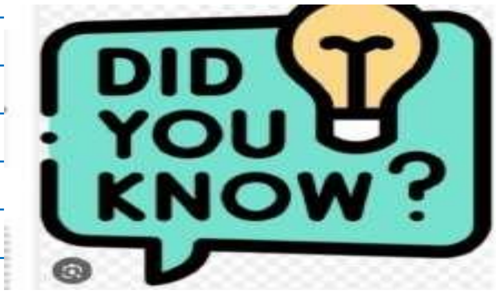
Chapter -4
Unit-3
TRADE NEGOTIATIONS

India, has already become part of 19 concluded agreements and is currently negotiating more than two dozens of such proposals.



Britain's exit from the European Union, the new free trade agreement [which is a successor of the North American Free Trade Agreement (NAFTA)] concluded between Canada, Mexico, and United States, namely United States-Mexico-Canada Agreement (USMCA).

Trade Negotiations
It is a process in which nations meet together to discuss possibility of trade with the goal of reaching at Trade agreement

When one parties seems to be bargaining for market access through reduction in tariff the others may be clamouring on the issue os possible grant of ptotection to domestic industry.

TAXONOMY OF REGIONAL TRADE AGREEMENTS (RTAS)

As of 1 February 2021, 339 RTAs were in force.

A regional trade agreement (RTA) is a treaty between two or more governments that define the rules of trade for all signatories.

Different Types of agreements

Unilateral trade agreements	Bilateral trade agreements	Multilateral trade agreements
under which an importing country offers trade incentivesin order to encourage the exporting country, that will improve the exporting country's economy. EG. GSP	agreements that set rules of trade between two countries, two blocs or a bloc and a country. These may be limited to certain good/services or certain types of market. EG. ASEAN- INDIA FTA	Trade among 3 or more nation &they are treated equally, aim to standarize commerce regulation encourge Export/Import reduce tariffs & Quotas. EG. WTO

Trading Bloc

- It has a group of countries that have a free trade agreement between themselves and may apply a common external tariff to other countries.
- Example: Arab League (AL), European Free Trade Association (EFTA)

Preferential Trade Agreements

- It is among a group of countries reduce trade barriers on a reciprocal and preferential basis for only the members of the group.
- E.g. Global System of Trade Preferences among Developing Countries (GSTP)

Free Trade Area

- It is a group of countries that eliminate all tariff and quota barriers on trade with the objective of increasing exchange of goods with each other.
- Example: The ASEAN–India Free Trade Area (AIFTA) is a free trade area among the ten member states of the Association of Southeast Asian Nations (ASEAN) and India. it came into force on 1 August 2005.

A customs union

- ✓ It is a group of countries that eliminate all tariffs on trade among themselves but maintain a common external tariff on trade with countries outside the union (thus, technically violating MFN).
- ✓ The common external tariff which distinguishes a customs union from a free trade area implies that, generally, the same tariff is charged wherever a member imports goods from outside the customs union.
- ✓ The EU is a Customs Union; its 27 member countries form a single territory for customs purposes. Other examples are Gulf Cooperation Council (GCC), Southern Common Market (MERCOSUR).

Common Market

- ✓ A Common Market deepens a customs union by providing for the free flow of output and of factors of production (labour, capital and other productive resources) by reducing or eliminating internal tariffs on goods and by creating a common set of external tariffs.
- ✓ The member countries attempt to harmonize some institutional arrangements and commercial and financial laws and regulations among themselves.
- ✓ There are also common barriers against non-members (e.g., EU, ASEAN)

Economic and Monetary Union

- ✓ In an Economic and Monetary Union, the members share a common currency.
- ✓ Adoption of common currency also makes it necessary to have a strong convergence in macroeconomic policies.
- ✓ For example, the European Union countries implement and adopt a single currency.

The political institutions that facilitate trade negotiations, and support international trade cooperation by providing the rules of the game have been the former General Agreements on Tariffs and Trade (GATT) and the World Trade Organization (WTO).

GATT

THE GENERAL AGREEMENT ON TARIFFS ANDTRADE

- ✓ The General Agreement on Tariffs and Trade (GATT) covers international trade in goods.
- ✓ The workings of the GATT agreement are the responsibility of the Council for Trade in Goods (Goods Council) which is made up of representatives from all WTO member countries.
- ✓ The Goods Council has 10 committees dealing with specific subjects (such as agriculture, market access, subsidies, anti-dumping measures, and so on). Again, these committees consist of all member countries.
- ✓ Also reporting to the Goods Council are a working party on state trading enterprises, and the Information Technology Agreement (ITA) Committee.

- ✓ **The GATT lost its relevance by the 1980s because :**
  - it was obsolete to the fast-evolving contemporary complex world trade scenario characterized by emerging globalisation
  - international investments had expanded substantially
  - intellectual property rights and trade in services were not covered by GATT
  - world merchandise trade increased by leaps and bounds and was beyond its scope.
  - the ambiguities in the multilateral system could be heavily exploited
  - efforts at liberalizing agricultural trade were not successful.
  - there were inadequacies in institutional structure and dispute settlement system
  - it was not a treaty and therefore terms of GATT were binding only insofar as they arenot incoherent with a nation's domestic rules.

THE URUGUAY ROUND

THE ESTABLISHMENT OF WTO

The need for a formal international organization which is more powerful and comprehensive was felt by many countries by late 1980s.

Having settled the most ambitious negotiating agenda that covered virtually every outstanding trade policy issue, the Uruguay Round brought about the biggest reform of the world's trading system.

VIDHYODAY
VIDHYA KA UDAY

- ✓ Members established 15 groups to work on limiting restrictions in the areas of tariffs.
- ✓ The Round started in Punta del Este in Uruguay in September 1986 and was scheduled to be completed by December 1990.
- ✓ However, due to many differences and especially due to heated controversies over agriculture, no consensus was arrived at.
- ✓ Finally, in December 1993, the Uruguay Round, the eighth and the most ambitious and largest ever round of multilateral trade negotiations in which 123 countries participated, was completed after seven years of elaborate negotiations.
- ✓ The agreement was signed by most countries on April 15, 1994, and took effect on July 1, 1995.

It marked the birth of the World Trade Organization (WTO) which is the single institutional framework encompassing the GATT, as modified by the Uruguay Round.

THE WORLD TRADE ORGANIZATION

WTO

The only global international organization dealing with the rules of trade between nations. The principal objective of the WTO is to facilitate the flow of international trade smoothly, freely, fairly, and predictably.

Objectives

- to set and enforce rules for international trade,
- to provide a forum for negotiating & monitoring further trade liberalization,
- to resolve trade disputes,
- to increase the transparency of decision-making processes,

to cooperate with other major international economic institution involved in global economic management,

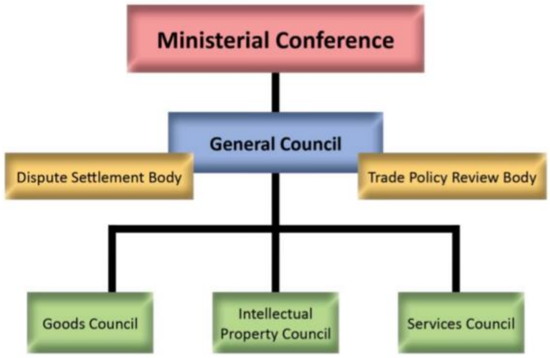
to help developing countries benefit fully from the global trading system.

The WTO, whose primary purpose is to open trade for the benefit of all, does its functions by acting as a forum for trade negotiations among member governments, administering trade agreements, reviewing national trade policies, assisting developing countries in trade policy issues, through technical assistance and training programmes and cooperating with other international organizations.

The Structure of the WTO

The WTO activities are supported by a Secretariat located in Geneva, headed by a Director General.

It has a three-tier system of decision making.



- ✓ **The Ministerial Conference** meets at least once every two years.
- ✓ the **General Council** which meets several times a year at the Geneva headquarters.
- ✓ The General Council also meets as the Trade Policy Review Body and the Dispute Settlement Body.
- ✓ **At the next level**, the **Goods Council, Services Council**
- ✓ **and Intellectual Property (TRIPS) Council** report to the General Council. These councils are responsible for overseeing the implementation of the WTO agreements in their respective areas of specialisation.
- ✓ The WTO Secretariat maintains working relations with almost 200 international organisations in activities ranging from statistics, research, standard-setting, and technical assistance and training.
- ✓ The WTO accounting for about 95% of world trade currently has **164 members,** of which **117 are developing countries** or separate customs territories.
- ✓ Around **24 others are negotiating membership**. The WTO's agreements have been ratified in all members' parliaments.

