as a zero-sum game

• One in which a gain by one country results in a loss by another.

• The primary objective of Mercantilism was to increase the power of the nation state wealth which measured by its holdings of treasure (usually gold)

Mercantilism theory leads to the starting of colonialism

European countries competed for world power and needed colonies to provide necessary raw materials so mother country does not have to import from other nations and markets for exports. Colonies power like the British used to trade with their colonies like India, Srilanka etc. by importing the raw material from & exporting the finished goods to colonies. The colonies had to export less valued goods and import more valued goods. Thus colonies were prevented from manufacturing. This practice allowed the colonial powers to enjoy trade surplus and forced the colonies to experience trade deficit. The theory benefitted the colonial powers and caused much discontent in colonies. In fact, this was the background situation for American Revolution. The mercantilism theory suggests for maintaining favorable BOT in the form of import of gold for export of goods and services. But the decay of gold standard reduces the validity of this theory. This theory was modified in neo-mercantilism.

2.2.3 Theory of Neo-Mercantilism

Neo-Mercantilism proposes that countries attempt to produce more than the demand in the domestic country in order to achieve a social objective like full employment in the domestic country or a political objective like assisting a friendly country. Mercantilist policies are politically attractive to some firms and their workers, as mercantilism benefits certain members of society. Modern supporters of these policies are known as neo-mercantilists, or protectionists e.g. China. This theory was attacked

only ground that the wealth of a nation is based on its available goods and service rather than on gold.

Let's sum up

In this section we have seen that Mercantilism led to the creation of monopolistic trading companies, such as the East India Company and the French East India Company. Neo-Mercantilism proposes that countries attempt to produce more than the demand in the domestic country in order to achieve a social objective like full employment in the domestic country or a political objective like assisting a friendly country.

Check your progress

1. Mercantilism, economic theory and practice common in Europe from ____

A. 16th to 18th century
B. Before 16th century
C. After 18th century
D. 19th to 20th century

2. Which of the following theory proposes that countries attempt to produce more than the demand in the domestic country in order to achieve a social objective

A. New trade theory
B. Porter diamond model
C. Neo-Mercantilism
D. Absolute cost advantage

3. which is considered as primary objective of Mercantilism

A. Increase the power of the nation wealth which measured by its holdings of treasure (usually gold)
B. Economic of scale would reduce the labour cost per unit per output.
C. Only two commodities are trades
D. Free trade exists between the countries

4. What is another name for the Modern supporters of Theory of Neo-Mercantilism policies

A. Mercantilists

B. Protectionists
C. Non-Protectionists
D. Modernist

5. Mercantilism led to the creation of ____ companies

A. Partnership
B. Monopolistic trading
C. Wholesale
D. Retail

SECTION 2.3: THEORY OF ABSOLUTE COST ADVANTAGE

Adam Smith, the Scottish economist viewed that mercantilism weakens a country. He advocated free trade among countries to increase a country's wealth. Free trade enables a country to provide a variety of goods and services to its people by specializing in the production of some goods and services and importing others. Which goods should a country produce and which goods it should import?

Adam Smith proposed Absolute Cost Advantage. Theory of International Trade (1776) based on the principle of division of labour. According to him application of this principle to international scenario helps the countries to specialize in the production of those goods in which they have cost advantage over other countries.

According to Adam Smith, every country should specialize in producing those products which it can produce at less cost than that of other countries and exchange these products with other products produced cheaply by other countries. Trade between two countries takes place when one country produces one product at less cost than that of another country and the other country has an absolute cost advantage over the first country in producing in any other product.

Skilled Labour and Specialisation Advantage*:*

Countries have absolute cost advantage due to the following reasons:

- Suitability of the skills of the labour of the country in producing certain products.
- Specialisation of labour in producing certain products leads to higher productivity and less labour cost per unit of output.

- Economic of scale would reduce the labour cost per unit per output.

Natural Advantage:

In addition to the skilled labour and specialization advantage, countries do also have natural advantage in producing certain products due to climatic conditions, access to certain natural resources etc.,

Acquired Advantage:

In addition to the skilled labour and natural advantages, countries also acquire advantages through technology and skills development. Japan acquired advantage in steel production through the imports of both iron and coal. The reason for this success is that Japan acquired labour saving and material saving technology. Denmark exports silver tableware due to the ability of Danish companies in developing distinctive products. Technologically advanced countries acquired abilities to develop substitute products for a number of natural products.

2.3.1 Assumptions of the Theory

Adam Smith proposed the absolute cost advantage theory based on the following assumptions:

1) Trade is between two countries
2) Only two commodities are trades
3) Free trade exists between the countries
4) The only element of cost of production is labour.

2.3.2 Implications of Absolute Cost Advantage Theory

This theory has the following implications:

- By trading, two countries can have more quantities of both the products.
- Living standards of the people of both the countries can be increased by trading between the countries.
- Inefficiency in producing certain products in some countries can be avoided.
- Global efficiency and effectiveness can be increased by trading.
- Global labour productivity and other resources productivity can be maximized.

Criticism:

No Absolute Advantage: According to this theory, one country should be able to produce at least one product at a comparatively low cost. But, in reality, most of the developing countries do not have absolute advantage of producing any product at the lowest cost. Yet they participate in international trade.

Country size: Countries vary in size. This theory does not deal with country-by-country differences in specialization.

Variety of resources: Though there are several resources like labour, technology and natural resources, this theory deals with only labour and ignores all other resources.

Transport cost: Though the cost of transportation plays a significant role in international trade, this theory ignored this aspect.

Scale Economic: Large scale economies reduces the cost of production and form a part of the absolute advantage. But this theory ignored that aspect also.

Absolute Advantage for many products: Some countries may have absolute advantage for many products. For ex., Japan, the USA, France, the UK etc. But this theory does not deal with such situations.

Let's sum up

Learners in this section we have seen that Adam Smith, the Scottish economist viewed that mercantilism weakens a country. He advocated free trade among countries to increase a country's wealth. Adam Smith proposed Absolute Cost Advantage. Theory of International Trade (1776) based on the principle of division of labour. According to him application of this principle to international scenario helps the countries to specialize in the production of those goods in which they have cost advantage over other countries. Also discussed the implications and assumptions of absolute cost advantage in detail.

Check your progress

1. Who proposed Absolute Cost Advantage?

A. Eli Heckscher
B. Bertil Ohlin
C. Paul Samuelson
D. Adam Smith

2. **Theory of International Trade (1776) is based on which of the following principle**.

A. Division of labour
B. Division of finance
C. Division of risk
D. Division of country

3. **Which one of the following is NOT the assumption of Absolute cost advantage theory**

A. Trade is between two countries
B. Only two commodities are trades
C. The only element of cost of production is raw materials.
D. Free trade exists between the countries

4. Large scale economies reduces __________

A. Cost of production
B. Cost of labour
C. Cost of raw materials
D. Cost of machineries

5. **Which one of the following refers to one country's ability to produce more of a particular good or service than another with the same quantity of resources with lower financial cost.**

A. Mercantilism
B. Absolute advantage
C. Neo-mercantilism
D. Comparative Advantage

SECTION 2.4: COMPARATIVE COST ADVANTAGE THEORY

Absolute Cost Advantage Theory fails to explain the situation when one country has absolute cost advantage in producing many products. David Ricardo, a British economist in his book “The Principles of Political Economy and Taxation” published in 1817 expanded the Absolute Cost Advantage theory to clarify this situation and developed the theory of Comparative Cost Advantage.

2.4.1 Assumptions

- There exists full employment.
- The only element of cost of production is labour. Production is the subject to the law of constant returns.
- There are no trade barriers.
- Trade is free from cost of production.
- Trade takes place between two countries.
- Only two products are traded.
- There are no costs of transport, etc.

Comparative cost advantage theory states that a country should produce and export those products for which it is relatively more productive than that of other countries and import those goods for which other countries are relatively more productive that it is. The comparative cost advantage theory is based on relative productivity differences and incorporates the concept of opportunity cost.

Comparative cost advantage theory also advocates that Japan should export audio tape recorders to India and India should export pens to Japan.

2.4.2 Implications

1. Efficient allocation of global resources.
2. Maximisation of global production at the least possible cost.
3. Product prices become more or less equal among world markets.
4. Demand for resources and products among world nations will be optimized.
5. It is better for the countries to specialize in those products which they relatively do better and export them.
6. It is better for the countries to buy other goods from other countries who are relatively better at producing them.

Comparative cost advantage theory is really an improvement over Adam Smith's theory of Cost Absolute advantage. This theory is not only an extension to the principles of division of labour and specialization, but applies the opportunity cost concept. It is also argued that lower labour cost need not to be a source of comparative advantage.

Let's sum up:

In this section we have discussed that the Absolute Cost Advantage Theory fails to explain the situation when one country has absolute cost advantage in producing many products. David Ricardo, a British economist in his book "The Principles of Political Economy and Taxation" published in 1817 expanded the Absolute Cost Advantage theory to clarify this situation and developed the theory of Comparative Cost Advantage. We have also seen the implications and assumptions of comparative cost advantage theory.

Check your progress

1. Who proposed comparative cost advantage theory

A. Bertil Ohlin
B. Paul Samuelson
C. Adam Smith
D. David Ricardo

2. Which one of the following is the book published by David Ricardo

A. The Principles of Political Economy and Taxation
B. The Principles of management
C. The principles of taxation
D. The principles of Economy

3. How many products/goods are traded according to Comparative cost advantage theory

A. Three
B. Two
C. Four
D. More than four

4. Comparative cost advantage theory is an improvement over which theory?

A. Neo-mercantilism
B. Mercantilism
C. Theory of Cost Absolute advantage
D. Heckscher- Ohlin Theory

5. Which one of the following is NOT the assumption of theory of comparative cost advantage theory?

A. There exists partial employment.
B. There are no trade barriers.
C. Trade is free from cost of production.
D. Trade takes place between two countries.

SECTION 2.5: HECKSCHER- OHLIN THEORY

The factor proportions model was originally developed by two Swedish economists, Eli Heckscher and his student Bertil Ohlin, in the 1920s. Many elaborations of the model were provided by Paul Samuelson after the 1930s, and thus sometimes the model is referred to as the Heckscher-Ohlin-Samuelson (HOS) model. In the 1950s and 1960s, some noteworthy extensions to the model were made by Jaroslav Vanek, and so occasionally the model is called the Heckscher-Ohlin-Vanek model.

The H-O model incorporates a number of realistic characteristics of production that are left out of the simple Ricardian model. In the simple Ricardian model only one factor of production, labor, is needed to produce goods and services. The productivity of labor is assumed to vary across countries, which implies a difference in technology between nations. It was the difference in technology that motivated advantageous international trade in the model.

The standard H-O model begins by expanding the number of factors of production from one to two. The model assumes that labor and capital are used in the production of two final goods. Here, capital refers to the physical machines and equipment that are used in production. Thus, machine tools, conveyers, trucks, forklifts, computers, office buildings, office supplies, and much more are considered capital.

All productive capital must be owned by someone. In a capitalist economy, most of the physical capital is owned by individuals and businesses. In a socialist economy, productive capital would be owned by the government. In most economies today, the government owns some of the productive capital, but private citizens and businesses own most of the capital. Any person who owns common stock issued by a business has an ownership share in that company and is entitled to dividends or income based on the

profitability of the company. As such, that person is a capitalist - that is, an owner of capital.

The H-O model assumes private ownership of capital. Use of capital in production will generate income for the owner. Income is referred as capital "rents." Thus, whereas the worker earns "wages" for his or her efforts in production, the capital owner earns rents.

The assumption of two productive factors, capital and labor, allows for the introduction of another realistic feature in production: differing factor proportions both across and within industries. When one considers a range of industries in a country, it is easy to convince oneself that the proportion of capital to labor applied in production varies considerably. For example, steel production generally involves large amounts of expensive machines and equipment spread over perhaps hundreds of acres of land, but it also uses relatively few workers. (Note that *relative* here means relative to other industries.) In the tomato industry, in contrast, harvesting requires hundreds of migrant workers to hand-pick and collect each fruit from the vine. The amount of machinery used in this process is relatively small.

In the H-O model, it is defined that the ratio of the quantity of capital to the quantity of labor used in a production process as the capital-labor ratio. Assume that different industries producing different goods have different capital-labor ratios. It is this ratio (or proportion) of one factor to another that gives the model its generic name: the factor proportions model.

In a model in which each country produces two goods, an assumption must be made as to which industry has the larger capital-labor ratio. Thus, if the two goods that a country can produce are steel and clothing and if steel production uses more capital per unit of labor than is used in clothing production, we would say the steel production is capital intensive relative to clothing production. Also, if steel production is capital intensive, then it implies that clothing production must be labor intensive relative to steel.

Another realistic characteristic of the world is that countries have different quantities - that is, endowments of capital and labor available for use in the production process. Thus, some countries like the United States are well endowed with physical

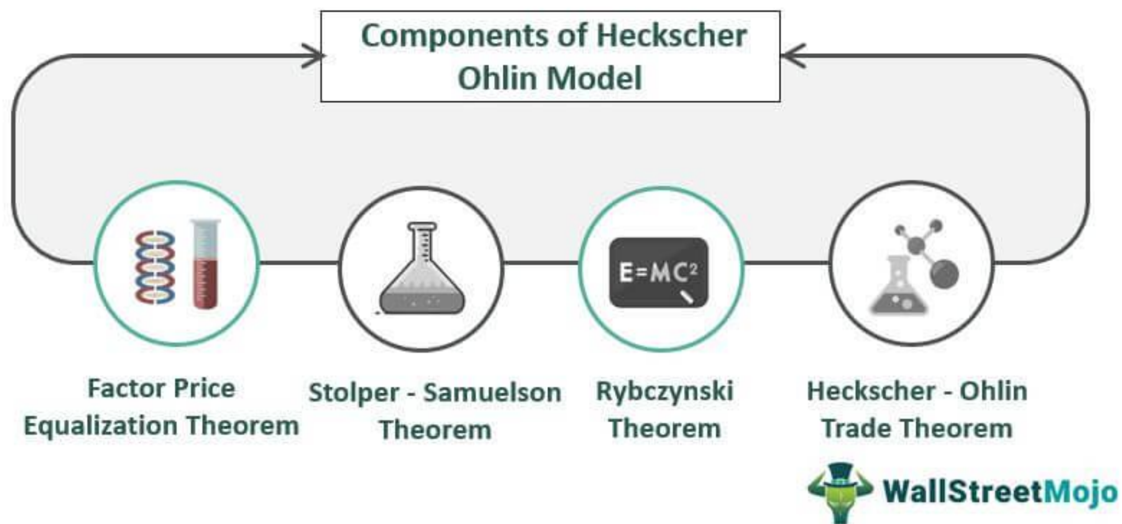
capital relative to their labor force. In contrast, many less-developed countries have much less physical capital but are well endowed with large labor forces. The ratio of the aggregate endowment of capital to the aggregate endowment of labor to define relative factor abundancy between countries is used. Thus if, for example, the United States has a larger ratio of aggregate capital per unit of labor than France's ratio, the United States is capital abundant relative to France. By implication, France would have a larger ratio of aggregate labor per unit of capital and thus France would be labor abundant relative to the United States.

The H-O model assumes that the only differences between countries are these variations in the relative endowments of factors of production. It is ultimately shown that (1) trade will occur, (2) trade will be nationally advantageous, and (3) trade will have characterizable effects on prices, wages, and rents when the nations differ in their relative factor endowments and when different industries use factors in different proportions.

It is worth emphasizing here a fundamental distinction between the H-O model and the Ricardian model. Whereas the Ricardian model assumes that production technologies differ between countries, the H-O model assumes that production technologies are the same. The reason for the identical technology assumption in the H-O model is perhaps not so much because it is believed that technologies are really the same, although a case can be made for that. Instead, the assumption is useful in that it enables us to see precisely how differences in resource endowments are sufficient to cause trade and it shows what impacts will arise entirely due to these differences.

2.5.1 FOUR MAIN THEOREMS IN THE H-O MODEL

There are four main theorems in the H-O model: the Heckscher-Ohlin (H-O) theorem, the Stolper-Samuelson theorem, the Rybczynski theorem, and the factor-price equalization theorem. The Stolper-Samuelson and Rybczynski theorems describe relationships between variables in the model, while the H-O and factor-price equalization theorems present some of the key results of the model. The application of these theorems also allows us to derive some other important implications of the model.



1. The Heckscher-Ohlin Theorem

The H-O theorem predicts the pattern of trade between countries based on the characteristics of the countries. The H-O theorem says that a capital-abundant country will export the capital-intensive good, while the labour-abundant country will export the labour-intensive good.

A country that is capital abundant is one that is well endowed with capital relative to the other country. This gives the country a propensity for producing the good that uses relatively more capital in the production process—that is, the capital-intensive good. As a result, if these two countries were not trading initially—that is, they were in autarky—the price of the capital-intensive good in the capital-abundant country would be bid down (due to its extra supply) relative to the price of the good in the other country. Similarly, in the country that is labor abundant, the price of the labour-intensive good would be bid down relative to the price of that good in the capital-abundant country.

Once trade is allowed, profit-seeking firms will move their products to the markets that temporarily have the higher price. Thus, the capital-abundant country will export the capital-intensive good since the price will be temporarily higher in the other country. Likewise, the labor-abundant country will export the labor-intensive good. Trade flows will rise until the prices of both goods are equalized in the two markets.

The H-O theorem demonstrates that differences in resource endowments as defined by national abundancies are one reason that international trade may occur.

2. The Stolper-Samuelson Theorem

The Stolper-Samuelson theorem describes the relationship between changes in output prices (or prices of goods) and changes in factor prices such as wages and rents within the context of the H-O model. The theorem was originally developed to illuminate the issue of how tariffs would affect the incomes of workers and capitalists (i.e., the distribution of income) within a country. However, the theorem is just as useful when applied to trade liberalization.

The theorem states that if the price of the capital-intensive good rises (for whatever reason), then the price of capital - the factor used intensively in that industry - will rise, while the wage rate paid to labor will fall. Thus, if the price of steel were to rise and if steel were capital intensive, the rental rate on capital would rise, while the wage rate would fall. Similarly, if the price of the labor-intensive good were to rise, then the wage rate would rise, while the rental rate would fall.

The theorem was later generalized by Ronald Jones, who constructed a magnification effect for prices in the context of the H-O model. The magnification effect allows for analysis of any change in the prices of both goods and provides information about the magnitude of the effects on wages and rents. Most importantly, the magnification effect allows one to analyse the effects of price changes on real wages and real rents earned by workers and capital owners. This is instructive since real returns indicate the purchasing power of wages and rents after accounting for price changes and thus are a better measure of well-being than the wage rate or rental rate alone.

Since prices change in a country when trade liberalization occurs, the magnification effect can be applied to yield an interesting and important result. A movement to free trade will cause the real return of a country's relatively abundant factor to rise, while the real return of the country's relatively scarce factor will fall. Thus if the United States and France are two countries that move to free trade and if the United States is capital abundant (while France is labor abundant), then capital owners in the United States will experience an increase in the purchasing power of their rental income

(i.e., they will gain), while workers will experience a decline in the purchasing power of their wage income (i.e., they will lose). Similarly, workers will gain in France, but capital owners will lose.

The country's abundant factor benefits regardless of the industry in which it is employed. Thus, capital owners in the United States would benefit from trade even if their capital is used in the declining import-competing sector. Similarly, workers would lose in the United States even if they are employed in the expanding export sector.

The reasons for this result are somewhat complicated, but the gist can be given fairly easily. When a country moves to free trade, the price of its exported goods will rise, while the price of its imported goods will fall. The higher prices in the export industry will inspire profit-seeking firms to expand production. At the same time, the import-competing industry, suffering from falling prices, will want to reduce production to cut its losses. Thus, capital and labor will be laid off in the import-competing sector but will be in demand in the expanding export sector. However, a problem arises in that the export sector is intensive in the country's abundant factor—let's say capital. This means that the export industry wants relatively more capital per worker than the ratio of factors that the import-competing industry is laying off. In the transition there will be an excess demand for capital, which will bid up its price, and an excess supply of labor, which will bid down its price. Hence, the capital owners in both industries experience an increase in their rents, while the workers in both industries experience a decline in their wages.

3. The Factor-Price Equalization Theorem

The factor-price equalization theorem says that when the prices of the output goods are equalized between countries, as when countries move to free trade, the prices of the factors (capital and labor) will also be equalized between countries. This implies that free trade will equalize the wages of workers and the rents earned on capital throughout the world.

The theorem derives from the assumptions of the model, the most critical of which are the assumptions that the two countries share the same production technology and that markets are perfectly competitive. In a perfectly competitive market, factors are paid on the basis of the value of their marginal productivity, which in turn depends on the output prices of the goods. Thus, when prices differ between countries, so will their

marginal productivities and hence so will their wages and rents. However, once goods' prices are equalized, as they are in free trade, the value of marginal products is also equalized between countries and hence the countries must also share the same wage rates and rental rates.

Factor-price equalization formed the basis for some arguments often heard in the debates leading up to the approval of the North American Free Trade Agreement (NAFTA) between the United States, Canada, and Mexico. Opponents of NAFTA feared that free trade with Mexico would lower U.S. wages to the level in Mexico. Factor-price equalization is consistent with this fear, although a more likely outcome would be a reduction in U.S. wages coupled with an increase in Mexican wages.

Furthermore, factor-price equalization is unlikely to apply perfectly in the real world. The H-O model assumes that technology is the same between countries in order to focus on the effects of different factor endowments. If production technologies differ across countries, as we assumed in the Ricardian model, then factor prices would not equalize once goods' prices equalize. As such, a better interpretation of the factor-price equalization theorem applied to real-world settings is that free trade should cause a tendency for factor prices to move together if some of the trade between countries is based on differences in factor endowments.

4. The Rybczynski Theorem

The Rybczynski theorem demonstrates the relationship between changes in national factor endowments and changes in the outputs of the final goods within the context of the H-O model. Briefly stated, it says that an increase in a country's endowment of a factor will cause an increase in output of the good that uses that factor intensively and a decrease in the output of the other good. In other words, if the United States experiences an increase in capital equipment, then that would cause an increase in output of the capital-intensive good (steel) and a decrease in the output of the labour-intensive good (clothing). The theorem is useful in addressing issues such as investment, population growth and hence labor force growth, immigration, and emigration, all within the context of the H-O model.

The theorem was also generalized by Ronald Jones, who constructed a magnification effect for quantities in the context of the H-O model. The magnification

effect allows for analysis of any change in both endowments and provides information about the magnitude of the effects on the outputs of the two goods.

Aggregate Economic Efficiency

The H-O model demonstrates that when countries move to free trade, they will experience an increase in aggregate efficiency. The change in prices will cause a shift in production of both goods in both countries. Each country will produce more of its export good and less of its import good. Unlike the Ricardian model, however, neither country will necessarily specialize in production of its export good. Nevertheless, the production shifts will improve productive efficiency in each country. Also, due to the changes in prices, consumers, in the aggregate, will experience an improvement in consumption efficiency. In other words, national welfare will rise for both countries when they move to free trade.

However, this does not imply that everyone benefits. As the Stolper-Samuelson theorem shows, the model clearly demonstrates that some factor owners will experience an increase in their real incomes, while others will experience a decrease in their factor incomes. Trade will generate winners and losers. The increase in national welfare essentially means that the sum of the gains to the winners will exceed the sum of the losses to the losers. For this reason, economists often apply the compensation principle.

The compensation principle states that as long as the total benefits exceed the total losses in the movement to free trade, then it must be possible to redistribute income from the winners to the losers such that everyone has at least as much as they had before trade liberalization occurred.

Note that the "standard" H-O model refers to the case of two countries, two goods, and two factors of production. The H-O model has been extended to many countries, many goods, and many factors, but most of the exposition in this text, and by economists in general, is in reference to the standard case.

Let's sum up

In this section we have seen that the factor proportions model was originally developed by two Swedish economists, Eli Heckscher and his student Bertil Ohlin, in the 1920s. The assumption of two productive factors, capital and labor, allows for the

introduction of another realistic feature in production: differing factor proportions both across and within industries. There are four main theorems in the H-O model: the Heckscher-Ohlin (H-O) theorem, the Stolper-Samuelson theorem, the Rybczynski theorem, and the factor-price equalization theorem.

Check your progress

1. Who developed the factor proportions model

A. Eli Heckscher and Bertil Ohlin
B. David Ricardo
C. Paul Samuelson
D. Adam Smith

2. Which one of the following is assumed in standard H-O model for production

A. Labour
B. Capital
C. Labour and capital
D. Raw materials

3. How many theorems are there in H-O model

A. One
B. Two
C. Three
D. Four

4. Which one of the following describes the relationship between changes in output prices (or prices of goods) and changes in factor prices

A. The Stolper-Samuelson Theorem
B. Factor-Price Equalization Theorem
C. Comparative cost advantage
D. Rybczynski Theorem

5. Rybczynski Theorem was proposed by ______

A. Eli Heckscher
B. Bertil

C. Ohlin
D. Ronald Jones

SECTION 2.6: NEW TRADE THEORY

It is observed that the Ricardian theory and H-O theory provided good explanations of trade theory till the first half of the 20th century. However, in due course many 35 researchers observed that comparative advantage seemed to be less relevant in the modern world. Economists now believe that the traditional trade theories (i.e. Ricardian theory and H-O theory) fail to provide a complete explanation of the structure of the world trade. The world trade data now contains several empirical regularities or stylized facts that appear to be inconsistent with the traditional theories. Thus, the assumptions of H-O theory like – perfect competition, constant returns to scale, and same technology are invalid in today's context of world trade. Hence, economists have modified H-O theory by relaxing most of its assumptions and have developed new trade theories or complementary trade theories. These new theories are based on economies of scale, imperfect competition, and differences in technology among nations.

2.6.1 Salient Features of New Theories of Trade

The new theories which are developed after 1970s have the following salient features –

(a) They have liberated the trade theory from the assumption of perfect competition made in the classical and neo-classical theories of trade.

(b) They are developed in an imperfect competitive framework and have incorporated developments in industrial organization theory within the trade theory.

(c) They have incorporated scale economies and product differentiation in the imperfect competitive framework within the H-O general equilibrium theory of comparative advantage.

(d) These theories have taken into account the important determinants of the pattern of international trade such as increasing returns to scale, technological innovation, product differentiation and international oligopoly rivalry, etc. The strategic trade policy models have provided theoretical justification for policy intervention in the form of import protection, export subsidies, etc. in increasing national relative advantage in exports.

(e) These theories show the possible interaction between the inter-industry pattern of trade based on relative factor endowment of factors of production and intra-industry trade based on scale economies and product differentiation.

(f) These theories are quite powerful in explaining the patterns of trade between developed countries as well as trade between developed and developing countries at any given point of time in static terms.

(g) Trade between developed countries in terms of this theory is explained by differences in the economies of scale existing among the different oligopoly firms as well as by the levels of technological progress among them. Trade between developed and developing countries also arises because of the developed countries have the advantage of economies of scale and highly developed technology while the developing countries lag behind in the economies of scale and technological progress.

2.6.2 Broad Categories of New Theories

The new theories can be broadly categorized into three types –

(1) Neo – technological trade theories

(2) Intra-industry trade models

(3) Strategic trade policy models.

1. Neo – Technological Trade Theories

The neo-technological trade theories emphasize the importance of technological innovation and the technological gap across firms and countries as a major source of international trade. The main theories are as follows:

(a) Kravis' Theory of Availability – In the Kravis' model, technological innovation as a basis of trade operates through his product availability hypothesis. The availability approach seeks to explain the pattern of trade in terms of domestic availability and non-availability of goods. Availability influences trade through demand and supply forces. According to him, a country produces and exports those goods which are 'available', that is, goods developed by its entrepreneurs and innovators. By availability he means an elastic supply. In short, as per Kravis' theory of availability, international trade takes place because of differences in the availability of certain products among countries.

(b) Linder's Theory of Volume of Trade and Demand Pattern – Linder (1961) in his theory gave importance to demand side factors like similarity in income levels across

nations and income distribution characteristics in determining pattern of trade. As per this theory, international trade takes place between those countries which have similar income levels and demand patterns. Thus, Linder's theory explains the reasons for large volume of trade in manufacturers among developed countries. The theory highlights the fact that the lion's share of world trade is among the developed countries with broadly similar per-capita incomes rather than between the developed and underdeveloped countries.

