Mukthagangotri, Mysuru-570 006

MBA

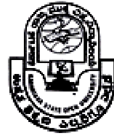
(FOURTH SEMESTER)

International Business

Department of Studies and Research in Management

Course : 20

Module : 1 to 5

KARNATAKA STATE  OPEN UNIVERSITY

MUKTHAGANGOTHRI, MYSURU- 570 006.

DEPARTMENT OF STUDIES AND RESEARCH IN MANAGEMENT

M.B.A IV Semester

COURSE - 20

INTERNATIONAL BUSINESS

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Dear Learner,

It gives me immense pleasure to welcome you to the Department of management to study MBA Second Year (Fourth Semester) in our esteemed university.

I am Extremely happy in placing this study material in your hand. The Department of Studies and Research in Management, Karnataka State Open University is providing you Self Learning Materials (SLM) for all the courses developed by the team of experts drawn from various conventional universities, Open Universities, B-Schools, Management institutions and professionals.

This study material explains the most complicated topics in a very simple and user-friendly manner, it starts with the Objectives, explanation of concepts followed by Case study, Notes, Summary, Key Words, Self Assessment Questions and References. It provides more value added information on contemporary issues.

Department has focussed on conceptual learning and on avoiding bulky and prolonged description. Every concept has been explained in the simplest manner. Some complicated concepts have been simplified in the study material, so that the learner can learn easily.

The Department of Management, Karnataka State Open University is offering three electives or specialization. You have already chosen the stream in which you wish to specialize i.e. Finance, Marketing and People Management. Hope you will gain expertise in you field.

The specialization in an MBA is due to business complexities and diversities. The MBA is over 100 years old now. Leading management institutes are trying to come up with new and innovative ways to educate the next generations of business leaders. In an MBA, an elective facilitates learners to plank extra focus on one particular area of interest and tailor their MBA in a different way depending on their background and future goals.

a) **Finance** – Finance is one of the most popular specializations of Master of Business Administration (MBA) program. MBA specialization in finance offers, benefits to working professionals in a variety of industries, including commercial and corporate banking, investment services and real estate. MBA in Finance gains you business and financial skills need to work in a number of enterprises. Finance Specialization balances mathematical rigor with management techniques. The finance papers offered by the department builds you as a stock market experts coupled with the knowledge of corporate finance and banking.

b) Marketing – Marketing has become one of the most desired specialization both by students and employees in recent years. With the shift to digital and online marketing, most businesses now have their own, in-house marketing teams specialized in bringing customers to the company. Prospective students aspiring to demonstrate that they have the potential to become an excellent marketing manager require a broad skill set. Individuals with soft skills, such as communications, tend to grow well in marketing field. Other desired skills for marketing typically include analytical and leadership skills. The department has carefully chosen the papers to impart the above skills in you.

c) People Management – The ever increasing importance of the individuals in the success of a business, makes an in depth study of human behaviour very crucial. Effective management requires insight over the aspects of human behaviour, which can only be gained through study of the related theories and principles of people management. The department has strived to provide you knowledge on training, change management, labour loss and so on to prepare you to face these soft challenges.

In addition to the study material provided to you, I advise you to go through the books which are suggested in the reference of every unit. Further, I also suggest you to make yourself acquainted by reading newspapers and journals.

Apparently, the curriculum designed by the board of studies helps you to prepare for UGC NET, various state commission examinations and UPSC examinations. With these words I welcome you for the wonderful learning experience of business education.

I wish all the best and good luck in your education and successful management career.

Dr. C. Mahadevamurthy
Chairman
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INTRODUCTION

INTERNATIONAL BUSINESS

With the globalization of the world economy, there has been a concomitant rise in the number of companies the at operate globally. Though international business as a concept has been around since the time of the East India Company and continued into the early decades of the 20th century, there was a lull in the in the international expansion of companies because of the Two World Wars. After that, there a hesitant move towards internationalizing the operations of multinational companies.

International business refers to a wide of business activities undertaken across national borders. Along with rapidly increasing globalization business has become a popular topic and has drawn the attention of business executives, government officials and academics. International business is different from domestic business. At the international level, the globalization of the world economy and the differences between countries present both opportunities and challenges to international business. Business managers need to take account of the globalised business environment when making international strategic decisions and in managing ongoing international operations.

Course: 20 International Business specify to fulfilling the needs of the learner from the view point of International Business Scenario has been grouped in to 5 modules, and it further divided into 20 units for better understanding.

Module - 1: Introduction to International Business consists of four units (1to4). First unit deals with Introduction to International Business, Definitions, Importance, Nature of Scope, Objectives, Trends, Advantages & Disadvantages of international Business. Unit 2 consist of Modes of Entry into International Business, Introduction, Definitions reason to entry, Factors influencing, Different modes of entry FDI with alliances and without alliances. Unit 3 includes Internationalization and multinational co operations, managerial implications, Introduction, meaning, process, theory of Internationalization, Types, Structure and role of developing countries, Introduction, Definitions, Evaluations, BOP, Challenges, Role of MNC's.

Module – 2: International business Environment comprises of four units (5-8), fifth unit explain an overview of political, Social and cultural, legal and Technological of Business Environment. Unit 6 designed to understand the economic environment. Introduction, definitions, natural, demographic and economic environment and environment condition in India. Unit 7 deals with regional trade blocks, Introduction, definition, concept types and benefits of economic integration and different types of regional trade blocks. EU, ASEAN, SAARC, NAFTA and inter regional trade among regional groups. Unit 8 specify world trade and protectionism introduction, definitions,

WTO objectives, structure, achievements and criticism. Tariff and non-tariff barriers of trade and negotiations in I.B.

Module 3: Theories of international business and bilateral and multilateral trade laws comprises of four units. (9-12), Ninth unit consist of mercantilism theories, introduction, concept of issues and different types of theories,. Unit ten deals with international trade theories, introduction, international PLC theory, exceptions to the cycle, porters and theory and business implication of international trade theories. Unit eleven describes GATT/WTO and international liberalization. Introduction GATT/WTO and WTO, different rounds of WTO and GATT, IPR, TRIPS TRIMS GATO services. Unit twelve depicts ministerial conference of SAARC. Introduction the profile, objectives institutional setup regional centres, legal issues, key declarations and challenges of SAARC.

Module – 4: Global Trading Environment consists of four units (13-16) Unit thirteen depicts global trading environment deals with Introduction, objectives, impact of Indian industrial sector, economic impact, business impact, technological and Indian problem with globalization. Unit fourteen includes EXIM policies, Government support, export incentives and export credit. Unit fifteen explains insurance and marine insurance, introduction, functions, principles, types of insurance, introduction, features operations of marine insurance. Unit sixteen consist of foreign direct investment, introduction, advantages and disadvantages, determinants, trends in FDI and forms of FDI.

Module – 5: International E-business consists of four units (17-20) seventeen units tells about introduction to e-commerce and e-business, introduction, meaning of types, factors affecting business dimensions & technological dimensions of e-commerce and e-business and mobile commerce. Unit eighteen explains introduction to internet, internet and extranets, business applications on internet and e-shopping, unit nineteen deals with electronic payment system, introduction, types, advantages and disadvantages e-signature, smart cord electronic fund transfer. Unit twenty explains security issues in e-business overview, issues of security and threats in e-commerce.

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MODULE - I
INTRODUCTION TO INTERNATIONAL BUSINESS

UNIT - 1 : INTERNATIONAL BUSINESS : AN OVER VIEW

Structure :

1.0 Objectives

1.1 Introduction

1.2 Meaning and Definations of International Business

1.3 Importance of International Business

1.4 Nature and Scope of International Business

1.5 Objectives or Goals of International Business

1.6 Trends in International Business

1.7 Advantages of International Business

1.8 Disadvantages of International Business

1.9 Summary

1.10 Self Assessment Questions

1.11 Case Study

1.12 Notes

1.13 References

1.0 OBJECTIVES

After studying this unit, you should be able to;

- Define the term International Business.
- Describe the nature and scope of International Business.
- Determine the current trends of International Business.
- Give an account on advantages and disadvantages of International Business.

1.1 INTRODUCTION

A business is an economic activity related to continuous buying and selling of goods and services for satisfying human wants. A business is an organisation involved in the trade of goods and services or both to the consumers. Today's business carries a complex area of commerce and industries which includes the activities of both production and distribution of goods services. To the enterprises business is related with the decision. What to produce? When to produce? Whom to produce? Where to produce? How much to produce? In simplest word we can say that the modern time's business is very much complex. As the environment is dynamic and changes frequently so the above questions always make the business enterprises to rethink about their business strategies. Stephenson defines business as, "the regular production or purchase and sale of goods undertaken with the objective of earning profit and acquiring wealth through the satisfaction of human wants".

International business means the buying and selling of the goods and services across the border. These business activities may be of government or private enterprises. Here the national border are crossed by the enterprises to expand their business activities like manufacturing, mining, construction, agriculture, banking, insurance, health, education, transportation, communication and so on. A business enterprise who goes for international business has to take a very wide and long view before making any decision, it has to refer to social, political, historical, cultural, geographical, physical, ecological and economic aspects of the another country where it had to business. International business by its nature is a primary determinant of international trade, one of the results of the increasing success of international business ventures is globalization.

For example,India used to export raw cotton, raw jute and iron ore during the early 1900s. The massive industrialization inthe country enabled us to export jute products, cotton

garments and steel during 1960s.India, during 1980s could create markets for its products, in addition to mere exporting. Theexport marketing efforts include creation of demand for Indian products like textiles, electronics,leather products, tea, coffee etc., arranging for appropriate distribution channels, attractivepackage, product development, pricing etc. This process is true not only with India, but also withalmost all developed and developing economies.

During the 1970s and 1980s the field of international business changed greatly. The economic growth of Europe and Japan, coupled with great strides by newly industrialized countries, resulted in more and more attention being focused on international business The 1990s saw the emergency of a strategic management focus for drawing together the field of international business. The descriptive ideas of the 1950s and 1960s, and the analytical ideas of the 1970s and 1980s were now being combined into an integrative approach. Historical and quantitative research was now being incorporated into models for describing, explaining and helping predict what was happening in the international arena.

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

Trading is no longer limited to some selected individuals and countries again. Trade cutacross nations and individuals of the world now days. It is more challenging and appreciated than before. This is because there is a fundamental shift in the world economy. We moving away from a world in which national economies were relatively self-contained entities, isolated from each other by barriers to cross-border trade and investment, by distance, time zones and language and national differences in government regulation, culture and business systems. And we are moving toward a world I which barriers to cross- border trade and investment are declining and perceived distance is shrinking due to advances in

transportation and telecommunication technology. This unit examines international trade/ business versus domestic business.

1.2 MEANING AND DEFINITIONS OF INTERNATIONAL BUSINESS

International business consists of transactions that are devised and carried out across national borders to satisfy the objectives of individuals, companies, and organizations. International business includes any type of business activity that crosses national borders. Though a number of definitions in the business literature can be found but no simple or universally accepted definition exists for the term international business.

International business is defined as organization that buys and/or sells goods and services across two or more national boundaries, even if management is located in a single country. International business is equated only with those big enterprises, which have operating units outside their own country.

- **International business:** a business that is primarily based in a single country but acquires some meaningful share of its resources or revenues (or both) from other countries.
- **Domestic business**: a business that acquires all its resources and sells its products or services within a single country.
- **Multinational business:** one that has a worldwide marketplace from which it buys raw materials, borrows money, and manufactures its products and to which it subsequently sells its products.
- **Global business:** a business that transcends national boundaries and is not committed to a single home country.

International Business is defines the process of focusing on the resources of the globe and objectives of the organizations on global business opportunities and threats. International business defined as global trade of goods/services or investment. More comprehensive view does not focus on the "firm" but on the exchange process. Free Trade occurs when a government does not attempt to influence, through quotas or duties, what its citizens can buy from another country or what they can produce and sell to another country. The Benefits of Trade allow a country to specialize in the manufacture and export of products that can be produced most efficiently in that country. The Pattern of International Trade

displays patterns that are are easy to understand (Saudi Arabia/oil or Mexico/labor intensive goods). Others are not so easy to understand (Japan).

In its traditional form of international trade and finance as well as its newest form of multinational business operations, international business has become massive in scale and has come to exercise a major influence over political, economic and social from many types of comparative business studies and from a knowledge of many aspects of foreign business operations. In fact, sometimes the foreign operations and the comparative business are used as synonymous for international business. Foreign business refers to domestic operations within a foreign country.

Comparative business focuses on similarities and differences among countries and business systems for focuses on similarities and differences among countries and business operations and comparative business as fields of enquiry do not have as their major point of interest the special problems that arise when business activities cross national boundaries. For example, the vital question of potential conflicts between the nation-state and the multinational firm, which receives major attention is international business, is not like to be centered or even peripheral in foreign operations and comparative business.

1.3 IMPORTANCE OF INTERNATIONAL BUSINESS

International business is an aspect of modern business. It is very important especially when the whole world is linked together as a globe village. For international business manager to succeed he/she should equip himself with the requirements of the business. It is equally important to examine how international trade has be carried out in such area. This will go along in aiding such international business. The different countries and companies are given the chance to expand and to share their products and services to others beyond their own territory. In fact, there is an actual give and take scenario between two or more nations that sign a mutual agreement of trading. The following are the points should be judge international business is important as follows:

- **It acquires more sales:**Businessmen will have the chance to expand their companies and to be known to other countries. Undoubtedly, this will increase their profits rather than restricting their business within their own borders. Our local country will also benefit from this since new products, technologies, and services are being offered for us to use.And, because we allow them to export their goods and services to us, we are also given the chance

to export our own products to them. In this way, both our local businessmen and government will also earn.

- **It opens new opportunities:**If there are increasing numbers of foreign companies in our country, they will need more manpower to help them in running the business. We will be given the chance to use and to share our skills and knowledge, once we are hired.In return, we will gain income to provide the needs of our family. The agreement also implies that we can go to their country to work, to study, or to live.

- **It gives new technologies:**Other countries have invented different technologies which can help us in our daily living like modern appliances and computers.For those countries that lack the means to create new high quality technologies can also have an access to enjoy the benefits once these technologies are exported to them. Another example is the invention of rear projection screens. These will help us in disseminating and advertising in our country.

- **It utilizes the resources:**Countries that are rich in fuel, minerals, and many more can utilize their resources by sharing these to others. Instead of keeping these resources, they can share these to other countries so that others will also have the benefits. In return of their resources, they can have more income for their government.

- **It provides quality products**:Different countries have their own unique and useful products and services that they can offer to us. In this way, we can choose the best ones that are helpful to us. There are wide varieties of choices when it comes to brands, prices, designs, and features.

- **It helps in earning foreign exchange:**Investors are welcomed to invest from both local and international. More investors mean that the economic status of our country will become stable. This helps a lot, especially those fellow citizens that need assistance from the local government.

- **It acquires investment in infrastructure:**Countries that deal with international business need to invest in infrastructure. This will help them in transporting and communicating with other business partners and customers. This will also help the people since these infrastructural developments are open to be used by the public

- Most companies are either international or compete with international companies.
- Modes of operation may differ from those used domestically.

- An understanding helps you to make better career decisions.
- An understanding helps you decide what governmental policies to support.

1.4 NATURE AND SCOPE OF INTERNATIONAL BUSINESS

The scope of international business focus on the particular problems and opportunities that emerge because of a firm is operating in more than one country. In a very real sense, international business involves the broadest and most generalized study of the field of business, adapted to a fairly unique across the border environment. Many of the parameters and environmental variables that are very important in international business (such as foreign legal systems, foreign exchange markets, cultural differences, and different rates of inflation) are either largely irrelevant to domestic business or are so reduced in range and complexity as to be of greatly diminished significance. Thus, it might be said that domestic business is a special limited case of international business.

The distinguishing feature of international business is that international firms operate in environments that are highly uncertain and where the rules of the game are often ambiguous, contradictory, and subject to rapid change, as compared to the domestic environment. In fact, conducting international business is really not like playing a whole new ball game, however, it is like playing in a different ballpark, where international managers have to learn the factors unique to the playing field. Managers who are astute in identifying new ways of doing business that satisfy the changing priorities of foreign governments have an obvious and major competitive advantage over their competitors who cannot or will not adapt to these changing priorities.

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

2) **International Marketing to International Business**: The multinational companies which were producing the products in their home countries and marketing them in various foreign countries before 1980s, started locating their plants and other

manufacturing facilities in foreign/host countries. Later, they started producing in one foreign country and marketing in other foreign countries.

For example: Uni Lever established its subsidiary company in India, i.e., Hindustan Lever Limited (HLL). HLL produces its products in India and markets them in Bangladesh, Sri Lanka, Nepal etc. Thus, the scope of international trade is expanded into international marketing and international marketing is expanded into international business.

3) **Wide Scope:** The scope of international business is much broader involvinginternational marketing, international investments, management of foreignexchange, procuring international finance from IMF, IBRD, International Finance Corporation (IFC), International Development Association (IDA) etc.management of international human resources, management of cultural diversity, management of international production and logistics, international strategic management.

4) **Inter-country compared to host country:** International business studies the business opportunities, threats, consumer's preferences, behaviour, cultures of thesocieties, employees, and business environmental factors, manufacturing locations, management styles, inputs and human resource management practices in various countries. International business to identify, classify and interpret the similarities and dissimilarities among the systems used to anticipate demand and market products. This system presents inter-country comparison and inters-continental comparison.

5) **Broader market is available**: domestic business the market is not restricted to national population. Population of other countries can also be targeted in international marketing.

6) **Involves at least two set of uncontrollable variables:** In domestic business the marketers have to interact with only one set of uncontrollable variables. In international marketing at least two set of uncontrollable variables are involved or more if the marketing organization deals in more countries.

7) **Requires broader competence**: Special management skills and broader competence is required in international marketing/business.

8) **Competition is intense:** An international business organization has to compete with both the domestic competitors and the international competitors. Hence, the competition is intense in international marketing.

9) **Involve high risk and challenges:** International business is prove to various kinds of risk and challenge such as political risk, cultural differences, changes in fashion and style offoreign customers, sudden war, changes in government rules and regulations, communication challenges due to language and cultural barriers, etc.

1.5 OBJECTIVES OR GOALS OF INTERNATIONAL BUSINESS

1. **To Achieve Higher Rate of Profits:**The basic objective of business is to achieve profits. When the domestic markets do not promise a higher rate of profits, business firms search for foreign markets that hold promise for higher rate of profits. Thus the objective of profit affects and motivates the business to expand operations to foreign countries. For example, Hewlett Packard in the USA earned 86.2% of its profits from the foreign markets compared to that of domestic markets in 2014. Apple earned US $ 730 million as net profit from the foreign markets and only US $ 620 million as net profit from its domestic market in 2014.

2. **Expanding the Production Capacities beyond the Demand of the Domestic Country:**Some of the domestic companies expand their production capacities more than the demand for the product in domestic countries. These companies, in such cases, are forced to sell their excess production in foreign developed countries.

3. **Severe Competition in Home Country:** The countries oriented towards market economies since 1960s experienced severe competition from other business firms in the home countries. The weak companies which could not meet the competition of the strong companies in the domestic country started entering the markets of the developing countries.

4. **Limited Home Market:**When the size of the home market is limited either due to the smaller size of the population or due to lower purchasing power of the people or both, the companies internationalize their operations. For example, most of the Japanese automobiles and electronic firms entered the USA, Europe and even African markets due to smaller size of the home market. Similarly, the mere six million population of Switzerland is the reason for Ciba-Geigy to internationalize its operations. ITC entered the European market due to the lower purchasing power of the Indians with regard to high quality cigarettes.

5. **Political Stability vs. Political Instability:** Political stability does not simply mean that continuation of the same party in power, but it does mean that continuation of the same policies of the Government for a quite longer period. It is viewed that the USA is a politically stable country; countries like the UK, France, Germany, Italy and Japan are also politically stable. Most of the African countries and some of the Asian countries are politically instable countries. Business firms prefer to enter politically stable countries and are restrained from locating their business operations in politically instable countries. In fact, business firms shift their operations from politically instable countries to politically stable countries.

6. **Availability of Technology and Competent Human Resources:** Availability of advanced technology and competent human resources in some countries act as pulling factors forbusiness firms from the home country. The developed countries due to these reasons attract companies from the developing world. In fact, American and European companies, in recent years, depended on Indian companies for software products and services through their business process outsourcing (BPO). India's software and service exports crossed US $ 23.4 billion in 2006 and it targets to cross US $ 60 billion by 2013. This is because the cost of professionals in India is 10 to 15 times less compared to the US and European labour markets.

7. **High Cost of Transportation:** Initially companies enter foreign countries their marketing operations. The home companies in any country enjoy higher profit margins as compared to the foreign firms on account of the cost of transportation of the products. Under suchconditions, the foreign companies are inclined to increase their profit margin by locating their manufacturing facilities in foreign countries through the Foreign Direct Investment (FDI) route to satisfy the demand of either one country or a group of neighbouring countries. For example, Mobile which was supplying petroleum products to Ethiopia, Kenya, Eritrea, Sudan etc., from its refineries in Saudi Arabia, established its refinery facilities in Eritrea in order to reduce the cost of transportation.

8. **Nearness to Raw Materials:** The source of highly qualitative raw materials and bulk raw materials is a major factor for attracting the companies from various foreign countries. For example Vedanta Resources is a London Stock Exchange (LSE) listed UK based company operating principally in India due to availability of raw materials

such as iron ore, copper, zinc and lead. It also has substantial operations in Zambia and Australia where ample copper is available.

9. **Liberalization and Globalization:** Most of the countries in the globe liberalized their economies and opened their countries to the rest of the globe. These change in policies attracted multinational companies to extend their operations to these countries.

10. **To Increase Market Share:** Some of the large-scale business firms would like to enhance their market share in the global market by expanding and intensifying their operations in various

foreign countries. Companies that expand internally tend to be 'oligopolistic'.

11. **Tariffs and Import Quotas:** It was quite common before globalization that governments imposed tariffs or duty on imports to protect the domestic company. Sometimes government alsofixes import quotas in order to reduce the competition to the domestic companies from the competent foreign companies. These practices are prevalent not only in developing countries but also in advanced countries.

1.6 TRENDS IN INTERNATIONAL BUSINESS

Fast forward to 2015 almost the entire global economy has changed. It is projected by 2020 that China will be the largest consumer economy and the United States will drop to second. International trade treaties are made between countries all over the world, regardless of how close they are, because transportation has become more efficient. In 2005, famous economist Thomas Friedman authored his book 'The World is Flat,' a reference to the path we are on to become one global economy where national boarders mean very little. Intense competition among countries, industries, and firms on a global level is a recent development owed to the confluence of several major trends. Among these trends are:

1) Forced Dynamism: International trade is forced to succumb to trends that shape the global political, cultural, and economic environment. International trade is a complex topic, because the environment it operates in is constantly changing. First, businesses are constantly pushing the frontiers of economic growth, technology, culture, and politics which also change the surrounding global society and global economic context. Secondly, factors external to international trade (e.g., developments in science and information technology) are constantly forcing international trade to change operate.

2) Cooperation among Countries:Countries cooperate with each other in thousands of ways through international organizations, treaties, and consultations. Such cooperation generally encourages the globalization of business by eliminating restrictions on it and by outlining frameworks that reduce uncertainties about what companies will and will not be allowed to do. Countries cooperate:

I. To gain reciprocal advantages,

II. To attack problems they cannot solve alone, and

III. To deal with concerns that lie outside anyone's territory.

Finally, countries set agreements on how to commercially exploit areas outside any of their territories. These include outer space (such as on the transmission of television programs), non-coastal areas of oceans and seas (such as on exploitation of minerals), and Antarctica (for example, limits on fishing within its coastal waters).

3) Liberalization of Cross-border Movements:Every country restricts the movement across its borders of goods and services as well as of the resources, such as workers and capital, to produce them. Such restrictions make international trade cumbersome; further, because the restrictions may change at any time, the ability to sustain international trade is always uncertain. However, governments today impose fewer restrictions on cross-border movements than they did a decade or two ago, allowing companies to better take advantage of international opportunities. Governments have decreased restrictions because they believe that:

- So-called open economies (having very few international restrictions) will give consumers better access to a greater variety of goods and services at lower prices,
- Producers will become more efficient by competing against foreign companies,
- If they reduce their own restrictions, other countries will do the same.

4. Transfer of Technology : Technology transfer is the process by which commercial technology is disseminated. This will take the form of a technology transfer transaction, which may or may not be a legally binding contract, but which will involve the communication, by the transferor of the relevant knowledge to the recipient. It also includes non-commercial technology transfers, such agreements may relate to infrastructure or agricultural development, or to international co-operation in the fields of research, education employment or transport.

5) Growth in Emerging Markets: The growth of emerging markets (e.g., India, China, Brazil, and other parts of Asia and South America especially) has impacted international trade in every way. The emerging markets have simultaneously increased the potential size and worth of current major international trade while also facilitating the emergence of a whole new generation of innovative companies.”The emerging world, long a source of cheap la, now rivals the rich countries for business innovation”.

6) New trends in international trade: International trade is increasingly recognized as a vital engine for economic development (World Bank)In 2013, the value of world merchandise trade rose by nearly 21%, the highest growth rate in 25 years (WTO, 2014 a), amounting to nearly USD 8.9 trillion. Taking account of dollar price changes, real world merchandise trade expanded by 9% in 2004, almost doubling from 5% in 2003. It continues to grow more rapidly than global Gross Domestic Products (GDP). For example, world trade grew at nearly 6% on average in 1994-2004, while global GDP at market exchange rates grew less than 3% in the same period. In the meantime, a number of new trends in international trade have been observed over recent years. Those mentioned below are among such trends which, in particular, are relevant when preparing the framework.

7) Trade in agricultural and manufactured goods: Manufactured goods, excluding mining products, recorded above average growth in worldmerchandise trade during the past two decades As a result, they accounted foraround three-quarters of world merchandise trade in 2013. By contrast, the share of agricultural goodstrade remained at around 9% in the three preceding years, which represented approximately 2% below theaverage level in the 1990s. One of the notable trends is that processed agricultural goods have becomemore important within trade in agricultural goods over the past decade. They accounted for 48% of globaltrade in agricultural goods in 2010-14,

8) Developing countries’ trade: In 2004, the share of developing countries in world merchandise trade stood at 31%, having increased from about 20% in the mid-1980s.This is the highest level since 1950. It is observed that developing countries are increasingly becoming an important destination for the exports of developed countries. Among those, in particular, some problems have been recognized in identifying tariff classification and assessing the Customs value3 of second-hand goods such as used cars, computer equipment, machinery and clothing. Also, developing countries contributed more to the 2003 growth of world merchandise trade than developed countries.

WorldTrade and Output Developments from 2010-2016

(At constant prices, annual percentage change)

Years	Merchandise exports	Merchandise production	GDP at market exchange rates	GDP at PPP
2010	3.5	5.0	9.5	6.0
2011	0.8	2.5	4.0	2.7
2012	1.7	2.6	4.2	3.1
2013	3.0	4.0	5.1	4.3
2014	2.1	2.8	4.7	6.0
2015	1.9	2.0	5.1	2.3
2016	2.8	3.7	4.6	5.2

Source: **WTO, IMF, World Economic Outlook.**

World Trade and Input Developments from 2010-2016

(At constant prices, annual percentage change)

Years	Merchandise Exports	Merchandise Production	GDP at Market Exchange Rates	GDP at PPP
2010	1.6	2.7	3.8	4.0
2011	1.1	2.4	3.2	5.7
2012	1.0	2.5	4.7	6.2
2013	1.3	2.8	4.4	7.5
2014	1.4	2.9	3.7	4.8
2015	1.9	3.7	4.0	5.7
2016	2.6	3.9	3.7	6.7

Source: WTO, IMF, World Economic Outlook.

1.7 ADVANTAGES OF INTERNATIONAL BUSINESS

Though international business is most important for a country's economy but there are some advantages and disadvantages of international business which are discussed as below:

1) **Earning valuable foreign currency:** A country is able to earn valuable foreign currency by exporting its goods to other countries.

2) **Division of labor:** International business leads to specialization in the production of goods. Thus, quality of goods for which it has maximum advantage.

3) **Optimum utilization of available resources:**International business reduces waste of national resources. It helps each country to make optimum use of its natural resources. Every country produces those goods for which it has maximum advantage.

4) **Increase in the standard of living of people:** Sale of surplus production of one country to another country leads to increase in the incomes and savings of the people of the former country. This raises the standard of living of the people of the exporting country.

5) **Benefits to consumers:** Consumers are also benefited from international business. A variety of goods of better quality is available to them at reasonable prices. Hence, consumers of importing countries are benefited as they have a good scope of choice of products.

6) **Encouragement to industrialization:** Exchange of technological know-how enables underdeveloped and developing countries to establish new industries with the assistance of foreign aid. Thus, international business helps in the development of industry.

7) **International peace and harmony:** International business removes rivalry between different countries and promotes international peace and harmony. It creates dependence on each other, improves mutual confidence and good faith.

8) **Cultural development:** International business fosters exchange of culture and ideas between countries having greater diversities. A better way of life, dress, food, etc. can be adopted form other countries.

9) **Economies of large-scale production:** International business leads to production on a large scale because of extensive demand. All the countries of the world can obtain the advantages of large-scale production.

10) **Stability in prices of products:** International business irons out wide fluctuations in the prices of products. It leads to stabilization of prices of products throughout the world.

11) **Widening the market for products:** International business widens the market for products all over the world. With the increase in the scale of operation, the profit of the business increases.

12) **Advantageous in emergencies:** International business enables us to face emergencies. In case of natural calamity, goods can be imported to meet necessaries.

13) **Creating employment opportunities:** International business boosts employment opportunities in an export-oriented market. It raises the standard of living of the countries dealing international business.

14) **Increase in Government revenue:** The Government imposes import and export duties for this trade. Thus, Government is able to earn a great deal of revenue from international business.

1.8 DISADVANTAGES OF INTERNATIONAL BUSINESS

International business strategy different from the domestic are the differences in the environment. The following are the main draw backs of international business are given below:

- **Political and legal differences:**The political and legal environment of foreign markets is different from that of the domestic. The complexity generally increases as the number of countries in which a company does business increases. It should also be noted that the political and legal environment is not the same in all provinces of many home markets.
- **Cultural differences:** The cultural differences, is one of the most difficult problems in international marketing. Many domestic markets, however, are also not free from cultural diversity in India.
- **Differences in the currency unit:**The currency unit varies from nation to nation. This may sometimes cause problems of currency convertibility, besides the problems of exchange rate fluctuations. The monetary system and regulations may also vary.
- **Differences in the language:**An international marketer often encounters problems arising out of the differences in the language. Even when the same language is used in different countries, the same words of terms may have different meanings. The language

problem, however, is not something peculiar to the international marketing. For example: the multiplicity of languages in India.

- **Differences in the marketing infrastructure:**The availability and nature of the marketing facilities available in different countries may vary widely. For example, an advertising medium very effective in one market may not be available or may be underdeveloped in another market.
- **Trade restrictions:**A trade restriction, particularly import controls, is a very important problem, which an international marketer faces.
- **High costs of distance:**When the markets are far removed by distance, the transport cost becomes high and the time required for affecting the delivery tends to become longer. Distance tends to increase certain other costs.
- **Economic Differences**: Economic inequality is the difference found in various measures of economic well-being among individuals in a group, among groups in a population, or among countries. Economic inequality is sometimes called income inequality, wealth inequality
- **Adverse effects on economy:** One country affects the economy of another country through international business. Moreover, large-scale exports discourage the industrial development of importing country. Consequently, the economy of the importing country suffers.
- **Competition with developed countries:** Developing countries are unable to compete with developed countries. It hampers the growth and development of developing countries, unless international business is controlled.
- **Rivalry among nations:** Intense competition and eagerness to export more commodities may lead rivalry among nations. As a consequence, international peace may be hampered.
- **Colonization:** Sometimes, the importing country is reduced to a colony due to economic and political dependence and industrial backwardness.
- **Exploitation:** International business leads to exploitation of developing countries the developed countries. The prosperous and dominant countries regulate the economy poor nations.

- **Legal problems:** Varied laws regulations and customs formalities followed different countries, have a direct b earring on their export and import trade.
- **Publicity of undesirable fashions:** Cultural values and heritages are not identical in all the countries. There are many aspects, which may not be suitable for our atmosphere, culture, tradition, etc. This, indecency is often found to be created in the name of cultural exchange.
- **Dumping policy:** Developed countries often sell their products to developing countries below the cost of production. As a result, industries in developing countries of the close down.
- **Complicated technical procedure:** International business in highly technical and it has complicated procedure. It involves various uses of important documents. It required expert services to cope with complicate procedures at different stages.
- **Shortage of goods in the exporting country**:Sometimes, traders prefer to sell their goods to other countries instate of in their own country in order to earn more profits. This results in the shortage of goods within the home country.
- **Adverse effects on home industry:** International business poses a threat to the survival of infant and nascent industries. Due to foreign competition and unrestricted imports upcoming industries in the home country may collapse.

1.9 SUMMARY

This unit discussed about the basic concepts of nature, scope, importance of international business. Recent trends in international business are discussed in the length.An account of advantages and disadvantages in international business is also given in this unit.

1.10 SELF ASSESSMENT QUESTIONS

1. Define international business?
2. Explain the nature and scope of international business in India?
3. Briefly explain the current trends in international business?
4. Mention the advantageous and disadvantageous in international business?

1.11 CASE STUDY

Case Study No.1

Dealing with China's Troubles

China's economy seems to be in trouble, which could be a very big problem for the world unless China's leaders and trading partners ensure that economic strains in the world's largest exporting nation do not lead to trade confrontations around the globe. China's housing bubble appears to be imploding, steel production is falling along with the demand for new construction and real estate developers are tottering, putting banks at risk. The Chinese government, which had been trying to curtail credit to slow the bubble's rise, abruptly changed course last month, reducing the amount of money banks must keep in reserve at the central bank for the first time since 2008. On top of everything else, foreign demand for Chinese exports has slowed.

A hard landing in China would have an immediate impact from Brazil to Russia, whose exports of steel, lumber and other commodities fed China's construction boom. And it will slow the world economy, which relies on China as one of the only remaining engines of growth. But the bigger risk could be a trade war. Chinese leaders eager to hang on to power by showing continued economic growth may be tempted to pursue beggar-thy-neighbor strategies and subsidize exports in ways that would further destabilize a fragile world economy already buffeted by a crisis in Europe.

There are worrying signs that Beijing is going the wrong way. Earlier this month, it imposed a volley of duties against American-made sport utility vehicles. It will have little economic importance as few of these vehicles are sold in China. But analysts viewed the move as a warning that China will retaliate against Washington's efforts to combat its subsidized exports. And the pace of appreciation of China's currency has slowed markedly. The Obama administration must also act with care. It is justified in challenging illegal trade practices, including pursuing its case at the World Trade Organization against illegal subsidies of Chinese makers of solar panels. But it should act multilaterally, including mustering other countries to add to the pressure on Beijing to act by the rules. Unilateral initiatives, like those in Congress to punish China for its cheap currency, are likely to cause more harm than good.

The ball is, however, in China's court. Beijing must understand that it is a bad idea to double-down on an export-led strategy. There are better alternatives, including sensible stimulus measures like investing in low-income housing and expanding government-run health insurance. These would boost consumer spending and growth, reducing China's dependence on export markets and investment bubbles. A policy switch like this would stimulate global growth. Sticking to the old game plan will drag the world down.

QUESTIONS

1. Discuses the overall case and explain the impact of china's international trade balance to reduce the trouble of china economy?

2. Briefly explain the major trade and tariff strategies to develop international business in china economy?

Case Study-2

Chinese New Year

It's the season when pundits traditionally make predictions about the year ahead. Mine concerns international economics: I predict that 2010 will be the year of China. And not in a good way. China has become a major financial and trade power. But it doesn't act like other big economies. Instead, it follows a mercantilist policy, keeping its trade surplus artificially high. And in today's depressed world, that policy is, to put it bluntly, predatory. Here's how it works: Unlike the dollar, the euro or the yen, whose values fluctuate freely, China's currency is pegged by official policy at about 6.8 yuan to the dollar. At this exchange rate, Chinese manufacturing has a large cost advantage over its rivals, leading to huge trade surpluses. Under normal circumstances, the inflow of dollars from those surpluses would push up the value of China's currency, unless it was offset by private investors heading the other way. And private investors are trying to get into China, not out of it. But China's government restricts capital inflows, even as it buys up dollars and parks them abroad, adding to a $2 trillion-plus hoard of foreign exchange reserves.

This policy is good for China's export-oriented state-industrial complex, not so good for Chinese consumers. But what about the rest of us? In the past, China's accumulation of foreign reserves, many of which were invested in American bonds, was arguably doing us a favor by keeping interest rates low — although what we did with those low interest rates was mainly to inflate a housing bubble. But right now the world is awash in cheap money,

looking for someplace to go. Short-term interest rates are close to zero; long-term interest rates are higher, but only because investors expect the zero-rate policy to end someday. China's bond purchases make little or no difference. Meanwhile, that trade surplus drains much-needed demand away from a depressed world economy. My back-of-the-envelope calculations suggest that for the next couple of years Chinese mercantilism may end up reducing U.S. employment by around 1.4 million jobs.

The Chinese refuse to acknowledge the problem. Recently Wen Jiabao, the prime minister, dismissed foreign complaints: "On one hand, you are asking for the yuan to appreciate, and on the other hand, you are taking all kinds of protectionist measures." Indeed: other countries are taking (modest) protectionist measures precisely because China refuses to let its currency rise. And more such measures are entirely appropriateeffectively steal jobs from other countries "turn out to be valid." He then went on to argue that persistently misaligned exchange rates create "genuine problems for free-trade apologetics." The best answer to these problems is getting exchange rates back to where they ought to be. But that's exactly what China is refusing to let happen.

The bottom line is that Chinese mercantilism is a growing problem, and the victims of that mercantilism have little to lose from a trade confrontation. So I'd urge China's government to reconsider its stubbornness. Otherwise, the very mild protectionism it's currently complaining about will be the start of something much bigger.

QUESTIONS

1) What are the justifications of the Chinese trade policy / trade surplus? What do they mean to China's trade partners?

2) Would a decrease of the Chinese trade surplus necessarily benefit to its trade partners?

1.12 NOTES

1.13 REFERNCES

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UNIT - 2 : MODES OF ENTRY INTO INTERNATIONAL BUSINESS

Structure :

2.0 Objectives

2.1 Introduction

2.2 Meaning and Definitions

2.3 Reasons to enter in to International Business

2.4 Factors Influencing International Business

2.5 Different Modes of Entering into International Business

2.6 Exporting

2.7 Licensing

2.8 Franchising

2.9 Special Modes

2.10 Foreign Direct Investment without Alliances

2.11 Foreign Direct Investment with Strategic Alliances

2.12 Summary

2.13 Self Assessment Questions

2.14 Case Study

2.15 Notes

2.16 References

2.0 OBJECTIVES

After studying this unit, you should be able to;

- Define the term International Business and entry mode.
- Describe the reasons for entering International Business.
- State the advantages and disadvantages in Franchising.
- Give a brief account on modes of entry into International Business.

2.1 INTRODUCTION

In today's global economy, what is the best way for a company to go global, go beyond its shores and enter untested territories on foreign shores? What is the safest way? What is the most profitable way? What is the most practical way? These are some of the questions every company has to answer when it makes globalization as its goal. These are also the issues that every company has to tackle when it puts its strategy to enter a new market. The advantages and the disadvantages associated with them.

In many cases, no company would like to share businesses or profits that it visualizes or expects in any markets. Often, companies are forced to form strategic alliances while entering new markets, or for that matter to continue servicing its current markets. This is the result of just one cause inadequacy, inadequacy related to different resources required to successfully service the markets and derive profits from it.

A mode of entry into the international market is the channel which your organization employs to gain an entry intothe new international market.Most of the companies decide to engage in international business activities for one of thefollowing reasons:-

a) To develop export sales in overseas markets.

b) To license technology.

c) To sell franchises.

d) To raise capital funds.

e) To find strategic partners or venture partners.

f) To find less expensive sources of raw material and/or components.

Choosing which method to use will depend upon a variety of factors such as what type of company and to some extent thedynamics of the particular industry.

2.2 MEANING AND DEFINITIONS

International Market Entry Mode is a widely used concept in international management, strategy and marketing literature, where it has been applied to explain the degree of internationalization, risk, and theperformance of the firm. The present paper explains the inappropriate use of this concept within currentinternational marketing literature. The comprehensive framework at the international marketentry modes will be presented in order to correctly use the concept in the economy.

a) International:

The term international has several meanings and is used differently; generally, it is concerning or belongingto all (or at least two) nations, and is used as an adjective (examples: international company, internationalproduct and international affairs). This adjective by nature explains incidents both moveable andimmovable. In their discussion of the international management Boyacigillerand Adler argued that by definition, international is contextual. It specifically includes theenvironment external to the domestic in which firms conduct business. In other context international means the crossing of national borders.

b) Business:

In business, the term market refers to a group of consumers or organizations interested in a product, hasthe resources to purchase the product, and is permitted by law and other regulations to acquire the product. Consumer market and business marketsare two different types of markets generally discussed within marketing literature. Consumer markets are theend-users of the product or service, and include individuals and households that are potential or actualbuyers of products and services. Business markets include individuals and organizations that are potential oractual buyers of goods and services that are used in, or in support of, the production of other products orservices that are supplied to others. The term market by definition covers both buyers and end users. Since a market is a collection of human elements, market by definition is a moveable element.

c) Entry Modes:

In a broad and general sense, entry modes or operation methods refer to the way of operating in the foreignmarket. In reaching strategic objectives, firms may choose from variousentry modes. Typical modes of entry include exporting, licensing, joint ventures, acquisitions, and greenfield Investments. Examiningdifferent types of entry modes and classify entry modes into contractual, exporting and investment modes.

2.3 REASONS TO ENTER INTO INTERNATIONAL BUSINESS

All organizations irrespective of whether they are small or medium or large are keen to enter into international business. Established companies are expanding their business. Many countries encourage trade, and removal of strangulating trade barriers motivates companies to aggressively multiply their targets. The governments of various countries are also determined to make their economy grow through international business, which has therefore become an inevitable part of their economic policy. Themotive behind international business can be as follows namely:

1. From an individual company's viewpoint

2. From the government's viewpoint.

From an individual company's viewpoint:

1) **Managing the product life cycle**: All companies have products which pass through different stages of their lifecycles. After the product reaches the last stage of the cycle called the declining stage in on country, it is important for the company to identify a few other countries where the whole life cycle stages could be encased**.**

For example : Enfield India reached maturity and the declining stage in India for the 350ccRoyal Enfield motorcycle. The company entered Kenya, West Indies, Mauritius and other destinations where heavy engine two wheelershave became popular.

2) **Geographic expansion as a growth strategy:** Even if companies expand their business at home, they may still overseas for new markets and better prospects.

For example, Arvind Mills expanded their business by either setting up units or opening warehouses abroad. Ranbaxy's growth is mainly attributed to geographic expansion every year to new territories.

3) **The adventurous spirit of younger generation in the organization**: The younger generation of business families has considerable internationalexposure. They arewilling to take risks and challenges and also create opportunities for their business.

For example Kumar Mangalam Birla of the Aditya Vikram Birla Group of companies has managed to establish their business operations in several countries across the globe in the last decade.

4) **Corporate ambition:**Every corporate in the country has strategic plans to multiply its sales turnover. In case some of the ventures fail, others will offset the losses because of multi-locational operations.

For example Coca cola is not doing well in a number of countries including India. But this will not affect the company because more than a hundred countries are contributing to offset the losses.

5) **Technology advantage:**Some companies have outstanding technology through which they enjoy core competencies. There is a need for such technology in all the countries. Biocon, Infosys and Tata Consultancy are known for their core competencies in biotechnology and software development respectively and a huge demand exists across many developed economies of the world for their technology.

6) **Building a corporate image:**Prior to profits and revenue generation, many companies first build their corporate image abroad. Once the image is built up, generating revenue is a comparatively easy task.

For example LG Electronics and Samsung Electronics built their image in India during the initial three to five years after their entry and generation of revenues and profits has been considerable as they have expanded to semi-urban and rural India overtaking traditional Indian brands Godrej and Videocon.

7) **Incentives and business impact:**Companies, which are involved in international business, enjoy fiscal, physical and infrastructural incentives while they set up business in the host country. The Adtiya Vikram Birla group enjoyed such incentives in Thailand and Indonesia. The home country may also offer many incentives in order to neutralize the cost and allow the country to compete in the world market.

For example recently the Prime Minister of Bangladesh Sheikh Hasina invited Indian companies to invest in proposed Special Economic Zones (SEZ) offering infrastructure facilities and tax holidays to such Indian companies.

8) **Labour advantage:** Many companies have a highly productive labour force. The unique skills may not be available throughout the world. Manufacturing units in India haveconsistently performed well, whether in the diamond industry (E.g. Surat) or automobile manufacturing.(**E.g**. Hyundai Motor car manufacturing plant near Chennai). Companies nurture the skills of such labour force and win world markets.

9) **New business opportunities:** Many companies have entered into business abroad, seeing unlimited opportunities.

For example: Health care companies like Cipla, Dr. Reddys Laboratories and Auronindo Pharma have entered into South American countries like Brazil and Argentina searching at the attractive business opportunities in such countries.

From a government viewpoint:

1) Earning valuable foreign exchange: Foreign exchange is necessary to balance the payments for imports. India imports crude oil, defense equipment, essential raw materials and medical equipment for which the payments have to be made in foreign exchange. If the exports are greater than imports it indicates a surplus in the balance of payments, on the other hand if the imports are higher and the exports are lower as has always been the case with India it indicates an adverse balance of payment in Indian economy.

2) Interdependency of nations: From time immemorial, nations have mutually depended on each other. Even during the era of Indus Valley civilization, Egypt and the Indus Valley depended on each other for various items. Today India depends on the Gulf regions for crude oil and in turn the Gulf region depends on India for rice, tea etc. Developed countries depend on developing countries for primary good, whereas developing countries depend on developed countries for value added finished products in India.

3) Trade theories and their impact: The theories of absolute advantage, comparative advantage and competitive advantage, which have been propounded by classical economists, indicate that a few nations have cost advantages in procurement of resources and production of finished products than other nations. Such advantages enable them to becompetitive. These resources may be in the form of labour, infrastructure, technology, natural resources or even a proactive policy of the government.

For example falling land prices in the South American countries of Paraguay and Uruguay has thrown open a tremendous opportunity for India edible oil companies to venture into offshore oilseeds cultivation with the industry representative body Solvent Extractor's Association (SEA) negotiating with ICICI Bank for a Rs. 150 Crore loan to part the proposed investment in the project.

4) Diplomatic relations: Diplomacy and trade always go hand in hand. Many sovereign nations send their diplomatic representatives to other countries with a motive of promoting trade besides maintaining cordial relations. Indian diplomats in Latin America have done a remarkable job of promoting India's business in the 1990s. However Pakistan being a failed nation has not been much successful in this endeavor.

5) Core competency of nations: Many countries are endowed with resources, which are produced at an optimum level. Such countries can compete well anywhere in the world. Rubber products from Malaysia, knitwear from India, rice from Thailand and wool from Australia are a few illustrations.

6) Investment for infrastructure: Over the years all countries have invested huge amounts of money on infrastructure by building airports, sea ports, economic zones and inland container terminals. If the trade activities do not increase and flourish, the country cannot recover the amounts invested. Hence, the government fixes targets for every infrastructure unit and time frame to achieve them. Economies like Mauritius, Hong Kong, Singapore, Malta and Cyprus invest in trade related infrastructure in order to elevate themselves to be foreign trade oriented economies.

7) National image: A new era has emerged from conquering countries by sword to winning by trade. A businessman gives priority to the image of the country he belongs to. We come across products with labels such as 'Made in Japan', 'Made in China' and 'Made in India'. Businessmen from Japan, China and India endeavor to make their products world class and bring credentials to their country while citizens achieve business success elsewhere in the world.

8) Foreign trade policy: All developing countries announce their foreign trade policies. A clear cut road map is drafted and given to promotional bodies so that timely implementation is possible. For instance the Commerce and Industry ministry Mr Anand Sharma has assured that the Government of India would extend its support to the slowdown

hit export sector by providing more sops in the Foreign Trade Policy (FTP) to be unveiled next month at a conference organized by the industry body Federation of Indian Chambers of Commerce and Industry (FICCI). He said that the FTP would be a mix of fiscal incentives and simplification of procedures for carrying out foreign trade.

9) National targets: By the year 2014, India aims to have a two percent share of the global market from the current level of one percent. Indian exports in 2014-15 were $154.73 Billion and India has set an export target of $200 Billion for 2014-15.

10) WTO and international agencies: The apex body of world trade, the World Trade Organization (WTO), a free, transparent and regulatory body upholds provisions related to elimination or reduction of tariff and non-tariff barriers. The International Bank for Reconstruction and Development (IBRD), popularly called the World Bank extends financial assistance on a soft loan basis in order to assist developing countries in the infrastructure and industrial development. The International Monetary Fund (IMF) maintains currency stability in various countries through regulatory mechanisms. Many more organizations like International Organization, International

StandardOrganization,International Telecommunication Union, and International Civil Aviation Organization are majorcatalysts to promote trade between nations.

2.4 FACTORS INFLUENCING INTERNATIONAL BUSINESS

Companies desiring to enter the foreign markets, face the dilemma while deciding method of entry into a given overseas location. Companies can reduce this dilemma by analyzing the decision factors.

Decision Factors: After deciding to go to foreign markets, the companies have to decide the mode of entry. This dilemma can he solved to some extent by considering the following factors:

- o Ownership Advantages
- o Location Advantages
- o Internationalization Advantages

♦ **Ownership Advantages:** Ownership advantages arethose benefits designed by a company by owning resources. These benefits provide competitive advantage to the company over itscompetitors. These advantages are both tangible and intangible.

FOR EXAMPLE: Toronto-based Inco. Ltd., of rich, nickel-bearing ores allowed the company to dominate the production of both primary nickel and nickel-based metal alloys.' Similarly, Tata Iron and Steel Company (TISCO) Ltd. owned its iron ore mines and coal nurses. This ownership grants the advantage of low cost producer to the company.

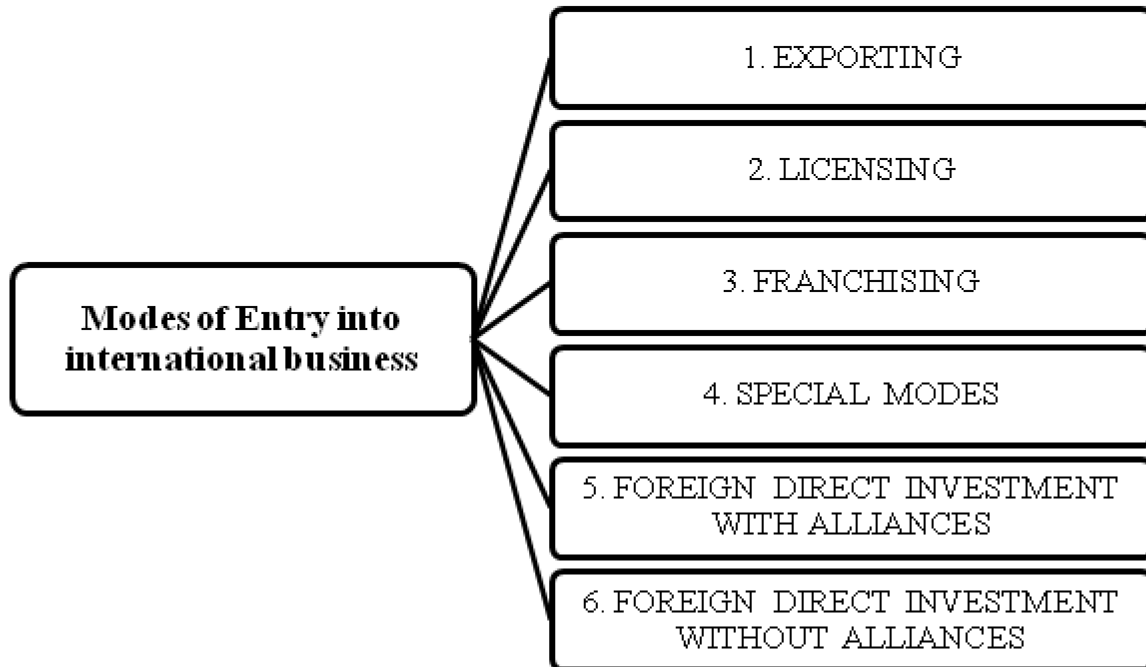
♦ **Location Advantages:** Certain locational factors grant benefit to the company when the manufacturing facilities are located in the host country rather than in the home country. If the company has locational advantages, it enters foreign markets through direct investment. Otherwise, if the location of manufacturing facilities in home country is advantageous than in host country, the company enters foreign markets through exporting. These locational factors include:

- Customer Needs, Preferences and Tastes
- Logistic Requirements
- Cheap Land Acquisition Cost
- Cheap Labour
- Political Stability
- Low Cost Raw Materials
- Climatic Conditions.

♦ **Internationalization Advantages**: Internationalization advantages are those benefits that a company gets by manufacturing goods or rendering services in the host country by itself rather than through contract arrangements with the companies in the host country. Sometimes the cost of negotiating, monitoring and enforcing an agreement with the host country's company would be difficult and costly. In such cases the company enters the international markets through direct investment. Otherwise, if the company thinks that the transaction costs are low, and the local companies in the host country can produce efficiently without the interest, the company can enter the foreign markets through contract manufacturing, franchising or licensing.

2.5 DIFFERENT MODES OF ENTERING INTO INTERNATIONAL BUSINESS

Many well known business units are highly successful in their home countries. However they are not able to face the challenges abroad. On the other hand there are organizations which do very well in international business but they lose out in the local arena. There are a number of organizations who do business, both in the domestic and international front, successfully, by properly allocating right resources in right countries. The following diagram shows that different modes of entering into international business as follows:



2.6 EXPORTING

Exporting refers to the process of selling of goods and services produced in the home country intosome other countries. While the reach of exportation is limited by transportation costs, govt. tariffs, marketcompetition and local customs and demand, it eradicates the need for repackaging, marketing and infrastructuredevelopment that other models call for. Exporting goods into a new market allows a society to judge how well itemswill sell and what, if any modifications are needed to the existing product so that it does well.

Exporting is one of the methods that organizations can use to enter foreign markets. In this entry method, products produced in one country are marketed in another country through business and distribution channels. Thus, it requires a significant investment in marketing strategies. In reality, exporting is the most traditional and well-established form of operating in foreign markets. It can be further categorized into direct or indirect export.

Exports differ from other entry modes in that the final or intermediate product is manufactured outside the target country and the subsequently transferred to it. On the one hand, indirect exporting uses agents located in the company's home country to handle the entire sale, including shipping and marketing, to the foreign market.

- Depending upon the size of the business, they are classified as small or large exporters. Current foreign trade policy in India provides incentives and facilities to promote both small exporters and large exporters who are status holders due to their performance in earning foreign exchange.
- Depending upon the product lines exported, they are classified as single product or multi product exporters.
- Depending upon their legal status they are classified as proprietary companies, partnership companies, private limited companies and public limited companies.
- Depending upon the destination of their exports, they are classified as single destination exporters or multi destination exporters. Nowadays, the majority of companies adopt the philosophy of multi product, multi locational, multi strategic and multi dimensional operations.
- Depending upon the frequency of their exports they are classified as occasional exporters and dynamic exporters.

Exporting can be of two types:-

- Direct Export
- Indirect Export.

▪ **Direct Export:** Direct exporting, on the other hand, means that the company itself is in charge of selling and delivering the products to the target market. Direct exporting also includes setting up an export department withinthe firm or having the firm's sales force sell directly to foreign customers or marketing intermediaries. Underdirect exporting, an

exporter must deal with a large number of foreign contacts, possibly one or more for eachcountry the company plans to enter. Although a direct exporting operation requires a larger degree of expertise, this method of market entry does provide the company with a greater degree of control over its distributionchannels than would indirect exporting.

Advantages of Direct Exporting are as follows:

- Control over selection of foreign markets and option of foreign representative firms.
- Good information feedback from the target marketplace, developing better relationships.
- Better protection of trademarks, patents, goodwill, and other intangible property
- Potentially greater sales, and therefore greater profit, than with indirect exporting.

Disadvantages of Direct Exporting are as follows:

- Higher start-up costs and higher risks as opposed to indirect exporting
- Requires higher investments of time, resources and personnel.
- Greater information requirements.
- Longer time-to-market as opposed to indirect exporting.

▪ **Indirect Exporting:** The business -entry technique that offers the lowest level of risk and the least market control is indirect export, in which products are carried abroad by others.The firm is not engaging in international marketing and no special activity is carried on within the firm; the sale is handled like domestic sales. Includes dealing through export management companies of foreign agents, merchants or distributors. Several types of intermediaries located in the domestic market are ready to assist a manufacturer in contacting international markets or buyers. The major advantage for managers using a domestic intermediary lies in that individual‘s knowledge of foreign market conditions. Particularly, for companies with little or no experience in exporting, theuse of a domestic intermediary provides the exporter with readily available expertise.

Advantages of indirect exporting are as follows:

- Fast market access.
- Concentration of resources towards production.

- Little or no financial commitment as the clients' exports usually covers most expenses associated with international sales.
- Low risk exists for companies who believe their domestic marketplace to be more important and for companies that are stilldeveloping their R&D, marketing, and sales strategies.
- Export management is outsourced, alleviating pressure from management team
- No direct handle of export operations.

Disadvantages of indirect marketing are as follows:

- Higher risk than with direct exporting.
- Little or no control over distribution, sales, marketing, etc. as opposed to direct exporting.
- Wrong choice of distributor, and by effect, market, may lead to inadequate market feedback affecting the internationalsuccess of the society.
- Potentially lower sales as compared to direct exporting (although low volume can be a central aspect of successfullyexporting directly). Export partners that incorrectly select a specific distributor/market may hinder a firm's functional ability.

