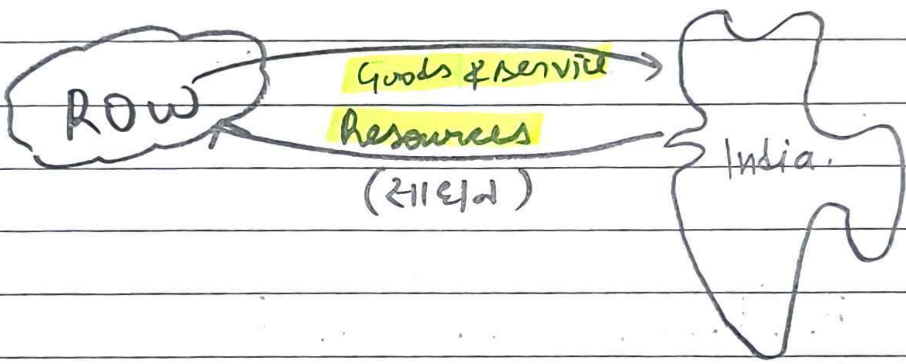
Chapter-9 International Trade

(8-10 marks)

Unit-1 Theories of International Trade

① INTRODUCTION

→ International Trade is the Exchange of goods & Services as well as resources between Countries.



Benefits	Demerits
• Economic Efficiency and Contributes to Economic growth & rising Incomes.	• often ~~that~~ not Equally beneficial to all nations.
• Greater Efficiency in use of natural, human, Industrial and financial resources Ensures "Productivity gains".	• Economic Exploitation of Underdeveloped nations.
• Access to new markets and new materials.	• Substantial Environmental damage.
• Stimulates Innovations.	• Exhaustion of natural resources.
	• Trade Cycles are also like to get transmitted rapidly to other Countries

• Improvement in Quality of goods & Services.	• Dependence of underdeveloped Countries on foreign nations.
• Contribute to human resource development	• There is often lack of transparency.
• Strengthen bonds between Countries.	• Too much of Export orientation.
Etc Etc Etc	Etc Etc Etc.

② IMPORTANT THEORIES

(i) The Mechantilists' view of International Trade.

derived from Merchantile → "Trade & Commercial affairs"

Favourable BOT/BOP

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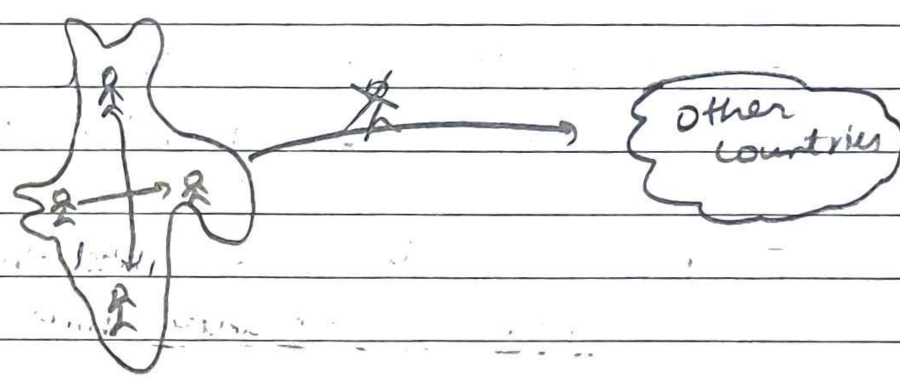
→ According to Microsoft Encarta Dictionary (2009), Mercantilism is the economic policy trending in Europe from 16th to 18th Century where the government used power to control Industry and trade with the belief that national power is achieved and Sustained by having constant large quantities of Exports over Imports.

(ii) Theory of absolute Advantage — Adam Smith

→ In this theory, Adam Smith assumed:-

a) Trade between two Countries.
b) Two Commodity
c) Transportation cost (x)
d) Labour was mobile with in country but Immobile between Countries.



e) He assumed that any trade between the two Countries Considered would take place if Each of the two Countries had an absolutely lower Cost in the production of one of the Commodities.

Adam Smith thought the Basis of International trade was Absolute COST Advantage.
The principal of Absolute advantage refers to the ability of a party to produce greater quantity of a good, using the Same amount of resources.
{Simple Comparasion of Labour productivity}.

Country A	Country B
1 person → 1hr → 8pizza	1 person → 1hr → 9pizza
Resource Same	Resources Same

(iii) Theory of Comparative advantage.

→ One of the most Important Concepts in Economics is given by DAVID RICARDO.

→ Ricardo observed that Trade was driven by Comparative rather than absolute cost.

→ Ricardos Insights was that such a Country Would still benefit from Trading according to Compartive advantange - Exporting products in which absolute advantage was greatest and Importing products in which absolute advantage with Comparatively less.

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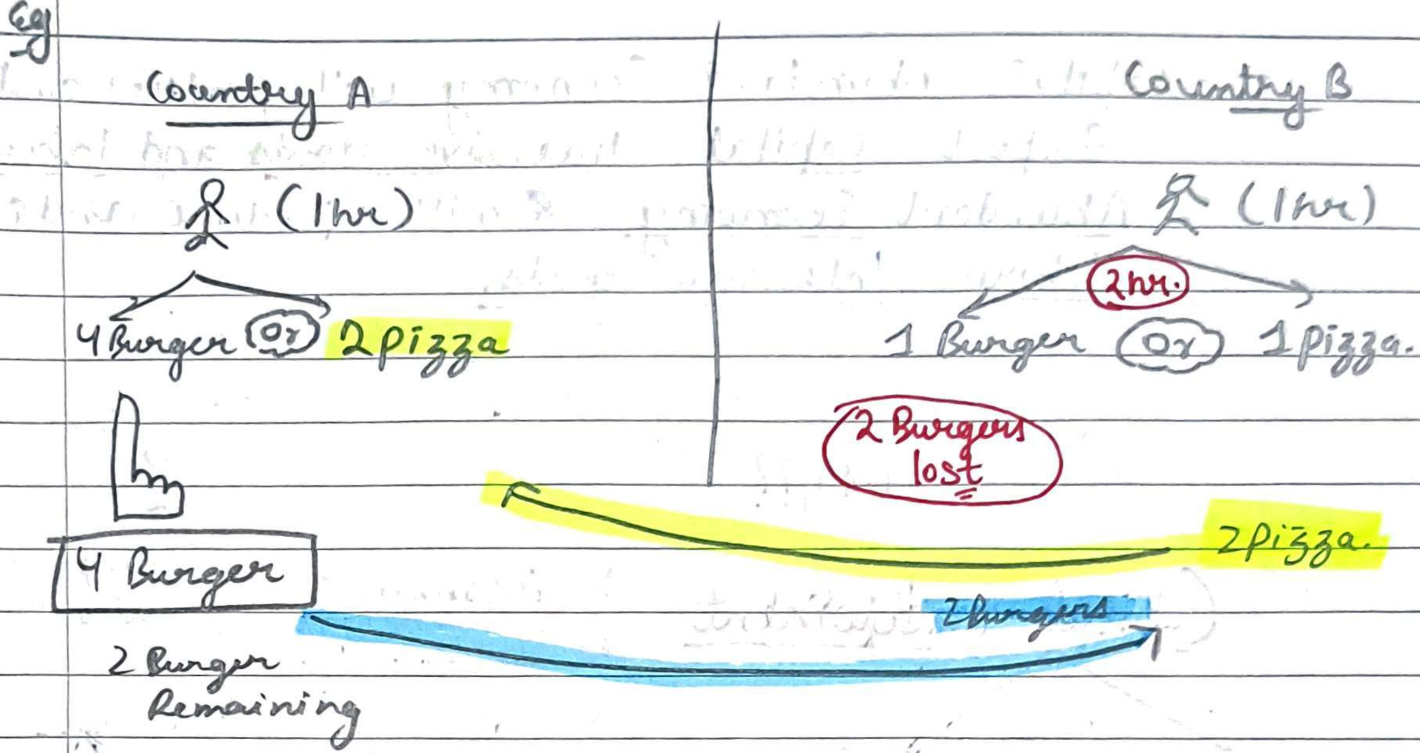


(iv) **Hechscher – Ohlin Theory**

→ This theory is also known as factor Endowment theory or Modern Theory of Trade.

→ It states that Comparative advantage in cost of production is Exclusively by the differences in factor Endowment.

→ A Country tends to Specialise :-

In Exports :- whose production requires Intensive use of its abundant resources.

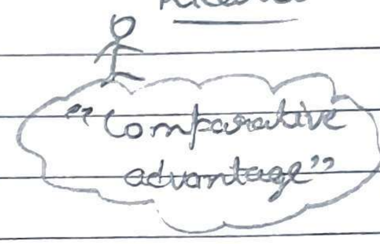
In Imports :- Whose Production requires Intensive Use of its Scarce resources.

-/-/-

→ Capital Abundant Economy will produce and Export Capital Intensive goods and labour Abundant Economy will produce and Export labour Intensive goods.

 Why??

Ricardo



Capital Endowment

(Labour) (Capital)

Labour Intensive Goods

Capital Intensive Goods

* Theory of Comparative Cost (Ricardo)	Modern Theory. (- Hechscher - Ohlin)
• Based on Labour theory of Value.	• Based on money cost which is more realistic.
• Considered Labour as sole factor.	• Consider labour as well Capital as Important factors.
• Studies only Comparative Costs of goods concerned	• Considers relative prices of the factors (labour & Capital.
• It is Normative in nature "Should be" होना चाहिए	• It is Positive in nature. What is / क्या है

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(V) Globalisation & New International Trade Theories

→ American Economist & journalist 'Paul Krugman received 2008 Nobel prize for Economics for his work in Economic geography and in Identifying International Trade pattern In late 1970s. Krugman noticed that the Earlier model did not fit into the International trade data.

