International Business
SYLLABUS

International Business
Introduction; Significance; Nature and Recent Trends; Features of International Business Environment; Culture Dynamics in Assessing Global Markets; International Political Spectrum and Management Decisions

International Business Environment
Economic Classifications and Transformation Processes Affecting International Business; International Legal Environment; Emerging Markets & Strategic Implications; Technological and Demographic Environment

Co-operative Business in International Operations
Regulations & Barrier to Free Trade; International Commodity Agreements: GSP & GSTP; GATT; WTO: Principles, Structure, Major Agreements, Conference & Third World Stand; Economic Integrators: IMF, World Bank, Asian Development Bank, UNCTAD, UNIDO

India in the Global Setting
Foreign Trade in India; EXIM Policy; Composition of Trade; Government Influence on Foreign Trade: Export Promotion Measures

International Monetary System & Foreign Exchange Market
Introduction to International Monetary System & Foreign Exchange Market; Business Implications of Exchange Rate Movement; Foreign Exchange Management Act (FEMA); Internationalization of Stock Market.

Suggested Readings:
1. International Business: Text and Cases by Francis Cherunilam, Publisher: Prentice Hall of India Private Limited, New Delhi
4. International Business by Ball, Publisher: McGraw Hill
5. International Business by Joshi, Rakesh Mohan, Publisher: Oxford University Press
6. International Business by Paul Justin, Publisher: Prentice Hall of India
7. International Business by Shajahan, Publisher: Macmillan India
INTERNATIONAL BUSINESS

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1.1 INTRODUCTION

The beverages you drink might be produced in India, but with the collaboration of a USA company. The tea you drink is prepared from the tea powder produced in Sri Lanka. The spares and hard-disk of the computer you operate might have been produced in the United States of America.

The perfume you apply might have been produced in France. The television you watch might have been produced with the Japanese technology. The shoe you wear might have been produced in Taiwan, but remarkeeted by an Italian company. Air France and so on so forth might have provided your air-travel services to you.

Most of you have the experience of browsing Internet and visiting different web sites, knowing the products and services offered by various companies across the globe. Some of you might have the experience of 'even ordering and buying the products through Internet. This process
gives you the opportunity of transacting in the international business arena without visiting or knowing the various countries and companies across the globe.

You get all these even without visiting or knowing the country of the company where they are produced. All these activities have become a reality due to the operations and activities of international business.

Thus, international business is the process of focusing on the resources of the globe and objectives of the organizations on global business opportunities and threats. We can also say that International Business is all business transactions - private & governmental – that involve two or more countries. Private companies undertake such transactions for profit; governments may or may not do the same in their transactions. It involves performance of business activities designed to plan, price, promote and direct the flow of a company’s goods and services to consumers or users in more than one nation for a profit. This apparently minor difference “in more than one nation” accounts for the complexity and diversity found in international marketing operations although the concepts of marketing remain basically the same for both domestic & international business.

1.1.1 Evolution of International Business

The business across the borders of the countries had been carried on since times immemorial. But, the business had been limited to the international trade until the recent past. The post-World War II period witnessed an unexpected expansion of national companies into international or multinational companies. The post 1990s period has given greater fillip to international business.

In fact, the term international business was not in existence before two decades. The term international business has emerged from the term international marketing, which in turn, emerged from the term ‘export marketing’.

International Trade to International Marketing: Originally, the producers used to export their products to the nearby countries and gradually extended the exports to far-off countries. Gradually, the companies extended the operations beyond trade. For example, India used to export raw cotton, raw jute and iron ore during the early 1900s. The massive industrialization in the country enabled us to export jute products, cotton garments and steel during 1960s.

India, during 1980s could create markets for its products, in addition to mere exporting. The export marketing efforts include creation of demand for Indian products like textiles, electronics, leather products, tea, coffee etc., arranging for appropriate distribution channels, attractive package, product development, pricing etc. This process is true not only with India, but also with almost all developed and developing economies.

International Marketing to International Business: The multinational companies which were producing the products in their home countries and marketing them in various foreign countries before 1980s started locating their plants and other manufacturing facilities in foreign/host countries. Later, they started producing in one foreign country and marketing in other foreign countries. For example, Uni Lever established its subsidiary company in India, i.e., Hindustan
Lever Limited (HLL). HLL produces its products in India and markets them in Bangladesh, Sri Lanka, Nepal etc. Thus, the scope of the international trade is expanded into international marketing and international marketing is expanded into international business.

1.1.1 Why do the Business firms of a country go to other countywide?

The basic question of "why do the Business firms of a country go to other countywide?" might have been in your mind. The answer is to achieve Higher Rate of Profits. We have discussed in various courses/subjects like Principles and Practice of Management, Managerial Economics and Financial Management that the basic objective of the business firms is to earn profits. When the domestic markets do not promise a higher rate of profits, business firms search for foreign markets, which promise for higher rate of profits. For example, Hewlett Packard earned 85.4% of its profits from the foreign markets compared to that of domestic markets in 1994. Apple earned US $ 390 million as net profit from the foreign markets and only US $ 310 millions as net profit from its domestic market in 1994.

Some of the domestic companies expanded their production capacities more than the demand for the product in the domestic countries. These companies, in such cases, are forced to sell their excess production in foreign developed countries. Toyota of Japan is an example.

1.2 SIGNIFICANCE

What differentiates international business from domestic ones?

It is the environment within which the marketing plans have to be implemented. Each market is unique & so varieties of strategies have to be formulated for the wide range of unfamiliar problems encountered in foreign markets. Competition, legal restraints, government controls, weather, fickle consumers and a number of other factors can, and frequently do, affect the profitable outcome of good sound marketing plans.

What then makes Internationalization of Business challenging?

The task of molding the controllable elements of the marketing decisions (home country environment) within the frame work of uncontrollable elements of the marketplace (home & host country environments) in such a way that the marketing objectives are achieved. Home country environment controllable activities are Price; Promotion, Product, Channels of Distribution. Assuming the necessary overall corporate resources, the businessman blends the above stated controllable activities to capitalize on the anticipated demand. They can be altered in the long run and, usually, in the short run, to adjust to changing market conditions, consumer tastes, or corporate objectives.

Home Country Environment Uncontrollable Factors: The factors are Political / Legal Forces, Competitive Structures, Economic Climate etc. These factors include home country elements that have a direct effect on the success of a foreign venture and are immediate control of the marketer.

Political Decision: Political Decision involving domestic foreign policy can have a direct effect on a firm’s international business operations. For e.g. The U.S. Government placed a total ban on
trade with Libya to condemn Libyan support for terrorists’ attacks, imposed restrictions on trade with South Africa to protest apartheid, and placed a total ban on trade with Iraq, whose actions constituted a threat to the national security of the United States & its allies. In each case the international operations of United State’s companies whether it was IBM, Exxon were restricted by these political decisions. Conversely positive effects also occur when there are changes in the foreign policy and the countries are given favored treatment. Such were the cases when South Africa abolished apartheid and the embargo was lifted and when the U.S government decided to uncouple the Human Rights issue from Foreign Trade Policy and grant the most favored nation status [MFN] to China. In both the case, business opportunities were created for the U.S. companies.

**Domestic Economic Climate:** Domestic Economic Climate is another important home – based uncontrollable variable with far-reaching effects on a company’s competitive position in foreign markets. The capacity to invest in plants and facilities, either in domestic or foreign markets, is to a large extent a function of the domestic economic vitality. If economic conditions deteriorate, restrictions against foreign investment and purchasing may be imposed to strengthen the domestic economy.

**Domestic Competition:** Domestic Competition can also have a profound effect upon the international marketer’s task. Eastman Kodak dominated the U.S film market and could depend on achieving profit goals that provided capital to invest in foreign markets. Without having to worry about the company’s lucrative base, management had the time & resources to devise aggressive international marketing programs. However, the competitive structure changed when Fuji Photo Film became a formidable competitor by lowering film prices in the United States, opening a $ 300 million plant, and gaining 12 % of the U.S market. As a result, Kodak had a direct energy and the resources back to the United States. Competitive within their home country affects a company’s domestic as well as international plans. Inextricably entwined with the effects of the domestic environment are the constraints imposed by the environment of each foreign country.

**Foreign Country Environment Uncontrollable Factors:** Foreign Country Environment Uncontrollable Factors are Political / Legal forces, Economic forces, Competitive forces, Level of Technology, Structure of Distribution, Geography & Distribution, Cultural forces etc. A business operating in its home country undoubtedly feels comfortable in forecasting the business climate and adjusting the business decisions to these elements. The process of evaluating the uncontrollable elements in an international marketing program, however involves substantial doses of cultural, political and economic shock.

A business operating in a number of foreign countries might find polar extremes in political stability, class structure, and economic climate – critical elements in business decisions. Let us now discuss some illustrations of the nature of foreign uncontrollable factors.
The Level of Technology: The level of technology can often be misread because of the vast differences that may exist between the developed & undeveloped countries.

- Technical expertise may not be available at a level necessary for product support.
- The general population may not have an adequate level of technical knowledge to properly maintain equipment.

So, the marketer’s task will be –

- Locals have to be specially trained or the company will have to provide the technical support.
- Take steps to ensure that the importance of routine maintenance is understood and carried out.

Political & Legal Issues: Political & legal issues face a business whether operating at home or in a foreign country. However, the issues abroad are often amplified by the “alien status” of the company. There are two dimensions to the alien status of a foreign business: alien in the sense that foreigners control the business and, alien in that the culture of the host country is alien to the management. The alien status of the business means that, when viewed as an outsider, it can be seen as an exploiter and receive prejudiced or unfair treatment at the hands of the local authorities. Political activists can rally support by advocating the expulsion of the “foreign exploiters” often with the open or tacit approval of the authorities. In United States, there are established legal procedures and due process to each party in a dispute has access while legal systems in other countries may still be evolving. The point is that a foreign country is foreign and thus always subject to the political whims of the government to a greater degree than a domestic firm.
**Why do Companies engage in International Business?**

In operating internationally, a company should consider its mission (what the company will seek to do and become over the long run), its objectives [specific performance targets to fulfill its mission] and strategy (the means to fulfill its objectives). There are four major operating objectives that may influence companies to engage in international business. These are:

- To achieve more sales;
- To acquire resources;
- To diversify their sources of sales and supplies & minimize risk;
- To counter – attack foreign competition.

**Expand Sales:** Any company’s Sales are dependent on two factors: The Consumer’s interest in the product/services & Consumer’s willingness & ability to buy them. The number of people and the amount of their purchasing power are higher for the world as a whole than for a single country, so companies may increase their sales by defining certain markets in international terms. Many of the world’s largest companies derive over half of their sales from outside their home country. These companies include BASF [Germany], Electrolux [Sweden], Gillette [The United States], Nestle [Switzerland], Phillips [Netherlands] & Sony [Japan]. However, smaller companies may also depend on foreign sales. They make sales of components to larger companies, which in turn sell finished products abroad.

**Acquire Resources:** Manufacturers and distributors seek out products, services and components produced in foreign countries. They also look for foreign capital, technologies and information they can use at home. Sometimes they use this to reduce their costs. For example, Disney relies on cheap manufacturing bases in China & Taiwan to supply clothing to its souvenir outlets. The potential benefits of this practice are obvious:

- Either the profit margin may be increased; or
- The cost savings may be passed on to consumers, who will in turn buy more products thus producing more profits through greater sales volume.

For example, Disney buys from the U.K.’s Stafford Shire Tableware because the company has developed automated techniques for putting complicated patterns on mugs, which Disney sells in its outlets. The potential benefits of this practice are obvious:

- Enable a company to improve its product quality;
- Differentiate it from the competitors.

In either case market shares & subsequent profits are increased.

**Diversify Sources of Sales & Supplies:** To help avoid wild swings in sales and profits, companies may seek out foreign markets and sources of supplies. The potential benefits of this practice are obvious as follows:
• Take advantage of the fact that the timing of business cycles – recessions and expansions – differs among countries; that is, sales decrease in a country that is in a recession and increase in one that is expanding economically.
• In addition, by obtaining supplies of the same product or component from different countries, companies may be able to avoid the full impact of price swings or shortages in any one country.

What is there in the environment to facilitate international business?
The international business has been growing recently at a faster pace than it did in earlier years and also at a faster pace than the domestic business has been recently. For example, global merchandise exports grew faster than global production in eleven of the twelve years in the 1984-1995 periods. Further, the proportion of world output accounted for by foreign owned facilities has been growing substantially. The above trends can be attributed to the below stated inter-related environmental factors:

• Rapid expansion in technology.
• Liberalization of cross – border movements.
• Development of supporting institutional arrangements.
• Increase in global competition.

Expansion of technology: As recently as 1970, there was no commercial supersonic transatlantic travel, faxing, e – mailing, Internet, teleconferencing or overseas direct dial telephone service. Today, the situation is radically different. Communications and travel are almost instantaneous. Further, the cost of the improved communication and transportation has risen less fast than costs in general. With the tremendous impact on International Business, the demand for new & innovative goods & services has increased which in turn leads to increased international business transactions. However, international business does usually involve greater distances with increased operating costs. However improved communications and transportation speed up interactions and improve manager’s ability to control foreign operations.

Liberalization of Cross – Border Movements: Every country restricts the movement across its borders of goods and services and the resources, such as workers and capital. Generally, governments today impose fewer restrictions than they did a decade or two ago. With the enactment of the World Trade Organization in 1995, there has been optimism that restrictions will continue to diminish. The governments have been led to lower trade barriers as:

• Their citizens have expressed the desire for better access to a greater variety of goods and services at a lower price;
• They reason that their domestic producers will become more efficient as a result of foreign competition;
• They hope to induce other countries to reduce their barriers to international movements;
• Fewer restrictions enable companies to take better advantage of international opportunities.

Development of Supporting Institutional Arrangements: Although barter accounts for about 10% of the world trade, it is not common because it can be cumbersome, time consuming, risky
and expensive. Increasingly, business relies on the institutions that facilitate trade. Today, most producers can be paid relatively easily for goods & services sold abroad because of, for example bank credit arrangements, clearing arrangements that convert one country’s currency into another’s and insurance that covers damage en – route and nonpayment by the buyer.

**Increase in Global Competition:** The pressures of increased foreign competition can persuade a company to expand its business into international markets. Today international business programs can be conducted with relatively much ease due to:

- Development of technological, governmental & institutional environments as has been discussed above;
- Can quickly shift production among countries because of their experience in foreign sales and efficient transportation facilities thus taking advantage of the cost differences

**What are the push & pull factors of the environment acting on the Global firm?**

**Pull Factors (Proactive reasons):** These are those factors of attraction, which pull the business to the foreign markets. In other words, companies are motivated to internationalize because of the attractiveness of the foreign market. Such attractiveness includes, broadly, the relative profitability and growth prospects.

**Push Factors (Reactive reasons):** These are those factors of the market & environment, which prompt the companies to internationalize e.g. compulsions of the domestic market like market saturation.

**List of Push & Pull Factors:**

**Increased Profitability through Economies of Scale:** International Business may help to improve the bottom line of a firm. One of the important motivations for foreign investment is to reduce the cost of production (e.g. by taking advantage of the cheap labour). The whole manufacturing of a product may be carried out in foreign locations or only certain stages of it are done abroad. Almost 205 of the merchandise imported into the United States are manufactured by foreign branches of the American companies. Several American companies ship parts and components to overseas locations where the labour intensive assembly operations are carried out and then the product is brought back home.

**Growth Opportunities:** MNCs are getting increasingly interested in a number of developing countries as the income and population are rapidly rising in these countries. Of the estimated one billion people to be added to the world population between 1999 and 2014, only about three per cent will be in the high-income economies.

**Domestic Market Constraints:** When the market potential has almost been fully tapped, the market for a number of products tends to decline or saturate e.g. the stock of several consumer durables like cars; TV sets etc. exceed the total number of households. Demographic trends like fall in the birth rate imply contraction of market for several baby products.
The technological advances have increased the size of the optimum scale of operation substantially in many industries, as is the case when technologically advanced countries like South Korea sets up economic size plants.

Domestic market may be too small. Nestle manages to do only 2% of its total sales from Switzerland & similarly, Philips has a very small contribution in its sales figures from its home market in Holland.

**Competition:** The global economic liberalization has transformed the orientation of the market from that of the seller to that of the customer. This has led to increased competition from foreign firms as well as from those within the country. So now companies have to plan systematically to go international in a big way.

**Government Policies & Regulations:** Governments give a number of incentives and other positive support to domestic companies to export and to invest in foreign countries. In India, companies may be obliged to earn foreign exchange to finance their imports and to meet certain other foreign exchange requirements like payment of royalty, dividend, etc. Government guidelines like environmental laws can cause companies to move to different countries.

**Spin off benefits:** International business helps to improve the image of the company in its home market. There is a “white skin advantage” thus making it a means to gain more market share domestically. Exports may have pay-offs for the internal market too by giving the domestic market better products & services. Foreign exchange earnings may enable a company to import capital good, technology etc. that may not be otherwise possible in countries like India. Another attraction of exports is the economic incentives offered by the government.

**Strategic Vision:** The stimulus for internationalization comes from the urge to grow, the need to become more competitive, the need to diversify and to gain strategic advantages of internationalization. The prospects & problems of market selection, the modus operandi and the business strategies to be adopted in different markets, however, depend a lot on the international business environment.

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**1.3 NATURE AND RECENT TRENDS**

The 1990s and the new millennium clearly indicate rapid internationalization and globalization. The entire globe is passing at a dramatic pace through the transition period. Today, the international trader is in a position to analyze and interpret the global social, technical, economic, political and natural environmental factors more clearly.

Conducting and managing international business operations is a crucial venture due to variations in political, social, cultural and economic factors, from one country to another country. For example, most of the African consumers prefer less costly products due to their poor economic conditions whereas the German consumers prefer high quality and high priced products due to their higher ability to buy. Therefore, the international businessman should produce and export less costly products to most of the African countries and vice versa to most of the European and North American countries. High priced and high quality Palmolive soaps are marketed in
European countries and the economy priced Palmolive soaps are exported and marketed in developing Countries like Ethiopia, Pakistan, Kenya, India, Cambodia etc.

International business houses need accurate information to make an appropriate decision. Europe was the most opportunistic market for leather goods and particularly for shoes. Bata based on the accurate data could make appropriate decision to enter various European countries.

International business houses need not only accurate but timely information. Coca-Cola could enter the European market based on the timely information, whereas Pepsi entered later. Another example is the timely entrance of Indian software companies into the US market compared to those of other countries. Indian software companies also made timely decision in the case of Europe.

The size of the international business should be large in order to have impact on the foreign Economies. Most of the multinational companies are significantly large in size. In fact, the Capital of some of the MNCs is more than our annual budget and GDGs of the some of the African countries. Most of the international business houses segment their markets based on the geographic market segmentation. Daewoo segmente d its market as North America, Europe, Africa, Indian subcontinent and Pacific markets.

International markets present more potentials than the domestic markets. This is due to the fact that international markets wide in scope varied in consumer tastes, preferences and Purchasing abilities, size of the population etc. For example, the IBM’s sales are more in foreign countries than in USA, similarly, Coca-Cola’s sales, Procter and Gamble’s sales.

The size of the population, sometimes, may not determine the size of the market. This is due to the backwardness of the economy and low purchasing power of the people. In fact, the size of Eritrea - an African country is roughly equal to that of the United Kingdom in terms of land area and size of the population. But, in terms of per capita income it is one of the poorest countries in the world with estimated per capita income of US $ 150 per annum. Therefore, the international business houses should consider the consumers' willingness to buy and also ability to buy the products. In fact, most of the multinational companies, which entered Indian market after 1991, failed in this respect. They viewed that almost the entire Indian population would be the customers. Therefore, they estimated that the demand for consumer durable goods would be increasing in India after globalisation. And they entered the Indian market. The heavy inflow of these goods and decline in the size of Indian middle class resulted in a slump in the demand for consumer durable goods.

**Wider Scope:** Foreign trade refers to the flow of goods across national political borders. Therefore, it refers to exporting and importing by international marketing companies plus creation of demand, promotion, pricing etc. As stated earlier, international business is much broader in scope. It involves international marketing, international investments, and management of foreign exchange, procuring international finance from IMF, IBRD, IFC, IDA etc., management of international human resources, management of cultural diversity, international marketing, management of international production and logistics, international strategic
management and the like. Thus, international business is broader in scope and covers all aspects of the system.

**Inter-country Comparative Study:** International business studies the business opportunities, threats, consumers' preferences, behavior, cultures of the societies, employees, business environmental factors, manufacturing locations, management styles, inputs and human resource management practices in various countries. International business seeks to identify, classify and interpret the similarities and dissimilarities among the systems used to anticipate demand and market products'. The system presents inter-country comparison and inter-continental comparison/comparative analysis helps the management to evaluate the markets, finances, human resources, consumers etc. of various countries. The comparative study also helps the management to evaluate the market potentials of various countries.

The study also indicates the degree of consumer acceptance of the product, product changes and developments in different countries. Managements of international business houses can group the countries with similar features and design the same products, fix similar price and formulate the same marketing strategies. For example, Prentice Hall grouped India, Nepal, Pakistan Bangladesh, Sri Lanka etc. into one category based on the customers' ability to pay and designed the same quality product and sell them at the same price in all these countries. Similarly, Dr. Reddy's Lab does the same for its products to sell in the African countries.

**Differences in Government Policies, Laws and Regulations:** Sovereign governments enact and implement the laws, and formulate and implement policies and regulations. The international business houses should follow these laws, policies and regulations. MNCs operating in India follow our labor laws, business laws and policies and regulations formulated by the Indian Government.

**Host Country's Monetary System:** Countries regulate the price level, flow of money, production levels etc. through their monetary systems. In addition, they regulate foreign exchange rates also through the monetary system. The tools of monetary system include bank rate, cash reserve ratio, statutory liquidity ratio etc. Governments also regulate remittance of the profit of international business houses to other countries. International companies should obey these regulations. The Indian Government introduced full convertibility on current account; in fact, many Governments introduced full convertibility on current account as a part of economic liberalisation.

**National Security Policies of the Host Countries:** Every country formulates the policies for its national security. Multinational companies should abide by these national security policies. For example, USA is a free economy as far as carrying out the business compared to many other countries in the world. However, USA also imposes restrictions regarding the business operations, which affect the national security.

**Cultural Factors:** Cultural and custom factors vary widely from one country to the. These factors include dressing habits, eating habits, religious factors and the like. Multinational companies should consider these factors of the host country while operating in that country. *For example,* the culture of the Fiji people is that they attend to the family activities at least three
times a day. Therefore, the companies operating in that country allow their workers to go home three times a day. Also, see Article 1 in Box.

**Article 1: impact of culture of Switzerland housewives on marketing of dishwashers**

In Switzerland, foreign dishwasher manufacturers expected the same rapid sales as they had first obtained in other West European markets; but sales in Switzerland were so slow that research had to be done to find out why (this research should, of course, have been done before not after market entry). The research showed that the Swiss housewife had a different set of values to, for example, her French and English counterparts; she was very conscious of her role as strict and hardworking and her responsibility for the health of her family. To the Swiss housewife dishwashers simply made life easy, and this conflicted with her Calvinistic work ethic. As a result of this research, dishwasher manufacturers had to change their advertising promoting, instead of ease and convenience, hygiene and health. They did this by emphasizing that because dishwashers used temperature higher than hand hot, the process was more hygienic than washing up by hand. Thereafter, they had no automatic dishwashers in Switzerland.

**Language:** language is an important factor in international business. Even though ‘English language' is a major language in business operations in the world, there are still a large number of 'non-English' speaking countries. Therefore, international business houses should train their employees in the local language of the host country. Added to this, there would be many languages in use in many, countries like ours. Therefore, the business houses should train their employees in the local languages also.

**Nationalism and Business Policy:** Nationalism is a dominating factor of the social life of the people of the host countries. In fact, nationalism also affects the business operations of the multinational corporations dramatically and drastically. The US people used the slogan *'Be American and Buy American made'* when the US automobile industry failed to meet the competition of Japanese automobile companies operating in USA. Similar incidents are also observed in developing countries. Therefore, international business houses should be cautious of nationalism and its after effects.

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1.4 FEATURES OF INTERNATIONAL BUSINESS ENVIRONMENT

On classifying the environmental factors on the basis of their extent of intimacy with the firm we arrive at three major levels of the environment.

- **Internal Environment**;
- **Micro environment / task environment / operating environment**;
- **Macro environment / general environment / remote environment**.

1.4.1 The Internal Environment

The factor components can be studied as follows:

**Value System:** The value system of the founders and those at the helm of affairs has important bearing on the choice of business, the mission and objectives of the organization, business policies and practices. It is a widely acknowledged fact that the extent to which all in the organization shares the value system is an important factor contributing to success. The value
system and ethical standards are also among the factors evaluated by many companies in the selection of foreign business partners. The value system of JRD Tata and the acceptance of it by others who matter were responsible for the voluntary incorporation in the Articles of Association of TISCO, its social and moral responsibilities to consumers, employees, shareholders, society and the people. After the EID Parry group was taken over by the Murugappa group, one of the most profitable businesses [liquor] of the ailing Parry group was sold off, as the liquor business did not fit into the value system of the Murugappa group.

**Hierarchy of Strategic Intent:** It envisions a desired leadership position and establishes the criterion the organization will use to chart its progress. The business domains of the company, priorities, direction of development, business philosophy, business policy etc. are guided by the mission and objectives of the company. For instance, Ambanis of the Reliance is credited with having a strategic intent of being a global leader in its field of activity by being the lowest cost producer of polyester products, a status achieved by the relentless pursuit of scale, vertical integration & operational effectiveness. For HCL, the Indian hardware giant, the strategic intent is an aspiration to become a global software and services company through focusing on global systems integration market that involves putting hardware, software and networking together and making it work.

![Hierarchy of Strategic Intent Diagram]

To prepare itself for surviving in the future, **IOC has enunciated its strategic intent** as follows:

**IOC’s Vision:** “Indian Oil aims to achieve international standards of excellence in all aspects of energy and diversified business with focus on customer delight through quality products & services”.

**IOC’s Mission:** “Maintaining national leadership in oil refining, marketing & pipe-line transportation”.

**IOC’s Objectives:** “Focusing on cost, quality, customer care, value addition and risk management.”

**IOC’s Corporate Strategies:** “Expansion and diversification and integration through strategic alliances and joint ventures.”
IOC’s Business Strategies: “Harnessing new business opportunities in petrochemicals, power and lube marketing.”

IOC’s Functional Strategies: “Focusing on R&D, training and consultancy, exploration & production, LNG and fuel management in India and abroad.”

Management Structure & Nature: The organizational structure [entrepreneurial / functional / divisional / strategic business unit / matrix / network structure / product based / customer based / geographic / intrapreneurial, the composition of the board of directors, extent of professionalism of management etc. are important factors influencing business decisions. The stand of the nominees of the financial institutions can also be very critical in some cases.

Internal Power Relationship: Factors like the amount of support the top management enjoys from different levels of employees, shareholders and the Board of Directors have important influence on the decisions and their implementation.

Human Resources: Skill, quality, morale, commitment, attitude etc., could contribute to the strength and weakness of any organization. Some organizations find it difficult to carry out restructuring or modernization because of resistance by employees whereas they are smoothly done in some others. The involvement, initiative etc., of people at different levels may vary from organization to organization. The organizational culture and overall environment have a bearing on them. John Towers, M.D., Rover Group, observes that a Japanese company of 30,000 employees is 30,000 process improvers. In a Western company, it is 2,000 process improvers and 28,000 workers.

Other Factors:
Company Image & Brand Equity: The image of the company matters while raising finance, forming joint ventures or other alliances, soliciting marketing intermediaries, entering purchase or sale contracts, launching new products etc.

Physical Assets and Facilities: The production capacity, technology and efficiency of the productive apparatus, distribution logistics etc., are among the factors which influence the competitiveness of a firm.

R&D and Technological Capabilities: R&D and Technological Capabilities, among other things, determine a company’s ability to innovate and compete.

Marketing Resources: The organization for marketing, quality of the marketing men, brand equity and distribution network have direct bearing on marketing efficiency. They are important also for brand extension, new product introduction etc.

1.4.2 Micro Environment
It is also known as the Task environment and Operating Environment because the micro environmental forces have a direct bearing on the operations of the firm. The micro environment consists of the actors in the company’s immediate environment that affects the performance of the company. These include:
• Suppliers;
• Marketing Intermediaries;
• Competitors;
• Customers;
• Publics.

It is quite obvious that the micro environmental factors are more intimately linked with the company than the macro factors. The micro forces need not necessarily affect all the firms in a particular industry in the same way. Some of the micro factors may be particular to a firm. For example, a firm which depends on a supplier may have a supplier environment which is entirely different from that of a firm whose supply source is different. When competing firms in an industry have the same micro elements, the relative success of the firms depends on their relative effectiveness in dealing with these elements.

** Suppliers: ** Those who supply the inputs like raw materials and components to the company. The importance of reliable source/sources of supply to the smooth functioning of the business is obvious.

- Uncertainties regarding the supply or other supply constraints often compel companies to maintain high inventories causing cost increase.
- Because of the sensitivity of the supply, many companies give high importance to Vendor development. Vertical integration, where feasible, helps solve the supply problem. It is very risky to depend on a single supplier because a strike, lock out or ay other production problem with that supplier may seriously affect the company. Similarly, a change in the attitude or behavior of the supplier may also affect the company. Hence, multiple sources of supply often help reduce such risks.
- The supply management assumes more importance in a scarcity environment. Company purchasing agents are learning how to “wine and dine” suppliers to obtain favorable treatment during periods of shortages. In other words, the purchasing department might have to “market” itself to suppliers.
- Recognizing the critical importance of the supply factor, companies all around the world are increasingly resorting to partnering/relationship marketing. Partnering is becoming more and more international and this provides a challenging opportunity for Indian suppliers to become international players.

** Customers: ** As it is often exhorted, the major task of a business is to create and sustain customers. A business exists only because of its customers. Monitoring the customer sensitivity is, therefore, a prerequisite for the business success. A company may have different categories of consumers like:

- Individuals;
- Households;
- Industries;
- Commercial Establishments;
- Government and other Institutions.
For example, the customers of a tyre company may include individual automobile owners, automobile manufacturers, public sector transport undertakings and other transport operators.

**Large Customer Base:** Depending on a single customer is often too risky because it may place the company in a poor bargaining position, apart from the risks of losing business consequent to the winding up of business by the customer or due to the customer’s switching over to the competitors of the company.

**Target Customers:** The choice of the customer segments should be made by considering a number of factors including the relative profitability, dependability, stability of demand, growth prospects and the extent of competition.

With the growing globalization, the customer environment is increasingly becoming global. Not only that the markets of other countries are becoming more open, the Indian market is becoming more exposed to the global competition and the customer is becoming more “global” in his shopping.

**Competitors:** Competitors include not only the other firms which market the same or similar products but also all those who compete for the discretionary income of the consumers i.e. desire competition. For example, the competition for a company’s televisions may come not only from other TV manufacturers but also from two-wheelers, refrigerators, cooking ranges, stereo sets and so on and from firms offering savings and investment schemes like Banks, companies accepting public deposits or issuing shares or debentures etc. This competition among these products may be described as desire competition as the primary task here is to influence the basic desire of the consumer. Such desire competition is generally very high in countries characterized by limited disposable incomes and many unsatisfied desires (and, of course, with many alternatives for spending/investing the disposable income).

If the consumer decides to spend his discretionary income on recreation (or recreation cum education) he will still be confronted with a number of alternatives to choose from like TV, Stereo, Two-in-One etc. The competition among such alternatives, which satisfy a particular category of desire, is called generic competition.

If the consumer decides to go in for a TV the next question is which form of the TV - LCD or Plasma etc. In other words, there is a product form competition. Finally the consumer encounters the brand competition, i.e., the competition between the different brands of the same product form. An implication of these different demands is that a marketer should strive to create primary and selective demand for his product.

**Marketing Intermediaries:** These aid the company in promoting, selling and distributing its goods to final buyers. The marketing intermediaries include the following:

- Middlemen such as agents and merchants who help the company find customers or close sales with them.
- Physical distribution firms which assist the company in stocking and moving goods form their origin to their destination, such as warehouses and transportation firms.
• Marketing service agencies which assist the company in targeting and promoting its products to the right markets such as advertising agencies, marketing research firms, media firms and consulting firms.
• Financial intermediaries, which finance marketing activities and insure business risks.

Marketing intermediaries are vital links between the company and the final consumers. A dislocation or disturbance of the link, or a wrong choice of the link, may cost the company very heavily. Retail chemists and druggists in India once decided to boycott the products of a leading company on some issue such as poor retail margin. This move for collective boycott was, however objected to by the MRTP Commission; but for this the company would, perhaps, have been in trouble. Hindustan Lever too faced major challenge when it faced a collective boycott in Kerala on the issue of trade margin.

Publics: Any group that has an actual or potential interest in or impact on an organization’s ability to achieve its interests. Media publics, citizens, action publics and local publics are some examples.

Such publics seriously affect some companies. For example, one of the leading companies in India was frequently under attack by the media public, particularly by a leading daily, which was allegedly bent on bringing down the share prices of the company by tarnishing its image. Such exposures or campaigns by the media might even influence the government decisions affecting the company. Local publics also affect many companies. Environmental pollution is an issue often taken up by a number of local publics. Actions by local publics on this issue have caused some companies to suspend operations and/or take pollution abatement measures.

Growth of consumer publics is an important development affecting business. It is wrong to think that all publics are threats to business. Some of the actions of the publics may cause problems for companies. However, some publics are an opportunity for the business. Some businessmen, for example, regard consumerism as an opportunity for the business. The media public maybe used to disseminate useful information. Similarly, fruitful cooperation between a company and the local publics may be established for the mutual benefit of the company and the local community.

International business is facing a growing challenge from publics, from both within the country and outside. Voluntary organizations have been mounting up protests against child labour, sweat labour, cruelty against animals, environmental problems, de-industrialization resulting from imports and so on. Exports of developing countries, particularly, are affected by such developments.

1.4.3 Macro Environment
A company and the forces in its micro environment operate in a larger macro environment of forces that shape opportunities and pose threats to the company. As stated earlier, the macro environment is also known as General Environment and Remote Environment. The macro forces are, generally, more uncontrollable than the micro forces. When the macro environment is uncontrollable, the success of the company depends on its adaptability to the environment. For example, if the cost of the imported components increases substantially because of the depreciation of the domestic currency, a solution may be their domestic manufacture.
macro environment factors include economic environment, political and Regulatory environment, Social/Cultural Environment, demographic environment, technological environment and natural environment.

1.4.4 Self – Reference Criterion
The key to successful international marketing is adaptation to the environmental differences from one market to another. Adaptation is a conscious effort on the part of the international marketer to anticipate the influences of both the foreign and domestic uncontrollable on the marketing mix and then to adjust the marketing mix to minimize the effects.

The primary obstacle to success in international marketing is a person’s Self Reference Criterion (SRC) in making decisions. It is an unconscious reference to one’s own cultural experiences, values and knowledge as a basis for decisions. The SRC impedes the ability to assess a foreign market in its true light. When confronted with a set of facts, we react spontaneously on the basis of knowledge assimilated over a lifetime – knowledge that is a product of the history of our culture. We seldom stop to think about a reaction; we simply react. Thus, when faced with a problem in another culture, the tendency is to react instinctively and refer to our SRC for a solution. Our reaction, however, is based on meanings, values, symbols and behaviour relevant to our own culture and usually different from those of a foreign culture. Such decisions are often not valid.

Let us read the below given illustrations on the impact of SRC:

Misunderstandings can occur about personal space between people of different cultures: In United States, unrelated individuals keep a certain physical distance between themselves and others when talking or when in groups. In some cultures the acceptable distance between individuals is substantially less than that which is comfortable to Americans. When someone from another culture approaches an American too closely, unaware of another culture’s acceptable distance the American unconsciously reacts by backing away to restore the proper distance (i.e., proper by American standards), and confusion results for both the parties. Thus, Americans assume foreigners are pushy, while foreigners assume Americans are unfriendly and standoffish. Both react to the values of their own SRCs, making them all victims of a cultural misunderstanding.

An American sales manager newly posted to Japan decided that his Japanese sales representatives did not need to come into the office every day for an early morning meeting before beginning calls on clients in Tokyo. After all, that was how things were done in the United States. However, the new policy, based on both the American’s SRC and a modicum of ethnocentrism, produced a precipitous decline in sales performance. In his subsequent discussions with his Japanese staff he determined that Japanese sales representatives are motivated mostly by peer pressure. Fortunately he was able to recognize that his SRC and his American “business acumen” did not apply in this case in Tokyo. A return to the proven system of daily meetings brought sales performance back to previous levels.

Misunderstandings can occur when you don’t realize the importance of cultural differences: A common mistake made by Americans is to refuse food or drink when offered. In the United States, a polite refusal is certainly acceptable, but in Asia or in the Middle East, a host
is offended if you refuse hospitality. While you don’t have to eat or drink much, you do have to accept the offering of hospitality.

A Westerner must learn that white is a symbol of mourning in parts of Asia, quite different from Western culture’s white for bridal gowns.

Time conscious Americans are not culturally prepared to understand the meaning of time to Latin Americans. It might result in lost sales when a “long waiting period” in the outer office of a Latin American customer was misinterpreted by an American sales executive.

A simple hand gesture has a number of different meanings in different parts of the world. When wanting to signify something is OK, most people in United States raise a hand and make a circle with the thumb and forefinger. However, this same hand gesture means “zero” or “worthless” to the French, “money” to the Japanese, and a general sexual insult in Greece. A U.S. President sent an unintentional message to some Australian protestors when he held up the first two fingers with the back of his hand to the protesters. Meaning to give the “victory” sign, he was unaware that in Australia the same gesture is equivalent to holding up the middle finger in the United States.

Cultural conditioning is like an iceberg – we are not aware of nine-tenths of it. Misunderstandings may occur in the evaluation of the appropriateness of a domestically designed marketing mix for a foreign market: “Esso”, the brand name of a gasoline, was a successful name in the United States and would seem harmless enough for a foreign country; however, in Japan, the name phonetically means “stalled car”, an undesirable image for gasoline. “Pet milk” is widely sold in U.S, but in France the word pet means, among other things, flatulence – again, not the desired image for canned milk. In U.S culture, a person’s SRC would not reveal a problem with either Esso or Pet, but in international marketing relying on one’s SRC could produce an inadequately adapted marketing program that ends in failure.

How can looking beyond SRC yield positive results?

Illustration - I: A British manufacturer of chocolate biscuits [cookies in American English], ignoring its SRC, knows that it must package its biscuits differently to accommodate the Japanese market. Thus, in Japan McVitie’s chocolate biscuits are wrapped individually, packed in presentation cardboard boxes and priced about three times higher than in the U.K. – the cookies are used as gifts and thus must look and be perceived as special.

Illustration - II: Unilever, appreciating the uniqueness of its markets, repackaged and reformulated its detergents for Brazil. Lack of washing machines among poorer Brazilians made a simpler soap formula necessary. Since people wash their clothes in rivers, powder was packaged in plastic rather than paper so it would not get soggy. Finally, since the Brazilians are price conscious and buy in small quantities, the soap was packaged in small, low priced packages.
Illustration -III: McDonald’s modifies its traditional Big Mac in India where it is known as the “Maharaja Mac.” This burger features two mutton patties, since most Indians consider cows sacred and don’t eat beef.

Although it is almost impossible for someone to learn every culture in depth and to be aware of every important difference, an awareness of the need to be sensitive to differences and to ask questions when doing business in another culture can avoid many of the mistakes possible in international business.

How can we avoid errors in business influenced by SRCs?

To avoid errors in business decisions, it is necessary to make a cross-cultural analysis isolating the SRC influences. The following steps are suggested as a framework for such an analysis.

Step 1: Define the business problem or goal in home – country cultural traits, habits, or norms.

Step 2: Define the business problem or goal in foreign – country cultural traits, habits or norms. Make no value judgments.

Step 3: Isolate the SRC influence in the problem and examine it carefully to see how it complicates the problem.

Step 4: Redefine the problem without the SRC influence and solve for the optimum business goal situation.

This approach requires an understanding of the culture of each foreign market as well as one’s own culture. Surprisingly, understanding one’s own culture may require additional study because much of the cultural influence on market behaviour remains at a subconscious level and is not clearly defined.

What is Global Awareness?

Opportunities in global business abound for those who are prepared to confront myriad obstacles with optimism and a willingness to continue learning new ways. The successful Businessperson in the 21st century will have global awareness and have a frame of reference that goes beyond a region or even a country and encompasses the world.

To be globally aware is to have:

- Objectivity;
- Tolerance of cultural differences;
- Knowledge of cultures, history, world market potential and global social, economic and political trends.

To be globally aware is to be objective: Objectivity is important in assessing opportunities, evaluating potential and responding to problems. Millions of dollars have been lost by companies that blindly entered the Chinese market on the belief that there were untold opportunities, whereas in reality, opportunities were only in select areas and also generally for those who were ready for long-term commitment. Many were caught in the euphoria of envisioning one billion
consumers, not seeing the realities of low income and purchasing power, poor distribution and logistics, inadequate media infrastructure and differences in tastes and preferences between Chinese and Western consumers. Thus, uninformed and not very objective decisions were made.

**To be globally aware is to have tolerance toward cultural differences:** Tolerance is to understand the cultural differences and accepting and working with others whose behaviour may be different from yours. You do not have to accept, as your own, the cultural ways of another but you must allow others to be different and equal. The fact that punctuality is less important in some cultures does not make them less productive, only different. The tolerant person understands the differences that may exist between cultures and uses that knowledge to relate effectively.

**To be globally aware is to be knowledgeable about cultures and history:** Knowledge of cultures is important in understanding the behaviour in the marketplace. Knowledge of history is important because the way people think and act is influenced by their history. Some Latin Americans’ reluctance about foreign investment or Chinese reluctance to open completely to outsiders can be understood better if you have a historical perspective.

**To be globally aware is to have knowledge of world market potentials and global economic, social and political trends:** Over the next few decades there will be enormous changes in market potentials in almost every region of the world, all of which a globally aware person must continuously monitor. Finally, a globally aware person will keep abreast of the global economic, social, and political trends because a country’s prospects can change as these trends shift direction or accelerate. The former republics of the Soviet Union, along with Russia, Eastern Europe, China, India, Africa, and Latin America, are undergoing economic, social, and political changes that have already altered the course of trade and defined new economic powers. The knowledgeable marketer will identify opportunity long before it becomes evident to others.

**How to build Global Awareness?**

- Global awareness can and should be built in organizations using several approaches. The obvious strategy is to select individual managers specifically for their demonstrated global awareness.
- Global awareness can also be obtained through personal relationships in other countries. Indeed, market entry is very often facilitated through previously established social ties.
- Certainly, successful long-term business relationships with foreign customers often result in an organizational global awareness based on the series of interactions required by commerce.
- Foreign agents and partners can also help directly in this regard.
- But perhaps the most effective approach is to have a culturally diverse senior executive staff or board of directors. Unfortunately, American managers seem to see relatively less value in this last approach than managers in most other countries.
1.5 CULTURE DYNAMICS IN ASSESSING GLOBAL MARKETS

1.5.1 What is Culture?
Comparative and so-called ‘intercultural’ studies are becoming increasingly more important in the global business environment. However, despite of its rising importance few researchers and educators rely on empirical cross cultural and intercultural research to interpret their observations.

The word ‘culture’ is often used loosely in everyday language to describe a number of quite distinct concepts; for example, the word is often used to describe concepts such as ‘organizational culture’ as well as ‘arts and culture’. What all of these concepts have in common is the implication that culture is an abstract entity which involves a number of usually man-made, collective and shared artifacts, behavioral patterns, values or other concepts which taken together form the culture as a whole. For example, people in an organization are said to share the organizational culture yet, at the same time, they define the organizational culture.

Historically, the word derives from the Latin word ‘colere’, which could be translated as ‘to build’, ‘to care for’, ‘to plant’ or ‘to cultivate’. Thus ‘culture’ usually referred to something that is derived from, or created by the intervention of humans – ‘culture’ is cultivated. On a more basic level, ‘culture’ has been used to describe the modus operandi of a group of people, such as implied by organizational culture. This concept of culture implies not only the shared modus operandi but also the shared values that underpin the modus operandi. A company can be said, for example, to have a ‘highly competitive culture’, thus implying that competitiveness is valued highly within that company, or in other words forms a core value within the company as a whole. Hence it can be argued, that ‘competitiveness’ is a shared value among those people working in that company. It also implies that the company as a whole will behave very competitively in the way it is conducting its business. Thus the concept describes both the underlying value as well as the behaviour that can be observed. Notably, the concept does not necessarily imply that all employees share the same value to the same degree, but it does imply that the employees will be more likely to share the common value, and express it, if not necessarily individually, then collectively. On a broader scale, Triandis introduced the concept of “subjective culture”, or a "characteristic way of perceiving its social environment" common to a culture. Based on these perceptions, and what has been perceived to work well in the past, values are passed on from generation to generation.

1.5.2 The levels of Culture
Iceberg Model: Culture consists of the following two layers:

- An invisible level or a level of values;
- A visible level of resultant behaviour or artifacts of some form.

The multilevel nature of culture is important because of several aspects: It identifies a visible area as well as an area that is not immediately visible, but that can be derived by careful attention to the visible elements of the cultural system, as we understand it.
Hofstede Model (1991): It proposes a set of four layers, each of which encompasses the lower level, as it depends on the lower level, or is a result of the lower level. In his view, ‘culture’ is like an onion: A system that can be peeled, layer-by-layer, in order to reveal the content. At the core of Hofstede’s model of culture are values, or in his words: “broad tendencies to prefer certain states of affairs over others”. These values form the most hidden layer of culture. Values as such represent the ideas that people have about how things “ought to be”. As such, Hofstede also emphasizes the assumption that values are strongly influencing behaviour. Above the values, Hofstede describes three levels of culture that are more clearly observable:

- **Rituals:** Such as ways of greeting and paying respect;
- **Heroes:** Such as admired persons who serve as an example for behaviour;
- **Symbols:** Such as words, color or other artifacts that carry a special meaning.

**What is the impact of culture on the workplace?**

Modern day organizations possess multinational workforces operating globally. Be it by email, telephone, and videoconference or in person, it is now commonplace for an employee based in London to spend more time liaising with a colleague or client in Milan than in Manchester. This increasing internationalization has brought new cultural challenges to many organizations. The ability of your employees to interact successfully with peoples of different cultures is dependent on their capacity to understand their own cultural makeup as well as that of their counterparts. The rules of conducting business in, for example, the U.S, Germany or Japan differ greatly from those of the United Kingdom. As with an iceberg, there is much more below the surface than is visible. Although most employees in contact with overseas cultures can master these invisible subtleties over time, trial and error learning is inefficient and, meanwhile, their errors may undermine your organization’s good-will or cause a deal to fail.

**1.5.3 Corporate Culture**

It has long been recognized that the organization cannot simply be described in terms of its formal structure. The concept of corporate culture is a central theme of the 'excellence' literature as well as HRM and total quality management. Its major exponents presented a 'strong' corporate culture as a key factor in enhancing competitive performance through greater employee commitment and flexibility. Employees in strong cultures know what is expected of them. Conversely, staff in weak cultures wastes time trying to discover what is required. According to this argument employees identify with a strong culture and take pride in their organization.

**The Deal and Kennedy model of corporate culture:** Deal and Kennedy's Corporate Cultures (1982) were inspirational and incorporated five critical elements:

1. **The Business Environment:** The orientation of organizations within this environment, for example a focus on sales or concentration on research and development - leads to specific cultural styles.
2. **Values:** Values are at the heart of corporate culture. They are made up of the key beliefs and concepts shared by an organization's employees. Successful managers are clear about these values and their managers publicly reinforce them.
3. **Heroes:** Personifications of the organization's values - achievers who provide role models for success within the company. Heroes have vision and go against the existing order if necessary in order to achieve that vision.

4. **Rites and Rituals:** Ceremonies and routine behavioural rituals reinforce the culture (product launches, sales conferences, employee birthday celebrations, etc.)

5. **The Cultural Network:** The carrier of stories and gossip that spread information about valued behaviour and 'heroic myths' around the organization

**Geert Hofstede's Contribution:** Probably the most famous study of how culture relates to values in the workplace was undertaken by Geert Hofstede. As part of his job as a psychologist working for IBM, Hofstede collected data on employee attitudes and values for more than 1,00,000 individuals. This data enable him to compare dimensions of culture across 40 countries. He isolated four dimensions that he claimed summarized different cultures – power distance, uncertainty avoidance, and individualism versus collectivism and masculinity versus femininity.

- **Hofstede’s power distance dimension:** It focused on how a society deals with the fact that people are unequal in physical and intellectual capabilities. According to Hofstede, high power distance cultures were found in countries that let inequalities grow over time into inequalities of power and wealth. Low power distance cultures were found in societies that tried to play down these inequalities as much as possible.

“Power distance is the extent to which less powerful members of institutions and organizations within a country expect and accept that power is distributed unequally.”

<table>
<thead>
<tr>
<th>High Power Distant Cultures</th>
<th>Low Power Distance Countries</th>
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<tbody>
<tr>
<td>Employees are afraid to express their doubts and disagreements with their autocratic and paternalistic bosses.</td>
<td>Bosses and subordinates work close together &amp; consult each together.</td>
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<tr>
<td>A very centralized structure of organization.</td>
<td>The hierarchies are flat with decentralized structure.</td>
</tr>
<tr>
<td>Subordinates expect to be told what to do because they are considered as unequal.</td>
<td>There is interdependence between employee and employer. Subordinates need to be consulted in the decision making process.</td>
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**Hofstede’s individualism versus collectivism dimension:** It focused on the relationship between the individual and his / her fellows. In individualistic societies, the ties between the individuals were loose and individual achievement and freedom was highly valued. In societies where collectivism was emphasized, the ties between individuals were tight. In such societies, people were born into collectives, such as extended family and everyone was supposed to look after the interest of his or her collective.

**Individualism** is the opposite of collectivism; together they form on of the dimensions of national cultures. Individualism stands for a society in which the ties between individuals are loose: everyone is expected to look after himself or herself and his or her immediate family only.
Collectivism stands for a society in which people from birth onwards are integrated into strong cohesive in groups, which throughout people’s lifetime continue to protect them in exchange for unquestioning loyalty.

What are the features of individualism?

- Individualistic cultures like USA (highest score = 1st rank) and France (10th rank) are more self-centred and emphasize mostly on their individual goals.
- People from individualistic cultures tend to think only of themselves as individuals and as “I” distinctive from other people. They make just a little different between in-group and out-group communication (USA). They prefer clarity in their conversations to communicate more effectively and come in general directly to the point like the Finns (17th rank) and Americans are doing. An exception here is Germans (15th rank) who indeed are an individualistic culture but their communication style is different. First details will be named and discussed and after that they will come to the point. Americans and Finns might feel annoyed because they say first what it is about and explain afterwards.
- People in individualistic cultures emphasize their success/achievements in job or private wealth and aiming up to reach more and/or a better job position. Especially in the USA the fight about jobs and trying to climb up in the hierarchy ladder is something very common there. It just counts to get there less caring who will leave behind one.
- In business they try to improve their connections and to gain more value out of them, not for establishing a good relationship but just to be involved in a calculative way.
- Employees are expected to defend their interests and to promote themselves when ever possible.

What are the features of collectivism?

- Asian collectivist cultures like China (Hong Kong 37th rank) have a great emphasize on groups and think more in terms of “we”.
- Harmony and loyalty within a company is very important and should always be maintained and confrontation should be avoided. In China it is out of question to disagree with someone’s opinion in public. You will do that in a more private and personal atmosphere to protect a person from the “loss of face”. In collectivistic cultures a direct confrontation will be always avoided.
- The relationship between employer and employee or business partners is based on trust and harmony and a deep understanding of moral values.
- The wealth of the company and the groups inside are more important than the individual one’s.

Hofstede’s uncertainty avoidance dimension: It measured the extent to which different cultures socialize their members into accepting ambiguous situations and tolerating uncertainty. Members of high uncertainty avoidance cultures placed a premium on job security, career patterns, retirement benefits and so on. They also had a strong need for rules and regulations; the manager was expected to issue clear instructions and subordinates’ initiatives were tightly
controlled. Lower uncertainty avoidance cultures were characterized by a greater readiness to take risks and less emotional resistance to change.

Some cultures need to have strong uncertainty avoidance like France. In France many strict regulations are used and tasks are heavily centralized in companies. For meetings it is important to consider that. There will be a much higher demand for details when creating a contract. This is to avoid any circumstances, which could cause any kind of uncertainty for French business people. Organizing is therefore rather inflexible concerning changes, which occur in business life. Germans and Finns who have a less but still strong level of uncertainty avoidance and a medium level of power distance have the need for clearly specified competences to avoid uncertainty. In case that problems would occur it is preferable to establish specific procedures and to distribute responsibilities to task forces.

**Hofstede’s masculinity versus femininity dimension:** It looked at the relationship between gender and work roles. In masculine cultures, sex roles were sharply differentiated and traditional “masculine values”, such as achievement and the effective exercise of power, determined cultural ideals. In feminine cultures, sex roles were less sharply distinguished and little differentiation was made between men & women in the same job.

**Tools of Analysis:** Hofstede created an index score for each of these four dimensions that ranged from 0 to 100 and scored high for high individualism, high power distance, high uncertainty avoidance and high masculinity. He averaged the score for all employees from a given country. Then he summarized the data for 20 select countries.

**Observation:**

- Western countries as the United States, Canada and Britain score high on the individualism scale and low on the power distance scale.
- At the other extreme are a group of Latin American and Asian countries that emphasize collectivism over individualism and score high on the distance power scale.
- Japan’s culture has strong uncertainty avoidance and high masculinity. This characterization fits the standard stereotype of Japan as a country that is male dominant and where uncertainty avoidance exhibits itself in the institution of lifetime employment.
- Sweden & Denmark stand out as countries where there is high emphasis on feminine value.

So, we can link an organization with its culture in each of the below given aspects:

- Centralized vs. Decentralized Decision Making:
- Safety vs. Risk
- Individual vs. Group Reward
- Informal vs. Formal Procedure
- High vs. Low Organizational Loyalty
- Cooperation vs. Competition
- Short-term vs. Long-term horizon
- Stability vs. Innovation
Culture & Consumer Behaviour: How do Markets Differ?
When multinational companies develop strategies for their global markets, they need to be flexible and alert to local culture. When market demands it, successful marketing strategies reflect local custom. Few examples of cultural issues multinational companies confront.

Illustration: Peculiarities of the Delivery system for Domino’s Pizza across nations:
In Britain, customers don’t like the idea of the deliveryman knocking on their doors. They think its rude.

In Japan, houses aren’t numbered sequentially so finding an address means searching among rows of houses numbered willy – nilly.

In Kuwait, pizza is more likely to be delivered to a waiting limousine than to someone’s front door.

In Iceland, where much of the population doesn’t have telephone service, Domino has a drive-in movie theatre chain to gain access to customers. Customers craving a reindeer-sausage pizza – one of the most popular flavours – flash their turn signals, and a theatre employee brings them a cellular phone to order a pizza that is delivered to the car.

What are the Nuances of Business Customs?

Cultural Imperatives: Refers to those business customs and expectations that must be met and conformed to or avoided if relationships are to be successful. Successful businesspeople know the Chinese word “guan-xi”, the Japanese “ningen kankei” or the Latin American compadre. All refer to friendship, human relations or attaining a level of trust. A complicating factor in cultural awareness is that what may be an imperative to avoid in one culture is an imperative to do in another. For example, In Japan prolonged eye contact is considered offensive and it is imperative that it be avoided. However with the Arab and Latin American executives, it is important to make strong eye contact or you run the risk of being seen as evasive and untrustworthy.

Cultural Adiaphorous: Relates to those areas of behaviour or to customs that cultural aliens may wish to conform to or participate in but that are not required; in other words permissible to follow the custom in question. A symbolic attempt to participate in adiaphorous is not only acceptable but also may help to understand. In the Czech Republic, an aperitif or other liquor offered at the beginning of the business meeting, even in the morning, is away to establish goodwill & trust. Chinese business negotiations often banquet at which large quantities of alcohol are consumed in an endless series of toasts. It is imperative that you participate in the toasts with a raised glass of the offered beverage but to drink is optional. Your Arab business associates will offer as part of the important ritual of establishing a level of friendship and trust; you should accept even if you take a ceremonial sip.

Cultural Exclusives: Refers to those business customs or behaviour patterns reserved exclusively for the locals and from which the foreigner is excluded. Highly offensive is a foreigner criticizing a country’s politics, mores, peculiarities (that is peculiar to the foreigner)
even though locals may, among themselves criticize such issues. There is truth in the old adage, “I’ll curse my brother but if you curse him, you’ll have a fight.”

**What is the importance of Inter-cultural communication in business?**

Fast travel, international media, and the Internet have made it easy for us to communicate with people all over the world. The process of economic globalization means that we cannot function in isolation but must interact with the rest of the world for survival. Intercultural communication is no longer an option, but a necessity. Because important decisions in business, politics, education, health, and culture these days usually affect citizens of more than one nation, the question of whether communication between people of different nations is effective and whether all parties emerge with the same understanding is of crucial importance. Individuals who deal with people from other cultures want to learn how to improve their performance through improving their communication skills. Numerous resources have sprung up to meet this emerging market in the business, academic and international relations communities: leading authors have written books and articles on the topic; business services provide consultation for improving the conduct of international business; universities and other educational institutions offer programs or degrees in Intercultural Communication; and researchers have established international journals and academic societies specializing in research on intercultural communication. In fact, intercultural communication has become a business in itself.

**Why is it important to improve intercultural communication?**

Lack of knowledge of another culture can lead, at the best, to embarrassing or amusing mistakes in communication. At the worst, such mistakes may confuse or even offend the people we wish to communicate with, making the conclusion of business deals or international agreements difficult or impossible. Some examples from the advertising world of how simply translating words is not enough, deeper understanding of the other culture is necessary to translate meaning effectively:

- A General Motors auto ad with "Body by Fisher" became "Corpse by Fisher" in Flemish.
- Colgate-Palmolive toothpaste named "Cue" was advertised in France before anyone realized that Cue also happened to be the name of a widely circulated pornographic book about oral sex.
- Pepsi Cola's "Come Alive with Pepsi" campaign, when it was translated for the Taiwanese market, conveyed the unsettling news that, "Pepsi brings your ancestors back from the grave."

**How can the gap between cultures bridged?**

- Seek information about the culture. Knowledge is power. Prejudice stems from ignorance, do your homework, don't make assumptions.
- Be other-oriented. You can no longer rely on the assumptions of your own cultural heritage. This is not to tear down the value of your own culture; it is to make you aware of the richness that is available to you in other viewpoints.
- Ask questions. Be prepared to share information about yourself, and be sensitive in the way you ask (you don't want to be perceived as prying). But open communication helps in reducing the uncertainty that is present in any relationship.
Develop mindfulness. This is another way of saying "be aware." Acknowledge that there is a connection between thoughts and deeds, and become aware of your own thinking and assumptions. Be conscious. Be active, not reactive. Be aware of your own self-talk.

- Develop flexibility.
- Tolerate ambiguity. Communicating with someone from another culture produces uncertainty, which can be uncomfortable. Learn to tolerate the discomfort until you come out on the other side.
- Avoid negative judgments. Resist thinking that your culture has all the answers. It has its strengths; so do other cultures.

1.6 INTERNATIONAL POLITICAL SPECTRUMS & MANAGEMENT DECISIONS

The political environment of the company includes national and international political factors which can affect its operations. These factors are called political as they principally emanate from the actions of governments which can be at a local or foreign level. This category also includes the methods of thinking and beliefs of all natures which can influence the behaviour of governments and citizens opposing the company without them emanating directly from a government (example: nationalism). For the company, the analysis of this political environment is important, as it principally consists of managing the risk that government actions do not influence international operations in a negative way and influence management in a more or less strong way. We can split the international political environment into three dimensions:

- The political environment of the country of origin.
- The political environment in the destination country.
- The international political environment.

1.6.1 The Political Environment of the Home Country

Your national or supranational (for European Union nationals for example) government, creates rules and regulations which constrain or favour international business according to the context. Governmental measures that can directly affect the export potential of the company are mentioned below:

- Exportation Aids;
- Financial Aids to SMEs to bring about Structural change;
- Export Subsidies;
- Pre – Shipment Credit Facilities;
- Duty- Drawback Facilities etc.
- Embargoes & Sanctions;
- Exiting of Prohibited Goods (high technology);
- Catalogued Products;
- Monitored Products;
- Free Trade Agreements;
- Tariff Ceilings etc.
Above these measures, others, of a more general order can also influence the behaviour of international business transactions. Many laws which are not specifically aimed at international commerce can have a major impact on foreign business affairs. For example, take social legislation. This will determine the management of expatriates. If you wish to set up an office abroad, these social rules risk strongly influencing your decisions regarding the creation of your project, and its profitability.

1.6.2 Political Environment of the Destination Country

The politics and the laws in the destination country affect international business operations in many ways. A good manager must understand the "dimensions" of the country towards which it is expecting to export, on the subject of working in a familiar environment where it can perceive change. The areas which can give rise to local government undertakings and can constitute a political risk for the company are:

- Political Ideology
- Ways of Thinking and Beliefs
- General Economic Health
- Attitude towards Corruption
- Respect for Private Foreign Property
- Respect in Relation to Intellectual Ownership

Companies generally prefer to work in countries where the government is stable and friendly.

**Political Ideologies:** These are varied and numerous, and it is difficult to relate them in one outline. We have chosen those recommended by Daniels et Radebaugh (1998) which synthesizes them depending on the degree of participation of the citizen in the decision making process.
There are two extremes in the theoretic sense of the term: Democracy and Totalitarianism. Between these two, different degrees of participation exist, conserving more or less the characteristics of the extreme regimes from which they are derived. A country being in a proposed classification category is far from being an unchangeable situation. If certain countries are submitted to the same political regime for many years, changes can take place in a rapid fashion. Consider for example the evolution of the former Democratic Republic of Germany since its unification with West Germany at the end of the 1980s. Another difficulty stems from the fact that the terms for designating political regimes, if they are the same, can correspond to different realities. On the basis of these different observations, how can the company evaluate the political regime in a country it does not know? To answer this question, we advise you to base yourself on the characteristics of these regimes rather than on the name which they go by. Let us take up these two extremes in the outline above, and study the elements which enable them to be identified.

**What is Democracy?**

- Freedom of Opinion, Expression, Press and Organization;
- Elections during which citizens decide who will be their representative;
- Independent and fair law court;
- Attentive to the rights of individuals and property;
- Relatively non-politicized bureaucracy and armed forces;
- Relatively easy access to the decision making process.

**What is Totalitarianism?**

Totalitarianism can take different forms, of which dictatorships and fascism are the most well known. In a country submitted to this regime, an individual or a group of people monopolize the political power and do not recognize any form of opposition. Only a small number of people participate in the decision making process. Totalitarian regimes can either be theocratic or civil. In the first case, religious leaders are also political leaders. In the second the government imposes its decisions, using the force of the army as much as possible. The characteristics of a totalitarian regime are the following:

- A single ideology;
- A single party;
- A repressive police force;
- A monopoly on means of communication;
- A monopoly on arms & a centralized economy

**Impact of political regimes on the management of international commercial operations**

1. **State Interference**: The first impact of the political regime on the company is connected to the public role in the economic life of the country. This interference can strongly affect the progress of commercial operations. A general rule (to be taken broadly however) is that the more totalitarian the regime, the more the interference from the government risks being important. This interference can manifest itself in different forms, such as, for example corruption and the destruction of private property.
2. **Political Stability:** The major political risk in many countries is the appearance of conflicts or violent changes. A manager must pay attention to this, before conducting business in a country where there is a strong probability of such events occurring. If a conflict does escalate, there is a risk of violence being directed against foreign firms and their employees. Wars, political disruption and terrorism can often take an anti-foreigner stance, making companies and their employees’ potential targets.

3. **Less drastic, but also disturbing are political changes in the government which are not due to a change in the government itself.** This occurs when a government, for one reason or another, changes its policy considering foreign businesses following external pressure. This pressure can be the result or nationalist or religious groups, or of a general sentiment towards a particular nation ("anti-Americans") or an economic system ("anti-capitalists"). In this context, it is difficult to give a general rule (even subtly different). Contrary to perceived ideas, democracy does not systematically rhyme with stability and totalitarianism with instability. Totalitarian powers have been in place for many years and present a rarely tested stability (such as in Saudi Arabia or China) and democracies have already seen their political stability harmed (case in point, the former Yugoslavia or Israel). On a permanent basis, managers must survey the government, its politics and its stability in order to determine the potential for changing politics, which could consequently affect the commercial operations of the company.

What are the ways of thinking & beliefs with political implications?
Ways of thinking and beliefs of all kinds can influence the general behaviour towards the company without it emanating directly from a government. Nationalism and patriotism for example, are sentiments which are shared by the inhabitants of most countries and which generally divide into four kinds of behaviour regarding the government and its citizens:

- Every country hopes to maintain its national sovereignty. (Within the European Union, this sentiment tends to be transferred to the community). Foreign companies can therefore be perceived as a menace to this sovereignty, and moreover, the number of foreign companies in the country is significant as the more there are, this sentiment will become more common.
- Countries wish to ensure their national security. Although a foreign firm does not represent a threat to military order, it can be considered as potentially harmful. Governments generally forbid the implanting of foreign firms in industrial sectors deemed sensitive, such as defense, communication and sometimes the energy and natural resources sectors.
- Through their industries, countries develop the sentiment of prestige. Certain sectors are seen as jewels of the local economy, and can be impassable as sources of national pride. Moreover many countries often look for national association solutions in order to avoid them being bought out by foreign industrial groups.
- The destination country very often requires foreign companies to respect ethical and moral rules. In this sense, the destination country can implement special laws and regulations to ensure that their behaviour is situated within the boundaries of clean morals and ethics. Take for example corruption, certain states take measures against corruptive practices, others consider them "acceptable" to a certain extent.
Some companies (above all multinationals as they are more "visible") have developed the concept of a "Citizen Company" putting the concept of business ethics forward. This term signifies that they are tempted to behave as if they were good citizens of the country into which they have been transplanted. Between marketing speech and the real political will of the company, it is sometimes difficult to make a difference. Of course, it is preferable that the second option takes priority.

**What is the scope of corruption across borders?**

In many countries, the payment of all kinds of "favours" is a common occurrence. A simple method (material or financial) is to expect services in exchange, as supplied by the administration, or by other companies. Moreover, some companies which undertake international work regularly are used to paying for bribes in order to win contracts or “sweeteners in order to get their dossier on top of the administration pile. In the 90s, the British Chamber of Commerce estimated that 14% of exporters have been faced with corruption. However, the company must be aware that being involved in corruption can be dangerous as, on the one hand, certain countries strongly condemn it with anti-corruption measures and on the other because corruption can have direct implications on company management.

**Anti-corruption measures:** The majority of industrialized countries make companies who operate abroad obey anti-corruption laws. The best known is the: "Foreign Corrupt Practices Act", adopted by the United States in 1977. This act does not only threaten American companies tempted to corrupt or be corrupted, but also multinational companies with offices in the United States. By contrast, the EU has not yet taken such radical measures. Legislation in this area limits itself to asking member states to observe measures against corruption by their civil servants through the Advice Act of 27th September 1996, establishing a protocol for the relative convention of protecting the financial interests of the European communities. By contrast, little is said on the subject of corruption in private businesses. No decision has been taken on a European scale and it is necessary to use national legislation.

Many companies deplore these measures, arguing that they damage their competitiveness on an international level in relation to companies stemming from the state who are less scrupulous on the subject of corruption. The ideal would be that institutions or international organizations take a decision in this area. However, a consensus on an international level appears difficult for four reasons:

- The problem elevates moral ethics. The perception of corruption differs from one state to another. Even if all countries condemn it, some of them are less "fussy" about the question.
- The problem is connected to the sums bought into play. In fact, it is difficult to draw a neat line of separation between a generous bribe and a sweetener in order to speed up the procedure.
- In some countries, corruption is used to compensate state incompetence when paying its civil servants.
- Applying different rules to companies in this field according to whether they export or not is impossible.
Decisions taken by international organizations therefore remain weak. In 1997, the OECD adopted a treaty incriminating the corruption of foreign civil servants. This simply limits itself to condemning deductibility on improper tax payments undertaken by the company for the purpose of corruption. The WTO and the United Nations have not yet created precise rules regarding them.

The company and corruption: The international manager must pay strict attention to drawing a distinctive line between "reasonable persuasion" for trading and complete corruption. Bribes can lead to poor quality performance and to the loss of moral standards amongst company personnel. Corruption can even lead to business practices becoming the opposite of ethics.

Non restrictive corruption can lead to the company's managers concentrating their efforts on the best methods of corruption and no longer on the best ways of producing and selling the product abroad.

The discussion on corruption can be heard as moral rules and general ethics. More and more, the general public, workers included, worry about subjects such as the protection of the environment and moral behaviour of companies. However these subjects are not covered in the same depth from one country to another. For example, the deforestation of the Amazon is acceptable to the Brazilian government, but scientists and consumers condemn it strongly for the consequences which this could have on the environment and the future. The export of tobacco is legal, but enables accusations of "exporting death" towards developed countries. China uses prisoners as a work force for the production of products for export, but many countries condemn this practice and refuse to import them.

In these circumstances, international companies must respect business ethics and notably those in the destination country. **Everything which is legal must not be exploited for the purpose of making a profit!** By applying a healthy attitude in relation to these problems, companies invest in the long term for consumer recognition and non-incrimination for immoral behaviour.