2.7 LICENSING

The practice of licensing is a means to let out into foreign markets while building a presence on the soil. It entails granting permission to a separate company to manaufacture goods or offer services in your company's name. An international licensing agreementl allows foreign firms, either only or non-exclusively to manufacture a proprietor's product for a fixed term in a specific marketkplace. Summing up, in this foreign market entry mode, a licenosr in the home country makes limited rights or resources available to the licensee in the host nation. The rights or resources may include patents, tradmarks, managerial skills, technology, and others that can make it possible for the licensee to manufacture and sell in the host country a similar product to the one the licensor has already been producing and selling in the home country without calling for the licensor to open a new operation overseas. While licensing eliminates many of the expenses and time involved with expanding overseas, it does need constant monitoring, training, permits and renewal and may still want a spokesperson from your company on the site to do the

operations. The licensor earnings usually take forms of one time payments, expert fees and royalty payments usually calculated as a percent of gross revenue. As this mode of introduction, the transference of knowledge between the parent company and the licensee is strongly present; the decision of forming an international license agreement depends on the respect the host government show for intellectual property and on the power of the licensor to choose the right partners and avoid them to compete in each other market. Licensing is a relatively flexible work arrangement that can be customized to meet the demands and interests of both, licensor and licensee. In the conclusion, you can stop up with satellite companies in markets close to the globe and a global brand at little to no danger.

Advantages of Licensing:

- Obtain extra income for technical know-how and services.
- Reach new markets not accessible by export from existing installations.
- Quickly expand without much hazard and large cap investment.
- Save the path for future investments in the marketplace.
- Retain established markets closed by trade restrictions.
- Political risk is minimized as the licensee is usually 100% locally owned.
- Is highly attractive for companies that are new in international business.

Disadvantages of Licensing:

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

2.8 FRANCHISING

Franchising refers to the methods of practicing and using another person's business philosophy. The franchisor grants the independent operator the right to distribute its products, techniques, and trademarks for a percentage of gross monthly sales and a royalty fee. Various tangibles and intangibles such as national or internationaladvertising, training, and other support services are commonly made available by the franchisor. Agreements typically last from five to thirty years, withpremature cancellations or terminations of most contracts bearing serious consequences for franchisees.

The franchising system can be defined as: "A system in which semi-independent business owners (franchisees) pay fees and royalties to a parent company (franchiser) in return for the right to become identified with its trademark, to sell its products or services, and often to use its business format and system." Here the organization puts together a package of the, successful ingredients that made them a success in their home market and then franchise this package to overseas investors.

Advantages of franchise:

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

Disadvantages of franchise:

- Franchises may turn into future contenders.
- Demand of franchises may be scarce when starting to franchise a company, which can contribute to making agreementswith the wrong prospects.
- A wrong franchisee may ruin the company's name and reputation in the marketplace.
- Comparing to other styles such as exporting and even licensing, international franchising requires a bigger financialinvestment to attract prospects and support and manage franchises.

2.9 SPECIAL MODES

These have special strategies and include:

1) **Turnkey Projects**:

Turn-key refers to something that is ready for immediate use, generally used in the sale or supply of goods or services. The term is common in the construction industry, for instance, in which it refers to the bundling of materials and labor by sub-contractors. A "turnkey" job by a plumber would include the parts (toilets, tub, faucets, pipes, etc.) as well as the plumber's labor, without any contribution by the general contractors. This is commonly used in motorsports to describe a car being sold with drive train (engine, transmission, etc.) as a racer may prefer to keep the pieces to use in another vehicle to preserve a combination. Similarly, this term may be used to advertise the sale of an established business, including all the equipment necessary to run it, or by a business-to-business supplier providing complete packages for business start-up.

Use in business:

In a turnkey business transaction, different entities are responsible for setting up a plant or equipment (e.g. trains/infrastructure) and for putting it into operation. It can include contractual actions - at least through the system, subsystem, or equipment installation phase. It may also include follow-on contractual actions, such as testing, training, logistical, and operational support. It is often given to the best bidder in a procurement process. Turnkey projects can also be extended, known as turnkey plus, where there is perhaps a small equity interest by the supplier and it will later on continue its operation through a management contract or licensing. Turnkey is often used to describe a home built ready for the customer to move in. If a contractor builds a "turnkey home" they frame the structure and finish the interior. Everything is completed down to the cabinets and carpet.

2) **Management Contracts:**

A management contract is an arrangement under which operational control of an enterprise is vested by contract in a separate enterprise which performs the necessary managerial functions in return for a fee. Management contracts involve not just selling a method of doing things (as with franchising or licensing) but involve actually doing them. A management contract can involve a wide range of functions, such as technical operation of a production facility, management of personnel, accounting, marketing services and training.

Management contracts have been used to a wide extent in the airline industry, and when foreign government action restricts other entry methods. Management contracts are often formed where there is a lack of local skills to run a project. It is an alternative to foreign direct investment as it does not involve as high risk and can yield higher returns for the company.

3) **Contract Manufacturing:**

Contract manufacturing is a process that established a working agreement between two companies. As part of the agreement, one company will custom produce parts or other materials on behalf of their client. In most cases, the manufacturer will also handle the ordering and shipment processes for the client. As a result, the client does not have to maintain manufacturing facilities, purchase raw materials, or hire labor in order to produce the finished goods. The basic working model used by contract manufacturers translates well into many different industries. Since the process is essentially outsourcing production to a partner who will privately brand the end product, there are a number of different business ventures that can make use of a contract manufacturing arrangement. There are a number of examples of pharmaceutical contract manufacturing currently functioning today, as well as similar arrangements in food manufacturing, the creation of computer components and other forms of electronic contract manufacturing. Even industries like personal care and hygiene products, automotive parts, and medical supplies are often created under the terms of a contract manufacture agreement. There are several advantages to a contract manufacturing arrangement. For the manufacturer, there is the guarantee of steady work. Having contracts in place that commit to certain levels of production for one, two and even five year periods makes it much easier to forecast the future financial stability of the company. For the client, there is no need to purchase or rent production facilities, buy equipment, purchase raw materials, or hire and trainemployees to produce the goods. There are also no headaches from dealing with employees who fail to report to work, equipment that breaks down, or any of the other minor details that any manufacturing company must face daily. All the client has to do is generate sales, forward orders to the manufacturer, and keep accurate records of all income and expenses associated with the business venture.

2.10 FOREIGN DIRECT INVESTMENT WITHOUT ALLIANCES

Some companies enter the foreign markets through exporting, licensing, franchising etc., get the knowledge and awareness of the foreign markets, culture of the country, customers' preferences, political situation of the country etc and then establish manufacturing facilities by ownership in the foreign countries. Baskin Robbin's in Russia followed this strategy Greenfield investment .A form of foreign direct investment where a parent company starts a new venture in a foreign country by constructing new operational facilities from the ground up. In addition to building new facilities, most parent companies also create new long-term jobs in the foreign country by hiring new employees.

This is opposite to a brown field investment. Green field investments occur when multinational corporations enter into developing countries to build new factories and/or stores. Developing countries often offer prospective companies tax-breaks, subsidies and other types of incentives to set up green field investments. Governments often see that losing corporate tax revenue is a small price to pay if jobs are created and knowledge and technology is gained to boost the country's human capital.

2.11 FOREIGN DIRECT INVESTMENT WITH STRATEGIC ALLIANCES

Innovations, creations, productivity, growth, expansions and diversifications in recent years are mostly accomplished by strategic alliances adopted by various companies like mergers, acquisitions and joint ventures. Strategic alliances are a co-operative approach to achieve the larger goals. Strategic alliances take different forms like licensing, franchising, contract manufacturing, JVs etc. Alliances are a strategy to explore a new market which the companies individually cannot do. Example: Xerox of USA and Fuji of Japan collaborated to explore new markets in Europe and Pacific Rim.

1) Mergers and Acquisition:

International mergers and acquisitions are growing day by day. These mergers and acquisitions refer to those mergers and acquisitions that are taking place beyond theboundaries of a particular country. International mergers and acquisitions are also termed as global mergers and acquisitions or cross-border mergers and acquisitions. Globalization and worldwide financial reforms have collectively contributed towards the development of

international mergers and acquisitions to a substantial extent. International mergers and acquisitions are taking place in different forms, for example horizontal mergers, vertical mergers, conglomerate mergers, reverse mergers, dilutive mergers, accretive mergers and others.

International mergers and acquisitions are performed for the purpose of obtaining some strategic benefits in the markets of a particular country. With the help of international mergers and acquisitions, multinational corporations can enjoy a number of advantages, which include economies of scale and market dominance. International mergers and acquisitions play an important role behind the growth of a company. These deals or transactions help a large number of companies penetrate into new markets fast and attain economies of scale. They also stimulate foreign directinvestment or FDI.The reputed international mergers and acquisitions agencies also provide educational programs and training in order to grow the expertise of the merger and acquisition professionals working in the global merger and acquisitions sector. The rules and regulations regarding international mergers and acquisitions keep on changing constantly and it is mandatory that the parties to international mergers and acquisitions get themselves updated with the various amendments. Numerous investment bank professionals, consultants and attorneys are there to offer valuable and knowledgeable recommendations to the merger and acquisition clients. Methods of Financing International Mergers and Acquisitions: Usually, the following methods are implemented for funding international mergers and acquisitions.

2) Joint venture:

A Joint Venture is an entity formed between two or more parties to undertake economic activity together. The parties agree to create a new entity to share in the revenues, expenses, and control of the enterprise. Joint ventures can be defined as "an enterprise in which two or more investors share ownership and control over property rights and operation". The venture can be for one specific project only, or a continuing business relationship. Entering into a joint venture is a major decision. Businesses of any size can use joint ventures to strengthen long-term relationships or to collaborate on short-term projects.

Joint Ventures tend to be equity-based, i.e. a young fellowship is set up with parties owning appropriation of the new line. To portion out the danger of market entry into a foreign market, two systems may get together toorganize a company to work in the host state. The two companies may share knowledge and expertise to help them in thedevelopment

of Company; of course profits will have to be apportioned between the two houses. Parties to an internationaljoint venture share the costs and burdens of operations while profiting equally from a marketplace share in both nations.

Advantages of joint venture:

- Forming joint venture is a popular strategy when venturinga broad because it combines the expertise of the foreign company and the market of the local company.
- Sharing of risks with a partner
- Joint financial strength
- A joint venture also shares the costs and risks of venturing into a new country.
- In fact, joint venture are sometimes the only permitted way to penetrate a market, as some countries impose having a local partner as a market-entrycriterion.
- Access to new markets and distribution networks.
- Access to greater resources, including specialized staff and technology.

Disadvantages of joint venture:

- Loss of effective management control can be a major disadvantage of thejoint venture with a local owner.
- The local owner may hold majorityownership of the joint venture and may have a greater say in businessdecisions and his lack of expertise could result in reduced profits,
- Shared profits are another huge disadvantage of the joint venture.
- Potential for conflict with your partner.
- Might lead to an imbalance in levels of expertise, investment or assets, brought into the venture by the different partners.
- Different cultures and management styles result in poor integration andco-operation.

2.12 SUMMARY

This unit discussed about the basic concepts of exporting, likening, franchising, foreign direct investment etc. Different modes of entering into international business are discussed in the length. An account ofreasons to enter International business is also given in this unit.

2.13 SELF ASSESSMENT QUESTIONS

1. What do you mean by joint venture?
2. Explain the reasons of entering into international business?
3. Briefly explain the different modes of entering into international business?
4. What do you mean by exporting and mention the major types of exporting?

2.14 CASE STUDY

Case study No.1

First venture abroad: Tokyo Disneyland

On April 15, 1983 Tokyo Disneyland (TDL), the first international Disney theme park, opened on reclaimed shallow areas of Tokyo Bay. Nowadays, with over 17 million visitors a year and more than 45 rides covering an area of 115 acres, Tokyo Disneyland ranks as one of the most highly visited theme parks in the world. By the end of the 1980s Tokyo Disneyland beat a record as it was the only Disney Park able to attract more than 15 million visitors a year. In the year 1989, thanks to the licensing agreement with TDL, Disney received royalties amounting to $573 million – a considerable figure given that it exceeded the operating income received from both Disney's US theme parks.

Tokyo Disneyland is owned and operated by a Japanese company, Oriental Land Company Limited (OLCL), which is a conglomerate of several distinct Japanese companies. In the mid-1960s OLCL's main objective was to exploit the area of the Tokyo Bay, since such land was ordered by the Japanese government to be utilized for "leisure" purposes only. It was at this point that OLCL sent study teams around the world to determine the best use for the land. After one of the teams visited the California Disneyland the decision was made to approach Disney with an offer to open a Disneyland in Japan. The company was interested but at the time was busy developing the Florida Park. Moreover, top managers at

Disney were deeply concerned about building a Disney theme park in a country with a completely different culture and viewed the venture as too risky, and they were probably right.

The two parties came out with a licensing agreement that would render OLCL exposed to all the risks while leaving Disney safe. OLCL was licensed by Disney to use its trademarks, intellectual property and engineering designs for rides. In return Disney would receive royalties of 10% on the admissions revenues and 5% on sales of food, beverages and souvenirs while also providing ongoing technical assistance to OLCL

Despite common knowledge, Tokyo Disneyland is more a Japanese product than a perfect copy of the American style. The fact that Tokyo Disneyland is owned by a Japanese company. Caused the Tokyo Park to adhere almost perfectly to local regulations and customs. Therefore, Tokyo Disneyland did not face all the issues that generally arise with other forms of international activities and entering the Japanese market was overall a smooth process.A licensing agreement, given Disney's lack of knowledge of the local market, was the right choice

QUESTIONS

1. Briefly analysis overall circumstances of this case and Disney company which kind of entry modes has been used to entering international business?
2. Describe the main impact of DisneyCompany selecting entry mode of joint venture to entering into international business?

Case Study No.2

Garments in Bangladesh

The clothing business is flourishing despite Chinese competition, Until 2005, the garment trade in Bangladesh, as in many poor countries, sprang up because of the quota system giving poor countries preferential access to important markets such as the European Union (EU) and America. So when the rules governing exports to rich countries were changed at the beginning of 2005, Bangladeshis feared huge job losses. Once the quotas that had guaranteed a share of the market to all exporting countries were abolished and replaced with a free trade-based system, they assumed, China would how over up all the jobs in the industry.

Yet Bangladesh's garment exports have been booming since then. In 2006, it sent clothes worth $8.9 billion to rich countries and up to $10.3 billion in 2010.Revenues from the garment trade account for about 80% of all exports and are double the remittances sent home by Bangladeshis working overseas—the economy's other pillar. When the recession hit developed nations in 2008, big importers like Wal-Mart in fact increased their imports to better serve their customers.

The country has made use of its labour, its only abundant resource. Wages are lower than in China, India, Cambodia or Vietnam, its main competitors. About 2m people—90% of them women—work in the rag trade, and another 15m jobs depend indirectly on making clothes, through firms that produce thread, buttons and textiles. On today's trends, Bangladesh's garment exports will soon overtake those of its giant neighbor, India. Cheap labour, along with reluctance among buyers to rely on China for all their purchases, appears to have won the Bangladeshi industry a reprieve. Investment in productivity boosting technologies and the existence of a vibrant network of supporting industries have also played a role in Bangladesh's textile industry's competitiveness.

Bangladesh is most competitive in knitwear, which has grown from 15% of its garment exports in the early 1990s to over half this year. The secret is the inputs, some three-quarters of which are made locally. That saves firms the transport and storage costs, import duties and long lead-times that come with the imported "woven" fabric used to make shirts and trousers. It also entitles them to duty-free access to the European Union. "In the long-run, the woven garment sector will probably leave Bangladesh", says Mohammed Quasem, a knitwear tycoon whose latest factory is about to start up in the town of Gazipur with 10,000 workers.

The recent growth in exports to its two biggest markets, the EU and America, occurred since the pair imposed transitionary restrictions on Chinese exports, that came to an end in 2008. Meanwhile, in Canada, the only big market that places no restrictions on China, Bangladesh had lost market share. To reduce the risk of a similar setback in America, Bangladesh enlisted Muhammad Yunus, its Nobel prize-winning micro-credit pioneer, to lobby for duty-free access, "to put Bangladesh on par with other least developed countries". But bosses feared that the stricter labour standards that would accompany such a concession might outweigh the benefits. Most garment workers are notunionized, although big protests did force the government to announce a near doubling of the minimum wage to Tk1662

($25) a month last year—the first increase since 1994.In the short run, garment-makers of all stripes are simply trying to survive an indiscriminate anti-corruption drive launched by Bangladesh's recently installed military regime a disadvantage for which neither low wages nor trade preferences can compensate.

QUESTIONS:

1. What is the current global position of Bangladesh's textile and garment industry?
2. Suggest one of the entry modes of international business? How can it be explained?

2.15 NOTES

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UNIT-3 : INTERNATIONALIZATION AND MULTINATIONAL CORPORATIONS MANAGERIAL IMPLICATIONS

Structure :

3.0 Objectives

3.1 Introduction

3.2 Meaning of Internationalisation

3.3 Internationalization Process

3.4 Internationalization Theory

3.5 Managerial Implications in International Business

3.6 Multinational Corporations and Their Involvement in International Business

3.7 Types of MNCs Invovled in International Business

3.8 The Structure and Critics MNCs

3.9 The Role of MNCs in International Business

3.10 Summary

3.11 Self Assessment Questions

3.12 Case Study

3.13 Notes

3.14 References

3.0 OBJECTIVES

After studying this unit, you should be able to;

- Define the term internationalization and MNCs.
- Describe the process of internationalization in international business.
- Explain the multinational corporations and their involvement in international business.
- Give a brief account on role of MNCs in international business.

3.1 INTRODUCTION

Internationalization of higher education is not new. Many of the earliest scholars travelled widely in Europe, but in the early modern era the focus on national development and internationalization became marginalized. Europe have aimed to promote mutual understanding and encourage collaboration among higher education institutions. Today, however, the accelerating rate of globalization has focused attention once again on student mobility, international research collaboration and education as an export industry.

In today's age of global knowledge and technology, an interconnected network and global awareness are increasingly viewed as major and sought-after assets. With the current labour market requiring graduates to have international, foreign language and intercultural skills to be able to interact in a global setting, institutions are placing more importance on internationalization.The number of students enrolled in higher education outside their country of citizenship practically doubled trend is likely to be continue.

The landscape of internationalized higher education is rapidly evolving. New countries and institutions are entering the global talent pool and challenging the established position of the traditional champions of international education. The English language is dominating new programmers and campuses are being built to welcome an increasing from emerging economies. New forms of institutions, programmers and teaching methods are being set up. In addition, the effects of the economic and financial crises are far-reaching and long-lasting, changing the flows of students and faculty across continents as well as brain circulation.

3.2 MEANING OF INTERNATIONALIZATION

Internationalization occurs only when firms perceive the benefits to exceed the costs. When internalization leads to foreign investment the firm may incur political and commercial risks due to unfamiliarity with the foreign environment. These are known as 'costs of doing business abroad' arising from the 'liability of foreignness. When such costs are high a firm may license or outsource production to an independent firm; or it may produce at home and export to the country instead. Internationalization is the process of increasing involvement of enterprises in international markets, although there is no agreed definition of internationalization. There are several internationalization theories which try to explain why there are international activities.

3.3 INTERNATIONALIZATION PROCESS

Most companies pass through different stages of international business. There are, of course, many companies which have transacted international business since their very beginning, including 100% export-oriented companies, the development of their international business would pass through different stages of evolution. A firm which is entirely domestic in its activities normally passes through different stages of internationalization before it becomes truly global. There are many companies which enthusiastically and systematically go international as part of their corporate plan.

A firm may initiate exports on an experimental basis, and if the results are satisfying, it would enlarge international business. In due course, it would be establish offices, branches or subsidiaries or joint ventures abroad. The expansionary (expanding) process may also be characterized by increasing the product mix and the number of market segments, markets & countries of operation. In the process, the company could be expected to become multinational or finally global.

In short, in many firms overseas business initially starts with low degree of commitment or involvement; but they gradually develop a global outlook and embark upon overseas business in a big way.

The following are the stages through which a company passes:

1. Domestic Company
2. International Company

3. Multinational Company
4. Global or Transnational Company

- **Domestic Company:**

A purely domestic company operates domestically because it never considers the alternative of going international. The growing stage-one company, when it reaches growth limits in its primary market, diversifies (expand/branch out/spread) into new markets, products &technologies instead of focusing on penetrating international markets. However, if factors like domestic market constraints, foreign market prospects, increasing competition etc, make the company reorient its strategies to top foreign market potential, it would be moving to the next stage in the evolution.A domestic company may extend(expand, enlarge increase) by exporting, licensing and franchising. The company may develop a more serious attribute towards foreign business and move to the next stage of development i.e., international company.

- **International Company:**

An international company is normally the second stage in the development of a company towards the transnational corporation. The marketing mix developed for the home market is extended into foreign markets.

- **Multinational Company:**

When a company decides to respond to market differences, it evolves into a stage-three multinational that pursues a multi-domestic strategy. The focus of the stage-three company is multinational, or in strategic terms, multi-domestic (i.e. the company formulates a unique strategy for each country in which it conducts business). In multinational companies, "each foreign subsidiary is managed as if it were an independent city state. The subsidiaries are part of an area structure in which each country is part of a regional organization that reports to world headquarters.

- **Global/Transnational Company:**

According to Keegan, a global company represents stage-four and a transnational company stage-five, in the evolution of companies. However, several people use these terms as synonyms and by global corporation they refer to the final stage in development of the corporation. According to Keegan, "The global company will have either a global marketing

strategy or a global sourcing strategy but not both. It will either focus on a global markets and source from the home or a single country to supply these markets, or it will focus on the domestic market & source from the world to supply its domestic channels. However, all strategies that is product development, production (including sourcing), marketing, etc, will be global with respect to the global corporation.The international company is much more than a company with sales, investments and operations in many countries. This company, which is increasingly dominating markets and industries around the world, is an integrated world enterprise that links global resources with global markets at a profit. This is the company that thinks globally and acts locally. It adopts a global strategy allowing it to minimize adaption in countries to that which will actually add value to the country customer.

The internationalization process of the individual firm is most closely associated with the research of Johanson and Wiedersheim-Paul and Johanson and Vahlne. Their work has probably also been the inspiration for the development of the Innovation-Related Internationalization Models. Johanson and Wiedersheim-Paul [1975] distinguish between four different modes of entering an international market, where the successive stages represent higher degrees of international involvement:

a) Stage 1: No regular export activities.

b) Stage 2: Export via independent representatives (agents).

c) Stage 3: Establishment of an overseas sales subsidiary.

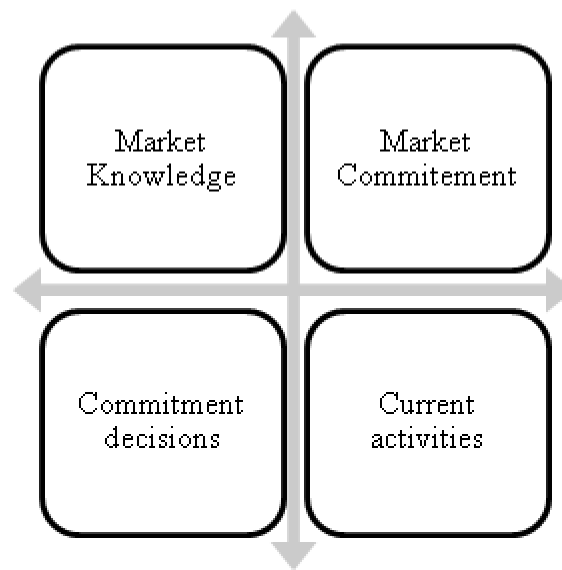
d) Stage 4: Overseas production/manufacturing units.

The assumption that the internationalization of a firm develops according to a chain of establishment was originally supported by evidence from a case study of four Swedish firms. The sequence of stages was restricted to a specific country market. The entry mode literature has further developed the evolution of international supply methods, including licensing and joint venture arrangements. To explain the internationalization across country markets, it was firms would enter new markets with successively greater psychic distance. The concept, psychic distance, has been defined as factors preventing or disturbing the flow of information between firm and market, including factors such as differences in language, culture, political systems, level of education, or level of industrial development.

The main structure is given by the distinction between state and change aspects of internationalization variables. The state aspects are the market commitment (resource

commitment to the foreign markets), and knowledge about foreign markets and operations. The change aspects are decisions to commit resources and performance of current business activities, a mechanism. International activities require both general knowledge and market-specific knowledge. Market-specific knowledge is assumed to be gained mainly through experience in the market, whereas knowledge of the operations can be transferred from one country to another.

The following diagram of internationalization process of the firm:



Finally, there is the continuing internationalization process of the global company in an otherwise nationally structured industry. Such a firm could be expected to be in an extremely strong position vis-a-vis its actual and potential competitors for obvious reasons. And being global, it could be expected to have the experience to cope with any culture or environment. It can use its strength "to shop around," largely undisturbed by competition. It can enter whatever markets it prefers in the order it prefers. The speed of the process with probably be primarily limited by the supply of management. It is quite possible that exports will be a sufficient means of market penetration. However, if transportation costs prevent exports, the global company might well establish a Greenfield operation. It has either no or limited competition to fear, and it might pay dividends to take the time and resources to build up a local organization that exactly corresponds to the needs of the firm.

3.4 INTERNATIONALIZATION THEORY

Internalization theory tries to explain whether MNCs use leasing or licensing methods for the sale of their products abroad or they produce abroad through FDI by themselves. In other words it answers the question why a company prefers FDI instead of producing in the home country and then exporting it. The theory is based on the study of Buckley and Casson in 1976. According to the theory firms maximize their profits in an imperfect competition environment. In this process if,

- Transportation costs are high, there are trade barriers,
- There is the problem of inadequate foreign market information,
- There is information asymmetries between sellers and buyers,
- There are transaction cost-increasing conditions, the firm chooses internalization and make FDI.

Thus firms may avoid delays, bargaining and customer ambiguities, and take the opportunities of the minimization of governmental regulations' adverse effects through transfer pricing and price differentiation between different markets.

1. OLI Paradigm (Eclectic Paradigm):

The theory has the most extensive scope among FDI theories. Dunning has created the theory by combining many former studies (eclectic).According to Dunning production of a firm in a foreign country depends on these three conditions:

1. Firm should have tangible and intangible assets and skills so that can compete with the domestic firms of the host country who have national knowledge and experience.
2. For a firm through an advantage taken from the host country it should be more profitable to produce in the host country than to produce in the home country and export it.
3. Making FDI should be more profitable than selling, leasing or licensing the skills.

These conditions which are called OLI by Dunning are the ownership (O), location (L) and internalization (I) advantages respectively.

The ownership advantage can be achieved through privileged ownership of some income bearing properties (patent, trade secrets or trademarks) and governance of separate but related activities from one head firm (economies of scale and synergy, diffusion of

geographical risk and cross-country arbitrage).The location advantages are those caused by the superiority of production method in the host country, high transportation costs, cheap labor, and proximity to the consumers, local image and the foreign governments' trade applications.

Internalization advantage means the advantage that is caused by the imperfect competition.Although the theory is much broader than the others, it is also criticized. First criticism is the decreased significance of the variables as they are immense. The variables are correlated with others. Another criticism is that the theory is static and cannot explain the paths and processes of firms in the internalization process. Some blames the theory as entirely micro economic and even claims that it has no difference with the theory of internalization.

2. Other Theories:

Although these theories are not as popular as the main stream theories, they have significant contributions in the development of main stream theories.

Caves Economies: According to Caves, if a firm wants to invest horizontally (the production of the same product in another location) its property should prevail the advantage of domestic firms in the host country resulting from being resident and the firm should decide that FDI is more profitable than either export or licensing.

Caves believe that the following factors are important in the decision stage of FDI:

Product differentiation (is formed with subjective alterations by little physical modifications, branding, advertisement, marketing strategies and differences in the complementary products; and maintained by property rights and high cost barriers against physical imitation).

- Oligopolistic market structure
- Organizational skills
- Transportation costs and tariffs
- R&D activities
- The FDI decision in vertical foreign investment (the production in which each part of a product may be produced in different locations and finally assembled) is made after the determination of optimal vertical integration level.

3. Oligopolistic Reaction Theory:

According to the Oligopolistic Reaction Theory of Knickerbocker, one firm invests in one country in order to increase its market share. Immediately thereafter the other rival oligopolistic firms invest in that country in order not to lose their market shares. This kind of investment is also known as "Follow-the-leader". Besides as firms avoid ambiguities and risks, they wait for an investment of a leader firm before themselves and its consequences and then they invest. This constitutes the reasoning of follow-the-leader theory.

4. Hymer and Kindleberger's Theory:

The most important contribution of Hymen's doctoral dissertation -completed in 1960- to the theory of FDI is that it explains why MNCs transfer intermediate goods such as knowledge and technology among countries.. Hymer separates two types of the division of labor. He states that the division of labor among firms is controlled by markets and therefore is the subject of international trade theory and the intra-firm division of labor is controlled by the entrepreneurs.

Hymer and his instructor Kindleberger rather focus on firm-specific factors. Foreign firms have superiority such as the ability to find cheap capital, marketing experience, privileged entry permits for some markets, patented or non-tradable technology, managerial efficiencies and economies of scale. Hymer and Kindleberger cannot explain precisely why a firm having these advantages tends to make FDI instead of export or leasing. Therefore the theory remains only as a guideline to other theories. On the other hand all the studies following Hymer's dissertation are constructed upon Hymer's ideas.

3.5 MANAGERIAL IMPLICATIONS IN INTERNATIONAL BUSINESS

The concept of managerial implications implies many companies recognize the benefits of employing a diverse workforce and, therefore, focus their efforts on hiring the best, most diverse employees available. Although workplace diversity offers companies many advantages, it also presents challenges for managers. As organizational diversity grows within a company, managers must dedicate much of their attention toward solving diversity challenges and creating a cohesive work environment. Leaders and managers ultimately determine whether diversity in the workplace is successful by creating effective policies, establishing the organization's vision and training employees on the importance of diversity.

An important element in a company experiencing a growth in diversity is the development and implementation of diversity policies. Managerial implication is very important concept considering international business. Thesebusiness activities which involve cross-border transactions of goods, services, resources between two or more nations internationalization is considered as an internally induced process. Transactions of economic resources include capital, skills, people etc. Developing diversity policies helps managers understand discrimination and the consequences for participating in discriminatory practices .developing and implementing diversity policies also helps companies maintain a competitive advantage over competitors who fail to take the same initiative. A successful organization holds its leaders and managers responsible for incorporating their policies and aligning employees with the company's mission and vision regarding diversity.

3.6 MULTINATIONAL CORPORATIONS AND THEIR INVOLVEMENT IN INTERNATIONAL BUSINESS

The multinational company (MNC) is a company involved in producing and marketing its outputs in several countries. The outputs may be goods, services, or various combinations of both. To develop the capacity to produce and market multination ally a firm must acquire managerial control over operating entities in a number of countries; in other words, it must establish subsidiary companies in all host economies and endow each with the necessary operating assets, such as factories, mines, department stores, hotels, banks, or whatever is required in the particular company's mines, field of activity.

The capacity to act simultaneously in numbers of countries of countries sets the MNC clearly apart from the domestic or unemotional company (UNC). The UNC has all its operating assets and organizational subunits (departments, divisions, subsidiaries) in its home country. It may on occasion engage in exporting or importing by transacting with foreign firms, but its own capacity to function is limited to the domestic market.

Some MNCs are motivated by profits, some by raw material, and some by markets, some by diversification, some by the stability that diversification of markets and operating environments may offer. Many pursue several or all of these objectives. Furthermore, the objectives vary with time, with place, and with circumstances. From the market perspective, some MNCs cater to individual consumers, some to government procurement, some to the industrial sector, and some to the military. Some MNCs operate in a competitive marketing atmosphere, other in oligopolistic rivalry, and some in monopolistic autonomy.

Neither in structure nor in behavior are all the MNCs alike. Rather, they are very highly differentiated and each variegated economic entities, each ranking as a complex organization and each possessing characteristics of its own. Organizations that engage in international business vary considerably in size and the extent to which their business activities cross national boundaries. One special type of organization engaged in global business is the multinational corporation (MNC). An MNC is an organization that engages in production or service activities through its own affiliates in several countries, maintains control over the policies of those affiliates, and manages from a global perspective. With a global perspective, top managers allocate resources and coordinate activities to take the best possible advantage of favourable business conditions throughout the world.

INDIAN MNCs CONTRIBUTES TO INTERNATIONAL BUSINESS (LIST OF INDIAN ACQUIRERS OF FIRMS ABROAD) :

- Tata motors to takeover Daewoo in South Korea for $118 million
- Ambanis to takeover flag international for $211 million
- Ranbaxy to takeover RPG Aventis a France based firm
- Wockhardt acquired CP pharmanceutical and Wallis Laboratories –both of Britain
- Hindalco took over mount garden and Nifty—copper mines in Australia
- Sundaram Fasteners has acquired Dana spicer Europe, the British arm of an MNC.
- Amtek Auto has acquired the GWK group in the UK
- Kirloskar Brothers took over SPP pumps, UK.

The rise of globalization and a globalized economy, particularly the proliferation of Multinational Corporations (MNCs), have raised questions about the role of business in global governance. The increased presence of MNCs in the International Political Economy has led to the startling reality that companies can be political entities and their influence as political actors can be sizeable, both in positive and negative capacities. A contemporaneous trend used to combat the negative actions of MNCs has been the emergence of Corporate Social Responsibility (CSR), the principle that companies have a duty to practice better business norms and use their resources for the best interest of the international community. Nevertheless the nature of certain corporate practices continues to be controversial, sparking a debate on the best way to regulate business across national borders. MNCs have been

evaluated and studied from both internal and external frameworks with accountability awarded to the companies themselves, the governments of the home country, the governments of the host country, the citizens of the host country, transnational soft law agreements, and the global social community. The discrepancies in the resulting literature conclude the only real conclusion is that there is no transparent path to standardize to corporate citizenship.

Multinational corporations directly inhibit the development of ESCR when they deliberately avoid or reduce the level of payments to local communities through taxation. It is common knowledge that MNCs have teams of accountants hired on the basis of accomplishing this very objective. Whether through semi-legal accounting strategies or by using their tremendous influence to convince host nations to reduce their tax burden, MNCs limit the enjoyment of ESCR for millions of people in the developing world.

3.7 TYPES OF MNCs INVOVLED IN INTERNATIONAL BUSINESS

♦ **Equity-based MNCs:** Many older MNCs obtained their multinational capacities through direct foreign investments. They either built from ground up or bought the equity of the desired capital assets, such as assembly plants, pharmaceutical laboratories, department stores, banks, flour mill, or whatever operating facilities they use. Either way, they became owners of these operating entities. Equity ownership provides the basis for managerial control over the foreign-based entities and opens the way for their affiliation or integration with one another internationally by the headquarters firm. The fact that all the older MNCs and many new ones have followed the equity ownership route has created the impression that direct foreign investment is the only way for a firm to multinationalize. This is not true. Direct foreign investments are synonymous with MNCs are no longer synonymous with direct investments. The MNCs in which the managerial control derives from equity ownership of affiliated enterprises in different host economies fall into four main types:

a. **Resource-based companies**. The main mission of these companies is to produce raw materials, such as metallic ores, oil, rubber, and tropical plantation crops (bananas, coffee, dates). Many of these are among the very oldest MNCs , with roots in the colonial era.

b. Public utility companies. These companies, which include military arsenals, differ from other economic sectors in that they are either natural monopolies or they serve a monopolistic (single buyer) market such as the national airline of the host nation.

c. Manufacturing companies. These were the largest growth sector of multinational business from the 1950s to the 1970s. in many instances the host countries were instrumental in attracting the manufacturing MNCs. Foreign investment incentive programs have been the common device for luring inbound industrial incentive. Intricate schemes of tax privilege, protection against import competition, relaxation of foreign exchange restriction, and government loan guarantees are parts of such arrangements.

d. Service industry MNCs. The largest components of this category are banks, carriers, retail stores (F. W. Woolworth, sears, Takashimaya), and firms that sell similar management services have followed the multinationalization of industrial companies.

♦ **Technology-Based MNCs**

A new generation of MNCs has started to emerge in which the source of multinational managerial control is technology, including management expertise, instead of ownership of operating assets. These are known as no equity MNCs. The hotel, mining, and construction industries have pioneered this new generation of MNCs. They offer an increasingly viable alternative to the older, equity-based model.

1) Management Contracts:

The main vehicles of the no equity MNC are long-term contracts with owners of suitable operating facilities, such as hotels or mining properties. Often the contracts are either formally or informally sanctioned by the host government. Under such a contract the owners will let the MNC take over possession and management of the business and the MNC will obligate itself to share profits with the owners by some agreed-upon formula. The management contract model of the hotel industry has become the basis for a number of variations that are rapidly gaining status not only in other service industries but also in the manufacturing and high-technology sectors, where they the potential for even greater importance in India.

2) Production Sharing Arrangements:

In mining, crude oil production, and other resource-based businesses, profit sharing may be replaced by output sharing. These arrangements provide that the MNC not only may

produce in an extractive sector (iron ore, coal, petroleum), but also must meet specific obligations for the development of indigenous. Supplier industries, for training engineers and managers and for keeping pace with developments in the industry concerned. This formula rests on an agreed sharing of the output of the venture. For instance, if the contract provides of 40: 60 output sharing of a mining property, the MNC will retain 40 percent of the tonnage and turn over to the owners or, what is more typical, market on the owners‘ behalf the remaining 60 percent.

3) Industrial Lease Agreements:

These are contracts under which an owner, sometimes a government corporation, leases a complete industrial facility, such as a factor or chemical laboratory, to an MNC. The rent consists normally of a fixed annual sum plus a scale of payments based on the output of the plant. Such lease arrangements are as yet limited to manufacturing activities in which there have been rapid technological advances or in which complex specialized facilities are required.

4) Technology Transfer Agreements:

In the high technology industries (electronics, aircraft, computers, biochemicals) where the host government places the highest priority on indigenous production capability, the new mode is a joint venture between the MNC, whose responsibility it is to provide the technology, and one or several indigenous companies, which are responsible for financing, often with government assistance.

3.8 THE STRUCTURE AND CRITICS OF MNCs

Regardless of which of these alternatives the contract provides, the organizational effect is the same. It transfers the management of the operation to the MNC and motivates the latter to maximize its productivity. These calls for the application of the most efficient alternatives in technology and management know-how available to the MNC.Objectives to foreign ownership of major business firms have risen in many countries. Simultaneously, the national goals and economic development plans of host countries are placing greater priority on technology imports and modernization of management practices. These trends are favoring the new no equity model at the expense of the old ownership model for multinational growth. Because of their visibility across the globe, international businesses

have invited criticisms. They have defenders too. Let us examine MNCs as they are perceived by critics. These critics are activist groups that attack MNCs on environmental and rights issues as follows.

- **Challenge to Nation-state Sovereignty** The developing countries want control of their economies and want to achieve their economic, political, and social objectives. The power of the MNCs can influence each of these objectives and in doing so may be obliged to give up some power and independence in exchange for the wealth an MNC may bring.
- **Inequities** One of the most enduring and persistent complaints about alleged inequities by LDCs is that prices of raw materials extracted from their countries, while prices of imported manufactured goods from industrialized countries arerising. This they say creates a growing inequity. Other perceived inequities include avoidance of taxes and giving the best management jobs to MNC home-country citizens.
- **Interference with Economic Objectives** interference can occur in many ways. For example, an MNC may wish to locate a plant in an area of prosperity when the host country would prefer its location in an underdeveloped region. MNC demands of local support can add to host-country expenditures for infrastructure. Since MNCs typically do their research and development at home, hostn countries become technologically dependent on the MNCs for innovation. The MNCs have the strength to attract bank loans that otherwise might be available for local businesses.
- **Social Disruption** The introduction of different mores, habits, behaviors, and ethical values, new products, management styles, distribution systems, more money, and technology, do affect local ways of thinking and doing things.
- **Environmental Degradation** Many nations are becoming more concerned about the impact of MNCs on their environment. Environmental concerns are rapidly moving higher in the chain of priorities throughout the world.
- **Imperialism** Many of the awakening nations look on foreign managers with fear and distrust as the embodiment of an old, not easily forgotten, exploitative colonialism
- **Symbol of Frustration and Antipathy** The LDCs have grievances about their position in the world that have nothing to do with the MNC but the MNC is a convenient visible target for their anger.

- **MNCs and Technology** the technology brought in by MNCs is hardly suitable to less developed countries. Such technology is highly capita intensive but developing countries need a lab our intensive one. In addition, technology brought in by MNCs is highly expensive. The MNCs charge exorbitantly in the form of fee and royalty, which put a severe strain on the foreign exchange resources of a developing country. There are also instances of technology is dumping, which implies that MNCs use obsolete technology with the help of turnkey projects shipped down from the principals of other counties. MNCs tend to make industries in developing countries permanently dependent on foreign expertise and technology.
- **Investment depression.** The MNC foreign investments deplete capital resources needed for domestic investment, thus undermining economic growth and new job creation in the United States.
- **Technology drain.** The MNC exports U.S. technology in order to exploit low cost foreign labor, depriving the U.S. worked of his or her rightful opportunity to share in the utilization and rewards of this technology. Through technology transfers and foreign investments the MNC replaces U.S. workers with foreign workers; that is, it exports jobs.
- **Export displacement.** The MNC displaces U.S. exports with foreign produced goods, thereby decreasing domestic employment and payrolls, causing the U.S. trade balance to deteriorate, and depressing economic conditions at home.
- **Low wage imports.** The MNC substitutes imports from its U.S.-affiliates in low wage countries for U.S.-made goods. These imports undermine U.S. wage standards, cause unemployment, and idle plant facilities.
- **Tax evasion.** The MNC evades taxes by deferring profit repatriation, manipulating transfer prices, and circumventing government regulations. The revenues lost to the national treasury result in a higher tax burden on the general public.
- **Payments misbalancing.** The MNC's activities have afflicted the United States with chronic balance of payments deficits, fueled inflation, debased the dollar as a stable currency, and contributed to international monetary disorders.

3.9 THE ROLE OF MNCs IN INTERNATIONAL BUSINESS

Multinational corporations (MNCs) are huge industrial organizations having a wide network of branches and subsidiaries spread over a number of countries. The two main characteristics of MNCs are their large size and the fact that their worldwide activities are centrally controlled by the parent companies. Such a company may enter into joint venture with a company in another country. There may be agreement among companies of different countries in respect of division of production, market, etc. These companies are to be found in almost all the advanced countries, with the USA perhaps the biggest amongst them. Their operations extend beyond their own countries, and cover not only the advanced countries but also the LDCs.

The following are the main role of MNCs in international business:

1) Filling Savings Gap: The first important contribution of MNCs is its role in filling the resource gap between targeted or desired investment and domestically mobilized savings. For example, to achieve a 7% growth rate of national output if the required rate of saving is 21% but if the savings that can be domestically mobilized is only 16% then there is a 'saving gap' of 5%. If the country can fill this gap with foreign direct investments from the MNCs, it will be in a better position to achieve its target rate of economic growth.

2) Filling Trade Gap: The second contribution relates to filling the foreign exchange or trade gap. An inflow of foreign capital can reduce or even remove the deficit in the balance of payments if the MNCs can generate a net positive flow of export earnings.

3) Filling Revenue Gap: The third important role of MNCs is filling the gap between targeted governmental tax revenues and locally raised taxes. By taxing MNC profits, LDC governments are able to mobilize public financial resources for development projects.

4) Filling Management/Technological Gap: Fourthly, Multinationals not only provide financial resources but they also supply a "package" of needed resources including management experience, entrepreneurial abilities, and technological skills. These can be transferred to their local counterparts by means of training programs and the process of 'learning by doing'.

5) Other Beneficial Roles: The MNCs also bring several other benefits to the host country.

a) The domestic labor may benefit in the form of higher real wages.

b) The consumers benefits by way of lower prices and better quality products.

c) Investments by MNCs will also induce more domestic investment. For example, ancillary units can be set up to 'feed' the main industries of the MNCs.

d) MNCs expenditures on research and development (R&D), although limited is bound to benefit the host country. Apart from these there are indirect gains through the realization of external economies.

The strong position of corporations in the world economyMNCs can and should enact positive influences resulting from self interest and the pursuit of profits, for example, increasing employment, increasing available capital, technology, knowledge, improved management and positive contributions to labour relations and administration. There for The role of MNCs increase all the time in the world economy. Indeed, corporations are becoming more independent from the control and regulation of both the parent and the host economy.

3.10 SUMMARY

This unit discussed about the basic concepts of internationalization process and managerial implication in international business. Multinational corporations and their involvement in international business are discussed in the length. An account of structure and critics of MNCs and role of MNCs in international business is also given in this unit.

3.11 SELF ASSESSMENT QUESTIONS

1) What do you mean by internationalization?

2) Explain the process of internationalization and mentions its theory?

3) Briefly explain the structure of MNCs and its critics in international business?

4) Discuses the main role of MNCs in international business?

3.12 CASE STUDY

Case study No.1

Volvo company pvt Ltd

Volvo Company started its activities in 1927.When the first car 'Jakob'was prepared and left its office in Gothenburg, Sweden. Assar Gabrielson and Gustaf Larrson founded this company. These two employees of the Swedish ball bearing company (SKF): Assar Gabrielson and Gustaf Larson decided to start construction of Cars suitable to Swedish climate. The emphasis was on the durability. The first Volvo Car came on the roads in 1927.This Company was producing both closed top and cabriolet models of their new four cylinders OV4 and PV4 models, which were constructed, to better withstand the harsh Swedish climate, than contemporary US imports. This company flourished in approximately 80 years of its life and became a group of companies in its life period.

The company started its internationalization process in 1928 for acquiring market knowledge in culturally closed countries by establishing its first subsidiary in Finland and sold 20 cars. To have market knowledge via export was a part of Volvo's first production plan and therefore it also started establishing representatives in Nordic countries in the beginning (Denmark and Norway) and to less industrialise distant countries Argentina, Brazil, Spain and Portugal. The business strategy by that time was to sell cars in spring and summer to countries with contrasting climate to Sweden as a means to even out the production over the year. TherforeCars were exported to the countries of south of equator, to Argentina.

Volvo had problems in arousing the dealer's interest in ´the excellence and durable, but in respect slightly provincial car was sold in the first year. The Volvo Car head office is located in Gothenburg, Sweden. Product development, marketing and administration are located in Gothenburg. The cars are marketing and sold by regional market companies and national sales companies in about 100 countries. In all 2.600 people are employed in marketing and sales. Sales to the company's 100-plus markets are handled by the respective national sales companies and approximately 2.300 local dealers. Most of the leadership is independent companies.

QUESTIONS:

1. Discuses the overall impact about this case study and also explain the problems of volva company (MNCs) to enter into international business?
2. How theVolvo Company enter into an internationalization process to sustain in theinternationalbusiness?

Case Study No.2

McDonald's Company Ltd

McDonald's is the leading global food service retailer with more than 35,000 restaurants serving nearly 70 million people in more than 100 countries each day. The company has over 42,000 employees making almost 40,000 trips annually. The challenge for McDonalds was to build a robust travel risk management program, whereby regions and divisions will be incentivized to join by having the ability to tailor it based on financial, cultural and regional concerns in the country.

McDonald's Global Security strategy is guided by McDonald's Home Office. This allows McDonald's to manage global security guidelines and standards while the regionals drive business locally. Based on this structure, McDonald's Global Security and Global Travel Services wanted to build a travel risk management program. Working in partnership with iJET and using the Travel Risk Maturity Model (TRM3) assessment as a basis, McDonald's was able to build a global security program that can now be adopted by any division at the regional level.

The outcome for McDonald's is a corporate level travel risk management program with brand recognition that is now ready to be implemented at the regional level. In 2012, the program was successfully implemented for the Asia/Pacific/Middle East/Africa (APMEA) region. The McTraveler Safety Program provided APMEA with corporate backed program components and their own tailored regional components down to the office level. McDonald's continues to build and rollout the turnkey solution to all regions and divisions.

QUESTIONS:

1. McDonald's company how they established there business in international level?
2. Explain the internalization strategies and managerial implications of McDonald's company to entering into international business?

3.13 NOTES

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3.14 REFERNCES

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UNIT - 4 : ROLE OF MNCs IN DEVELOPING COUNTRIES

Structure :

4.0 Objectives

4.1 Introduction

4.2 Meaning and Definitions of MNCs

4.3 Evolution of Multinational Corporations

4.4 Balance of Payment (BOP) Relevance

4.5 Challenges and Specific Reasons for Expanding BOP in IB

4.6 The Role of MNCs in Developing Countries

4.7 Summary

4.8 Self Assessment Questions

4.9 Case Study

4.10 Notes

4.11 References

4.0 OBJECTIVES

After studying this unit, you should be able to:

- Define the term balance of payment.
- Describe the evolution of multinational corporations.
- Determine the role of multinational corporations in developing countries.
- Give an account on BOP relevance in international business.

4.1 INTRODUCTION

In today's global economy MNCs are playing an important role especially in emerging markets. But what are MNCs? Multinational corporations are those large firms which are incorporated in one country but which own, control or manage production and distribution facilities in several countries. Therefore, these multinational corporations are also known as transnational corporations. They transact business in a large number of countries and often operate in diversified business activities. Multinational companies (MNCs) play an important role in linking rich and poor economies and in transferring capital, knowledge, ideas and value systems across borders of different countries. Their interaction with institutions, organizations and individuals generates both positive and negative spillovers for various groups of stakeholders in both the home and host countries.

A good understanding of the role of MNCs in emerging economies is vital both for policymakers and for MNCs themselves. Policymakers are today influencing the regulatory regime under which both MNCs and local business partners operate. They are interested in understanding how foreign direct investment (FDI) influences economic development and national welfare. This is critically important for emerging markets as the sole purpose of their policy framework is to achieve increased levels of economic development for their country. The expectation that FDI will benefit the local economy has motivated many governments to offer attractive incentive packages to entice investors.

The rationale is that the social benefits of inward FDI would exceed the private benefits of FDI, and investors would take into account only the latter when deciding over investment locations. Despite the policy relevance, the impact of MNCs on host economies is not well understood. Some FDI is good, almost certainly some is harmful. It is difficult to assess

which FDI falls into which category. Thus, the interest in analyzing the role and impact of MNCs.

4.2 MEANING AND DEFINITIONS OF MNCs

A Multinational Corporation (MNC) or Multinational Enterprise (MNE) or Transnational Corporation (TNC) or Multinational Organization (MNO) is a Corporation / enterprise that manages production establishments or delivers services in at least two countries. Multinational Corporations (MNC) are often divided into three broad groups:

Horizontally integrated multinational corporations manage production

- Establishments located in different countries to produce the same or similar products. Vertically integrated multinational corporations manage production
- Establishment in certain country/countries to produce products that serve as input to its production establishments in other country/countries. Diversified multinational corporations manage production establishments
- Located in different countries that is neither horizontally nor vertically integrated

A multinational corporation (MNC) is a corporation that has its facilities and other assets in at least one country other than its home country. Such companies have offices and/or factories in different countries and usually have a centralized head office where they co-ordinate global management. The multinational corporation is a business organization whose activities are located in more than two countries and is the organizational form that defines foreign direct investment. This form consists of a country location where the firm is incorporated and of the establishment of branches or subsidiaries in foreign countries. Multinational companies can, obviously, vary in the extent of their multinational activities in terms of the number of countries in which they operate. A large multinational corporation can operate in 100 countries, with hundreds of thousands of employees located outside its home country.

The economic definition, however, does not capture the importance of the multinational corporation as the organizational mechanism by which different social and economic systems confront each other. The multinational corporation, because usually it develops in the cultural and social context of one nation, exports its organizational baggage from one institutional setting to another. In this regard, it plays a powerful role as a mechanism

by which to transfer organizational knowledge across borders. However, while being foreign implies that it might serve the valuable role of importing new practices, its foreign status also implies that its practices are likely to conflict with existing institutions and cultural norms. Moreover, since multinational corporations are often large, they pose unusual challenges to national and regional governments who seek to maintain political autonomy and yet are often anxious to seek the investment, technology, and managerial skills of foreign firms. There are, thus, economic and sociological definitions of the multinational corporation that differ, and yet complement, each other. In the economic definition, the multinational corporation is the control of foreign activities through the auspices of the firm. In the sociological definition, the multinational corporation is the mechanism by which organizational practices are transferred and replicated from one country to another county such as India.

4.3 EVOLUTION OF MULTINATIONAL CORPORATIONS

The dynamics of international business created a great need for the evolution of Multinational Corporation. The multinational corporation is a company engaged in producing and selling goods or services in more than one country. It normally consists of a parent company located in the home country and few or more foreign subsidiaries. Some MNCs have more than 100 foreign subsidiaries scattered around the world. It is the globally coordinated allocation of resources by a single centralized management that differentiates the multinational enterprise from other firms engaged in international business.

MNCs make decisions about market-entry strategy; ownership of foreign operations; and production, marketing, and financial activities with an eye to what is best for the corporation as a whole. The true multinational corporation emphasizes group performance rather than the performance of its individual parts.

There are different types of multinational companies, such as; Raw-Material Seekers:

- Raw-material seekers were the earliest multinationals and their aim was to exploit the raw materials that could be found overseas. The modern-day counterparts of these firms, the multinational oil and mining companies such as British Petroleum, Exxon Mobil, International Nickel, etc.

- Market Seekers: The market seeker is the archetype of the modern multinational firm that goes overseas to produce and sell in foreign markets. Examples include IBM, Toyota, Unilever, Coca-cola.
- Cost Minimizers: Cost minimizers are a fairly recent category of firms doing business internationally. These firms seek out and invest in lower-cost production sites overseas (for example, Hong Kong, Malaysia, Taiwan, and India) to remain cost competitive both at home and abroad. MNCs have to follow the changes in macroeconomic factors, environmental and social issues, and business and industry developments. These factors will all profoundly shape the corporate landscape in the coming years. The following section deals with these trends.

4.4 BALANCE OF PAYMENT (BOP) RELEVANCE

The Balance of Payments (BOP) is the method countries use to monitor all international monetary transactions at a specific period of time. The balance of payments, also known as balance of international payments and abbreviated BOP, of a country is the record of all economic transactions between the residents of the country and the rest of the world in a particular period (over a quarter of a year or more commonly over a year). These transactions are made by individuals, firms and government bodies. Thus the balance of payments includes all external visible and non-visible transactions of a country.

The term "balance of payments" includes all payments and obligations made to outside countries against all payments and obligations received from outside countries. It's a record of all financial flows in and out of a country from the rest of the world. For Example: The calculation of balance of payments doesn't has the task of merely subtracting out flows from inflows ,its scope is beyond that. If all receipts and payments are considered, then the payments and receipts of each country are, and must be, equal. Any apparent inequality simply leaves one country acquiring assets in the others. For instance, if Indian residents buy electronic gadgets from China, and have no other transactions with China, then in such a situation Chinese must end up holding "Indian rupee ", which they may hold in the form of bank deposits in India or in the form of some other investment. The payments made by Indians to China for electronic gadgets are balanced by the payments that are made by Chinese to Indian individuals and institutions, including banks, for the acquisition of assets in India in terms of rupees.

It represents a summation of country's current demand and supply of the claims on foreign currencies and of foreign claims on its currency. These transactions include payments for the country's exports and imports of goods, services, financial capital, and financial transfers. It is prepared in a single currency, typically the domestic currency for the country concerned. Sources of funds for a nation, such as exports or the receipts of loans and investments, are recorded as positive or surplus items. Uses of funds, such as for imports or to invest in foreign countries, are recorded as negative or deficit items.

When all components of the BOP accounts are included they must sum to zero with no overall surplus or deficit. For example, if a country is importing more than it exports, its trade balance will be in deficit, but the shortfall will have to be counterbalanced in other ways – such as by funds earned from its foreign investments, by running down central bank reserves or by receiving loans from other countries.

While the overall BOP accounts will always balance when all types of payments are included, imbalances are possible on individual elements of the BOP, such as the current account, the capital account excluding the central bank's reserve account, or the sum of the two. Imbalances in the latter sum can result in surplus countries accumulating wealth, while deficit nations become increasingly indebted. The term balance of payments often refers to this sum: a country's balance of payments is said to be in surplus (equivalently, the balance of payments is positive) by a specific amount if sources of funds (such as export goods sold and bonds sold) exceed uses of funds (such as paying for imported goods and paying for foreign bonds purchased) by that amount. There is said to be a balance of payments deficit (the balance of payments is said to be negative) if the former are less than the latter. A BOP surplus (or deficit) is accompanied by an accumulation (or decummulation) of foreign exchange reserves by the central bank

The role of timely and comprehensive balance of payments and their relevance, market expectations and uncertainties in fundamentals.

a) The current account balance as an indicator of excess or under-spending. Temporary and cyclical deficit /surpluses on the current account, and their impact on inflation and country's terms of trade.

b) The use of BOP data for an understanding the movements in the exchange rate through analysis of the supply and demand of foreign currencies driven by the trends in the BOP components.

c) The use of BOP statistics in explaining changes in the money supply, an important indicator for the determination of monetary policy.

d) The possibility that BOP could be used as a supplementary data source for monetary statistics under certain circumstances will be described (in particular, they can be used to adjust monetary aggregates for holdings by nonresidents of monetary instruments).

e) The use of BOP in the context of analyzing globalization and its effect. The manual could usefully describe the contribution of BOP and highlight the conceptual implications for national BOP, for example toll processing, transfer pricing, and provision of group-wide IT services. Reference could be made to the Manual on Globalization Indicators.

f) The role of BOP data in the money market operations of central banks. Changes in the net foreign assets of the central bank as important explanatory variables of changes in the liquidity requirement in the money market.

g) Statistics on international trade in services in understanding structural changes in the economy and the penetration of foreign markets. Decomposition analysis of price and volume effects of nominal and real exchange rate changes on the balance on goods and services.

h) Statistics on inward and outward foreign direct investment in assessing the role of foreign financing, including ownership and control, in the corporate sector (both financial and nonfinancial), and the income generating capacity of investments abroad.

i) Trends in the financial account in response to financial market conditions and economic developments for understanding the link between a change in interest rate conditions and the amount, direction, and structure of external financial flows.

j) Statistics on international banking flows and stocks may be useful to understand issues in the globalization of international banking and to help focus on the soundness of the domestic banking system. The use of BOP data as an alternative way of assessing an economy's relations with the rest of the world.

Most countries of the world have their own national currency (domestic currency), which is used as money within the respective countries. Although all currency is money, most of the money of the world is actually stored as electronic information, such as savings

and checking accounts, in the databases of banks. Nonetheless, this electronic information always expresses quantity in terms of a certain currency; therefore, hereinafter, we will use the term *currency* to designate all forms of money that are denominated in the currency. Hence, there is a flow of the world's currencies to virtually every country of the world. The international balance of payments (BOP) is a snapshot of the net result of these international transactions over a specified time period monthly, quarterly, or annually.