The Guiding Principles of World Trade Organization (WTO)

- Trade without discrimination MFN & NTP
- Freer trade gradually, through negotiation
- Predictability through binding and transparency
- Promoting fair competition
- Encouraging development and economic reform

Trade without discrimination

Most-favoured-nation

MFN treating other people equally Under the WTO agreements, countries cannot normally discriminate between their trading partners.

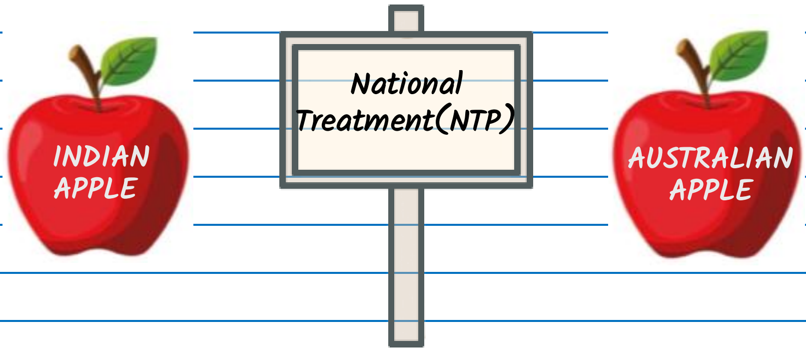
Grant someone a special favour (such as a lower customs duty rate for one of their products) and you have to do the same for all other WTO members.

This principle is known as most-favoured-nation (MFN) treatment.

✓ 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.

note to self
EXCEPTION

For example, countries can set up a **free trade agreement** that applies only to goods traded within the group — discriminating against goods from outside.



NTP is Treating foreigners and locals equally Imported and locally- produced goods should be treated equally — at least after the foreign goods have enteredthe market.

The same should apply to foreign and domestic services, and to foreign and local trademarks, copyrights and patents.

✓ This principle of "national treatment" 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 principleis handled slightly differently in each of these.

Freer trade gradually, through negotiation

Lowering trade barriers is one of the most obvious means of encouraging

The barriers concerned include customs duties (or tariffs) and measures such as import bans or quotas that restrict quantities selectively..

✓ The WTO agreements allow countries to introduce changes gradually, through "progressive liberalization".

✓ Developing countries are usually given longer to fulfil their obligations.

Predictability through binding and transparency

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.

✓ A country can change its bindings, but only after negotiating with its trading partners, which could mean compensating them for loss of trade.

✓ In agriculture, 100% of products now have bound tariffs. The result of all this is a substantially higher degree of market security for traders and investors.

✓ The system tries to improve predictability and stability in other ways as well.

✓ Many WTO agreements require governments to disclose their policies and practices publicly within the country or by notifying the WTO.

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 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.

Encouraging development and economic reform

The WTO system contributes to development. 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.
- ✓ The current Doha Development Agenda includes developing countries' concerns about the difficulties they face in implementing the Uruguay Round agreements.

WTO Agreements

The WTO agreements cover goods, services and intellectual property and the permitted exceptions.

These agreements are often called the WTO's trade rules, and the WTO is often described as "rules-based", a system based on rules. The rules are actually agreements that the governments negotiated.

<u>Following are the important agreements under WTO.</u>

1. **Agreement on Agriculture** aims at strengthening GATT disciplines and improving agricultural trade. It includes three areas of market access, domestic support and export subsidies.
2. **Agreement on the Application of Sanitary and Phytosanitary (SPS) Measures** establishes multilateral frameworks for the planning, adoption and implementation of sanitary and phytosanitary.
3. **Agreement on Textiles and Clothing replaced the Multi-Fibre Arrangement (MFA)** which was prevalent since 1974 and entailed import protection policies.
4. **Agreement on Technical Barriers to Trade (TBT)** aims to prevent standards and conformity assessment systems from becoming unnecessary trade barriers by securing their transparency and harmonization with international standards.
5. **Agreement on Trade-Related Investment Measures (TRIMs)** expands disciplines governing investment measures in relation to cross-border investments.
6. **Anti-Dumping Agreement** seeks to tighten and codify disciplines for calculating dumping margins and conducting dumping investigations, etc. in order to prevent anti-dumping measures from being abused or misused to protect domestic industries.
7. **Customs Valuation Agreement** specifies rules for more consistent and reliable customs valuation and aims to harmonize customs valuation systems on an international basis by eliminating arbitrary valuation systems.
8. **Agreement on Pre-shipment Inspection (PSI)** intends to secure transparency of pre- shipment inspection wherein a company designated by the importing country conducts inspection of the quality, volume, price, tariff classification, customs valuation, etc. of merchandise in the territory of the exporting country on behalf of the importing country's custom office and issues certificates.
9. **Agreement on Rules of Origin** provides for the harmonization of rules of origin for application and also provides for dispute settlement procedures and creates the rules of origin committee.
10. **Agreement on Import Licensing Procedures** relates to simplification of administrative procedures and to ensure their fair operation so that import licensing procedures of different countries may not act as trade barriers.

11. **Agreement on Subsidies and Countervailing Measures** aims to clarify definitions of subsidies, strengthen disciplines by subsidy type and to strengthen and clarify procedures for adopting countervailing tariffs.
12. **Agreement on Safeguards** clarify disciplines for requirements and procedures for imposing safeguards and related measures which are emergency measures to restrict imports in the event of a sudden surge in imports.
13. **General Agreement on Trade in Services (GATS):** This agreement provides the general obligations regarding trade in services, such as most- favoured-nation treatment and transparency.
14. **Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS):** This agreement stipulates most-favoured-nation treatment and national treatment for intellectual properties, such as copyright, trademarks, geographical indications, industrial designs, patents, Etc.
15. **Trade Policy Review Mechanism (TPRM)** provides the procedures for the trade policy review mechanism to conduct periodical reviews of members' trade policies and practices conducted by the Trade Policy Review Body (TPRB).
16. **Plurilateral Trade Agreements:** The Plurilateral trade agreements involve several countries with a common interest but do not involve all WTO countries.

THE DOHA ROUND

- ✓ The Doha Round, formally the Doha Development Agenda, which is the ninth round since the Second World War was officially launched at the WTO's Fourth Ministerial Conference in Doha, Qatar, in November 2001.
- ✓ The round seeks to accomplish major modifications of the international trading system through lower trade barriers and revised trade rules.
- ✓ The negotiations include 20 areas of trade, including agriculture, services trade, market access for non-agricultural products (NAMA), trade in services, trade facilitation, environment, geographical indications and certain intellectual property issues.
- ✓ The most controversial topic in the Doha Agenda was **agriculture trade.**

G20 ECONOMIES: FACILITATING TRADE

Export restrictions contribute to shortages, price volatility, and uncertainty.

- ✓ G20 economies must build on their collective pledges from the 12th Ministerial Conference and demonstrate leadership to keep markets open and predictable, so that food and fertilizer in particular can flow to where they are needed," said WTO Director-General Ngozi Okonjo-Iweala, who will be attending the G20 Leaders' Summit in Bali, Indonesia, on 15-16 November.