(c) Posner's Imitation Gap or Technological Gap Theory – M.V.Posner (1961) analysed the effect of technology on trade. He regards technological changes as a continuous process which influences the pattern of international trade. The model is based on the assumption that trading countries have similar factor endowments and identical production functions for established products. But, the technology is different between the trading countries. This difference in the technology leads to introduction of new products and new production processes by a firm in a country. As a result, an innovating firm which creates a new product might acquire a temporary comparative advantage in the exports of its products to other countries. This comparative advantage could be called as 'technology gap'. To conclude, the technological gap theory is more realistic than the traditional theories because it analyses the effect of technical changes on the pattern of international trade.

(d) Vernon's Product Cycle Theory – Vernon (1966) has put forth the product cycle hypothesis. Vernon's model is a generalization and extension of the technological gap model. It states that the development of a new product moves through a cycle or a series of stages in the course of its development, and its comparative advantage changes as it moves through the cycle.

As a new product passes through different stages in a domestic market, in the similar way it passes through different stages in the international market. Generally, a product passes through the three stages during its life time. These stages are - (a) New product stage, (b) Maturing product stage and (c) Standardized product stage. To conclude, we can say that the Posner's technological model stresses the time lag in the imitation process, while Vernon's product cycle model stresses the standardization process. Both the models, try to explain dynamic comparative advantage for new products and new

production processes, as opposed to the basic H-O model which explains static comparative advantage.

2. Intra – Industry Trade Models

Intra – industry trade refers to trade between identical countries which are exporting & importing similar but differentiated products. The intra- industry trade models developed after 1970s take into account firm level internal economies of scale and 39 product differentiation in explaining trade between identical economies. In the late 1970s, several researchers like - Krugman, Dixit & Norman, Lancaster etc. independently formalized the idea that economies of scale and imperfect competition can give rise to trade even in the absence of comparative advantage. It was the Grubel & Lloyd's (1975)8 study which formed the basis for the development of intra-industry trade models. They found that international trade was maximum between identical (capital abundant) developed countries, and these countries, exported and imported similar but differentiated products. It was Krugman (1979) who formalized it into a systematic general equilibrium model by taking Dixit & Stiglitz's (1977) general equilibrium theory of monopolistic competition for the first time. The main intra –industry models are as follows:

(1) Krugman's Model (1979) – Paul Krugman's model marks a distinctive and realistic departure from the traditional models because it recognizes the role of economies of scale and monopolistic competition in international trade.

Krugman in his model points out that trade is possible between the two countries having identical tastes, technology, factor endowments & income levels, because of product differentiation and internal economies of scale in production. Thus, the sources of trade between identical economies lies in product differentiation and internal economies of scale in production of manufactured goods under a monopolistic competitive framework. The implications of his model are – (a) Trade increases the choice of goods available to consumers and thereby improves consumer welfare. (b) Trade can cause an increase in demand, production and real income, facilitated by economies of scale.

(2) Brander – Krugman Model (1983) – The Brander- Krugman model of intra-industry trade is based on oligopolistic competition. This model considers the 40 application of the concept of dumping in international trade. The Brander- Krugman model considers a

situation in which two firms of two countries resort to dumping in each other's domestic market. Hence, their model is also known as reciprocal dumping model. Dumping in the context of international trade means a practice in which a firm sells its products in foreign market at a price much lower than its domestic price. The situation in which dumping leads to a two-way trade in the same product is known as reciprocal dumping. The possibility of dumping in international trade was first noted by Brander (1981) and then extended by Brander & Krugman (1983). The Brander- Krugman model suggests that with the opening up of trade the monopoly situation turns into a duopolistic market structure, which is a form of oligopolistic competition. Thus, their reciprocal dumping model explains the intra-industry trade in homogenous products under oligopolistic competition. However, the model fails to explain the net effect of such peculiar trade on a nation's economic welfare.

3. Strategic Trade Policy Models

The strategic trade policy models provide certain theoretical justification for policy intervention such as home market protection and export subsidies towards increasing exports and national welfare. In the broader sense, the strategic trade policy models are an extension of intraindustry trade models. These models are developed in a partial equilibrium framework by assuming oligopolistic competition. The basis of these models lies in the trade war between industrialized countries such as United States, Japan, and the European Community. Two strategic trade theory models are as follows:

(a) Krugman's Model (1984) – Krugman's strategic trade policy model shows that import protection of domestic producers could lead to export promotion. In this model three forms of economies of scale are taken into account - (a) Static internal (to a firm) economies, (b) Economies in Research & Development and investment, (c) Dynamic economies of learning by doing.

(b) Brander & Spencer's Model (1985) – Brander & Spencer's model shows that export subsidies could help domestic producers to capture third country markets at the cost of foreign rivals. This is a two stage (game theory) model in which governments (simultaneously) choose subsidy levels in the first stage and firms (simultaneously) choose output levels in the second stage. There is no domestic consumption in either country. i.e. firms produce only for the third country market. The model assumes foreign

firm does not receive export subsidy. An export subsidy to a domestic firm is considered as a reduction in its cost of production. Hence, it becomes profitable for the domestic firm to expand its sale in the third country market, and capture a large market share at the cost of the foreign rival.

2.6.3 Various aspects of New Trade Theory (NTT)

New Trade Theory (NTT) provides a more comprehensive understanding of international trade than traditional theories by incorporating elements such as economies of scale, imperfect competition, and product differentiation. Let's delve into the detailed aspects of NTT and how it reshapes the perspective on international trade.

1. **Economies of Scale**
    - Internal Economies of Scale: Cost advantages that a firm obtains due to expansion. As firms grow and produce more, the average cost per unit decreases. This can result from factors like more efficient production techniques, bulk purchasing of materials, and spreading fixed costs over a larger output. Example: The automotive industry, where large-scale production reduces per-unit costs, allowing firms like Toyota or Ford to be more competitive internationally.
    - External Economies of Scale: Cost advantages that accrue to firms due to the overall growth of the industry within a specific region. Concentration of firms in a region leads to the development of specialized suppliers, a skilled labor force, and shared infrastructure, benefiting all firms in the industry. Example: Silicon Valley's tech industry, where proximity to suppliers, skilled workers, and venture capital fosters innovation and growth.
2. **Monopolistic Competition**
    - Product Differentiation: Firms create distinct products through variations in quality, features, branding, etc. This leads to a situation where many firms can coexist because each firm’s product caters to slightly different preferences. Example: The smartphone market, where brands like Apple, Samsung, and Google offer unique features and ecosystems that appeal to different consumer segments.

- Market Power: The ability of a firm to set prices above marginal cost due to differentiated products. Firms can achieve higher profit margins and invest more in R&D, further differentiating their products. Example: High-end fashion brands like Gucci or Louis Vuitton, which command premium prices due to brand value and product uniqueness.

3. First-Mover Advantage

Firms that enter a market early can establish a strong market position before competitors. Early entrants can build brand recognition, secure key resources, and develop customer loyalty, creating barriers to entry for later firms.Example: Amazon in the e-commerce space, leveraging its early entry to establish extensive logistics and customer loyalty programs.

4. Network Effects

Positive Feedback Loops: The value of a product or service increases as more people use it. Firms that achieve a critical mass of users can dominate a market, making it difficult for new entrants to compete. Example: Social media platforms like Facebook or messaging apps like WhatsApp, where the large user base itself attracts more users.

5. Strategic Trade Policy

Government Intervention: Governments can support industries with the potential for economies of scale or significant market impacts. Policies such as subsidies, tax incentives, or protective tariffs can help domestic firms grow and compete internationally. Example: Government support for the aerospace industry, as seen in the United States with Boeing or in Europe with Airbus.

In conclusion, New Trade Theory enriches the understanding of international trade by incorporating real-world complexities such as economies of scale, imperfect competition, and strategic government intervention. It provides a more dynamic and nuanced framework compared to traditional trade theories, highlighting the importance of firm behavior, market structure, and innovation in shaping global trade patterns.

Let’s sum up:

Learners in this section we have discussed about the new theories that can be broadly categorized into three types. They are Neo – technological trade theories, Intra-industry trade models and Strategic trade policy models. Various aspects of new trade theory are economies of scale, monopolistic competition, First-Mover Advantage, Network Effects and Strategic Trade Policy.

Check your progress

1. The new trade theories were developed after _____

A. 1960
B. 1970
C. 1980
D. 1990

2. Which one of the following emphasize the importance of technological innovation and the technological gap across firms

A. The neo-technological trade theory
B. Neo-mercantilism
C. Mercantilism
D. Theory of Cost Absolute advantage

3. Which theory states that the development of a new product moves through a cycle or a series of stages in the course of its development.

A. Posner's Imitation Gap
B. Technological Gap Theory
C. Kravis' Theory of Availability
D. Vernon's Product Cycle Theory

4. Which one refers to the trade between identical countries which are exporting & importing similar but differentiated products

A. Domestic trade
B. Intra – industry trade
C. Inter-industry trade
D. National trade

5. The Brander- Krugman model of intra-industry trade is based on ______.

A. Perfect competition
B. Monopolistic competition
C. Oligopolistic Competition
D. Pure competition

SECTION 2.7: Porter's National Competitive Advantage Theory or Porter Diamond Model

Porter's National Competitive Advantage Theory or Porter Diamond Model

The Porter Diamond Theory of National Advantage, or the Porter Diamond Model, is a model that describes the competitive advantage that nations or groups possess based on factors available to them. The theory explains how governments can act to improve a country's position in a globally competitive economic environment. In the continuing evolution of international trade theories, Michael Porter of Harvard Business School developed a new model to explain national competitive advantage in 1990. Porter's theory stated that a nation's competitiveness in an industry depends on the capacity of the industry to innovate and upgrade. His theory focused on explaining why some nations are more competitive in certain industries. To explain his theory, Porter identified four determinants that he linked together.

The four determinants are (1) local market resources and capabilities, (2) local market demand conditions, (3) local suppliers and complementary industries, and (4) local firm characteristics.

1. Local market resources and capabilities (factor conditions). Porter recognized the value of the factor proportions theory, which considers a nation's resources (e.g., natural resources and available labor) as key factors in determining what products a country will import or export. Porter added to these basic factors a new list of advanced factors, which he defined as skilled labor, investments in education, technology, and infrastructure. He perceived these advanced factors as providing a country with a sustainable competitive advantage.

2. Local market demand conditions. Porter believed that a sophisticated home market is critical to ensuring ongoing innovation, thereby creating a sustainable competitive advantage. Companies whose domestic markets are sophisticated, trendsetting, and demanding forces continuous innovation and the development of new products and technologies. Many sources credit the demanding US consumer with forcing US software companies to continuously innovate, thus creating a sustainable competitive advantage in software products and services.
3. Local suppliers and complementary industries. To remain competitive, large global firms benefit from having strong, efficient supporting and related industries to provide the inputs required by the industry. Certain industries cluster geographically, which provides efficiencies and productivity.
4. Local firm characteristics. Local firm characteristics include firm strategy, industry structure, and industry rivalry. Local strategy affects a firm’s competitiveness. A healthy level of rivalry between local firms will spur innovation and competitiveness.

Deciding factors of national comparative economic advantage theory

The Porter Diamond Model suggests that countries can create advantages for themselves, such as a strong technology industry or a skilled labor force. Another application of the Porter Diamond Model is used in corporate strategy as a framework to analyze the relative merits of investing and operating in national markets.

The Porter Diamond Model is visually represented by a diagram that resembles the points of a diamond and includes the interrelated determinants that Porter theorizes as the deciding factors of national comparative economic advantage:

- Firm strategy, structure, and rivalry
- Related supporting industries
- Demand conditions
- Factor conditions

Factor conditions

Factor conditions are those elements that Porter believes a country's economy can create for itself, such as a large pool of skilled labour, technological innovation, infrastructure and capital. One way for the government to accomplish that goal is to stimulate competition between domestic companies by establishing and enforcing anti-trust laws.

Firm strategy, structure, and rivalry

Firm strategy, structure, and rivalry define that competition leads to increased production and the development of technological innovations. The concentration of market power, degree of competition, and ability of rival firms to enter a nation's market are influential.

Related supporting industries

Related supporting industries consider the upstream and downstream industries that facilitate innovation through exchanging ideas. These can spur innovation depending on the degree of transparency and knowledge transfer.

Demand conditions

Demand conditions refer to the size and nature of the customer base for products, which also drives innovation and product improvement. Larger consumer markets will

demand and stimulate a need to differentiate and innovate and increase market scale for businesses.

Let's sum up:

Learners we have seen in this section that the Porter Diamond Theory of National Advantage, or the Porter Diamond Model, is a model that describes the competitive advantage that nations or groups possess based on factors available to them. The four determinants are local market resources and capabilities, local market demand conditions, local suppliers and complementary industries, and local firm characteristics. Deciding factors of national comparative economic advantage theory were Firm strategy, structure, and rivalry, Related supporting industries, Demand conditions and Factor conditions.

Check your progress

1. **Which one of the following is NOT the determinants of Porter's National Competitive Advantage Theory.**
   A. Local market resources and capabilities
   B. Local market supply conditions
   C. Local suppliers and complementary industries
   D. Local firm characteristics

2. **In which year Porter's National Competitive Advantage Theory was developed?**
   A. 1990
   B. 1989
   C. 1988
   D. 1987

3. **Which of the following include firm strategy, industry structure, and industry rivalry.**
   A. Local suppliers
   B. Local firm characteristics
   C. Local demand conditions
   D. Local market

4. __________ **refer to the size and nature of the customer base for products, which also drives innovation and product improvement**

A. Supply condition
B. Technology
C. Market size
D. Demand conditions

5. **Which one of the following is not the element of factor conditions**

A. Limited skilled labour
B. Technological innovation
C. Infrastructure
D. Capital

2.8 Unit summary

Learners in this second unit we have seen that Trade theories have evolved to explain the mechanisms and benefits of international trade. Mercantilism, the earliest theory, advocates for a trade surplus and accumulating wealth through exports over imports. In contrast, Adam Smith's Absolute Advantage theory suggests that countries should specialize in producing goods they can produce most efficiently. David Ricardo's Comparative Advantage theory further refines this by demonstrating that trade can be beneficial even if one country holds an absolute advantage in all products, as long as there are differences in relative efficiencies. The Heckscher-Ohlin Theory expands on this by attributing a country's trade advantages to its factor endowments, such as labor and capital. The New Trade Theory introduces the significance of economies of scale and network effects, suggesting that trade can increase market size and product variety. Lastly, Porter's Diamond Competitive Advantage Theory outlines how a nation's competitiveness is shaped by four broad attributes: factor conditions, demand conditions, related and supporting industries, and firm strategy, structure, and rivalry. Together, these theories provide a comprehensive framework for understanding the complexities of global trade dynamics.

2.9 Glossary

Absolute Advantage	This theory asserts that a country has an absolute advantage if it can produce a good more efficiently (using fewer resources) than another country. Nations should specialize in goods where they hold this advantage
Comparative Advantage	It states that trade would still be gainful even if one country is less efficient than the other, but specializes in the production of commodities or goods where its disadvantages are relatively lower (comparative advantage) and exports the same.
Mercantilism	An economic theory that emphasizes the importance of stockpiling wealth, primarily gold and silver, through a positive balance of trade. It advocates for maximizing exports and minimizing imports to achieve national prosperity
Heckscher-Ohlin Theory	A theory that attributes a country's comparative advantage to its factor endowments, such as land, labor, and capital. Countries will export products that utilize their abundant and cheap factors of production and import products that require factors in which they are relatively scarce
The New Trade Theory	Emphasizes the role of economies of scale and network effects in international trade. It suggests that through specialization and large-scale production, countries can lower costs and increase the variety of goods available, benefiting from increased market size.
Porter's Diamond Competitive Advantage Theory	A theory that explains national competitive advantage through four interrelated determinants: factor conditions (natural resources, labor, infrastructure), demand conditions (domestic market size and sophistication), related and supporting industries, and firm strategy, structure, and rivalry. These factors collectively determine the competitive advantage of nations

2.10 Self-Assessment Questions

Short Answers: (5 Marks)

1. Why are international trade theories important?
2. List out the Classical country-based theories and Modern firm-based theories
3. Write a short note on Theory of Neo-Mercantilism
4. Write a note on Implications of Absolute Cost Advantage Theory
5. State the assumptions of comparative cost advantage theory
6. What are the various aspects of new trade theory?
7. Write a note on Criticisms and Limitations of new trade theory.
8. Brief note on Porter's National Competitive Advantage Theory.
9. List out the Determinants of Porter Diamond Model.
10. Describe the deciding factors of national comparative economic advantage theory.

Long Answers: (8 Marks)

1. Discuss in detail about theory of absolute cost advantage
2. Explain Heckscher- Ohlin Theory in detail
3. Elaborate in detail about the four main theorems in the H-O model
4. Explain in detail about the Neo – technological trade theories and Intra-industry trade models.

2.11 Case Study

International Trade Theory - Comparative Advantage

Background

This case study examines the application of the Comparative Advantage theory in international trade between two countries: Japan and Brazil.

Countries and Industries

- Japan: Advanced industrial sector, strong technology and automotive industries, limited agricultural resources.

- Brazil: Abundant natural resources, strong agricultural sector, developing industrial sector.

Both countries produce two goods: cars and coffee

Production Capabilities

- Japan can produce either 10 million cars or 30 million bags of coffee per year.
- Brazil can produce either 6 million cars or 60 million bags of coffee per year.

Opportunity Costs

To determine comparative advantage, we calculate the opportunity costs for producing one good over the other in each country.

Japan:

- 1 car = 3 bags of coffee (30 million coffee / 10 million cars)
- 1 bag of coffee = 1/3 car (10 million cars / 30 million coffee)

Brazil:

- 1 car = 10 bags of coffee (60 million coffee / 6 million cars)
- 1 bag of coffee = 1/10 car (6 million cars / 60 million coffee)

Comparative Advantage

Comparative advantage suggests that each country should specialize in producing the good for which it has the lowest opportunity cost. Japan has a comparative advantage in producing **cars** because the opportunity cost of producing one car (3 bags of coffee) is lower than in Brazil (10 bags of coffee). Brazil has a comparative advantage in producing **coffee** because the opportunity cost of producing one bag of coffee (1/10 car) is lower than in Japan (1/3 car).

Trade Decision

Based on the principle of comparative advantage, the countries decide to specialize and trade: Japan specializes in producing cars and Brazil specializes in producing coffee.

Trade Agreement

- Japan and Brazil agree to trade based on the following terms:
- Japan will produce 10 million cars.
- Brazil will produce 60 million bags of coffee.
- They agree on an exchange rate: 1 car for 5 bags of coffee.

Trade Outcomes

Before Trade:

- Japan: Produces 5 million cars and 15 million bags of coffee (splitting production 50/50).
- Brazil: Produces 3 million cars and 30 million bags of coffee (splitting production 50/50).

After Specialization:

- Japan: Produces 10 million cars, trades 4 million cars for 20 million bags of coffee.
- Brazil: Produces 60 million bags of coffee, trades 20 million bags of coffee for 4 million cars.

Final Consumption

- Japan: 6 million cars (10 million produced - 4 million traded) and 20 million bags of coffee.
- Brazil: 4 million cars and 40 million bags of coffee (60 million produced - 20 million traded).

Benefits of Trade

- Japan: Gains 1 million more cars and 5 million more bags of coffee compared to pre-trade.
- Brazil: Gains 1 million more cars and 10 million more bags of coffee compared to pre-trade.

Question:

1. Analyze and summarize the given case study.

2.12 Answers for check your progress

Modules	S. No.	Answers
Module 1	**1.**	A. Conventional trade
	2.	C. Mercantilism
	3.	A. Comparative Advantage
	4.	D. Both factor and product markets are characterized by monopolistic competition
	5.	B. Traditional trade theory
Module 2	**1.**	A. 16th to 18th century
	2.	C. Neo-mercantilism
	3.	A. Increase the power of the nation wealth which measured by its holdings of treasure (usually gold)
	4.	B. Protectionists
	5.	B. Monopolistic trading
Module 3	**1.**	D. Adam Smith
	2.	A. Division of labour
	3.	C. The only element of cost of production is raw materials
	4.	A. Cost of production
	5.	B. Absolute Advantage
Module 4	**1.**	D. David Ricardo
	2.	A. The Principles of Political Economy and Taxation

	3.	B. Two
	4.	C. Theory of Cost Absolute advantage
	5.	A. There exists partial employment.
Module 5	**1.**	A. Eli Heckscher and Bertil Ohlin
	2.	C. Labour and capital
	3.	D. four
	4.	A. The Stolper-Samuelson Theorem
	5.	D. Ronald Jones
Module 6	**1.**	B. 1970
	2.	A. The neo-technological trade theory
	3.	D. Vernon's Product Cycle Theory
	4.	B. Intra – industry trade
	5.	C. Oligopolistic Competition
Module 7	**1.**	B. Local market supply conditions
	2.	A. 1990
	3.	B. Local firm characteristics
	4.	D. Demand conditions
	5.	A. Limited skilled labour

2.13 Suggested Readings

1. Edward E. Leamer, James Levinsohn (1995), International Trade Theory and Policy: A Review of the Literature, Handbook of International Economics, Elsevier

2. Robert C. Feenstra (2004), Advanced International Trade: Theory and Evidence, Princeton University Press, ISBN: 978-0691114101

2.14 Open Source E-Content Links

S.No.	Topic	E-Content Link
1.	Theories of	https://www.youtube.com/watch?v=wYWDDWDDChk

	International trade	
2.	Heckscher-Ohlin Theory of international trade	https://www.youtube.com/watch?v=2tSG1cGBrgs

2.15 References

- International Economics" by M.L. Jhingan, Vrinda Publications
- "International Trade and Export Management" by Francis Cherunilam, Himalaya Publishing House
- International Trade: Theory and Policy" by Paul R. Krugman and Maurice Obstfeld, Pearson
- The Theory of International Trade" by Avinash Dixit and Victor Norman, Cambridge University Press
- "International Economics" by H.G. Mannur, Vikas Publishing House
- International Trade: Theory and Evidence" by James R. Markusen, James R. Melvin, William H. Kaempfer, and Keith E. Maskus, McGraw-Hill

UNIT 3 - Foreign Investments

Foreign Investments - Pattern, Foreign exchange rates and their impact on trade and investment flows - Functions of Foreign Exchange Market- Foreign Direct Investments - Factors influencing FDI - Modes of FDI entry - Horizontal and Vertical Foreign Direct Investment - Advantages of Host and Home Countries.

SECTION 3.1: FOREIGN INVESTMENTS

3.1.1 Introduction

Economic development remains an urgent global need. Globalization – which links countries closer than ever before with each other - reinforces this need. The countries have achieved impressive increases in income, over a billion people than a hundred countries stilt live in poverty. Economic inequalities within co remain large, and there is little sign of convergence in incomes across countries. A number of developing countries face increasing marginalization.

Globalization accentuates the increasing importance of the international economics for developing countries. Flows of finance, information, skills, technology, go services between countries are increasing rapidly. FDI is one of the most dynamic increasing international resource flows to developing countries, FDI flows are particularly important because FDI is a package of tangible and intangible assets, and because firms TNCs deploy them are now important players in the global economy can affect development, by complementing domestic investment and by undertaking trade and transfers of knowledge, skills and technology. However, TNCs do not substitute for domestic effort: they can only provide access to tangible and intangible assets and catalyze domestic investment and capabilities. In a world of intensifying competition and accelerating technological change, this complementary and catalytic role can very valuable. Since globalization has its dangers, countries need to prepare their

capabilities to harness its potential including through FDI. However, FDI on its own cannot counteract the marginalization of developing countries.

Meaning of foreign investment

Foreign investment is when a domestic investor decides to purchase ownership of an asset in a foreign country. It involves cash flows moving from one country to another to execute the transaction. If the ownership stake is large enough, the foreign investor may be able to influence the entity's business strategy.

Understanding Foreign Investments

Foreign investments are often made by larger financial institutions hoping to diversify their portfolio or expand operations for one of their current companies internationally. It is often considered a move for scaling purposes or a catalyst to spur in economic growth.

For example, some companies may expand their offices worldwide to reach global talent and connections. Examples would include Goldman Sachs, J.P. Morgan, Morgan Stanley, and other large corporations. In other cases, some companies may open facilities or operations to capitalize on cheaper labor or production costs offered in specific countries.

For textile companies in particular, such as retail production, many factories are located in China and Bangladesh despite sales being focussed on North America – such as H&M or Zara – because material and labor are significantly cheaper there; thus, outsourcing would result in higher profitability. In other cases, some large corporations will prefer to conduct business in countries that have lower tax rates.

3.1.2 Role of Foreign Investment

The factors that propel sustained economic development have not changed o time. They include the generation and efficient allocation of capital and labour, application of technology and the creation of skills and institutions. These facts determine how well each economy uses its endowments and adds to them. They also affect how flexibly and dynamically each country responds to changing economic conditions, However, the global context for development has changed enormous the past three decades. These changes affect not only the role of FDI in host countries, but also government policies on EDT. The following three are of particular significance.

i) The nature and pace of knowledge - and, particularly, technological knowledge - change

The creation and diffusion of productive knowledge have become central to growth and development. “Knowledge” includes not only technical knowledge (research and development, design, process engineering), but also knowledge of organisation, management and inter-firm and international relationships. Much of this knowledge is tacit. Today, the resources devoted to such knowledge exceed investment in tangible machinery and equipment in many of the world’s most dynamic firms, and the costs of generating new knowledge are rising constantly.

The importance of knowledge is not limited to modern or high-tech activities but pervades all sectors and industries, including traditional activities in the primary sector (for instance, vegetable and flower exports), manufacturing (such as textiles, clothing and footwear), and services (such as tourism and banking). As a result, achieving development objectives is, more than ever, a continuous learning process.

The sheer pace of technological change, in particular, is unprecedented arid is accelerating. This means that enterprises that want to be competitive internationally reed both the knowledge to use technologies efficiently and to keep pace with developments. Innovators need to invest more in creating new knowledge, but even followers need the capacity - difficult to acquire - to access and use this new knowledge, or in fortuitous circumstances, to identify windows of opportunity for technological caps.

The skills required for this are changing concomitantly, as are institutions and their relations with productive enterprises; one development is the closer linking of science with technology-generation in industry. An important result of this new “technological paradigm” is that research-intensive activities are growing more rapidly than others in production and trade; thus, sustained economic growth calls increasingly not just for the application of new technology to existing activities, but also for a shift of activities up the value-added chain.

The most profound technological changes today emanate from a merger of communications and information processing technologies. While the telegraph, telephone and computer were significant technological achievements; they pale in

comparison with emerging technologies based on the interface between microprocessors arid telecommunications. These are generic technologies that affect practically the whole range of economic and even social and cultural activities. Information can now be transmitted across the globe at very low cost.

ii) Shrinking economic space and changing competitive conditions

Technical progress in transport and communications has caused economic space to shrink dramatically. Countries now face much more intense and immediate competition than ever before. This leads to a significant restructuring of their comparative advantages' ad activities. The nature of competition itself is changing, with the rapid introduction of new products, shorter product cycles, flexibility of response to demand, and customer interaction becoming more important than traditional forms of competition based on lower costs. At the enterprise level, this calls for new management and technical skills and organizational forms. In many instances, it leads to flatter hierarchies and greater use of networking and cooperation between related firms and also competing firms (for instance, component suppliers now play a much more direct role in new technology development). At the national level, it requires countries to be more open to international flows of information, and to improve national capabilities to absorb and use that information: to develop new skills, institutions and innovative capacities. Countries that cart do that - either generally or in niche markets - can move up the value-added ladder.

iii) Changing attitudes and policy regimes

Most developing and transition countries have moved to market-oriented and private sector led economies. This shift reflects disillusionment with past strategies and growing. Difficulties in pursuing them in the new technological and competitive setting. The shrinking of economic space has itself rendered elements of traditional strategies absolute while the flow of information has made governments more aware of policies a performance in other countries. Policy benchmarking in all areas is becoming more

common which, in turn, puts more pressure on countries to innovate in the policy arena. There is widespread reduction and removal of trade barriers, deregulation of internal markets, privatization and liberalization of technology and investment flows at the national level. At the international level, regulation has intensified and is being harmonized. For instance, the TRIPS agreement of the Uruguay Round has introduced a common more rigorous, system of intellectual property protection; the TRIMs agreement established disciplines over certain performance requirements; and quality requirements such as ISO standards are becoming prerequisites for participating in international production and trade.