Every international transaction is either a BOP credit or debit. BOP credits are transactions that either increase domestic liabilities or revenues or decrease assets and expenses, while BOP debits are transactions that are opposite of credits — decreases in domestic liabilities or revenues or increases in assets or expenses. So if a United States resident buys an Australian bond, a BOP credit will result from the liability to pay for the bond, and a BOP debit will result from the increase of foreign securities by the United States. If an American business imports goods, the increase in assets results in a BOP debit while the liability to pay for the goods is a BOP credit.

If a domestic resident wants to buy a foreign product or service, she must first convert the domestic currency into the foreign currency to make the purchase. If a business wants to sell products in a foreign country, then the business will collect foreign currency for those sales. Much of that money will probably remain with the foreign branch of the business to pay local wages and other expenses. However, the business will probably want to bring some of that money home, in which case, it will want to convert the foreign currency into its domestic currency. The balance of payments is concerned with transactions and thus deals with flows rather than with stocks. That is, the balance of payments deals with economic events that take place during a reference period and not with outstanding totals of economic assets and liabilities that exist at particular moments in time.

This narrow view of BOP coverage should be considered in relation to the closely connected, stock-oriented international investment position. The international investment position (IIP) is a statistical statement (compiled as of a specific date such as year end) of the value and composition of an economy's claims on the rest of the world and the value of that economy's financial liabilities to the rest of the world. The difference between an economy's stock of international financial assets and financial liabilities is that part of an economy's net worth attributable to, or derived from, its external sector.

An issue of frequent debate is whether BOP coverage should be restricted to transactions or whether, at the other extreme, the BOP statement should show all changes in the value of an economy's holdings of external financial items. Opinions have differed, and conventions reflecting different analytic approaches have been suggested. The conventions recommended in the fifth edition of the BPM generally require a narrow view of BOP coverage.

Many international transactions recorded in the balance of payments do not involve payments of money.To provide a comprehensive record of an economy's transactions with the rest of the world, the balance of payments includes some transactions that do not give rise to immediate money payments and some transactions that do not elicit any such payments. The inclusion of transactions other than those involving money payments constitutes the principal difference between a BOP statement and an exchange record in BOP.

Transactions that involve external financial assets and two resident parties and transactions that involve external financial liabilities and two nonresident parties are, theoretically, included in the balance of payments, these transactions are transparent in the BOP presentation. However, some BOP presentations explicitly reflect these transactions if (for transactions in external financial assets) the two residents are in different sectors of the economy or if (for transactions involving external financial liabilities) the two nonresidents are residents of different countries.

4.5 CHALLENGES AND SPECIFIC REASONS FOR EXPANDING BOP IN IB

The status of relevant support measures in Japan (measures that could be used for supporting BOP business) and their association with the aforementioned future steps (Direction: six items) have been sorted and analyzed. The results indicate that there are some areas with no support tools, that some existing support tools are not targeting BOP businesses, and that the accessibility of such tools is limited to specific countries or areas. These findings show that Japan has yet to provide sufficient measures for supporting BOP business. In view of overseas organizations' support measures and their characteristics, it is necessary to introduce the following support measures to encourage Japanese companies to enter the BOP business.

SI. No.	Direction	Specific measures
1.	Supporting the acquisition of information required for BOP business	Investigating and distributing information about domestic overseas good practices and support tools and BOP business Having government organizations' overseas offices investigate and distribute. And information about market environment and potential needs.
2.	Supporting the development of partnerships	Conducting feasibility studies on specific business proposals by companies, NPOs, etc.Helping Japanese companies find domestic/overseas NPOs, companies, government and organizations, etc. to partner.
3.	Supporting educational activities for local BOP population and relevant parties	Having government organizations' overseas offices provide enlightenment, educational activities (e.g. offering training, dispatching experts) to local government organizations, NPOs, etc.
4.	Supporting the resolution of funding / financial issues	Promoting the use of existing support systems (JBIC (Japan Bank for International Cooperation), NEXI (Nippon Export and Investment Insurance), etc.) Resuming JICA's(Japan International Cooperation Agency) overseas investment / loan and function (providing long-term and short-term loans to compliment risks).
5.	Supporting the promotion of technological development	Offering various support tools and assisting pairing of partners.
6.	Promoting the development of business infrastructures in developing countries (hardware / software)	Making greater use of existing systems such as yen loans, grant-in-aid, technical cooperation and trade insurance Considering support measures for the use of microfinance's (small-scale finance services for the BOP group).
7.	The need for organically linking various support measures	Developing the "BOP business promotion platform" for organically linking the above support measures -- One-Stop delivery of information on BOP business -- Consultation and referral concerning BOP business -- Venue for parties involved in BOP business to exchange information and hold mutual consultation.

4.6 THE ROLE OF MNCs IN DEVELOPING COUNTRIES

The MNCs play an important role in the economic development of underdeveloped countries. What are multinational companies? These are enterprises or organizations with services spread across more than one country on a global scale. India is a home to a number of multinational companies since the country's market was liberalized in 1991. India houses majority of multinational companies hailing from the United States. There are also multinational companies from other countries. The multinational companies from the United States account to 37% of turnover of first 20 firms that operate in India; the others come from European Union and their Asia counterparts. Multi National Corporations (MNCs) are huge industrial organizations which extend their industrial and marketing operations through a network of their branches or their majority owned Foreign Affiliates (MOFAs). MNCs are also known as transactional corporations (TNCs). Instead of aiming for maximization of their profits from one or two products, the MNCs operate in a number of fields and from this point of view, their business strategy extends over a number of products and over a number of countries.

1) **Agreement with Local Firms for Sale of MNCs Products:** A multinational firm can enter into an agreement with local firms for exporting the product produced by it in the home country to them for sale in their countries. In this case, a multinational firm allows the foreign firms to sell its product in the foreign markets and control all aspects of sale operations.

2) **Setting up of Subsidiaries:** The second mode for investment abroad by a multinational firm is to set up a wholly owned subsidiary to operate in the foreign country. In this case a multinational firm has complete control over its business operations ranging from the production of its product or service to its sale to the ultimate use or consumers. A subsidiary of a multinational corporation in a particular country is set up under the company act of that country. Such subsidiary firm benefits from the managerial skills, financial resources, and international reputation of their parent company. However, it enjoys some independence from the parent company.

3) **Branches of Multinational Corporation**: Instead of establishing its subsidiaries, Multinational Corporation can set up their branches in other countries. Being branches they are not legally independent business unit but are linked with their parent company.

4) **Foreign Collaboration or Joint Ventures**: Thirdly, the multinational corporations set up joint ventures with foreign firms to either produce its product jointly with local companies of foreign countries for sale of the product in the foreign markets. A multinational firm may set up its business operation in collaboration with foreign local firms to obtain raw materials not available in the home country. More often, to reduce its overall production costs multinational companies set up joint ventures with local foreign firms to manufacture inputs or subcomponents in foreign markets to produce the final product in the home country.

5) **Role of MNCs in India**: Prior to 1991 Multinational companies did not play much role in the Indian economy. In the pre-reform period the Indian economy was dominated by public enterprises. To prevent concentration of economic power industrial policy 1956 did not allow the private firms to grow in size beyond a point. By definition multinational companies are quite large and operate in several countries. While multinational companies played a significant role in the promotion of growth and trade in South-East Asian countries they did not play much role in the Indian economy where import-substitution development strategy was followed. Since 1991 with the adoption of industrial policy of liberalization and privatization, the role of private foreign capital has been recognized as important for rapid growth of the Indian economy. Since source of bulk of foreign capital and investment are MNCs, they have been allowed to operate in the Indian economy subject to some regulations. The role of these corporations has been increasingly recognized in India in the post reform period. The following are the important reasons for this change in policy towards multinational companies in the post-reform period:

6) **Promotion of Foreign Investment**: In the recent years, external assistance to developing countries has been declining. This is because the donor developed countries have not been willing to part with a larger proportion of their GDP as assistance to developing countries. MNCs can bridge the gap between the requirements of foreign capital for increasing foreign investment in India. The foreign investment policies pursued since 1991, have allowed MNCs to make investment in India subject to different ceilings fixed for different industries or projects. However, in some industries 100 per cent export-oriented units (EOUs) can be set up. It may be noted, like domestic investment, foreign investment has also a multiplier effect on income and employment

in a country. For example, the effect of Suzuki firm's investment in Maruti Udyog manufacturing cars is not confined to income and employment for the workers and employees of Maruti Udyog but goes beyond that. Many workers are employed in dealer firms who sell Maruti cars. Moreover, many intermediate goods are supplied by Indian suppliers to Maruti Udyog and for this many workers are employed by them to manufacture various parts and components used in Maruti cars. Thus their incomes also go up by investment by a Japanese multinational in Maruti Udyog Limited in India. 7.

7) **Non-Debt Creating Capital inflows**: In pre-reform period in India when foreign direct investment by MNCs was discouraged, we relied heavily on external commercial borrowing (ECB) which was of debt-creating capital inflows. This raised the burden of external debt and debt service payments reached the alarming figure of 35 per cent of our current account receipts. This created doubts about our ability to fulfill our debt obligations and there was a flight of capital from India and this resulted in balance of payments crisis in 1991.As direct foreign investment by multinational corporations represents non-debt creating capital inflows we can avoid the liability of debt-servicing payments. Moreover, the advantage of investment by MNCs lies in the fact that servicing of non-debt capital begins only when the MNC firm reaches the stage of making profits to repatriate Thus, MNCs can play an important role in reducing stress strains and on India's balance of payments (BOP).

8) **Technology Transfer:** Another important role of multinational corporations is that they transfer sophisticated technology to developing countries which are essential for raising productivity of working class and enable us to start new productive ventures requiring high technology. Whenever, multinational firms set up their subsidiary production units or joint- venture units, they not only import new equipment and machinery embodying new technology but also skills and technical know-how to use the new equipment and machinery. As a result, the Indian workers and engineers come to know of new superior technology and the way to use it. In India, the corporate sector spends a very small fraction of its resources on Research and Development (R&D). It is the big MNCs which can spend resources on the development of new technologies which in turn benefits the developing countries by transferring the new technology developed by them. Therefore, MNCs can play an important role in the technological up-gradation of the Indian economy.

9) **Promotion of Exports**: With extensive links all over the world and producing products efficiently and therefore with lower costs multinationals can play a significant role in promoting exports of a country in which they invest. For example, the rapid expansion in China's exports in recent years is due to the large investment made by multinationals in various fields of Chinese industry. In recent years, Japanese automobile company Suzuki made a large investment in Maruti Udyog with a joint collaboration with Government of India. Maruti cars are not only being sold in the Indian domestic market but are exported in a large number to the foreign countries. Samsung, LG, Honda have all contributed to better technologies coming into India.

10) **Investment in Infrastructure**: With a large command over financial resources and their superior ability to raise resources both globally and inside India it is seen that multinational corporations also invest in infrastructure such as power projects, modernization of airports and posts, telecommunication. The investment in infrastructure gives a boost to industrial growth and helps in creating income and employment in the India economy. The external economies generated by investment in infrastructure by MNCs would in turn crowd in investment by the indigenous private sector and will therefore stimulate higher economic growth.

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

a. Infrastructure,

b. High technology and

c. Exports, and

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

11) **A Critique of Multinational Corporations:** In recent years foreign direct investment through multinational corporations has vastly increased in India and other developing countries. In the increasingly liberalized economic environment multinational corporations which are in search for global profits are induced to make investment in developing countries. As explained above, foreign direct investment by multinational firms bring many benefits to the recipient countries but there are many potential dangers and disadvantages from the viewpoint of economic growth and employment

generation. Therefore, role of multinational corporations in India and other developing countries has its negative side as well. Some of the criticisms leveled against multinational corporations are enter into international business.

12) **Capturing Markets**: The biggest risk of having MNCs in developing countries is that the MNCs with their large resource and competitive strength tend to eliminate competition from domestically produced goods and thus capture the market. This is especially done by lowering prices to such an extent that the local firms with limited resources are not able to sustain the heavy losses and succumb to it. When these firms are eliminated then the MNCs slowly raise their prices again and thus succeed in capturing markets.

13) **Use of Capital-intensive**: Techniques It has been seen that increasing capital intensity in modern manufacturing sector is responsible for slow growth of employment opportunities in India's industrial sector. These capital-intensive techniques may be imported by large domestic firms but presently they are being increasingly used by multinational corporations which bring their technology when they invest in India. Emphasizing this factor, Thirwall rightly writes, "In this case the technology may be inappropriate not because there is not a spectrum of technology or inappropriate selection is made but because the technology available is circumscribed by the global profit maximizing motives of multinational companies investing in the less-developed country concerned

14) **Encouragement to Inessential Consumption**: The investment by multinational companies leads to overall increase in investment in India but it is alleged that they encourage conspicuous consumption in the economy. These companies cater to the wants of the already well-to-do people. For example, in India very expensive cars (such as Honda City, Hyundai Accent, Mercedes, Audi, BMW etc.) the air conditioners, costly laptops, washing machines expensive fridges, 293 and Plasma TVs are being produced/sold by multinational companies. Such goods are quite inappropriate for a poor country like India. Besides, their consumption has a demonstration effect on the consumption of others. This tends to raise the propensity to consume and adversely affects the increase in savings of the country.

15) **Import of Obsolete Technology:** Another criticism of MNCs is based on the ground that they import obsolete machines and technology. As mentioned above, some of the

imported technologies are inappropriate to the conditions of Indian economy. It is alleged that India has been made a dumping ground for obsolete technology. Moreover, the multinational corporations do not undertake Research and Development (R&D) in India to promote local technologies suited to the Indian factor-endowment conditions. Instead, they concentrate R&D activity at their headquarters.

16) **Setting up Environment-Polluting Industries:** It has been found that investment by multinational corporations in developing countries such as India is usually made for capturing domestic markets rather than for export promotion. Moreover, in order to evade strict environment control measures in their home countries they set up polluting industrial units in India. A classic example of this is a highly polluting chemical plant set up in Bhopal resulting in gas tragedy when thousands of people were either killed or made handicapped due to severe ailments. "With the tightening of environmental measures in such countries, there is a tendency among the MNCs to locate the polluting industries in the poor countries, where environmental legislation is non-existent or is not properly implemented, as exemplified in the Bhopal gas tragedy".

17) **Volatility in Exchange Rate**: Another major consequence of liberalised foreign investment by multinational corporations is its impact on the foreign exchange rate of the host country. Foreign capital inflows affect the foreign exchange rate of the Indian rupee. A large capital inflow through foreign investment brings about increase in the supply of foreign exchange say of US dollars. With demand for foreign exchange being given, increase in supply of foreign exchange will lead to the appreciation of exchange rate of rupee. This appreciation of the Indian rupee will discourage exports and encourage imports causing deficit in balance of trade. For example, in India in the fiscal years 2004-05 and 2005- 06, there were large capital inflows by FII (giant financial multinationals) in the Indian economy to take advantage of higher interest rates here and also booming of the Indian capital market. On the other hand, when interest rates rise in the parent countries of these multinationals or rates of return from capital markets go up or when there is loss of confidence in the host country about its capacity to make payments of its debt as happened in case of South-East Asia in the late nineties there is large outflow of capital by multinational companies resulting in the crisis and huge depreciation of their exchange rate. Thus, capital inflows

and outflows by multinationals have been responsible for large volatility of exchange rate. Then there is the question of repatriation of profits by the multinationals. Though a part of profit is reinvested by them ultinational companies in the host country, a large amount of profits are remitted to their own parent countries. This has a potential disadvantage for the developing countries, especially when they are facing foreign exchange problem. Commenting on this Thirwall writes "FDI has the potential disadvantage even when compared with loan finance, that there may be outflow of profits that lasts much longer.

18) **Transfer pricing and Evasion of Local Taxes**: Multinational corporations are usually vertically integrated. The production of a commodity by multinational firm comprises various phases in its production the components used in the production of a final commodity may be produced in its parent country or in its affiliates in other countries. Transfer pricing refers to the prices a vertically integrated multinational firm charges for its components or parts used for the production of the final commodity, say in India. These prices of components or parts are not real prices as determined by demand for and supply of them. They are arbitrarily fixed by the companies so that they have to pay less tax in India. They artificially inflate the transfer prices for intermediate products (i.e., components) produced in their parent country or their overseas affiliates so as to show lower profits earned in India.

4.7 SUMMARY

This unit discussed about the basic concepts of balance of payment and evolution of multinational corporations in international business. The roles of MNCs in developing country are discussed in the length. An account of challenges and specific reasons for expanding balance of payment in international business is also given in this unit.

4.8 SELF ASSESSMENT QUESTIONS

1. Define balance of payment (BOP)?
2. Explain the evolution of multinational corporations in India?
3. Briefly explain the role of MNCs in developing countries?
4. Mention the specific reasons for expanding balance of payment in international business?

4.9 CASE STUDY

Case Study No.1

Dell company Pvt. Ltd.

DELL's competencies are their cost strategy. In consistent to being an integrated cost leader, DELL produces high quality PCs by using their Direct Business Model approach and sells them directly to the customers. DELL's weaknesses are single sourcing, new product and reliance on corporate clients. DELL has opportunities like the potential growth in overseas markets as the industry is still in growth phase and the entering of the new product markets. Henceforth, the threats are technological changes that are expected since technology can only get better. Global economy and increased competition in which DELL's financial ratios identifies that the company is no match for their competitors.

DELL's most competitive force is the Direct-Model concept which helped them to reach above-average returns and remains in business today. Customers have developed a brand-name loyalty to Dell because of their low cost differentiation strategy. The huge threat faced by DELL is the fierce competition in the industry. If DELL enters into a merge it would not have to spend so much money and time trying to develop a face-to-face communications, if the local business is already well known. According to cost saving benefits, the company will not have to spend any extra money for product development if it is already developed. Furthermore, there will be plenty of joint financial support. If there is synergy between the two companies, their market penetration will be that much easier to achieve.

DELL initiated ways to overcome its weaknesses and use its strengths to gain advantages over its competitors- by careful analyzing of the factors that contribute to the company's success in business strategies that had implemented created the path for the company's continued success. Today, in fast-moving areas such as wireless and hybrid cars, you can see how market windows open and close relatively quickly. The economic rents accrue to those who can thoughtfully scan the market environment and quickly spot profitable opportunities. One of the hottest areas in technology and business process today is around predictive analytics, which is all about helping companies to determine their next move and stay one step ahead of the competition. One way to analyze a competitor's strategic intent and migration path is to assess its expansion plans into new market segments and offering

sets for example, think of Dell moving into printers or Microsoft moving into the CRM space.

Although time-to-market is important, it doesn't mean doing things haphazardly or without some analysis. Often, companies do get stuck in an "analysis-paralysis" loop and don't take action until it's too late. In companies, strategy means nothing more than a plan based largely on today's markets, today's product set and today's competitors and emphasizing the financial forecast and such a strategy may successfully identify opportunities to capture the upside of the current business over the next few years but can rarely anticipate extreme competition, much less show how to reposition a business to face it. Effective strategy should steer companies toward where an industry is heading and where it is today.

QUESTIONS:

1. Briefly explain the internationalization process of dell company pvt Ltd?
2. Discuses the overall case study and also drawn corporate strategy of dell company private limited to enter an international business?

Case Study No.2

Brazilian –Chinese international trade relations.

Foreign Trade, bilateral trade between the two emerging BRIC nations exceeded $50 billion USD during the first 11 months of 2010 while Chinese exports to Brazil increased 62 percent, continuing a strong upward trend. China now accounts for more than 12 percent of Brazil's exports. In comparison, bilateral trade amounted to only $36 billion USD in 2009, despite tripling in value over the past five years. During a one-day summit of BRIC nations in Brasília last April, Chinese President Hu Jintao noted that intra-BRIC cooperation "now faces both valuable opportunities and severe challenges," and that BRIC nations "should set clear objectives for cooperation" to advance their common interests "from a strategic height."

True to words, both China and Brazil have, in recent years, been diligently tapping into a wealth of collaborative opportunities. Today, China is not only Brazil's largest trade partner, but also its largest exporting destination and second-largest importer. Both China and Brazil have much to offer each other. Brazil has an abundance of natural resources, including energy supplies, minerals, and raw materials, all of which are in great demand in China's booming marketplace. China's relatively low production costs and developed

industrial infrastructure, on the other hand, offer Brazil a steady, cheap, and plentiful supply of manufactured goods. Consequently, most Brazilian exports to China are in the form of commodities, while most Chinese imports to Brazil are of manufactured products.

Brazil's growing reliance on the export of raw materials to China has been a subject of concern, despite its high profitability due to a commodity boom that is being fueled by high Chinese demand. In 2009, for example, raw materials and soybeans accounted for 77 percent of Brazil's total exports to China, and 41 percent of Brazil's total exports. These represent significant increases from 2002, when such primary exports made up less than two-thirds of Brazil's exports to China, and only 22 percent of all exports. The growing homogeneity of Brazilian exports to China, in conjunction with the increasing share of such exports as a percentage of Brazil's total trade volume, have led some to believe that this trend could fuel infrastructure development in China at the expense of deindustrialization in Brazil.

The bilateral agreements that were signed at the BRIC summit in Brasília last April were specifically aimed at boosting trade and energy cooperation between the two countries, and include provisions for the construction of a Chinese steel plant in Brazil. The long-term economic benefits of China and Brazil's trade relationship are substantial, and the nature of this important bilateral relationship will become an important part of the domestic policy agendas of both major BRIC nations. Problems, such as Brazil's growing bilateral trade deficit with China, as well as the threat of deindustrialization from trade imbalances caused by an overabundance of

Brazilian commodities exports, pose substantial risks to the relationship's long term growth. However, the economic climate remains promising, while the level of economic integration is still shallow. Brazilian exports do not directly compete with Chinese exports in most markets, and China's rapid growth prospects will continue to usher in new opportunities for Brazil's energy and commodities sectors. Consequently, Brazil's primary challenges remain in its ability to enhance the value of its energy supplies and its raw materials exports to satisfy Chinese demands. The administration of Brazil's new president, Dilma Rousseff, must confront these difficult challenges this decade in order to properly manage the risks and opportunities of her country's growing trade integration with China.

QUESTIONS:

1. China is also expanding its foreign direct investment in Brazil. Why? What are the consequences thereof for Brazil?
2. What is the nature of the Brazilian-Chinese bilateral trade in international pattern? How can it be explained?

4.10 NOTES

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MODULE -II
INTERNATIONAL BUSINESS ENVIRONMENT

UNIT - 5: AN OVERVIEW OF POLITICAL, SOCIAL AND CULTURAL, LEGAL AND TECHNOLOGICAL ENVIRONMENT

Structure :

5.0 Objectives

5.1 Introduction

5.2 Meaning and Definitions

5.3 Features of business Environment

5.4 Importance of Business Environment

5.5 Political Environment

5.6 Types of political Systems

5.7 Social and Cultural Environment

5.8 Elements of Social Cultural Environment

5.9 Legal Environment

5.10 Technological Environment

5.11 Summary

5.12 Self Assessment Questions

5.13 Case Study

5.14 Notes

5.15 References

5.0 OBJECTIVES

After studying this unit, you should be able to;

- Define the term International Business
- Describe the Nature and Scope of International Business
- Determine the Current Trends of International Business
- Give an account on Advantages and Disadvantages of International Business

5.1 INTRODUCTION

Environmental analysis is defined as "the process by which strategists monitor the economic, governmental/legal, market/competitive, supplier/ technological, geographic, and social settings to determine opportunities and threats to their firms". "Environmental diagnosis consists of managerial decisions made by analyzing the significance of the data (opportunities and threats) of the environmental analysis".

Global economy is at crossroads. There is no single or simple answer to current economic problems. Transparency in the conduct of monetary and fiscal policies is needed to provide an anchor for expectations. Developments that seem unusual, even unbalanced, need to necessarily be judged unsustainable. For example, the potential gains offered by new technology, particularly in the production of goods and financial services, may provide a sound rationale for a number of trends that currently seem hard to explain. Yet, a starting point characterized by significant macroeconomic imbalances and major financial restructuring does not present a comforting environment for policymakers; given very low interest rates and virtual price stability in many countries, the scope for lowering real policy rates is now limited. This chapter implies a continuing need to focus on measures to strengthen the global financial system which looks to be the most vulnerable part of market based economies.

Just as the life and success of an individual depend on his innate capability, including physiological factors, traits and skills, to cope with the environment, the survival and success of a business firm depend on its innate strength – the resources as its command, including physical resources, financial resources, skill and organization – and its adaptability to the environment. Every business enterprise, thus, consists of a set of internal factors and is confronted with a set of external factors.

The internal factors are generally regarded as controllable factors because the company has control over these factors; it can alter or modify such factors as its personnel, physical facilities, organization and functional means, such as the marketing mix, to suit the environment. The external factors, on the other hand, are by and large, beyond the control of a company. The external or environmental factors such as the economic factors, socio-cultural factors, government and legal factors, demographic factors, geo-physical factors etc. are, therefore, generally regarded as uncontrollable factors. As the environmental factors are beyond the control of a firm, its success will depend to a very large extent on its adaptability to the environment, that its ability to properly design and adjust the internal (the controllable) variables to take advantage of the opportunities and to combat the threats in the environment.

5.2 MEANING AND DEFINITIONS

The International Business Environment can be defined as the environment in different sovereign countries, with factors exogenous to the home environment of the organization, influencing decision-making on resource use and capabilities. As stated earlier, the success of every business depends on adapting itself to the environment within which it functions. For example, when there is a change in the government polices the business has to make the necessary changes to adapt itself to the new policies. Similarly, a change in the technology may render the existing products obsolete, as we have seen that the introduction of computer has replaced the typewriters; the color television has made the black and white television out of fashion. Again a change in the fashion or customers' taste may shift the demand in the market for a particular product, e.g., the demand for jeans reduced the sale of other traditional wear. All these aspects are external factors that are beyond the control of the business. So the business units must have to adapt themselves to these changes in order to survive and succeed in business. Hence, itis very necessary to have a clear understanding of the concept of business environment and the nature of its various components.

The term 'business environment' connotes external forces, factors and institutions that arebeyond the control of the business and they affect the functioning of a business enterprise.

These include customers, competitors, suppliers, government, and the social, political,legal and technological factors etc. While some of these factors or forces may have directin fluence over the business firm, others may operate indirectly. Thus, business environmentmay be defined as the total surroundings, which have a direct or indirect bearing on

thefunctioning of business. It may also be defined as the set of external factors, such aseconomic factors, social factors, political and legal factors, demographic factors, and technicalfactors etc., which are uncontrollable in nature and affects the business decisions of a firm.

5.3 FEATURES OF BUSINESS ENVIRONMENT

On the basis of the above discussion the features of business environment can be summarized as follows.

a) Business environment is the sum total of all factors external to the business firm and those greatly influence their functioning.

b) It covers factors and forces like customers, competitors, suppliers, government, and the social, cultural, political, technological and legal conditions.

c) The business environment is dynamic in nature, that means, it keeps on changing.

d) The changes in business environment are unpredictable. It is very difficult to predict the exact nature of future happenings and the changes in economic and social environment.

e) Business Environment differs from place to place, region to region and country tocountry. Political conditions in India differ from those in Pakistan. Taste and values

f) Cherished by people in India and China vary considerably.

5.4 IMPORTANCE OF BUSINESS ENVIRONMENT

There is a close and continuous interaction between the business and its environment. This interaction helps in strengthening the business firm and using its resources more effectively. As stated above, the business environment is multifaceted, complex, and dynamic in nature and has a far-reaching impact on the survival and growth of the business. To be more specific, proper understanding of the social, political, legal and economic environment helps the business in the following ways:

1) **Determining Opportunities and Threats:** The interaction between the business and its environment would identify opportunities for and threats to the business. It helps the business enterprises for meeting the challenges successfully.

2) **Giving Direction for Growth:** The interaction with the environment leads to opening up new frontiers of growth for the business firms. It enables the business to identify the areas for growth and expansion of their activities.

3) **Continuous Learning:** Environmental analysis makes the task of managers easier in dealing with business challenges. The managers are motivated to continuously update their knowledge, understanding and skills to meet the predicted changes in realm of business.

4) **Image Building:** Environmental understanding helps the business organizations in improving their image by showing their sensitivity to the environment within which they are working. For example, in view of the shortage of power, many companies have set up Captive Power Plants (CPP) in their factories to meet their own requirement of power

5) **Meeting Competition:** It helps the firms to analyze the competitors' strategies and formulate their own strategies accordingly.

6) **Identifying Firm's Strength and Weakness:** Business environment helps to identify the individual strengths and weaknesses in view of the technological and global developments.

5.5 POLITICAL ENVIRONMENT

Political and government environment has close relationship with the economic system and economic policy. For example, the communist countries had a centrally planned economic system. In most countries, apart from those laws that control investment and related matters, there are a number of laws that regulate the conduct of the business. These laws cover such matters as standards of products, packaging, promotion etc.In many countries, with a view to protecting consumer interests, regulations have become stronger. Regulations to protect the purity of the environment and preserve the ecological balance have assumed great importance in many countries.

Some governments specify certain standards for the products (including packaging) to be marketed in the country; some even prohibit the marketing of certain products. In most nations, promotional activities are subject to various types of controls. Media advertising is not permitted in Libya. Several European countries restrain the use of children in commercial advertisements. In a number of countries, including India, the advertisement of alcoholic liquor is prohibited. Advertisements, including packaging, of cigarettes must carry the statutory warning that "cigarette smoking is injurious to health".

Similarly, advertisements of baby food must necessarily inform the potential buyer that breast-feeding in the best. In countries like Germany, product comparison advertisements and the use of superlatives like 'best' or 'excellent' in advertisements is not allowed In the United States, the Federal Trade Commission is empowered to require a company to provide the quality,

performance or comparative prices of its products. This includes the political system, the government policies and attitude towards the businesscommunity and the unionism. All these aspects have a bearing on the strategies adoptedby the business firms.

The stability of the government also influences business and relatedactivities to a great extent. It sends a signal of strength, confidence to various interestgroups and investors. Further, ideology of the political party also influences the businessorganization and its operations. You may be aware that Coca-Cola, a cold drink widelyused even now, had to wind up operations in India in late seventies. Again the trade unionactivities also influence the operation of business enterprises. Most of the labor unions inIndia are affiliated to various political parties. Strikes, lockouts and labor disputes etc.also adversely affect the business operations. However, with the competitive businessenvironment, trade unions are now showing great maturity and started contributing positivelyto the success of the business organization and its operations through workers participationin management.

There are a host of statutory controls on business in India. If the MRTP companies wanted to expand their business substantially, they had to convince the government that such expansion was in the public interest. Indeed, the "Government in India has an all-pervasive and predominantly restrictive influence over various aspects of business, e.g, industrial licensing which decides location, capacity and process; import licensing for machinery and materials; size and price of capital issue; loan finance; pricing; managerial remuneration; expansion plans; distribution restrictions and a host of other enactments. Therefore, a considerable part of attention of a Chief Executive and his senior colleagues has to be devoted to a continuous dialogue with various government agencies to ensure growth and profitability within the framework of controls and restraints".

Many countries today have laws to regulate competition in the public interest. Elimination of unfair competition and dilution of monopoly power are the important objectives of these regulations. In India, the monopolistic undertakings, dominants undertakings and large industrial houses are subject to a number of regulations which prevent the concentration of economic power to the common detriment. The MRTP Act also controls monopolistic, restrictive and unfair trade practices which are prejudicial to public interest. Such regulations brighten the prospects of small and new firms. They also increase the scope of some of the existing firms to venture into new areas of business.Certain changes in government policies such as the industrial policy, fiscal policy, tariff policy etc. may have profound impact on business. Some policy developments create opportunities as well as threats.

In other words, a development which brightens the prospects of some enterprises may pose a threat to some others. For example, the industrial policy liberalizations in India, particularly around the mid-eighties have opened up new opportunities and threats. They have provided a lot of opportunities to a large number of enterprises to diversify and to make their product mix better. But they have also given rise to serious threat to many existing products by way of increased competitions; many seller's markets have given way to buyer's markets. Even products which were seldom advertised have come to be promoted very heavily. This battle for the market has provided a splendid opportunity for the advertising industry. Advertising billing has been increasing substantially.

The critical concern Political environment has a very important impact on every business operation no matter what its size, its area of operation. Whether the company is domestic, national, international, large or small political factors of the country it is located in will have an impact on it. And the most crucial & unavoidable realities of international business are that both host and home governments are integral partners. Reflected in its policies and attitudes toward business area governments idea of how best to promote the national interest, considering its own resources and political philosophy. A government control's and restricts a company's activities by encouraging and offering support or by discouraging and banning or restricting its activities depending on the government. Here steps in international law. International law recognizes the right of nations to grant or withhold permission to do business within its political boundaries and control its citizens when it comes to conducting business. Thus, political environment of countries is a critical concern for the international marketer and he should examine the salient features of political features of global markets they plan to enter.

Political Parties:

Particularly important to the marketer is the knowledge of all philosophies of all major political parties within a country, since anyone might become dominant and alter prevailing attitudes. In those countries where there are two strong political parties where usually one succeeds the other, it is important to know the direction each of the parties is likely to take. Changes in direction a country may take toward trade and related issues are caused not only by political parties but also by politically strong interest groups and factions within different political parties, which cooperate to affect trade policies.

5.6 TYPES OF POLITICAL SYSTEMS

1) Democracy:

Democracy is *for the people, by the people, and of the people,* its similar to participative management, in this system people are encouraged to participate in decision making, a peoples representative can be selected by the people through a process of election, and the responsibility of leading the nation is kept on the shoulders of the elected representative. Eg. India

2) Dictatorship:

It is also called as authoritarianism, which is quite opposite to democracy, here the hole power is in the hands of the leader, and people should follow the leader, all the policies related to economy, business etc are governed by the leader. Eg Saudi Arabia

3) Political Risks of Global Business:

a) **Confiscation:** The most severe political risk is confiscation, which is seizing of company's assets without payment.

b) **Expropriation:** Which requires reimbursement, for the government seized investment.

c) **Domestication:** This occurs when host country takes steps to transfer foreign investments to national control and ownership through series of government decrees. A change in the government's attitudes, policies, economic plans and philosophies toward the role of foreign investment is the reason behind the decision to confiscate, expropriate or domesticate existing foreign assets.

d) **Assessing Political Vulnerability:**Some products are more politically vulnerable than others, in that they receive more government attention. This special attention may result in positive or negative actions towards the company. Unfortunately there are no absolute guidelines for marketer's to follow whether the product will receive government attention or not.

5.7 SOCIAL AND CULTURAL ENVIRONMENT

The socio-cultural fabric is an important environmental factor that should be analyzed while formulating business strategies. The cost of ignoring the customs, traditions, taboos, tastes and preferences, etc., of people could be very high.The buying and consumption habits of the people, their language, beliefs and values, customs and traditions, tastes and preferences, education are all factors that affect business.

For a business to be successful, its strategy should be the one that is appropriate in the socio-cultural environment. The marketing mix will have to be so designed as best to suit the environmental characteristics of the market. In Thailand, Helene Curtis switched to black shampoo because Thai women felt that it made their hair look glossier. Nestle, a Swiss multinational company, today brews more than forty varieties of instant coffee to satisfy different national tastes.

Even when people of different cultures use the same basic product, the mode of consumption, conditions of use, purpose of use or the perceptions of the product attributes may vary so much so that the product attributes method of presentation, positioning, or method of promoting the product may have to be varied to suit the characteristics of different markets. For example, the two most important foreign markets for Indian shrimp are the U.S and Japan. The product attributes for the success of the product in these two markets differ.

In the U.S. market, correct weight and bacteriological factors are more important rather than eye appeal, colour, uniformity of size and arrangement of the shrimp which are very important in Japan. Similarly, the mode of consumption of tuna, another seafood export from India, differs between the U.S. and European countries. Tuna fish sandwiches, an American favorite which accounts for about 80 per cent of American tuna consumption, have little appeal in high tuna consumption European countries where people eat it right from the can. A very interesting example is that of the Vicks Vaporub, the popular pain balm, which is used as a mosquito repellant in some of the tropical areas.

The differences in languages sometimes pose a serious problem, even necessitating a change in the brand name. Preeti was, perhaps, a good brand name in India, but it did not suit in the overseas market; and hence it was appropriate to adopt 'Prestige' for the overseas markets. Chevrolet's brand name 'Nova' in Spanish means "it doesn't go". In Japanese, General Motors' "Body by Fisher" translates as corpse by Fisher". In Japanese, again, 3M's slogan "sticks like crazy "translates as "sticks foolishly". In some languages, Pepsi-Cola's slogan "come alive" translates as "come out of the grave".

The values and beliefs associated with colour vary significantly between different cultures. Blue, considered feminine and warm in Holland, is regarded as masculine and cold in Sweden. Green is a favorite colour in the Muslim world; but in Malaysia, it is associated with illness. White indicates death and mourning in China and Korea; but in some countries, it expresses happiness and is the colour of the wedding dress of the bride. Red is a popular colour in the communist countries; but many African countries have a national distaste for red colour.

Social inertia and associated factors come in the way of the promotion of certain products, services or ideas. We come across such social stigmas in the marketing of family planning ideas, use of bio-gas for cooking, etc. In such circumstances, the success of marketing depends, to a very large extent, on the success in changing social attitudes or value systems. There are also a number of demographic factors, such as the age, and sex composition of population, family size, habitat, religion, etc., which influence the business.

While dealing with the social environment, we must also consider the social environment of the business which encompasses its social responsibility and the alertness or vigilance of the consumers and of society at large. The societal environment has assumed great importance in recent years. As Barker observes, business "traditionally has been held responsible for quantities-for the supply of goods and jobs, for costs, prices, wages, hours of works, and for standards of living.

Today, however, business is being asked to take a responsibility for the quality of life in our society. The expectation is that business- in addition to its traditional accountability for economic performance and results – will concern itself with the health of the society, that it will come up with the cures for the ills that currently beset us and, indeed, will find ways of anticipating and preventing future problems in these areas".As Stern succinctly points out, the "more educated the society becomes, the more interdependent it becomes, and the more discretionary the use of its resources, the more marketing will become enmeshed in social issues. Marketing personnel are at interface between company and society. In this position, they have the responsibility not merely for designing a competitive marketing strategy, but for sensitizing business to the social, as well as the product demand of society.

In the context of cultural environment when doing business abroad, a company first should determine whether a usual business practice in a foreign country differs from its home-country experience. Understanding the cultures of groups of people is useful because business employs, sells to, buys from, is regulated by, and is owned by people.

5.8 ELEMENTS OF SOCIAL CULTURAL ENVIRONMENT

The major elements of culture are material culture, language, aesthetics, education, religion, attitudes and values and social organization.

1) **Material Culture:** Material culture refers to tools, artifacts and technology. Before marketing in a foreign culture it is important to assess the material culture like transportation, power, and communications and so on. All aspects of marketing are affected by material culture like sources of power for products, media availability and distribution. **For example**, refrigerated transport does not exist in many African countries. Material culture introductions into a country may bring about cultural changes which may or may not be desirable.

2) **Language:** Language reflects the nature and values of society. There may be many sub-cultural languages like dialects which may have to be accounted for. Some countries have two or three languages. In Zimbabwe there are three languages - English, Shona and Ndebele with numerous dialects. In Nigeria, some linguistic groups have engaged in hostile activities. Language can cause communication problems - especially in the use of media or written material. It is best to learn the language or engage someone who understands it well.

3) **Aesthetics: Aesthetics** refer to the ideas in a culture concerning beauty and good taste as expressed in the arts -music, art, drama and dancing and the particular appreciation of colour and form. African music is different in form to Western music. Aesthetic differences affect design, colours, packaging, brand names and media messages. For example, unless explained, the brand name FAVCO would mean nothing to Western importers, in Zimbabwe most people would instantly recognize FAVCO as the brand of horticultural produce.

4) **Education:** Education refers to the transmission of skills, ideas and attitudes as well as training in particular disciplines. Education can transmit cultural ideas or be used for change, for example the local university can build up an economy's performance. The UN agency UNESCO gathers data on education information. For example it shows in Ethiopia only 12% of the viable age group enrol at secondary school, but the figure is 97% in the USA. Education levels, or lack of it, affect marketers in a number of ways:

a. Advertising programmes and labeling

b. Girls and women excluded from formal education (literacy rates)

c. Conducting market research

d. Complex products with instructions

e. Relations with distributors and,

f. Support sources - finance, advancing agencies etc

5) **Religion:** Religion provides the best insight into a society's behavior and helps answer the question why people behave rather than how they behave. A survey in the early 1980s revealed the following religious groupings.

SI. NO.	Religious/Groups	Million
1.	Animism	300
2.	Buddhism	280
3.	Christianity	1500
4.	Hinduism	600
5.	Islam	800
6.	Shinto	120
Total		**3600**

Source: Survey of reports census 2011.

6) **Attitudes and values:** Values often have a religious foundation, and attitudes relate to economic activities. It is essential to ascertain attitudes towards marketing activities which lead to wealth or material gain, for example, in Buddhist society these may not be relevant. Also "change" may not be needed, or even wanted, and it may be better to relate products to traditional values rather than just new ones. Many African societies are risk averse; therefore, entrepreneurialism may not always be relevant. Attitudes are always precursors of human behavior and so it is essential that research is done carefully on these.

7) **Social Organisation:** Refers to the way people relate to each other, for example, extended families, units, kinship. In some countries kinship may be a tribe and so segmentation may have to be based on this. Other forms of groups may be religious or political, age, caste and so on. All these groups may affect the marketer in his planning. There are other aspects of culture, but the above covers the main ingredients. In one form or another have to be taken account of when marketing internationally.

5.9 LEGAL ENVIRONMENT

All business occurs within a particular legal and regulatory environment the current legal environment in the United States spins on a variety of complex issues that have an impact on business: international trade, capital gains taxes, unemployment, aging baby boomers, technology, employment laws, and social concerns such as health care, child care, and job training. This legal tapestry means businesses must be even more vigilant to include consideration of the legal environment in their strategic planning. The legal environment is well recognized as one of the most significant influences with which strategic plans must contend.

Origins of International Law:

There is no comprehensive system of laws or regulations for guiding business transactions between two countries. The legal environment consists of laws and policies from all countries engaged in international commercial activity. Early trade customs centered around the law of the sea and provided, among other things, for rights of shipping in foreign ports, salvage rights, and freedom of passage. During the Middle Ages, international principles embodied in the lewmercatoria (law merchant) governed commercial transactions throughout Europe. Although laws governing international transactions were more extensive in some countries than others, the customs and codes of conduct created a workable legal structure for the protection and encouragement of international transactions. The international commerce codes in use today in much of Europe and in the United States are derived in part from those old codes.

Sources of International Law

The main sources of international commercial law are the laws of individual countries, the laws embodied in trade agreements between or among countries, and the rules enacted by a worldwide or regional organization such as the United Nations or the European Union. There is no international regulatory agency or system of courts universally accepted for controlling international business behavior or resolving international conflicts among businesses or countries. This refers to set of laws, regulations, which influence the business organisations and theiroperations. Every business organization has to obey, and work within the framework ofthe law in international business environment.

The important legislations that concern the business enterprises include:

1) Companies Act, 1956

2) Foreign Exchange Management Act, 1999

3) The Factories Act, 1948
4) Industrial Disputes Act, 1972
5) Payment of Gratuity Act, 1972
6) Industries (Development and Regulation) Act, 1951
7) Prevention of Food Adulteration Act, 1954
8) Essential Commodities Act, 2002
9) The Standards of Weights and Measures Act, 1956
10) Monopolies and Restrictive Trade Practices Act, 1969
11) Trade Marks Act, 1999
12) Bureau of Indian Standards Act, 1986
13) Consumer Protection Act, 1986
14) Environment Protection Act.

International law can be enforced to some degree through:

a) The International Court of Justice,

b) International arbitration, or

c) The courts of an individual country. However, the decisions of those tribunals in resolving international business disputes can be enforced only if the countries involved agree to be bound by them.

Types of Legal Systems

a) Common Law System; Based on tradition, precedent, and custom and usage, and the courts fulfill an important role in interpreting the law according to those characteristics.

b) Civil Law System or a Codified Legal System: Based on a very detailed set of laws that are organized into a code. This code is the foundation for doing business. Over 70 countries operate on a civil law basis. The two legal systems differ primarily in that common law is based on the courts interpretation of events, whereas civil law is based on how the law is applied to the facts. Ex: Contracts.

c) **Statutory Law**: Common law countries depend not only on case law but also on statutory law (legislation) the law passed by the government. This can also be a source of legal variation between countries. For example, the US Freedom of information Act is more far reaching than similar UK legislation, so that transactions between the government and companies have to be more transparent in the USA than in UK.

d) **Code Law**: This is the world's most common system. It is explicit codification in written terms of what is and what is not permissible. Such laws can be written down in criminal, civil and commercial codes, which are then used to determine the outcome of all legal matters.

e) **Religious Law** This law is based on the officially established rules governing the faith and practice of a particular religion. A country that applies religious law to civil and criminal conduct is called a theocracy. In Iran, for example, a group of mullahs, or holy men, determine the legal it or illegal it through their interpretation of the Koran, the holy book of Islam. Religious laws can create interesting problems for firms. Consider the teaching of the Muslim holy book, the Koran, which denounces charging interest on loans as an unfair exploitation of the poor. Muslim firms and financial institutions have had to develop alternative financing arrangements to acquire and finance capital. Muslim businesses

f) **Theocratic Law System:** Based on religious precepts. Islamic law. The U.S. has the most lawyers of any country in the world and is one of the highest in the number of lawyers per capita. Ex: 312 lawyers per 100,000 compared to 101 lawyers per 100,000 in Japan.

g) **Bureaucratic Law:** Which is practiced in many communist countries as well as dictatorships, is law that is set by the country's current leadership? This law is subject to change rapidly, when regimes change. In the summer of 2003, the citizens of Hong Kong feared that the Chinese government would impose an ant subversion law on the island, as is in place on the mainland. This law, which could be used to quell future protests in Hong Kong, contradicted the concept of "one nation, two systems" that has existed between China and Hong Kong since China took over possession of the island from Great Britain in 1997. While the Chinese government eventually backed off on its implementation of an antisubversion law in Hong Kong, this is an example of how bureaucratic law can suddenly change the operating environment in a formerly open society.

5.10 TECHNOLOGICAL ENVIRONMENT

Technology has played a major role in the life of people, right from snail mail to e-mail the way we live has dramatically changed from the past decade. Technology has removed the global barriers like distance, time etc. thanks to the latest technological developments like Internet, e-mail, video conferencing, cell phone etc that plays a major role in international business. Technological environment include the methods, techniques and approaches adopted forproduction of goods and services and its distribution. The varying technological environmentsof different countries affect the designing of products.

Technological change can have impact on the decisions taken by International Business. Technological change can involve:

New process of production: new ways of doing things which rises productivity of factor inputs, as with use of robotics in car assembly techniques which has dramatically raised output per assembly line worker. For example around 80% of technological change has been process innovation. For example, online banking and many new financial services are direct result of advances in micro processor based technologies.

For example: in USA and manyother countries electrical appliances are designed for 110 volts. But when these are madefor India, they have to be of 220 volts. In the modern competitive age, the pace oftechnological changes is very fast. Hence, in order to survive and grow in the market, abusiness has to adopt the technological changes from time to time. It may be noted that scientific research for improvement and innovation in products and services is a regularactivity in most of the big industrial organizations. Now a day infect, no firm can afford topersist with the outdated technologies.

It is widely held that multinational activity is more efficient foreign multinationals promotes technology transfer to the benefit of domestic companies. For example, when Nissan established a car plant in Northern –Eastern England, it demanded much of higher standards of UK components suppliers than the incumbent national producer such as Ford and Rover. There is some limitation in technology transfer: for example in case of inward FDI may reflect multinationals seeking to exploit an ownership-specific advantage over domestic companies. In such circumstances, it is unlikely that foreign multinationals will willingly share the technologically based sources of its competitive advantage over local rivals.

A further obstacle to technology transfer may involve the issue of cultural dissonance. The psychic distance between US and UK companies is relatively small. Both shares a broadly common culture, a common language and they have a reasonably high level of mutual understanding. However success of multinationals from (Japan) or other parts of east and south-east Asia is built on a very different setting. An opposing view point to the potential damage to the host country's of technology transfer when it enables foreign affiliates to dominate domestic markets and displace domestic producers.

Benefits of Technology in Management Decision Making:

Technology helps the manager to make decisions related to business in the following ways:

i. **Decision Support System:** It is an information system which collects the information from various sources like government, customers and suppliers and global market and competitors and helps the manager to interact with the mathematical decision models to make decision.

ii. **Group Decision Support System: An** expert system with set of hardware, software & procedures that support a group of people engaged in a decision-related meeting.

iii. **Office Automation System: An** office automation system uses computers or networks to carry out various office operations.

iv. **Transaction Processing System: A** system that handles the processing and tracking of transactions is called TPS.

v. **Management Information System: MIS** is a set of software tools that enables managers to gather, organize, & evaluate information about a workgroup, department or entire organization.

vi. **Expert System:** Expert System is a specialized application that performs tasks that would normally be done by a human.

The impact of technical change on competitive advantages is also considered. For example new technologies in manufacturing of semi-conductors have had a major impact on that industry. The monster chip fabrication plants, or Fabs, can produce more than US$8 billion of chips a year, more than several medium-sized producers combined, around 5% of global capacity.

5.11 SUMMARY

This unit discussed about the basic concepts of meaning, importance and features international business environment. Political, social and cultural, technological, legal environment are discussed in the length. An account of types of political system and elements of social cultural environment is also given in this unit

5.12 SELF ASSESSMENT QUESTIONS

1. Define International Business Environment?
2. Briefly explain the Macro International Business Environment?
3. Explain the Socio-Cultural environment of International Business?
4. Mention the types of Political Systems in India?

5.13 CASE STUDY

Case Study No.1

Nestle Company Pvt. Ltd.

Despite its undisputed success, Nestle' realized by the early 1990s that it faced significant challenges in maintaining its growth rate. The large Western European and North American markets were stature. In several countries population growth had stagnated and in some there had been a small decline in food consumption. The retail environment in many Western nations had become increasingly challenging, and the balance of power was shifting away from the large-scale manufacturers of branched foods and beverages and toward ration wide supermarket and discount chains. Increasingly, retailers found themselves in the unfamiliar position of playing off against each other manufacturers of branded foods, thus bargaining down prices. Particularly in Europe, this trend was enhanced by the successful introduction of private-label brands by several of Europe's leading super-market chains. The results included increased price competition in several key segments of the food and beverage market, such as cereals, coffee and soft drinks.

At Nestle, one response has been to look toward emerging markets in Eastern Europe, Asia and Latin American for growth possibilities. The logic is simple and obvious – a combination of economic and population growth, when coupled with the widespread adoption of market-oriented economic policies by the governments of many developing nations, makes for attractive

business opportunities. Many of these countries are still relatively poor, but their economies are growing rapidly. For example, if current economic growth forecasts occur, by 2010 there will be 700 million people in China and India that have income levels approaching those to Spain in the mid 1990 S. As income levels rise, it is increasingly likely that consumers in these nations will start to substitute branded food products for basic food stuffs, creating a large market opportunity for companies such as Nestle.

In general, the company's strategy has been to enter emerging markets, early-before competitors and build a substantial position by selling basic food items that appeal to the local population base, such as infant formula condensed milk, noodles, and tofu. By narrowing its initial market focus to just a handful of strategic brands, Nestle' claims it can simplify life, reduce risk, and concentrate its marketing resources and managerial effort on a limited number of key niches. The goal is tobuild a commanding market position in each of these niches. By pursuing such strategy, Nestle has taken as much as 85 percent of the market for instant coffee in Mexico, 66 percent of the market for powdered milk in the Philippines and 70 percent of the market for soups in Chile. As income levels rise, the company progressively moves out from these niches, introducing more upscale items, such as mineral water chocolate, cookies and prepared food stuffs.

Although the company is known worldwide for several key brands, such as Nescafe, it uses local brands in many markets. The company owns 8,5000 brands, but only 750 of them are registered in more than one country, and only 80 are registered in more than 10 countries. While the company will use the same, "global brands" in multiple developed markets, in the developing world it focuses on trying to optimize ingredients and processing technology to local conditions and then using a brand name that resonates locally. Customization rather than globalization is the key to the company's strategy in emerging markets.

QUESTIONS:

1. Briefly give overall view of environmental scanning of Nestle to focus its growth efforts on International Business? Why?
2. What is the company's strategy with regard to business development in Nestle Company using technological environment?

Case Study No.2

Microsoft Corporations Ltd.

The U.S. International Trade Commission estimates that pirates cost U.S. industry more than $100 billion in lost profits each year. Microsoft Corporation found an extensive network pirating its window software. The group was talented enough to even copy the hologram used to discourage pirating. Microsoft filed a law suit privately and elicited the assistance of the International Trade Commission to sanction the antipiracy group in Taiwan.

New technologies can both create and destroy jobs. Where the new technologies involve process innovation then labour is often replaced by capital equipment in the production process and the term 'technological unemployment' is often used. For example, the US Internet banking company has introduced 'smart' technologies into every aspect of its operations, so that its $2.4bn of deposits are now managed by just 180 people, compared to the 2,000 people required to manage deposits of this size in less technologically advanced banks. However, the new technologies may lower product prices and raise product quality, thereby increasing product demand and creating new jobs, even if these are different from the original jobs displaced.

QUESTIONS:

1. What is expected of Taiwan Government under the circumstances to balance legal environment of the firm?
2. Discuss the overall case study and explain the impact of technological environment in International Business?

5.14 NOTES

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5.15 REFERENCES

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UNIT - 6 : ECONOMIC ENVIRONMENT

Structure :

6.0 Objectives

6.1 Introduction

6.2 Meaning and Definitions

6.3 Natural Environment

6.4 Demographic Environment

6.5 Economic Envirnoment

6.6 The Economic Environment Conditions in India

6.7 Summary

6.8 Self Assessment Questions

6.9 Case Study

6.10 Notes

6.11 References

6.0 OBJECTIVES

After studying this unit, you should be able to;

- Define the term international economic environment.
- Describe the concept of demographic environment in IBE.
- Determine the concept of natural environment in IBE.
- Give an account on present economic environment conditions in india.

6.1 INTRODUCTION

The economic environment has the most profound influence on the business. The globalization of economy has brought the nations together. We are moving towards a closely knot economy, from the era of protectionism and self-sufficiency. Therefore, there is a need to study the current economic environment and the variables that shape the same.The most radical changes have happened on the economic front in the last two decades, which have changed the entire mathematics of international business environment.

The political events such as the disintegration of USSR have made the world a multi-polar entity. At the same time, the technological advances, particularly those in the field of information technology have made the world a smaller place. The strengthening of the global economic institutions, particularly WTO have led to a major integration of the nations. However, the main driving force behind these developments remains the economic environment. Irrespective of the nature and size of business, no business entity is left insulated from the global changes. The competition is right on the door of every business. Therefore, anyone aspiring to excel in business needs to understand these economic environmental variables and master, with dexterity, the techniques to gain maximum advantage out of them. The most profound of the changes is the dislocation of local competition.

Some of major changes in the past decades are:

1. Capital movement rather than trade have become the driving force of the world economy.
2. Production has become disassociated from employment.
3. Primary products have lost their traditional association from the industrial economy.
4. The economics seems to have a greater influence on the politics, than vice versa.

5. The ideology of nation controlling the economy is primarily rejected. There is a realization of the benefits of free market economy.

The established of above principles of economics have been redefined and we understand the economics of interdependence and cooperation instead of protectionism. The old rules of competition are also undergoing a change. From a direct head on confrontation, the businesses are developing the niches where each of the players grows and excels.

6.2 MEANING AND DEFINITIONS

Economic Environment refers to all those economic factors, which have a bearing on the functioning of a business. Business depends on the economic environment for all the needed inputs. It also depends on the economic environment to sell the finished goods. Naturally, the dependence of business on the economic environment is total and is not surprising because, as it is rightly said, business is one unit of the total economy.

Economic environment influences the business to a great extent. It refers to all those economic factors which affect the functioning of a business unit. Dependence of business on economic environment is total for input and also to sell the finished goods. Trained economists supplying the Macro economic forecast and research are found in major companies in manufacturing, commerce and finance which prove the importance of economic environment in international business environment.

The economic environment consists of external factors in a business' market and the broader economy that can influence a business. You can divide the economic environment into the microeconomic environment, which affects business decision making - such as individual actions of firms and consumers - and the macroeconomic environment, which affects an entire economy and all of its participants. The totality of economic factors, such as employment, income, inflation, interest rates, productivity, and wealth, that influence the buying behavior of consumers and institutions. The state became the encourager of savings and also an important investor and the owner of capital. Since the state was to be the primary agent of economic changeit followed that private sector activities had to be strictly regulated and controlled to conform to the objectives of state policy. The economic environment resulting from the 2007 financial crisis created a great deal of fear amongst companies thereby limiting their capital spending budgets in India.

6.3 NATURAL ENVIRONMENT

The natural environment includes geographical and ecological factors that influence thebusiness operations. These factors include the availability of natural resources, weatherand climatic condition, location aspect, topographical factors, etc. Business is greatlyinfluenced by the nature of natural environment. For example, sugar factories are set uponly at those places where sugarcane can be grown. It is always considered better toestablish manufacturing unit near the sources of input. Further, government's policies tomaintain ecological balance, conservation of natural resources etc. put additional responsibility on the business sector.

Geographical and ecological factors, such as natural resource endowments, weather and climatic conditions, topographical factors, locational aspects in the global context, port facilities, etc., are all relevant to business. Differences in geographical conditions between markets may sometimes call for changes in the marketing mix. Geographical and ecological factors also influence the location of certain industries. For example, industries with high material index tend to be located near the raw material sources. Climatic and weather conditions affect the location of certain industries like the cotton textile industry. Topographical factors may, affect the demand pattern. For example, in hilly areas with a difficult terrain, jeeps may be in greater demand than cars.

Ecological factors have recently assumed great importance. The depletion of natural resources, environmental pollution and the disturbance of the ecological balance has caused great concern. Government policies aimed at the preservation of environmental purity and ecological balance, conservation of non-replenishale resources, etc., have resulted in additional responsibilities and problems for business, and some of these have the effect of increasing the cost of production and marketing. Externalities have become an important problem the business has to confront with.