Refer (iv) — The Hechschen-ohlin model predicted that trade would be based on such factors as Ratio of Capital to Labour.

80 : 20 } Capital Endowment
or
70 : 30

But, Krugman noticed that most of the International Trade takes place between countries with roughly the Same ratio of Capital to Labour.

→ Krugman defended free trade.

"In praise of Cheap Labour" published in slate in 1997

Cheap Labour को outsource करो

→ Paul A Samuelson :- The factor prize Equalization theoram

International trade Equalizes the factor prizes between trading nations.

→ NTT (New Trade Theory) gave two advantages to the countries that Import goods to Compete with domestic goods:-

(a) Economies of Scale

Scale of production (↑↑) Cost (↓↓)

(b) Network Effect (Bandwagon Effect)

(Eg. whatsapp or Microsoft windows)

- The way one persons value for a good or service is affected by value of that good or service to other.

The value of product or service is Enhanced as the number of Individuals Using it Increases.

Unit-2 **Instruments of Trade policy.**

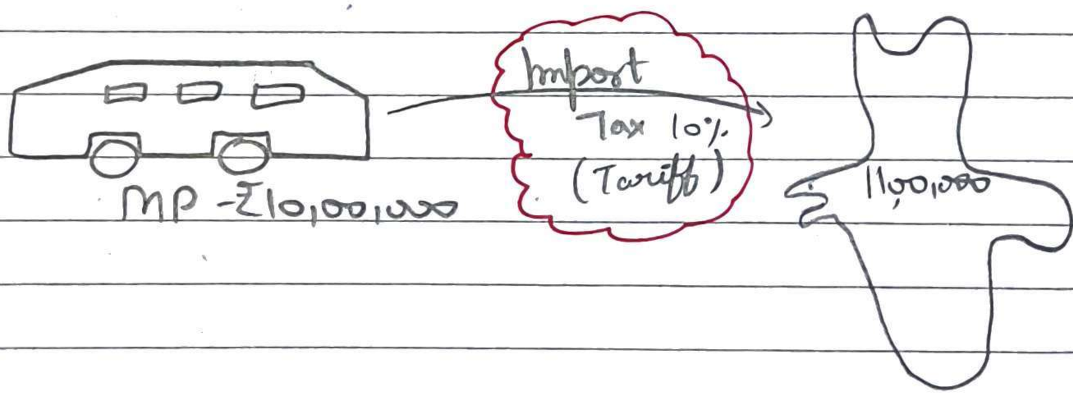
- Tariff
  - 16 types
- Non-Tariff measures (NTM)
  - Technical
    - 2 types
  - Non Technical
    - 13 types
- Export Related Measures
  - 4 types

I TARIFF

→ Tariff is known as Customer duties Imposed on goods & services which are imposed on Exported

→ In this Unit, tariff would refer to Import duties

* Tariff leave the world market price of the goods Unaffected while raising their prices in the domestic market.



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① **Specific Tariff**:- fixed amt. of money per physical Unit.

Eg. ~~rupee~~ ₹1000 per bicycle.

② **Ad valorem tariff**:- fixed %. of the value of commodity.

Eg.- 20% on value of bicycle.

* Generally it leads to deliberate Undervaluation.

③ **Mixed tariff**:- tariff is Expressed Either on the basis of quantity or on the basis of value.

basis of quantity → Specific tariff.

basis of value → Ad valorem tariff.

Eg. tariff on cheese at 5% ad valorem Or ₹100 per kg ; whichever is HIGHER.

* **Compound tariff / Duty**:- Combination of both ad valorem and specific Tariff.

Eg. Tariff on cheese 5% ad valorem & ₹100 per kg.

(4) Technical / other tariff

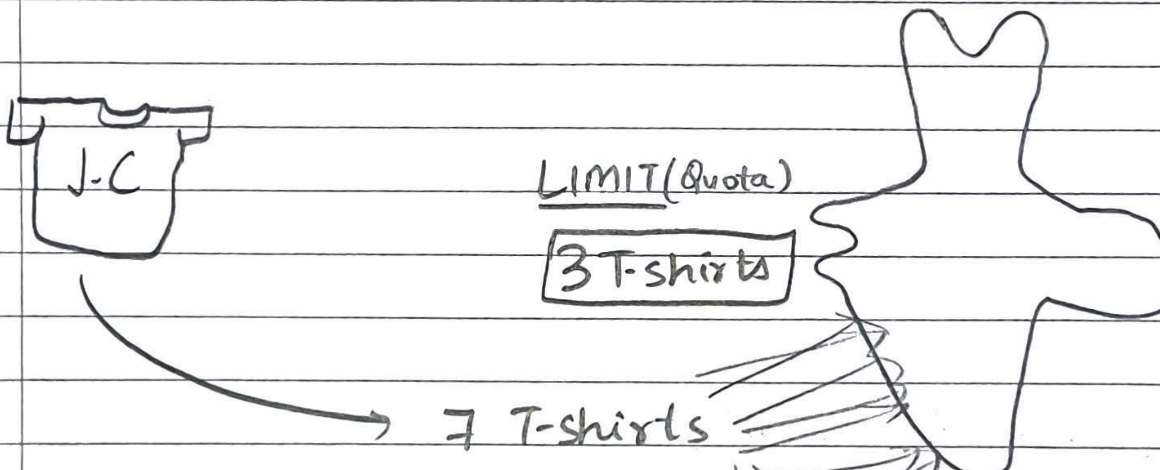
- Calculated on Basis of "specific Contents" of Imported goods.

Eg:- ₹ 3000 on Solar panel and ₹50 per kg on the battery Installed.

(5) Tariff Rate Quotas (TRQ)

→ Combines two policy Instruments : Quotas & Tariff.

→ Imports Entering "Under the specific quota" Portion are Usually charged lower tariff and Imports above the threshold usually Charged higher tariff.



[3 Tshirt - Tax 0.5%]

Extra 4 Tshirt → tax 25%.

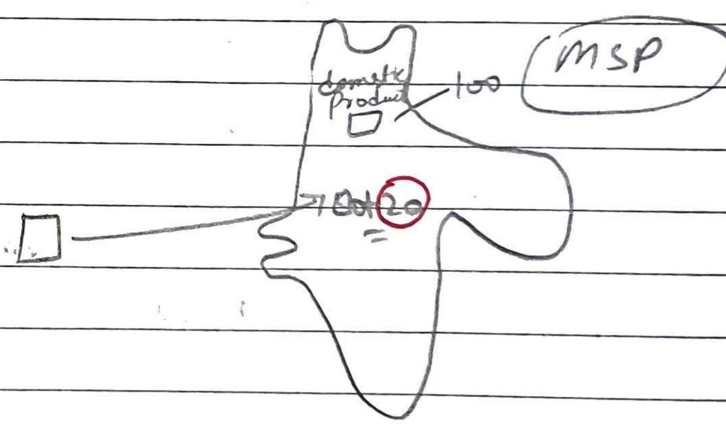
⑥ Most - favoured Nation Tariff (MFN)

- refers to import tariffs which Countries promise to Impose on Imports from other members of WTO.

- MFN rates are the highest that WTO members charge Each other.

⑦ Variable Tariff.

- duty typically fixed to bring the price of an Imported Commodity up to level of the domestic support price of the Country.



⑧ Preferencial tariff.

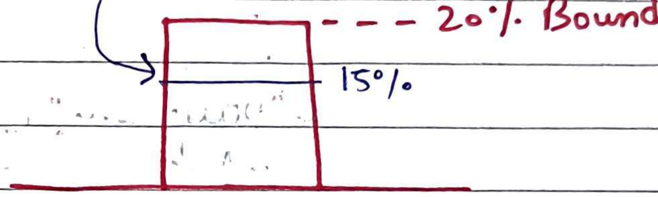
- Nearly all Countries are part of atleast one preferential trade agreement, under which they promise to give other Country's product lower tariff than MFN Rate.

(9) Bound Tariff.

- Under this, WTO binds itself with a legal Commitment not to raise tariff rate above a certain level.

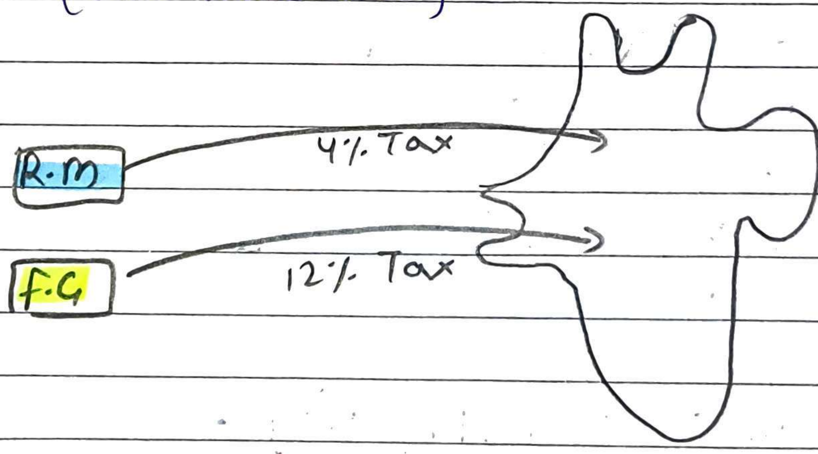
(10) Applied Tariff.

- It is the actually Charged tariff on MFN basis.