Perhaps nowhere is the policy change more striking than in the changing attitude of governments to TNCs. Why have governments changed their attitudes to TNCs? There are several reasons for the change in attitudes towards TNCs and the intensification of competition for PD Governments recognize that TNCs can provide a package external resources that can contribute to development. There is also now an increasing number of TNCs from developing countries, reflected in the fact that the share c developing countries in PD outflows has increased from about two per cent at the beginning of the 1980s to approximately 15 per cent of a much higher total in the mid, 1990s; their home governments want access for their firms to foreign markets and locations.

At the same time, many governments have improved their administrative capabilities and feel more comfortable in dealing with TNCs. Efficient FDI screening has been difficult even for countries with sophisticated bureaucracies, given the need to relate it to changing country and sectoral advantages, changing firm strategies a competition, and political pressures from other countries. On the aggregate 1evel external financing has shifted from official to private sources, especially towards FDI. Finally, the liberalization of FDI (and trade) policy is often part of the conditionality in IMF and World Bank adjustment programmes, and is promoted by many leading aid donors.

Reflecting this change of attitude, FDT is now not just permitted - it is avidly sought governments and, indeed, many sub- national public sector entities at all levels, from provinces to individual communities. Apart from active promotion (which has led to

the establishment of investment promotion agencies in a great number of counties, having their disposal an array of incentives), policy liberalization is the principal tool. Liberalization has been extended to such service industries as telecommunication, transportation and power generation and distribution, previously closed to foreign investors. Many developing countries and economies in transition have concluded bilateral treaties to protect FDI and avoid double taxation. A number of regional schemes (notably the European Union, NAFTA, ASEAN and MERCOSUR) have reduced barriers to FDI or are in the process of doing so, facilitating intra-regional investment trade flows. At the multilateral level, the General Agreement on Trade in Services has contributed to the liberalization of EDT in services, and the TRIMs Agreement has the use of certain performance requirements. The FDI global regime that has emerged after these changes, though uneven, is much more friendly towards foreign investors than in the past.

Let's sum up:

Learners we have seen in this section that Foreign investment is when a domestic investor decides to purchase ownership of an asset in a foreign country. It involves cash flows moving from one country to another to execute the transaction. If the ownership stake is large enough, the foreign investor may be able to influence the entity's business strategy. Foreign investments are often made by larger financial institutions hoping to diversify their portfolio or expand operations for one of their current companies internationally. It is often considered a move for scaling purposes or a catalyst to spur in economic growth.

Check your progress

1. **Which of the following in transport and communications has caused economic space to shrink dramatically**.

A. Technical progress
B. Communication progress
C. Transport progress
D. Technological progress

2. **When a domestic investor decides to purchase ownership of an asset in a foreign country.**

A. Domestic investment
B. Foreign investment
C. Joint venture
D. Partnership

3. **Foreign investment involves ______ moving from one country to another to execute the transaction.**

A. Transport
B. Marketing
C. Labour
D. Cash flows

4. **Foreign investments are often made by larger _____ hoping to diversify their portfolio.**

A. Financial institutions
B. Companies
C. Government
D. Labour force

5. Some companies may open facilities or operations to capitalize on cheaper labor or _____ offered in specific countries.

A. Salary
B. Wages
C. Production costs
D. Raw materials

SECTION 3.2: FOREIGN EXCHANGE RATES

3.2.1 Introduction

Foreign exchange is the mechanism by which the currency of one country gets converted into the currency of another country. The conversion of currency is done by the banks who deal in foreign exchange. These banks maintain stocks of one currency in the form of balances with banks. The Foreign Exchange Market is a market where the

buyers and sellers are involved in the sale and purchase of foreign currencies. In other words, a market where the currencies of different countries are bought and sold is called a foreign exchange market.

3.2.2 Nature of foreign exchange

- Volatile, affected by hedger, arbitrager, speculator.
- Affected by demand and supply. Affected by rate of interest.
- Affected by balance of payment surplus and deficit.
- Affected inflation rate.
- Spot and forward rates are different.
- Affected by the economic stability of the country.
- Affected by the fiscal policy of the government.
- Affected by the political condition of the country.
- It can be quoted directly or indirectly

3.2.3 Types of Foreign Exchange Transactions

- ❖ **Spot Transaction:** The spot transaction is when the buyer and seller of different currencies settle their payments within the two days of the deal. It is the fastest way to exchange the currencies. Here, the currencies are exchanged over a two-day period, which means no contract is signed between the country. The exchange rate at which the currencies are exchanged is called the Spot Exchange Rate**.** This rate is often the prevailing exchange rate. The market in which the spot sale and purchase of currencies is facilitated is called as a Spot Market.
- ❖ **Forward Transaction:** A forward transaction is a future transaction where the buyer and seller enter into an agreement of sale and purchase of currency after 90 days of the deal at a fixed exchange rate on a definite date in the future. The rate at which the currency is exchanged is called a Forward Exchange Rate. The market in which the deals for the sale and purchase of currency at some future date are made is called a Forward Market.

- **Future Transaction:** The future transactions are also the forward transactions and deals with the contracts in the same manner as that of normal forward transactions. But however, the transaction made in a future contract differs from the transaction made in the forward contract.
- **Swap Transactions:** The Swap Transactions involve a simultaneous borrowing and lending of two different currencies between two investors. Here one investor borrows the currency and lends another currency to the second investor. The obligation to repay the currencies is used as collateral, and the amount is repaid at a forward rate. The swap contracts allow the investors to utilize the funds in the currency held by him/her to pay off the obligations denominated in a different currency without suffering a foreign exchange risk.
- **Option Transactions:** The foreign exchange option gives an investor the right, but not the obligation to exchange the currency in one denomination to another at an agreed exchange rate on a pre-defined date. An option to buy the currency is called as a Call Option, while the option to sell the currency is called as a Put Option.

3.2.4 Impact on trade and investment flows

Merchandize trade

This refers to a nation's imports and exports. In general, a weaker currency makes imports more expensive, while stimulating exports by making them cheaper for overseas customers to buy. A weak or strong currency can contribute to a nation's trade deficit or trade surplus over time.

Economic Growth

The basic formula for an economy's GDP is:

$GDP = C + I + G + (X - M)$,

C= Consumption or consumer spending, the biggest component of an economy

I=Capital investment by businesses and households

G=Government spending$(X-M)$=Exports−Imports, or net exports

From this equation, it is clear that the higher the value of net exports, the higher a nation's GDP. As discussed earlier, net exports have an inverse correlation with the strength of the domestic currency.

Capital flows

Foreign capital tends to flow into countries that have strong governments, dynamic economies, and stable currencies. A nation needs a relatively stable currency to attract capital from foreign investors. Otherwise, the prospect of exchange-rate losses inflicted by currency depreciation may deter overseas investors. There are two types of capital flows: foreign direct investment (FDI), in which foreign investors take stakes in existing companies or build new facilities in the recipient market; and foreign portfolio investment, in which foreign investors buy, sell and trade securities in the recipient market. FDI is a critical funding source for growing economies such as China and India.

Inflation

A devalued currency can result in "imported" inflation for countries that are substantial importers. A sudden 20% decline in the domestic currency could result in imports costing 25% more, as a 20% decline means a 25% increase is needed to get back to the original price point.

Interest Rates

As mentioned earlier, exchange rates are a key consideration for most central banks when setting monetary policy. In September 2012, Bank of Canada governor Mark Carney said the bank took the persistent strength of the Canadian dollar into account when setting monetary policy. Carney said the Canadian dollar's strength was one reason why his country's monetary policy had been "exceptionally accommodative" for so long.

A strong domestic currency exerts drag on the economy, achieving the same result as a tighter monetary policy (i.e. higher interest rates). In addition, further tightening of monetary policy at a time when the domestic currency is already strong may exacerbate the problem by attracting hot money from foreign investors seeking higher yielding investments (which would further strengthen the domestic currency).

3.2.5 Global Impact of Currencies: Examples

The forex market is the most actively traded market in the world, with an excess of more than $5 trillion traded daily, far exceeding global equities. Despite such enormous trading volumes, currencies usually stay off the front pages. However, there are times when currencies move in dramatic fashion and the reverberations are felt around the world. We list below a few examples:

The Asian Crisis of 1997-98

A prime example of the havoc caused by adverse currency moves is the Asian Financial Crisis, which began with the devaluation of the Thai baht in summer of 1997. The devaluation occurred after the baht came under intense speculative attack, forcing Thailand's central bank to abandon its peg to the U.S. dollar and float the currency. This currency contagion spread to neighboring countries such as Indonesia, Malaysia and South Korea, leading to a severe contraction in these economies as bankruptcies soared and stock markets plunged.

China's Undervalued Yuan

Between 1995 and 2005, China held the renminbi steady at about 8.2 per dollar, enabling its export juggernaut to gather steam from what trade partners said was an artificially suppressed and undervalued currency. In 2005, China responded to the growing chorus of complaints from the U.S. and other nations. It allowed the yuan to steadily appreciate, from over 8.2 RMB to the dollar to about 6 per dollar by 2013.

Japanese Yen's Gyrations From 2008 to Mid-2013

The Japanese yen was one of the most volatile currencies between 2008 and 2013. Because of Japan's policy of near zero-bound interest rates, traders favored the yen for carry trades, in which they borrowed yen for next to nothing and invested in higher yielding overseas assets. But as the global credit crunch intensified in 2008, the yen began appreciating sharply as panicked investors bought the currency in droves to repay yen-denominated loans. As a result, the yen appreciated by more than 25% against the U.S. dollar in the five months to January 2009. Then in 2013, Prime Minister Shinzo Abe unveiled monetary stimulus and fiscal stimulus plans (nicknamed "Abenomics") that led to a 16% plunge in the yen within the first five months of the year.

Euro Fears (2010-12)

Concerns that the deeply indebted nations of Greece, Portugal, Spain and Italy would be forced out of the European Union led the euro to plunge 20% from 1.51 to the dollar in December 2009 to about 1.19 in June 2010. The euro recovered its strength over the next year, but that only proved temporary. A resurgence of EU break-up fears led to a 19% slump in the euro from May 2011 to July 2012.

Let’s sum up:

Learners in this section we have seen that Foreign exchange is the mechanism by which the currency of one country gets converted into the currency of another country. The conversion of currency is done by the banks who deal in foreign exchange. These banks maintain stocks of one currency in the form of balances with banks. The Foreign Exchange Market is a market where the buyers and sellers are involved in the sale and purchase of foreign currencies. In other words, a market where the currencies of different countries are bought and sold is called a foreign exchange market. Global Impact of Currencies: Examples are The Asian Crisis of 1997-98, China’s Undervalued Yuan, Japanese Yen’s Gyrations From 2008 to Mid-2013, Euro Fears (2010-12).

Check your progress

1. **What is an exchange rate?**
   A. The price of one country's currency in terms of another currency
   B. The interest rate charged by central banks
   C. The amount of gold backing a currency
   D. The annual growth rate of a country's GDP
2. **What is a floating exchange rate?**
   A. A fixed exchange rate pegged to another currency
   B. An exchange rate determined by supply and demand in the foreign exchange market
   C. An exchange rate set by the government
   D. An exchange rate that is adjusted periodically by the central bank
3. **What is the primary impact of a stronger domestic currency on exports?**
   A. Increases the volume of exports
   B. Reduces the volume of exports
   C. No effect on the volume of exports
   D. Makes exports more competitive
4. **Which factor does NOT typically influence exchange rates?**
   A. Interest rates
   B. Inflation rates
   C. Political stability
   D. Population size
5. **What is 'foreign exchange risk'?**

A. The risk of losing money due to changes in exchange rates

B. The risk of a country's economy collapsing

C. The risk associated with foreign direct investment

D. The risk of default on a foreign loan

SECTION 3.3: FUNCTIONS OF FOREIGN EXCHANGE MARKET

The following are the functions of foreign exchange market.

Transfer Function: The basic and the most visible function of foreign exchange market is the transfer of funds (foreign currency) from one country to another for the settlement of payments. It basically includes the conversion of one currency to another, wherein the role of FOREX is to transfer the purchasing power from one country to another. For example**,** if the exporter of India import goods from the USA and the payment is to be made in dollars, then the conversion of the rupee to the dollar will be facilitated by FOREX. The transfer function is performed through a use of credit instruments, such as bank drafts, bills of foreign exchange, and telephone transfers.

Credit Function: FOREX provides a short-term credit to the importers so as to facilitate the smooth flow of goods and services from country to country. An importer can use credit to finance the foreign purchases. Such as an Indian company wants to purchase the machinery from the USA, can pay for the purchase by issuing a bill of exchange in the foreign exchange market, essentially with a three-month maturity.

Hedging Function: The third function of a foreign exchange market is to hedge foreign exchange risks. The parties to the foreign exchange are often afraid of the fluctuations in the exchange rates, i.e., the price of one currency in terms of another. The change in the exchange rate may result in a gain or loss to the party concerned.

Let’s sum up:

Learners we have seen the functions of foreign exchange market in this section. Transfer Function is the basic and the most visible function of foreign exchange market is the transfer of funds (foreign currency) from one country to another for the settlement

of payments. FOREX provides a short-term credit to the importers so as to facilitate the smooth flow of goods and services from country to country. The third function of a foreign exchange market is to hedge foreign exchange risks.

Check your progress

1. What is the primary function of the foreign exchange market?

A. To determine interest rates
B. To facilitate the exchange of currencies between countries
C. To control inflation
D. To set government policies

2. Which of the following is a key function of the foreign exchange market?

A. Providing insurance for international trade
B. Facilitating international investment by providing the means to convert currencies
C. Regulating global trade tariffs
D. Setting international labor standards

3. What role does the foreign exchange market play in hedging?

A. It eliminates the need for currency conversion
B. It allows businesses to lock in exchange rates to avoid the risk of fluctuations
C. It provides loans to exporters
D. It determines the creditworthiness of international borrowers

4. How does the foreign exchange market support international trade?

A. By setting export quotas
B. By providing a mechanism to easily convert one currency into another, facilitating transactions between countries
C. By establishing trade agreements between nations
D. By regulating the quality of goods traded internationally

5. What is the purpose of 'speculation' in the foreign exchange market?**

A. To provide long-term financing for international projects
B. To profit from the changes in exchange rates
C. To stabilize currency values

D. To ensure compliance with international trade laws

SECTION 3.4: FOREIGN DIRECT INVESTMENTS

The term foreign direct investment (FDI) refers to an ownership stake in a foreign company or project made by an investor, company, or government from another country. FDI is generally used to describe a business decision to acquire a substantial stake in a foreign business or to buy it outright to expand operations to a new region. The term is usually not used to describe a stock investment in a foreign company alone. FDI is a key element in international economic integration because it creates stable and long-lasting links between economies.

3.4.1 Nature of Foreign Direct Investments

Any investment from an individual or firm that is located in a foreign country into a country is called Foreign Direct Investment.

- Generally, FDI is when a foreign entity acquires ownership or controlling stake in the shares of a company in one country, or establishes businesses there.
- It is different from foreign portfolio investment where the foreign entity merely buys equity shares of a company.
- In FDI, the foreign entity has a say in the day-to-day operations of the company.
- FDI is not just the inflow of money, but also the inflow of technology, knowledge, skills and expertise/know-how.
- It is a major source of non-debt financial resources for the economic development of a country.
- FDI generally takes place in an economy which has the prospect of growth and also a skilled workforce.
- FDI has developed radically as a major form of international capital transfer since the last many years.

- The advantages of FDI are not evenly distributed. It depends on the host country’s systems and infrastructure.
- The determinants of FDI in host countries are:
  - Policy framework
  - Rules with respect to entry and operations/functioning (mergers/acquisitions and competition)
  - Political, economic and social stability
  - Treatment standards of foreign affiliates
  - International agreements
  - Trade policy (tariff and non-tariff barriers)
  - Privatisation policy

3.4.2 Functions of Foreign Direct Investments

- Economic Growth: FDI can stimulate economic growth in the host countries due to the injection of capital into the economy. This growth can lead to increases in GDP and economic output.
- Job Creation: Through the establishment of new businesses or expansion of existing ones, FDI often results in job creation, which can lower unemployment rates in the host country.
- Transfer of Skills and Technology: Companies from developed countries often bring advanced technology and management skills to the host countries, contributing to the development and modernization of their economies.
- Promotion of Competition: FDI can stimulate competition in the domestic market, leading to improvements in production processes, product quality, and innovation.
- Enhancement of International Trade: Because many FDIs involve some form of export, they can increase a country's participation in the global market, improve the trade balance, and bring foreign currency into the country.

- Infrastructural Development: Multinational corporations often invest in infrastructure as part of their FDI, including road networks, power facilities, and telecommunications, which aids in the overall development of the host nation's infrastructure.
- Tax Revenue: Governments can obtain additional revenue from taxes on the profits generated by the foreign owned entities, which can be used to finance public services and investments.

FDI in India

The investment climate in India has improved tremendously since 1991 when the government opened up the economy and initiated the LPG strategies.

- The improvement in this regard is commonly attributed to the easing of FDI norms.
- Many sectors have opened up for foreign investment partially or wholly since the economic liberalization of the country.
- Currently, India ranks in the list of the top 100 countries in ease of doing business
- In 2019, India was among the top ten receivers of FDI, totalling $49 billion inflows, as per a UN report. This is a 16% increase from 2018.
- In February 2020, the DPIIT notifies policy to allow 100% FDI in insurance intermediaries.
- In April 2020, the DPIIT came out with a new rule, which stated that the entity of any company that shares a land border with India or where the beneficial owner of investment into India is situated in or is a citizen of such a country can invest only under the Government route. In other words, such entities can only invest following the approval of the Government of India
- In early 2020, the government decided to sell a 100% stake in the national airline's Air India

FDI Routes in India

There are three routes through which FDI flows into India. They are described in the following table:

Category 1	Category 2	Category 3
100% FDI permitted through **Automatic Route**	Up to 100% FDI permitted through **Government Route**	Up to 100% FDI permitted through **Automatic + Government Route**

Automatic Route FDI

In the **automatic route**, the foreign entity does not require the prior approval of the government or the RBI.

Examples:

- Medical devices: up to 100%
- Thermal power: up to 100%
- Services under Civil Aviation Services such as Maintenance & Repair Organizations
- Insurance: up to 49%
- Infrastructure company in the securities market: up to 49%
- Ports and shipping
- Railway infrastructure
- Pension: up to 49%
- Power exchanges: up to 49%
- Petroleum Refining (By PSUs): up to 49%

Government Route FDI

Under the **government route**, the foreign entity should compulsorily take the approval of the government. It should file an application through the Foreign Investment Facilitation Portal, which facilitates single-window clearance. This application is then forwarded to the respective ministry or department, which then approves or rejects the application after consultation with the DPIIT.

Examples:

- Broadcasting Content Services: 49%
- Banking & Public sector: 20%
- Food Products Retail Trading: 100%
- Core Investment Company: 100%
- Multi-Brand Retail Trading: 51%
- Mining & Minerals separations of titanium bearing minerals and ores: 100%
- Print Media (publications/printing of scientific and technical magazines/speciality journals/periodicals and a facsimile edition of foreign newspapers): 100%
- Satellite (Establishment and operations): 100%
- Print Media (publishing of newspaper, periodicals and Indian editions of foreign magazines dealing with news & current affairs): 26%

Sectors where FDI is prohibited

There are some sectors where any FDI is completely prohibited. They are:

- Agricultural or Plantation Activities (although there are many exceptions like horticulture, fisheries, tea plantations, Pisciculture, animal husbandry, etc.)
- Atomic Energy Generation
- Nidhi Company
- Lotteries (online, private, government, etc.)
- Investment in Chit Funds
- Trading in TDR’s

- Any Gambling or Betting businesses
- Cigars, Cigarettes, or any related tobacco industry
- Housing and Real Estate (except townships, commercial projects, etc.)

New FDI policy

According to the new FDI policy, an entity of a country, which shares a land border with India or where the beneficial owner of investment into India is situated in or is a citizen of any such country, can invest only under the Government route.

A transfer of ownership in an FDI deal that benefits any country that shares a border with India will also need government approval.

Investors from countries not covered by the new policy only have to inform the RBI after a transaction rather than asking for prior permission from the relevant government department.

According to the new law, China, along with Afghanistan and Bangladesh, have to invest through government methods, which means they have to take government permission, which was earlier limited to Afghanistan and Bangladesh. The revised rule has now brought companies from China under the government route filter.

3.4.3 Benefits of FDI

FDI brings in many advantages to the country. Some of them are discussed below.

1. Brings in financial resources for economic development.
2. Brings in new technologies, skills, knowledge, etc.
3. Generates more employment opportunities for the people.
4. Brings in a more competitive business environment in the country.
5. Improves the quality of products and services in sectors.

Advantages of FDI

- Job creation: FDI leads to the location of new businesses, which creates jobs for the local workforce. This helps reduce unemployment.
- Capital inflows: FDI brings in foreign capital as investments into the nation. These funds can then be used for development.
- Technology and skills transfer: Foreign firms often bring new technologies, management techniques, and expertise that benefit the local economy.
- Access to global supply chains: Local suppliers get options to evolve part of the foreign investors' supply chains. This opens up export markets.
- Increased competitiveness: The entry of foreign investors forces local firms to improve efficiency to contest actually. This makes the economy more effective.
- Economic growth: All of the above factors donate to the overall growth of the economy in the long run.

Disadvantages of FDI

However, there are also some disadvantages associated with foreign direct investment. Some of them are:

- Loss of control: Allowing foreign ownership of local assets results in a partial loss of national control over those assets.
- Risk of capital flight: There is a risk of foreign investors pulling out their funds during economic downturns or crises.
- Cultural issues: The operations and practices of foreign investors may not align with local cultures in all respects.
- Environmental issues: Some foreign investors may not follow the same stringent environmental standards as required locally.

- Uneven development: FDI concentrates on few urban centers, leaving out vast rural regions and smaller towns.
- Dependency risks: Over-reliance on FDI can make the economy dependent on foreign capital for its growth.
- It can affect domestic investment, and domestic companies adversely.
- Small companies in a country may not be able to withstand the onslaught of MNCs in their sector. There is the risk of many domestic firms shutting shop as a result of increased FDI.
- FDI may also adversely affect the exchange rates of a country.
- Foreign direct investment or exchange rate limits may be harmful to the investors.
- When a company invests in other countries, it can affect the investment in the companies in the domestic market.
- Often, exchange rates are limited to benefit one company and derogate the benefit of another company.
- Foreign direct investment is a capital-intensive deal, which makes it risky for the company to invest in a new start-up and business in the market due to the higher risk of failure.

Government measures to increase FDI in India

1. Government schemes like production-linked incentive (PLI) scheme in 2020 for electronics manufacturing, have been notified to attract foreign investments.
2. In 2019, the amendment of FDI Policy 2017 by the government, to permit 100% FDI under automatic route in coal mining activities enhanced FDI inflow.

3. FDI in manufacturing was already under the 100% automatic route, however, in 2019, the government clarified that investments in Indian entities engaged in contract manufacturing is also permitted under the 100% automatic route provided it is undertaken through a legitimate contract.
4. Further, the government permitted 26% FDI in digital sectors. The sector has particularly high return capabilities in India as favourable demographics, substantial mobile and internet penetration, massive consumption along technology uptake provides great market opportunity for a foreign investor.
5. Foreign Investment Facilitation Portal (FIFP) is the online single point interface of the Government of India with investors to facilitate FDI. It is administered by the Department for Promotion of Industry and Internal Trade, Ministry of Commerce and Industry.
6. FDI inflow is further expected to increase –
   - as foreign investors have shown interest in the government's moves to allow private train operations and bid out airports.
   - Valuable sectors such as defence manufacturing where the government enhanced the FDI limit under the automatic route from 49% to 74% in May 2020, is also expected to attract large investments going forward.

3.4.4 Regulatory framework of FDI in India

In India, there are several laws regulating FDI inflows. They are:

- Companies Act
- Securities and Exchange Board of India Act, 1992 and SEBI Regulations
- Foreign Exchange Management Act (FEMA)
- Foreign Trade (Development and Regulation) Act, 1992
- Civil Procedure Code, 1908
- Indian Contract Act, 1872
- Arbitration and Conciliation Act, 1996

- Competition Act, 2002
- Income Tax Act, 1961
- Foreign Direct Investment Policy (FDI Policy)

The regulation of foreign direct investment in India has been examined below.

- FDI Policy: The Department for Promotion of Industry and Internal Trade (DPIIT) under the Ministry of Commerce and Industry acquires India's FDI policy. It publishes a tight FDI policy document yearly.
- Types of FDI: 100% FDI is allowed under the automatic route in most sectors. Some sectors require government approval through the FIPB route.
- Sectoral Caps: Certain sectors have a limit on the max FDI allowed. For example, up to 74% in insurance and 100% in single-brand retail.
- Prohibited Sectors: FDI is prohibited in gambling, lottery, atomic energy, etc.
- Conditions for FDI: The government may impose certain needs for FDI in sensitive sectors. For example, local sourcing, export obligations, etc.
- RBI Regulations: The Reserve Bank of India regulates the implementation of the FDI policy and monitors FDI inflows. It issues notifications regarding FDI policy changes.
- SEBI Regulations: The Securities and Exchange Board of India lays down rules and regulations regarding FDI in listed Indian companies.
- FEMA Regulations: The Foreign Exchange Management Act (FEMA) regulates cross-border investments in India. It governs investments by NRIs, OCIs, etc.
- Tax laws: The Indian tax laws govern the taxation of foreign companies operating in India and the taxation of incomes from foreign investments.
- Investment Promotion Agencies: Agencies like Invest India and state governments act as a single point of contact for foreign investors looking to invest in India.

3.4.5 Impact of FDI on Indian Economy

- Foreign direct investment can help increase the economy by transferring the resources, skills, and technology to businesses that expand and grow.
- FDI also increases the company's assets by expanding the company's profit by improving cash flow by making an investment. This increases the productivity of the business & workers.
- It makes the rupee strong compared to dollars due to an increase in foreign countries' exports.
- As consumption increases, which leads to an increase in the companies' income and a rise in tax revenue and government spending. Every investment has a gestation period, and the return increases after a few years.

3.4.6 Trends in Foreign Direct Investment

Foreign direct investment (FDI) is effective in the global economy, facilitating capital flows, international trade, and technology transfer. The volume and pattern of FDI flows have undergone key changes in recent decades due to various economic, political, and technological trends. Here are the major trends in FDI.

- Rising FDI flows: The total value of global FDI inflows and outflows has increased significantly in the last few decades, from $59 billion in 1990 to $1.5 trillion in 2019. Developing nations have seen particularly rapid growth in FDI.

- Shift towards services: In the past, most FDI was concentrated in manufacturing. But now, more FDI is entering services sectors like finance, telecom, logistics, etc. This reflects the growing importance of the service economy.

- Mega-mergers and acquisitions: Cross-border mergers and acquisitions have emerged as a major channel for FDI, mainly among large firms. This allows firms to quickly expand into new markets and acquire technology.

- Rise of South-South FDI: FDI flows among developing nations, primarily China investing in Africa and Latin America, have grown substantially. This helps spread production networks globally.

- Intra-firm FDI on the rise: More FDI is going towards cross-border investments within the same multinational groups to optimize their global value chains.
- FDI in high-tech industries: An increasing share of FDI goes into high-technology sectors like biotechnology, computer software, telecommunications, etc. This is driven by the global tech boom.
- Sustainability evolving critical: More investors are paying attention to the environmental and social impact of FDI projects. Sustainable FDI is likely to grow in the future.
- Rise of Greenfield FDI projects: There has been a rise in the number of new Greenfield FDI projects where companies set up new facilities from scratch. This indicates investor confidence in the prospects of host economies.
- The growing importance of intangible assets: An increasing share of FDI is going into acquiring intangible assets like brands, intellectual property, proprietary technology, and expertise. This allows faster growth and market dominance.
- Focus on emerging markets: Developing nations, huge emerging markets like China, India, Brazil, Indonesia, etc., are attracting a growing portion of global FDI inflows due to their rising client base and potential for growth.
- Shift towards robotics and automation: More FDI is entering industries that utilize robotics, artificial intelligence, automation, and other advanced technologies to optimize production and labor costs. This represents the Fourth Industrial Revolution.
- The increasing role of e-commerce: The growth of e-commerce giants and their international expansion through FDI is reshaping global trade and retail landscapes. Online platforms are enabling cross-border flows of goods, services, and investments.
- Rising strategic FDI: Governments in many countries use FDI policy to achieve strategic goals like acquiring critical technologies, building abilities in priority sectors, and gaining access to natural resources.