- ✓ The report indicates that supply chains on the whole have thus far proved to be resilient, despite the war in Ukraine, the continuing impacts of the COVID-19 pandemic, the highest inflation many countries have experienced in decades, and the impacts of monetary tightening by central banks seeking to limit price increases.
- ✓ That said, specific industries and regions have been differently impacted.
- ✓ Overall, the pace of implementation of new export restrictions by WTO members has increased since 2020, first in the context of the pandemic and subsequently with the war in Ukraine and the food crisis.
- ✓ Some of these export restrictions have been gradually lifted, but several still remain in place.
- ✓ As of mid-October 2022, WTO members still had in place 52 export restrictions on food, feed and fertilizers, in addition to 27 export restrictions on products essential to combat COVID-19. Of these, 44% of the export restrictions on food, feed and fertilizers, and 63% of the pandemic-related export restrictions, were maintained by G20 economies.
- ✓ During the review period, G20 economies introduced 66 new trade-facilitating measures and 47 trade-restrictive measures on goods. These measures were not related to the pandemic.
- ✓ At the same time, the accumulated stockpile of G20 import restrictions continued to grow. By mid-October, 11.6% of G20 imports were affected by trade-restricting measures implemented since 2009 and still in force.
- ✓ Initiations of trade remedy investigations by G20 economies declined sharply during the review period (17 initiations), after a peak in 2020 that was the highest since the beginning of the trade monitoring exercise in 2009.
- ✓ Anti-dumping measures continued to be the most frequent trade remedy action in terms of initiations and terminations.
- ✓ Similarly, the implementation of new COVID-19-related trade measures by G20 economies decelerated over the past five months, with four new such measures recorded on goods and one on services.
- ✓ The number of new COVID-19-related support measures to mitigate the social and economic impacts of the pandemic also fell sharply over the past five months.
- ✓ Since the beginning of the pandemic, 201 COVID-19 trade and trade-related measures in goods were implemented by G20 economies. Most (61%) were trade facilitating, while the rest (39%) could be considered trade restrictive.
- ✓ G20 economies also continued to phase out pandemic-related import and export measures.
- ✓ By mid-October 2022, 77% of export restrictions had been repealed, leaving 17 restrictions in place.
- ✓ Although the number of the pandemic-related trade restrictions in place decreased, their trade coverage remained significant, at USD 122.0 billion.
- ✓ The WTO trade monitoring reports have been prepared by the WTO Secretariat since 2009.

G20 Members: Argentina, Australia Brazil, Canada, France, Germany etc.

Chapter -4 (Unit -3)
TRADE NEGOTIATIONS

1. What does GATT stand for?
(a) Global Association for Trade and Tariffs
(b) General Agreement on Tariffs and Trade
(c) Global Alliance for Trade Treaties
(d) General Association of Trade and Taxes

2. When was GATT established?
(a) 1945
(b) 1948
(c) 1955
(d) 1960

3. What was the main objective of GATT?
(a) To promote regional trade agreements
(b) To eliminate tariffs and trade barriers among member countries
(c) To establish a unified currency system
(d) To regulate intellectual property rights

4. Which organization succeeded GATT in 1995 and took over its functions?
(a) World Trade Organization (WTO)
(b) International Monetary Fund (IMF)
(c) United Nations (UN)
(d) World Bank

5. Under GATT, which round of negotiations, held in 1986-1994, led to significant reductions in tariffs and the creation of the WTO?
(a) Tokyo Round
(b) Uruguay Round
(c) Doha Round
(d) Cancun Round

6. Which of the following culminated in the establishment of the World Trade Organization?
(a) The Doha Round
(b) The Tokyo Round
(c) The Uruguay Round
(d) The Kennedy Round

7. Choose the correct statement
(a) The GATT was meant to prevent exploitation of poor countries by richer countries
(b) The GATT dealt with trade in goods only, while, the WTO covers services as well as intellectual property.
(c) All members of the World Trade Organization are required to avoid tariffs of all types
(d) All the above

8. The 'National treatment' principle stands for
(a) the procedures within the WTO for resolving disagreements about trade policyamong countries
(b) the principle that imported products are to be treated no worse in the domestic market than the local ones
(c) exported products are to be treated no worse in the domestic market than the local ones
(d) imported products should have the same tariff, no matter where they are imported from

9. 'Bound tariff' refers to
(a) clubbing of tariffs of different commodities into one common measure
(b) the lower limit of the tariff below which a nation cannot be taxing its imports
(c) the upper limit on the tariff that a country can levy on a particular good, according to its commitments under the GATT and WTO.
(d) the limit within which the country's export duty should fall so that there are

cheaper exports

10 The essence of 'MFN principle' is

(a) equality of treatment of all member countries of WTO in respect of matters related to trade

(b) favour one, country, you need to favour all in the same manner

(c) every WTO member will treat all its trading partners equally without any prejudice and discrimination

(d) all the above

11. The World Trade Organization (WTO)

(a) has now been replaced by the GATT

(b) has an inbuilt mechanism to settle disputes among members

(c) was established to ensure free and fair trade internationally.

(d)(b) and (c) above

12. The Agreement on Agriculture includes explicit and binding commitments made by WTO Member governments

(a) on increasing agricultural productivity and rural development

(b) market access and agricultural credit support

(c) market access, domestic support and export subsidies

(d) market access, import subsidies and export subsidies

13. The Agreement on Textiles and Clothing

(a) provides that textile trade should be deregulated gradually and the tariffs should be increased

(b) replaced the Multi-Fiber Arrangement (MFA) which was prevalent since 1974

(c) granted rights of textile exporting countries to increase tariffs to protect their domestic textile industries

(d) stipulated that tariffs in all countries should be the same

14. The Agreement on Trade-Related Aspects of Intellectual Property Rights

(a) stipulates to administer a system of enforcement of intellectual property rights.

(b) provides for most-favoured-nation treatment and national treatment for intellectual properties

(c) mandates to maintain high levels of intellectual property protection by all members

(d) all the above

15. The most controversial topic in the yet to conclude Doha Agenda is

(a) trade in manufactured goods

(b) trade in intellectual property rights-based goods

(c) trade in agricultural goods

(d) market access to goods from developed countries

16. The WTO commitments

(a) affect developed countries adversely because they have comparatively less agricultural goods

(b) affect developing countries more because they need to make radical adjustments

(c) affect both developed and developing countries equally

(d) affect none as they increase world trade and ensure prosperity to all

17. Which of the following best describes Foreign Direct Investment (FDI)?

(a) Investment in foreign stocks and bonds by individuals and institutions

(b) Investment in a foreign country with the intention of controlling a business operation

(c) Investment in a foreign country's financial markets, such as stock exchanges

(d) Investment in a foreign country's infrastructure projects

18. What is the main difference between Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI)?
(a) FDI involves investment in financial assets, while FPI involves investment in physical assets.
(b) FDI is long-term investment with the intention of controlling a business, while FPI is short-term investment for financial returns.
(c) FDI is limited to large institutional investors, while FPI is open to individual investors.
(d) FDI is only allowed in developed countries, while FPI is allowed in both developed and developing countries.

19. Which of the following is an example of Foreign Portfolio Investment (FPI)?
(a) A multinational corporation acquiring a local manufacturing plant in a foreign country
(b) An individual purchasing shares of a foreign company's stock on a foreign stock exchange
(c) A foreign government providing funds for a public infrastructure project in another country
(d) A foreign bank investing in a technology startup in its home country

20. Which type of investment is more volatile and can quickly move in and out of a country's financial markets?
(a) Foreign Direct Investment (FDI)
(b) Foreign Portfolio Investment (FPI)
(c) Both FDI and FPI have the same level of volatility
(d) Neither FDI nor FPI are subject to volatility

21. What is the primary purpose of Foreign Direct Investment (FDI)?
(a) To generate short-term financial returns
(b) To gain ownership and control over a business in a foreign country
(c) To diversify investment portfolios across multiple countries
(d) To provide funding for public infrastructure projects in developing countries

22. Which country is /are a past of " USMCA" Agreement.
(a) United States
(b) Mexico
(c) Canada
(d) All of these

Answer Key

1	B	2	B	3	B	4	A	5	B	6	C	7	B	8	B	9	C	10	D
11	D	12	C	13	B	14	D	15	C	16	B	17	B	18	B	19	B	20	B
21	B	22	D																

Chapter -4
Unit-4
EXCHANGE RATE AND ITS ECONOMIC EFFECTS

Foreign Exchange Transaction

It is a transaction that is denominated / requires settlement in a foreign currency, including transaction

- *Buy or sells goods or services whose price is denominated in a foreign currency*
- *Becomes a party to an unperformed forward exchange contract.*
- *Borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency*
- *acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.*

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Exchange Rate Regimes

It is a method by which the value of the domestic currency in terms of foreign currencies is determined.

floating exchange rate regime OR a flexible exchange rate and

fixed exchange rate regime

Floating exchange rate system

In the system governments and central banks do not participate in the market for foreign exchange.