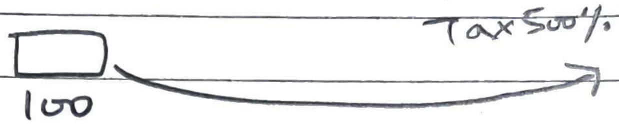
(11) Escalated tariff.

- It is the system where in the nominal tariff rates on Import of manufactured goods are higher than the nominal tariff rates on Intermediate Inputs (raw materials)



(12) **Prohibitive tariff.** -

It is a tariff set so high that no Imports can Enter.

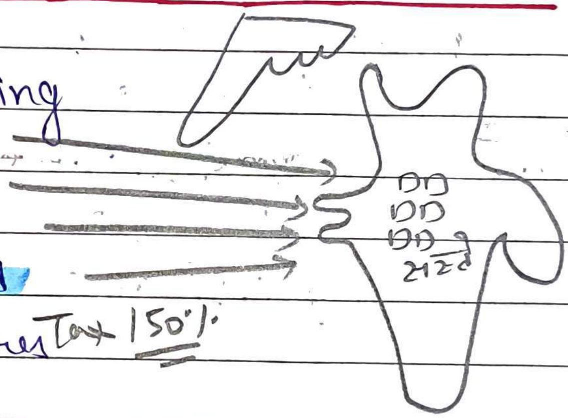


(13) **Import Subsidies**

· An Import Subsidy is simply a "payment" per unit or as % of Value on goods Imported.

(14) **Tariff as Response to "Trade Distortion."**

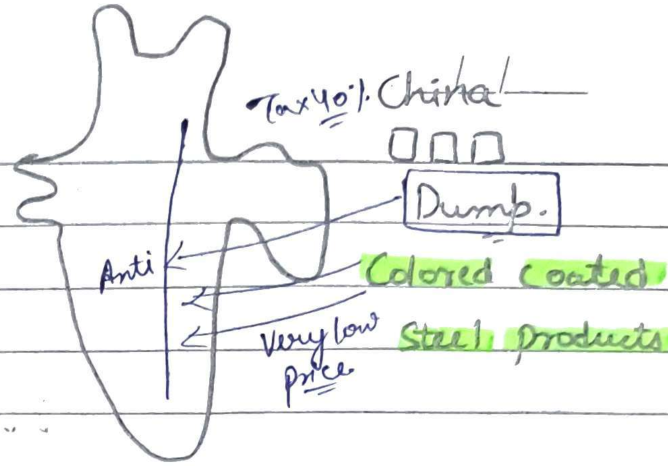
→ The affected Importing Countries upon Confirmation of distortion, respond quickly by measures in form of tariff response.



{Also known as Trigger-price Mechanism}

(15) **Anti - Dumping Duty** - It is a Protectionist tariff that domestic govt. Imposes on foreign Imports that it believes are priced below fair market Values.

"2017"

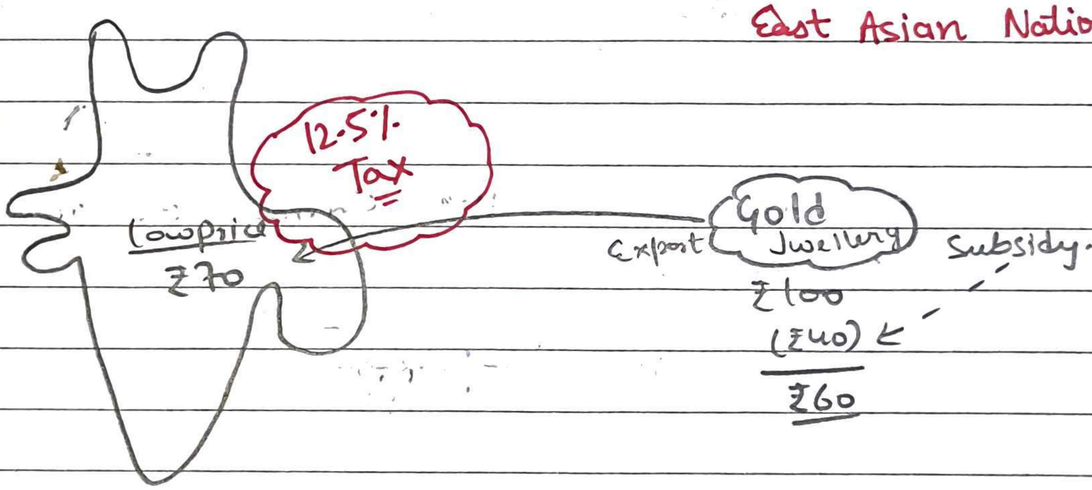


(16) Countervailing Duties.

Tariffs that aim to off set the artifically low prices charged by Exporter's who enjoy Export Subsidies.

"ASEAN"
Association of South East Asian Nations

"2016"



* Effects of Tariffs:

- It Creates obstacle to trade.
- Imported Goods becomes Expensive.
- Tariff Encourages Production & Consumption of domestically produced goods.
- Producers importing goods may charge higher prices, which may lead to Increase in their Profits.

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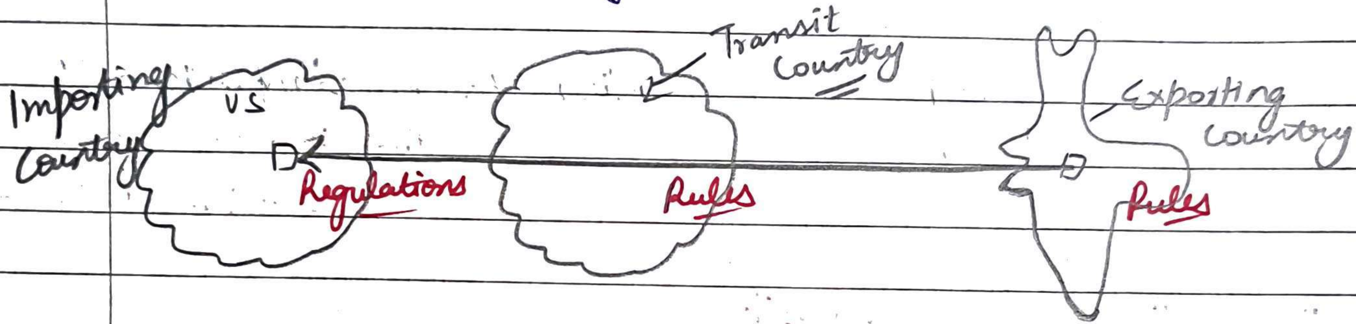
→ Tariff also Increase government revenue.

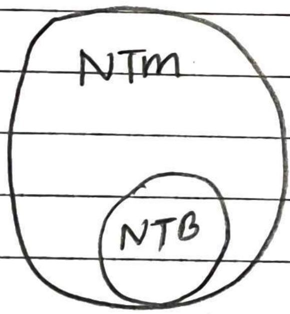
II Non-Tariff measures. (NTM)

→ NTMs Consists of mandatory requirements, rules, or regulations that are legally set by the govt. of the Exporting, Importing or the transit Country.



→ NTMs are not ~~a~~ the Same as non-tariff barriers.

[NTM ≠ NTB]



NTB is sub set of NTM.

→ Two Types:-

① Technical Measures.

(a) Sanitary and Phyto Sanitary (SPS) measures.

To protect human, animal or planet life from risks a rising from pests, toxins, Contaminants etc & to protect biodiversity.

Eg. Prohibition of Poulty from countries affected by flu.

(b) Technical Barriers to trade. (TBT)

- It covers both food and non-food traded products refer to mandatory "Standards and Technical Regulation" that define the specific characteristics that product should have.

Eg:- food Laws, labelling.

② Non Techincal Measures.

It relates to trade requirements like shipping requirements, Custom formalities, trade rules, taxation policies Etc.

- Hard Measures
- Threat Measures
- Other Measures.

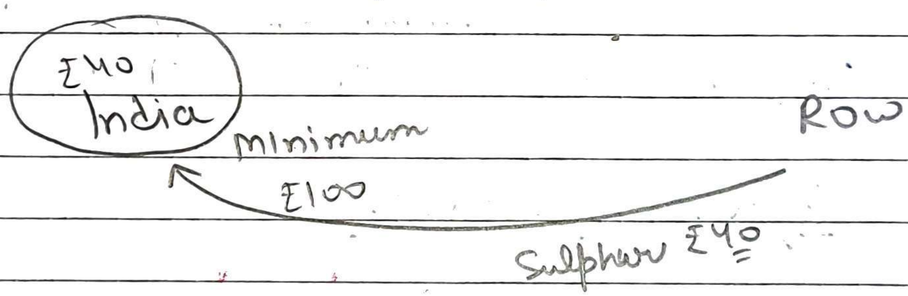
Hard measures	Threat measures	Other measures
(Price & Quantity Control)	(Anti Dumping & Safeguards)	

(i) **Import Quotas**

Import Quotas is a "direct restriction" which specify that only a certain physical amt. of the good will be allowed into the Country during a given period of time. (generally 1 year)

(ii) **Price Control Measures** - Steps taken to control or influence the prices of imported goods in order to support the domestic prices of certain products.

Eg:- $\boxed{\text{Minimum Import Price}}$ Established for Sulphur.