To what extent is the private property attacked in the foreign country?
Establishing commercial relations with a country which does not respect the private property of foreign firms, can be uncertain. This non-respect can be translated as one of three measures, namely expropriation, confiscation or domestication. You need to pay attention to these practices as they are good indicators of the fragility of the political climate, considering foreign companies.

Major Political risks are mentioned below:

**Expropriation:** Expropriation is the transfer of property by the local government to a local entity for compensation. Expropriation is an attractive practice for many governments as it enables them to show that the power in the area is protecting national interests and enables a rapid transfer of resources. Even if expropriation does not make the local government give compensation to injured proprietors, compensation negotiations are often prolonged and frequently give insufficient amounts to the former proprietor. Governments can for example offer compensation in the local currency which cannot be exchanged. Even in these
circumstances, companies frequently accept them in the absence of an alternative. However, the application of this measure decreases more and more, states are answerable to the technique of repurchasing foreign companies to repair the damage. In fact, this practice represents an expense for the state that uses it, as it makes foreign companies hesitant to invest there.

**Confiscation:** Confiscation is the transfer of property by a government to a local entity without offering any possibility of compensation to the former owner. Some companies are more threatened by confiscation than others. It is often the case when they have considerable importance (strategic, turnover, volume of production) in the countries where they have chosen to reside, or they cannot transfer their operational site. For these reasons, sectors such as mining, energy, public services and banks have frequently been the target of such governmental actions.

**Domestication:** Some countries apply a much more subtle technique than domestication. By this measure, the government demands the transfer of property and managerial responsibilities. By basing itself on these laws, it can ensure that a large part of the production will be undertaken locally or can also require that a large amount of the profit remains in the country. Social laws and the protection of intellectual and fiscal property can also be ensured by this type of appropriation.

Domestication can have profound effects on an international commercial operation. If it is imposed after a short delay, commercial operations can be managed by local supervisors who are untrained and inexperienced. It can also force a company to buy its supplies locally, which can lead to an increase in price, less efficiency or a lower quality of products. Finally, domestication affects operations in the long term, such as the international competitiveness of the company and in this way, become a major problem for the expansion of company activities

**What is the extent of attack on the intellectual property rights?**

Intellectual property encompasses industrial property (patents, brands, designs and models) as well as authorship or neighboring rights (authorship rights in all senses). Companies use these tools to be able to profit from the competitive advantage obtained through innovation without being victims of counter-factors (principally concerning luxury products as well as consumer goods such as computers or CDs). However, the protection offered by these tools is not concrete, and this is for four principle reasons:

- Their field of activity is geographically limited. The exporter who wishes to protect his product world-wide must deposit certificates, brands, authorization rights in all parts of the world (depending on these countries heeding the international conventions or not) which implies a large budget and therefore limits the protection to a few geographical zones.
- In the specific contexts of certificates, supplying this protection implies revealing its secret and making certificates freely accessible.
- States do not always have sufficient resources (tribunals, detection of violations) to efficiently manage infringements to intellectual protection.
- Actions taken by the government in order to protect intellectual property varies from state to state. For example, China tackles this problem in a more latitudinarian way than countries in the European Union or the United States. Also, even if international rules ...
have been drawn up (notably by the OECD, WTO etc.), it is still a long way before security is the same in all countries in the world, and that intellectual property is recognized in the same way in all parts of the globe.

Legal protection which can be a benefit to companies in the area of intellectual property is never absolute. Protection, which needs to be produced in a selective way, must take into account real incurred risks and the costs engendered by registration procedures. If the action of the government of the country with which you wish to establish a business movement is weak in the area or contrarily reinforces the respect for public property, your company runs the risk of losing its competitiveness. In fact, local companies can quickly imitate! In this respect, the most risky part of the world is Asia, China, Indonesia, Malaysia, Singapore, Taiwan, Thailand and The Philippines which hold a dismal record in hijacking intellectual property.

How to evaluate the foreign political risk and protect yourself from it?
The political ideology in the destination country, its ways of thinking and beliefs, its general economic health its attitude regarding corruption and its respect for private or intellectual foreign property can give rise to local government actions which constitute a major risk for the company. One of the major preoccupations of the company is to face political risk. To protect yourself, you must be able to evaluate it and adopt the following necessary measures:

- Evaluating the political risk;
- Evaluating the political risk in the destination country can be done in two ways, above all if the exportation is envisaged as a regular flow of business: first of all an analysis of the vulnerability of the company in relation to the target country, followed by analysis of the potential environment of the destination country and the risk which it represents;

1. **Analysis of the vulnerability of the company:** The elements to evaluate in such an analysis cover external factors, but also internal factors in the company. We offer you here a non-exhaustive list to adapt depending on the specifications of your company

**External Factors:**

- **The country of origin of the company:** All other things being equal a company will have a better welcome in a country which maintains good relations with its country of origin.
- **The product or industry:** The "sensitivity" of the product or industry is an important consideration. Generally, main subjects, public services, communication, pharmacology and products which can have a military usage are the products deemed sensitive, which are more exposed to political risks than others.
- **The size of operations:** The larger the company, the more it will be perceived as a foreign threat.
- **The visibility of the company:** The more visible the company, the greater its vulnerability outside its borders. Visibility is a function which covers different realities. It encompasses the size of the company, its localization, but also the nature of its product. Consumer goods are more visible than industrial goods. Also, completed goods are more visible than the components about to enter the production process. It is the same
concerning product marketing; an international brand is more visible than a national brand.

**Internal Factors:**

- **The contribution of the company to the well-being of the destination country:** How much work is it going to generate locally? What new resources is the company going to introduce?
- **The localization of operations:** Generally, the stronger the intensity of the localization of the company in the country, the better it will be accepted and integrated in the local community. Different levels exist in localization - engaging local managers and technical staff, developing local products and a local brand name.

2. **Analyzing the political risk in the destination country:** Evaluating the political risk is often prevaricated by the fact that the perception is disturbed a priori that men and women can have the political risk which is present in certain regions of the world or certain economic blocks. However, if uncertainty can be effectively higher on the African continent for example, political risks are present all over the world and also in stable European regions. It is therefore not enough to base yourself on a subjective evaluation and desiring to lower this subjectivity with a short visit to the location is illusory. In effect, this type of visit is undertaken in less than ideal conditions, without knowledge of the local language and habits and customs. It appears more appropriate to turn towards exterior methods of evaluating the political risk in the target country.

Some organizations offer to evaluate the political risk. This is one of the roles of the "Office National du Ducroire" an export credit insurance company. It offers a country by country analysis of risk-countries which will affect a company's trade outside of its national borders. Also, you can consult an international news press review relating to all countries, raw materials, international organizations.

Another example of a tool for estimating political risk is undertaken by the "Business Environment Risk Intelligence (BERI)" service. This service evaluates 48 countries quarterly on the basis of 15 economic, political and financial criteria on a scale numbered from 0 to 4.

A final example, covering the section entitled political ideology, is that of Freedom House, a non-governmental organization which offers a classification of countries depending on their respect for political rights and civil liberties.

The difficulty in using these indicators is detecting what they measure precisely. In addition, the BERI service provides a good indication, but it includes in its analysis risks connected to foreign investment (cost of work, long term loans etc.). It therefore ignores exportation. It is not less discerning about it, but believes that you will be interested in its composition yourself. It is the same for all indicators. Ask yourself what it measures, the definition of "Political risk" not being the same for all.

The list of sources of information could be long. The safest way of detecting them is to enquire at your export credit insurer, your bank, or the organization supporting export in your country.
Protecting yourself against the political risk: The way of protecting yourself against political risk strongly depends on the country you are interested in but also the regularity of business relations which you wish to develop there. A regular flow of business requires long term surveillance before and after commencement.

1. Regarding regular business transactions

Before Commencement:

- Base yourself on an objective evaluation, preferably using indicators outside of the company;
- . Get into contact quickly with local authorities;
- Take out an insurance policy against political risk.

After Commencement:

- Set up a system of surveying political events which affect the country, using the press. Some private companies organize this type of observation, allowing you to discover potential trouble as soon as possible, and to react quickly in order to reduce losses to a minimum;
- Develop a communication programme adapted to the country (with consumers, the sales force, etc);
- Entrust exportation to personnel who are open minded and have an important ability to adapt.
- Draw up a list of unexpected events and actions which the company can implement as they arise.

2. Regarding one-off business transactions

With regard to one-off business transactions, it appears difficult, if not impossible to set up a protection system such as is described above. The company must often react without delay. In this case, the minimum that the company can do is:

- Make enquiries to an insurance company (public or private) regarding the possibilities for covering political risk, which exists for the country with which it wishes to trade (notably with regard to transport, fair insurance, and country-risk policies;
- Use risk/country indicators for example offered by, COFACE (in France) or DUCROIRE (in Belgium);
- Ask for a large advance during the execution of the contract; increase profit margins if the competition allows it.

Political risk can show itself more solidly with the risks of non-payment or of exchange. Techniques such as documentary credit, guarantee on request, and forward purchase of currency can help the company to protect it.
1.7 REVIEW QUESTIONS

1. What are the evolution stages of international business?
2. Discuss the nature of international business?
3. The study of international business is fine if you are going to work in a large multinational enterprise, but it has no relevance for individuals who are going to work in small firms.” Evaluate this statement.
4. Ultimately, the study of international business is no different from the study of domestic business. Thus, there is no point in having a separate course on international business.” Evaluate this statement.
5. How does culture relate to the use of Information Technology?
6. Where lay the problems in knowledge sharing across cultures?
7. How to facilitate IT adoption in different cultural contexts?
8. What are the various reasons which motivate the domestic firms to go for international business?
9. What are the stages of internationalization?
10. You are the CEO of a company that has to choose between making a $100 million investment in China or India. Both investments promise the same long-run return, so your choice is driven by risk considerations. Which investment would you favour and why?
INTERNATIONAL BUSINESS ENVIRONMENT

2.1 Economic Classifications and Transformation Processes Affecting International Business
   2.1.1 Major Types of Economic Systems across Nations
   2.1.2 Steps of Economic Transformation

2.2 International Legal Environment

2.3 Emerging Markets & Strategic Implications

2.4 Technological and Demographic Environment.
   2.4.1 Demographic Environment
   2.4.2 Technological Environment

2.5 Review Questions

2.1 ECONOMIC CLASSIFICATIONS AND TRANSFORMATION PROCESSES AFFECTING INTERNATIONAL BUSINESS

2.1.1 Major Types of Economic Systems across Nations

Market Economy: The characteristics of a pure market economy are as under:

Private Ownership: Private ownership of all productive activities are as opposed to being owned by the state.

1. Forces of Demand & Supply: All goods and services that a country produces, and the quantity in which they are produced, are not planned by anyone. Rather, production is determined by the interaction of supply and demand and signaled to producers through the price system. If demand for a product exceeds supply, prices will rise signaling producers to produce more. If supply exceeds demand; prices will fall, signaling producers to produce less.

2. Sovereignty of Consumers: The purchasing patterns of, consumers, as signaled to producers through the mechanism of the price system, determine what is produced, and in what quantity.

3. No restrictions on supply: A restriction on supply occurs when a single firm monopolizes a market. In such circumstances, rather an increase output in response to increased demand, a monopolist might restrict output and let prices rise. This allows the monopolist to take a greater profit margin; on each unit it sells. Although it is good for the monopolist, it is bad for the consumer, who has to pay higher prices. Since a monopolist has no competitors, it has no incentive to search for ways to lower production costs. Rather, it can simply pass on cost increases to consumers in the form of higher prices. The net result is that the monopolist is likely to become increasingly inefficient, producing high priced, low quality goods, while society suffers as a consequence.
4. **Role of Government:** Encourage vigorous competition between private producers by outlawing monopolies and restrictive business practices (anti trust laws serve this function in the United States).

5. **Role of Entrepreneurs:** Since they have a right to the profits generated by their own efforts, so they have an incentive to search for better ways of serving consumer needs by introducing new products, by developing more efficient production processes, by better marketing and after sales service, or simply through managing their businesses more efficiently than their competitors. In turn the constant improvement in product and process that results from such an incentive has been argued to have a major positive impact on economic growth and development.

**Command Economy:** In a pure command economy:

1. The goods and the services that a country produces, the quantity in which they are produced and the prices at which they are sold are all planned by the government.
2. Objective is for the government to allocate resources for “the good of society”.
3. All businesses are state owned, the rationale being that the government can then direct them to make investments that are in the best interests of the nation as a whole, rather in the interests of the private individuals.
4. Historically, command economies were found in communist countries where collectivist goals were given priority over individual goals.
5. One of the major drawbacks of such economies is that the state owned enterprises have little incentive to control costs and be efficient, because they cannot go out of business. Also, dynamism and innovation are absent from command economies. Instead of growing and becoming more prosperous, such economies tend to be characterized by stagnation.

**Mixed Economy:** Between market economies and command economies can be found mixed economy. The following are the characteristics in a mixed economy:

1. Certain sectors are left to private ownership and free market mechanisms while other sectors have significant state ownership and government planning. Great Britain, France and Sweden were mixed economies, but extensive privatization has reduced state ownership of business in all three.
2. Governments also tend to take into state ownership troubled firms whose continued operation is thought to be vital to national interests.

**State Directed Economy:** In a state directed economy:

1. State plays a significant role in directing the investment activities of private enterprise through ”industrial policy” and in otherwise regulating business activity in accordance with national goals. Japan & South Korea are frequently cited as examples of state-directed economies.
2. A state directed economy differs from a mixed economy in so far as the state does not routinely take private enterprises into public ownership. Instead it nurtures private
enterprise but proactively directs investments made by private firms in accordance with the goals of its industrial policy.

3. The intellectual foundation is based on the so called infant industry argument which suggests that that in some industries, economies of scale are so large and incumbent firms from developed nations have such an advantage that it is difficult for new firms from developing nations to establish themselves.

4. One criticism of state directed economies is that government bureaucrats don’t necessarily make better decisions about the allocation of investment capital than the market mechanism would. A decade of stagnant growth in Japan coupled with the 1997 implosion of the South Korean economy has added legitimacy to these criticisms.

2.1.2 Steps of Economic Transformation

The shift toward a market-based economy typically entails the following steps:

**Financial Deregulation in a Global Economy:** Removing Barriers Trade liberalization and the information revolution have paved the way for the globalization of financial markets. The pace of financial globalization, however, will depend critically on whether governments get out of the way of the market or whether they try to block the natural course of market forces by erecting new barriers to the globalization of trade and finance. Like other institutions, financial institutions evolve best when left alone to respond to consumer choice. In an environment of free competition and private property rights, owners will be held accountable for the services they provide, whether those services are the provision of computer software or the provision of financial instruments.

**Role of the Government:** The best the state can do with respect to money is to provide a framework of legal rules within which the people can develop the monetary institutions that suit them best. The problem is to get governments off the backs of banks and to let financial markets grow without the burden of excessive regulation.

The proper role of government policy should be to make markets as resilient and efficient as possible. Government policymakers should get rid of the traditional bottlenecks of over regulation, over taxation, and overprotection, and let markets work. In almost every country, the financial sector is one of the most highly politicized and regulated parts of the economy. In no other sector of the economy, with the possible exception of foreign trade, have governments intervened so broadly, so consistently, and with such telling effect.

**Market Discipline versus Centralized Controls:** Market prices provide incentives and information to guide decision makers in the allocation of scarce resources. Insofar as markets are competitive and prices are flexible, resources will tend to flow to the uses deemed most valuable by consumers. Institutions that serve consumers best will survive; institutions that do not will fail. Thus, the market itself can act as a brake on inefficient institutions while encouraging the success of efficient ones. If financial institutions were subject to global competition, if insolvent banks were allowed to fail, if deposit insurance were properly priced, and if monetary equilibrium prevailed, there would be little reason to expect banking to be inherently unstable. Free entry and exit, full disclosure, and personal liability for risk-taking would motivate owners
and managers of financial institutions to create wealth while safeguarding their customers’ deposits. And placing limits on the creation of government flat money would help achieve monetary stability.

In such an environment, the market would sort out prudent and foolish decisions and, thereby, act as a disciplinary force on financial institutions. Regulatory costs would fall because markets are much more efficient at modifying banks’ behavior than regulators could ever hope to be. Regulatory costs would fall because markets are much more efficient at modifying banks’ behavior than regulators could ever hope to be.

Financial Stability and Monetary Stability: It makes no sense to talk about financial stability without talking about monetary stability. Banks and non-bank financial institutions operate within a specific monetary regime. If that regime is unstable, as evidenced by erratic variations in the quantity of high-powered money and an uncertain price-level path, the financial system will be adversely affected.

The best path toward monetary stability is free banking with competing private currencies. If that path is not politically feasible, one should at least make sure that the central bank’s power to print high-powered money is limited, either by freezing the monetary base or by limiting its rate of growth by adopting a feedback rule to stabilize nominal income. Regardless of the rule chosen, there needs to be a monetary constitution that fosters the predictability of the future path of the price level and of the monetary regime within which financial institutions operate. Predictability would make property rights more secure and increase the efficiency of the price system. Banks would make their investment decisions without the threat of unexpected swings in the value of money, and relative prices would convey more information without being distorted by monetary shocks.

Evolution of the Global Economy: The integration of the global economy has not been planned; it has evolved through a competitive market process. Governments have intervened, but markets have responded by circumventing regulations and creating new financial instruments, such as derivatives, and new financial institutions, such as non-bank mutual funds. There is no reason to believe that economic integration requires monetary integration. The European common market does not necessitate a single currency and a European central bank. As Anna Schwartz notes, “Free trade is achievable without fixed exchange rates or monetary union. Fixed exchange rates have economic costs, and monetary union is a political pipe dream.”

Yoshio Suzuki (1994) cites the experience of Japan in the late 1980s as an example of misguided international coordination. Instead of adhering to a non-inflationary monetary policy, Japan was pushed into an expansionary policy by the 1987 Louvre Accord, which was designed to lower interest rates in Japan and strengthened the dollar against the yen. The expectation of lower interest rates inflated asset prices in Japan until the asset bubble burst in 1990, after a series of increases in the interest rate. The lesson for Suzuki is that leading economic powers like Japan and the United States should “have autonomy in their economic policies.” If either economic superpower “sacrifices its domestic stabilization policy for the benefit of the other superpower, the resultant domestic destabilization will eventually cause serious harm to global stability”. The smooth evolution of an integrated world economy will stem not from forced international
coordination but from policy competition among sovereign nations. Each country seeking to liberalize and stabilize its own domestic economy will help liberalize and stabilize the global economy. A decentralized, competitive approach to global policy coordination is useful because it allows countries to discern policy mistakes and to discover the most beneficial policy mix. International coordination works best when it is voluntary and there is a general appreciation of and adherence to a common set of rules that limit the power of governments to tax, spend, regulate, and print money. A rules-based approach to macroeconomic policymaking and a competitive approach to regulatory policy making will help promote economic liberty and achieve domestic and global stability.

**Privatization:** Privatization is the economic process of transferring property, from public ownership to private ownership. The opposite process is nationalization. In theory, privatization helps establish a "free market", as well as fostering capitalist competition. Conversely, socialists view privatization negatively; they argue that it reduces state control of essential services. Privatization is frequently associated with industrial or service-oriented enterprises, such as mining, manufacturing or power generation, but it can also apply to any asset, such as land, roads, or even rights to water. In recent years, government services such as health, sanitation, and education have been particularly targeted for privatization in many countries.

**Advocates of privatization argue that governments run businesses poorly for the following reasons:**

1. They may only be interested in improving a company in cases when the performance of the company becomes politically sensitive.
2. Conversely, the government may put off improvements due to political sensitivity — even in cases of companies that are run well.
3. The company may become prone to corruption; company employees may be selected for political reasons rather than business ones.
4. The government may seek to run a company for social goals rather than business ones.
5. It is claimed by supporters of privatization that privately held companies could more easily raise capital in the financial markets than publicly owned ones.
6. Governments may "bail out" poorly run businesses with money when, economically, it may be better to let the business fold.
7. Parts of a business which persistently lose money are more likely to be shut down in a private business (this is conversely seen as a negative by critics of privatization).
8. Nationalized industries can be prone to interference from politicians for political or populist reasons. Such as, for example, making an industry buy supplies from local producers, when that may be more expensive than buying from abroad, forcing an industry to freeze its prices/fares to satisfy the electorate or control inflation, increasing its staffing to reduce unemployment, or moving its operations to marginal constituencies, these can cause nationalized industries to become uneconomic and uncompetitive.

In particular, the first and last reasons become important because money is a scarce resource: if government-run companies are losing money, or if they are not as profitable as possible, this money is unavailable to other, more efficient firms. Thus, the efficient firms will have a harder time finding capital, which makes it difficult for them to raise production and create more
employment. Ideally, privatizations are organized as auctions where bidders compete to offer the state the highest price, creating real value that can be used by the state as investment capital. The state can also allow foreigners to buy privatized enterprises, whereby an outside investor invests the capital needed to upgrade and modernize the firm, making it internationally competitive.

**Arguments against Privatization:** Opponents of privatization argue that it is undesirable to let private entrepreneurs own public institutions for the following reasons:

1. Private companies do not have any other goal than to maximize profit.
2. The public does not have any control or oversight of private companies.
3. A centralized enterprise is generally more cost effective than multiple smaller ones. Therefore splitting up a public company into smaller private chunks will reduce efficiency.
4. Profits from successful enterprises end up in private pockets instead of being available for the common good.
5. Nationalized industries are usually guaranteed against bankruptcy by the state, they can therefore borrow money at a lower interest rate to reflect the lower risk of loan default to the lender.
6. In cases where public services or utilities are privatized, it can create a conflict of interest between profit and maintaining a sufficient service. A private company may be tempted to cut back on maintenance or staff training etc, to maximize profits.

In practical terms, there are many pitfalls to privatization. Privatization has rarely worked out ideally because it is so intertwined with political concerns, especially in post-communist economies or in developing nations where corruption is endemic. Even in advanced market economies like Great Britain, where privatization has been popular with governments (if not all of the public) since the Thatcher era, problems center on the fact that privatization programs are very politically sensitive, raising many legitimate political debates. For examples:

- Who decides how to set values on state enterprises?
- Does the state accepts cash or for government-provided coupons?
- Should the state allow the workers or managers of the enterprise to gain control over their own workplace?
- Should the state allow foreigners to buy privatized enterprises?
- Which levels of government can privatize which assets? How much?

In the short-term, privatization can cause tremendous social upheaval, as privatizations are nearly always accompanied by large layoffs. If a small firm is privatized in a large economy, the effect may be negligible. If a single large firm or many small firms are privatized at once, a whole nation's economy may plunge into despair. For example, in the Soviet Union, many state industries were often not even value adding, with cost of inputs exceeding the cost of outputs. After privatization, sixteen percent of the workforce became unemployed in both Eastern Germany and Poland. The social consequences of this process have been horrendous, impoverishing millions, but to little social benefit in many post-Communist countries. In the
process, Russia has gone from having one of the world's most equitable distributions of wealth in the Soviet era to one of the least today. There has been a dearth of large-scale investment to modernize Soviet industries and businesses still trade with each other by means of barter.

Privatization in the absence of a market system may lead to assets being held by a few very wealthy people, a so-called oligarchy, at the expense of the general population and may discredit the process of economic reform. This is notably the case in Russia, Mexico, and Brazil.

If the privatized company is a natural monopoly, or exists in a market, which is prone to serious market failures, consumers may be worse off if the company is in private hands. This seems to have been the case with rail privatization in the UK and New Zealand; in both countries, government intervention has become necessary. In cases where privatization has been successful, it is because genuine competition has arisen. A good example of this is long-distance telecommunications in Europe, where the former state-owned enterprises lost their monopolies, competitors entered the market, and tariffs for international calls fell dramatically.

If the privatization does not fully transfer property rights to the newly private firm, there may be disincentives for the firm to make capital investments. This was a particular problem in the case of the privatized rail track-leasing company in the UK.

Many have argued that the strategy of privatization in Russia differed from those seen in more successful post-communist economies like Hungary and Poland, and combined with capital market liberalization, and failure to establish institutional infrastructure, have led to incentives for capital flight, contributing to post-communist economic contraction in Russia. Likewise, countries such as Argentina, which embarked upon far-reaching privatization programs, selling off valuable, profitable industries such as energy companies, rapidly impoverished the governments. Revenue streams which could previously be directed towards social ends (health, education, etc.) suddenly dried up, resulting in catastrophic drop in public services.

Privatization can also have a ripple effect on local economies. State-owned enterprises can be obliged to patronize national or local suppliers. Privatized companies don't have that restriction, hence shift purchasing elsewhere. Bolivia underwent a rigorous privatization program in the mid-1990s, with disastrous impact on the local economy.

Finally, it has been argued that the Chinese economic reform has illustrated that economic reform can take place in the absence of mass privatization.

**Corporatization:** The effect of corporatization has been to convert the state departments into public companies and interpose commercial boards of directors between the shareholding ministers and the management of the enterprises. To some extent, this model has enabled efficiencies to be gained without ownership of strategic organizations being transferred. This has been the policy of the People's Republic of China.

**The Role of Inflation in the Economy:** A great deal of economic literature concerns the question of what causes inflation and what effects it has. A small amount of inflation is often viewed as having a positive effect on the economy. One reason for this is that it is difficult to
renegotiate some prices, and particularly wages, downwards, so that with generally increasing prices it is easier for relative prices to adjust.

Inflation may also have the following **negative effects** on the economy:

- **Uncertainty**: Increasing uncertainty may discourage investment and saving;
- **Redistribution**: It will redistribute income from those on fixed incomes, such as pensioners, and shifts it to those who draw a variable income, for example from wages and profits which may keep pace with inflation. Similarly it will redistribute wealth from those who lend a fixed amount of money to those who borrow. For example, where the government is a net debtor, as is usually the case, it will reduce this debt redistributing money towards the government. Thus inflation is sometimes viewed as similar to a hidden tax.
- **International Trade**: If the rate of inflation is higher than that abroad, a fixed exchange rate will be undermined through a weakening balance of trade
- **Shoe Leather Costs**: Because the value of cash is eroded by inflation, people will tend to hold less cash during times of inflation. This imposes real costs, for example in more frequent trips to the bank. (The term is a humorous reference to the cost of replacing shoe leather worn out when walking to the bank.)
- **Menu Costs**: Firms must change their prices more frequently, which impose costs, for example with restaurants having to reprint menus.

On balance many economists see moderate inflation as a benefit, and so there are a variety of fiscal policy arguments, which favor moderate inflation. Central banks can affect inflation to a significant extent through setting the prime rate of lending and through other operations. This is due to the fact that most money in industrialized economies is based on debt (see money and credit money), and so controlling debt is thought to control the amount of money existing and so influence inflation. A government may find some level of inflation to be desirable, particularly in order to raise funds.

**Causes of inflation**: Inflation may be caused by an increase in the quantity of money in circulation. This has been seen most graphically when governments have financed spending in a crisis by printing money, leading to hyperinflation where prices rise at extremely high rates. Another cause of inflation occurs when there are many people and organizations with enough market power to increase their prices.

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**2.2 INTERNATIONAL LEGAL ENVIRONMENT**

Three heritages form the bases for the majority of the legal systems of the world. Common Law derived from English law and found in England, the United States, Canada and other countries once under English influence. Civil or Code law derived from Roman law and found in Germany, Japan, France and in non- Islamic and non- Marxist countries. Islamic Law derived from the interpretation of the Koran and found in Pakistan, Iran, Saudi Arabia and other Islamic States. A fourth heritage for a commercial legal system is the Marxist – socialist economies of Russia and the republics of the former Soviet Union, Eastern Europe, China and other Marxist – socialist states.
Common Law and Code Law: Common law is based on tradition, past practices and legal precedents set by the courts through interpretations of statutes, legal legislation and past rulings. Common law seeks “interpretation through the past decisions of higher courts which interpret the same statues or apply established and customary principles of law to a similar set of facts”. Code Law on the other hand, is based on an all-inclusive system of written rules [codes] of law. Under code law, the legal system is generally divided into three separate codes: commercial, civil and criminal.

How do the two systems differ?

Illustration: Performance of a Contract.
Under Common law in the United States, it is fairly clear that impossibility of performance does not necessarily excuse compliance with the provisions of a contract unless it is impossible to comply for reasons of an act of God, such as some extraordinary happening of nature not reasonably anticipated by either party or contract. Hence floods, lightning, earthquakes and similar occurrences are generally considered acts of God. Under Code law, acts of God are not limited solely to acts of nature but are extended to include “unavoidable interference with performance, whether resulting from forces of nature or unforeseeable human acts,” including such things as labor strikes and riots.

Situations: A contract was entered into to deliver a specific quantity of cloth. In one case, before the seller could make delivery an earthquake caused the destruction of the cloth and compliance was then impossible. In the second case, pipes in the sprinkler system where the material was stored froze and broke, spilling water on the cloth and destroying it.

In each case, loss of the merchandise was sustained and delivery could not be made. Were the parties in these cases absolved of their obligations under the contract because of the impossibility of delivery?

Result: In the first situation the earthquake would be considered an act of God under both common and code law and impossibility of performance would excuse compliance under the contract. In the second situation, courts in common – law countries would probably rule the bursting of water pipes did not constitute an act of God if it happened in a climate where freezing could be expected. Therefore, impossibility of delivery would not necessarily excuse compliance with the provisions of the contract. In code – law countries, where the scope of impossibility of performance is extended considerably, the destruction might very well be ruled an act of God, and thus release from compliance with the contract could be obtained.

Islamic Law: It defines a complete system that prescribes specific patterns of social and economic behaviour for all individuals. It includes issues such as property rights, economic decision making, and types of economic freedom. The overriding objective of the Islamic system is social objective. Some of its unique aspects are as follows:

- The prohibition against the payment of interest or “riba”, defined as unlawful advantage by way of excess of deferment, that is, interest or usury. To comply with this law in financial transactions, trade with markup or cost – plus sale (murabha) and leasing
(ijara) are the most frequently used. In both murabba and ijara, a mutually negotiated margin is included in the sale price or leasing payment.

- Advocates risk sharing, individual’s rights and duties, property rights and the sanctity of contracts.
- Prohibition against the investment in those activities that violate the Shar’ah. For example, any investment in business dealing with alcohol, gambling and casinos will be prohibited.

How do International Disputes arise?

Illustration: Border disputes continue between the United States and Canada and between the United States and Mexico

Many of these disputes deal with agricultural products as well as lumber. Unfortunately, many of the criteria used for resolving anti-dumping and countervail disputes really do not apply to agriculture and lumber as they are borrowed from manufactured products. Second, there is often a wide discrepancy between trade law and economics. Third, in terms of the increased emphasis on international globalization, the World Trade Organization (WTO) will play an increasing role in resolving disputes. Fourth, environmental and resource issues are starting to play a role in border dispute resolutions.

Environmental Issues: Underlying the resolution of trade disputes is a country’s cost of production. However, some countries’ costs are low because of low environmental standards. This often provides an advantage for one country over its competitors. Does this provide a basis for trade remedy action?

Country-of-Origin Labeling: The United States is to enact legislation that will require country of origin labeling. Is this a means to promote trade or will it be a vehicle for industry protection? How will trade disputes be resolved once origin of labeling is in place?

The Use of Subsidies: Agricultural subsidies are still rampant. For example, under Canada’s AIDA program, Canadian hog producers received significant subsidies, but these are not permanent in nature. Because of such a program, does the United States have a basis for trade action against Canadian hog producers? Will the United States reopen its countervail and dumping actions against Canadian cattle producers?

Valuing Resources: In the lumber business between Canada and the United States, a key issue was the cost of stumpage fees in Canada. Natural resource based industries such as lumber are somewhat different in trade disputes than primary agricultural products. Was there any basis for the U.S. duties imposed on Canadian lumber? What was the impact of these duties?

The Role of Multinationals: Many of the agricultural products traded internationally are produced and processed by multinationals. What role do they play in border dispute resolutions? Do they lobby and buy legal talent to keep the borders open or to have them shut?

Trade in Substitute Products: Often trade occurs where a country exports commodity that is a substitute for a commodity that it imports. For example, the United States exports high fructose
corn syrup (HFCS) to Mexico and imports sugar. Mexico has brought countervailing charges against U.S. HFCS exports to that country in retaliation to restricted imports of Mexican sugar.

**Quantitative Impacts:** In resolving trade disputes, often the United States provides results from model constructed by USDA and the International Trade Commission. However, academics have questioned the reliability of such models. What if other quantitative models were used in trade resolutions? Would the results be significantly different?

**How are the disputes resolved?**

Disputes that do arise can be resolved in any of the following ways:

- One or more parties agree to accept a situation in which their interests are not fully satisfied.
- The parties submit the situation to an impartial person or panel, who decides which interests should be satisfied and which should not. Usually, the impartial person or panel will refer to pre-existing rules or guidelines that had been agreed by all parties or were at least known to all parties. Often these rules are what we call laws.
- The perceptions of one or more parties change, so that there is no longer a perceived difference in interests.
- The interests of one or more parties change, so that there is no longer a difference in interests.

**The Three Factors:** At this point, it is useful to recognize that there are three independent fundamental factors that affect the resolution of disputes.

- **Interests:** Interest is defined by a party in an interaction and the thing that party is interested in (money, recognition, physical goods, or whatever).
- **Power:** Power is given by a combination of external circumstances and self-confidence.
- **Rights:** Rights are given by an external framework, for example national laws or contracts between parties.

When a party has a common interest with another party, and power, and rights, it is in a very favorable situation. For example, Hewlett-Packard (HP) shares with its customers the interest in producing and selling high-quality, low-cost printers; HP has the financial power to develop printers and the marketing power to distribute them; HP has the rights to patents and trade secrets.
that allow it to produce the best products. More commonly, one of the elements is missing. For example, in the laser jet printer market, Canon has the same interests as HP and its customers, many of the same rights as HP to the patents on the technology, but it lacks the marketing power.

Rights may confer power: for example, a patent confers the power to prevent competitors from creating a given product. But power may be required to exercise a right: for example, financial power is required to litigate a patent-infringement suit against a large company. Either rights or power may be ceded in order to satisfy an interest; conversely, to satisfy an interest may require ceding rights or power: for example, authors whose interests are financial rewards typically cede their copyright rights to a publisher. Thus there are connections between interests, power, and rights, and in real life there are usually trade-offs between the three factors.

What are the methods of Dispute Resolution?
If the buyer refuses to pay, the product is of inferior quality, the shipment arrives late, or any one of the myriad problems that can arise – what recourse does the international marketer have?

Conciliation: Also known as mediation is a non-binding agreement between parties to resolve disputes by asking a third party to mediate differences. Conciliation sessions are private and all conferences between parties and the mediator are confidential; the statement made by the parties may not be disclosed or used as evidence in any subsequent litigation or arbitration. Conciliation is considered to be especially effective when resolving disputes with Chinese business partners since they are threatened less by conciliation than arbitration. The Chinese believe that when a dispute occurs, informal, friendly negotiation should be used first to solve that problem; if that fails, conciliation should be tried. In fact, some Chinese companies may avoid doing business with companies that resort first to arbitration. Both sides agreeing on a third party to mediate can establish informal conciliation. Formal conciliation is conducted under the auspices of some tribunal such as the Beijing Conciliation Center, which assigns one or two conciliators to mediate. If an agreement is reached, a conciliation statement based on the signed agreement is recorded.

Arbitration: The usual arbitration procedure is for the parties involved to select a disinterested and informed party or parties as referee to determine the merits of the case and make a judgment that both parties agree to honor. Although informal arbitration is workable, most arbitration is
conducted under the auspices of one of the more formal domestic and international arbitration groups organized specifically to facilitate mediation of commercial disputes. Some of the active arbitral centers are:

- The Inter-American Commercial Arbitration Commission.
- The International Chamber of Commerce.

**Arbitration clauses require agreement on two counts:**

- The parties agree to arbitrate in a case of a dispute according to the rules and procedures of some arbitration tribunal.
- They agree to abide by the awards resulting from the arbitration.

Difficulty arises when parties to a contract fail to honor the agreements. In most countries, arbitration clauses are recognized by the courts and are enforceable by law within those countries. Over 120 countries have signed a U.S. Convention on the Recognition and Enforcement of Foreign Arbitral Awards, also known as the New York Convention, which binds them to uphold foreign arbitral awards issued in member countries.

**Litigation:** Lawsuits in public courts are avoided for many reasons. Most observers of lawsuits between citizens of different countries believe that almost all victories are spurious because the cost, frustrating delays and extended aggravation, which these cases produce, are more oppressive by far than any matter of comparable size. In India, for instance, there is a backlog of more than three million cases and litigating a breach of contract between private parties can take a decade or more.

**Other Deterrents to Litigation are:**

- Fear of creating a poor image and damaging public relations.
- Fear of unfair treatment in a foreign court.
- Difficulty in collecting a judgment that may otherwise have been collected in a mutually agreed settlement through arbitration.
- The relatively high cost and time required when bringing legal action.
- Loss of confidentiality – Unlike arbitration and conciliation proceedings that are confidential, litigation is public.

**How do Legal differences affect the Marketing Plans across Nations?**

Although differences in languages and customs may be negated, legal differences between countries may still prevent a standardized marketing program.

**Marketing Laws:** There are vast differences in enforcement and interpretation among countries having laws covering the same marketing activities. Laws governing sales promotions in the European Community offer good examples of such diversity.
• In Australia, premium offers to consumers come under the discount law, which prohibits any cash reductions that give preferential treatment to different group of customers.
• In Finland, premium offers are allowed with considerable scope as long as the word “free” is not used and the consumers are not coerced to buy the products.
• France also regulates premium offers, which are, for all practical purposes, illegal because it is illegal to sell for less than cost price or to offer a customer a gift or premium conditional on the purchase of another product.

Laws concerning **product comparison**, a natural and effective means of communication also offer good examples of diversity:

• In Germany, comparisons in advertisements are always subject to the competitor’s right to go to the courts and ask for proof of any implied or stated superiority.
• In Canada, the rulings are even more stringent: All claims and statements must be examined to ensure that any representation to the public is not false or misleading. Such representation cannot be made verbally in selling or contained in or on anything that comes to the attention of the public [such as particular labels, inserts in products, or any other form of advertising including what may be expressed in a sales letter.]. The courts are expected to apply the “credulous person stand,” which means that if any reasonable person could possibly misunderstand the representation, the representation is misleading.
• In Puerto Rico and Virgin Islands, the law requires that the rules for any promotion should be printed in Spanish and English. And during the entire time of promotion both versions must be printed in at least one general circulation newspaper once a week. If the promotion includes a drawing, Puerto Rico requires that a notary be present when the drawing takes place.

**Green Marketing Legislation:** MNCs also face a growing variety of legislation designed to address environmental issues. Global concern for the environment extends beyond industrial pollution, hazardous waste disposal and rampant deforestation to include issues that focus directly on consumer products.

**Green marketing laws focus on product packaging and its effect on solid waste management and environment friendly products.** Germany has passed the most stringent green marketing laws that regulate the management and recycling of packaging waste. The new packaging law was introduced in three phases.

• The first phase required all transport packaging such as crates, drums, pallets and Styrofoam containers to be accepted back by the manufactures and distributors for recycling.
• The second phase require manufacturers, distributors and retailers to accept all returned secondary packaging, including corrugated boxes, blister packs, packaging designed to prevent theft, packaging for vending machine applications and packaging for promotional purposes.
• The third phase requires all retailers and distributors and manufacturers to accept returned sales packaging including cans, plastic containers for dairy products, foil wrapping, Styrofoam packages and folding cartons such as cereal boxes. The requirement for
retailers to take back sales packaging has been suspended as long as the voluntary green
dot program remains a viable substitute.

Many European countries have identified products that comply with a certain criteria that make
them more environments friendly than similar products. Such products that meet those criteria
will be awarded an “eco-label” that the manufacturer can display on the packaging as a signal to
the customers of environment friendly product.

**Antitrust - An Evolving Issue:** With the exception of the United States, antitrust laws have been
either nonexistent or not enforced in most of the world’s countries for the better part of the 20\textsuperscript{th}
Century. However, now the European Community, Japan and many other countries have begun
to actively enforce their anti – trust laws patterned after those in the United States.
Antimonopoly, price discrimination, supply restrictions and full line forcing are areas in which
the European Court of Justice has dealt severe penalties. Examples are as follows:

- Before Procter & Gamble Company was allowed to buy VP-Schickedanz AG, a German
  hygiene products company, it had to agree to sell off one of the German company’s
divisions that produced Camelia, a brand of Sanitary napkins. P&G already marketed a
brand of sanitary napkins in Europe, and the Commission was concerned that allowing
them to keep Camelia would give them a controlling 60% of the German Sanitary
products market and 81% of Spain’s.
- Coca-Cola was fined $ 1.8 million for anticompetitive practices by France’s antitrust
  authority; two months later Coca-Cola paid a $2 million fine in Venezuela for violating
laws that prohibit market concentrations restrictive to free competition.

**How to deal with the problem of Intellectual Property Rights Protection across borders?**

**Most valuable assets of company are:**

- Brand names or Trademarks symbolizing quality and a host of other features designed to
  entice customers to buy their brands to the exclusion of others.
- Researched products, processes, designs and formulas that provide companies with
  advantages over their competitors.

Normally, intellectual property rights can be legally protected to prevent other companies from
infringing on such assets. Although difficult to pinpoint, lost sales from the unauthorized use of
patents, trademarks and copyrights amount to about $ 60 billion annually for the U.S alone. It
translates into more than a million lost jobs. Pirated compact – disk music sales are estimated to
exceed $5 billion annually and are growing at 6% per year. A major provision of the Uruguay
Round of GATT establishes substantially higher standards of protection for full range of
intellectual property rights [IPR] than are embodied in current international agreements.

**Inadequate Protection:** Most frequent errors is assuming that because the company has
established rights in the United States, they will be protected around the world or that rightful
ownership can be established should the need arise. For example:
• With McDonald in Japan, where enterprising Japanese registered its “Golden Arches” trademark as their own. After having to buy its trademark for an undisclosed amount, McDonald’s maintains a very active program to protect its trademarks.

• A South Korean company legally uses the coach brand on handbags and leather goods. The company registered the Coach trademark first and has the legal right to use that mark in Korea. The result is that a Coach-branded briefcase that is virtually indistinguishable from the U.S product can be purchased for $135 in South Korea versus $320 in the United States.

Prior Use versus Registration: In a Common law country such as United States, ownership of intellectual property rights is established by prior use – whoever can establish first use is typically considered the rightful owner.

In a Code law country, ownership is established by registration rather than by prior use – the first to register a trademark or other property right is considered the rightful owner. For example, a trademark in Jordan belongs to whoever registers it first in Jordan. Thus, you can find “McDonald's restaurant, “Microsoft” software and “Safeway’s “groceries all legally belong to a Jordanians. Besides the first to register issue, companies may encounter other problems with registering. China has improved intellectual property rights protection substantially and generally recognizes “first to invent”. However a Chinese company can capture the patent for a product invented elsewhere; it only needs to reverse-engineer or reproduce the product from published specifications and registers it in China before the original inventor.

International Conventions: There are three major ones as follows:

2. The Inter American Convention.
3. The Madrid Arrangement, which established the Bureau for International Registration of Trademarks. It includes 26 European countries.

In addition, the World Intellectual Property Organization [WIPO] of the United Nations is responsible for the promotion of the protection and administration of the various multilateral treaties through cooperation among its Member States.

Two Multi-country patent arrangements have streamlined patent procedures in Europe.

• Patent Cooperation Treaty (PCT) – facilitates the application of patents among its member countries.
• European Patent Convention (EPC) – establishes a regional patent system allowing any nationality to file a single international application for a European patent. Once the patent is approved, the patent has the same effect as a national patent in each individual country.
A Brief Study of the Regulatory Environment of the United States:

Protecting Competition: Major federal legislation passed to encourage fair competition
- Sherman Antitrust Act (1890);
- Clayton Act (1914);
- Robinson-Patman Act (1936);
- Federal Trade Commission Act;
- Celler-Kefauver Antimatter Act;
- Hart-Scott-Rodino Act;

Product-Related Legislation:
1. Company Protection: Companies are afforded basic protection for their products under the patent law. The copyright law gives the author of a literary, dramatic, musical, or artistic work the exclusive right to print, perform, or copy the work. Digital technology has necessitated new copyright legislation to improve protection of copyrighted digital products against piracy.

2. Consumer Protection: There are many consumer-oriented federal laws regarding products. [Meat Inspection Act (1906), Food, Drug, and Cosmetics Act (1938), Fair Packaging and Labeling Act (1966), Consumer Product Safety Act (1972]. A grassroots movement started in the 1960s to increase the influence, power, and rights of consumers in dealing with institutions. In responses to consumer interests the following acts were established:
   - Clean Air Act (1990),
   - Telephone Consumer Protection Act (1991),

3. Both Company and Consumer Protection: The Lanham Act (1946) provides for registration of a company’s trademarks for exclusive use unless it becomes generic. The Trademark Law Revision Act (1988) changed the Lanham Act to allow a company to secure rights to a name before actual use by declaring intent to use the name. Trademarks also protect consumers by assuring them that they get the product they want. The U.S. Supreme Court has ruled that companies may obtain trademarks for colors associated with their products.

Pricing-Related Legislation: The Robinson-Patman Act - regulate pricing practices. The courts view price fixing itself as illegal. Certain forms of price discounting are allowed. Quantity discounts are acceptable. Buyers can be charged different prices for a product provided there are differences in manufacturing or delivery costs.

Distribution-Related Legislation: The government has four concerns with regard to distribution and the maintenance of competition:

1. Exclusive dealing: Buyer to handle only the products of one manufacturer and not those of competitors. This is illegal when it substantially lessens competition.
2. Requirement contracts: Require a buyer to purchase all or part of its needs for a product
from one seller for a period of time. Not always illegal, depending on a court’s interpretation of their impact on distribution.

3. **Exclusive territorial distributorships:** Manufacturer grants a distributor the sole rights to sell a product in a specific geographic area, often receive regulatory scrutiny.

4. **Tying arrangements:** Seller requires the purchaser of one product also to buy another item in the line. These contracts may be illegal when the seller has such economic power in the tying product that the seller can restrain trade in the tied product.

**Advertising and Promotion-Related Legislation:** The Federal Trade Commission (FTC) monitors deceptive or misleading advertising and unfair business practices. It has the power to issue cease and de-cease orders and to order corrective advertising.

**Other Laws Designed to Regulate Advertising:**

- The Wheeler-Lea Act - controls false advertising.
- Federal Cigarette Labeling and Advertising Act (1967)

**Control through Self-Regulation:** An alternative to government control. An industry attempts to police itself. The best-known self-regulatory group is the Better Business Bureau (BBB). BBB Online provides objective consumer protection for Internet shoppers. Participating companies must follow the BBB’s standards before they display the BBB logo on their website.

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**2.3 EMERGING MARKETS & STRATEGIC IMPLICATIONS**

**What is the recent trend of economic growth?**
It consists of three multinational market regions that comprise major trading blocs: Europe, Asia and America. Within each trading bloc are fully industrialized countries as typified by Germany, Japan and the United States; rapidly industrializing countries such as Mexico, Singapore and South Korea that are close on the heels of the fully industrialized and other countries that are achieving economic development but at more modest rates.

**What are the stages of economic development?**
Five stage model presented by Walt Rostow for classifying countries by the stage of economic development.

**Stage 1: The Traditional society:** Countries in this stage lack the capability of significantly increasing the level of productivity. There is a marked absence of systematic application of the methods of modern science and technology. Literacy is low, as are other types of social overhead.

**Stage 2: The preconditions for take off:** Includes those societies in the process of transition to the take off stage. During this period, the advances of modern science are beginning to be applied in agriculture and production. The development of transportation, communication, power, education, health and other public undertakings are begun in a small but important way.
Stage 3: The Take off: Countries achieve a growth pattern which becomes a normal condition. Human Resources and social overhead has been developed to sustain steady development. Agriculture and industrial modernization lead to rapid expansion in these areas.

Stage 4: The drive to Maturity: After take off, sustained progress is maintained and the economy seeks to extend modern technology to all fronts of economic activity. The economy takes on international involvement. In this stage, an economy demonstrates that it has the technological and entrepreneurial skills to produce not everything, but anything it chooses to produce.

Stage 5: The age of high mass consumption: Leads to shifts in the leading economic sectors towards durable consumers’ goods and services. Real income per capita rises to the point where a very large number of people have significant amounts of discretionary income.

The United States uses a system to classify a country’s stage of economic development based on its level of industrialization. It groups countries into three categories:

- MDCs (More Developed Countries): Industrialized countries with high per capita income such as Canada, England, France, Germany, Japan and the United States.
- LDCs (Less Developed Countries): Industrially developing countries just entering the world trade, many of which are in Asia and Latin America, with relatively low per capita income.
- LLDCs (Least developed Countries): Industrially underdeveloped, agrarian, subsistence societies with rural populations, extremely low per capita income levels, and little world trade involvement. These are found in Central Africa and parts of Asia.

Many countries that are classified as LDCs are industrializing at a very rapid rate while others are advancing at more traditional rates of economic development.

Newly Industrialized Countries: The category of newly industrializing countries (NICs) is a social/economic classification status applied to several countries around the world by political scientists and economists. NICs are countries that are not quite yet at the status of a full-fledged capitalist, liberal democracy but still more advanced than third world countries or the category of least developed nations. NIC usually share some common features:

- A recent industrialization [switch from agricultural to industrial economy].
- Recent reforms allowing for greater political liberalization and democracy.
- Increased social freedom and civil rights.
- An increasingly open economy allowing for freer trade with nations.

NIC receive a lot of support from non – governmental organizations such as WTO and other internal support. Among the NICs, South Korea, Taiwan, Hong Kong and Singapore are discussed as the “Four Tigers” of South East Asia in terms of GDP per head and personal income. These four countries began their industrialization as assemblers of products for U.S and Japanese companies, but are now major world competitors in their own right. Korea, for example, exports such high tech goods as petrochemicals, electronics, machinery and steel all of
which are in direct competition with Japanese and U.S based products. The factors that existed to some extent during the economic growth of NICs were:

1. Political Stability in policies affecting their development.
2. Economic, political and legal reforms.
3. Entrepreneurship: In all of these nations, free enterprise in the hands of the self-employed was the seed of the new economic growth.
4. Planning: A central plan with observable and measurable development goals linked to specific policies.
5. Outward Orientation: Production for the domestic market and export markets with differentiation.
6. Factors of Production: An environment existed where these factors could easily come from outside the country and be directed to development objectives.
7. Strategic choice of Industries: Directing resources into promising target sectors.
8. Incentives to force a high domestic rate of savings and to direct capital to update the infrastructure, transportation, housing, education and training.

How can agriculture act as an economic engine for a NIC?
Let’s explain it through the growth progress of CHILE. Chile’s economy has expanded at an average rate of 7.2% since 1987. But since 1976, when Chile opened up trade, the relative size of its manufacturing sector has declined from 27% of GDP in 1973 to 16.8% in 1995. On the other hand, exports of agricultural products have been the star performers. Chile is one of the world’s largest fruit exporters in 1990s. Sophisticated production technology and management methods also were applied to the production of table grapes, wine, and salmon from fish farms and a variety of other processed and semi processed agricultural products.

Developing Countries and Emerging Markets:
The Department of Commerce estimates that over 75% of the expected growth in the world trade over the next two decades will come from more than 130 developing and newly industrialized countries [NICs]; a small core of these countries will account for more than half of that growth. Commerce researchers also predict that imports to the countries identified as Big Emerging Markets (BEMs) with half of the world’s population and accounting for 255 of the industrialized world’s GDP today, will by 2010 be 50% of that of the industrialized world.

Trends in International Trade and Emerging Business Models
The WCO Council Sessions in June 2004 adopted a Resolution on global security and facilitation measures concerning the international supply chain, by which a High Level Strategic Group (HLSG) was established to prepare the Framework of Standards to Secure and Facilitate Global Trade (hereinafter “Framework”). Following the subsequent HLSG work, the 52nd Session of the WCO Policy Commission in December 2004 adopted a Resolution on the work of the HLSG (hereinafter “2004 PC Resolution”), by which the WCO Secretariat is mandated to take up a number of tasks to support the HLSG in preparing the Framework. However, this section aims to carry out the task to identify new trends in international trade (See Table -1).

New Trends in International Trade: International trade is increasingly recognized as a vital engine for economic development (World Bank, 2005a; UNCTAD, 2004a). In 2004, the value of
world merchandise trade rose by nearly 21%, the highest growth rate in 25 years (WTO, 2005a), amounting to nearly USD 8.9 trillion. Taking account of dollar price changes, real world merchandise trade expanded by 9% in 2004, almost doubling from 5% in 2003. It continues to grow more rapidly than global Gross Domestic Products (GDP). For example, world trade grew at nearly 6% on average in 1994-2004, while global GDP at market exchange rates grew less than 3% in the same period. In the meantime, a number of new trends in international trade have been observed over recent years. Those mentioned below are among such trends which, in particular, are relevant when preparing the Framework.

Trade in Agricultural and Manufactured Goods: Manufactured goods, excluding mining products, recorded above average growth in world merchandise trade during the past two decades (WTO, 2004a; 2005b). As a result, they accounted for around three-quarters of world merchandise trade in 2003. By contrast, the share of agricultural goods trade remained at around 9% in the three preceding years, which represented approximately 2% below the average level in the 1990s. One of the notable trends is that processed agricultural goods have become more important within trade in agricultural goods over the past decade. They accounted for 48% of global trade in agricultural goods in 2001-2, rising from 42% in 1990-1. This upward trend can be observed across countries and agricultural product groups throughout the 1990-2002 period.
World merchandise trade by region and selected country, 2004 (Billion dollars and percentage)

Table -1

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(a) Includes the Caribbean.
(b) Algeria, Angola, Congo, Equatorial Guinea, Gabon, Libya, Nigeria, Sudan.
(c) Chinese Taipei, Hong Kong China, Rep. of Korea, and Singapore.

Source: WTO.

Trade between partners of Regional Trade Agreements (RTAs): A surge in trade between RTA partners was achieved mainly by a recent proliferation of RTAs. According to a WTO report (2004b), some 220 RTAs were estimated operational as of October 2004, of which 150 had been notified to the GATT/WTO. Nearly all WTO Members belong to at least one RTA, and each belongs to six RTAs on average (World Bank, 2005b). The number of RTAs is likely to
continue to increase in coming years, considering the number of RTAs under negotiation. Consequently, it was estimated that the share of trade between RTA partners of world merchandise trade will grow to 55% by 2005 if all expected RTAs are concluded, rising from 43% at present (OECD, 2002a).

**Developing Countries’ Trade:** In 2004, the share of developing countries in world merchandise trade stood at 31%, having increased from about 20% in the mid-1980s (WTO, 2005a; UNCTAD, 2004a). This is the highest level since 1950. It is observed that developing countries are increasingly becoming an important destination for the exports of developed countries. Among those, in particular, some problems have been recognized in identifying tariff classification and assessing the Customs value of second-hand goods such as used cars, computer equipment, machinery and clothing. Also, developing countries contributed more to the 2003 growth of world merchandise trade than developed countries. It was estimated that nearly four-fifths of the real growth in 2003 was attributable to developing countries, including transition economies (UNCTAD, 2004a). This trend requires caution, given that many developing countries, including African countries, Less Developed Countries (LDCs) and Small Island Developing States (SIDS) remain relatively marginalized from international trade (UNCTAD, 2005). However, it is observed that new efforts are being made in order to reinvigorate their regional liberalization programmes and take initiatives aimed at deeper integration into global trade. For example, the New Partnership for Africa’s Development (NEPAD) in African counties was initiated in 2001. One of its primary objectives is to “halt the marginalization of Africa in the global process and enhance its full and beneficial integration into the global economy” (NEPAD, 2004).

**South-South Trade:** Merchandise trade between developing countries, i.e. South-South trade, has significantly increased at an annual average rate of 11% during the past decade, accounting for nearly 13% of world merchandise trade in 2000 (UNCTAD, 2005). Around 40% of exports from developing countries were destined for other developing countries. Intra-regional trade, in particular through RTAs, played a central role in the rise of South-South trade. Also, inter-regional trade showed signs of growth, albeit on a smaller basis. In addition, intra-Asia trade took a dominant position in this trend, accounting for around 80% of the total South-South trade in 2000, but strong growth in intra-regional trade in Africa and Latin America was also observed.

**Containerized Cargo:** There are a number of freight containers in use within different modes, for example, Unit Load Devices (ULDs) for aviation, Swap Bodies for road-rail carriage in Europe, and various types of maritime containers (e.g. dry and refrigerated containers) for seaborne shipping (OECD, 2003a). Among those, maritime containers are the most numerous container types involved in international trade. They are also used for inter-modal transportation, in which they are carried by maritime, inland waterway, road, and rail operators. It was estimated that that over 6 billion tons of goods were traded by sea in 2003 (UNCTAD, 2004c). This accounts for over 80% of world trade by weight (OECD, 2003a). With 36% for tanker cargo (i.e. crude oil and oil products) and 24% for bulk cargo (e.g. steel, iron ore and coal), non-bulk cargo accounted for 40% by weight of the total seaborne cargo, most of which was carried in maritime containers (UNCTAD, 2004c). It was also estimated that there were 10.8 million maritime containers in circulation worldwide in mid-2003 (World Shipping Council, 2003).
Air Cargo; Express Cargo: It is reported that world air cargo accounts at present for a small portion of world merchandise trade by weight, but a significant portion by value. World air cargo traffic has rapidly grown at a rate of over 10% during the past decade, and it is expected to continue to grow rapidly in coming years. For example, air cargo traffic has doubled over the past decade as measured in Revenue Tonne-Kilometres (RTKs: weight multiplied by distance for charged cargo). Within air cargo, the share of express cargo has also grown rapidly from 4.1% in 1992 to nearly 11% in 2003 in terms of RTKs (Boeing, 2004).

This important growth in express traffic can be attributed to several factors: globalization and associated Just-In-Time production and distribution systems; increased trade in high-value low-weight products; and the provision of a service that assists SMEs to compete effectively in an increasingly global market.

Global Production Network: Global production specialization has advanced, in particular in manufactured goods (World Bank, 2005b). Firstly, the share of manufactured goods within world merchandise trade has grown significantly throughout the world. Secondly, the share of parts and components exports of total merchandise exports has greatly increased in all six regions of the world, for example from 6% in 1980 to 15% in 2002 in the East Asia region (Figure 1). Thirdly, exported goods contain a significant portion of imported intermediate inputs. In the “international segmentation of production”, intermediate inputs are exported for more processed intermediate inputs, which are then exported to the next stage in production.

One of the indicators to measure import content of exports is the index of vertical specialization. It shows a significant import content of exports in all six regions, for example, over 45% in the East Asia region in 2001 (Figure 2).

![Figure 1](image1.png)  ![Figure 2](image2.png)

Source: UN COMTRADE

Intra-Firm Trade: Intra-firm trade, i.e. trade within the same company and/or its affiliates, reportedly accounts for around one-third of world merchandise trade, although aggregate data are only available for a few countries (OECD, 2002b). In the case of the US, for example, it accounted for 36.2% of exports and 39.4% of imports in 1999, having remained stable over the
1990s. In Japan, on the other hand, it accounted for 30.8% of exports and 23.6% of imports in 1999, which have significantly increased over the same period.

There was some evidence that much intra-firm trade between high-income countries was of finished goods destined for affiliates primarily involved in marketing and distribution. Even when affiliates needed further manufacturing, it was most likely that finished goods were destined for local markets. For example, around 95% of the 1999 sales by Japanese affiliates in North America and Europe happened in the same region. By contrast, intra-firm trade between high and middle-income countries was directly related to the internationalization of production (see above). The affiliates in the middle-income countries were mostly instructed to manufacture goods destined for other markets, including the country of the parent company.

**E-commerce:** Electronic commerce (e-commerce, described as “doing business electronically”) has become a dominant factor in international trade and business, although traditional methods of trade and business continue to be utilized widely. For example, the use of Information and Communication Technology (ICT) such as Internet communication has made cross-border activities easier and more practical (OECD, 2002c). It can reduce business costs in seeking potential foreign business partners, as well as improve a firm’s visibility in global marketing services, in particular for SMEs. In addition, it allows sellers to reach potential buyers for their products beyond their national borders. In other words, it enables firms to take more opportunities to expand their business in global markets. As a result, trade patterns are changing, for example, smaller shipments are increasing, and different goods are exported to and imported from more countries.

**Emerging Business Model:** Business models in international trade may vary from industry to industry and company to company involved in the international movement of cargo. However, there are general observations on several emerging business models in the supply chain. Brief research into some of them, which is relevant in preparing the Framework, is provided below.

**Just-in-time System:** The just-in-time system of goods delivery is widely accepted in international trade, in particular in the context of manufactured goods. It requires inventory to reach a production place precisely when it is needed. Thus, a supply chain is designed to reduce problems in the flow of materials, components, and finished goods across the parties involved in the international movement of cargo. For example, it was estimated that large companies in the United States on average reduced inventory from 1.57 months in the early 1990’s to 1.36 months in 2001. Then, it was estimated that over USD 100 billion was saved by the logistics efforts alone in the United States during the past decade (OECD, 2003a). In order for the supply chain to function, all the parties concerned need high performance in terms of punctuality, rapidity and reliability in addition to the traditional criteria of price and operating time. Also, each link of the chain needs to be synchronized; otherwise there would be little gain.

**Supply Chain Security:** The loss of cargo shipments through theft and misrouting used to be a main security element in the supply chain. In the light of increasing threats of terrorism, however, it has emerged that the mantra of the international supply chain “getting the right product to the right place at the right time” has been modified by adding “without compromising the national security” (Waduge, 2003). The whole security level of a supply chain is heavily
affected by the level of security in all the parties concerned. In other words, any security effort might be in vain if a party in the supply chain fails to achieve a minimum level of security.

**Just-in-case System:** Considering recent natural, political or technological disruptions to the international supply chain, the system has moved away slightly from reliance on “just-in-time” delivery to the “just-in-case” system, in which a supply chain has a certain degree of flexibility with a sound contingency plan. There is a need to consider just-in-case suppliers, vendors, or logistics as well as just in-case inventory. It is increasingly recognized that it is too dangerous to rely heavily on a single source or logistics. A back-up system may be needed to mitigate uncertainty. As the just-in-case system may raise costs, it may be necessary to consider the balance between the level of security and extra costs in the supply chain.

**Outsourcing to Local Parties:** It is observed that many large companies have outsourced their production and service business to local companies. This is partly because they increasingly recognize the benefits of exploiting local companies’ in-depth knowledge of local markets and Customs. In the logistics area, companies specialized in logistics activities; called third party logistics (3PL), play an important role in the international supply chain.

**Internationalization of SMEs:** SMEs increasingly play an important role in emerging business models in the international supply chain. As large companies pursue production specialization as well as seek external complementary service resources, SMEs may gain growing business opportunities to be integrated into the global economy. There are many ways of internationalizing SMEs, for example by forming strategic alliances with trading companies, mergers and acquisitions (M&As), and inter-firm networking (OECD, 2004). ICT such as Internet is also one of the driving elements in the internationalization of SMEs.

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2.4 TECHNOLOGICAL & DEMOGRAPHIC ENVIRONMENT

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2.4.1 Demographic Environment

Marketers are keenly interested in:

- The size and growth rate of population in cities, regions and nations.
- Age distribution and ethnic mix.
- Educational levels; household patterns.
- Regional characteristics and movements across nations.

**Worldwide population growth:** The world population is showing "explosive" growth: it totaled 6.1 billion in 2000 and will exceed 7.9 billion by the year 2025. The cause for concern is that population growth is highest in countries and communities that can least afford it. The less developed regions of the world currently account for 76 percent of the world population and are growing at 2 percent per year, whereas the population in the more developed countries is growing at only 0.6 percent per year. In the developing countries, the death rate has been falling as a result of modern medicine, but the birthrate has remained fairly stable.
**Implications for Business:** A growing population does not mean growing markets unless these markets have sufficient purchasing power. Nonetheless, companies that carefully analyze their markets can find major opportunities. For example, to curb its skyrocketing population, the Chinese government has passed regulations limiting families to one child. One consequence of these regulations: These children are spoiled and fussed over as never before. Known in China as "little emperors," Chinese children are being showered with everything from candy to computers as a result of the "six pocket syndrome." As many as six adults - parents, grandparents, great-grandparents, and aunts and uncles-may be indulging the whims of each child. This trend has encouraged toy companies such as Japan's Bandai Company (famous for its Mighty Morphin' Power Rangers), Denmark's Lego Group, and Mattel to enter the Chinese market.

**Population Age Mix:** A population can be subdivided into six age groups: preschool, school-age children, teens, young adults age 25 to 40, middle-aged adults age 40 to 65, and older adults age 65 and up. For marketers, the most populous age groups shape the marketing environment. National populations vary in their age mix. At one extreme is Mexico, a country with a very young population and rapid population growth. At the other extreme is Japan, a country with one of the world's oldest populations. Milk, diapers, school supplies, and toys would be important products in Mexico. Japan's population would consume many more adult products.

**Population Trends in America:**

- **"The graying of America":** The U.S. population shows a continued increase in the number of people over age 65. Greater marketing attention has been focused on the mature household, headed by people over 50 years old. These households control 75 percent of the net worth of U.S. households.
- **The Baby Boomers:** Born between 1946 and 1964, they account for 56-58% of the purchases in most consumer product and service categories. This group focuses on family, health, convenience, finances, reading materials. They are fixated on their youth, not their age, and ads geared to them tend to capitalize on nostalgia from their past. Boomers grew up on advertising, so they are an easy market to reach.
- **Generation Y:** Born after 1976, (baby boomers began having children) they are born to shop. They are also described as the echo-boom and the baby boomlet - about 58 million Americans are under age 16. They have Great impact on companies selling products from toys to Club Med family vacations. Environmental changes affecting Generation Y include:
  - 60% of children aged < 6 have working mothers.
  - 61% of children aged 3 - 5 attend preschool.
  - 60% of households with children aged < 7 have computers.

**Ethnic & Other Ethnic Groups:** Countries vary in ethnic and radical make – up. At one extreme is Japan, where almost everyone is Japanese; at the other is the United States, where people come from virtually all nations. Now people call the United States a “salad bowl” society with ethnic groups maintaining their ethnic differences, neighborhoods and cultures comprising of:

- 72% White.
- 13% African Americans.
• 11% Latinos – subgroups of Mexican [5.4%], Puerto Rican [1.1%] and Cuban [0.45%] descent.
• 3.8% Asian Americans – subgroups of Chinese, Filipinos, Japanese, Asian Indians and Koreans in that order.

Each group has certain specific wants and buying habits. Several foods, clothing and furniture companies have directed their products and promotions to one or more of these groups.

**Note:** Diversity goes beyond ethnic and racial markets. More than 52 million Americans have disabilities, and they constitute a market for home delivery companies such as Peapod and for various medical services.

**Educational Groups:** Five major groups: illiterates, high school dropouts, high school degrees, college degrees and professional degrees.
In Japan, 99% of the population is literate.
In United States, 10 – 15% of the population may be illiterate.
High number of educated people in the United States spells a high demand for quality books, magazines and travel and a high supply of skills.

**Household Patterns:** The traditional household consists of a husband, wife and children (and sometimes grandparents). In United States, one out of eight households is non-traditional and includes single live alone, adult live together of one or both sexes, single parent families, childless married couples and empty nesters. Each group has a distinctive set of needs and buying habits. For example, people in the SSWD group [single, separated, widowed, divorced] need smaller apartments; inexpensive and smaller appliances and smaller sized food packages.

**Geographical Shifts in Population:** Let us look at the population shifts in United States for reference.

- Continued major shift to western and sun-belt states in the 1990s leading to increase in demand for air conditioning and lessening the demand for warm clothing and home heating equipment. California, Texas, and Florida accounted for 33 percent of the net population change. These states gained more than 3 million persons each.
- Populations are also shifting within states. During the 1990s, the population shifted from suburbs to more remote suburbs called exurbs to smaller towns called perturbs. They lead more casual lives, do more outdoor living and have greater neighbor interaction, higher incomes and younger families. They buy vans, home workshop equipment, outdoor furniture, lawn and gardening tools and outdoor cooking equipment.

The Census Bureau collects data using a three-level classification system. From the largest to the smallest, these three areas are:

- The consolidated metropolitan statistical area (CMSA)
- The primary metropolitan statistical area (PMSA)
- The metropolitan statistical area (MSA).
- The average U.S. citizen moves every six years.
2.4.2 The International Technological Environment

Technology refers to inventions or innovations from applied science or engineering research. Technological innovation can replace existing products and companies.

Why is it so important?

- It brings new products, processes, and materials.
- It directly impacts every aspects of our society (transportation, energy, communications, entertainment, health care, food, agriculture, industry).
- It alters the rules of global trade and competition.

What makes up the TE?
Institutions that create new knowledge, and apply that knowledge to develop products and processes.

What are the Technologies of Tomorrow?

- Nanotechnology (the science of unimaginably small electronics);
- The convergence of personal computer and telephone technologies;
- The Internet’s becoming the backbone of information-intensive industries;
- The emergence of biotechnology as a key component of the economy;
- Electronic Business Technologies.

What is the Technology's Impact on Customer Value?

- The cost of technology is plummeting causing customer value assessment of technology-based products to focus on other dimensions such as quality, service & relationships;
- Technology also provides value through the development of new products and the way existing products are produced;
- Many companies are using technological developments to allow recycling products through the manufacturing cycle several times;
- Another approach is pre-cycling—efforts by manufacturers to reduce waste by decreasing the amount of packaging they use.