Market forces also restrain large swings in demand or supply.

1. allowing a Central bank and/or government to pursue its own independent monetary policy.
2. exchange rate regime allows exchange rate to be used as a policy tool
3. central bank is not required to maintain a huge foreign exchange reserves.

1. Free Floating lies in their predictability.
2. make international transactions riskier

Managed Float Systems

- ✓ In this System Exchange rates are still free to float, but governments try to influence their values.
- ✓ Government or central bank participation in a floating exchange rate system is called a managed float.
- ✓ Governments and central banks often seek to increase or decrease their exchange rates by buying or selling their own currencies.
- ✓ Countries that have a floating exchange rate system intervene from time to time in the currency market in an effort to raise or lower the price of their own currency.
- ✓ the purpose of such intervention is to prevent sudden large swings in the value of a nation's currency. Such intervention is likely to have only a small impact, if any, on exchange rates.

Fixed Exchange Rates

Exchange rate between two currencies is set by government policy.

+

1. avoids currency fluctuations and eliminates exchange rate risks and transaction costs.
2. profits are not affected by the exchange rate fluctuations. thus, enhance international trade and investment.
3. reduction in speculation
4. discipline on a country's monetary authority
5. greater trade and investment
6. enhance the credibility of the country's monetary-policy.

−

1. central bank is required to stand ready to intervene in the foreign exchange market to maintain an adequate amount of foreign exchange reserves for this purpose.

Fixed Rate brings More currency Monetary Credibility stability

− Lacks Flexibility

Floating Rate has greater Policy Flexibility

− Less Stability

Nominal v/s Real Exchange Rates

Nominal Rate

Rate at which a person can trade the currency of one country for currency of another country

It can be used to find domestic price of foreign goods.

Real Ex. Rate

Rate at which a person can trade the Goods & services of one country for 'Goods & services of another

It is a key determinate net export of goods & service

$$\text{Real exchange rate} = \text{Nominal exchange rate} \times \frac{\text{Domestic Price}}{\text{Foreign Price}}$$

OR

$$\text{Real exchange rate} = \text{Nominal exchange rate} \times \frac{\text{Domestic Price Index}}{\text{Foreign Price Index}}$$

Nominal effective Exchange Rate (NEER)

It is a measure of the value of a domestic currency against a weighted average of various foreign currencies.

The Real Effective Exchange Rate (REER)

$$\text{REER} = \frac{\text{Nominal effective exchange Rate}}{\text{Price deflator}}$$

REER ↑ Export Expensive ↓

FOREIGN EXCHANGE MARKET

Active Players

commercial banks

Executing orders from exporters, importers, funds, hedgers & private in stments

Also perform trading operation in their own interests

Brokerage houses

Contractors between large number of banks, funds commission Houses dealing centers etc.

Passive Players

They can not set their own quotations. They make trades at quotations offered by Active market players.

Aim of Passive Players

- Payment of export-import contracts,
- Foreign industrial investments,
- The opening of branches abroad,
- Creation of joint ventures,
- Tourism,
- Speculation ,Hedging etc.,

Types of transactions

Current Transactions

Carried out in spot Market & involve and immediate delivery.

Future Transactions

Buy or sell currencies for Future delivery which carried out in forward / future Markets

Spot Rate

Exchange rate for spot trading

Forward Rate

Exchange rate that specify a Future date

Forward Premium

Forward Exchange Rate > Spot Exchange Rate

Forward Discount

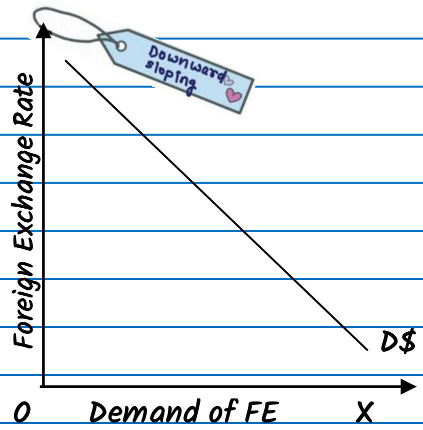
Forward Exchange Rate < Spot Exchange Rate

Determination of Nominal Exchange Rate

The supply of and demand for foreign exchange in the domestic foreign exchange market determine a country's exchange rate.

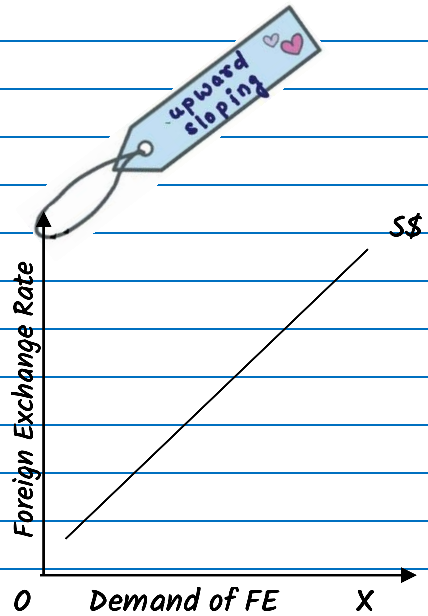
Demand for foreign exchange

1. Goods and services.
2. Unilateral transfers i,e gifts.
3. To make investment income payments abroad i,e interest.
4. To purchase financial assets, stocks, bonds etc.
5. To open a foreign bank account
6. To acquire direct ownership of real capital.
7. For speculation and hedging activities related to risk-taking or risk-avoidance.



Supply for foreign exchange

1. Export of Goods & Services
2. Unilateral transfers to home country.
3. investment income payments,
4. FDI & FPI.
5. Placement of bank deposits.
6. Speculation.
7. Hedging



Determination of the exchange rate

The equilibrium rate of exchange is determined

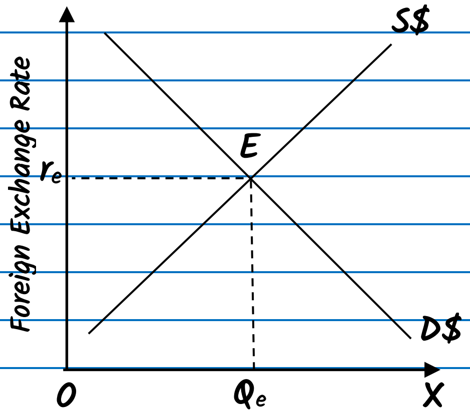
By

interaction of the supply and demand for a particular foreign currency. i,e $

In this diagram demand curve (D$) and supply curve (S$) of dollars intersect to'E' equilibrium

Q_e = Equilibrium Quantity

r_e = Equilibrium Rate



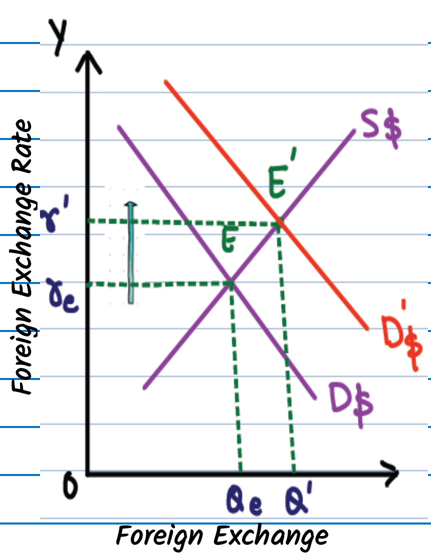
Changes In Exchange Rates

Home-currency depreciation

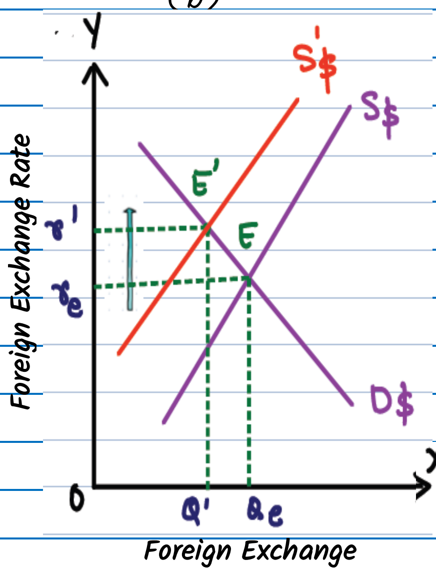
It takes place when there is an increase in the home currency price of the foreign cur- rency (or, alternatively, a decrease in the foreign currency price of the home currency). The home currency thus becomes relatively less valuable.