Equally significant, but sadly ignored, are the factors like climate,minerals, soil, landform, rivers and oceans, coast lines, natural resources, flora and fauna etc. Which have considerable influence on thefunctioning of a business. It is the natural environment which decidesthe resources for any business. Manufacturing, which is one of the aspects of business, depends onphysical environment for inputs like raw material, labour of variousskills, water, fuel etc. Trade between two regions of a nation or between two nations is the result of geographic factors. Because of naturalfactors, certain areas are more suitable for production

of certain goodsand other areas are in need of such goods. Transportation and communication, the main prop of business, depend to a larger extent on geographic factors. Uneven landforms, desserts, oceans, forest, rivers etc. are barriers to develop this vital infrastructure. Some businesses likemining of coal and ores, drilling of oil and most important agriculture which depends most on nature. Thus the impact of natural environment cannot be ignored moreover it should be given top priority for any successful business.

6.4 DEMOGRAPHIC ENVIRONMENT

Demographic factors like the size, growth rate, age composition, sex composition, etc. of the population, family size, economic stratification of the population, educational levels, languages, caste, religion etc. Are all factors that are relevant to business. Demographic factors such as size of the population, population growth rate, age composition, life expectancy, family size, spatial dispersal, occupational status, employment pattern etc, affect the demand for goods and services. Markets with growing population and income are growth markets. But the decline in the birth rates in countries like the United States has affected the demand for baby products. Johnson and Johnson have overcome this problem by repositioning their products like baby shampoo and baby soap, promoting them also to the adult segment, particularly to the females. The occupational and spatial mobilities of population have implications for business. If labour is easily mobile between different occupations and regions, its supply will be relatively smooth, and this will affect the wage rate. If labour is highly heterogeneous in respect of language, caste and religion, ethnicity, etc., personnel management is likely to become a more complex task. The heterogeneous population with its varied tastes, preferences, beliefs, temperaments, etc. gives rise to differing demand patterns and calls for different marketing strategies. References to a number of demographic factors that have business implications have already been made under socio-cultural environment.

A rapidly increasing population indicates a growing demand for many products. High population growth rate also indicates an enormous increase in labour supply. When the Western countries experienced the industrial revolution, they had the problem of labour supply, for the population growth rate was comparatively low. Labour shortage and rising wages encouraged the growth of labour-saving technologies and automation. But most developing countries of today are experiencing a population explosion and a situation of

labour surplus. The governments of developing countries, therefore, encourage labour intensive methods of production. Capital intensive methods, automation and even rationalization are opposed by labour and many sociologists, politicians and economists in these countries. The population growth rate, thus, is an important environmental factor which affects business. Cheap labour and a growing market have encouraged many multinational corporations to invest in developing countries.

The following are the other demographic structural characteristics as follows:

Populations can also be examined in a number of other ways including their ethnicity and geographical distribution.

- **Population change:** As the previous analysis indicates, populations can change in either size and/or structure, with important consequences for economic activity both within and between countries. The size and structure of a country's population depend on a number of variables, the most important of which are the birth rate, the death rate and the net migration rate
- **The birth rate:** Birth rates tend to be expressed as the number of live births per thousand of the population in a given year. In many countries this figure has been falling steadily over a long period of time for a number of reasons. These include: A trend towards smaller families as people become better off and health improves and death rates fall. The increased availability of contraception. x The trend towards later marriages and later childbearing for social and/or economic reasons and Declining fertility rates, Changing attitudes towards women and work. In some countries governments have offered financial and other incentives to married couples to try to reduce the birth rate (e.g. China) as a means of controlling population growth. In other countries incentives have been offered to try to reverse the actual or potential decline in the birth rate because of its economic consequences (e.g. France, Singapore). Declining birth rates are, of course, an important contributor to an ageing population; they can also have other consequences. For instance, a recent increase in the birth rate in the UK has led to a call by the Optimum Population Trust for British couples to restrict themselves to 2 children in order to reduce the impact of population growth on the natural environment. In Nigeria, various governments have tried to restrict couples to four children per couple but this has not been effectively handled.

- **The death rate**: birth rates, death rates are usually measured per thousand of the population in a given year. For developed economies, this figure has tended to fall over time before reaching a plateau. Among the main contributors to this trend have been rising living standards, including better housing, sanitation and nutrition and developments in medical technology and practice. And also better education. This refers to the size, density, distribution and growth rate of population. All these factors have a direct bearing on the demand for various goods and services. For example a country where population rate is high and children constitute a large section of population, and then there is more demand for baby products. Similarly the demand of the people of cities and towns are different than the people of rural areas. The high rise of population indicates the easy availability of labour. These encourage the business enterprises to use labour intensive techniques of production. Moreover, availability of skill labour in certain areas motivates the firms to set up their units in such area. For example, the business units from America, Canada, Australia, Germany, UK, are coming to India due to easy availability of skilled manpower. Thus, a firm that keeps a watch on the changes on the demographic front and reads them accurately will find opportunities knocking at its doorsteps.

6.5 ECONOMIC ENVIRONMENT

The economic environment includes economic conditions, economic policies and economic system of the country. All these have a bearing on the strategies adopted by the firms and any change in these areas is likely to have a far-reaching impact on their operations. Let us have a brief idea about each of these areas of business environment**.** The survival and success of each and every business enterprise depend fully on its economicenvironment.

The completely free market economy, however, is an abstract system rather than a real one. Today, even the so-called market economies are subject to a of government regulations. Countries like the United States, Japan, Australia, Canada and member countries of the EEC are regarded as market economies. The communist countries have, by and large, a centrally planned economic system. Under the rule of a communist or authoritarian socialist government, the state owns all the means of production, determines the goals of production and controls the economy according to a central master plan. There is hardly any consumer sovereignty in a centrally planned economy, unlike in the free market economy. The consumption pattern in a centrally planned economy is dictated by the state. China,

East Germany Soviet Union, Czechoslovakia, Hungary, Poland etc., had centrally planned economies. However, recently several of these countries have discarded communist system and have moved towards the market economy. In between the capitalist system and the centrally planned system falls the system of the mixed economy, under which both the public and private sectors co-exist, as in India. The extent of state participation varies widely between the mixed economies. However, in many mixed economies, the strategic and other nationally very important industries are fully owned or dominated by the state.

According to the industrial policy of the Government of India until July 1991, the development of 17 of the most important industries was reserved for the state. In the development of another 12 major industries, the state was to play a dominant role. In the remaining industries, co-operative enterprises, joint sector enterprises and small scale units were to get preferential treatment over large entrepreneurs in the private sector. The government policy, thus limited the scope of private business. However, the new policy ushered in since July 1991 has wide opened many of the industries for the private sector. The scope of international business depends, to a large extent, on the economic system. At one end, there are the free market economies or capitalist economies, and at the other end are the centrally planned economies or communist countries. In between these two are the mixed economies. Within the mixed economic system itself, there are wide variations. The main factors that affect the economic environments are:

1) **Economic Conditions:** The economic conditions of a nation refer to a set of economicfactors that have great influence on business organisations and their operations. Theseinclude gross domestic product, per capita income, markets for goods and services,availability of capital, foreign exchange reserve, growth of foreign trade, strength ofcapital market etc. All these help in improving the pace of economic growth.

2) **Economic Policies:** All business activities and operations are directly influenced bythe economic policies framed by the government from time to time. The government keeps on changing these policies from time to time in view of thedevelopments taking place in the economic scenario, political expediency and the changing requirement. Every business firm has to function strictly within the policy framework and respond to the changes therein.Some of the important economic policies are:

I. Industrial policy

II. Fiscal policy

III. Monetary policy

IV. Foreign investment policy

V. Export –Import policy

VI. Exim policy

I. Industrial policy: The Industrial policy of the government coversall those principles, policies, rules, regulations and procedures, which direct and control the industrial enterprises of the countryand shape the pattern of industrial development.

II. Fiscal policy: It includes government policy in respect of publicexpenditure, taxation and public debt.

III. Monetary policy: It includes all those activities and interventionsthat aim at smooth supply of credit to the business and a boostto trade and industry.

IV. Foreign investment policy: This policy aims at regulating theinflow of foreign investment in various sectors for speeding upindustrial development and take advantage of the moderntechnology.

V. Export–Import policy (Exim policy): It aims at increasing exportsand bridge the gap between expert and import. Through thispolicy, the government announces various duties/levies. The focus now-a-days lies on removing.

3) Economic System: The world economy is primarily governed by three types of economic systems, The scope of a private business and the extent ofgovernment regulation of economic activities depend to a very largeextent on the nature of economic system, which is an important part of business environment. Broadly the economic system is divided into threegroups viz.,

a) Capitalist economy: The system of capitalism stresses the philosophy of individualism believing in private ownership of all agents of production, in private sharing of distribution processes that determine the functions rewards of each participant, and in individual expression of consumer choice through a free market place. In its political manifestation, capitalism may fall in a range between extreme individualisms and anarchism (no government) and the acceptance of some state sanctions.

b) **Socialist economy:** Under socialism, the tools of production are to be organized, managed and owned by the government, with the benefits occurring to the public.A strong public sector, agrarian reforms, control over private wealth and investment and national self reliance are the other planks of socialism. Socialism does not involve an equal division of existing wealth among the people, but advocates the egalitarian principle. It believes in providing employment to all and emphasizes suitable rewards to the efforts put in by every worker. Also called fabian socialism, this philosophy is followed in our country and other social democratic countries in the world

c) **Mixed economy**: Communism goes further to abolish all private property and property rights to income. The state would own and direct all instruments of production. Sharing in the distributive process would have no relationship to private property since this right would not exist. Alternatively called maxism, communism was followed in Russia, China and East European Countries.

India has adopted the mixed economy system which implies co-existence of public sector and private sector. Economic conditions, economic policies and the economic system are the important external factors that constitute the economic environment of a business. The economic conditions of a country-for example, the nature of the economy, the stage of development of the economy, economic resources, the level of income, the distribution of income and assets, etc- are among the very important determinants of business strategies.

In a developing country, the low income may be the reason for the very low demand for a product. The sale of a product for which the demand is income-elastic naturally increases with an increase in income. But a firm is unable to increase the purchasing power of the people to generate a higher demand for its product. Hence, it may have to reduce the price of the product to increase the sales. The reduction in the cost of production may have to be effected to facilitate price reduction. It may even be necessary to invent or develop a new low-cost product to suit the low-income market. Thus Colgate designed a simple, hand-driven, inexpensive ($10) washing machine for low-income buyers in less developed countries. Similarly, the National Cash Register Company took an innovative step backward by developing a crank-operated cash register that would sell at half the cost of a modern cash register and this was well received in a number of developing countries

In countries where investment and income are steadily and rapidly rising, business prospects are generally bright, and further investments are encouraged. There are a number

of economists and businessmen who feel that the developed countries are no longer worthwhile propositions for investment because these economies have reached more or less saturation levels in certain respects. In developed economies, replacement demand accounts for a considerable part of the total demand for many consumer durables whereas the replacement demand is negligible in the developing economies.

The economic policy of the government, needless to say, has a very great impact on business. Some types or categories of business are favorably affected by government policy, some adversely affected, while it is neutral in respect of others. For example, a restrictive import policy, or a policy of protecting the home industries, may greatly help the import-competing industries. Similarly, an industry that falls within the priority sector in terms of the government policy may get a number of incentives and other positive support from the government, whereas those industries which are regarded as inessential may have the odds against them. In India, the government's concern about the concentration of economic power restricted the role of the large industrial houses and foreign concerns to the core sector, the heavy investment sector, the export sector and backward regions.

The monetary and fiscal policies, by the incentives and disincentives they offer and by their neutrality, also affect the business in different ways. An industrial undertaking may be able to take advantage of external economies by locating itself in a large city; but the Government of India's policy was to discourage industrial location in such places and constrain or persuade industries undertaking, a backward area location may have many disadvantages. However, the incentives available for units located in these backward areas many compensate them for these disadvantages, at least to some extent.

The most radical changes have happened on the economic front in the last two decades, which have changed the entire mathematics of international business environment. The political events such as the disintegration of USSR have made the world a multi-polar entity. At the same time, the technological advances, particularly those in the field of information technology have made the world a smaller place. The strengthening of the global economic institutions, particularly WTO have led to a major integration of the nations. However, the main driving force behind these developments remains the economic environment. Irrespective of the nature and size of business, no business entity is left insulated from the global changes. The competition is right on the door of every business. Therefore, anyone aspiring to excel in business needs to understand these economic environmental variables

and master, with dexterity, the techniques to gain maximum advantage out of them. The most profound of the changes is the dislocation of local competition. Some of major changes in the past decades are:

- Capital movement rather than trade have become the driving force of the world economy.
- Production has become disassociated from employment.
- Primary products have lost their traditional association from the industrial economy.
- The economics seems to have a greater influence on the politics, than vice versa.
- The ideology of nation controlling the economy is primarily rejected. There is a realization of the benefits of free market economy.

The established principles of economics have been redefined and we understand the economics of interdependence and cooperation instead of protectionism. The old rules of competition are also undergoing a change. From a direct head on confrontation, the businesses are developing the niches where each of the players grows and excels.

In the context of economic environment is unemployment situation in developing countries and economies in transition is more pressing, in both cyclical and structural terms. Official unemployment data, which often cover only urban areas, in general, underestimate by a large margin the severity of unemployment and, particularly, the underemployment situation in most developing countries. Nonetheless, even by this measure, only a small number of countries in Asia, in Latin America and in the group of economies in transition registered a notable reduction in unemployment rates in 2005.Unemployment rates for most Asian economies are still above their levels prior to the Asian financial crisis of the late 1990s.

In China and many Asian economies, where people in rural areas still account for a large share of the population, surplus labour and high rates of underemployment in the rural areas remain a long-term policy concern. In South Asia, for example, the formal sector is unable to absorb a rapidly growing workforce and unemployment is highest among the young — which is also the case for many other developing countries. Despite some improvement, unemployment rates in most Latin American countries and economies in transition are still high — near 10 per cent. Structural unemployment and underemployment problems are particularly acute in Africa despite its recent growth recovery. Official rates of unemployment are at 10 per cent or higher in some of these economies.

Meanwhile, only about a dozen developing countries experienced a decline in per capita GDP during 20014-2015, the smallest number in decades. Such a trend is expected to continue in 2006. The employment situation worldwide is improving, but is far from satisfactory. Employment creation has lagged behind output growth in the global recovery of the past few years. Despite some noticeable improvement, most recently in 2016, unemployment rates in a large number of countries are still higher than their levels prior to the global downturn of 2000-2001. Many developing countries are also facing high levels of structural unemployment and underemployment, limiting the activeness of growth in reducing poverty. A gradual recovery in employment continues in most developed countries. In the United States of America, the average monthly increase in wage employment has strengthened in 2006, with the unemployment rate dropping below 5 per cent. In Eastern Europe, unemployment rates are still about 12 percentage point above their low levels of 2011, but a gradual improvement is discernible. The unemployment rate in Japan has been declining steadily, and labour markets in Australia, Canada and New Zealand are exceptionally strong.

World Economic Situation and Prospects as of mid-2015 higher than what was projected at the beginning of the year in World Economic Situation and Prospects 2015. A number of downside risks have heightened most recently and they will weigh on the world economy in the near to medium future. The large global imbalances remain the primary source of uncertainty for the stability of the world economy, but there are other sources of uncertainties that are not negligible, such as the persistence of higher oil prices, the cooling o. in the housing sector in a number of economies, the risk of avian influenza's turning into a pandemic, and the rising interest rates worldwide, as well as some geopolitical uncertainties. One salient feature of the global economic expansion of the past two years has been the improvement in the breadth of growth performance among developing countries: a large number of developing countries.

The present status of the world economy can best be defined as beginning on a strong note. As a number of major developed economies managed to rebound from the notable slowdown in late 2015, many developing countries maintained the momentum of broad and solid growth. A measurable moderation is expected, however, in the second half of 2015, with the annual growth of world gross product (WGP) for 2015 as a whole at about 3.6 per cent the same pace as in 2015 and marginally. The global projections are based on the

weighted average of projected individual-country growth rates using the gross domestic product (GDP) valued in 2000 dollar prices for each country. Other global projections tend to use GDP valued in purchasing power parity (PPP) dollars. When using those weights, the United Nations global forecast for world economic growth would be 4.8 per cent for 2015.

6.6 THE ECONOMIC ENVIRONMENT CONDIIONS IN INDIA

Economic conditions such as inflation, economic growth, unemployment, balance of payments are some of the economic factors in the economic environment that affect business organization operations. In what follows, we shall briefly discuss some of these factors Inflation is usually defined as an upward and persistent movement in the general level of prices over a given period of time; it can also be characterized as a fall in the value of money. For governments reducing such movements to a minimum is seen as a primary economic objective. Explanations as to why prices tend to rise over time vary considerably, but broadly speaking fall into two main categories.

First, supply-siders tend to focus on rising production costs - particularly wages, energy and imported materials - as a major reason for inflation, with firms passing on increased costs to the consumer in the form of higher wholesale and/or retail prices. Second, excessive demand in the economy, brought about, for example, by tax cuts, cheaper borrowing or excessive government spending, which encourages firms to take advantage of the consumer's willingness to spend money by increasing their prices. Where indigenous firms are unable to satisfy all the additional demand, the tendency is for imports to increase. This may not only cause further price rises, particularly if imported goods are more expensive or if exchange rate movements become unfavorable, but also can herald a deteriorating balance of payments situation and difficult trading conditions for domestic businesses.

Government concern with inflation which crosses both party and state boundaries - reflects the fact that rising price levels can have serious consequences for the economy in general and for businesses in particular, especially if a country's domestic inflation rates are significantly higher than those of its main competitors. In markets where price is an important determinant of demand, rising prices may result in some businesses losing sales, and this can affect turnover and may ultimately affect employment if firms reduce their labour force in order to reduce their costs. Added to this, the uncertainty caused by a difficult trading environment may make somebusinesses unwilling to invest in new plant and

equipment, particularly if interest rates are high and if inflation looks unlikely to fall for some time. Such a response, while understandable, is unlikely to improve a firm's future competitiveness or its ability to exploit any possible increases in demand as market conditions change.

Rising prices may also affect businesses by encouraging employees to seek higher wages in order to maintain or increase their living standards. Where firms agree to such wage increases, the temptation, of course, is to pass this on to the consumer in the form of a price rise, especially if demand looks unlikely to be affected to any great extent. Should this process occur generally in the economy, the result may be a wages/prices inflationary spiral, in which wage increases push up prices which push up wage increases which further push up prices and so on. From an international competitive point of view, such an occurrence, if allowed to continue unchecked, could be disastrous for both firms and the economy.

Economic Growth is an objective shared by governments and organisations alike. For governments, the aim is usually to achieve steady and sustained levels of non-inflationary growth, preferably led by exports (i.e. export-led growth). Such growth is normally indicated by annual increases in real national income or gross domestic product (where 'real' = allowing for inflation, and 'gross domestic product (GDP)' = the economy's annual output of goods and services measured in monetary terms).2 To compensate for changes in the size of the population, growth rates tend to be expressed in terms of real national income per capita (i.e. real GDP divided by population).

A Stable Exchange Rate A country's currency has two values: an internal value and an external value. Internally, its value is expressed in terms of the goods and services it can buy and hence it is affected by changes in domestic prices. Externally, its value is expressed as an exchange rate which governs how much of another country's currency it can purchase (e.g. £1 = $2 or $1 =N140). Since foreign trade normally involves an exchange of currencies, fluctuations in the external value of a currency will influence the price of imports and exports and hence can affect the trading prospects for business, as well as a country's balance of payments and its rate of inflation. On the whole, governments and businesses involved in international trade tend to prefer exchange rates to remain relatively stable, because of the greater degree of certainty this brings to the trading environment; it also tends to make overseas investors more confident that their funds are likely to hold their value. To this extent, schemes which seek to fix exchange rates within predetermined levels (e.g. the

ERM), or which encourage the use of a common currency (e.g. the euro), tend to have the support of the business community, which prefers predictability to uncertainty where trading conditions are concerned.

Fiscal Policy Fiscal policy involves the use of changes in government spending and taxation to influence the level and composition of aggregate demand in the economy and, given the amounts involved, this clearly has important implications for business. Elementary circular flow analysis suggests, for instance, that reductions in taxation and/or increases in government spending will inject additional income into the economy and will, via the multiplier effect, increase the demand for goods and services, with favourable consequences for business. Reductions in government spending and/or increases in taxation will have the opposite effect, depressing business prospects and probably discouraging investment and causing a rise in unemployment. Apart from their overall impact on aggregate demand, fiscal changes can be used to achieve specific objectives, some of which will be of direct or indirect benefit to the business community. Reductions in taxes on company profits and/or increases in tax allowances for investment in capital equipment can be used to encourage business to increase investment spending, hence boosting the income of firms producing industrial products and causing some additional spending on consumption.

Monetary Policy Monetary policy seeks to influence monetary variables such as the money supply or rates of interest in order to regulate the economy. While the supply of money and interest rates (i.e. the cost of borrowing) are interrelated, it is convenient to consider them separately. As far as changes in interest rates are concerned, these clearly have implications for business activity, as circular flow analysis demonstrates. Lower interest rates not only encourage firms to invest as the cost of borrowing falls, but also encourage consumption as disposable incomes rise and as the cost of loans and overdrafts decreases. Such increased consumption tends to be an added spur to investment, particularly if inflation rates (and, therefore 'real' interest rates) are low and this can help to boost the economy in the short term, as well as improving the supply side in the longer term. Raising interest rates tends to have the opposite effect - causing a fall in consumption as mortgages and other prices rise, and deferring investment because of the additional cost of borrowing and the decline in business confidence as consumer spending falls. If interest rates remain persistently high, the encouragement given to savers and the discouragement given to borrowers and spenders may help to generate a recession, characterised by falling output, income, spending and employment and by increasing business failure

International Economic Institutions and Organizations Given that external factors constrain the ability of governments to regulate their economy, it is appropriate to conclude this analysis of the macroeconomic context of business with a brief review of a number of important international economic institutions and organisations which affect the trading environment. Foremost among these is the European Union. In the discussions below, attention is focused on the International Monetary Fund (IMF), the Organisation for Economic Co-operation and Development (OECD), the European Bank for Reconstruction and Development (EBRD), the World Trade Organisation (WTO) the World Bank.

The economic environment influences business organizations. Economics environment entails the interest rates, inflation, government policies and the allocation of scarce productive resources to alternative uses. Business organizations must watch the economic activities where it operates with the aim of taking advantages of the opportunities inherent in it while avoiding the threats. Organizations have to pay due attention to the influence of a wide range of institutions and organizations, some of which operate at international level..

Economic forces affect the general health and well-being of a country or world region. They include interest rates, inflation, unemployment, and economic growth. Economic forces produce many opportunities and threat for managers. Low levels of unemployment and falling interest rates mean a change in the customer base. More people have more money to spend, and as a result, organizations have an opportunity to sell more goods and services. Good economic times affect supplies. Resources become easier to acquire, and organizations have an opportunity to flourish. In contrast, worsening macroeconomic conditions, pose a major threat because they limit managers' ability to gain access to the resources their organization needs. Profit oriented organizations such as retail stores and hotels have fewer customers for their goods and services during economic downturns .Even a moderate deterioration in national or regional economic conditions can seriously affect performance. Poor economic conditions make the environment more complex and managers' job more difficult and demanding. Managers may need to reduce the number of individuals in their departments and increase the motivation of remaining employees. Successful managers realize the important effects that economic forces have on their organizations, and they pay close attention to what is occurring in the national and regional economies to respond appropriately.

6.7 SUMMARY

This unit discussed about the basic concepts of meaning and definitions of economic environment in international business. The macro environment concepts of demographic and natural environment are discussed in the length. An account of economic environment and present economic conditions in India is also given in this unit.

6.8 SELF ASSESSMENT QUESTIONS

1) Define international economic environment?

2) Briefly explain the important categories are involved in demographic environment in international business?

3) Explain the concept of natural environment in international business environment?

4) Give an account of present economic condition in India?

6.9 CASE STUDY

Case Study No.1

ABCD Company Pvt. Ltd.

Four senior executives of the world's largest firms with extensive holdings outside the home country speak.

Company A: "We are a multinational firm. We distribute the products in about 100 countries. We distribute the products in about 100 countries. We manufacture in over 17 countries and do research and development in three countries. We look at all new investment projects both domestic and overseas using exactly the same criteria". The executive from Company A continues, "of course most of the key posts in our subsidiaries are held by home-country nationals. Whenever replacements for these men are bought, it is the practice, if not the policy, to look next to you at the head office and pick someone (usually a home country national) you know and trust".

Company B: "We are a multinational firm. Only 1% of the personnel in our affiliate companies are non-national. Most of these are US executives in temporary assignments. In all major markets, the affiliate managing director is of the local nationality". He continues, "of course there are very few non Americans in the key posts at headquarters. The few we

have are so Americanized that we usually do not notice their nationality, unfortunately you cannot find good foreigners who are willing to live in the United States, where our headquarters is located. American has the drive and initiative we like. Infact, the European nationals would prefer to report to an American rather than to some other European".

Company C: "We are a multinational firm. Our product division executives have worldwide profit responsibility. As our organizational chart shows, the United States is just one region on a par with Europe, Latin America, Africa etc. in each division". He continues, "The worldwide product division concept is rather difficult to implement. The senior executives in charge of these divisions have little overseas experience. They have been promoted from domestic posts and tend to view foreign consumer needs as really basically the same as ours. Also, product division executives tend to focus on the domestic market because the domestic market is larger and generates more revenue than the fragmented foreign markets. The rewards are for global performance; but strategy is to focus on domestic. Most of our senior executives do not understand what happens overseas and really do not trust foreign executives, even those in key positions".

Company D: (non – American) "We are a multinational firm. We have at least 18 nationalities represented at our headquarters. Most senior executives speak at least two languages. About 30% of our staff at headquarters are foreigners". He continues, "since the voting shareholders must by law come from the home country, the home country's interest must be given careful consideration. But we are proud of our nationality, we should not be ashamed of it. Infact many times we have been reluctant to use home country ideas overseas, to our detriment, especially in our US subsidiary. Our country produces good executives, who tend to stay with us a long time. It is harder to keep executives from the United States.

QUESTIONS:

1. Explain the four companies economic environment to access international business?
2. Suggest which company is having best natural and demographic environment potential to extent the business in international level?

Case Study No.2

Tee Food Technology Company Ltd

In September 1997, Rice Tee a small food technology company based in Texas, United State was granted a patent by the US Patent office to call an aromatic rice variety developed in USA Basmathi. India challenged the case, arguing that basmati is unique aromatic rice grown in northern India, and not a name Rice Tee could claim. Infact only inventions can be patented. Consequently, the US patent office accepted India's basic position, and Rice Tee had to drop 15 of the 20 claims that it had made. Of the remaining claim Rice Tee managed to evolve three new varieties of rice for which it got a patent from United State Patent and trademarks Office (USPTO), as India had not objected to these. The ruling has not handed over Rice Tee the basmati brand. Rather, it provides it a patent for superior three stains of basmati developed by cross-breeding a Pakistani basmati with a semi-dwarf American variety.

According to the WTO Agreement, Geographical indications like basmati can be legally protected and their misuse can be thus prevented. Unfortunately the thing is that Government of India has not taken timely steps for protecting our Geographical indications and bio-diversity. Although a Geographical Indications of Goods Bill was introduced in Indian Parliament in 1999, even at the end of 2001 it had not become an Act.

QUESTIONS:

1. Give an brief account of environment scanning in over all case study?
2. Evaluate the legal environment rule played by Government of India in preventing the misuse of the basmati?

6.10 NOTES

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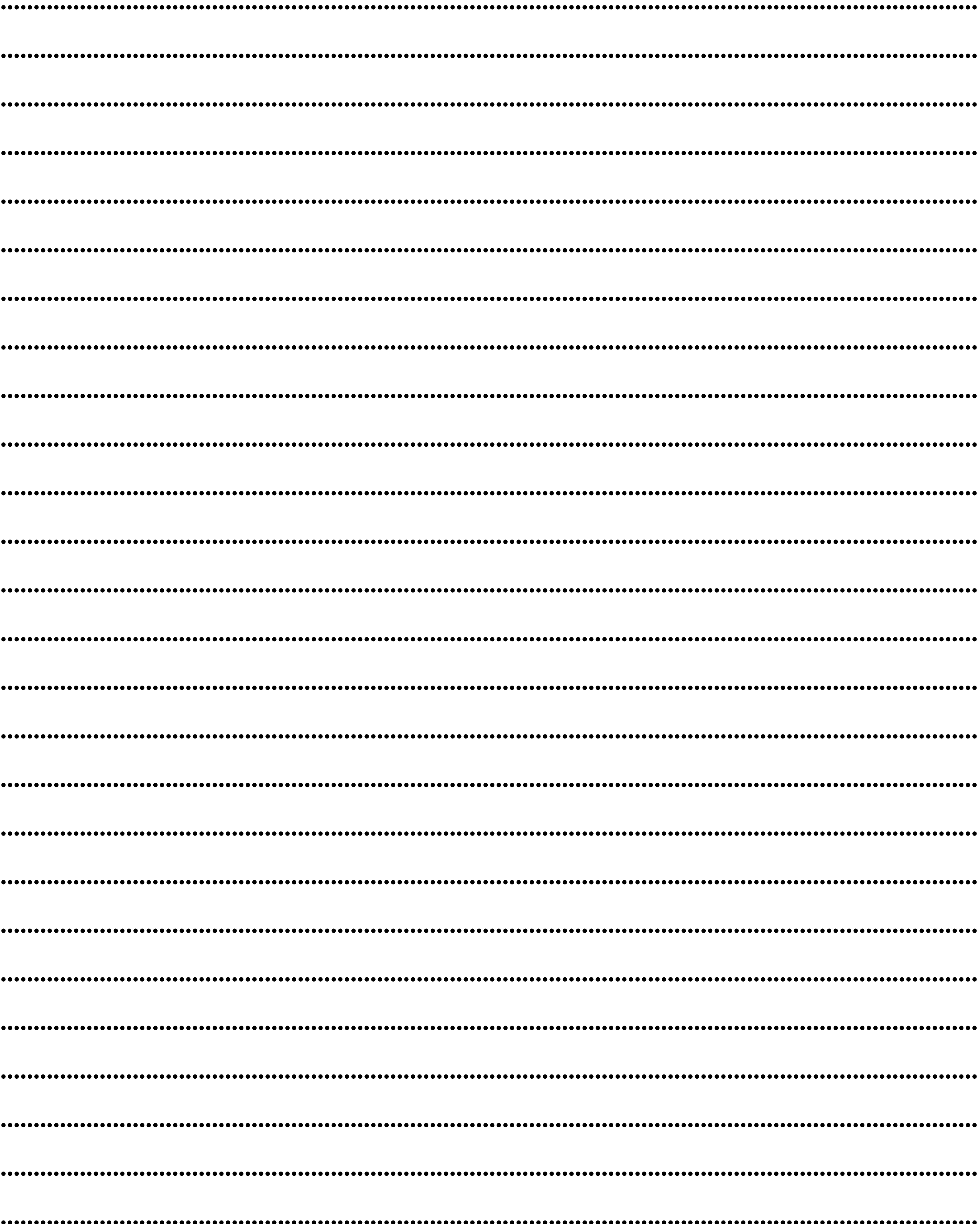

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UNIT - 7 : REGIONAL TRADE BLOCKS

Structure :

7.0 Objectives

7.1 Introduction

7.2 Meaning and Definations

7.3 The Concept of Economic Integration

7.4 Types of Economic Integration

7.5 Benefits of Economic Integration

7.6 Defferent types of Regional Trade Blocks

7.7 European Union (EU)

7.8 Association of South-East Nations (ASEAN)

7.9 South Asian Association for Regional Cooperation (SAARC)

7.10 North American Free Trade Agreement (NAFTA).

7.11 Inter Regional Trade Among Regional Groups

7.12 Summary

7.13 Self Assessment Questions

7.14 Case Study

7.15 Notes

7.16 References

7.0 OBJECTIVES

After studying this unit, you should be able to;

- Define the term Economic Integration
- Describe the types of Regional Trade Blocks
- Determine the benefits of Economic Integration
- Give an account on EU, ASEAN, SAARC, and NAFTA.

7.1 INTRODUCTION

Since the 1960s, regional economic integration has been a goal pursued by most middle-income countries. For some, it was a means to take advantage of geographical proximity to enlarged markets. Regional integration would allow economies to gain in terms of scale of production and in moving up the value chain, through import substitution industrialization and without opening up immediately to competition with the most advanced exporters in the world. It was the path chosen by Latin American economies in the 1960s and 1970s. Later, in the 1980s, most Latin American economies, in the face of a very severe financial crisis, were induced through International Monetary Fund (IMF) adjustment programs to unilaterally open their economies to world trade; as a consequence, the process of regional integration received less attention.

East Asian economies, meanwhile, have pursued an export-driven development strategy at a national level since the 1960s. With the support of their governments, a selected group of private and public companies oriented their output toward external markets, seeking to create international production and distribution networks. Cooperation among firms in a regional context emerged as a natural process. The integration of the firm level created shared interests for influencing governments to move toward more formal associations, such as the Association of Southeast Asian Nations (ASEAN). The opening up of the East Asian economies was further advanced by the severe financial shock of the late 1990s and the consequent reforms induced by the IMF and the World Bank.

For Eastern European middle-income economies, dramatic political changes such as the collapse of the Soviet Union forced deep changes in the way they perceived their integration into the world economy. After 1989, Eastern European countries rejected any

association with the former Soviet Union and sought to create an association among themselves, as a step toward full accession to the (Western) European Union. The EU would, in turn, set the criteria these countries would need to meet to be accepted as full members.

Thus, it is quite clear that while the three regions considered in this study all converged toward opening up to trade and toward RTAs, they followed very different paths in getting there. Two underlying common factors pushed in that direction: a decline in transport and communication costs, and increased awareness of, and desire for, world-class consumer goods. The opportunity to become a part of global production chains also was appealing all these factors made isolationism less viable. Regional trade agreements now, when the main problems and challenges seem to lie elsewhere? Before the current crisis, the implied strategy of middle-income countries was that exports to developed economies' markets would be the main engine of growth. The assumptions were that the developed economies would continue exhibiting robust growth and that multilateral trade negotiation would make their markets more accessible.

7.2 MEANING AND DEFINITIONS

Regional trade blocks toward globally free trade, or does it place obstacles in its way, and perhaps even increase the likelihood of trade wars between competing blocs? The stakes in the bet as to whether RIAs are stepping stones to multilateral trade liberalization or millstones around its neck are truly huge. trade and increasing competition have been behind virtually every sustained economic growth experience, and the unprecedented postwar growth of world output and income has clearly been allied to the growth of world trade and trade liberalization. Progress here affects everyone, and is particularly important for the small and medium economies that depend heavily on international trade, and are the principal beneficiaries of an orderly and nondiscriminatory trading regime.

A trading bloc is defined by four characteristics:

1) It participates in a special trade relationship established by a formal agreement that promotes and facilitates trade within that group of countries in preference to trade with outside nations by discriminating against nonmembers

2) It has attained or has as a stated goal the deepening of trade liberalization or integration with the objective of establishing a free trade area, customs union, or common market

3) It strives to reach common positions in negotiations with third countries, with other trade blocs, or in multilateral forums

4) It attempts to coordinate national economic policies to minimize disruption to intra-bloc economic transactions.

7.3 THE CONCEPT OF ECONOMIC INTEGRATION

"Economic integration" and "business culture," two concepts that are also processes, have great importance in today's international business arena. Contemporary financial literature contains many separate references to each and sometimes, though not as often as one would wish, features discussions of their connections. Many people understandably invoke the notions of economic integration and business culture as convenient shorthand, without analyzing these terms with the comprehensiveness they deserve.

Economic integration and business culture are also significant historical phenomena both in themselves and as subjects of scholarly research. But just as these notions have become useful if superficial abbreviations in discussions of today's global business news, so also have they become too compressed as they have been projected back into the past. Analysts take what they think economic integration and business culture mean in the present and read these unspecifieddefinitions into past situations. Thus, the shorthand of the present becomes the shackles of the past. And it is the future that is the greatest loser, because all evidence suggests that economic integration and business culture, as interrelated processes, will become even more important in the twenty-first century. It is imperative that business historians develop the comprehensive definitions and refined methods for studying these concepts that their historical and contemporary

This task does not necessitate creation, Elements of definitions and components of possible methods already exist. Consider definitions first. Economic integration can have two main thrusts: removing barriers to business and economic activity; and involving participants in an economic grouping in progressively closer relationships. It is an umbrella term for different kinds of groupings pursuing different kinds of integration with different strategies. Economic integration requires economic "unification" and, while related, the two are distinct processes. Unification means gluing or stitching things together; the parts of the unified product keep their previous identities but they are now joined together in some manner. Integration builds on unification but it is something more. An analogy resides

in the difference between amosaic and a tapestry. A mosaic unifies pieces; a tapestry interweaves threads. Mosaic is to unification as tapestry is to integration.

Economic integration, as defined here, can take several forms that represent varying degrees of integration. These are a free-trade area, a customs union, a common market, an economic and complete economic integration. In a trade area, tariffs (and quantitative restrictions) between the participating countries are abolished, but each country retains its own tariffs against nonmembers. Establishing a customs union involves, besides the suppression of discrimination in the field of commodity movements within the union, the equalization of tariffs in trade with nonmember countries. A higher form of economic integration is attained in a common market, where not only trade restrictions but also restrictions00 factor movements are abolished. An economic union, as distinct from a common market, combines the suppression of restrictions on commodity and factor policies, in order to remove discrimination that was due to disparities in these policies. Finally, total economic integration presupposes the unification of monetary, fiscal, social, and countercyclical policies and requires the setting-up of a supra-national authority whose decisions are binding for the member states.

Adopting the definition given above, the theory of economic integration will be concerned with the economic effects oi integration in its various forms and with problems that arise from divergences in national monetary, fiscal, and other policies. The theory of economic integration can be regarded as a part oi international economic, but it also enlarges the field of international made theory by exploring the impact of national markets on growth and examining the need for the coordination of economic policies in a union. Finally, the theory of economic integration should incorporate elements of location theory, too. The integration of adjacent countries amounts to the removal oi artificial barriers that obstruct continuous economic activity through national frontiers, and the ensuing relocation of production and regional agglomerative and deglomerative tendencies cannot be adequately discussed without making use of the tools of locational analysis.

7.4 TYPES OF ECONOMIC INTEGRATION

Economic integration and economic cooperation have been used interchangeably referring to the same phenomena. However, the term regional integration has acquired several quite technical definitions while regional cooperation is applied vaguely to any inter-state activity with less than global participation and which is designed to meet

commonly experienced needs. The definitional meaning of the term integration involves some ambiguity. Some authors include social integration in it while others subsume different forms of international cooperation under it The following are the five types of economic integration as follows: Free trade area is the lowest extent of national integration, political union the greatest. Each level of integration incorporates the properties of those levels that precede it.

- **Free Trade Area:** Countries remove all barriers to trade among members, but each country determines its own barriers against nonmembers and policies differ greatly against nonmember countries from one country to another. Countries in a free trade area also establish a process to resolve trade disputes between members.
- **Customs Union:** Countries remove all barriers to trade among members but erect a common trade policy against nonmembers. And differs from a free trade area in that members treat all nonmembers similarly. Countries might also negotiate as a single entity with other supranational organizations such as the WTO.
- **Common Market:** Countries remove all barriers to trade and the movement of labor and capital between themselves, but erect a common trade policy against nonmembers. Adds the free movement of important factors of production such as people and cross-border investment. Requires cooperation in economic and labor policy, so is very difficult to attain.
- **Economic Union:** Countries remove barriers to trade and the movement of labor and capital, erect a common trade policy against nonmembers, and coordinate their economic policies. Requires members to harmonize their tax, monetary, and fiscal policies, create a common currency, and concede a certain amount of sovereignty to the supranational organization.
- **Political Union:** Countries coordinate aspects of economic and political systems. Members accept a common stance on economic and political policies regarding nonmember nations. Nations are allowed a degree of freedom in setting.

7.5 BENEFITS OF ECONOMIC INTEGRATION

Economic integration can be defined as a kind of arrangement where countries get in agreement to coordinate and manage their fiscal, trade, and monetary policies in order to be mutually benefitted by them. There are many degrees of economic integration, but the most preferred and popular one is free trade. In economic integration no country pays customs duty within the integrated area, so it results in lower prices both for the distributors and the consumers. The ultimate aim of economic integration is to increase trade across the world. There are many other advantages associated with this concept. Some of these are:

1) Progress in trade:

All countries that follow economic integration have extremely wide assortment of goods and services from which they can choose. Introduction of economic integration helps in acquiring goods and services at much low costs. This is because the removal of trade barriers reduces or removes the tariffs entirely. Reduced duties and lowered prices save a lot of spare money with countries which can be usedfor buying more products and services.

2) Ease of agreement:

When countries enter into regional integration, they easily get into agreements and stick to them for long periods of time.

3) Improved political cooperation:

Countries entering economic integration form groups and have greater political influence as compared to influence created by a single nation. Integration is a vital strategy for addressing the effects of political instability and human conflicts that might affect a region.

4) Opportunities for employment:

The various options available in economic integration help to liberalize and encourage trade. This results in market expansion due to which high amount of capital is invested in a country's economy. This creates higher opportunities for employment of people from all over the world. They thus move from one country to another in search of jobs or for earning higher pay.

5) Beneficial for financial markets:

Economic integration is extremely beneficial for financial markets as it eases firm to borrow finances at low rate if interest. This is because capital liquidity of larger capital market increases and the resultant diversification reduces the risks associated with high investment.

6) Increase in Foreign Direct Investments:

Economic integration helps to increase the amount of money in Foreign Direct Investment (FDI). Once firms start FDI, through new operations or by merger, takeover, and acquisition, it becomes a international enterprise. Thus economic integration is a win-win situation for all the firms, people and the economies involved in the process. Is has become a preferred strategy for most of the countries such as india.

7) Trade Creation:

Member countries have (a) wider selection of goods and services not previously available; (b) acquire goods and services at a lower cost after trade barriers due to lowered tariffs or removal of tariffs (c) encourage more trade between member countries the balance of money spend from cheaper goods and services, can be used to buy more products and services.

8) Greater Consensus:

Unlike WTO with hugh membership (147 countries), easier to gain consensus amongst small memberships in regional integration

9) Political Cooperation:

A group of nation can have significantly greater political influence than each nation would have individually. This integration is an essential strategy to address the effects of conflicts and political instability that may affect the region. Useful tool to handle the social and economic challenges associated with globalization in India.

10) Employment Opportunities:

As economic integration encourage trade liberation and lead to market expansion, more investment into the country and greater diffusion of technology, it create more employment opportunities for people to move from one country to another to find jobs or to earn higher pay. For example, industries requiring mostly unskilled labor tends to shift production to low wage countries within a regional cooperation in India.

7.6 DIFFERENT TYPES OF REGIONAL TRADE BLOCKS

Empires are building. Before united Germany observed its first anniversary,other former members of the defunct Warsaw Pact wereknocking on the European Community's door. North, Central, andSouth Americans are treating seriously the prospect of getting together.Japan, feeling the pressure, is concurrently appealing to the UnitedStates to rethink NAFTA and applying to ASEAN to open up. It isnot quite future shock to imagine a world divided into three tradingempires: the Americas, Europe, and Asia.

The following are the major types of regional trade blocks as follows:

1) European Union (EU)
2) Association of south-East Asian nations (ASEAN)
3) South Asian association for regional co-operation (SAARC)
4) North America free trade agreement (NAFTA)

7.7 EUROPEAN UNION (EU)

Initial discussions for a regional union in Europe began in 1948, in the aftermath of World War Two to promote stability and economic cooperation between member states. Comprised of 28 European countries, the EU has established common institutions - the Council (which represents national governments), the European Parliament (which represents the people), and the European Commission (an independent body that represents the collective European interest) to democratically legislate specific matters of joint interest to participating countries at a European level. The EU has developed a single market through a standardized system of laws that apply in all of its member states. These policies aim to secure the free movement of people, goods, services, and capital between its member countries.

History of European Union:

Year	Milestone
1951	Germany, France, Italy, the Netherlands, Belgium, and Luxembourg sign the Coal and Steel treaty to manage heavy industries together
1957	Coal and Steel Treaty members sign the Treaty of Rome, which leads to the creation of a "common market" under the European Economic Community (EEC).
1965	The Brussels Treaty merges leadership positions within the three separate organizations into one large body known as the Council of Ministers.
1973	The first enlargement of the EC took place with the addition of Denmark, Ireland, and the United Kingdom.
1974	The European Council is established to specifically set long-term agendas for political and economic integration.
1979	Europeans elect European Parliament members for the first time
1987	Single European Act (SEA) comes into enforcement, expanding common market flexibility
1992	The Maastricht Treaty is signed, which established rules of common currency in addition to providing further coordination for foreign and security policy. The European Community formally changes its name to the European Union.
1998	A new currency, the euro, was launched in world money markets. It became the unit of exchange for all of the EU states except the United Kingdom, Sweden, and Denmark.
2003	Treaty of Nice entered into force to set forth rules streamlining the size and procedures of EU institutions
2004	Ten new countries joined the EU, and the European constitution is signed by all 25 EU countries. Ratification failed in 2005
2007	Bulgaria and Romania join the EU, bringing membership to 27 countries.
2009	Treaty of Lisbon entered into force to provide EU with modern institutions to address issues such as globalization, climate change, security, and energy.
2010	At a European Council meeting in Brussels, EU leaders adopt a 10-year strategy for smart, sustainable and inclusive growth: Europe 2020. They also decide to open accession negotiations with Iceland.
2013	The European Union enforces economic sanctions against Russia in response to Croatia becomes the 28th country to join the European Union Russia's "illegal annexation of Crimea and deliberate destabilization of a neighboring sovereign countries in the world.

Source: V.K Ball (2014).

♦ **Member countries of European Union:**

Austria, Italy, Belgium, Latvia, Bulgaria, Lithuania, Croatia, Luxembourg, Cyprus, Malta Czech, Republic Netherlands, Denmark, Poland, Estonia ,Portugal, Finland, Romania, France Slovakia, Germany, Slovenia, Greece Spain, Hungary, Sweden, Ireland, United Kingdom.

♦ **Structure of European Union:**

a) **European Parliament:** More than 700 members who are elected by popular vote within each member nation every five years. Parliament acts as a consultative rather than a legislative body by debating and amending legislation proposed by the European Commission.

b) **Council of the European Union:** The legislative body of the EU. Council members change depending on the topic under discussion (e.g., For agriculture, the Council is comprised of agriculture ministers of each member). No proposed legislation becomes EU law unless the Council votes it into law. Some legislation today requires only a simple majority to win approval.

c) **European Commission:** The executive body of the EU whose commissioners are appointed by each country—larger nations get two commissioners, smaller countries one. Drafts legislation, manages and implements policy, and monitors compliance with EU law.

d) **Court of Justice:** The EU court of appeals includes one justice from each member country. One type of case heard is when a member nation is accused of not meeting its treaty obligations. Justices are required to act in the interest of the EU as a whole, not in the interest of their own countries.

e) **Court of Auditors:** Composed of 27 members (one from each member nation) appointed for six-year terms. Duty is to audit EU accounts and implement EU budget, improve EU financial management, and report to member nations' citizens on the use of public funds.

7.8 ASSOCIATION OF SOUTH –EAST NATIONS (ASEAN)

The Association of Southeast Asian Nations (ASEAN) was formed in 1967 by Indonesia, Malaysia, the Philippines, Singapore, and Thailand to promote political and economic cooperation and regional stability. The ASEAN Declaration in 1967, considered ASEAN's founding document, formalized the principles of peace and cooperation to which ASEAN is dedicated. The ASEAN Charter entered into force on 15 December 2008. With the entry into force of the ASEAN Charter, ASEAN established its legal identity as an international organization and took a major

step in its community-building process. The ASEAN Community is comprised of three pillars, the Political-Security Community, Economic Community, and Socio-Cultural Community.

History of Association of Southeast Asian Nations (ASEAN)

Year	Milestone
1967	ASEAN is established in Bangkok at the height of the Vietnam War by the five original member countries: Indonesia, Malaysia, Philippines, Singapore, and Thailand
1978	First ASEAN–European Economic Community ministerial meeting held in Brussels.
1994	ASEAN establishes the ASEAN Regional Forum (ARF), which is focused on security interdependence in the Asia-Pacific region. Besides ASEAN member states, the present participants include Australia, Canada, China, European Union, India, Japan, South Korea, North Korea, Mongolia, New Zealand, Pakistan, Papua New Guinea, the Russian Federation and the United States.
1997	First meeting of ASEAN Plus Three, comprising leaders of the 10 ASEAN members and their counterparts from East Asia – China, Japan and South Korea. Laos and Myanmar join ASEAN.
1998	The two day ASEAN summit opens in Hanoi, Vietnam. Cambodia is admitted formally. The ASEAN nations approve the “Hanoi Action Plan,” a 34-point declaration that emphasized economic recovery based on free market policies.
2000	The Chiang Mai Initiative (CMI) is set up to help East Asian cash strapped countries defend their currencies in times of trouble. The initiative comes in response to the 1997 East Asian financial crises. ASEAN, China, Japan, and South Korea launch the multilateral arrangement of currency swaps (CMI).
2002	China and ASEAN agree to a China-ASEAN free-trade area to be implemented in stages up to 2015.
2005	First meeting of ASEAN Plus Six, also called the East Asia Summit, comprising the ASEAN countries plus China, Japan, South Korea, India, Australia and New Zealand
2007	ASEAN signs charter giving its 10 member states a legal identity, a first step towards its aim of a free trade area by 2015
2008	The Association of Southeast Asian Nations moves to forge an EU-style community, signing a charter that makes the bloc a legal entity. This could pave the way for creating a single market within seven years.
2010	A free-trade agreement between China and the 10 members of the Association of Southeast Asia Nations (ASEAN) comes into effect. The six richest members scrap tariffs on 90% of goods. The four poorest (Vietnam, Cambodia, Laos, Myanmar) will not need to cut tariffs to the same level until 2015.
2013	ASEAN members and their trading partners (Australia, China, India, Japan, New Zealand, and South Korea) begin the first round of negotiations on establishment of the Regional Comprehensive Economic Partnership
2015	The ASEAN Economic Community (AEC) Blueprint is adopted by ASEAN leaders at the 27th ASEAN summit. This blueprint provides broad directions to achieve a highly integrated and cohesive economy; a competitive, innovative, and dynamic ASEAN; enhanced connectivity and sectoral cooperation; a resilient, inclusive, people-oriented, and people-centered ASEAN; and a global ASEAN

Sources: V.K Ball (2014).

Member Countries of ASEAN: Brunei, Malaysia, Burma, Philippines, Cambodia, Singapore, Indonesia, Thailand, Laos, Vietnam,

The Association of Southeast Asian Nations is a political and economic organization of ten Southeast Asian countries. It was formed on August 8, 1967 by Indonesia, Malaysia, the Philippines, Singapore, and Thailand. Since then, membership has expanded to include Brunei, Cambodia, Laos, Myanmar (Burma), and Vietnam. Its aims include accelerating economic growth, social progress, and socio cultural evolution among its members, alongside protection of regional stability as well as providing a mechanism for member countries to resolve differences peacefully.

ASEAN covers a land area of 4.4 million square kilometers, 3% of the total land area of Earth. ASEAN territorial waters cover an area about three times larger than its land counterpart. Member countries have a combined population of approximately 625 million people, 8.8% of the world's population. In 2015, the organization's combined nominal GDP had grown to more than US$2.8 trillion. If ASEAN were a single entity, it would rank as the seventh largest economy in the world, behind the USA, China, Japan, Germany, the United Kingdom and France.[5] ASEAN shares land borders with India, China, Bangladesh, East Timor, and Papua New Guinea, and maritime borders with India, China, and Australia. Both East Timor and Papua New Guinea are backed by certain ASEAN members for their membership in the organization.

7.9 SOUTH ASIAN ASSOCIATION FOR REGIONAL COOPERATION (SAARC)

The South Asian Association for Regional Cooperation, or SAARC, is an economic and geopolitical organization that was established to promote socio-economic development, stability, and welfare economics, and collective self-reliance within its member nations. Founded during a summit in 1985, SAARC's initial members include Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka. Due to rapid expansion within the region, Afghanistan received full-member status and countries are considered observers. SAARC respects the principles of sovereign equality, territorial integrity, and national independence as it strives to attain sustainable economic growth.

History of South Asian Association for Regional Cooperation (SAARC)

Year	Milestone
1905	Foreign ministry officials of Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, and Sri Lanka meet for the first time in Colombo, Sri Lanka.
1983	At an international conference held in New Delhi, India the foreign ministers of the seven countries adopt the Declaration on South Asian Association Regional Cooperation (SAARC) and formally launched the Integrated Programme of Action (IPA).
1985	SAARC is established when its charter is formally approved. First Summit is held in Dhaka, Bangladesh.
2004	The agreement on the South Asian Free Trade Area (SAFTA) is signed
2007	Afghanistan becomes a member of SAARC during the 14th SAARC Summit.
2009	Australia, China, the EU, Iran, Japan, Mauritius, Myanmar, South Korea, and the United States become observers of SAARC.
2013	Outstanding contribution for the Protection of Environment and mitigation of Climate Change.

Sources: V.K Ball, (2014).

South Asian Free Trade Area (SAFTA) leading subsequently towards a Customs Union, Common Market and Economic Union. In 1995, the Sixteenth session of the Council of Ministers (New Delhi, 18–19 December 1995) agreed on the need to strive for the realisation of SAFTA and to this end an Inter-Governmental Expert Group (IGEG) was set up in 1996 to identify the necessary steps for progressing to a free trade area. The Tenth SAARC Summit (Colombo, 29–31 July 1998) decided to set up a Committee of Experts (COE) to draft a comprehensive treaty framework for creating a free trade area within the region, taking into consideration the asymmetries in development within the region and bearing in mind the need to fix realistic and achievable targets.

The SAFTA Agreement was signed on 6 January 2004 during Twelfth SAARC Summit held in Islamabad, Pakistan. The Agreement entered into force on 1 January 2006, and the Trade Liberalization Programme commenced from 1 July 2006. Under this agreement,

SAARC members will bring their duties down to 20 per cent by 2009. Following the Agreement coming into force the SAFTA Ministerial Council (SMC) has been established comprising the Commerce Ministers of the Member States. In 2012 the SAARC exports increased substantially to US$354.6 billion from US$206.7 billion in 2009. Imports too increased from US$330 billion to US$602 billion over the same period. But the intra-SAARC trade amounts to just a little over 1% of SAARC's GDP. In contrast, in ASEAN (which is actually smaller than SAARC in terms of size of economy) the intra-bloc trade stands at 10% of its GDP.

7.10 NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA)

On January 1, 1994, the North American Free Trade Agreement (NAFTA) between the United States, Canada, and Mexico entered force to create a trilateral trading bloc in North America. The agreement superseded the original Canada-United States Free Trade Agreement between the U.S. and Canada. NAFTA seeks to liberalize restrictions on trade among the three countries. Since its entry into force, NAFTA has eliminated most tariff and non-tariff barriers for trade and investment between its three member countries. NAFTA aims to promote the conditions of free competition in order to increase market access and investment opportunities within the free trade area.

History of North America free trade agreement

Year	Milestone
1992	NAFTA is signed by U.S. President George H.W. Bush, Mexican President Carlos Salinas, and Canadian Prime Minister Brian Mulroney.
1994	NAFTA takes effect
2001	At the Miami Summit, the three signatories of NAFTA officially invite Chile to become a contractual party of the agreement.
2006	At the Miami Summit, the three signatories of NAFTA officially invite Chile to become a contractual party of the agreement.
2008	Canadian Prime Minister Jean Chrétien, U.S. President George W. Bush and Mexican President Vicente Fox agree to establish the North American Energy Working Group (NAEWG) to give regional attention to energy issues and enhance trilateral cooperation. The Group is managed by the three federal Energy secretaries and ministry
2010	All tariffs between the three countries are eliminated

Sources: V.K Ball, (2014).

The member countries are Canada and united states, producers and distributors must determine if their products meet NAFTA rules to qualify for tariff-free status. The producer or distributor must also provide a NAFTA "certificate of origin" to an importer to claim an exemption from tariffs. Mexico's exports to the United States jumped an astonishing275%, from under $40 billion to more than $150 billion. Canada's exports to the United States more than doubled, fromalmost $117 billion to $287 billion, while US exports to Canadagrew 76%, from $100 billion to $176 billion. Canada's exports to Mexico grew more than threefold from $640million to nearly $2.7 billion. The agreement's effect on employment and wages is not easy todetermine. The US Trade Representative Office and the group of unions debate NAFTA's effect on jobs in the country.

7.11 INTER REGIONAL TRADE AMONG REGIONAL GROUPS

Regions trade internationally, as well as between each other, and it is a fact that interregional trade is much freer than international trade. For regions (in the same nation) distances between markets tend to be smaller (not necessarily so in the US when contrasting it with Europe) and the institutional and monetary frameworks are usually the same. Thus they have the same currency, an integrated capital market and common banking system all of which facilitate trade. Few of the international barriers that inhibit free trade are present in interregional trade although distortions do exist, such as regional policy (labor and/or capital subsidies). However trade is much more "open" at the interregional level. In 1995 Scotland's exports accounted for almost 80% of its GDP (69% in 1979), approximately half of which went to the rest of the UK with the other half to the rest of the world.

This openness can be illustrated using UK and European data. As world trade becomes even more open (through GATT and the European single market) so the UK's regions become increasingly exposed to the fluctuations in world trade. Figures suggest that many countries in Europe are now almost as open as regions within a single country. They are likely to have become even more "open" since the advent of the single currency. Whilst the figures below show that trade between EU countries is particularly open, more recent work suggests that local as well as regional economies are increasingly trading where barriers are lowest.