(iii) **Non-automatic Licensing & Prohibitions**

- These ~~are~~ measures are normally aimed at limiting the quantity of goods that can be

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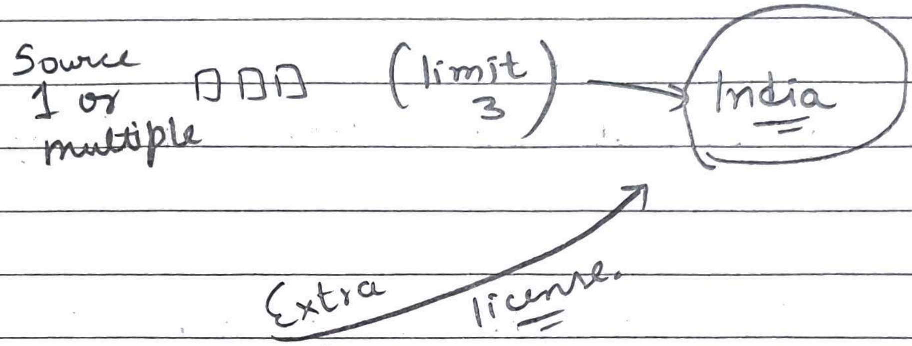
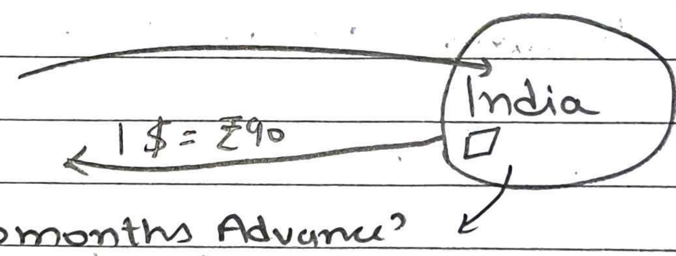
Imported, regardless of whether they originate from different Sources or from one particular Supplier.

for Eg:- textiles may be allowed only on discretion-ary license by the Importing Country.



(iv) Financial Measures.

The objective of these measures is to Increase the Import Costs by regulating the access to and cost of foreign Exchange for Imports and to define the terms of payments.



(V) Measures affecting Competition.

- These measures are aimed at granting Exclusive or special preferences /pri-veledges to one or few limited group of Economic operators.

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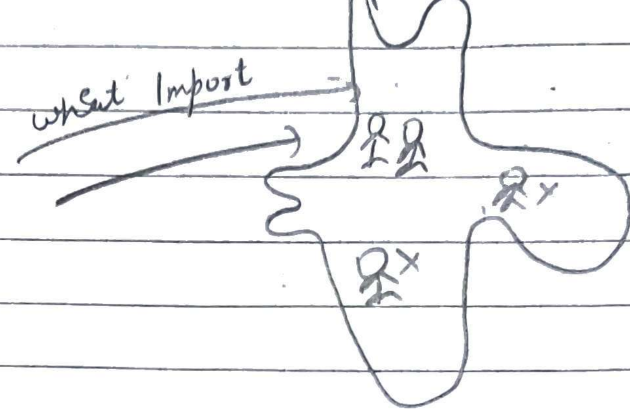


(vi) Government Procurement policies.

सरकार   खरीदना

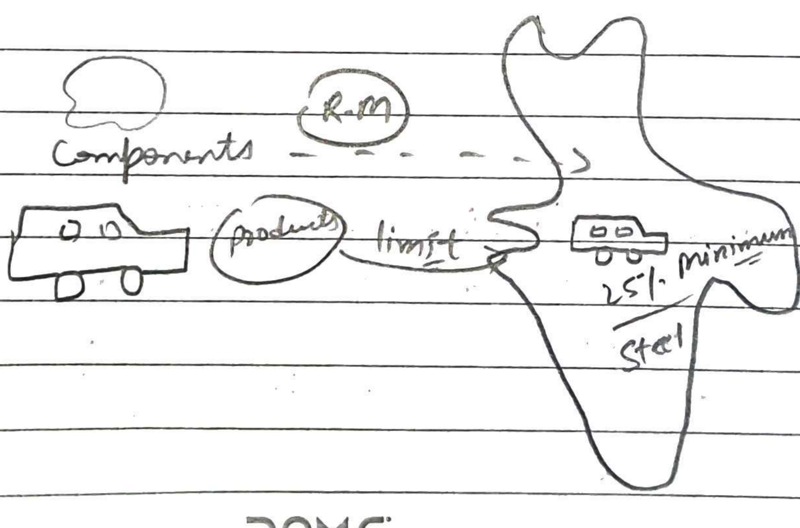
→ Government may give preference to the local tender rather than foreign tenders.

(vii) Trade Related Investment measures.

→ Requirement to use certain minimum levels of locally made components.

→ Restricting the level of Imported Components

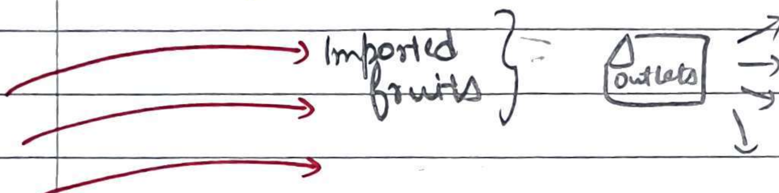
→ limiting the purchase/ use of Imported products.



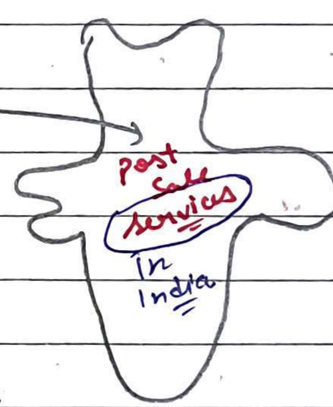
(viii) Distribution Restrictions.

These are limitations Imposed on distribution of goods in the Importing country Involving "additional license" or "Certification requirement."

Eg. Restriction that Imported fruits may be Sold only through Outlets having refrigation facilities.



(ix) Restriction on Post-Sales Services.



→ Services may be reserved to local Service companies of the Importing Country.

(x) Administrative Procedures.

→ Any kind of particular Procedures and formalities

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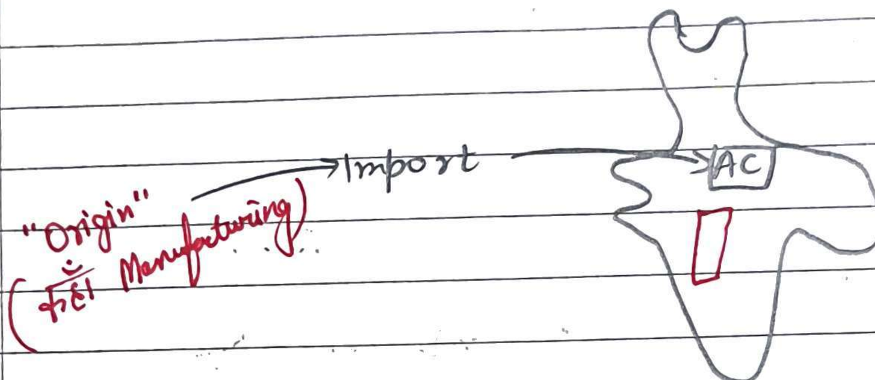
(xi) **Rules of Origin.**

- Important procedural **obstacle** occur in the home country for making available certifications regarding Origin of goods.



(xii) **Safeguard measures.**

- Restrict Imports of a product temporarily.

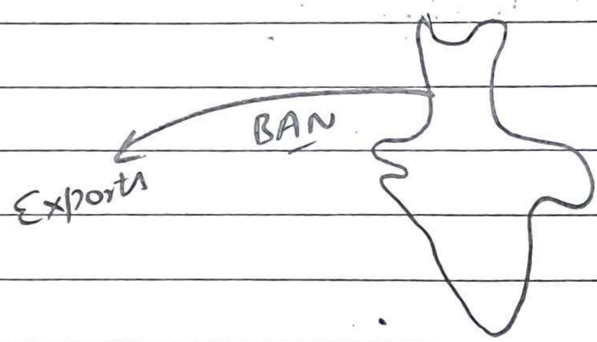
(xiii) **Embargos**

It is a Total ban imposed by government on Import / Export of particular product for Indefinite period.

III Export-Related measures.

(I) Ban on Exports

During the period of shortage, export of agri-cultural products may be prohibited to make them available for domestic consumption.



खाने की कमी है।

(ii) Export taxes

- Export tax is a tax collected on exported goods specific may be specific or ad valorem.

specific → Fixed Amount

ad valorem → Fixed %

(iii) Export duties & Incentives.

- like duty drawback, duty free access to Imported components etc.

(iv) Voluntary Export Restraints.

VER is type of Informal quota administered by Exporting country voluntarily restraining the quantity of goods that can be Exported out of the Country during a specified period of time.

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* **Recent developments**

→ Free trade agreement with Mauritius on 1 April 2021.

→ 18 feb, 2022 : Comprehensive Economic partnership agreement (CEPA) with UAE.

→ Economic Cooperation & Trade Agreement (ECTA) with Australia on 2^{nd} April 2022.

→

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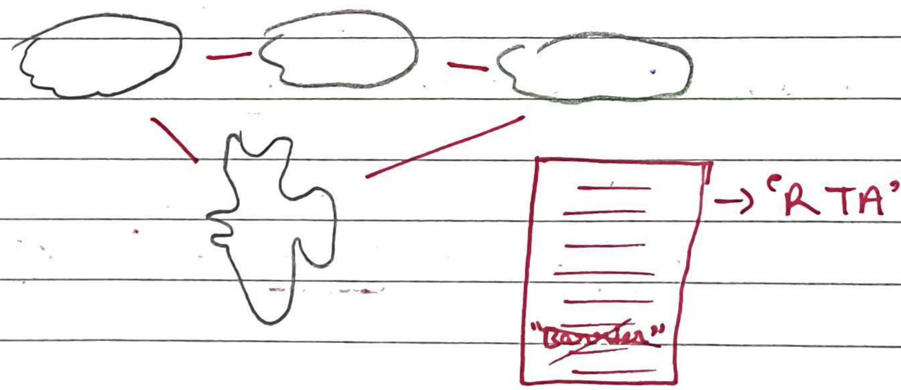
Unit - 3 **Trade Negotitions**

RTA GATT WTO

① Regional Trade Agreements (RTA)

RTAs are defined as grouping of Countries which are formed within the Objective of reducing barriers to trade between member Countries.