Under a floating rate system, Home Currency depreciation take place when

(a)



(b)



For eg. : 1\$ = ₹ 80

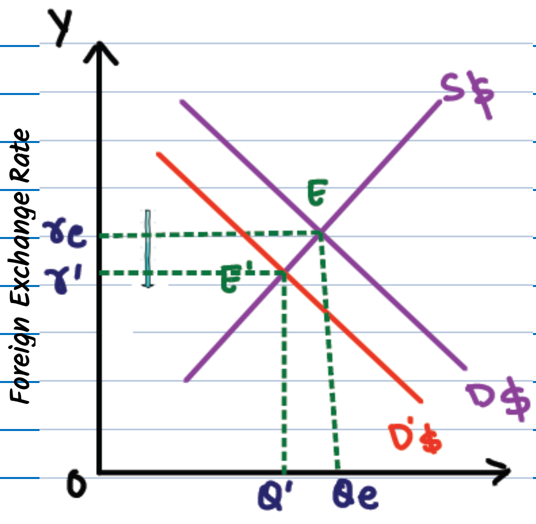
1\$ = ₹ 81

It indicate more units of domestic currency are required to buy one unit of foreign currency. This is called home domestic currency or foreign currency appreciation.

Home-currency Appreciation

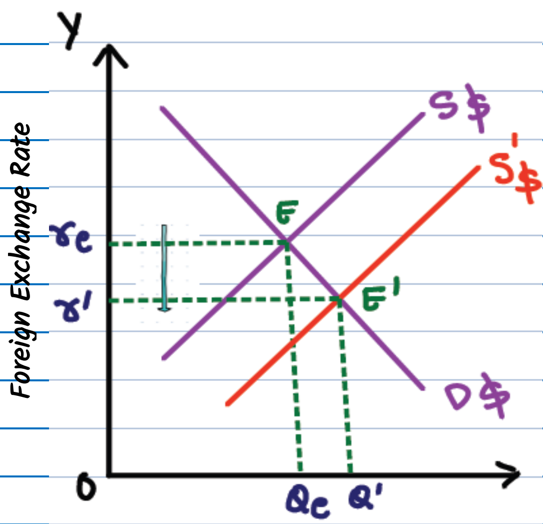
It takes place where there is an decrease in the home currency price of foreign currency. The home currency thusbecomes relatively more valuable.
Under Floating exchange rate system Home currency Appreciation take place when.

(a)
Demand curve shift to left



Foreign Exchange

(b)
Supply curve shift to right



Foreign Exchange

For eg. : 1\$ = ₹ 80

1\$ = ₹ 76

It Indicate lesser units of domestic currency are required to buy one unit of foreign currency. This is called Home Domestic Appreciation or Foreign currency Depreciation.

Devaluation V/S Depreciation

Devaluation	Depreciation
It is deliberate adjustment in the value of country's currency related to another currency or group of currencies.	It is decrease in value of currency due to Market forces of Demand and supply.
It take place in fixed Exchange rate regime.	It take place in floating Exchange rate regime.

Revaluation

opposite of Devaluation

Appreciation

opposite of Depreciation

Impact of Exchange Rate Fluctuation

Currency Depreciation

Home Currency Depreciation have following effect

1. Due to Home currency depreciation country's export become cheaper

   As a result Export Increases
2. In increase level of economic activity & creates output expansion

   Expansionary impact in the economy.
3. Positive effect on employment & Potentially on wages.
4. Due to Home currency depreciation country's Import become Expensive.

   It increased cost of imported good & leads to cost push inflation.

5. The fiscal health of a country whose currency depreciates is likely to be affected with rising export earnings and import payments and consequent impact on current account balance.

6. Companies that borrowed in foreign exchange but did not sufficiently hedge these loans against exchange risks, would be negatively impacted as they would require more domestic currency to repay.

7. Currency depreciation result increase debt burden, lower profit & adverse effect on B/s. As well increase debt burden of Government.

8. Financial forecasting become more difficult for firms therefore need of heading against risk.

9. Depreciation currency hits investor sentiments & has radial impact on pattern of international capital flow.

10. Foreign capital inflows are vulnerable when local currency weakens. Therefore FPI as well as FDI flows are likely to shrink This shoots up capital account deficit.

note to self:

To reduce the fiscal deficit

at the end of 2022, Russia and India agreed to switch to trade settlements in their national currencies.
In mid-November last year, India announced plans to double the volume of trade with Russia,
In late autumn, the Indian authorities allowed the use of Rupees in international trade settlements.

Currency Appreciation

Home currency Appreciation Following effect

1. Due to Home Currency Appreciation country's export become Expensive
   As a Result Export Decreases.
2. Since Import become cheaper, it max expect increase in the quantity of imports.
   It reduce Domestic AD & therefore economic growth likely to all.
3. If Appreciation sets during the recessionary phase there would be further fall in AD & Higher level of Unemployment.

If economy is facing a boom ,an appreciation of domestic of domestic currency would trim down inflation pressure & soften the rate of growth.

4. An appreciation may cause reduction in the levels of inflation Lower price of imported capital goods, components and raw materials which reduce cost of production. Living standard of people likely to improve due to cheaper consumer goods.
5. Increased Export prices, domestic industry have greater incentive to introduce technological innovations & capital intensive production to cut cost to remain competitive.
6. Increasing Import & Decreasing Exports are cause larger deficit & worsen the current Account.

It depends upon elasticity of demand.

Inelastic Demand of Export or Import Improvement in current Account

Elastic Demand of Export or Import Adversely effect current Account

Loss of competitiveness will be insignificant if currency appreciation is because of strong fundamentals of the economy.

Chapter -4 (Unit -4)
EXCHANGE RATE AND ITS ECONOMIC EFFECTS

1. Based on the supply and demand model of determination of exchange rate, which of the following ought to cause the domestic currency of Country X to appreciate against dollar?
(a) The US decides not to import from Country X
(b) An increase in remittances from the employees who are employed abroad to their families in the home country
(c) Increased imports by consumers of Country X
(d) Repayment of foreign debts by Country X

2. All else equal, which of the following is true if consumers of India develop taste for imported commodities and decide to buy more from the US?
(a) The demand curve for dollars shifts to the right and Indian Rupee appreciates
(b) The supply of US dollars shrinks and, therefore, import prices decrease
(c) The demand curve for dollars shifts to the right and Indian Rupee depreciates
(d) The demand curve for dollars shifts to the left and leads to an increase in exchange rate

3. 'The nominal exchange rate is expressed in units of one currency per unit of the other currency. A real exchange rate adjusts this for changes in price levels'. The statements are
(a) wholly correct
(b) partially correct
(c) wholly incorrect
(d) None of the above

4. Match the following by choosing the term which has the same meaning

(i) floating exchange rate	a. depreciation
(ii) fixed exchange rate	b. revaluation
(iii) pegged exchange rate	c. flexible exchange rate
(iv) devaluation	d. appreciation

(a) (i c); (ii d); (iii b); (iv a)
(b) (i b); (ii a); (iii d); (iv c)
(c) (i a); (ii d) ; (iii b); (iv c)
(d) (i d); (ii a); (iii b); (iv c)

5. Choose the correct statement
(a) An indirect quote is the number of units of a local currency exchangeable for one unit of a foreign currency
(b) the fixed exchange rate regime is said to be efficient and highly transparent.
(c) A direct quote is the number of units of a local currency exchangeable for one unit of a foreign currency
(d) Exchange rates are generally fixed by the central bank of the country

6. Which of the following statements istrue?
(a) Home-currency appreciation or foreign-currency depreciation takes place when there is a decrease in the home currency price of foreign currency
(b) Home-currency depreciation takes place when there is an increase in the home currency price of the foreign currency
(c) Home-currency depreciation is the same as foreign-currency appreciation and implies that the home currency has become relatively less valuable.
(d) All the above

7. An increase in the supply of foreign exchange

(a) shifts the supply curve to the right and as a consequence, the exchange rate declines

(b) shifts the supply curve to the right and as a consequence, the exchange rate increases