- Interest in frontier markets: Some investors are exploring options in more minor and frontier markets to benefit from their relatively higher growth prospects and potential for outsized returns. However, risks are also high in these economies.

Sectoral Trends in FDI

Foreign direct investment (FDI) flows across various sectors of the economy based on options for growth and profitability. Here are some vital sectoral trends in FDI.

- Services sector: The services sector, including finance, telecom, business actions, and real estate, has emerged as the largest recipient of global FDI. The share of FDI in services has risen from about 40% in the 1990s to over 65%.
- Manufacturing: Manufacturing, especially in labor-intensive industries, attracted the bulk of FDI in the past, but its share has declined in recent decades due to rising costs. Yet, high-tech manufacturing persists in seeing significant FDI.
- Natural Resources: Extractive industries like mining, oil, and natural gas still attract large FDI inflows in resource-rich growing nations. However, some resource-based projects are now facing more scrutiny over environmental and social impacts.
- Infrastructure: FDI in infrastructure sectors like transportation, power, and telecom has steadily risen to develop critical assets in many countries. Governments often actively promote infrastructure FDI through incentives and subsidies.
- Agriculture: FDI in agriculture, mainly commercial farming, and agro-processing, has been increasing in recent years. This has the prospect of boosting productivity and farm incomes but also raises concerns about minor farmer impacts.
- Technology: The technology sector, including computer software, e-commerce, semiconductors, etc., has arisen as a major FDI magnet. Tech firms lead many cross-border mergers and acquisitions.

- Real Estate: Foreign investment in commercial and residential markets has been growing, mainly in emerging cities. This has driven up property prices in some areas.
- Retail: Organized retail is opening up to FDI in more nations, enabling the growth of global supermarket and hypermarket chains into new markets.

Global FDI flows, manufacturing, natural aids, infrastructure, and technology sectors continue to see significant cross-border investments to meet their financing and capability needs. Yet, governments must carefully evaluate the actual costs and benefits of FDI in various sectors to maximize likely gains. Suitable rules and incentives can optimize sectoral FDI for growth.

Global FDI Trends

Foreign Direct Investment (FDI) trends can vary from year to year and are influenced by a range of factors, including economic conditions, government policies, trade agreements, geopolitical events, and technological advancements. As of my last knowledge update in January 2022, here are some general global FDI trends and considerations:

- Global FDI Flows:
    - FDI flows experienced a downturn in the early stages of the COVID-19 pandemic in 2020. However, there was some recovery in FDI in 2021 as the global economy began to stabilize.
- Regional Shifts:
    - Asia has been a major destination for FDI, with countries like China, India, and Southeast Asian nations attracting significant investments.
    - Africa has also been an emerging region for FDI, driven by its growing population, resources, and improving business environments in some countries.
    - North America and Western Europe continue to be attractive destinations for FDI, particularly in the technology and innovation sectors.

- Key Sectors:
  - Technology and digital industries have been receiving substantial FDI, with a focus on areas such as e-commerce, artificial intelligence, and renewable energy.
  - Healthcare and pharmaceuticals attracted increased investment due to the COVID-19 pandemic.
  - Renewable energy and sustainable practices have drawn significant investments as countries work toward achieving climate goals.
- Policy Changes:
  - Some countries have adjusted their FDI policies to protect sensitive industries, particularly in the areas of national security and critical infrastructure.
  - Many governments have offered incentives to attract FDI, such as tax breaks, grants, and streamlined regulations.
- Geopolitical Factors:
  - Geopolitical tensions and trade disputes can affect FDI trends. Tensions between major economies like the U.S. and China have had implications for cross-border investments.
- Sustainability and ESG:
  - Environmental, Social, and Governance (ESG) considerations have become increasingly important for investors. FDI is increasingly directed toward sustainable and responsible investments.
- COVID-19 Pandemic:
  - The pandemic accelerated trends in e-commerce, remote work, and digitalization, leading to shifts in FDI toward technology-related sectors.
- Bilateral and Regional Agreements:

- Trade and investment agreements, such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the Regional Comprehensive Economic Partnership (RCEP), have influenced FDI patterns.

Let's sum up:

Learners we have seen in this section that any investment from an individual or firm that is located in a foreign country into a country is called Foreign Direct Investment. Functions of Foreign Direct Investments includes economic growth, job creation, Transfer of Skills and Technology etc. The investment climate in India has improved tremendously since 1991 when the government opened up the economy and initiated the LPG strategies. There are three routes through which FDI flows into India. Government schemes like production-linked incentive (PLI) scheme in 2020 for electronics manufacturing, have been notified to attract foreign investments. Foreign direct investment can help increase the economy by transferring the resources, skills, and technology to businesses that expand and grow. Foreign direct investment (FDI) is effective in the global economy, facilitating capital flows, international trade, and technology transfer.

Check your progress

1. What is Foreign Direct Investment (FDI)?

A. Investment in a foreign country's stock market
B. Direct investment in the production or business operations in a foreign country
C. Purchase of foreign currency
D. Loan given to a foreign government

2. Which of the following is a common form of FDI?

A. Exporting goods to another country
B. Opening a subsidiary or branch in a foreign country

C. Buying government bonds of another country
D. Licensing technology to a foreign company

3. Which sector is typically most attractive for FDI in developing countries?

A. Agriculture
B. Manufacturing and industrial sector
C. Education
D. Public administration

4. What is a 'greenfield investment'?

A. Investment in eco-friendly projects
B. Establishing new operations or facilities from scratch in a foreign country
C. Merging with an existing company in a foreign country
D. Investing in the stock market of a foreign country

5. Which country has historically been one of the largest recipients of FDI?

A. India
B. United States
C. Brazil
D. Russia

SECTION 3.5: FACTORS INFLUENCING FDI

Foreign direct investment (FDI) is an investment made by a company or an individual in one country into business interests located in another country. FDI is an important driver of economic growth.

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 country 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 harmonization 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.

Let's sum up:

Learners in this section we have seen that Foreign direct investment (FDI) is an investment made by a company or an individual in one country into business interests located in another country. FDI is an important driver of economic growth. the factors influencing FDI includes wage rates, labour skills, tax rates, Transport and infrastructure, Size of economy / potential for growth, Exchange rate, commodities, access to free trade areas etc.

Check your progress

1. Which of the following factors most directly influences FDI in a country?

A. Population size
B. Average temperature
C. Political stability and regulatory environment
D. Domestic sports achievements

2. What role do natural resources play in attracting FDI?

A. They generally repel foreign investors
B. They have no impact on FDI
C. They only attract investments in the technology sector
D. They attract foreign investors looking to exploit these resources

3. How does market size and growth potential influence FDI?

A. Smaller, stagnant markets attract more FDI
B. Larger and rapidly growing markets attract more FDI
C. Market size and growth have no influence on FDI
D. Only markets with declining growth attract FDI

4. How do tax incentives affect FDI?

A. They make no difference to foreign investors
B. They can attract foreign investors by reducing the cost of investment
C. They increase the regulatory burden on foreign investors
D. They discourage investment due to complexity

5. Which of the following political factors can deter FDI?

A. Stable government
B. Transparent legal system
C. Political instability and corruption
D. Strong intellectual property rights

SECTION 3.6: MODE OF FDI ENTRY

The modes of FDI has been mentioned below.

- **Greenfield Investment**: An investor establishes a new operation in the host country from the ground up. The investor builds new productive assets like factories, offices or R&D centers. Direct investment in new facilities or the expansion of existing facilities. Greenfield investments are the primary target of a host nation's promotional efforts because they create new production capacity and jobs, transfer technology and know-how, and can lead to linkages to the global marketplace. However, it often does this by crowding out local industry; multinationals are able to produce goods more cheaply (because of advanced technology and efficient processes) and uses up resources (labor, intermediate goods, etc).
- **Mergers and Acquisitions**: An investor acquires partial or full ownership of an existing company in the host country through purchase of shares or assets. This is often the quickest way to enter a market. It occur when a transfer of existing assets from local firms to foreign firms takes place, this is the primary type of FDI. Cross-border mergers occur when the assets and operation of firms from different countries are combined to establish a new legal entity. Cross-border acquisitions occur when the control of assets and operations is transferred from a local to a foreign company, with the local company becoming an affiliate of the foreign company.

- **Joint Ventures:** Two or more companies come together to form a new business entity in the host country. Each partner contributes resources and shares ownership, control, profits and losses.
- **Licensing and Franchising**: An investor obtains rights to use intangible assets like trademarks, patents, trade secrets or business models in the host country in exchange for fees or royalties.
- **Contract Production**: An investor contracts a firm in the host country to produce goods and services according to specifications without acquiring ownership.
- **Privatization**: Governments sell part or all of state-owned enterprises to foreign investors to raise funds and improve efficiency.
- **Brownfield Investment**: An investor purchases existing operational assets like factories, real estate or mines in the host country. Less risk than greenfield investments.

3.6.1 Types of FDI in India

Types of FDI in Indian context has been explained below.

- **Greenfield Investment**: Many major global companies have set up new manufacturing facilities in India through greenfield investments. Examples include car makers like Volkswagen, Hyundai and Renault Nissan. Tech firms like Samsung, Apple and Nokia have also established new R&D and production centers.
- **Mergers and Acquisitions**: Foreign acquisitions of Indian companies have been common. Major deals include Hindustan Unilever acquiring Hindustan Lever, ArcelorMittal acquiring Essar Steel, and Vodafone acquiring Hutchison Essar. Many foreign private equity firms have also invested in Indian companies.
- **Joint Ventures**: Several India-focused joint ventures have been formed, particularly in the automotive industry. Examples include Maruti Suzuki between Suzuki and the Government of India, Tata Motors JV with Fiat, and Ford JV with Mahindra & Mahindra. Many pharmaceutical companies also have JVs in India.

- **Licensing and Franchising**: Numerous global brands have entered India through licensing and franchising agreements. This includes fast food chains like McDonald's, KFC and Pizza Hut. Retailers like Marks & Spencer, Sephora and IKEA also operate franchises in India.
- **Contract Production**: Several global companies outsource manufacturing and services to Indian firms under contract. This includes technology services, call centers, generic drug manufacturing and automobile components.
- **Privatization**: The Indian government privatized many state-owned enterprises in the 1990s and 2000s, attracting significant FDI. Companies like Vodafone, British Telecom and Hindalco acquired stakes in telecom and mineral firms.

Let's sum up:

Learners in this section we have seen that Greenfield Investment refers to an investor establishes a new operation in the host country from the ground up. The investor builds new productive assets like factories, offices or R&D centers. Mergers and Acquisitions refers to an investor acquires partial or full ownership of an existing company in the host country through purchase of shares or assets. Joint Ventures refers Two or more companies come together to form a new business entity in the host country. Licensing and Franchising refers an investor obtains rights to use intangible assets like trademarks, patents, trade secrets or business models in the host country in exchange for fees or royalties. Types of FDI in India are greenfield investment, Mergers and Acquisitions, Joint Ventures, Licensing and Franchising, Contract Production, Privatization.

Check your progress

1. Which mode of FDI entry involves acquiring an existing company in a foreign country?

A. Brownfield investment

B. Greenfield investment

C. Joint venture

D. Licensing

2. What is a joint venture in the context of FDI?

A. A sole proprietorship set up in a foreign country
B. A partnership between a foreign company and a local company to share ownership and control
C. A government contract in a foreign country
D. A franchising agreement with a foreign company

3. Which of the following is a key advantage of a greenfield investment?

A. Lower initial investment costs
B. Reduced regulatory requirements
C. Immediate access to established market and customer base
D. Full control over business operations and corporate culture

4. What is franchising in terms of FDI entry modes?

A. Full ownership of a foreign company
B. Granting a foreign entity, the rights to operate using the brand and business model of the parent company
C. Merging with a foreign company
D. Forming a strategic alliance without equity involvement

5. What is the primary benefit of entering a foreign market through a merger or acquisition?

A. Full control over market operations
B. Lower operational costs
C. Speed of entry and immediate access to existing resources and market share
D. Simplified regulatory processes

SECTION 3.7: HORIZONTAL AND VERTICAL FOREIGN DIRECT INVESTMENT

- **Horizontal Foreign Direct Investment:**

  Investment in the same industry abroad as a firm operates in at home. his type of FDI involves a company replicating its existing operations in another

country to serve that foreign market. The parent company and foreign subsidiary produce similar products targeting their respective domestic markets. Benefits include access to new customers, economies of scale, and ability to customize products for local markets. However, horizontal FDI also means more direct competition with local firms.

- **Vertical Foreign Direct Investment:**

  This involves a company investing in another country to secure supplies of inputs or components for its production processes. It allows the company to control the supply chain for critical inputs. Examples include automobile companies investing in tire factories or electronics firms investing in component manufacturers. Benefits of vertical FDI include secure supply of inputs, reduced costs, and higher quality control. However, it also means the company becomes dependent on those foreign suppliers. It takes two forms:

  - Backward vertical FDI: where an industry abroad provides inputs for a firm's domestic production process
  - Forward vertical FDI: When an MNC uses its home supplied inputs for production in host country.

- **Conglomerate FDI**:

  When MNC manufactures the product in foreign countries which are not manufactured by the company at home. This occurs when a company invests in unrelated businesses in another country. The parent company and foreign subsidiary operate in different industries, value chains and market segments. Benefits include diversification of business risks and opportunities to leverage managerial expertise across industries. However, managing unrelated businesses can also be complex.

Let's sum up:

Learners in this section we have seen that Investment in the same industry abroad as a firm operates in at home is horizontal foreign direct investment. his type of FDI involves a company replicating its existing operations in another country to serve that foreign market. Vertical Foreign Direct

Investment involves a company investing in another country to secure supplies of inputs or components for its production processes. When MNC manufactures the product in foreign countries which are not manufactured by the company at home is conglomerate FDI.

Check your progress

1. **What is horizontal FDI?**
   A. Investment in a different industry abroad
   B. Investment in the same industry abroad as the company operates domestically
   C. Investment in infrastructure projects in a foreign country
   D. Investment through joint ventures

2. **What is vertical FDI?**
   A. Investment in the same industry abroad
   B. Investment in a different stage of the supply chain in a foreign country
   C. Investment in unrelated industries abroad
   D. Investment in financial instruments abroad

3. **Which of the following is an example of horizontal FDI?**
   A. A car manufacturer in Japan opening a new factory in Germany to produce cars
   B. A clothing retailer in the US investing in a textile manufacturing plant in India
   C. A software company in Canada acquiring a logistics company in Brazil
   D. A food processing company in France purchasing agricultural land in Argentina

4. **Which of the following is an example of vertical FDI?**
   A. A smartphone manufacturer in South Korea acquiring a retail chain in the US
   B. A beverage company in the UK purchasing a sugar plantation in Brazil

C. A financial services firm in Germany opening a branch in China
D. A telecommunications company in Sweden setting up a new R&D center in Japan

5. **Which type of FDI involves a company moving into the distribution of its products?**

A. Horizontal FDI
B. Backward vertical FDI
C. Forward vertical FDI
D. Conglomerate FDI

SECTION 3.8: COSTS AND BENEFITS OF FDI TO HOME AND HOST COUNTRIES

Foreign direct investment (FDI) can bring important benefits to both host countries that receive the investments as well as home countries where the investing companies are based. However, there are also costs and risks associated with FDI for all parties involved. Here are the major costs and benefits of FDI for host and home countries.

For Host countries

Costs and benefits of FDI for host countries have been stated below.

- FDI can create jobs and drive economic growth through the capital invested, jobs generated and technology transferred. However, foreign firms can crowd out small local businesses and create dependence on foreign technology.
- FDI contributes to infrastructure development through investments in transport, electricity, telecommunications etc. However, some projects may cause environmental issues.
- FDI gives access to international markets and supply chains which helps local firms but exposes them to global competition.

- Host countries lose some policy autonomy and control as they have to conform to demands of foreign investors. However, FDI can introduce best practices in corporate governance and management.
- FDI brings new capital that can be invested in productive assets and infrastructure. This expands the productive capacity of the economy and supports growth.
- Foreign companies bring advanced technologies, managerial skills and business practices that improve the productivity and competitiveness of local firms through spillover effects.
- FDI creates more jobs directly through the operations of foreign affiliates and indirectly through higher demand for goods and services from local suppliers. This reduces unemployment.
- FDI gives access to foreign markets for local companies that become part of global supply chains. This helps expand their customer base and sales.
- Technology transfer requirements and performance benchmarks can be imposed on foreign investors to maximize technology spillovers and beneficial impacts.

However, FDI can also do the following.

- Lead to unfair competition for small local firms that cannot compete with large foreign multinationals.
- Increase income inequality if foreign firms mainly employ skilled labor.
- Cause environmental degradation if regulations are lax.
- Expose the economy to external shocks and volatility due to global business cycles.
- Limit policy autonomy since governments cater to demands of foreign investors.

For home countries

Costs and benefits of FDI for home countries have been stated below.

- Companies gain higher profits and returns from their FDI projects. But profits repatriated back home escape host country taxes, resulting in loss of potential tax revenue.
- FDI provides access to cheaper resources, lower cost production locations and new markets for growth. But it also exposes firms to risks in foreign markets.
- FDI enables international expansion and upgrading of skills/technology. However, it can also result in job losses at home in labor intensive sectors.
- There is a risk of strategic technology and intellectual property outflows to host countries through FDI.
- Multinational companies gain higher profits from utilizing advantages like intellectual property and brand recognition in foreign markets.
- FDI allows firms to expand production and sales to a larger global customer base, achieving economies of scale.
- Access to natural resources and lower cost locations enhance competitiveness of home country companies.
- FDI forces domestic firms to improve efficiency through competitive pressure.

However, FDI can also do the following.

- Lead to job losses at home in labor intensive industries that shift production abroad.
- Result in technology and intellectual property outflows that benefit competitors in host countries.
- Expose firms to political and operational risks in foreign markets.
- Reduce tax revenues for home country governments if profits are not repatriated.
- Cause exchange rate appreciation that hurts export competitiveness.

Let's sum up:

Learners in this section we have seen Costs and benefits of FDI for home and host countries. Foreign direct investment (FDI) can bring important benefits to both host countries that receive the investments as well as home countries where the investing

companies are based. FDI can create jobs and drive economic growth through the capital invested, jobs generated and technology transferred. However, foreign firms can crowd out small local businesses and create dependence on foreign technology. Companies gain higher profits and returns from their FDI projects. But profits repatriated back home escape host country taxes, resulting in loss of potential tax revenue.

Check your progress

1. What is one primary benefit of FDI to the host country?

A. Decrease in employment opportunities
B. Increase in local competition
C. Transfer of technology and skills
D. Decrease in capital inflows

2. A significant benefit of FDI to the home country includes:

A. Diversification of markets
B. Outflow of capital
C. Loss of jobs
D. Reduction in global influence

3. How does FDI benefit the host country's economy?

A. By increasing domestic competition
B. By raising local firms' productivity
C. By depleting local resources
D. By increasing tariffs on imports

4. Which of the following is a benefit of FDI for the home country's businesses?

A. Access to new markets and resources
B. Loss of control over foreign operations
C. Increased regulatory scrutiny

D. Higher transportation costs

5. How can FDI negatively impact the host country's economy?

A. By creating monopolies and reducing competition
B. By increasing employment opportunities
C. By fostering innovation
D. By increasing tax revenues

3.9 Unit summary

Dear learners, in this third unit we have seen how Foreign investments significantly influence global economic dynamics through various patterns and mechanisms. Foreign exchange rates play a critical role in shaping trade and investment flows by affecting the cost and profitability of cross-border transactions. The foreign exchange market facilitates these transactions by providing a platform for currency trading, hedging, and speculation. Foreign Direct Investments (FDI), which involve a long-term interest and control by a foreign entity in a host country, are influenced by factors such as market size, economic stability, and regulatory environment. FDI entry modes include mergers and acquisitions, joint ventures, and greenfield investments. Horizontal FDI refers to the same type of production activities in different countries, while vertical FDI involves different stages of production in different countries. Both host and home countries benefit from FDI; host countries gain technology transfer, job creation, and improved infrastructure, while home countries benefit from increased market access and diversification of assets. This interconnected framework underscores the importance of foreign investments and exchange rates in the global economy.

3.10 Glossary:

Foreign Investment	This term refers to the allocation of capital by an individual, company, or government from one country into

	assets or businesses located in another country
Foreign Exchange Rates	The value of one currency in terms of another, which impacts trade and investment flows by affecting the cost of goods, services, and capital between countries
Foreign Exchange Market	**: A global marketplace for trading currencies that provides liquidity, facilitates currency conversion, allows for hedging against exchange rate risks, and supports speculative activities
Foreign Direct Investments (FDI)	Investments made by a firm or individual in one country into business interests located in another country, typically involving control or significant influence over the foreign business operations.
Mergers and Acquisitions	Buying or merging with existing firms in the host country.
Joint Ventures	Partnering with local firms to establish a new business entity.
Greenfield Investments	Establishing new operations or facilities from scratch in the host country.
Horizontal Foreign Direct Investment	When a company invests in the same type of production activities in a foreign country as it operates in its home country.
Vertical Foreign Direct Investment	When a company invests in different stages of production or value chain activities in a foreign country, either upstream (backward vertical integration) or downstream (forward vertical integration).
Investment Flows	This term describes the movement of capital across borders for the purpose of investment

3.11 Self-Assessment Questions

Short Answers: (5 Marks)

1. Write a brief note on foreign investments?

2. Explain the role of foreign investments.
3. List out the nature of foreign exchange.
4. What are the Functions of foreign exchange market?
5. Explain the Functions of foreign direct investments.
6. Write a note on Benefits of FDI.
7. Explain the Regulatory framework of FDI in India.
8. Briefly discuss the Types of FDI in India.
9. Describe the Modes of FDI entry.
10. Explain about Horizontal and Vertical Foreign Direct Investment.

Long Answers: (8 Marks)

1. Explain in detail about the types of Foreign Exchange Transactions and Impact on trade and investment flows
2. Discuss about the advantages, disadvantages and Government measures to increase FDI in India.
3. Elaborate the trends in Foreign Direct Investment
4. Discuss in detail about the Factors influencing FDI
5. Explain the Costs and Benefits of FDI to Home and Host countries

3.12 Case Study

Foreign Investment Patterns of "GreenTech Solutions"

Company Background

GreenTech Solutions is a renewable energy company based in Germany. It specializes in solar panel manufacturing and installation. Over the past decade, GreenTech has successfully expanded its operations into various international markets. GreenTech decided to invest in India due to the country's growing demand for renewable energy and favorable government policies promoting clean energy

investments. GreenTech's foreign investment pattern in India can be divided into three phases:

1. Initial Market Entry (2015) - Mode of Entry: Joint Venture - Local Partner: SunPower India - Investment: $20 million - Objective: Leverage SunPower's local market knowledge and establish a foothold in the Indian renewable energy market.

2. Expansion Phase (2018) - Mode of Entry: Wholly-Owned Subsidiary - Investment: $50 million - Objective: Increase production capacity and cater to the rising demand for solar panels. Establish a manufacturing plant in Gujarat, benefiting from the region's industrial infrastructure and favorable government incentives.

3. Diversification Phase (2021) - Mode of Entry: Strategic Acquisitions - Acquisition Target: EcoEnergy Solutions, a local solar installation and maintenance company - Investment: $30 million - Objective: Enhance service offerings and provide end-to-end solutions, from manufacturing to installation and maintenance.

Investment Outcomes

1. Initial Market Entry (2015) - Benefits: Quick market penetration through SunPower's established distribution network - Understanding of local regulatory and business environment. Challenges: Cultural and operational differences between German and Indian business practices.

2. Expansion Phase (2018) - Benefits: Increased production capacity reduced costs and improved competitiveness - Enhanced control over the supply chain and quality standards. Challenges: Significant capital expenditure and management of a large workforce. Navigating local regulatory changes and maintaining compliance.

3. Diversification Phase (2021) - Benefits: Broadened service portfolio to include installation and maintenance. Increased customer satisfaction and repeat business through comprehensive service offerings. Challenges: Integration of EcoEnergy

Solutions' operations and aligning corporate cultures. Managing the acquired company's existing contracts and obligations.

Financial Impact: Revenue Growth: From $50 million in 2015 to $200 million in 2023, driven by increased production capacity and market reach. Market Share: Achieved a 15% market share in the Indian solar panel market by 2023. Profit Margins: Improved profit margins due to economies of scale and enhanced service offerings.

Strategic Insights

1. Joint Ventures: Effective for initial market entry, providing local insights and shared risks. 2. Wholly-Owned Subsidiaries: Beneficial for scaling operations and maintaining control over production and quality. 3. Strategic Acquisitions: Valuable for diversifying service offerings and enhancing customer value.

GreenTech Solutions' foreign investment pattern in India showcases a strategic approach to market entry, expansion, and diversification. By leveraging joint ventures, wholly-owned subsidiaries, and strategic acquisitions, GreenTech successfully established a strong presence in the Indian renewable energy market, driving significant revenue growth and market share. This case study highlights the importance of adapting investment strategies to local market conditions and the benefits of a phased approach to foreign investment.

Question

3. Analyze and summarize the given case study.

3.13 Answers for check your progress

Modules	S. No.	Answers
Module 1	**1.**	A. Technical progress
	2.	B. Foreign investment
	3.	D. Cash flows
	4.	A. Financial institutions

	5.	C. Production costs
Module 2	**1.**	A. The price of one country's currency in terms of another currency
	2.	B. An exchange rate determined by supply and demand in the foreign exchange market
	3.	B. Reduces the volume of exports
	4.	D. Population size
	5.	A. The risk of losing money due to changes in exchange rates
Module 3	**1.**	B. To facilitate the exchange of currencies between countries
	2.	B. Facilitating international investment by providing the means to convert currencies
	3.	B. It allows businesses to lock in exchange rates to avoid the risk of fluctuations
	4.	B. By providing a mechanism to easily convert one currency into another, facilitating transactions between countries
	5.	B. To profit from the changes in exchange rates
Module 4	**1.**	B. Direct investment in the production or business operations in a foreign country
	2.	B. Opening a subsidiary or branch in a foreign country
	3.	B. Manufacturing and industrial sector
	4.	B. Establishing new operations or facilities from scratch in a foreign country
	5.	B. United States
Module 5	**1.**	C. Political stability and regulatory environment

	2.	D. They attract foreign investors looking to exploit these resources
	3.	B. Larger and rapidly growing markets attract more FDI
	4.	B. They can attract foreign investors by reducing the cost of investment
	5.	C. Political instability and corruption
Module 6	**1.**	A. Brownfield investment
	2.	B. A partnership between a foreign company and a local company to share ownership and control
	3.	D. Full control over business operations and corporate culture
	4.	B. Granting a foreign entity, the rights to operate using the brand and business model of the parent company
	5.	C. Speed of entry and immediate access to existing resources and market share
Module 7	**1.**	B. Investment in the same industry abroad as the company operates domestically
	2.	B. Investment in a different stage of the supply chain in a foreign country
	3.	A. A car manufacturer in Japan opening a new factory in Germany to produce cars
	4.	B. A beverage company in the UK purchasing a sugar plantation in Brazil
	5.	C. Forward vertical FDI
MODULE 8	**1.**	C. Transfer of technology and skills
	2.	A. Diversification of markets
	3.	B. By raising local firms' productivity

	4.	A. Access to new markets and resources
	5.	A. By creating monopolies and reducing competition

3.14 Suggested Readings

1. Peijie Wang (2009), The Economics of Foreign Exchange and Global Finance, Springer, ISBN: 978-3642000319.

2. Julian Walmsley (2000), Foreign Exchange Markets, John Wiley & Sons, ISBN: 978-0471848349

3.15 Open Source E-Content Links

S.No.	Topic	E-Content Link
1.	Foreign Direct Investments	https://www.youtube.com/watch?v=ScCCUEE68pY
2.	Foreign Exchange Market	https://www.youtube.com/watch?v=AvWeRCN9bPs

3.16 References

- International Financial Management by P.G. Apte, Tata McGraw-Hill Education
- International Finance: Theory and Practice by S. Eun Choel and Bruce Resnick, McGraw-Hill Education (Indian Edition available)
- Global Financial Markets by Ian H. Giddy, AITBS Publishers and Distributors (Indian Edition available)
- Foreign Direct Investment in India and World by Niti Bhasin, New Century Publications
- International Financial Management by Vyuptakesh Sharan, PHI Learning
- International Economics: Theory and Policy by Paul R. Krugman, Maurice Obstfeld, and Marc Melitz, Pearson

UNIT 4 - Drivers in Globalization

Drivers in Globalization - Globalization of Markets, production, investments and Technology. World trade in goods and services - Major trends and developments - World trade and protectionism - Tariff and non-tariff barriers.