{As on 1st feb 2021, 339 RTAs were in force}



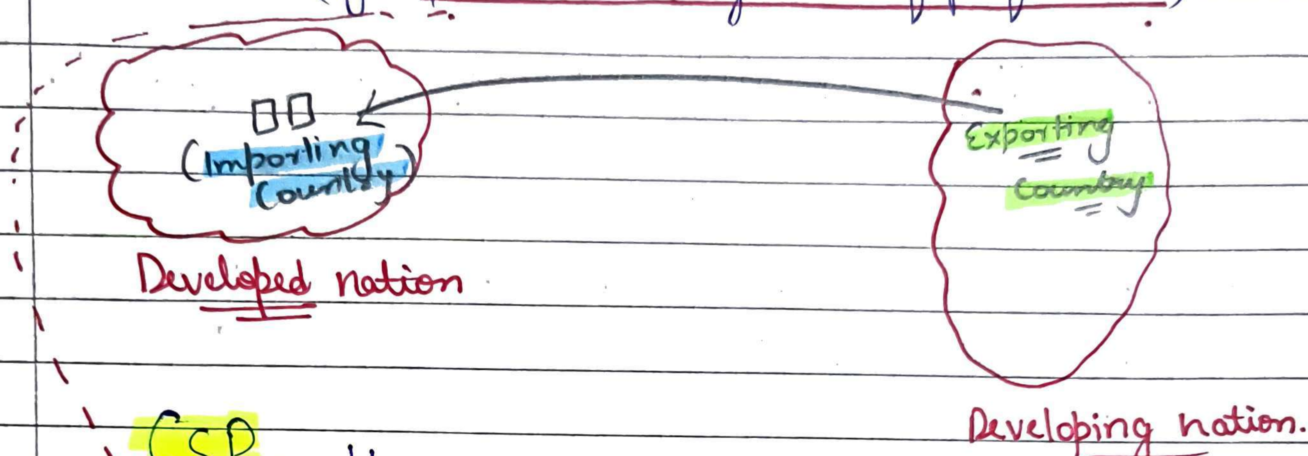
→ Types of RTA

① **Unilateral Trade Agreements**

"ONE WAY"

Under this an importing country offers "trade incentives" in order to Encourage the Exporting Country.

(Eg. Generalised System of preferences)



GSP - It promotes Economic development by Eliminating duties on various products.

② **Bilateral Trade Agreements**

Two way

Agreements that set rules of trade between two Countries, two blocs or a bloc and a Country.

group of countries

(Eg - ASEAN - India free Trade Area)

BLOC ⟺ Country

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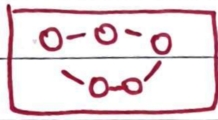
(3) Regional - preferential Trade Agreements

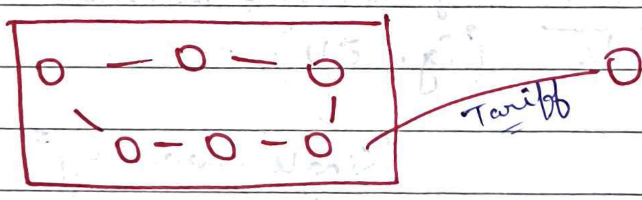
Agreements among a group of Countries to reduce trade barriers on a reciprocal & preferencial basis only for the numbers of group [Eg GSTP]



Global System of Trade preferences.

(4) Trading bloc

Group of Countries that have free trade agreement between themselves and may apply a Common External tariff to other Countries. Eg- Arab League (AL), European Free Trade Association (EFTA)



(5) Free Trade Area

It is a group of Countries that Elimate all tariff & quota barriers on trade with objective of Increasing Exchange of goods among themselves. (Eg- ASEAN India free Trade area)

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(6) **A Customs Union** is a group of Countries that Eliminate all tariffs on trade among themselves, but maintain a Common External tariff on trade with other Countries. (It is technically violation of MFN)

(7) Common Market

A Common market deepens a custom union by providing for free flow of Output and of factors of production by reducing or Eliminating Internal tariffs and by Creating Common External tariff.

(Eg. European Union, ASEAN)

(8) Economic & Monetary Union.

Free transit of goods & Services through the boards (Eg. EU)

"Single Currency"

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② $\boxed{\text{General Agreements on Tariff \& Trade (GATT)}}$

→ GATT Covers International trade in **goods**.

→ The workings of GATT agreements are the responsibility of the <u>Council for Trade in Goods</u>. (Goods Council)

→ The Goods Council has $\boxed{\text{10 Committees}}$. These Committees consist of all member Countries.

→ The GATT lost its Relevance by 1980s because..

a) **Intellectual Property Rights** & trade in **Services** were not Covered.

b) $\boxed{\text{Ambiguities}}$ in multilateral system.

Confusion

GOODS का Trade

c) World $\boxed{\text{merchandise trade}}$ Increased a lot and it was beyond the Scope of GATT.

d) Efforts at $\boxed{\text{liberalising agriculture}}$ were <u>not Successful</u>.

e) <u>Inadequacies</u> in "<u>dispute Settlement System</u>"

f) It was **NOT a treaty**.

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* URUGUAY ROUND

→ Uruguay round brought about the biggest reform of the World's trading system. Members Established 15 groups to work on limiting restrictions.

→ The Round Started in Punta del Este in Uruguay in September 1986. In December 1993, the Uruguay round (8th) was the most ambitious & largest ever round with 123 Countries participated, was completed.

→ The agreement was signed by most Countries on 15 April, 1994 and the Effect from 1 July 1995 marked the birth of "WTO".

(3) World Trade Organisation (WTO)

→ Six key objectives

(i) To set & enforce rules for International Trade.

(ii) To Provide $\boxed{\text{forum}}$ for negotiations.

मंच

(iii) To $\boxed{\text{resolve disputes.}}$

(iv) To Increase Transparency.

(v) To Involve in global Economic management.

"International आर्थिक Management"

(vi) To help developing nations.

→ Structure of WTO.

WTO activities are Supported by a Secretariat located in GENEVA by Director General.

It has three tier System of decision making.

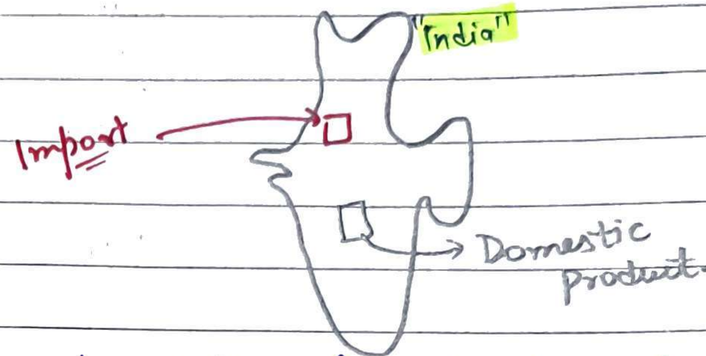
Top
↓
middle
↓
lower

WTO accounts for almost 95% of world trades and Currently having 164 member Countries. (of which 117 are developing Countries)

→ "Guiding Principle of WTO"

① Most favoured nation. (MFN) – Treating other people Equally.

② **National Treatment** - Treating foreigners & locals **Equally**.



This principle of National Treatment is also found in all three main WTO agreements

(Article 3 of GATT, Article 17 of GATS and Article 3 of TRIPS.)

GATT → Goods

GATS → General Agreement on Trade in Services

TRIPS → Agreement on Trade Related Aspects of Intellectual Property Rights.

③ **Free Trade** - WTO allows progressive liberalisation.

"धीरे - धीरे Barriers खतम करते हैं"

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(4) Predictability. - In WTO, when countries agree to open their markets for goods or services, they "bind" their commitments. Countries should make trade rules as clear as possible (Transparent)

(5) Promoting fair Competition. - WTO promotes fair competition in agriculture, Intellectual property, services etc.

(6) Encouraging development & Economic reforms.

- developed countries have started to allow duty free & quota free imports for almost all products from least-developed countries.

→ WTO Agreements.

- Agreement on Agriculture.
- Agreement on application of SPS measures.
- Agreement on Textiles & Clothing replaced the Multi-fibre agreement (MFA) since 1974.
- Agreements on TBT (Technical Barriers to Trade)

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- Agreements on TRIMs (Trade Related Investment Measures)

- Agreements related Anti-Dumping.

- Custom Valuation agreements.

- Agreements relating to pre-Shipment Inspection (PSI)

- Agreements on rules of origin.

- Agreements on Import licensing procedure.

- Agreements on Subsidies and Countervailing measures.

- GATS and TRIPS.

- Trade policy Review Mechanism (TPRM)

- Plurilateral Agreements.

  - It Involves Several Countries with common Interest but do not Involve all WTO countries.

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X DOHA Round (9th)

- Qatar in November 2001
- Talks about negotiations Including 20 areas of Trade.
- Most Controvertial topic was "Agriculture trade"

* G20

- "Group of 20" is the premier forum for International Economic Cooperation. India holds the presidency of G20 from 1Dec 2022 to 30 Nov. 2023.
- G20 was founded in 1999 after the Asian financial Crises.
- Since the beginning of COVID-19, trade related measures were Implemented by G20 and 61% measures were "trade facilitating."