(c) more units of domestic currency are required to buy a unit of foreign exchange

(d) the domestic currency depreciates and the foreign currency appreciates

8. Currency devaluation

(a) may increase the price of imported commodities and, therefore, reduce the international competitiveness of domestic industries

(b) may reduce export prices and increase the international competitiveness of domestic industries

(c) may cause a fall in the volume of exports and promote consumer welfare through increased availability of goods and services

(d)(a) and (c) above

9. At any point of time, all markets tend to have the same exchange rate for a given currency due to

(a) Hedging

(b) Speculation

(c) Arbitrage

(d) Currency futures

10. 'Vehicle Currency' refers to

(a) a currency that is widely used to denominate international contracts made by parties because it is the national currency of either of the parties

(b) a currency that is traded internationally and, therefore, is in high demand

(c) a type of currency used in euro area for synchronization of exchange rates

(d) a currency that is widely used to denominate international contracts made by parties even when it is not the national currency of either of the parties

Answer Key

1	B	2	C	3	A	4	D	5	C	6	D	7	A	8	B	9	C	10	B

Chapter -4
Unit-5
INTERNATIONAL CAPITAL MOVEMENTS

International Capital Movements

"Foreign capital includes any inflow of capital into the home country from abroad."

TYPES OF FOREIGN CAPITAL

- Foreign aid or assistance
- Investments
- Borrowings

Foreign Aid / Assistance

- Bilateral or Direct inter-govt. grants.
- Multilateral Aid From Many Govt. Who pool funds
- Tied Aid with strict rules for use of Money & untied Aid NO rules
- Foreign Grants

Borrowings

- Direct inter-govt. Loans
- Loans from inter-national Institutes
- Soft Loans from IDA
- External commercial Borrowings (ECB)
- Trade credit facilities

Investments

- FDI Foreign Direct Investment
- FPI Foreign Portfolio Investment

Foreign Direct Investment

*all investments involving a **long-term relationship** and reflecting a lasting **interest** and **control** of a resident entity in one economy*

- In Factories Investments, Land etc.
- Foreign Ownership of Production Facilities

Least 10% of the ordinary shares or voting power in public / Pvt. Enterprise by a Non Resident FDI

FDI has 3 Components

- Equity Capital
- Reinvested earnings
- Direct Capital in the form of intra company loans

FDI Investors

- individuals,
- incorporated or unincorporated private or public enterprises,
- associated groups of individuals or enterprises,
- governments or government agencies,
- estates, trusts, or
- any other organizations or any combination of the above-mentioned entities.

Forms of FDI

- Opening of overseas companies
- Est. of Subsidiaries or branches
- Creation of Joint Venture on contract basis.
- Joint developments of Natural Resources
- Purchase or annexation of companies receiving foreign capital

Classification of FDI

Horizontal

If Audi invest in TATA Motors

When Investors establishes same type of Business operation in foreign counter, as it operates in his home country.

VERTICAL

When investor establishes or acquire a business activity in foreign country which is different from investor's main Business Activity

"Some way supplement its Major Activity."

If MCdonald Acquire Large scale meat processing plant in Canada.

CONGLOMERATE

When investor makes a foreign investments in a business that is unrelated to its existing business in its home country.

TOYOTA May Invest in fabindia

note to self:

Two -way FDI Reciprocal investment between countries.

Japan ⇄ USA

Foreign Portfolio Investment

FPI is the flow of 'Financial Capital rather than 'real' capital' and does not involve ownership or control on the part of investor.

- Deposit of fund
- Investment in capital Market
- Purchase of Bond

Features of FPI

- Stake in a firm at below 10% of ordinary shares
- Immediate effect on BOP or Exchange Rates
- Not concerned with either manufacture of Goods or provision of services
- Short term in Nature, Not intended to enhance productive capacity
- Sole intention is remunerative returns & concerned about safety of their capital
- Portfolio capital moves to recipient country which has higher potential for profitability.
- Speculative in Nature they evaluate prospects of each independent unit in which they want to invest.
- Do not have intention of exercising voting power or control or manage
- Once Confidence has shaken , FPI has tendency to speedily shift from one country to another.

Difference b/w FDI & FPI

Foreign Direct Investment (FDI)	Foreign Portfolio Investment (FPI)
1. creation of physical assets	1. creation of financial assets
2. Long term in nature	2. Short term in nature
3. Difficult to withdraw	3. Easy to withdraw
4. No speculative	4. Speculative in nature
5. Accompained by Technology	5. Not Accompained
6. Securities held with significant influence on management.	6. Securities held as financial Investment. No influence.
7. Interest in management & Control	7. No Interest in management & Control
8. Direct Impact on Labour & wages	8. No Direct Impact on Labour & wages

REASONS FOR FDI

✓ The chief motive for shifting of capital between different regions or between different industries is the expectation of higher rate of return than what is possible in the home country.

✓ **Investments move across borders on account of :**

- the **increasing interdependence** of national economies and the consequent trade relations and international industrial cooperation established among them
- **internationalisation** of production and investment of transnational corporations in their subsidiaries and affiliates.
- desire to **reap economies of large-scale** operation arising from technological growth
- lack of feasibility of licensing agreements with foreign producers in view of the rapidrate of technological innovations
- necessity to **retain direct control** of production knowledge or managerial skill that could easily and profitably beutilized by corporations
- desire to procure a promising foreign firm to **avoid future competition** and the possible loss of export markets

- **risk diversification** so that recessions or downturns may be experienced with reduced severity
- shared common language or common boundaries and **possible saving in time and transport costs** because of geographical proximity
- necessity to retain complete control over its trade patents and to ensure consistent quality and service or for **creating monopolies** in a global context
- promoting **optimal utilization** of physical, human, financial and other resources
- desire to capture large and rapidly growing **high potential emerging markets** with substantially high and growing population
- ease of penetration into the markets of those countries that have established import restrictions such as blanket bans, high customs duties or non-tariff barriers which make it difficult for the foreign firm to sell in the host-country market by **'getting behind the tariff wall'.**
- **lower environmental standards** in the host country and the consequent relative savings in costs
- **stable political environment** and overall favourable investment climate in the host country
- higher degree of openness to foreign capital exhibited by the recipient country and the prevalence of preferential investment systems such as **special** economic zones to encourage direct foreign investments
- the strategy to obtain control of strategic raw material or resource so as to ensure their uninterrupted supply at the lowest possible price; usually a form of vertical integration
- desire to secure access to **minerals or raw material deposits** located elsewhere andearn profits through processing them to finished form (Eg.FDI in petroleum)
- the existence of **low relative wages** in the host country because of relative labour abundance coupled with shortage and high cost of labour in capital exporting countries, especially when the production process is labour intensive.
- **lower level of economic efficiency** in host countries and identifiable gaps in development.
- **tax differentials and tax policies** of the host country which support foreign direct investment. However, a low tax burden cannot compensate for a generally fragile and unattractive FDI environment.
- inevitability of **defensive investments** in order to preserve a firm's competitive position.
- high gross domestic product and high per capita income coupled with their high rate of growth. There are also other philanthropic objectives such as strengthening of **socio-economic infrastructure,** alleviation of **poverty** and maintenance of **ecological balance** of the host country, and
- prevalence of **high standards of social amenities** and possibility of good quality of lifein the host country.

DETERMINANTS OF FDI

Economic Determinants

Market -seeking FDI

- Market size and per capita income
- Market growth
- Access to regional and global markets
- Country-specific consumer preferences
- Structure of markets

Resource - or asset-seeking FDI

- Raw materials
- Low -cost unskilled labor Availability of skilled labor
- Technological
- innovative,
- infrastructure

Efficiency - seeking FDI

- Costs of above physical and human resources
- Other input costs
- Membership of country in a regional integration agreement

Policy Frame work

- Economic, political, and social stability
- Rules regarding entry and operations
- Standards of treatment of foreign affiliate
- Policies on functioning and structure of markets (e.g., regarding competition)
- International agreements on FDI Privatization policy
- Trade policies and coherence of FDI and trade policies
- Tax policy

Business Facilitation

- Investment promotion (including image building and investment- generating activities and investment-facilitation services)
- Investment incentives
- "Hassle costs" (related to corruption and administrative efficiency)
- Social amenities (e.g., bilingual schools, quality of life)
- After-investment services

Factors in the host country discouraging inflow of foreign investments

- infrastructure lags,
- high rates of inflation,
- balance of payment deficits,
- poor literacy and low labour skills,
- rigidity in the labour market,
- bureaucracy and corruption,
- unfavourable tax regime,
- cumbersome legal formalities and delays,
- difficulties in contract enforcement,
- land acquisition issues,
- small size of market and lack of potential for its growth,
- political instability,
- absence of well-defined property rights,
- exchange rate volatility,
- poor track-record of investments,
- prevalence of non-tariff barriers,
- stringent regulations,
- lack of openness,
- language barriers,
- high rates of industrial disputes,
- lack of security to life and property,
- lack of facilities for immigration and employment of foreign technical and administrative personnel,
- double taxation and
- lack of a general spirit of friendliness towards foreign investors.