SECTION 4.1: DRIVERS IN GLOBALIZATION

4.1.1 Introduction

Globalization in business is connected with flows such as outsourcing, free trade, and global supply chains. Globalization is vital as it raises the size of the global market and allows various goods to be produced and sold for lower prices. Globalization has changed the firm world by enabling firms to expand their reach across national borders more easily. Technological advances like the internet and transportation advances have reduced the time, costs, and intricacies of doing business internationally. This has allowed firms of all sizes to sell their goods and services to a global customer base. Large multinational corporations have embraced globalization by outsourcing manufacturing and offshoring customer support services to lower-cost nations. However, small and medium-sized firms also tap into global options through e-commerce, importing supplies, and partnering with global vendors.

What is Globalization?

Globalization in business refers to the increasing links between nations and people worldwide through trade, cultures, technologies, and ideas. As globalization has progressed, many aspects of daily life that used to be local or national have become global in scale and access.

4.1.2 Causes of Globalization

- Technology: Technology has been a driving force behind globalization by enabling faster and cheaper communication, transportation, and data processing

across borders. The internet, mobile phones, and advanced software have connected people and businesses worldwide.

- Trade liberalization: Governments have progressively lowered trade barriers like tariffs and quotas through trade agreements, making it easier for goods and services to flow internationally. This has spurred global trade and investment.
- Transportation: Advances in transportation infrastructure and technologies like shipping containers, aircraft, and logistics networks have greatly reduced the time and costs of transporting goods between nations.
- Multinational firms: Large firms have grown their operations into foreign markets through foreign direct investment, global sourcing, and offshoring. This has enabled the spread of economic globalization.
- Growth of services: The globalization of services industries like finance, tourism, information technology, and business services has accelerated as these sectors become digitized and trade rules are lowered.
- Rise of outsourcing: Firms increasingly outsource firm functions and services to providers in lower-cost nations, joining previously local economic activities into global supply chains.
- Standardization: The development of global standards in areas like product quality, technology, and contact has enabled the coordination and integration of economic activities across borders.
- Economic development: The rise of economic powers like China, India, and Brazil with large populations, growing middle classes, and global aspirations have contributed immense new resources and markets to the global economy.

4.1.3 Types of Globalization

Globalisation is mainly divided into three different kinds. The three types of globalisations that influence one and another in their work. They work in interdependence with each other.

The Three Types of Globalisation are:

- **Economic Globalisation:** In this type of globalisation, countries aim to integrate international financial markets and coordinate monetary exchange. Multinational corporations that operate in more than two countries play an essential role in a nation's economic globalisation. Economic globalisation is the North American Free Trade Agreement or NAFTA, an economic agreement between the United States, Canada and Mexico.
- **Political Globalisation:** This is globalisation that refers to a nation's policies that aim at bringing it closer to other nations politically and economically. Political globalisation helps build a bond between countries with each other. Some examples of political globalisation are North Atlantic Trade Organisation (NATO) and United Nations (UN).
- **Cultural Globalisation:** In this type of globalisation, the focus is on the technological and societal factors which bring people together. Cultural globalisation includes ease of communication, social media and access to faster and better transportation.

4.1.4 Different types of Drivers in Globalization

Globalization is driven by several key factors that facilitate the increasing interconnectedness and interdependence of the world's economies, cultures, and populations. These drivers can be broadly categorized into technological, economic, political, cultural, and social factors. Here is an overview of the main drivers of globalization:

1. Technological Drivers

a. Information and Communication Technology (ICT):

Advances in ICT, such as the internet, mobile technology, and social media, have made communication faster, cheaper, and more accessible. This has enabled businesses to operate and coordinate activities across the globe seamlessly.

b. Transportation Technology:

Improvements in transportation, including air travel, shipping, and logistics, have reduced the cost and time required to move goods and people around the world.

2.Economic Drivers

a. Trade Liberalization:

The reduction of trade barriers, such as tariffs and quotas, through agreements like the World Trade Organization (WTO) has facilitated the free flow of goods and services between countries.

b. Foreign Direct Investment (FDI):

The increase in FDI has allowed multinational corporations to establish operations in multiple countries, spreading technology, capital, and managerial expertise globally.

c. Global Supply Chains:

Companies have developed complex global supply chains to take advantage of cost efficiencies, such as lower labor costs in developing countries.

3. Political Drivers

a. Deregulation and Economic Reforms:

Many countries have adopted economic reforms and deregulation policies to attract foreign investment and promote economic growth, further integrating their economies into the global market.

b. International Organizations:

Organizations such as the United Nations (UN), the International Monetary Fund (IMF), and the World Bank play significant roles in promoting economic stability, trade, and development, which support globalization.

c. Regional Trade Agreements:

Regional trade agreements like the European Union (EU), North American Free Trade Agreement (NAFTA), and the Association of Southeast Asian Nations (ASEAN) facilitate economic integration among member countries.

4. Cultural Drivers

a. Global Media:

The spread of global media companies and the internet has facilitated the global dissemination of cultural products, ideas, and values, leading to greater cultural convergence.

b. Tourism:

Increased international travel and tourism have fostered greater cultural exchange and understanding among people from different countries.

5. Social Drivers

a. Migration:

The movement of people across borders for work, education, or asylum has led to the exchange of cultures, skills, and knowledge, contributing to globalization.

b. Education:

International education and the globalization of universities have allowed for the exchange of students and academics, promoting global knowledge and cultural exchange.

6. Environmental Drivers

a. Global Environmental Issues:

Challenges such as climate change, biodiversity loss, and pollution are global in nature and require international cooperation, driving globalization in terms of policy-making and shared solutions.

These drivers of globalization are interlinked and collectively contribute to the increasing integration of the world's economies, cultures, and populations. While globalization brings numerous benefits, such as economic growth, technological advancement, and cultural exchange, it also poses challenges, including economic inequality, cultural homogenization, and environmental degradation. Understanding these drivers helps in addressing both the opportunities and challenges presented by globalization.

4.1.5 Advantages of Globalization

The advantages of globalization in business have been stated below.

- Economic growth: Globalization can spur economic growth through increased trade, investment, and field. When nations open up to trade, they gain access to larger markets that help businesses and the overall economy expand.
- Increased competition: Globalization brings more international competition that can motivate firms to become more innovative, efficient, and productive to remain competitive. This drives improvements and progress.

- Access to capital: Globalization enables firms and nations to access larger pools of international capital through foreign investment. This capital can fund business expansion and economic development projects.
- Access to resources: Globalization allows nations and firms to gain access to natural resources, materials, technology, and talent from around the world. This enhances productivity and innovation potential.
- Lower prices: Globalization raises rival and market access, enabling firms to source materials and labor from lower-cost suppliers. This puts downward pressure on prices for consumers.
- Increased trade: Globalization breaks down trade barriers and facilitates the transfer of goods and services across borders. This increases the volume of global trade that connects firms and economies.
- Technology transfer: Globalization speeds up the spread of technology and learning sharing between nations. Developing nations benefit from access to foreign innovation and expertise.
- Cultural sharing: Globalization enables the exchange of cultural goods and affairs between nations. This enriches societies by exposing people to new ideas, values, and ways of life.
- Employment options: Globalization provides more jobs and career options for workers in growing industries and multinational corporations operating internationally.

4.1.6 Disadvantages of Globalization

The disadvantages of globalization in business have been stated below.

- Job losses: Globalization has contributed to job losses in developed nations as firms offshore production and outsource services to lower-cost nations. This has negatively moved the incomes and job security of some workers.

- Increased inequality: Globalization has led to widening income gaps both between and within nations. While benefiting multinational firms and high-skilled workers, it has disadvantaged low-skilled laborers and the poor.
- Economic flux: The related global economy has led to economic crises flaring rapidly across borders. Financial market volatility and flux in one nation can impact economies worldwide.
- Loss of national control: Globalization reduces the power of national governments to independently pick economic policies. They now must consider global pressures and global market forces.
- Threat to local culture: The spread of global brands, media, and pop culture through globalization risks local traditions and cultural variety in some nations.
- Environmental damage: The growth in global trade and economic activity enabled by globalization has raised environmental issues like pollution, natural resource depletion, and climate change.
- Exploitation risks: Globalized supply chains can create openness where poor labor and environmental practices in some countries go unnoticed and unregulated.
- Health risks: The rapid spread of diseases through raised global travel, trade, and migration has created risks of pandemics arising from localized attacks.
- Tax avoidance: Globalization enables global firms to avoid taxes by shifting profits between jurisdictions, which reduces government revenues.

4.1.7 Effects of globalization

The effects of globalization on business have been stated below.

- Increased trade and investment: Globalization have led to a dramatic rise in international trade, foreign investment, and cross-border financial flows. This has integrated national economies more closely together.

- Access to cheaper goods: Consumers in many countries now have access to a wider variety of goods and services at lower prices due to imports, outsourcing, and offshoring enabled by globalization.

- Economic growth: Globalization has donated to higher economic growth in many nations through greater field, match, efficiency, and technological diffusion. However, the gains have not been evenly distributed.
- Spread of technology: Globalization has accelerated the spread of technology and innovation across borders as firms operate and source globally. This has boosted productivity.
- Rise of outsourcing and offshoring: Firms have increasingly outsourced functions and offshore production to lower-cost countries, changing supply chains into global networks.
- Transfer of details: The flow of people, information, and ideas enabled by globalization has facilitated the spread of knowledge and best practices across international borders.
- Increased competitiveness: Firms now compete with players from around the world, exerting pressure to enhance efficiency, quality, and innovation. This has made firms more competitive globally.
- Loss of jobs in some sectors: Globalization has resulted in some job losses in mature initiatives in created nations that face lower-cost foreign competition.
- Widening income gaps: Income inequality has risen both between and within many nations due to differential impacts based on skills, industry, and adaptability to globalization.

Let’s sum up:

Learners in this section we have seen that Globalization in business refers to the increasing links between nations and people worldwide through trade, cultures, technologies, and ideas. The Three Types of Globalization are economic, political and cultural globalization. Drivers in globalization are technical, economic, political,

cultural, social, environmental drivers. We have also seen the advantages and disadvantages of globalization, effects of globalization.

Check your progress

1. Which of the following is considered a primary driver of globalization?

A. National policies

B. Cultural diversity

C. Domestic trade

D. Technological advancements

2. What is one of the main economic drivers of globalization?

A. Increased taxation

B. Trade liberalization

C. Nationalization of industries

D. Agricultural reforms

3. Which of the following is a political driver of globalization?

A. National isolation policies

B. International trade agreements

C. Local governance

D. Provincial autonomy

4. How has transportation influenced globalization?

A. By reducing the cost and time of shipping goods

B. By making travel slower

C. By increasing the cost of goods

D. By limiting access to remote areas

5. Which of the following is NOT a driver of globalization?

A. Advances in communication technology

B. Increased economic interdependence

C. Protectionist trade policies

D. Global financial markets

4.2: Globalization of markets, production, investments and technology

4.2.1 Globalization of Markets

The globalization of markets refers to the process by which markets around the world become more interconnected and integrated. This phenomenon has several key dimensions and implications for businesses operating on an international scale.

1. Market Expansion and Access

- Increased Reach: Globalization allows businesses to expand beyond their domestic markets, accessing customers worldwide. This expanded reach leads to larger customer bases and higher potential sales.
- Emerging Markets: Companies can tap into emerging markets in developing countries, which often present significant growth opportunities due to rising incomes and expanding middle classes.

2. Convergence of Consumer Preferences

- Global Brands: Brands like Apple, Nike, and Samsung have become globally recognized, illustrating how consumer preferences can converge around certain products and services.
- Homogenization vs. Localization: While globalization can lead to homogenization of tastes (e.g., widespread popularity of fast food), it also encourages localization, where companies tailor products to meet local tastes and preferences (glocalization).

3. Increased Competition

- Global Competitors: Companies face competition not only from domestic firms but also from international players. This increased competition can drive innovation, efficiency, and improvements in quality.

- Market Entry Strategies: Firms must develop effective strategies for entering and competing in foreign markets, such as joint ventures, strategic alliances, and wholly-owned subsidiaries.

4. Standardization and Adaptation
    - Economies of Scale: By standardizing products for global markets, companies can achieve economies of scale, reducing costs and improving margins.
    - Customization: Despite the benefits of standardization, firms often need to adapt products to meet local regulations, cultural preferences, and market conditions.

5. Digital Transformation and E-Commerce
    - Online Marketplaces: The rise of e-commerce platforms like Amazon, Alibaba, and eBay has facilitated the globalization of markets, allowing even small businesses to reach international customers.
    - Digital Marketing: Companies use digital marketing strategies, including social media, SEO, and online advertising, to target global audiences effectively.

6. Global Supply Chains and Distribution Networks
    - Logistics and Distribution: Efficient global supply chains and distribution networks enable companies to deliver products to international markets quickly and cost-effectively.
    - Cross-Border Trade: Free trade agreements and reduced tariffs facilitate cross-border trade, making it easier for companies to operate internationally.

7. Regulatory and Legal Considerations
    - Compliance: Firms must navigate different regulatory environments, ensuring compliance with local laws and standards. This includes product safety, labor laws, and environmental regulations.
    - Intellectual Property: Protecting intellectual property (IP) in global markets is crucial, as IP laws and enforcement vary by country.

8. Cultural Sensitivity and Marketing

- Cultural Awareness: Understanding cultural differences is essential for effective marketing and customer engagement. This includes language, social norms, and consumer behavior.
- Localized Campaigns: Companies often develop localized marketing campaigns to resonate with specific cultural contexts, increasing their appeal to local customers.

9. Economic and Political Factors

- Economic Conditions: Companies must consider economic factors such as exchange rates, inflation, and economic stability when entering foreign markets.
- Political Environment: Political stability, trade policies, and diplomatic relations between countries can significantly impact international business operations.

Example 1: McDonald's

Global Presence: McDonald's operates in over 100 countries, adapting its menu to local tastes (e.g., offering McAloo Tikki in India and Teriyaki Burger in Japan).

Standardization and Adaptation: While maintaining core menu items for global consistency, McDonald's customizes its offerings to meet local preferences and cultural sensitivities.

Example 2: Apple

Global Brand: Apple's products, such as the iPhone and MacBook, are globally recognized and in demand.

Supply Chain Efficiency: Apple leverages a highly efficient global supply chain, sourcing components from multiple countries and assembling products in locations like China to optimize costs and efficiency.

Implications for Businesses

Strategic Planning: Businesses need comprehensive strategies that address global market dynamics, competition, and consumer preferences.

Cultural Competence: Developing cultural competence is crucial for effective international marketing and customer relations.

Risk Management: Firms must be adept at managing risks associated with political instability, economic fluctuations, and regulatory changes.

-Sustainability: Companies are increasingly expected to adopt sustainable practices, balancing economic growth with environmental and social responsibility.

The globalization of markets presents both opportunities and challenges for businesses. Companies that can effectively navigate the complexities of global markets, understand and respond to diverse consumer needs, and leverage global efficiencies will be well-positioned to succeed in the international arena.

4.2.2 Globalization of production

Globalization of production refers to the practice of sourcing goods and services from different locations around the globe to take advantage of national differences in the cost and quality of factors of production (such as labor, energy, land, and capital). This strategy allows companies to optimize their operations by minimizing costs and maximizing efficiency.

1. Cost Efficiency

- Labor Costs: Firms often relocate production to countries with lower labor costs. For example, many Western companies have outsourced manufacturing to countries like China, India, and Vietnam to benefit from cheaper labor.
- Resource Optimization: Companies source raw materials from locations where they are abundant and inexpensive, reducing overall production costs.

2. Global Supply Chains

- Complex Networks: Modern production processes involve multiple countries. Components may be produced in one country, assembled in another, and then sold globally. This creates complex and interconnected supply chains.
- Logistics and Transportation: Efficient logistics and transportation systems are crucial for managing global supply chains. Advances in shipping, air freight, and logistics technology have facilitated this process.

3. Specialization and Expertise

- Access to Specialized Skills: By globalizing production, firms can tap into specialized skills and expertise available in different regions. For example,

Silicon Valley is renowned for its tech expertise, while Germany is known for engineering excellence.

- Innovation Hubs: Companies establish R&D centers in innovation hubs around the world to benefit from local expertise and innovation ecosystems.

4. Quality and Standards

- Quality Control: Ensuring consistent quality across global production sites is a challenge. Firms implement rigorous quality control measures and standards to maintain product quality.
- Standardization: Standardizing processes and components across different locations helps in maintaining consistency and interoperability.

5. Risk Management

- Diversification: By spreading production across multiple locations, companies can mitigate risks such as political instability, natural disasters, and supply chain disruptions.
- Redundancy: Having multiple production sites can provide redundancy and ensure continuity in case of disruptions in one location.

6. Technological Advancements

- Automation and Robotics: Technological advancements in automation and robotics have made it feasible to maintain high production efficiency across different locations.
- Information Technology: IT systems enable real-time monitoring and management of global production processes, improving coordination and efficiency.

7. Environmental and Ethical Considerations

- Sustainability: Companies are increasingly focusing on sustainable production practices. This includes reducing carbon footprints, minimizing waste, and ensuring environmentally friendly sourcing.
- Ethical Sourcing: Firms must ensure ethical labor practices in their supply chains to avoid issues like child labor, poor working conditions, and exploitation.

Example 1: Apple Inc.

1. Global Supply Chain: Apple's production process involves sourcing components from various countries (e.g., semiconductors from South Korea, displays from Japan) and assembling products in China.
2. Efficiency and Quality: Apple's global supply chain is designed to optimize cost, efficiency, and quality. The company also maintains strict quality control standards across all production sites.

Example 2: Nike

1. Outsourcing Production: Nike outsources most of its production to factories in countries like Vietnam, Indonesia, and China. This strategy leverages lower labor costs and specialized manufacturing capabilities.
2. Supply Chain Management: Nike uses advanced supply chain management techniques to ensure timely delivery and quality of its products worldwide.

Implications for Businesses

- Strategic Planning: Companies need to strategically plan their global production networks to balance cost, efficiency, quality, and risk.
- Supply Chain Coordination: Effective coordination and management of global supply chains are crucial for ensuring smooth operations and timely delivery.
- Compliance and Standards: Firms must comply with international standards and regulations, ensuring consistent quality and ethical practices across all production sites.
- Technological Integration: Investing in technology for automation, real-time monitoring, and data analytics can significantly enhance global production efficiency.

The globalization of production allows companies to optimize costs, access specialized skills, and manage risks more effectively. However, it also requires sophisticated management of complex supply chains, adherence to quality standards, and a focus on sustainability and ethical practices. Firms that can successfully navigate these challenges will gain significant competitive advantages in the global marketplace.

4.2.3 Globalization of investments

Globalization of investments refers to the process by which investors and businesses allocate capital across international borders to diversify their portfolios, access new markets, and enhance returns. This trend has been facilitated by technological advancements, liberalization of financial markets, and the increasing interconnectedness of the global economy.

1. Foreign Direct Investment (FDI)

- Definition: FDI involves a company or individual investing in business operations in another country, such as by acquiring a foreign company, establishing new operations, or expanding existing ones.
- Benefits: FDI provides companies with direct control over foreign assets, access to local markets, and potential cost advantages. Host countries benefit from job creation, technology transfer, and economic growth.

2. Portfolio Investment

- Definition: Portfolio investment involves purchasing foreign securities, such as stocks and bonds, without gaining control over the companies. This type of investment focuses on financial returns rather than management control.
- Diversification: International portfolio investments help investors diversify risk by spreading investments across different markets and economies, which can reduce volatility and enhance returns.

3. Cross-Border Mergers and Acquisitions (M&A)

- Definition: Cross-border M&A involves companies from different countries merging or one company acquiring another. This strategy can quickly enhance a company's global footprint and market access.
- Strategic Objectives: M&A activities can help companies achieve economies of scale, gain access to new technologies, and enter new markets rapidly.

4. Capital Markets Integration

- Financial Markets: The integration of global capital markets allows for the free flow of capital across borders, providing investors with access to a broader range of investment opportunities.
- Regulatory Harmonization: Efforts to harmonize financial regulations and standards across countries facilitate smoother cross-border investment flows.

5. Private Equity and Venture Capital

- Private Equity: Private equity firms invest in companies worldwide, often focusing on restructuring or growing the businesses to achieve higher returns. This can involve leveraged buyouts, growth capital, and distressed investments.
- Venture Capital: Venture capital firms invest in startups and early-stage companies with high growth potential. Globalization enables these firms to tap into innovative ventures across different regions, especially in tech hubs like Silicon Valley, Shenzhen, and Berlin.

6. Sovereign Wealth Funds

- Definition: Sovereign wealth funds (SWFs) are state-owned investment funds that invest in a variety of assets, including international equities, bonds, real estate, and infrastructure.
- Global Impact: SWFs, such as those from Norway, the UAE, and China, have significant influence on global financial markets due to their large asset bases and diverse investment portfolios.

7. Technological Advancements

- Fintech: Technological innovations in financial technology (fintech) have made it easier for investors to access global markets, conduct transactions, and manage portfolios. Platforms like online trading, robo-advisors, and blockchain facilitate cross-border investments.
- Data Analytics: Advanced data analytics and AI help investors make informed decisions by analyzing global market trends, economic indicators, and company performance.

8. Economic and Political Considerations

- Economic Policies: Government policies, such as tax incentives, trade agreements, and investment treaties, play a crucial role in attracting foreign investments.
- Political Stability: Political stability and transparent legal systems are critical factors for investors when considering international investments. Unstable political environments can deter investment due to higher risks.

9. Ethical and Environmental Factors

- Sustainable Investing: There is a growing trend towards sustainable and socially responsible investing. Investors are increasingly considering environmental, social, and governance (ESG) factors when making investment decisions.
- Corporate Governance: Good corporate governance practices in target investment markets are essential for attracting and retaining foreign investments.

Example 1: Amazon

- Global Expansion: Amazon has made significant investments in establishing operations, logistics centers, and research facilities across the globe, including in Europe, Asia, and Latin America.
- Market Entry: Through strategic acquisitions and investments, Amazon has entered new markets and strengthened its position in existing ones, such as its acquisition of Souq.com to enter the Middle Eastern market.

Example 2: SoftBank Vision Fund

- Investment Strategy: The SoftBank Vision Fund, with its massive capital base, invests in a wide range of technology companies globally, including in the U.S., China, and India.
- Global Influence: By investing in innovative tech startups and established companies, SoftBank has significantly influenced global tech industry trends and developments

Implications for Businesses and Investors

Risk Management: Companies and investors must manage risks associated with currency fluctuations, political instability, and regulatory changes when investing internationally.

Strategic Planning: Effective strategic planning is essential to identify profitable investment opportunities and to navigate the complexities of different markets.

Cultural Competence: Understanding cultural differences and local business practices is crucial for successful international investments and operations.

Sustainability: Emphasizing sustainable investment practices can enhance long-term returns and align with global trends towards responsible investing.

The globalization of investments offers numerous opportunities for businesses and investors to diversify their portfolios, access new markets, and achieve higher returns. However, it also presents challenges related to risk management, regulatory compliance, and cultural differences. By leveraging technological advancements and adopting strategic planning, companies and investors can successfully navigate the global investment landscape and capitalize on its potential.

4.2.4 Globalization of Technology

The globalization of technology refers to the spread and integration of technology across borders, facilitating international collaboration, innovation, and the dissemination of knowledge and resources. This phenomenon has significantly impacted economies, industries, and societies worldwide.

1. Technological Transfer and Diffusion

- Definition: Technology transfer involves the process by which technology developed in one country or company is adopted and adapted by another. This can occur through various means, including direct investment, licensing agreements, joint ventures, and informal exchanges.
- Diffusion: The diffusion of technology refers to how new technologies spread across different countries and regions. Factors influencing diffusion include economic development, education levels, infrastructure, and government policies.

2. Research and Development (R&D)

- Global R&D Networks: Companies and research institutions establish R&D centers in various countries to leverage local expertise, resources, and innovation ecosystems. For example, multinational corporations like IBM and Google have R&D facilities worldwide.
- Collaboration: International collaboration in R&D allows for the pooling of resources, sharing of knowledge, and faster innovation. Collaborative projects, such as those within the European Union's Horizon 2020 program, exemplify this trend.

3. Information and Communication Technology (ICT)

- Digital Infrastructure: The expansion of ICT, including the internet, mobile networks, and data centers, has facilitated global connectivity and information sharing. This infrastructure is the backbone of modern globalized technology.
- E-Commerce and Digital Platforms: Companies like Amazon, Alibaba, and eBay have revolutionized commerce by creating global digital marketplaces. These platforms enable businesses and consumers to engage in cross-border transactions seamlessly.

4. Standardization

- Global Standards: The adoption of global technical standards, such as those set by the International Organization for Standardization (ISO) and the International Electrotechnical Commission (IEC), ensures compatibility and interoperability of technologies across countries.
- Regulatory Harmonization: Efforts to harmonize regulations, such as the General Data Protection Regulation (GDPR) in the EU, influence global practices in data protection and privacy.

5. Innovation Ecosystems

- Tech Hubs: Cities like Silicon Valley, Shenzhen, and Bangalore have become global technology hubs, attracting talent, investment, and companies from around the world. These hubs foster innovation through dense networks of startups, established firms, and academic institutions.

- Incubators and Accelerators: International programs and institutions support startups through funding, mentorship, and resources, facilitating global innovation and entrepreneurship.

6. Impact on Industries

- Manufacturing: Advanced manufacturing technologies, such as robotics, 3D printing, and IoT, have globalized production processes, enabling more efficient and flexible manufacturing across borders.
- Healthcare: Innovations in medical technology, telemedicine, and pharmaceuticals have been rapidly adopted globally, improving healthcare outcomes and access in various regions.
- Finance: Fintech innovations, including mobile banking, blockchain, and digital payments, have transformed global finance, making financial services more accessible and efficient.

7. Education and Skills Development

- Online Learning: The rise of online learning platforms like Coursera, edX, and Khan Academy has made education more accessible worldwide, enabling learners to acquire new skills and knowledge irrespective of their location.
- Global Talent Pool: Companies can tap into a global talent pool, hiring skilled professionals from different countries, facilitated by remote work technologies and global labor markets.

8. Social and Ethical Considerations

- Digital Divide: Despite the benefits, there is a digital divide where some regions, especially in developing countries, have limited access to advanced technologies and the internet.
- Privacy and Security: The globalization of technology raises concerns about data privacy and cybersecurity. Ensuring secure and ethical use of technology is a critical challenge.
- Cultural Impact: The spread of technology can influence cultural norms and practices, leading to both positive exchanges and potential homogenization of cultures.

Example 1: Microsoft

- Global R&D: Microsoft operates numerous R&D centers worldwide, including in India, China, and Israel, leveraging local talent and innovation.
- Product Adaptation: Microsoft adapts its products to meet local market needs, such as creating versions of software that support multiple languages and regional preferences.

Example 2: Tesla

- Global Manufacturing: Tesla has established Gigafactories in the U.S., China, and Germany to produce electric vehicles and batteries, optimizing production and distribution for different markets.
- Technology Sharing: Tesla's open patents policy encourages the adoption and development of electric vehicle technologies globally.

Implications for Businesses and Society

Strategic Planning: Businesses must develop strategies to leverage global technological advancements, including investing in international R&D and adopting new technologies.

Innovation Management: Effective management of innovation involves collaborating across borders, protecting intellectual property, and navigating global regulatory environments.

Sustainable Development: Technological globalization can support sustainable development by enabling cleaner production methods, improving resource efficiency, and addressing global challenges like climate change.

The globalization of technology has far-reaching implications for businesses, economies, and societies. It drives innovation, enhances connectivity, and provides opportunities for economic growth and development. However, it also presents challenges such as managing the digital divide, ensuring data privacy and security, and addressing ethical concerns. Companies and policymakers must work together to maximize the benefits of technological globalization while mitigating its risks.

Let's sum up:

Learners in this section we have seen that the globalization of markets refers to the process by which markets around the world become more interconnected and

integrated. Globalization of production refers to the practice of sourcing goods and services from different locations around the globe to take advantage of national differences in the cost and quality of factors of production (such as labor, energy, land, and capital). Globalization of investments refers to the process by which investors and businesses allocate capital across international borders to diversify their portfolios, access new markets, and enhance returns. The globalization of technology refers to the spread and integration of technology across borders, facilitating international collaboration, innovation, and the dissemination of knowledge and resources.