Current Trends in the TE

- Globalization
  ✓ Resource allocated to technology development;
  ✓ Changing location of manufacturing facilities;
  ✓ Rise of multinationals;
  ✓ Comparative advantage of nations.
- Time Compression
  ✓ Shortened product life cycles;
  ✓ Shortened development times;
✓ Decreasing payback periods.

- Technology Integration
  ✓ Combining technologies to develop new products;
  ✓ Combining technologies to commercialize products.

2.5 REVIEW QUESTIONS

1. Free market economies stimulate greater economic growth, whereas state directed economies stifle growth! Discuss.
2. Discuss briefly the role played by Indian Entrepreneurs in the development of Indian economy.
3. Differences in the structure of Law between countries can have important implications for the practice of international business.” – Evaluate this.
4. Discuss the extraterritoriality of the U.S laws.
5. List down the requirements of the Indian Legal system for Foreign Investments.
6. List down the traits of those countries considered big emerging markets.
7. How might the Internet and the associated World Wide Web affect International business activity and the globalization of the world economy?
8. How have changes in technology contributed to the globalization of markets and production?
REGIONALISM IN INTERNATIONAL OPERATIONS

Structure

3.1 Intercontinental Trading Blocks: Policies, Motives, Trends, and Regional Statistics

3.2 Regionalism in South Asia

3.3 Need for Free Trade & Economic Integration

3.4 SAARC
   3.4.1 Objectives
   3.4.2 Integrated Program of Action (IPA)

3.5 European Union: Structure, Single Market Aspect, & its Expansion

3.6 North American Free Trade Organization.

3.7 Review Questions

3.1 INTERCONTINENTAL TRADING BLOCKS: POLICIES, MOTIVES, TRENDS, AND REGIONAL STATISTICS

What is Regionalism?
By July 2003, only three WTO members — Macau China, Mongolia and Chinese Taipei — were not party to a regional trade agreement. The surge in these agreements has continued unabated since the early 1990s. By May 2003, over 265 had been notified to the WTO (and its predecessor, GATT). Of these, 138 were notified after the WTO was created in January 1995. Over 190 are currently in force; another 60 are believed to be operational although not yet notified.

Regionalism in Trade is Back and Here to Stay
Slow progress at the GATT has led some economists to conclude that a division of the world into three trading blocs—Europe, the Americas, and East Asia—is the fastest road to multilateral free trade. They argue that negotiations for free trade are far more likely to succeed when conducted among three parties, rather than 154. And for many countries, the proliferation of non-tariff barriers in the developed world has made regional integration an attractive policy option. Integration with the United States or European Communities (EC) offers them guaranteed access to a large market.

Not surprisingly, Mexico, Chile, and other Latin American countries are lining up to join a free trade area (FTA) with the United States. And several countries in Western Europe, Eastern Europe, and North Africa are knocking at the EC's door.
Similarly, perceptions of a fortress mentality in Europe and fears of an imminent Western hemispheric FTA have led some East Asian nations to contemplate a defensive regional bloc of their own. And in the former Soviet Union, political disintegration has made regional integration a way of preserving fast-disintegrating trade among the new republics.

**What are the contradictions in Global Economic Policy as regards to regionalism?**

Economic policy in the major industrial countries during the last couple of decades is characterized by several paradoxes. While in most countries, there was a withdrawal of the state from managing national markets (e.g. deregulation, privatization), there was also increasing intervention in external trade. At the same time, those who favour more protectionist trade policies claim that some countries have been far too liberal for far too long. From the point of view of traditional integration theory, regional integration is a cause for concern; free trade zones and customs unions are generally seen as inferior to multilateral free trade. The reason is that a unilateral reduction of tariffs based on the most favored nation (MFN) clause improves the economy’s welfare in the same way as an equivalent reduction within a regional trading arrangement, but it avoids discriminatory effects against non-member states.

The ongoing changes in the trading structure across the globe presage a very different world order. Trade is today driven more by technology and skill intensity between nations rather than by resource endowment and natural comparative advantage.

- Firstly, there are two pre-eminent actors on the international economic Scene - the European Community and the United States. Each of these has an inescapable leadership role, which is shared by no other country or group of countries.
- Second, in both the Community and the US, as in other member countries of the OECD, there have been a clear trend towards economic liberalism, i.e., towards more market-oriented and less regulated economic systems. This has extended to international as well as domestic transactions, in part through regional arrangements for closer economic integration. Contrary to what is often asserted, these regional arrangements have not led to the establishment of inward-looking “economic blocs”, nor is such a development likely.
- Third, despite the broad trend towards liberalism, most though not all the OECD countries and the EC and the US, in particular, have continued to operate, and in some ways, even to extend a range of measures for selective trade protection. These measures are not consistent with the generally—and increasingly accepted principle that market outcomes should be decided by competitive processes rather than by administrative regulation. Hence, there is a conspicuous element of incongruity, of dualism, in official policies.
- Fourth, this reliance on selective protection is long established, and the main protectionist instruments are not new; in these respects, the trade policies of the EC and the US, as also of some other OECD countries, have changed little over the past two decades. But outside the OECD area, the world economy has been subject in recent years to remarkable and unforeseen changes. In particular:
  - Amazingly high rates of growth are being achieved now in a number of East Asian countries including China.
Many developing countries have substantially liberalized their trade and investment regimes.

The process of transformation in central and Eastern Europe, with the aim of establishing market economies linked to the rest of the world, is well under way. These changes have opened up the prospect of a generally freer and more integrated world economy, which would bring with it substantial and widely shared gains.

- Fifth, whether and how far these gains will be realized depends to a large extent on the external policies of the EC and the US. The entrenched protectionist elements in these policies have now become not only more anomalous but also more costly. Only by adopting a consistently liberal approach, can the Community and the US exercise effectively the responsibilities of world leadership.

Trends in the Nineties: During the early 1990s, countries all over the world, especially in Europe and the Western Hemisphere, have been forming Regional Trading Arrangements (RTAs) and intensifying existing ones at a rapid pace. Some of the increased emphasis on these blocs stemmed from frustration with the slow pace of the Uruguay Round negotiations. But there have been other reasons as well that suggest that the trend towards increased regionalism is likely to continue. Some have questioned whether this trend is desirable as the best way to liberalize trade on a most favoured nation (MFN) basis (i.e., no discrimination between trading partners), which can also be done unilaterally (autonomous liberalization) or in the context of multilateral trade talks. Formation of RTAs should not be allowed to divert attention from the MFN liberalization and the ultimate goal of global free trade. That an RTA facilitates or impedes eventual global free trade depends on how it is designed—including whether procedures for joining the arrangement are liberal or if it satisfies World Trade Organization (WTO) rules, or it is accompanied by some degree of liberalization on an MFN basis. So far, it appears that the rapid expansion of intraregional trade within the world’s leading RTAs has not been at the expense of non-members, although it is possible that trade with nonmembers might have grown ever faster without the RTAs.

Viewed together, regionalization in the early 1990s reveals the following characteristics:

- The number of regional commitments has risen, and so has the number of countries belonging to one (or more) integration area(s).
- The most significant commitments surpass the goals of internal trade liberalization (free trade area) and the introduction of a common external tariff (customs union). They include free factor movement, institutional harmonization and elements of a common approach in the formulation of trade, industrial and competition policies. This trend can be observed most clearly in the case of the European Community.
- Various regional agreements indicate that regionalism is beginning to produce its own dynamics: regionalization is increasingly seen as inevitable because existing arrangements are threatening to separate non-members from the integrated markets. The dominant Mexican motive for entering into the formation of NAFTA, i.e. to secure entry into US markets, and the increasing efforts of other Latin American countries in the bargain for bilateral trading arrangements with the United States (for the same reason)
amplify this in sufficient measure. This argument has also been raised in Asia, where the European and North American examples have opened up a new discussion about regional cooperation.

What are the types of Regional Preferential Arrangements?
Several different types of regional preferential arrangements departing from the non-discriminatory principle can be identified as follows:

1. The least formal grouping is the **tariff preference area** in which the member countries impose lower taxes on all or part of their reciprocal flows of products compared to those paid by third party countries.
2. More integrated is the **free trade area**. A free trade area consists of a group of countries, which have eliminated customs duties and non-tariff restrictions on the movement of goods among themselves. However, each member keeps in place its own tariffs on imports from external countries.
3. Economists distinguish another type of discriminatory trade arrangement; this is the **customs union**. A customs union eliminates tariffs amongst its members. In addition, it sets up a common external tariff on goods imported into, and not originally produced in, the area covered by the agreement. Customs duties are then shared between the members.
4. A fourth level of preferential arrangements can sometimes be encountered: the **common market**. Besides removing internal barriers to trade and organizing an external tariff on goods imported, such a system contributes to strengthening liberalization by ensuring the free movement of the factors of production (labour and capital).
5. Finally, economists generally describe another more integrated trade zone, the **economic union**. In an economic union, the members harmonize their economic policies, including the adoption of common commercial and monetary policies as well as a common currency.

What are the motives for regionalism?
The motivation for forming RTAs has varied from region to region and even from country to country within an RTA, but a few factors seem to have played a key role, some of which are as follows:

- Members may have seen **economic benefits** from achieving a more efficient production structure (including by exploiting economies of scale through spreading fixed costs over larger regional markets) and enhanced economic growth from foreign direct investment, learning by doing, and research and development.
- Members may have valued **non-economic objectives** such as strengthening political ties and managing migration flows.
- Smaller countries may have sought increased **security of market access or “safe haven”** by forming RTAs with larger countries.
- Countries may have wanted to lock in **unilateral domestic policy reforms**.
- Members may have wanted to **improve their bargaining power** in multilateral trade negotiations.
- As countries have formed new RTAs, or deepened existing ones, trade may have been diverted from third countries. This may have tipped the political balance in third
countries in favour of joining the RTA, as exporters’ interests began to prevail over the interests of import-competing firms. As more countries joined the RTA, excluded countries may have suffered additional **trade diversion** and, eventually, incentives to join may have outweighed interests of import-competing firms — the domino effect.

- Members may have wanted to **promote industries** that are not viable without a protected regional market — **regional infant industries**, the idea being that they would be internationally competitive if given sufficient time to develop (although RTAs mostly influenced by this perspective have been the least successful in expanding trade and promoting regional growth).

**What is the Theory of Customs Union?**
Customs Union involves both **Trade Creation** and **Trade Diversion** (By Jacob Viner, & Richard Lipsey).

**What is the net effect on welfare?**
Let’s understand this with a simple example. 3 countries, A, B, C, can produce wheat for $10, $8, and $6 respectively. Suppose A imposes 50% tariff.

Then B wheat costs: $8 + $4 = $12
C wheat costs: $6 + $3 = $9

Now A forms CU (customs union) with B:

B wheat costs $8
C wheat costs $6 + $3 = $9

Trade is diverted from C to B -- an efficiency loss.

Figure 3.1 gives a partial equilibrium illustration of the “trade diversion” and “trade creation” effects of a customs union.

Prior to CU: A imports D$_1$ - S$_1$ from C, with tariff t.
After CU: A imports D$_2$ - S$_2$ from B, tariff free.

Trade Creation Effect: a + b (**welfare gain**)
Trade Diversion Effect: area c (**welfare loss**)

Whether c > (a + b) depends on:

- How high is t prior to CU;
- How close are the costs of B to costs of C;
- Elasticity of S and D
- Width of cost difference between A and B.

The greater are the elasticities of S and D, the greater the trade creation effect, relative to trade diversion.
Some Reasons for Optimism in Reference to Customs Union: Tendency for CUs (as well as FTAs) to extend membership over time (e.g. EU, NAFTA) may make it easier to extend trade liberalization via negotiations between blocs (“bi-lateral” in this sense). Under GATT / WTO rules, the common external tariff cannot be higher than pre-CU tariff levels.

Dynamic Benefits:

1. Increased demand for non-CU imports, despite the barriers; i.e., income effects may outweigh trade diversion effects for non-members.
2. Comparative advantage improves productivity.

Static Efficiency Gains:

1. Elimination of consumption & production efficiency losses, as in partial & general equilibrium diagrams on effects of tariff.
2. Protection harms consumers and diverts resources from non-protected sectors.

Increased Competition: Producers compete and sell in the most profitable markets; consumers buy at lowest world prices.

Greater Opportunities: Greater Opportunities for learning and innovation.
Criticisms: The term 'orthodox customs union theory' has been coined as the theory has been built on relatively strict assumptions i.e. perfect competition in the commodity market and factor markets, perfect factor mobility within individual countries but not among the countries, foreign trade equilibrium and full employment. The opportunity cost in production is reflected in the relative commodity prices in each country and transport costs are not included since tariffs are assumed to be the only kind of international trade barrier. It also only deals with the static welfare effects of a customs union. It has both positive and negative welfare effects, compared to a situation in which every member state practices protectionism.

Regional Statistics:

I. Sub-Saharan Africa Preferential Arrangements

1. Southern African customs union (SACU)
2. Mano river union (MRU)
3. Economic community of west African states (ECOWAS)
4. Indian ocean commission (IOC)
5. Economic community of central African states (ECCAS)
6. Southern African development community (SADC)
7. West African economic and monetary union (WAEMU)
8. Communauté économique et monétaire de l’afrique centrale (CEMAC)
9. Common market for eastern and southern Africa (COMESA)
10. East Africa cooperation (EAC)
11. Indian ocean rim association for regional cooperation (IOC-ARC)
12. The African trade and opportunity act

II. South-America Preferential Arrangements

1. Andean community (AC)
2. Latin America integration association (ALADI)
3. Andean trade preference act (ATPA)
4. Southern cone common market (MERCOSUR)

II.I Central-America and Caribbean Preferential Arrangements

1. Central American common market (CACM)
2. Caribbean community and common market (CARICOM)
3. Organization of eastern Caribbean states (OECS)
4. Caribbean basin initiative (CBI)
5. The group of three (G3)
6. Association of Caribbean states (ACS)
7. Bilateral free trade agreements

IV. North America Preferential Arrangements

1. North American free trade agreement (NAFTA)
2. Free-trade area of the Americas (FTAA)

V/ Asia and Pacific Preferential Arrangements

1. Asia-Pacific Economic Co-operation Forum (APEC)
2. ASEAN Free Trade Area (AFTA)
3. South Asia Free Trade Area (SAFTA)

VI Central Asia, Middle East and North Africa Preferential Arrangements

1. Gulf Co-operation Council (GCC)
2. Arab Common Market (ACM)
3. Economic Co-operation Organization (ECO)
4. Arab Maghreb Union (AMU)

VII Western Europe Preferential Arrangements

1. European Union (EU)
2. European Free Trade Association (EFTA)
3. European Economic Area (EEA)

VIII Eastern Europe and Former USSR’s Republics Preferential Arrangements

1. Commonwealth of Independent States (CIS)
2. Economic Co-operation Area of the Black Sea (ECABS)
3. Central European Free-trade Agreement (CEFTA)
4. Baltic Free Trade Area (BFTA)
5. The Customs Union
6. The Union of Two
7. Initiative for Co-operation in Southeast Europe
8. Economic Commonwealth of Central Asia (ECCA)
9. GUAM
10. Croatian Slovenian Free Trade Agreement (CSFTA)
11. Bilateral Free Trade Agreement

IX Other

1. The Generalized System of Preferences (GSP)
2. The World Trade Organization (WTO)
3. Countries classifications by UNDP

3.2 Regionalism in South Asia

Free trade in South Asia: If the success of regional economic integration in other parts of the world is any guide, a free trade arrangement among the South Asian countries - namely India, Pakistan, Bangladesh, Sri Lanka, Nepal, Bhutan and the Maldives - will be a big step towards
their greater economic welfare. India already has signed a free trade agreement (FTA) with Thailand, is set to sign one with the Association of Southeast Asian Nations (ASEAN), and expects to sign another specifically with Singapore early next year. All these agreements could be the first step towards closer economic integration among the nations in this part of the world.

On the Asian continent, while several Regional Trade Agreements (RTAs) involving ASEAN and Mercosur (Argentina, Brazil, Paraguay and Uruguay) have come into being, the South Asian Preferential Trade Agreement, the South Asian Free Trade Area, and the ASEAN Free Trade Area, if seriously implemented, should complement each other, thus making regional economic integration viable. To this end, the trade policies of these countries must further the cause of regional cooperation towards developing their external sector.

3.3 NEED FOR FREE TRADE & ECONOMIC INTEGRATION

While advanced countries have successfully formed their own larger RTAs, such as the North American Free Trade Agreement and the European Union's accord - there is every possibility that South Asian countries will become marginalized unless they can present their arguments with one voice and a collective responsibility. Once they realize that free trade among themselves is a sine qua non for their economic uplift, there should be no foot-dragging in translating this concept into reality.

The strongest argument for removing trade barriers, says the report, is the recognition that effective integration necessitates more than reducing tariffs and quotas. Many other trade barriers have the effect of segmenting markets and obstructing the free flow of goods, services, investments and development schemes that call for joint efforts. Therefore, wide-ranging policy measures are essential for removing all kinds of tariff and non-tariff barriers.

Moreover, a direct move from closed to open regionalism has the advantage of being more outward-oriented and more committed to liberalizing, rather than controlling world trade and commerce. From the point of view of globalization, this advantage for Asian countries in general and South Asian countries in particular cannot be exaggerated. No wonder the World Bank Experts Group has given special emphasis to this point while examining the economic problems of South Asia.

In a liberal trading regime, South Asia will not only reap the benefits of an increased volume of trade, larger investment flows and a rise in the level of production, but also new technologies that were hitherto unknown to the workforce, much of it illiterate.

The World Bank, the South Commission and UNCTAD all have emphasized that given their stark variations in growth indicators, the countries of South Asia "could somewhat level pegging if they could plan their economic development under a free trade mechanism of growth".

One example underscores the nature of this variation: India is over 10,000 times larger, 3,000 times more populous and has a gross domestic product over 800 times greater than the Maldives, the smallest country in South Asia. It is also most striking that in South Asia it is India, which is changing the dynamics of interaction among the countries of the region. This is evident not only
in terms of New Delhi's physical size but also its geographical location, which has made it "central" to the region. While there is great diversity in the region, home to over a fifth of the world's population and has more or less similar economic development, South Asia has a disproportionate number of people living below the poverty line. It should be pointed out here that a free trade area in South Asia would provide numerous microeconomic benefits such as transparency and the allocation efficiency of trade in goods, services and investments. Regional trade agreements are normally criticized for promoting trade diversion rather than trade creation. Such debates are rather sterile in the specific context of South Asia. The rest of Asia, particularly East Asia and Southeast Asia, is comprised of keenly competitive economies and Indian enterprises' exposure to their competitive aggression will have a wholesome tonic effect on the country's manufacturing sector.

**Problems:** But also there are some competitive problems among Asian countries. The major problem is that basically they supply the same kind of products to the global market. Naturally, competition problems impede trade arrangements. Just as India and Sri Lanka cannot get over their rivalry in agro-products, such as tea, rubber, coconuts, and so on, Indonesia, Malaysia and Thailand have their own rivalry in the field of garments, while Singapore and Malaysia compete in electronics. Japan and South Korea share many common articles as well. China is in a league of its own.

This rivalry is not unique to South Asia; the RTAs of advanced countries also have this problem. Therefore, the best way forward in this maze is to synergise, for rivals to cooperate and adopt a joint marketing strategy to enter into new unexplored markets. Like the idea of forming tea cartels to enable India, Kenya and Sri Lanka to join and work together for their common good, ways must be found for a wider spectrum of Asian countries to settle their differences and look for common ground.

3.3 SAARC

The South Asian Association for Regional Cooperation (SAARC) comprises the seven countries of South Asia, i.e. Bangladesh, Bhutan, India, The Maldives, Nepal, Pakistan and Sri Lanka. SAARC is a manifestation of the determination of the peoples of South Asia to work together towards finding solutions to their common problems in a spirit of friendship, trust and understanding and to create an order based on mutual respect, equity and shared benefits. The primary objective of the Association is the acceleration of the process of economic and social development in member states, through collective action in agreed areas of cooperation.

**Evolution:** The idea of regional cooperation in South Asia was first mooted in November 1980. After consultations, the Foreign Secretaries of the seven countries met for the first time in Colombo in April 1981. This was followed up, a few months later, by a meeting of the Committee of the whole, which identified five broad areas for regional cooperation. The Foreign Ministers, at their first meeting in New Delhi in August 1983, adopted the Declaration on South Asian Association for Regional Cooperation (SAARC) and formally launched the ‘Integrated Programme of Action’ (IPA) in the five agreed areas of cooperation namely, Agriculture; Rural Development; Telecommunications; Meteorology, and Health and Population Activities. Later, Transport; Postal Services; Scientific and Technological Cooperation; Sports, Arts and Culture
were added to the IPA. The Heads of State or Government at their first SAARC Summit held in Dhaka on 7-8 December 1985 adopted the Charter formally establishing the South Asian Association for Regional Cooperation (SAARC).

**Trade and Economic Cooperation:** SAARC has taken important steps to expand cooperation among member countries in the core economic areas.

- In 1991, a Regional Study on Trade, Manufactures and Services (TMS) was completed outlining a number of recommendations for promoting regional cooperation in the core economic areas.
- The Council of Ministers at its Ninth Session in Malé in July 1991 endorsed the Study and decided to set up a high-level Committee on Economic Cooperation (CEC). This Committee has so far held six meetings.
- At the Colombo Summit in December 1991, the Heads of State or Government approved the establishment of an Intergovernmental Group (IGG) to seek agreement on an institutional framework under which specific measures for trade liberalization among SAARC member states could be furthered. IGG evolved a draft Agreement on SAARC Preferential Trading Arrangement (SAPTA) during its first two Meetings. Subsequently, the Council of Ministers, upon the recommendation of CEC signed the framework Agreement on SAPTA in Dhaka on 11 April 1993 during the Seventh SAARC Summit.
- In the subsequent four Meetings of IGG, the member states conducted their bilateral/multilateral trade negotiations in which they exchanged concessions to be offered /sought. The Consolidated National Schedules of Concessions were finalized in the Sixth Meeting of the IGG held at the SAARC Secretariat, Katmandu on 20-21 April 1995 and subsequently approved by the Council of Ministers in May 1995. All SAARC member countries have ratified the SAPTA Agreement and as per Article 22 of the Agreement, SAPTA will enter into force on 7th December 1995 - two years ahead of the time schedule envisaged initially.

**3.4.1 Objectives**

The Objectives of SAARC are summarized below:

1. To promote the welfare of the peoples of South Asia and to improve their quality of life.
2. To accelerate economic growth, social progress and cultural development in the region and to provide all individuals the opportunity to live in dignity and to realize their full potential.
3. To promote and strengthen collective self-reliance among the countries of South Asia.
4. To contribute to mutual trust, understanding and appreciation of one another's problems.
5. To promote active collaboration and mutual assistance in the economic, social, cultural, technical and scientific fields.
6. To strengthen cooperation with other developing countries.
7. To strengthen cooperation among themselves in international forums on matters of common interests.
8. To cooperate with international and regional organizations with similar aims and purposes.
3.4.2 Integrated Program of Action (IPA)

Summary of work on SAARC’s Integrated Programme of Action (IPA) is given below:

**Agriculture:** Agriculture being one of the original five areas identified for regional cooperation, the first meeting of the Technical Committee on Agriculture was held in 1983. Subsequently, forestry was also included in the work of the Committee.

- The Technical Committee facilitated among the member states, the exchange of germplasm, breeding materials on livestock and fishery and a prototypes of farm tools and equipment. Activities for improved livestock through exchange of animals, frozen semen and vaccine were undertaken. Rice and wheat breeding programmes for enhancing productivity were also conducted. Pursuant to the recommendation of the Technical Committee on Agriculture, the SAARC Agricultural Information Center (SAIC) was set up at Dhaka in 1988 - the first SAARC Regional Institution of its kind.

- Regular meetings of counterpart scientists were an important feature of the Committee’s programmes. The list of counterpart scientists in the twelve agreed areas of crops and disciplines were finalized for networking. These included rice (millet); wheat; oilseeds; horticulture (potato) vegetables and fruits; fisheries; forestry; transfer of technology; livestock (animal health and production); farm machinery and implements; post harvest technology; agriculture economics and policies on soils. Progress was made towards establishing a network on amelioration of problem soils.

**Communication:** The Technical Committee on Telecommunications and the Technical Committee on Postal Services both established in 1983 were amalgamated into a single Technical Committee on Communications in 1993. In the telecommunication sector, substantial progress was achieved in implementing the recommendations for the establishment of ISD, automatic telex, and bureau fax facilities, improvement of inter-country links, operation and maintenance of communications links. An initiative was taken to establish an information network among the Member Countries.

Seminars and workshops on data transmission, digital switching, network management and operations, software maintenance were held. Adoption of new technologies in rural telecommunication systems, IDR satellite technology and improvement of rural telecommunications were also addressed.

**Environment and Meteorology:** The Technical Committee on Meteorology and the Technical Committee on Environment were merged as a single Technical Committee in January 1996. Environment was identified as an area that called for the urgent attention of SAARC in 1987, when the SAARC Leaders commissioned a Study on Causes and Consequences of Natural Disasters and the Protection and Preservation of the Environment. National studies were undertaken and subsequently consolidated into a Regional Study, which was approved by the Sixth SAARC Summit.

Another Regional Study conducted by SAARC relates to the Greenhouse Effect and its Impact on the Region. This was completed in 1992 and approved by the Seventh SAARC Summit. The
SAARC Environment Ministers, who met in Male in October 1997, formulated an Action Plan for implementation of the recommendations contained in the two Studies. The progress on the Action Plan was reviewed in their Colombo Meeting in November 1998. The work programme of the Technical Committees also covered topics such as approaches to environmental legislation, regulations and standards in SAARC countries; rehabilitation of degraded lands; training course on wetlands assessment and management; and workshops on alternate/renewable energy and on SAARC national experts on climate change.

In the field of meteorology, a number of seminars / workshops were organized in areas such as joint inter-comparison of barometers, meteorological instruments, agricultural meteorology, numerical weather prediction, crop-weather relationship and crop-yield forecast, long range weather forecasting and radar meteorology. Training programmes were conducted on meteorological telecommunications, management and establishment of national data centers on monsoon forecasting.

**Health, Population Activities and Child Welfare:** The Technical Committee was established in 1984. It had taken a number of initiatives to address several key issues relating to population control, health care and disease control. The Committee emphasized the need for strengthening efforts to combat problems posed by the resurgence of communicable diseases such as malaria, TB, water borne diseases and the emergence of AIDS as major health hazards. Networking arrangements for training research and eradication of malaria and regional approach for combating major diseases in the region were undertaken. A Directory of training programmes in six priority areas, i.e. malaria, tuberculosis, leprosy, diarrhoeal diseases, human rabies as maternal and child health was completed. The SAARC Tuberculosis Center, established in Katmandu in 1992, has been specifically entrusted to work towards the prevention and control of tuberculosis in the SAARC region.

Three ministerial conferences were held in 1986, 1992 and 1996 respectively. The Ministerial Conference on Women and Family Health held in Katmandu (1993) and the Ministerial Meeting on Disabled Persons held in Islamabad (1993) also contributed to the expanded work of the Technical Committee. Annual reviews on the survival, protection and development of children, which began in 1993, have now become a regular feature of the agenda of the Technical Committee. The Ninth SAARC Summit expressed the need to formulate a Convention on Regional Arrangements on the Promotion of Child Welfare in South Asia. Work in this area has now been completed.

**Prevention of Drug Trafficking and Drug Abuse:** The Technical Committee, which was established in 1987, contributed significantly towards the finalization of the SAARC Convention on Narcotic Drugs and Psychotropic Substances in November 1990. Cooperation among Drug Law Enforcement Agencies and Officers was developed through short-term activities such as seminars and training courses. Nodal Agencies in Member States exchange information on drug offences, which are collated, analyzed and disseminated by the SAARC Drug Offences Monitoring Desk (SDOMD) in Colombo. In the field of demand reduction, short-term activities such as workshops and seminars held so far focused on the role of media in the prevention of drug abuse, community mobilization against drug abuse, preventive education, school curriculum development, treatment and relapse prevention and exchange of information on
indigenous and innovative methods of treatment. Meetings of selected NGOs involved in the prevention of drug abuse were held. A Directory of such organizations was also compiled.

**Rural Development**

The Technical Committee, which first met in 1984, decided to address all issues relating to rural development. These range from preparation of research studies on selected topics to compilation of lists of experts, training institutes, and institutions involved in transfer of appropriate technology. Workshops, seminars and training courses were held on a wide spectrum of themes including poverty focused development, rural energy, social mobilization, rural infrastructure and social ecology. Income and employment generation; creation of assets and enhancing availability of credit access, human resources development, rural infrastructure development and maintenance; development and enhancement of productivity; rural environments were other priorities implemented. Issues related to diversification of rural economies, mobilization of resources for rural development; gender perspective of rural development, assured supply of inputs for rural production and improved marketing facilities and institutional environment for rural development constituted the agreed agenda of work.

**Science and Technology:** The Technical Committee was established in 1983. A wide variety of programmes including short-term activities such as seminars, workshops, meetings of experts, training programmes, joint research projects, preparation of state-of-the-art reports and compilation of directories were undertaken. Training programmes were held for scientists and technologists in the areas of tannery waste management; low cost housing; development of prawn hatcheries; electronics and molecular biology. Joint research projects on design and manufacture of food processing equipment and appropriate post harvest food technology for perishable items were carried out. Reports were completed on bio-gas; mineral resources exploration; producer gas; application of remote sensing techniques; use of organic fertilizers; building material and housing technologies; selected rural technologies - food processing technologies, handicrafts; and electronic products.

**Tourism:** The Technical Committee was established in 1991. It adopted an Action Plan on Tourism. As an integral part of its agenda, the Committee reviewed the progress on the SAARC Scheme for Promotion of Organized Tourism and the Action Plan. The activities of the Committee included training facilities by the Member States in the field of tourism and hotel management; production of a SAARC Travel Guide and a SAARC tourism promotional film on the theme "A Unique Holiday with Diversity: From Top of the World to the Sunny Beaches".

**Transport:** The Technical Committee on Transport was established in 1983. Its mandate covered three major segments of transport, i.e. land transport divided into roadways and railways; sea transport sub-divided into inland waterways and shipping; and air transport. The activities of the Committee, which included seminars and workshops on the different areas of its agenda, exchange of data and information, preparation of status papers, compilation of database and directories of consultancy centers for transport sector.

Training courses were conducted on corporate planning for railway sector and highway and bridge engineering. A Compendia of Information on Roads in the SAARC Region was completed and a database on railway transport was compiled. A study on in-depth examination
of transport infrastructure and transit facilities was completed. Four new specific areas of cooperation in the transport sector namely transport safety; rural transport, environmental aspects, and energy conservation were identified by the Committee.

**Women in Development:** Women in Development was identified as an area of cooperation under the IPA in 1986. Specific issues taken up by the Committee included preparation of a Regional Plan of Action for Women and effective dissemination of technical information relating to women in development. Five SAARC Solidarity Journals were published to coincide with the SAARC Summits. The fifth issue focused on the theme "violence against women" while the earlier issues covered rural development for women; the girl-child; and women in the informal sector. The year 1990 was designated as the SAARC Year of the Girl-Child and 1991-2000 as the SAARC Decade of the Girl-Child. The Technical Committee adopted a Plan of Action to observe the Decade. A mid-decade review on the implementation of the Plan of Action was conducted in October 1996. An appraisal of the situation of Girl Children in Especially Difficult Circumstances (GCEDC) was carried out in December 1996. Key common issues and concerns of SAARC Member States were identified, and recommendations made both on policy and programme issues.

The Ninth SAARC Summit emphasized the creation of a socio-economic environment in the SAARC region, which would provide equal opportunities to children from all economic sections. It directed the Member Countries to examine the possibility of formulating a Regional Convention on Combating the Crime of Trafficking in Women and Children for Prostitution. The drafting of the Convention was undertaken by the Technical Committee.

**SAPTA: Its Evolution & Importance:** Following the initiative taken during the Sixth SAARC Summit (Colombo, 1991) to establish SAPTA for increasing intra-regional trade, a Framework Agreement on SAARC Preferential Trading Arrangement (SAPTA) was finalized by the Committee on Economic Cooperation based on a draft prepared by the Inter-Governmental Group (IGG) on Trade Liberalization. The Foreign Ministers of all the SAARC member states signed the Agreement on 11 April 1993 during the Seventh SAARC Summit in Dhaka. This Agreement is an important landmark in the history of SAARC as it is expected to go a long way in promoting intraregional trade and in gradually removing trade barriers presently existing among the member countries. The basic principles of SAPTA are as follows:

1. Overall reciprocity and mutuality of advantages
3. Inclusion of all types of products - raw, semi-processed and processed.
4. Special and favourable treatment to Least Developed Countries (LDCs). The special treatment to LDCs includes allowance of favourable percentage points, application of relaxed rules of origin, favourable terms for technical assistance, duty-free access, deeper tariff preferences, removal of non-tariff and para-tariff barriers, negotiation of long-term contracts to support sustainable exports and provision of special facilities with regard to shipping and identification, preparation and establishment of industrial and agricultural projects, training facilities and support to export marketing, etc. possibly linked to cooperative financing and buyback arrangements.
The SAARC Preferential Trading Arrangement is expected to play an important role in boosting intra-regional trade. According to the country perspective reports on SAPTA, this preferential arrangement would benefit SAARC countries due to the following reasons:

1. The countries can substantially reduce the transport and transit cost because of geographical contiguity among the members.
2. Capital goods produced within the region may be more compatible to the factor endowment of member states than those imported from developed countries.
3. The increasing competition among the member states would result in technical efficiency in existing industry as marginal firms might be forced to reduce their cost. Resources will be reallocated away from less efficient firms and monopolies protected by the tariff wall will no longer be in a sheltered position.
4. As economic ties get stronger and countries become committed to common economic goals, political problems will gradually recede. When economic benefits gain significance, amicable environment may evolve for dissolving political problems.
5. Regional cooperation may also pave the way for regional banks or corporations, which might be influential in promoting regional investment in larger projects.

3.5 EUROPEAN UNION: STRUCTURE, SINGLE MARKET ASPECT, & ITS EXPANSION

The European Union--previously known as the European Community--is an institutional framework for the construction of a united Europe. It was created after World War II to unite the nations of Europe economically so another war among them would be unthinkable. Fifteen countries are members of the European Union, and some 370 million people share the common institutions and policies that have brought an unprecedented era of peace and prosperity to Western Europe.

Who are the member nations of E.U?
Initially it was a 15 member states of Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, The United Kingdom. It became the 25 member states on May 25th, 2004 - Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, and Slovenia in addition to the original 15 member states.

Copenhagen Criteria for Membership: Applicant Countries must fulfill the following conditions for EU Membership:
Democracy, the rule of law, human rights, respect for minorities; a functioning market economy and the capacity to cope with competitive pressures; the ability to take on the obligations of membership.
Chronology:

- 1952 Six countries - Belgium, France, the Federal Republic of Germany, Italy, Luxembourg and the Netherlands - create the European Coal and Steel Community (ECSC) by pooling their coal and steel resources in a common market controlled by an independent supranational authority.
- 1958 The Rome Treaties set up the European Economic Community (EEC) and the European Atomic Energy Community (Euratom), extending the common market for coal and steel to all economic sectors in the member countries.
- 1965 The Merger Treaty is signed in Brussels on April 8. It provides for a Single Commission and Single Council of the then three European Communities.
- 1973 The United Kingdom, Ireland, and Denmark join the European Community (EC).
- 1979 The European Parliament is elected, for the first time, by direct universal suffrage and the European Monetary System (EMS) becomes operative.
- 1981 Greece becomes the 10th member state.
- 1985 The program to complete the Single Market by 1992 is launched.
- 1986 Spain and Portugal become the 11th and 12th member states.
- 1989 The Madrid European Council launches the plan for achievement of Economic and Monetary Union (EMU).
- 1990 East and West Germany are reunited after the fall of the Berlin Wall.
- 1991 Two parallel intergovernmental conferences produce the Treaty on European Union (Maastricht), which EU leaders approve at the Maastricht European Council.
- 1992 Treaty on European Union signed in Maastricht and sent to member states for ratification. First referendum in Denmark rejects the Treaty.
- 1993 The Single Market enters into force on January 1. In May, a second Danish referendum ratifies the Maastricht Treaty, which takes effect in November.
- 1994 The EU and the 7-member European Free Trade Association (EFTA) form the European Economic Area, a single market of 19 countries. The EU completes membership negotiations with EFTA members Austria, Finland, Norway and Sweden.
- 1995 Austria, Finland and Sweden join the EU on January 1. Norway fails to ratify its accession treaty. The EU prepares the 1996 Intergovernmental Conference on institutional reform.
- 1999 The Euro is introduced on January 1 electronically in 12 participating member states, with complete introduction to occur in 2002. The Amsterdam Treaty enters into force on May 1.
- 2001 The Treaty of Nice results from the 2000 Intergovernmental Conference.
- 2002 The Euro is fully launched on January 1. The European Convention begins, as part of the debate on the future of Europe, to propose a new framework and structures for the European Union--geared to changes in the world situation, the needs of the citizens of Europe and the future development of the European Union. On October 9, the European Commission recommends that candidate countries Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, the Slovak Republic and Slovenia be the first to join the EU under the latest enlargement process, possibly in time for the elections to the European Parliament scheduled for June 2004.
- 2003 The Treaty of Nice enters into force on 1st February.
Common Policies: The first steps toward European integration began when the founding members first pooled their coal and steel industries. They then set about creating a single market in which goods, services, people and capital would move as freely as within one country. The single market came into being in January 1993. The original treaties gave the Union competence in a number of areas including foreign trade, agriculture, competition and transport. Over the years, in response to economic developments, formal competence was extended to new areas such as research and technology, energy, the environment, development (foreign aid), education and training.

The EU after Maastricht: To strengthen integration, the Maastricht Treaty on European Union cleared the way for the completion of Economic and Monetary Union (EMU), involving the introduction of a single currency no later than 1999 and a European Central Bank. The Treaty also launched the Common Foreign and Security Policy (CFSP) and a Justice and Home Affairs policy, which are managed at an intergovernmental level. The Treaty of Nice resulted from the 2000 Intergovernmental Conference. The Euro was fully launched in 2002. The Debate on the Future of Europe--as well as the European Convention--began also in 2002, as an enlarged Union drew near reality.

The Budget: The Union has its own automatic sources of revenue. These "own resources" are comprised of a part of the Value Added Tax (VAT) collected by the member states, customs duties on industrial products and levies on agricultural imports, as well as a contribution by each member state based on its Gross National Product. The budget, $99 billion in 2002, finances the common policies like agriculture, research and development, programs linked to the single market, as well as overseas assistance and other external activities of the European Union. In addition, more than one-quarter of the budget goes to redistribute wealth from the richer to the poorer countries via the so-called Structural Funds. A new cohesion fund, designed to accelerate this process, was agreed as part of the Maastricht Treaty. The EU budget represents about 1.2 percent of the combined Gross Domestic Product of the member states.

Governing Bodies: The following summarizes the role and composition of the main institutions since the Maastricht Treaty and the accession of Austria, Finland and Sweden.

The European Commission: The body proposes policies and legislation, is responsible for administration, and ensures that the provisions of the Treaties and the decisions of the institutions are properly implemented. The current Commission (2000-2005) consists of 20 Commissioners, including the President (Romano Prodi), who are appointed by common agreement among the member states and approved as a body by the European Parliament. Commissioners hold portfolios of responsibility and act in the interest of the Union, independently of national governments.

The Council: The Council enacts legislation binding throughout EU territory and directs intergovernmental cooperation. The Council is composed of ministers representing the national governments of the 15 Member States. Different ministers attend Council meetings depending on the agenda. Most decisions are made by majority vote, but some decisions (for instance on foreign policy in the framework of the CFSP, taxation, and environmental issues) still require unanimity. The Presidency of the Council rotates among the member states every six months.
Each Presidency concludes with a European Council which brings together the Heads of State or Government of the 15.

**The European Parliament (EP):** It is composed of 626 members, directly elected to five-year terms. Members of the European Parliament (MEPs) form political rather than national groups. The European Parliament now has a limited legislative role thanks to the co-decision procedure introduced by the Maastricht Treaty. The Parliament acts as the EU's public forum, debating issues of public importance and questioning the Commission and the Council. The Parliament can amend or reject the EU budget.

**The European Court of Justice (ECJ):** It interprets EU law and its rulings are binding. The Court comprises 15 judges assisted by 9 advocates-general. It is assisted by a Court of First Instance, which has jurisdiction to hear cases in limited areas.

**The European Court of Auditor (ECA):** It consists of 15 members appointed by a unanimous decision of the Council after consulting Parliament, monitors the Union's financial activities.

**The European Economic and Social Committee (ESC):** It comprises 222 members who represent employers, employees and numerous other groups such as farmers and consumers. It must be consulted before the adoption of a significant number of decisions; it may also deliver opinions on its own initiative.

**The Committee of the Regions (COR):** It established by the Treaty on European Union, also comprises 222 members, representing local and regional authorities. It must be consulted before the adoption of decisions affecting regional interests, and it may also deliver own-initiative opinions.

**EU - A Major Partner for the United States:** European integration was launched after World War II with the active support of the United States, and the Atlantic partnership has remained firm ever since. As US Secretary of State Colin Powell noted in 2001, "The European Union's principled response to the September 11th attacks and to our call for a worldwide effort against terrorism is just the latest demonstration of the fact that a strong united Europe is good, indeed essential, for the United States, for Europe, and for the world. Our common objective is security for our peoples. Let no one doubt the will and the power of our free societies to defend the security of our citizens, even as we safeguard our democratic values."

The United States and Europe are economically interdependent. Some 40 percent of US investment abroad goes to the EU, as do some 20 percent of US exports, making the EU one of the top two markets for the US. The EU is the source of some 50 percent of foreign investment in the US. Up to 3 million highly paid jobs in the US are due to EU investment.

A permanent dialogue is carried on between the EU and the US on matters of mutual concern through regular consultations at the highest official levels. As both the EU and the US wish to strengthen mutual cooperation, proposals are being considered on how to improve the transatlantic dialogue.
The EU and World Affairs: As one of the world's largest trading powers, and as a leading economic partner for most countries, the EU is a major player on the world scene. Its scope for action extends increasingly beyond trade and economic questions. More than 130 countries maintain diplomatic relations with the EU, and the EU has over 100 delegations around the world. The EU enjoys a close relationship with the countries of Central and Eastern Europe (so-called CEECs). The EU is spending almost $9 billion over five years to help prepare nine CEECs to prepare for EU membership. Since their independence in 1989, the EU has concluded trade and cooperation accords with most CEECs and has been at the forefront of the international effort to assist them in the process of economic and political reform.

The EU is also strengthening its links with the Mediterranean countries, which will receive some $6 billion in EU assistance over the next five years. The EU maintains special trade and aid relationships with many developing countries. Under the Cotonou (formerly Lomé) Convention, virtually all products originating from 77 ACP (African, Caribbean and Pacific) countries enjoy tariff-free access to the EU single market, as well as a stable export earnings program (STABEX) and considerable financial aid. The EU is the largest donor of the humanitarian aid to the victims of the conflict in former Yugoslavia and has played an active role in the mediation effort.

Euro – Common Currency: The euro is the currency of twelve European Union countries: Belgium, Germany, Greece, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal and Finland. Euro banknotes and coins have been in circulation since 1 January 2002 and are now a part of daily life for over 300 million Europeans living in the euro area. There are a number of clear benefits to having a single European currency.

- Practical benefits for citizens: traveling with the euro.
- Single market: reaping the full benefits of the EU's single market.
- Single financial market: benefits for savers and borrowers.
- Macroeconomic framework: benefits of a single currency to the economy as a whole.

Major Issues & Agendas

1. Agriculture & Food Safety Issues: In Food guidelines concerning the traceability and labeling of genetically modified organisms and the traceability of food and feed products produced from genetically modified organisms were set. In Agriculture, guidelines were set for the development of national strategies and best practices to ensure the co-existence of genetically modified crops with conventional and organic farming. It aims at developing possible monitoring systems needed for verification, and at estimating the costs of relevant changes in farming practices, monitoring systems and of potential insurance systems to cover possible financial losses due to adventitious presence of GM. The followings issues were addressed:

- Animal Transport: Introduced important changes such as the approval of transporters, the route plan, as well as loading densities and traveling times limit;
- Food Labeling: Enabling European consumers to get comprehensive information on the contents and the composition of food products. Labeling helps consumers to make an informed choice while purchasing their foodstuffs;
• Rapid Alert System: The Rapid Alert System for Food and Feed (RASFF) is a system to provide the control authorities with an effective tool for exchange of information on measures taken to ensure food safety;
• Agriculture Issues: The priority of the Common Agricultural Policy (CAP) should be to ensure that agricultural products are healthy and safe, promote the respect of the environment, protect medium or small sized farms and help farmers to adapt their production to consumer expectations.

The aim is transparency, quality and safety and a farm sector in tune with the environment and animal welfare. The new CAP will be geared towards consumers and taxpayers, while giving EU farmers the freedom to produce what the market wants. In future, the vast majority of subsidies will be paid independently from the volume of production. To avoid abandonment of production, Member States may choose to maintain a limited link between subsidy and production under well-defined conditions and within clear limits. These new "single farm payments" will be linked to the respect of environmental, food safety and animal welfare standards. Severing the link between subsidies and production will make EU farmers more competitive and market orientated, while providing the necessary income stability. More money will be available to farmers for environmental, quality or animal welfare programmes by reducing direct payments for bigger farms.

2. Chemicals / Dangerous Substances: The EU legislation is complex, but it can be distilled into two distinct categories:

• Manufacturers and importers of chemicals must "classify" all substances according to the law's description of "dangerous," as defined in Article 2 (2) of 67/548/EEC (as amended) and ranging from explosive to toxic to carcinogenic to flammable. Once classified, chemicals are then required to be packaged and labeled accordingly;
• "New" products must be "notified" to the Member State Competent Authorities. Products considered to be "new" are those, which were not included in the European Inventory of Existing Chemical Substances (EINECS), a closed inventory of substances on the EU market as of mid-September 1981. Notification of a new product entails provision of the results of specified testing and the subsequent compilation of a technical dossier. A substance is subject to notification if it is not covered by one of the exemptions granted by Directive 92/32/EEC.

3. Competition: The Community rules on competition are laid down by Articles 81 to 89 of the EC Treaty. This introduction is based on these articles of the Treaty, and is divided into these sections – undertakings, state aids, cooperation with national authorities and courts and with non – Community countries. A broad overall policy has been established with regard to restrictive agreements and concerted practices. Certain types of agreement are prohibited almost without exception. These are:

• Horizontal or vertical agreements that fix prices directly or indirectly;
• Agreements on conditions of sale;
• Agreements that partition market segments, concerning price reductions, for example, or seeking to prohibit, restrict or, on the contrary, promote imports or exports;
• Agreements on production or delivery quotas;
• Agreements on investments;
• Joint sales offices;
• Market-sharing agreements;
• Agreements conferring exclusive rights to public service contracts;
• Agreements leading to discrimination against other trading parties;
• Collective boycotts;
• Voluntary restraints (Agreements not to engage in certain types of competitive behaviour).

4. **Customs & Tariffs:** The member states of the European Union form a "customs union." This means that all the member countries apply a common external tariff on imports from outside the EU and a unified commercial policy toward third-country goods. Once an imported good clears customs in the EU, it moves freely throughout the full customs territory.

The bulk of the rules governing EU customs are in the Customs Code, a lengthy legal document that has been amended repeatedly. The "tariff" (as opposed to the tariff schedule) in the EU’s vernacular refers not only to the nomenclature and duty rates, but also to all other Community legislation that has an effect on the level of customs duty payable on a particular import, for example country of origin. The "tariff" is a collection of laws—as opposed to a single, codified law itself. To facilitate access to these legal requirements, the Commission has created TARIC. The TARIC presents all third-country and preferential duty rates actually applicable, as well as all commercial policy measures. TARIC includes information on tariff suspensions, tariff quotas, preferential treatment, anti-dumping and countervailing duties, import prohibitions and restrictions, quantitative limits, export surveillance, licenses and certificates.

5. **Generalized System of Preference:** The Generalized System of Preferences (GSP) was designed to allow industrialized countries to grant non-reciprocal tariff reductions to developing countries. The underlying idea was to help the developing world industrialize. The European Union was the first to implement its own GSP in 1971. Under the EU’s GSP scheme, most of the developing countries covered are also covered by the ACP (African - Caribbean - Pacific) or Mediterranean agreements. However, the GSP allows Asian and Latin American countries to export to the EU at lower than normal duty rates for manufactured goods and processed agricultural products. Preferential duty rates under GSP are given relative to the MFN rate that is found in the annual tariff schedule. To benefit from GSP tariff preferences, products from eligible countries must be "originating" according to the EU’s rules of origin for the purposes of GSP.

6. **Human Rights:** The European Union is committed to ensuring human and fundamental rights among its citizenry, as well as in its external policy. The Maastricht Treaty introduced the concept of European citizenship, which included a series of civil and political rights that are further refined by the Treaty of Amsterdam. This latter Treaty established procedures intended to protect these rights. According to the Treaty, the EU is empowered to take
appropriate action to combat discrimination based on sex, race or ethnic origin, religion, belief, disability, age or sexual orientation.

7. **Intellectual Property Protection:**

**Copyright & Related Issues:** Through a series of "Green Papers" and their follow-up reports, the EU has formulated an action plan and has adopted legislation on the legal protection of computer programs and databases, satellite broadcasting and cable transmission, rental right and lending right (consolidated version), certain related to the information society (consolidated version), resale rights to benefit the author of an original work of art and the duration of copyright protection (consolidated version). By providing a high comparable level of copyright protection in all member states, this harmonization has created a climate conducive to innovation and creativity while making it easier for these rights to be exercised throughout the Community.

**Patents:** In the patents field, there are two main conventions. The first, the Munich Convention on the European Patent—to which all EU member states are signatories—provides for patents for a number of countries to be obtained through a single application to the: European Patent Office (EPO). The second, the Luxembourg Convention on European Patents, was signed in 1989. One patent granted under the terms of this convention would be good throughout all of the member states of the EU, eliminating the necessity of individual, national patents. The Luxembourg Convention must be ratified by all EU member states before it goes into effect. Fewer than half of the member states have ratified it.

8. **Trademark:** The Community Trademark System, which became fully operational on 1 April 1996, provides for trademark protection with "unitary effect." Essentially, this is "one-stop shopping" for trademark registration in the EU. Simply by filing a single application for and registering a Community Trademark (CTM), trademark protection is valid throughout the territory of the EU member states. Once registered, a Community Trademark is subject to a single set of uniform rules throughout the EU. These rules relate, for example, to the scope of protection of the mark, to the renewal and invalidation of the registration and to all possible legal proceedings relating to it. The proprietor of the (registered) Community Trademark shall enjoy exclusive rights to the mark, implying that he can prohibit the use of his mark by third parties throughout Union territory. Registration of the mark shall be valid for a period of ten years and may be renewed for further periods of ten years.

The European Union’s Participation in Asia: Asia is a crucial partner for the EU, whether economically, politically or culturally. The wider Asian and Asia-Pacific region (including South Asia, South-East Asia, North-East Asia and Australasia) accounts for 56% of the world’s population, 25% of world GNP, and 22% of the world’s international trade. The region has been the cradle of several of the world’s major religions, and has an unparalleled cultural richness. The EU’s economic and commercial relations with Asia are of great importance for our own prosperity. Asia as a whole accounts for 21% of the EU’s external exports, and is our third-largest regional trading partner, after Europe outside the EU (31%) and NAFTA (28%). Asia also accounts for a significant share of EU foreign investment flows, while certain Asian countries
are important investors in the EU. Within the WTO, Asian countries play a very important role, and China’s entry into the WTO will help strengthen that body further.

The EU’s dialogue with Asian partners on global and regional security issues is important for our own security. The region is the locus of some of the world’s major sources of tension or conflict (for example in Kashmir, Sri Lanka, Afghanistan, in Aceh or Mindanao, or in the Taiwan Straits, the South China Sea or the inter-Korean border). Several Asian states have a nuclear capability, and certain countries continue to cause concern in relation to the proliferation of weapons of mass destruction. Asian countries of course have always played a major part in the working of the UN and its various bodies. Asia is also home to two-thirds of the world’s poor, with 800 million people living on less than $1 per day. Questions of food-security, health and access to basic services are still pressing issues in the lower-income countries of the region, and serious disparities of income and opportunity still challenge many middle-income countries in the region. The EU plays a major part in helping our Asian partners address these issues, and the EU as a whole (EC plus Member States) accounts for 30% of total aid flows to developing Asia. Asia is tremendously diverse, economically and politically, socially and culturally, and also in terms of scale. The region includes the two most populous countries in the world (China and India), and some of the smallest (Brunei and Bhutan); it includes some of the richest countries in the world (Japan, Singapore), and some of the poorest (eight Asian countries are on the UN Least-Developed list). India is the world’s largest democracy, while there are countries in the region, which are still subject to military or theocratic dictatorships.

Asia has also changed dramatically in recent years, both economically and politically. The "East Asian boom" from the 70s through the 90s was followed by an "East Asian crisis". Post-crisis recovery has thankfully been more rapid than might have been expected, and the underlying economic dynamism of the region is not in question. The crisis has however underlined the imperative need for all countries concerned to continue with a pro-active reform agenda.

Political changes in Asia have also been rapid in recent years. In the Sub-continent, tensions between India and Pakistan have now taken on a nuclear dimension. In South-East Asia, the political transition and economic crisis in Indonesia have helped lay a foundation for democratization while also seeing an increase in centrifugal pressures. ASEAN has expanded its membership to include Burma, Cambodia and Laos, while East Timor, on the verge of independence, may shortly apply to become ASEAN’s 11th member. In North-East Asia, President Kim’s "Sunshine Policy" has brought a dramatic change to the prospects for peace on the Korean Peninsula, while China continues to pursue internal economic reform, and to exert an increasing economic and political influence across the whole region.

Asia’s importance for the EU is incontestable, and it is imperative for the EU to follow a forward-looking policy of engagement with Asia, both in the region and globally.

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3.6 NORTH AMERICAN FREE TRADE ORGANIZATION

The North American Free Trade Agreement or NAFTA is an agreement signed by the governments of the United States, Canada, and Mexico creating a trilateral trade bloc in North America. The agreement came into force on January 1, 1994. It superseded the Canada-United
States Free Trade Agreement between the U.S. and Canada. In terms of combined purchasing power parity GDP of its members, as of 2007 the trade block is the largest in the world and second largest by nominal GDP comparison. The North American Free Trade Agreement (NAFTA) has two supplements:

- The North American Agreement on Environmental Cooperation (NAAEC); and
- The North American Agreement on Labor Cooperation (NAALC).

**Background:** In 1988 Canada and the United States signed the Canada-United States Free Trade Agreement. The American government then entered into negotiations with the Mexican government for a similar treaty, and Canada asked to join the negotiations in order to preserve its perceived gains under the 1988 deal.[1] The international climate at the time favoured expanding trade blocs, and the Maastricht Treaty which created the European Union was signed in 1992.

**Negotiation and Ratification:** Following diplomatic negotiations dating back to 1991 between the three nations, the leaders met in San Antonio, Texas, on December 17, 1992, to sign NAFTA. U.S. President George H.W. Bush, Canadian Prime Minister Brian Mulroney and Mexican President Carlos Salinas, each responsible for spearheading and promoting the agreement, ceremonially signed it. The agreement then needed to be ratified by each nation's legislative or parliamentary branch.

Before the negotiations were finalized, Bill Clinton came into office in the U.S. and Kim Campbell in Canada, and before the agreement became law, Jean Chrétien had taken office in Canada. The proposed Canada – US trade agreement had been extremely controversial and divisive in Canada, and the 1988 Canadian election was fought almost exclusively on that issue. In that election more Canadians voted for anti-free trade parties (the Liberals and the New Democrats) but more seats in parliament were won by the pro-free trade Progressive Conservatives (PCs). Mulroney and the PCs had a parliamentary majority and were able to easily pass the Canada-U.S. FTA and NAFTA bills. However Mulroney himself had become deeply unpopular and resigned on June 25, 1993. He was replaced as Conservative leader and prime minister by Kim Campbell, who then led the PC party into the 1993 election where they were decimated by the Liberals under Jean Chrétien. Chrétien had campaigned on a promise to renegotiate or abrogate NAFTA, but instead negotiated the two supplemental agreements with the new U.S. Democratic president, and ideological ally, Bill Clinton. Bill Clinton had become president of the U.S. before the agreement came into force, and is seen here signing the U.S. implementation legislation.

In the U.S., Bush, who had worked to "fast track" the signing prior to the end of his term, ran out of time and had to pass the required ratification and signing into law to incoming president Bill Clinton. Prior to sending it to the House of Representatives, Clinton introduced clauses intended to protect American workers and allay the concerns of many House members. It also required U.S. partners to adhere to environmental practices and regulations similar to its own. The ability to enforce these clauses, especially with Mexico, was considered questionable, and with much consternation and emotional discussion the House of Representatives approved NAFTA on November 17, 1993, by a vote of 234 to 200. Remarkably, the agreement's supporters included 132 Republicans and only 102 Democrats. NAFTA did not get the votes needed to pass as a
Treaty in the U.S. Senate. That unusual combination reflected the challenges President Clinton faced in convincing Congress that the controversial piece of legislation would truly benefit all Americans. The agreement was signed into law in the U.S. on December 8, 1993, by President Bill Clinton and went into effect on January 1, 1994.

Provisions: The goal of NAFTA was to eliminate barriers to trade and investment between the USA, Canada and Mexico. The implementation of NAFTA on January 1, 1994, brought the immediate elimination of tariffs on more than one half of US imports from Mexico and more than one third of US exports to Mexico. Within 10 years of the implementation of the agreement all US-Mexico tariffs would be eliminated except for some US agricultural exports to Mexico that were to be phased out in 15 years. Most US-Canada trade was already duty free. NAFTA also seeks to eliminate non-tariff trade barriers.

Effects: NAFTA's effects, both positive and negative, have been quantified by several economists. Some argue that NAFTA has been positive for Mexico, which has seen its poverty rates fall and real income rise (in the form of lower prices, especially food), even after accounting for the 1994–1995 economic crisis. Others argue that NAFTA has been beneficial to business owners and elites in all three countries, but has had negative impacts on farmers in Mexico who saw food prices fall based on cheap imports from U.S. agribusiness, and negative impacts on U.S. workers in manufacturing and assembly industries who lost jobs. Critics also argue that NAFTA has contributed to the rising levels of inequality in both the U.S. and Mexico. Some economists believe that NAFTA has not been enough (or worked fast enough) to produce an economic convergence, nor to substantially reduce poverty rates. Some have suggested that in order to fully benefit from the agreement, Mexico must invest more in education and promote innovation in infrastructure and agriculture.

Trade: According to Issac (2005), overall, NAFTA has not caused trade diversion, aside from a few industries such as textiles and apparel, in which rules of origin negotiated in the agreement were specifically designed to make U.S. firms prefer Mexican manufacturers. The World Bank also showed that the combined percentage growth of NAFTA imports was accompanied by an almost similar increase of non-NAFTA exports.

Industry: Maquiladoras (Mexican factories which take in imported raw materials and produce goods for export) have become the landmark of trade in Mexico. These are plants that moved to this region from the United States, hence the debate over the loss of American jobs. Hufbauer's (2005) book shows that income in the maquiladora sector has increased 15.5% since the implementation of NAFTA in 1994. Other sectors now benefit from the free trade agreement, and the share of exports from non-border states has increased in the last five years while the share of exports from maquiladora-border states has decreased. This has allowed for the rapid growth of non-border metropolitan areas, such as Toluca, León and Pueblo; all three larger in population than Tijuana, Ciudad Juarez, and Reynosa. The main non-maquiladora industry that has suffered from NAFTA is the automobile industry.

Environment: For more details on this topic, see NAFTA's Impact on the Environment. Securing U.S. congressional approval for NAFTA would have been impossible without addressing public concerns about NAFTA’s environmental impact. The Clinton administration
negotiated a side agreement on the environment with Canada and Mexico, the North American Agreement on Environmental Cooperation (NAAEC), which led to the creation of the Commission for Environmental Cooperation (CEC) in 1994. To alleviate concerns that NAFTA, the first regional trade agreement between a developing country and two developed countries, would have negative environmental impacts, the CEC was given a mandate to conduct ongoing ex post environmental assessment of NAFTA.

In response to this mandate, the CEC created a framework for conducting environmental analysis of NAFTA, one of the first ex post frameworks for the environmental assessment of trade liberalization. The framework was designed to produce a focused and systematic body of evidence with respect to the initial hypotheses about NAFTA and the environment, such as the concern that NAFTA would create a “race to the bottom” in environmental regulation among the three countries, or the hope that NAFTA would pressure governments to increase their environmental protection mechanisms. The CEC has held four symposia using this framework to evaluate the environmental impacts of NAFTA and has commissioned 47 papers on this subject. In keeping with the CEC’s overall strategy of transparency and public involvement, the CEC commissioned these papers from leading independent experts.

Overall, none of the initial hypotheses was confirmed. NAFTA did not inherently present a systemic threat to the North American environment, as was originally feared, but NAFTA-related environmental threats instead occurred in specific areas where government environmental policy, infrastructure, or mechanisms, were unprepared for the increasing scale of production under trade liberalization. In some cases, environmental policy was neglected in the wake of trade liberalization; in other cases, NAFTA's measures for investment protection, and measures against non-tariff trade barriers, threatened to discourage more vigorous environmental policy. The most serious overall increases in pollution due to NAFTA were found in the base metals sector, the Mexican petroleum sector, and the transportation equipment sector in the United States and Mexico, but not in Canada.

**Agriculture:** From the earliest negotiation, agriculture was (and still remains) a controversial topic within NAFTA, as it has been with almost all free trade agreements that have been signed within the WTO framework. Agriculture is the only section that was not negotiated trilaterally; instead, three separate agreements were signed between each pair of parties. The Canada–U.S. agreement contains significant restrictions and tariff quotas on agricultural products (mainly sugar, dairy, and poultry products), whereas the Mexico–U.S. pact allows for a wider liberalization within a framework of phase-out periods (it was the first North–South FTA on agriculture to be signed). The overall effect of the Mexico–U.S. agricultural agreement is a matter of dispute. Mexico did not invest in the infrastructure necessary for competition, such as efficient railroads and highways, creating more difficult living conditions for the country's poor. Still, the causes of rural poverty cannot be directly attributed to NAFTA; in fact, Mexico's agricultural exports increased 9.4 percent annually between 1994 and 2001, while imports increased by only 6.9 percent a year during the same period.

Production of corn in Mexico has increased since NAFTA's implementation. However, internal corn demand has increased beyond Mexico's sufficiency, and imports have become necessary, far beyond the quotas Mexico had originally negotiated. Zahniser & Coyle have also pointed out
that corn prices in Mexico, adjusted for international prices, have drastically decreased, yet through a program of subsidies expanded by former president Vicente Fox, production has remained stable since 2000.

The logical result of a lower commodity price is that more use of it is made downstream. Unfortunately, many of the same rural people who would have been likely to produce higher-margin value-added products in Mexico have instead emigrated. The rise in corn prices due to increased ethanol demand may improve the situation of corn farmers in Mexico.

In a study published in the August 2008 issue of the American Journal of Agricultural Economics, NAFTA has increased U.S. agricultural exports to Mexico and Canada even though most of this increase occurred a decade after its ratification. The study focused on the effects that gradual "phase-in" periods in regional trade agreements, including NAFTA, have on trade flows. Most of the increase in members’ agricultural trade, which was only recently brought under the purview of the World Trade Organization, was due to very high trade barriers before NAFTA or other regional trade agreements.

**Mobility of Persons:** According to the Department of Homeland Security Yearbook of Immigration Statistics, during fiscal year 2006, 74,098 foreign professionals (64,633 Canadians and 9,247 Mexicans) were admitted into the United States for temporary employment under NAFTA, in the treaty national's dependent (TD) status. Because DHS counts the number of the new I-94 arrival records filled at the border, and the TN-1 admission is valid for one year, the number of non-immigrants in TN status present in the U.S. at the end of the fiscal year is approximately equal to the number of admissions during the year. (A discrepancy may be caused by some TN entrants leaving the country or changing status before their one-year admission period expired, while other immigrants admitted earlier may change their status to TN or TD, or extend earlier granted TN status).

Canadian authorities estimated that, as of December 1, 2006, the total of 24,830 U.S. citizens and 15,219 Mexican citizens were present in Canada as "foreign workers". These numbers include both entrants under the NAFTA agreement and those who have entered under other provisions of the Canadian immigration law.[23] New entries of foreign workers in 2006 were 16,841 (U.S. citizens) and 13,933 (Mexicans).[24]

**Criticism and Controversies:**

**Canada:**

- There is much concern in Canada over the provision that if something is sold even once as a commodity, the government cannot stop its sale in the future.[25] This applies to the water from Canada's lakes and rivers, fueling fears over the possible destruction of Canadian ecosystems and water supply.
- In 1999, Sun Belt Water Inc., a company out of Santa Barbara, California, filed an Arbitration Claim under Chapter 11 of the NAFTA claiming $105 million as a result of Canada's prohibition on the export of bulk water by marine tanker, a move that destroyed the Sun Belt business venture. Sun Belt maintains a website where many documents
concerning the Arbitration are posted www.sunbeltwater.com. The claim sent shock waves through Canadian governments that scrambled to update water legislation and remains unresolved.

- Other fears come from the effects NAFTA has had on Canadian lawmaking. In 1996, the gasoline additive MMT was brought into Canada by an American company. At the time, the Canadian federal government banned the importation of the additive. The American company brought a claim under NAFTA Chapter 11 seeking US$201 million and by Canadian provinces under the Agreement on Internal Trade ("AIT"). The American company argued that their additive had not been conclusively linked to any health dangers, and that the prohibition was damaging to their company. Following a finding that the ban was a violation of the AIT, the Canadian federal government repealed the ban and settled with the American company for US$13 million. Studies by Health and Welfare Canada (now Health Canada) on the health effects of MMT in fuel found no significant health effects associated with exposure to these exhaust emissions. Other Canadian researchers and the U.S. Environmental Protection Agency disagree with Health Canada, and cite studies that include possible nerve damage.

US Deindustrialization: An increase in domestic manufacturing output and a proportionally greater domestic investment in manufacturing do not necessarily mean an increase in domestic manufacturing jobs; this increase may simply reflect greater automation and higher productivity. Although the U.S. total civilian employment may have grown by almost 15 million in between 1993 and 2001, manufacturing jobs have been only increased by 476,000 in the same time period. Furthermore from 1994 to 2007, net manufacturing employment has declined by 3,654,000, and during this period several other free trade agreements have been concluded or expanded.

Impact on Mexican Farmers: Critics of NAFTA cite negative affects on Mexico's corn farmers. In 2000, U.S government subsidies to the corn sector totaled $10.1 billion, a figure ten times greater than the total Mexican agricultural budget that year. These subsidies have lead to charges of de facto dumping which jeopardizes Mexican farms and the country's food self-sufficiency.

Other studies reject NAFTA as the force responsible for depressing the incomes of poor corn farmers, citing the trend's existence more than a decade before NAFTA's existence, an increase in maize production after NAFTA went into effect in 1994, and the lack of a measurable impact on the price of Mexican corn due to subsidized corn coming into Mexico from the United States, though they agree that the abolition of U.S. agricultural subsidies would benefit Mexican farmers. According to Graham Purchase in Anarchism and Environmental Survival, NAFTA could cause "the destruction of the EJIDOS (peasant cooperative village holdings) by corporate interests, and threatens to completely reverse the gains made by rural peoples in the Mexican Revolution."

NAFTA’s Naming: American intellectual Noam Chomsky has argued that the only true words in the phrase "North American Free Trade Agreement" seem to be "North America", as what is called trade is in reality mostly restricted intra-corporate transfers of products and services.
Agreement is lacking as NAFTA was passed with a lack of democratic oversight protocols and widespread public opposition.

**The Labor Component as a Factor of Production:** The critics observed that by obstructing the free circulation of labour and stock both from employment to employment, and from place to place, occasions in some cases a very inconvenient inequality in the whole of the advantages and disadvantages of their different employments. Within NAFTA official law and agreements, the movement of labor is temporary and very restrictive, especially for unskilled workers. Mexican (legal and illegal) migration to the USA is surging, but not due to NAFTA provisions. NAFTA provisions for freedom of movement of workers are very restrictive compared to one of the economic freedoms of the European Union, the freedom of movement for workers.

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### 3.7 REVIEW QUESTIONS

1. Discuss whether the loss of national sovereignty in the pursuit of economic and political integration.
2. It has been argued that 1990s is the decade of the Triad Strategy, which takes into consideration three important areas – Asia, North America and Europe. Discuss.
3. Discuss the problems & prospects of SAARC.
4. Discuss the participation of the European Banks in the International Financial system.
5. Discuss the pattern of trade inflow & outflow in the European Union.
6. Does product qualify for NAFTA if made in the United States?
7. What should an exporter in the United States do if, after completing and signing a Certificate of Origin, they have reason to believe that the certificate contains information is not correct?
8. How long does one have to keep records on NAFTA shipment?
9. Which Harmonized Number should appear in Block 6 of the NAFTA Certificate of Origin: the US, Canadian or Mexican tariff number?
10. May Customs Brokers sign certificates?
CO-OPERATIVE BUSINESS IN INTERNATIONAL OPERATIONS

Structure

4.1 Regulations & Barrier to Free Trade

4.2 Overview of Global Efforts for Removal of Trade Barriers

4.3 International Commodity Agreements: GSP & GSTP

4.4 GATT

4.5 WTO
   4.5.1 Introduction
   4.5.2 Principles
   4.5.3 Structure
   4.5.4 Major Agreements
   4.5.5 Conference & Third World Stand

4.6 Economic Integrators
   4.6.1 IMF
   4.6.2 World Bank
   4.6.3 Asian Development Bank
   4.6.4 UNCTAD
   4.6.5 UNIDO

4.7 Review Questions

4.1 REGULATIONS & BARRIER TO FREE TRADE

The "anti-globalization" movement has inspired students and activists in a manner reminiscent of the civil rights and anti-Vietnam war crusades of the '60's. In November and December 1999, activists significantly disrupted a week-long meeting of the World Trade Organization in Seattle. Subsequent protests have occurred in Washington D.C., Europe and Canada. The general concern is that:

1. **Trade unions tend to be "anti-global" because of national job loss.** The majority of union employment is in the manufacturing sector of the economy. This is the sector of the economy, which has been most adversely affected by globalization as international companies increasingly take advantage of unskilled labor abroad, especially in low wage countries. The service sectors of the economy that have benefited from freer trade tend to be less represented by organized labor.