A recent survey of Basingstoke businesses, to some extent this is similar to the arguments about agglomeration economies and industrial clusters. This is in complete contrast to the assumption of constant returns to scale as used in the Heckscher-Ohlin model. Armstrong and

Taylor draw on the work by Porter, which stresses the importance to four sets of competitiveness-enhancing factors. Understanding why regions, and localities, specialize in making and exporting certain commodities is important to regional economists. Regional economies need to actively trade and develop the commodities in which they have a competitive advantage and are successful at making if they are to run a balance of payments surplus. Unfortunately, there is little hard data about regional trade, what there is suggests that in the UK the Southern and East Midlands regions run balance of payment surpluses and the northern regions deficits

They reinforce one another and generate a situation of cumulative causation. The most widely cited example in the literature is of Northern Italy and in particular the food, clothing, household goods and drink manufacturing industries. suggested that over 75% of local firms traded with other firms within the district, almost 60% traded elsewhere in the UK (outside the Thames Valley and Hampshire areas) and 27% exported overseas. Of the exporters almost all traded with the EU.

7.12 SUMMARY

This unit discussed about the basic concepts of meaning and of economic integration and regional trade blocks. The different regional trade blocks such as EU, ASEAN, SAARC, and NAFTA are discussed in the length. An account of types and benefits of economic integration is also given in this unit..

7.13 SELF ASSESSMENT QUESTIONS

1) Define the term economic integration
2) Mention the types of different regional trade blocks
3) Briefly explain the benefits of economic integration?
4) Write a note on EU, ASEAN, SAARC, and NAFTA?

7.14 CASE STUDY

Case Study No.1

Chinese light-bulb imports spark EU controversy

A row is brewing over a proposal by UK Trade Commissioner Peter Mandelson to scrap EU anti-dumping duties of up to 66% on energy-efficient light bulbs imported from China, as his German counterpart, in charge of industry, Günter Verheugen, attempts to block the move.EU trade chief Peter Mandelson is pushing for the punitive tariff to be lifted completely – a move that could see the price paid by consumers cut by around two thirds. He has the support of a majority of European producers, including the Dutch electronics group Philips, which outsources the manufacturing of its power-saving bulbs to China. But German industry Commissioner Günter Verheugen is opposed to the move, claiming that it could cause job losses for Germany's national light-bulb manufacturer Osram, as below-cost imports from China flow into the EU. He is expected to call for a compromise in the form of a two-year extension of duties.

Earlier in July, a spokesperson for Mandelson dismissed such claims, saying that it was purely "a question of commercial competition between two European companies" and that "Osram is seeking to continue anti-dumping measures because they hit Philips proportionately harder". However, according to the Foreign Trade Association (FTA), an umbrella group of importers and retailers in Europe, Verheugen could have the support of a number of his colleagues, such as Commission President José Manuel Barroso and Energy Commissioner Andris Piebalgs.

FTA Legal Advisor Stuart Newman pointed to the "absurdity" of maintaining tariffs at a time when the EU is attempting to increase the use of green technologies in order to achieve its dual goal of cutting energy use and CO2 emissions by 20% by 2020. Lighting accounts for around 14% of electricity use in the EU and experts say that replacing traditional light bulbs with power-saving ones could offset CO2 emissions by 25 million tonnes per year. Furthermore, the Commission is currently looking to phase out ordinary light bulbs completely and European manufacturers are thought to be unable to meet total demand in this growing market. "We cannot believe that it is in the interests either of European industry or of consumers to continue these measures,"

But the issue is also seen as a test case for the future of the EU's anti-dumping policy, currently under review. A number of EU nations fear that it could be used as a precedent in future cases for the EU to give more weight to the interests of companies producing or sourcing goods

in countries with cheap labor costs, such as China, than to those with production based in Europe – a move that manufacturing countries such as Spain, Italy and a number of new member states are likely to resist.

QUESTIONS:

1. Discuses and overall case study and explain the impact of economic integration in Chinese's country?
2. Briefly explain the structure of regional trade agreement between European countries from above the case study?

Case Study No.2

Kraft to Acquire Cadbury in Deal Worth $19 Billion

The intervention of a government minister in Kraft's battle to buy Cadbury says much about the strength of British feeling for their favorite chocolate-maker. The American food giant's sweetened offer, too toothsome to turn down, was accepted by Cadbury's board on Tuesday January 19th. Kraft will pay £11.9 billion ($19.4 billion) for Cadbury in cash and shares, some 50% more than the firm's value before the bidding started in September. Yet last week Britain's business secretary, Lord Mandelson, warned a big group of the country's institutional investors doubtless fixing those from Cadbury with a narrowed eye against the dangers of short-termism.

A month earlier he had promised Kraft that the British government would scrutinize a foreign buyer to ensure that "respect" was paid to Cadbury's proud heritage. The firm has been catering to the British for 186 years. In a country that cheerfully waves in foreign buyers for its businesses the threat of "huge opposition" from the government was an unusual change of tone. Kraft too received some words of wisdom on its attempted takeover from a senior American, although the advice of Warren Buffet was of a more practical kind. His investment firm, Berkshire Hathaway, is a big shareholder in Kraft.

Ms Rosenfeld was quick to acknowledge on Tuesday that Kraft has "great respect for Cadbury's brands, heritage and people". Perhaps that will allay Lord Mandelson's fears. Cadbury's unions opposed the move, worried about job cuts, but the firm's board has reasoned that the price is right to bring together the two companies to create the world's biggest confectioner. Earlier the board had insisted that Cadbury was better off alone. Now Cadbury will become part of the "global powerhouse" that Ms Rosenfeld envisages.

The two businesses are strong in different markets. Kraft has little presence in Britain's confectionery market, where Cadbury is strong, but it has thriving businesses in mainland Europe, where Cadbury has made few inroads. Cadbury has a booming chewing-gum business, particularly in Europe and Latin America, an area where Kraft has little expertise. And between them they can make up lost ground in China, where Mars, the world's second-placed sweet-maker when the deal goes through, holds the upper hand. The deal is also set to yield cost savings of $675m a year.

Other potential bidders still have the chance to make a more appealing offer but it seems that Kraft's touted rivals will remain silent. America's Hershey, smaller even than Cadbury, seems unlikely to be able to muster the financial forces to upset Kraft's bid. Nestlé ruled itself out of the running by after buying Kraft's American Pizza business for $3.7 billion early this month. Ms Rosenfeld may yet find the takeover of Cadbury a tricky process. In dealing with potential rivals, satisfying Cadbury's board and soothing Mr Buffet, Kraft's boss has proved she is a deft operator.

QUESTIONS:

1. Give Overall circumstances related to trade agreements between regional trade blocks with the American company?
2. Explain the government intervention in the matter of trade and tariff agreement American company to enter an international business in global context?

7.14 NOTES

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UNIT-8 : WORLD TRADE AND PROTECTIONISUM

Structures :

8.0 Objectives

8.1 Introduction

8.2 Meaning and Definations

8.3 Objectives of WTO

8.4 Functions of WTO

8.5 Structure of WTO

8.6 Achivements of WTO

8.7 Criticism of WTO

8.8 Tariff and Non-tariff Barriers of Trade

8.9 Negotiations in International Business

8.10 Summary

8.11 Self Assessment Question

8.12 Case Study

8.13 Notes

8.14 References

8.0 OBJECTIVES

After studying this unit, you should be able to;

- Define the world trade organizations.
- Describe the objectives and functions of WTO.
- Determine the structure and Achievements of WTO.
- Give an account on tariff and non tariff barriers to trade.

8.1 INTRODUCTION

The World War–II, which lasted from 1939 to 1945, left many countries in Europe and Asia totally ravaged. Their economies were shattered; there was tremendous stain on political and social systems resulting in wide spread annihilation and migration of people. Intentional peace was ruffled. Something had to be done to put these war-ravaged economies back in shape. Simultaneously, the various colonies in Asia and Africa were acquiring political freedom. And there was urgent pressure on them for rapid economic development and political stabilization. In this background the United Nations Organization (UNO) was born on the collective wisdom of the world. Progressively, the UNO came to encompass the concerns for development in economic, commercial, scientific, social and cultural sphere of the member nations. It formed various forums and agencies. One such forum under the UNO was the General Agreement on Tariffs and Trade (GATT) which was established in 1947.

GATT emerged from the Havana Charter . In International Conference on Trade and Employment in Havana in the winter of 1947-48, fifty-three nations drew up and signed a charter for establishing an International Trade Organization (ITO). But the US Congress did not ratify the Havana Charter with the result that the ITO never came into existence. Simultaneously, twenty-three nations agreed to continue extensive tariff negotiations for trade concessions at Geneva, which were incorporated in a General Agreement of Tariffs and Trade. This was signed on 30th October 1947 and came into force form 1st January 1948 when other nations had also signed it. The critical juncture was reached during the Uruguay Round of multilateral trade negotiations, which may be called the final act. It was signed by 12 countries in which India was signatory popularly known as Dunkel agreement.

The WTO was established on January 1, 1995. It is the embodiment of the Uruguay Round results and the successor to GATT. Account of 76 Governments became members of WTO on its first day. It has now 146 members, India being one of the founder members. It has a legal status and enjoys privileges and immunities on the same footing as the IMF and the World Bank. It is composed of the Ministerial Conference and the General Council. The Ministerial Conference (MC) is the highest body. It is composed of the representatives of all the Members. The Ministerial Conference is the executive of the WTO and responsible for carrying out the functions of the WTO. The MC meets at least once every two years.

8.2 MEANING AND DEFINITIONS

The World Trade Organization (WTO) is the only global international organization dealing with the rules of trade between nations. At its heart are the WTOagreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments.

The World Trade Organization (WTO) is the only international organization that deals with the global rules of trade between nations. The WTO is built on WTO agreements signed by the majority of the world's trading nations; its main function is to help producers of goods and services, exporters and importers better protect and manage their businesses.The **World Trade Organization (WTO)** establishes rules of trade among its member nations. To this end, the WTO also handles trade disputes, monitors trade policies, provides technical assistance for developing countries and cooperates with other international trade organizations.

The WTO was created on January 1, 1995, and is headquartered in Geneva, Switzerland. The WTO replaced the General Agreement on Tariffs and Trade (GATT), which was created in 1948. GATT primarily regulated the trade of goods; the WTO regulates the trade of services and intellectual property as well. GATT still exists as the WTO's umbrella treaty for trade in goods.The World Trade Organization (WTO) is the only global international organization dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments. The goal is to help producers of goods and services, exporters, and importers conduct their business.

The WTO was officially created in January of 1995 and essentially replaced the General Agreement on Tariffs and Trade (GATT), which had been in force since 1948, a few years after the Second World War. Before the WTO was created, an initiative to start something similarknown as the International Trade Organization (ITO) took place. Unfortunately, the ITO treaty was not approved by the U.S. and a few other countries and ultimately never went into effect.In the 1980s, as the world economies became more global in trade and business, it became evident that GATT was not built or structured to address many of the new global trading challenges that were arising. As a result, the biggest trade negotiating event on record began in 1986. It was known as the Uruguay Round, seeing as it took place in Punta del Este, Uruguay. One of the final accomplishments of this round was the creation of the WTO.

8.3 OBJECTIVES OF WTO

The following are the main objectives of WTO:

1) Its relation in the field of trade and economic endeavor shall be conducted with a view to raising standards of living, ensuring full employment and large and steadily growing volume of real income and effective demand, and expanding the production and trade in goods and services.

2) To allow for the optimal use of the world's resources in accordance with the objective of sustainable development, seeking both (a) to protect and preserve the environment, and (b) to enhance the means for doing so in a manner consistent with respective needs and concerns at different levels of economic development.

3) To make positive efforts designed to ensure that developing countries especially the least developed among them, secure a share in the growth in international trade commensurate with the needs of their economic development.

4) To achieve these objectives by entering into reciprocal and mutually advantageous arrangements directed towards substantial reduction of tariffs and other barriers to trade and the elimination of discriminatory treatment in international trade relations.

5) To develop an integrated, more viable and durable multilateral trading system encompassing the GATT, the results of past trade liberalization efforts, and all the results of the Uruguay Round of multilateral trade negotiations.

6) To ensure linkages between trade policies, environment policies and sustainable development.

8.4 FUNCTIONS OF WTO

The following are the main functions of WTO:

1) It facilitates the implementation, administration and operation of the objectives of the Agreement and of the Multilateral Trade Agreements.

2) It provides the framework for the implementation, administration and operation of the Plurilateral Trade Agreements relating to trade in civil aircraft, government procurement, trade in diary products and bovine meat.

3) It provides the forum for negotiations among its members concerning their multilateral trade relations in matters relating to the agreements and a framework for the implementation of the result of such negotiations, as decided by the Ministerial Conference.

4) It administers the Understanding on Rules and Procedures governing the Settlement of Disputes of the Agreement.

5) It cooperates with the IMF and the World Bank and its affiliated agencies with a view to achieving greater coherence in global economic policy-making.

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

7) The WTO shall provide the forum for negotiations among its Members concerning their multilateral trade relations in matters dealt with under the agreements in the Annexes to this Agreement. The WTO may also provide a forum for further negotiations among its Members concerning their multilateral trade relations, and a framework for the implementation of the results of such negotiations, as may be decided by the Ministerial Conference.

8) The WTO shall administer the Understanding on Rules and Procedures Governing the Settlement of Disputes (hereinafter referred to as the “Dispute Settlement Understanding” or “DSU”) in Annex 2 to this Agreement.

9) The WTO shall administer the Trade Policy Review Mechanism (hereinafter referred to as the "TPRM") provided for in Annex 3 to this Agreement.

10) With a view to achieving greater coherence in global economic policy-making, the WTO shall cooperate, as appropriate, with the International Monetary Fund and with the International Bank for Reconstruction and Development and its affiliated agencies.

8.5 STRUCTURE OF WTO

The following are the main structure of WTO:

1) There shall be a Ministerial Conference composed of representatives of all the Members, which shall meet at least once every two years. The Ministerial Conference shall carry out the functions of the WTO and take actions necessary to this effect. The Ministerial Conference shall have the authority to take decisions on all matters under any of the Multilateral Trade Agreements, if so requested by a Member, in accordance with the specific requirements for decision-making in this Agreement and in the relevant Multilateral Trade Agreement.

2) There shall be a General Council composed of representatives of all the Members, which shall meet as appropriate. In the intervals between meetings of the Ministerial Conference, its functions shall be conducted by the General Council. The General Council shall also carry out the functions assigned to it by this Agreement. The General Council shall establish its rules of procedure and approve the rules of procedure by the Committees.

3) The General Council shall convene as appropriate to discharge the responsibilities of the Dispute Settlement Body provided for in the Dispute Settlement Understanding. The Dispute Settlement Body may have its own chairman and shall establish such rules of procedure as it deems necessary for the fulfillment of those responsibilities.

4) The General Council shall convene as appropriate to discharge the responsibilities of the Trade Policy Review Body provided for in the TPRM. The Trade Policy Review Body may have its own chairman and shall establish such rules of procedure as it deems necessary for the fulfillment of those responsibilities.

5) There shall be a Council for Trade in Goods, a Council for Trade in Services and a Council for Trade-Related Aspects of Intellectual Property Rights (hereinafter referred

to as the "Council for TRIPS"), which shall operate under the general guidance of the General Council. The Council for Trade in Goods shall oversee the functioning of the Multilateral Trade Agreements in Annex 1A. The Council for Trade in Services shall oversee the functioning of the General Agreement on Trade in Services (hereinafter referred to as "GATS"). The Council for TRIPS shall oversee the functioning of the Agreement on Trade-Related Aspects of Intellectual Property Rights (hereinafter referred to as the "Agreement on TRIPS"). These Councils shall carry out the functions assigned to them by their respective agreements and by the General Council. They shall establish their respective rules of procedure subject to the approval of the General Council. Membership in these Councils shall be open to representatives of all Members. These Councils shall meet as necessary to carry out their functions.

6) The Council for Trade in Goods, the Council for Trade in Services and the Council for TRIPS shall establish subsidiary bodies as required. These subsidiary bodies shall establish their respective rules of procedure subject to the approval of their respective Councils.

7) The Ministerial Conference shall establish a Committee on Trade and Development, a Committee on Balance-of-Payments Restrictions and a Committee on Budget, Finance and Administration, which shall carry out the functions assigned to them by this Agreement and by the Multilateral Trade Agreements, and any additional functions assigned to them by the General Council, and may establish such additional Committees with such functions as it may deem appropriate. As part of its functions, the Committee on Trade and Development shall periodically review the special provisions in the Multilateral Trade Agreements in favour of the least-developed country Members and report to the General Council for appropriate action. Membership in these Committees shall be open to representatives of all Members.

8) The bodies provided for under the Plurilateral Trade Agreements shall carry out the functions assigned to them under those Agreements and shall operate within the institutional framework of the WTO. These bodies shall keep the General Council informed of their activities on a regular basis.

9) The General Council has also been given two additional specific tasks. The WTO Agreement requires it to convene as the Dispute Settlement Body and as the Trade Policy Review Body. These are responsible respectively for the operation of the dispute

settlement and trade policy review arrangements of the WTO. Six Meetings for these purposes take place much more frequently: experience so far is that the Dispute Settlement Body meets about once a month, and the Trade Policy Review Body still more often compared to other countries.

10) The second group of permanent bodies reporting to the General Council and specified in the WTO Agreement consists of the Committee on Trade and Development, the Committee on Balance-of-Payments Restrictions, and the Committee on Budget, Finance and Administration.

11) Expansion of the Rule of Law: In the past five years, the 50 year-old trading system has been transformed from a limited set of rules and disciplines that applied to the United States and a few of our trading partners, to a system with specific rules applicable in full to all Members. Thus the WTO eliminates the potential for "free riders" on the benefits of an open trading system.

12) Intellectual Property Rights Protection: In the 21st century, economies will rely on innovation and ingenuity to promote economic development and investment – both human and capital. This is why WTO Member governments agreed to a far-ranging set of rules to protect and enforce intellectual property rights, including copyrights, patents and trademarks. To ensure that innovation and technology continue to serve as engines of growth in rich and poor countries alike, the WTO provides strong protection and a system of rules that applies to all.

13) Force for Global Economic Stability: The WTO has also strengthened the world's ability to address economic crises. During the financial crisis of 1997 and 1998, for example, the respect WTO members showed for open market commitments helped to prevent a cycle of protection and retaliation similar to that of the Depression era, ensuring affected countries the access to markets they needed for recovery, and minimizing damage to American farmers and manufacturing exporters.

8.6 ACHIVEMENTS OF WTO

Following are the achievements of WTO in the short period it has been in existence:

1) WTO has helped in making greater market orientations a general rule. Tariff based protection has become the rule.

2) Restrictive measures, which were being used for balance of payments purposes, have declined markedly.

3) WTO has brought services trade into the multilateral system. Many countries are opening their markets for trade and investment either unilaterally or through regional or multilateral negotiations.

4) Many underdeveloped countries have promoted economic growth in their countries. They have undergone radical trade, exchange and domestic reforms, which have improved the efficiency of resource use and opened new investment opportunities.

5) Bilateralism has been, to a great extent, placed under control by the extension of WTO provisions to services, TRIPS and TRIMS and by the unified dispute settlement mechanism, in which the possibility of unilaterally blocking the adoption of panel decisions no longer exists.

6) The Trade Policy Review Mechanism has created a process of continuous monitoring of trade policy developments, which by promoting greater transparency has assisted in the process of liberalization and reform.

7) The WTO's dispute-settlement system "is the result of the evolution of rules, procedures and practices developed over almost half a century under the GATT 1947".In 1994, the WTO members agreed on the Understanding on Rules and Procedures Governing the Settlement of Disputes (DSU) annexed to the "Final Act" signed in Marrakesh in 1994.

8) Dispute settlement is regarded by the WTO as the central pillar of the multilateral trading system, and as a "unique contribution to the stability of the global economy".

9) WTO members have agreed that, if they believe fellow-members are violating trade rules, they will use the multilateral system of settling disputes instead of taking action unilaterally.

10) Creation of a Dynamic Forum for Trade Liberalization: The WTO is a system responsive to rapid changes in the 21st century world economy. After its creation in 1995, the WTO first set in motion and then realized agreements in financial services, basic tele communications services and information technology. These opened new markets and produced gains larger in scope than the results of the Uruguay Round. The WTO has laid the groundwork for further advances by setting a built-in agenda to continue to liberalize and reform areas like agriculture and services, and initiating further work on electronic commerce and other emerging trade issues.

11) Global Membership: Growing in membership from 119 in 1995 to 135 in 1999, with another 30 applicants seeking to negotiate entry, the WTO is becoming more universal. The fall of the Berlin Wall brought new urgency to integrate former command economies into the trading system. Despite much more stringent requirements for membership than were used in the GATT, acceptance of WTO rules has become an integral part of a country's successful strategy for growth and development – making WTO membership a key element in the reformist policies of newly emerging market economies in Central and Eastern Europe, and of countries in Asia and in the Middle East.

WTO has now become a forum for perpetual negotiations on newer and newer subjects and for using trade rules to establish standards and enforce compliance even in non-trade areas. Everything now seems to require the hand of WTO, As trade has become more important to the U.S. domestic economy and in our relations with other countries, it is only natural that the WTO should be subject to greater scrutiny. In 1970, trade (exports + imports) was valued at 13 percent of U.S. GDP; in 1999 it exceeded 30 percent of GDP. While the WTO can respond by doing a better job in explaining its practices and procedures to the public, and by reforming procedures outmoded in this era of rapid communication, it is also not surprising that a new organization such as the WTO encounters some misconceptions.

8.7 CRITICISMS OF WTO

The WTO, however, has still to make progress on the following issues:

- The trade reform process is incomplete in many countries, some tariff peaks remain, and negotiations are still proceedings in various areas, notably in basic telecommunications and financial services.
- There have been at least some reversals in the overall liberalisation process in some developing countries. Examples may be increasing of antidumping measures, selective tariff increases and investment related measures.
- The combination of globalization and technological change creates a premium on high skill as against low skill. Concerns have been raised that this will amount to growing social divisions.
- The major share of the benefits of the WTO has gone to the countries of the North. WTO has been much more beneficial to the developed countries where the benefits of free trade accrue primarily to the underdeveloped countries, the progress has been much slower.
- The WTO has not done much for the development of non-tariff barriers to imports from the underdeveloped countries such as anti dumping duties.
- One size fits all approach is increasingly getting embedded in the WTO rules and disciplines. The policies and rules appropriate or advantages to the industrialized world are getting established as common rules to be obeyed by the developing countries as well. As a result, the multilateral trade rules are increasingly becoming a codification of the policies, perceptions, laws and regulations of the industrialized countries.
- As a result of pressures resulting from WTO, the interests of international trade, which are primarily the interests of transnational corporations, take precedence over local concerns and policies even if such a course exposes the local population to serious health and security risks.
- All the WTO members are not equally integrated in the multilateral system.
- As brought out in the last Ministerial Meeting at Mexico in September 2003, the implementation related issues are becoming a source of serious concern.

- The WTO has not relegated U.S. interests to a bloated international Secretariat of faceless bureaucrats: The WTO is a "member-driven" organization. WTO Members like the United States take responsibility for monitoring compliance with the Agreements and setting the course for the Organization.
- The WTO is staffed by a Secretariat of international civil servants headed by a Director-General. Unlike many other institutions, the Secretariat does not operate with a high degree of independence, and serves at the direction of the membership.
- The WTO is not a specialized UN agency, reflecting the strong views of its Members that it should not be included in the UN structure. And like the earlier GATT, the WTO takes decisions by consensus, despite the fact that there are highly-limited provisions for voting in certain instances.

Much work lies ahead, of course. They intend to work at the WTO to further open markets to American goods and services; to enforce the commitments our trading partners have made; reform the WTO to improve transparency and access to civil society; and to ensure that it contributes to our work to promote environmental protection and internationally recognized core labor standards worldwide. Much of this work will be complex and difficult. WTO Members were, for example, unable to launch a new Round of trade negotiations in 1999, reflecting the fact that these issues are complex and often lead to negotiating deadlock. But after five years, the record of the WTO is one of success. American workers and companies depend on open markets around the world; American living standards, especially for the poorest, depend on our own open market policies.

The WTO is our strongest guarantee that these policies will remain in place. The United States is the world's largest exporter which in turn accounts for 11.7 million American jobs. The institution and its rules provide the best possible foundation for a world which is open, responsive to the rule of law, and able to offer new opportunities and higher living standards to its people. The record of the past fifty years should give us a great deal of confidence. Taken as a whole, the multilateral trading system has promoted the rule of law, created new opportunities for worldwide economic growth, and created opportunities for Americans. This amply justifies the decision Congress took five years ago to support creation of the WTO as a successor to the GATT. It should remind us how significant will be the rewards of success as we take up the challenges of the new century.

8.8 TARIFF AND NON-TARIFF BARRIERS OF TRADE

Tariffs, which are taxes on imports of commodities into a country or region, are among the oldest forms of government intervention in economic activity. They are implemented for two clear economic purposes. First, they provide revenue for the government. Second, they improve economic returns to firms and suppliers of resources to domestic industry that face competition from foreign imports. Tariffs are widely used to protect domestic producers' incomes from foreign competition. This protection comes at an economic cost to domestic consumers who pay higher prices for import competing goods, and to the economy as a whole through the inefficient allocation of resources to the import competing domestic industry. Therefore, since 1948, when average tariffs on manufactured goods exceeded 30 percent in most developed economies, those economies have sought to reduce tariffs on manufactured goods through several rounds of negotiations under the General Agreement on Tariffs Trade (GATT).

Only in the most recent Uruguay Non-Tariff Barrier is any obstacle to international trade that is not an import or export duty. They may take the form of import quotas, subsidies, customs delays, technical barriers, or other systems preventing or impeding trade Round of negotiations were trade and tariff restrictions in agriculture addressed. In the past, and even under GATT, tariffs levied on some agricultural commodities by some countries have been very large. When coupled with other barriers to trade they have often constituted formidable barriers to market access from foreign producers. In fact, tariffs that are set high enough can block all trade and act just like import bans.

A tariff-rate quota (TRQ) combines the idea of a tariff with that of a quota. The typical TRQ will set a low tariff for imports of a fixed quantity and a higher tariff for any imports that exceed that initial quantity. In a legal sense and at the WTO, countries are allowed to combine the use of two tariffs in the form of a TRQ, even when they have agreed not to use strict import quotas. In the United States, important TRQ schedules are set for beef, sugar, peanuts, and many dairy products. In each case, the initial tariff rate is quite low, but the over-quota tariff is prohibitive or close to prohibitive for most normal trade. Explicit import quotas used to be quite common in agricultural trade.

They allowed governments to strictly limit the amount of imports of a commodity and thus to plan on a particular import quantity in setting domestic commodity programs.

Another common non-tariff barrier (NTB) was the so-called "voluntary export restraint" (VER) under which exporting countries would agree to limit shipments of a commodity to the importing country, although often only under threat of some even more restrictive or onerous activity. In some cases, exporters were willing to comply with a VER because they were able to capture economic benefits through higher prices for their exports in the importing country's market.

In the Uruguay round of the GATT/WTO negotiations, members agreed to drop the use of import quotas and other non-tariff barriers in favor of tariff-rate quotas. Countries also agreed to gradually lower each tariff rate and raise the quantity to which the low tariff applied. Thus, over time, trade would be taxed at a lower rate and trade flows would increase Given current U.S. commitments under the WTO on market access, options are limited for U.S. policy innovations in the 2002 Farm Bill vis a vis tariffs on agricultural imports from other countries. Providing higher prices to domestic producers by increasing tariffs on agricultural imports is not permitted. In addition, particularly because the U.S. is a net exporter of many agricultural commodities, successive U.S. governments have generally taken a strong position within the WTO that tariff and TRQ barriers need to be reduced.

Countries use many mechanisms to restrict imports. A critical objective of the Uruguay Round of GATT negotiations, shared by the U.S., was the elimination of non-tariff barriers to trade in agricultural commodities (including quotas) and, where necessary, to replace them with tariffs a process called tarrification. Tarrification of agricultural commodities was largely achieved and viewed as a major success of the 1994 GATT agreement. Thus, if the U.S. honors its GATT commitments, the utilization of new non-tariff barriers to trade is not really an option for the 2002 Farm Bill.

Governments have used domestic content regulations to restrict imports. The intent is usually to stimulate the development of domestic industries. Domestic content regulations typically specify the percentage of a product's total value that must be produced domestically in order for the product to be sold in the domestic market (Carbaugh). Several developing countries have imposed domestic content requirements to foster agricultural, automobile, and textile production. They are normally used in conjunction with a policy of import substitution in which domestic production replaces imports. Domestic content requirements have not been as prevalent in agriculture as in some other industries, such as automobiles, but some agricultural examples illustrate their effects. Australia used domestic content requirements to support leaf tobacco production. In order to pay a relatively low import.

Some countries have targeted specific types of imports through implementing multiple exchange rate policy under which importers were required to pay different exchange rates for foreign currency depending on the commodities they were importing. The objectives of such programs have been to reduce balance of payments problems and to raise revenues for the government. Multiple exchange rate programs were rare in the 1990s, and generally have not been utilized by developed economies Finally, exchange rate policies are usually not sector-specific In the United States, they are clearly under the purview of the Federal Reserve Board and, as such, will not likely be a major issue for the 2002 Farm Bill. There have been many calls in recent congressional testimony, however, to offset the negative impacts caused by a strengthening US dollar with counter-cyclical payments to export in india.

Duty on imported tobacco, Australian cigarette manufacturers were required to use 57 percent domestic leaf tobacco. Member countries of trade agreements also use domestic content rules to ensure that nonmembers do not manipulate the agreements to circumvent tariffs. For example, North American Free Trade Agreement (NAFTA) rules of origin provisions stipulate that all single-strength citrus juice must be made from 100 percent NAFTA origin fresh citrus fruit. Again, as is the case with other trade barriers, it seems unlikely that introducing domestic content rules to enhance domestic demand for U.S. agricultural commodities.

All countries impose technical rules about packaging, product definitions, labeling, etc. In the context of international trade, such rules may also be used as non-tariff trade barriers. For example, imagine if Korea were to require that oranges sold in the country be less than two inches in diameter. Oranges grown in Korea happen to be much smaller than Navel oranges grown in California, so this type of "technical" rule would effectively ban the sales of California oranges and protect the market for Korean oranges. Such rules violate WTO provisions that require countries to treat imports a nd domestic products equivalently and not to advantage products from one source over another, even in indirect ways. Again, however, these issues will likely be dealt with through bilateral and multilateral trade negotiations.

Import licenses have proved to be effective mechanisms for restricting imports. Under an import licensing scheme, importers of a commodity are required to obtain a license for each shipment they bring into the country. Without explicitly utilizing a quota mechanism,

a country can simply restrict imports on any basis it chooses through its allocation of import licenses. Prior to the implementation of NAFTA, for example, Mexico required that wheat and other agricultural commodity imports be permitted only under license. Elimination of import licenses for agricultural commodities was a critical objective of the Uruguay Round of GATT negotiations and thus the use of this mechanism to protect U.S. agricultural producers is unlikely an option for the 2002 Farm Bill.

Governments have used domestic content regulations to restrict imports. The intent is usually to stimulate the development of domestic industries. Domestic content regulations typically specify the percentage of a product's total value that must be produced domestically in order for the product to be sold in the domestic market (Carbaugh). Several developing countries have imposed domestic content requirements to foster agricultural, automobile, and textile production. They are normally used in conjunction with a policy of import substitution in which domestic production replaces imports.

The most common instruments of direct regulation of imports (and sometimes export) are licenses and quotas. Almost all industrialized countries apply these non-tariff methods. The license system requires that a state (through specially authorized office) issues permits for foreign trade transactions of import and export commodities included in the lists of licensed merchandises. Product licensing can take many forms and procedures. The main types of licenses are general license that permits unrestricted importation or exportation of goods included in the lists for a certain period of time; and one-time license for a certain product importer (exporter) to import (or export). One-time license indicates a quantity of goods, its cost, its country of origin (or destination), and in some cases also customs point through which import (or export) of goods should be carried out. The use of licensing systems as an instrument for foreign trade regulation is based on a number of international level standards agreements. In particular, these agreements include some provisions of the General Agreement on Tariffs and Trade and the Agreement on Import Licensing Procedures, concluded under the (GATT).

The consequence of this trade barrier is normally reflected in the consumers' loss because of higher prices and limited selection of goods as well as in the companies that employ the imported materials in the production process, increasing their costs. An import quota can be unilateral, levied by the country without negotiations with exporting country, and bilateral or multilateral, when it is imposed after negotiations and agreement with

exporting country. An export quota is a restricted amount of goods that can leave the country. There are different reasons for imposing of export quota by the country, which can be the guarantee of the supply of the products that are in shortage in the domestic market, manipulation of the prices on the international level, and the control of goods strategically important for the country. In some cases, the importing countries request exporting countries to impose voluntary export restraints.

Sometimes, restrictions on imports from certain places are fully consistent with protecting consumers, the environment, or agriculture from harmful diseases or pests that may accompany the imported product. The WTO Sanitary (SPS) provisions on technical trade rules specifically recognize that all countries feel a responsibility to secure their borders against the importation of unsafe products. Prior to 1994, however, such barriers were often simply used as excuses to keep out a product for which there was no real evidence of any problem. These phony technical barriers were just an excuse to keep out competitive products.

The current WTO agreement requires that whenever a technical barrier is challenged, a member country must show that the barrier has solid scientific justification and restricts trade as little as possible to achieve its scientific objectives. This requirement has resulted in a number of barriers being relaxed around the world. It should be emphasized that WTO rules do not require member countries to harmonize rules or adopt international standards only that there must be some scientific basis for the rules that are adopted must be based on sound science and they do not have to be harmonized with the initiatives of other countries.

8.9 NEGOTIATIONS IN INTERNATIONAL BUSINESS

Negotiation is a process to manage relationships. It is a basic human activity that exists between husband and wife, children and parents, employers and employees, buyers and sellers and between businesses associates. In business relationships the stakes are often high and therefore it is necessary to plan and prepare the negotiation more carefully(Ghauri 2003a). When business parties negotiate the purpose is to influence the process so they can get a better deal than just accepting or rejecting what the other party is offering. It is a voluntary process between the two parties where both can modify their offers and expectations to come closer to each other. Another view of the process is to see it as problem solving process Negotiation is an important part of developing business in any market. The estimated time spent in negotiations is 50 per cent of the total working time.

Business negotiations differ from other negotiations. In business it is considered the most challenging communication tasks (1999) and are more and more considered a crucial part of the managerial process, which is highly relevant to the implementation of business strategies. International business negotiations have many characteristics that distinguish them from negotiations in the domestic markets. The process to manage relationships becomes more complex when more than one culture is involved. Deals are drafted between business people from different countries having different cultural backgrounds. National culture programming leads to patterns of thinking, feeling and acting. Successful negotiations require understanding of each party's culture and may also require adaptation of the negotiating strategy so it is consistent with the other party's culture.

Negotiation is important, especially in business-to-business markets where companies build long-term relationships. Establish, maintain and faster relationships are of prime importance for the market transaction to take place (Ghauri 2003a). In business-to-business relationships Western firms are increasingly doing business with firms from Asia. Moreover Western firms are opening offices and sales subsidiaries all over the world and firms are facing greater problems in negotiating with local sales offices often manned with local managers. It is therefore, interesting to investigate how culture interfere the negotiationbehavior of parties coming from different countries and cultures, even if they officially belong to the same organization e.g., HQ (head quarters)/ subsidiaries.

8.10 SUMMARY

This unit discussed about the basic concepts of objectives and important functions of world trade organizations (WTO).Tariff and non tariff barriers to trade and negotiations in international business are discussed in the length. An account of structure and achievements of world trade organizations is also given in this unit.

8.11 SELF ASSESSMENT QUESTIONS

1) Define the term world trade organizations?
2) Mention the major functions of world trade organizations?
3) Briefly explain structure and achievements of world trade organization?
4) List out the tariff and non tariff barriers to trade?

8.12 CASE STUDY

Case Study No.1

WTO upholds steel duty ruling

The World Trade Organization (WTO) today put US president George Bush in a tight spot as it ruled that US duties on imported steel from the EU and other countries are illegal. In its final verdict, the WTO appeals panel upheld an earlier ruling against the US in July. Pascal Lamy, the EU trade commissioner said the US had failed to prove that its industry had been harmed by a sudden flood of cheap imports - a condition for imposing such duties under WTO rules. Brussels says it will start retaliating if the US steel duties are still in place five days after today's decision has been formally adopted by the WTO, probably at the end of November. The steel tariff issue is one of several areas of economic contention between the US and the EU. The EU is already preparing sanctions against US exports after winning another WTO verdict over tax break for US exporters such as Boeing. Meanwhile the US has taken the EU to the WTO over a dispute on labeling of genetically modified foods.

The WTO steel decision places Mr Bush in an awkward position. He introduced the steel tariffs last year under pressure from domestic producers, who claimed they were suffering damage from a flood of cheap imports. If he reverses his own policy he risks damaging his political prospects in steel-producing states such as Pennsylvania, West Virginia and Ohio, ahead of next year's presidential vote. The EU has threatened to retaliate with some \$2.2bn (£1.3bn) in duties on US goods. To increase political pressure on the White House, many of the products targeted are produced in swing states thought to be crucial to Mr Bush's re-election prospects. Supachai Panitchpakdi, the WTO director-general said he hopes the parties involved will be able to solve the problem without resorting to sanctions. "I'm sure there will be some way out," Mr Supachai said in Beijing. "I expect to see the conciliatory approach that we have seen in the past, and I certainly recommend that approach."

Leaving the EU aside, Japan, South Korea, Norway, Switzerland, China, New Zealand and Brazil have all filed complaints against the US. All of those countries could now retaliate against US imports if the duties are not removed. Mr Bush's decision to impose duties of up to 30% on foreign steel also came under fire from within the US. Car makers, in particular, said the move increased the price of their materials, causing job losses in the

industry and making vehicles more expensive. In a sign that the Bush administration is trying to extricate itself from a bind of its own creation, it has been reviewing whether to maintain the duties for the full three-year period, which would run past the elections until March 2005.

QUESTIONS:

1. Briefly explain the functions WTO played to dispute settlementfrom above the case study?
2. Explain the trade agreement between WTO with the other nations to sustained international business in the regional trade blocks?

Case Study No.2

Europeans May Hold Their Fire on U.S. Steel Tariffs

The European Commission, the executive body of the union, said today that it welcomed a decision by the Bush administration, announced on Thursday, to exempt 178 more product categories from the protective tariffs it imposed in March, bringing the total number of exempted products to 727. More than half the European steel exports to the United States originally covered by the tariffs, which will last three years and range from 8 percent to 30 percent, have now been exempted, the commission said. Pascal Lamy, the European commissioner responsible for trade, urged today that the remaining tariffs be withdrawn "soonest, and in any event immediately after the decision of the panel condemning the U.S. measures." He referred to a World Trade Organization panel that is evaluating whether the United States tariffs are permissible under global trade rules.

The panel, acting on complaints from the union and from other affected nations including Brazil and South Korea, is widely expected to reject the tariffs sometime next year. "The decision to exclude many E.U. products from the U.S. safeguard measures will help both E.U. exports and those many industries in the U.S. which need high-quality imports from Europe," Mr. Lamy said. "Let us hope that the next step will be action to restructure that part of the U.S. steel industry which has traditionally been behind the adoption of protectionist measures." Government ministers of the union's 15 member nations are scheduled to decide next month whether to go through with short-term retaliatory tariffs they have threatened to impose on United States goods including textiles from the Carolinas and citrus fruit from Florida a list chosen for domestic political effect in the United States.

The union has postponed the decision several times to allow Washington more time to address its concerns. Officially, the union is still pursuing retaliation under the trade organization's rules. But trade experts took Mr. Lamy's remarks today as a hint that the union and the United States had reached a deal to avert rapid sanctions. "It sounds like he is saying that they are not going to happen," said Richard Weiner, a trade specialist in the Brussels office of the Hogan & Hartson law firm. "It would be hard to imagine the ministers disagreeing with the trade commissioner." Though the remaining steel tariffs still hinder free trade, he said, the latest round of exemptions "have taken the sting out of them."

European steel producers take a dimmer view. The British-Dutch steel maker Corus urged the union to move ahead with measures against the United States. "We see no reason for the E.U. to change its stance," said Mike Hitchcock, a Corus spokesman. About 824,000 tons of Corus steel exports would have been affected by the original tariffs this year, Mr. Hitchcock said; exemptions announced since then gave relief for only 231,000 tons, or 28 percent. Mr. Hitchcock called the latest round of exemptions disappointing. For Arcelor, the top European steel exporter to the United States, the latest round of exemptions gave relief for 70,000 tons a year, bringing the exempted total to about 23 percent of the one million tons originally affected. "Previous exclusions in recent months have been far from enough," said an Arcelor official in Luxembourg, where the company is based. "I imagine our official line would be unchanged after the latest offering from Washington."

United States officials said these would be the last exemptions offered this year, though a new round will be considered between November and next March. "We will press our customers in the United States to push for further exclusions for our products the next time around," Mr. Hitchcock of Corus. European Union officials hinted today that the union might put off retaliating against United States steel tariffs until next year, signaling that Washington may have bought itself some time by greatly narrowing the scope of the disputed tariffs

QUESTIONS:

1. Give brief summary of above the case study related to trade and tariff in international business?
2. List out the tariff and non tariff barriers of European Union trade block in international business?

8.13 NOTES

8.14 REFERENCES

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MODULE- III

THEORIES OF INTERNATIONAL BUSINESS AND BILATERAL AND MULTILATERAL TRADE LAWS

UNIT - 9 : MERCANTILISM THEORIES

Structure :

9.0 Objectives

9.1 Introduction

9.2 The Concept of Merchantilism Theory

9.3 Three Basic Issues of International Trade Theories

9.4 The Absolutute Advantage Theory

9.5 The Law of Comparative Advantage

9.6 Heckscher-Ohlin Theory

9.7 New Theories of International Trade

9.8 Broad Categories of New Theories

9.9 Summary

9.10 Self Assessment Questions

9.11 Case Study

9.12 Notes

9.13 References

9.0 OBJECTIVES

After studying this unit, you should be able to;

- Define the term Mercantilism
- Describe the concept of Absolute Advantage Theory
- Determine the new theories of International Trade
- Give an account of the Law of Comparative Advantage Theory

9.1 INTRODUCTION

It was only after the publication of The Wealth of Nations by Adam Smith in 1776, the subject of economics emerged in an organized scientific form. Prior to that during the 17th and 18th centuries in Europe a group of men – like merchants, bankers, traders, government officials and philosophers, wrote essays and pamphlets on international trade that advocated an economic philosophy known as mercantilism. The term mercantilism first acquired significance at the hands of Adam Smith. Mercantilism, as the term implies is closely associated with trade and commercial activities of an economy. Mercantilist theory was highly nationalistic in its outlook and favoured state regulation and centralization of economic activities including foreign trade. The mercantilists believed that a nation's wealth and prosperity is reflected in its stock of precious metals (also known as specie), namely, gold and silver. At that time, as gold and silver were the currency of trade between nations, a country could accumulate gold and silver by exporting more and importing less.

The more gold and silver a nation had, the richer and more powerful it was. They argued that government should do everything possible to maximize exports and minimize imports. However, since all nations could not simultaneously have an export surplus and the amount of gold and silver was limited at any particular point of time, one nation could gain only at the expense of other nations.In other words, mercantilists believed that trade was a zero sum game. For mercantilists, the objective of foreign trade was considered to be achievement of surplus in the balance of payments. Hence, they advocated achieving as high trade surplus as possible.

In this context, Blaug points out that "The core of mercantilism, of course, is the doctrine that a favorable balance of trade is desirable because it is somehow productive of national prosperity.When mercantilist authors speak of the surplus in the balance of trade, they mean an

excess of exports, both visible and invisible, over imports, calling either for an inflow of gold or for granting of credit to foreign countries, that is capital exports. In other words, they were roughly thinking of what we would now call 'the current account' as distinct from ' the capital account' in the balance of payments. Another flaw of mercantilism is that it they viewed trade as a zero sum game. This view was challenged by Adam Smith and David Ricardo who demonstrated that trade was a positive sum game in which all trading nations can gain even if some benefit more than others.

9.2 THE CONCEPT OF MERCANTILISM THEORY

Mercantilism is a philosophy from about 300 years ago. The base of this theory was the "commercial revolution", the transition from local economies to national economies, from feudalism to capitalism, from a rudimentary trade to a larger international trade. Mercantilism represents, more than anything else, the economic strategies widely promulgated bythe European nation states1 in the early capitalist era – circa 1500 to 1850 and arguably by anumber of Asian states in the 20th and 21st centuries. Classical economics was both a reaction tomercantilism, and a synthesis of the thinking that underpinned both the mercantile and agriculture systems of capitalism, as they were understood in late 18th century Europe. Thus the mercantilistpre-economists were writers – commonly but not always businessmen who lived in Europe duringthis era, and to a greater or lesser extent supported the political strategies adopted

Geographical discoveries not only stimulated the international trade, but also produced an affluent flow of gold and silver, which could be used to encourage the economy based on money and prices. The state exercised much control over economic life, chiefly through corporations and trading companies. Production was carefully regulated with the object of securing goods of high quality and low cost, thus enabling the nation to hold its place in foreign markets. The theory states that the world only contained a fixed amount of wealth and that to increase a country wealth; one country had to take some wealth from another, either through having a higher import/export ratio. So, this tendency, to export more and import less and to receive in exchange gold (the deficit is paid in gold) is called MERCANTILISM.

The term 'mercantilism' is widely held to refer a broad period of European history during

Which absolute monarchs followed illiberal policies based on false premises: protectionism, widespread monopolies, and the confusion of wealth, money and power. However, beyond this broad and standard definition, it is difficult to identify a clear set of intermediary

objectives and policy tools that would define more precisely what mercantilism .A well-known part of the problem, of course, is that the theoretical foundations of mercantilism are shallow. Contrary to what Adam Smith suggested, there is no single, logically consistent "mercantile system", For example, many authors take for granted that the overarching aims of mercantilist policies were to substitute domestic production for imports and to absorb foreign technology. But they rarely ask whether local development or technological diffusion at the domestic level were significant objectives many mercantilist policy-makers for the production of luxury goods.

Mercantilism met its match during the War for Independence. The new United States quickly took precautions, to banish the policy from their borders, by creating a weak federal government that would serve God, instead of the elite. But the economic conflict had given the American people a taste for the paper dollar, and Mercantilism still retained its ugly head in the form of slavery and the creation of a central, state controlled bank. Christianity was weakened by Unitarianism and the Puritan's Post-millennialism was slowly degraded, statist economic policy crept into the American way of life. Men returned to the state as their god, and history began to repeat itself. The Northern states instituted economic regulations over the south and the Southern states promoted slavery to tip the economic scales in their favor. This resulted in Civil war and a Northern, manufacturing class dominating over the Southern farming class. By the end of Lincoln's term, big, central government was re-instituted as societal norm and the South was subjugated under Northern rule.

Mercantilist policy makes the market, the state's play-thing. Something to be fiddled with until it gives way to the state's relentless desire. A nation implementing mercantilist policy, would through taxes, tariffs, coercion, regulations suck gold out of the market, all this to bring more and more property under the reigns of the state. To the many central planners of the age this made perfect sense. But the policy of the government's perfect sense was and is fatal to any organic market. Without being able to buy goods from other nations (the deportation of gold) the market began to starve. Each of the great nations saw it in their authority, to take what they sought fit.

It was the divine right of kings, for rulers to claim what they will, and patriotism for their citizen to support their malevolence against such chosen victims. This belief in absolute governance came with the revival of classical literature and thought which flourished during the Renaissance. This mindset of royal superiority led to its logical end of its superiority over other royals. Causing many land feuds, economic struggles, and religious conflicts, as were not so uncommon with their reverend saints of antiquity. Since then, Its abandoned the gold standard, implemented the income and property tax, created the Federal Reserve, forced our dollar on the rest of the world, and have been

making colonies out of anyone that disagrees with us. It is true, by the beginning of the 20th century mercantilism had restated itself onto the global stage.

Its new saint, John Maynard Keynes, has now indoctrinated every school across the nation with Neo-Mercantilist principles. Keynes opponent, Murray Rothbard clearly defines mercantilism in this way. "Mercantilism, which reached its height in the Europe of the seventeenth and eighteenth centuries, was a system of which employed economic fallacy to build up a structure of imperial state power, as well as special subsidy and monopolistic privilege to individuals or groups favored by the state. Thus, mercantilism held exports should be encouraged by the government and imports discouraged."Mercantilism is a complex scheme to rob us of our God given rights, to topple the Christian quest for dominion, and place all property under the reigns of the state. Our history is a testimony of its terrible influence, and its defenselessness when faced against a Christian minority. So let us now free ourselves from the terrible hand of Mercantilism before it is too late.

9.3 THREE BASIC ISSUES OF INTERNATIONAL TRADE THEORIES

It is to be noted that mercantilists failed to address three relevant issues of international trade which are as follows:

1) **Gains from trade** – The first important issue is about the gains from trade? Do countries gain from international trade. Where do the gains come from , and how are they divided among the trading countries

2) **Structure of trade** – The second relevant issue is the structure or direction or pattern of international trade. In other words, which goods are exported and which are imported by each trading country? What are the fundamental laws that govern the international allocation of resources and the flow of trade?

3) **Terms of trade** – The third relevant issue is the terms of trade. In other words, at what prices are the exported and imported goods exchanged.

9.4 THE ABSOLUTUTE ADVANTAGE THEORY

It was Adam Smith who emphasized the importance of free trade in increasing wealth of all trading nations. According to Adam Smith, mutually beneficial trade is based on the principle of absolute advantage. His theory is based on the assumptions that there are two countries, two commodities and one factor (labour) of production. Adam Smith's theory is based on labour theory of value, which asserts that labour is the only factor of production and that in a closed

economy goods exchange for one another according to the relative amounts of labour they embody. The principle of absolute cost advantage points that a country will specialize and export a commodity in which it has an absolute cost advantage.

Adam Smith is recognized as the founder of modern economics and as one of the first and most famous thinkers who argued in favour of free trade. However, his theory of international trade is rather poorly known or appreciated. Today most textbooks of economics in general—and of international trade in particular start their introduction to trade theory with a short chapter on Adam Smith and the theory of absolute advantage, a theory allegedly invented by him. These texts then swiftly discard the absolute advantage theory in favour of a comparative advantage theory, which is connected to David Ricardo. However, Smith's writings include a more sophisticated theoretical approach to international trade than he is given credit for in the textbooks. In particular, his account shows that unrestricted trade and free international competition are more beneficial to a nation than the mercantilist economic policy that existed in many parts of Europe during the 18th century.

This theory presents a deeper understanding of Smith's original ideas., The briefly discuss the different methods used to reconstruct the ideas and theories of past thinkers. Then I will examine Smith's works, and compare them with the textbook version of his theory. The result is that Smith's original account differs widely from its textbook presentation. Textbooks use a deficient and illegitimate approach to the reconstruction of Smith's ideas, namely demography. This approach has been used with the aim of including Smith in a cohesive history of international trade theory that leads straight to modern neoclassical theory. In the last section, I will discuss what modern economics can learn both from Smith's original ideas and from the way in which his theory has been misrepresented.

For Smith, international trade has the same underlying cause as all kinds of trade. In The wealth of nations (WN hereafter), trade is the consequence of the human "propensity to truck, barter, and exchange one thing for another" .That does not mean that trade has no selfish motive. On the contrary, whenever people trade with each other they pursue their own interests, not some altruistic ones. They must benefit from trade otherwise they would not pursue it. Thus, merchants carry on commerce internationally because they earn profits by it. However, Smith endeavors to show that not only single merchants but the society as a whole benefits from international trade.

Smith also mentions an additional beneficial aspect of international trade, namely that it transfers knowledge and technology between different nations. The adoption and use of new production techniques lead to productivity growth and thus to economic development and an increase in wealth. Smith points out that these gains can even be more important to a nation than access to a wider market, especially for a big nation. He discusses this point with regard to China. China already has a large domestic market and would therefore primarily gain from open trade with Europe by getting access to its technology rather than by widening its market

Smith's intention is to show that international trade is beneficial for all nations involved in trade. However, he concedes that nations do not necessarily benefit in equal parts: "trade which, without force or constraint, is naturally and regularly carried on between any two places is always advantageous, though not always equally so, to both. Just as domestic trade is not equally beneficial to all regions within a country, international trade is not equally beneficial to all nations. Trade can even amplify differences between them, especially if they differ in their wealth. In line with this idea, in his Lectures on jurisprudence Smith compares the trade relations between a rich and a poor man to that between a developed and underdeveloped nation

In the second half of the 18thcentury, mercantilist policies became an obstacle for the economic progress. Adam Smith (father of liberalism and economical science) brought the argument in his book "The Wealth of Nations", published in 1776, that the mercantilist policies favorite producers and disadvantaged the interests of consumers. Adam Smith's theory starts with the idea that export is profitable if you can import goods that could satisfy better the necessities of consumers instead of producing them on the internal market. Theessence of Adam Smith theory is that the rule that leads the exchanges from any market, internal or external, is to determine the value of goods by measuring the labour incorporated in them. In order to demonstrate its theory, Adam Smith analyzed for the beginning country A, using one factor of production, the productivity of labour, evaluated in the necessary of hours needed to produce a unit of measure of the products X and Y. He used a unifactorial system of economy. Because all the economies have limited resources, there are limits in the level of production, and if a country wants to produce much of one product it has to give up producing another goods, existing in this case renounce of trade.

Subsequent economists did not pay much attention to Smith's theory of international trade. In general, it is not seen as relevant because of the predominance of the theory of comparative advantage, which "has been the bedrock on which all subsequent developments in

the theory of international trade have rested" As a result, Smith's theory was barely noticed and not developed any further. Nonetheless, many of today's textbooks deal briefly with the theory of absolute advantage, which is ascribed to Smith. They portray Smith's theory as "a stepping-stone to a more sophisticated theory", namely the theory of comparative advantage that is attributed to David Ricardo. Following this, most textbooks discuss the merits and failings of the Ricardian model and introduce the neoclassical version of the theory of comparative advantage, including the Heckscher-Ohlin model and the factor price equalization theorem. In this way, Smith's theory is presented as the starting point of a theoretical development that leads directly to neoclassical trade models. Smith's concerns and ideas are thus aligned with those of neoclassical trade theories. However, they are dwarfed by the theory of comparative advantage, which is one of the most praised theories in economics.

9.5 THE LAW OF COMPARATIVE ADVANTAGE

According to Ricardo, it is not the absolute but the comparative differences in costs that determine trade relations between two countries. The comparative cost theory was first systematically formulated by the English economist David Ricardo in his Principles of Political Economy and Taxation published in 1817. It was later refined by J. S. Mill, Marshall, Taussig and others. According to Ricardo, differences in comparative costs form the basis of international trade. The law of comparative advantage indicates that each country will specialize in the production of those commodities in which it has the greatest comparative advantage or the least comparative disadvantage. Thus, a country will export those commodities in which its comparative advantage is the greatest and import those commodities in which its comparative disadvantage is the least.

The comparative cost doctrine is not complete in itself. It has been severely criticized by economists due to its unrealistic assumptions. Prof. Bertil Ohlin critically pointed out that the principle of comparative advantage is not applicable to international trade alone, rather it is applicable to all trade. Furthermore, the theory does not explain why there are differences in costs. Ricardo's theory of comparative advantage did not explain the ratios at which the two commodities would be exchanged for one another. In other words, it does not indicate what the terms of trade are. It was J. S. Mill who discussed this issue in detail his theory of reciprocal demand. The Ricardian theory, though based on a number of wrong assumptions, is regarded as an important landmark in the development of the theory of international trade

If a country or individual is relatively more efficient in the production of a good than another country or individual then we say that she has comparative advantage in production of that good. Comparative advantage measures efficiency in terms of relative magnitudes. Since countries have limited resources and level of technology they tend to produce gods or services in which they have a comparative advantage. Comparative advantage (from now on CA) implies an opportunity cost associated with the production of one good compared to another. That is why countries tend to specialize in production of certain products. This notion is called international division of labor in the country.

Comparative advantage theory is much more general than the preceding discussion of special cases but predictions about the pattern of trade weaken with generality. On average a country will import goods that would be relatively expensive in the absence of trade. The confirming evidence based on Japan's opening to trade in the 1850's. The assumptions of the general model are that (i) price taking consumers minimize the expenditure needed to realize any level of utility (real income), and (ii) producers behave so as to maximize the national product given the resource endowments. Assumption (i) implies downward sloping demand curves in the generalized form. Assumption (ii) leads to upward sloping supply curves in the generalized form. Scale economies and imperfect competition, treated below in the section on endogenous advantage in country.

In economics, the law of comparative advantage refers to the ability of a party (an individual, a firm, or a country) to produce a particular good or service at a lower marginal cost and opportunity cost than another party. It can be contrasted with absolute advantage which refers to the ability of a party to produce a particular good at a lower absolute cost than another. Comparative advantage explains how trade can create value for both parties even when one can produce all goods with fewer resources than the other. The net benefits of such an outcome are called gains from trade.

David Ricardo explained comparative advantage in his 1817 book On the Principles of Political Economy and Taxation in an example involving England and Portugal. In Portugal it is possible to produce both wine and cloth with less labor than it would take to produce the same quantities in England. However the relative costs of producing those two goods are different in the two countries. In England it is very hard to produce wine, and only moderately difficult to produce cloth. In Portugal both are easy to produce. Therefore while it is cheaper to produce cloth in Portugal than England, it is cheaper still for Portugal to produce excess wine, and trade

that for English cloth. Conversely, England benefits from this trade because its cost for producing cloth has not changed but it can now get wine at a lower price, closer to the cost of cloth. The conclusion drawn is that each country can gain by specializing in the good where it has comparative advantage, and trading that good for the other.

One of the reasons why a country might have comparative advantage in a good is that countries in their factor endowments. There are two factors capital and labor. The home country is the capital abundant one, the one with more capital per unit of labor. One of the goods is more capital intensive than the other: it uses more capital per unit of labor than the other good. Countries have access to same technologies - factor endowments only difference between countries Under free trade, the capital abundant country (home) is expected to produce relatively more of the capital intensive good than the other country. Capital abundant country (home) therefore is expected to export the capital intensive good if no strong bias in consumption. Owners of capital in the capital abundant country (home) due to seeing their rents rise relative to prices of goods, while owners of labor (home workers) suffer due to seeing their wage fall relative to prices of goods. As long as capital endowments in the two countries are not too different and which good is capital intensive is the same in both countries, the wage and rent will be the same across countries under free trade with no transport costs.