Check your progress

1. What does globalization of markets refer to?

A. Expansion of domestic markets
B. Merging of distinct national markets into a global marketplace
C. Isolation of markets from international competition
D. Regulation of markets by national governments

2. Which of the following is a key driver of globalization of production?

A. High local labor costs
B. Availability of cheaper raw materials
C. Decreased transportation costs
D. Increased tariffs

3. Globalization of investments primarily involves:

A. Free flow of capital across national borders
B. Restricting foreign direct investments
C. Investing only in domestic markets
D. Nationalization of foreign companies

4. Which of the following technologies has most significantly contributed to the globalization of markets?

A. Biotechnology
B. Renewable energy technologies
C. Information and communication technology (ICT)
D. Space exploration technologies

5. Foreign direct investment (FDI) is an example of:
A. Globalization of production
B. Globalization of markets
C. Globalization of culture
D. Globalization of investments

SECTION 4.3: WORLD TRADE IN GOODS AND SERVICES

World trade in goods and services refers to the global exchange of tangible products (goods) and intangible offerings (services) between countries. This trade is a crucial aspect of international business, influencing economic growth, development, and the interconnectedness of global markets. Goods encompass physical products that can be seen, touched, and transported. They are classified into various categories such as: Consumer goods: Items bought by consumers for personal use (e.g., clothing, electronics). Capital goods: Goods used to produce other goods (e.g., machinery, equipment). Intermediate goods: Products used in the production process of other goods (e.g., raw materials, components).

4.3.1 Factors Influencing Trade in Goods

1. Comparative Advantage: Countries specialize in producing goods where they have a lower opportunity cost, leading to more efficient global production.
2. Trade Policies: Tariffs, quotas, and subsidies affect the flow of goods between countries.
3. Logistics and Infrastructure: Efficient transportation and logistics systems facilitate the movement of goods.
4.Exchange Rates: Fluctuations in currency values impact the cost and competitiveness of goods on the international market.

5. Technological Advancements: Improvements in production and communication technologies enhance the efficiency and scope of trade.

Services are intangible activities that provide value without producing physical products. They include sectors such as:

1. Financial Services: Banking, insurance, and investment services.
2. Travel and Tourism: Services related to travel, hospitality, and tourism.
3. Telecommunications and IT: Services involving communication technologies and information systems.
4. Education and Healthcare: Services providing education and health care to individuals and businesses.

4.3.2 Factors Influencing Trade in Services

1. Digitalization: The rise of the internet and digital technologies has significantly boosted the trade in services.
2. Regulatory Environment: Different countries have varying regulations affecting the provision and consumption of services.
3. Cultural Exchange: Cultural factors influence the demand for services like entertainment, education, and tourism.
4. Economic Integration: Trade agreements and economic unions can facilitate or hinder the flow of services.
5. **Labor Mobility:** The movement of skilled professionals across borders impacts the service industry.

4.3.3 Importance of World Trade in Goods and Services

1. Economic Growth: Trade contributes to GDP growth by opening markets and creating new opportunities for businesses.
2. Employment: It generates jobs in industries related to export and import activities.
3. Consumer Benefits: Consumers have access to a wider variety of goods and services, often at lower prices due to competition.
4. Innovation and Efficiency: Exposure to global competition encourages innovation and efficiency in production.

5. Interdependence: Trade fosters economic interdependence among nations, promoting peace and stability.

4.3.4 Challenges in World Trade

1. Trade Barriers: Tariffs, quotas, and non-tariff barriers can restrict the free flow of goods and services.
2. Trade Disputes: Disagreements between countries over trade practices can lead to conflicts and trade wars.
3. Economic Disparities: Uneven benefits from trade can exacerbate inequalities between and within countries.
4. Environmental Impact: Increased production and transportation of goods can lead to environmental degradation.
5. Political Instability: Political changes and instability can disrupt trade flows and affect global supply chains.

Let's sum up:

We have seen in this section that World trade in goods and services is a vital component of international business, driving economic growth and development. It is influenced by various factors, including comparative advantage, trade policies, technological advancements, and regulatory environments. Despite its benefits, challenges such as trade barriers, economic disparities, and environmental impacts must be managed to ensure sustainable and equitable trade practices. Key institutions like the WTO, IMF, and World Bank play significant roles in facilitating and regulating international trade, ensuring it contributes to global prosperity.

Check your progress:

1. Which organization is primarily responsible for regulating international trade in goods and services?

A. International Monetary Fund (IMF)

B. United Nations (UN)

C. World Trade Organization (WTO)

D. World Bank

2. Which of the following is a key benefit of international trade in goods and services?

A. Decreased competition

B. Access to a larger variety of goods and services

C. Increased national isolation

D. Higher prices for consumers

3. A trade deficit occurs when:

A. A country exports more than it imports

B. A country imports more than it exports

C. A country's exports and imports are equal

D. A country only imports goods and does not export

4. Which sector is most affected by the liberalization of trade in services?

A. Manufacturing

B. Agriculture

C. Financial services

D. Mining

5. Which of the following is an example of a service traded internationally?

A. Cars

B. Computers

C. Clothing

D. Legal consulting

SECTION 4.4: MAJOR TRENDS AND DEVELOPMENTS

Current trends are near the cumulative foreign trade and interdependence of firms, markets and countries. Strong race among countries, industries, and firms on a global level is a recent development due to the union of several major trends. Among these trends are:

1. **Forced Dynamism**

International trade is forced to submit to trends that shape the universal political, cultural, and economic environment. International trade is a difficult topic, because the environment it functions in is continuously changing. First, businesses are continuously aggressive the boundaries of economic growth, technology, culture, and politics which also modification the nearby global society and global economic setting. Secondly, factors external to international trade (e.g., developments in science and information technology) are continuously forcing international trade to change how they operate.

2. **Cooperation among Countries**

Countries collaborate with each other in thousands of ways through international organizations, agreements, and discussions. Such collaboration usually inspires the globalization of business by removing limitations on it and by outlining agendas that diminish reservations about what establishments will and will not be permissible to do.

Countries cooperate to gain reciprocal advantages, to attack problems they cannot solve alone, and to deal with concerns that lie outside anyone's territory. Agreements on a variety of commercially linked actions, such as conveyance and trade, allow nations to gain give-and-take advantages. For example, groups of countries have agreed to permit foreign airlines to land in and fly over their regions, such as Canada's and Russia's agreements beginning in soon to allow polar over flights that will save five hours between New York and Hong Kong. Groups of countries have also agreed to defend the property of foreign-owned companies and to license foreign-made goods and services to arrive their zones with fewer limitations. In calculation, countries collaborate on problems they cannot solve alone, such as by organizing national economic programs (including interest rates) so that global economic conditions are slightly disturbed, and by limiting imports of convinced products to protect threatened classes. Finally, countries set agreements on how to commercially adventure areas outside any of their grounds. These comprise outer space (such as on the transmission of television programs), blocked-in areas of lots and seas (such as on exploitation of minerals), and Antarctica (for example, limits on fishing within its coastal waters).

3. **Liberalization of Cross-border Movements**

Every country limits the movement across its borders of goods and services as well as of the properties, such as workers and capital, to harvest them. Such limitations make international trade burdensome; extra, because the boundaries may change at any time, the capability to tolerate international trade is always indefinite. However, governments today execute fewer constraints on cross-border movements than they did a period or two ago, allowing companies to better take benefit of international chances. Governments have reduced restrictions because they believe that: 1. So-called open economies (having very few international restrictions) will give consumers better access to a superior diversity of goods and services at lower prices, 2. Producers will become more well-organized by opposing against foreign companies, and 3. If they decrease their own limitations, other republics will do the same.

4. **Transfer of Technology**

Technology transfer is the procedure by which profitable technology is dispersed. This will take the form of a technology transmission transaction, which may or may not be an officially compulsory contract, but which will include the message, by the transferor, of the applicable knowledge to the addressee. It also comprises non-commercial technology transfers, such as those found in international collaboration promises between developed and developing states. Such agreements may relate to infrastructure or agricultural development, or to international; collaboration in the fields of research, education, employment or transport.

5. **Growth in Emerging Markets**

The growth of emerging markets (e.g., India, China, Brazil, and other parts of Asia and South America especially) has compressed international trade in every way. The emerging markets have instantaneously increased the probable size and worth of current major international trade while also simplifying the emergence of a whole new cohort of innovative companies.

Let's sum up:

Learners we have seen in this section that International trade is forced to submit to trends that shape the universal political, cultural, and economic environment. Countries cooperate to gain reciprocal advantages, to attack problems they cannot solve alone, and to deal with concerns that lie outside anyone's territory. Every country

limits the movement across its borders of goods and services as well as of the properties, such as workers and capital, to harvest them. Technology transfer is the procedure by which profitable technology is dispersed. This will take the form of a technology transmission transaction, which may or may not be an officially compulsory contract, but which will include the message, by the transferor, of the applicable knowledge to the addressee. The growth of emerging markets (e.g., India, China, Brazil, and other parts of Asia and South America especially) has compressed international trade in every way.

Check Your Progress

1. What is one of the significant impacts of digital globalization?

A. Slower communication between countries

B. Increased cost of international transactions

C. Enhanced connectivity and information exchange worldwide

D. Reduction in the number of global markets

2. Which term refers to the global movement of people for employment, education, and better living conditions?

A. Immigration

B. Global workforce

C. Urbanization

D. Migration

3. How has the rise of e-commerce impacted globalization?

A. It has made it harder to sell products internationally.

B. It has facilitated easier and faster cross-border transactions.

C. It has decreased consumer choice.

D. It has led to increased trade barriers.

4. What role do multinational corporations (MNCs) play in globalization?

A. They focus exclusively on their home markets.

B. They drive international trade and investment.

C. They oppose global trade agreements.

D. They limit the spread of technology.

5. What is a major political trend influencing globalization today?

A. Rise of protectionist policies

B. Strengthening of global trade agreements

C. Decrease in international cooperation

D. Decline of regional trade blocs

SECTION 4.5: WORLD TRADE AND PROTECTIONISM

Protectionism is the sum of government trade policies intended to assist domestic producers against foreign producers in a particular industry, by means of raising the price of foreign products, lowering cost for domestic producers, and limiting foreign producers' access to domestic market. The methods to achieve such protection are all too familiar and include:

- Tariff taxes on imports which continue to be used in spite of great progress under GATT;
- Quota ceilings on quantity of foreign products sold in domestic market, which limit the supply and raise the price of imported products;
- Regulatory obstacles that place hurdles in the way of imported products such as product classifications and seemingly endless lists of standards and specifications;
- Subsidies to domestic producers that range from tax breaks to direct cash payments; and
- Currency controls to limit access to foreign currencies or manipulate exchange rates to inflate the price of foreign products and lower the price of domestic products.

The arguments for protectionism include national defence, balance of payments, employment and infant industries.

National defence:

Protecting producers in industries such as weapon manufacturing is deemed prudent to protect the country's preparedness for times of adversity. This argument has wide patriotic appeal, but it also has weaknesses. First, protections given to so-called essential industries are very costly to tax payers and seem to have become routine and matter of fact. Second, numerous industries qualify to be crucial for national security including plastics, chemicals, metals, and computers. Should all these industries enjoy protection from international competition? Third, in today's business environment of global networking, it is inconceivable to identify a sensitive industry that is without networks of foreign partners and even co-owners. In the defense industry, Boeing, Raytheon and DRS Technologies all have dozens of strategic relationships with international suppliers, partners, clients, and foreign governments as well. Furthermore, these companies do compete internationally.

Balance of payments:

Advocates of protectionism are alarmed at the deficit in the balance of payments' current account. When trade deficit persists and grows, politicians begin to wield protectionism to battle the perceived injustice in the country's trade relations. This argument, while popular, disregards key issues. First, study after study in the economics of trade continues to show that trade deficit per se is not harmful to the economy. Second, concentrating only on the balance of trade is but a partial and limited view of a country's balance of payments. A positive balance in another account, such as the capital account, which measures capital inflows and outflows, accompanies a deficit in the balance of trade. That is the case with the US balance of payments and it is a fact rarely mentioned by arguments for protectionism. Third, protections that reduce imports invariably reduce exports and do not change the deficit situation.

Employment:

An industry that has not been preparing for competition, global or domestic, loses market share and jobs are lost. Workers and their representatives and employers lobby the government very strongly to obtain protections, and they often do. Protections reduce imports and preserve some jobs, but the subsequent reduction in exports reduces employment in export industries. Employment gains from reduced imports and

losses from reduced exports balance each other out with a net employment effect near zero! A second issue is the cost per job saved. The cost to the public can reach hundreds of thousands of dollars per a single job saved. Third, while employment in the buffered industry is spared, it worsens in industries that depend on imports, like industrial users of imported goods, retailers, trade related service industries, and so on. In addition, the rise in the price of protected goods increases the cost of doing business in these industries and makes them less competitive.

Infant industries:

This is another popular argument in developing and developed countries as well. A newly established industry may not enjoy the cost and production efficiencies enjoyed by competitors who have been in business long enough to develop production efficiencies and innovative technologies. Therefore, the newly established industry applies pressure on its government to shield it from international competition by means of imposing trade restrictions in the face of imports for a number of years until the domestic industry presumably establishes its comparative advantage. Unfortunately, the protected industry continues to rely on its political power and allies to extend the duration of its "infancy" and resist lifting the protections. Such infant industries enjoy the luxury of protection and often grow in size and begin to resemble an oligopoly with significant political power to preserve and even raise levels and types of protection.

There are other arguments for protectionism such as strategic trade policy, spillover effect, income redistribution, and so on.

Let's sum up

Learners we have seen in this section that Protectionism is the sum of government trade policies intended to assist domestic producers against foreign producers in a particular industry, by means of raising the price of foreign products, lowering cost for domestic producers, and limiting foreign producers' access to domestic market. The arguments for protectionism include national defence, balance of payments, employment and infant industries.

Check your progress

1. What is protectionism?

A. Policies that encourage free trade between nations

B. The establishment of free trade zones

C. Measures taken by a government to restrict or limit international trade

D. The creation of international trade agreements

2. Which of the following is a common tool used in protectionist policies?

A. Free trade agreements

B. Import tariffs

C. Export subsidies

D. Deregulation

3. Which of the following is a potential negative effect of protectionism?

A. Increased domestic competition

B. Lower production costs

C. Increased foreign investment

D. Higher prices for consumers

4. Which of the following is an argument often used in favor of protectionism?

A. It increases the variety of goods available to consumers.

B. It protects emerging industries in developing countries.

C. It promotes international cooperation.

D. It leads to lower consumer prices.

5. Which of the following is a likely consequence of a country adopting strong protectionist policies?

A. Enhanced international trade relationships

B. Retaliation from trading partners

C. Decrease in domestic production

D. Increase in foreign goods available domestically

SECTION 4.6: TARIFF AND NON-TARIFF BARRIERS

Trade barriers are limitations that governments impose on international trade. There are two main types of trade barriers - tariffs and non-tariff barriers.

4.6.1 Tariff Barriers

Tariffs are direct taxes on imported goods. When a country imposes tariffs, it makes imported products more expensive. This makes domestic products relatively cheaper and more competitive. Tariffs are taxes. They are the fees that a country places on imported goods or services. When a business from Country A sells a product to Country B, Country B might make the business pay a tariff, or tax, on the product. This makes the product more expensive in Country B. When two nations trade in commodities, the country in which the goods are exported levies a tax in order to generate revenue for the government while also raising the price of foreign goods so that domestic firms can compete with foreign products. The fee is in the form of a tax or duty which is referred to as a Tariff Barrier. The amount of tax or duty levied as a tariff is added to the cost of the import, making foreign goods more expensive, which is ultimately borne by the product’s customer. The tariff is paid to the customs authorities of the country where the goods are being sent.

4.6.2 Types of Tariff Barriers

- Import duties: Besides simply increasing the cost of imported goods, import duties distort trade by making traders divert imports to countries with lower duties. This reduces overall trade efficiency.
- Import quotas: They restrict the number of imports, creating artificial needs and higher prices in the domestic market. Quotas also boost importers to bid up the prices of the limited quota licenses.
- Surcharges: They deepen the economic costs of import duties by further raising import prices beyond normal tariff levels. This disproportionately shields local producers.

4.6.3 Non-Tariff Barriers

Non-tariff barriers are other rules or regulations that a country uses to control trade. They don't involve a tax, but they can still make it more difficult or expensive for

businesses to sell their products in other countries. Some common types of non-tariff barriers include quotas, licensing requirements, and standards.

- Import bans: While aimed at legitimate purposes, they can be misused as protectionist measures by technicalities in their implementation. They also impose high costs on consumers who lose access to banned products.
- Product standards: Foreign exporters often face high compliance costs to meet unknown product standards of importing nations. It gives an advantage to domestic producers already familiar with the standards.
- Import licenses: The discretionary power of officials in approving or rejecting import licenses can be misused for protectionist reasons. It raises uncertainty and raises costs for importers.
- Export subsidies: They distort world prices and discriminate against exporters from countries that do not provide subsidies. This harms free and fair global competition.

Wider Effects of trade barriers

- Trade barriers reduce potential gains from trade based on comparative advantage. Less specialization means forgoing higher productivity and economic growth.
- Consumers face higher prices and less variety due to limited competition from imports. This especially hurts the poor, who spend much of their income on protected goods.
- Exporters in countries imposing trade barriers also face retaliation from other nations, hurting their export competitiveness.
- Global living standards can be lower if the most efficient producers are prevented from giving certain goods and services globally.

4.6.4 Differences between Tariff and Non-tariff barriers

Basis	Tariff Barriers	Non – Tariff Barriers
Meaning	Tariff Barriers are taxes or fees imposed by the	Non-tariff barriers include all the limitations other than taxes

	government on imports in order to protect domestic industries and boost revenue for the government.	imposed by the government on imports in order to protect domestic enterprises and discriminate against new entrants.
Permissibility	The World Trade Organisation authorised its members to impose tariff barriers but only at reasonable rates.	Import quotas and voluntary export barriers were eliminated by the World Trade Organisation.
Nature	Tariff barriers are explicit in nature.	Non-tariff barriers are implicit in nature.
Form	Tariff barriers are imposed in the form of Taxes and Duties.	Non-tariff barriers are imposed in the form of Regulations, Conditions, Requirements, Formalities, etc.
Revenue	Tariff barriers generate revenue for the government.	Non-tariff barriers do not generate revenue for the government.
Affects	Tariff barriers affect the price of imported goods.	Non-tariff barriers affect the quantity or price or both of the imported goods.
Monopolistic Organisations	As the government charges tariff barriers, monopolistic organisations' prices can be controlled.	The monopolistic organisation charges high rates for low output.
Profit	Profits made by the importers can be restricted through tariff barriers.	Importers can make high profits through non-tariff barriers.
Example	Import Duties, Export Duties, Ad-valorem Duties, etc.	Import Licensing, Foreign Exchange Regulations, Import

		Quotas, etc.

Let’s sum up

Learners in this section we have seen that tariffs and non-tariff barriers aim to protect local industries by reducing foreign competition. However, they also have economic costs in terms of higher prices, reduced consumer choice, less trade and lower productivity gains from field. This is why countries negotiate trade deals and participate in organizations like the WTO to mutually reduce unnecessary trade barriers as much as possible while addressing legitimate concerns about unfair trade practices. The ultimate goal is to maximize the benefits of international trade.

Check your progress

1. What is a tariff?

A. A limit on the amount of a good that can be imported

B. A tax imposed on imported goods

C. A subsidy given to domestic producers

D. A ban on certain exports

2. Which of the following is a non-tariff barrier to trade?

A. Import quotas

B. Export subsidies

C. Tariffs

D. Currency devaluation

3. Which organization is known for promoting global trade by reducing tariffs and other trade barriers?

A. International Monetary Fund (IMF)

B. World Health Organization (WHO)

C. World Trade Organization (WTO)

D. United Nations (UN)

4. What is the primary goal of imposing tariffs on imported goods?

A. To increase the price of domestic goods

B. To protect domestic industries from foreign competition

C. To encourage foreign investment

D. To promote international trade

5. Which of the following is NOT a non-tariff barrier?

A. Import licensing

B. Export quotas

C. Ad valorem tariffs

D. Health and safety standards

4.7 Unit Summary

Learners in this fourth unit we have seen that Globalization is driven by the integration of markets, production, investments, and technology on a global scale. The globalization of markets refers to the convergence of consumer preferences and the expansion of businesses beyond national borders. Globalization of production involves sourcing goods and services from various locations worldwide to optimize cost and efficiency. Investments have become increasingly international, with capital flowing across borders to seek higher returns and diversify portfolios. Technological advancements facilitate these processes by improving communication, transportation, and data management. World trade in goods and services has seen significant trends and developments, such as the rise of emerging markets, increased trade volumes, and the growth of global supply chains. However, this expansion faces challenges from protectionist measures, including tariffs and non-tariff barriers, which countries use to shield domestic industries from foreign competition. These barriers can disrupt trade flows and economic integration, highlighting the ongoing tension between free trade and protectionism in the global economy.

4.8 Glossary

Trade Liberalization	The process of reducing or eliminating trade barriers, such as tariffs and non-tariff barriers, to encourage free flow of goods and services between countries. It aims to create a more open and competitive international market.

Foreign Direct Investment (FDI)	Investment made by a firm or individual in one country into business interests located in another country, typically involving control or significant influence over the foreign business operations
Portfolio Investment	Investment in financial assets such as stocks and bonds in a foreign country
Private Equity	Capital investment made into private companies or the buyout of public companies that results in the delisting of public equity. Private equity investments are typically made by private equity firms, venture capital firms, or angel investors.
Venture Capital	A subset of private equity focusing on early-stage, high-potential growth startups. Venture capitalists provide capital in exchange for equity and often play a significant role in guiding the company's strategy and growth.
Fintech	Fintech refers to the integration of technology into offerings by financial services companies to improve their use and delivery to consumers.
Corporate Governance	The system of rules, practices, and processes by which a company is directed and controlled
Protectionism	Economic policy of restraining trade between countries through methods such as tariffs, quotas, and other regulations to protect domestic industries from foreign competition.
Tariff Barriers	Taxes imposed on imported goods and services to make them more expensive and less competitive compared to domestic products
Non-Tariff Barriers	Regulatory and procedural measures other than tariffs that restrict imports or exports

4.9 Self-Assessment Questions

Short Answers: (5 Marks)

1. Write a short note on globalization.

2. Causes of globalization.
3. Different types of globalization.
4. Advantages of globalization.
5. disadvantages of globalization.
6. What are the effects of globalization?
7. Write a note on world trade in goods and services.
8. Major trends and developments in globalization.
9. What are the effects of trade barriers?
10. Difference between tariff and non-tariff barriers.

Long Answers: (8 Marks)

1. Explain in detail about the drivers of globalization
2. Discuss in detail about Globalization of Markets and production with examples.
3. Elaborately explain about Globalization of investments and Technology with examples
4. Discuss about world trade and protectionism

4.10 Case Study

Viraj Profiles Limited

Viraj Profiles Limited founded by Mr Neeraj Raja Kochher (Chairman & Managing Director) in the year 1991 in Tarapur MIDC (Tal. & Dist. Palghar). It was started as a small induction furnace to manufacture utensil grade steel for domestic markets with employee strength of 150 people. Over the years the company expanded its operations across the globe, increased its product portfolio and today the company boasts of employee strength of 9000. Under the leadership of Mr. Neeraj Kochher, Viraj has expanded its foot prints across 6 continents, more than 90 countries and is currently serving to more than 1300 satisfied customers. Now it is the second largest manufacturer of stainless steel long products in the world and is ranked number one in stainless steel flanges. Fundamental in ensuring the continuous growth of the organisation, Mr Neeraj Raja Kochhar has transformed the company into, one of the

fastest growing business houses in India, is currently a major player in the global stainless-steel market with a capacity of 528,000 tonnes per annum and with an annual turnover of over US $ 1.5 billion. Over the last 20 years the Co. has achieved over 90 product certifications and approvals in the petrochemical, food and beverage, construction, pharmaceutical, defence and marine industries.

Mission of the Company:

• To be one stop shop for stainless steel engineering products.

• To be the first preference of the global market leaders.

• Up gradation and adaption of latest technology.

• Product and market development for maximizing value.

• Delivering operational excellence.

• Continual growth through customer service, innovation, quality& commitment.

• Plough back income to diversify into stainless steel projects.

• To be a responsible & abiding Corporate Citizen.

• Committed for a greener environment.

• To be the organization of choice & a great place to work.

• Openness to backward & forward integration to sharpen.

Challenges of Globalisation

1) To ensure that the benefits of globalisation extend to all countries.

2) To ensure that the benefits of globalisation extend to all parts of the country.

3) To tackle the increased global competition.

4) To protect labour rights, employment practices, and the environment

Question

4. Analyze and summarize the given case study.

4.11 Answers for check your progress

Modules	S. No.	Answers
Module 1	1.	D. Technological advancements
	2.	B. Trade liberalization
	3.	B. International trade agreements
	4.	A. By reducing the cost and time of shipping goods
	5.	C. Protectionist trade policies
Module 2	1.	B. Merging of distinct national markets into a global marketplace
	2.	B. Availability of cheaper raw materials
	3.	A. Free flow of capital across national borders
	4.	C. Information and communication technology (ICT)
	5.	D. Globalization of investments
Module 3	1.	C. World Trade Organization (WTO)
	2.	B. Access to a larger variety of goods and services
	3.	B. A country imports more than it exports
	4.	C. Financial services
	5.	D. Legal consulting
Module 4	1.	C. Enhanced connectivity and information exchange worldwide
	2.	D. Migration
	3.	B. It has facilitated easier and faster cross-border transactions.
	4.	B. They drive international trade and investment.

	5.	A. Rise of protectionist policies
Module 5	**1.**	C. Measures taken by a government to restrict or limit international trade
	2.	B. Import tariffs
	3.	D. Higher prices for consumers
	4.	B. It protects emerging industries in developing countries.
	5.	B. Retaliation from trading partners
Module 6	**1.**	B. A tax imposed on imported goods
	2.	A. Import quotas
	3.	C. World Trade Organization (WTO)
	4.	B. To protect domestic industries from foreign competition
	5.	C. Ad valorem tariffs

4.12 Suggested Readings

1. Robert E. Baldwin (1984), The Political Economy of Non-Tariff Barriers: A Cross-National Analysis, European Economic Review, Cambridge University Press.

2. Joseph E. Stiglitz (2002) Globalization and Its Discontents, W.W. Norton & Company.

4.13 Open Source E-Content Links

S.No.	Topic	E-Content Link
1.	Drivers of Globalization	https://www.youtube.com/watch?v=Z9uj81Mng78
2.	World trade and protectionism - Tariff and non-tariff barriers.	https://www.youtube.com/watch?v=dOWq26rPF2I

4.14 References

- Globalization and Development: Indian Experience" by Raj Kapila and Uma Kapila, Academic Foundation

- Globalization and Indian Economy" by K. C. Rana and K. N. Verma, Atlantic Publishers & Distributors
- Globalization and International Business by N. V. R. Naidu and T. Krishna Rao, I K International Publishing House
- Globalisation, Growth and Inequality in India by Rajnish Kumar, Routledge India
- World Trade and Payments: An Introduction by C. Paul Hallwood and Ronald MacDonald, Pearson Education (Indian Edition available)
- Globalization and World Trade: An Analytical Approach" by Khosrow Fatemi, Routledge.

UNIT 5 - Regional Economic Groupings

Regional Economic Groupings in Practice- Levels of Regional Economic Integration - Regionalism vs. Multilateralism- Important Regional Economic Groupings in the World. Contemporary Issues in International Business- Institutional support to international business-like BREXIT, IMF, World Bank, ILO and WTO.

SECTION 5.1: REGIONAL ECONOMIC GROUPINGS

5.1.1 Regional Economic Groupings – Meaning

Regional economic integration refers to cooperation between various countries of a particular region in order to develop that particular area. It includes economic integration of various trading areas of different countries it is also known as Regional Trade Block, Regional Economic Forces and Regional Grouping. A regional trade block is a type of intergovernmental agreement, in which barriers to trade are reduced or eliminated among participating countries. Regional Economic Integration is a collaborative arrangement between different countries in order to take advantage of market opportunities and to promote economic growth and stability.