2. Many environmental organizations have participated in the anti-global movement because they believe that the World Trade Organization has promoted policies that enable corporations to escape national restrictions on business practices by calling such
restrictions "trade barriers". They also **accuse global companies of dominating the politics of third world governments.** For example, many environmental activists accuse Shell Oil Company of promoting a regime that executed the Nigerian environmentalist Ken Saro-Wiwa. At the same time, however, most environmental organizations recognize that cooperation fostered by international institutions is critical to effective environmental control so it would be inaccurate to classify most environmental organizations as "anti-global".

3. Social activists, including Ralph Nader's Public Citizen organization, are chiefly concerned that the social protections which help protect workers and the poor in Europe and the United States will become eroded because workers in the emerging countries will not have these protections.

4. Poor nations and their advocates argue that free trade is a benefit for richer nations at the expense of poorer nations because tariff barriers are necessary for poor countries to develop their economies. They also argue that World Bank lending policies force poor countries to adopt economic policies that benefit only their wealthy trading partners and leave them with overwhelming.

5. Many isolationists oppose globalization because of a concern that the U.S. will lose its ability to control its own destiny and economy.

All these interests have succeeded in focusing unprecedented and needed attention on two modern developments which had been previously too often overlooked:

1. The growing interdependence of the world's nations; and

2. The alarming disparity between rich and poor countries.

**What are the different forms of trade barriers?**

To encourage development of domestic industry and protect existing industry, governments may establish such barriers to trade as tariffs, quotas, boycotts, monetary barriers, nontariff barriers and market barriers. Barriers are imposed against imports and against foreign businesses. While the inspiration for such barriers may be economic or political, they are encouraged by local industry. Whether or not the barriers are economically logical, the fact is they exist.

**Tariffs:** A tariff, simply defined, is a tax imposed by a government on goods entering at its borders. Tariffs may be used as a revenue generating tax or to discourage the importation of goods, or for both reasons. In general, tariffs:

**Increase –** Inflationary pressures.
- Special interests’ privileges.
- Government control and political considerations in economic matters.
- The number of tariffs [they beget other tariffs]

**Weaken -** Balance of payments positions.
- Supply and demand patterns.
- International understanding [they can start trade wars].

**Restrict -** Manufacturers’ supply sources.
- Choices available to consumers.
- Competition.
In addition, tariffs are arbitrary, discriminatory and require constant administration and supervision. They often are used as reprisals against protectionist moves of trading partners. In a dispute with the European Community over pasta export subsidies, the United States ordered a 40% increase in tariffs on European spaghetti and fancy pasta. The U.S retaliated against U.S walnuts and lemons. The pasta war raged on as Europe increased tariffs on U.S fertilizer, paper products, and beef tallow and the United States responded in kind. The war ended when the Europeans finally dropped pasta export subsidies.

**Non-Tariff Barriers:** Non-tariff barriers are government laws, regulations, policies, conditions, restrictions, or specific requirements, and private sector business practices or prohibitions that protect the domestic industries from foreign competition. They are the means of keeping the foreign goods out of domestic market while abiding by the multilateral agreements that the country has signed through the WTO (World Trade Organization).

**Quotas:** Import quota is the number or amount of goods of a specific kind or class, such as garments and shoes that the government of importing country will permit to be imported. Import quotas are normally imposed on an annual and a country basis. Export quota is the number or amount of goods of a specific kind or class that the government of exporting country will allow to be exported. The purpose of export quota is to protect the domestic supply of the goods, for example, sugar, cement and lumber. Export quota may also be used to boost the world prices of such commodities as oil and strategic metals, and to protect the natural resources of the exporting country.

The term quota usually refers to the import quota. In practice, the term export quota often, but incorrectly, refers to the import quota. When exporters talk about the export quota, most often they are referring to the import quota of the importing country.

The quota is allocated, in the form of a permit or a license, to the exporters (the export-manufacturers and export-traders) usually on pro rata, based on their past export records. The quota allocation normally is administered by the government export office or the national industry association of the exporting country, for example garment manufacturers' association and footwear manufacturers' association.

For new exporters, the chance of being given a quota by the administering office is often slim. However, they can still export either by selling their products to exporters with excess quota --- having a quota but for reasons like shortage of supply, they are unable to serve or utilize all the amount or quantity allocated by the administering office --- or by 'buying' the excess quota from willing sellers (exporters), with approval from the administering office. To ensure that the quota granted to an exporting country is fully served or utilized within a given time, the administering office of that country may allow the 'quota buying' between exporters.

When a quota is reached, imports from an exporting country cannot be legally obtained. Hence, the quota is more effective in limiting imports than the tariff barriers.
Import Levies: Levies on imported and transit goods are often collected from the use of ports and terminal facilities. They are collected to pay the costs of maintenance and development of the infrastructures. Levies may vary from port to port (or point to point) within a country.

Pre-shipment Inspections: The government normally requires some form of inspection for health, safety, security, and tax purposes, before goods are allowed to leave or enter a country.

Export Pre-shipment Inspection: The government pre-shipment inspection on some export goods, such as electrical and electronic items, is required in many exporting countries in order to protect the country's quality image abroad and the foreign consumers.

Import Pre-shipment Inspection: Certain importing countries require—stipulate in the letter of credit—pre-shipment inspection by their government engaged independent surveyor, which is a form of non-tariff barrier. The import government may pay an annual fee to the official surveyor. Moreover, in practice, an inspection fee is collected from the exporter in each shipment. The main purpose of the inspection, conducted at the exporting country, is price and quantity verification, in order to stamp out rampant import under declaration where the government loses a lot on tax revenue. The inspection has increased the government import collection but not to the level expected, that is, the under declaration continues. Importers would be discouraged to under declare imports if the duty was low. Consequently, government may collect more duties and taxes and save additional inspection expenses. The inspection was restricted to shipments coming from certain developing countries, but later included all countries. Exporters from developed countries, who have been selling without under declaration, to the importing countries concerned for decades are affected too. In reality, the export price is often lower than the domestic selling price. The surveyor's inspection tends to compare the export invoice price against the domestic selling price in the exporting country. The pre-shipment inspection generates dissent and discontent from exporters and importers.

Consular Invoice or Legalization or Visa of Export Documents: Certain importing countries, particularly Central America, require a Consular Invoice. The consular fee can be a percentage of the invoice value. Some importing countries require that the export documents be legalized by their Consulate or the Commercial Section of the Embassy located in the exporting country. A fee is usually charged.

Health, Safety and Technical Standards: Certain products require the health certificate, safety test marks, or standards certification of the importing country before they are allowed entry. The product modification may be needed to meet the import requirements, which means additional product inventory and expenses.

Currency Deposit in Importations: Currency deposit, in local or foreign currency, may be required in applying for a letter of credit (L/C) and/or an import permit. In practice, many banks require a deposit and the amount varies from bank to bank. In times of foreign exchange shortage in a country, the government may require a 100% deposit in foreign currency (U.S. Dollar usually).

Product Labeling in Foreign Language: Product labeling in the official language of the importing country is often required, especially health and food products, which normally require
the name of manufacturer and product expiry date. It may mean having new packaging to
conform to import requirements. Consequently, additional product inventory and expenses are
often necessary.

**Closed Market Distribution:** The closed market distribution can be a government and/or a
private sector business practice or prohibition that precludes foreign goods from the domestic
distribution channels. This may occur in a country having a centrally planned economy or a deep
sense of nationalism.

**Advertising Restrictions:** In some countries, the comparative advertising—naming or showing
of competing products—is prohibited by laws. The kind of product and the extent of advertising
claims are regulated, which may render the advertisement less effective. Violators could face
heavy penalties.

**Free and Preferential Tariff Treatments:** Import duties are generally classified into regular
(general) duty, preferential duty and free duty. The free and preferential tariff treatments, often
called the special tariff status, are designed to promote trade with countries for reasons of foreign
policy. Some of the more commonly encountered tariff treatments include MFN, GSP, FT and
BPT.

**MFN (Most Favored Nation):** The non-discriminatory treatment of all signatory countries to
the WTO (World Trade Organization) with the same duty rate for purposes of imports.

**GSP (Generalized System of Preferences):** A free or reduced duty granted by the developed
countries to certain manufactured goods from the least developed countries, in order to bolster
their exports and economic growth. Please see Form A in the GSP Program for related
information.

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**4.2 OVERVIEW OF GLOBAL EFFORTS FOR REMOVAL OF TRADE BARRIERS**

World trade has been liberalized considerably as a result of the Uruguay Round but significant
trade barriers remain including in areas of interest to developing countries like textiles and
agriculture, according to a new WTO Secretariat study. This new report makes clear that the
WTO has plenty of unfinished business,” said Director-General Mike Moore. “The best way we
can tackle the many remaining trade barriers that are preventing people and countries from
realizing their full potential is in a wider set of negotiations.” The new WTO Secretariat study
profiles post-Uruguay Round market access conditions in three areas — industrial tariffs,
agriculture and services — the latter two of which are already the subject of ongoing
negotiations. The detailed study is intended as a comprehensive resource for negotiators and the
interested public. Some of the findings presented in the new WTO Secretariat study are:

- Among the 42 developed and developing countries surveyed the average level of bound
tariffs for industrial products ranges from 1.8% to 59%.
- Numerous countries have bound their industrial tariffs at levels significantly above the
levels actually applied, with differences between the average bound and average applied
rates reaching more than 30% in some countries. In such cases, bindings contribute little to the stability of the applied tariffs.

- Forty-seven WTO Members and five Observers participate in the Information Technology Agreement, which provides for the elimination of tariffs on IT products. These countries currently account for 93% of world trade in IT products.
- Among the Asian countries in the sample, the share of agricultural tariff lines with bound duties above 100% ranges from zero to 69%, while among European countries the figure ranges from 1% to 45%.
- The nine countries that joined the WTO between January 1995 and July 2000 have assumed higher levels of commitments, in terms of services sectors included, than incumbent Members at comparable levels of development.
- In services the two most important modes of supply are - (cross-border supply) and (supply through commercial presence). So far members appear to have concentrated much of negotiating effort on supply through commercial presence. There may, however, be a greater focus on in the current negotiations as a result of the growth of e-commerce.

What are International Commodity Agreements?

International Commodity Agreements are inter-governmental arrangements concerning the production of, and trade in, certain primary products with a view to stabilizing their prices. Commodity agreements have been tried in different cases for quite some time now. "The worsening for primary product exporters of their terms of trade in the second half of the fifties, their lagging export earnings, inadequate reserves, mounting external indebtedness,' and the consequential frustration of plans for rapid economic developments caused these countries to cast around for ways of escaping from their predicament. Out of this search came the idea that commodity agreements could be used as a way of raising (or halting a fall in) the world prices of commodities, and in this way of transferring income from consuming to producing countries.

In its Final Act, the UNCTAD-I made a comprehensive statement on the functions of international commodity agreements. The commodity agreements should have, it said, "a basic objective of stimulating a dynamic and steady growth and ensuring reasonable predictability in the real export earnings of the developing countries so as to provide them with expanding resources for their economic and social development, while taking into account the interests of consumers in importing countries, through remunerative, equitable and stable prices for primary commodities, having due regard to their import purchasing power, assured satisfactory access and increased imports and consumption as well as' coordination of production and marketing policies. Commodity Agreements may take any of the four forms, namely, quota, buffer stock, bilateral contract, or multilateral contract.

Quota Agreements: International quota agreements seek to prevent a fall in commodity prices by regulating their supply. Under the quota agreement, export quotas are determined and allocated to participating countries according to some mutually agreed formula, and they undertake to restrict the export or production by a certain percentage of the basic quota decided by the central committee or council. For instance, Coffee Agreement among the major producers of Latin America and Africa limited the amount that could be exported by each country.
Quota agreements have already been tried in case of coffee and sugar, and commodities like tea and bananas have been suggested prospective candidates for new agreement. It has been pointed out that quotas are bad theoretically because they imply misallocation of resources. They protect inefficient producers, freeze markets, and probably keep supplies below the optimum level.

Quotas have the advantage, however, of being manageable. They avoid accumulation of stocks, require no financing and do not call for continuous operating decisions. Some past base year, however arbitrary, can usually be made to serve as a standard to facilitate delicate decisions. In practice, quotas would probably have to be combined with buffer pools in order to provide the necessary short-run flexibility of supply.

**Buffer Stock Agreements:** International buffer stock agreements seek to stabilize commodity prices by maintaining the demand-supply balance. Buffer stock agreements stabilize the price by increasing the market supply by the sale of the commodity when the price tends to rise and by absorbing the excess supply to prevent a fall in the price. The buffer stock plan, thus, requires an international agency to set a range of prices and to buy the commodity at the minimum and sell at the maximum. The buffer pool method has already been tried in case of tin, cocoa, and sugar, and commodities like rubber, tea and copper have been suggested as prospective candidates for new agreements.

The buffer stock arrangements, however, suffer from certain limitations.

- It can be affected only for those products that can be stored at a relatively low cost without the danger of deterioration.
- Large financial resources and stocks of the commodity are required to launch the programme successfully.
- It has, moreover, been pointed out that "in the absence of production and export quotas to protect the buffer pool, there is always the prospect that some countries light use it to create easy foreign exchange for themselves. Export subsidies and special exchange rates might provide the means to that end. Finally, the present division of the world into different currency areas would hamper the functioning of buffer pools."

**Bilateral/Multilateral Contracts:** Bilateral contract to purchase and sell certain quantities of a commodity at agreed prices may be entered into between a major importer and exporter of the commodity. In such an agreement, an upper price and a lower price are specified. If the market price, throughout the period of the agreement, remains within these specified limits, the agreement becomes inoperative. But if the market price rises above the upper limit specified, the exporting country is obliged to sell to the importing country a certain specified quantity of the commodity at the upper price fixed by the agreement. On the other hand, if the market price falls below the lower limit specified the importer is obliged to purchase the contracted quantity at the specified lower price. Such international sale and purchase contracts may also be entered into by two or more exporters and importers. Bilateral/multilateral agreements are usually concluded between the major supplier(s) and the major importer(s) of the commodities.
The best known example of this type of commodity agreement is the International Wheat Agreement, which fixed the maximum price at which the exporting countries guaranteed to supply stipulated amounts of wheat to the importing countries, and the minimum price at which the importing countries agreed to purchase fixed amounts of wheat from the exporters.

As Wallich points out, this type of agreement has the advantage of preserving the free market as an allocator of resources and an indicator of trends, provided that not all the supplies are covered by it. The technical problems of the contract are quite manageable, although difficulties grow as the agreement is drawn tighter to make it more effective. The contract has the grave disadvantage, however, of creating a two-price system. It requires domestic controls of some sort and a buffer stock to implement it, and it is quite apt to put the participating governments into the commodities' business. In an extreme case, it may become nothing but a payment by the government of one country to that of another without ever touching the producer or consumer.

The experiences of the post-war market stabilization schemes indicate that a combination of different control techniques is likely to be more effective than reliance on a single technique alone.

### 4.3 GSP & GSTP

**What is GSP?**

Intergovernmental negotiations held under the auspices of UNCTAD resulted in the adoption of the *Generalized System of Preferences (GSP)* whereby preferential tariff treatment is granted on a non-reciprocal and non-discriminatory basis by most developed countries to exports from developing countries. Specific products are allowed to enter the markets of preference-giving countries with most-favoured-nation (MFN) duties reduced or eliminated.

**What are its objectives?**

As is stated in resolution 21(ii) taken at the UNCTAD II conference in New Delhi in 1968, "the objectives of GSP for the developing countries should be:

1. To make developing countries aware of the potential for trade expansion arising from GSP schemes and to increase their capabilities to make use of these schemes.
2. To disseminate information regarding regulations and procedures governing trade under such schemes.
3. To help preference-receiving countries establish domestic focal points to facilitate and increase utilization of the GSP.
4. To provide information on trade-related regulations such as anti-dumping and countervailing duties, customs regulations, import-licensing procedures, and other trade laws regulating market access conditions in preference-giving countries.

**How did it evolve?**

Under GSP schemes of preference-giving counties, selected products originating in developing countries are granted reduced or zero tariff rates over the MFN rates. The least developed countries (LDCs) receive special and preferential treatment for a wider coverage of products and deeper tariff cuts. The idea of granting developing countries preferential tariff rates in the
markets of industrialized countries was originally presented by the first Secretary-General of UNCTAD, at the first UNCTAD conference in 1964. The GSP was adopted at UNCTAD II in New Delhi in 1968.

In 1971, the GATT Contracting Parties approved a waiver to Article I of the Agreement for 10 years in order to authorize the GSP scheme. Later, the Contracting Parties decided to adopt the 1979 Enabling Clause, Decision of the Contracting Parties of 28 November 1979 (26S/203) titled "Differential and More Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries", creating a permanent waiver to the most-favoured-nation clause to allow preference-giving countries to grant preferential tariff treatment under their respective GSP schemes.

There are currently 16 national GSP schemes notified to the UNCTAD secretariat. The following countries grant GSP schemes: Australia, Belarus, Bulgaria, Canada, the Czech Republic, the European Community, Hungary, Japan, New Zealand, Norway, Poland, the Russian Federation, the Slovak Republic, Switzerland, Turkey and the United States of America.

What is the GSTP?
The Global System of Trade Preferences GSTP is an Agreement on economic co-operation for promotion of trade by providing preferential trading among developing countries. The scope of GSTP has included complementary trade liberalization techniques as follow:

- Tariff reduction
- Removal or reduction of non-tariff and para-tariff barriers
- Direct trade measures as well as mid-term and long-term contracts
- Sectoral agreement

What is the Background of the GSTP?
The Group of 77 (G-77), was founded in June 15, 1964 by seventy-seven developing countries, has aims to promote collective self-reliance and enhance bargaining powers of developing countries in trade negotiation. Beginning with the first Ministerial Meeting of the G-77 in Algier in 1967 that adopted the Charter of Algiers. At present, the membership of G-77 has increased to 132 countries but the original name was retained because it has a historic significance. The Global System of Trade Preferences (GSTP) was established by the members of G-77 in accordance with the Arusha Programme of Collective Self -Reliance, the Caracas Programme of Action and the Ministerial Declaration on GSTP adopted by the Meeting of Foreign Minister on GSTP in New Delhi of 1985. In April 1988, forty-eight members of G-77, including Thailand, signed the GSTP Agreement.

What are its objectives?
To promote and protect mutual trade benefit and extend the economic co-operation among developing member countries under the GSTP Agreement by granting preferential tariff treatment for eligible products from each countries.
What are its benefits?

- To enhance production and employment among developing countries;
- To encourage the economic co-operation;
- To make a balanced and equitable process of global economic development; and
- To establishment of New Economic Order.

What are the principles of GSTP?
The GSTP shall be established in accordance with the following principles:

1. The GSTP shall be reserved for the exclusive participation of developing countries members of G-77.
2. The benefits of the GSTP shall accrue to the developing countries members of G-77 who are the participants of the GSTP.
3. The GSTP shall be based and applied on the principle of mutuality of advantage in such away as to benefit equitably all participants, taking into account their respective levels of economic and industrial development, the pattern of their external trade and their trade policies and systems.
4. The GSTP shall be negotiated step by step, improve and extended in successive stages, with periodic reviews.
5. The GSTP shall not replace, but supplement and reinforce, present and future sub regional, region and interregional economic groupings of developing countries of G-77, and shall take into account the concerns and commitments of such economic groupings.
6. The special needs of the least developed countries shall be clearly recognized and concrete preferential measures in favour of these countries should be agree upon; the least developed countries will not be required to make a concessions on a reciprocal basis.
7. The GSTP shall include all products, manufactures, and commodities in their raw, semi-processed and process forms.
8. Intergovernmental sub-regional, regional and interregional groupings for economic co-operation among developing countries, members of G-77 may participate, fully as such, if and when they consider it desirable, in any or all phases of the work on the GSTP.

Margin of Preferences: Under the GSTP it ranges from 2.5 to 100%.

Product Coverage: In the first round of negotiation, all participants has agreed to give preference tariff treatment for eligible products covering agricultural and industrial products exported from a participant country to another participant country. Presently, there are eligible products under the GSTP about 1,626 items.

The Rules of Origin: For receiving preferential tariff treatment:

- The products must comply with the rule of origin in accordance with the GSTP Agreement.
- Total value of the product must have import content value not exceed 50% of F.O.B. value of the product.
• Direct consignment to importing participant country.
• Attachment of certificated of origin issued by government authority of exporting participant countries.

**GSTP Committee:** It consists of government representatives from participant countries, performs function to facilitate the operation and further the objective of the agreement. The Committee shall be responsible for reviewing and monitoring the implementation of the results of the negotiation, carrying out consultations, making recommendations, taking decision as required and undertaking whatever of the objective and the provisions of this Agreement.

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**4.4 GATT**

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**GATT: ‘Provisional’ for almost half a century.**
From 1948 to 1994, the General Agreement on Tariffs and Trade (GATT) provided the rules for much of world trade and presided over periods that saw some of the highest growth rates in international commerce. It seemed well-established, but throughout those 47 years, it was a provisional agreement and organization.

The original intention was to create a third institution to handle the trade side of international economic co-operation, joining the two “Bretton Woods” institutions, the World Bank and the International Monetary Fund. Over 50 countries participated in negotiations to create an International Trade Organization (ITO) as a specialized agency of the United Nations. The draft ITO Charter was ambitious. It extended beyond world trade disciplines, to include rules on employment, commodity agreements, restrictive business practices, international investment, and services.

Even before the talks concluded, 23 of the 50 participants decided in 1946 to negotiate to reduce and bind customs tariffs. With the Second World War only recently ended, they wanted to give an early boost to trade liberalization, and to begin to correct the legacy of protectionist measures that remained in place from the early 1930s.

This first round of negotiations resulted in 45,000 tariff concessions affecting $10 billion of trade, about one fifth of the world’s total. The 23 also agreed that they should accept some of the trade rules of the draft ITO Charter. This, they believed, should be done swiftly and “provisionally” in order to protect the value of the tariff concessions they had negotiated. The combined package of trade rules and tariff concessions became known as the General Agreement on Tariffs and Trade. It entered into force in January 1948, while the ITO Charter was still being negotiated. The 23 became founding GATT members (officially, “contracting parties”).

Although the ITO Charter was finally agreed at a UN Conference on Trade and Employment in Havana in March 1948, ratification in some national legislatures proved impossible. The most serious opposition was in the US Congress, even though the US government had been one of the driving forces. In 1950, the United States government announced that it would not seek Congressional ratification of the Havana Charter, and the ITO was effectively dead. Even though it was provisional, the GATT remained the only multilateral instrument governing international trade from 1948 until the WTO was established in 1995.
For almost half a century, the GATT’s basic legal principles remained much as they were in 1948. There were additions in the form of a section on development added in the 1960s and “plurilateral” agreements (i.e. with voluntary membership) in the 1970s, and efforts to reduce tariffs further continued. Much of this was achieved through a series of multilateral negotiations known as “trade rounds” — the biggest leaps forward in international trade liberalization have come through these rounds that were held under GATT’s auspices.

In the early years, the GATT trade rounds concentrated on further reducing tariffs. Then, the Kennedy Round in the mid-sixties brought about a GATT Anti-Dumping Agreement and a section on development. The Tokyo Round during the seventies was the first major attempt to tackle trade barriers that do not take the form of tariffs, and to improve the system. The eighth, the Uruguay Round of 1986-94, was the last and most extensive of all. It led to the World Trade Organization (WTO) and a new set of agreements.

### GATT Rounds:

<table>
<thead>
<tr>
<th>Year</th>
<th>Place/name</th>
<th>Subjects covered</th>
<th>Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>1947</td>
<td>Geneva</td>
<td></td>
<td>23</td>
</tr>
<tr>
<td>1949</td>
<td>Annecy</td>
<td>Tariffs</td>
<td>13</td>
</tr>
<tr>
<td>1951</td>
<td>Torquay</td>
<td>Tariffs</td>
<td>38</td>
</tr>
<tr>
<td>1956</td>
<td>Geneva</td>
<td>Tariffs</td>
<td>26</td>
</tr>
<tr>
<td>1960-1961</td>
<td>Geneva Dillon Round</td>
<td>Tariffs</td>
<td>26</td>
</tr>
<tr>
<td>1964-1967</td>
<td>Geneva Kennedy Round</td>
<td>Tariffs and Anti-Dumping Measures</td>
<td>62</td>
</tr>
<tr>
<td>1986-1994</td>
<td>Geneva Uruguay Round</td>
<td>Tariffs, non-tariff measures, rules, services, intellectual property, dispute settlement, textiles, agriculture, creation of WTO, etc</td>
<td>123</td>
</tr>
</tbody>
</table>

**Did GATT succeed?**
GATT was provisional with a limited field of action, but its success over 47 years in promoting and securing the liberalization of much of world trade is incontestable. Continual reductions in tariffs alone helped spur very high rates of world trade growth during the 1950s and 1960s — around 8% a year on average. And the momentum of trade liberalization helped ensure that trade growth consistently out-paced production growth throughout the GATT era, a measure of countries’ increasing ability to trade with each other and to reap the benefits of trade. The rush of new members during the Uruguay Round demonstrated that the multilateral trading system was recognized as an anchor for development and an instrument of economic and trade reform.
But all was not well. As time passed new problems arose. The Tokyo Round in the 1970s was an attempt to tackle some of these but its achievements were limited. This was a sign of difficult times to come.

GATT’s success in reducing tariffs to such a low level, combined with a series of economic recessions in the 1970s and early 1980s, drove governments to devise other forms of protection for sectors facing increased foreign competition. High rates of unemployment and constant factory closures led governments in Western Europe and North America to seek bilateral market-sharing arrangements with competitors and to embark on a subsidies race to maintain their holds on agricultural trade. Both these changes undermined GATT’s credibility and effectiveness.

The problem was not just a deteriorating trade policy environment. By the early 1980s the General Agreement was clearly no longer as relevant to the realities of world trade as it had been in the 1940s. For a start, world trade had become far more complex and important than 40 years before: the globalization of the world economy was underway, trade in services — not covered by GATT rules — was of major interest to more and more countries, and international investment had expanded. The expansion of services trade was also closely tied to further increases in world merchandise trade. In other respects, GATT had been found wanting. For instance, in agriculture, loopholes in the multilateral system were heavily exploited, and efforts at liberalizing agricultural trade met with little success. In the textiles and clothing sector, an exception to GATT’s normal disciplines was negotiated in the 1960s and early 1970s, leading to the Multi-fiber Arrangement. Even GATT’s institutional structure and its dispute settlement system were causing concern.

These and other factors convinced GATT members that a new effort to reinforce and extend the multilateral system should be attempted. That effort resulted in the Uruguay Round, the Marrakesh Declaration, and the creation of the WTO.

4.4 The Uruguay Round

It took seven and a half years, almost twice the original schedule. By the end, 123 countries were taking part. It covered almost all trade, from toothbrushes to pleasure boats, from banking to telecommunications, from the genes of wild rice to AIDS treatments. It was quite simply the largest trade negotiation ever, and most probably the largest negotiation of any kind in history.

The Uruguay Round brought about the biggest reform of the world’s trading system since GATT was created at the end of the Second World War. And yet, despite its troubled progress, the Uruguay Round did see some early results. Within only two years, participants had agreed on a package of cuts in import duties on tropical products — which are mainly exported by developing countries. They had also revised the rules for settling disputes, with some measures implemented on the spot. And they called for regular reports on GATT members’ trade policies, a move considered important for making trade regimes transparent around the world.
4.5 WTO

4.5.1 Introduction
The World Trade Organization (WTO) deals with the rules of trade between nations at a global or near-global level. But there is more to it than that. There are a number of ways of looking at the WTO. It’s an organization for liberalizing trade. It’s a forum for governments to negotiate trade agreements. It’s a place for them to settle trade disputes. It operates a system of trade rules. (But it’s not Superman, just in case anyone thought it could solve — or cause — all the world’s problems)

Essentially, the WTO is a place where member governments go, to try to sort out the trade problems they face with each other. The first step is to talk. The WTO was born out of negotiations, and everything the WTO does is the result of negotiations. The bulk of the WTO's current work comes from the 1986-94 negotiations called the Uruguay Round and earlier negotiations under the General Agreement on Tariffs and Trade (GATT). The WTO is currently the host to new negotiations, under the “Doha Development Agenda” launched in 2001.

Where countries have faced trade barriers and wanted them lowered, the negotiations have helped to liberalize trade. But the WTO is not just about liberalizing trade, and in some circumstances its rules support maintaining trade barriers, for example to protect consumers or prevent the spread of disease.

At its heart are the WTO agreements, negotiated and signed by the bulk of the world’s trading nations. These documents provide the legal ground-rules for international commerce. They are essentially contracts, binding governments to keep their trade policies within agreed limits. Although negotiated and signed by governments, the goal is to help producers of goods and services, exporters, and importers conduct their business, while allowing governments to meet social and environmental objectives.

The system’s overriding purpose is to help trade flow as freely as possible, so long as there are no undesirable side effects. That partly means removing obstacles. It also means ensuring that individuals, companies and governments know what the trade rules are around the world, and giving them the confidence that there will be no sudden changes of policy. In other words, the rules have to be “transparent” and predictable.

To settle disputes is the third important side to the WTO’s work. Trade relations often involve conflicting interests. Agreements, including those painstakingly negotiated in the WTO system, often need interpreting. The most harmonious way to settle these differences is through some neutral procedure based on an agreed legal foundation. That is the purpose behind the dispute settlement process written into the WTO agreements]

4.5.2 The Principles of WTO
The WTO agreements are lengthy and complex because they are legal texts covering a wide range of activities. They deal with: agriculture, textiles and clothing, banking, telecommunications, government purchases, industrial standards and product safety, food
sanitation regulations, intellectual property, and much more. But a number of simple, fundamental principles run throughout all of these documents. These principles are the foundation of the multilateral trading system. Let’s have a closer look at these principles:

1. Trade without Discrimination:
   A. This principle is known as most-favoured-nation (MFN) treatment. It is so important that it is the first article of the General Agreement on Tariffs and Trade (GATT), which governs trade in goods. MFN is also a priority in the General Agreement on Trade in Services (GATS) (Article 2) and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) (Article 4), although in each agreement the principle is handled slightly differently. Together, those three agreements cover all three main areas of trade handled by the WTO.

   Some exceptions are allowed. For example, countries can set up a free trade agreement that applies only to goods traded within the group — discriminating against goods from outside. Or they can give developing countries special access to their markets. Or a country can raise barriers against products that are considered to be traded unfairly from specific countries. And in services, countries are allowed, in limited circumstances, to discriminate. But the agreements only permit these exceptions under strict conditions. In general, MFN means that every time a country lowers a trade barrier or opens up a market, it has to do so for the same goods or services from all its trading partners — whether rich or poor, weak or strong.

   B. National Treatment (Treating Foreigners and Locals Equally): Imported and locally-produced goods should be treated equally — at least after the foreign goods have entered the market. The same should apply to foreign and domestic services, and to foreign and local trademarks, copyrights and patents. This principle of “national treatment” (giving others the same treatment as one’s own nationals) is also found in all the three main WTO agreements (Article 3 of GATT, Article 17 of GATS and Article 3 of TRIPS), although once again the principle is handled slightly differently in each of these.

   National treatment only applies once a product; service or item of intellectual property has entered the market. Therefore, charging customs duty on an import is not a violation of national treatment even if locally produced products are not charged an equivalent tax.

2. Freer Trade (Gradually, through Negotiation): Lowering trade barriers is one of the most obvious means of encouraging trade. The barriers concerned include customs duties (or tariffs) and measures such as import bans or quotas that restrict quantities selectively. From time to time other issues such as red tape and exchange rate policies have also been discussed.

   Since GATT’s creation in 1947-48 there have been eight rounds of trade negotiations. A ninth round, under the Doha Development Agenda, is now underway. At first these focused on lowering tariffs (customs duties) on imported goods. As a result of the negotiations, by the mid-1990s industrial countries’ tariff rates on industrial goods had fallen steadily to less than 4%. But by the 1980s, the negotiations had expanded to cover non-tariff barriers on goods, and to the new areas such as services and intellectual property. Opening markets can be beneficial, but it also requires adjustment. The WTO agreements allow countries to introduce changes gradually,
through “progressive liberalization”. Developing countries are usually given longer to fulfill their obligations.

3. Predictability (through Binding and Transparency): Sometimes, promising not to raise a trade barrier can be as important as lowering one, because the promise gives businesses a clearer view of their future opportunities. With stability and predictability, investment is encouraged, jobs are created and consumers can fully enjoy the benefits of competition — choice and lower prices. The multilateral trading system is an attempt by governments to make the business environment stable and predictable. The Uruguay Round increased bindings. Percentages of tariffs bound before and after the 1986-94 talks are tabulated below:

<table>
<thead>
<tr>
<th>Countries</th>
<th>Before</th>
<th>After</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developed countries</td>
<td>78</td>
<td>99</td>
</tr>
<tr>
<td>Developing countries</td>
<td>21</td>
<td>73</td>
</tr>
<tr>
<td>Transition economies</td>
<td>73</td>
<td>98</td>
</tr>
</tbody>
</table>

(These are tariff lines, so percentages are not weighted according to trade volume or value).

In the WTO, when countries agree to open their markets for goods or services, they “bind” their commitments. For goods, these bindings amount to ceilings on customs tariff rates. Sometimes countries tax imports at rates that are lower than the bound rates. Frequently this is the case in developing countries. In developed countries the rates actually charged and the bound rates tend to be the same.

A country can change its bindings, but only after negotiating with its trading partners, which could mean compensating them for loss of trade. One of the achievements of the Uruguay Round of multilateral trade talks was to increase the amount of trade under binding commitments (see table). In agriculture, 100% of products now have bound tariffs. The result of all this: a substantially higher degree of market security for traders and investors.

The system tries to improve predictability and stability in other ways as well. One-way is to discourage the use of quotas and other measures used to set limits on quantities of imports — administering quotas can lead to more red tape and accusations of unfair play. Another is to make countries’ trade rules as clear and public (“transparent”) as possible. Many WTO agreements require governments to disclose their policies and practices publicly within the country or by notifying the WTO. The regular surveillance of national trade policies through the Trade Policy Review Mechanism provides a further means of encouraging transparency both domestically and at the multilateral level.

4 Promoting Fair Competition: The WTO is sometimes described as a “free trade” institution, but that is not entirely accurate. The system does allow tariffs and, in limited circumstances, other forms of protection. More accurately, it is a system of rules dedicated to open, fair and undistorted competition.

The rules on non-discrimination — MFN and national treatment — are designed to secure fair conditions of trade. So too are those on dumping (exporting at below cost to gain market share)
and subsidies. The issues are complex, and the rules try to establish what is fair or unfair, and how governments can respond, in particular by charging additional import duties calculated to compensate for damage caused by unfair trade.

Many of the other WTO agreements aim to support fair competition: in agriculture, intellectual property, services, for example. The agreement on government procurement (a “plurilateral” agreement because it is signed by only a few WTO members) extends competition rules to purchases by thousands of government entities in many countries.

5. Encouraging Development and Economic Reform: The WTO system contributes to development. On the other hand, developing countries need flexibility in the time they take to implement the system’s agreements. And the agreements themselves inherit the earlier provisions of GATT that allow for special assistance and trade concessions for developing countries.

Over three quarters of WTO members are developing countries and countries in transition to market economies. During the seven and a half years of the Uruguay Round, over 60 of these countries implemented trade liberalization programmes autonomously. At the same time, developing countries and transition economies were much more active and influential in the Uruguay Round negotiations than in any previous round, and they are even more so in the current Doha Development Agenda.

At the end of the Uruguay Round, developing countries were prepared to take on most of the obligations that are required of developed countries. A ministerial decision adopted at the end of the round says better-off countries should accelerate implementing market access commitments on goods exported by the least-developed countries, and it seeks increased technical assistance for them. More recently, developed countries have started to allow duty-free and quota-free imports for almost all products from least-developed countries. On all of this, the WTO and its members are still going through a learning process. The current Doha Development Agenda includes developing countries’ concerns about the difficulties they face in implementing the Uruguay Round agreements.
4.5.3 The Organization Structure of WTO

**WTO structure**

All WTO members may participate in all councils, committees, etc., except Appellate Body, Dispute Settlement panels, Textiles Monitoring Body, and plurilateral committees.

**Key**
- Reporting to General Council (or a subsidiary)
- Reporting to Dispute Settlement Body
- Plurilateral committees inform the General Council or Goods Council of their activities, although these agreements are not signed by all WTO members
- Trade Negotiations Committee reports to General Council

The General Council also meets as the Trade Policy Review Body and Dispute Settlement Body
4.5.4 The Major Agreements of WTO

The WTO Agreements cover goods, services and intellectual property. They spell out the principles of liberalization, and the permitted exceptions. They include individual countries’ commitments to lower customs tariffs and other trade barriers, and to open and keep open services markets. They set procedures for settling disputes. They prescribe special treatment for developing countries. They require governments to make their trade policies transparent by notifying the WTO about laws in force and measures adopted, and through regular reports by the secretariat on countries’ trade policies. These agreements are often called the WTO’s trade rules, and the WTO is often described as “rules-based”, a system based on rules. But it’s important to remember that the rules are actually agreements that governments negotiated.

**Tariffs (More Bindings and Closer to Zero):** There is no legally binding agreement that sets out the targets for tariff reductions (e.g. by what percentage they were to be cut as a result of the Uruguay Round). Instead, individual countries listed their commitments in schedules annexed to Marrakesh Protocol to the General Agreement on Tariffs and Trade 1994. This is the legally binding agreement for the reduced tariff rates. Since then, additional commitments were made under the 1997 Information Technology Agreement.

**Binding Tariffs:** The market access schedules are not simply announcements of tariff rates. They represent commitments not to increase tariffs above the listed rates — the rates are “bound”. For developed countries, the bound rates are generally the rates actually charged. Most developing countries have bound the rates somewhat higher than the actual rates charged, so the bound rates serve as ceilings. Countries can break a commitment (i.e. raise a tariff above the bound rate), but only with difficulty. To do so they have to negotiate with the countries most concerned and that could result in compensation for trading partners’ loss of trade.

**Agriculture (Fairer Markets for Farmers):** The original GATT did apply to agricultural trade, but it contained loopholes. For example, it allowed countries to use some non-tariff measures such as import quotas, and to subsidize. Agricultural trade became highly distorted, especially with the use of export subsidies that would not normally have been allowed for industrial products. The Uruguay Round produced the first multilateral agreement dedicated to the sector. It was a significant first step towards order, fair competition and a less distorted sector. It was implemented over a six year period (and is still being implemented by developing countries under their 10-year period), that began in 1995. The Uruguay Round agreement included a commitment to continue the reform through new negotiations. These were launched in 2000, as required by the Agriculture Agreement.

**Provisions:** Commitments on tariffs, tariff quotas, domestic supports, export subsidies: in schedules annexed to the Marrakesh Protocol to the General Agreement on Tariffs and Trade 1994. The objective of the Agriculture Agreement is to reform trade in the sector and to make policies more market-oriented. This would improve predictability and security for importing and exporting countries alike.
The new rules and commitments apply to:

1. Market access — various trade restrictions confronting imports
2. Domestic support — subsidies and other programmes, including those that raise or guarantee farm gate prices and farmers’ incomes
3. Export subsidies and other methods used to make exports artificially competitive.

The agreement does allow governments to support their rural economies, but preferably through policies that cause less distortion to trade. It also allows some flexibility in the way commitments are implemented. Developing countries do not have to cut their subsidies or lower their tariffs as much as developed countries, and they are given extra time to complete their obligations. Least-developed countries don’t have to do this at all. Special provisions deal with the interests of countries that rely on imports for their food supplies, and the concerns of least-developed economies.

“Peace” provisions within the agreement aim to reduce the likelihood of disputes or challenges on agricultural subsidies over a period of nine years, until the end of 2003.

**Standards and Safety:** Article 20 of the General Agreement on Tariffs and Trade (GATT) allows governments to act on trade in order to protect human, animal or plant life or health, provided they do not discriminate or use this as disguised protectionism. In addition, there are two specific WTO agreements dealing with food safety and animal and plant health and safety, and with product standards - **Sanitary and Phyto-sanitary Measures Agreement (SPS)**.

- FAO/WHO Codex Alimentarius Commission: **For food**
- International Animal Health Organization (Office International des Epizooties): **For animal health**

**The Technical Barriers to Trade Agreement (TBT):** It tries to ensure that regulations, standards, testing and certification procedures do not create unnecessary obstacles.

**Textiles:** From 1974 until the end of the Uruguay Round, the trade was governed by the **Multifibre Arrangement (MFA)**. This was a framework for bilateral agreements or unilateral actions that established quotas limiting imports into countries whose domestic industries were facing serious damage from rapidly increasing imports. The quotas were the most visible feature. They conflicted with GATT’s general preference for customs tariffs instead of measures that restrict quantities. They were also exceptions to the GATT principle of treating all trading partners equally because they specified how much the importing country was going to accept from individual exporting countries. Since 1995, the WTO’s **Agreement on Textiles and Clothing (ATC)** has taken over from the Multifibre Arrangement. By 1 January 2005, the sector is to be fully integrated into normal GATT rules. In particular, the quotas will come to an end, and importing countries will no longer be able to discriminate between exporters. The Agreement on Textiles and Clothing will itself no longer exist: it’s the only WTO agreement that has self-destruction built in.
Services: General Agreement on Trade in Services (GATS) is the first and only set of multilateral rules governing international trade in services. Negotiated in the Uruguay Round, it was developed in response to the huge growth of the services economy over the past 30 years and the greater potential for trading services brought about by the communications revolution. The General Agreement on Trade in Services has three elements, the main text containing general obligations and disciplines; annexes dealing with rules for specific sectors; and individual countries’ specific commitments to provide access to their markets, including indications of where countries are temporarily not applying the “most-favoured-nation” principle of non-discrimination.

**Basic Principles:**

- All services are covered by GATS.
- Most-favoured-nation treatment applies to all services, except the one-off temporary exemptions.
- National treatment applies in the areas where commitments are made.
- Transparency in regulations, inquiry points.
- Regulations have to be objective and reasonable.
- International payments: normally unrestricted.
- Individual countries’ commitments: negotiated and bound.
- Progressive liberalization: through further negotiations.

**Intellectual Property: Protection and Enforcement:** The WTO’s Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), negotiated in the 1986-94 Uruguay Round, and introduced intellectual property rules into the multilateral trading system for the first time.

**Types of intellectual property:** The areas covered by the TRIPS Agreement are:

1. Copyright and related rights
2. Trademarks, including service marks
3. Geographical indications
4. Industrial designs
5. Patents
6. Layout-designs (topographies) of integrated circuits
7. Undisclosed information, including trade secrets

The agreement covers five broad issues:

1. How basic principles of the trading system and other international intellectual property agreements should be applied
2. How to give adequate protection to intellectual property rights
3. How countries should enforce those rights adequately in their own territories
4. How to settle disputes on intellectual property between members of the WTO
5. Special transitional arrangements during the period when the new system is being introduced.
Anti Dumping, Subsidies, Safeguards: Binding tariffs, and applying them equally to all trading partners (most-favoured-nation treatment, or MFN) is key to the smooth flow of trade in goods. The WTO agreements uphold the principles, but they also allow exceptions — in some circumstances. Three of these issues are:

1. Actions taken against dumping (selling at an unfairly low price).
2. Subsidies and special “countervailing” duties to offset the subsidies.
3. Emergency measures to limit imports temporarily, designed to “safeguard” domestic industries.

Non-Tariff Barriers (Red Tape etc.): A number of agreements deal with various bureaucratic or legal issues that could involve hindrances to trade.

- **Import licensing:** The Agreement on Import Licensing Procedures says import licensing should be simple, transparent and predictable. For example, the agreement requires governments to publish sufficient information for traders to know how and why the licenses are granted. It also describes how countries should notify the WTO when they introduce new import licensing procedures or change existing procedures. The agreement offers guidance on how governments should assess applications for licenses.

- **Rules for the valuation of goods at customs:** The WTO agreement on customs valuation aims for a fair, uniform and neutral system for the valuation of goods for customs purposes — a system that conforms to commercial realities, and which outlaws the use of arbitrary or fictitious customs values.

- **Pre-shipment inspection:** The obligations of exporting members towards countries using pre-shipment inspection include non-discrimination in the application of domestic laws and regulations, prompt publication of those laws and regulations and the provision of technical assistance where requested.

- **Rules of origin:** The Rules of Origin Agreement requires WTO members to ensure that their rules of origin are transparent; that they do not have restricting, distorting or disruptive effects on international trade; that they are administered in a consistent, uniform, impartial and reasonable manner; and that they are based on a positive standard (in other words, they should state what does confer origin rather than what does not).

- **Investment measures:** The Trade-Related Investment Measures (TRIMs) Agreement applies only to measures that affect trade in goods. It recognizes that certain measures can restrict and distort trade, and states that no member shall apply any measure that discriminates against foreigners or foreign products (i.e. violates “national treatment” principles in GATT). It also outlaws investment measures that lead to restrictions in quantities (violating another principle in GATT). The list includes measures that require particular levels of local procurement by an enterprise (“local content requirements”). It also discourages measures that limit a company’s imports or set targets for the company to export (“trade balancing requirements”).

Plurilateral of minority interest: For the most part, all WTO members subscribe to all WTO agreements. After the Uruguay Round, however, there remained four agreements, originally negotiated in the Tokyo Round, which had a narrower group of signatories and are known as “plurilateral agreements”. All other Tokyo Round agreements became multilateral obligations.
(i.e. obligations for all WTO members) when the World Trade Organization was established in 1995. The four were:

1. Trade in civil aircraft
2. Government procurement
3. Dairy products

The bovine meat and dairy agreements were terminated in 1997.

4.5.5 Conferences & Third World Stand

Analysis of the Final Ministerial Declaration of the 4th Ministerial Conference of the WTO in Doha

Implementation Issues: Developing countries tabled 102 issues in the run-up to Seattle that were to have been dealt with as a matter of priority. These were problems arising either from commitments that have not been implemented by the rich countries, or problems with implementations by developing countries due to their lack of capacity or the adverse impacts on their development. The Declaration includes some further consideration of these issues, some non-binding encouragement for the developed countries to be sympathetic, but has only minor adjustments on the way these agreements are implemented. In particular, the commitment to allow quota fee and tariff free access to exports from developing countries has remained as an aspiration. Some countries such as New Zealand have done so - the EU has retained temporary protection for bananas and domestic producers of sugar and rice. Many other countries have failed to act on this long-standing commitment, despite the small proportion of trade that LDCs represent with 10% of the world's population, they only account for 0.4% of world trade.

Aside from the ongoing negotiations on agriculture, there will be negotiations on fisheries and anti-dumping laws (as part of 'Subsidies and Countervailing Measures'), but these are riddled with caveats and get-out clauses for the developed countries. There will be a report prepared on the remaining implementation issues for discussion at the end of 2002, for possible action thereafter. A problem is that developing countries will be asked to pay twice in terms of their inclusion in negotiations. The lack of concrete actions to resolve these problems identified as a matter of the highest priority by developing countries makes a mockery of the concept of the "Development Round", and calls into question the real commitment of the British government and the EU to make trade rules fairer to the poor.

Agriculture: The agriculture negotiations started in January 2000 and are ongoing. The main point of contention in Doha was whether the EU would agree to the aim of "reductions of, with a view to phasing out, all forms of export subsidies." At the last hour, they did agree, but added a caveat to say that this aim is "without prejudging the outcome of negotiations". This severely undermines any commitment to open up EU agricultural markets to exports from developing world.
Services: The text does not include the proposals from developing countries for an assessment to precede any negotiations (as specified in the GATS agreement) and sets dates for making proposals on liberalization. Requests for countries to open up their services sectors will be submitted by 30 June 2002 and initial offers of countries to liberalize will be submitted by 31 March 2003. Negotiations on services, as with the other agreements, will be completed by 1 January 2005. This is a very compressed timetable, meaning that developing countries would not be able to undertake the required research and consultation before having to offer up service sectors for liberalization. The commitments that they make would effectively be irreversible under the disciplines of Article XXI.

In another section of the Declaration (on WTO Rules), there is a dangerous new commitment to "the reduction or, as appropriate, elimination of tariff and non-tariff barriers to environmental goods and services." Not only would this include environmentally damaging services such as nuclear waste processing, but would include services such as water. This would then provide an accelerated commitment for opening up the supply of water, waste collection and disposal, and other services, often provided by the public sector, in all countries.

Negotiations on market access for non-agricultural products: The agreement commits to new negotiations on all products, without exclusions. It includes issues of importance to developing countries such as tariff peaks and tariff escalation, and "less than full reciprocity in reduction commitments" for developing and Least Developed Countries. But developing countries argue that they should not be required to give up their protection for local businesses at all, given their stage of development and recognizing that some of the highest protection is used by the rich nations to block exports from the developing world. Nor does it include the repeated call from developing countries for assessment of their experience of tariff reductions under the Uruguay Round before making any new commitments.

TRIPs: The Declaration on TRIPs and Public Health confirms the existing agreement in saying that the TRIPs agreement "does not and should not prevent Members from taking measures to protect public health". This confirmation in the Declaration was only required because of the aggressive attacks by the US on the rights of countries to prioritize affordable treatment for health emergencies such as HIV/AIDS. Developing countries were forced to waste a huge amount of time clarifying that the existing agreement allows them to do so. However, there is still doubt as to whether the declaration will be fully legally enforceable. There was little attention to other problems with the TRIPs agreement, including African nations' proposals to strengthen traditional rights over natural resources and traditional knowledge against bio-piracy (as in multinationals patenting the active ingredients of plants used by indigenous peoples), to prohibit the patenting of life, and a clear statement that the Bio-safety Protocol (allowing countries to refuse the release of GM seeds) takes precedence over WTO rules.

Investment and Competition Policy: The Ministerial Declaration includes a complicated agreement to start pre-negotiations on both of these issues, but a decision on full negotiations must be taken on the basis of explicit consensus at the next Ministerial conference (in two years' time). These agreements have been highly controversial, since they were rejected by developing countries at the Singapore Ministerial meeting in 1996 (along with government procurement and trade facilitation, they are often referred to as the 'Singapore issues'). A Working Group was
established with the condition that negotiations would start only on the basis of an explicit consensus amongst WTO members. Such a consensus does not exist and these issues should never have been in the agenda that came to Qatar. The majority of developing countries have consistently opposed negotiations on these issues, pointing out that they are mainly in the interests of multinationals from the rich world. In a deeply unfair negotiations process in Geneva, the statements from around 90 developing countries against starting negotiations were ignored. The EU gave extremely high priority to these issues - according to negotiators from other countries; these issues were the highest priority, along with agriculture. In Doha, these issues were initially dropped and then dramatically inserted on a take-it or leave-it basis at the very last stage.

**Transparency in Government Procurement and Trade Facilitation:** Again, the Ministerial Declaration includes a complicated agreement to start pre-negotiations on both of these issues, but a decision on full negotiations must be taken on the basis of explicit consensus at the next Ministerial conference (in two years' time). Developing countries consider that negotiations on government procurement have little to do with trade and do not belong in the WTO, and are not included in the mandated that established the WTO in 1995. The negotiations will be limited to transparency in government procurement, an apparently innocuous step, but developing countries are concerned that this will lead to negotiations on opening up government procurement in developing countries (often used as an important instrument for development) to foreign multinationals. This is the stated aim of many of the developed countries. Of even more concern is the potential use of transparency as a means to provide multinationals with a means to challenge government procurement policies. It is a thin end of a dangerous wedge to start negotiations on this issue.

**WTO Rules:** There is an apparent commitment to negotiate on the issues that are important to many countries, including stopping the abuse of anti-dumping rules by the rich countries. However, the Declaration includes a caveat in saying that there will be negotiations "while preserving the basic concepts, principles and effectiveness of these Agreements and their instruments and objectives". This renders such negotiations virtually powerless.

**Environment:** The Declaration includes negotiations on Multilateral Environmental Agreements (MEAs). However, there are again caveats. The text includes the statement "the negotiations shall not prejudice the WTO rights of any Member that is not a party to the MEA in question". That gives the US a let-out clause on agreements they have not signed, such as the Kyoto Protocol on Climate Change and the Bio-safety Protocol. It also provides an incentive for countries not to sign up to MEAs, thereby benefiting from international action without being bound by any of its provisions. There will be negotiations on fisheries subsidies that have caused huge problems for community and small fisheries in developing countries. However, again there are caveats. The negotiations will only "aim to clarify and improve WTO disciplines on fisheries subsidies" without aiming to stop their use by the EU to deplete the fisheries of West Africa and other regions. There is also to be continued work in the Committee on Trade and the Environment on TRIPs and eco-labeling. A decision on whether to negotiate will be taken at the next Ministerial meeting.
The Work Programme: This agenda of trade negotiations is proposed to be completed within 3 years. This is a very short period, given the huge agenda and the experience of the last Round of trade negotiations (the Uruguay Round) that took 8 years. Developing countries have repeatedly said that they cannot undertake a massive new work programme, especially given economic crisis in many of the poorest countries. The promises of funds for capacity building come in the context of falling aid budgets and a string of broken promises in the past. Money will only be diverted from other uses, such as health care and education. Building capacity to undertake negotiations requires many years, requiring hiring of staff, training and gaining the necessary expertise. The huge agenda and lack of capacity means commitments would be made without the necessary research, assessment and public consultation. The pressures on them are added through the creation of a new committee to oversee the negotiations and the grouping together of all the issues into a single package. As seen in Doha, it is extremely difficult for developing countries to reject a big package of measures and put at risk the multilateral trade system that could protect them from targeting by the major trading powers. In Doha, as in previous agreements, it was obvious that this could be achieved through unfair multilateral processes as well as bilateral action. There is no commitment in the Declaration to the "fundamental and radical reform" of the WTO called for in Seattle by Stephen Byers, then UK Secretary of State for Trade and Industry.

Analysis of the WTO's Fifth Ministerial Conference in Cancun, Mexico

Agricultural Subsidies: Rich countries spend billions subsidizing their agricultural sector, leading to chronic overproduction and dumping surpluses on global markets. Poor countries demand reform of this trade practice that impoverishes small-scale farmers while enriching large agri-business.

The mid term review of the Common Agricultural Policy [CAP] is an historic opportunity for the European Union to address the devastating impact of its agricultural policies on developing countries but a firm political will has to be displayed in doing so.

An end to dumping will generate adjustment costs in Europe. Policy makers in Europe have responsibilities for rural development and the environment. To this end, EU should: agree a plan for phasing out all agricultural subsidies that facilitate export dumping, or the sale on world markets of goods at prices below their costs of production. As an immediate step, the EU should agree a binding timetable to eliminate all forms of export subsidies.

Genetically Modified Organisms (GMOs): Biotechnology is redefining agricultural production. This new technology combines the “best” genes of many natural life forms to create specialized organisms. The main beneficiaries of this technology are US agribusiness companies such as Monsanto and Syngenta, who are pressuring the rest of the world to accept GMOs and adopt this technology. Concerned NGOs are critical of GMOs, arguing that the threats to human health and biodiversity are too high and the lack of international labeling standards hinders people’s right to choose. Many of these NGOs support mandatory labeling, long term safety testing, more stringent government regulation and full corporate liability for damages caused to the environment and food supply.
Multilateral Agreement on Investment: In May 1995, the OECD Council, at Ministerial level, committed the Organization to the immediate start of negotiations aimed at reaching a Multilateral Agreement on Investment (MAI), which would:

1. Provide a broad multilateral framework for international investment with high standards for the liberalization of investment regimes and investment protection and with effective dispute settlement procedures;
2. Be a freestanding international treaty open to all OECD Members and the European Community, and to accession by non-OECD Member countries, which will be consulted as the negotiations progress.

Barely a year has passed since a decade of intense Uruguay Round negotiations culminated in the ushering in of the World Trade Organization (WTO) Agreement under which developing countries assumed major obligations; and even before their cumulative effects have been well understood, intense pressures are being built up to force developing countries to assume totally new obligations in the field of investment. Having obtained in these negotiations significant concessions for their transnational corporations (TNCs) in the area of goods, services and intellectual property monopolies, the major industrialized countries are now seeking total freedom abroad for their TNCs. In the early stages of the Uruguay Round, the majors had in fact proposed new disciplines in the area of investment. But after testing the waters for some time, they thought it prudent to limit their expectations in this area to the traditional GATT obligations. But now that the Agreements are in operation, some of them are coming back with the very same, but significantly strengthened and reinforced proposals. In particular, the European Commission is pushing hard for starting a process for multilateral negotiations on investment in the WTO. It is attempting to get an endorsement for the start of the process at the Ministerial Meeting in Singapore. The EU makes no secret of its intention to seek a multilateral agreement on investment within the framework of the rights and obligations of the WTO Agreement. As far as can be made out from EU documents, the contents of the proposed multilateral investment agreement (MIA), will give full rights for foreign investors to invest and establish themselves in all sectors (excluding perhaps, defense) in any WTO member, get treatment for the Foreign Direct Investment (FDI) at least on the same level as accorded to the domestic investments, and effective implementation of the obligations undertaken in the agreement.

Thus the proposal aims at eliminating all flexibility which a country may have at present to permit foreign investment and allocate FDI to priority sectors; to discourage or stop altogether the flow of foreign investments in sectors where such investment is not considered desirable or appropriate; to provide special preferences for domestic investment and stipulate conditions for FDI, like ceiling on equity, restrictions on ownership and so on. Investors will thus have freedom without any responsibility, except in respect of their own profits. The implementation of the obligations of governments is sought to be ensured by locating the MIA in the WTO, so that for any perceived infringement, action can be taken against exports of the country.

Implications of FDI: Foreign investment is often welcome to countries, as it augments the country’s capital and investment stocks. But the main implication of FDI is that the returns on such investments - in the form of dividends and profits, as well as many fees including license fees, management expenses and so on - are sent out of the country in foreign exchange. Hence, if
the investments do not help the country, either directly or indirectly, to earn foreign exchange, the negative effects of the outflow may be serious.

The FDI can perform a **direct beneficial role** by producing exportable goods and services, and an indirect role by producing such goods and services which may help in producing other exportable goods and services or in replacing imported goods and services. Besides, an indirect role can also include developing infrastructure facilities that may encourage further FDI inflows. But if the FDI is only for capturing the domestic market, it may still generate profit for the investor, but such profit may leave the country in foreign exchange.

There are **two other serious implications**. First, in profitable domestic consumption sectors, foreign investments may overwhelm domestic investors (which may generally not be as strong as the foreign counterparts) and in some cases may eliminate them. Second, some critical sectors, like land, minerals and forests, where countries often like to have effective control on ownership because of social, political and strategic reasons, may, in a big way, pass under the control of foreign nationals.

**India & WTO**: India Opposes Talks on Investment Rules. India yesterday strongly reaffirmed its determination to oppose negotiations on investment rules in the Doha world trade round, potentially setting the scene for a serious clash at the World Trade Organization’s ministerial meeting in Cancún, Mexico, in two weeks. If maintained, India's stance could put it on a collision course with the European Union and other countries including Japan, South Korea and Switzerland. They want the meeting to initiate negotiations on investment as well as on competition policy, transparency in government procurement and trade facilitation. Efforts to narrow the differences in the WTO's preparatory talks for Cancún have been unsuccessful, forcing Carlos Pérez Del Castillo, chairman of the organization’s ruling general council, to confront ministers with a stark choice between launching negotiations or shelving the issues indefinitely pending further study.

India has long been suspicious of foreign investment even though it has liberalized its policies in recent years. Many other developing countries share India's concerns, saying a WTO agreement would restrict their policy freedom without guaranteeing increased investment inflows. "There is no consensus among WTO members to discuss an agreement on investment," India said. "We would be concerned about the compromise with the space for sovereign decision-making (that the agreement would entail)."

Some WTO members have suggested separating the four issues so progress can be made on the less contentious ones. However, the EU and Japan have so far resisted such an approach, fearing it would kill any remaining prospect of negotiations on investment. Securing a WTO investment agreement is the only big objective in the Doha round for Japan, where businesses hope it would help protect their extensive operations in China. However, a deal is a far lower priority for most industries in the EU, which appears to see an agreement mainly as compensation for giving ground on farm trade.

India also renewed demands for developed countries to lower export subsidies, domestic support and farm trade barriers. "The challenge of WTO is not how to make the prosperous and highly
subsidized [western] farmer even more prosperous," he said. "It is to address the security concerns of our own 650m unsubsidized farmers. India also wants a sufficient cushion with regard to its own agricultural tariffs."

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### 4.6 ECONOMIC INTEGRATORS: IMF, WORLD BANK, ASIAN DEVELOPMENT BANK, UNCTAD, UNIDO

#### 4.6.1 IMF

The International Monetary Fund is a specialized agency of the United Nations system set up by treaty in 1945 to help promote the health of the world economy. Headquartered in Washington, D.C., it is governed by its almost global membership of 184 countries. The IMF is the central institution of the international monetary system—the system of international payments and exchange rates among national currencies that enable business to take place between countries. The IMF works for global prosperity by promoting the balanced expansion of world trade:

1. Stability of exchange rates,
2. Avoidance of competitive devaluations, and
3. Orderly correction of balance of payments problems.

**The Main Purposes of IMF**

- To promote international monetary cooperation through a permanent institution that provides the machinery for consultation and collaboration on international monetary problems.
- To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.
- To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
- To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions that hamper the growth of world trade.
- To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.
- In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

**What is an SDR?**

The **SDR**, or special drawing right, is an international reserve asset introduced by the IMF in 1969 (under the First Amendment to its Articles of Agreement) out of concern among IMF members that the current stock, and prospective growth, of international reserves might not be sufficient to support the expansion of world trade. The main reserve assets were gold and U.S. dollars, and members did not want global reserves to depend on gold production, with its
inherent uncertainties, and continuing U.S. balance of payments deficits, which would be needed to provide continuing growth in U.S. dollar reserves. The SDR was introduced as a supplementary reserve asset, which the IMF could "allocate" periodically to members when the need arose, and cancel, as necessary.

SDRs, sometimes known as "paper gold" although they have no physical form, have been allocated to member countries (as book-keeping entries) as a percentage of their quotas. So far, the IMF has allocated SDR 21.4 billion (about $29 billion) to member countries. The last allocation took place in 1981, when SDR 4.1 billion was allocated to the 141 countries that were then members of the IMF. Since 1981, the membership has not seen a need for another general allocation of SDRs, partly because of the growth of international capital markets. In September 1997, however, in light of the IMF’s expanded membership—which included countries that had not received an allocation—the Board of Governors proposed a Fourth Amendment to the Articles of Agreement. When approved by the required majority of member governments, this will authorize a special one-time "equity" allocation of SDR 21.4 billion, to be distributed so as to raise all members' ratios of cumulative SDR allocations to quotas to a common benchmark. IMF member countries may use SDRs in transactions among themselves, with 16 "institutional" holders of SDRs, and with the IMF. The SDR is also the IMF’s unit of account. A number of other international and regional organizations and international conventions use it as a unit of account or as a basis for a unit of account. The SDR’s value is set daily using a basket of four major currencies: the euro, Japanese yen, pound sterling, and U.S. dollar. On August 1, 2001, SDR 1 = US$1.26. The composition of the basket is reviewed every five years to ensure that it is representative of the currencies used in international transactions, and that the weights assigned to the currencies reflect their relative importance in the world's trading and financial systems.

Selected IMF Lending Facilities:

- **Stand By Arrangements**: Stand By Arrangements are form the core of the IMF's lending policies. A Stand-By Arrangement provides assurance to a member country that it can draw up to a specified amount, usually over 12–18 months, to deal with a short-term balance of payments problem.

- **Extended Fund Facility**: IMF support for members under the Extended Fund Facility provides assurance that a member country can draw up to a specified amount, usually over three to four years, to help it tackle structural economic problems that are causing serious weaknesses in its balance of payments.

- **Poverty Reduction and Growth Facility**: It replaced the Enhanced Structural Adjustment Facility in November 1999. A low-interest facility to help the poorest member countries facing protracted balance of payments problems. The cost to borrowers is subsidized with resources raised through past sales of IMF-owned gold, together with loans and grants provided to the IMF for the purpose by its members.

- **Supplemental Reserve Facility**: Provides additional short-term financing to member countries experiencing exceptional balance of payments difficulty because of a sudden and disruptive loss of market confidence reflected in capital outflows. The interest rate on SRF loans includes a surcharge over the IMF's usual lending rate.

- **Contingent Credit Lines**: Precautionary lines of defense enabling members pursuing strong economic policies to obtain IMF financing on a short-term basis when faced by a
sudden and disruptive loss of market confidence because of contagion from difficulties in other countries.

- **Emergency Assistance:** Introduced in 1962 to help members cope with balance of payments problems arising from sudden and unforeseeable natural disasters, this form of assistance was extended in 1995 to cover certain situations in which members have emerged from military conflicts that have disrupted institutional and administrative capacity.

### 4.6.2 World Bank

The World Bank is not a “bank” in the common sense. It is one of the United Nations’ specialized agencies, and is made up of 184 member countries. These countries are jointly responsible for how the institution is financed and how its money is spent. Along with the rest of the development community, the World Bank centers its efforts on the reaching the **Millennium Development Goals**, agreed to by UN members in 2000 and aimed at sustainable poverty reduction. The "World Bank" is the name that has come to be used for the **International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA)**. Together these organizations provide low-interest loans, interest-free credit, and grants to developing countries. Some 10,000 development professionals from nearly every country in the world work in the World Bank's Washington DC headquarters or in its 109 country offices.

**The World Bank Group:** World Bank in addition to IBRD and IDA, and three other organizations make up the World Bank Group. The **International Finance Corporation (IFC)** promotes private sector investment by supporting high-risk sectors and countries. The **Multilateral Investment Guarantee Agency (MIGA)** provides political risk insurance (guarantees) to investors in and lenders to developing countries. And the **International Center for Settlement of Investment Disputes (ICSID)** settles investment disputes between foreign investors and their host countries.

**Mission Statement (The dream is a world free of poverty):**

- To fight poverty with passion and professionalism for lasting results;
- To help people help themselves and their environment by providing resources, sharing knowledge, building capacity, and forging partnerships in the public and private sectors;
- To be an excellent institution able to attract, excite, and nurture diverse and committed staff with exceptional skills that know how to listen and learn;

**Operations:** The World Bank provides funds at low interest rates, no interest, or in the form of grants to countries that have no access or unfavorable access to international markets.

**Financing Development:** The World Bank provides a number of different types of financing for projects designed to reduce poverty and facilitate the Millennium Development Goals. These include loans from the International Bank of Reconstruction and Development (IBRD) and credits and grants through the International Development Association (IDA). A number of other grant mechanisms also exist. The type of financing available to a developing country is determined by the level of need. The AAA-rated IBRD is financed through the sale of World Bank Bonds. In fiscal 2002, it raised $23 billion in financial markets. Unlike a financial
institution, however, the Bank does not operate for profit maximization—it uses its high credit rating to pass the low interest it pays on to its developing country clients.

**IBRD Borrowers:** This group is generally made up of middle-income countries. IBRD offers loans at near-market terms but with long maturities to countries with a per capita income of less than $5,185. These borrowers typically have some access to private capital markets. The Bank essentially facilitates access to capital in larger volumes, on better terms, with longer maturities, and in a more sustainable manner than the market provides.

Seventy-five percent of the world’s poorest people, those who live on less than $1 per day, live in countries that receive IBRD lending.

The money that is borrowed by governments has to be used for specific programming—for poverty reduction, delivery of social services, environmental protection, or economic growth, for example. Countries that borrow from IBRD have more time to repay than if they borrowed from a commercial bank—15 to 20 years with a three-to-five-year grace period before repayment of principal begins. In fiscal 2002 IBRD provided loans totaling $11.5 billion in support of 96 projects in 40 countries. IBRD loans (and IDA credits) are typically accompanied by non-lending services to ensure the most effective use of funds.

**IDA’s Interest-Free Loans:** The loans have a 35-40-year repayment period with a 10-year grace period. While IDA traditionally has provided interest-free credit, it is increasingly providing grants to the poorest countries as well. Currently, to be eligible for IDA assistance, a country must have a per capita gross national income of $875 or less. IDA is financed by a partnership of donors, who come together every three years to decide on the amount of new resources required to fund IDA’s future lending program and to discuss lending policies and priorities. Going forward, 18 to 21 percent of IDA resources will be used for grants. IDA credits and grants make up about one-quarter of the Bank’s financial assistance. And outside of IDA, very little of the Bank’s income is provided by member countries. Of IBRD’s funds, 5 percent come from contributions of rich countries, paid in when they join the Bank.