MODES OF FDI

1. Opening of a subsidiary or associate company
2. Equity injection into an overseas company,
3. Acquiring a controlling interest in an existing foreign company,
4. Mergers and acquisitions(M&A)
5. Joint venture
6. Green field investment
7. Brownfield investments .

Green Field Investment

Establishment of New overseas affiliates for freshly starting production by a parent company.

Brown Field Investment

FDI Which makes use of the existing Infra by merging, acquiring, leasing instead of developing a New one.

For Example : In India 100% FDI under automatic route is allowed in Brownfield Airport projects.

Benefits of FDI

- Entry of foreign enterprises usually fosters competition and generates a competitive environment in the host country. The domestic enterprises are compelled to compete with the foreign enterprises operating in the domestic market. This results in positive outcomes in the form of cost-reducing and quality-improving innovations, higher efficiency and increasing variety of better products and services at lower prices ensuring wider choice and welfare for consumers.
- International capital allows countries to finance more investment than can be supported by domestic savings. The provision of increased capital to work with labour and other resources available in the host country can enhance the total output/GDP (as well as output per unit of input) flowing from the factors of production.
- From the perspective of emerging and developing countries, FDI can accelerate growth and foster economic development by providing the much needed capital, technological know-how, management skills, marketing methods and critical human capital skills in the form of managers and technicians. The spill-over effects of the new technologies usually spread beyond the foreign corporations. In addition, the new technology can clearly enhance the recipient country's production possibilities.
- Competition for FDI among national governments also has helped to promote political and structural reforms important to attract foreign investors, including legal systems and macroeconomic policies.
- Since FDI involves setting up of production base (in terms of factories, power plants, etc.), it generates direct employment in the recipient country. Subsequent FDI as wellas domestic investments propelled in the downstream and upstream projects that come up in multitude of other services, generate multiplier effects on employment and income/GDP.
- FDI not only creates direct employment opportunities but also, through backward and forward linkages, generate indirect employment opportunities. This impact is particularly important if the recipient country is a developing country with an excess supply of labour caused by population pressure.
- Foreign direct investments also promote relatively higher wages for skilled jobs. More indirect employment will be generated to people in the lower-end services sector occupations thereby catering to an extent even to the less educated and unskilled persons engaged in those units.
- Foreign corporations provide better access to foreign markets. Unlike portfolio investments, FDI generally entails people-to-people relations and is usually considered as a promoter of bilateral and international relations. Greater openness to foreign capital leads to higher national dependence on international investors, making the cost of discords higher.
- There is also greater possibility for the promotion of ancillary units resulting in job creation and skill development for workers.

- Foreign enterprises possessing marketing information with their global network of marketing are in a unique position to utilize these strengths to promote the exports of developing countries. If the foreign capital produces goods with export potential, the host country is in a position to secure scarce foreign exchange needed to import capital equipments or materials to assist the country's development plans or to ease its external debt servicing.
- If the host country is in a position to implement effective tax measures, the foreign investment projects also would act as a source of new tax revenue which can be used for development projects.
- It is likely that foreign investments enter into industries in which economies of scale can be realized so that consumer prices may be reduced. Domestic firms might not always be able to generate the necessary capital to achieve the cost reductions associated with large-scale production.
- Increased competition resulting from the inflow of foreign direct investments facilitates weakening of the market power of domestic monopolies resulting in a possible increase in output and fall in prices.
- Since FDI has a distinct advantage over the external borrowings, it is considered to have a favourable impact on the host country's balance of payment position, and
- Better work culture and higher productivity standards brought in by foreign firms may possibly induce productivity related awareness and may also contribute to overall human resources development.

Problems With FDI

- FDIs are likely to concentrate on capital-intensive methods of production and service so that they need to hire only relatively few workers. Such technology is inappropriate for a labour-abundant country as it does not support generation of jobs which is a crucial requirement to address the two fundamental areas of concern for the less developed countries namely, poverty and unemployment
- The inherent tendency of FDI flows to move towards regions or states which are well endowed in terms of natural resources and availability of infrastructure has the potential to accentuate regional disparity. Foreign capital is also criticized for accentuating the already existing income inequalities in the host country.
- In the context of developing countries, it is usually alleged that the inflow of foreign capital may cause the domestic governments to slow down its efforts to generate more domestic savings, especially when tax mechanisms are difficult to implement. If the foreign corporations are able to secure incentives in the form of tax holidays or similar provisions, the host country loses tax revenues.
- Often, the foreign firms may partly finance their domestic investments by borrowing funds in the host country's capital market. This action can raise interest rates in thehost

country and lead to a decline in domestic investments through 'crowding-out' effect. Moreover, suppliers of funds in developing economies would prefer foreign firms due to perceived lower risks and such shifts of funds may divert capital away from investments which are crucial for the development needs of the country.

- The expected benefits from easing of the balance of payments situation might remain unrealised or narrowed down due to the likely instability in the balance of payments and the exchange rate. Obviously, FDI brings in more foreign exchange, improves the balance of payments and raises the value of the host country's currency in the exchange markets. However, when imported inputs need to be obtained or when profits are repatriated, a strain is placed on the host country's balance of payments and the home currency leading to its depreciation. Such instabilities jeopardize long- term economic planning. Foreign corporations also have a tendency to use their usual input suppliers which can lead to increased imports. Also, large scale repatriation of profits can be stressful on exchange rates and the balance of payments.
- Jobs that require expertise and entrepreneurial skills for creative decision making may generally be retained in the home country and therefore the host country is left with routine management jobs that demand only lower levels of skills and ability. The argument of possible human resource development and acquisition of new innovative skills through FDI may not be realized in reality.
- High profit orientation of foreign direct investors tend to promote a distorted pattern of production and investment such that production could get concentrated on items of elite and popular consumption and on non-essential items.
- Foreign entities are usually accused of being anti-ethical as they frequently resort to methods like aggressive advertising and anticompetitive practices which would induce market distortions.
- A large foreign firm with deep pockets may undercut a competitive local industry because of various advantages (such as in technology) possessed by it and may even drive out domestic firms from the industry resulting in serious problems of displacement of labour. The foreign firms may also exercise a high degree of market power and exist as monopolists with all the accompanying disadvantages of monopoly. The high growth of wages in foreign corporations can influence a similar escalation in the domestic corporations which are not able to cover this increase with growth of productivity. The result is decreasing competitiveness of domestic companies which might prove detrimental to the long-term interests of industrial development of the host country.
- FDI usually involves domestic companies 'off –shoring', or shifting jobs and operations abroad in pursuit of lower operating costs and consequent higher profits. This has deleterious effects on employment potential of home country.
- The continuance of lower labour or environmental standards in host countries is highly appreciated by the profit seeking foreign enterprises. This is of great concern because efforts to converge such standards often fail to receive support from interested parties.

- At times, there is potential national security considerations involved when foreign firms function in the territory of the host country, especially when acute hostilities prevail.
- FDI may have adverse impact on the host country's commodity terms of trade (defined as the price of a country's exports divided by the price of its imports). This could occur if the investments go into production of export-oriented goods and the country is a large country in the sale of its exports. Thus, increased exports drive down the price of exports relative to the price of imports.
- FDI is also held responsible by many for ruthless exploitation of natural resources and the possible environmental damage.
- With substantial FDI in developing countries there is a strong possibility of emergence of a dual economy with a developed foreign sector and an underdeveloped domestic sector.
- Perhaps the most disturbing of the various charges levied against foreign direct investment is that a large foreign investment sector can exert excessive amount of power in a variety of ways so that there is potential loss of control by host country over domestic policies and therefore the less developed host country's sovereignty is put at risk. Mighty multinational firms are often criticized of corruption issues, unduly influencing policy making and evasion of corporate social responsibility.