5.1.2 Factors contributing to regional groupings

Political Objective: The basic motive behind formation of the European Union was political, i.e., to avoid future conflicts among European nations after the two world wars. The West European countries, who had paid a very heavy price during the first and the second world wars had, after considerable deliberations, decided to seek political unity through economic route. With the support provided by USA under the Marshall Plan, they decided to form the United Community by surrendering their individual national sovereignties to a regional body on trade and economic matters. This gave birth to the European Common Market, to start with, and now the countries are moving towards political and economic union.

Response to Slow Progress of Global Liberalisation: One of the factors that has contributed to formation of economic groups with emphasis on removal of mutual trade barriers can perhaps be traced to the dissatisfaction, at the relatively slow progress, at international level, of attempts at liberalisation of international trade. The Uruguay Round of Trade Negotiations, which commenced as far back as 1986 could, after all, be concluded during December 1993 only and still there are a number of issues on which agreement is yet to be reached. It is, therefore, no wonder if some countries had felt that, probably, it was better to begin the trade liberalisation agenda by knocking down barriers among limited number of countries in the region, while at the same time continue working towards barrier removal at global level.

Regional Initiatives: One of the reasons for emergence of regional groupings can be traced to a feeling, among countries belonging to a region, that it was far easier and made better economic sense to trade more with the countries in the region rather than with 343 countries outside the region. The objective was to fully exploit the advantages offered by regional initiatives. This logic was behind the philosophy of South-South trade and the trade groupings becoming region oriented. The poor countries in particular, given the small size of their markets, looked at regional grouping as a better means to achieve their objective of import substituting industrialization since it gave them the benefit of an enlarged market.

Demonstration Effect: Another reason for the countries belonging to a particular region flocking together, probably, was to improve their bargaining power when they noticed that developments towards formation of groupings were taking place in other regions. This was more in the form of demonstration effect or self-defense mechanism mainly undertaken to avoid the likely problems of isolation from the general trend.

Let’s sum up:

In this section we have seen that Regional economic integration refers to cooperation between various countries of a particular region in order to develop that particular area. It includes economic integration of various trading areas of different countries it is also known as Regional Trade Block, Regional Economic Forces and Regional Grouping.

Check your progress

1. What is the primary purpose of regional economic groupings?

A. To create political alliances

B. To promote free trade and economic cooperation among member countries

C. To establish a common currency

D. To limit global trade

2. Which of the following is an example of a regional economic grouping?

A. International Monetary Fund (IMF)

B. United Nations (UN)

C. European Union (EU)

D. World Trade Organization (WTO)

3. Which of the following is a feature of the European Union?

A. No common policies among member states

B. A single market with the free movement of goods, services, capital, and labor

C. No political cooperation

D. A unified military force

4. Which regional economic grouping is known for having a common external tariff and free internal trade among member countries?

A. ASEAN

B. Mercosur

C. NAFTA

D. SAARC

5. Which of the following is a key benefit of regional economic groupings?

A. Increased tariffs on member countries

B. Restricted trade between member countries

C. Enhanced economic growth through reduced trade barriers

D. Political instability

SECTION 5.2: REGIONAL ECONOMIC INTEGRATION

5.2.1 Introduction

Regional economic integration refers to a way where neighboring nations work to merge their thrifts by falling barriers to trade, investment, and mobility of labor and capital within the region. The goal is for the region to become more useful and roaring through alliance and mutual support. Regional economic integration begins with free trade areas that remove tariffs and quotas on member nations' trade. The next stage is a typical market that allows for the free move of labor, capital, and goods within the region.

5.2.2 Levels of Regional Economic Integration

Preferential Trading Areas, where the member countries lower barriers to imports of identified products from one another.

Free Trade Area, where barriers to trade in respect of all items among member countries are completely eliminated while each member country follows its own policy in regard to trade with non-member countries;

Customs Union, where, apart from elimination of all barriers to trade among themselves, the member countries follow a common policy in regard to their trade with non-members;

Common Market, where the region becomes a common market for all factors of production including labour, services and capital; and Economic Community, where the member countries follow common policies in respect of all economic matters;

The regional groupings that exist today fall in one or more of the above categories or are variations/combinations of some form/forms, the Bangkok Agreement among

Bangladesh, India, Laos, South Korea and Sri Lanka is a specimen of a preferential trading arrangement: EFTA and NAFTA are free trade areas: there are a number of examples of customs union and common market: they include Central American Common Market, Caribbean Common Market, ANDEAN Common Market and Arab Common Market while the European Union is, perhaps, the best example of evolution of a regional grouping through the stages of customs union to common market to economic community.

5.2.3 Objectives of Regional Economic Integration

The goals of regional economic integration have been stated below.

Promote trade - The main goal is to raise trade of goods and services between member countries by reducing or eliminating tariffs and non-tariff barriers. Regional integration aims to make it easier and cheaper for nations to trade with each other.

Create larger markets - By merging their thrifts, member nations gain access to a larger regional market with more likely clients and suppliers. This allows firms to reach thrifts of scale and be more competitive globally.

Specialization - Member nations can specialize in creating and shipping the types of goods and services they are best at and have a close edge in. This leads to more efficient production.

Attract more investment - A larger integrated regional market is more alluring to investors. Regional integration aims to increase foreign direct investment in the region.

Foster economic growth - The gain in trade, investment and efficiencies from specialization are intended to enable faster economic growth for member nations.

Improve living standards - The economic growth benefits of regional integration can help improve norms of living and lower poverty for locals of member nations.

Enhance stability - Deeper economic ties and interdependence between member countries are meant to promote peace, stability and reduce the likelihood of conflict.

5.2.4 Effects of Regional Economic Integration

The effects of regional economic integration have been stated below.

1. Increased trade and investment within the region- By easing tariffs and other trade barriers, regional integration leads to more trade and asset between member nations.
2. Specialization and comparative advantage- Member nations can specialize in making and exporting goods they are relatively efficient at, taking advantage of regional comparative advantage.
3. Economies of scale- A larger integrated regional market allows firms to produce at higher volumes and achieve lower costs through economies of scale.
4. Competition and innovation- Firms face more competition from regional rivals, pushing them to innovate and become more efficient.
5. Growth and development- Increased trade, investment, and specialization from integration boost economic growth and growth within the region.
6. Reduced poverty- Integration's positive impact on growth helps reduce poverty and income contrasts across the member nations.
7. Political stability- Economic integration fosters interdependence that spills over into closer political ties and alliance, contributing to regional stability.
8. Global competitiveness- A larger integrated regional economy evolves more competitive globally, supporting the region's position globally.
9. Job creation- Integration may lead to job creation in export sectors, while some import-competing sectors face under stress. The net impact relies on specific country contexts.
10. Access to larger markets- Firms gain access to a larger integrated regional market that makes the region more attractive for foreign investors.

5.2.5 Advantages and Disadvantages of Regional Economic Integration

The edges and drawbacks of regional economic integration have been stated below.

Advantages of Regional Economic Integration

The advantages of regional economic integration have been stated below.

1. Grown trade- By reducing trade barriers, regional integration boosts the flow of goods, services, and investment within the bloc. This allows members to benefit more from international trade.
2. Economies of scale- An integrated regional market provides access to a larger customer base, allowing firms to produce at larger scales and reduce costs through efficiency gains.
3. Specialization and efficiency- Members can specialize in making and exporting goods they have a comparative advantage while importing others from the larger regional market. This enhances overall productivity and efficiency.
4. Increased investment- A larger integrated market makes the region a more attractive destination for foreign direct investment that benefits all member economies.
5. Technology transfer- Greater trade and investment flows within the bloc facilitate the transfer of technology, knowledge, and skills among members. This boosts creation and productivity.
6. Political stability- Economic interdependence fosters alliance, stability, and security among member states. Regional integration becomes multi-dimensional.
7. Reduced poverty- By increasing growth potential, regional integration aims to reduce poverty and raise income levels across the merged region. A rising tide lifts all boats.
8. Global competitiveness- Regional integration allows fellows to jointly address regional and global issues, giving the bloc more weight and voice on the world stage.

Disadvantages of Regional Economic Integration

The drawbacks of regional economic integration have been stated below.

1. Loss of sovereignty- Member states may lose some control over their trade policies and regulations.
2. Increased competition- Domestic industries may face more competition from other member nations. This can lead to job losses and eviction of workers.

3. Increased economic contrasts. The benefits of integration may not be evenly distributed across nations. More grown members may benefit more, raising the economic gap.
4. Risk of conflicts- There could be conflicts over the allocation of benefits and costs among member nations. This can strain the integration.
5. Cost of coordination- Costs are associated with blending policies, rules, and governance forms across nations. This can be weak.
6. Trade diversion- Members may trade more with each other at the cost of lower-cost non-members. This can be weak.
7. Raised barriers to non-members- Integration may raise barriers to trade with non-members, disabling them.
8. Policy imposition- There is a risk of larger members imposing their policies on smaller members. This can exacerbate tensions.
9. Slower decision-making- Decision-making may become more complex with multiple members, slowing down the process.
10. Spread of economic issues- Issues like financial crises, downturns, and inflation may spread more easily within the integrated region.

5.2.6 Impact of Regional Economic Integration

The impact of regional economic integration has been stated below.

Positive Impacts

The positive impacts have been stated below.

- Boosted trade and investment
- Field and efficiency
- Economic growth
- Larger markets
- Technology transfer
- Poverty reduction
- Potential Negative Impacts

The negative impacts have been stated below.

- Job disruption
- Grown inequality
- Loss of tariff revenue
- Environmental impacts
- Political tensions

5.2.7 Limitations of Regional Economic Integration

The limitations of regional economic integration have been stated below.

1. Uneven development - Member nations are often at various stages of economic growth, which can limit the benefits of integration.
2. Political disputes - Recorded and ongoing political tensions or disputes between fellows pose challenges to economic alliance.
3. Performance issues - Weak implementation and enforcement of regional agreements can damage useful integration.
4. Non-tariff barriers - Despite efforts, non-tariff barriers like quotas, regulations, and administrative hurdles still persist within many integration blocs.
5. Limited trade creation - Much of the boost in trade that occurs may even come from trade pursuit rather than the efficient trade creation expected.
6. Restrictions on labor movement - Most integration arrangements still place rules on the free stir of skilled and unskilled labor between member states.
7. Winner/loser imbalances - Not all member nations or economic sectors benefit equally from integration, creating political tensions.
8. Environmental impacts - Integration and raised economic activity can worsen environmental sustainability challenges.

Let’s sum up:

In this section we have seen that Regional economic integration involves the consolidation of economic policies and regulations among neighboring countries to enhance economic cooperation and trade. It exists at various levels: free trade areas (removal of tariffs among member countries), customs unions (common external tariffs), common markets (free movement of goods, services, capital, and labor), economic unions (harmonized economic policies), and full political unions (shared governance).

The objectives include boosting trade and investment, reducing costs, increasing market access, and fostering political and economic stability. Advantages encompass economic growth, enhanced competitiveness, and greater political cohesion among member states. However, disadvantages include loss of national sovereignty, the potential for economic disparities among regions, and the risk of trade diversion from more efficient global producers to less efficient regional ones.

Check your progress

1. **What is regional economic integration?**

A. The process of isolating economies within a region

B. The process of reducing trade barriers and increasing economic cooperation among countries within a region

C. The process of creating economic barriers between regions

D. The establishment of global trade organizations

2. Which of the following is the first and most basic level of regional economic integration?

A. Economic union

B. Free trade area

C. Common market

D. Customs union

3. Which level of regional economic integration allows for the free movement of goods, services, capital, and labor?

A. Free trade area

B. Customs union

C. Common market

D. Economic union

4. The European Union is an example of which level of regional economic integration?

A. Free trade area

B. Customs union

C. Common market

D. Economic union

5. The North American Free Trade Agreement (NAFTA), now replaced by the USMCA, is an example of:

A. Free trade area
B. Customs union
C. Common market
D. Economic union

SECTION 5.3: REGIONALISM VS. MULTILATERALISM

5.3.1 REGIONALISM - MEANING

Regionalism, often viewed as an attempt to optimize the interest of a region's population through the manipulation of the political process, can be traced back to second half of the nineteenth century, when England and France signed the Cobden Chevalier Treaty. Research states that regionalism has occurred in several different phases. However, in the beginning, the regional agreements were conceived more as strategic or political alliances than trade liberalisation. Economic regionalism, institutional arrangements designed to facilitate the free flow of goods and services and to coordinate foreign economic policies between countries in the same geographic region, can be viewed as a conscious attempt to manage the opportunities and constraints created by the dramatic increase in international economic ties since the end of World War II. Examples of economic regionalism include free-trade areas, customs unions, common markets, and economic unions.

5.3.2 Reasons for Growth of Regionalism

Geographical Unity: Neighbouring countries are geographically co-located and share a number of resources such as rivers, oceans, mountains, etc. This co-location requires cooperation and coordination to avoid unnecessary strains, and thus has led to growth to regionalism.

Cultural Ties: Countries in neighbourhood often have a history of shared cultural ties, with exchange of people and customs. These cultural ties, when acknowledged in the modern times, have often led to regional alliances.

Economic Needs: Prosperous neighbourhood is of utmost importance for prosperity of a country, as it is difficult to be an oasis of prosperity in a desert of penury and laggardness. Realisation of such interconnectedness has spurred regionalism.

Security: Security of the region was the prime reason which brought Britain and France into first regional alliance in the second half of the nineteenth century. Since then, the security of the region, interdependent on security of neighbour(s), against common foe has fostered many regional treaties, promoting the growth of regionalism.

Failure of Multilateralism: The Multilateralism that grew in the aftermath of the second world war failed to address the grievances of the members. Moreover, the United Nations, one of the major multilateral organisations, has failed the issue of inequity among members and address the concerns of the developing and least developed countries. It is evident in its failure to honour the demands of reform of UNSC membership, to suit the present global geo-political standings.

Ideological Affinity: Post-French revolution Europe saw a spurt in regional (monarchical) alliances to prevent the spread of republican form of government. Regionalism has prospered due to ideological affinity between countries and their policies. Example: The North Atlantic Treaty Organisation (NATO) and the Warsaw Pact (both had elements of regionalism).

5.3.3 Multilateralism - Meaning

Multilateralism is the process of organizing relations between groups of three or more states on the principles of indivisibility of interests among participants, a commitment to diffuse reciprocity, and a system of dispute settlement intended to enforce a particular mode of behaviour.

The term Multilateralism can be defined as interaction between States in regular pattern guided by generalized principles of conduct – i.e., principles which specify appropriate conduct for a class of actions, without regard to the particularistic interests of the parties or the strategic exigencies at the time. It also denotes consultation and cooperation between states over shared aims without resorting to coercion, bribery and

blackmail. In such a system, States do not take unilateral action or exert bilateral pressure.

5.3.4 Reasons for Growth of Multilateralism

Political: After the sanguinary second war, a realization dawned on the global leaders to work out the mechanism for a multilateral forum, where all the countries could together resolve their issues, find a peaceful resolution to their grievances and also workout the modalities of future growth. Thus, was laid the foundation of the first multilateral organization, i.e. United Nations.

Globalized Economy: In an interdependent and globalized economy where resources from one country are being processed and sold in others. Multilateral forums become a necessity to overcome differences and plan a common uniform strategy. Example: World Trade Organization (WTO).

Security: Terrorism and its gory menace is lurking as a threat to the human race and has already caused significant damages-physically and economically. Thus, multilateral forums, where a coordinated strategy to deal with terrorism can be evolved have been gaining currency. Example: India's demand for Comprehensive Convention on International Terrorism (CCIT) under the aegis of the UN.

Enhanced Cooperation and Coordination: Coordination and cooperation among different international forums like the United Nations, the World Bank, the IMF and the WTO is a must for sustainable and equitable development, and universal access to the benefits of people globally.

Sustainable Development: Despite several efforts to reduce poverty and ensure sustainable development, overall development has not been at the desired level across the globe. Multilateral forums, thus, are being used to achieve sustainable development.

Disadvantages of Bilateralism: Difficulties in negotiations in bilateral treaties due to geopolitical reasons have furthered the cause of multilateral forums.

Let's sum up:

In this section we have seen that Economic regionalism, institutional arrangements designed to facilitate the free flow of goods and services and to coordinate foreign economic policies between countries in the same geographic region,

can be viewed as a conscious attempt to manage the opportunities and constraints created by the dramatic increase in international economic ties since the end of World War II. Examples of economic regionalism include free-trade areas, customs unions, common markets, and economic unions. Multilateralism is the process of organizing relations between groups of three or more states on the principles of indivisibility of interests among participants, a commitment to diffuse reciprocity, and a system of dispute settlement intended to enforce a particular mode of behaviour.

Check your progress

1. What is regionalism in the context of international trade?

A. The focus on global trade agreements involving all countries

B. The formation of trade agreements between countries within a specific geographic region

C. The isolation of a country from international trade

D. The establishment of unilateral trade policies

2. What is multilateralism?

A. Trade agreements involving two countries

B. Trade agreements involving multiple countries, often globally

C. Trade policies set by individual countries

D. Economic integration within a single region

3. Which of the following is an example of a multilateral trade agreement?**

A. North American Free Trade Agreement (NAFTA)

B. European Union (EU)

C. World Trade Organization (WTO) agreements

D. Association of Southeast Asian Nations (ASEAN)

4. Which of the following is a potential benefit of regionalism?

A. It creates global trade standards.

B. It fosters economic integration and cooperation within a region.

C. It eliminates all trade barriers worldwide.

D. It prioritizes national policies over regional cooperation.

5. A regional trade agreement that eliminates tariffs and allows for the free movement of goods and services within a region is an example of:

A. Multilateralism
B. Unilateralism
C. Regionalism
D. Protectionism

SECTION 5.4: IMPORTANT REGIONAL ECONOMIC GROUPINGS IN THE WORLD

In 1992, May-June, Norman S. Fieleke in his study on “one Trading World or Many: The Issue of Regional Trading Blocs”: New England Economic Review, listed 23 such arrangements in 119 countries accounting for about 82 per cent of global trade in commodities. In an address (GATT Press Communique No. GATT/1596 of 16th September 1993) at a Seminar organised by the EC/Rio Group on Regional Integration (CEFIR), Mr. Peter Sutherland, the Director General of GATT mentioned that there were, in all, 85 regional arrangements in the world, of which 28 had been notified to GATT since 1992. According to WTO, the numbers of regional trade agreements notified to the Organisation at the end of the year 2003 was 193. These arrangements include Economic Communities, Common Markets, Customs Unions, Free Trade Areas and Trade Preference Associations. Countries which are not members of such arrangements seek to link themselves to regional groupings in some way or the other. The following table shows some of the better-known groupings that are in operation today.

	Name of the Arrangement Member Countries	Name of the Arrangement Member Countries
AFTA	ASEAN free Trade Area	Brunei Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam
ASEAN	Association of South East Asian Nations	Brunei Darussalam, Cambodia, Indonesia Laos Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam
BAFTA	Baltic Free-Trade Area	Estonia Latvia Lithuania
BANGKOK	Bangkok Agreement	Bangladesh, China, India, Republic of Korea Laos, Sri Lanka
CAN	Andean Community	Bolivia Colombai Ecuador Peru Venezuela
CARICOM	Caribbean Community and Common Market	Antigua and Barbuda Bahamas Barbados Belize Dominica Grenada Guyana Haiti Jamaica Montserrat Trinidad and Tobago St. Kitts and Nevis St Lucia St. Vincet and the Grenadines Surinam
CACM	Central American Common Market	Costa Rica EI Salvador, Guatemala Nicaragua
CEFTA	Central European Free Trade Agreement	Bulgaria, Croatia, Romania
CEMAC	Economic and Monetary Community of Central Africa	Cameroon central African Republic Chad Congo Equatorial

		Guinea Gabon
CER	Closer Trade Relations Trade Agreement	Australia New Zealand
CIS	Commonwealth of Independent States	Azerbaijan, Armenia, Belarus, Georgia Moldova Kazakhstan, Russian Federation Ukraine, Uzbekistan, Tajikistan, Kyrgyz Republic
COMESA	Common Market for Eastern and Southern Africa	Angola, Burundi, Comoros Democratic Republic of Congo, Djibouti, Egypt, Eritrea Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles Sudan, Swaziland, Uganda, Zambia Zimbabwe
EAC	East African Cooperation	Kenya, Tanzania, Uganda
EAEC	Eurasian Economic Community	Belarus, Kazakhstan, Kyrgyz Republic Russian Federation, Tajikistan
EU	EU European	Union Austria Belgium Cyprus Czech Republic Denmark Estonia Finland France Germany Greece Hungary Ireland Italy Latvia Lithuania Luxembourg Malta Netherlands Poland Portugal Slovak Republic Slovenia Spain Sweden United Kingdom
ECO	Economic Cooperation Organization	Afghanistan, Azerbaijan, Iran, Kazakhstan, Kyrgyz Republic

		Pakistan Tajikistan Turkey, Turkmenistan, Uzbekistan
EEA	European Economic Area	EC Iceland Liechtenstein Norway
EFTA	EFTA European Free Trade Association	Iceland, Liechtenstein, Norway Switzerland
GCC	Gulf Cooperation Council	Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, United Arab Emirates
GSTP	General System of Trade Preferences among Developing countries	Algeria, Argentina, Bangladesh, Benin, Bolivia, Brazil, Cameroon, Chile, Colombia, Cuba, Democratic People's Republic of Korea, Ecuador, Egypt, Ghana, Guinea Guyana India, Indonesia, Islamic Republic of Iran, Iraq, Libya, Malaysia, Mexico, Morocco, Mozambique, Myanmar Nicaragua, Nigeria, Pakistan, Peru Philippines, Republic of Korea, Romania, Singapore, Sri Lanka, Sudan, Thailand, Trinidad and Tobago Tunisia United Republic of Tanzania, Venezuela, Vietnam, Yugoslavia, Zimbabwe
LAIA	Latin American Integration Association	Argentina, Bolivia, Brazil, Chile, Colombia, Cuba, Ecuador, Mexico, Paraguay, Peru, Uruguay, Venezuela
MERCOSUR	Southern Common Market	Argentina, Brazil, Paraguay,

		Uruguay
MSG	Melanesian Spearhead Group	Fiji, Papua New Guinea, Solomon Islands, Vanuatu
NAFTA	North American Free Trade Agreement	Canada, Mexico, United States
OCT	Overseas Countries and Territories	Greenland, New Caledonia, French Polynesia, French Southern and Antarctic Territories Wallis and Futuna Islands Mayotte Saint Pierre and Miquelon Aruba Netherlands Antilles Anguilla Cayman 'stands Falkland Islands, South Georgia and South Sandwich Islands Montserrat Pitcairn saint Helena's Ascension Island Tristan da Cunha Turks and Caicos Islands British Antarctic Territory British India Ocean Territory British Virgin Islands
PATCRA	Agreement on Trade and Commercial Relations between the Government of Australia and the Government of Papua New Guinea	Australia, Papua New Guinea
PTN	Protocol relating to Trade Negotiations	Bangladesh, Brazil, Chile, Egypt, Israel, Mexico, Pakistan, Paraguay, Peru, Philippines, Republic of Korea, Romania, Tunisia, Turkey, Uruguay Yugoslavia

SADC	Southern African Development Community	Angola, Botswana, Lesotho, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Zambia, Zimbabwe
SAPTA	South Asian Preferential Trade Arrangement	Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka
SPARTECA	South Pacific Regional Trade and Economic Cooperation Agreement	Australia, New Zealand, Cook Islands, Fiji, Kiribati, Marshall Islands, Micronesia, Nauru, Niue, Papua New Guinea, Solomon Islands, Tonga, Tuvalu, Vanuatu, Western Samoa
UEMOA	West African Economic and Monetary Union	Benin, Burkina, Faso, Ivory coast, Guinea Bissau, Mali, Niger, Senegal and Togo

Let's sum up:

In this section we have seen the various important regional economic groupings in the world.

Check your progress

1. Which regional economic grouping consists of 27 European countries and aims to ensure free movement of people, goods, services, and capital?

A. ASEAN

B. NAFTA

C. EU

D. MERCOSUR

2. The North American Free Trade Agreement (NAFTA), now replaced by the USMCA, includes which countries?

A. USA, Canada, Mexico
B. USA, Brazil, Argentina
C. USA, Canada, United Kingdom
D. USA, Mexico, Colombia

3. Which regional economic grouping is known for its goal of economic integration among countries in Southeast Asia?

A. CARICOM
B. GCC
C. ASEAN
D. SAARC

4. The Southern Common Market, known as MERCOSUR, primarily includes countries from which region?

A. North America
B. Europe
C. Southeast Asia
D. South America

5. Which regional economic grouping includes countries like Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the UAE?

A. SAARC
B. GCC
C. EU
D. NAFTA

SECTION 5.5: CONTEMPORARY ISSUES IN INTERNATIONAL BUSINESS

Contemporary issues in international business are complex and multifaceted, reflecting the dynamic and interconnected nature of the global economy. These issues encompass a wide range of topics, including trade policies, globalization, technological advancements, cultural differences, environmental concerns, and geopolitical tensions. Here's a detailed look at some of the most significant contemporary issues in international business:

1. Global Trade Policies and Protectionism

Trade Wars: Increasing protectionist policies, such as tariffs and trade barriers, have led to trade wars, most notably between the United States and China. These conflicts disrupt global supply chains and create uncertainty for businesses.

Regional Trade Agreements: The rise of regional trade agreements like the USMCA (United States-Mexico-Canada Agreement) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) shape the landscape of international trade.

Brexit: The United Kingdom's exit from the European Union has significant implications for trade policies, regulatory frameworks, and economic relationships within Europe and beyond.

2. Technological Advancements

Digital Transformation: The adoption of digital technologies, including artificial intelligence, blockchain, and the Internet of Things (IoT), is revolutionizing business operations, supply chain management, and customer engagement.

E-commerce: The growth of e-commerce platforms has enabled businesses to reach global markets more efficiently, but it also brings challenges such as cybersecurity threats and the need for robust logistics and delivery systems.

Data Privacy and Security: With the increasing importance of data in business, issues related to data privacy and security, such as compliance with GDPR (General Data Protection Regulation) and other data protection laws, are critical.

3. Sustainability and Environmental Issues

Climate Change: Businesses are increasingly pressured to adopt sustainable practices to mitigate their environmental impact. This includes reducing carbon footprints, utilizing renewable energy, and promoting circular economy principles.

Corporate Social Responsibility (CSR): Companies are expected to engage in CSR activities that contribute to social and environmental well-being, which can enhance their reputation and stakeholder relationships.

Sustainable Supply Chains: Ensuring that supply chains are sustainable and ethically sourced is becoming a priority for international businesses, requiring transparency and accountability at all levels.

4. Cultural and Ethical Challenges

Cross-Cultural Management: Navigating cultural differences in international business operations is crucial. Effective cross-cultural communication and management can enhance collaboration and prevent misunderstandings.

Ethical Standards: Varying ethical standards and practices across countries can pose challenges. Businesses must navigate issues such as corruption, labor rights, and fair trade practices to maintain ethical integrity.

Corporate Governance: Ensuring robust corporate governance practices that comply with international standards and local regulations is essential for building trust and credibility.

5**. Geopolitical Risks**

Political Instability: Businesses operating in politically unstable regions face risks such as expropriation, civil unrest, and changes in regulatory environments, which can impact operations and profitability.

Economic Sanctions: Sanctions imposed by countries or international organizations can restrict business activities and create barriers to market entry or expansion.

Global Security: Issues such as terrorism and cyber-attacks pose significant risks to international business operations, necessitating robust risk management and contingency planning.

6. Globalization and Localization

Global vs. Local Strategies: Balancing global standardization with local adaptation is a key challenge. Businesses need to develop strategies that leverage global efficiencies while meeting local market needs and preferences.

Emerging Markets: Expanding into emerging markets presents opportunities for growth but also challenges related to understanding local business environments, regulatory frameworks, and consumer behavior.

Talent Management: Attracting and retaining global talent requires strategies that address diverse cultural expectations, compensation practices, and career development opportunities.

7. Financial and Economic Issues

Currency Fluctuations: Exchange rate volatility can impact profitability and pricing strategies. Businesses need to employ hedging strategies to manage currency risks.

Access to Capital: Differences in access to capital and financial markets across countries can influence international business expansion and investment decisions.

Economic Disparities: Addressing economic disparities and ensuring inclusive growth is important for maintaining social stability and fostering a positive business environment.