(39% measure were trade Restrictive)

By October 2022, 77% of Export restrictions has been repealed. → खत्म कर दी

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Unit-4 Exchange Rates and its Economic Effects

① Introduction

→ A foreign currency transaction that is denominated in or requires settlement in foreign Exchange.

→ Exchange Rate is the rate at which the currency of one Country is Exchanged for the Currency of another Country.

Eg $\boxed{1\$ = ₹80}$

→ A direct quote (European Currency Quotation) is the no. of units of local currency Exchangable for one unit of foreign currency.

$\boxed{₹80/\$}$

→ A Indirect quote (American Currency Quotation) is the number of Units of foreign Currency Exchangable for one unit of local Currency.

$\boxed{\$0.0125/₹}$

→ (2) Exchange Rate Regimes. (3 Regimes)

(i) free - floating Exchange Rate System

- Rate determined by market forces of demand & Supply.
- No Government Intervention.
- Self Regulatong 🙂
- No need to maintain foreign Currency Reserves.
- Less Stability ☹
- Speculation can be there
- International trades are risker.

(ii) Managed floating System.

→ Government & Central Bank often seek to Increase or decrease their Exchange rates by buying or Selling their own Currencies.

→ Such Intervention is likely to have only a Small Impact.

(iii) fixed Exchange rate System

→ Set by Government

→ Stability. 🙂

→ Less speculation 🙂

→ Avoids Currency fluctiation 🙂

→ Government has to keep huge foreign Currency Reserves ☹

→ It Enhances International trade & Investment.

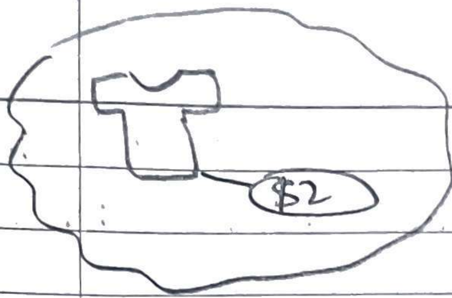
* Basically, Free floating Exchange Rate System is Efficient and transparent. It allows Central Bank to pursue its own Independent monetary policy.

(3) Nominal & "Real" Exchange Rates

→ Nominal Exchange Rates is Expressed in Units of one Currency per Unit of other Currency. A real Exchange rate adjusts this for changes in price levels.

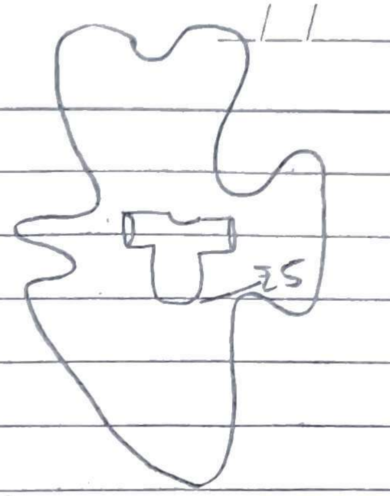
→ A real Exchange Rate is the Rate at which a person can trade the goods or Services one country for the goods or Services of another.

→ $$\boxed{\text{Real Exchange Rates} = \frac{\text{Nominal Exchanges Rate} \times \text{Domestic prices}}{\text{foreign prices}}}$$



Nominal Exchange Rate =

$\boxed{\$ = ₹1}$



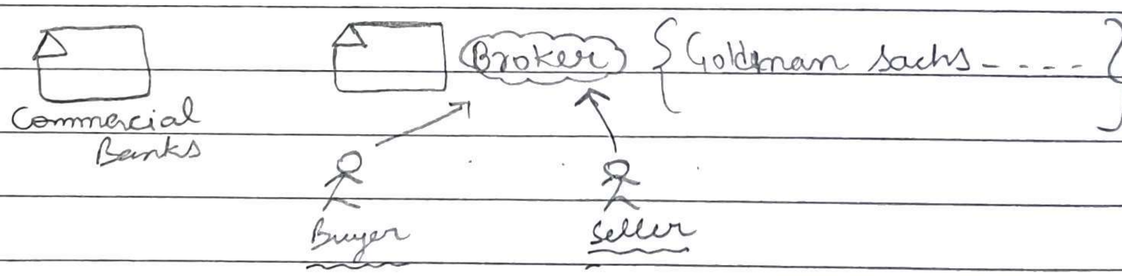
Real Exchange rate $= ₹1 \times \frac{5}{2}$

$= 2.5$

> * Real Effective Exchange Rate (REER) $= \frac{\text{Nominal Exchange Rate}}{\text{price deflator}}$

④ Foreign Exchange Market

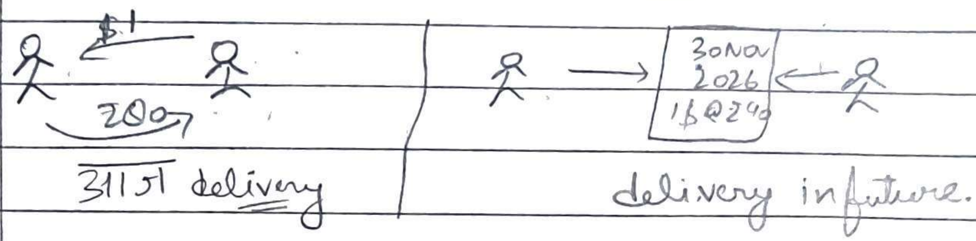
→ Forex Market mainly Consists of Commercial Banks & Brokerage houses (known as market makers)



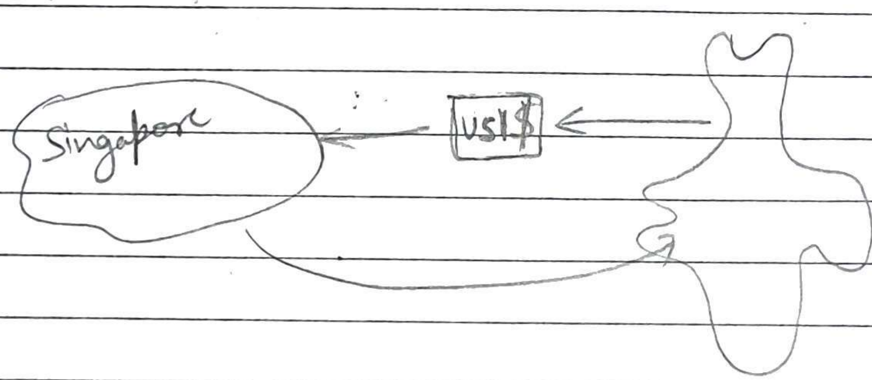
→ In foreign Exchange market, there are two types of transactions :-

a) Currency transactions which are carried out in the $\boxed{\text{spot market}}$ and Exchange involves immediate delivery.

b) future transactions where in Contracts are agreed upon to buy or sell currencies for future delivery which are carried out in $\boxed{\text{forward / future market.}}$



✗ A foreign Exchange Transaction can involve any two Currencies, but mostly US$ is involved (Even though it is not the national currency of either of the countries.)
Thus, US$ is called "vehicle currency".



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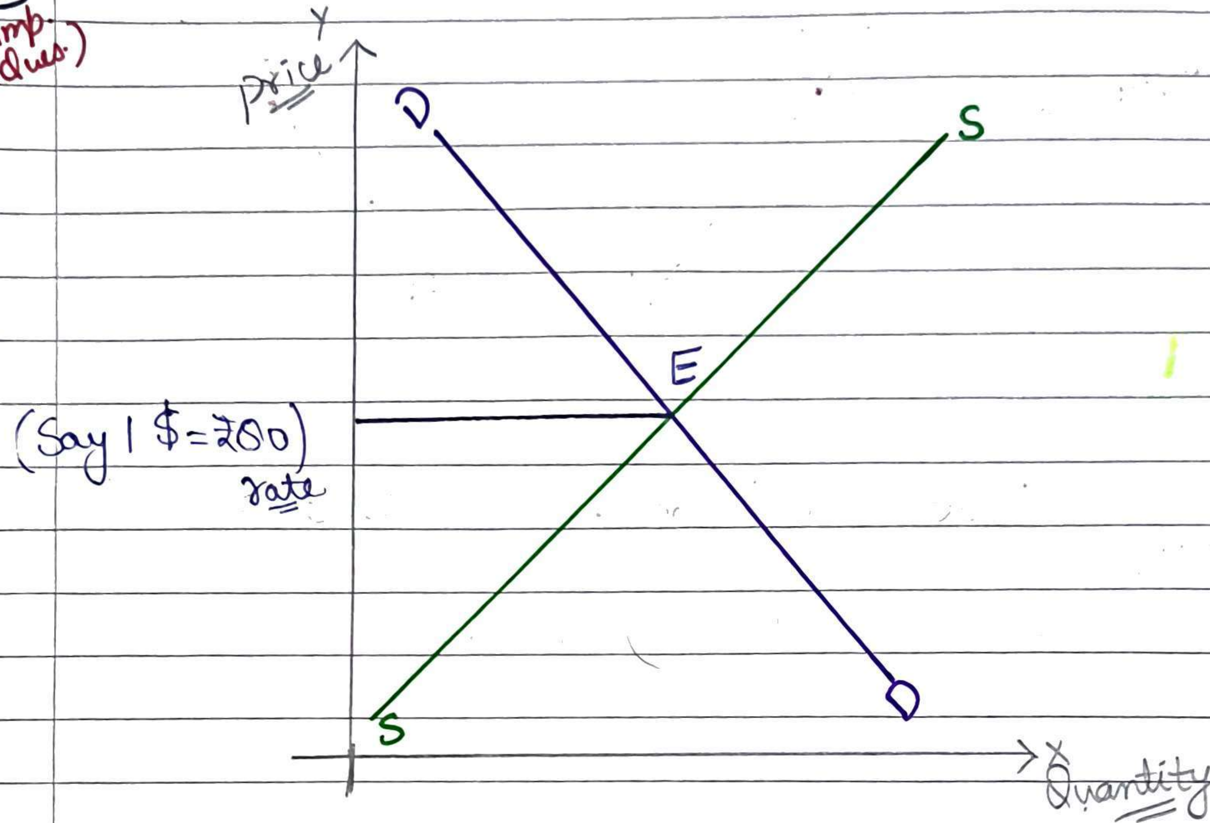
5 Determination of Nominal Exchange rate

V.Imp. (Max Ques.)