**The Heavily Indebted Poor Countries (HIPC) Initiative:** Launched in 1996 by the World Bank and the International Monetary Fund (IMF), is the first international response to the problem of debt burdens. The Initiative has removed the debt overhang for a number of countries, freeing up funds for spending on social services.

**Five Agencies: One Group**

1. **The International Bank for Reconstruction and Development:** IBRD aims to reduce poverty in middle-income and creditworthy poorer countries by promoting sustainable development, through loans, guarantees, and nonlending—including analytical and advisory—services. IBRD does not maximize profit but has earned a net income each year since 1948. Its profits fund several developmental activities and ensure financial strength, which enables low-cost borrowings in capital markets, and good terms for borrowing clients. Owned by member countries, IBRD links voting power to members’ capital subscriptions—in turn based on a country’s relative economic strength.
2. **The International Development Association**: Contributions to IDA enable the World Bank to provide $7 billion per year in interest-free credits to the world’s 81 poorest countries, home to 2.5 billion people. This support is vital because these countries have little or no capacity to borrow on market terms. In most of these countries incomes average under just $500 a year per person and many people survive on much less. IDA helps provide access to better basic services (such as education, health care, and clean water and sanitation) and supports reforms and investments aimed at productivity growth and employment creation.

3. **The International Finance Corporation**: IFC’s mandate is to further economic development through the private sector. Working with business partners, it invests in sustainable private enterprises in developing countries and provides long-term loans, guarantees, and risk management and advisory services to its clients. IFC invests in projects in regions and sectors underserved by private investment and finds new ways to develop promising opportunities in markets deemed too risky by commercial investors in the absence of IFC participation.

4. **The Multilateral Investment Guarantee Agency**: MIGA helps encourage foreign investment in developing countries by providing guarantees to foreign investors against losses caused by noncommercial risks, such as expropriation, currency inconvertibility and transfer restrictions, and war and civil disturbances. Furthermore, MIGA provides technical assistance to help countries disseminate information on investment opportunities. The agency also offers investment dispute mediation on request.

5. **The International Center for Settlement of Investment Disputes**: ICSID helps to encourage foreign investment by providing international facilities for conciliation and arbitration of investment disputes, in this way helping to foster an atmosphere of mutual confidence between states and foreign investors. Many international agreements concerning investment refer to ICSID’s arbitration facilities. ICSID also has research and publishing activities in the areas of arbitration law and foreign investment law.

### 4.6.3 Asian Development Bank
ADB is a multilateral development finance institution dedicated to reducing poverty in Asia and the Pacific. Established in 1966, they are now owned by 63 members, mostly from the region. Headquarters is in Manila with offices around the world: The list is given below:

- 16 resident missions in Asia.
- A regional mission for the Pacific in Vanuatu.
- A country office in the Philippines.
- Representative offices in Frankfurt for Europe, Tokyo for Japan, and Washington, DC for North America.
- A special office in Timor-Leste.
- Extended missions in Gujarat, India and Papua New Guinea.

They have over 2,000 employees from nearly 50 countries.
What does ADB do?

- Extends loans and equity investments to its developing member countries (DMCs) for their economic and social development,
- Provides technical assistance for the planning and execution of development projects and programs and for advisory services,
- Promotes and facilitates investment of public and private capital for development, and
- Responds to requests for assistance in coordinating development policies and plans of its developing member countries.

Sectors: ADB's operations are diverse, covering agriculture and natural resources, energy, finance industry and non-fuel minerals, social infrastructure, transport, and communications activities involving multiple sectors.

Development Tools: ADB lends to governments and to public and private enterprises in its developing member countries. ADB's principal tools are loans and technical assistance, which are provided to governments for specific, high-priority development projects and programs. ADB's lending both supports and promotes investment for development based on a country's priorities.

How is ADB different from commercial banks?
ADB is a non-profit, multilateral development finance institution that engages in mostly public sector lending for development purposes in its developing member countries. ADB’s clients are its member governments, who are also its shareholders.

Shareholders & Management: Just like any other bank, ADB has shareholders. Of the 63 members, Japan and the United States are the largest shareholders, each with 15.9 percent. The Board of Governors, comprising one representative from each member, meets annually. It elects the 12 members of the Board of Directors, with each director appointing an alternate. The ADB President is elected by the Board of Governors and is the chairperson of the Board of Directors.

How does it manage its finances?

Operations are financed by:
- Issuing bonds
- Recycling repayments
- Receiving contributions from members

ADB manages special funds, which currently comprise the following:
- Asian Development Fund
- Technical Assistance Special Fund
- Japan Special Fund, including the Asian Currency Crisis Support Facility, and
- ADB Institute Special Fund.
- Other Funds: ADB also manages the fund for the Japan Scholarship Program and channel financing of grants provided by bilateral donors to support technical assistance and soft components of loans.
4.6.4 United Nations Conference on Trade & Development (UNCTAD)

Established in 1964, the United Nations Conference on Trade and Development (UNCTAD) aims at the development-friendly integration of developing countries into the world economy. It is the focal point within the United Nations for the integrated treatment of trade and development and the interrelated issues in the areas of finance, technology, investment and sustainable development.

It is a forum for intergovernmental discussions and deliberations, supported by discussions with experts and exchanges of experience, aimed at consensus building. The web section entitled "Meetings" provides details regarding intergovernmental deliberations and discussions. It undertakes research, policy analysis and data collection in order to provide substantive inputs for the discussions of experts and government representatives. The web section entitled "Digital Library" provides details on themes covered and publications issued. UNCTAD, in co-operation with other organizations and donor countries, provides technical assistance tailored to the needs of the developing countries, with special attention being paid to the needs of the least developed countries, and countries with economy in transition.

Major Issues Addressed:

- **International Trade**: The task consists of identifying international trade policy tools supportive of development efforts in a globalizing economy; suggesting ways and means to address the constraints faced by developing countries in deriving full benefits from the multilateral trading system; providing technical support to developing countries in understanding trade-related negotiation issues; addressing issues related to competition law and policy; development and diversification of the commodity sector; promoting risk management against commodity price fluctuations; addressing constraints faced by the developing countries in responding to environmental challenges etc.

- **Investment, Enterprise and Technology**: The main objectives are analyzing trends in foreign direct investment and its impact on development; understanding issues involved in international investment agreements so as to attract and benefit from foreign direct investment; enhancing interaction between domestic and foreign investment; assisting capacity-building efforts and the development of small and medium-size enterprises in a globalizing economy; supporting efforts to respond to technological and scientific changes; developing policy instruments to facilitate technology transfer etc.

- **Globalization, Interdependence and Development**: The main objectives are conducting research on the broad trends and prospects in the world economy and examining successful development experiences to help promote policies and strategies at the national and international level that are conducive to development; analyzing the causes and effects of financial crises and contributing to the debate on measures for the prevention, management and resolution of such crises; providing technical assistance for the management of external debt and suggesting solutions to the debt problem of developing countries; contributing to the implementation of the United Nations New Agenda for the Development of Africa (UN-NADAF) etc.

- **Services Infrastructure for Development, Trade Efficiency, and Human Resources Development**: Under this scheme UNCTAD is facilitating international trade through better use of information technologies and management systems in trade-supporting
services; carrying out capacity-building activities and training in these areas; analyzing the challenges and opportunities for developing countries of using e-commerce for development; enhancing multimodal transport and trade logistics, with special attention to the particular difficulties encountered by landlocked developing countries and transit developing countries.

- **Least Developed, Landlocked and Small Island Developing Countries:** UNCTAD is assisting in the implementation of the United Nations Programme of Action for the Least Developed Countries for the Decade 2001-2010, adopted in Brussels, Belgium, in May 2001, with particular attention to the special handicaps of landlocked developing countries and small island developing States.

- **Technical Cooperation Activities:** An important element in achieving the objectives and policies outlined in the Bangkok Declaration and Plan of Action, UNCTAD’s technical co-operation emphasizes knowledge sharing and enhancement, human resources development, productive capacity building, as well as support to trade facilitation and logistics, as instruments to facilitate a more equitable integration of developing countries into the global economy and to enhance their economic growth and development prospects.

### 4.6.5 United Nations Industrial Development Organization (UNIDO)

**Vision:** To improve the living conditions of people and promote global prosperity through offering tailor-made solutions for the sustainable industrial development of developing countries and countries with economies in transition.

**Mission:** The United Nations Industrial Development Organization (UNIDO) helps developing countries and countries with economies in transition in their fight against marginalization in today’s globalize world. It mobilizes knowledge, skills, information and technology to promote productive employment, a competitive economy and a sound environment.

**Background:** UNIDO was set up in 1966 and became a specialized agency of the United Nations in 1985. As part of the United Nations common system, UNIDO has responsibility for promoting industrialization throughout the developing world, in cooperation with its 171 Member States. Its headquarters are in Vienna, and it is represented in 35 developing countries. This representation and a number of specialized field offices, for investment and technology promotion and other specific aspects of its work, give UNIDO an active presence in the field.

**Core Functions and Services:** As a global forum, UNIDO generates and disseminates knowledge relating to industrial matters and provides a platform for the various actors in the public and private sectors, civil society organizations and the policy-making community in general to enhance cooperation, establish dialogue and develop partnerships in order to address the challenges ahead.

As a technical cooperation agency, UNIDO designs and implements programme to support the industrial development efforts of its clients. It also offers tailor-made specialized support for programme development. The two core functions are both complementary and mutually supportive. On the one hand, experience gained in the technical cooperation work of UNIDO can
be shared with policy makers; on the other, the Organization's analytical work shows where technical cooperation will have the greatest impact by helping to define priorities.

The Business Plan: UNIDO has grouped the activities of into two areas of concentration:

1. Strengthening industrial capacities, including programmes in support of the global forum function and policy advice.
2. Cleaner and Sustainable Industrial Development: In addition, while maintaining the universal character and vocation of UNIDO, the Business Plan provided for the Organization's activities to be focused geographically on least developed countries, in particular in Africa; sectorally on agro-based industries, and thematically on small and medium enterprises (SMEs).

UNIDO achieves these objectives through:

- Integrated Programmes (IPs) or Country Service Frameworks (CSFs), based on combinations of its eight service modules or;
- Stand-alone projects involving only one or two service modules.

UNIDO's Eight Service Modules:

- Industrial Governance and Statistics;
- Investment and Technology Promotion;
- Industrial Competitiveness and Trade;
- Private Sector Development;
- Agro-Industry;
- Sustainable Energy and Climate Change;
- Montreal Protocol (substances that deplete the ozone layer);
- Environmental management

Financial Resources: Funding for UNIDO activities is drawn from the regular budget, the operational budget and voluntary contributions. The regular budget is derived from Member States' assessed contributions. The operational budget is derived from the implementation of projects. For example, the estimated volume of UNIDO operations for 2004-2005 was €356 million. The breakup was - regular budget €144.3 million, operational budget €21.5 million and anticipated voluntary contributions €189.8 million.

Structure: UNIDO has three policy-making organs:

- The Programme and Budget Committee.
- The Industrial Development Board.
- The General Conference.

The chief policy-making organ of the Organization, the General Conference, comprising representatives of all Member States, takes place every two years. The Programme and Budget
Committee, consisting of 27 Members elected by the General Conference for a two-year term, is a subsidiary organ of the Board, and assists it in preparing work programmes and budgets.

The Industrial Development Board of 53 Members reviews the implementation of the work programme, the regular and operational budgets and, every four years, recommends a candidate for Director-General (DG) to the General Conference for appointment. The DG heads the UNIDO Secretariat.

4.7 REVIEW QUESTIONS

1. Discuss the important issues that India wants to discuss in WTO.
2. Find out the Donor Agencies assisting Indian Development Work.
3. Discuss how Indian exporters avail of the benefits of the preferential treatments due to GSP & GSTP. Also, how the scenario will change once this treatment is withdrawn.
4. Compare the basic structure, agreement proposals and effectiveness of GATT & WTO.
Global Business Policy

Structure

5.1 Theories of Industrial Trade

5.2 International Investment Theories

5.3 Global Trade & Balance of Payments

5.4 Foreign Investments

5.5 Review Questions

5.1 Theories of Industrial Trade

Mercantilism: It is the economic theory that a nation's prosperity depended upon its supply of gold and silver, that the total volume of trade is unchangeable. Thus the theory suggests that the government should play an active role in the economy by encouraging exports and discouraging imports, especially through the use of tariffs. These ideas stemmed from bullionism, a theory that precious metals equal wealth. The term was coined by the economist Adam Smith in 1776, from the Latin word mercari, which means "to run a trade", from merx, meaning "commodity". It was initially used solely by critics, such as Smith.

Mercantilist Tenets: Nations are in a direct zero-sum competition with each other for wealth. Gold and silver bullion are synonymous with wealth. The main corollary to these precepts, which would define international relations for centuries, is that a country needs a positive balance of trade to gain more precious resources. Each nation has to export more goods and services than it imports, except for nations that can produce a lot of its own precious metals. From a mercantilist perspective, England established colonies in the western hemisphere to have an independent source of timber, rather than depending on purchases from the Baltic area; this was important in ship-building, and thus in maintaining naval power. Mercantilism fuelled colonialism under the belief that a large empire was the key to wealth. A key tenet of mercantilism is that exporting raw or unfinished materials disadvantages a nation, as greater wealth results from performing value-added manufacturing work within that nation. Thus, for instance England banned the export of unfinished cloth to the Netherlands.

Reliance on foreign trade is also harmful. Thus England passed the Navigation Acts, requiring that ships entering English ports either be English or is carrying goods from their country of origin. This prevented the Dutch from most trade with England (as they produced few goods of their own).

Mercantilism also fueled the intense violence of the 17th and 18th centuries in Europe. Since the level of world trade was viewed as fixed, it followed that the only way to increase a nation's
trade was to take it from another. A number of wars (for example, the Anglo-Dutch Wars and the Franco-Dutch Wars) can be linked directly to mercantilist theories.

One key complaint of American revolutionaries in the late 18th century related to the British use of tariffs. Mercantilist theory implies that if one wants as much gold as possible in one's empire, one's colonies cannot trade gold for international goods. Thus, trade restrictions limited commerce with outside powers, forcing colonists to buy finished goods only from their ruling power, and keeping prices higher than Adam Smith would have viewed as efficient. The presence of a small Caribbean island (St Eustace) owned by the Dutch, who had supported the idea of free trade since the days of Hugo Grotius (1583 – 1645), played a major role in the revolution that followed. The island was open to all and had no tariffs whatsoever. After the Declaration of Independence, its governor decided to salute the USS Andrea Doria, a warship under the flag of the Continental Congress. This was the first recognition of the United States as an independent country.

Adam Smith's Invisible Hand and liberal theory of economics gradually put an end to the dominance of mercantilism. Liberalism and mercantilism differed on one key issue. Mercantilism states that the entire world's people must compete for the world's limited wealth. Adam Smith believed that wealth and trade was a non-zero-sum game, which essentially means two parties involved in a transaction could each actually gain, because the exchanged items were more valuable to their new owners. Bullionism dictated that gold was gold — period. Thus, what one party gained, the other party had to give up (i.e., the zero-sum game assumption). Smith felt that gold was nothing more than a yellow mineral that was valuable only because there wasn't much of it. The majority of economists now agree with Smith.

Elements of mercantilist theory have remained in economic discourse throughout the years. There is a limited amount of gold in the world and, more importantly today, a limited amount of oil. A key motivator of Japan's World War II expansionism, for example, was the need to acquire control of natural resources such as minerals, timber, oil and rubber, which the Japanese islands lacked in bulk. Latin America's Cold-War Populism, and import substitution economic schemes, along with past and present Marxist theories, rest on the belief that the colonial economic structures still remain in place, with raw-goods exporters at odds with what equates to finished-goods exporters. (McDonald's products, for example, are in their own way finished goods.)

The economist John Maynard Keynes supported some of the tenets of mercantilism. While Adam Smith rejected the idea of bullion being more important than any other commodity, Keynes saw an inflow of gold and silver as being beneficial. He argued that greater gold reserves leads to lower interest rates, and thus the ability to borrow more money at a lower cost. This would both stimulate growth and aid government borrowing. Keynes also adopted the essential idea of mercantilism that government intervention in the economy is a necessity. A number of political parties embraced Keynes' theories, and they came into force under Franklin Roosevelt's New Deal program in the United States and also under Britain's Labour government after the Second World War.

Mercantilist theory also influences the notion that trade surpluses are automatically good and that trade deficits are automatically bad. Some economists argue that Japanese trade policy in the
1970s and 1980s was in large part based on mercantilist concepts and that these policies form one of the causes of Japanese economic stagnation in the 1990s.

**Theory of Absolute Advantage:** This was developed by Adam Smith in his famous book “The Wealth of Nations”.

**Adam Smith’ Model (Absolute advantage as a basis for trade):**

**Assumptions:**

1. Factor of production cannot move between countries.
   - This assumption guarantees that a nation’s PPF does not change shape or location once trade begins.
   - It also implies that immigration and Multinational Corporation are not allowed in this model.
2. There are no barriers to trade.
   - Free trade in all goods.
   - Non-existence of tariff, quota and other trade barriers.
3. Exports must pay for imports
   - Trade must be balanced.
   - Rules out the net flow of money to the country.
4. Labor is the only relevant factor of production in terms of productivity analysis or cost of production.
5. Production exhibits constant returns to scale between input and output.
   - By constant return to scale, we mean a technological relationship such that proportional changes in all inputs lead to proportional change in output. In other words, doubling the inputs leads to double the output.

**Theory of Comparative Advantage:** Countries gain from trade because of differences in the relative costs of producing different commodities.

An example:
2 countries: France and UK
2 commodities: Beef and Cheese
1 production input: Labour

**Technology matrix:**
Units of labour required to produce one tonne of output:

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<tr>
<th></th>
<th>Beef</th>
<th>Cheese</th>
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<tbody>
<tr>
<td>France</td>
<td>3</td>
<td>6</td>
</tr>
<tr>
<td>U.K</td>
<td>2</td>
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Concept of **opportunity cost:**
- What has to be given up in order to consume something?
- The opportunity cost of consuming X is what is foregone in terms of Y.
• In the example the opportunity cost of a tonne of beef in France is 2.5 tonne of cheese.

**If trade cannot take place:** Relative prices in the two countries are given by the relative input costs:

- In France one tonne of beef costs 2.5 tonne of cheese.
- In the UK one tonne of beef costs 0.5 tonne of cheese.

**If trade is permitted:**

- France gains from trade if it can buy a tonne of beef for less than 2.5 tonne of cheese
- UK gains if one tonne of beef is sold for more than 0.5 tonne of cheese

**Mutually beneficial trade can take place at any price between 0.5 and 2.5 tonne of cheese per tonne of beef** (i.e. a range of possible "exchange rates" allow both countries to gain from trade). Note that what matters is relative costs, not actual levels of cost. France might be less efficient in producing both commodities, but could still gain from trade. For example, Units of Labour required producing one tonne of output.

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<td>France</td>
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<td>U.K.</td>
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In this example cheese requires more labour to be produced in France than in the UK, but mutually beneficial trade is still possible, because France's productivity disadvantage is less in one commodity (cheese) than the other (beef). Only if relative costs are the same is it impossible to find gains from trade. For example:

Units of labour required to produce one tonne of output

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<tr>
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<td>U.K.</td>
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Here the pre-trade price of beef in terms of cheese is the same in France as in the UK, and trade opens up no possibilities for improvement for either country.

**Sources of Comparative Advantage:**

**What determines relative costs?**

1. Efficiency;
2. Relative factor endowments (Heckscher-Ohlin theory of trade);
3. Technology

**The Heckscher-Ohlin (Factor Proportions) Model:** This 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 (or HOS) model. In the 1950s and
60s some noteworthy extensions to the model were made by Jaroslav Vanek and so occasionally
the model is called the Heckscher-Ohlin-Vanek model. Here we will simply call all versions of
the model either the "Heckscher-Ohlin (or H-O) model" or simply the more generic "Factor-
Proportions Model".

Assumptions:

1. The model begins by **expanding the number of factors of production from one to two**. It
assumes that **labor and capital** are used in the production of two final goods. Here, capital
refers to the physical machines and equipment that is used in production. Thus, machine
tools, conveyers, trucks, forklifts, computers, office buildings, office supplies, and much
more, is considered capital. It allows for the introduction of another realistic feature in
production; that of **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 used varies considerably. For example, steel production
generally involves large amounts of expensive machines and equipment spread over
perhaps hundreds of acres of land, but also uses relatively few workers. In the tomato
industry, in contrast, harvesting requires hundreds of migrant workers to handpick and
collect each fruit from the vine. The amount of machinery used in this process is relatively
small.

2. The H-O model assumes **private ownership of capital**. Use of capital in production will
generate income for the owner. We will refer to that income as capital "rents". Thus,
whereas the worker earns "wages" for their efforts in production, the capital owner earns
rents.

3. In the H-O model we define the ratio of the quantity of capital to the quantity of labor used
in a production process as the capital-labor ratio. We imagine, and therefore 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.

4. The H-O model assumes that the **only difference between countries is these differences
in the relative endowments of factors of production rather than productivity**. It is
ultimately shown that trade will occur, trade will be nationally advantageous, and trade will
have characterizable effects upon prices, wages and rents, when the nations differ in their
relative factor endowments and when different industries use factors in different
proportions. The most abundant a factor, the lower its cost. It predicts that countries will
export those goods that make intensive use of factors that are locally abundant while
importing goods that make intensive use of factors that are locally scarce.

**The Leontief Paradox**: Using the Heckscher - Ohlin Theory, Leontief postulated that since
United States was relatively abundant in capital compared to other nations, the United States
would be an exporter of capital-intensive goods and an importer of labor-intensive goods. To his
surprise, however he found that U.S exports were less capital intensive than U.S imports. Since
this result was in variance with the predictions of the theory, it has become to be known as
Leontief Paradox.
One possible explanation is that United States has a special advantage in producing new goods or products made with innovative technologies. Such products may be less capital intensive than those products whose technology has had time to mature.

**Product Life Cycle Theory:** Raymond Vernon, attempting to explain patterns of international trade, observed a *circular phenomenon in the composition of trade between countries in the world market*. Advanced countries, which have the ability and competence to innovate as well as high-income levels and mass consumption become initial exporters of goods. However, they lose their exports initially to developing countries and subsequently to less developed countries and eventually become importers of these goods. Vernon's hypothesis was an attempt to advance the trade theory beyond the static framework of the comparative advantage of David Ricardo and other classical economists. It explored hitherto ignored or unexplained areas of international trade theory such as timing of innovation, effects of scale economies and the role of uncertainty and ignorance in trade patterns. His intent was not to propose a theory of product life cycle as commonly understood by marketing theorists.

While discussing Vernon's model, Louis T. Wells, Jr. states that "the model claims that many products go through a trade cycle, during which the United States is initially an exporter, then loses its export markets and may finally become an importer of the product". Warren Keegan, a marketing scholar, on the other hand, refers to the International Product Life Cycle in the following manner: "The International Product Life Cycle model suggests that many products go through a cycle during which high income, mass consumption countries are initially exporters, and then lose their export markets, and finally become importers of the product." These are clear instances where trade cycle and product life cycle have been defined almost identically in the international context.

Sales volume and profits become the critical micro variables in the product life cycle framework. In the introductory stage of a product's life, sales are typically slow and profits negative. In the growth stage, both sales and profits rise at a rapid rate. During maturity, sales volume may continue to rise at a declining rate and profit may stay high. In the decline state, both sales and profit decrease. Sales and profits are the principal variables for marketing decisions. The product life cycle is essentially a tool for firms to design marketing mix strategies for different states of the life span of a product or service. However, Vernon stresses the degree of standardization as evidence of maturation of the product. A mature product typically may become standardized across international markets. The yardstick for maturity in the product life cycle approach is the rate of sales growth. Changes in this rate mark the transition from one stage of the product life cycle to the next.

An interesting example of these differing perceptions of maturity can be found in the market for personal computers. In the past decade, many facets of the computer hardware and software products became standardized either through strength of market leaders such as IBM and Microsoft or by the joint efforts of industry, users and/or government to establish standards. Currently this market has standards but is by no means mature. It is still rapidly expanding domestically as well as globally. Using Vernon's yardstick of maturity, the computer industry is in a mature stage of the product cycle whereas it is still in the growth stage according to the product life cycle approach.
Another striking difference between Vernon's perception of the international product cycle and marketers' view of the product life cycle is that the former focuses mainly on inventions and new products. It overlooks the tried and well-established products in the domestic market, which do not enter international markets to take advantage of the economies of scale. Firms that manufacture these products have had ample opportunities for growth in the domestic market and they do not think of the international market until the market for their products reach maturity. McDonald's, Pizza Hut and Kentucky Fried Chicken did not go international until the domestic markets were nearly saturated. The product life cycle concept is generally a tool for making decisions relating to domestic markets.

**International Product Life Cycle:** The international product life cycle can be defined as market life span stages the product goes through in international markets sequentially, simultaneously or asynchronously. The sequential stages are introduction, growth, maturity, decline and extinction in the international markets. When a product is positioned in different international markets at the same time and is going through similar life cycle stages, the cycle process is simultaneous. The life cycle stages are asynchronous when the product is in different stages in different international markets at the same time. The life cycle stage in which a product can be positioned is influenced by macro variables indigenous to country markets.

**Differences between the product life cycle and international product life cycle:** The first relates to rejuvenation or rebirth in international markets of a product that is in decline domestically for market related reasons or is close to extinction. Consumption of cigarettes in the United States market has been rapidly declining due to health consciousness of consumers and changes in public policy towards smoking. But the markets for American cigarettes are expanding in China, Eastern Europe and Russia. The handloom produced 'Bleeding Madras' fabrics were almost extinct in the Indian domestic market when it gained a new lease on life after being introduced as a fashion product for summer wear in the United States. Finding new international markets can rejuvenate products that have reached the declining stage in the domestic market.

The second difference is that if a culture specific product is designed for the international market, it can attain a new dimension of the product life cycle that is not possible the domestic market. For example, fast food outlets like Burger King and McDonalds can design a product for cultures permeated by Buddhist or Hindu vegetarian values. This product can succeed and go through product life stages in international markets and still not be acceptable in domestic markets. The international product life cycle is clearly different from the product cycle concept that is essentially circular and the product life cycle with its numerous variations.

**New Trade Theories:** Although most economists support free trade, in the 1970s a growing number of them became increasingly puzzled by the large differences between the predictions of free trade theory and real-world trade flows. Their solution to this puzzle is known as new trade theory.

One mystery was that trade was growing fastest between industrial countries with similar economies and endowments of the factors of production. In many new industries, there was no clear comparative advantage for any country. Patterns of production and trade often seemed
matters of chance. Trade between two countries would often consist mostly of similar goods; for example, one country would sell cars to another country from which it would import different models of cars.

One explanation, associated in particular with Paul Krugman of the Massachusetts Institute of Technology, drew on Adam Smith’s idea that the division of labour lowers unit costs. Economies of scale within firms are incompatible with the perfect competition assumed by traditional trade theory. **A more realistic assumption is that many markets have monopolistic competition. When a monopolistically competitive market expands, it does so through a mixture of more firms (greater product variety) and bigger firms, with bigger-scale economies. Free trade expands market size beyond national borders and so allows firms to reap bigger economies of scale, to the benefit of consumers, workers and shareholders.**

The up growth may be greater the more similar are the trading economies. This may explain why trade liberalization is easier to achieve between similar countries. Thus, for example, the free-trade agreement between the United States and Canada produced only minor local complaints, whereas its subsequent expansion to include the very different economy of Mexico was much more controversial.

**The Theory of Competitive Advantage of Nations:** Porter is a famous Harvard business professor. He conducted a comprehensive study of 10 nations to learn what leads to success. Recently his company was commissioned to study Canada in a report called "Canada at the Crossroads". Porter believes standard classical theories on comparative advantage are inadequate (or even wrong). According to Porter, a nation attains a competitive advantage if its firms are competitive. Firms become competitive through innovation. Innovation can include technical improvements to the product or to the production process.

**The Diamond - Four Determinants of National Competitive Advantage:** Four attributes of a nation comprise Porter's "Diamond" of national advantage. They are:

1. Factor conditions (i.e. the nation's position in factors of production, such as skilled labour and infrastructure);
2. Demand conditions (i.e. sophisticated customers in home market);
3. Related and supporting industries;
4. Firm strategy, structure and rivalry (i.e. conditions for organization of companies, and the nature of domestic rivalry).

**Factor Conditions:** It refers to inputs used as factors of production - such as labour, land, natural resources, capital and infrastructure. This sounds similar to standard economic theory, but Porter argues that the "key" factors of production (or specialized factors) are created, not inherited. Specialized factors of production are skilled labour, capital and infrastructure.

"Non-key" factors or general use factors, such as unskilled labour and raw materials, can be obtained by any company and, hence, do not generate sustained competitive advantage. However, specialized factors involve heavy, sustained investment. They are more difficult to
duplicate. This leads to a competitive advantage, because if other firms cannot easily duplicate these factors, they are valuable.

Porter argues that a lack of resources often actually helps countries to become competitive (call it selected factor disadvantage). Abundance generates waste and scarcity generates an innovative mindset. Such countries are forced to innovate to overcome their problem of scarce resources. How true is this?

- Switzerland was the first country to experience labour shortages. They abandoned labour-intensive watches and concentrated on innovative/high-end watches.
- Japan has high priced land and so its factory space is at a premium. This lead to just-in-time inventory techniques (Japanese firms can’t have a lot of stock taking up space, so to cope with the potential of not have goods around when they need it, they innovated traditional inventory techniques).
- Sweden has a short building season and high construction costs. These two things combined created a need for pre-fabricated houses.

**Demand Conditions:** Porter argues that a sophisticated domestic market is an important element to producing competitiveness. Firms that face a sophisticated domestic market are likely to sell superior products because the market demands high quality and a close proximity to such consumers enables the firm to better understand the needs and desires of the customers (this same argument can be used to explain the first stage of the IPLC theory when a product is just initially being developed and after it has been perfected, it doesn’t have to be so close to the discriminating consumers).

If the nation’s discriminating values spread to other countries, then the local firms will be competitive in the global market. One example is the French wine industry. The French are sophisticated wine consumers. These consumers force and help French wineries to produce high quality wines.

**Related and Supporting Industries:** Porter also argues that a set of strong related and supporting industries is important to the competitiveness of firms. This includes suppliers and related industries. This usually occurs at a regional level as opposed to a national level. Examples include Silicon Valley in the U.S., Detroit (for the auto industry) and Italy (leather-shoes-other leather goods industry).

**Clustering or Agglomeration:** The phenomenon of competitors (and upstream and/or downstream industries) locating in the same area is known as clustering or agglomeration.

**What are the advantages and disadvantages of locating within a cluster?**
Some advantages to locating close to your rivals may be:

- Potential technology knowledge spillovers;
- An association of a region on the part of consumers with a product and high quality and therefore some market power;
- An association of a region on the part of applicable labour force;
• Some disadvantages to locating close to your rivals are potential poaching of your employees by rival companies and obvious increase in competition possibly decreasing mark-ups.

Firm Strategy, Structure and Rivalry

Strategy:

a) Capital Markets: Domestic capital markets affect the strategy of firms. Some countries’ capital markets have a long-run outlook, while others have a short-run outlook. Industries vary in how long the long run is. Countries with a short-run outlook (like the U.S.) will tend to be more competitive in industries where investment is short-term (like the computer industry). Countries with a long run outlook (like Switzerland) will tend to be more competitive in industries where investment is long term (like the pharmaceutical industry).

b) Individuals’ Career Choices: Individuals base their career decisions on opportunities and prestige. A country will be competitive in an industry whose key personnel hold positions that are considered prestigious.

Structure: Porter argues that the best management styles vary among industries. Some countries may be oriented toward a particular style of management. Those countries will tend to be more competitive in industries for which that style of management is suited. For example, Germany tends to have hierarchical management structures composed of managers with strong technical backgrounds and Italy has smaller, family-run firms.

Rivalry: Porter argues that intense competition spurs innovation. Competition is particularly fierce in Japan, where many companies compete vigorously in most industries. International competition is not as intense and motivating. With international competition, there are enough differences between companies and their environments to provide handy excuses to managers who were outperformed by their competitors.

The Diamond as a System: The points on the diamond constitute a system and are self-reinforcing.

Domestic rivalry for final goods stimulates the emergence of an industry that provides specialized intermediate goods. Keen domestic competition leads to more sophisticated consumers who come to expect upgrading and innovation. The diamond promotes clustering. Porter provides a somewhat detailed example to illustrate the system. The example is the ceramic tile industry in Italy. Porter emphasizes the role of chance in the model. Random events can either benefit or harm a firm’s competitive position. These can be anything like major technological breakthroughs or inventions, acts of war and destruction, or dramatic shifts in exchange rates.

When there is a large industry presence in an area, it will increase the supply of specific factors (i.e. workers with industry-specific training) since they will tend to get higher returns and less risk of losing employment. At the same time, upstream firms (i.e.: those who supply intermediate
inputs) will invest in the area. They will also wish to save on transport costs, tariffs, inter-firm communication costs, inventories, etc. The downstream firms (i.e.: those use our industry’s product as an input) will also invest in the area. This causes additional savings of the type listed before. Finally, attracted by the good set of specific factors, upstream and downstream firms, producers in related industries (i.e.: those who use similar inputs or whose goods are purchased by the same set of customers) will also invest. This will trigger subsequent rounds of investment.

Implications for Governments: The government plays an important role in Porter’s diamond model. Like everybody else, Porter argues that there are some things that governments do that they shouldn't, and other things that they do not do but should. He says, "Government’s proper role is as a catalyst and challenger; it is to encourage or even push companies to raise their aspirations and move to higher levels of competitive performance …"

Governments can influence all four of Porter’s determinants through a variety of actions such as:

1. Subsidies to firms, either directly (money) or indirectly (through infrastructure);
2. Tax codes applicable to corporation, business or property ownership;
3. Educational policies that affect the skill level of workers;
4. They should focus on specialized factor creation.

The problem, of course, is through these actions, it becomes clear which industries they are choosing to help innovate. What methods do they use to choose? What happens if they pick the wrong industries?
Criticisms: Although Porter theory is renowned, it has a number of critics.

1. Porter developed this paper based on case studies and these tend to only apply to developed economies;
2. Porter argues that only outward-FDI is valuable in creating competitive advantage, and inbound-FDI does not increase domestic competition significantly because the domestic firms lack the capability to defend their own markets and face a process of market-share erosion and decline. However, there seems to be little empirical evidence to support that claim.
3. The Porter model does not adequately address the role of MNCs. There seems to be ample evidence that the diamond is influenced by factors outside the home country.

5.2 INTERNATIONAL INVESTMENT THEORIES

New technologies, advanced communication, increased trade, and political changes have created a global economy in which currencies are merging and the borders between countries and economies are coming down. With the globalization of the world markets, companies will increasingly face formidable competitors both in and outside of their countries. Let us start with U.S investors.

a) Many of the winners in the global competitive arena are not U.S. based: Where a company is headquartered has become less important, its industry has become more important in influencing its stock price. As a result, market dominance in an industry has been critical to a company's success, its location has not.

b) Privatization is increasing the number of equity opportunities: Privatization of former state-owned businesses is happening all over the world. Many of these companies, which once relied on subsidies or debt financing, will now use incentive pay, stock options, and stock ownership to increase their profits. If these companies are successful, their higher profits mean increased earnings. Increased earnings typically drive investor's share prices higher.

c) International companies are focusing on maximizing shareholder value: In Europe and Japan, companies have restructured. They have put more emphasis on lower headcounts, bonuses, and stock options, and less on executive salaries. This helps focus management on delivering value for all shareholders. The results could be good news for those who invest outside the US in the coming years.

d) Changing demographics are affecting stock markets: As the U.S. population ages, investment in tax-advantaged retirement savings programs is providing capital for the U.S. stock market, helping to fuel its growth. In the 1990s, investors reacted to fears about Social Security and diminishing pension plans by investing a growing percentage of their wealth in the stock market. Both Europe and Japan could repeat the retirement-driven surge of equity investing the U.S. has experienced in the past 25 years. Their situations are very similar to those in the US in the mid 1970s:

- A population only modestly invested in stocks (see table below)
- Limited and/or under-funded private pension systems
- Legislation reform to encourage retirement investment
e) **Gross Domestic Product often grows more rapidly in developing economies:** While the growth of the Gross Domestic Product in the U.S. is healthy for a well-developed economy, it has paled in comparison with that of many developing countries.

Investing in only one country or economy may limit your portfolio's growth potential and diversity. Despite an impressive performance over the past 15 years, the red-hot US stock market has failed to compete with stock markets of several foreign countries. In fact, the US finished seventh overall in total stock market returns over the last fifteen years.

**International Investments Help Diversify one’s Portfolio:** Many experts believe that international investments in a portfolio increase diversification, which in turn can reduce overall investment risk. Because the markets of the world do not move in lockstep, a downturn in one country's economy can often be offset by a rise in another. Let’s discuss the following points:

1. **Using international investments to reduce volatility:** Volatility in your portfolio can increase the risk of loss of principal. While attempting to minimize volatility, some investors choose low-risk securities, however these securities tend to have lower rates of return. Professional money managers advise that investors balance their portfolios with some investments with higher growth potential but choose them so that some of the potential fluctuations (risks) cancel each other out. In statistical terms, the goal is a combined standard deviation (standard deviation is a measure of risk in a portfolio) that is low, relative to the standard deviations of the portfolio's individual holdings. The goal is a high average rate of return, with fewer radical fluctuations in value.

2. **The Efficient Frontier:** The optimum combination of asset classes to achieve a given risk vs. return scenario in a portfolio is called the Efficient Frontier. When the rate of return and standard deviations for all the portfolios possible by allocating among a collection of securities (like all the stocks in the S&P 500) is graphed, the region bounded by an upward-sloping curve is the efficient frontier (See Fig. 5.2). For any given value of standard deviation, investors will want the portfolio that gives the greatest possible rate of return; so you always want a portfolio that lies along the efficient frontier, rather than inside the curve. Applying the same theories to international investments has shown that over the last 30 years, a 100% domestically invested portfolio (represented by S&P 500) would have provided higher return and less risk than a 100% internationally invested portfolio (represented by the Morgan Stanley Capital Europe Australasia Far East Index (MSCI EAFE)). But creating a portfolio that is 70% domestic investments (70% S&P 500) and 30% international investments (30% MSCI EAFE) would have provided similar returns with 10% less volatility (risk) than the S&P 500 portfolio alone.
Fig. 5.2

The chart below illustrates the Efficient Frontier by comparing annual returns and risk for portfolios with varying percentages of international investments.

Fig. 5.3 Benefit of International Investment

Morgan Stanley Capital International Europe, Australasia, and Far East (EAFE®) Index is a market capitalization-weighted index that is designed to represent the performance of developed stock markets outside the United States and Canada. Standard & Poor's 500 SM Index (S&amp;P 500®) is a market capitalization-weighted index of common stocks.

**Measuring risk from international investments:** The chart below shows the amount of risk, as represented by standard deviation over a three-year period, for portfolios invested in various percentages of foreign stocks. As you can see from the chart, portfolios with 5%, 10%, or 15% in foreign stocks assume little to no additional risk over domestic investments.
International investments can help reduce risk in a portfolio without adversely affecting returns. So how much of a portfolio should be in international investments to reap the benefits of diversification? Below are three examples of target asset mixes that have incorporated international investments for three different goals.

- **Balanced** (5% International Stock / 45% Domestic Stock / 40% Domestic Bonds / 10% Domestic Short Term)
  This strategy is a **reasonable benchmark** for many investors, offering a combination of enhanced return potential and risk reduction over time.

- **Growth** (10% International Stock / 60% Domestic Stock / 25% Domestic Bonds / 5% Domestic Short Term)
  This portfolio is for more **seasoned investors**. It has the potential to increase returns overall and reduced risk over a long period of time.

- **Aggressive Growth** (15% International Stock / 70% Domestic Stock / 15% Domestic Bonds)
  This portfolio is for **aggressive investors** who seek high returns and who are willing to accept greater day-to-day volatility.

**International Stock Funds:** One way to add international investments to a portfolio is to invest in mutual funds. Mutual funds provide professional money management expertise and, because assets are invested across industry sectors and securities, added diversification. These two features may further reduce the risk associated with international investing.

1. **Diversified Funds** - These funds are often considered to be a less aggressive type of international fund because of their emphasis on diversification within established markets. Many investors use these funds to form the foundation of the international component of their portfolio.
2. Index - This fund offers a simple, low-cost way to invest in the securities of the Morgan Stanley Capital International Europe, Australasia, and Far East (MSCI EAFE®) Index that represents the performance of foreign stock markets.

Targeted Mutual Funds: Once you have created a balanced portfolio, you can consider capitalizing on more targeted international funds, such as Fidelity's regional funds.

1. **Regional Funds:** These funds can offer a way to turn a specific geographic interest into a strategy for investing in specific countries or regions of the world.

2. **Emerging Markets:** These funds focus on the world's developing countries, where rapid industrialization may offer high potential gains, but also lead to extreme volatility.

3. **Small Companies:** This fund offers the opportunity to invest in faster-growing, smaller companies in Japan, although investors must be willing to take on additional risk inherent in small-cap investing.

4. **Global Bonds:** These funds invest in debt securities of issuers in foreign issuers, including emerging markets. They may invest in equity securities of emerging market issuers, debt securities of non-emerging market foreign issuers, and lower quality debt securities of U.S. issuers.

The Risks of International Investing: As with any investment, international investing carries some risks, including some unique to international markets. Keeping in mind, some regions are more volatile and can have the potential for faster gains -- or faster losses the major risk factors are listed below:

- **The instability of emerging markets:** When most people think of international investing, they think of emerging markets. In countries like Thailand and Peru -- where volatility and risk tend to be high -- economies are usually dominated by only a few stocks, industries or sectors. This concentration, combined with unstable political or economic environment, may lead to dramatic rises and falls in investment value.

- **Foreign markets may be more volatile than the home markets:** Markets in many countries are more volatile than ours, but volatility measures downward and upward movement. It's easy to lose sight of the fact that volatility measures upward movement, because when an emerging market falls suddenly, the press has a dramatic story to tell. However, when emerging markets rise suddenly, it's reported as a fact, not a drama.

- **Currency fluctuation:** Currency fluctuation can be good for investors. Foreign exchange rates fluctuate constantly with changes in the supply and demand for each currency. This can increase or decrease the dollar value of an investment even if the security's price remains unchanged. For U.S. investors, the value of a company's stock depends on the exchange rate between a country's currency and the U.S. dollar - and that rate may change daily. But currency fluctuation can actually work in an investor's favor. For example, returns on foreign stocks are increased when the dollar's value falls versus other currencies; therefore, the country's currency fluctuation would make money for you when you converted your gains back to dollars.

- **Foreign governments can be unstable.** Revolutions, riots, assassinations, border skirmishes, full-fledged wars, even major policy changes -- all affect equity markets, especially those closest to the trouble, and crises like this are a constant in some regions.
Investing in some parts of the world means accepting volatility as a constant. However, developed markets, such as Scandinavia and Switzerland, can be as politically stable as the U.S.

When considering emerging market equities, it is to be kept in mind that they:

- Are extremely volatile asset subclasses.
- Continue to trade at sharp valuation discounts to developed country stocks.
- Currently exhibit improved fundamentals represent a large and growing portion of the world’s population and economy.
- Can enhance international portfolio diversification.

When considering an investment in emerging market debt, it is to be kept in mind that they:

- Are a volatile asset class.
- Can enhance diversification because its performance has low correlation with other asset classes.
- Currently demonstrate improved credit worthiness.

When considering international small-cap stocks, it is to be kept in mind that they:

- Rotate market leadership with international large-cap stocks.
- Can lower the volatility of a portfolio by expanding the investment universe.
- Potentially provide better opportunities to realize the advantages of active investment management.

5.3 GLOBAL TRADE & BALANCE OF PAYMENTS

What is Trade Performance Index?
The Trade Performance Index comprises a set of 24 quantitative indicators benchmarking the export performance of 184 countries. It:-

1. Ranks 14 different product sectors in each country.
2. Summarizes performance indicators into current index and change index.

Competition policy – Developing & Developed Countries:
It is important for developing countries to have a competition policy that takes account of their level of development and the objective of sustained economic growth to counter the potential of privatization, deregulation, liberalization and the international merger movement. Competition policies adopted by developed nations UK and US are not appropriate for developing countries. Specifically, in considering competition policy from a developmental perspective:
• Emphasis on dynamic rather than static efficiency as the main objective of competition policy
• A concept of 'optimal degree of competition' (rather than of maximum competition) to promote long term growth
• A related concept of 'optimal combination of competition and co-operation' between firms so that developing countries can achieve fast long term economic growth
• Government co-ordination of investment decisions and close co-operation between government and business to maintain the private sector investment and hence steady growth of profits
• Recognition of the concept of 'simulated competition'
• Recognition of the importance for developing countries of industrial policy and the need for coherence between industrial and competition policies.

Developing countries should institute domestic competition policies suited to their stage of development and proposes the establishment of an international competition authority, to prevent restrictive business practices and competition-reducing actions of large multinationals.

**Paction – The Model International Sale Contract:** Paction is a web-based application which allows a buyer and a seller to prepare, negotiate and complete contracts for the international sale and purchase of goods, online. The contracts produced by the application are based on the International Chamber of Commerce's model international sale contract, which provides a clear and concise set of conditions, balancing the interests of buyers and sellers.

The application was conceived and developed by Allagraf Limited. It has been built in order to provide easy access not just to the ICC's standard terms of contract, developed over the years from input provided by the world's leading experts on international trade law, but also to offer help, advice and further reading related to those terms of contract.

Another advantage of the application is that the contract text produced by the application is concise, delivering only the clauses relevant to the transaction being contemplated, rather than the general set of conditions, which of course have to provide for all possible situations. In other words, you get a tailor-made contract.

The application has been designed with the smaller trader, perhaps new to international trade, in mind. For them, the extensive on-line help available within the application is of particular interest. But larger companies and already experienced international traders can also benefit from the application. Of course they can access the help facilities if they need to, but they can also use shortcuts through the application to arrive at the desired outcome as quickly as possible.

**Other benefits of the application include:**
1. The security of ICC approved and designed contracts.
2. Convenience of making standard terms available to trading partners over the Web, rather than by paper communications.
3. Tracking of contract revisions using time and date stamping.
4. Ability to sign contracts online, using a digital ID.
5. Secure storage of contracts.
India in the changing global trade scenario during the 1990s: India commenced its major thrust towards globalization in July 1991 with two simultaneous forces, unilateral and multilateral, playing their role together. Unilateral reforms were undertaken with regard to exchange rate policy, foreign investment, external borrowing, import licensing, custom tariffs and export subsidies. The multilateral aspect of India’s trade-policy reforms relates to India’s commitments to the WTO with regard to trade in goods and services.

- In spite of the slow process of liberalization of India’s trade regime since the late 1970s, 93 per cent of India’s local production of internationally tradable goods continued to be protected by some type of quantitative restrictions (QRs) on imports as of 1990-91. The QR coverage was 94 per cent for agricultural and 90 per cent for manufactured intermediate and capital goods.
- Import licenses were granted subject to indigenous clearance, that is, a proof that there was no source of indigenous supply. India had one of the most restrictive import-tariff structures among developing countries. The import-weighted tariff rate was 87 per cent in 1989-90 accompanied by a collection rate of 51 per cent. The latter half of the 1980s had witnessed a rapid increase in import tariffs.

Such a protective regime had led India into a sustained phase of allocating its resources inefficiently. India’s share in world trade declined from 2.0 per cent in 1950-51 to 1.0 percent in 1965-66, and to 0.5 per cent by 1973-74, and continued to hover around this figure till 1990-91.

India's trade policy regime was quite complex up to the beginning of 1990s. There were various categories of importers, import licenses and ways of importing. The Import and Export policy (1990-93) was replaced by Export and Import policy (1992-97) with effect from April 1, 1992. The content was substantially reduced to 20 pages, thus making matters simpler for the actual agents of trade, namely exporters and importers. The new EXIM 1992-97 policy contained Negative List imports subject to licensing. Almost all consumer goods remained subject to import licensing.

The first stage of India's reforms after 1991 continued to focus on manufacturing while agriculture was largely ignored.

- The share of value added in the manufacturing sector, protected by QRs, declined from 90 to 47 percent by May 1992 and further down to 36 per cent by May 1995.
- The corresponding decline was much less in agriculture, from 94 to 93 per cent by May 1992 and further to 84 per cent by May 1995. The tradable GDP protected by QRs was still at 66 per cent as of May 1995. It has been estimated that about one-third of the value of India's import in 1998-99 was subject to some type of NTBs. After the EXIM Policy (April 1998) announcement, about 30 per cent of the 10-digit tariff lines (3068 out of 10281) under the Harmonized System of India's trade classification (HS-ITC) were subject to NTBs (prohibited, restricted or canalized).
- The import of 40 per cent of agricultural products is still restricted since these are classified as consumer goods.
Prior to 1991, India’s import tariff structure was among the highest in the world. The Tax Reforms Committee chaired by Chelliah proposed that the import-weighted average duty rate should go down from 87 per cent in 1989-90 to 45 per cent in 1995-96 and further to 25 per cent by 1998-99 (Government of India, 1993). India has lowered its average (unweighted) applied tariff rate from 125 per cent in 1990-91 to 71 per cent in 1993-94, 41 per cent in 1995-96 and to 35 per cent in 1997-98. The corresponding reduction in the import-weighted average has gone down from 87 per cent in 1990-91 to 47 per cent in 1993-94, 25 per cent in 1995-96 and to 20 per cent in 1997-98, thus moving ahead of the recommendations of the Chelliah Committee.

The peak rate of duty has declined from 355 per cent in 1990-91 to 45 percent in 1997-98 and to 40 per cent in 1999-2000.

The import of some restricted items has been liberalized through permitting their imports through freely transferable Special Import Licenses (SILs). Apart from being used as a step towards liberalization, the SIL regime also provides incentives to exporters. SILs are granted to large established exporters; exporters of electronic and telecommunication equipment, diamonds, gems and jewelry, deemed exports; and manufacturers who have acquired the prescribed quality certification.

The coverage of tariff lines has gradually expanded since their introduction in 1992-93. Tariff lines have typically moved from the restricted list to the SIL list, and thereafter to the free list. SILs were concentrated in industrial products with nearly 55.8 per cent of the HS eight-digit tariff lines under SIL as on April 1, 1997. The corresponding coverage was 29.6 per cent for textile and clothing products and 14.6 per cent for agricultural products including fisheries. The SIL coverage has been extended systematically since April 1997, freeing various items from the restricted list to the SIL list and from the SIL list to the OGL list.

Various items have also been de-canalized. The newly freed categories include various items from two of the most restricted groups, namely agro products and consumer goods. The recently freed agro products include dairy items, fish and a variety of processed foods while the consumer goods include toiletries, electronic items and cooking ranges. India’s unrestrained use of QRs was strongly challenged in the WTO balance of payments committee by the United States, European Union and other developed countries in December 1995.

India is a founding member of the GATT (1947) as well as of the WTO, which came into effect from January 1, 1995. By virtue of its WTO membership, India automatically is availed of Most Favored Nation Treatment (MFN) and National Treatment (NT) from all WTO members for its exports and vice versa. Its participation in this increasingly rule-based system is aimed towards ensuring more stability and predictability in its international trade.

The Uruguay Round resulted in increased tariff binding commitments by developing countries. India has bound 67 per cent of its tariff lines compared to 6 per cent prior to this round. All agricultural tariff lines and nearly 62 per cent of the tariff lines of industrial goods are now bound. The unbound lines include some consumer goods and industrial items. Ceiling bindings for industrial goods are generally at 40 per cent ad valorem for finished goods and 25 per cent on intermediate goods, machinery and equipment. The phased reduction to these bound levels is to be achieved during the 10-year period commencing 1995. Tariff rates on equipment covered under the Information
Technology Agreement and software shall be brought down to zero by 2005. The only exception is in textiles in which India has kept the option of reverting to the 1990 tariff levels in case the Agreement on Textiles and Clothing does not fully materialize by 2005.

- It may be observed from that applied tariff rates in India are below the Uruguay Round bound levels. The differential is the maximum in the case of agriculture and also in unprocessed primary goods categories. The bound rates do not show tariff escalation by the stage of processing, in fact, the reverse seems to be true, which is also equally undesirable.

**What is balance of Payments?**

The balance of payments (BOP) is the method countries use to monitor all international monetary transactions at a specific period of time. Usually, the BOP is calculated every quarter and every calendar year. All trades conducted by both the private and public sectors are accounted for in the BOP in order to determine how much money is going in and out of a country. If a country has received money, this is known as a credit, and, if a country has paid or given money, the transaction is counted as a debit. Theoretically, the BOP should be zero, meaning that assets (credits) and liabilities (debits) should balance. But in practice this is rarely the case and, thus, the BOP can tell the observer if a country has a deficit or a surplus and from which part of the economy the discrepancies are stemming.

**The Balance of Payments Divided:** The BOP is divided into three main categories: the current account, the capital account, and the financial account. Within these three categories are subdivisions, each of which account for a different type of international monetary transaction.

**The Current Account:** The current account is used to mark the inflow and outflow of goods and services into a country. Earnings on investments, both public and private, are also put into the current account. Within the current account are credits and debits on the trade of merchandise, which includes goods such as raw materials and manufactured goods that are bought, sold, or given away (possibly in the form of aid). Services refer to receipts from tourism, transportation (like the levy that must be paid in Egypt when a ship passes through the Suez Canal), engineering, business service fees (from lawyers or management consulting, for example), and royalties from patents and copyrights. When combined, goods and services together make up a country's balance of trade (BOT). The BOT is typically the biggest bulk of a country's balance of payments as it makes up total imports and exports. If a country has a balance of trade deficit, it imports more than it exports, and if it has a balance of trade surplus, it exports more than it imports.

Receipts from income-generating assets such as stocks (in the form of dividends) are also recorded in the current account. The last component of the current account is unilateral transfers. These are credits that are mostly worker's remittances, which are salaries sent back into the home country of a national working abroad, as well as foreign aid that is directly received.

**The Capital Account:** The capital account is where all international capital transfers are recorded. This refers to the acquisition or disposal of non-financial assets (for example, a physical asset such as land) and non-produced assets, which are needed for production but have not been produced, like a mine used for the extraction of diamonds.
The capital account is broken down into the monetary flows branching from debt forgiveness, the transfer of goods, and financial assets by migrants leaving or entering a country, the transfer of ownership on fixed assets (assets such as equipment used in the production process to generate income), the transfer of funds received to the sale or acquisition of fixed assets, gift and inheritance taxes, death levies, and, finally, uninsured damage to fixed assets.

**The Financial Account:** In the financial account, international monetary flows related to investment in business, real estate, bonds, and stocks are documented. Also included are government-owned assets such as foreign reserves, gold, special drawing rights (SDRs) held with the International Monetary Fund (IMF), private assets held abroad, and direct foreign investment. Assets owned by foreigners, private and official, are also recorded in the financial account.

**The Balancing Act:** The current account should be balanced against the combined-capital and financial accounts. However, as mentioned above, this rarely happens. We should also note that, with fluctuating exchange rates, the change in the value of money can add to BOP discrepancies. When there is a deficit in the current account, which is a balance of trade deficit, the difference can be borrowed or funded by the capital account. If a country has a fixed asset abroad, this borrowed amount is marked as a capital account outflow. However, the sale of that fixed asset would be considered a current account inflow (earnings from investments). The current account deficit would thus be funded.

When a country has a current account deficit that is financed by the capital account, the country is actually foregoing capital assets for more goods and services. If a country is borrowing money to fund its current account deficit, this would appear as an inflow of foreign capital in the BOP.

**Liberalizing the Accounts:** The rise of global financial transactions and trade is in the late twentieth century spurred BOP and macroeconomic liberalization in many developing nations. With the advent of the emerging market economic boom—in which capital flows into these markets tripled from USD 50 million to USD 150 million from the late 1980's until the Asian crisis—developing countries were urged to lift restrictions on capital and financial-account transactions in order to take advantage of these capital inflows. Many of these countries had restrictive macroeconomic policies, by which regulations prevented foreign ownership of financial and non-financial assets. The regulations also limited the transfer of funds abroad. But with capital and financial account liberalization, capital markets began to grow, not only allowing a more transparent and sophisticated market for investors, but also giving rise to foreign direct investment. For example, investments in the form of a new power station would bring a country greater exposure to new technologies and efficiency, eventually increasing the nation's overall gross domestic product (GDP) by allowing for greater volumes of production. Liberalization can also facilitate less risk by allowing greater diversification in various markets.

**India’s BOP (2008 – 09)**

**Widening Trade Deficit:** India’s trade deficit on a balance of payments (BOP) basis has widened significantly by $ 26 billion to $ 69.2 billion in the first six months (April-September) of fiscal year* 2008-09 from $ 43.2 billion in the comparable period in previous fiscal. The
widening trade deficit is attributed to significant growth in imports. During the second quarter (July-September) alone the trade deficit grew by over $17 billion to $38.6 billion in second quarter (July-September) of fiscal 2008-09 against compared with $21.2 billion in the comparable period of previous fiscal. This is revealed in the report of the country’s central banking authority Reserve Bank of India (RBI) on “India's Balance of Payments Developments during the Second Quarter (July-September 2008) of 2008-09 and Revisions in 2006-07, 2007-08”.

The key features of India’s BOP that emerged in the first half of fiscal 2008-09 were:

1. Widening trade deficit ($69.2 billion) led by high imports;
2. Significant increase in invisible surplus ($46.8 billion) led by remittances from overseas Indians and software services exports;
3. Higher current account deficit ($22.3 billion) due to high trade deficit;
4. Volatile and relatively lower net capital inflows ($19.9 billion) than April-September 2007-08 ($50.9 billion); and
5. Decline in reserves (excluding valuation) of $2.5 billion (as against an accretion to reserves of $40.4 billion in April-September 2007-08).

The increase in trade deficit is attributed to higher growth in imports than exports. Compared with 24.6 percent export growth, imports were up by 45 percent during this period. On a BOP basis, merchandise exports were up by 17.6 percent compared with previous fiscal’s 2nd quarter and imports grew by over two times over 22.2 percent recorded in Q2 in 2007-08.

According to the data released by the Directorate General of Commercial Intelligence and Statistics (DGCI&S), both oil imports and non-oil imports during Q2 of 2008-09 were significantly higher by 45.1 percent (11.3 percent in Q2 of 2007-08) and 37.6 percent (22.4 percent in Q2 of 2007-08), respectively. Oil imports in Q2 of 2008-09 accounted for about 33.2 percent of total imports (32.0 percent in Q2 of 2007-08). The major drivers of non-oil imports were capital goods, chemicals and fertilizers.

Consequent upon the relatively higher growth in imports than exports, trade deficit on a BOP basis was higher at $38.6 billion in Q2 of 2008-09 ($21.2 billion in Q2 of 2007-08).

<p>| Major Items of India's balance of Payments (April-March, 2008-09) (In $ million) |
|---------------------------------|-----------------|-----------------|
|                                 | April-March (2008-09) (P) | April-March (2007-08) (PR) |
| Exports                        | 175,184          | 166,163          |
| Imports                        | 294,587          | 257,789          |
| Trade Balance                  | -119,403         | -91,626          |
| Invisibles, net                | 89,586           | 74,592           |
| Current Account Balance        | -29,817          | -17,034          |</p>
<table>
<thead>
<tr>
<th>Capital Account*</th>
<th>9,737</th>
<th>109,198</th>
</tr>
</thead>
<tbody>
<tr>
<td>Change in Reserves# (+ indicates increase; - indicates decrease)</td>
<td>20,080</td>
<td>-92,164</td>
</tr>
</tbody>
</table>

Including errors & omissions; # On BOP basis excluding valuation; P: Preliminary, PR: Partially revised. R: revised

SOURCE: Reserve Bank of India Report

5.4 FOREIGN INVESTMENTS

Foreign Investments can be classified into two.

1. Foreign Institutional Investments;
2. Foreign Direct Investments.

Foreign Institutional Investment: It refers to institutional role in investments. It can be differentiated into banking, non-banking financial & non-banking donor agencies.

Foreign Direct Investment (FDT): FDI has the potential to generate employment, raise productivity, transfer skills and technology, enhance exports and contribute to the long-term economic development of the world’s developing countries. More than ever, countries at all levels of development seek to leverage FDI for development.

To increase understanding of issues related to FDI and enhance its benefits for developing countries, particularly the least developed countries (LDCs), UNCTAD analyses FDI trends and their impact on development; compiles data on FDI; provides advisory services and training on international investment issues; helps developing countries improve policies and institutions that deal with FDI; and helps these countries participate in international negotiations on investment.

- Foreign affiliates of some 64,000 transnational corporations (TNCs) generate 53 million jobs.
- FDI is the largest source of external finance for developing countries.
- Developing countries’ inward stock of FDI amounted to about one third of their GDP, compared to just 10 per cent in 1980.
- One-third of global trade is intra-firm trade.

FDI Portfolio Investment: Direct investment consists of three components:

1. Investment into share capital of the
   - New firm – Greenfield;
   - Already existing firms – additional investments.
2. Reinvested income – foreign investor reinvests his share of profit
3. Long and short term loans from foreign investor.
In practical terms UNCTAD has agreed that foreign direct investor is in the case if more than 10\% of share capital of the firms belongs to one investor. Otherwise, if the share is less than 10\% it is treated as portfolio investment

**Significance of Foreign Direct Investment Policies:** FDI has become a key battleground for emerging markets and some developed countries. Government-level policies are needed to enable FDI inflows and maximize their returns for both investors and recipient countries. Foreign direct investment (FDI) policies play a major role in the economic growth of developing countries around the world. Attracting FDI inflows with conductive policies has therefore become a key battleground in the emerging markets.

Developed countries also seek to bring in more FDI and use various policies and incentives to attract overseas investors, particularly for capital-intensive industries and advanced technology. The primary aim of these policies is to create a friendly business environment where foreign investors feel comfortable with the legal and financial framework of the country, and have the potential to reap profits from economically viable businesses. The prospect of new growth opportunities and outsized profits encourages large capital inflows across a range of industry and opportunity types.

Investors tend to look for predictable environments where they understand how decision-making processes work. Governments therefore are incentivized to build up a track record of rational decision making. The business environment often requires work to remove onerous regulations, reduce corruption and encourage transparency. Governments often also seek to improve their domestic infrastructure to meet the operational needs of investors.

Providing fiscal incentives for attracting FDI is a subject of controversy – analysts have argued both in favor and against the idea. A general consensus is developing in favor of certain incentives which have been proven historically to grow profits and therefore foreign investments.

When policies are effective, significant FDI investments are injected into countries that help the domestic economy to grow. Different countries and regions offer various kinds of fiscal incentives, with a related variance in the level of FDI investments attracted.

Governments are increasingly setting up promotional agencies to foster foreign direct investment. These agencies promote FDI-friendly policies, identify prospective sectors and investors, and structure specific deals and incentives for major foreign investors such as multi-national corporations (MNCs).

Global trade associations also play a major role in some of these investment activities. These associations are tasked with creating a positive environment for foreign direct investors and ensuring that both investors and recipient countries enjoy a favorable environment.

The formation of human capital is vital for the continued growth of FDI inflows. To enable the most beneficial, technology and IP-driven FDI, highly skilled personnel are necessary. Governments must therefore enact policies to provide training and skills upgrading to develop their workforce and meet the employment needs of foreign investors.
FDI Inflows in India: The Inflow of FDI into the country over various years is as follows:

<table>
<thead>
<tr>
<th>Year (April-March)</th>
<th>Amount of FDI inflows (In US$ million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1992-1993</td>
<td>393</td>
</tr>
<tr>
<td>1993-1994</td>
<td>654</td>
</tr>
<tr>
<td>1994-1995</td>
<td>1,374</td>
</tr>
<tr>
<td>1995-1996</td>
<td>2,141</td>
</tr>
<tr>
<td>1996-1997</td>
<td>2,770</td>
</tr>
<tr>
<td>1997-1998</td>
<td>3,682</td>
</tr>
<tr>
<td>1998-1999</td>
<td>3,083</td>
</tr>
<tr>
<td>1999-2000</td>
<td>2,439</td>
</tr>
<tr>
<td>2000-2001</td>
<td>2,908</td>
</tr>
<tr>
<td>2001-2002</td>
<td>4,222</td>
</tr>
<tr>
<td>2002-2003</td>
<td>3,134</td>
</tr>
<tr>
<td>2003-2004</td>
<td>2,634</td>
</tr>
<tr>
<td>2004-2005</td>
<td>3,755*</td>
</tr>
<tr>
<td>2005-2006 (Up to March 2006)</td>
<td>5,549</td>
</tr>
</tbody>
</table>

World Investment Report 2009: Geneva, 17 September 2009 - The worst global economic and financial crisis in a generation has slowed the international production of goods and services by the world’s estimated 82,000 transnational corporations (TNCs) and their 810,000 foreign affiliates, the latest World Investment Report reveals.

Strong effects were felt by TNCs in 2008 and early 2009, the annual study says. Among transnational firms there were declining profits, increasing divestments and layoffs, and a number of major restructurings and bankruptcies. Nevertheless, TNCs’ foreign affiliates continue to mark their importance in the global economy, accounting for not less than 10% of world GDP and employing about 78 million people -- more than double the total labour force of a major industrialized nation such as Germany.

The report provides a special focus on the impact of the crisis on the 100 largest non-financial TNCs worldwide. Preliminary estimates reveal a marked slowdown in 2008 in the international sales and assets of these companies. UNCTAD’s World Investment Prospects Survey (WIPS) 2009-2011 provides some insight into the role of the ongoing crisis on investment flows, revealing that 85% of business executives of the largest TNCs believe that the global economic downturn has prompted cutbacks in their international investment plans.

As in previous years, UNCTAD’s list of the world’s largest 100 non-financial TNCs is dominated by manufacturing and petroleum companies. Both of these groups have seen their fortunes change during the crisis as the demand for both manufactured goods and fuels has dropped markedly, erasing or reducing the profit margins at many of the largest companies.
Overall, the profits of the largest 100 TNCs in the world fell by more than 25% in 2008. Large TNCs from developing economies likewise have been impacted, but still managed to fill a record seven positions on UNCTAD’s list of the world’s largest 100 non-financial TNCs. TNCs from developed countries, however, still account for the largest share of the top 100 non-financial TNCs, with EU-based firms at the top of the list (57 entries), followed by the USA (20 entries) and Japan (10 entries).

Looking forward, while large TNCs appear pessimistic about global FDI prospects in 2009, they are more optimistic about 2010 and 2011. Results of the WIPS survey show that half of TNCs see their FDI expenditures exceeding 2008 levels in 2011. Continuing ambitions to internationalize, as shown by the survey, and a continuing urge to explore expansion possibilities in faster-growing developing and transition economies are among the drivers expected to expand FDI by TNCs worldwide in the coming years.

5.5 REVIEW QUESTIONS

1. Prepare a list of investors in any country of the Asian – Pacific region since the last three years pointing out their motivating factors and difficulties faced.
2. List down the major areas of foreign investments in the top 5 states of India.
INDIA IN THE GLOBAL SETTING

Structure

1.1 Foreign Trade in India
1.2 EXIM Policy
1.3 Composition of Trade
1.4 Government Influence on Foreign Trade: Export Promotion Measures
1.5 Review Questions

6.1 FOREIGN TRADE IN INDIA

Why invest in India?
There are several good reasons for investing in India:

• One of the largest economies in the world.
• Strategic location - access to the vast domestic and South Asian market.
• A large and rapidly growing consumer market up to 300 million people constitute the market for branded consumer goods - estimated to be growing at 8% per annum. Demand for several consumer products is growing at over 12% per annum.
• Foreign investment is welcome; approval is required but is automatic in sixty categories of industries.
• Skilled manpower and professional managers are available at competitive cost.
• One of the largest manufacturing sectors in the world, spanning almost all areas of manufacturing activities.
• One of the largest pools of scientists, engineers, technicians and managers in the world.
• Rich base of mineral and agricultural resources.
• Long history of market economy infrastructure
• Sophisticated financial sector.
• Vibrant capital market with over 9,000 listed companies and market capitalization of US$ 154 billion (March, 1996)
• Well developed R&D infrastructure and technical and marketing services.
• Policy environment that provides freedom of entry, investment, location, choice of technology, production, import and export.
• Well balanced package of fiscal incentives.
• A sophisticated legal and accounting system.
• English is widely spoken and understood.
• Rupee is convertible on Current Account at market determined rate.
• Free and full repatriation of capital, technical fee, royalty and dividends.
• Foreign brand names are freely used.
• No income tax on profits derived from export of goods.
• Complete exemption from Customs Duty on industrial inputs and Corporate Tax Holiday for five years for 100 per cent Export Oriented units and units in Export Processing Zones.
• Corporate Tax applicable to the foreign companies of a country with which agreement for avoidance of Double Taxation exists, can be one which is lower between the rates prevailing in any one of the two countries and the treaty rate.
• A long history of stable parliamentary democracy.

How to do Foreign Direct Investment in India?
As part of the economic reforms programme, policy and procedures governing foreign investment and technology transfer have been significantly simplified and streamlined.

Automatic Route: Today, foreign investment is freely allowed in all sectors including the services sector except in cases where there are sectoral ceilings.