8. Innovation and Competitiveness

Research and Development (R&D): Investing in R&D is critical for maintaining competitive advantage and driving innovation in international markets.

Intellectual Property (IP): Protecting IP rights is essential for safeguarding innovations, but it can be challenging due to varying enforcement standards across countries.

Competitive Strategies: Developing competitive strategies that leverage technological advancements, cost efficiencies, and unique value propositions is crucial for success in the global marketplace.

Let's sum up:

In this section we have seen the contemporary issues in international business require companies to be agile, adaptable, and forward-thinking. By understanding and addressing these challenges, businesses can navigate the complexities of the global economy and seize opportunities for growth and innovation.

Check your progress

1. Which of the following is a key contemporary issue in international business?

A. Reduction of tariffs globally

B. Management of global supply chain disruptions

C. Elimination of all trade agreements

D. Decline in international trade

2. What is the impact of trade wars on international business?

A. They generally promote free trade

B. They can lead to increased tariffs and trade barriers

C. They encourage global economic cooperation

D. They have no significant impact

3. What is a major concern for international businesses regarding environmental sustainability?

A. Decreasing consumer demand for green products

B. Increasing regulatory requirements and compliance costs

C. Decreased importance of corporate social responsibility (CSR)

D. Limited focus on renewable energy sources

4. How has the COVID-19 pandemic influenced international business practices?

A. It has had no impact on business practices

B. It has reduced the need for digital transformation

C. It has accelerated the adoption of remote work and digital tools

D. It has decreased e-commerce activity globally

5. Which factor is critical for international businesses to consider in their strategy to combat climate change?

A. Ignoring carbon emissions

B. Limiting collaboration with environmental organizations

C. Reducing focus on environmental policies

D. Investing in sustainable practices and renewable energy sources

SECTION 5.6: INSTITUTIONAL SUPPORT TO INTERNATIONAL BUSINESS-LIKE BREXIT, IMF, WORLD BANK, ILO AND WTO

5.6.1 BREXIT

Brexit refers to the United Kingdom's (UK) decision to leave the European Union (EU), a political and economic union of 27 European countries. The term is a portmanteau of "Britain" and "exit." Here’s a detailed look at Brexit, its background, process, impacts, and contemporary issues related to it.

Background and Reasons for Brexit

Historical Context: The UK joined the European Economic Community (EEC), the precursor to the EU, in 1973. Over the years, there has been ongoing debate within the UK about the benefits and drawbacks of EU membership.

Key Reasons for Brexit:

- Sovereignty: Concerns about loss of national sovereignty to EU institutions.
- Immigration: Issues related to the free movement of people within the EU and the impact on public services and jobs.
- Economic Independence: Desire to create independent trade policies outside the EU framework.
- Regulation: Frustration with EU regulations perceived as burdensome.

The Brexit Process

1. Referendum:

On June 23, 2016, the UK held a referendum where 51.9% of voters chose to leave the EU.

2. Article 50:

On March 29, 2017, the UK triggered Article 50 of the Treaty on European Union, starting a two-year countdown to Brexit.

3. Negotiations:

The UK and the EU engaged in complex negotiations to settle terms of the exit, including issues like the financial settlement, citizens' rights, and the Irish border.

4. Withdrawal Agreement:

A Withdrawal Agreement was finally reached, setting out the terms of the UK's departure. It included provisions for a transition period lasting until December 31, 2020.

5. Transition Period:

During this time, the UK remained in the EU single market and customs union while negotiating a future trade relationship.

6. Trade and Cooperation Agreement (TCA):

On December 24, 2020, the UK and the EU reached the Trade and Cooperation Agreement, which came into effect on January 1, 2021, setting the terms for future trade and cooperation.

Impacts of Brexit

1**. Economic Impact:**

Trade: New trade barriers and customs checks have impacted the flow of goods between the UK and the EU. Investment: Uncertainty surrounding Brexit initially led to reduced business investment. Currency: The British pound experienced significant volatility.

2. Political Impact:

UK Politics: Brexit has deeply influenced UK politics, leading to changes in party leadership and political priorities. Devolution: It has raised questions about the future of the UK's constitutional arrangement, particularly regarding Scotland and Northern Ireland.

3. Social Impact:

Immigration: Changes to immigration policies have affected the labor market and sectors reliant on EU workers. Citizens' Rights: Issues related to the rights of UK citizens in the EU and EU citizens in the UK.

4. Regulatory Impact:

Divergence: The UK now has the ability to diverge from EU regulations, affecting industries like finance, pharmaceuticals, and agriculture. Compliance: Businesses must navigate a more complex regulatory landscape to trade with the EU.

BREXIT in international business

Brexit, the UK's exit from the EU, has had profound and multifaceted effects on international business. The impacts extend across trade, regulatory compliance, supply chains, labor markets, financial services, and overall economic performance. Here is a detailed analysis of these impacts: Trade Barriers and Tariffs: Customs Checks and Tariffs: Post-Brexit, businesses face new customs checks and tariffs when trading between the UK and the EU. These have increased costs, complexity, and delays in the supply chain. Non-Tariff Barriers: These include increased paperwork, compliance with different regulatory standards, and customs declarations, all adding to the operational burdens for companies engaged in cross-border trade.

5.6.2 IMF – International Monetary Fund

The International Monetary Fund (IMF) is an international organization that was created on July 22, 1944 at the Bretton Woods Conference and came into existence on December 27, 1945 when 29 countries signed the Articles of Agreement. It originally had 45 members. The IMF's stated goal was to stabilize exchange rates and assist the reconstruction of the world’s international payment system post-World War II. Countries contribute money to a pool through a quota system from which countries with payment imbalances can borrow funds temporarily. Through this activity and others such as surveillance of its members' economies and policies, the IMF works to improve the economies of its member countries. The IMF describes itself as “an organization of 188 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world. The organization's stated objectives are to promote international economic cooperation, international trade, employment, and exchange rate stability, including by making financial resources available to member countries to meet balance of payments needs. Its headquarters are in Washington, D.C., United States.

Objectives of IMF

IMF was developed as an initiative to promote international monetary cooperation, enable international trade, achieve financial stability, stimulate high employment, diminish poverty in the world, and sustain economic growth. Initially, there were 29

countries with a goal of redoing the global payment system. Today, the organization has 189 members. The main objectives of the International Monetary Fund (IMF) are mentioned below:

- To improve and promote global monetary cooperation of the world.
- To secure financial stability by eliminating or minimizing the exchange rate stability.
- To facilitate a balanced international trade.
- To promote high employment through economic assistance and sustainable economic growth.
- To reduce poverty around the world.

Functions

The International Monetary Fund (IMF) plays a critical role in the global economy and international business. The IMF aims to promote international monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world. Here are the key functions of the IMF in international business:

1. Surveillance and Monitoring

Economic Surveillance: The IMF monitors the global economy and individual member countries' economic and financial developments. This includes analyzing macroeconomic policies, economic trends, and potential risks.

Policy Advice: Based on its surveillance, the IMF provides policy advice to member countries to help them achieve economic stability and growth. This advice can influence national economic policies, including fiscal, monetary, and exchange rate policies.

2. Financial Assistance

Lending Programs: The IMF provides financial assistance to member countries facing balance of payments problems or financial crises. This support helps countries stabilize their economies and restore growth. Common programs include Stand-By Arrangements (SBAs) and Extended Fund Facility (EFF).

Emergency Assistance: In times of urgent financial crises, the IMF can provide emergency assistance through mechanisms like the Rapid Financing Instrument (RFI) and the Rapid Credit Facility (RCF).

3. Capacity Development

Technical Assistance: The IMF offers technical assistance to member countries in areas such as fiscal policy, monetary policy, exchange rate policy, financial sector supervision, and statistics. This helps countries build the capacity to design and implement effective policies.

Training Programs: The IMF conducts training programs for government and central bank officials to enhance their skills in economic management and policy implementation.

4. Research and Analysis

Economic Research: The IMF conducts research on a wide range of economic and financial issues, including global economic outlook, financial stability, fiscal policy, and economic development. This research informs IMF policy advice and lending decisions.

Publications: The IMF publishes a variety of reports and papers, such as the World Economic Outlook (WEO), Global Financial Stability Report (GFSR), and Fiscal Monitor, which provide valuable insights and analyses on global economic trends and policy issues.

5. Global Financial Stability

Crisis Prevention and Management: The IMF works to prevent financial crises by providing early warnings of potential vulnerabilities and offering policy advice to address them. In the event of a crisis, the IMF helps manage and resolve it through financial assistance and policy support.

Financial Sector Surveillance: The IMF assesses the health and stability of the global financial system, including financial institutions and markets. This involves evaluating risks and vulnerabilities that could impact international financial stability.

6. Promoting International Trade and Investment

Trade Policies: The IMF promotes open and fair international trade by advising member countries on trade policy reforms and helping them integrate into the global economy.

Investment Climate: The IMF supports member countries in creating a conducive environment for foreign direct investment (FDI) by advising on economic policies and structural reforms that enhance economic stability and growth.

7. Supporting Poverty Reduction and Economic Development

Poverty Reduction and Growth Trust (PRGT): The IMF provides concessional financial assistance to low-income countries through the PRGT, helping them achieve macroeconomic stability, reduce poverty, and promote sustainable economic growth.

Debt Relief Initiatives: The IMF participates in international debt relief initiatives, such as the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI), to help reduce the debt burden of eligible low-income countries.

8. Policy Coordination

International Cooperation: The IMF fosters international cooperation by providing a platform for dialogue and policy coordination among its member countries. This includes working with other international organizations, such as the World Bank, World Trade Organization (WTO), and regional development banks.

5.6.3 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

Another 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.

Institutions under World bank

The World bank group has five institutions under its control. Each of them performs specific functions. All these groups collectively form this international organization.

- **International Bank for Reconstruction & Development (IBRD)**

  Created in 1944 aims at overseeing the reconstruction and development of devastated countries. It provides financial aid through loans to nations destroyed during the Second World War.

- **International Development Association (IDA)**

  Existing in 1960, it aims at providing funds to under-developed (poor) countries with high debt issues. Here, the loans come with no or zero interest charges. Also, the payback period can last up to 38 years.

- **International Finance Corporation (IFC)**

  Founded in 1956, it intends to provide capital to private companies in developing nations. It can be either equity or bonds.

- **Multilateral Investment Guarantee Agency (MIGA)**

  Established in 1988, MIGA aims to provide insurance against rising political risks in developing nations.

- **International Centre for Settlement of Investment Disputes (ICSID)**

  It came into existence in 1966. This body provides a platform to solve disputes within the member nations. The first case got registered in 1972.

Functions of the World Bank

- It helps the war-devasted countries by granting them loans for reconstruction.
- Thus, they provide extensive experience and the financial resources of the bank help the poor countries increase their economic growth, reducing poverty and a better standard of living.
- Also, it helps the underdeveloped countries by granting development loans.
- So, it also provides loans to various governments for irrigation, agriculture, water supply, health, education, etc.
- It promotes foreign investments to other organizations by guaranteeing the loans.
- Also, the world bank provides economic, monetary, and technical advice to the member countries for any of their projects.

- Thus, it encourages the development of of-industries in underdeveloped countries by introducing the various economic reforms.

5.6.4 INTERNATIONAL LABOUR ORGANISATION (ILO)

The International Labour Organisation (ILO) was founded in 1919. After the Second World War, the ILO became the first United Nations specialised agency. ILO bodies consist of representatives of governments, employers and workers from the 186 member states. This structure allows the bodies to be a unique, worldwide, tripartite forum for discussion of key social and labour issues.

ILO mission and objectives

The organisation's main aims are to promote rights at work, encourage decent employment opportunities, enhance social protection and strengthen dialogue on work-related issues. These aims are described in detail in the ILO's four strategic objectives:

1. Promote and realise standards and fundamental principles and rights at work;
2. Create greater opportunities for women and men to decent employment and income;
3. Enhance the coverage and effectiveness of social protection for all;
4. Strengthen tripartism and social dialogue.

These aims and objectives are implemented through:

1. Formulation of international policies and programmes to promote basic human rights, improve working and living conditions, and enhance employment opportunities;
2. Creation of international labour standards backed by a unique system to supervise their application;
3. An extensive programme of international technical cooperation formulated and implemented in an active partnership with constituents, to help countries put these policies into practice in an effective manner;
4. Training, education and research activities to help advance all of these efforts.

Functions of International Labour Organization (ILO)

The ILO plays an important role in the formulation of policies which are focused on solving labour issues. The ILO also has other functions, such as:

- It adopts international labour standards. They are adopted in the form of conventions. It also controls the implementation of its conventions.
- It aids the member states in resolving their social and labour problems.
- It advocates and works for the protection of Human rights.
- It is responsible for the research and publication of information regarding social and labour issues.
- The Trade Unions play a pivotal role in developing policies at the ILO, thus the Bureau for Workers' Activities at the secretariat is dedicated to strengthening independent and democratic trade unions so they can better defend workers' rights and interests.
- The ILO also assumes a supervisory role: it monitors the implementation of ILO conventions ratified by member states.
    - The implementation is done through the Committee of Experts, the International Labour Conference's Tripartite Committee and the member-states.
    - Member states are obligated to send reports on the development of the implementation of the conventions they have approved.
- **Registration of complaints:** The ILO registers complaints against entities that are violating international rules.
    - The ILO, however, does not impose any sanctions on the governments.
    - Complaints can also be filed against member states for not complying with ILO conventions that have been ratified.
- **International Labour Standards:** The ILO is also responsible for setting International Labour Standards. The international labour conventions which are set by the ILO are ratified by the member states. These are mostly non-binding in nature.
    - But once a member state accepts conventions, it becomes legally binding. The conventions are often used to bring national laws in alignment with international standards.

- **ILO Global Commission on the Future of Work:** The formation of an ILO Global Commission on the Future of Work marks the second stage in the ILO Future of Work Initiative.
    - The Commission outlines a vision for a human-centred agenda that is based on investing in people's capabilities, institutions of work and decent and sustainable work.
    - It also describes the challenges caused by new technology, climate change and demography and appeals for a collective global response to the disturbances being caused in the world of work.

5.6.5 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.

Objectives of WTO

The six key objectives of the World Trade Organization have been discussed below.

1. **Establishing and Enforcing Rules for International Trade**

The international trading rules by the World Trade Organisation are established under three separate agreements – rules relating to the international trade in goods; the agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) and the General Agreement on Trade in Services (GATS).

The enforcement of rules by the WTO takes place by way of a multilateral system of disputes settlement in the instances of violation of trade rules by member countries. The members are obligated under ratified agreements to honor and abide by the procedures and judgments.

2. Acting as A Global Apex Forum

World Trade organization is the global forum for monitoring and negotiating further trade liberalization. The premise of trade liberalization measures undertaken by WTO is based on the benefits of member countries to optimally utilize the position of comparative advantage due to a free and fair trade regime.

3. Resolution of Trade Disputes

Trade disputes, before the WTO, usually arise out of deviation from agreements between member countries. The resolution of such trade disputes does not take place unilaterally but through a multilateral system involving set rules and procedures before the dispute settlement body.

4. Increasing Transparency in the Decision-Making Process

The World Trade Organisation attempts to increase transparency in the decision-making process by way of more participation in the decision-making and consensus rule, in particular. The combined effect of such measures helps to develop institutional transparency.

5. Collaboration between International Economic Institutions

The global economic institutions include the World Trade Organisation, the International Monetary Fund, the United Nations Conference on Trade and Development, and the World Bank.

With the advent of globalization, close cooperation has become necessary between multilateral institutions. These institutions are functional in the sector of formulation and implementation of a global economic policy framework. In the absence of regular consultation and mutual cooperation, policymaking may be disrupted.

6. Safeguarding the Trading Interest of Developing Countries

Stringent regulations are implemented by the WTO to protect the trading interests of developing countries. It supports such member countries to leverage the capacity for carrying out the mandates of the organization, managing disputes, and implementing relevant technical standards.

Features of WTO

The major features of the World Trade Organization are –

- The scope of WTO is far more expensive than the erstwhile General Agreement on Trade and Tariff. For instance, GATT solely focused on goods while excluding textiles and agriculture. On the other hand, WTO covers all goods, services, and investment policies along with intellectual property.
- WTO Secretariat has formalized and bolstered the mechanisms for the review of policies as well as the settlement of disputes. This aspect has become crucial due to the proliferation of member countries and more goods and services being covered by the WTO. Another important consideration in this regard is the substantial increase in open access to different international markets.
- There are rules implemented for the protection of small and weak countries against the discriminatory trade practices of developed countries.
- National Treatment articles and Most Favored Nation (MFN) clause permits equal access to markets for just treatment of both domestic and foreign suppliers.

- Each member country of the WTO carries a single voting right and all members enjoy privilege on the global scale.
- The WTO agreements encompass all the member states and act as a common forum of deliberation for the members.

Functions of WTO:

- 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.
- The WTO shall provide the forum for negotiations among its members concerning their multilateral trade relations in matters dealt with under the Agreements.
- The WTO shall administer the 'Understanding on Rules and Procedures Governing the Settlement of Disputes'.
- The WTO shall administer the 'Trade Review Mechanism'.
- 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:

- To supervise on a regular basis the operation of the revised agreements and ministerial declarations relating to: Goods, services, and TRIPs.
- To act as a Dispute Settlement Body
- To serve as a Trade Review Mechanism,
- 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.

Let's sum up:

Learners we have seen in this section that Brexit, the UK's exit from the EU, has had profound and multifaceted effects on international business. The impacts extend across trade, regulatory compliance, supply chains, labor markets, financial services, and overall economic performance. IMF plays a multifaceted role in international business by promoting global economic stability, providing financial assistance, offering technical expertise, conducting economic research, and fostering international cooperation. These functions help create a stable and predictable global economic environment, which is essential for international business operations and growth. 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.

Check your progress

1. What is the main purpose of the International Monetary Fund (IMF)?

A. To promote international monetary cooperation and exchange rate stability

B. To provide long-term development loans

C. To enforce trade regulations

D. To promote labor standards

2. What is the primary focus of the International Labour Organization (ILO)?

A. Trade liberalization

B. Monetary policy

C. Labor standards and rights

D. Development finance

3. Which organization was established to oversee international trade agreements and resolve trade disputes?

A. IMF

B. World Bank

C. ILO

D. WTO

4. What was one of the economic motivations behind Brexit?

A. To increase the UK's financial contributions to the EU

B. To regain sovereignty over trade policies and immigration controls

C. To adopt the Euro as its currency

D. To expand labor mobility within the EU

5. Which organization was created to help countries reconstruct and develop after World War II?

A. IMF

B. WTO

C. ILO

D. World Bank

5.7 Unit Summary

Dear Learners in this unit we have seen Regional economic groupings play a crucial role in the global economy by facilitating various levels of regional economic integration, ranging from free trade areas to customs unions, common markets, economic unions, and political unions. These groupings aim to enhance economic cooperation and reduce trade barriers among member countries. The debate between regionalism and multilateralism centers on whether economic integration should occur within specific regions or through global agreements. Key regional economic groupings include the European Union (EU), North American Free Trade Agreement (NAFTA), Association of Southeast Asian Nations (ASEAN), and Mercosur. Contemporary issues in international business, such as BREXIT, highlight the complexities of economic integration and disintegration. Institutional support from organizations like the International Monetary Fund (IMF), World Bank, International Labour Organization (ILO), and World Trade Organization (WTO) is vital for stabilizing the global economy, promoting development, and facilitating international trade. These institutions provide financial assistance, policy guidance, and frameworks for international cooperation, addressing challenges and opportunities in the dynamic landscape of global business.

5.8 Glossary

Term	Definition
Regional Economic Groupings	Associations of countries within a specific geographic region that come together to reduce trade barriers and enhance economic cooperation
Free Trade Area	Member countries remove tariffs and other trade barriers among themselves but maintain individual trade policies with non-members (e.g., NAFTA).
Customs Union	In addition to a free trade area, member countries adopt a common external tariff on imports from non-member countries (e.g., Mercosur).
Common Market	Extends a customs union by allowing free movement of labor and capital among member countries (e.g., the European Economic Area).
Economic Union	Combines a common market with harmonized economic policies, including a common currency (e.g., the Eurozone).
Regionalism	The process of countries in a specific region forming economic groupings or alliances to enhance economic cooperation and integration.
Multilateralism	The process of multiple countries from different regions collaborating on a global scale through international organizations and agreements to address common economic issues (e.g., WTO agreements).
BREXIT	The United Kingdom's withdrawal from the European Union
International Monetary Fund (IMF)	Provides financial assistance and policy advice to countries facing economic instability.
World Bank	Offers financial and technical assistance for development projects in developing countries

International Labour Organization (ILO)	Sets international labor standards and promotes social justice and decent work conditions.
World Trade Organization (WTO)	Regulates international trade by providing a framework for negotiating trade agreements and resolving disputes.

5.9 Self-Assessment Questions

Short Answers: (5 Marks)

1. Write a note on regional economic groupings
2. What are the Levels of Regional Economic Integration?
3. Describe the Objectives of Regional Economic Integration
4. Briefly explain the Effects of Regional Economic Integration
5. List out the Factors contributing to regional groupings
6. Mention the Advantages and Disadvantages of Regional Economic Integration
7. Write a brief note on Limitations of Regional Economic Integration
8. Write a short note on IMF
9. List out the objectives of world bank
10. What is the mission and objectives of ILO?

Long Answers: (8 Marks)

1. Explain the concept and reasons for the growth of Regionalism and multilateralism.
2. Discuss in detail about the Important Regional Economic Groupings in the World.
3. Contemporary Issues in International business.
4. Elaborate the Functions of IMF and world bank.
5. Explain in detail about the objectives, features and functions of WTO.

5.10 Case Study

Globalization in International Business (McDonald's)

Globalization refers to the increasing interconnectedness and interdependence of the world's markets and businesses. It involves the expansion of international trade, investment, information technology, and cross-border cooperation. This case study focuses on the impact of globalization on the international operations of McDonald's, one of the world's largest and most recognizable fast-food chains. McDonald's, founded in 1940 in the United States, has grown into a global brand with over 38,000 locations in more than 100 countries. The company's success is a testament to its ability to adapt to different cultural, economic, and regulatory environments worldwide.

Market Expansion: Entry into new international markets - Cultural Adaptation: Adjusting products and services to local tastes and preferences - Supply Chain Management: Establishing a global supply chain to ensure consistency and efficiency - Technology Integration: Leveraging technology for operational efficiency and customer engagement. Regulatory Compliance: Navigating varying regulatory landscapes across countries.

Impact on McDonald's

A. Market Expansion and Localization - Global Presence: McDonald's has successfully entered and established a presence in diverse markets across the globe, from urban centers in developed countries to remote areas in developing countries - Localized Menus: McDonald's adapts its menu to cater to local tastes and preferences. For example, in India, where a significant portion of the population is vegetarian, McDonald's offers a range of vegetarian options like the McAloo Tikki burger. In Japan, McDonald's serves Teriyaki burgers and the Ebi Filet-O (shrimp burger).

B. Supply Chain and Operational Efficiency

Global Supply Chain: McDonald's operates a highly efficient global supply chain to maintain product consistency and quality. It works with local suppliers to source fresh ingredients, which helps in reducing costs and supporting local economies.

Standardization and Flexibility: While McDonald's maintains strict quality standards globally, it also allows for flexibility to adapt to local sourcing practices and regulations.

C. Technology and Innovation

Digital Ordering and Delivery: McDonald's has embraced technology by implementing digital ordering kiosks, mobile apps, and partnering with delivery services like Uber Eats and DoorDash to enhance customer convenience.

Sustainability Initiatives: The company invests in sustainable practices, such as reducing plastic use, sourcing sustainable beef, and implementing energy-efficient practices in its restaurants worldwide.

D. Regulatory Compliance and Ethical Practices

Health Regulations: McDonald's adheres to varying health and safety regulations across different countries. It adjusts its operations to comply with local laws, such as calorie labeling requirements and food safety standards.

Corporate Social Responsibility (CSR): McDonald's engages in CSR activities, including charity work through the Ronald McDonald House Charities, promoting environmental sustainability, and supporting local communities.

Challenges and Considerations

A. Cultural Sensitivity

Cultural Differences: McDonald's must navigate and respect cultural differences, which can impact menu offerings, marketing strategies, and customer service practices.

Brand Perception: The company needs to balance its global brand identity with local adaptations to maintain a positive brand perception.

B. Economic and Political Factors

Economic Instability: Economic fluctuations in different regions can affect consumer spending and McDonald's profitability.

Political Risks: Changes in political environments, such as trade policies, taxation, and labor laws, can pose challenges to McDonald's operations.

C. Competition

Local Competitors: McDonald's faces stiff competition from local fast-food chains that may have a better understanding of the local market and consumer preferences.

Global Rivals: Other global fast-food giants like KFC, Subway, and Burger King also compete for market share.

Response Strategies

A. Strategic Partnerships

Local Partnerships: Collaborating with local businesses for sourcing, marketing, and distribution to enhance market presence and operational efficiency.

Franchising Model: Expanding through franchising allows McDonald's to leverage local expertise and resources.

B. Innovation and Customer Engagement

Product Innovation: Continuously innovating menu items to keep up with changing consumer preferences and dietary trends.

Customer Feedback: Utilizing customer feedback and data analytics to improve service quality and customer satisfaction.

C. Focus on Sustainability

Sustainable Practices: Implementing environmentally friendly practices across operations, such as waste reduction, energy efficiency, and sustainable sourcing.

Community Engagement: Actively engaging with local communities through social responsibility initiatives to build a positive brand image.

McDonald's exemplifies how globalization can enable businesses to expand and thrive in diverse international markets. By adapting to local cultures, maintaining a robust global supply chain, leveraging technology, and navigating regulatory environments, McDonald's has successfully become a global icon. However, the company must continuously innovate and address challenges to sustain its global presence and appeal.

Question

5. Analyze and summarize the given case study.

5.11 Answers for check your progress

Modules	S. No.	Answers
Module 1	**1.**	B. To promote free trade and economic cooperation among member countries
	2.	C. European Union (EU)
	3.	B. A single market with the free movement of goods, services, capital, and labor

	4.	B. Mercosur
	5.	C. Enhanced economic growth through reduced trade barriers
Module 2	**1.**	B. The process of reducing trade barriers and increasing economic cooperation among countries within a region
	2.	B. Free trade area
	3.	C. Common market
	4.	D. Economic union
	5.	A. Free trade area
Module 3	**1.**	B. The formation of trade agreements between countries within a specific geographic region
	2.	B. Trade agreements involving multiple countries, often globally
	3.	C. World Trade Organization (WTO) agreements
	4.	B. It fosters economic integration and cooperation within a region.
	5.	C. Regionalism
Module 4	**1.**	C. EU
	2.	A. USA, Canada, Mexico
	3.	C. ASEAN
	4.	D. South America
	5.	B. GCC
Module 5	**1.**	B. Management of global supply chain disruptions
	2.	B. They can lead to increased tariffs and trade barriers
	3.	B. Increasing regulatory requirements and compliance costs

	4.	C. It has accelerated the adoption of remote work and digital tools
	5.	D. Investing in sustainable practices and renewable energy sources
Module 6	**1.**	A. To promote international monetary cooperation and exchange rate stability
	2.	C. Labor standards and rights
	3.	D. WTO
	4.	B. To regain sovereignty over trade policies and immigration controls
	5.	D. World Bank

5.12 Suggested Readings

1. Richard E. Baldwin (2012), Regional Economic Integration in a Global Framework, Journal of Economic Integration, Cambridge University Press.

2. James Raymond Vreeland (2007), The International Monetary Fund: Politics of Conditional Lending, Review of International Organizations, Routledge.

5.13 Open Source E-Content Links

S.No.	Topic	E-Content Link
1.	Regional Economic Integration	https://www.youtube.com/watch?v=CQnvMXhgm-s
2.	World Bank	https://www.youtube.com/watch?v=I8QHzxQ2lwg

5.14 References

- "International Business: Text and Cases" by P. Subba Rao, Himalaya Publishing House.

- International Business Environment" by Francis Cherunilam, Himalaya Publishing House.
- Global Trade and International Business by M.L. Jhingan, Vrinda Publications
- International Economics by H.G. Mannur, Vikas Publishing House
- Globalisation and Development: India's Experience by Raj Kapila and Uma Kapila, Academic Foundation
- Investopedia
- International Business: Competing in the Global Marketplace" by Charles W.L. Hill, G. Tomas M. Hult, McGraw-Hill Education