Why Demand?? (Why $ is Demanded??)	Why Supply?? (Why Inflow of $??)
→ To purchase goods & Services from foreign Country.	→ Exports
→ $\boxed{\text{foreign Tour.}}$ ↑↑ Demand↑↑	→ Investments by foreigners in our Country.
→ To send Unilateral transfers	→ Unilateral transfer Recd.
→ To make Investment in foreign Countries.	→ foreigners visiting India.
→ To open foreign Bank A/c	→ Speculation.
→ for speculation	Etc Etc Etc.
Etc Etc.	

DOMS

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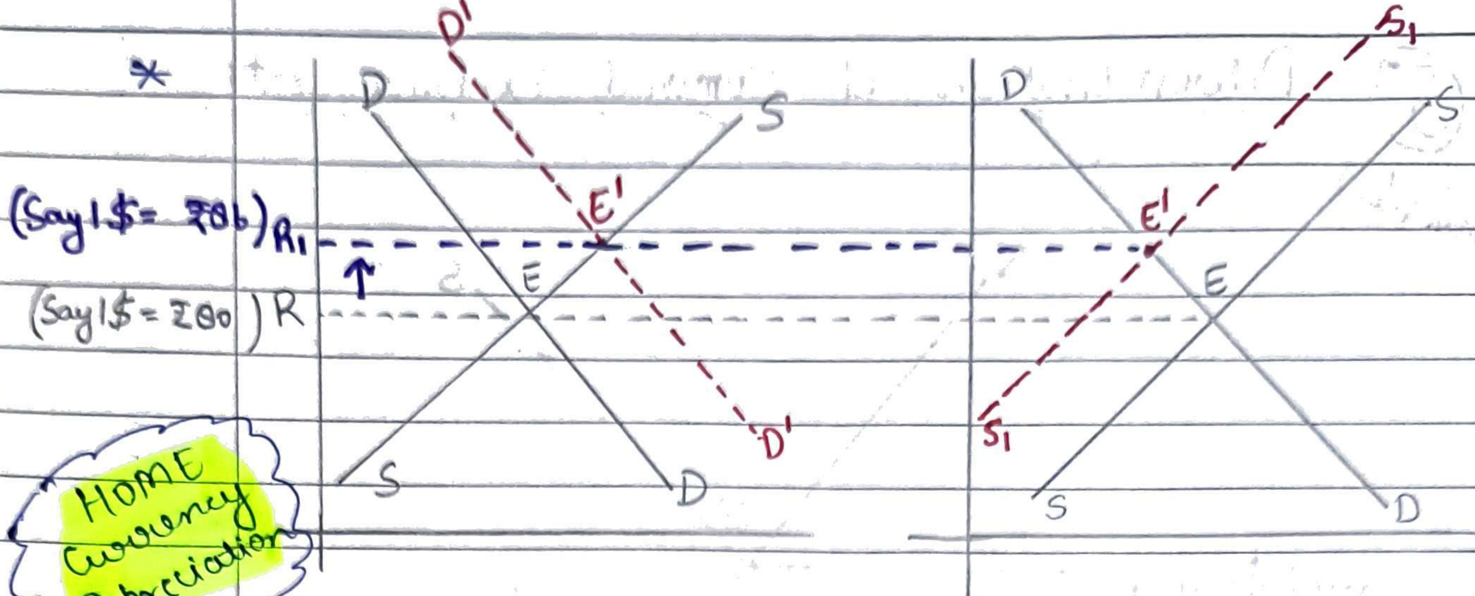


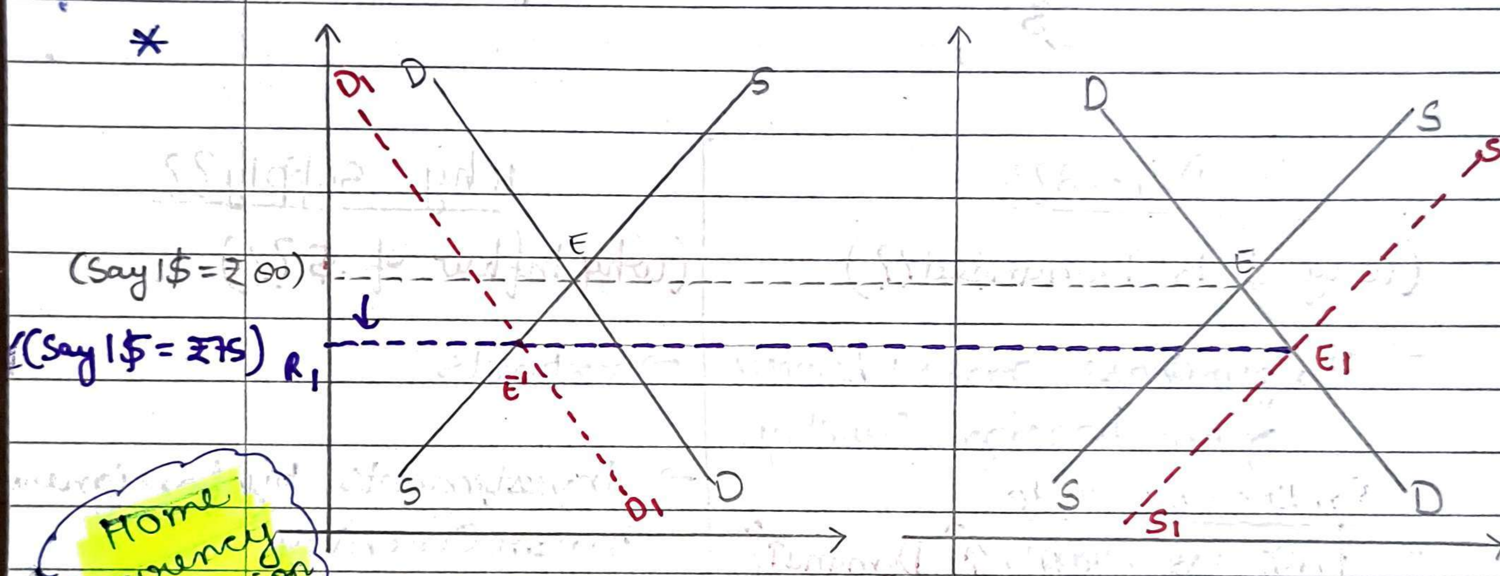
HOME Currency Depreciation

(रुपया कमजोर)

Increase in Demand

Decrease in Supply.

*



Home Currency Appreciation

(रुपया मजबूत)

Decrease in Demand

Increase in Supply.

RBI

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* Effects of Currency Depreciation & Currency appreciation.

Exchange Rate depreciation lowers the relative prices of Country's Exports (Export Rises), raises the relative price of its Imports (Import falls), leads to output Expansion, Encourage Economic activity, Increases International Competitiveness & Improves Balance of Trade.

Currency appreciation raises the prices of Exports (Export falls), Increases Import, adverse effect on Competitiveness, causes larger deficits & worsens the trade Balance.

6 Depreciation (Appreciation) V/s Devaluation (Revaluation)

Earlier 1\$ = ₹80	Earlier 1\$ = ₹80
Now 1\$ = ₹85	Now 1\$ = ₹85

Depreciation (रुपया कमजोर हो गया) Devaluation.

It occurs due to market forces of Demand & Supply.	Deliberately done by Government.

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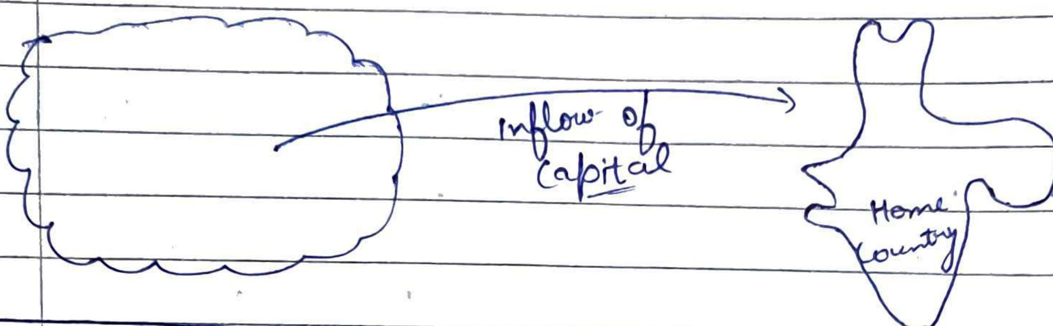
Unit-5 International Capital Movements

① foreign Capital

→ foreign capital includes any inflow of capital into the home country from abroad.