The term 'reciprocal demand' indicates a country's demand for one commodity in terms of the quantities of the other commodity which it is prepared to give up in exchange. Thus, it is the reciprocal demand that determines the terms of trade which, in turn, determines the relative share of each country. Equilibrium would be established at that ratio of exchange between the two commodities at which quantities demanded by each country of the commodity which it imports from the other, should be exactly sufficient to pay for one another. Mill's theory of reciprocal demand relates to the possible terms of trade at which the two commodities will exchange for each other between the two countries. The terms of trade here refer to 'the barter terms of trade' between the two countries i.e. the ratio of the quantity of imports for a given quantity of exports of a country.

9.6 HECKSCHER-OHLIN THEORY

One of the main drawbacks of Ricardian theory of comparative cost was that it did not explain why differences in comparative costs exist. In 1919, Eli Heckscher propounded the idea that trade results from differences in factor endowments in different countries The idea was further carried forward and developed by Bertil Ohlin in 1933 in his famous book Inter-regional and International Trade. This book forms the basis for what is known as Heckscher Ohlin theory or modern theory of international trade.

The Heckscher Ohlin theory is based on most of the assumptions of the classical theories of international trade and leads to the development of two important theorems – (a) Heckscher – Ohlin theorem and (b) Factor price equalization theorem. Heckscher& Ohlin have explained the basis of international trade in terms of factor endowments. According to Heckscher & Ohlin, regions or countries have different factor endowments. It means that some countries are rich in capital while some are rich in labour. In their theory, the concept of factor endowments or factor abundance is used in relative terms and not in absolute terms. Moreover, they have defined the concept of factor endowment or factor abundance in terms of two criteria

(a) Price criterion and

(b) Physical criterion

On the basis of above criterion the Heckscher – Ohlin theorem states that – " A nation will export the commodity whose production requires the intensive use of the nation's relatively abundant and cheap factor and import the commodity whose production requires the intensive use of the nation's relatively scarce and expensive factor ." In other words, the countries in which capital is cheap & abundant will export capital - intensive goods and import labour – intensive goods. On the contrary, the countries in which labour is cheap & abundant will export labour – intensive goods and import capital-intensive goods

a) **Price criterion**- As per price criterion, a country is said to be capital abundant if the ratio of price of capital to the price of labour (PK / PL) is *lower* as compared to the other country. This criterion considers both demand for and supply of factors.

b) **Physical criterion –** As per physical criterion, a country is said to be capital abundant if the ratio of the total amount of capital to the total amount of labour (K/L) is *greater* as compared to other country. This criterion considers only supply of factors.

Thus, for them it is the differences in factor intensities in the production of goods along with actual differences in factor endowments of the countries which explain international differences in comparative costs of production. The Heckscher Ohlin theory further leads to the development of factor price equalization theorem. The factor price equalization theorem indicates that free international trade will ultimately lead to equalization of commodity prices and factor prices. Economists Paul Samuelson & Wolfgang Stolper have further contributed to this theory and have formed Stolper – Samuelson theorem.Stolper –Samuelson theorem explains the effect of change in relative product prices on factor allocation and income distribution.

It postulates that an increase in the relative price of a commodity raises the return or earnings of the factor used intensively in the production of that commodity. In other words, an increase in the relative price of labour intensive commodity will increase wages. Similarly, an increase in the relative price of capital intensive commodity will increase the price of capital. This implies that free trade would raise the returns to the abundant factor and reduce the returns to the scarce factor It is clear from the above that the Heckscher Ohlin (hence forth, H-O) theory is superior to Ricardian theory. It accepts comparative advantage as the cause of international trade and explains the reasons behind the differences in comparative cost. Thus, it supplements the Ricardian theory of comparative cost. However, one of the limitations of H-O theory is that it is based on static model of given factor endowments and given technology.

9.7 NEW THEORIES OF INTERNATIONAL TRADE

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

♦ *SALIENT FEATURES OF NEW THEORIES OD TRADE*

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

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

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

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

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

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

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

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

9.8 BROAD CATEGORIES OF NEW THEORIES

The new theories can be broadly categorized into three types – (1) Neo – technological trade theories (2) Intra-industry trade models (3) Strategic trade policy models.

1) ***NEO – TECHNOLOGICAL TRADE THEORIES***

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

a) **Kravis' Theory of Availability:** In the Kravis'(1956)model, technological innovation as a basis of trade operates through his product availability hypothesis. The availability approach seeks to explain the pattern of trade in terms of domestic availability and non-availability of goods. Availability influences trade through demand and supply forces. According to him, a country produces and exports those goods which are ' available', that is, goods developed by its entrepreneurs and innovators. By availability he means an elastic supply. In short, as per Kravis' theory of availability, international trade takes place because of differences in the availability of certain products among countries.

b) **Linder's Theory of Volume of Trade and Demand Pattern:** Linder (1961)in his theory gave importance to demand side factors like similarity in income levels across nations and income distribution characteristics in determining pattern of trade. As per this theory, international trade takes place between those countries which have similar income levels and demand patterns. Thus, Linder's theory explains the reasons for large volume of trade in manufacturers among developed countries. The theory highlights the fact that the lion's share of world trade is among the developed countries with broadly similar per-capita incomes rather than between the developed and underdeveloped countries.

c) **Posner's Imitation Gap or Technological Gap Theory:** M.V.Posner (1961) analyzed the effect of technology on trade. He regards technological changes as a continuous process which influences the pattern of international trade. The model is based on the assumption that trading countries have similar factor endowments and identical production functions for established products. But, the technology is different between the trading

countries. This difference in the technology leads to introduction of new products and new production processes by a firm in a country. As a result, an innovating firm which creates a new product might acquire a temporary comparative advantage in the exports of its products to other countries. This comparative advantage could be called as 'technology gap'. To conclude, the technological gap theory is more realistic than the traditional theories because it analyses the effect of technical changes on the pattern of international trade.

d) **Vernon's Product Cycle Theory** – Vernon (1966)has put forth the product cycle hypothesis. Vernon's model is a generalization and extension of the technological gap model. It states that the development of a new product moves through a cycle or a series of stages in the course of its development, and its comparative advantage changes as it moves through the cycle. As a new product passes through different stages in a domestic market, in the similar way it passes through different stages in the international market. Generally, a product passes through the three stages during its life time. These stages are - (a) New product stage, (b) Maturing product stage and (c) Standardized product stage. To conclude, we can say that the Posner's technological model stresses the time lag in the imitation process, while Vernon's product cycle model stresses the standardization process. Both the models, try to explain dynamic comparative advantage for new products and new production processes, as opposed to the basic H-O model which explains static comparative advantage.

2) ***INTRA –INDUSTRY TRADE MODELS***

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

- **Krugman's Model (1979)**: Paul Krugman's model marks a distinctive and realistic departure from the traditional models because it recognizes the role of economies of scale and monopolistic competition in international trade. Krugman in his model points out that trade is possible between the two countries having identical tastes, technology, factor endowments & income levels, because of product differentiation and internal economies of scale in production. Thus, the sources of trade between identical economies lies in product differentiation and internal economies of scale in production of manufactured goods under monopolistic competitive framework.The implications of his model are – (a) Trade increases the choice of goods available to consumers and thereby improves consumer welfare. (b) Trade can cause an increase in demand, production and real income, facilitated by economies of scale.
- **Brander Krugman Model (1983)**: The Brander- Krugman model of intra-industry trade is based on oligopolistic competition. This model considers the application of the concept of dumping in international trade. The Brander- Krugman model considers a situation in which two firms of two countries resort to dumping in each other's domestic market. Hence, their model is also known as reciprocal dumping model. Dumping in the context of international trade means a practice in which a firm sells its products in foreign market at a price much lower than its domestic price. The situation in which dumping leads to a two way trade in the same product is known as reciprocal dumping. The possibility of dumping in international trade was first noted by Brander (1981)and then extended by Brander & Krugman (1983). The Brander Krugman model suggests that with the opening up of trade the monopoly situation turns into a duopolistic market structure, which is a form of oligopolistic competition. Thus, their reciprocal dumping model explains the intra- industry trade in homogenous products under oligopolistic competition. However, the model fails to explain the net effect of such peculiar trade on a nation's economic welfare of the country.

3) *STRATEGIC TRADE POLICY MODEL*

The strategic trade policy models provide certain theoretical justification for policy intervention such as home market protection and export subsidies towards increasing exports and national welfare. In the broader sense, the strategic trade policy models are an extension of intra-industry trade models. These models are developed in a partial equilibrium framework by assuming oligopolistic competition. The basis of these models lies in the trade war between

industrialized countries such as United States, Japan, and the European Community. Two strategic trade theory models are as follows:

- **Krugman's Model (1984):** Krugman's strategic trade policy model shows that import protection of domestic producers could lead to export promotion. In this model three forms of economies of scale are taken into account-(a) Static internal (to a firm) economies, (b) Economies in Research & Development and investment, (c) Dynamic economies of learning by doing the international trade.
- **Brander & Spencer's Model (1985):**Brander & Spencer's model shows that export subsidies could help domestic producers to capture third country markets at the cost of foreign rivals. This is a two stage (game theory) model in which governments (simultaneously) choose subsidy levels in the first stage and firms (simultaneously) choose output levels in the second stage. There is no domestic consumption in either country. i.e. firms produce only for the third country market. The model assumes foreign firm does not receive export subsidy. An export subsidy to a domestic firm is considered as a reduction in its cost of production. Hence, it becomes profitable for the domestic firm to expand its sale in the third country market, and capture a large market share at the cost of the foreign rival.

Imperfect markets with potentials for reciprocal dumping by nations in each other's market led Brander and Spencer formulate the notion of "strategic trade"; The above relates to situations when demand curves are subject to elasticity that are different in the two countries Using the famous example of the Airbus and Boeing industries, the strategy was one of an aggressive preemption, by creating a market niche through subsidized dumping of exports. A parallel possibility also exists with internal economies of scale at a national level, when countries that are historically ahead of others in producing the good have an advantage over others, with the capacity to produce at a price lower than what other countries could offer at the starting point. Similar to the Listian "infant industry" case, situations as above justify strategic trade policy with subsidies offered in the high-cost country in order to enable the latter reap the scale economies. Alternatively (and also paradoxically) the above also lays the basis for aggressive strategic trade on the part of industrially advanced nations.

Trade theory also encompasses endogenous differences between countries. One focus is on economies of scale. The wider market due to trade induces a cost advantage in an industry in one of the countries. Another theory is based on monopolistic competition, whereby the

wider markets due to trade increase product variety as buyers seek the special characteristics of foreign brands. Differentiated products trade flows both ways within product categories. Trade costs also shape the pattern of trade. The economic theory of gravity explains the complex bilateral trade patterns among countries. Actual trade is much lower than gravity predicts in a frictionless world, providing evidence of trade costs much larger than those due to policy or transportation. The costs are well explained by geography and a set of national differences. The stability of the relationships over time suggests that these costs change slowly in developed countries.

9.9 SUMMARY

This unit discussed about the basic concepts of mercantilism and three basic issues of international trade theories. The law of comparative advantage theory and absolute advantage theories are discussed in the length. An account of heckscher-ohilin theory and new international trade theories is also given in this unit.

9.10 SELF ASSESSMENT QUESTIONS

1) Define the term mercantilism?
2) Briefly explain the law of comparative advantage theory in international business?
3) Write a note on absolute advantage theory?
4) List out the different types of new international trade theories?

9.11 CASE STUDY

Case Study No.1

IKEA expansion in Russia stalled.

The IKEA northwest Moscow store in Russia is pictured May 29. The company may halt its expansion into Russia after running into red tape.In just nine years, Swedish furniture retailer IKEA has opened 11 of its huge stores in Russia in hopes of capitalizing on Russia’s nascent middle class. Now the company says it may halt its expansion drive after running into trouble with the government’s powerful reach. But some observers say the economic crisis may be as much of a factor in IKEA’s fortunes as the local bureaucracy.

IKEA hit a bump when officials in Samara in the Volga River region demanded a planned store be able to withstand near-hurricane-force winds, although such violent weather is rare. The strongest recorded winds never exceeded 17 meters per second, a little more than half the 30-meter-per-second standard set by local government. Back in April, IKEA said the store in Samara was tentatively scheduled to open May 11. More than a month later, the store has not opened yet, and IKEA said it cannot give even a tentative timeline.

Regulators and bureaucrats frustrate entrepreneurs everywhere, but Russia's multilayered government has proven especially difficult for businesses to negotiate. And in addition to red tape, sometimes there's corruption. President Dmitry Medvedev last year declared corruption a key threat to his country's modernization and social stability and pushed through anti-corruption legislation, but little progress has been made. In the early part of the decade, IKEA was vocal about corruption, asserting it was subjected to blackmail, sabotage and pressure for bribes. As the company gained a foothold, the rhetoric vanished and IKEA executives now shun the words "bribe" or "corruption" and prefer phrases like "gray areas" to account for their troubles with the officialdom. While other companies also confront such issues, IKEA has been among the most vocal.

Russia's weaker economy may be another factor in throttling back the retailer's growth plans. "The main motivation now is the uncertainty of where the economy is going," said Chris Weafer, chief strategist at Uralsib investment bank. "Corruption, bureaucracy and red tape have never put them off before." The discretionary income of Russians has declined, people are holding off on buying apartments and doing renovations, and, as a consequence, are buying less furniture. "They need GDP growth to help them expand, and that's reversed," said James Fenkner, head of Moscow-based Red Star Asset Management. Privately held IKEA does not disclose its profits, but IKEA's Kaufmann says the company has "positive accumulated sales" in 10 out of 11 Russian stores with "double digit growth" for Russia on average. IKEA previously said it had invested more than $3 billion in Russia and was planning to open four stores this year. IKEA employs 7,000 people across Russia.

QUESTIONS

1. How the Russian economy expand their business in international trade Markets?
2. What are the tariff and agreements between regional trade blocks and Russian economy to enter into international business?

Case Study No.2

Russia and Western clubs: no thanks, Geneva

If had become almost a ritual. Every year Russian officials promised that by the end of the following year their country would complete the negotiations to join the World Trade Organization. Every year the timetable slipped by another year. But now Vladimir Putin, Russia's prime minister, has broken with the ritual by announcing that, after 16 years of trying to get in, Russia no longer wants to join the WTO on its own but only as part of a customs union that it has forged with Belarus and Kazakhstan. The turnaround shocked trade negotiators on both sides, who only weeks ago were trying to iron out the last wrinkles in a deal.

In practical terms Russia will lose little. It exports mainly oil and gas, which are largely not covered by the WTO. Being outside the organization for a bit longer gives it more freedom to raise import duties on second-hand cars or export duties on timber. Some observers suggest that the Kremlin was never truly comfortable with the idea of free trade and saw the rules as a nuisance rather than a stimulus to restructure the economy. Yet Russia's aspiration to membership, which in turn opened up the prospect of joining the Paris-based OECD club of rich countries, demonstrated its desire for integration into the global economic system.

Now the Kremlin seems to prefer being a distinct regional power that can offer alternative economic and military institutions and alliances to the West's. Mr Putin has long argued that international organisations such as the WTO and the International Monetary Fund have outlived their day and should be supplemented or even replaced by regional clubs. In the multipolar world that Russia advocates, it sees itself as a centre of regional influence. A military alliance between Russia and Uzbekistan, Belarus, Armenia, Kazakhstan, Kyrgyzstan and Tajikistan, called the Collective Security Treaty Organisation (CSTO), should be "no worse than NATO", Dmitry Medvedev, Russia's president, argued recently.

Russia sees any foreign project that touches the former Soviet Union, including the European Union's new eastern partnership, as a direct challenge. Yet the bigger threat to its ambitions to reassert regional influence lies in its own attitude towards the neighbours. Even as it was signing a customs union with Belarus, Russia imposed a ban on Belarusian milk products, which it claimed did not meet its new packaging rules (rather as it once argued that Georgian wine, fruit and mineral water were of substandard quality). But Alyaksandr Lukashenka, the autocratic president of Belarus, interpreted this (probably accurately) as a punishment for being

rude about Russia and refusing to back its policy of recognising the independence of the Georgian territories of Abkhazia and South Ossetia.

Mr Lukashenka is known for his own blackmailing tactics. When Alexei Kudrin, Russia's finance minister, questioned Belarus's solvency and withheld a $500m loan offer a few weeks ago, Mr Lukashenka hit back by saying: "If it does not work with Russia…we will have to try our luck in another part of the planet." In response to the milk ban, he boycotted the latest CSTO summit, insisting that talk of collective security against the background of trade wars waged by some CSTO members against others made a mockery of common sense. Fyodor Lukyanov, a foreign-policy pundit in Moscow, commented that, as soon as the CSTO ceased functioning as a mere symbol of loyalty to Russia and began to set concrete goals, "it became clear how little the organization met the real interest of its members."

QUESTIONS:

1. Disuses overall case study and explain the trade strategies to used enter in to international business?
2. What is the main impact of new trade theories are enter into Russian international economy or business?

9.10 NOTES

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UNIT -10 : INTERNATIONAL TRADE THEORIES

Structure :

10.0 Objectivses

10.1 Introduction

10.2 International Product Life Cycle Theory

10.3 Exceptions to the Cycle

10.4 Porters Diamond Theory

10.5 Business Implication of International Trade Theories

10.6 Summary

10.7 Self Assessment Questions

10.8 Case Study

10.9 Notses

10.10 References

10.0 OBJECTIVES

After studying this unit, you should be able to;

- Define the International Trade Theories.
- Describe the theory of Product Life Cycle.
- Determine the phases of Porter's Diamond t Model Theories.
- Give an account on Business Implication of International Trade Theories.

10.1 INTRODUCTION

International trade theories are simply different theories to explain international trade. Trade is the concept of exchanging goods and services between two people or entities. International trade is then the concept of this exchange between people or entities in two different countries. International trade theories are simply different theories to explain international trade. Trade is the concept of exchanging goods and services between two people or entities. *International trade* is then the concept of this exchange between people or entities in two different countries.

Trading globally gives consumers and countries the opportunity to be exposed to new markets and products. Almost every kind of product can be found on the international market: food, clothes, spare parts, oil, jewelry, wine, stocks, currencies and water. Services are also traded: tourism, banking, consulting and transportation. A product that is sold to the global market is an export, and a product that is bought from the global market is an import. Imports and exports are accounted for in a country's current account in the balance of payments.

The importance of international trade to a nation's economic welfare and development has been heavily documented in the economics literature since Adam Smith's (1776) pioneering inquiry into the nature and causes of the wealth of nations. The rationale underlying this relationship suggests that economies need to export goods and services in order to generate revenue to finance imported goods and services which cannot be produced.

A theory of international business should explain how the issues of government concerned with TNC activities are defined, how they are negotiated, what trade-offs are involved, how differences are resolved, what adjustments are made over time and why. A

uniquely international theory should explain the patterns of exports and imports, the gains from trade, the organizational methods employed, all types of contractual relations, strategies and operations in international production-and all of those as they are affected by governmental interventions (unilaterally or multilaterally), giving rise to multiple sets of rules for IB. The essence of the theory must explain differential barriers and incentives to foreign business imposed by sovereign Governments in an effort to alter the distribution of benefits, and the effects of those policies on TNC(s) decisions and operations. In addition, it must focus on the impacts of TNC(s) on government policies.

The consolidation of a theoretical base usually requires a number of years as the scope of the discipline is established. Despite the fact that academic and managerial interest in IB have grown rapidly with the expansion of business internationally, theories applied to IB have sought mainly, though not exclusively, to expand the arena of their explanations without incorporating responses of the firms to national policies and actions or the causes of those governmental positions. Yet, government interventions are central to IB practice and analysis. Any theory of international business must be a theory of policies and activities of business and Governments, in conflict and cooperation. Although there have been many studies of IB/ Government relations, there is still disagreement over the definition and scope of the IB discipline, with some basing it on theoretical constructs and others on empirical/ phenomenological evidence.

International business (IB) has been a subject of academic research since the early twentieth century, principally focusing on trade and inter-company relations. The study of export activities, foreign direct investment, technology transfer and the management of transnational corporations (TNCs) was recognized as an appropriate and valuable goal of academic research only in the past three decades. As with other nascent disciplines, international business has advanced haltingly through several efforts to establish a theoretical base and agreed lines of investigation. The international product cycle described by Raymond Vernon (1966) probably was the first major theory of the movement of production overseas, rather than just to explain international trade; since then, several theories have been put forward and intricately iterated without any of them gaining world-wide acceptance. Each is partial in some significant sense, and none addresses the essential nature of international business.

International trade issues generally pose three types of questions for economists. The first is based on explanations of trade flows between at least two nations. The second refers to the nature and extent of gains or losses to an economy. Finally, the third issue concerns the effects of trade policies on an economy. Most theories of international trade are dedicated to the first question, and attention will now turn to theoretical responses to such an issue in the form of: classical trade theory; factor proportion theory; and product life cycle theory.

10.2 INTERNATIONAL PRODUUCT LIFE CYCLE THEORY

The lowering of barriers to international trade has resulted in many opportunities for American companies to profit from exports. Clearly, the businessman needs ways of analyzing the potential exportability of his products and, equally important, tools for predicting which products are likely to be threatened by import competition. Until recently, the manager was dependent on the explanations of trade offered by the classical and neo-classical economists. Their reasoning generally led to the conclusion that each country will concentrate on exporting those products which make the most use of the country's abundant production factors. The economic theory is elegant—it can be stated mathematically or geometrically and it can be manipulated to yield, under certain assumptions, answers to questions such as what is the value of free trade to a country, or what are the costs and benefits of certain restrictions. So long as the problems posed are of a very broad nature, the theory provides a useful way of analyzing them. However, when the theory is applied to the detailed problems facing the businessman it becomes of limited value.

The international product cycle, initially proposed by Vernon (1966), seeks to explain the patterns of international trade and FDI in manufactured goods that occurred among non-communist countries during the period after the Second World War. The international product cycle removes the classical assumption that factors and products are immobile internationally, focusing on the firm's decisions on trade and investment based on both cost and revenue conditions. The theory takes the TNC as the unit of analysis and explores the importance of both product creation and effective marketing for new manufactured goods, leading to a dynamic sequence of domestic production, export, foreign direct investment and, finally, production abroad. Its explanatory power can be applied also to the movement of industry from north to south within the United States, and it essentially relates to regions

(or markets) in different stages of development. It is a theory of shifting production location, but it does not incorporate the role of Governments in influencing cross-border locations. It is, therefore, a theory of location in the absence of national boundaries. and several followers have given attention to empirical and policy aspects of government/ INC relationships, but not within the context of the international product cycle model.

A new approach to international trade which appears most promising in aiding the business executive is closely related to the product life cycle concept in marketing. The model claims that many products go through a trade cycle, during which the United States is initially an exporter, then loses its export markets and may finally become an importer of the product. Empirical studies of trade in synthetic materials, electronic products, office machinery, consumer durables, and motion pictures have demonstrated that these products follow a cycle of international trade similar to the one which the model describes. According to the trade cycle concept, many products follow a pattern which could be divided into four stages:

1) Phase I: U.S. export strength
2) Phase II: Foreign production starts
3) Phase III: Foreign production competitive in export markets
4) Phase IV: Import competition begins.

A brief look at the reasoning underlying each of these stages will give some clues which will help the businessman to identify the stage in which particular products may be. The concept can then be an aid in predicting the product trade performance to come and in understanding what actions the manager can take to modify the pattern for certain products and to profit from different stages of the cycle.

1) Phase I: US. export strength:

What kinds of new products are likely to be introduced first in the United States? It can be assumed that American entrepreneurs have no particular monopoly on scientific know-how or on very basic technical ability. What they do have, however, is a great deal of knowledge about a very special market one which is unique in having a large body of very high-income consumers. Products which satisfy the special demands of these customers are especially likely to be introduced in the United States. Moreover, due to a monopoly

position of the United States as a supplier of the new products which satisfy these unique demands, they offer the best opportunities for export. Empirical studies have failed to show a very simple relationship between demand and invention. However, there can be little doubt that certain products are simply more likely to be developed in America. Automatic transmissions for automobiles promised to be pretty expensive additions to cars.

If an inventor considers the chances of his brainchild's being purchased by - consumers, a U. S. inventor would be more likely to pursue an automatic transmission than a European. The European inventor would more probably concern himself with ideas suitable to European demands. He might respond to high fuel taxes and taxes on engine displacement by developing engines which produce more horsepower per cubic inch. He might develop better handling suspensions in response to the road conditions. An inventor usually comes up with products suitable to his own market. It is even more likely that the final product development leading to commercial production will be achieved by an entrepreneur responding to his own national demand. Even if an American is most likely to be the first to produce a high-income product, why does he not set up his first plant abroad where labor is cheaper. Certainly for many products the cost of materials and of capital is not sufficiently higher in Europe to offset the advantages offered by cheaper labor. Moreover, the burden of tariffs and freight are light enough now for many items. And the uncertainties of manufacture abroad are diminishing as more American companies gain experience. There are, though, very rational reasons why the American entrepreneur might prefer to start manufacture at home.

At the early stages of a product's life, design is often in a constant state of flux. There is a real advantage which accrues to a manufacturer who is close to the market for his products so that he can rapidly translate demands for design changes into more suitable products. Moreover, these changes often require the availability of close communication with specialized suppliers. Hence, the instability of product design for new products argues for a location in the United States—near to the market and close to a wide range of specialized suppliers. The entrepreneur is less likely to be concerned with small cost differences for very new products. The existence of a monopoly or the significant product differentiation at the early stage of the product life cycle reduces the importance of costs to the manufacturer. The multitude of designs and the lack of standard performance specifications make it very difficult for the consumer to compare prices. Also, in the early stage of the

product life cycle the consumer is frequently not very concerned with price. Success comes to the manufacturer who can quickly adjust both his product design and marketing strategy to consumers' needs which are just beginning to be well identified.

At this point, the American manufacturers have a virtual monopoly for the new product in the world market. Foreigners who want the good must order it from the United States. In fact, wealthy consumers abroad, foreigners with particular needs for the product, and Americans living abroad seem to hear about it very quickly. Unsolicited orders begin to appear from overseas. U. S. exports start to grow initially from the trickle created by these early orders to a steady stream as active export programs are established in the American firms.

2) Phase II: Foreign production starts:

Incomes and product familiarity abroad increase, causing overseas markets eventually to become large enough that the product which once appealed primarily to the U. S. consumer has a broad appeal in the wealthier foreign countries. Not only does a potential foreign producer now have a market close-at hand, but some of his costs will be lower than those of the U. S. producer. Imports from America have to bear duty and overseas freight charges costs which local products will not carry. Moreover, the potential foreign producer may have to invest less in product development the U. S. manufacturer has done part of this for him. Some measure of the size of his potential market has been demonstrated by the successful sale of imports. Favorable profit projections based on a demonstrated market and an ability to under price imports will eventually induce an entrepreneur in a wealthy foreign market usually first in Western Europe to take the plunge and start serious manufacture.

American subsidiary which starts production abroad, realizing that if it does not, some other company will. However, the calculations that yield favorable costs projections for competition with imports from the United States in the foreign producer's home market do not necessarily lead to the conclusion that the foreign producer will be a successful competitor in third markets. For many modern manufactured goods to be at a serious disadvantage due to the small size of his plant in a market where he also must bear the burdens of freight and tariffs. Scale-economies are so important for many products that the U. S. manufacturer, with his large plants supplying the American market, can still produce more cheaply than the early foreign producers who must manufacture on a significantly

smaller scale. During this second stage American exports still supply most of the world's markets. However, as foreign producers begin to manufacture, U. S. exports to certain markets will decline. The pattern will probably be a slowdown in the rate of growth of U. S. exports. The slowdown in the rate of growth of exports of home dishwashers in the last few years as European manufacturers have begun production provides an example of a product in this phase of the cycle.

3) Phase III: Foreign production competitive in export markets:

As to be early foreign manufacturers become larger and more experienced their costs should fall. They will begin to reap the advantages of scale economies previously available only to U. S. manufacturers. But, in addition, they will often have lower labor bills. Hence, their costs may be such that foreign products become competitive with American goods in third markets where goods from both countries have to carry similar freight and duty charges. During this stage, U. S. producers will be protected from imports in their domestic market where they are not faced with duty and overseas transportation costs. However, foreign g-oods will gradually take over the markets abroad which were previously held by American exports. The rate of growth of U. S. exports will continue to decline. The success of European ranges and refrigerators in Latin America points out that these products are in this phase.

4) Phase IV: Import competition begins:

As the foreign manufacturer reaches mass production based on his home and export markets, his lower labor rates and perhaps newer plant may enable him to produce at lower costs than an American manufacturer. His cost savings may be sufficient that he can pay ocean freight and American duty and still compete with the American in his own market. This stage will be reached earlier if the foreign producer begins to think in terms of marginal costs for export pricing. If he believes that he can sell above full costs in his home market and "dump" abroad to use up his excess capacity, he may very quickly undercut the U. S. producers pricing on full costs. During this final stage, U. S. exports will be reduced to a trickle, supplying very special customers abroad, while import competition may become severe. The bicycle is a product which has been in this phase for some time.

Thus the cycle is complete from the United States as a strong exporter to the stage where imports may capture a significant share of the American market.schematically the U. S. export performance for an hypothetical product. The early foreign producers—usually

Western Europeans will face a cycle similar to that of the U. S. manufacturer. As still lower-income markets become large enough, producers in these countries will eventually become competitive displacing the dominance of the early foreign manufacturers. The manufacture of products moves from country to becoming exporters of manufactured goods. The classic example is standardized textiles. Another interesting example is the export of certain standardized computer components from Argentina. However, the current gi*owth rate of over 12% per year for exports of manufacturers from less-developed countries may indicate that they will soon become an important factor for the American businessman.

10.3 EXCEPTIONS TO THE CYCLE

Not all products can be expected to follow the cyclical pattern described. The model says little about products which do not have a particularly strong demand in the United States. In addition, for some products the location of manufacture is tied to some particular natural resource agricultural, to certain types of land; mining and initial processing, to areas containing the mineral. The manufacturing processes for some products such as the traditional handicraft goods have only slightly increasing returns to scale. Moreover, some products appear to remain sufficiently differentiated so that price discrepancies play only a slight role. For example, American cigarettes have continued to command a price-premium in Europe. There are also manufactured goods for which even the U. S. market is not large enough to allow significant scale economies. Such products tend to be produced in various locations close to market clusters, and no one area achieves a large cost advantage.

Trade tends to be more on the basis of product differentiation or specialization. However, as demand in the United States grows, a standard version may be produced in quantity, bringing the cost down so that the product moves into the cycle under discussion. High-performance sports cars and sail boats may be examples of this product. Until recently, much of the production for such sports cars was located in various areas of Europe and was based on small production quantities. Recently both of these products have seen some large-scale manufacture in the U. S. and significant cost-reductions. General Motors led the way with mass manufacture of the Corvette. More American manufacturers will probably enter the high-performance sports car market and compete with the virtually hand-produced, expensive European sports cars.

The Trade Cycle and Business Planning Obviously, no simple model can explain the behavior of all products in international trade. However, the trade cycle model does appear to be useful for understanding trade patterns in a wide range of manufactured goods. Although no such model should be used by the businessman without a careful examination of individual products, it does provide some very useful hints as to which products might be exportable and which might suffer import competition. The concept can give some clues as to the success of various product policies. The model provides some insights into the role which market segmentation can play in increasing exports and protecting against imports. Design modifications can be made for certain products which can change the appeal of the product to different kinds of customers and thus modify the trade cycle.

In fact, the manufacturer often makes such changes for reasons unrelated to international trade but rather as a response to changes in the nature of his home market. As the American consumer becomes wealthier and more sophisticated, and as domestic competition becomes more severe, the manufacturer often makes his products more automatic, more powerful, more luxurious. The marketer may be trying to differentiate his product from those of his competitor, or he may simply be responding to the demands of a wealthier consumer. These changes may make the product more suited to the growing incomes of the American customer, but they will also affect its exportability. The item may become too expensive for the majority of foreign consumers, hastening competition from foreign-produced goods.This gradual product sophistication may, however, provide some protection against imports in the United States. No doubt, the size and automatic features of the American automobile have had a special appeal to the high-income American market and have consequently held back the of imports.

The product design has, however, had another effect: simpler, cheaper foreign cars have been able to capture a part of the U. S. market more concerned with economy of operation and lack of style obsolescence than with luxury, fashion, and automatic features second cars, student cars, etc.The American automobile industry did not respond to imports by trying to produce a real economy car in competition with the Volkswagen and Renault, but rather produced a middle-range product (the compacts) which competed with Volvo and Peugeot, for example. The move was probably a wise one. No doubt, the producers of the economy cars abroad had reached cost savings from scale economies equivalent to anything the U. S. producers could hope to obtain. Moreover, they had lower labor costs. By choosing

to attack the middle range, the American manufacturers chose a market where they could have a scale advantage for a time, until the higher income segment of the European market was so large that middle-range cars would be more important. Perhaps the U. S. manufacturers simultaneously created a more exportable product for the future.

For products where design sophistication consists of adding special features to a basic model, export versions can be produced simply by eliminating some of the extras. Thus, some producers can extend the exportability of their products while simultaneously satisfying the more sophisticated needs of their home market. The existence of segmented markets leads to Americans' exporting and importing the same product: exporting large automobiles to high-income consumers abroad while importing small, economy cars; exporting large refrigerators while importing small ones for campers and summer homes. The relative competitiveness of the United States in 1965-66 in the higher-quality versions of a product stands out well in the case of home freezers.

Prices were contrasted for comparable home freezers of different sizes in Germany and in the United States. For each model the lowest-priced unit was chosen for comparison. The larger models were cheaper in the United States and the smaller models in Germany. American manufacturers did not yet need to worry about imports of large freezers, but they were already beginning to experience competition from smaller models. Of course, the point is finally reached for many products where design changes can no longer make the American product competitive abroad or safe from imports. The U. S. firms may follow two strategies for survival: a continual product rollover, shifting resources to new products more suited to the unique demands of the American market; and manufacturing abroad to take advantage of lower production costs and to save tariffs and transportation charges. The strategies are not mutually exclusive, but both require advanced planning and constant surveillance of the future of individual products and assessments of the company's capabilities.

10.4 PORTERS DIAMOND THEORY

Porter aimed at establishing a link between the academic literatures in strategic management and international economics in his book "Competitive Advantage of Nations" in 1990 and create a base for developing national policies on competitiveness.Porter contended that the greater number of trade-related theories has been only focused on cost and a new theory was essential that "should attract a comprehensive understanding of

competition that contains segmented markets, differentiated products, the technological differences and economies of scale". He suggested that this new theory should be able to define why firms from certain nations implement better strategies than others competing in certain sectors for this purpose Porter made an examination in ten countries (USA, Germany, Denmark, South Korea, Britain, Italy, Sweden, Switzerland, Japan and Singapore) including different economic characteristics of 100 sectors for four years to try to find the elements that determine the competitiveness of nations and sub-sectors to determine what kind contributions provided to the development of competitive structures of countries some regions are more competitive than others are" and tried to make clear how firms gain superior positions in certain sectors of the country on global competitiveness.

For this reason, porter has developed The Diamond Model to identify factors of competitive advantage of countries and sectors and to create the theoretical underpinnings of this interplay of country and industry competitiveness topics as a result of his analysis. The model creates a structure that determines the rules of competition in a sector and makes it important to have a role to play based on the opinion of achieving a long-term competitiveness. Porter associated the determinants of sectors that state competitive advantage of nations with the value of a diamond. Four corners of the diamond are "factor conditions ", "demand conditions", "firm strategy, structure and competition" and "the presence of related and supporting industries". Also "luck" and "the government" factors are included in the system. These factors are described as factors affecting the competitiveness as a support of the four factors.

All factors contain: all assets and skills vital for industry's competitive advantage; information which create the opportunities and give the answer to how convenient assets and skills should be managed; aims of all interest groups; and what is most important, particular power of the company to investing and innovating In Porter's Diamond Model, the system is constantly in motion as a whole in the face of positive and negative effects. Provide the competitive advantage depends on the renewal of the system and what takes place very rapidly in innovation. While the quality and intensity of mutual interaction in the entire system causes to the broad and common interaction, the presence of dynamic and competitive environment which constantly engaged in a new knowledge and talented players causes to global competitive advantageincreasingly, corporate strategies have to be seen in a global context. Even if an organization does not plan to import or to export directly,

management has to look at an international business environment, in which actions of competitors, buyers, sellers, new entrants of providers of substitutes may influence the domestic market.

The Porters Diamond model is a helpful tool for this analysis. Michael Porter introduced a model that allows analyzing why some nations are more competitive than others are, and why some industries within nations are more competitive than others

1. Factor conditions:

Factor conditions are values of the firm's skill to supply those factors of research production that allow a unit to compete. They are the factors of production and infrastructure necessary to compete in a particular industry. As believed by the standard trade theory the states are endowed with separate stocks of factors. The theory mentions that the state will export those products, which produce incentive use of the factors with which it is comparatively well endowed. A simple definition for what the factor of production is concerns to the terms like capital, land and labor. Porter regards this definition as too general, and not suitable to give open insights to the competitive advantage, hence he argues that the factors should be divided into categories that are more particular. Factors, as defined by Porter, may be divided into five broad groups.

These factors can be grouped into human resources (the amount, abilities and cost of staff etc.), material resources (the abundance, quality, approachability and cost of the state's land, water etc.), knowledge resources (the state's stock of scientific, technical and market knowledge bearing on goods (products) and services. Information resources universities, government research institutes, government statistical agencies, business and scientific literature, market research reports, databases etc.), capital resources (the quantity and costs of capital available to fund the sector and infrastructure (the type, quality and user cost infrastructure available and affecting the competition, including the transportation system, the communication system, mail and parcel delivery etc.) Also three distinctions may be done among the factors. The first distinction divides factors into basic or advanced factors. The second distinction is between generalized and specialized factors.

The third distinction is whether the factors are inherited (such as location or natural resources) or provided by the nation. Advanced, specialized and created factors provide more sustainable advantages than basic, generalized or inherited and are necessary to achieve

sophisticated forms of competitive advantage. Advanced and specialized factors, on the other hand, are regarded as being a more decisive and sustainable basis for competitive advantage Competitive advantage are dependent on how efficiently and effectively the factors are used and the "condition" of these factors (the quality, significance and even shortage) is more important than the subsidy and cost of them because it is admissible that easy access to big quantity of factors results in a kind of "inefficiency" of their usage. Moreover, if other three dimensions are in a favorable position for a sector, the pressure of competition would be (maximum and the firms are committed to exist in the sector, this scarcity shortage of factors could be (productive only if firms take the notify of this shortage well.

2. Demand conditions:

Porter (1990) suggests that the demand conditions which indicate the nature of home demand formed the second broad determinant of national competitive advantage. This is one of the most interesting dimensions as it relates to the nature of consumers in the home market. Demand conditions are the pressures based on buyers requirements about quality, price, and services in a particular industry. Demand conditions affect the forming of certain factor conditions. They have effect on the pace and direction of innovation and product development. For instance, Japanese car buyers exert strain on Japanese car makers with regard to high quality standards impelling them to develop the quality of their goods, operations, and activities, which in turn makes ready the whole industry to compete internationally. Demand conditions are values of demand by the society for a unit's research and can be understood in a unit s success at publishing research and attracting funding and people to guarantee research. The combination of demand conditions is showed by three main characteristics that are important to gaining national competitive advantage.

♦ **Home Demand Conditions**: There are three characteristics of the composition of home demand: segmented structure of demand, sophisticated and demanding buyers and anticipatory buyers needs. Nations achieve competitive advantage in sectors or in sector parts where the home demand provides native firms a clearer or earlier picture of buyer demands than foreign competitors can have This will make the industry(sector) ready to compete internationally in next levels Porter (1990) argues that the sophistication of demand is much more significant than the size of demand. When a sector operates in a sophisticated and demanding domestic market it is compelled to innovate and sell better goods because the market needs high quality.

♦ **Demand Size and Pattern of Growth:** Size of home demand, number of individual buyers, growth rate of home demand, early home demand and early saturation. Porter argues that home market size is an advantage if it stimulates investment and reinvestment or dynamism. The existence of a number of individual buyers in a nation produces better surroundings for innovation than is the situation where one or two customers command the home market for a goods or a service. The rate of growth of investments in a sector is to a large extent a mission of how quickly it s home market is developing. Early home demand helps local firms to action sooner than foreign rivals to become established in a nation. Also early saturation, the early penetration supports native firms to become constituted.

♦ **Internationalization of Domestic Demand**: Mobile and transnational local buyers and influences of foreign need. If state's buyers for goods or service are mobile or transnational firms, an advantage occurs for the state's companies as the home buyers are also foreign buyers. About the "demand condition", Porter suggest that although, at any rate, a minimum quantity of home demand is required to improve the sector to expand and develop, but the quality of this demand is more significant than the amount of that. By quality of demand, basically, Porter means how complex are features and specifications that customers (principally home buyers) expect

3) The related and supplier industries:

The existence of related or supplier industries in a nation is argued as the third dimension of diamond model. The presence or absence in the nation of related industries and supplier industries which interact (both horizontally and vertically) with the target sector is a basic factor. Until the mid-1980s for instance, the technological leadership in the U.S. semiconductor industry supplied the basis for U.S. achievement in personal computers and several various other technically advanced electronic goods. In a broad view, Porter accepts that examples of all over the world show that it is approximately unthinkable to find only a single successful industry (sector) without strong and challenging supportive and related industries.

The relationships among these clusters of industries are crucial to the success of a determined sector within a nation as "they operate learning, innovation and competitiveness, and are thought about put together the maximum synergies when all requisite institutions necessary to operate learning, innovation, and competiveness and economic agents are linked

up. However, it is possibly unrealistic in a developing country setting to e look for all sectors that are related to one internationally competitive sector to be competitive as well. Related industries are those in which organizations can organize or allocate activities in the value chain when competing, or those, that produce complement goods. They are those that are some buyers, building factors and/or technologies in general. The supplier industries creates potentials for comparative advantage by producing inputs, providing new methodologies and opportunities to utilize new technology, transferring of knowledge, innovations, etc.

The presence of related industries often results in new competitive industries, and offers opportunities to informational and technological exchange. Competitive advantage in supplier industries gives potential competitive advantage to firms in many other sectors in several ways. First, the firms have effective, rapid and early access to the most cost efficient input [16]. These sectors offer cost-effective inputs, but they also take part in the upgrading process, thus encouraging other firms in the chain to innovate. Second, even more important are the opportunities of continued co-ordination between supplier and buyer industries, regarding innovation and upgrading processes. The close proximity of related industries provides a faster reply to market trends and changes, and make quick innovation easy.

This confirms available access to the raw materials and abilities required to make advantage through either low costs or differentiation. Third, competitive advantage occur from close working relations among supplier and buyer industries. When native supporting industries are competitive, firms take advantage of more cost efficient and innovative inputs. This effect becomes more reinforced when the suppliers themselves are powerful and important global rival. Related and supporting industries directly or indirectly related to many different sectors and a sector which covers all the players and are a clustering of the industry. Clusters are inter-related firms and other enterprises that manage the competitiveness of a determined sector. Nation successful industries(sectors) are usually linked through vertical (buyer/supplier) or horizontal (common general buyers, technology, channels, etc.) bases. Vertical clusters create high quality, while the horizontal clusters create highly competitive firms. Porter argues that the advantage of both supportive and related industries counts on the rest of the “Diamond”, and its systematic character in international business.

4) Firms' strategy, structure and rivalry

Three basic parameters of sector are covered in the forth dimension of this model as "firms strategy, structure and rivalry". Porter suggests that the strategy of firms, the structure of industry and the rivalry have effects on the competitiveness of the sector firms strategy, structure and rivalry get hold of the hardiness of home competition. Whether a sector is extremely competitive domestically will affect the rise in productivity required to compete internationally. Firms strategy, structure and rivalry are measures of situations that explain how a sector is originated, systemized and managed and the nature of domestic competition that could support a nation achieve a sustained competitive advantage. Porter attempts to list some non-economic factors (such as traditions and values that affect the motivation of companies for getting into the sector and the impact of spatial proximity in this dimension.

The aims, strategies, politics and methods of organizing companies in sectors vary widely among nations and there is not a unique business system that is universally suitable. National advantage emerges from a good harmony between these selections and the sources of competitive advantage in a specific sector. Porter suggests that domestic competition and the look for competitive advantage within a region can help supply organizations with bases for succeeding such advantage on a more global scale. In the global competition the rivalry is very important if successful companies compete energetically at home and constrain each other to develop and innovate. The pattern of rivalry has effect to the process of innovation and the final plans for international achievement The way in which firms are managed and prefer to compete and innovate is influenced by national conditions.

Cultural aspects play an important role. As most significant national diversities in business practices and approaches can be put into words: the training, backstage and the orientation of leaders, management manner and structures, hierarchic style, decision deciding, the relationship between work and management, working morale, relationship with the consumers or interactions between companies. These national diversities make advantage and disadvantages in competing in different categories of sectors. Typical corporate aims and goals in relation to models of commitment among employers are of special unique importance. They are hardly affected by systems of ownership and control. Family-based business that are controlled and managed by owner-managers will act differently than publicly quoted

5) Change

Porter regards the chance events as matters that have little to do with situations in the nation. Chance events are usually improvements outside the control of the companies. Chance events are regarded by definition as beyond the control of firms (companies) but may make forces that remold the sector structure, allowing shifts in competitive position. Namely, such events avoid the advantages of previously constituted rivals and make potential that a new nation's companies can replace them to succeed competitive advantage in response to new and different conditions."Chance" is composed of factors (mainly external to the sector) that are not well foreseen and (almost influenced by sector) such as new inventions, political decisions by foreign governments, wars, rapid changes in financial markets or exchange rates, surges of world or regional demand, discontinuities in input costs, other radical technical changes (biotechnology and microelectronic). For instance, the heightened border security, resulting from the September eleven terrorist attacks on the US undermined import traffic volumes from Mexico, which has had a large effect on Mexican exporters.

10.5 BUSINESS IMPLICATION OF INTERNATIONAL TRADE THEORIES

The theories of international trade are that no two countries are the same in terms of resources endowment and the efficiency at which those resources are being put to use. This has led to differences in the productivity of nations around the world, thereby resulting in the globalization of production where individual firms disperse their productive activities to different parts of the world, in order to optimally and efficiently be more productive in costs and innovation. Hence, one can say that the implications of international trade theory for business practice are evident in the location of their operations globally, the push for first mover advantages in certain industries, and their influence on government to push for policies that are beneficial to their operations.

Empirical evidences have favored the need for free trade among nations of the world. While some anti-globalization movements are vociferous about their intentions against free trade, I strongly believe that free trade has been a blessing more than a curse. Just like any other issues are not flawless, there will always be losers and winners in the world of international trade. However, "the benefits to the winners outweigh the costs borne by the losers, resulting in a net gain to society". The implication of this to business is that, even in

countries where there are barriers to the free trade system, firms can locate their production facilities in them so that they can compete with the indigenous firms on an even footing, thereby creating a positive-sum game where everyone gains including the final consumers.

The development of international business theory is presented according to its key concepts and main contributors. It follows a chronological order with the year of publication of the first contribution to the key concept of its main author(s) as principal criteria. However, and due to space limitations of the article, some key concepts and main contributions that appear within the table in the appendix are not further outlined.

10.6 SUMMARY

This unit discussed about the basic concepts and phases bilateral and multilateral theories of international trade. The international product life cycle theory and the porter's diamond theories are discussed in the length. An account of business implications of international trade theories is also given in this unit.

10.6 SELF ASSESSMENT QUESTIONS

1) Define the term international trade theories?
2) Briefly explain the theory of product life cycle theory?
3) Explain the phases of porter's diamond t model theories?
4) Explain how business implication with international trade theories?

10.8 CASE STUDY

Case Study No.1

ASEAN: business as usual

Among the many regional groupings around the world, the Association of South-East Asian Nations (ASEAN) is one of those whose actions, more often than not, have failed to match their aspirations. This was supposed to change with the adoption of ASEAN's new charter, which came into force on December 15th 2008. Alas, the first summit of the organisation's national leaders since then-held in Thailand on February 28th-March 1st-showed that it was pretty much business as usual. Some serious work was done in the Thai resort of Cha-Am Hua Hin, to be sure. Most importantly, ASEAN's ten members, which

together encompass a market of 570m people, at last signed a free-trade agreement (FTA) with Australia and New Zealand after almost five years of negotiations.

The 12 economies partaking in this FTA wield a combined GDP of US$2.7trn as of 2007 and are expected to see US$48bn in additional trade by 2020. ASEAN already has inked similar deals with China, Japan and South Korea, and now only lacks an agreement with India to round out FTAs with all its major neighboring economies. On most other issues it tackled, however, ASEAN reverted to form as a regional talking shop. The gathered leaders made a lot of noise about deepening the integration of their economies to minimize the adverse impacts of the global financial crisis. But they failed to come up with any concrete measures other than praising their finance ministers, who met five days earlier with their counterparts from China, Japan and South Korea to expand an existing region wide currency-swap arrangement to US$120bn from US$80bn. This mechanism allows any signatory government facing a foreign-currency shortage to borrow from the others to avert a temporary liquidity crunch. ,

ASEAN adopted a formal charter in 2007-its 40-year anniversary-to provide “the legal and institutional framework” for “a more rules-based [and] effective organisation”. The ultimate aim of the charter, which still lacks enforcement or voting provisions, is to realise an ASEAN economic community by 2015.That is unlikely to happen. At the Cha-am summit, evidence of hard decision-making was in short supply. For example, despite a high-minded rejection of protectionism, no steps were taken to stop a number of policies favouring domestic producers or workers that some member countries have adopted in recent months. Even if politicians had more spine, the huge economic disparities among ASEAN’s member countries work against closer integration. For export-dependent Malaysia, Singapore and Thailand, it makes better sense to ship more goods to North America and Europe than to their poorer ASEAN cohorts-because the relatively sophisticated products that they produce, such as consumer electronics, are too expensive for Cambodians or Burmese.

Meanwhile, the international-pariah status of Myanmar is a thorn in the side that ASEAN just can’t seem to handle to anyone’s satisfaction. The leaders again refrained from pressing Myanmar’s prime minister on freeing the country’s most prominent democracy advocate from house-arrest. Neither did they tackle head on the plight of the Rohingya refugees, a Muslim people from western Myanmar who have fled repression by that country’s junta to Bangladesh and more recently to Thailand, only to be turned back out to the sea by

local Thai authorities. Yet by its own reckoning, "one of the most important undertakings to make ASEAN a genuinely people-oriented community" is the grouping's plans to set up a human rights body by the end of the year. But judging by the continued unwillingness to move beyond easy words, the new human rights body will only serve to highlight ASEAN's weakness as a multinational organization in Asian countries.

QUESTIONS

1. Discuses the overall case study and what are all business implications in international trade theories?
2. List out what are the business strategies has been followed by ASEN regional trade blocks from above this case study?

Case Study No.2

Britain: sterling's weakness fails to boost exports

A fall in the value of the pound pushes up the cost of imports but was supposed to boost UK exports by making them cheaper on world markets. The weakness of sterling is certainly affecting the cost of living but – as today's trade figures demonstrate – is having scant impact on Britain's ability to pay its way in the world. The much-yearned-for rebalancing of the economy in favour of manufacturing and exports is simply not happening. The kindest explanation for the increase in the deficit in January is that the bad weather prevented British goods from getting to their overseas destinations. This is not especially convincing; blizzards in January cannot explain why exports in the latest quarter (November 2009 to January 2010) were 3% down on the same period a year earlier, when the global economic downturn was at its most virulent.

Another argument is that it will take time for the effects of a cheaper pound to show up. Economists talk about the J-curve effect of a depreciation, whereby the balance of trade deteriorates before improving, because the cost of imports rises immediately but it takes time for exporters to respond. This does not wash either. Sterling has been under pressure for the past two-and-a-half years and has fallen by around 25% against a basket of global currencies. There should have been some response by now. Rebalancing the economy requires investment and exports to take the place of consumer and government spending. So, if the trade data continues to be poor in February and March that could have an impact on the first-quarter growth figures, which are due out less than a fortnight before what is

expected to be polling day. So what is going on? Firstly, more than half of UK visible exports go to the rest of Europe, which is currently the slowest-growing region of the global economy.

The value of UK exports to Ireland, in the grip of an economic depression, stood at £1.4bn in January; the value of UK exports to China – growing at an annual rate of 10% – amounted to £500m.Secondly, there is evidence that UK manufacturers are using the cheaper pound to boost their depressed profit margins rather than to increase export volumes. In theory, a UK-made car that was selling for €10,000 in Germany or France before the crisis should now have a price tag of €7,500 because the depreciation of sterling makes British goods more competitive overseas. In practice, companies are leaving the price of their goods unchanged and increasing their profits by €2,500 on each car. Given the squeeze on manufacturers, this is perhaps understandable and – if it helps companies survive what has been the worst recession of the post-war era – not entirely bad news either. It does mean, though, that exports will not get their expected boost.

Finally, there is the most disquieting explanation of the lot, namely that British industry has been so hollowed out by the four recessions since the mid-1970s that it no longer has the capacity to take full advantage of a weaker pound. All the main political parties accept that this may indeed be the case, which is why there has been a Damascene conversion to activist industrial policies. The report prepared for David Cameron by James Dyson is part of this growing consensus; there is now a belief across the parties that the UK economy is too narrowly focused and that manufacturing has been neglected for far too long. Industry would welcome some tender loving care from Westminster. It might ask, however, why it has taken so long

QUESTIONS

1. Discuses from overall case study and also list out the reasons for failure in exporting business in international level?
2. Give proper suggestions for improve U.K export strategies to enter into an international business?

10.9 NOTES

10.11 REFERENCES

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UNIT -11: GATT/ WTO AND INTERNATIONAL LIBERALISATION

Structure :

11.0 Objectives

11.1 Introduction

11.2 General Agreements on Trade and Tariffs (GATT)

11.3 The Core Principles of The GATT

11.4 World Trade Organizations (WTO)

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11.0 OBJECTIVES

After studying this unit, you should be able to;

- Define the general agreements on trade and tariffs (GATT).
- Describe the core principles of GATT.
- Determine the different rounds of WTO and GATT.
- Give an account on IPRs, TRIPs, TRIMs, and GATs.

11.1 INTRODUCTION

The original intention was to create a third institution to handle the trade side of international economic co-operation joining the two "Bretton Woods" institutions, the World Bank and the International Monetary Fund. Over 50 countries participated in negotiations to create an International Trade Organization (ITO) as a specialized agency of the United Nations. The draft ITO Charter was ambitious. It extended beyond world trade disciplines, to include rules on employment, commodity agreements, restrictive business practices, international investment, and services. Even before the talks concluded, 23 of the 50 participants decided in 1946 to negotiate to reduce and bind customs tariffs. With the Second World War only recently ended, they wanted to give an early boost to trade liberalization, and to begin to correct the legacy of protectionist measures which remained in place from the early 1930s.

First round of negotiations resulted in 45,000 tariff concessions affecting $10 billion of trade, about one fifth of the world's total. This 23 countries also agreed that they should accept some of the trade rules of the draft ITO Charter. The combined package of trade rules and tariff concessions became known as the General Agreement on Tariffs and Trade. It entered into force in January 1948, while the ITO Charter was still being negotiated. The 23 became founding GATT members. After this first round of negotiations in Geneva – Switzerland, GATT improved by 7 more rounds of negotiations. Finally in the 8th round named Uruguay Round creation of WTO covered in the country.

From 1948 to 1994, the General Agreement on Tariffs and Trade (GATT) provided the rules for much of world trade and presided over periods that saw some of the highest growth rates in international commerce. It seemed well-established, but throughout those 47 years, it was a provisional agreement and organization. The original intention was to create a third institution to handle the trade side of international economic cooperation, joining the two "Bretton Woods" institutions, the World Bank and the International Monetary Fund.

11.2 GENERAL AGREEMENTS ON TRADE AND TARIFFS (GATT)

General Agreement on Tariffs and Trade (GATT) was a multilateral agreement regulating international trade. According to its preamble, its purpose was the "substantial reduction of tariffs and other trade barriers and the elimination of preferences, on a reciprocal and mutually advantageous basis." It was negotiated during the Nations Conference on Trade and Employment and was the outcome of the failure of negotiating governments to create the International Trade Organization (ITO). GATT was signed by 23 nations in Geneva on October 30, 1947 and took effect on January 1, 1948. It lasted until the signature by 123 nations in Marrakesh on April 14, 1994 of the Uruguay Round Agreements, which established the World Trade Organization (WTO) on January 1, 1995.

The success of GATT as a dynamic institution that has fostered dramatic increases in worldwide trade lies in its founding principles of reciprocity and nondiscrimination. Reciprocity refers to the practice that occurs in GATT negotiating rounds, whereby one country offers to reduce a barrier to trade and a second country "reciprocates" by offering to reduce one of its own trade barriers. Reciprocity, the practice of swapping tariff concessions, facilitates the reduction of trade barriers. Nondiscrimination, or equal treatment, means that if one GATT member offers a benefit or a tariff concession to another GATT member, for example, a reduction in its import tariff, it must offer the same tariff reduction to all GATT members. Thus, nondiscrimination extends the benefits of a reciprocal tariff reduction beyond the two parties that initially negotiated it to all GATT members, together, these principles work toward increasing the efficiency of the world trading system.

GATT, through its practice of reciprocal tariff reductions, provided the necessary mechanism for countries to commit to freer trade. Under GATT, large countries that reduced their import tariffs would experience a net gain because their trading partners would simultaneously reduce their import tariffs. In all countries, the reallocation of labor and capital away from protected import-competing firms and toward export sectors would generate real efficiency gains. It is evident that reciprocity is necessary for two large countries to engage in trade liberalization, but this could have been achieved with a network of bilateral However, while convenience and practicality are important, nondiscrimination would not have become a central feature of GATT if it did not yield real economic benefits.

In summary, GATT's founding principles of reciprocity and nondiscrimination facilitate increases in well-being for the countries that belong to the WTO. By coordinating tariff reductions among large countries, GATT makes efficiency gains from trade a reality. By requiring that countries set nondiscriminatory tariffs, GATT facilitates the production of goods in the most efficient location. However, a number of exceptions to GATT's nondiscrimination rule exist. In the next section, explores these exceptions and why GATT allows the use of discriminatory tariffs in special circumstance.