All items/activities except the following are under the automatic route for foreign direct investment (FDI):

• All proposals that require an Industrial License. An Industrial License is mandatory if:
  1. The item involved requires an industrial license under the Industries (Development & Regulation) Act, 1951 or
  2. The foreign equity portion is more than 24% of the equity capital of units manufacturing items reserved for small scale industries; or
  3. The item concerned requires an Industrial License in terms of the location policy
• All proposals in which the foreign collaborator has a previous venture or tie-up in India. (Excluding IT Sector).
• All proposals relating to the acquisition of shares in an existing Indian company in favour of a foreign investor.
• All proposals outside the notified sectoral policy/caps, or under sectors in which FDI is not permitted

Investment in public sector units as also in Export Oriented Units (EOUs), and units in Export Processing Zones (EPZs), Special Economic Zones (SEZs), Software Technology Parks (STPs) and Electronics Hardware Technology Parks (EHTPs) also qualify for the Automatic Route.

FDI in the Sector up to 26%, is allowed under the automatic route subject to license from the insurance regulatory & development Authority for undertaking insurance activities.

In addition to Automatic Approval for new companies, such approval can also be granted for existing companies proposing to induct foreign equity, for existing companies with an expansion programme, the additional requirements are that:

• The increase in equity level must result from the expansion of the equity base of the existing company.
• The money to be remitted should be in foreign currency, and
• The proposed expansion programme should be predominantly in the sector(s) under automatic route.

For existing companies without an expansion programme, the additional requirements for eligibility for automatic approval are:

• They should be engaged predominantly in industries under the automatic route.
• The increase in equity level must be from expansion of the equity base, and
• The foreign equity must come in foreign currency.

Otherwise, the proposal would need Government approval through the Foreign Investment Promotion Board (FIPB).

Investors coming through the Automatic Route are required to file relevant documents with the Reserve Bank of India within 30 days after the issue of shares to foreign investors. Proposals which do not fulfill the conditions for automatic approval will require the approval of the Government. The investors have to make an application to the Foreign Investment Promotion Board, Ministry of Commerce & Industry, Udyog Bhawan, New Delhi, for obtaining such approval.

Guidelines for Indian direct investment in joint ventures and wholly owned subsidiaries abroad:

For purposes of these guidelines:

a. "Direct investment" shall mean investment by an Indian party in the equity share capital of a foreign concern with a view to acquiring a long-term interest in that concern. Besides the equity stake, such long term interest may be reflected through representation on the Board of Directors of the foreign concern and in the supply of technical know-how, capital goods, components, raw materials, etc. and managerial personnel to the foreign concern.

b. "Host Country" shall mean the country in which the foreign concern receiving the direct investment is formed, registered or incorporated.

c. "Indian party" shall mean a private or public limited company incorporated in accordance with the laws of India. When more than one Indian body corporate makes a direct investment in a foreign concern, all the bodies corporate shall together constitute the "Indian party".

d. "Joint Venture" shall mean a foreign concern formed, registered or incorporated in accordance with the laws and regulations of the host country in which the Indian party makes a direct investment, whether such investment amounts to a majority or minority shareholding.

e. "Wholly Owned Subsidiary" shall mean a foreign concern formed, registered or incorporated in accordance with the laws and regulations of the host country whose entire equity share capital is owned by the Indian party.

Criteria for Investment in India: In considering an application under category "B", the Committee shall have due regard to the following:
a) The financial position, standing and business track record of the Indian and foreign parties;
b) Experience and track record of the Indian party in exports and its external orientation;
c) Quantum of the proposed investment and the size of the overseas venture in the context of the resources, net worth and scale of operations of the Indian party;
d) Repatriation by way of dividends, fees, royalties, commissions or other entitlements from the foreign concerns for supply of technical know-how, consultancy, managerial or other services within five years with effect from the date of first remittance of equity to the foreign concern or the date of first shipment of equity exports or the due date for receipt of entitlements which are to be capitalized, whichever is earlier.
e) Benefits to the country in terms of foreign exchange earnings, two way trade generation, technology transfer, access to raw materials, intermediates or final products not available in India;
f) Prima facie viability of the proposed investment.

Provided that the proposals for overseas direct investment in the financial sector under Category "B" shall also conform to the requirements laid down for this sector at para 5.1

Indian financial and banking institutions considering supporting the venture will examine independently the commercial viability of the proposal.

6.2 EXIM POLICY

What are the major features of the EXIM Policy?

Service Exports: Duty free import facility for service sector having a minimum foreign exchange earning of Rs.10 lakh. The duty free entitlement shall be 10% of the average foreign exchange earned in the preceding three licensing years. However, for hotels, the same shall be 5% of the average foreign exchange earned in the preceding three licensing years. This entitlement can be used for import of office equipments, professional equipments, spares and consumables. However, imports of agriculture and dairy products shall not be allowed for imports against the entitlement. The entitlement and the goods imported against such entitlement shall be non-transferable.

Agro Exports:

1. Corporate sector with proven credential will be encouraged to sponsor Agro Export Zone for boosting agro exports. The corporate to provide services such as provision of pre/post harvest treatment and operations, plant protection, processing, packaging, storage and related R&D.
2. DEPB rate for selected agro products to factor in the cost of pre-production inputs such as fertilizer, pesticides and seeds.
Status Holders:

1. Duty-free import entitlement for status holders having incremental growth of more than 25% in FOB value of exports (in free foreign exchange). This facility shall however be available to status holders having a minimum export turnover of Rs.25 Crore (in free foreign exchange). The duty free entitlement shall be 10% of the incremental growth in exports and can be used for import of capital goods, office equipment and inputs for their own factory or the factory of the associate/supporting manufacturer/job worker. The entitlement/goods shall not be transferable. This facility shall be available on the exports made from 1.4.2003.

2. Annual Advance License facility for status holders to be introduced to enable them to plan for their imports of raw material and components on an annual basis and take advantage of bulk purchases.

3. The Input-Output norms for status holders to be fixed on priority basis within a period of 60 days.

4. Status holders in STPI shall be permitted free movement of professional equipments like laptop/computer.

Hardware/Software:

1. To give a boost to electronic hardware industry, supplies of all 217 ITA-1 items from EHTP units to DTA shall qualify for fulfillment of export obligation.

2. To promote growth of exports in embedded software, hardware shall be admissible for duty free import for testing and development purposes. Hardware up to a value of US$ 10,000 shall be allowed to be disposed off subject to STPI certification.

3. 100% depreciation to be available over a period of 3 years to computer and computer peripherals for units in EOU/EHTP/STP/SEZ.

Gem & Jewellery Sector:


2. Nominated agencies to accept payment in dollars for cost of import of precious metals from EEFC account of exporter.

3. Gem & Jewellery units in SEZ and EOUs can receive precious metal i.e. Gold/silver/platinum prior to exports or post exports equivalent to value of jewellery exported. This means that they can bring export proceeds in kind against the present provision of bringing in cash only.

Export Clusters:

1. Upgradation of infrastructure in existing clusters/industrial locations under the Department of Industrial Policy & Promotion (DIPP) scheme to increase overall competitiveness of the export clusters.

2. Supplemental efforts to be made under the ASIDE scheme and similar schemes of other Ministries to bridge technology and productivity gaps in identified clusters.
3. 10 such clusters with high growth potential to be reinvigorated based on a participatory approach.

**Rehabilitation of Sick Units:** For revival of sick units, extension of export obligation period to be allowed to such units based on BIFR rehabilitation schemes. This facility shall also be available to units outside the purview of BIFR but operating under the State rehabilitation programme.

**Removal of Quantitative Restrictions:**

1. Import of 69 items covering animal products, vegetables and spices, antibiotics and films removed from restricted list.
2. Export of 5 items namely paddy except basmati, cotton linters, rare earth, silk cocoons, family planning devices except condoms removed from restricted list.

**Special Economic Zones Scheme:**

1. Sales from Domestic Tariff Area (DTA) to SEZs to be treated as export. This would now entitle domestic suppliers to Drawback/ DEPB benefits, CST exemption and Service Tax exemption.
2. Agriculture/Horticulture processing SEZ units will now be allowed to provide inputs and equipments to contract farmers in DTA to promote production of goods as per the requirement of importing countries. This is expected to integrate the production and processing and help in promoting SEZs specializing in agro exports.
3. Foreign bound passengers will now be allowed to take goods from SEZs to promote trade, tourism and exports.
4. Domestic sales by SEZ units will now be exempt from SAD.
5. Restriction of one-year period for remittance of export proceeds removed for SEZ units.
6. Netting of export permitted for SEZ unit provided it is between same exporter and importer over a period of 12 months.
7. SEZ units permitted to take job work abroad and exports goods from there only.
8. SEZ units can capitalize import payables.
9. Wastage for subcontracting/exchange by gem and jewellery units in transactions between SEZ and DTA will now be allowed.
10. Export/import of all products through post parcel/courier by SEZ units will now be allowed.
11. The value of capital goods imported by SEZ units will now be amortized uniformly over 10 years.
12. SEZ units will now be allowed to sell all products including gems and jewellery through exhibitions and duty free shops or shops set up abroad.
13. Goods required for operation and maintenance of SEZ units will now be allowed duty free.

**EOU Scheme:**

1. Agriculture/Horticulture processing EOUs will now be allowed to provide inputs and equipments to contract farmers in DTA to promote production of goods as per the
requirement of importing countries. This is expected to integrate the production and processing and help in promoting agro exports.

2. EOU s are now required to be only net positive foreign exchange earner and there will now be no export performance requirement.

3. Foreign bound passengers will now be allowed to take goods from EOUs to promote trade, tourism and exports.

4. The value of capital goods imported by EOUs will now be amortized uniformly over 10 years.

5. Period of utilization of raw materials prescribed for EOUs increased from 1 year to 3 years.

6. Gems and jewellery EOUs are now being permitted sub-contracting in DTA.

7. Wastage for subcontracting/exchange by gems and jewellery units in transactions between EOUs and DTA will now be allowed as per norms.

8. Export/import of all products through post parcel/courier by EOUs will now be allowed.

9. EOUs will now be allowed to sell all products including gems and jewellery through exhibitions and duty free shops or shops set up abroad.

10. Gems and jewellery EOUs will now be entitled to advance domestic sales.

**EPCG Scheme:**

1. The scheme shall now allow import of capital goods for pre-production and post-production facilities also.

2. The Export Obligation under the scheme shall now be linked to the duty saved and shall be 8 times the duty saved.

3. To facilitate upgradation of existing plant and machinery, import of spares shall also be allowed under the scheme.

4. To promote higher value addition in exports, the existing condition of imposing an additional Export Obligation of 50% for products in the higher product chain to be done away with.

5. Greater flexibility for fulfillment of export obligation under the scheme by allowing export of any other product manufactured by the exporter. This shall take care of the dynamics of international market.

6. Capital goods up to 10 years old shall also be allowed under the scheme.

7. To facilitate diversification into the software sector, existing manufacturer exporters will be allowed to fulfill export obligation arising out of import of capital goods under the scheme for setting up of software units through export of manufactured goods of the same company.

8. Royalty payments received from abroad and testing charges received in free foreign exchange to be counted for discharge of export obligation under EPCG scheme.

**DEPB Scheme:**

1. Facility for provisional DEPB rate introduced to encourage diversification and promote export of new products.

2. DEPB rates rationalized in line with general reduction in Customs duty.
Advance License:
2. Anti-dumping and safeguard duty exemption to advance license for deemed exports for supplies to EOU/SEZ/EHTP/STP.

DFRC Scheme:
1. Duty Free Replenishment Certificate scheme extended to deemed exports to provide a boost to domestic manufacturer.
2. Value addition under DFRC scheme reduced from 33% to 25%.

Reduction of Transaction Cost:
1. High priority being accorded to the EDI implementation programme covering all major community partners in order to minimize transaction cost, time and discretion. We are now gearing ourselves to provide on line approvals to exporters where exports have been affected from 23 EDI ports.
2. Online issuance of Importer-Exporter Code (IEC) number by linking the DGFT EDI network with the Income Tax PAN database is under progress.
3. Applications filed electronically (through website www.nic.in/eximpol) shall have a 50% lower processing fee as compared to manual applications.

Miscellaneous
1. Actual user condition for import of second hand capital goods up to 10 years old dispensed with.
2. Reduction in penal interest rate from 24% to 15% for all old cases of default under EXIM Policy.
3. Restriction on export of warranty spares removed.
4. IEC holder to furnish online return of imports/exports made on yearly basis.
5. Export of free of cost goods for export promotion @ 2% of average annual exports in preceding three years subject to ceiling of Rs.5 lakh permitted

What is the pattern of India’s foreign trade?

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**Indian Import Statistics:** The Indian foreign trade was primarily restricted until the onset of economic reforms and liberalization of foreign trade policy in 1991. Since liberalization India's international trade has been showing an upward trend with opening of its trade doors to the rest of the world. Indian export sector during April 2008 marked the growth of 18.11% with total exports increased to US $ 162.9 billion while the Indian Import shoot up with an increase of 34.30% during the same period.

**Top Ten Commodities:** These are the major categories of goods that alone contribute to about 78.8% of the total imports made by India. The top ten commodities are:

- Petroleum Crude and Products
- Gold & Silver
- Electronic Goods
- Machinery other than Electrical
- Organic & Inorganic Chemicals
- Precious & Semi-Precious Stones
- Iron & Steel
- Metalliferous Ores & Products
- Coal
- Transport Equipment

**Import of Principal Commodities:** India's import of Principal Commodities is basically divided into the following five major categories:

- **Bulk Imports:** The main items under the Bulk Imports category with percent of share during April-September 2007 are: Fertilizers (36.22%), Iron & Steel (36%), Edible Oil (18.31%), Non Ferrous Metals (11.51%), Petroleum Products (4.09%) and Metalliferous Products (1.55%).
- **Precious & Semi-Precious Stones:** The Pearls, Precious and Semi-Precious Stones commodity accounts for 4.22% share in India's total import and during the considered period this category goods showed an increase of 16.24%.
- **Machinery:** Under this category import of Transportation Equipment, Machine Tools, Machinery and products in Electrical and other than Electrical group marked an increase of 34.57%, 23.49%, 14.52% and 13.25% respectively in the period of April-September 2007.
- **Project Goods:** This category has 0.52% share in the overall imports of India and during the said period it marked the decrease of 38.99% with the value of Rs.2392.57 Crore.
- **Others:** In this item head following commodities shown an increase- Gold & Silver (52.25%), Electronic Goods (12.32%), Professional Instruments (10.77%) and Organic & Inorganic Chemicals (8.06%).

**Country Wise Import Statistics:** Indian Economy has shown a remarkable upward trend over the past decade with an average annual GDP of around 6%. The well structured economic reforms after 1991 along with the liberalization of trade policies and tax reforms put the Economy of India on the path to become the world's rapidly growing economies. As per World Trade Organization (WTO) as of 2006 India share in the world trade stands at 1.2% and since
liberalization the value of India's international trade has been moderate. The economic reforms led to open doors of India's International trade with the various countries of the world and currently China, US, UAE, UK, Japan and the European Union are the major trade partners of India.

**Import from Top Ten Countries:** Among the list of India's Top Ten Importing trade partners comes:

- China (11.2%)
- Saudi Arab (7.2%)
- USA (5.8%)
- Switzerland (5.6%)
- United Arab Emirates (5.5%)
- Iran (4.2%)
- Australia (4.0%)
- Federal Republic of Germany (3.8%)
- Nigeria (3.3%)
- Singapore (3.1%)

**India's Region Wise Import Direction:** The import in India is mainly directed from the five regions namely:

- Asia & Asean (61.13%)
- Europe (21.20%)
- America (9.05%)
- Africa (6.68%)

**Changing Trends in Trade with Importing Countries:** During the period of April to September 2007 India's major trading partners have marked upward trend in their share as:

- Europe (23.65%)
- Asia & Asean (11.80%)
- America (11.56%)
- Africa (8.22%)
- CIS & Baltics (1.11%)

6.4 **GOVERNMENT INFLUENCE ON FOREIGN TRADE: EXPORT PROMOTION MEASURES**

What are the main features for Export Promotion in Government’s EXIM Policy?
The new Export-Import (EXIM) Policy unveiled by the government on March 31, 2002 set the pace for export promotion measures not only during 2002-03 but for the entire period of the next five years coinciding with the Tenth Five Year Plan. The export promotion strategy zeroed in on export market diversification as one of its policy planks with special focus on hitherto untapped regions like sub-Saharan Africa and the Commonwealth of Independent States (CIS). The Policy
contained several far-reaching components to take India’s exports on a steady growth trajectory. These included, among others, removal of all import curbs or quantitative restrictions (QRs), save a few sensitive items reserved for exports through state trading enterprises, a farm-to-port approach for exports of agricultural products, special thrust on cottage sectors and handicrafts and beefed up Assistance to States for Infrastructural Development for Exports (ASIDE). Apart from these specific booster measures, the government also rationalized and simplified procedures in respect of various export promotion schemes with a view to cutting down unwanted hassles and bringing down the transaction cost to industry and trade tangibly. A brief description of the policy initiatives to boost exports is given below.

New Initiatives for the Special Economic Zones (SEZs): Offshore Banking Units (OBUs) have been permitted under the SEZ Scheme. This should help some of these zones to emerge as financial nerve centres of Asia. Units in SEZ would be permitted to undertake hedging of commodity price risks, provided such transactions are undertaken by the units on stand-alone basis. This will impart security to the returns of the unit. It has also been decided to permit External Commercial Borrowings (ECBs) for tenure of less than three years in SEZs. This should provide opportunities for accessing working capital loan for these units at internationally competitive rates.

Export Promotion Council for EOUs: The Export Promotion Council for Export Oriented Units (EOUs) was set up and operational in January 2003. This has been done in response of the long felt need of the EOUs for separate Export Promotion Council. The Council has started functioning with immediate effect. The EPC for EOUs would specifically cater to the needs of EOU/SEZ Sector which has over 2300 operational EOUs/SEZ units spread all over the country providing direct employment to over 7 lakh people and having 13% share in the national exports. The Council has set an ambitious road map to achieve and contribute 25% of the national export through manufacturing exports by the year 2007. In the next couple of years this sector is looking for achieving 10 billion US dollars exports.

Initiatives for the Agriculture Sector: Export restrictions like registration and packaging requirements have been removed on Butter, Wheat and Wheat products, Coarse Grains, Groundnut Oil and Cashew to Russia. Quantitative and packaging restrictions on wheat and its products, Butter, Pulses, grain and flour of Barley, Maize, Bajra, Ragi and Jowar were already removed on 5th March 2002. Other recent policy initiatives which may have a positive impact on exports are given below:

- Restrictions on export of all cultivated (other than wild) varieties of seed, except Jute and Onion have been lifted.
- To promote export of agro and agro based products, 20 Agro Export Zones have been notified.
- In order to promote diversification of agriculture, transport subsidy is to be made available for export of fruits, vegetables, floriculture, poultry and dairy products.
- 3% special DEPB rate has been proposed for primary & processed foods exported in retail packaging of 1 kg or less.
New Policy Initiatives for the Cottage Sector and the Handicrafts: Given the importance of the cottage sector and handicrafts in India’s exports, the following policy initiatives were announced in the EXIM Policy, some of which have already been given effect to an amount of Rs. 5 Crore under Market Access Initiative (MAI) has been earmarked for promoting cottage sector exports coming under the KVIC.

- The units in the handicrafts sector can also access funds from MAI scheme for development of website for virtual exhibition of their product.
- Under the Export Promotion Capital Goods (EPCG) scheme, these units will not be required to maintain average level of exports, while calculating the Export Obligation.
- These units shall be entitled to the benefit of Export House status on achieving lower average export performance of Rs.5 Crore as against Rs. 15 Crore for others; and
- The units in handicraft sector shall be entitled to duty free imports of an enlarged list of items as embellishments up to 3% of FOB value of their exports.

Export Promotion Measures for the Small Scale Industry: Yet another milestone in 2002 in the quest for pushing export products of heritage value was the enhancement of export capabilities of the small scale sector, which accounts for about 50 per cent of the country’s exports. These capabilities were strengthened through a programme for “Special Focus on Cottage Sector and Handicrafts” including promotion of cotton sector exports under Khadi & Village Industries commission, access to funds from Market Access Initiative (MAI) for units in the handicrafts sector and benefits of export house status at a lower average export performance. Analogous benefits would be extended to industrial cluster towns with export potential like Tirupur (hosiery), Panipat (woolen blankets) and Ludhiana (woolen knitwear). Some of the important initiatives for fostering “clusters”/“pockets of excellence” for exports are given below:-

- Common service providers in these areas shall be entitled for facility of EPCG scheme. These units will also not be required to maintain average level of exports, while calculating the export obligation.
- The recognized associations of units in identified clusters with export potential like Tirupur, Panipat, Ludhiana, etc., would be able to access the funds under the Market Access Initiative scheme for creating focused technological services and marketing abroad.
- Such areas will receive priority for assistance for identified critical infrastructure gaps from the scheme on Central Assistance to States.
- Entitlement for Export House status will be given at Rs. 5 Crore instead of Rs.15 Crore for others.

Commodity Specific Initiatives in the EXIM Policy: In addition to the above, certain additional policy measures have been taken / are proposed to be taken during the year to facilitate/promote export of specific commodities. These are given below:

1. **Leather:** Duty free imports of trimmings and embellishments up to 3% of the FOB value hitherto confined to leather garments, has been extended to all leather products.
2. **Textiles:**

- Sample fabrics permitted duty free within the 3% limit for trimmings and embellishments.
- 10% variation in GSM is allowed for fabrics under Advance License.
- Additional items such as zip fasteners, inlay cards, eyelets, rivets, eyes, toggles, Velcro tape, cord and cord stopper are included in input output norms.
- Duty Entitlement Passbook (DEPB) rates for all kinds of blended fabrics are permitted. Such blended fabrics are to have the lowest rate as applicable to different constituent fabrics.

3. **Gems & Jewellery:**

- Customs duty on import of rough diamonds is being reduced to 0%. Import of rough diamonds is already freely allowed.
- Licensing regime for rough diamond is being abolished. This should help the country emerge as a major international centre for diamonds.
- Value addition norms for export of plain jewellery have been reduced from 10% to 7%. Export of all mechanize un-studded jewellery is now allowed at a value addition of 3% only. Having already achieved leadership position in diamonds, efforts will be made for achieving quantum jump on jewellery exports as well.
- Personal carriage of jewellery is to be allowed through Hyderabad & Jaipur airport as well.

4. **Electronic Hardware:**

- Electronic Hardware Technology Park (EHTP) scheme is being modified to enable the sector to face the zero duty regimes under ITA (Information Technology Agreement)-1. The units shall be entitled to following facility:
- No other export obligation for units in EHTP.
- Supplies of ITA I items having zero duty in the domestic market to be eligible for counting of export obligation.

5. **Chemicals and Pharmaceuticals:**

- All pesticides formulations are to have 65% of DEPB rate of such pesticides.
- Free export of samples is permitted without any limit.
- Reimbursement of 50% of registration fees is allowed for registration of drugs.

6. **Project goods:**

- Free import is allowed on equipment and other goods used abroad for more than one year.
7. **Facilities for Status Holders:** According to the EXIM Policy announcements status holders have been made eligible for the following new/special facilities:

- License / Certificate/Permissions and Customs clearances for both imports and exports on self-declaration basis;
- Fixation of Input-Output norms on priority;
- Priority Finance for medium and long term capital requirement as per conditions notified by RBI;
- Exemption from compulsory negotiation of documents through banks. The remittance, however, would continue to be received through banking channels;
- 100% retention of foreign exchange in Exchange Earners’ Foreign Currency (EEFC) account;
- Enhancement in normal repatriation period from 180 days to 360 days.

8. **Neutralizing High Fuel Costs:**

- Exporters are often faced with increasing costs due to high cost of fuel. To deal with this problem, it has been decided to rebate fuel costs in Standard Input Output Norms (SIONs) for all export products. This is expected to enhance the cost competitiveness of exports.

**Other Measures in the EXIM Policy:**

- Import/Export of samples is to be liberalized for encouraging product up-gradation.
- Penal interest rate for bonafide defaults is to be brought down from 24% to 15%.
- No penalty is to be imposed for non-realization of export proceeds in respect of cases covered by ECGC insurance package.
- No seizure is to be made of stock in trade as this disrupts the manufacturing process affecting delivery schedule of exporters.
- Foreign Inward Remittance Certificate (FIRC) is to be accepted in lieu of Bank Realization Certificate for documents negotiated directly.
- Optional facility will be available to exporters to convert from one scheme to another scheme. In case the exporter is denied the benefit under one scheme, he shall be entitled to claim benefit under some other scheme.
- Newcomers are to be entitled for licenses without any verification against execution of Bank Guarantee.

**Diversification of Markets:**

- “Business Centre” is to be set up in Indian missions abroad for visiting Indian exporters/businessmen.
- ITPO portal is to host a permanent virtual exhibition of Indian export product.
- **North Eastern States, Sikkim and Jammu & Kashmir:** Transport subsidy is to be given for exports from units located in North East, Sikkim and Jammu & Kashmir so as to offset the disadvantage of being far from ports.
**Re-location of industries:** To encourage re-location of industries to India, plant and machineries would be permitted to be imported without a license, where the depreciated value of such relocating plants exceeds Rs. 50 Crore.

**Rationalization of Export Promotion Schemes:** Apart from the above measures, the Government has also rationalized several provisions of some existing export promotion schemes with a view to remove unwanted hassles and brings down the transaction cost of industry and trade. Major rationalization measures taken for the existing schemes are given below:

(a) **Advance License**

- Duty Exemption Entitlement Certificate (DEEC) book has been abolished. Redemption is now on the basis of Shipping Bills and Bank Realization Certificates.
- Advance License for Annual Requirement scheme has been withdrawn. The exporters can avail Advance License for any value.
- Mandatory spares are now allowed in the Advance License up to 10% of the CIF value.

(b) **Duty Free Replenishment Certificate (DFRC)**

- Technical characteristics are to be dispensed with for purpose of audit.

(c) **Duty Entitlement Passbook (DEPB)**

- Value cap exemption granted on 429 items is to continue.
- Market Value (PMV) verification would not be undertaken except on specific intelligence.
- Same DEPB rate for exports are to be whether as CBUs or in CKD/SKD form.
- Reduction in rates only after due notices.
- DEPB for transport vehicles to Nepal in free foreign exchange.
- DEPB rates for composite items to have lowest rate applicable for such constituent.

(d) **Export Promotion Capital Goods (EPCG)**

- EPCG licenses of Rs.100 Crore or more to have 12-year export obligation (EO) period with 5 year moratorium period.
- EO fulfillment period extended from 8 years to 12 years in respect of units in agro-export zones and in respect of companies under the revival plan of BIFR.
- Supplies under Deemed Exports to be eligible for export obligation fulfillment along with deemed export benefit.
- Re-fixation of EO in respect of past cases of imports of second hand capital goods under EPCG Scheme.

**Central Assistance to States for Developing Export Infrastructure (ASIDE) and other Allied Activities:** Adequate and reliable infrastructure is essential to facilitate unhindered production, cut down the cost of production and make exports internationally competitive. While the responsibility for promotion of exports and creating the necessary specialized infrastructure
has largely been undertaken by the Central Government so far, it is increasingly felt that the States have to play an equally important role in this endeavor. The role of the State Governments is critical from the point of view of boosting production of exportable surplus, providing the infrastructural facilities such as land, power, water, roads, connectivity, pollution control measures and a conducive regulatory environment for production of goods and services. It is, therefore, felt that coordinated efforts by the Central Government in cooperation with the State Governments are necessary for development of infrastructure for export promotion.

Department of Commerce had been implementing, through its agencies, schemes for promotion and facilitation of export commodities and creation of infrastructure attendant thereto. The Export Promotion Industrial Parks Scheme (EPIP), Export Promotion Zones scheme (EPZ), and the Critical Infrastructure Balancing Scheme (CIB) were implemented to help create infrastructure for exports in specific locations and to meet specific objectives. However, it was felt that the general needs of infrastructure improvement for exports were not met by such schemes. Therefore, with a view to optimizing the utilization of resources and to achieve the objectives of export growth through a coordinated effort of the Central Government and the States, a new scheme has been drawn up by merging the earlier schemes. The objective and main features of the new Scheme are given below:

**Objective:** The objective of the scheme is to involve the states in the export effort. States do not perceive direct gains from the growth in exports from the State. Moreover, the States do not often have adequate resources to participate in funding of infrastructure for exports. The new scheme, therefore, intends to establish a mechanism for seeking the involvement of the State Governments in such efforts through assistance linked to export performance.

**Salient Features of the Scheme:** The new scheme provides an outlay for development of export infrastructure which will be distributed to the States according to pre-defined criteria. The existing EPIP, EPZ and CIB schemes stand merged with the new scheme. The scheme for Export Development Fund (EDF) for the North East and Sikkim (implemented since 2000-2001) also stands merged with the new scheme. After this merger, the ongoing projects under the schemes shall be funded by the States from the resources provided under the new scheme. The specific purposes for which the funds allocated under the Scheme can be sanctioned and utilized are as follows:

- Creation of new Export Promotion Industrial Parks/Zones (including Special Economic Zones (SEZs)/Agro-Business Zones) and augmenting facilities in the existing ones.
- Setting up of electronic and other related infrastructure in export conclave.
- Equity participation in infrastructure projects including the setting up of SEZs.
- Meeting requirements of capital outlay of EPIPs /EPZs/SEZs.
- Development of complementary infrastructure such as roads connecting the production centres with the ports, setting up of Inland Container Depots and Container Freight Stations.
- Stabilizing power supply through additional transformers and islanding of export production centres, etc.,
- Development of minor ports and jetties of a particular specification to serve export purpose.
• Assistance for setting up common effluent treatment facilities.
• Projects of national and regional importance.
• Activities permitted as per EDF in relation to North East and Sikkim.

The outlay of the scheme will have two components. 80% of the funds (State component) shall be earmarked for allocation to the States on the basis of the approved criteria. The balance 20% (central component), and amounts equivalent to un-utilized portion of the funds allocated to the States in the past year(s), if any, shall be retained at the central level for meeting the requirements of inter-state projects, capital outlays of EPZs, activities relating to promotion of exports from the NER as per the existing guidelines of EDF and any other activity considered important by the Central Government from the regional or the national perspective.

The export performance and growth of exports from the State will be assessed on the basis of the information available from the office of the Director General of Commercial Intelligence & Statistics (DGCIS). The office of the DGCIS will compile the State-wise data of exports from the Shipping Bills submitted by the exporter. The Shipping Bill form provides a column in which the exporter will enter the name of the State/UT from where the export goods have originated.

There shall be a State Level Export Promotion Committee (SLEPC) headed by the Chief Secretary of the State and consisting of the Secretaries of concerned Departments at the State level, and a representative of the States cell of the Department of Commerce (DOC) and the Joint Director General of Foreign Trade posted in that State/region and the Development Commissioners of the SEZ/EPZ in the State. SLEPC will scrutinize and approve specific projects and oversee the implementation of the Scheme.

An allocation of Rs. 1725 Crore has been made for this scheme. For the entire period of the 10th Five Year Plan of which Rs 330 Crore is budgeted in the financial year 2002-2003. The funds are disbursed directly to a Nodal Agency nominated by the State Government where it is kept in a separate head in the accounts of the Nodal Agency.

**Export Enhancement and Export Studies – Market Access Initiative:** The prevailing macro-economic situation with emphasis on exports requires obtaining greater market intelligence, promoting and facilitating direct access to major retail markets in focus countries for focus products, promotion of branded products and a greater involvement of State Governments in export promotion. A Scheme on “Export Enhancement and Export Studies” has been already been in operation. The scope of this scheme has now been expanded to include Export Enhancement and Export Studies – Market Access Initiative with the following additional objectives:

a) Identifying the priorities of research relevant to the Department of Commerce and sponsoring research studies consistent with the priorities.
b) Arranging for wide dissemination and discussions on the results of such studies.
c) Supporting EPCs /Trade Promotion Organizations for market survey/studies for selected products in the chosen countries to generate data for promotion of exports from India.
d) Assisting exporters and EPCs for participation in international departmental store promotion programmes, intensive publicity campaigns and participation in international
trade fairs, seminars, buyer-seller meets for a few selected focus products in focus countries.

e) Assisting the exporters and EPCs in promotion of India, Indian products and Indian brands in the international market.

f) Assisting projects for research and product development.

g) Assisting any other activity, appropriate for promoting chosen product(s) on Country-Product focus approach basis.

h) Supplementing State Government efforts in carrying out export potential survey of the State for identified product groups.

Export Promotion Councils and Trade Promotion Organizations would be required to project their requirements for undertaking marketing promotion efforts abroad on country-product focus approach basis in a single project covering the objectives of the expanded scheme, which they propose to undertake. Such a project should be for identified product(s) whose export has potential for promotion to a chosen country. For each product, exporters participating in the project should be identified by the EPC. Selected exporters shall identify the need for intervention, its components and cost sharing by them within the parameters of the Scheme. The scope of the scheme would cover the following activities:

a) **Marketing Studies**: Marketing studies on country product focus approach basis could be undertaken under this scheme to have an in-depth analysis of the existing and potential markets for evolving market related strategy, meeting the requirements of each market with regard to the local taste, requirements and quality.

b) **Showrooms**: Showrooms could be set up for selected consumer items at identified centers on the basis of marketing studies in leased or rental accommodation. The participants will bear the rental/leased charges and full maintenance. The 75%, 50%, 25% of the leased/rental charges will be borne by the scheme in the 1st, 2nd and 3rd year respectively.

c) **Warehousing facility**: Warehousing facilities could also be established on the same pattern as of showrooms to ensure quicker deliveries.

d) **Participation in International Departmental Stores**: Tie up with local distributors and major stores could be used under this scheme as a tool for promoting particular product(s). A list of International Departmental Stores/Chains will be prepared and standardized. Supplies to these stores under brand names and ‘Made in India’ labels would be rewarded with 2% of the fob value at the time of initial entry and one year thereafter.

e) **Publicity Campaign**: Under this scheme, intensive campaigns for launching identified product/products in chosen markets through advertisement, pamphlets, banners, hoarding, radio, television would be encouraged.

f) **Participation in International Trade Fairs, Seminars, Buyer-Seller Meets**: India, like any other country, has been participating in various International Trade fairs. However, such participation is generally not part of a comprehensive strategy. Thus, it is required to link participation in Trade Fairs at identified potential destinations with effective publicity campaigns, seminars, buyer-seller meets, etc.

g) **Brand Promotion**: Brand promotion along with Marketing would be focused as a component of the approved project under the scheme to replace the poor perception of India as a supplier of low quality items, to a supplier of high-tech value addition world-class quality products. In addition to the incentives for supplying branded products with
“Made In India” labels in the selected international departmental stores, the scheme would undertake marketing of India and its focus products in the identified countries.

h) **Research & Product Development:** Selected exporters/Export Promotion Councils (EPCs)/Trade promotion Organization (TPO) would be assisted in modernizing and upgrading the identified products as per needs of the targeted markets on country-product focus basis as component of the approved project under the scheme.

i) **Export Potential Surveys of the States to identify product groups:** The scheme would supplement the State Governments in carrying out export potential survey of the State for identified product groups to evolve market related strategy for promoting exports of the identified product groups from the State.

An Empowered Committee headed by Secretary, Department of Commerce would approve the projects under this Scheme and also monitor the progress made in the projects, evaluate the impact of the support given from time to time, etc. The Committee would meet as and when required, but at least once in every quarter.

6.5 **REVIEW QUESTIONS**

1. What are the top ten export commodities for India in terms of foreign exchange expenditure?
2. What are the top ten export commodities for India in terms of their growth rate in total imports?
3. List down the Export Promotion measures for the small scale industries.
4. Study any one industrial sector and recommend some steps to boost its exports.
INTERNATIONAL MONETARY SYSTEM & FOREIGN EXCHANGE MARKET

Structure

7.1 Introduction to International Monetary System
7.2 Foreign Exchange Market
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7.1 INTRODUCTION TO INTERNATIONAL MONETARY SYSTEM

The salient features of International Monetary System: A well functioning monetary system is the crucial nexus of the international economy because it facilitates the growth of trade, foreign investment, and global interdependence. Establishment of a sound monetary system is a prerequisite for a prosperous world economy. An efficient and stable international monetary system must solve 3 technical problems:

1. Liquidity: the system must provide an adequate (but not inflationary) supply of currency to finance trade, facilitate adjustment, and provide financial reserves
2. Adjustment: the system must specify methods to resolve national payment disequilibria (i.e. changes in exchange rates, contraction/expansion of domestic economic activities, imposition of direct control over international transactions)
3. Confidence: the system must prevent destabilizing shifts in the composition of national reserves

Every state desires not only an efficient international system but also, one that does not seriously harm its own interests. Every international monetary system rests on a particular political order.

How has the Global Monetary System evolved?

The Era of Specie Money:

- In the pre-modern period, precious metals or specie money (gold and silver) served as the basis of the international monetary system.
- Local and international currencies tended to be sharply separated from one another.
• "Great currencies"(the solidus of Constantine, the Dinar, the Ducat) minted from gold or silver, were relative stable and sometimes held their values for centuries.
• Money could not be created by political fiat; it could only be obtained through trade, plunder, or the possession of mines.
• The value of international money was primarily dependent upon its supply and was largely outside the control of individual states.
• The supplier of the international currency gained few special privileges (the right of seignior-age), and the international use of particular currency was not a source of international power.
• In the pre-modern era, international currencies enjoyed economic and political autonomy. The international monetary system was apolitical.

16th and 17th centuries:
• The nature and role of the system began to change with the discovery of gold and silver in the Americas and the expansion of international trade.
• The separation of local moneys from international moneys began to break down as a consequence of the great influx into Europe of New World precious metals, the growing monetarization of national economies and increasing economic interdependence.
• Gold and silver drove out traditional local currencies.
• National economies became increasingly interdependent and subordinate to the operations of the expanding international economic system.

The Era of Political Money (18th and 19th centuries):
• Governments began to issue paper money, modern banking arose, and public and private credit instruments proliferated (Financial Revolution)
• Governments acquired control over the money supply and could influence the level of economic activity through the creation of money
• The Financial Revolution solved the historic economic problem of the inadequacy of the money supply.
• The Financial Revolution created an inflationary bias, and raised the international problem of monetary stability.
• Monetary stability and efficient operation of the monetary system require the subordination of domestic policies to international rules and conventions.
• The conflict between domestic economic autonomy and international economic stability has become the fundamental dilemma of monetary relations.

The Classical Gold Standard (1870-1914):
• The international gold standard was the classic resolution of the dilemma of domestic economic autonomy versus international economic stability.
• In theory, this monetary system was "an impersonal, fully automatic, and politically symmetrical international monetary order dependent simply on a combination of
domestic price flexibility and natural constraints on the production of gold to ensure optimality of both the adjustment process and reserve supply

- The system provided a fixed exchange mechanism for adjusting the international balance of payments as trade and payment imbalances among nations were brought back into equilibrium through the flow of gold
- In practice, the classical gold standard operated quite differently from the liberal ideal although it facilitated an unprecedented growth of world trade, global prosperity and economic stability

1. The international monetary system under the classical gold standard was not automatic.
2. The banks could, and did respond to gold flows in a highly discretionary manner in order to cushion the effect on domestic economy
3. The international monetary system under the classical gold standard did not operate impersonally
4. It was organized and managed by Great Britain and to a lesser extent by emerging financial centers in Western Europe
5. The international monetary system under the classical gold standard was not politically symmetrical in its effects on various national economies

Great Britain and other wealthy capital exporters could adjust to payments disequilibria and cushion their ill effects on economic activity through the regulation of capital flows. Capital importers had no such protection

**The classical gold standard solved the 3 fundamental of an international monetary order:**

1. The adjustment problem was solved as individual countries adjusted domestic economic activities to a level that maintained the value of their currency relative to gold.
2. The liquidity problem was solved since the production of the gold was generally sufficient to meet world demand at the prevailing price in terms of sterling.
3. The confidence problem was solved because people believed that Great Britain had the power and the will to maintain the prevailing sterling value of gold.

These solutions subordinated domestic economic autonomy to the international goal of monetary stability.

**The Interregnum between British and American Leadership (1914-1944):**

- A major consequence of WWI was a nationalization of the world monetary system.
- Upon the outbreak of the war, nations acted to safeguard their gold supplies and disengaged from the system of fixed exchange rates to facilitate the freeing and mobilization of their economies for war.
- The gold standard collapsed and its place was taken by makeshift arrangements of floating rates.
- Domestic economic autonomy triumphed over international monetary order due to the exigencies of the war.
The basic task in the immediate aftermath of WWI was reestablishment of an international economic system and the creation of a stable monetary order.

A return to the gold standard was ruled out because severe inflation had eroded the purchasing power of the world’s stock of gold.

The Genoa Conference of 1922 created a gold-exchange standard.

Nations would include gold-backed currencies, particularly British sterling, in their reserves in order to economize on the use of gold.

The gold-exchange standard survived for just a few years (its collapse was a major factor in precipitating the Great Depression of 1930)

Reasons for the breakdown of this monetary order:

1. Many governments began to value domestic welfare objectives more highly than a stable international monetary order.
2. Labor and business could resist the wage/price flexibility (in a downward direction) that had facilitated the operation of a fixed exchange rate system.
3. British economic policy; when Great Britain returned to the gold standard in 1925 reset the sterling value of gold at too high a par value.
4. Great Britain no longer had the power to manage the monetary system.
5. Domestic welfare goals and national rivalries became more important than international norms. This made cooperation impossible.

The ensuing economic chaos led to fragmentation of the international monetary system into several competing monetary blocks (the British "sterling clock"; the American "dollar block"; the French "gold block"; and Germany, Italy, and Japan created autarkic empires)

The world economy entered an era of unprecedented economic warfare, with competitive devaluations, and fluctuating currencies as each economic block attempted to solve its payments and employment problems at the expense of the others. US began to assume the responsibility of leadership in the mid-1930s. The US Reciprocal Trade Act in 1934 (reciprocal lowering of tariffs) and the Tripartite Agreement between US, GB, and France, in 1936, to moderate conflict between the 3 major currency centers were set.

The Bretton Woods System (1944-1976):

- The Bretton Woods Conference in 1944 was charged with the creation of a stable world economic order
- A product of American-British cooperation, The Bretton Woods system had the following features:
  1. It envisioned a world in which governments would have considerable freedom to pursue national economic objectives;
  2. The monetary order would be based on fixed exchange rates;
  3. It encouraged an open system, by committing members to the convertibility of their respective currencies into other currencies and to free trade;
4. The IMF was created to supervise the operation of the monetary system and provide medium-term lending to countries experiencing temporary balance-of-payments difficulties (also the International Bank for Reconstruction and Development [IBRD known as the World Bank]);

5. The system permitted a nation, in the event of a "fundamental disequilibrium", to change its exchange rate with international consent (the definition of a "fundamental disequilibrium" was left vague).

During the Bretton Woods system, the state assumed a greater role in the economy to guarantee full employment and other goals, but its actions became subject to international rules:

- The Bretton Woods planners expected that after a brief transition (5 years) the international economy would recover and the system would enter into operation
- From 1945 to 1947, the US actively pressed for implementation of the Bretton Woods system as originally conceived (US provided resources to the IMF and the World Bank and urged other countries to do likewise)
- By 1947, the US conclude that the Bretton Woods system was not working and that the Western system was on the verge of collapse (WWII had destroyed the European economic system, and the IMF’s modest credit facilities were insufficient to deal with Europe’s huge needs)

Then, the US assumed primarily responsibility for the management of the world monetary system. The strength of the US economy, the lessons of the inter-war period, and security incentives made US leadership acceptable economically and politically at home. The Europeans and Japanese also accepted US management because they needed US assistance to rebuild their domestic production, finance their international trade, and provide political stability

The US managed the international monetary system by:

1. Providing liquidity: gold production was insufficient; the dollar was the only strong currency to meet the rising demands for international liquidity. The strength of the US economy, the fixed relationship of the dollar to gold ($35 an ounce), and the commitment of the US government to convert dollars into gold at that price made the dollar as good as gold. But there was a huge dollar shortage (the US was running trade surpluses); and in order for the system to work, it would be necessary for the US to reverse this flow and to run a payment deficit, which of course happened.

2. Facilitating short-term adjustment through foreign aid and military expenditures, which helped offset the US trade surplus and the European and Japanese deficits. Also, the US abandoned the Bretton Woods goal of convertibility and tolerated European and Japanese trade protection and discrimination against the dollar.

Finally the US used the Marshall Plan aid to encourage devaluation of many European currencies to support nation programs of monetary stabilization. The system worked well. It led to an era of unprecedented growth in international trade, and increasing global interdependence.
After 1967, things began to change: the devaluation of the pound, the massive escalation of the Vietnam war, the severe deterioration of America’s balance of payments, mounting world inflation (Vietnam War and Johnson’s Great Society program) increase monetary instability, and speculative attacks on the dollar required international action. Cooperative measures were taken by leading economic powers designed to increase confidence in the dollar and to dampen monetary speculation (currency swaps organized by the Bank for International Settlements). The IMF created the Special Drawing Rights (SDR) as a reserve asset to complement the dollar as a reserve currency and thus solve the liquidity-creation problem.

The US had abdicated monetary leadership and pursued a policy of benign neglect. The US let others defend the existing exchange rate system, permitted a huge foreign dollar build up, and maintained passive during currency crises.

The US followed its domestic policies regardless of the international consequences and disregarded the inflationary consequences of the huge dollar outflows in other parts of the system. The US no longer sought to mobilize the system for reform.

By late summer 1971, benign neglect was no longer a sustainable policy. On August 15, 1971, President Nixon announced a new economic policy: henceforth, the dollar would no longer be convertible into gold, and the US would impose a surcharge of 10% on dutiable imports in an effort to force West Germany and Japan to revalue their currencies.

The shock of August was followed by efforts by the Group of Ten (Belgium, France, Germany, Italy, the Netherlands, Sweden, Canada, Japan, the United Kingdom, and the US) under US leadership to patch up the system of international monetary management.

An agreement reached at the Smithsonian Institution in Washington, DC, in December 1971, which provided for a 10% devaluation of the dollar in relation to gold, a realignment of other exchange rates, and greater flexibility in rates that would float within a plus or minus 2.25% of parity.

In 1973, the Bretton Woods system came to an end. In March, the decision was taken to let exchange rates float, management was left to the market and in a minor way to central banks. The de facto end of fixed exchange rates and the Bretton Woods system was made in 1976 at a meeting of the leading IMF members held in Kingston Jamaica. The Jamaica Conference decided the following:

1. Floating exchange rates were legalized;
2. The reserve role of gold was reduced;
3. The determination of the par value of a currency became the responsibility of the country itself.

Domestic autonomy had triumph over international rules; nations disengaged from the requirements of a fixed exchange rate system in order to pursue national objectives such as expanding exports, stimulating economic activities or preventing the importation of inflationary pressures.
Several structural changes that emerged in the 1960s and early 1970s also contributed to the breakdown of the Bretton Woods system as given below:

1. **The development of a high level of financial integration:** The return to convertibility of the Western European currencies at the end of 1958, and of the Japanese yen in 1964 made possible the huge expansion of international financial transactions. Multinational banks became the vehicles for large international financial flows (1n 1965 only 13 US banks had branches abroad, by 1974, 125 did).

2. **Financial integration was also a result of the internationalization of production:** MNCs that controlled large liquid assets became sophisticated in moving their capital from country to country to take advantage of interest rate spreads or expected exchange rate adjustments.

3. **A final source of financial integration in this period was the Eurocurrency market:** Eurocurrencies are national currencies – dollars, franc, yen- held and traded outside their home country, primarily in Europe. The market flourished largely because it was controlled neither by state regulation nor by constraints of domestic money markets. It was able to establish highly competitive interest rates that attracted huge sums. Because it consists largely of short-term money, funds in Eurocurrency market are highly mobile and volatile. These new patterns of financial integration made possible huge international capital flows that also put great strains on the international monetary system.

**The Post Bretton Woods period (1976 - present):** The interdependent and more pluralistic international monetary system that has prevailed since 1976 has confronted several major management problems.

**The long-standing dilemma of the dollar:** Despite continuing challenges to the dollar’s credibility and persistent dissatisfaction abroad with US economic policies, the US dollar survives as the world’s major currency. The size of the US economy, its highly developed financial markets, and its political stability make it desirable and feasible to use the dollar. The US government continues to support the dollar’s role.

Since 1980s there has been, however, a shift away from the dollar as the exclusive reserve and transaction currency; in 1978, the dollar accounted for 76% of official holdings of foreign exchange, while the deutsche mark accounted for 11% and the yen for 3%; by 1993, the dollar’s share had fallen to 61%, while the mark had risen to 16% and the yen to 9%. Finally, in the 1980s and 1990s a number of countries liberalized financial regulations making it easier for their currencies to be used and held abroad.

**Floating exchange rates are another central characteristic and major problem of the prevailing system:** Although most of the IMF’s members maintain some form of fixed exchange rate, the world’s major currencies float against one another. Proponents had argued that a float would provide for relative stability and rationality in exchange rates. Floating exchange rates have operated effectively in several ways:

- They have not disrupted international trade and investment.
• They were probably the only system that could have survived the serious economic shocks of the 1970s and 1980s including the oil crises and the inflation differentials
• They encouraged the long-term movement of exchange rate changes generally in a direction of correct payments imbalances

There are problems, however, with the floating rate system. Exchange rates have been highly volatile, frustrating a smooth and rapid adjustment process. Most major currencies have been subjected to wide and often inexplicable fluctuations, especially in short-term rates.

**Massive financial imbalances that have not been adjusted through market mechanisms are another problem of the prevailing monetary system:** The oil crises of the 1970s created such a financial imbalance. A rapid increase in bank lending to developing countries solved the problem of recycling OPEC financial surpluses.

The debt crises in the 1980s created a serious adjustment problem. The international community succeeded in containing these debts rises through an ongoing series of rescheduling of both public and private debts

Unprecedented imbalances among the developed countries created an equally destabilizing situation. Despite expectations, the floating exchange rate system has not ensured effective current account adjustment and has not prevented the development of large, unsustainable external deficits and surpluses.

In 1980s the US accumulated 2 massive and unprecedented deficits ("twin deficits"):  

1. A large budget deficit: the result of lowering taxes without reducing government spending;  
2. Trade and balance of payments deficits by increasing demand for imports and creating favorable conditions for capital inflows (an overvalued dollar, strong US economic growth, the rise in protectionist barriers etc).

The twin deficits called for adjustments in US economic policies, which were not forthcoming because:

• Improvements in the budget deficit were blocked by a political conflict between a president opposed to raising taxes and a Congress opposed to spending cuts.  
• Improvements in the trade deficit were hampered by the budget crisis as well as by the resistance of the administration to adopt domestic policies that would lead to devaluation of the dollar.

Instead of adjusting, the US, as in the past, used its unique position in the international monetary system to finance its deficits. However, at some point, the trade deficit would undermine confidence in the US currency and lead to a decline in the dollar and a serious shock to the system.
By the 1990s, the domestic political consensus in the US shifted toward greater willingness to address the problem of the budget deficit and US policy focused on the need for the US to be competitive in international markets.

Two minor images of the US trade deficit were the trade surpluses of Japan and West Germany.

The prevailing system has not resolved the problem of the Interdependence. Even the US, especially in the recent times, has not been able to pursue national economic policies without regard to international constraints.

Achieving the level of international cooperation necessary to maintain stability in the world monetary system has proved difficult because of domestic political constraints and because each nation still cherishes autonomy.

The period since 1976 has been one of muddling through, characterized as much by national and regional management as by multilateral management.

Although the monetary powers have cooperated to stabilize the system during periods of crisis and have periodically sought to coordinate economic policies in order to achieve long-term stability, policy coordination has been limited in scope and in success.

Despite the growth of interdependence, national governments have been either unwilling or unable to adjust national economic policies to international economic needs.

The danger in the present system is that with incomplete management, crises may go unregulated, cumulate, and become far more difficult and costly to resolve.

7.2 FOREIGN EXCHANGE MARKET

The foreign exchange market is the generic term for the worldwide institutions that exist to exchange or trade the currencies of different countries. There exists no single trading center, and the market operates 24 hours a day. "Foreign exchange" is often shortened to "forex", or "fx". The foreign exchange market is loosely organized in two tiers:

- Retail Tier; and
- Wholesale Tier.

The retail tier is where the small agents buy and sell foreign exchange, orienting themselves to the reference rates of such agencies as Reuters which are adjusted round-the-clock to actual events in the market. The wholesale tier is an informal network of more than 1000 banks and currency brokerage firms that deal with each other and with large corporations. When the financial press talks about the foreign exchange market in general it refers to the wholesale tier.

Spot Market: Spot Market is the exchange market for payment and delivery today. In practice, "today" means today in the retail tier and two business days in the wholesale tier. The forward market (or "futures") involves contracting today for the future purchase or sale of foreign currency. In a forward transaction the settlement date is deferred much further into the future than in a spot transaction, and no cash moves on either side until that settlement date.
Dealers and brokers, when acting as market makers, provide two prices: a bid and an ask. Once given, the quote is binding (for a few seconds), i.e. the market maker will buy foreign exchange at the bid quote and sell at the ask quote. The arithmetic average of the bid rate and the ask rate is called the mid rate (or middle rate, or midpoint rate). The difference between the bid and the ask is the spread. Market makers make a profit from the bid-ask spread. Bid-ask spreads can usually range between 0.03% and 0.07%, which is significantly lower than spreads in other financial markets, but which is compensated by the high volume in the foreign exchange market (about ten times the volume of international trade in goods and services).

Commercial banks account for the largest proportion of total trading volume. About three quarters of all foreign exchange trading is between banks. These transactions are called Inter bank or direct dealing transactions. Direct dealing saves the commission charged by brokers.

The primary clearing system for international transactions is operated by SWIFT (Society for Worldwide Interbank Financial Telecommunication). The electronic transfer system works in a very simple way: two banks involved in a foreign currency transaction will simply transfer bank deposits through SWIFT to settle a transaction.

The daily reference (or "information", or "nominal") exchange rates published by financial institutions, newspapers, central banks and providers are usually either based on an analysis of a high volume of foreign exchange trading during the previous day, or on concentration procedures which occur every day at a certain time between central banks. In the first case the providers analyze, over a period of time, bid and ask currency prices provided in real time by suppliers such as Reuters, Bloomberg, Dow Jones Telerate, Knight-Ridder, Tullet & Tokyo, Bridge, etc. This raw data is validated with consideration to frequency, unusual peaks, possible errors, etc. The average of these filtered bid and ask prices over a certain period of time is called median price. Usually only the mid rate of the median price is provided. Where bid and ask rates are provided instead, the mid rate can easily be calculated.

Outside the foreign exchange trading community, "inter-bank rates", "reference rates", "nominal rates", "wholesale rates", "swift rates", "spot rates", and "cash rates" are often used to mean the same thing. Depending on the context, "cash rates" can however refer either to spot market rates (opposed to those of the forward market), or to rates which apply when a customer goes to the bank to exchange cash from one currency to another (opposed to inter-bank rates). Similarly, "retail rates" is also often used to refer to the exchange rates offered to customers by banks and exchange agencies, and not the rates of the retail tier of the foreign exchange market. "Cross rates" usually refers to exchange rates that do not involve the US dollar, but more in general it can also be used to indicate direct exchange rates between two currencies which usually use a third currency as a reference.

7.3 BUSINESS IMPLICATIONS OF EXCHANGE RATE MOVEMENTS

Management of Risk for Profit Maximization: It is well said, "Profit is the reward of risk". When a production manager selects an equipment or marketing manager an advertising campaign, or a finance manager a portfolio of securities all of them face uncertain cash flows. Accessing risk and incorporating the same in final decision is an integral part of financial
analysis. We can’t avoid the risk to full extent, but we can analyze the risk, characterizing future cash flows and if we found it at the adjustable rate we can go for it.

Global integration has been accompanied by increasing volatility in many commodity and financial market. By this financial prices have become more volatile, which definitely has detrimental impact on a number of firms which were ill prepared for unexpected price shifts. Volatility in financial prices are broadly due to interest rate, exchange rates, commodity prices and equity prices.

World economy has changed in three dramatic respects in last twenty years. First, the collapse of Breton woods system and the advent of floating exchange rates has led to unprecedented volatility in interest rates and exchange rates. Second, the globalization of trade and finance, which led to, increased integration of markets. Third that commodity prices have become unstable and are on a downward drift.

Prior to 1970’s, corporate managers in developed countries concerned themselves mainly with issues such as marketing strategy, production and inventory management, quality and cost control risks they faced were largely related to production costs and behavior of product markets. The advent of floating exchange rates and overall market liberalization has irrevocably complicated the management of business and altered the nature of risk involved. That is why financial risk management has quickly evolved into a sophisticated and important task in nearly all developed countries as they are no longer immune to market volatility experienced in more developed countries.

Increasing use of international financial markets and emphasis on international trade has left many developing country firms more exposed to exchange rate, interest rate and commodity price risk than ever before.

**Sources of Risk:** The sources of risks can be classified into:

- **Exchange rates risk;**
- **Interest rates risk;** and
- **Commodity price risk**

Movement of exchange rates affect firms involved with international trade, as well as firms that have utilized international financing. Consider a company that financed new investment with a dollar loan. During the construction period local currency was devalued by more than 80% with the result that project costs increased more than 70% and company will not be able to pay back its international debt.

Change in interest, either in local or international, can prove to be equally devastating if left undamaged. As an example, a Latin American financial institution became an active buyer of medium term local government notes, which it financed through short-term borrowings. The expected profitability of this operation was based on the belief that yield curve slopes upward i.e. the longer maturity would carry higher interest rates. During first few years interest rate declined and company earned substantial returns through speculative strategy of borrowing short maturities and investing in longer maturities. In the last year interest rates have reversed
direction as a result, interest rate earned on medium term notes is below the firms cost of founding, with no secondary market in which to liquidate the notes, the company has incurred a loss-commodity price movement can be ruinous to products and uses alike. Let for example case of Caribbean cotton growing project provides an illustrational the time when project was proposed, international cotton prices were near an historic low. With good soils, skilled management and the possibility of two crops pet year the project looked good in paper, even for prices 10% lower than those observed at the time and well below informed forecast. By the time the project had come on life 3 years later however international prices had dropped by over 40% following an increase in world production. The development made the project un-feasible, and after various attempts of revival the company went bankrupt.

Other Kinds of Risk:

- **Insurable Risk**: Those that firms that can protect themselves against by paying an insurance premium. The insurance company than bears any resulting liabilities or cost of damages. Risk of this sort often physical in nature and include fire, mechanical failure and other accidents.

- **Economic and Political Risk**: Originate from the nature of economy and country in which firms do business. Includes following: inflation, economic growth rates, the BOP, country risk and regulation

- **Inflation Risk**: Both inflation and its uncertainty influence the planning horizon of firms. High inflation is also volatile inducing firms to devote more resources to the task of financial management. It also forces firms to shorten their planning horizons. In such a highly inflationary situation, risk management becomes a focal point for the firm. Argentina illustrates this well. Following years of high inflation management grew accustomed to financial operations generating the profits needed to keep manufacturing operations afloat. High import barriers kept competition at bay. There by permitting continued operations with out needed investment. Ultimately, how ever inflation was tamed and import barriers reduced now Argentine firms scrambling to improve the efficiency of the operations and reducing the emphasis on financial management.

**Economic Growth Rate and BOP**: Higher growth rate may lead to a sense of optimism about the future, a perception that local currency will be strong and possibly a lower aversion to risk. But this indirectly reveals that management is often willing to accept higher level of exposure to risk than other wise. Similarly a surplus in the current (or trade) account of BOP may instill a feeling of confidence in a currency that induces firms to bear more exchange risks than normal.

- **Country Risk**: It is the combination of macro economic and political factors upon which international markets base a credit assessment. Consequence of this risk- higher cost of funds and shorter maturities. This has important implication for risk managers because it can severely limit there assess to some important derivative securities, which have long maturities.

**Management of Risk**: Risk stems from uncertainty from future and profit is the reward of risk. Managing risk using modern financial instrument eliminates all uncertainties, including both favorable and unfavorable outcomes.
Risk Management Techniques:

**Forward Contact:** A forward contract is an agreement between two parties to exchange an asset for cash at a pre-determined future date for a price that is specified today. For e.g. if you agree on Dec. 1 to buy 100 tons of wheat on April at a price "x" then you have entered into a forward contract with the wheat dealer. According to this agreement you have bought forward wheat or you are long forward wheat, whereas wheat dealer has sold forward wheat or is short forward wheat. No money or wheat charges have hand when the deal is signed.

**Short Position:** It commits the seller to deliver an item at the contracted price on maturity.
**Long Position:** It commits the buyer to purchase the item at contracted price on maturity.

**Pay Off Profile:**

**What are payoffs to the forward buyer and forward seller?**

When the spot price in future exceeds the contracted price, the forward buyer gains spot price - contract price. If it is other way than loss is cost price - spot price.

**Pay off profile for a forward contract:** Pay off to the seller of a forward contract is a mirror image of the payoff to the buyer.

**Forward contract can be used for Hedging:** Change in price of oil due to war, shortage or calamity is a source of risk for any country as it can completely change its economy. Risk profile country as an oil buyer is depicted in the figure.

![Fig. 7.1](image)

What a country can do to cope with its oil price risk? It should buy a forward contract. If it does so its exposure to unexpected changes in oil prices will be eliminated.

**Hedging with Future Contracts:** A future contract is standardized forward contract. A forward contract is tailor made contract (terms are negotiated between buyer and seller) where a future contract is standardized contract (quantity, date and delivery condition are standardized).
While there is no secondary for forward contracts, future contracts are traded on organized exchangers.

Forward contract usually end with deliveries whereas future contracts are settled with the differences.

No collateral is required for a forward contract. In a future contract, however a margin is required.

Forward contracts are settled on maturity date whereas future contracts are ‘marked to market’ on a daily basis. This means that profits and losses on future contracts are settled daily.

**Illustration:** Suppose on August 1st, you take a Long position in a future contract that matures on October 1st. agreed upon price is, say, Rs. 100/- at the close of trading on September 1st, future price rises to Rs. 105/- the marking to market feature means that three things have been occurred:

- First, you will receive a cash profit of Rs 5/-.
- Second, the existing future contract with a price of Rs 100/- is cancelled.
- Third, you will receive a new future contract at Rs 105/-.

Thus, ‘marking to market’ feature implies that the future contracts are settled every day. We can say that future contract is converted into a sequence of one-day forward contracts.

**Illustration:** X has a borrowing of $ 100 million on which a floating interest rate of LIBOR (London inter bank office rate) plus.25% is payable and Y has a borrowing of 100 million $ on which a fixed interest of 10.5% is payable. X and Y enter into an interest rate swap transaction under which X agrees to pay Y a fixed interest of 10.5% is payable. X and Y enter into an interest rate swap transaction under which X agrees to pay Y a fixed interest of 10.5% and Y agrees to pay X a floating interest rate of 10.5% and Y agrees to pay X a floating interest rate of LIBOR plus .25%. It can be diagrammatically represented as:

LIBOR + 0.25%

![Fig. 7.2](image)

**Currency Swamps:** In a currency swap both the principal and interest in one currency are swamped for principal and interest in another currency. On maturity principal amounts are swamped back. Thus the currency swap involves:

- An exchange of principal amounts today.
- An exchange interest payment during the currency of the loan.
- A re - exchange of principal amounts at the time of maturity.
Hedging with Option Contracts: An option contract is an agreement under which the seller (or writer) of option grants the buyer (or holder) the right, but not the obligation to buy or sell (depending on weather it is a call option or put option)

The buyer (or holder) of an option has to pay the premium to enjoy the right. An option on an asset gives the buyer the right to buy or sell the underlying asset at a fixed price over a fixed period of time. There are a variety of option types – Put option give the right to sell, Call options the right to buy. The seller is commonly referred as the writer of the option, while the price is callers the premium,

Option are sold both over – the – counter by financial institutions and on organized exchanges and are available for a variety of assets including many currencies, interest rate instruments and commodities. For example, purchase of a Put option on dollars combined with the simultaneous sale of a call option on dollars combined with the simultaneous sale of a call option on dollars produces what is known as a collar that sandwiches the future dollar exchange rate between two known values.

What are the driving forces behind Exchange rates?
Numerous factors determine exchange rates, and all are related to the trading relationship between two countries. Remember, exchange rates are relative, expressed as a comparison of the currencies of two countries. The following are some of the principal determinants of the exchange rate between two countries, but we should note that these factors are in no particular order. Like many aspects of economics, the relative importance of these factors is subject to much debate.

Differentials in Inflation: As a rule of thumb, a country with a consistently lower inflation rate exhibits a rising currency value, as its purchasing power increases relative to other currencies. During the last half of the 20th century, the countries with low inflation included Japan, Germany and Switzerland, while the U.S. and Canada achieved low inflation only later. Those countries with higher inflation typically see depreciation in their currency in relation to their trading partners. This is also usually accompanied by higher interest rates.

Differentials in Interest Rates: Interest rates, inflation and exchange rates are all highly correlated. By manipulating interest rates, central banks exert influence over both inflation and exchange rates, and changing interest rates impact inflation and currency values. Higher interest rates offer lenders in an economy a higher return relative to other countries. Therefore, higher interest rates attract foreign capital and cause the exchange rate to rise. The impact of higher interest rates is mitigated, however, if inflation in the country is much higher than in others, or if additional factors serve to drive the currency down. The opposite relationship exists for decreasing interest rates--that is, lower interest rates tend to decrease exchange rates.

Current-account Deficits: The current account is the balance of trade between a country and its trading partners (for more, see "Understanding the Current Account in the Balance of Payments"), reflecting all payments between countries for goods, services, interest and dividends. A deficit in the current account shows the country is spending more on foreign trade than it is earning, and that it is borrowing capital from foreign sources to make up the deficit. In
other words, the country requires more foreign currency than it receives through sales of exports, and it supplies more of its own currency than foreigners demand for its products. The excess demand for foreign currency lowers the country's exchange rate until domestic goods and services are cheap enough for foreigners, and foreign assets are too expensive to generate sales for domestic interests.

**Public Debt:** Countries will engage in large-scale deficit financing to pay for public sector projects and governmental funding. While such activity stimulates the domestic economy, nations with large public deficits and debts are less attractive to foreign investors. A large debt encourages inflation, and if inflation is high, then, in the future, the debt will be serviced and ultimately paid off with cheaper real dollars.

In the worst case scenario, a government may print money to pay part of a large debt, but increasing the money supply inevitably causes inflation. Moreover, if a government is not able to service its deficit through domestic means (selling domestic bonds, increasing the money supply), then it must increase the supply of securities for sale to foreigners, thereby lowering their price. Finally, a large debt may prove worrisome to foreigners if they believe the country risks defaulting on its obligations. Foreigners will be less willing to own securities denominated in that currency if the risk of default is great. For this reason, the country's debt rating (as determined by Moody's or Standard & Poor's, for example) is a crucial determinant of its exchange rate.

**Terms of Trade** – A ratio comparing export prices to import prices, the terms of trade is related to current accounts and the balance of payments. If the price of a country's exports rises by a greater rate than that of its imports, its terms of trade have favorably improved. Increasing terms of trade shows greater demand for the country's exports. This, in turn, results in rising revenues from exports, which provides increased demand for the country's currency (and an increase in the currency's value). If the price of exports rises by a smaller rate than that of its imports, the currency's value will decrease in relation to its trading partners.

**Political Stability and Economic Performance:** Foreign investors inevitably seek out stable countries with strong economic performance in which to invest their capital. A country with such positive attributes will draw investment funds away from other countries perceived to have more political and economic risk. Political turmoil, for example, can cause a loss of confidence in a currency and a movement of capital to the currencies of more stable countries.

**Conclusion:** The exchange rate of the currency in which a portfolio holds the bulk of its investments determines that portfolio's real return. A declining exchange rate obviously decreases the purchasing power of income and capital gains derived from any returns. Moreover, the exchange rate influences other income factors such as interest rates, inflation, and even capital gains from domestic securities. While exchange rates are determined by numerous complex factors that often leave even the most experienced economists flummoxed, investors should still have some understanding of how currency values and exchange rates play an important role in the rate of return on their investments.
Forex Regulation in India:

**Institutional Role:** Foreign Exchange Dealer's Association of India (FEDAI) was registered under section 25 of Indian Companies Act, 1956. It was set up in 1958 as an Association of banks dealing in foreign exchange in India (typically called Authorized Dealers - ADs) as a self regulatory body and is incorporated under Section 25 of the Companies Act, 1956. Its major activities include framing of rules governing the conduct of inter-bank foreign exchange business among banks vis-à-vis public and liaison with RBI for reforms and development of forex market. Presently some of the functions are as follows:

1. Guidelines and Rules for Forex Business;
2. Training of Bank Personnel in the areas of Foreign Exchange Business;
3. Accreditation of Forex Brokers;
4. Advising/Assisting member banks in settling issues/matters in their dealings;
5. Represent member banks on Government/Reserve Bank of India/Other Bodies;
6. Announcement of daily and periodical rates to member banks.

Due to continuing integration of the global financial markets and increased pace of de-regulation, the role of self-regulatory organizations like FEDAI has also transformed. In such an environment, FEDAI plays a catalytic role for smooth functioning of the markets through closer co-ordination with the RBI, other organizations like FIMMDA, the Forex Association of India and various market participants. FEDAI also maximizes the benefits derived from synergies of member banks through innovation in areas like new customized products, benchmarking against international standards on accounting, market practices, risk management systems, etc.

**Member Banks:** Public sector banks, foreign banks, private sector banks, financial institutions, co-operative banks & others like Thomas Cook.

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### 7.4 FOREIGN EXCHANGE MANAGEMENT ACT (FEMA)

**Foreign Exchange Regulation Act:** The Foreign Exchange Management Act (FEMA) is a law to replace the draconian Foreign Exchange Regulation Act, 1973. FEMA is an act to regulate dealings in foreign exchange and foreign securities with the objective of conservation of foreign exchange resources of India and its proper utilization in the economic development of India. It extends to whole of India and applies to all the citizens of India, outside India as well as in India and to branches and agencies of Indian companies or body corporate, outside India.