FOREIGN DIRECT INVESTMENT IN INDIA

- FDI significant non-debt financial resource for India's economic development.
- Foreign corporations invest in India to benefit from the country's particular investment privileges such as tax breaks and comparatively lower salaries.
- This helps India develop technological know-how and create jobs as well as other benefits. These investments have been coming into India because of the government's supportive policy framework, vibrant business climate, risingglobal competitiveness and economic influence.
- The government has recently made numerous efforts, including easing FDI regulations in various industries, PSUs, oil refineries, telecom and defence.
- India's FDI inflows reached record levels during 2020-21. The total FDI inflows stood at US$ 81,973 million, a 10% increase overthe previous financial year.
- According to the World Investment Report 2022, India was ranked eighth among the world's major FDI recipients in 2020, up from ninth in 2019. Information and technology, telecommunication and automobile were the major receivers of FDI in FY22.
- With the help of significant transactions in the technology and health sectors, multinational companies (MNCs) have pursued strategic collaborations with top domestic businessgroupings, fuelling an increase in cross-border M&A of 83% to US$ 27 billion

OVERSEAS DIRECT INVESTMENT BY INDIAN COMPANIES

India is primarily a domestic demand-driven economy, with consumption and investments contributing to 70% of the economic activity.

According to data released by the Reserve Bank of India (RBI), overseas direct investment stood at US$ 1,922.51 million in September 2022.

TATA Steel — In June 2022, Tata Steel announced plans to invest 7 million pounds (US$ 837.95 billion) for its Hartlepool Tube Mill in North-East England.

TATA Communication — Tata Communications invested US$ 690 million in its wholly-owned subsidiary in Singapore.

Jindal Steel & Power — Jindal Steel and Power invested US$ 366 million in its wholly owned subsidiary in Mauritius

Wipro — Wipro invested US$ 204.96 million in its wholly-owned subsidiary in Cyprus.

Jindal Saw — Jindal Saw invested US$ 64.5 million in its wholly-owned subsidiary in the United Arab Emirates.

Aisa & Lupin Ltd. — Restaurant Brand Aisa and Lupin Ltd invested US$ 141.34 million and US$ 131.25 million in their JVs in Indonesia and the US, respectively.

Reliance Energy — Reliance New Energy invested US$ 87.73 million in its wholly owned subsidiary inNorway.

Mohalla Internet Pvt. Ltd. — Mohalla Internet Pvt. Ltd. invested US$ 86 million in its fully owned unit in Mauritius.

ONGC — ONGC Videsh invested US$ 83.31 million in a joint-venture in Russia.

ICICI Bank — ICICI Bank ties up with Santander in Britain in a pact aimed at facilitating the banking requirements of corporates operating across both countries.

ANI Technologies — ANI Technologies, the promoter of OLA, invested US$ 675 million in its wholly-owned subsidiary in Singapore.

Dr Reddy

Dr Reddy invested US$ 149.99 million in a joint- venture (JV) in the US.

Reliance Energy

A total of US$ 168.9 million was invested by Reliance New Energy in a JV and wholly- owned subsidy in Germany and Norway.

TATA Steel

In July 2022, Tata Steel signed a Memorandum of Understanding (MoU) with BHP, a leading global resources company, with the intention to jointly study and explore low- carbon iron and steelmaking technology.

Ola Electric

In January 2022, Ola Electric, the ride-hailing company's electric vehicle (EV) subsidiary, announced its plans to establish Ola Future foundry, a global hub for advance engineering and vehicle design in the UK, investing US$ 100 million over the next 5 years.

Essar Group

In January, Essar Group of India announced that it had created a joint venture with Progressive Energy of the UK to invest US$ 1.34 billion in a hydrogen manufacturing plant at its Essar Stanlow refinery complex.

Hindalco Ltd.

In January, Hindalco Ltd's US subsidiary, Novelis, announced its plans to invest US$ 365 million in a state-of-the-art vehicle recycling facility in North America.

Chapet-4 (Unit -5)
INTERNATIONAL CAPITAL MOVEMENTS

1. Which of the following statements is incorrect?
(a) Direct investments are real investments in factories, assets, land, inventories etc. and involve foreign ownership of production facilities.
(b) Foreign portfolio investments involve flow of 'financial capital'.
(c) Foreign direct investment (FDI) is not concerned with either manufacture of goods or with provision of services.
(d) Portfolio capital moves to a recipient country which has revealed its potential for higher returns and profitability.

2. Which of the following is a component of foreign capital?
(a) Direct inter government loans
(b) Loans from international institutions (e.g. World Bank, IMF, ADB)
(c) Soft loans for e.g. from affiliates of World Bank such as IDA
(d) All the above

3. Which of the following would be an example of foreign direct investment from Country X?
(a) A firm in Country X buys bonds issued by a Chinese computer manufacturer.
(b) A computer firm in Country X enters into a contract with a Malaysian firm for the latter to make and sell to it processors
(c)Mr. Z a citizen of Country X buys a controlling share in an Italian electronics firm
(d) None of the above

4. Which of the following types of FDI includes creation of fresh assets and production facilities in the host country?
(a) Brownfield investment
(b) Merger and acquisition
(c) Greenfield investment
(d) Strategic alliances

5. Which is the leading country in respect of inflow of FDI to India?
(a) Mauritius
(b) USA
(c) Japan
(d) USA

6. An argument in favour of direct foreign investment is that it tends to
(a) promote rural development
(b) increase access to modern technology
(c) protect domestic industries
(d) keep inflation under control

7. Which of the following is a reason for foreign direct investment?
(a) secure access to minerals or raw materials
(b) desire to capture of large and rapidly growing emerging markets
(c) desire to influence home country industries
(d)(a) and (b) above

8. A foreign direct investor
(a) May enter India only through automatic route
(b) May enter India only through government route
(c) May enter India only through equity in domestic enterprises
(d) Any of the above

9. Foreign investments are prohibited in
(a) Power generation and distribution
(b) Highways and waterways

(c) Chit funds and Nidhi company
(d) Airports and air transport

10. Which of the following statement is false in respect of FPI?
(a) portfolio capital in general, moves to investment in financial stocks, bonds and other financial instruments
(b) is effected largely by individuals and institutions through the mechanism of capital market
(c) is difficult to recover as it involves purely long-term investments and the investors have controlling interest
(d) investors also do not have any intention of exercising voting power or controlling or managing the affairs of the company.

11. What does the exchange rate represent?
(a) The price of a domestic currency in terms of foreign currency
(b) The price of a foreign currency in terms of domestic currency
(c) The cost of goods and services in a foreign country
(d) The difference between import and export values

12. What type of exchange rate system allows the exchange rate to be determined by market forces of supply and demand?
(a) Fixed exchange rate system
(b) Managed exchange rate system
(c) Floating exchange rate system
(d) Pegged exchange rate system

13. In a floating exchange rate system, how are exchange rates determined?
(a) By government authorities based on economic indicators
(b) By commercial banks in the foreign exchange market
(c) By a fixed formula decided upon by the central bank
(d) By market forces of supply and demand

14. If the exchange rate between the US dollar (USD) and the Euro (EUR) changes from 1 USD = 0.85 EUR to 1 USD = 0.80 EUR, how has the USD appreciated or depreciated against the Euro?
(a) Appreciated by 0.05 EUR
(b) Appreciated by 0.85 EUR
(c) Depreciated by 0.05 EUR
(d) Depreciated by 0.80 EUR

15. Which of the following statements is true regarding a fixed exchange rate system?
(a) Exchange rates fluctuate based on market forces of supply and demand
(b) Central banks intervene to maintain a stable exchange rate
(c) Exchange rates are determined by the international stock markets
(d) Countries using fixed exchange rates are not part of the global economy

Answer Key

1	C	2	D	3	C	4	C	5	A	6	B	7	D	8	D	9	C	10	C
11	A	12	C	13	D	14	C	15	B										