Other GATT rules specify that safeguards should only be used when imports increase unexpectedly or as the result of unforeseen developments. This leads to numerous debates over what developments can be classified as "unforeseen." Prior to the Uruguay Round's revisions to the safeguard rules in 1994, the use of a safeguard measure was subject to measured retaliation. If a country imposed a safeguard on a product, its trading partners that were hurt by the safeguard could retaliate with their own tariff increases on other products. As part of the Uruguay Round reforms, the safeguard rules changed so that safeguards are no longer subject to retaliation for the first three years they are in effect. This rule change was intended to make nondiscriminatory safeguards more attractive for protection-seeking governments relative to discriminatory antidumping duties.

GATT is a multilateral trade agreement with the authority to regulate the trade regulations of its member governments. As an international treaty, it has no authority over individuals, private firms, or public corporations. Rather, it governs the interactions of countries that voluntarily agree to abide by its rules. Three main commitments are established to be given effect "to the fullest extent possible" by developed countries: priority to the reduction and elimination of tariff and non-tariff barriers to products of export interest to developing countries; restraint in introducing or increasing tariff or non-tariff barriers on these products; and restraint on imposing new fiscal measures, and consideration to their reduction and elimination in the framework of fiscal policy adjustments, on primary products wholly or mainly produced in the territories of developing countries.

The WTO mediates and settles disputes among its members. Disputes that cannot be resolved among the members themselves are referred to a panel of three persons who act as judges. When a country is found to be in violation of its GATT obligations, it has three choices. It can appeal and have the case retried before an appellate body, it can amend its laws to bring them in line with GATT, or it can keep its laws as they are and face "measured retaliation" from its aggrieved trading partners.

If a country loses an appeal, its options revert to amending its laws or facing retaliation. GATT, especially those with a principal supplying interest, were developed economies. They focused their negotiation efforts on reducing import barriers in other countries that were of primary interest to their own exporters, and they used the trade-off of expanded market access abroad for exporting industries against increased market access granted at home to foreign industries and thus the losses to industries competing against these imports. Since the trade barriers targeted for elimination were typically those in the import markets of other developed countries, the primary result was that developed countries were asked to reduce their tariffs. Put differently, since most developing countries were neither principal suppliers nor major importing markets, little was asked of them in terms of their own trade liberalization, and little of what was of direct export interest to developing countries was liberalized by others. Such an outcome is consistent with the pattern of import tariff –trade.

11.3 THE CORE PRINCIPLES OF THE GATT

The central principles common to the GATT 1994 and its predecessor are well known. They are so important, however, that they must be recalled and briefly discussed. They are the Most-Favored-Nation (MFN) rule, the principle of reduction and binding of national tariffs,

Two major exceptions to these central rules that have also been carried over into the GATT 1994, the provisions on regional trading arrangements and on restrictions to protect the balance-of-payments will be considered separately, in conjunction with the Uruguay Round understandings that have slightly modified them.

♦ **Most-favored nation:**

The MFN rule is basic to the whole edifice of the GATT. It requires that if one GATT (now WTO) signatory grants to another country "more favorable treatment" (such as a reduction in the customs duty payable on imports of a particular product), it must immediately and unconditionally give the same treatment to imports from all signatories.

♦ **Tariff reductions and bindings**:

The second core principle is that the members undertake commitments in which they state the maximum level of import duty or other charge or restriction that they will apply to imports of specified types of goods. These commitments or "bindings" may result initially from bilateral negotiations, in which (for instance) the government concerned has agreed to another country's request that it reduce the import duty on certain products. However, the

commitments are then recorded in national schedules which, through the provisions of Article II, become part of each country's obligations under the GATT and, because of the operation of the MFN rule, apply to imports from any member.

♦ **National treatment**:

The rule of national treatment, in Article III of the GATT, is also of fundamental importance. It complements the MFN rule. Whereas , by requiring MFN treatment, puts the products of all of a country's trading partners on equal terms with one another, the national treatment principle puts those products on equal terms also with the products of the importing country itself. once imports have passed the national frontier (and in so doing have paid whatever import duty is imposed) they must be treated no worse than domestic products. Internal taxes or other charges on the imports must be no higher than on domestic products, and laws and regulations affecting their sale, purchase, transportation, distribution or use must be no less favorable than for goods of national origin in their own country.

♦ **Tariffs preferred**:

The national treatment principle means that protection of the domestic supplier of a product should be given only through action at the frontier. A further set of GATT rules has the shared aim of restricting even frontier protection, as far as possible, to the single instrument of import duties. Quantitative restrictions on imports, and on exports, are in general Alternative forms of protection (usually in the form of duties) that are permitted if domestic industries are threatened by imports that are subsidized or dumped are also elaborately regulated by further Uruguay Round agreements. However, the basic aim of making import duties the sole form of trade restriction has been retained under the GATT 1994 indeed for international trade.

♦ **Transparency:**

A further principle carried over to GATT 1994 is that of transparency. Multilateral review and transparency is a major element in the WTO itself (i.e. in the Agreement Establishing the WTO). It is retained also in general requirements imposed by GATT for trade policies and regulations affecting trade in goods, and in more specific requirements built into many other Uruguay Round agreements. These key elements which shaped the functioning of the old GATT system, and which are still present under the GATT 1994, will not be discussed further here. Numerous studies of these principles, pitched at every level of detail and sophistication, have been published over the years since the GATT came into force, and have passed judgment on

their economic and political effect. The purpose of recalling them here is only to underline that they will continue to operate, and presumably to have similar effects, under the WTO. The discussion which follows will turn instead to changes introduced into the GATT rules by the Uruguay Round agreements.

11.4 WORLD TRADE ORGANIZATIONS (WTO)

WTO, established in 1995, is relatively young for an international institution, it has its origins in the Breton Woods Conference at the end of World War II. At this conference, finance ministers from the Allied nations gathered to discuss the failings of World War I's Versailles Treaty and the creation of a new international monetary system that would support postwar reconstruction, economic stability, and peace. The Bretton Woods Conference produced two of the most important international economic institutions of the postwar period: the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (the World Bank). Recognizing that the beggar-thy-neighbor tariff policies of the 1930s had contributed to the environment that led to war, ministers discussed the need for a third postwar institution, the International Trade Organization (ITO), but left the problem of designing it to their colleagues in government ministries with responsibility for trade.

One of the most striking features of the WTO is its system for dispute settlement. This is intended to help resolve disputes that arise among governments with respect to their legal obligations under the WTO rules. Detailed procedures exist for resolving these disputes, with emphasis initially put on direct consultation between the parties involved. Such consultations are very often successful, but if they are not, ultimate responsibility for settling disputes still lies with member governments, through the Dispute Settlement Body. As demonstrated by the cotton subsidies case brought by Brazil against the United States, developing countries are becoming more active in seeking WTO arbitration and have initiated more than 40% of the disputes submitted to its Dispute Settlement Mechanism. But, 42% of developing country complaints to the WTO were directed against other developing countries, compared to 5% under the GATT. Complaints most frequently target non-tariff barriers in general, followed closely by a large number of cases dealing with unfair trade practices or the measures taken to offset them. By far the largest number of disputes concern agriculture. Most cases are ultimately settled, predominantly in favor of the complaining party, and in a majority of cases the parties to the dispute comply with the ruling.

However, the proceedings can be protracted and implementation can prove to be problematic. When no agreement is reached, countries may ask the WTO for the right to impose retaliatory measures, such as a surtax on imports. This can even happen between very close trading partners such as the US and the EU, or the US and Canada. A number of suggestions have been put forward to improve the dispute settlement process. Some proposals would strengthen the ability of smaller and poorer countries to bring cases, while others aim to improve practices in general and the adjudication procedure specifically. There is also a need to work out the appropriate responses in the face of persistent non-compliance as well as how to calculate equivalent damages.

The Preamble to the WTO Agreement essentially sets out, in the broadest terms, the objectives of the whole body of agreements reached at the end of the Uruguay Round. Much of the language of the Preamble is taken over from the GATT, with several modifications. Thus, principal objectives of the WTO, as of the GATT, are raising standards of living, ensuring full employment, expanding production and trade, and allowing optimal use of the world's resources. The WTO Preamble adds three elements. It refers to production of and trade in goods and services (the GATT spoke only of goods); it states the objective of sustainable development, "seeking both to protect and preserve the environment"; and it recognizes the need for positive efforts to ensure that developing countries, and especially the least-developed countries, "secure a share in international trade commensurate with the needs of their economic development".The declared means of achieving these objectives is exactly the same as that laid down 47 years earlier in the GATT: "reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in India.

- **Implementing agreements**:

The first, and broadest, function is to "facilitate the implementation, administration and operation, and further the objectives, of this Agreement and of the Multilateral Trade Agreements", and also to "provide the framework for the implementation, administration and operation of the Plurilateral Trade Agreements". The wording reflects the difference between the multilateral agreements, to which all member governments are committed, and the plurilateral agreements which are under the WTO umbrella but cannot expect the same degree of support.

- **Negotiations**:

The WTO's second function is to be a negotiating forum. Again, a distinction is made between negotiations for which the WTO shall provide the forum, and those for which it may

provide a forum. The first category, specifically reserved to the WTO, consists of multilateral negotiations on matters dealt with in the annexes to the agreement that is, on the subjects already covered by the GATT and the Uruguay Round. The second category is defined only as "further" negotiations concerning multilateral trade relations, as may be decided by the WTO's Ministerial Conference: should such negotiations take place, the WTO can also provide the framework for putting their results into effect.

♦ **Disputes and policy reviews**:

The third and fourth functions of the WTO are to administer the arrangements in Annexes 2 and 3 for the settlement of disputes that may arise between members and for the review of trade policies. Finally, the WTO is to cooperate, as appropriate, with the International Monetary Fund and the World Bank "with a view to achieving greater coherence in global economic policymaking"

In Developing countries, The WTO Agreement's Preamble are buttressed by two separate texts that were adopted by Ministers on the same day that they signed the Marrakesh agreements. One text, of particular importance because it has a bearing on virtually every other agreement in the Uruguay Round package, is a decision on measures in favor of least-developed countries. Its central point is that these countries, as long as they remain in the least-developed category,2 will only be required to undertake commitments and concessions under the Uruguay Round agreements "to the extent consistent with their individual development, financial and trade needs, or their administrative and institutional capabilities"3, and that the rules and transitional arrangements in the agreements**.** The WTO Agreement is preceded by two other texts, neither of which involves obligations that are still relevant. This is an essentially political declaration by Ministers, celebrating conclusion of the Uruguay Round. The other (the Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations) is the formal agreement by which each country's representative recognized the attached substantive texts as representing the results of the Round. The Final Act distinguishes between three groups of texts. ¨

The first group consists of what is now known as the Marrakesh Agreement: that is, the WTO agreement itself, plus all the agreements annexed to it. By signing the Final Act, each government undertook to submit the Marrakesh Agreement for ratification by the national legislature or other appropriate authority. The second group, consisting of Ministerial Decisions and Declarations related to the Uruguay Round results, did not need ratification, and therefore were actually adopted through signature of the Final Act. The third group contains just one text,

the Understanding on Commitments in Financial Services, which did not require adoption. Two points in the Final Act are worth noting: the target date of 1 January 1995 which was set (and met) for entry into force of the WTO; and the conditions for acceptance, which reflect the requirements for original membership set out in of the WTO Agreement.

11.5 DIFFERENT ROUNDS OF WTO AND GATT

The Uruguay Round was meant to comprehensively address these concerns. The first meetings were held in November 1982, in Geneva, but it proved impossible to reach an agreement on agriculture. Nevertheless, the work programme formed the basis for what was to become the Uruguay Round negotiating agenda, launched in September 1986, in Punta del Este, Uruguay. The new agenda covered virtually every outstanding trade policy issue, including agriculture and textiles, and it introduced several new areas, notably trade in services and intellectual property. All the original GATT articles were up for review in the biggest negotiating mandate on trade ever agreed. The Round was supposed to take four years, but took twice as long. This was not surprising given the number of countries that were members of the GATT by then (more than 100), the complexity of the issues under negotiation (non-tariff barriers) and the highly sensitive nature of the issues at stake (including agriculture).

The Uruguay Round of multilateral trade negotiations was initiated by the United States in 1985 and was formally launched in September 1986 at Punta del Este, Uruguay. The Round was launched at a time when significant structural shifts had occurred in most of the industrialized countries. The service industry had grown and was continuing to expand while at the same time communication technologies were revolutionized. It also came at a time when there was a certain degree of crisis in international agricultural markets and when major reconfiguration of global economic and political balance of forces was emerging. The earlier Rounds of GATT were preoccupied almost entirely with negotiations of lower tariffs. However, beginning with the Kennedy Round' and assuming more importance in the Tokyo Round a substantial amount of trade related non-tariff matters were negotiated. In a sense, the 'Uruguay Round' was now seeking to extend its coverage to new areas.

The Uruguay Round brought about the biggest reform of the world's trading system since GATT was created at the end of the Second World War. And yet, despite its troubled progress, the Uruguay Round did see some early results. Within only two years, participants had agreed on a package of cuts in import duties on tropical products which are mainly exported by developing

countries. They had also revised the rules for settling disputes, with some measures implemented on the spot. And they called for regular reports on GATT members' trade policies, a move considered important for making trade regimes transparent around the world.

The final agreement was signed in Marrakech, Morocco, in 1994. One of the most visible results was that the WTO replaced GATT in 1995, even though the General Agreement still exists as the WTO's umbrella treaty for trade in goods. The Uruguay Round was highly significant in reinforcing the architecture of the world trading system.Existing multilateral rules, disciplines and enforcement procedures were strengthened, including the Agreements on Subsidies and Countervailing Measures, and on Safeguards, as well as the Dispute Settlement arrangements. In addition to progress on the traditional agenda on tariffs and non-tariff barriers, three new agreements were signed: the General Agreement on Trade in Services (GATS), the Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) and the Agreement Nevertheless, the Uruguay Round left unfinished business. A specific commitment to restart negotiations in some areas saw a new round launched in Doha, the capital of Qatar, in 2001.

11.6 INTELECTUAL PROPERTY RIGHTS (IPR)

Many of the rapid and unprecedented changes in intellectual property law and policy over the past two decades are due to their intersection with international trade and the numerous international trade agreements negotiated and brought into force during this period. This increased activity with respect to international trade agreements is partly the result of the explosion in cross-border exchanges of goods, services, capital and knowledge that has taken place since World War II. During this period, global trade transactions have grown at a rate that is at least twice as fast, in most years, as the increase in many countries' domestic output. Another reason for the increased significance of intellectual property rights in international trade is that structural changes have taken place in all economies, albeit at different rates. In particular, knowledge technology, ideas, methods and techniques is quickly becoming society's most important economic asset. The growth of knowledge as a tradable asset, which takes many forms in its creation, dissemination and movement across borders, is now an established feature of all economies

Increased international trade activity, reflecting the growing convergence between global trade and intellectual property rights has been linked to the successful negotiation of the Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS), in the mid-1990s,

as part of the outcome of the multilateral Uruguay Round, a key component of the then newly created World Trade Organization (WTO). TRIPS was followed by the inclusion of intellectual property rights standards and enforcement obligations in many regional and bilateral trade agreements, and in stand-alone plurilateral arrangements, such as the recently concluded Anti Counterfeiting Trade Agreement (ACTA) involving nearly 40 countries. The heightened policy interest in trade-related intellectual property rights is not due entirely to the increased level of trading activity. As the knowledge-driven economy has grown, new perceptions have arisen about the importance of innovation and creativity in society, and how it should best be promoted. Further, public opinion in many countries has become more concerned about issues such as the public commons; public health; the distribution of income; and the sources, nature and implications of economic growth on human well-being all matters affected by the ownership and distribution of intellectual property rights.

In contrast to international trade agreements, standards and enforcement procedures pertaining to intellectual property rights date back much farther. While domestic laws to protect private property begin in 1474 with the Venetian Statute and in England from the very early eighteenth century, they covered primarily printed works. Some years later, the Paris Convention on the Protection of Industrial Property, concluded in 1883, was the first international instrument to cover patents on industrial innovations. The Berne Convention for the Protection of Literary and Artistic Works was established three years later to cover copyright, and the Madrid Agreement Concerning the International Registration of Marks, dealing with trademarks, was concluded five years later. Even today, the subject matter of these three agreements covers the principal categories of intellectual property, although industrial designs, geographical indications (GIs), computer circuit topographies and plant breeders' rights, as well as traditional knowledge, access to genetic resources and trade secrets, have become increasingly important as stand-alone categories in the past two decades.

11.7 TRADE-RELATED ASPECTS OF INTELLECTUAL PROPERTY RIGHTS (TRIPs)

The WTO's Trade-Related Aspects of Intellectual Property Rights (TRIPS) Agreement establishes minimum levels of protection that each government must provide for the intellectual property of fellow WTO members. Governments are allowed to reduce any short-term costs through various exceptions, or for example to tackle public health problems by bypassing property rights in specified ways. The TRIPS agreement covers: Copyright and related rights in fields

such as rental and broadcast. Performers must have the right to prevent bootlegging, or the unauthorized recording, reproduction and broadcast of live performances, for a period of no less than 50 years. Producers of sound recordings must have the right to prevent the unauthorized reproduction for 50 years. Trademarks, including service marks. Service marks are logos and other such symbols used to identify services companies whose activity, repairing a burst pipe for example, cannot be stamped with a physical mark like other products.

The Agreement on Trade related Aspects of Intellectual Property Rights of the WTO is commonly known as the TRIPS Agreement or simply TRIPS. TRIPS is one of the main agreements comprising the World Trade Organization (WTO) Agreement. This Agreement was negotiated as part of the eighth round of multilateral trade negotiations in the period 1986-94 under General Agreement on Tariffs and Trade (GATT) commonly referred to as the Uruguay Round extending from 1986 to 1994. It appears as Annex 1 C of the Marrakesh Agreement which is the name for the main WTO Agreement. The Uruguay Round introduced intellectual property rights into the multilateral trading system for the first time through a set of comprehensive disciplines.

The TRIPS Agreement is part of the "single undertaking" resulting from the Uruguay Round negotiations. This implies that the TRIPS Agreement applies to all WTO members, mandatorily. The precursor to the WTO was the General Agreement on Tariffs and Trade (GATT) which sought to address issues related to international trade in goods. The operation of the GATT over the years resulted in lowering of tariffs in general in international trade. As a result, increasingly, other domestic policies of nations came into focus of the trading nations It also means that the provisions of the agreement are subject to WTO dispute settlement mechanism which is contained in the Dispute Settlement Understanding (the "Understanding on Rules and Procedures Governing the Settlement of Disputes"). The TRIPS Agreement is one of the most important agreements of the WTO.

Geographical indications: Often these are place names related to food and drink such as the Champagne, which can only be named as such if it is produced in the Champagne region of France. Industrial designs: They must be protected for at least 10 years. Patent protection: It must be available for at least 20 years for both products and processes and in almost all fields of technology. Governments can refuse to issue a patent for an invention if its commercial exploitation is prohibited for reasons of public order or morality. They can also exclude diagnostic, therapeutic and surgical methods; plants and animals other than microorganisms; and biological processes for the production of plants or animals other than microbiological

processes. Protection is required for plant varieties either by patents or by a special system, such as the breeder's rights provided in international conventions. Layout-designs or topographies, of integrated circuits. Undisclosed information, including trade secrets.

For Trade Related Intellectual Property (TRIPS) there were wide agreements on patents, copyrights, performer's rights, trade-marks, geographical indications, industrial designs, microchip layout designs and trade secrets. Patents were granted protection for twenty years and strict limitations were imposed on compulsory licensing of patented products, such as pharmaceuticals, in developing countries. Semiconductor layout designs will be protected for ten years. Trade-marks and geographical indications will be accorded increased protection and for the first time trade secrets will be protected from unauthorized disclosure. Copyrights will be protected for at least fifty years. Authors of computer programs and films will have exclusive rental rights as will performers and producers of sound recording and broadcast.

Copyright and related rights:

Rights granted to authors of literary and artistic works, and the rights of performers, producers of phonograms and broadcasting organizations. The main purpose of protection of copyright and related rights is to encourage and reward creative work. The distinguishing feature of this category of rights is that they protect only the tangible expression of an idea and not the idea itself. Further, these rights generally come into existence the moment a work is created and need not be registered with any central authority.

Industrial property:

This category includes: (1) the protection of distinctive signs such as trademarks and geographical indications, and (2) industrial property protected primarily to stimulate innovation, design and the creation of technology which are protected through laws on protection of inventions (patents), industrial designs and trade secret.

11.8 TRADE RELATED INVESTMENT MEASURES (TRIMS)

In the late 1980s, a significant increase in foreign direct investment was taking place throughout the world. Some of the countries receiving that foreign investment, however, imposed numerous restrictions on it that were designed to protect and foster domestic industries and to prevent the outflow of foreign exchange reserves. Examples of these restrictions include local content requirements (which require that locally-produced goods be purchased or used), manufacturing requirements (which require certain components be domestically manufactured),

trade balancing requirements, domestic sales requirements, technology transfer requirements, export performance requirements (which require that a specified percentage of production volume be exported), local equity restrictions, foreign exchange restrictions, remittance restrictions, licensing requirements, and employment restrictions. Some of these investment measures distort trade in violation of GATT and are therefore prohibited.

The Government of Indonesia notified the measures regarding the above items to the WTO, as measures to be local content requirements falling under of the illustrative list annexed to the TRIMs Agreement. It however announced on 31, October 1996 that it would withdraw its auto-related notification on the grounds that the local content requirements in its auto sector did not constitute a TRIM within the meaning of the Agreement. Although the measures that the WTO had been notified of were not in contravention of the Agreement, Japan still monitored them to ensure that they were not expanded and were eliminated on schedule. The automotive TRIMs appear to have been eliminated in mid-1999; Indonesia did not seek an extension under the provisions of the Agreement. However, the National Car Program introduced in 1996 does give preferential treatment in proportion to the achievement in the country.

Until the completion of the Uruguay Round negotiations, which produced a well-rounded Agreement on Trade-Related Investment Measures (hereinafter the "TRIMs Agreement"), the few international agreements that provided disciplines for measures restricting foreign investment provided only limited guidance in terms of content and country coverage. The OECD Code on Liberalization of Capital Movements, for example, requires members to liberalise restrictions on direct investment in a broad range of areas. The OECD Code's efficacy, however, is limited by the numerous reservations made by each of the Members. In addition, there are other international treaties, bilateral and multilateral, under which signatories extend most-favored-nation treatment to direct investment. Only a few such treaties, however, provide national treatment for direct investment. Moreover, although the APEC Investment Principles adopted in November 1994 provide rules for investment as a whole, including non-discrimination and national treatment, they have no binding force.

In the short term, TRIMs provide countries with perceived benefits. Some governments view TRIMs as a way to protect and foster domestic industry. TRIMs are also mistakenly seen as an effective remedy for a deteriorating balance of payments. These perceived benefits account for their frequent use in developing countries. In the long run, however, TRIMs may well retard economic development and weaken the economies of the countries that impose them by stifling

the free flow of investment. Local content requirements, for example, illustrate this distinction between short-term advantage and long-term disadvantage. Local content requirements may force a foreign affiliated producer to use locally produced parts. Although this requirement results in immediate sales for the domestic parts industry, it also means that this industry is shielded from the salutary effects of competition.

In the end, this industry will fail to improve its international competitiveness. Moreover, the industry using these parts is unable to procure high-quality, low-priced parts and components from other countries, and will be less able to produce internationally competitive finished products. The domestic industry can hope to achieve, at best, import substitution, but the likelihood of further development is poor. The consumer in the host country also suffers as a result of TRIMs. The consumer has no choice but to spend much more on a finished product than would be necessary under a system of liberalized imports. Since consumers placed in such a position must pay a higher price, growth of domestic demand will stagnate. This lack of demand also hinders the long-term economic development of domestic industries.

11.9 GENERAL AGREEMENTS ON TRADE AND SERVICES (GATS)

It is a known fact that trade in services is the rapidly growing field in the global scenario. According to WTO, in the year 2001, services constituted about 60% of the world's output (in GDP). The trade in services has particularly increased in developing countries. The total trade in services occupied more than 50% in the exports of the developing countries. The rapid growth and change has prompted the members of the WTO to bring in changes in rules and regulations on trade in services and GATS was introduced on 1st January 1995. This is one of the important agreements of WTO which contains two main parts: the frame work of agreement containing rules and regulations and the schedule of Nations who gave the commitment on access to their domestic markets by foreign suppliers. Now WTO has 148 member countries.

Each WTO member lists in its national schedule those services, which it wished to guarantee access to foreign suppliers. All member countries are considered as MFNs (Most Favoured Nations) i.e, all commitments apply on non – discriminatory basis to all member countries.

The General Agreement on Trade in Services (GATS) entered into force in January 1995. It is the first multilateral, legally enforceable agreement covering international trade in services. The GATS consists of two types of obligations: general obligations that apply to all service

sectors, and sector-specific obligations that apply only to sectors listed by Members in Schedules of Specific Commitments. The Agreement does not apply to services supplied in the exercise of governmental authority; matters relating to national security; non-discriminatory regulations taken for public policy reasons, including health, safety, public order and morals; measures affecting air transport traffic rights and related services, or to measures relating to immigration and permanent employment. The GATS covers most internationally traded services including banking, telecommunications, tourism, and professional services.

The services economy has been enjoying spectacular growth over the last two decades. To begin with, technological advances in the field of telecommunication and information processing have allowed speedy delivery of various financial, educational, business, entertainment, and professional services across borders and oceans. Furthermore, improved transportation services have helped to make tourism, distribution, and construction services into powerful global industries. The General Agreement on Trade in Services (GATS) is one of the crucial agreements that fall under the legal framework of the World Trade Organization (WTO).

Its purpose is to "secure progressively higher levels of liberalization of trade in services through successive rounds of negotiations, which should aim at promoting the interests of all Members of the WTO and at achieving an overall balance of rights and obligations" (Article XIX of GATS). The articles of GATS, and a set of Annexes, establish some general rules for government measures that affect trade in services. In addition, national schedules of commitments set out specific commitments by each WTO Member country. The schedules are an integral part of the Agreement, as tariff schedules are an integral part of the GATT. While the text of the Agreement applies uniformly to all Members of the WTO, the schedules reflect liberalizing commitments undertaken individually by each Member of the WTO.

11.10 SUMMARY

This unit discussed about the basic concepts and principles of general agreements on trade and tariffs (GATT).The concepts of WTO, IPRs, TRIPs, TRIMs, and GATs are discussed in the length. An account of different rounds of WTO and GATT is also given in this unit.

11.11 SELF ASSESSMENT QUESTIONS

1) Define the term GATT?
2) Briefly explain the role and functions of WTO?
3) List out core principles of GATT?
4) Write a note on IPRs,TRIPs,TRIMs,GATs?

11.12 CASE STUDY

Case Study No.1

Swiss economy shrinks as exports slump

Swiss gross domestic product (GDP) for the first quarter of 2009 has fallen by 0.8 per cent on the previous three months, its worst quarterly performance since 1992. Negative growth was registered in particular in exports, according to the State Secretariat for Economic Affairs (Seco) on Tuesday. The year on year drop was 2.4 per cent, the sharpest contraction since 1976. "It's a bad number – Switzerland is in a bad shape – but in other countries the effect is even worse," Seco's chief economist, Aymo Brunetti, told swissinfo.ch. He admitted it was "more or less in line with what we expected". "We all know that at least for world markets it's the worst recession since the SecondWorld War, so it's not very surprising that Switzerland is affected," he said. This was confirmed by UBS analyst Reto Hunerwadel.

"The 2.4% drop in GDP is not very upbeat, confirming the Swiss economy is still feeling the heat of the global economic slowdown. But it is still comparably solid compared with other European economies," he said. German GDP for example has slumped 3.8% on the quarter in the first three months of 2009. Seco reported that exports dropped by 5.4% on the quarter, coming on top of an 8.7% fall in the final quarter of 2008. Exports of goods – down 6.6% – were again more seriously affected than exports of services, down 2.3%. In contrast to exports, imports of goods and services remained at the same level as the previous quarter."Of course we've been very clearly affected on the exports side, but at least on the domestic markets we had some very good years.

So we think the domestic market is quite resilient," Brunetti said. He highlighted some factors he believed played a role in Switzerland's less-worse-than-others performance. "We don't have the kind of problem in the housing market that many other countries have. We had

quite high wage settlements at the end of last year and these might give some stabilising effect on the consumption side.” Nevertheless, Switzerland slipped into recession last summer and the Swiss National Bank (SNB) forecasts an economic contraction of up to 3% in 2009, which would be the worst decline in over 30 years, after an overall growth of 1.6% in 2008. A “noteworthy” rise in spending, said Seco, was observed only in the fields of healthcare and communications. In contrast, spending declined in the sectors for clothing, furniture, transport and financial and insurance services. Construction continued its downward trend, dropping 1%.

As for the future, Brunetti hopes “that the policies that have been undertaken until now will be sufficient, but if the recession continues, there is a discussion in Switzerland on whether there is a need for another package of measures”. The economic stimulus measures would follow two earlier rounds of funding in the past year totalling SFr1 billion. “A lot has been done on the monetary policy side, but intentionally we have a step-by-step approach because the uncertainty is so big – on both the favourable and unfavourable side,” Brunetti said. “It will be very interesting to see what happens in the next quarter, because in many countries the first quarter was so bad that the evaluation was that this must be a kind of turning point,” he added. “But I would be very careful of making forecasts about the turning point – it all depends on the recovery of world markets. This is the most important thing for the Swiss business cycle right now in the swizs.”

QUESTIONS:

1. Write a note on reasons and impact of swizz economy shrinks exports slump in international trade?
2. Explain the role general agreements of trade and tariff (GATT) in swizz economy to enter into international market?

Case Study No.2

Why Germany needs to change

Elsewhere in the world, Europe is widely regarded as a continent whose economy is rigid and sclerotic, whose people are work-shy and welfare-dependent, and whose industrial base is antiquated and declining the broken cogs and levers that condemn the old world to a gloomy future. As with most clichés, there is some truth in it. Yet as our special report in this week’s issue shows, the achievements of Germany, Europe’s biggest economy, tell a rather different story. A decade ago Germany was the sick man of Europe, plagued by slow growth and high unemployment, with big manufacturers moving out in a desperate search for lower costs. Now, despite the recession, unemployment is lower than it was five years ago.

Although Germany recently ceded its place as the world's biggest exporter to China, its exporting prowess remains undimmed. As a share of GDP, its current-account surplus this year will be bigger than China's. This feat gives the lie to the picture, common in America and Asia, of Europe as a washed-up continent incapable of change. And, for the rest of Europe, there is a lot to be said for having a strong economy at the continent's geographical and political centre. Yet Germany's success is paradoxically also causing problems for its neighbors problems which they, and Germany, need to address. Germany's impressive flexibility is the consequence of old virtues combined with new ones. The old consensus-building management system helped employers keep unions on side when costs needed to be held down. The famous Mittelstand (small and medium-sized firms, often family-owned) went through its operations, step by step, judging what to do in Germany, what to send abroad and what to outsource.

At the same time, economic policy took a new, liberalizing, direction. The Schroder government introduced reforms to the labour market and welfare systems in 2003-04; spurred on by those, and by competitive pressures from Europe's single currency, German business ruthlessly held down real wages. Unit labour costs fell by an annual average of 1.4% in 2000-08 in Germany, compared with a decline of 0.7% in America and rises of 0.8% and 0.9% in France and Britain respectively. Although last year's recession hit Germany hard, its economy is in much better shape now than it was a decade ago a point that should be noted in France, where President Nicolas Sarkozy has taken to railing against outsourcing, and in southern Europe, which bends over backwards to preserve overgenerous wages and restricted labour markets.

Germany is rightly proud of its ability to control costs and keep on exporting. But it also needs to recognize that its success has been won in part at the expense of its European neighbors. Germans like to believe that they made a huge sacrifice in giving up their beloved D-mark ten years ago, but they have in truth benefited more than anyone else from the euro. Almost half of Germany's exports go to other euro-area countries that can no longer resort to devaluation to counter German competitiveness. While Anglo-Saxons were throwing money around, Germans kept saving. Domestic investment has not kept pace. The result of Germans' prowess at exporting, combined with their reluctance to spend and invest, has been huge trade surpluses. Germany's excess savings have been funnelled abroad often into subprime assets in America and government bonds in such countries as Greece..

It is certainly true that Germany's neighbours have a great deal of work to do. France, Italy and Spain need to follow Germany in loosening up their labour markets; Italy, Spain and

Greece need to tighten their public finances. But Germany also needs to push ahead with liberalization. Its web of regulations is too constricting; its job protection is too rigid; its health, welfare and education systems still need big doses of change; its service sector is underdeveloped. You do not have to be a free-market zealot to think that it is too hard to start a new business in Germany, or to worry that a fat tax "wedge" to pay for health care and welfare reduces low-paid service jobs. Nor do all the changes Germany needs to make mean cutting government back. Too few women are in full-time work, partly because child-care support is lacking. The country's demographic prospects are dire.

QUESTIONS:

1. Explain Why Germany economy needs to change to expand their business in international or global level?
2. Give brief summary of German economic conditions and what is the impact of WTO intervention in this case study?

11.13 NOTES

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UNIT - 12 : MINISTRIAL CONFERENCE OF SAARC

Structures :

12.0 Objectives

12.1 Iintroduction

12.2 The Profile of SAARC

12.3 Objectives of SAARC

12.4 The Institutional Set-up

12.5 Regional Centers for SAARC

12.6 Legal Issues, Conventions and Agreements

12.7 The Key SAARC Declarations

12.8 Challenges to SAARC Process

12.9 Summary

12.10 Self Assessment Questions

12.11 Case Study

12.12 Notes

12.13 References

12.0 OBJECTIVES

After studying this unit, you should be able to;

- Define the SAARC.
- Describe the objectives and profiles of SAARC.
- Determine the regional centers and institution set up of SAARC.
- Give an account on Key SAARC declarations.

12.1 INTRODUCTION

The Third SAARC Ministerial Conference on Children of South Asia was held in Rawalpindi on 20-22 August, 1996. The Conference was attended by all SAARC Member States and SAARC Secretariat' UNICEF also attended as a special invite. The Conference was inaugurated by Her Excellency Mahatma Benazir Bhutto, Prime Minister of the Islamic Republic of Pakistan. In her address the Prime Minister emphasized the need for sustained support from all Member States t0 fulfill the dream of nurturing children in a secure and happy environment' Moving from promise to performance, South Asian countries must implement the commitments already made, in order to: decrease the 50 million child deaths predicted over the next decade alone; attain economic solvency; end gender discrimination; and fight the spread of epidemics'. South Asia has provided inspiring examples of courage, determination and compassion. The immunization programme, for example, has been implemented successfully, as have rural primary education, water supply, and family planning in many instances' The agenda of this Conference reflects indigenous experience.

The Prime Minister stressed that the focal point of our development agenda must be the rights of children, aiming to promote gender equality, female literacy and equal opportunity for rural and urban children' Recognizing the value of human dignity, national development plans in the region are rightly focusing on socio-cultural, moral and ecological dimensions' Pakistan's own participation in reshaping the Programmer of Action of the Ministerial Conference on Population and Development held in Cairo t0 meet religious and ethical values of Member States was a singular contribution' Knowing well that there are no short cuts to development, Pakistan has embarked upon an ambitious programme to address the long neglected social sec through the Social Action Programme. Partly in

collaboration with UNICEE Pakistan has concentrated on elimination of child labor. The idea of a South Asia Association for Regional Cooperation was mooted in 1980. The foreign Ministers of the future SAARC countries met at Colombo in 1981 to discuss the issue of regional cooperation and agreed upon the principles of unanimity in decision making and keeping bilateral disputes out of the framework of regional cooperation.

The Integrated Programme of Action (IPA) was endorsed in a Foreign Secretary meeting held at Dhaka in August 1982. The IPA identified eleven areas of cooperation – agriculture, communications, education-culture-sports, environment and meteorology, health and population activities, prevention of drug trafficking and drug abuse, rural development, science and technology, tourism, transport, and women in development. To translate the objectives enshrined in the Charter the Foreign Ministers of member countries met in Colombo for the first Preparatory meeting of SAARC. They agreed on the agenda for SAARC, which included issues like rural development, agriculture, meteorology, telecommunication, health and population, science and technology, transport, and posts & telegraph services. The third meeting held in Thimpu agreed on sports, arts and culture, and planning and development, which were incorporated into the list of areas for cooperation. The Thimpu meeting also led to agreement on the creation of an institutional framework for SAARC and decided the venue and the dates of the first SAARC summit. After these three preparatory meetings the SAARC summit was held in Dhaka in 1985.

12.2 THE PROFILE OF SAARC

The South Asian Association for Regional Cooperation (SAARC) comprises the seven countries of South Asia, Bangladesh, Bhutan, India, The Maldives, Nepal, Pakistan and Sri Lanka. It is an Association based on the consciousness that in an increasingly independent world, the objectives of peace, freedom, social justice and economic prosperity are best achieved in the South Asian region by fostering mutual understanding, good neighborly relations and meaningful cooperation among the Member States which are bound by ties of history and culture. The idea of regional cooperation in South Asia was first mooted in November 1980. After consultations, the Foreign Secretaries of seven countries met for the first time in Colombo in April 1981. This was followed up, a few months later, by a meeting of the Committee of the Whole, which identified five broad areas for regional cooperation.

The Foreign Ministers, at their first meeting in New Delhi in August 1983, adopted the Declaration on South Asian Regional Cooperation (SAARC) and formally launched the Integrated Programme of Action (IPA) initially in five agreed areas of Cooperation namely, Agriculture; Rural Development; Telecommunications; Meteorology, and Health and Population. Scientific and Technological Cooperation; Sports, Arts and Culture were added to the IPA at a later stage. The Heads of State of Government at their First SAARC Summit held in Dhaka on 7-8 December 1985 adopted the Charter formally establishing the South Asian Association for Regional Cooperation (SAARC).The SAARC Charter envisages that cooperation among member-states will be based on sovereign equality, territorial integrity, political independence and non-interference in internal affairs. The Charter further states that regional cooperation shall not substitute for bilateral or multilateral cooperation or be inconsistent with them but rather it should compliment them. SAARC charter day is celebrated on December 8 every year. The charter was adopted in the first SAARC summit held in Dhaka in 1985.

12.3 OBJECTIVES OF SAARC

The objectives, principles and general provisions as mentioned in the SAARC Charter are as follows:

- To promote the welfare of the peoples of South Asia and to improve their quality of life;
- To accelerate economic growth, social progress and cultural development in the region and to provide all individuals the opportunity to live in dignity and to realize their full potential;
- To promote and strengthen collective self-reliance among the countries of South Asia;
- To contribute to mutual trust, understanding and appreciation of one another's problems;
- To promote active collaboration and mutual assistance in the economic, social, cultural technical and scientific fields;
- To strengthen cooperation with other developing countries;
- To strengthen cooperation among themselves in international forums on matters of common interests and

- To cooperate with international and regional organizations with similar aims and purposes.
- Cooperation within the framework of the Association is based on respect for the principles of sovereign equality, territorial integrity, political independence, non-interference in the internal affairs of other States and mutual benefit.
- Such cooperation is to complement and not to substitute bilateral or multilateral cooperation.
- Such cooperation should be consistent with bilateral and multilateral obligations of Member States.
- Decisions at all levels in SAARC shall be taken on the basis of unanimity;
- Bilateral and contentious issues shall be excluded from the deliberations of the Association.

12.4 THE INSTITUTIONAL SET-UP

The Charter of the Association provides for the following:

- **The Summit:** The highest authority of the Association rests with the Heads of State or Government, who meet annually at Summit level. To date, eleven meetings of the Heads of State or Government have been held respectively in Dhaka (1985), Bangalore (1986), Kathmandu (1987), Islamabad (1988), Male (1990), Colombo (1991), Dhaka (1993) New Delhi (1995), and Male (1997), Colombo (1998) and Kathmandu (2002). The Heads of State or Government during the Ninth SAARC Summit agreed that a process of informal political consultations would prove useful in promoting peace, stability and amity and accelerated socio-economic cooperation in the region. This was further reiterated at the Tenth SAARC Summit.

- **The Council of Ministers:** The Council of Ministers, which comprises the Foreign Ministers of Member States, is responsible for formulating policies, reviewing progress, deciding on new areas of cooperation, establishing additional mechanisms as deemed necessary and deciding on other matters of general interest to the Association. The Council is expected to meet twice a year and may also meet in extraordinary session by agreement of the Member States. Informal meetings of the Council are also held as agreed during the Sessions of the United Nations General Assembly.

- **The Standing Committee:** The Standing Committee comprising the Foreign Secretaries of Member States is entrusted with the task of overall monitoring and coordination of programmes; the approval of projects and programmes and the modalities of financing; determining inter-sectoral priorities; mobilizing regional and external resources; and identifying new areas of cooperation. It meets as often as deemed necessary and submits its reports to the Council of Ministers. The Standing Committee may also set up Action Committees comprising of Member States concerned with implementation of projects involving more than two Member States. The Standing Committee is assisted by a Programming Committee. The Programming Committee, which comprises senior officials, is responsible for scrutinizing the Secretariat Budget, finalizing the Calendar of Activities, and taking any other matter assigned to it by the Standing Committee. The Programming Committee has also been entrusted to consider and submit to the Standing Committee, recommendations for action on the Reports of the Technical Committees, SAARC Regional Centers and the SAARC Audio Visual Exchange (SAVE) Committee.

- **The Technical Committees:** At the time SAARC was formally established in 1985, the core of its work programme was the Integrated Programme of Action (IPA), consisting of a number of Technical Committees on agreed areas of cooperation. However, as the agreed Agenda of SAARC expanded, new areas were identified for regional cooperation. The IPA too, was expanded correspondingly. The Technical Committees formulate specialized programmers and prepare projects in their respective fields under the IPA. They are responsible for monitoring the implementation of such activities and submit their reports to the Standing Committee through the Programming Committee. Under the new SAARC Integrated Programme of Action (SIPA), the number of Technical Committees has been reduced from eleven to seven mainly through the amalgamation of the different sectors covered by the various Technical Committees and eliminating overlapping, duplication and waste. The prime objective of the reorganization has been to enhance clarity in terms of the goals and targets of the activities undertaken, as well as to improve the Committees quality and efficacy. An in-built mechanism for automatic review of activities under SIPA has been provided for. The review will be undertaken every three years by an independent multi-disciplinary Expert Group that would be constituted by the Secretary General in Consultation with the Member States. The Secretary General reports to the Standing Committee on the progress of the implementation of the IPA both at its inter-Summit and the pre-Summit sessions.

- **Specialized Ministerial Meetings**: Since the establishment of the Association, a number of SAARC ministerial meetings have been held, to focus attention on specific areas of common concerns, and have become an integral part of the consultative structure. These meetings initiated cooperation in important areas such as trade, manufactures and services, basic needs, human resources development, database on socioeconomic indicators, energy modeling techniques, plan modeling techniques and poverty alleviation strategies in SAARC.

12.5 REGIONAL CENTERS FOR SAARC

SAARC has established five regional centers. Each centre is managed by a Governing Board which includes the Director of the Centre. The Governing Board reports to the Standing Committee. The Regional Centers are as follows:

- **SAARC Agricultural Information Centre (SAIC) :**

The first regional institution was established in Dhaka in 1988. SAIC serves to network relevant National Information Centers in each Member State with a view to exchange regionally generated technical information particularly to strengthen agricultural research and development activities. SAIC has brought out several publications which contain information on agricultural institutions in SAARC countries and current services on fisheries, forestry, livestock and crops such as rice. SAIC also publishes a quarterly newsletter

- **SAARC Tuberculosis Centre (STC):**

The STC was set up in 1992 in Kathmandu. The main objective of STC is to work towards the prevention and control of TB in the region by coordinating the efforts of the National TB Programme of the Member States.

- **SAARC Documentation Centre (SDC):**

The SDC was established at the Indian National Scientific Documentation Centre in New Delhi in May 1994. The SAARC Documentation System comprises the central facility i.e. SDC and its sub-units in Member States act as the Centre's repositories with the SAARC Secretariat and SAARC Regional Institutions. In fulfilling the need for ready access to information, the SDC focuses on data in Member States and international databases in the areas of biological, physical, chemical, engineering, and life sciences as well as in development matters.

- **SAARC Meteorological Research Centre (SMRC):**

The SMRC in Dhaka was inaugurated on January 2, 1995. The Centre concentrates primarily on the research aspects of weather forecasting and monitoring. The research areas include weather prediction and compiling climatologically information. In addition to monitoring weather phenomena, the Centre is also engaged in developing a networking system among the Member States.

- **SAARC Human Resources Development Centre (SHRDC) :**

The SAARC Human Resources Development Centre (SHRDC) has been established in Islamabad with an objective to undertake research, training and dissemination of information on human resources development issues.

- **Charter of the SAARC and Provisional Rules of Procedure:**

The Charter of SAARC which was adopted in Dhaka on December 8, 1985 by the Heads of States/Government of the seven member countries remains the constitutional instrument under which the process of cooperation moves forward. This publication includes the Charter, and the Provisional Rules of Procedure which shall apply to the various meetings of SAARC.

- **Declaration of SAARC Summits (1985 – 2002):**

The Declaration of the Heads of State/ Government of member countries of SAARC at the conclusion of all the eleven Summits that have taken place since the inception of SAARC have been compiled into this publication.

- **Regional Economic Cooperation:**

This publication highlights the activities that have taken place in the field of regional economic cooperation including economic and trade issues leading to the Agreement on SAARC Preferential Trade Agreement (SAPTA)

- **Trade Facilitation Measures:**

Action has also been simultaneously initiated on a series of practical measures aimed at trade facilitation, such as consideration of a Regional Agreement on the Promotion and Protection of Investments in the SAARC Region, the setting up of a SAARC Arbitration Council, and the consideration of a Regional Agreement on the Avoid once of Double

Taxation. In 1996, a Group on Customs Cooperation was set-up and entrusted with a mandate inter-alia to harmonies customs rules and regulations; simplify documentation and procedural requirements; upgrade infrastructure facilities and provide training facilities. A Customs Action Plan has also been drawn up. Standing Group on Standards, Quality Control and Measurement was also established by the second meeting of SAARC Commerce Ministers in May 1998.

■ **Enhancement of Institutional Capacity :**

The Colombo Summit recognized the need to strengthen the individual financial systems of the SAARC countries through the enhancement of their institutional capacity, surveillance mechanisms, as well as through closer consultations on, and coordination of, macroeconomic policies where appropriate. In order to enhance SAARC's collective capacity in respect of policy analysis with specific emphasis on international financial and monetary as well as trade and investment issues, meetings of finance officials of SAARC countries have been held, including regular consultations between Governors of Central Bank.

■ **SAARC Preferential Trading Arrangement (SAPTA):**

The Tenth Summit in Colombo approved the formulation on an institutional framework for trade liberalization in SAARC through SAPTA. In 1993, the framework agreement on SAPTA was finalized and signed at the Seventh Summit at Dhaka. It entered into force in 1993.

The basic principles underlying SAPTA are:

♦ Overall reciprocity and mutuality of advantages so as to benefit equitably all Contracting States taking into account their respective levels of economic and industrial development, the pattern of their external trade, trade and tariff policies and systems;

♦ Negotiation of tariff reform step by step, improved and extended in successive stages through periodic reviews;

♦ Recognition of the special needs of the Least Developed Contracting States and agreement on concrete preferential measures in their favour; and

♦ Inclusion of all products, manufactures and commodities in their raw, semi-processed and processed forms.

The Tenth SAARC Summit in Colombo also decided on the setting up of a Committee of Experts which would draft a comprehensive treaty regime for creating a free trade area within the region. The Committee has been set up and a draft prepared by the Secretariat is under consideration. The process has benefited from inputs suggested by the South Asian corporate sector in India. In addition, as mandated by the Colombo Summit, a Network of Researchers on Global, Financial and Economic Issues has been set up to identify, analyze and help SAARC face global, financial and economic developments affecting the region. The Network which brings together the views of the private sector, central banks, planning ministries, research institutes and eminent economists nominated by Governments is working on an immediate and long term research agenda which would help identify areas of common concerns, as well as new areas of cooperation among the Member Countries. The Network also brings out the South Asia Economic Journal in collaboration Asian Commission on Poverty Alleviation (ISACPA) consisting of eminent persons from Member States to conduct an in-depth study of the diverse experience of Member States and report their recommendations on the alleviation of poverty to the Seventh Summit in SAARC.

12.6 LEGAL ISSUES, CONVENTIONS AND AGREEMENTS

- **Agreement on the SAARC Food Security:**

Reserve during the Third SAARC Summit in Kathmandu 1987, an agreement on establishing the SAARC Food Security Reserve was signed. The agreement which came into force on 12 August 1988 provides for a reserve of food grains to meet emergencies in Member Countries. The size of the Reserve stood at 241,580 tonnes as of March 2001. The possibility of instituting more practical measures for facilitating the use of the Reserve during emergencies was considered at a special meeting of the Board held in Kathmandu in April 2001.

- **Regional Convention on Suppression of Terrorism:**

The SAARC Regional Convention on the Suppression of Terrorism was signed in Kathmandu in November 1987 during the Third SAARC Summit and came into force on 22 August 1988 following ratification by all Member States. The Convention provides a regional focus to many of the well established principles of international law in respect of terrorist offences. Under its provisions, Member States are committed to extradite or prosecute alleged offenders thus preventing them from enjoying safe havens. Regional cooperation is

also envisaged in preventive action to combat terrorism through exchange of information, intelligence and expertise identified for mutual cooperation under the Convention.

- **Regional Convention on Narcotic Drugs and Psychotropic Substances:**

The SAARC Convention on Narcotic Drugs and Psychotropic Substances which was signed in Male during the Fifth SAARC Summit in November 1990 came into force on 15 September 1993, following ratification by all Member States. The Convention seeks to reinforce and complement, at the regional level, the relevant international conventions and promote regional cooperation among Member States in both law enforcement and demand reduction.

- **Convention on Prevention of Trafficking of Women and Children for Prostitution:**

The SAARC Convention on the Prevention of Trafficking of Women and Children for Prostitution was signed on 5 January 2002, at the Eleventh Summit in Kathmandu. The scope of the Convention is to promote cooperation amongst Member States to effectively deal with various aspects of prevention, interdiction and suppression of trafficking in women and children; repatriation and rehabilitation of victims of trafficking and preventing the use of women and children in international prostitution networks, particularly where the SAARC Countries are the countries of origin, transit and destination.

- **Convention on Regional Arrangements for the Promotion of Child Welfare:**

The SAARC Convention on Regional Arrangements for the Promotion of Child Welfare in South Asia was signed on 5 January 2002 at the inauguration of the Eleventh Summit in Kathmandu. The purpose and objectives of the Convention are to unite the SAARC Member Countries in their determination of redeeming the promises made by them to the South Asian Child at the World Summit for Children and various other national, regional and international conferences and successive SAARC Summits; to facilitate and help in the development and protection of the full potential of the South Asian child, promote understanding and awareness of the rights, duties and responsibilities of the children and others; and to set up appropriate regional arrangements to assist the Member States in fulfilling the rights of the child, taking into account the changing needs of the child.

12.7 THE KEY SAARC DECLARATIONS

- ***POVERTY:***

The issue of Poverty and the quality of life in South Asia has been addressed at almost all the SAARC Summits. At the Sixth Summit held at Colombo, the "Heads of State or Governments decided to establish an independent South Asian Commission on Poverty Alleviation, consisting of eminent persons from each member Stat" The report, meeting the challenge, is an excellent document. To further highlight this issue, the 11th SAARC Declaration in seven paragraphs, "The leaders directed the Council of Ministers to coordinate efforts to integrate poverty alleviation programmers into the development strategies of member states." In this context, they agreed to reconstitute the Independent South Asian Commission on Poverty Alleviation and further called that the first meeting of this Commission be held before the Ministers' Conference in April 2002.

- ***ECONOMIC CO-OPERATION:***

Economic Cooperation has been in the forefront of discussions at all the Summits. At the Sixth Summit an agreement for the establishing of a SAARC Preferential Trade Arrangement (SAPTA) was proposed. This was finalized in 1993 and came into effect in December 1995. This is to lead to South Asian Free Trade-which was reflected in the 11th SAARC Declaration "Recognizing the need to move quickly towards a South Asian Free Trade Area, the Heads of State or Government directed the Council of Ministers to finalize the text of the Draft Treaty framework by the end of 2002." There have also been regular consultations on the issue of WTO, WIPO, and others. Besides, SAARC has relations with the following International organizations.

- ***VIOLENCE / SMALLARMS:***

Small Arms have not emerged as an agenda item under SAARC, though various Summits have reflected the Arms Race, the Need for Disarmament efforts etc. However, at the Tenth Summit held at Male, "The Heads of State or Government expressed concern that Member States were compelled to divert their scarce resources in combating terrorism." The issue of Terrorism finds reflection right from the Second SAARC Summit. The SAARC Regional Convention on Suppression of Terrorism is a result of these concerns. At the Eleventh Summit they have gone a step further by reiterating their firm resolve to accelerate enactment of enabling legislation with a definite time-frame for the full implementation of

the convention together with the strengthening of SAARC Terrorist Offences Monitoring Desk."

♦ ***TRAVEL IN THE REGION:***

Restrictions of various categories of persons are being lifted and travel has been made easier where there are no bilateral tensions.

♦ ***CIVIL SOCIETY:***

Civil Society finds reflection in almost all of the SAARC Declarations. This has helped in the emergence of the SAARC Chamber of Commerce, SAARC Law, Architects, Management Development Institutions, Federation of Universities, of Town Planners, Accounts, of Speakers and Parliamentarians.

♦ ***TRAFFICKING IN WOMEN AND CHILDREN:***

The Nineth SAARC Summit noted this issue and at the Tenth Summit it welcomed a draft text to be signed at the Eleventh Summit. Also at the Tenth Summit "They agreed to work in close association, where possible, with professionals and other women's groups in the Region" on this issue. A Convention was signed at the Eleventh Summit.

♦ ***THE ENVIRONMENT:***

This is another issue of concern that has been taken note of in each successive SAARC Summit. At the Sixth Summit they took note of the report on the Regional Study on the Causes and Consequences of Natural Disasters and the Protection and Preservation of the Environment and endorsed the Council of Ministers to establish a Committee on the Environment. In the Second Summit – A Regional Study on Greenhouse Effect and Its Impact on the Region, was also taken note of. At the Eleventh Summit they called for an early and effective implementation of the SAARC Environment Plan of Action. To come to an agreement on any specific issue, the SAARC countries are involved in a series of meetings and consultations at the highest levels. Some of these processes have been recorded in the SAARC Publications: Milestones in the Evolution of Regional Cooperation in South Asia in 6 volumes. Further some very good studies conducted include the Conventions on Suppression of Terrorism, Narcotic Drugs & Psychotropic Substances, Preferential Trading Arrangements, Poverty, Preventing and Combating Trafficking in Women and Children for Prostitution, Promotion of Child Welfare in South Asia. A SAARC Group of Eminent Persons

was constituted by the Nineth SAARC Summit held in Male with the objective to undertake a comprehensive appraisal of SAARC and to identify measures including mechanisms to further realize and enhance the effectiveness of the Association in achieving its objectives in the economy.

12.8 CHALLENGESTO SAARC PROCESS

The independent South Asian Commission on Poverty Alleviation was established by the Heads of State of the South Asian Association for Regional Cooperation (SAARC). Its brief was to enquire into the development options for South Asia. In its report of 1992, the Commission stated that no matter what indices are used, the broad magnitude of poverty was in the order of 40 percent in the region as a whole. This magnitude of poverty was likely to increase in the short to medium term as a result of ideologically oriented liberalization and simplistic structural adjustment policies. The Commission also sent a political message to the SAARC Summit of 1993, that these numbers not only put democracy at risk in South Asia, but also would make for an unmanageable polity. No SAARC country could solve this problem by itself. As an indispensable first step a coherent regional effort at poverty eradication in a given time frame was required.

The SAARC heads of State accepted these warning signals when they endorsed and took over ownership of the recommendations of the Poverty Commission Report. The recommendations laid out an overall longer-term development strategy and a transitional shorter-term pro-poor strategy with social mobilization. The objective was the eradication of the worst forms of poverty in South Asia in a given time frame, leaving only residual numbers to be carried by safety nets and welfare. Both the long and short-term transitional strategies were pro-poor and growth oriented, and not redistribution and welfare oriented. Thus, there was a two-fold challenge to SAARC - one to bring the problem of poverty to the centre stage of concern, and the other to embark on a pro-poor growth strategy.

Today, with the failure of South East Asia to sustain the miracle of simplistic liberalization, the increased polarization of South Asian societies and the inability to stabilize the polities, one is compelled to ask the question: why are SAARC Governments and their Finance and Trade Ministries, uncritically wedded to this ideologically oriented globalization, liberalization and inadequate structural adjustment strategy Even the United Nations Development Programme (UNDP), 1999 Human Development Report has said

globalisation, in its present frame, is making the rich richer and the poor poorer, between and within countries. How can there be a sustained consensus on this irrational external oriented strategy and not on the more complex strategy, with greater self-reliance that was elaborated on the Poverty Commission report? The report is culturally rooted, economically rational and also politically sound. This more rational strategy is not based on re-distributive justice but rather on a parallel pro-poor growth strategy starting at the base of the economy. This could demonstrate that the poor need not be the problem in South Asia. The poor could be a part of the solution and a resource in the nation.

The challenge to SAARC is to revise its approach towards more self-reliant development and a stable polity. By eradicating the worst forms of poverty, such a strategy would also set the preconditions for trade liberalization and trade cooperation. This advice by an independent South Asian Commission was not taken seriously enough. Instead, an ad hoc shopping list approach to SAARC has continued, with a great deal of rhetoric about poverty eradication The recommendation of the Poverty Commission Report was for each country to prepare a proper coherent macro-plan. Using the overall perspective and premises for action in the report as points of departure, South Asia could articulate a new vision for the poor, so that the poor are no longer part of the problem, but can contribute directly to the solution. The whole process should be monitored continuously in a participatory manner with built-in-self-corrective measures.