FERA is a very stringent act. Unlike other laws where everything is permitted unless specifically prohibited, under FERA nothing is permitted unless specifically permitted. Hence the tenor and tone of the Act is very drastic. It provides for imprisonment for violation of even a very minor offense. Under this act, a person is presumed guilty unless he proves himself innocent whereas under other laws, a person is presumed innocent unless he is proven guilty. Therefore one has to be very careful while dealing in foreign exchange and ensure that all legal compliances are carried out.
With liberalization, there has been a move to remove the drastic measures of FERA and replace it with a set of liberal foreign exchange management regulations. A draft of the Foreign Exchange Management Bill (FEMA) has been prepared by the Government of India to replace FERA keeping in view the liberal spirit of the Indian economy. However, until FEMA is enacted, the provisions of FERA apply.

FERA contains definitions of certain terms that have been used throughout the Act. Their meaning of these terms may differ under other laws or under common language. But for the purposes of FERA, the terms will signify the meaning as defined there under. Let us take up some of the more important ones.

- **Authorized Dealer** means a person for the time being authorized by the Reserve Bank of India (RBI) under section 6 to deal in foreign exchange.
- **Bearer Certificate** means a certificate of title to securities, whose ownership can be transferred by mere delivery, whether with endorsement or not. In this sense, it is similar to a bearer cheque i.e. whoever has such a certificate can easily encash it without any other person’s endorsement.
- **Certificate of Title** to a security means any document used in the ordinary course of business as a proof of the possession or control of the security or authorizing or purporting to authorize, either by endorsement or by delivery the possessor of the document to transfer or receive the security thereby represented.
- **Coupon** means the coupon representing the dividends or interest on a security. For example, Dividend Warrants.
- **Currency** includes all coins, currency notes, bank notes, postal notes, postal orders, money orders, cheque, drafts, traveler’s cheques, letters of credit, bills of exchange and promissory notes.
- **Export** means (a) the taking out of India to a place outside India any goods; or (b) Provision of services from India to any person outside India.
- **Foreign Currency** means any currency other than Indian currency.
- **Foreign Exchange** means foreign currency and includes:
  1. All deposits, credits and balances payable in any foreign currency and any drafts, traveler’s cheque, letters of credit and bills of exchange expressed or drawn in Indian currency but payable in any foreign currency.
  2. Any instrument payable at the option of the drawee or the holder thereof or any other party, either in Indian currency or in foreign currency or partly in one and partly in the other.
- **Foreign Security** means any security created or issued outside India and any security, the principal of or the interest on which is payable in any foreign currency or is payable outside India.
- **Indian Currency** means the currency that is expressed or drawn in Indian rupees but does not include special bank notes and special one rupee notes issued under section 28A of the Reserve Bank of India Act, 1934. Such Rupee One notes are issued by the Ministry of Finance.
• **Indian Customs Waters** means water extending into the sea up to a distance of 12 nautical miles measured from the appropriate base line on the coast of India and includes any bay, gulf, harbour, creek or tidal river.

• **Money Changer** means a person for the time being authorized under section 7 to deal in foreign exchange.

• **Owner**, in relation to any security, includes:

1. Any person who has the power to transfer the security; or
2. Any person who has the custody thereof; or
3. Any person who receives, whether on his own behalf or on behalf of any other person, dividends or interest thereon and who has any interest therein;
4. In a case where a security is held on in any trust or dividends or interest thereon are paid into a trust fund, owner also includes any trustee or any person entitled to enforce performance of the trust or to revoke or vary, with or without the consent of any other person, the trust or any terms thereof or to the control investments of the trust moneys.

• **Person Resident in India** means:

1. A citizen of India, who has at anytime after 25th March 1947 been staying in India but does not include citizen of India who has gone out of or stays outside India (a) for taking an employment outside India; or (b) for carrying on outside India any business or vocation; or for any other purpose, in circumstances which indicate the intention to stay outside India for an uncertain period.
2. A citizen of India who having ceased to be a person resident in India as per the above conditions, who returns to or stays in India (a) for taking an employment in India; or (b) for carrying on business or vocation in India; or (c) for any other purpose in circumstances which indicate his intention to stay in India for an uncertain period.
3. A person, not being a citizen of India who has come to or stays in India (a) for taking an employment; or for carrying on business or vocation in India; or for any other purpose in circumstances which indicate his intention to stay in India for an uncertain period; or for staying with his or her spouse, such spouse being a person resident in India.
4. A citizen of India who has not stayed in India at anytime after 25th day of March 1947 comes to India for any of the aforesaid purposes

• **Person resident outside India** means a person who is not resident in India.

• **Precious stones** include pearls and semi precious stones and such other stones or gems as the Central Government may, for the purposes of this Act, notify in the Official Gazette.

• **Securities** means shares, stock, bonds, debentures stock, government securities as defined in the Public Debt Act, 1944, savings certificates to which the Government Savings Certificate Act, 1959 applies, deposit receipts in respect of deposits of securities and units or sub-units of the Unit Trust and includes certificates of title to securities but does not include bills of exchange or promissory notes other than government promissory notes. Transfer in relation to any security includes transfer by way of loan or security.
**Authorized Dealer in Foreign Exchange:** Authorized dealers are persons who can legally deal in foreign exchange. Most of the authorized dealers are banks. However, not all branches of the banks are authorized dealers. Only certain designated branches of banks act as authorized dealers. Any person wanting to deal in foreign exchange must deal through the authorized dealers unless specifically exempted from doing so.

An application must be made by a person desiring to be an authorized dealer to the RBI. The RBI may authorise that person to be an authorized dealer if he meets with certain parameters laid down for this purpose. An authorization by the RBI for this purpose will be in writing and may authorise dealing in all foreign currencies or may be restricted to authorized dealing in specified foreign currencies only. It may authorise transaction of all descriptions in foreign currency or it may be restricted to specific transitions only. It may be granted for a specific period or within specified amount. It may be granted subject to such conditions as many specified therein.

An authorization granted by the Reserve Bank may be revoked at anytime if the RBI is satisfied that it may be in public interest to do so or if authorized dealer has not complied with the conditions subject to which the authorization was granted or has contravened any of the provision of this Act or rules, notification direction or orders made there under. However before revoking the authorization, the authorized dealer should be given a reasonable opportunity of making representation in the matter.

An authorise dealer must in all his dealings in foreign exchange and in the exercise and discharge of the powers and functions given to him under FERA comply with all general and special directions and instructions that the reserve bank may from time to time think fit to give. Except with the previous permission of the reserve bank, the authorized dealer cannot not engage in any transaction relating any foreign exchange which is not in conformity in the terms of his authorization.

An authorized dealer must before undertaking any transaction in foreign exchange on behalf of any other person, require that person to make such declaration and to give such information which reasonably satisfies him that the transaction will not involve and is not designed for the purpose of contravention or evasion of the provisions of FERA or any rules, notification or direction made there under and if that person refuses to comply with such requirement or makes only unsatisfactory compliance thereof, the authorized dealer should refuse to undertake the transaction and must report the matter to the reserve bank.

**Money Changer:** Money changers are authorized to deal in foreign exchange but for very limited and specific purposes. Generally, hotels, foreign travel agents, foreign tour operators, etc who have foreign exchange requirements for specific purposes only are allowed to become money changers. They must function strictly within the terms and conditions under which they are licensed to act as money changers.

An application must be made by a person desiring to be a money changer to the RBI. The RBI may authorise that person to be a money changer if he meets with certain parameters laid down for this purpose. An authorization by the RBI for this purpose will be in writing and may authorise dealing in all foreign currencies or may be restricted to authorized dealing in specified
foreign currencies only. It may authorise transaction of all descriptions in foreign currency or it may be restricted to specific transactions only. It may be granted for a specific period or within specified amount. It may be granted subject to such conditions as many specified therein.

All other provisions are similar to those applicable to authorized dealers. For the purpose of dealings with money changers, foreign currency means foreign currency in the form of notes, coins and traveler’s cheques and dealing means purchasing foreign currency notes, coins or traveler’s cheque or selling foreign currency in form of notes and coins.

7.5 REGULATION & MANAGEMENT OF FOREIGN EXCHANGE

Except with the general or special permission of the Reserve Bank, no person can:

- Deal in or transfer any foreign exchange or foreign security to any person not being an authorized person;
- Make any payment to or for the credit of any person resident outside India in any manner;
- Receive otherwise through an authorized person, any payment by order or on behalf of any person resident outside India in any manner. Where any person in, or resident in India receives any payment by order or on behalf of any person resident outside India through any other person (including an authorized person) without a corresponding inward remittance from any place outside India, then, such person shall be deemed to have received such payment otherwise than through an authorized person.
- Enter into any financial transaction in India as consideration for or in association with acquisition or creation or transfer of a right to acquire, any asset outside India by any person

Financial transaction means making any payment to, or for the credit of any person, or receiving any payment for, by order or on behalf of any person, or drawing, issuing or negotiating any bill of exchange or promissory note, or transferring any security or acknowledging any debt.

No person resident in India can acquire, hold, own, possess or transfer any foreign exchange, foreign security or any immovable property situated outside India except with the general or special permission of the Reserve Bank.

Any person may sell or draw foreign exchange to or from an authorized person if such sale or drawal is a current account transaction. However, the Central Government may, in public interest and in consultation with the Reserve Bank, impose such reasonable restrictions for current account transactions as may be prescribed.

Any person may sell or draw foreign exchange to or from an authorized person for a capital account transaction. The Reserve Bank may, in consultation with the Central Government, specify:

- Any class or classes of capital account transactions which are permissible;
- The limit up to which foreign exchange shall be admissible for such transactions.
However, the Reserve Bank cannot impose any restriction on the drawal of foreign exchange for payments due on account of amortization of loans or for depreciation of direct investments in the ordinary course of business.

The Reserve Bank can, by regulations, prohibit, restrict or regulate the following:

- Transfer or issue of any foreign security by a person resident in India;
- Transfer or issue of any security by a person resident outside India;
- Transfer or issue of any security or foreign security by any branch, office or agency in India of a person resident outside India;
- Any borrowing or lending in foreign exchange in whatever form or by whatever name called;
- Any borrowing or tending in rupees in whatever form or by whatever name called between a person resident in India and a person resident outside India;
- Deposits between persons resident in India and persons resident outside India;
- Export, import or holding of currency or currency notes;
- Transfer of immovable property outside India, other than a lease not exceeding five years, by a person resident in India;
- Acquisition or transfer of immovable property in India, other than a lease not exceeding five years, by a person resident outside India;
- Giving of a guarantee or surety in respect of any debt, obligation or other liability incurred (a) by a person resident in India and owed to a person resident outside India or (b) by a person resident outside India.

A person resident in India may hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India.

A person resident outside India may hold, own, transfer or invest in Indian currency, security or any immovable property situated in India if such currency, security or property was acquired, held or owned by such person when he was resident in India or inherited from a person who was resident in India.

The Reserve Bank may, by regulation, prohibit, restrict, or regulate establishment in India of a branch, office or other place of business by a person resident outside India, for carrying on any activity relating to such branch, office or other place of business.

Every exporter of goods must:

- Furnish to the Reserve Bank or to such other authority a declaration in such form and in such manner as may be specified, containing true and correct material particulars, including the amount representing the full export value or, if the full export value of the goods is not ascertainable at the time of export, the value which the exporter, having regard to the prevailing market conditions, expects to receive on the sale of the goods in a market outside India;
• Furnish to the Reserve Bank such other information as may be required by the Reserve Bank for the purpose of ensuring the realization of the export proceeds by such exporter.

The Reserve Bank may, for the purpose of ensuring that the full export value of the goods or such reduced value of the goods as the Reserve Bank determines, having regard to the prevailing market-conditions, is received without any delay, direct any exporter to comply with such requirements as it deems fit.

Every exporter of services shall furnish to the Reserve Bank or to such other authorities a declaration in such form and in such manner as may be specified, containing the true and correct material particulars in relation to payment for such services.

Where any amount of foreign exchange is due or has accrued to any person resident in India, such person shall take all reasonable steps to realize and repatriate to India such foreign exchange within such period and in such manner as may be specified by the Reserve Bank.

Private Capital Flows to Emerging Markets: The international capital flows to emerging markets had fallen sharply in 1997 and 1998 in the wake of the financial crises in Asia and Russia. The net private capital flows to emerging markets stabilized in 1999. Total net private capital flows to emerging markets in 1999 were about US $ 81 billion, 7.2% higher than the 1998 figure, and 64.5% lower than the peak level of 1995. The stabilization of net private capital flows reflected continuing growth in foreign direct investment (FDI) and a recovery in portfolio investment, which more than offset a continuing decline in bank lending. It may, however, be noted that gross private financing has picked up substantially, which is not reflected in net capital flows due to sizeable debt repayments by some large economies. FDI continued to grow in 1999. Given the large reduction in bank exposures, FDI more than accounted for the total of all net private capital flows to emerging markets in 1999. FDI grew or was stable in most regions. According to IMF estimates, the FDI now accounts for 2.1% GDP of emerging markets and is nearly as large as gross private market financing in the bond, equity and loan markets combined.

7.6 INTERNATIONALIZATION OF STOCK MARKETS

During the last few years, the emerging markets have been forging increasing linkages with the global capital markets. The internationalization of the emerging equity markets has taken place in various forms:

1. Several companies belonging to the emerging markets have raised capital through issue of American/Global/European Depository Receipts, which are traded on a foreign exchange.
2. Many emerging markets have, over the last few years, opened their domestic capital markets to attract foreign investors, especially institutional investors, to invest in domestic equity.
3. Some newly listed emerging market companies have floated IPOs in mature markets, bypassing local markets completely. In particular, information technology companies from Latin America have recently chosen to list directly on the US NASDAQ market.
4. Some established emerging market companies have been taken over by advanced market companies and have subsequently been de-listed from the local exchanges. This has happened in the case of some oil, banking and telecom stocks from Latin America.
5. A number of companies from advanced markets are considering spinning off or creating tracking stocks for their emerging market operations. Several US companies are considering this with Latin American internet operations.

The above trends have many implications.

- Firstly, the companies in emerging markets have witnessed rapidly increasing proportion of foreign ownership.
- Secondly, some of these developments can have potentially negative implications for emerging stock markets by making them vulnerable to developments in global markets.
- Thirdly, it is increasingly being felt by policy makers in emerging markets that price determination is moving offshore, which is affecting the interests of domestic investors.

**Consolidation of Stock Exchanges:** During the decade of 1990s, there have been substantial changes in the way stock exchanges are being run, by whom they are run, how trading takes place and at what cost, and how clearing and settlement is done. Several factors have contributed to transformation of the structure of traditional markets:

1. The stock exchanges are increasingly consolidating themselves in the form of corporate entity rather than being run as cozy clubs;
2. The development of information technology has been associated with development of cheaper ways of trading shares than the traditional systems, which relied heavily on brokers and telephones;
3. There has been an emergence of highly successful electronic communication networks (ECNs), which now account for a growing electronic marketplace in US stocks and some of which have applied for exchange status;
4. Substantial decline in trading costs;
5. Transfer of value away from trading, which the core service is provided by every stock exchange, to clearing and settlement. Due to above factors, the pressures are mounting on stock exchanges from different directions and there has been an intensive debate on the future of stock exchanges. As worldwide securities markets become increasingly homogenous and competitive, the current number of exchanges is not expected to remain viable. As a consequence, the exchanges worldwide are reviewing their ownership structures and have begun the process of consolidation. The idea of mergers came from the argument that if liquidity is dispersed over a number of trading systems, price discovery becomes more difficult. The growth of ECNs and other trading systems that compete with traditional stock exchanges has certainly led to a dispersal of liquidity.
7.7 REVIEW QUESTIONS

1. Make a flowchart depicting the evolution process of the International Monetary Process.
2. Study the current exchange rates between the Indian Rupee and top ten international currencies.
3. What are the risks associated with investments?
4. List down the specific risks associated with International Business and how does it affect the trading between the two countries?
5. What are the major stock exchanges available in India?
6. What are their main functioning areas?
7. List down and explain market places other than the stock exchanges where the trading of securities can be done.
MULTINATIONAL CORPORATIONS

Structure

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8.1 MULTINATIONAL CORPORATIONS

How do we define an MNC?
A multinational corporation (MNC) or transnational corporation (TNC), also called multinational enterprise (MNE), is a corporation or enterprise that manages production or delivers services in more than one country. It can also be referred to as an international corporation. The first modern MNC is generally thought to be the Poor Knights of Christ and the Temple of Solomon, first endorsed by the pope in 1129. The key element of transnational corporations was present even back then: the British East India Company and Dutch East India Company were operating in different countries than the ones where they had their headquarters. Nowadays many corporations have offices, branches or manufacturing plants in different countries than where their original and main headquarter is located. This is the very definition of a transnational corporation- having multiple operation points that all respond to one headquarter. This often results in very powerful corporations that have budgets that exceed some national GDPs. Multinational corporations can have a powerful influence in local economies as well as the world
economy and play an important role in international relations and globalization. The presence of such powerful players in the world economy is reason for much controversy.

Economists are not in agreement as to how multinational or transnational corporations should be defined. Multinational corporations have many dimensions and can be viewed from several perspectives - ownership, management, strategy, structural, etc.

Ownership Criterion: Some argue that ownership is a key criterion. A firm becomes multinational only when the head quarter or parent company is effectively owned by nationals of two or more countries. For example, Shell and Unilever, controlled by British and Dutch interests, are good examples. However, by ownership test, very few multinationals are multinational. The ownerships of most MNCs are uninalional. Thus, ownership does not really matter.

Nationality Mix of Headquarter Managers: An international company is multinational if the managers of the parent company are nationals of several countries. Usually, managers of the headquarters are nationals of the home country. This may be a transitional phenomenon. Very few companies pass this test currently.

Business Strategy (Global Profit Maximization): According to Howard Perlmutter (1969), Multinational companies may pursue policies that are home country-oriented or host country-oriented or world-oriented. Perlmutter uses such terms as ethnocentric, polycentric and geocentric. However, "ethnocentric" is misleading because it focuses on race or ethnicity, especially when the home country itself is populated by many different races, whereas "polycentric" loses its meaning when the MNCs operate only in one or two foreign countries.

According to Franklin Root (1994), an MNC is a parent company that:

1. Engages in foreign production through its affiliates located in several countries,
2. Exercises direct control over the policies of its affiliates,
3. Implements business strategies in production, marketing, finance and staffing that transcend national boundaries (geocentric).

In other words, MNCs exhibit no loyalty to the country in which they are incorporated.

The Stages of Evolution of MNCs:

1. Export stage

   • Initial Inquiries => Firms Rely on Export Agents;
   • Expansion of Export Sales;
   • Further Expansion of Foreign Sales Branch or Assembly Operations (To Save Transport Cost).
2. **Foreign Production Stage**: There is a limit to foreign sales (Tariffs, NTBs). Once the firm chooses foreign production as a method of delivering goods to foreign markets, it must decide whether to establish a foreign production subsidiary or license the technology to a foreign firm.

**Licensing**: It is usually the first experience because it is easy. It does not require any capital expenditure. It is not risky. Payment is a fixed % of sales. However, there are problems in this system. The mother firm cannot exercise any managerial control over the licensee (it is independent). The licensee may transfer industrial secrets to another independent firm, thereby creating a rival.

**Direct Investment**: It requires the decision of top management because it is a critical step. It is risky (lack of information). Plants are established in several countries. Licensing is switched from independent producers to its subsidiaries.

3. **Multinational Stage**: The company becomes a multinational enterprise when it begins to plan, organize and coordinate production, marketing, R&D, financing, and staffing. For each of these operations, the firm must find the best location. Among the Manufacturing MNCs 24 of top fifty firms are located in the U.S, 9 in Japan, 6 in Germany. Among Petroleum companies 6 out of 10 are located in the U.S. In the Food/Restaurant Chains 10 of 10 are in the U.S.

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### 8.2 MARKET IMPERFECTIONS

It may seem strange that a corporation can decide to do business in a different country, where it doesn't know the laws, local customs or business practices. Why is it not more efficient to combine assets of value overseas with local factors of production at lower costs by renting or selling them to local investors?

One reason is that the use of the market for coordinating the behaviour of agents located in different countries is less efficient than coordinating them by a multinational enterprise as an institution. The additional costs caused by the entrance in foreign markets are of less interest for the local enterprise. According to Hymer, Kindleberger and Caves, the existence of MNEs is reasoned by structural market imperfections for final products.\(^{1}\) In Hymer's example, there are considered two firms as monopolists in their own market and isolated from competition by transportation costs and other tariff and non-tariff barriers. If these costs decrease, both are forced to competition; which will reduce their profits. The firms can maximize their joint income by a merger or acquisition which will lower the competition in the shared market. Due to the transformation of two separated companies into one MNE the pecuniary externalities are going to be internalized. However, this doesn't mean that there is an improvement for the society.

This could also be the case if there are few substitutes or limited licenses in a foreign market. The consolidation is often established by acquisition, merger or the vertical integration of the potential licensee into overseas manufacturing. This makes it easy for the MNE to enforce price discrimination schemes in various countries. Therefore Humyer considered the emergence of multinational firms as "an (negative) instrument for restraining competition between firms of different nations".
Market imperfections had been considered by Hymer as structural and caused by the deviations from perfect competition in the final product markets. Further reasons are originated from the control of proprietary technology and distribution systems, scale economies, privileged access to inputs and product differentiation. In the absence of these factors, markets are fully efficient. The transaction costs theories of MNEs had been developed simultaneously and independently by McManus (1972), Buckley & Casson (1976), Brown (1976) and Hennart (1977, 1982) All these authors claimed that market imperfections are inherent conditions in markets and MNEs are institutions which try to bypass these imperfections. The imperfections in markets are natural as the neoclassical assumptions like full knowledge and enforcement don't exist in real markets.

8.3 INTERNATIONAL POWER

8.3.1 Tax Competition
Multinational corporations have played an important role in globalization. Countries and sometimes sub-national regions must compete against one another for the establishment of MNC facilities, and the subsequent tax revenue, employment, and economic activity. To compete, countries and regional political districts sometimes offer incentives to MNCs such as tax breaks, pledges of governmental assistance or improved infrastructure, or lax environmental and labor standards enforcement. This process of becoming more attractive to foreign investment can be characterized as a race to the bottom, a push towards greater autonomy for corporate bodies, or both.

However, some scholars for instance the Columbia economist Jagdish Bhagwati, have argued that multinationals are engaged in a 'race to the top.' While multinationals certainly regard a low tax burden or low labor costs as an element of comparative advantage, there is no evidence to suggest that MNCs deliberately avail themselves of lax environmental regulation or poor labour standards. As Bhagwati has pointed out, MNC profits are tied to operational efficiency, which includes a high degree of standardization. Thus, MNCs are likely to tailor production processes in all of their operations in conformity to those jurisdictions where they operate (which will almost always include one or more of the US, Japan or EU) which has the most rigorous standards. As for labor costs, while MNCs clearly pay workers in, e.g. Vietnam, much less than they would in the US (though it is worth noting that higher American productivity—linked to technology—means that any comparison is tricky, since in America the same company would probably hire far fewer people and automate whatever process they performed in Vietnam with manual labour), it is also the case that they tend to pay a premium of between 10% and 100% on local labor rates. Finally, depending on the nature of the MNC, investment in any country reflects a desire for a long-term return. Costs associated with establishing plant, training workers, etc., can be very high; once established in a jurisdiction, therefore, many MNCs are quite vulnerable to predatory practices such as, e.g., expropriation, sudden contract renegotiation, the arbitrary withdrawal or compulsory purchase of unnecessary 'licenses,' etc. Thus, both the negotiating power of MNCs and the supposed 'race to the bottom' may be overstated, while the substantial benefits which MNCs bring (tax revenues aside) are often understated.
8.3.2 Market Withdrawal
Because of their size, multinationals can have a significant impact on government policy, primarily through the threat of market withdrawal. For example, in an effort to reduce health care costs, some countries have tried to force pharmaceutical companies to license their patented drugs to local competitors for a very low fee, thereby artificially lowering the price. When faced with that threat, multinational pharmaceutical firms have simply withdrawn from the market, which often leads to limited availability of advanced drugs. In these cases, governments have been forced to back down from their efforts. Similar corporate and government confrontations have occurred when governments tried to force MNCs to make their intellectual property public in an effort to gain technology for local entrepreneurs. When companies are faced with the option of losing a core competitive technological advantage or withdrawing from a national market, they may choose the latter. This withdrawal often causes governments to change policy. Countries that have been the most successful in this type of confrontation with multinational corporations are large countries such as United States and Brazil which have viable indigenous market competitors.

8.3.3 Lobbying
Multinational corporate lobbying is directed at a range of business concerns, from tariff structures to environmental regulations. There is no unified multinational perspective on any of these issues. Companies that have invested heavily in pollution control mechanisms may lobby for very tough environmental standards in an effort to force non-compliant competitors into a weaker position. Corporations lobby tariffs to restrict competition of foreign industries. For every tariff category that one multinational wants to have reduced, there is another multinational that wants the tariff raised. Even within the U.S. auto industry, the fraction of a company's imported components will vary, so some firms favor tighter import restrictions, while others favor looser ones. Says Ely Oliveira, Manager Director of the MCT/IR: This is very serious and is very hard and takes a lot of work for the owner.

Multinational corporations such as Wal-mart and McDonald's receive benefits from government zoning laws, to create barriers to entry. Many industries such as General Electric and Boeing lobby the government to receive subsidies to preserve their monopoly.

8.3.4 Patents
Many multinational corporations hold patents to prevent competitors from arising. For example, Adidas holds patents on shoe designs; Siemens A.G. holds many patents on equipment and infrastructure; and Microsoft benefits from software patents. The pharmaceutical companies lobby international agreements to enforce patent laws on others.

8.3.5 Intra-firm Trade
Intra-firm trade plays a critical role in the operations of multinational companies. It may help an MNC to reduce costs, such as the distribution of goods or acquisition of inputs abroad, or it may help integrate production processes on a global scale. Intra-firm trade may respond differently to changes in economic conditions than trade between unrelated parties. For example, it may – at least in the short term – be more insulated from competitive forces in certain markets, or from overall changes in prices, exchange rates, or general economic conditions. Furthermore, prices
that govern intra-firm trade – often termed "transfer prices" – may have their own unique characteristics and determinants.

Statistics on intra-firm trade are largely missing. An exception is the United States, which is the home country of most of the world's largest multinationals. The Bureau of Economic Analysis (BEA) has detailed statistics on US multinationals' operations and on foreign multinationals' operations in the US, including intra-firm trade.

8.3.6 Government Power
In addition to efforts by multinational corporations to affect governments, there is much government action intended to affect corporate behavior. The threat of nationalization (forcing a company to sell its local assets to the government or to other local nationals) or changes in local business laws and regulations can limit a multinational's power. These issues become of increasing importance because of the emergence of MNCs in developing countries.

8.4 MICRO - MULTINATIONALS
Enabled by Internet based communication tools, a new breed of multinational companies is growing in numbers. These multinationals start operating in different countries from the very early stages. These companies are being called micro-multinationals. What differentiates micro-multinationals from the large MNCs is the fact that they are small businesses. Some of these micro-multinationals, particularly software development companies, have been hiring employees in multiple countries from the beginning of the Internet era. But more and more micro-multinationals are actively starting to market their products and services in various countries. Internet tools like Google, Yahoo, MSN, Ebay and Amazon make it easier for the micro-multinationals to reach potential customers in other countries.

Service sector micro-multinationals, like Indigo Design & Engineering Associates Pvt. Ltd., Face book, Alibaba etc. started as dispersed virtual businesses with employees, clients and resources located in various countries. Their rapid growth is a direct result of being able to use the internet, cheaper telephony and lower traveling costs to create unique business opportunities.

8.5 DOMINANCE OF MNCS
Multinational Corporations (MNCs) have greater flexibility in the movement of goods and resources. They have more leverage in playing one country against the other for government concessions.

Corporations had therefore the potential, from the onset, to become very powerful. Even Abraham Lincoln recognized this. "I see in the near future a crisis approaching that unnerves me and causes me to tremble for the safety of my country. ... corporations have been enthroned and an era of corruption in high places will follow, and the money power of the country will endeavor to prolong its reign by working upon the prejudices of the people until all wealth is aggregated in a few hands and the Republic is destroyed." -- U.S. President Abraham Lincoln, Nov. 21, 1864 (Letter to Col. William F. Elkins) Ref: "The Lincoln Encyclopedia", Archer H. Shaw (Macmillan, 1950, NY).
Adam Smith, in his famous book the Wealth of Nations, the "bible" of capitalism, was also critical of some aspects of corporate activity. He saw corporations as working to evade the laws of the market, trying to interfere with prices and controlling trade etc.

**MNCs are accused of numerous negative externalities as follows:**

1. The benefits of foreign investment are poorly or unfairly distributed between the MNC and the host country.
2. MNCs preempt the development of an indigenous economic base by squeezing out local entrepreneurs.
3. They employ inappropriate capital-intensive technology, adding to country unemployment.
4. The worse the distribution of income in the host country.
5. They alter consumer tastes in the host country, undermining its culture.
6. They subvert host country political processes by co-opting the local elites and using their influence to keep host governments and authorities in line.

Conflicts arise from the exercise of economic power by MNCs with regard to company objectives rather than the interests of the countries involved. The interest of the countries rarely coincides, so that MNCs would find it impossible to meet all of their needs anyway.

**Host countries influence MNCs behavior in a variety of ways:**

1. Developed countries set the rules of the game.
2. Third world countries lack regulations or mechanisms to enforce regulations that do exist.
3. Third world countries lack legal and administrative institutions and the technical proficiency to implement national policies.
4. An international regulatory structure has evolved over the years to deal with some of these problems, since it is impossible for any single country to effectively deal with multinationals unilaterally.

**8.6 INTERNATIONAL REGULATORY STRUCTURE**

1. United Nations Centre on Transnational Corporations (UNCTC) has developed an international code of conduct to provide a stable, predictable, and transparent framework to facilitate the flow of resources across national boundaries. The code has been criticized as not being performance oriented with political objectives to redistribute wealth and income.
2. The General Agreement on Tariffs and Trade (GATT) was formed in October 1947 as the world's trading club. (Members account for over 80 percent of world trade.) Its purpose is to promote world trade.
3. The United Nations Conference on Trade and Development was formed in response to disappointment over GATT's performance for less developed countries (the distribution of benefits).
4. The Organization of Economic Cooperation and Development was formed. Guidelines are an attempt by industrialized countries to regulate MNCs to suit their objectives.
NAFTA and the EEC are examples of regional organization to remove trade constraints and include consideration of regional regulatory policies of such things as working conditions and environmental standards. These include:

- Stimulation of trade between participating countries.
- Participation of countries to give up some degree of sovereignty in terms of economic matters.
- Encouragement of lower prices, economies of scale and technology transfer.

National Policy involves unilateral policy to regulate MNCs in order to accomplish national goals and objectives. They may use fiscal policy, trade policy, technology transfer limitations, and other national policies to affect a firm's operations. In the US these policies are applied to operations of MNCs in foreign countries. These include:

1. Laws affecting competitive conduct in foreign countries.
2. Technology transfer into countries that might have national security implications
3. Bribery in foreign countries.
4. Policies to stimulate exports and restrict imports of foreign goods and services
5. Imposition of economic sanctions to accomplish certain political objectives.

8.7 ETHICS AND MULTINATIONALS

MNCs can be caught between different standards and expectations regarding ethical behavior in different countries. Cultural relativism may result in acceptable behavior in some countries that is unacceptable in this country. How should MNCs respond?

1. Adopt a when-in Rome-do-as the-Romans-do policy?
   Or
2. Adopt a uniform worldwide standard of behavior?

The foreign payments controversy in the early 1970s during which companies made questionable payments to politicians for election or favors and to agents of the government to win contracts caused great concern among U.S. officials and the public. Business tried to explain that these payments were a necessary cost of doing business. The public concern was that these payments corrupted the free enterprise system. Theoretically, a third party solution could be provided by an international body. The United Nations prepared resolutions but they were never formulated into an international code of conduct.

Eventually Congress passed the **Foreign Corrupt Practice Act (1977)** that contains both anti-bribery provisions and accounting provisions. There has been a growing consensus regarding multinational guidelines that includes:

1. Employment practices and policies;
2. Consumer protection;
3. Environmental protection;
4. Political payments and involvement;
5. Basic human rights and fundamental freedoms;

**International Public Affairs** are more complex because of advanced in foreign trade and direct foreign investment by US companies. Public affairs programs are necessary for MNCs to cultivate markets and adjust products and services to the needs and tastes of foreign consumers, and to adapt to the priorities and values of host governments. They perform the same basic functions as all companies with respect to their external but the process is more complicated. Functions of international public affairs staffs include:

1. Issues scanning and analysis;
2. Forecasting and planning;
3. Relations with overseas officials;
4. Political risk analysis;
5. International philanthropy and community relations;
6. Development of international codes of conduct.

**Multinational Corporations and Human Rights:** Large, transnational corporations (TNCs) are becoming increasingly powerful. Additional problems are resulting and a variety of social justice, human rights, third world development and environmental groups, amongst others are raising a number of concerns, including the followings:

- Profits are the driving factor, not necessarily the way their workers are treated, or how society and the environment are affected.
- Corporations are often major violators of human rights.
- There is a deliberate lack of social clauses and regulations (to maximize profits)
- Large companies often use or lobby for conditions that result in manipulated international trade pacts and agreements, in order to maximize profits, via things such as cheap labor. (Many of these agreements have also not been democratically decided; hence most people are not aware of some of the issues that may have left them in certain conditions.)
- This can also be seen in the form of sweat shops or child labor in the developing world to promote their products back in the West.
- Tax avoidance is thought to have enormous costs to the general public.
- Without the ability to form unions that would be able to give a voice to the workers, (which gives us a hint as to why major corporations and its mainstream media demonizes all unions so much) the future looks bleak. (As a Human Rights Watch report details, even the United States suffers from the denial of such rights.)
- Despite rhetoric of many corporations signing up to human rights related pacts and agreements, their lack of real commitment is still apparent

**Multinational Corporations & Environment:** Global Environmental Problems gained new importance in the 1980s when global warming and ozone depletion added to the emphasis upon international environmental cooperation with regard to air pollution.

Corporate interests and actions can harm the environment. Economics and globalization affect the environment as the capital flowing into the developing nations are often funding projects that are potentially damaging to the world's environment. Yet, many of these are presented as either
development projects or countered as actually being favorable (or at least not harming) the environment.

In the late 1990s attention was drawn to a United Nations (U.N.) project to get corporate collaboration/sponsorship in development projects, supporting human rights and the environment, and being generally more responsible and accountable. However it fell under a lot of criticism for involving corporations that are known to have contributed or caused some of the more severe human rights and environment problems, allowing these companies to attempt to repair their tarnished image, while not actually tackling the problems.

In May 2002, the United Nations Environment Program (UNEP) released an extensive report saying that there was a growing gap between the efforts to reduce the impact of business and industry on nature and the worsening state of the planet and that this gap is due to the fact that only a small number of companies in each industry are actively integrating social and environmental factors into business decisions.

One sharp example of environmental problems caused by multinational corporations is the drive to extract oil from Nigeria. In Africa, corporations have even backed the military to harass, even kill, local people who continue to protest at the environmental and other problems the activities of the various oil companies have caused.

The interests of the various big polluters, such as the auto, mining, oil and chemical corporations influenced the Kyoto Global Climate Change Conference outcome. Corporate interest could be said to be behind biotechnology and genetically engineered food production, which may be counter to issues relating to feeding the world's hungry. The concerns on the environment are therefore magnified.

With increased consumerism, there has been a rise in the number of environmental groups campaigning on various issues such as environmentally friendly products. To varying extents then, environmental concerns are issues that sometimes make the mainstream news. However, a cover story, of Down To Earth magazine from Delhi-based Centre for Science and Environment as an example, warns that the latest craze in green and ethical consumerism may just be another way for corporations to exploit people and make money by misrepresenting the facts. As another example of this, Earth Day Resources' annual - Don't Be Fooled Awards - highlight some of what they call the corporate "green washing" that goes on through advertising and lobbying campaigns.

There are countless examples where corporate involvement in various issues could contribute to environmental problems as a result. Corporations are major entities in the world and thus have an enormous impact (negative and positive) on all our lives. And concerns of overly corporate-led globalization contributing to environmental problems are increasing, as reported and documented by countless environmental and social justice groups around the world. It should be noted of course, that the larger multinational corporations and industries are extremely influential in politics, media and so on, and hence have a key role to play, good and bad.
Politics and Corporate Interests can be Intertwined: the political sides of things, there have been countless measures pushed and lobbied for that favors corporations directly or indirectly getting out of some of their responsibilities on environmental issues by passing on the costs to others. Various environmental groups constantly campaign on such issues, so this comes as no surprise to state this. But political frameworks can often from the onset cause enormous problems.

In 1991, then Chief Economist for the World Bank Lawrence Summers, (and US Treasury Secretary, in the Clinton Administration, until George Bush and the Republican party came into power), had been a strong backer of the controversial structural adjustment policies. He wrote in an internal memo:

"Just between you and me, shouldn't the World Bank be encouraging more migration of dirty industries to the LDCs (less developed countries)? The economic logic behind dumping a load of toxic waste in the lowest wage country is impeccable, and we should face up to that. Under-populated countries in Africa are vastly under-polluted; their air quality is probably vastly inefficiently low compared to Los Angeles or Mexico City The concern over an agent that causes a one in a million change in the odds of prostate cancer is obviously going to be much higher in a country where people survive to get prostate cancer than in a country where under-five mortality is 200 per thousand."

Even what appeared in an Economist article, by a foremost pusher of Structural Adjustment, we see that politics can affect markets to help or worsen environmental issues. Furthermore, in this issue, it gives a further excuse for corporations to prevent refitting factories in the first world with the costly environmentally oriented measures and protections, and move elsewhere where regulations have been reduced or removed thanks to economic "agreements". As a result, we may see a relatively cleaner environment in the industrialized world, but it is not all explainable by using newer technologies (which is certainly one of the explanations).

8.8 CORPORATIONS AND WORKER'S RIGHTS

Structural Adjustment programs of the IMF and World Bank have led to a race to the bottom, where standards of living are continuously reduced. Labor, as one example of this, gets cheaper and cheaper which benefits the multinational companies, but not the workers themselves. Various international trade agreements that large corporations are able to strongly lobby favorable conditions in, are often designed in part to make resources (including work forces) cheaper.

As some corporations and industries become increasingly globalize, they effect more and more people. Take for example the situation in Massachusetts -- they were trying to put laws in place to prevent or restrict corporations doing business with regimes that violate certain rights of people in some way -- they were pressured by a coalition of 600 major corporations in that State, saying that this is unconstitutional. The judges agreed.
Famous brands like Nike and many others all do this. In some respect it is a cycle of competition driving each other to such measures to keep up and to maximize profits. Nike, for example use cheap labor in South East Asia, where they can get away from the tighter enforcement and regulations of USA and Europe. In fact, they have been exposed for using child labor, as well.

The apparel industry has often been strongly criticized for the use of sweat shop-like conditions in its East Asian factories. In May 1998, for example, a panel of experts on international law condemned the violation of workers rights in the garments and sportswear industries; twelve witnesses from ten developing countries had testified on actual working conditions in the industry, pointing out seven leading transnational: sportswear manufacturers Nike and Addidas, clothing traders H&M, Levi Strauss, C&A and Walt Disney, and the world's biggest mail order company, Otto-Verstand.

Harsh labor conditions in the toy industry for people in third world countries such as China have also led to much criticism, showing “hidden costs” to popular toys such as those based on Harry Potter, Star Wars, Pokemon, Barbie, etc.

It is interesting to note that while globalization has led to the opening up of borders for increased trade the same is not true for people. Yet, people all over the world seem be losing their national identity due to the current model of globalization. The introduction of “flexibility”, while good for businesses, can hurt workers, as the International Labor Organization (ILO) has shown.

The famous McLibel action against McDonald's came about because of various abuses of its power and threats of legal action for any criticism about them. While individuals have tried to present some facts about various aspects of the way McDonald's do business, some media companies have been prevented them doing so. These media corporations themselves are worried about publishing and broadcasting certain information that could lead to threats of legal action and other forms of corporate punishment even when the claims are fair and justified.

Human Rights Watch has criticized the labor situation in the United States. In general, the USA provides a better standard of living, opportunities etc. than most countries. However, that does not mean that it is free from problems as well. The following quote summarizes it quite well:

“Without diminishing the seriousness of the obstacles and violations confronted by workers in the United States, a balanced perspective must be maintained. U.S. workers generally do not confront gross human rights violations where death squads assassinate trade union organizers or collective bargaining and strikes are outlawed. But the absence of systematic government repression does not mean that workers in the United States have effective exercise of the right to freedom of association. On the contrary, workers' freedom of association is under sustained attack in the United States, and the government is often failing its responsibility under international human rights standards to deter such attacks and protect workers' rights”. -- Unfair Advantage; Workers' Freedom of Association in the United States under International Human Rights Standards, Human Rights Watch, August 2000. They go on to show that while the US has many provisions in its laws to protect workers, there are many aspects of the laws which undermine such rights and that there is often very little done to uphold fundamental rights to the freedom of associations etc.
8.9 MOVING ON

A meeting in Oslo suggests that the current model of the Markets and Globalization may not be the way to go. This is because when it comes to a country trying to impose some environmental or societal considerations and legislation on multinational corporations, they just move to a country where the rules and regulations aren't as strict. One reason that this situation arises is because of the flawed structural adjustment programs which force developing nations to continuously cut back in order to export more at a cheaper rate and race to the bottom. Take the following as examples:

- **Coca Cola in Zambia** have closed their operations there due to disagreements about tax exemptions.
- How the tobacco industry is now moving on to Asia as sales in USA and Europe decline and the US settlements do nothing to prevent this. India is one example where there is tremendous increase in smoking, and smoking related illnesses and death.
- **Nike**, as mentioned above, as well as many other retail companies, uses cheap labor in South East Asia, where they can get away from the tighter enforcement and regulations of USA and Europe.
- **Phillips-Van-Huesen** has been criticized for closing a factory in Guatemala because the workers tried to form a union to protect their basic rights. A report by three human rights organizations revealed the details. It reveals how the company closed a factory in order to destroy the union and profit from lower wages by sweatshop contractors in Guatemala.
- In April 2002, **Levi Strauss & Company**, “a brand practically synonymous with the U.S.A., decided to shutter virtually all domestic production and shift its manufacturing overseas.” Earlier, in 1992, the Washington Post had exposed Levi's exploitation of Chinese prison labor to make jeans and throughout the 90s, various apparel companies had been accused of various forms of exploitation and sweatshop labor in poorer countries. Levis tried to introduce a code of standards, but it seems that Levis too has been feeling the competition pressure and in order to maximize profits and reduce costs, now also feels compelled to join the herd, so to speak, and go for cheaper labor costs.
- **Even baby foods** have an impact on poorer countries. Multinational companies, such as Nestle, that create breast milk substitutes promote their use very heavily in many developing countries, as a replacement for breast feeding altogether. This is shown to have negative health effects on babies. UNICEF in their 1995 State of the World's Children report describe how millions of children needlessly died due to not being exclusively breast-fed for the first six months. UNICEF, the World Health Organization and others came up with a code of conduct to ensure responsible advertising and promotion of substitute products. 118 governments accepted. Only the United States didn't. John Madeley described that Nestle and other baby foods companies had put pressure on governments not to introduce strong codes. Gabon, Pakistan, South Africa, Sri Lanka, Swaziland, Uganda, Uruguay and Zimbabwe came under pressure in 1997 and 1998. In Zimbabwe, Nestle reportedly threatened to disinvest from the country if strong measures were introduced. -- John Madeley, Big Business Poor Peoples; The Impact of Transnational Corporations on the World's Poor.
8.10 MULTINATIONAL COMPANIES IN INDIA

The post financial liberation era in India has experienced huge influx of 'Multinational Companies in India' and propelled India's economy to greater heights. Although, majority of these companies are of American origin but it did not take too long for other nations to realize the huge potential that India Inc offers. 'Multinational Companies in India' represent a diversified portfolio of companies representing different nations. It is well documented that American companies accounts for around 37% of the turnover of the top 20 firms operating in India. But, the scenario for 'MNC in India' has changed a lot in recent years, since more and more firms from European Union like Britain, Italy, France, Germany, Netherlands, Finland, Belgium etc have outsourced their work to India. Finnish mobile handset manufacturing giant Nokia has the second largest base in India. British Petroleum and Vodafone (to start operation soon) represent the British. A host of automobile companies like Fiat, Piaggio etc from Italy have opened shop in India with R&D wing attached. French Heavy Engineering major Alstom and Pharma major Sanofi Aventis is one of the earliest entrants in the scene and is expanding very fast. Oil companies, Infrastructure builders from Middle East are also flocking in India to catch the boom. South Korean electronics giants Samsung and LG Electronics and small and mid-segment car major Hyundai Motors are doing excellent business and using India as a hub for global delivery. Japan is also not far behind with host of electronics and automobiles shops. Companies like Singtel of Singapore and Malaysian giant Salem Group are showing huge interest for investment.

In spite of the huge growth India Inc have some bottlenecks, like:

- Irrational policies (Tax structure and Trade barriers).
- Low invest in infrastructure - physical and information technology.
- Slow reforms (political reforms to improve stability, privatization and deregulation, labor reforms).

A report says, performance of 3 out of every 4 'Multinational Companies' has met or exceeded internal targets and expectations. India is perceived to be at par with China in terms of FDI attractiveness by 'Multinational Companies in India'. In view of 'Multinational Companies' community, it ranks higher than China, Malaysia, Thailand, and Philippines in terms of MNC performance. Multinational Companies operating in India cite India's highly educated workforce, management talent, rule of law, transparency, cultural affinity, and regulatory environment as more favorable than others. Moreover, they acknowledged, India's leadership in IT, business processing, and R&D investments. 'Multinational Companies in India' are bullish on:

- India's market potential.
- Labor competitiveness.
- Macro-economic stability.
- FDI attractiveness.
GLOBALIZATION OF WORLD ECONOMY

Structure

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9.1 INTRODUCTION

What is Globalization?
Economic "globalization" is a historical process, the result of human innovation and technological progress. It refers to the increasing integration of economies around the world, particularly through trade and financial flows. The term sometimes also refers to the movement of people (labor) and knowledge (technology) across international borders. There are also broader cultural, political and environmental dimensions of globalization.

At its most basic, there is nothing mysterious about globalization. The term has come into common usage since the 1980s, reflecting technological advances that have made it easier and quicker to complete international transactions—both trade and financial flows. It refers to an extension beyond national borders of the same market forces that have operated for centuries at all levels of human economic activity—village markets, urban industries, or financial centers.

Markets promote efficiency through competition and the division of labor—the specialization that allows people and economies to focus on what they do best. Global markets offer greater opportunity for people to tap into more and larger markets around the world. It means that they can have access to more capital flows, technology, cheaper imports, and larger export markets.
But markets do not necessarily ensure that the benefits of increased efficiency are shared by all. Countries must be prepared to embrace the policies needed, and in the case of the poorest countries may need the support of the international community as they do so.

Who are the Players?

Pro – Globalization:

- **International Organizations:** World Trade Organization, International Monetary Fund, World Bank, The Organization for Economic Cooperation and Development (OECD), United Nations Conference on Trade and Development (UNCTAD), World Economic Forum, etc.
- **Public Affairs Organization:** World Growth Organization, Institute of Economic Affairs, International Policy Network, etc.

Anti- Globalization:

- **Environmentalist groups:** Friends of the Earth, The Sierra Club, Greenpeace The Centre for International Environmental Law, etc.
- **Social Development Agencies:** International aid agencies, such as Oxfam and World Vision International
- **Third world government organizations:** The South Centre, the Group of and left activist organizations on developing issues, such as the Third World Network

**Trade Unions and Globalization:** As globalization throws up problems for workers that do not respond to purely national solutions, international co-operation and solidarity between trade unionists, unions, national centres (such as the TUC) and international trade union organizations play an increasingly crucial role in safeguarding workers' rights.

Some of the key problems arising from, or intensified by globalization are listed below:

- Tackling Trade Union and Human Rights Abuses;
- Balancing the Power of Multinationals;
- Unions Unite against HIV/AIDS;
- Protecting Public Services

9.1.1 International Forum on Globalization (IFG)

The IFG first convened in San Francisco in January 1994 in the wake of the North American Free Trade Agreement's (Anita’s) passage and the conclusion of the Uruguay Round of the General Agreement on Tariffs and Trade (GATT). For the groups and leaders who had worked tirelessly to explain to the public and to policymakers that the proposed trade agreements would lead to multiple negative consequences, it was time to regroup.

At first the IFG functioned as a think tank among some thirty people (later expanded to over sixty) to discuss the issues and develop alternative strategies that might reverse the globalization trend and redirect actions toward revitalizing local economies. The meetings enabled associates
to work through differences among themselves—for example, the different frames of reference between "northern" and "southern" (Third World) activists. Other discussions focused on the differing views of environmental and labor issues within trade agreements; the role of new technologies in the globalization juggernaut; and the steps needed to re-localize control. The meetings provided an un-pressured atmosphere to begin a process of co-education and collaboration.

Based on these meetings, IFG associates agreed to begin speaking out against economic globalization because it was clear that public discourse—in the media, academia, and among governments—had not seriously questioned the commonly held belief that a globalize economy would "lift all boats." Nor was it understood that viable alternative perspectives and analyses existed.

**The goal of the IFG, therefore, is twofold**

1. Expose the multiple effects of economic globalization in order to stimulate debate;
2. Seek to reverse the globalization process by encouraging ideas and activities which revitalize local economies and communities, and ensure long term ecological stability.

**Globalization, Growth and Poverty**

Globalization has helped reduce poverty in a large number of developing countries but it must be harnessed better to help the world’s poorest, most marginalized countries improve the lives of their citizens, according to the report Globalization, Growth and Poverty: Building an Inclusive World Economy. This is especially important in the wake of September 11 and the worldwide economic slowdown, which is expected to hit poor people particularly hard.

The study shows that 24 developing countries that increased their integration into the world economy over two decades ending in the late 1990s achieved higher growth in incomes, longer life expectancy and better schooling. These countries, home to some 3 billion people, enjoyed an average 5 percent growth rate in income per capita in the 1990s compared to 2 percent in rich countries. Many of these countries—such as China, India, Hungary and Mexico—have adopted domestic policies and institutions that have enabled people to take advantage of global markets and have thus sharply increased the share of trade in their GDP. These countries have been catching up with the rich ones—their annual growth rates increased from 1 percent in the 1960s to 5 percent in the 1990s. People in these integrating countries saw their wages rise, and the number of people in poverty declined.

But not all countries have integrated successfully into the global economy. The report says that some 2 billion people—particularly in sub-Saharan Africa, the Middle East, and the former Soviet Union—live in countries that are being left behind. These countries have been unable to increase their integration with the world economy; their ratio of trade to GDP either remained flat or actually declined. On average, these economies have contracted, poverty has risen, and education levels have risen less rapidly than in the more globalize countries.

The study puts forth a seven-point plan to help all developing countries better take advantage of the benefits of globalization while managing the risks. It calls on poor countries to improve their
investment climates and put in place better social protection to support poor people in adapting to and taking advantage of opportunities in a changing economic environment. It also calls upon rich countries to open their markets to exports from developing countries and to slash their large agricultural subsidies, which undercut poor country exports. The report argues for a substantial increase in development assistance, particularly to address problems in education and health.

9.1.2 The Seven-Point Plan of Actions

A ‘Development Round’ of Trade Talks: Developing countries would gain enormously if rich nations make the WTO Doha Development Agenda a reality and agreed to bring down their trade barriers. Poor workers in developing countries today face tariffs twice as high as workers in rich countries. This must change. Rich countries must also take action to reduce dramatically their agricultural subsidies – which currently stand at $350 billion a year, roughly seven times what rich countries spend on development aid. These subsidies not only hurt poor people in developing countries, they also mean higher taxes and higher prices for people in rich countries. Developing countries would also benefit from better access to each other’s markets – barriers between them are still higher than the barriers they face in rich countries.

Improving the Investment Climate in Developing Countries: Encouraging investment and creating jobs requires good economic governance – measures to combat corruption, better-functioning bureaucracies and better regulation, contract enforcement, and protection of property rights. This is especially important for small and medium-sized firms and farms which are key to job creation and to raising living standards of the rural poor.

Improving Delivery of Education and Health Services: The developing countries that have gained the most from integrating into the world economy have shown impressive gains in primary education and infant mortality. This suggests that many countries have made investments in education and health services that enable the poor to benefit from growth.

Provide Social Protection to a Changing Labor Market: Tailoring social protection to the needs of a changing economy helps individual workers adjust to the challenges of a more open economy. Better social protection enables workers and entrepreneurs to take more risks and to avail themselves of new opportunities.

Rich Nations Should Increase Foreign Aid – Evidence shows that private investors can be slow to respond when low-income countries improve their investment climate and social services. It is precisely at this stage when large-scale aid can have a great impact on growth and poverty reduction. Aid should also address the serious health and geographic problems of the most marginalized countries. Foreign aid has fallen to 0.22 percent of donor countries' GDP --its smallest proportion since it was first institutionalized with the Marshall Plan in 1947.

Support Debt Relief for Reformers – Reducing the debt of the most marginalized countries, especially in Africa, will enable them to participate more in globalization and the benefits it can bring. Debt relief is particularly powerful for those countries that improve their investment climate and social services. Debt relief packages are now in place for 25 countries under the enhanced HIPC Initiative for which total committed assistance is estimated at some US$36
billion. It is critical, though, that further debt relief should not come out of the shrinking pie of foreign aid, which would simply move aid resources around. Debt relief must come in addition to foreign aid.

**Tackling Greenhouse Gases:** There is broad agreement among scientists that human activity is leading to potentially disastrous global warming, and that these changes in climate will be especially burdensome for poor countries and poor people. The report urges more effective international cooperation to address these problems.

**9.1.3 The Role of the World Bank**

In 1995, there was no comprehensive mechanism in place for debt relief for the poorest countries, by either the multilateral institutions or other creditors. Today, 22 countries have begun receiving debt relief under the **Heavily Indebted Poor Country (HIPC)** Initiative, 18 of them in Africa—for a total of $34 billion. The total external debt of these countries will be reduced by two-thirds, lowering their indebtedness to levels below the average for all developing countries.

After HIPC debt relief, these countries will spend about 2 percent of GDP on debt service—well below the level in other developing countries—compared to about 7 percent on social expenditures. More countries joined the first 22 by the end of 2001. They hope that the remaining countries eligible for relief under the HIPC Initiative will emerge from war or conflict so that they too can complete the program.

But agreements on debt relief alone are not enough. They need to be linked with explicitly articulated development strategies targeting poverty reduction. World Bank is helping countries prepare such poverty reduction strategy papers (PRSPs). Today, they have interim PRSPs with 32 countries and completed PRSPs with 4 countries.

Development is not about a quick fix or a silver bullet. Nor will it endure if it does not have broad-based support. What is significant about this new approach, embodied in the PRSP, is that it is comprehensive, long-term, and involves the participation of all the players, including the private sector and civil society. As such it stands a much better chance not only of surviving major political shifts, but also of reaching deep into communities and societies where real change takes place. They now need to broaden this approach further by including in it measurements of results and accountability for performance by governments, the international and bilateral institutions, civil society, and the private sector so that we can track progress as we go forward.

There have been other important changes in the Bank's work and its focus. HIV/AIDS has infected more than 50 million people worldwide and killed close to 21.8 million, over 17 million of them Africans. Few years ago the Bank was committing $35 million to fight HIV/AIDS; they have now moved to a commitment of $1 billion, an increase of almost 30 times. And they will make more money available as effective programs are developed. They are working on prevention and working through public education programs, local clinics, and village groups; but they have also been active on the issue of treatment and the cost of retroviral drugs. And they are all too conscious of the fact that HIV/AIDS and other
communicable and deadly diseases can only be addressed after dealing with health service delivery systems in general, and in this aspect we have been, and will continue to be, engaged.

They are also stepping up their work on post-conflict situations. Few years ago they had 15 post-conflict operations; today they have 35, and they are looking at how the Bank can get involved in post-conflict countries at an earlier stage. Their contribution will be to work with countries and regions to create the growth and social equity that will help prevent conflict.

Few years ago, they in the Bank did not speak about corruption – it was seen as too political and, for many, an impossible challenge. Today they are working on anti-corruption and good governance programs in 95 countries.

Few years ago, there was little or no focus on community-driven development. Today they have over $1.5 billion in commitments—projects such as the nutrition project in Mozambique that has radically reduced the incidence of malnutrition, and the social funds in Malawi. Their objective is to see these kinds of community programs replicated all across Africa and throughout the developing world. They believe that people who live in poverty should not be treated as a liability, but rather as a creative asset that will contribute more than anyone else to eradicate poverty. They do not want charity, they want a chance, and community-based development programs provide such an opportunity.

Their experience in reaching out to communities in India, China, and transition countries has been very promising. Today over 70 percent of their projects involve civil society and communities in some way, up from below 50 percent in 1995. In all these endeavors, the key is to move from projects to programs that can be replicated and expanded on a national scale. There are other demands. The Bank also focuses on gender issues. The Bank has the comprehensive environmental and social safeguard policies.

9.2 GLOBAL INTEGRATION

Large political empires no longer drive change as in the past. With the fall of the three-world order, the open marketplace has appeared as a new interpretative paradigm. U.S. success has driven the globe in this direction, even as global cultures have redefined America. Also significant is the rise of transnational forces that have begun to affect the sovereign autonomy of nation-states. Education, economic prosperity, and political rights are expanding. Nevertheless, many still remain behind.

9.2.1 Finance and Trade

Pulling back from formal management of money, state leaders turned to policy that called for unrestricted, deregulated markets and profits rather than the welfare-oriented Keynesian approach. This made it easier for investors to transact business in the international financial sector. In the 1980s, Latin American nations, defaulting on IMF loans, widely opened domestic markets and initiated a boom in international finance which other countries followed. The Internet has allowed rapid movement of money.
Globalization has stimulated commercial interdependence as goods move around the globe. Trade has also shifted the division of labor as manufacturing spread internationally and economic growth accelerated in places like Asia. Fearing competition, regional open-trade blocs such as NAFTA and the European Union have arisen. As changes occur, new goods have risen in importance, including services, computers, and pharmaceuticals. Information-based production has risen dramatically in wealthy nations while knowledge remains scarce in poorer nations.

9.2.2 Migration
The movement of people has also increased integration as individuals and families leave poor countries to seek opportunities in wealthier ones. Ironically, migrants frequently follow the tracks of vacating imperialist powers. Even as corporations locate their factories in poorer nations, laborers there often prefer migration and the lowest wages in richer nations. International migration has been accompanied by regional and national migration from poor rural areas to urban centers, as in Nigeria. Migration is often viewed as temporary, particularly since it is difficult to integrate into European or Japanese society. Nevertheless, labor shortages often require these temporary migrant workers, who, establishing homes, become targets of exclusion and violence.

The United States has had less trouble integrating migrants coming from places like Mexico or Asia, and migration has transformed the ethnic composition of cities, particularly Los Angeles. As the number of migrant workers has increased, nations have had to grapple with relative integration and the ethnic makeup of political communities. While most migrants move voluntarily, many are still forced to move as a result of violence. Africa hosts the largest concentration of such migrants.

9.2.3 Culture
While American culture’s popularity and spread is largely responsible for the rise of a global entertainment culture, it takes its cues increasingly from other parts of the world. Thus, on a global scale there is less diversity, but from the perspective of an individual there is opportunity for much more.

New Media: Cassettes and CDs, television, films, and even international cable networks have helped distribute culture around the globe. Sports have become an international industry, as evidenced by Michael Jordan’s popularity and the impressive support of international sporting events like the World Cup.

Global Culture: Migration has allowed cultures to spill into new areas and take root or generate completely new genres. Often music or TV serials, for example, have become tied to youth or ethnic cultures trying to express dissatisfaction with the political status quo. Governments do not ignore these challenges and sometimes seek to resist "Americanization." At the same time, American culture has expanded to embrace other non-American performers.

Local Culture: Local cultural developments do not merely imitate global cultural norms, but they have often created expressions based on local or national cultural icons. Culture has also adapted to local tastes and rules that tend to reward the "fittest" only. In China this means dealing with censors, while elsewhere it means dealing with unions or simply the demands of the market.
Competition has opened the way for blacks, women, and homosexual performers. Globalization has led to an increasingly homogenized world culture, yet has also stimulated local cultures that have become increasingly diverse.

9.2.4 Communications
Advanced communications in the form of telecommunications, computers, and the World Wide Web have greatly increased the trend toward globalization. New opportunities for wealth creation over international boundaries have produced some of the world’s richest people. Indian, Mexican, and Taiwanese firms produce computers and educate fleets of computer programmers. As communication opportunities expand, the gap between rich and poor has become increasingly determined by who can get online and who cannot. In short, globalization has led to integration, but also to wider economic disparities.

9.3 THE DEMOGRAPHY OF GLOBALIZATION
Declining mortality rates have boosted the world’s population dramatically but at faster rates in Asia, Africa, and Latin America. Wealthier nations and the poorest nations show slower growth rates or declining rates. China’s burgeoning growth rates led the government to adopt a "one-child policy." In wealthier nations, declining birthrates came as a matter of choice and lifestyle.

Families: The definition of family has become fluid, with divorces and out-of-wedlock births increasing.

Aging: People live longer, creating older populations. Lower fertility rates have allowed the percentages of older citizens to gain on the percentages of younger people. This increasingly burdens a society seeking to support an expanding aged population. In societies that have no welfare programs, this creates dire circumstances.

Health: In rich, modernized cities, epidemics have been held in check. Developing nations hosting urban squalor, however, still have trouble containing disease. The spread of AIDS has changed personal behavior and has led to a variety of expensive treatments unavailable in poorer nations where education has not been readily available.

Education: In some areas like India, more men are more educated, while women still lag behind, often laboring under severe poverty. In the United States, women secure more than half of all college degrees. In China, education has gained great strides but still has far to go in rural areas, particularly for women.

Work: Women have entered the workplace in greater numbers but have yet to reach parity with men in their competition for top positions. Child care continues to divide the time of women. Working women in Canada and Australia needing child-care services often employ others who frequently end up being women from Jamaica or the Philippines with children of their own.

Feminism: Feminist calls for changes in the status and condition of women went global in the 1970s. Seeking equal pay and opportunity, global feminism fights discrimination that keeps
women in positions of subordination. In 1995, Beijing hosted the Fourth World Conference on Women to produce "a platform for action" on policies affecting women.

**Production and Consumption**: Production and consumption have also changed considerably. How to feed a global population has been the predominant challenge.

- **Agricultural Production**: Chemistry and biology have accelerated agricultural production, but more so in America and Asia than elsewhere, where opening new land by destroying rain forests is cheaper. In Africa, agriculture simply has not kept up due to political constraints, lack of incentives, and poor markets for goods. Starvation, therefore, became common during the 1980s.
- **Natural Resources**: Americans produce much, but they consume great quantities of water, energy, and fossil fuels. In 1991, these consumption needs led to the Gulf War.
- **Environment**: Pollution has become a problem of global proportions. Many polluters have merely moved to poorer nations, thus shifting the onus. Pollution in poorer nations is often the price paid for economic development and payment of international loans. As pollution problems rise, national leaders find it increasingly difficult to reach agreements. In 1986, Chernobyl’s meltdown signaled a new level of international urgency.

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### 9.4 RISKS AND OPPORTUNITIES OF GLOBALIZATION

1. **The "Globalization" process and the role of the market**: As a market phenomenon, globalization originates from technical progress and particularly from its capacity to reduce the cost of mobilizing goods, services, money, people and information. This reduction of "economic distance" has allowed the current regulation opportunities to be employed in the markets of goods, services and factors, diminishing (although not eliminating) the importance of geography and the effectiveness of political blocks. In its current situation, the "Globalization" process also increases the capacity of the participants to geographically fragment the productive processes, which has a counterpart the sustained growth of commerce (especially of manufacturing) and international investment.

Cohen (1996) states that the discipline (macroeconomic) imposed by the integration of the financial markets is less than it seem for at least three reasons.

- The first is that fiscal and monetary policies have limited long term impact on the true variables of the economy, even in circumstances in which the mobility of the capital is imperfect.
- The second is that the mobility of the capital is not yet perfect, as demonstrated by the empirical investigations on the degree of possibility of substitution that exists among different national actives.
- In third place, to a certain degree, the authorities are still faced with trade-offs between their political autonomy and the degree of exchange instability that resulted. Unless authorities have an absolute preference for the stability of the type of the change, normally it is possible to preserve a certain degree of autonomy in the management of the macroeconomic policies in exchange for a certain level of exchange volatility.
As a result, even in areas directly affected by the vast process of financial globalization the national authorities preserve degrees of autonomy. This autonomy, however, is not distributed in a homogeneous fashion: some national States (and their public authorities) have greater access to it than others. The relevant issue from the point of view of the policies is not whether or not the process of globalization is restrictive (there is no doubt about that), but instead which elements explain the national differences and defining the precise nature of the trade off each public authority is faced with. The degree of independence (and reputation) of the monetary authority; the structural characteristics of the relationship between the bank and industrial areas; the status of external accounts and other attributes such as the size and degree of accessibility of the economy have been identified as variables that influence the degree of political autonomy of the national authorities.

Another example of national specifications survival can be seen in the microeconomic environment or in regional policies. Garret and Lange (1991) state that even when the national macroeconomic policies autonomy has been severely reduced, we can still confirm the persistence of differentiated policies of competition increase that make use of "offerist" instruments of politics. Elements such as the degree of presence of transnational capital or local institutional specifications contribute to the permanence of the differences.

In synthesis, Globalization as a market phenomenon has made a considerable impact on the functioning of the markets and the effectiveness of the national public policies. However, authorities still count on varying degrees of autonomy, which are expressed in different political trade offs. Indeed, the reach of this autonomy has been sensibly reduced and varies from country to country. The analyses of the elements that explain this variable (including the role of dynamics of path dependency) seem to be more useful than the mere reiteration of generally valid global tendencies.

2. Globalization (The role of policies): Globalization is not the only phenomenon driven by the market. The policies (i.e.: the moving of the obstacles that separate them and the harmonizing of dissimilar national institutions) also play an important role. Frequently, the harmonizing or movement of the regulations is in response to market pressures. Occasionally, the policy decisions are the ones that promote and accelerate the integration of the markets and therefore, the movement towards globalization.

On a political level, globalization makes reference to the pressures towards convergence of practices and diverse national institutions. Its basis lies in the existence of spillovers and "psychological externals" or "political faults". The first occur each time that decisions or events that take place in a national economy have influence over others (macroeconomic interdependence is a typical example). The "psychological externals" or "political faults" occur when the diversity of practices and the resulting institutions of the national state organization is questioned by the participants with enough power and influence to state their preferences or values as "superior" or "universal". This has happened when issues such as respect for human rights or environmental practices have been introduced.

On a political level the globalization process is expressed in the agenda of "deep integration". As a paradox, its rise has been stimulated by the reduction of the border barriers that has taken place
during the last fifty years (the "superficial integration"). The success of the national policies and international negotiation during the post-war era in reducing border obstacles to the movement of goods and property and, in a varying degree, to the services and tangible and intangible forms of capital (financing, technology or control of active) has exalted the non-border obstacles of the "deep integration" agenda" (especially, although not exclusively, among the industrialized countries). This agenda is not only more complex than the traditional border agenda, but also the recommendations for regulations regarding how to direct it are subject to a much more extensive debate.

The "profound integration" agenda (the expression in politics of the process of "globalization") covers a wide variety of issues and on the limit; it includes virtually all the policies and non-border national practices.

From the viewpoint of developing countries, Haggard (1995) includes in this agenda the following topics:

1. The extension of international rules for the area of trade to the area of investment, insuring national dealing and market access (including the service portion) for international investors;
2. The treatment of national regulatory regimes that have discriminating effects or "unbalance the game area", such as the differences in the protection of intellectual property, in national standards and regional or generic (financial, industrial, technological, competition, environmental, labor, etc.) policies; and
3. The treatment of the "friction system" derived from differences in corporate and industrial structures and national politics.

This "deep integration" agenda touches on two related problems. The first is to precise the extension and give instrumental value to the concept of "leveling the game field". The second is the discernment of the costs and benefits associated with the reduction of diversity.

The idea of "leveling the game field" is attractive as an image but dangerous as a general objective of politics. In broad terms, it seems reasonable to sustain that those practices and institutions that give an "unjustified" competitive advantage to one part should be "leveled". But this affirmation avoids the problem: Where should the limit be placed between a "justified" advantage and an "unjustified" one? What type of national practices are the function of legitimate preferences and which are in the interest of obtaining advantages in international competition?

The discernment of the costs and benefits of the reduction of diversity is equally complex. In first place, to evaluate the costs and the benefits, should "cosmopolitan” or “national” criteria be employed? In second place, how do you evaluate the usefulness of agents or States with substantial differences in their levels of income and productivity? For example, what price will the citizens of a low income country be willing to pay (expressed in a slower pace of economic growth) in order to reduce their aggression towards the environment? Should the citizens of developed countries have to pay for the accumulated damage on the environment or should the "clean slate" criteria be applied?
These issues are extremely contentious and ultimately, they remit to a play for power and influence over the international system. The contemporary international agenda— as well as other moments in history—is plethoric with them. This illustrates the mandate and coverage of the recently created World Trade Organization. In this fashion, the countries of Latin America and the Caribbean should measure, not only the tension created by the globalization process as a market phenomenon, but also the tension which originates from the initiatives that deepen globalization as a political phenomenon. Distinguishing between one and the other is not always easy.