① foreign aid or assistance. (मदद)	→ Bilateral or direct inter government grants. → Multilateral aid from many government. → Tied aid with stipulation. → condition. → Untied aid with no stipulation. → foreign grants (voluntary) from Institutions or organisations.
② Borrowings. (LOAN)	→ Direct inter government loans. → loans from International Institutions. → Soft loans.* (No Harsh Conditions) → External "Commercial" Borrowings. → Trade "Credit" facilities.
③ Deposits from NRI	

④ Investments (निवेश)

→ foreign portfolio Investment (FPI)

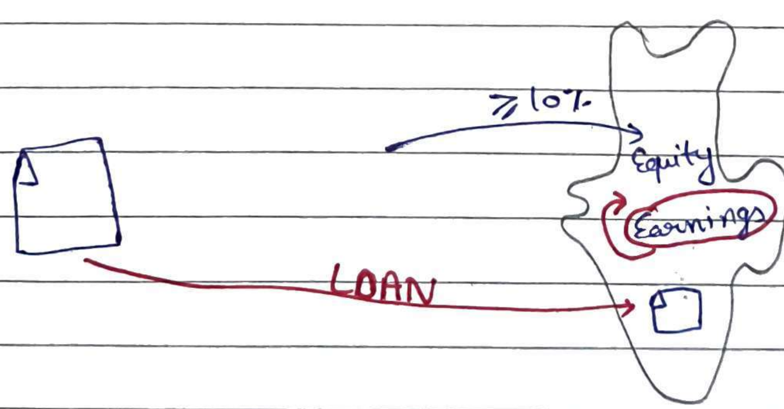
→ foreign Direct Investment (FDI)

② Foreign Direct Investment (FDI)

→ According to IMF and OECD, the acquisition of at least 10% of ordinary shares or voting power in a public or private Enterprise by Non-resident Investors makes FDI.

→ FDI has 3 components :-

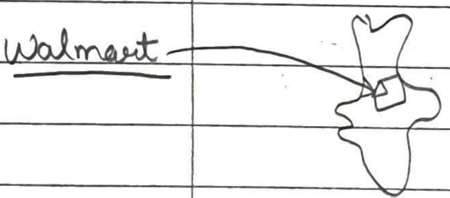
a) Equity Capital
b) Reinvested Earnings.
c) Other direct Capital (Eg. Intra-Company loans)



→ FDI are real investments in factories, assets, land, Inventories etc and Involve foreign ownership of production facilities.

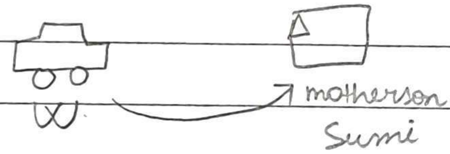
→ FDI may be categorised as:-

Horizontal
It takes place when Investor Establishes Same type of business Operation in foreign Country.

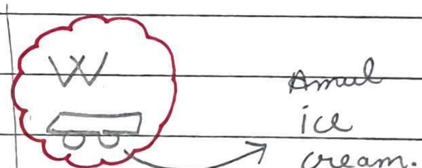


Vertical
It takes place when Investor Establishes a different activity from its main business activity but may be Supportive.

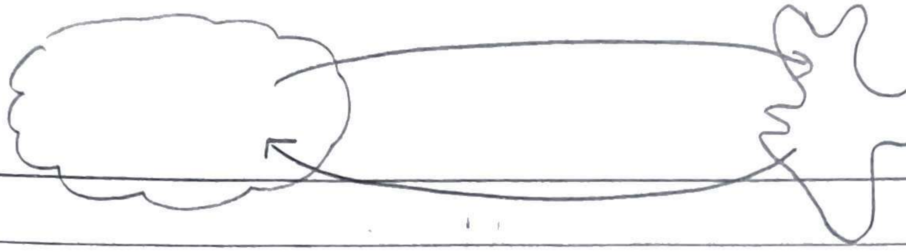
Eg- Germany Volkswagen acquired plastic moulding Company in India.



Conglomerate
It takes place when Investor makes Investment in a business that is altogether Unrelated.



* Two way Direct foreign Investment.



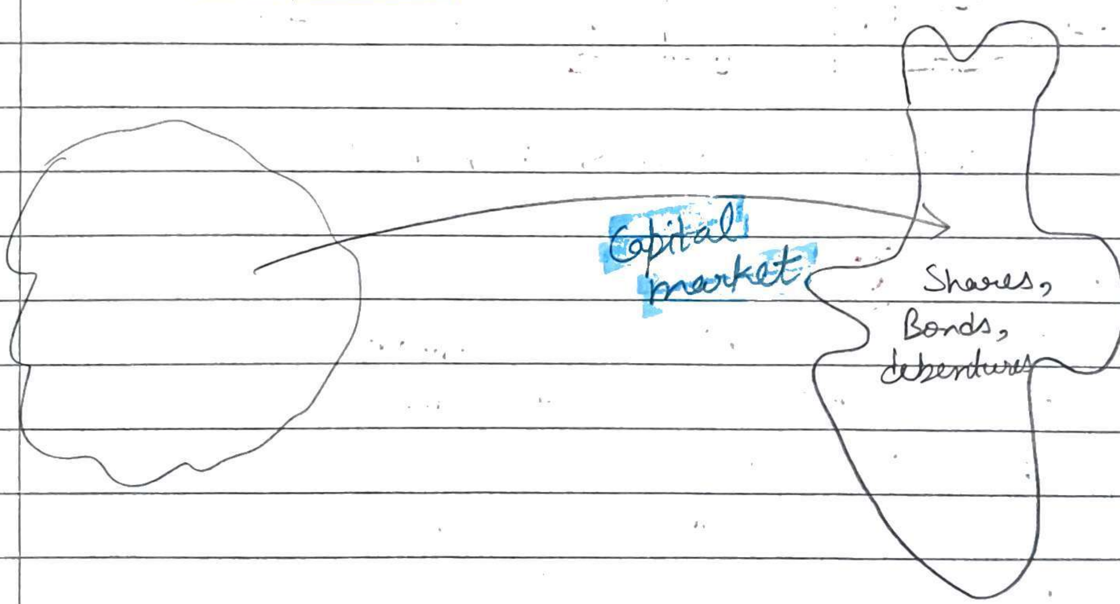
③ foreign Portfolio Investment (FPI)

→ foreign portfolio Investment is the flow of financial Capital rather than real Capital.

(does not Involve ownership or Control on part of Investor)

→ These flows are generally <u>Short-term</u> and have their Immediate effects on BOP and Exchange rates (No major Effects on Production or Income generation)

→ Portfolio Investments are characterised by lower Stakes in Companies with their total Stake at below 10%.



* Speculation → FPI (✓)

* Direct Impact on Employment → FDI (✓)

* Difficult to withdraw → FDI (✓)

* Interest in management → FDI (✓)

* financial assets → FPI (✓)

* Physical assets → FDI (✓)

* Short term → FPI (✓)

4 Reasons for FDI

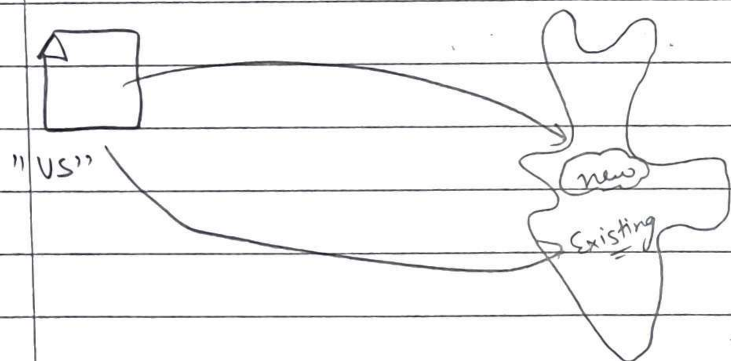
The main reasons for FDI are:-

(i) profits 🙂
(ii) higher rate of return फायदा
(iii) Possible "Economics" of large Scale operations.
(iv) Risk diversification.
(v) Capture of "Emerging" markets.
(vi) lower host Country Environmental & labour Standards.

(vii) by passing tariff & non-tariff barriers.
(viii) Cost Effective availability of Inputs.
(ix) Tax benefits.

* FDI takes place through :-

a) opening Subsidiary Company or associate
b) Equity Injection. - lumpsum Investment.
c) acquiring Control
d) Mergers & Acquisitions
e) Joint Venture
f) Green field Investment → New facility
g) Brown field Investment. → Existing facility.



⑤ Problems of FDI

→ Use of Inappropriate Capital Intensive methods in labour abundant Country.
→ Increase in regional disparity.
→ Crowding out of domestic Investment.
→ Diversion of Capital resulting in distorted pattern of production.
Disturb ~~Stable~~
→ Instability in BoP & Exchange rates.

- Repatriation of profits
- "Anti Ethical" market distortions.
- "off - shorling" or shifting of $\boxed{\text{jobs.}}$
- Decrease in Competitiveness of domestic Companies.
- Over Exploitation of natural resources.
- "Harmful" Jeopardizing national Security.
- worsening Commodity terms of trade etc etc.

$$\frac{\text{prices of Exports}}{\text{Prices of Imports.}}$$

(6) Benefits of FDI

- New Innovations
- Higher Employment
- Higher Efficiency
- Better Products
- Lower Prices
- welfare for consumers.
- Better access to foreign markets
- Improvement in BoP etc etc etc.

* $\boxed{\text{MAURITIUS}}$ is the leading Country in respect of Inflow of FDI to India.

* A foreign investor may Enter India:-
  - Through automatic route
  - Through government route
  - Through Equity in domestic Enterprises.

* FDI is prohibited in Chit fund & Nidhi Company.

* According to RBI, Overseas Direct Investment stood at US $ 1922.51 million in Sep 2022.

  Investment made by Indian Companies in foreign Companies.

* According to World Investment Report 2022, India was ranked 8th among the world's major FDI receipients (US$ 81,973 million during 2020-21)