3. The opportunities for globalization: The costs and tensions that the globalization process inflicts on national economies are well known. The most apparent are the limitations on the effectiveness of national policies and the conflict that is presented by the break that exists between the government structures (of a predominantly national base) and the "global" nature of certain trends and economic interactions. However, the "globalization" process also offers new opportunities for national economies.

On one side, the "globalization" process presents the opportunity to better the conditions of access to markets that had previously been more fragmented. The information flow, technology and portfolio capital have been the ones who have increased their mobility the most and therefore, they make up the markets where access conditions have also had the most improvement for economies with relatively less capacity of endogenous generation. However, the conditions for taking advantage of these opportunities are heterogeneously distributed among the countries. One central aspect therefore, resides in the identification of attributes that better the capacity and allow reversal of the negative aspects inherited from past behavior (path dependency).

An example of what is mentioned here is presented by a typical trait of the recent process of globalization, and that is the improvement in the capacity of the participants to fragment the productive process in scattered geographical locations. The noticeable reduction of transportation and communication costs has facilitated the division of the productive process, allowing the participation of a greater number of geographical locations according to the advantages that each one contributes to the chain of added value. This fact has broadened the opportunities so that individual economies can participate more actively in the international production networks administered by the large multinational companies. This process has been accompanied by a direct foreign investment boom and from the proliferation of new forms of association with no holdings between participants. As Oman (1994) states, however, the possibility of participating in these production networks depends on the effectiveness with which the receiving economy responds to the demands of macroeconomic stability, availability of infrastructure, qualification and adaptability of the laborers, attributes which are intrinsic to the new pattern of production organization.

The process of globalization also creates new opportunities in that it increases competition, settles the basis for the establishment of new corporate and societal alliances and contributes to the break up of established oligopolies. If these factors blocked modernization, had developed a rent seeking type of behavior and exploited the rest of the community, the new coalitions can generate results that are more favorable than the status quo. In the same fashion, globalization
may allow, under certain circumstances, the improvement of the quality of domestic policies by increasing the cost of enforcing policies that cannot be sustained.

9.5 COMMERCIAL DIPLOMACY

9.5.1 Objectives of UNCTAD Programme on Commercial Diplomacy

The Programme encompasses two interlinked and mutually supportive areas of activity:

- Training for trade negotiators of developing countries and economies in transition, particularly on the WTO ongoing negotiations, from the development perspective;
- Support to research and training institutions of developing countries and economies in transition on international trade issues, so as to enhance their own capacity.

In the design as well as in the implementation of its activities, Commercial Diplomacy Program takes into account:

- The specific interests of developing countries and economies in transition in the preparation of international trade negotiations: regular consultations and contacts with delegates and national institutions facilitate the identification of priorities and modalities for each activity.
- Inputs provided by the technical work realized in the Trade Negotiations and Commercial Diplomacy Branch in connection with the "positive agenda": the training material of the Commercial Diplomacy Programme is based on UNCTAD analytical inputs stemming from research and the various meetings where WTO issues are considered, as well as training and research work by other agencies, academic institutions or international experts. Cooperation with WTO staff is a regular feature of the Programme.
- The development perspective as the overarching theme of both training and support to national institutions: this means focusing on issues such as the implications of international trade flows and disciplines for development strategies in training activities, as well as in supporting local researchers, by providing the insights and the methodologies that are required to tackle this perspective and to adapt it to specific local needs.
- Regional diversity among developing countries: except for some training activities on general trade issues which are of interest to any developing country or economy in transition, the Programme emphasizes regional, sub-regional or specific national needs; activities therefore rely on regular contacts and intense coordination with regional and sub-regional institutions and with the authorities of beneficiary countries.
- Coordination and cooperation with existing national, international and regional organizations involved in training and research on international trade, to avoid duplication of efforts: The Programme relies on a network encompassing existing institutional structures, but in the medium term it could also stimulate the establishment of new institutions (public or private) for training and research in developing countries and economies in transition.
Training & Research Activities: To achieve its goals, the Programme has been developing different kinds of activities, such as:

- **Regional and Sub-Regional Meetings:** To identify the main existing institutions (governmental, academic, private sector "think tanks", etc.), their research and training needs, and the "capacity-building" actions that could be initiated.

- **Training Courses and Seminars on International Trade Issues:** For policy-makers, government officials, trainers, businessmen and parliamentarians at the national or the regional level, based on the Programme’s training material.

- **Simulations of Trade Negotiations:**
  a) To assist negotiators in developing and least developed countries to prepare for trade negotiations.
  b) Participation in ongoing national programmes and UNCTAD technical assistance activities
  c) Related training and research on multilateral trade negotiations is supported by the Programme.
  d) Capacity Building and Technical Cooperation for Developing Countries: Post-Doha Work Programme (UNCTAD/RMS/TCS/1).

- **Policy Papers:**
  a) The preparation of national, sub-regional and regional strategies for multilateral trade negotiations, in order to "customize" the Programme’s training material and contribute to the formulation of the positive agenda.
  b) Dissemination of the Programme’s training and research material

9.5.2 Trade-Related Capacity Building (TRCB)
UNCTAD has been providing assistance to the developing countries in the area of trade negotiations since the GATT Tokyo Round: its mandate on "trade and development" has always included support for the effective participation of the developing countries in multilateral trade negotiations. At UNCTAD IX (Midrand, 1996) and X (Bangkok, 2000), this mandate was strengthened in view of the establishment of the WTO with the launching of two UNCTAD technical assistance instruments: the "Positive Agenda" and the Commercial Diplomacy Programmes. The mandate to provide support to regional trade agreements among developing countries was also strengthened. UNCTAD is currently implementing some 25 technical assistance projects covering different topics of the trade negotiations – at the regional/sub-regional or national level, depending on the scope of the corresponding extra budgetary resources. In February 2002, UNCTAD’s Secretary-General announced a "post-Doha technical assistance and capacity building plan" based on specific requests made to the UNCTAD secretariat by the developing countries.

Is the Doha Work Programme a development round?
The final outcome of the Doha negotiations will show to what extent the concerns of the developing countries have been taken into account and to what extent the new trade rules emerging from the negotiations deserve the label “development agenda”. At this stage, it is clear that one of the basic conditions to achieve these objectives is to ensure an effective participation of the developing countries in the negotiating process, so that their concerns are duly taken into account in all stages of the process of shaping new trade rules.
MAP OF TRADE-RELATED CAPACITY-BUILDING (TRCB)

Starting point:

COUNTRY'S DEVELOPMENT STRATEGY

Trade policy

Export promotion
Targets support to exporters, infrastructure, transport, services, etc.
Main agencies: ITC, UNCTAD, WB

Implementation of trade rules
Targets institutional and legal frameworks.
Main agencies: WTO, WB, (UNCTAD)

Trade Dispute Settlement
Targets legal skills in trade law.
Main agencies: WTO, Center for Advisory Legal Services, UNCTAD

Trade Negotiations
Targets trade diplomats
Main agencies: UNCTAD, WTO, WB

All these areas of the trade policy concern 3 dimensions:
- Bilateral trade
- Regional trade (subregional trade arrangements; North/South and South/South; ACP/EU)
- Multilateral trade (WTO level)
...and involve several topics
(with or w/o ongoing negotiations at the bilateral, regional, multilateral levels):
- Agriculture trade
- Market access issues
- Trade in services
- Trade rules
- Trade and environment
- Trade and investment
- Trade and competition
- Trade facilitation
- Government procurement
- E-commerce
- Trade, debt and finance
- Trade and transfer of technology
- Other "trade and end..." issues

...and require different TA and CB instruments and timeframes:
- Long-term TA-CB
- Short-term TA-CB
- Support to institutional capacity
- Support to research capacity
- HQD and training
- Support to Geneva Missions and capital-based decision makers
- Different audiences (public/private, parliamentarians, etc.)
- Different levels of skills and needs

THE TRCB HAS LINKS WITH:

1. AGRICULTURE AND INDUSTRIAL DOMESTIC POLICIES (FAO, UNIDO, WB, UNDP)
   determine trade policy

2. INVESTMENT AND TECHNOLOGY POLICY (UNCTAD, WB, UNIDO)
   Involves:
   - Investment regimes
   - Inv. technology agreements
   - Inv. Promotion
   - Dispute settlement on inv., etc.

3. COMPETITION POLICY (UNCTAD, WB)
   Involves:
   - Domestic laws and institutions
   - Regional/international rules on competition

4. INTELLECTUAL PROPERTY (WIPO, WTO)
   Involves:
   - Domestic laws and institutions
   - Regional/international rules on intel. prop.

5. ENVIRONMENT POLICY (UNEP, WB, WTO, UNCTAD)
   Involves:
   - Domestic laws and institutions
   - Regional/international rules on environment

6. MACROECONOMIC POLICIES (IMF, WB, WTO, UNCTAD)
   Involves:
   - Strong links with trade policy
   - Fiscal and monetary policies
   - Impact of the international economic environment
   - Coherence issues

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The new role of trade-related capacity building in the negotiating agenda: The important role given to technical assistance and capacity building in the Doha Work Programme represents a success on the part of the developing countries. It demonstrates a fundamental change: the quality and the quantity of the technical assistance provided to the developing countries now have the same political value as other items of the multilateral trade agenda. Indeed, the new negotiations launched at Doha will not achieve meaningful development results if the scope and the impact of the technical assistance and capacity building do not match the expectations of the developing countries.

This is why the Doha Ministerial Declaration gives an unprecedented role to technical assistance and capacity building and provides for a review of the assistance provided by December 2002. In fact, for many developing countries and least developed countries, the provision of efficient assistance is a key precondition to undertaking further trade commitments. This is a new factor marking a sharp difference in the landscape of the multilateral trading system as compared to the previous trade rounds.

9.5.3 Post Doha Context

What is “quality” trade-related capacity building in the context of the Doha negotiations? Here lies a crucial debate that is only starting among the donors and the recipient countries. The quality of the assistance delivered has to match the scope of the negotiating challenges from the point of view of long-term development needs. What, therefore, are the concrete needs raised by the Doha Work Programme from the point of view of the developing countries and their negotiating capacity? The design and delivery of trade-related capacity building, must take account of the following:

The scope and the implications of the Doha mandates are much larger than those of the Uruguay Round:

a) There are more topics on the trade agenda;
b) They have deeper implications for national legal frameworks and for domestic economic and social policies;
c) There are more interfaces between the areas of the Doha Work Programme that are being negotiated. The interfaces must be understood and taken into account when formulating strategies for the negotiations, because there will be a “single undertaking” at the end of the process.

9.5.4 UNCTAD Guidelines

The guidelines of UNCTAD’s trade-related technical assistance and capacity building, and UNCTAD’s value added:

- UNCTAD’s actions are inspired by the “positive agenda” approach: be proactive;
- Priority to demand-driven and tailor-made initiatives: no one-size-fits-all activities, be flexible and creative;
- Target short-term and long-term needs, as well as regional and multilateral agendas, as appropriate: be comprehensive and forward-looking;
- Integrate trade and development policies: be holistic;
• Do not pretend to have the truth and cooperate with others: be modest;
• Focus on the developing countries’ interests and rights: put yourself in their place.

9.5.5 Commercial Diplomacy Activities with Other Organizations

AITIC (Agency for International Trade Information and Cooperation): AITIC is an independent organization, based in Geneva, whose goal is to help less advantaged countries to benefit from the globalization process in general and the multilateral trading system in particular by assisting them in taking a more active part in the work of the World Trade Organization (WTO) and other trade-related organizations in Geneva.

ECA (Economic Commission for Africa)/OAU (Organization of African Unity): ECA/OAU and UNCTAD jointly organized the Meeting of the African Regional Group for consultations on the WTO 4th Ministerial Conference on 24-26 July 2001 at ECA headquarters. One of the main outputs of this meeting was the identification of capacity-building actions to be submitted to the UNDP African Regional Bureau, for the 2002 regional cooperation framework.

ECLAC (Economic Commission for Latin America and the Caribbean): The Regional Meeting on Research and Training Needs in International Trade for Latin America and the Caribbean was held at ECLAC headquarters in Santiago, Chile, on 4-5 November 1999. No other joint activities are planned at the moment due to the lack of resources for this region.

ESCWA (Economic and Social Commission for Western Asia): Since last year, ESCWA has been supporting the translation into Arabic and the dissemination of the Commercial Diplomacy training materials. The Secretary-General of ESCWA attended the Meeting of the Arab Group at Chavannes de Bogis, on 20-21 July 2001. More training activities regarding trade negotiations on WTO and regional trade issues are being planned with the direct involvement and support of ESCWA.

ESCAP (Economic and Social Commission for Asia and the Pacific): The Regional Meeting on Research and Training Needs in International Trade for Asia-Pacific countries was jointly organized and co-financed by UNCTAD, ESCAP and the Indian Institute of Foreign Trade in Delhi, on 14-16 November 2000. ESCAP was directly responsible for one of the sessions devoted to the LDCs of the region. In February 2002 UNCTAD and ESCAP co-organized a Regional Meeting on the Accession to the WTO of the Asia-Pacific countries. Other UNCTAD training and capacity-building activities on trade negotiations will involve the ESCAP, ASEAN and the Colombo Plan secretariats, particularly on the preparatory process for the 5th WTO Ministerial Conference for the trade officials of the region and businessmen.

TRALAC (Trade Law Centre for Southern Africa): TRALAC is an autonomous regional organization, founded and supported by the Swiss State Secretariat for Economic Affairs, the University of Stellenbosch Faculty of Law and the University Of Namibia Faculty Of Law. It seeks to find ways and means to address the needs of Southern African States and societies with regard to international trade law.
10.1 GLOBAL ADVERTISING & PROMOTION

What is exactly meant by going global?
The concept of global marketplace could be defined as a company’s ability to provide products anywhere, anytime, to a local market. As the world evolves, few businesses can ignore the global marketplace. Small to mid-size firms are faced with the challenge of deciding whether or not their businesses are candidates for global expansion and, if so, how to get started. The following are steps in beginning the global expansion process:

- Conduct Market Research Within Your Budget
- Assess Your Internal Resources
- Get Yourself Export Ready
- Adopt a Global Mind-set

There are four basic approaches to participation in the global marketplace:

- Exporting your existing products to a foreign market
- Modifying your products to fit the cultural and environmental requirement of foreign markets
- Filling a market niche in a foreign market
- Developing a new and unique market niche in a foreign market

Whether or not you decided to expand your business globally, global business expansion should be a part of your strategic-planning thinking process. If you decide to go global, here are some questions to ask yourself:

- Is my company a candidate for global expansion?
- Do I have the global mind-set to move my firm into the global marketplace?
• Am I willing to commit the time and energy to accomplish this task?
• Am I willing to commit resources to do the homework that is necessary for foreign-market entry?
• Can I commit the resources to continually monitor these markets?
• Am I willing to assume the risks that are involved in international business development?
• Do I have the patience to remain in select international markets for the long term?

Global Ads Aim for One Brand, Image:

CANNES, France: It's a small world and is getting smaller for advertisers. The web, e-mail and wireless technology give people 24/7 global connections. Carriers such as UPS and FedEx deliver overnight around the world. International travels are cheaper and more available. Alliances led by the expanding European Union and its single euro currency are breaking down trade and political borders.

"The whole communication infrastructure has changed," says Ken Bernhardt, professor of marketing at Georgia State University's Robinson College of Business. "It's easier for businesses to communicate with each other so you truly can have today what people talked about in the past, which was think global, act local."

Nowhere is the trend more evident than with award contenders from around the world here at the 51st annual Cannes Lions International Advertising Festival. They show that marketing is being altered to fit today's worldly consumers, who expect to see a brand stand for the same thing no matter where they are. That means a global marketer today needs one brand image and message that works worldwide.

"You need to standardize to a greater degree, because consumers will notice differences in different markets more than they would have 10 to 15 years ago," Bernhardt says. "The brand needs to be the same." Making that easier to do is the fact that ad companies have become worldwide networks of agencies. An idea born in London can be executed with localized sophistication in Tokyo, New York and Amsterdam.
Among one-world marketers:

**Citibank:** The U.S. financial services brand runs credit card, retail banking and consumer loan businesses worldwide. No matter the locale, "The business is the business, and we want to make sure we're not schizophrenic," says Anne MacDonald, head of global marketing. "We want our brand values consistent around the world." Citibank does so by using one model to develop credit cards, signs and even office interiors.

![Citibank](image)

McDonald's; The fast-food giant last year created its first global ad campaign after finding young adults worldwide were rejecting McDonald's for the same reason — the brand was not contemporary to them — and decided to address the issue with one answer. "Strategically we said, 'Why would we do it 10 different ways? Let's do it in one voice,' " says Larry Light, global chief marketing officer at McDonald's. That voice now sings, "I'm lovin' it." Supporting the global theme are 25 new ads.

![McDonald's](image)

**Pepsi:** The youthful brand is recognized for its ad humor in the USA and has applied that to ads globally — with local cultural twists. An ad in India, for instance, tells of a boy who, when he drinks a Pepsi, can train elephants to do tricks. His career is shattered, however, when another boy pops open a Pepsi during a performance, and the elephants follow him. "How consumers experience the personality of the brand should be tempered by the culture," says Dave Burwick, chief marketing officer, North America.

**Procter & Gamble:** In its drive to be a "high-performance marketing organization," P&G has pushed for broadcast TV and more focus on media that can be better tailored for local needs around the world, says Jim Stengel, global marketing officer. It is perfecting the concept of global brands with regional flair, he says. It sells about 50 of its brands in North and Latin America, Europe, Middle East and Africa. Stengel says P&G is "reinventing our approach to
marketing." It is making media choices based on when and where it can best reach its customers, then creating ads to suit that media.

**Reebok:** The sports apparel and footwear brand has built a new global marketing campaign around the Olympics that includes print ads of such athletes as basketball player Yao Ming in ancient Greek garb and poses. Reebok also is creating sculptures of the athletes modeled on poses from the famous Parthenon Frieze. "We try very hard to make a program like this very relevant to cultures around the world," says Denise Kaigler, vice president, global communications.

**Hewlett-Packard:** Whether in England, Russia, Australia or the USA, H-P's message is that its technology helps businesses handle change. The ads are in a variety of media, but particularly outdoor.

A recent poster outside London's National Gallery promoted H-P technology to restore just the right shade of yellow to a Van Gogh painting. Another ad will go up next week in Moscow's Red Square. Choosing such landmark locations "allows us to become part of the city," says Gary Elliott, vice president, brand marketing.

**UPS:** The overnight carrier uses just three ads that run in 20 countries for its global message that its service builds businesses. UPS does so because it has found "that the similarities among decision makers in our category, whether in China, India or Mexico, their needs, wants and fears are amazingly consistent," says Larry Bloomenkranz, Vice President, Global Advertising and Brand Management. It varies the faces in the ads — one might have an Asian cast, another white — "so people can recognize themselves in the advertising," Bloomenkranz says.

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**10.2 GLOBAL SUPPLY CHAIN MANAGEMENT**

**How (and why) Nike recovered from its Supply Chain Disaster?**

Too many Air Garnetts. Too few Air Jordans. Nike lost money, time and a measure of pride when its demand-planning software led it astray. How did it recover? Patience, perseverance and, most important, an understanding of what it was trying to accomplish in the first place.

"I thought we weren't going to talk about i2," growls Roland Wolfram, Nike's vice president of global operations and technology, his eyes flashing at his PR manager with ill-concealed ire.

Wolfram, who was promoted in April to vice president and general manager of the Asia-Pacific division, is all Nike. His complexion is ruddy, his lips cracked from working out or working hard, or both. He's casually dressed, but with a typical Nike sharpness to his turtleneck and slacks, a sharpness reflected also in his urgent, aggressive defense of his company—a Nike pride that would seem arrogant were not the company so dominant in its industry.

Wolfram calls the i2 problem—a software glitch that cost Nike more than $100 million in lost sales, depressed its stock price by 20 percent, triggered a flurry of class-action lawsuits, and caused its chairman, president and CEO, Phil Knight, to lament famously, "This is what you get for $400 million, huh?"—a "speed bump." Some speed bump. In the athletic footwear business, only Nike, with a 32 percent worldwide market share (almost double Adidas, its nearest rival)
and a $20 billion market cap that's more than the rest of the manufacturers and retailers in the industry combined, could afford to talk about $100 million like that.

It drives Wolfram crazy that while the rest of the world knows his company for its swoosh buckling marketing and its association with the world's most famous athletes, the IT world thinks of Nike as the company that screwed up its supply chain—specifically, the i2 demand-planning engine that, in 2000, spat out orders for thousands more Air Garnett sneakers than the market had appetite for and called for thousands fewer Air Jordans than were needed.

"For the people who follow this sort of thing, we became a poster child [for failed implementations]." Wolfram says.

But there was a lesson too for people who do, in fact, follow "this sort of thing," specifically CIOs. The lesson of Nike's failure and subsequent rebound lies in the fact that it had a business plan that was widely understood and accepted at every level of the company. Given that, and the resiliency it afforded the company, in the end the i2 failure turned out to be, indeed, just a "speed bump."

**The i2 Failure: Tactical or Strategic?**

Nike's June 2000 problems with its i2 system reflect the double whammy typical of high-profile enterprise computing failures. First, there's a software problem closely tied to a core business process—in this case, factory orders. Then the glitch sends a ripple through product delivery that grows into a wave crashing on the balance sheet. The wave is big enough that the company must reveal the losses at a quarterly conference call with analysts or risk the wrath of the Securities and Exchange Commission, shareholders or both. And that's when it hits the pages of The Wall Street Journal, inspiring articles and white papers on the general subject of IT's hubris, limitations, value and cost.

The idea that something so mundane as a computer glitch could affect the performance of a huge company is still so novel that it makes headlines. But what doesn't usually enter the analysis is whether the problem was tactical (and fixable) or strategic (meaning the company should never have bought the software in the first place and most likely won't ever get any value from it). The latter is a goof worthy of a poster; the former is a speed bump.

Nike claims that the problems with its i2 demand-planning software were tactical and therefore fixable. It was too slow, didn't integrate well, had some bugs, and Nike's planners were inadequately trained in how to use the system before it went live. Nike says all these problems were fixed by fall 2000. And the company asserts that its business wasn't affected after that quarter. Indeed, at press time, Nike had just announced that its third-quarter 2003 profit margins were its highest ever.

If there was a strategic failure in Nike's supply chain project, it was that Nike had bought in to software designed to crystal ball demand. Throwing a bunch of historical sales numbers into a program and waiting for a magic number to emerge from the algorithm—the basic concept behind demand-planning software—doesn't work well anywhere, and in this case didn't even support Nike's business model. Nike depends upon tightly controlling the athletic footwear
supply chain and getting retailers to commit to orders far in advance. There's not much room for a crystal ball in that scenario.

Indeed, Nike confirms that it stopped using i2's demand planner for its short- and medium-range sneaker planning (it's still used for Nike's small but growing apparel business) in the spring of 2001, moving those functions into its SAP ERP system, which is grounded more in orders and invoices than in predictive algorithms. "This allows us to simplify some of our integration requirements," says Nike CIO Gordon Steele.

Wolfram says Nike's demand-planning strategy was and continues to be a mixture of art and technology. Nike sells too many products (120,000) in too many cycles (four per year) to do things by intuition alone. "We've tuned our system so we do our runs against [historical models], and then people look at it to make sure it makes sense," he says. The computer models are trusted more when the product is a reliable seller (that is, just about anything with Michael Jordan's name on it) and the planners' intuition plays a bigger role in new or more volatile products. In this case, says Wolfram, talking with retailers does more good than consulting the system.

"There's been a change in the technology for demand planning," says AMR Research Vice President Bill Swanton, who declined to address the Nike case specifically. "In the late '90s, companies said all we need is the data and we can plan everything perfectly. Today, companies are trying to do consensus planning rather than demand planning." That means moving away from the crystal ball and toward sharing information up and down the supply chain with customers, retailers, distributors and manufacturers. "If you can share information faster and more accurately among a lot of people, you will see trends a lot sooner, and that's where the true value of supply chain projects is," Swanton says.

If You Have a Game Plan, You Can Snag the Rebound: Another thing that makes Wolfram angry (his already ruddy complexion going completely red) is the widespread assumption that Nike was betting on algorithms and changed course when that didn't work out. Wolfram says that, on the contrary, i2's demand-planning software was never intended to be the hero of Nike's supply chain project—one of the most ambitious ever attempted by a company its size. It was (and still is), he claims, part of a wider strategy to integrate ERP, supply chain planning and CRM software onto a single platform shared by Nike operations in North America, as well as Europe, the Middle East and Africa (EMEA). "Frankly," he asserts, "we pretty much stayed the course."

Single Instance (If It Was Easy, Everyone Would Just Do It): Nike's global single-instance strategy is the envy of ERP geeks. According to a recent AMR Research survey of 110 big companies (80 percent had revenue of $500 million or more) using ERP, only 23 percent said they had single instance, while another 36 percent are trying to get there, and 17 percent are trying to at least get their instances down to one per major global region—and spending hundreds of millions of dollars to do so.

Nike can certainly testify to the downside of the strategy—a long, difficult road to process change. But Nike's centralized planning, production and delivery processes for sneakers are
tailor-made for the single-instance strategy, because there are few unique, localized processes to mix up that big database.

Nike made a bold early bet on the risky and difficult strategy of creating a single, giant, integrated database within its SAP ERP system for every employee in North America and EMEA. (Nike's Asia-Pacific division will be on a separate instance of the software.) This meant getting everyone to agree on business practices and common data definitions before the software went in—a rarity in ERP project management.

The difficulty of integrating information across a distributed company has brought down many ERP projects, such as drugstore chain FoxMeyer's SAP ERP system in the late '90s and Tri-Valley Growers' 1997 choice of Oracle's ill-fated ERP package for the consumer packaged-good industry. Neither company ever got its systems working properly nor that contributed to both eventually shutting their doors. Other companies gave up on the vision of total information integration and installed many different versions of their ERP systems—as many as 400 different versions, or instances, of a single vendor's ERP system at some really large companies, according to AMR.

But Nike claims it has never wavered from its single-instance strategy, even when problems with the first piece of that strategy, the i2 system, hit the news on Feb. 26, 2001. The same project leaders who were in place at the time of the i2 problems (CIO Steele and the business lead, Shelley Dewey, Nike's vice president of supply chain) are still running the project today. The reason Steele and Dewey survived was because when their system failed, they had a lifeline to hang onto: a clear business case for the overall supply chain project. If achieved, they claim it will save the company a lot more than Knight's $400 million and the $100 million in wayward sneakers.

Nike's supply chain project is supposed to drive the manufacturing cycle for a sneaker down from nine months to six. Cutting out that three months would match Nike's manufacturing cycle to its retailers' ordering schedule—they order 90 percent of their sneakers six months in advance of delivery. This means Nike could begin manufacturing its sneakers to order rather than three months in advance and then hoping they can sell them. Converting the supply chain from make-to-sell to make-to-order is the dream of any company desirous of gaining competitive advantage through its supply chain. Dell has done it, famously, with PCs; Nike wants to do it just as famously with sneakers.

Nike hasn't gotten there yet. And its business case relies on a nearly 30-year-old model that some analysts and retailers grumble is out of touch with the reality of today's market. But it's a business case Nike's leaders believe in. This is how CIOs keep their jobs when a project goes off track and it's how they keep getting funding to keep it going.

Like many truths, this one is simple yet profound: Projects that survive breakdowns do so because everyone in the business, not just IT, understands what the system is supposed to do for the company—and sees value in it. Indeed, after his infamous conference call outburst in 2001, Knight added that, "I think it will, in the long run, be a competitive advantage."
"We wish to God Phil [Knight] hadn't said what he said," says Steele with a laugh. "But his belief in this project has never wavered. [When the i2 problems emerged], we sat down and talked about what the issues were and he said, OK, I understand, carry on." (Knight declined to be interviewed by CIO.)

**How Nike Built a Robust Business Case**

Knight, not normally known for self-control, has shown extraordinary patience with Nike's supply chain project. And he's needed it. "Once we got into this, we quickly realized that what we originally thought was going to be a two-to-three-year effort would be more like five to seven," says Wolfram.

It's been six years now and counting, with the final stage of the project due to be finished sometime in 2006 at a total cost that has gone from a projected $400 million to $500 million, according to Wolfram.

The theme of Nike's sneaker supply chain is centralization. All product design, factory contracting and delivery is planned and coordinated from Beaverton, Ore. The supply chain is built around a six-month order cycle, called the "Futures" program that was developed in 1975 in response to the then-chaotic market for running shoes. In those days, the Far East sneaker supply chain was in its infancy, deliveries were spotty, inflation was high, and runners bought whatever shoes they could find regardless of brand. Nike won that market by guaranteeing delivery and an inflation-proof discount in return for getting its orders six months in advance. Retailers went along happily because runners didn't much care about style or looks—they wanted technically advanced shoes that fit and were in steady supply. Retailers knew their Nike shoes would sell no matter how far in advance they ordered them.

But as Nike became increasingly global, its supply chain began to fragment. By 1998, Nike had 27 order management systems around the globe, all highly customized and poorly linked to Beaverton. To gain control over its nine-month manufacturing cycle, Nike decided that it needed systems as centralized as its planning processes. ERP software, specifically SAP's R/3 software, would be the bedrock of Nike's strategy, with i2 supply, demand and collaboration planner software applications and Siebel's CRM software also knitted into the overall system using middleware from STC.

Nike's patience was a virtue here too. It skipped AFS (Apparel and Footwear Solution), which was the initial version of SAP's R/3 software developed specifically for the apparel and footwear industry. Archrival Reebok, which partnered with VF (makers of Wrangler Jeans and Vanity Fair bras, among other things) on the beta effort to develop AFS beginning in 1996, struggled for years to implement the buggy, unstable AFS software. (Reebok declined to be interviewed for this story.) And although Nike purchased AFS in 1998, it didn't attempt to install it until SAP began working on the second, more stable version of the software. "Most of the early adopters were busy installing AFS in 1999," says Steele with a satisfied smile. "That's when we began spending a lot of time with SAP, sending our people over to Germany to tell them what we'd like to see in the second version."
Why i2 Went Wrong

Unfortunately, Nike didn't apply that same patience to the implementation of the first part of its supply chain strategy: i2's demand and supply planner software applications. Rather than wait to deploy i2 as part of its SAP ERP project, Nike decided to install i2 beginning in 1999, while it was still using its legacy systems.

According to court documents filed by Nike and i2 shareholders in class-action suits, little went right before June 2000. i2's predictive demand application and its supply chain planner (which maps out the manufacturing of specific products) used different business rules and stored data in different formats, making it difficult to integrate the two applications. The i2 software needed to be so heavily customized to operate with Nike's legacy systems that it took as much as a minute for a single entry to be recorded by the software. And, overwhelmed by the tens of millions of product numbers Nike used, the system frequently crashed.

But these problems would have remained only glitches had they not spilled over into factory orders. The system ignored some orders and duplicated others. The demand planner also deleted ordering data six to eight weeks after it was entered, making it impossible for planners to recall what they had asked each factory to produce. Soon, way too many orders for Air Garnets were going over the wires to Asian factories while calls for Air Jordans were lost or deleted.

When the problems were discovered, Nike had to develop workarounds. Data from i2's demand predictor had to be downloaded and manually reloaded into the supply chain planner by occupying programmers, quality assurance personnel and businesspeople whenever the applications were required to share data—which was as often as weekly. Consultants were brought in to build databases to bypass portions of the i2 applications, and custom bridges were constructed to enable the i2 demand and supply planner applications to share.

Nike claims the kinks were ironed out by November 2000, but the damage was done, affecting sales and inventory deep into Nike's next quarter. When the company's SAP system arrived, short- and medium-range planning moved out of i2 altogether and into SAP. Nike says the $10 million i2 system was a small part of the $500 million overall project cost, although some observers assert that the i2 cost was higher.

Why did things go so wrong? Wolfram says Nike lulled itself into a false sense of security about the i2 installation because, by comparison with the SAP plan, it was a much smaller project. (Nike has about 200 planners who use the demand and supply planning systems.) "This felt like something we could do a little easier since it wasn't changing everything else [in the business]," he says. "But it turned out it was very complicated."

"Could we have taken more time with the rollout?" asks Steele. "Probably. Could we have done a better job with software quality? Sure. Could the planners have been better prepared to use the system before it went live? You can never train enough."

Nike Learns Patience: Nike learned from its mistakes. There would be no rushing the SAP installation. And even though Nike executives occasionally questioned the project's complexity
and expense, Steele never considered abandoning the single-instance strategy. "We said single instance is a decision, not a discussion," says Steele.

Nike wanted to do a staged, geographically based rollout of SAP, but it also wanted to avoid making each rollout so specific to a region that it would require specialized support. That meant building a design for the U.S. rollout that accommodated some of the peculiarities of the EMEA rollout—such as multiple currency support and different legal restrictions—even though those things were not required for doing business in the United States. This necessitated creating a global template for SAP processes, with all the regions agreeing on the minutiae of doing business. Naturally, this made each rollout longer and more complex.

Canada, a relatively small (roughly $300 million) piece of Nike's $11 billion business, went first, on Thanksgiving weekend 2000 (the pre-spring rush quiet time), with SAP's AFS ERP, a bundle of i2 applications and Siebel's CRM system. Steele and regional Nike executives, dressed in smocks, served Thanksgiving dinner to project employees working around the clock. Other regions—the United States and EMEA—followed on successive Thanksgivings, putting 6,350 users worldwide on the system by the end of 2002. (The last two regions, Asia-Pacific and Latin America, are scheduled for rollout before the end of 2006, according to Nike.) Steele claims he's never had to serve humble pie along with the turkey, saying to date there have been no disruptions to Nike's business from the three rollouts.

This may be because of Nike's newfound respect for training, another weakness of the i2 implementation. Nike's U.S. customer service representatives received 140 to 180 hours of training from highly trained fellow Nike "super users," says Andy Russell, Nike's global transition director. Employees are locked out of the system until they complete the full training course, he says.

**What Phil Knight Ultimately Got for His Money**

So what have six years and $500 million done for Nike's business? Wolfram claims that better collaboration with Far East factories has reduced the amount of "pre-building" of shoes from 30 percent of Nike's total manufacturing units to around 3 percent. The lead time for shoes, he asserts, has gone from nine months to six (in some periods of high demand, seven). But John Shanley, managing director with Wells Fargo, says, "Retailers are saying it's still closer to nine months than six." Gross margins have increased slightly since 2001 but not significantly.

Inventory levels have been reduced, says Supply Chain Vice President Dewey, by cutting Nike's factory order interval time from one month to a week in some cases. But here, too, the effects may not be trickling down to the balance sheet as fast as Nike would like. Inventory levels are still at the mercy of Nike's fickle audience of teens. Nike's inventory turns were 4.34 per year in 2003, according to Footwear News, an industry trade magazine, slightly less than the industry average of 4.39 and behind rivals Reebok (5.07) and K-Swiss (4.47).

Nike also is behind its rivals in direct point-of-sale (POS) integration with retailers, says Shanley. Supply chain experts agree that actual data from stores, rather than software algorithms, are the best predictors of demand. But Nike's SAP system cannot yet accept POS data, though the company says it's working on it. So far, the most direct benefits of the system have been
typical for ERP: improved financial visibility, cash flow management, revenue forecasting, and an ability to juggle Nike's cash stockpile in different currencies to take advantage of shifting exchange rates—benefits that are enhanced by the single database that holds all the data.

But Steele maintains that the best is yet to come. "We haven't changed our processes too much yet," he says, "because we didn't want to complicate the rollouts." Eventually, he believes Nike will get that six-month lead time down to three. But, he cautions, that would require "significant changes on the part of our retail and supplier partners as well as Nike processes." He'd better hurry. Shanley says the sneaker market has changed a lot since Nike created its Futures program in the '70s. Retailers don't like having to order products six months in advance when fashions can change in a flash. Rivals are allowing retailers much more leeway in ordering practices, eroding Nike's market lead in select areas.

But because Nike developed a plan in 1998, and stuck with it, the company claims it can make a coordinated global effort to cut that lead time. The system to make that happen is in place—which, given all that has transpired in the past seven years, is rather remarkable.

Comments:
Corporate World learnt a very good lesson from Nike, the way it went down and how it rebound. Every company started to feel and recognize the importance of supply chain. So, started to integrate their systems and IBM has even started research with four top Universities on this.

When we select any vendor for some software, however good it may be and has better features even, still need to check with few things like:

1. How well does the new software integrate with our systems.
2. What would be the Time line by which it would really satisfy our purpose?
3. What’s the output of Cost Benefit Analysis? Is it worthy to go for a new software?
4. Who are the best vendors and do they have any previous experience in implementing for similar companies like us?

Supply-Demand should be checked according to the market conditions even. If we have data for the demand according to the market conditions that would really fetch.

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10.3 INTERNATIONAL LABOR MANAGEMENT
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The International Labour Organization is the UN specialized agency which seeks the promotion of social justice and internationally recognized human and labour rights. It was founded in 1919 and is the only surviving major creation of the Treaty of Versailles that brought the League of Nations into being and it became the first specialized agency of the UN in 1946.

The ILO formulates international labour standards in the form of Conventions and Recommendations setting minimum standards of basic labour rights: freedom of association, the right to organize, collective bargaining, abolition of forced labour, equality of opportunity and
treatment, and other standards regulating conditions across the entire spectrum of work related issues. It provides technical assistance primarily in the fields of:

- Vocational training and vocational rehabilitation;
- Employment policy;
- Labour administration;
- Labour law and industrial relations;
- Working conditions;
- Management development;
- Cooperatives;
- Social security;
- Labour statistics and occupational safety and health.

It promotes the development of independent employers' and workers' organizations and provides training and advisory services to those organizations. Within the UN system, the ILO has a unique tripartite structure with workers and employers participating as equal partners with governments in the work of its governing organs.

**The International Labour Conference:** The member States of the ILO meet at the International Labour Conference, held every year in Geneva, Switzerland, in the month of June. Each Member State is represented by a delegation consisting of two government delegates, an employer delegate, a worker delegate, and their respective advisers. (Employer and Worker delegates are nominated in agreement with the most representative national organizations of employers and workers.)

Every delegate has the same rights, and all can express themselves freely and vote as they wish. It happens that worker and employer delegates sometimes vote against their government's representatives or against each other. This diversity of viewpoints, however, does not prevent decisions being adopted by very large majorities, or in some cases even unanimously.

Many of the government representatives are cabinet ministers responsible for labour affairs in their own countries. Heads of State and prime ministers also take the floor at the Conference. International organizations, both governmental and others, attend as observers. The Conference, which is often called an international parliament of labour, has several main tasks.

First, there is the crafting and adoption of international labour standards in the form of Conventions and Recommendations. Conventions are international treaties that, once adopted by the Conference, are open to ratification by member States. Ratification creates a legal obligation to apply the provisions of the Convention in question. Recommendations, on the other hand, are intended to guide national action, but are not open to ratification, and are not legally binding.

The Conference also supervises the application of Conventions and Recommendations at the national level. It examines the reports which the governments of all member States are required to submit, detailing their compliance with obligations arising out of ratified Conventions, and their law and practice in respect of Conventions and Recommendations (ratified or not) on which reports have been requested by the Governing Body of the ILO.
Since the adoption of the Declaration on Fundamental Principles and Rights at Work (1998), another important function of the Conference is to examine the Global Report prepared by the Office under the follow-up procedure required by the Declaration. Over a four-year cycle, the Conference examines in turn Global Reports covering the four fundamental rights, namely: (a) freedom of association and the effective recognition of the right to collective bargaining; (b) the elimination of all forms of forced or compulsory labour; (c) the effective abolition of child labour; and (d) the elimination of discrimination in respect of employment and occupation.

The Conference is also a forum where social and labour questions of importance to the entire world are discussed freely - sometimes passionately. Delegates explore the course of social progress in the world, but the central theme is the report presented each year by the ILO's Director-General. In recent years, these reports have addressed: Social insurance and social protection (1993), Defending values, promoting change: Social justice in a global economy (1994), Promoting employment (1995), and the ILO, standard setting and globalization (1997), Decent Work (1999), and Reducing the decent work deficit: A global challenge (2001). The Conference also passes resolutions that provide guidelines for the ILO's general policy and future activities. Every two years the Conference adopts the ILO's biennial work programmes and budget, which is financed by member States.

**Governing Body of the International Labour Office:** The Governing Body is the executive body of the International Labour Office (the Office is the secretariat of the Organization). It meets three times a year, in March, June and November. It takes decisions on ILO policy, decides the agenda of the International Labour Conference, adopts the draft Programme and Budget of the Organization for submission to the Conference, and elects the Director-General.

It is composed of 56 titular members (28 Governments, 14 Employers and 14 Workers) and 66 deputy members (28 Governments, 19 Employers and 19 Workers). Ten of the titular government seats are permanently held by States of chief industrial importance (Brazil, China, France, Germany, India, Italy, Japan, the Russian Federation, the United Kingdom and the United States). The other Government members are elected by the Conference every three years (the last elections were held in June 2002). The Employer and Worker members are elected in their individual capacity. The Governing Body has the following committees:

- Committee on Freedom of Association (CFA)
- Programme, Financial and Administrative Committee (PFA)
- Committee on Legal Issues and International Labour Standards (LILS)
- Subcommittee on Multinational Enterprises (MNE)
- Committee on Employment and Social Policy (ESP)
- Committee on Sectoral and Technical Meetings and Related Issues (STM)
- Committee on Technical Cooperation (TC)
- Working Party on the Social Dimension of Globalization (WP/SDG)
### Databases of ILO

#### Country and regional information

<table>
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<th>Description</th>
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<tbody>
<tr>
<td><strong>EUROPE country information</strong></td>
<td>Country information system of the ILO Regional Office for Europe</td>
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<tr>
<td><strong>GLOBAL COMPACT country information</strong></td>
<td>Country information system on human rights, labour standards, and environmental protection. (Maintained by the United Nations Global Compact Network with the participation of the ILO and UNEP)</td>
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#### Occupational safety

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<td>Occupational safety and health, safety standards, chemical and physical hazards</td>
</tr>
<tr>
<td><strong>CIS Network</strong></td>
<td>CIS Centers and other institutions of occupational health and safety</td>
</tr>
<tr>
<td><strong>ICSC</strong></td>
<td>Database for finding international chemical safety cards</td>
</tr>
<tr>
<td><strong>Substance Abuse and Tobacco in the Workplace Database</strong></td>
<td>Provides key information on issues related to alcohol, tobacco and other drugs in the workplace.</td>
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#### Labour administration

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<td>Information system on labour administrations in the world</td>
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#### Labour statistics

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<td>Key Indicators of the Labour Market</td>
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<td><strong>LABORSTA</strong></td>
<td>The labour statistics database operated by the ILO Bureau of Statistics</td>
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<td><strong>ILM</strong></td>
<td>International Labour Migration Database</td>
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#### Legal information

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<td>A database on the application of international labour standards</td>
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<tr>
<td><strong>e.quality@work</strong></td>
<td>Compilation of basic information on gender equality laws, policies and programmes, including international labour standards as well as national legislation, policies, practices and institutional arrangements introduced by governments, trade unions and public and private sector enterprises</td>
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<tr>
<td><strong>ILOLEX</strong></td>
<td>A database on international labour standards containing ILO Conventions and Recommendations</td>
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<td></td>
<td>Quick database search of: ILO Conventions and ILO Recommendations</td>
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<tr>
<td><strong>NATLEX</strong></td>
<td>A database of national labour law</td>
</tr>
<tr>
<td><strong>TRIBLEX</strong></td>
<td>Thematic analysis of the case law of the ILO Administrative Tribunal</td>
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**Social security**

| Social Security Worldwide (SSW) | Covers six different databases on social protection: Scheme Description, Complementary and Private Pensions, Reforms, Legislation, Bibliography and Thesaurus. Produced by the International Social Security Association (ISSA) with the support of the ILO. ILO staff at HQ: available through the ISSA Intranet: [http://issa.intranet/ssw](http://issa.intranet/ssw). Outside the ILO: [www.issa.int/ssw](http://www.issa.int/ssw). A user id and a password are needed; for information about access contact: issadoc@ilo.org |

**Vocational training and rehabilitation**

| **INFOR** | Bibliographic database of the Inter-American Vocational Training Research and Documentation Centre (CINTERFOR) |
| **GLADNET InfoBase** | Global Applied Disability Research and Information Network on Employment and Training (produced with the collaboration of the ILO) |

**Terminology**

| **ILOTERM** | An invaluable working tool for linguists, provides English, French, Spanish and German equivalents of terms in the social and labour fields |

**World of work**

| **ASISTDOC** | A bibliographic database on labour-based technology |
| **BASI** | Business and Social Initiatives database |
| **BDS** | Business Development Service database |
| **e.quality@work** | Compilation of basic information on gender equality laws, policies and programmes, including international labour standards as well as national legislation, policies, practices and institutional arrangements introduced by governments, trade unions and public and private sector enterprises |
| **ILO Photo Gallery** | An ever-increasing collection of photos available to the public free of charge |
| **ILO Publications Website** | A comprehensive selection of new and recent ILO publications in the areas of labour, employment, social protection, women at work, occupational safety and health, child labour, management and training, labour statistics and more |
| **Informal Economy Resource Database** | Covers ILO activities and research related to the informal economy and tools that are relevant for this area |
| **LABORAL** | The bibliographic database operated by the ILO Regional Office for Latin America and the Caribbean |
### Labordoc

The ILO's largest bibliographic database; provides international coverage of labour topics including employment, labour relations, labour law, working conditions, vocational training, social security, occupational safety and health, women workers, child labour, migrant workers, economic and social rights and all labour-related aspects of social and economic development.

### Labour force survey

Labour Force Survey is a standard survey of work-related statistics. The following countries and territories make their Labour Force Surveys available online...

### Poverty, Local Development and Decent Work

This Resource Database contains more than 200 tools and resources that directly or indirectly focus on poverty from a macro-level perspective and/or from a local development perspective within the ILO's decent work framework.

### SI-PROMICRO

Information and documentation on micro enterprises in Central America (produced with the collaboration of the ILO) (in Spanish)

### Work Gate

A virtual library providing access to over 350 Internet sites and other electronic resources, selected for their quality and relevance to the work of ILO staff and constituents.

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### 10.4 CHANGING PROFILE OF THE GLOBAL MANAGER

The profile of a global manager is not just looking at the global market but also the domestic market. And the ingredients which make a global manager are simple basics which are imbibed into us but lose their prominence. Awareness, exposure, comprehension, conviction and maturity are the qualities which make the global managers of today, said corporate. At the other end of the spectrum, management institutions need to constantly upgrade their knowledge and be sensitive to the changing environment to help create global managers.

These were the thoughts elucidated by speakers at the 8th Directors’ Conclave in Mumbai which was organized by All India Management Association and Bombay Management Association in collaboration with Narsee Monjee Institute of Management.

R Gopalakrishnan, executive director, Tata Sons Ltd said that global managers are made not through inherent quality but ones which are acquired. “There are three or four criteria which make global managers. They are the awareness of the world beyond your realm, need to gain exposure, comprehension of the fact that the information is relevant for me as well and conviction,” said Mr. Gopalakrishnan.

At the conclave, speakers from the industry said that in the era of globalization, there is no such thing as a global manager. Instead business managers of today have to operate in a climate, which comprise the changing aspirations of customers, shareholders, employees and Government.
Mr. Arvind Agarwal, President, Corporate Development & HR, RPG Enterprises, said that there are business managers, country managers and functional managers, who have their own set of responsibilities. “At the core of a global manager is personal maturity and the maturity comprises of discipline, focus, respect for the cultural differences, ability to manage owns growth in the highly competitive atmosphere and emotional intelligence,” said Mr. Agarwal. He added that the hallmarks of a global managers is that they are hands on and tend to take the responsibilities on themselves instead of passing it onto others. “The traits of a global manager are fundamental and are present in all managers. They are not Chinese, Japanese or Indian,” said Mr. Agarwal.

Satish Pradhan, Executive Vice President, Tata Sons Ltd believed that the idea should not be to become what he called ’export quality’ manager. Explaining further, he said that globalization today means that a company is competing in the domestic market and protecting its turf from international players making an entry. Alternatively, it is the same company foraying into international market. So in essence, the trait of a global manager is as useful internationally as it is when it comes to the domestic market. “A global manager is one who understands and recognizes the patterns. The manager is able to withstand the pressure and is sensitive to issues and lastly the family or social moorings also play an important role in making a good manager,” said Mr. Pradhan.

Dr. Prakash Apte, Director, IIM Bangalore said that the ’export quality’ tag is fine as long as the consideration is not just costs but the capability and talent of Indian managers. And the process of fine-tuning the talent and capability of the Indian managers also rests largely with business schools and management institutions. “The institutions have to keep the course content on par with the rest of the world. The faculty has to keep itself abreast with the latest practices and techniques. The idea is to take the international standards and marry it with the socio-economic context of India,” said Dr Apte.

Globalize your Business Strategy: Learning executives must globalize the business strategy for learning inside the corporation. What are your global vision, philosophy, and plan for your learning business? How are you going to develop a global vision that excites, challenges, and educates your workforce?

Step 1: Create a Global Vision and Values- First and foremost, global leaders must excite other people about their vision for becoming a world-class organization. Facilitating worldwide conversations that articulate the higher purpose of the organization lets globally literate leaders globalize their vision and values.

In Japan, a culture shaped by ambiguity, Ryuzaburo Kaku, honorary chairman of Japan-based Canon, has no ambiguity whatsoever about his vision of the future: "Living and working for the common good" is his goal. That concept of kyosei drives him and the company to become a powerful force for social, political, and economic transformation in Japan and beyond. Worldwide successful companies globalize their vision and values across marketplaces, products, customers, suppliers, and partners. By building credible, coherent, compelling global points of view, such companies create a rallying point for all employees.
Action steps for learning executives:

- Develop a vision for becoming a world-class organization.
- Globalize your learning vision and values.
- Build a global point of view.

Step 2: Build a global roadmap

George Fisher, retired chairman and CEO of the Eastman Kodak Company, had a global vision, but he knew he needed global leaders at all levels to achieve the vision and that those leaders would need a roadmap, a global trajectory of where he wanted Kodak to go in the future.

"The New Kodak: A Roadmap for Corporate Renewal" provided Fisher with the tools to help achieve customer, employee, and shareholder satisfaction. The challenge was that the roadmap had to be readable around the world. Fisher tailored his map to local traditions, allowing for a certain amount of freedom by culture without losing the fundamental intent.

Action steps for learning executives:

- Chart a global roadmap for the organization’s learning future.
- Teach the global context of the business.
- Tailor the roadmap for local adaptation.

Step 3: Execute a global enterprise strategy

Learning executives must understand the link between the key strategies (business, leadership, culture, and learning), and they must invite participation from senior executives, operating units, and learners to develop an enterprise-wide strategy.

Under the leadership of Phil Condit, Boeing has crafted a global vision: "people working together as a global enterprise for aerospace leadership." Out of that vision, Boeing created a global enterprise strategy--a component of which is the Boeing Leadership Center, launched in 1999 to develop leaders who can take advantage of rapid changes in the global economy. Carefully designed to help managers at each stage of their careers, Boeing has effectively created a global learning strategy and linked business strategy to leadership, culture, and learning.

Action steps for learning executives:

- Cultivate a global learning philosophy.
- Initiate an integrative global enterprise strategy.
- Learners, and outside experts.

Step 4: Create global leadership competencies

"The data wave is breaking higher every day," says Sir Peter Bonfield, CEO of London-based British Telecommunications. "Mono poly, bureaucracy, and stagnation are out; competition, choice, and innovation are in."

Out of that complex global tsunami, British Telecommunications has emerged as a fast, market-driven business riding the crest of the data wave. To make it work, Bonfield had to create a
business-literate workforce with global leadership competency at every level, tailored to local conditions. By liberating leaders to lead, using continuous feedback mechanisms such as 360 assessments, Bonfield has combined BT's inspirational vision with the metrics of success to create corporate scorecards that reward leading indicators rather than static ones.

**Action steps for learning executives:**

- Assess global literacy capability worldwide.
- Globalize and localize leadership competencies.
- Require global literacy skills of executives, managers, and employees.

**Step 5: Develop globally literate executive teams** - Developing globally intelligent executive teams may be the most important job of learning managers. By facilitating worldwide conversations about global markets and opportunities, learning executives can help deepen globally literate leadership skills around the table. Denmark-based pharmaceutical giant Novo Nordisk sends "culture coaches" around the world to help teach and facilitate executive teams as the company personalizes and operationalizes its global vision and values. Executives must come to the table having "bought" and "sold" best practices from divisions around the world to cross-pollinate their thinking at the top of the organization.

**Action steps for learning executives:**

- Cultivate psychological, business, and cultural intelligence.
- Foster cross-cultural executive communication.
- Teach executive teams about global context, competencies, and problem solving.

**Step 6: Cultivate global leaders at all levels** - Helen Alexander, managing director of the UK-based Economist Group, cultivates diversity and debate across cultures. She looks for and cultivates "highly educated and flexible, open-minded people who can work across borders, who can be international and local at the same time, and who are naturally culturally sensitive. We want people who can think beyond cultural differences."

By teaching people to work together in a high-speed environment, Alexander has created a highly respected publication, to which global businesspeople turn for viewpoints and analyses.

**Action steps for learning executives:**

- Make international a part of the company's bloodstream.
- Foster cross-business and cross-cultural work assignments.
- Develop global coaching and mentoring networks.
- Globalize your Culture Strategy

The next challenge for training executives is to create a fast, dynamic global learning environment, in which every employee understands the need for global leadership skills. By building a global culture of innovation and accountability, training executives can promote the transfer of global knowledge and penalize the blockers.
Step 7: Globalize your management routines - Coca-Cola knows that effective managers have productive daily routines and ineffective managers don't. Certain management routines can be useful for all managers around the world to learn. Coca-Cola's Management Routines programme is designed for managers to emulate or alter to fit their own styles, depending on their cultural back-grounds.

This global toolbox augments managers' worldwide communication tools and includes lessons in dialogue, learning coaches, and global learning catalogues. Globalizing Coca-Cola's management routines has led to soft innovations in a company known for hard results.

Action steps for learning executives:

- Identify universal global management tasks.
- Determine what is global and mandatory and what is local and discretionary.
- Ensure that global leaders model global management tasks.

Step 8: Create a global-local business culture - When Jean-Louis Beffa visits the Palace of Versailles, he can't help but admire the windows. His pride is well founded: The French Company he now leads, Saint-Gobain, created those windows. Beffa knows that the market for palace windows has dwindled in the ensuing 330 years of Saint-Gobain's history. To remain relevant in a much-changed world, Beffa has created a nimble organization with a global foot-print: Employees must learn about the French, European, and global perspectives of their business. He cultivates a global-local culture by ensuring that employees can move quickly between those three worlds. Global learning and communications systems enable that to happen.

Action items for learning executives:

- Globalize-localize HR policies and systems.
- Create a global information infrastructure.
- Develop global communication systems.

Step 9: Foster multitalented, cross-cultural teams - Cows are key players in New Zealand's economy, accounting for 23 per cent of the nation's GDP (gross domestic product). The New Zealand Dairy Board capitalizes on that asset, realizing that there's no place for all that milk to go but outside of New Zealand.

Thus, strengthening diverse, multicultural teams is vital to New Zealand's international success. By staying true to New Zealand principles yet respecting different cultural norms, globally literate leaders of the dairy board use conflict to build understanding, creativity, and momentum.

Warren Larsen, CEO of the New Zealand Dairy Board, created a new structure for his organization, with global teams at its centre. It's a structure that leverages collective intelligence and institutionalizes social literacy. Larsen said, "If we're smart and form strong cultural relationships, then performance goes up."
By fostering virtual, multicultural teams, Larsen was able to create a 24/7 culture and global communities of practice, enabling his organization to beat much larger competitors in the global marketplace. This small co-op of farmers recently sold US$40 million worth of mozzarella to the world's largest pizza chain, Pizza Hut.

**Action items for learning executives:**

- Foster virtual, multicultural teams.
- Develop global business action teams.
- Create global learning communities of practice.
- Globalize your Learning Strategy

A company's global business, leadership, and culture strategies naturally shape its learning strategy. The challenge for learning executives is to identify and priorities current and future learning needs, create global learning programmes to address those needs, and use global learning partner networks to execute the plan. Ultimately, learning executives must demonstrate the impact of global literacy on employee retention, satisfaction, and development; innovation; and other critical business goals.

**Step 10: Deliver enterprise-wide tools and processes** - Training costs nothing reads the large plaque in the entrance to Motorola University's main campus. Driven by former chairman Robert Galvin, Motorola has built its reputation around the single-minded pursuit of learning. Its learning strategy is linked directly to the corporation's critical business issues: leadership development in a global market, systems solutions, growth through organization renewal, global brand-equity management, and knowledge management. Global skills are integrated through and across the learning curriculum at Motorola--using enterprise-wide, multidimensional learning tools that teach collaborative, cross-cultural competence. Motorola is a global learning laboratory.

**Action steps for learning executives:**

- Create enterprise-wide, multidimensional learning tools (assessments, laboratories, E-learning, action learning).
- Foster global collaborative learning technologies (Web-based, distance, satellite, multimedia).
- Build a global learning infrastructure (learning portal, virtual campus, just-in-time, partner networks).

**Step 11: Create global knowledge banks** - Shelley Lazarus, CEO of Ogilvy & Mather, knows that creativity is the lifeblood of her ad company. She uses "test beds and experiments" throughout O&M: Four to five offices do things in different ways at all times, with lessons shared around the world to capture global knowledge (assets, databases, skills, and best practices). The new IBM brand identity created by O&M-"solutions for a smaller planet"--brought the world together and made IBM smaller and friendlier, using foreign languages. It was a campaign created out of dynamic global knowledge banks and collaborative communities worldwide. Lazarus knows that each leader, division, and country has something unique to share.
Her learning strategy is designed to capture those unique contributions for the benefit of the business.

**Action steps for learning executives:**

- Teach global collaborative competencies to management teams.
- Develop a global knowledge bank of stories and best practices.
- Develop a global knowledge management community.

**Step 12: Build global-local centres of excellence** - Any successful global enterprise has functions that are global in nature (vision and values, technology infrastructure, and communication systems) as well as local assets and centers of excellence.

Lars Ramqvist, CEO of Sweden's Ericsson, builds a boundary less enterprise while localizing competence. "Our Centres of Excellence," he says: "have their own expertise and are linked globally. Each group of employees brings some unique expertise to the business. Our 100,000 employees work together because they know that the other 99,999 will turn to the experts inside the company to buy their expertise when needed." Ramqvist has created internal markets for ideas, talents, jobs, and projects.

**Action steps for learning executives:**

- Develop a global benchmarking process.
- Develop local centers of innovation and excellence around the world.
- Develop global metrics and standards for performance and excellence.

Those 12 steps are critical to creating global success. Learning executives must demand global literacy of them and teach the global literacy’s to other people at all levels of the business encouraging them to be more personally aware, socially skilled, economically enlightened, and culturally wise. As leaders, they must understand their national strengths and be aware of their national flaws, preserving what is best in their countries while learning from other nations around the world. By developing more people at more levels of the organization with global illiteracies and linking the key strategies, learning executives help their companies create leadership competence around the world and increase their potential for 21st century success.

**10.5 CASE STUDY**

**Competing Globally: Mastering Cross-Cultural Negotiations:** As organisations expand their global business, there is a growing need to develop the cultural competency of today's managers. Technology and capital are no longer the sole competitive edges. This article describes the problems facing managers in their international business dealings and explains how business leaders can enhance their global expansion.

BERNARD Smith is the newly appointed general manager of international marketing for a large British trading firm. His first challenge is to chair the multicultural sales managers meeting,
comprising the American director of marketing, John Miller; the German operations manager, Hans Schmidt; the Japanese distribution manager, Nato Suzuki; the Arab financial manager, Mohammed Salleh; and the Chinese manager of market research, Li Chen. What a challenge!

After a brief introduction by each manager to present the status of his group's activities, Smith formally opens the floor to the managers' feedback. Schmidt questions the data that Suzuki presented and its sources. Suzuki responds briefly, but senses an argument. Not wanting to break up the harmony with Schmidt, Suzuki suggests that the two of them meet later for lunch.

In the meantime, Miller tries to defend Suzuki's position, at which point Miller and Schmidt get into a heated debate. Salleh tries to intervene; pointing out that everyone should listen to what each has to say.

In order to proceed with the meeting, Salleh invites Suzuki to present his rationale, experiences, and final opinions on the data presented. Believing in teamwork, Suzuki takes the opportunity to ask the other managers to clarify some of the points discussed, before finally giving his opinion.

Attempting to alleviate the tension, Smith makes a small joke and then requests that Chen elaborate on the data presented, realizing that the Chinese has been waiting for an invitation. Like Suzuki, Chen responds without drawing any conclusions, and leaves the decision to the chair, valuing the senior person's authority. He then turns to Salleh and requests more money for research. Salleh categorically refuses, stating that he is solely in charge of finances and that the entire budget has already been allocated. Chen bows to his authority, too.

Smith decides to wrap up the debate and comes to a consensus on the disputed issues. Miller immediately recommends a democratic vote: "Let's do it and fix it later if any problems arise."

Schmidt insists on delaying any vote before all data are in. Suzuki smiles nervously and points out that the debate has to be continued until a group decision is made and all are in agreement. He suggests that more time be given to help everyone settle down, perhaps during lunch and even after a round of golf. For his part, Salleh supports Miller's suggestion for a vote, stating: "God will help the majority."

Smith finds himself in the middle of typical multicultural clash and calls for coffee break, wondering what he will do to achieve consensus. Luckily, his secretary, Jane, comes to the rescue and reminds him of his flight to Asia in two hours. Politely, Smith excuses himself and heads for Heathrow airport, hoping the problem will take care of itself while he is gone.

But Smith is only fooling himself. The problem won't correct itself, and unless you are aware of each of your team member's cultural values, multi-cultural meetings can be very frustrating, time consuming, and unproductive.

Smith's first stop was in Kuala Lumpur, where he phoned his client, Abdul Magid, to confirm his appointment at 9 am. Abdul's company has been one of his big targets, and he hoped to capture their order quickly. Unfortunately, he was told that his meeting was changed to an 11 o'clock
lunch with the assistant manager, Noor Ismail. He had no choice but to agree and to shuffle his meeting with another potential client.

He arrived at Ismail's office on time and quickly began discussing how much profit the Malaysian company could make from his new products. But Ismail was more interested in learning about Smith's company's credibility and past activities in Malaysia than specific negotiation details. After an hour into the meeting, when Smith was eager to know if the price offer was acceptable, Ismail said he had to meet with other suppliers and asked Smith if he would like to join other members of the team for lunch. Smith wondered if Ismail was just passing the buck.

**No Confirmation:** Two days later, without a confirmation from Ismail, who still had to meet with Smith's competitors, a less confident Smith boarded his flight to Jakarta. He had worked very hard over the previous three months to recruit his Indonesian marketing agent, who had arranged several marketing meetings and presentations with potentially lucrative companies.

Smith and his agent spent a full day with one prospective company, scheduling meetings with three of the important buyers. Each meeting consisted an hour of waiting and 15 minutes of presentation. Smith tried to make a sale to each of the directors, but ended up simply giving away samples of his product line. Again he was surprised that price negotiations did not begin. He thought his low prices would easily clinch the sale, but his agent was just planting the seeds that Smith would have to water with more samples.

On his last night in Indonesia, Smith's agent invited him and two other purchasing managers to dinner. He was confident about the deal, and after three hours of dinner and discussion, the purchasing manager smiled politely and said: God willing, you may possibly receive our order." The purchasing manager and the agent then left and Smith had a US$200 bill on his account. No order was made and it was already time to fly off to Korea.

Boarding a flight to Seoul, Smith recalled his previous negotiations with a Korean junior manager who had tentatively confirmed a sales agreement. Smith asked his company's legal staff to draw up a contract for final signature. To his surprise, upon meeting the junior manager in Seoul, Smith was told the vice president had not actually agreed upon the terms of the contract, claiming that another company was offering a similar product line at a reduced price. The Korean manager was asking for another 30 per cent discount! The meeting ended with no agreement and Smith had to leave for Japan.

Smith felt happy that he could fall back on his Japanese agent, whom he had been conversing over the phone over several months. Now giving his first presentation, he found himself in a lengthy question and answer session. He was happy the Japanese carefully examined the samples and asked so many questions, thinking that it indicated he would secure a good order. Smith therefore talked with even more enthusiasm for the rest of the hour and made attempts to elicit feedback from the VP. But even after his presentation, no offers were made. Feeling pressured to close a sale, Smith invited the team to a sushi dinner where he was also bombarded with many
questions concerning the products' quality, and his company's ability to meet production quotas. But at the end of the dinner, no formal order was made.

Trying to catch three hours of sleep before his flight back to London, he wondered what he did wrong on his trip. Can you help him?

**Points to Ponder:** Each culture is unique. In order to succeed with the previous cultures and in your next multicultural management and negotiation, keep in mind the following:

**Japanese:** To succeed with the Japanese, you must make an extra effort to be properly introduced and establish long-term relationships. Try to maintain group harmony, even if you personally disagree with a decision.

Focus on achieving group consensus that will eventually lead to group achievement. If you fit within the team, you will receive a deeper bow.

**Arabs:** They will be interested in your contacts, education, and position in society. They value authority and personal relationships. They may not be as elaborate in their information seeking as the Japanese and will base their decisions on intuition and their religious beliefs. They appreciate flattery and acknowledgment—provide these and you will get a bigger hug.

**Chinese:** They value seniority and authority. This is usually achieved after hard work and recognition from their peers and families. Their decisions are usually not questioned by subordinates. However, they take care of the people under them, in both business and health matters. They will even link you into their expanded network.

**Americans:** When dealing with them, be aware of their values of equality, independence, freedom, action-orientation, and openness.

Americans appreciate having all the cards on the table and discussing each one based on its own merits. Within the first few minutes of meeting with an American, you will be asked what you do. They will even go to war to save the underdog.

**Malaysians and Indonesians:** Negotiating and dealing with this group can be a long process. You have to identify and work with three important players. The first is the person who introduces you. The second will work on recommending your proposal, and the third will sign on the proposal. You have to plant a seed and keep watering it through visits, gifts, and entertainment.

**Koreans:** To understand Korean business culture, you must look at the Korean military academies. The country, companies, and family are run in a military fashion. The employee is working for the boss. No matter what anybody else says, no confirmation will be made until the boss gives the contract his stamp of approval.

**Mastering the Multicultural Management and Negotiation Process:** But how one can really master the skills for multicultural management and negotiation? Today's managers must be
aware that every member of the team will come to the workplace carrying his own cultural baggage, which has been developed over time, based on his cultural orientation and reward/punishment systems. In order to create cultural synergy among diverse people, one must be able to first recognize one's basic cultural bias and how it differs from that of the people one is dealing with. One must start by showing admiration and respect for other cultures. Only when this happens can cultural synergy exist; one plus one will be greater than two.

To facilitate and encourage cross-cultural discussion and team building, members of a team or project should be assigned to form culturally diverse teams. The emphasis should be on producing a new team with a new and distinct culture that maximizes the energy of the team, accomplishes its goals, and get projects done on time. This builds on the unique cultural values of the individual team members.

We usually do this during our two-day multicultural seminar with project teams comprising members that come from different cultures and nationalities. During the interaction, members of the team start building trust and admiration for each other's values and end up with one or two mentors from the team that can help them minimize cultural clashes.

The following pointers are worth keeping in mind to enhance the success of your current of future multi-cultural and for the company's global business:

- Do not assume that capital, technology, and market access are the only competitive edges.
- Provide each member of your team with preliminary cross-cultural orientations and training about the national and corporate cultures of the other team members, as well as the companies you are dealing with.
- When your team or joint venture is three to six months old, establish a forum in which your team can begin the process of creating and building a new culture common to all new members. Find and stress common values, encourage members to compromise, establish cultural mentors, and accept values that are not stressed in their own cultures.
- Encourage new members of the joint venture to focus their attention on changes within the business subcultures, especially the subcultures of their clients, competitors, regulators, suppliers, and the community. This will change their focus from internal to external cultures. Creating urgency or forms of crisis outside the house will help solidify and minimize team differences.
- Every six months or so, use a facilitator—either an external professional or internal employee—to coach your teams on the critical task of developing a dialogue among the members of your multicultural team.
10.5 REVIEW QUESTIONS

1. What are the core characteristics of the process we call globalization?
2. How has trade liberalization affected trade and economic growth at the level of individual countries? Has global economic inequality increased?
3. Has trade liberalization stimulated South-North migration of labour?
4. What have been the effects on employment and wages in advanced industrial countries?
5. What have been the effects on employment and wages in developing countries?
6. Has trade growth been associated with "unfair trade", "social dumping" and "race to the bottom"?
7. The second part focuses specifically on labour market effects of the growing flows of foreign direct investment (FDI). The questions being addressed are:
8. What are the patterns of cross-border capital flows? How have these patterns been changing?
9. Do FDI flows increase the aggregate rate of investment in developing countries?
10. How do the operations of transnational corporations - the main vehicles of FDI - affect employment and wages in manufacturing in developing countries?
11. Is ‘Demand Forecasting’ an impossible dream?
12. Can the failure of Nike be attributed to systemic problems or tactical ones?
“The lesson content has been compiled from various sources in public domain including but not limited to the internet for the convenience of the users. The university has no proprietary right on the same.”