The report helped to clarify a great deal of conceptual confusion and conflicting, narrow, ideologically oriented advice both from internal and external sources being given to SAARC Governments, regarding solutions to the poverty problem. The repeated endorsement of the recommendations at the 1993 and 1995 SAARC Summits meant that the ownership of the vision and recommendations and the how of poverty eradication were now in the hands of the Heads of State of SAARC. SAARC also needs to take up the resolution of long standing bi-lateral issues if it is to move towards achieving its objectives. Presently bilateral problems and issues cannot be discussed under, of its Charter stating "Bilateral and contentious issues shall be excluded from the deliberations". Further, it needs to strengthen its link and involvement of the civil society organizations and regional coalitions to ensure that people's perspective on the regional issues is adequately included in all its deliberation.

It observes that the limited success of SAARC; the pre-occupation with other SAARC issues; inherent trust deficit in the region; not all member countries having access to sea; the persistence of maritime disputes among some of the members has prevented SAARC from actively discussing it to develop a regional approach. These obstacles are surmountable. Since Blue Economy is already part of the national discourse of some of the members, these can be transposed onto the regional SAARC platform and all can benefit from the combined knowledge pool; secondly, since it is Bangladesh and not India which is taking the lead, the veil of suspicion generally associated with India will not be there; third, the landlocked SAARC countries should be convinced that the benefits of Blue Economy will percolate to them too; and lastly, it is seen that at the core of the concept of Blue Economy is 'sustainable development' which is inclusive, people centric and has been on the SAARC agenda since a long time. This now needs to be implanted on the template of Blue Economy. In the above context the paper briefly looks at the concept of Blue Economy; the 37th Session of SAARC Council of Ministers; and mechanisms to make Blue Economy part of the SAARC Agenda.

12.9 SUMMARY

This unit discussed about the concepts and profile, objectives of ministerial conferences of SAARC. The institutional set up, regional centers and legal issues and agreements of SAARC are discussed in the length. An account of key declarations and challenges to SAARC process in regional trade block theories is also given in this unit.

12.10 SELF ASSESSMENT QUESTIONS

1) Briefly explain the profile of SAARC?
2) Explain the major objectives of SAARC?
3) List out the key SAARC declarations WTO agreements?
4) Mention the major challenge us to process of SAARC?

12.11 CASE STUDY

Case Study No.1

WTO Chief Sees Russian Economy

Russia's appetite for joining the World Trade Organization appears to have evaporated, even though the trade group has been proving its mettle in discouraging protectionist reactions during the recent financial upheaval, the head of the WTO said Friday. Pascal Lamy, head of the WTO, said domestic politics had changed Russia's stance. Russia, the most important country outside the WTO, has been pursuing membership for 16 years. In 2004, the country signed a trade deal with the European Union to pave the way for its admission to the global trade body. Today, Russia seems to be less interested, Pascal Lamy, who last month started his second term as director general of the WTO, said during an interview. He pointed to the announcement in June by the Russian Prime minister, Vladimir V. Putin, that Russia, Kazakhstan and Belarus would pursue WTO membership jointly as a customs union something for which there is no precedent under WTO rules. "It will make the application of Russia much more complex, it will run even longer," Mr. Lamy said. "The fundamental reality is that there is no energy in Moscow to join" any more, said Mr. Lamy, who five years ago, as the European trade commissioner, negotiated the deal with Moscow.

The reasons for the waning enthusiasm, analysts say, are tied to domestic politics, the composition of Russia's energy-heavy exports and a suspicion of the motives of the West. Joining the group that sets rules for globalization had been a major foreign policy goal of Mr. Putin, so his pivot this summer to say that Russia would join only in a customs union baffled trade negotiators. In Moscow, however, the change in stance was seen as reflecting a fault line in the government over economic policy. Aides to President Dmitri A. Medvedev had been pushing WTO membership as a tool to help diversify the economy away from oil exports. Supporters of Mr. Putin have argued instead for an emphasis on increasing earnings from oil and raw materials exports in the country.

By last month, the apparent rift had grown so wide that Mr. Medvedev felt compelled to contest the characterization of the WTO membership debate as signifying a public split with the powerful Mr. Putin. "In the WTO, they started to say that the president has one point of view, the prime minister another on this question," Mr. Medvedev said, according to the news agency Interfax. "That's a mistake. The decision on how we will join has been

taken." Joining through the customs union will probably mean a long delay for Russia's accession. The attitudes of Russia and China toward the WTO have been "like night and day," Mr. Lamy said. That might largely be explained by China's much greater dependence on exports of manufactured goods. Beijing joined the WTO in 2001 "as an insurance against protectionism, to enhance domestic development," Mr. Lamy said. That insurance policy seems to have paid off so far during the global slowdown,

QUESTIONS:

1. Why has Russia long been reluctant to join the World Trade Organization (WTO)?
2. Why does the US strongly support Russia's WTO membership?

Case Study No.2

EU and South Korea sign free trade deal

EU Trade Commissioner Karel De Gucht, the Belgian Minister of Foreign Affairs Steven Vanackere representing the Presidency of the Council of the European Union (EU), and the Korean Minister for Trade Kim Jong-Hoon today signed a Free Trade Agreement (FTA) between the EU and South Korea. This FTA is the most ambitious trade agreement ever negotiated by the EU and the first with an Asian country. Today's signature signals a significant step on the road to its implementation and is one of the main events of the EU-Korea Summit taking place in Brussels today. "The agreement between the EU and South Korea marks a significant achievement in improving our trade links. It will provide a real boost to jobs and growth in Europe at this critical time. This wide-ranging and innovative deal is a benchmark for what we want to achieve in other trade agreements", said Commissioner De Gucht. "Tackling the more difficult non-tariff barriers to international commerce can cut the costs of doing business as much if not more than getting rid of import duties." The text of the FTA was initialled between the European Commission and South Korea on 15 October 2009. Since then the text of the Agreement was translated into Korean and 21 EU languages. All EU Member States have signed the FTA ahead of today's official signing ceremony.

The date of provisional application will be 1 July 2011, provided that the European Parliament has given its consent to the FTA and the Regulation of the European Parliament and of the Council implementing the bilateral safeguard clause of the EU-South Korea FTA is in place. The EU Member States will have to also ratify the agreement according to their

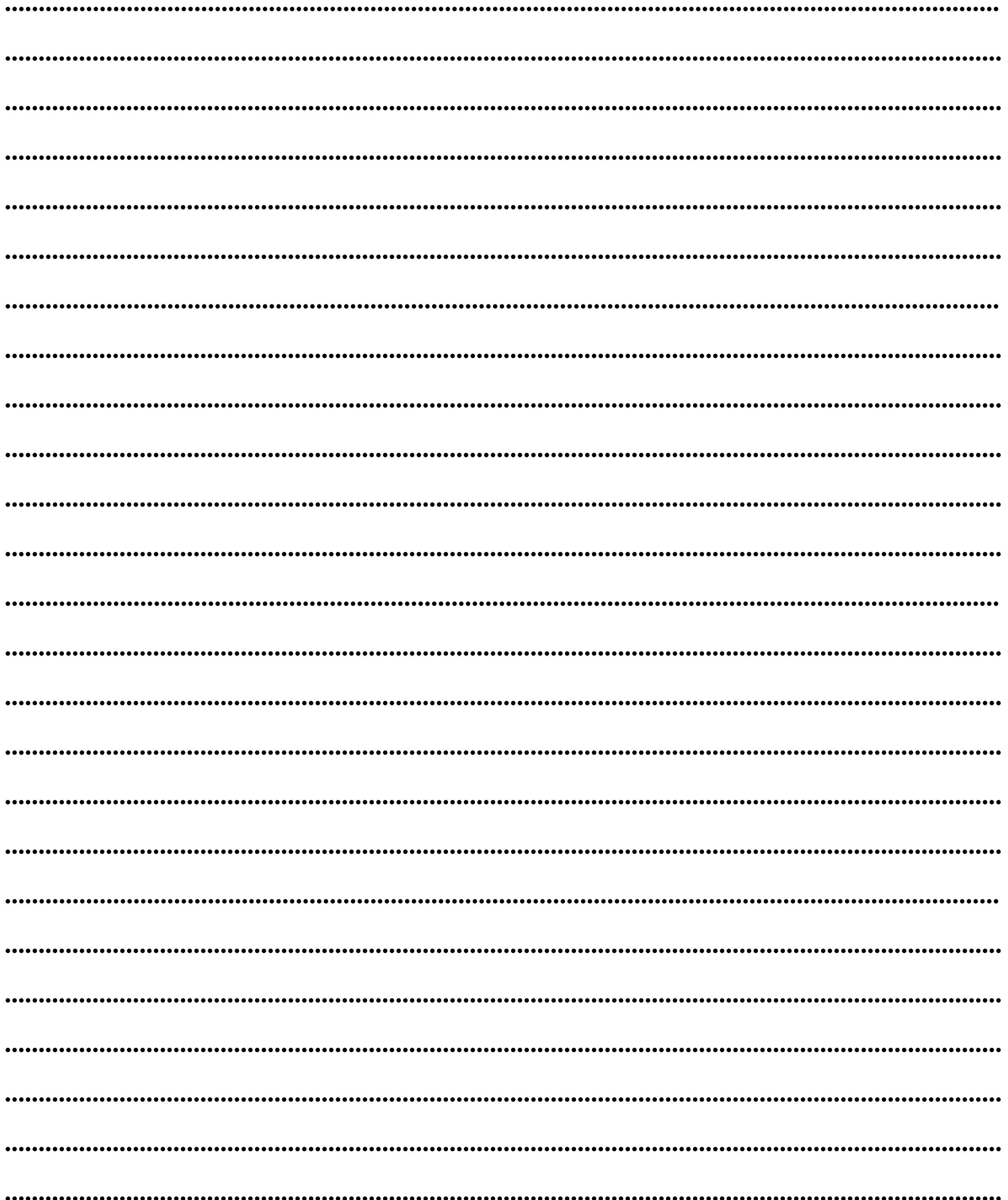
own laws and procedures. One study estimates that the deal will create new trade in goods and services worth €19.1 billion for the EU; another study calculates that it will more than double the bilateral EU-South Korea trade in the next 20 years compared to a scenario without the FTA. The agreement will remove virtually all import duties between the two economies as well as many non-tariff barriers. It will relieve EU exporters of industrial and agricultural goods to South Korea from paying tariffs. Once the duties are fully eliminated, EU exporters will save € 1.6 billion annually. Half of these savings will be applicable already on the day of the entry into force of the Agreement. The FTA will also create new market access in services and investment and will make major advances in areas such as intellectual property, procurement, competition policy and trade and sustainable development.

The financial crises, this trend slowed down in 2009 when the EU's exports to South Korea reached € 21.5 billion. In the same year, South Korea exported € 32.1 billion worth of goods to the EU. The value of EU services exports to South Korea in 2008 was close to € 8 billion, while EU absorbed € 4.4 billion of Korean services. EU-South Korea goods trade was worth around €54 billion in 2009. The EU currently runs a deficit with South Korea in goods trade, although trends suggest that the Korean market offers significant growth potential. For products like chemicals, pharmaceuticals, auto parts, industrial machinery, shoes, medical equipment, non-ferrous metals, iron and steel, leather and fur, wood, ceramics, and glass, the EU enjoys a solid trade surplus. Similarly, for agricultural products South Korea is one of the more valuable export markets globally for EU farmers, with annual sales of over €1 billion. On services, the EU has a surplus with South Korea of €3.4 billion, with exports of €7.8 billion in 2008 and imports of €4.4 billion. In terms of tariffs, South Korea and the EU will eliminate 98.7% of duties in trade value for both industrial and agricultural products within 5 years from the entry into force of the FTA. By the end of the transitional periods, duties will be eliminated on almost all products, with a few exceptions in the agricultural sector. This is the most ambitious trade coverage ever achieved in a FTA negotiated by the EU

QUESTIONS:

1. What are the objectives and contents of the recent free trade agreement signed between the European Union and South Korea?
2. Why are Japanese businessmen worried about the agreement? Why are Japanese policy-makers trying to sign a similar deal with the EU?

12.12 NOTES



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MODULE-IV
GLOBAL TRADING ENVIRONMENT

UNIT 13: GLOBALIZATION AND ITS IMPACT ON INDIAN INDUSTRY, GLOBALIZATION AND INTERNAL REFORM PROCESS

Structure:

13.0 Objectives

13.1 Introduction to Globalization

13.2 Drivers of Globalization

13.3 Impact of Globalization on Indian Industrial sector

13.4 Economic impact of globalization in India

13.5 Impact of globalization on business in India

13.6 Technological and cultural impact of globalization in India

13.7 India's problem with Globalization

13.8 Notes

13.9 Summary

13.10 Keywords

13.11 Self Assessment Questions

13.12 References

13.0 OBJECTIVES

After studying this unit, you should be able to;

- To understand the meaning and features of Globalization
- To know the objectives of Globalization
- To study the economic impact of globalization in India
- To study the technologies and cultural impact of globalization in India.

13.1 INTRODUCTION TO GLOBALIZATION

The term globalization means International Integration. Opening up of world trade, development of advanced means of communication, internationalization of financial markets, growing importance of MNC's, population migrations and more generally increased mobility of persons, goods, capital, data and ideas. It is a process through which the diverse world is unified into a single society.

Globalization refers to the process of integration of the world into one huge market. It provides several things to several people with removal of all trade barriers among countries.

Globalization happens through three channels: trade in goods & services, movement of capital and flow of finance. Globalization in India is generally taken to mean 'integrating' the economy of the country with the world economy. The real thrust to the globalization process was provided by the new economic policy introduced by the Government of India in July 1991 at the behest of the IMF and the World Bank. Globalization is the process of integrating various economies of the world without creating any hindrances in the free flow of goods and services, technology, capital and even labor or human capital.

The term globalization has, therefore, four parameters:

1. Reduction of trade barriers to permit free flow of goods and services amongnation-states;
2. Creation of environment in which free flow of capital can take place among nation-stated;
3. Creation of environment, permitting free flow of technology; and

4. Last, but not the least, from the point of view of developing countries, creationof environment in which free movement of labor can take place in differentcountries of the world.

13.2 DRIVERS OF GLOBALISATION

Various economies including the former communist and socialist countries opened their economies to the rest of the globe. The shifts in globalization and international business have been at a fast rate after 1990s. The external environmental factors have been contributing significantly for the remarkable strides in global business. The drivers of globalization/factors contributing to the globalization include establishment of WTO, emergence and growth of regional integration, decline in trade barriers, decline in investment barriers and increase in FDI, technological changes and growth of MNCs.

Establishment of World Trade Organization:

Governments of the member countries of General Agreement on Trade and Tariff (GATT) concluded the Uruguay round negotiations on the 15th December, 1994. The ministers expressed their political support to the outcome of the meeting by signing the Final Act in Marrakesh, morocco on the 15th April, 1994. According to the Marrakesh declaration, the results of the Uruguay round would, “strengthen the world economy and lead to more trade, investment, employment and income growth throughout the world”. The World Trade Organization was established with effect from 1st January, 1995 in order to facilitate the implementation, administration and operation and further the objectives of this agreement and on the Multinational Trade Agreements and shall also provide the framework for implementation, administration and operation of the Plurilateral Trade Agreements.

The value of exports increased by 487 percent and import increased by 480 percent after the establishment of WTO, i.e., during 1995 and 2013 despite the negative effect of global economic recession of 2007-2010.

♦ ***REGIONAL INTEGRATION***

The regional integration of the countries of the same region or areas increases the size of market, aggregate demand for products and services, quantity of production, employment and ultimately the economic activity of the region. Further, the people of the region get a variety of products at comparatively lower prices. This factor, in turn, enhances

the purchasing power and living standards of the people. The significant regional integrations include European Union, NAFTA, ASEAN, SAARC, EFTA, APEC, MERCOSUR and ANDEAN. These regional integrations are also known as trade blocks and are discussed in detail in chapter 12.

♦ ***DECLINING TRADE BARRIERS***

Another significant driver of globalization is the declining trade barriers. International trade occurs when the goods flow across the countries. Government used to impose trade barriers like quotas and tariffs in order to protect domestic business from the competition of international business. Advanced countries after World War II agreed to reduce tariffs in order to encourage free flow of goods. The member countries of the General Agreement on Trade and Tariff (GATT) in various rounds of negotiations agreed to reduce the tariff rates. The Uruguay round of negotiations contributed to further reduction of trade barriers and extension of GATT to cover manufactured goods and services.

Consequently, the USA reduced the rate of tariffs from 44 percent in 1913 to 14 percent in 1950, to 4.8 percent in 1990, to 4.0 percent in 2003 and further to 3.5 percent (bound) and 3.4 percent (MFN) in 2013. Similarly, Japan reduced the rate of tariff from 30 percent in 1913 to 5.3 percent in 1990 to 3.8 percent in 2003 and to 3.5 percent in 2013. France reduced from 21 percent in 1913 and to 4 percent in 2003. Germany and Sweden reduced from 20 percent in 1913 to 4 percent in 2003. Thus, most of the advanced countries reduced the tariff rates to less than 4 percent in 2013. The growth of international trade between 1950 and 2013 was about 35-fold. These reductions in tariff and other trade barriers contributed for the growth of global trade.

♦ ***DECLINING INVESTMENT BARRIERS***

Global business firms invest capital in order to establish manufacturing and other facilities in foreign countries. Foreign governments impose barriers on foreign investment in order to protect domestic industry. But various countries have been removing these barriers on foreign direct investment in order to encourage the growth of global business. Various governments made more than 1,238 changes in the laws governing foreign direct investment between 1991and 2009. Out of these amendments, more than 95 percent were in favour of foreign direct investment. In addition, bilateral treaties increased from 181 as of 1980 to 1,856 as of 2000 among 160 countries. These treaties, which were designed to promote

and protect investment among countries, enabled the fast growth of globalization of not only trade, but also production. Consequently, the global production increased by 9.5-fold between 1950 and 2009.

♦ *GROWTH IN FOREIGN DIRECT INVESTMENT*

The investment made by a company in new manufacturing and/or marketing facilities in a foreign country is referred to as Foreign Direct Investment (FDI). There are a number of reasons for the growth of FDI in recent years. These reasons include: increase in sales and profits, enter into rapidly growing markets, reduce costs, consolidate trade blocs, protect domestic markets, protect foreign markets, and acquire technological and managerial know-how.

FDI flows have increased dramatically during the last 25 years, with a rapid growth during 1990s. The outflow of FDI was more than 15 times after 1990s compared to that during 1970s. It increased from US$ 564 billion in 1980 to US$ 2,864 billion in 2008, but declined to US$ 1391 in 2012. The inflow of FDI also declined from US$ 1940.9 billion in 2007 to US$ 1351 billion in 2012. Advanced countries were the major players in the flow of FDI. They were the predominant providers and recipients of FDI as 82.21 percent of FDI was provided by advanced countries and they received 70 percent of the FDI in 2007. But the share of advanced countries in providing FDI declined from 82.21 percent in 2008 to 65.34 percent in 2012 and in receiving FDI declined from 70 percent in 2007 to 41.52 percent in 2012. It indicated that developing countries provided 34.66 percent of total FDI and received 58.48 percent of total global FDI in 2012. The USA was the largest provider as well as recipient of FDI in 2012. China was the second largest FDI receiver and Japan was the second largest provider of FDI after USA in 2012. Emerging economics are now receiving high FDI than what they received in 1980s. However, a few countries like China, Hong Kong, Brazil, Mexico, India and Singapore are receiving over 50 percent of FDI among developing countries. Growth and spread of FDI enlarged the globalization of production and marketing.

♦ *STRIDES IN TECHNOLOGY*

Technological change is amazing and phenomenal after 1980s. In fact, it is like a revolution in case of telecommunication, information technology and transportation technology. Companies spread latest technology throughout the globe and technology itself

makes the global company possible and fastness the process of globalization. In addition, the latest developments in information technology have enabled the global company to develop into a virtual global company.

Microprocessors and Telecommunications:

The development of microprocessors paved the way for the growth of high-power, superior-speed low cost computing and handling vast amount of information. These have been revolutionary changes in global telecommunications consequent upon the developments in microprocessors. The development in microprocessors and telecommunication improved the speed and efficiency of coordinating the operations of global business firms.

The Internet and World Wide Web:

The Internet and World Wide Web will be the backbone of future global business. The activities of the global companies across the globe are coordinated, monitored and controlled with the help of Internet. The various facilities of the internet and World Wide Web like e-mail; voice mail, data, and real-time video communications such as videoconferencing enable the global business companies to operate efficiently. For example, the executives of a new automobile company in India can visit the home page of the Japanese and the US automobile companies by using WWW search engine and download information on product designs, specifications, models, price, service to the customers, market information, etc. This new Indian automobile company can make use of the information in designing its cars and pricing them. Similarly people across the globe speak to each other at lowest cost using Yahoo Voice Mail, Skype, MSN voice messenger, etc.

Transportation Technology:

The significant development in transportation technology reduced the distance among the countries drastically. The important developments in the transport technology include: commercial jet aircraft, super fighters, containers, etc. These developments made the transshipment from one mode to another easy and reduced the travel time from one country to another drastically.

♦ *TRENDS IN WORLD TRADE VOLUMES AND PRICES*

World trade in terms volume increased significantly during 2010 as the growth rate of world trade in terms of volume was 12.8 percent during this period. This percentage was

7.0 percent during 1995-2004 and varied between 7.6 and 9.2 percent during 2005 and 2007. World trade in terms of value was as low as 2.7 percent in 2012. However, the world trade prices declined in 2012. In fact, world trade in terms of volume declined (-10.6 percent) in 2009 due to decline in prices (-6.7 percent) consequent upon global economic recession. The projections indicate that the volume of world trade will increase by 4.9 percent in 2014. Table 1.1 presents trends in world trade and prices during 1995 and 2014.

♦ *REGION-WISE TRENDS IN EXPORTS VOLUME*

Emerging economies recorded higher growth rate of volume of exports during 1995 to 2006 and in 2012 compared to that of advanced economies. In fact, Central and Eastern European countries recorded higher growth rate compared to that of emerging market and developing economies and advanced economies. Above all the developing Asian countries recorded highest growth rate of volume of exports except in 2012. The projections also indicate that developing Asian countries will have highest growth rate of volume of exports in 2014.

♦ *REGION-WISE TRENDS IN IMPORT VOLUME*

Central and Eastern European countries recorded higher growth rate of volume of imports during 1995 to 2006 followed by developing Asian countries compared to that of advanced economies, emerging market and developing economies and all other countries. Middle East, North African countries, Pakistan and Afghanistan recorded highest growth rate of volume of imports in 2012 followed by Commonwealth of Independent countries recorded. Projections for 2014 indicate that developing Asian countries will have highest growth rate of volume of imports in 2014.

♦ *GROWTH OF MULTINATIONAL COMPANIES*

A multinational corporation/company is an organization doing business in more than one country. Transnational company produces, markets, invests and operates across the world. MNCs and TNCs have been growing and spreading their operations due to market, financial and other superiorities and the expansion of international markets.

13.3 IMPACT OF GLOBALIZATION ON THE INDIAN INDUSTRIAL SECTOR

- **Global Prospects:-**

In recent months, the world economy has seen the emerging signs of a recovery in economic activity, particularly in the US, Japan and emerging Asia. In the US, which dominated the world growth in the previous years, the pace of growth has picked up, assisted by expansionary macroeconomic policies and supportive financial conditions. In the process, US has accumulated twin deficits –current account deficit at five per cent and fiscal account deficit at six per cent. Equity and bond markets have responded with optimism to prospects of recovery with investor interest returning to technology stocks more rapidly than to other sectors. In Japan, there are stronger signs in the third quarter that a cyclical upswing is underway, led by industrial activity and exports. In the UK and Australia, signs of recovery are clearly evident with rising household spending reflected in retail price inflation, prompting monetary authorities in these two countries to raise key policy interest rates against inflation surprises. China continues to grow at a remarkably strong pace while activity in other parts of Asia is bouncing back from the effects of SARS. There is nevertheless considerable uncertainty regarding the durability of the pick-up. Despite the prospects of stronger growth, Japan continues to experience deflation. The ongoing concerns relating to structural weaknesses in the financial system remain. In contrast to the rest of the world, the euro area remains conspicuously weak although there are tentative signs of a modest recovery in recent months. Household demand remains sluggish and the unemployment rate for the area as a whole has risen. The recent evidence through data and forward-looking indicators, particularly in financial markets, point to a strengthening of global growth outlook. IMF (World Economic Outlook, 2003) projected world output to grow by 4.1 percent in 2004 as against 3.2 percent in 2003. Recently, the IMF has upgraded its forecast of India's gross domestic product growth for 2003-04 to 7.5 percent. Its earlier projection was 7.0 percent. According to the World Bank, India could achieve eight per cent economic growth, provided the government steps up reforms, hikes investment in infrastructure and carries out major policy changes to make capital more productive and contains fiscal deficit and wasteful subsidies. Keeping in view the positive developments, the Reserve Bank of India raised its estimate for economic growth in the current fiscal year to March 2004 to seven per cent, with an upward bias, from 6.5 to 7 percent earlier. The improved prospects

for real activity globally should add strength to the upward momentum in growth. There is room at this juncture for greater optimism in growth prospects than before. The Centre for Monitoring Indian Economy (CMIE) has upped its real GDP growth forecast to 8.2 percent from its earlier forecast of 7.4 percent. NCAER projected growth in GDP at 8.1 percent for 2003-04. If one goes by these projections, India will be one of the fastest growing economies among the emerging markets.

- **Indian Growth Scenario:-**

The adverse impact of the unprecedented balance of payments crisis of 1991 was perhaps most pronounced in the case of the industrial sector, which experienced a negative growth of 0.6 per cent in 1991-92. Following the reforms and opening up of the economy, the industry bounced back shortly, with double digit growth during 1994-95 and 1995-96, and 7.1 percent in 1996-97. Indeed, primarily on the strength of industry, the GDP growth exceeded 7 percent, for the first time since Independence, for a consecutive period of three years during 1994-95 to 1996-97. However, the industrial slowdown, set in 1996-97, intensified and elongated subsequently interspersed by a brief recovery during 1999-00 and 2000-01. Finally, the signs of recovery, which were first noticed in 2002-03, have since turned stronger with 6.2 per cent growth in the current financial year so far (upto November). On the whole, the industrial growth decelerated to 6.1 per cent in the 1990s from 6.8 per cent in the 1980s. The 1990s witnessed a shift in the production structure in favour of registered manufacturing as against the unregistered manufacturing. While the share of registered manufacturing in industrial GDP increased from 38.6 per cent in 1990-91 to 41.5 per cent in 2001-02, the share of unregistered manufacturing declined from 22.5 percent to 21.6 percent during the same period. Even within registered manufacturing, traditional industries such as textile, jute and other vegetable fibre textiles witnessed a decline in their respective shares in the reform period while the modern segments like metal products and electrical machinery forged ahead. Six industry groups viz., beverages and tobacco', 'textile products', 'leather and leather products', rubber and plastic, petroleum and coal products', 'chemical and chemical products' and 'metal products and alloy industries' with a combined weight of 36 per cent in the IIP withstood the slowdown 1996-2002 while during 2002-03, 10 industry groups (notably 'food products', 'beverages and tobacco', 'transport equipment and parts' and 'textile products', etc.) witnessed an increased growth over 2001-02. A broad analysis of industrial growth during the nineties as per the use-based

classification reveals that while the consumer goods industries sustained growth momentum to some extent during the latter part of the reform period, substantial decline in growth was witnessed in basic and intermediate goods segments. The demand for these goods in the face of sustained consumption demand during 1996-97 to 2001-02 implies that industry may be undertaking inventory adjustment created by the initial phase of capacity creation and overproduction. Although production of capital goods witnessed an improved average growth during the latter phase of the reform period, a rapid decline was observed during 2000-02 onwards, indicating the impact of weakening investment demand in the economy. However, a sharp recovery in capital goods sector during 2002-03 and its sustenance during 2003-04, indicates positive investment sentiment among the producers.

- **Quality Aspects:-**

The subdued industrial growth of the 1990s, however, camouflages the qualitative transformation of the industry in the wake of India's participation in the global economy. Indeed, the post-globalisation phase has witnessed increasing resilience and immunity to shocks (RBI Annual Report 2002-03, art no. 7.2, p.118). More recently in 2002-03, the overall growth performance was not only sustained but also turned out as one of the highest in the world despite a confluence of several shocks such as border tension, severe drought, increase in international crude oil prices, SARS scare and continuing slowdown in global economic activity. In the past, a single such shock had derailed and destabilized the growth process. The contrarian recent experience, however, motivates me to move on to the qualitative aspects of industrial performance, which were attained through an assiduous process of restructuring and reengineering undertaken in the 1990s. For this purpose, I would mostly focus on the largest constituent of industrial activities, viz., manufacturing, which accounts for around 17 percent of GDP, 12 percent of total workforce, and 80 percent of merchandise exports. Besides, unlike the East Asian countries, where the manufacturing-GDP ratio declined sharply over the last decade, the same has largely sustained in India.

Globalisation transforms the industrial scenario by affecting the behaviour of the incumbent firms as also the potential entrants while providing a larger menu of choices with consumer. Therefore, the impact analysis of the qualitative aspects of industry has been attempted under the following heads: profitability, productivity, market/cost structure, corporate size/spread, and diversification.

A. Profitability:

The opening up of the economy could impact upon the industrial profitability not necessarily in a predictable fashion. As competition intensifies with globalisation, profitability takes a beating. However, competition could have a spurring effect on productivity at least in the growing sectors, which might, in turn, push up profitability. On the whole, the Indian evidence in the 1990s indicates higher profits for the factory sector, growing at 21.6 percent per annum as against 19.4 percent in the 1980s. Such trends appear to have been reinforced in the more recent period. As per a recent RBI survey, profits after tax (PAT) of the private corporate business grew by over 45.2 per cent in the first half of 2007-08 on top of 24.2 percent in the corresponding period of the previous year.

B. Productivity:

Similar to the impact on profitability, globalisation entails productivity losses in the contracting sectors and productivity gains in the expanding sectors. Generally, outward orientation performs a valuable role in developing the labour skills, technology, market experience and expertise, which can produce a sustained increase in productivity. The evidence for most Asian countries points towards a significant effect of trade liberalization on productivity (Das, 2002). Empirical studies have been equivocal on the trends in productivity in India during 1990s. This is because estimates of productivity are susceptible to the underlying assumptions about the structure of the production function and the methodology of estimation. The RBI Report on Currency and Finance 2002-03has thrown up some preliminary evidence on the decline in total factor productivity growth (TFPG) of the manufacturing sector in the 1990s. Such a decline in TFPG could be a reflection of the underlying structural and cyclical factors (Das, 2003). Among the structural factors, exit restrictions for labour and cumbersome bankruptcy procedures could have led to higher incidence of industrial sickness, adversely impacting upon the manufacturing TFPG. Furthermore, the cyclical downturn from the mid-1990s may have resulted in higher excess capacity and concomitantly, lower TFPG. At the sectoral level, however, there are evidences of improved TFPG for the exporting sectors vis-à-vis the non-exporting ones (Dholakia and Kapur, 2001; Unel, 2003). Apart from TFPG, the role of factor (capital and labour) accumulation and the corresponding productivity in the growth of manufacturing needs to be placed in perspective. While capital intensity has increased during the 1990s, growth in capital productivity in the manufacturing sector has declined vis-à-vis the previous decade.

During the 1990s, growth in fixed capital outweighed the growth in value added in most of the 17 two-digit industry groups. This has possibly led to a lower or negative capital productivity growth for the majority barring two groups, viz., wood and furniture, and chemicals. On the other hand, growth in labour productivity increased during the 1990s. Industry-wise, however, the increase was limited to a handful of six industry groups, notably, wood and furniture, chemicals, metal products and transport equipment. On the whole, labour seems to have responded flexibly vis-à-vis capital to the challenges of globalisation.

C. Cost Accounting:

In the past protected environment, Indian enterprises were not sufficiently induced to improve cost efficiency. Opening up of the economy in the 1990s has led to the adoption of new techniques, technologies and processes to ensure that costs are continually reduced (Rao, 1998). The reduction in customs duty and decontrol of many industrial goods have also facilitated easy import of cheaper raw materials and capital goods and, thereby, contributed to cost reduction. Until recently, interest payments used to have a major bearing on the cost structure of the industry. With the opening up of the economy, the industry has now access to alternative and cheaper sources of funds. The sustained policy initiatives for macro stability and structural reforms have led to a softening the domestic interest rates has been felt all the more in an integrated world. In the process, interest payments by the factory sector have decelerated to 14.5 percent during the 1990s from 18.4 percent during the 1980s. During the first half of 2003-04, interest payments by the corporate business sector have, indeed, declined by 16.8 percent over and above a decline of 10.6 percent in the corresponding period of 2002-03.

D. Exports and Industry:

Although India's exports account for less than one percent of global exports, it ranks among the top 15 countries in terms of export gains during 1985-2000 (World Investment Report, 2002). Significantly, exports-GDP ratio increased to 10 percent in 2002 from a low of 4.5 percent in the 1980s. The latest DGCIS data have placed the exports growth at 42.7 percent for December 2003. With this, the exports growth turned out to be 13.5 percent during the current financial year so far and remained above the target of 12 percent for 2003-04. The resounding achievement on the exports front even in the face of persisting appreciation of Rupee testifies that India's exports have come of age and have attained the competitive edge in the global market place. The destination pattern of India's exports has

undergone remarkable changes in the recent period whereby the importance of developing countries as an export market has considerably increased. Besides, the importance of primary products in the export basket has witnessed a steady decline and especially since the 1990s. In contrast, the technology-intensive products, in general, and engineering and petro products, in particular, have displayed dramatic improvement in the recent period.

E. Imports and Industry:

Imports, especially those of capital goods, are often taken as a leading indicator for industrial production as also of the near-term investment climate in the economy. A definite relationship between imports and industrial production, however, may be difficult to establish as imports could be either complements or substitutes to domestic industry. In the Indian case, non-oil imports, thus far, have been mostly in the form of capital goods, raw materials, and intermediate goods, which complement the industrial production. A number of recent studies have found a positive relation between industry-related imports and industrial growth (Nambiar, Mungekar and Tadas, 1999; Neogi and Ghosh, 1998). The RBI Reporton Currency and Finance 2002-03has also indicated that during April 1996 to March 2003, (i)imports had a unidirectional impact on industrial output; and (ii) both total imports and the 'select imports' positively affect industrial output as also manufacturing output with an approximate lag of four quarters. The significant growth in the net fixed capital formation and gross capital formation of the factory sector during the 1990s reflects improved absorption capacity of the industry in the post-globalisation phase. Contrary to the perceived fear in the wake of removal of quota from April 1, 2001, there has been no flood of imports so far. Indeed, 2001-02 had been the first year in more than 20 years to record a current account surplus. During the current financial year so far, non-oil imports have grown at close to 30 percent in the context of continuing industrial resurgence.

F. Market Structure:

The concentration within an industry is measured by the dominance of firms in terms of market share. The Hirschman-Herfindhal Index (HHI) is a popular measure for such purpose. The analysis of HHI for a sample of 231 four-digit level industries indicates that only 76 industries have shown an increase in concentration between 1992-93 and 2000-01.4 In contrast, 150 industries witnessed decline in concentration during this period. When the 231 industries are regrouped on the basis of identical broad categories, only four industry groups show a significant decrease in HHI. Out of 10 other broad industry groups, which

did not record a significant change in their respective HHI, 8 have witnessed a decrease while two have recorded an increase. This shows that market structure in most of the industries has become more competitive possibly with the entry of new players and the monopoly power of the top firms has somewhat eroded.

G. Market Concentration of Top Ten Companies:

Market concentration can also be examined by looking at the added up shares of the top companies in the total. Accordingly, the market share of top ten companies in terms of sales was calculated across industries. Interestingly, the market share of the top ten companies increased in industries like wholesale and retail trade, paper and paper products, jute textile, tea plantation, sugar and engineering during the 1990s as compared to the 1980s. On the other hand, the market share of the top ten companies decreased in respect of the following industries over the same period: rubber & plastic industries, cement & cement products, construction and chemical & chemical products. On the whole, the picture turned out to be mixed.

H. Corporate Size and Spread:

It is quite clear that the private corporate sector as a whole responded well to the on-going reforms. As per an NCAER study (2001), the share of smaller factories declined during the 1990s, and that of larger factories increased, which may be the result of the on-going process of mergers and acquisitions under liberalization. When compared to UK, US, Japan, South Korea and China, the share of large size industrial enterprises was found to be much higher in India (World Bank, 1989). Due to speedier urbanization during the 1990s, the spread of industries moved gradually from urban to rural areas in pursuance of economies of scale with respect to land, labour and infrastructural developments. This is reflected in enhanced invested capital in the factory sector of the rural areas at 41.0 percent in 1997-98 as against 26.2 percent in 1990-91.

I. Industrial Diversification:

The diversification of the industrial structure is generally measured by the Berry's index in the literature. As per some preliminary evidence based on the Berry's Index, the industrial diversification has not undergone much change during the 1990s. Another aspect of industrial structure is the diversification of output across the States. In a liberalized and more open economy framework, new industries are expected to be set up in States with

smaller industrial base. However, during the 1990s, skewness of industrial output across the States appears to have increased. This implies that the industrial output is getting concentrated in a few States.

J. Takeover - Domestic and Abroad:

At the time of opening up in 1991, there were apprehensions that the foreign companies would buy out the Indian ones. In reality, however, foreign companies turned out not so active in mergers and they accounted for about a third of the acquisitions between 1990-91 and 1998-99 (Basant, 1999).7 In contrast, globalization has now made it possible for Indian multinationals to take over foreign companies. For example, it is reported that Essel Packaging has taken over Propack of Switzerland to form EsselPropack, now the biggest producer of laminated tubes in the world. During the current financial year, such Indian takeovers have accelerated so much as to constitute a new trend. Not only the biggest Indian companies but also the mid-sized companies are increasingly becoming multinationals through foreign acquisitions. Thus, the brick and mortar economy, which is otherwise felt to be not so competitive, has finally caught up with the new economy in terms of acquisitions of foreign companies.

K. Impact on SSI:

SSI production decelerated to 8.2 percent during the 1990s from 11.1 percent during the 1980s. Nevertheless, the decelerated SSI growth has been in tandem with the overall manufacturing slowdown over the same period. During 2000-03, the SSI sector has reported an average growth of 7.3 percent, surpassing the overall manufacturing performance. The lifting of quantitative restrictions on imports from April 2001 does not seem to have affected the sector much as reflected in resurgence in growth in the recent period. In this regard, an ICRIER study indicates that instead of quality competition the SSI sector is faced with price competition from imports on account of inflow of certain goods through informal channels, avoiding customs duties. Nonetheless, the import competition seems to have caught on the larger SSI units. On the other hand, the small ones, being inherently flexible have promptly switched over into newer activities. Government of India introduced a large number of innovative promotional measures to uplift the growth of small scale sector. Major features of the Small Industrial policy of 1991:

1. Emphasis to shift from cheap credit to adequate credit.
2. Equity participation by other undertakings (both domestic and foreign) upto 24 percent.
3. Introducing of factoring services by banks.
4. Marketing of mass consumption goods under common brand name.
5. Setting up of sub- contracting exchanges.
6. Establishment of technology development cell.
7. Opening of quality counselling and technology information centres.
8. New technology up gradation programmes.

13.4 ECONOMIC IMPACT OF GLOBALIZATION IN INDIA

- Multilateral agreements in trade, taking on such new agendas as environmental and social conditions.
- New multilateral agreements for services, Intellectual properties, communications, and more binding on national governments than any previous agreements.
- Market economic policies spreading around the world, with greater privatization and liberalization than in earlier decades.
- Growing global markets in services. People can now execute trade services globally - from medical advice to software writing to data processing that could never really be traded before.

13.5 IMPACT OF GLOBALIZATION ON BUSINESS IN INDIA

- India has a consumer base of 1.14 billion people.
- India is the 3rd largest global telecom market. The mobile subscriber base has grown from 0.3 Million in 1996 to over 250 million currently.
- India add over 200 shopping malls in 2010 and 715 malls in 2015.
- India is the world's:

- 2nd largest two-wheeler market,
- 4th largest commercial vehicle market
- 11th largest passenger car market.

Expected to be the 7th largest automobile market by 2016.

13.6 TECHNOLOGICAL& CULTURAL IMPACT OF GLOBALIZATION IN INDIA

- Access to television grew from 20% of the urban population (1991) to 90% of the urban population (2009). Even in the rural areas satellite television has a grown up market.
- In the cities Internet facility is everywhere .Extension of internet facilities even to rural areas.
- Global food chain /restaurants has already found a huge market in the urban areas of India.
- Lavish Multiplex movie halls, big shopping malls and high rise residential are seen in every cities.
- Telecommunication and Software Industries are booming in India.
- Entertainment sector in India has a worldwide market. Bollywood movies are distributed and accepted worldwide. Big international companies (Walt Disney, 20th Century Fox, and Columbia Pictures) are investing on this sector.
- Famous International brands (Armani, Gucci, Nike, Omega etc.) are investing in the Indian market with the changing of fashion statement of Indians.

Impact of globalization on agriculture in India

- Agriculture acquired 17.4% of India's GDP in 2015.
- 60% of population still depends on agriculture for their livelihood.
- Occupied 43% of India's geographical areas.
- Agriculture Scientists are applying new technologies and instruments in growing crops.
- Different state governments of India are taking initiative to literate the farmers.

Impact of globalization on education in India

- Literacy rate in India at present is 74.04%
- Foreign Universities are collaborating with different Indian Universities.

13.7 INDIA'S PROBLEM WITH GLOBALIZATION

- Some section of people in India, basically poor and very poor, tribal groups, they did not feel the heat of globalization at all. They remain poor & poorest as they were.
- Increased gap between rich and poor fuels potential terrorist reaction.
- Ethical responsibility of business has been diminished.
- Youth group of India leaving their studies very early and joining Call centres to earn easy money thereby losing their social life after getting habituated with monotonous work.
- High growth but problem of unemployment.
- Multi party rule, hence political ideology intervenes globalization (reservation, labor law reforms).
- Price hike of every daily usable commodities.

13.8 NOTES

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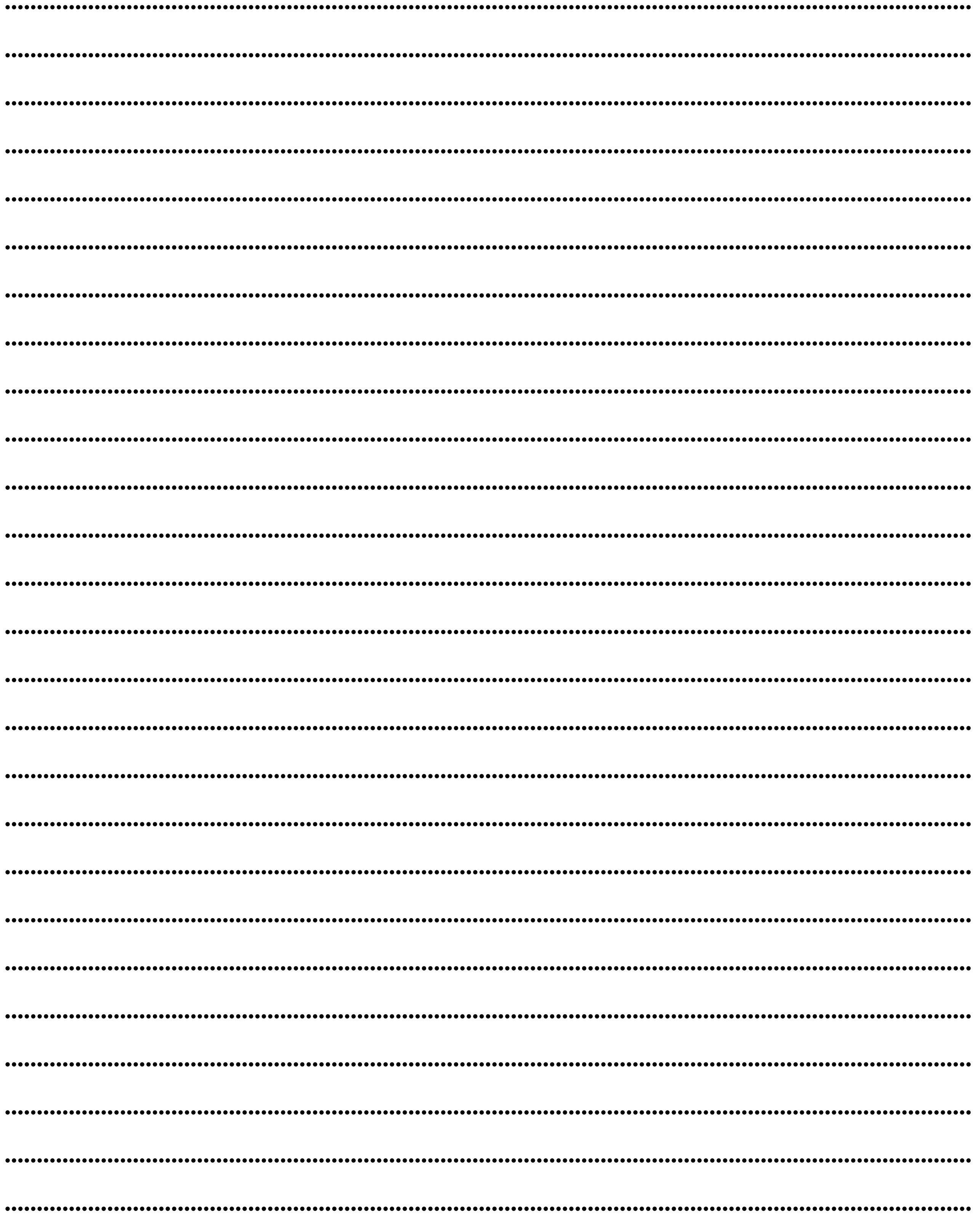

13.9 SUMMARY

India gained highly from the LPG model as its GDP increased to 9.7% in 2007-2008. In respect of market capitalization, India ranks fourth in the world. But even after globalization, condition of agriculture has not improved. The share of agriculture in the GDP is only 17%. The number of landless families has increased and farmers are still committing suicide. But seeing the positive effects of globalization, it can be said that very soon India will overcome these hurdles too and march strongly on its path of development. The lesson of recent experience is that a country must carefully choose a combination of policies that best enables it to take the opportunity - while avoiding the pitfalls. For over a century the United States has been the largest economy in the world but major developments have taken place in the world Economy since then, leading to the shift of focus from the US and the rich countries of Europe to the two Asian giants- India and China. Economics experts and various studies conducted across the globe envisage India and China to rule the world in the 21st century. India, which is now the fourth largest economy in terms of purchasing power parity, may overtake Japan and become third major economic power within 10 years. To conclude we can say that the modernization that we see around us in our daily life is a contribution of Globalization. Globalization has both positive and as well as negative impacts on various sectors of Indian Economy. So Globalization has taken us a long way from 1991 which has resultant in the advancement our country.

13.10 KEYWORDS

Globalization

DI

LPG

SSI

Market structure

Industries

Services sectors

13.11 SELF ASSESSMENT QUESTIONS

1) Globalization and its impact on Indian economy
2) Factors affecting India to adopt Globalization
3) What are the problems faced by Globalization
4) Impacts of Globalization on different sectors in India

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UNIT-14 : EXIM POLICY, GOVERNMENT SUPPORT, EXPORT INCENTIVES AND EXPORT CREDIT

Structure:

14.0 Objectives

14.1 Introduction to EXIM policy

14.2 Objectives of FTP (EXIM) policy

14.3 Same Highlights of the present FTP 2015-2020

14.4 Export Incentives

14.5 Export Credit

14.6 Export credit guarantee corporation

14.7 Notes

14.8 Summary

14.9 Keywords

14.10 Self Assessment Questions

14.11 References

14.0 OBJECTIVES

After studying this unit, you should be able to;

- To understand the meaning and features of EXIM policy
- To know the objectives of FTP
- To study the role Export incentives
- To study the functions of ECGC

14.1 INTRODUCTION TO EXIM POLICY

India's Foreign Trade Policy also known as Export Import Policy (EXIM) in general, aims at developing export potential, improving export performance, encouraging foreign trade and creating favorable balance of payments position. Foreign Trade Policy (PTP) is prepared and announced by the Central Government (Ministry of Commerce). Foreign Trade Policy or EXIM Policy is a set of guidelines and instructions established by the DGFT (Directorate General of Foreign Trade) in matters related to the import and export of goods in India.

Indian EXIM Policy contains various policy related decisions taken by the government in the sphere of Foreign Trade, i.e., with respect to imports and exports from the country and more especially export promotion measures, policies and procedures related thereto.

14.2 OBJECTIVES OF FTP (EXIM) POLICY

The main objectives are:

1. To accelerate the economy from low level of economic activities to high level of economic activities by making it a globally oriented vibrant economy and to derive maximum benefits from expanding global market opportunities.
2. To stimulate sustained economic growth by providing access to essential raw materials, intermediates, components,' consumables and capital goods required for augmenting production.
3. To enhance the techno local strength and efficiency of Indian agriculture, industry and services, thereby, improving their competitiveness.

4. To generate employment opportunities and encourage the attainment of internationally accepted standards of quality.

5. To provide quality consumer products at reasonable prices.

In the light of the above mentioned objectives, there are two broad aspects of the FTP (EXIM) Policy; the import policy which is concerned with regulation and management of imports and the export policy which is concerned with exports not only promotion but also regulation. The main objective of the Government's EXIM Policy is to promote exports to the maximum extent. Exports should be promoted in such a manner that the economy of the country is not affected by unregulated exportable items specially needed within the country. Export control is, therefore, exercised in respect of a limited number of items whose supply position demands that their exports should be regulated in the larger interests of the country.

14.3 SOME HIGHLIGHTS OF THE PRESENT FOREIGN TRADE POLICY 2015-2020

- India to be made a significant participant in world trade by 2020
- Commerce Minister announced two new schemes in Foreign Trade Policy 2015-2020Two New Schemes announced in FTP Are MEIS & SEIS. FTP 2015-20 introduces two new schemes, namely "Merchandise Exports from India Scheme (MEIS)" and "Services Exports from India Scheme (SEIS)". These schemes (MEIS and SEIS) replace multiple schemes earlier in place, each with different conditions for eligibility and usage.
- Merchandize exports from India (MEIS) to promote specific services for specific Markets Foreign Trade Policy
- For services, all schemes have been replaced by a 'Services Export from India Scheme'(SEIS), which will benefit all services exporters in India.
- FTP would reduce export obligations by 25% and give boost to domestic manufacturing
- e-Commerce of handicrafts, handlooms, books etc., eligible for benefits of MEIS. e-Commerce exports up to Rs.25000 per consignment will get SFIS benefits.
- Industrial products to be supported in major markets at rates ranging from 2% to 3%.

- Branding campaigns planned to promote exports in sectors where India has traditional Strength.
- Duty credit scrips to be freely transferable and usable for payment of customs duty, excise duty and service tax.
- Manufacturers who are also status holders will be enabled to self-certify their manufactured goods as originating from India. – Tax and duty on Indian manufacturers have been reduced, to boost Make in India vision
- Reduced Export Obligation (EO) (75%) for domestic procurement under EPCG scheme.
- Inter-ministerial consultations to be held online for issue of various licences.
- No need to repeatedly submit physical copies of documents available on Exporter Importer Profile.
- Validity period of SCOMET export authorisation extended from present 12 months to 24 months. Export obligation period for export items related to defence, military store, aerospace and nuclear energy to be 24 months instead of 18 months
- Calicut Airport, Kerala and ArakonamICDs(Inland Container Depots), Tamil Nadu notified as registered ports for import and export.
- Vishakhapatnam and Bhimavarm added as Towns of Export Excellence.
- Certificate from independent chartered engineer for redemption of EPCG authorisation no longer required.

14.4 EXPORT INCENTIVES

The Government of India has framed several schemes to promote exports and to obtain foreign exchange. These schemes grant incentives and other benefits. The few important export incentives, from the point of view of indirect taxes are briefed below:

a. Free Trade Zones (FTZ)

Several FTZs have been established at various places in India like Kandla, Noida, Cochin, etc. No excise duties are payable on goods manufactured in these zones provided they are made for export purpose. Goods being brought in these zones from different parts

of the country are brought without the payment of any excise duty. Moreover, no customs duties are payable on imported raw material and components used in the manufacture of such goods being exported.

b. Electronic Hardware Technology Park / Software Technology Parks

This scheme is just like FTZ scheme, but it is restricted to units in electronics and computer hardware and software sector.

c. Advance Licence / Duty Exemption Entitlement Scheme (DEEC)

In this scheme advance licence, either quantity based (Qbal) or value based (Vabal), is given to an exporter against which the raw materials and other components may be imported without payment of customs duty provided the manufactured goods are exported. These licences are transferable in the open market at a price.

d. Export Promotion Capital Goods Scheme (EPCG)

According to this scheme, a domestic manufacturer can import machinery and plant without paying customs duty or settling at a concessional rate of customs duty. But his undertakings should be as mentioned below:

Note:-

- NFE stands for net foreign earnings.
- CIF stands for cost plus insurance plus freight cost of the machinery.
- FOB stands for Free on Board i.e. export value excluding cost of freight and insurance.

14.5 EXPORT CREDIT

In order to be competitive in markets, exporters are often expected to offer attractive credit terms to their overseas buyers. Extending such credits to foreign buyers put considerable strain on the liquidity of the exporting firms. Therefore, it is extremely important to make adequate trade finances available to the exporters from external sources at competitive terms during the post-shipment stage.

Unless competitive trade finance is available to the exporters, they often resort to quote lower prices to compensate their inability to offer competitive credit terms. As a part of export promotion strategy, national governments around the world offer export credit, often at concessional rates to facilitate exports.

a. Export Credit in India:

In India, export credit is available both in Indian rupees and foreign currency as discussed here.

b. Export credit in Indian rupees:

The Reserve Bank of India (RBI) prescribes a ceiling rate for the rupee export credit linked to Benchmark Prime Lending Rates (BPLRs) of individual banks available to their domestic borrowers. However, the banks have the freedom to decide the actual rates to be charged with specified ceilings.

c. Pre-shipment credit:

Pre-shipment credit means any loan or advance granted by a bank to an exporter for financing the purchase, processing, manufacturing, or packing of goods prior to shipment. It is also known as packing credit. As the ultimate payment is made by the importer, his/her creditworthiness is important to the bank.

d. Period of advance:

The period of packing credit given by the bank varies on a case to case basis, depending upon the exporter's requirement for procurement, processing, or manufacturing and shipping of goods. Primarily, individual banks decide the period of packing credit for exports.

e. Liquidation of packing credit:

The pre-shipment credit granted to an exporter is liquidated out of the proceeds of the bills drawn for the exported commodities on its purchases, discount, etc., thereby converting pre-shipment credit to post-shipment credit.

f. Post-shipment credit:

Post-shipment credit means any loan or advance granted or any other credit provided by a bank to an exporter of goods from the date of extending credit after shipment of goods to the date of realization of export proceeds. It includes any loan or advance granted to an exporter, in consideration of any duty drawback allowed by the government from time to time.

g. Export credit in foreign currency:

In order to make credit available to the exporters at internationally competitive rates, banks (authorized dealers) also extend credit in foreign currency' (Exhibit 15.3) at LIBOR

(London Interbank Offered Rates), EURO LIBOR (London Interbank Offered Rates dominated in Euro), or EURIBOR (Euro Interbank Offered Rates).

LIBOR is a daily reference rate based on the interest rates at which banks offer to lend unsecured funds to other banks in the London wholesale (or 'interbank') money market. The rate paid by one bank to another for a deposit is known as London Interbank Bid Rate (LIBID).

h. Pre-shipment credit in foreign currency:

To enable the exporters to have operational flexibility, banks extend pre-shipment credit in foreign currency (PCFC) in any one of the convertible currencies, such as US dollars, pound sterling, Japanese yen, euro, etc., in respect to an export order invoiced in another convertible currency.

For instance, an exporter can avail of PCFC in US dollars against an export order invoiced in euro. However, the risk and cost of cross-currency transaction are that of the exporter.

Under this scheme, the exporters have the following options to avail export finance:

i. To avail of pre-shipment credit in rupees and then the post-shipment credit either in rupees or discounting/re-discounting of export bills under Export Bills Abroad (EBR) scheme

ii. To avail of pre-shipment credit in foreign currency and discount/rediscounting of the export bills in foreign currency under EBR scheme

iii. To avail of pre-shipment credit in rupees and then convert at the discretion of the bank

Banks are also permitted to extend PCFC for exports to Asian Currency Union (ACU) countries. The applicable benefit to the exporters accrues only after the realization of the export bills or when the resultant export bills are rediscounted on 'without recourse' basis. The lending rate to the exporter should not exceed 1.0 percent over LIBOR, EURO LIBOR, or EURIBOR, excluding withholding tax.

Post-shipment credit in foreign currency:

The exporters also have options to avail post-shipment export credit either in foreign currency or domestic currency. However, the post-shipment credit has also to be in foreign

currency if the pre-shipment credit has already been availed in foreign currency so as to liquidate the pre-shipment credit.

Normally, the scheme covers bills with usance period up to 180 days from the date of shipment. However, RBI approval needs to be obtained for longer periods. Similar to the PCFC scheme, post-shipment credit can also be obtained in any convertible currency. However, most Indian banks provide credit in US dollars.

Export Finance to Overseas Importers:

Generally, commercial banks extend exports credit, often at concessional rates, to finance export transactions to the exporters as a part of their export promotion measures. In addition, credit is also available to overseas buyers so as to facilitate import of goods from India, mainly under two forms:

Buyer's credit:

It is a credit extended by a bank in exporter's country to an overseas buyer, enabling the buyer to pay for machinery and equipment that s/he may be importing for a specific project.

Line of credit:

It is a credit extended by a bank in exporting country (for example, India) to an overseas bank, institution, or government for the purpose of facilitating the import of a variety of listed goods from the exporting country (India) into the overseas country. A number of importers in the foreign country may be importing the goods under one line of credit.

Commercial banks carry out the task of export financing under the guidelines of the central bank (for example Reserve Bank of India). The export financing regulations are modified from time to time. Most countries have an apex bank coordinating the country's efforts of financing international trade.

For instance, the Export-Import Bank of India is the principal financial institution coordinating the working of institutions engaged in export import finance in India, whereas the US too has the Export-Import Bank of the US for carrying out similar activities.

Credit Risk Insurance in Export Finance:

Easy and hassle-free access to export finance significantly enhances firms' abilities to compete in international markets. Prior to agreeing to finance a firm's export transactions,

banks need to be assured of the ability of the borrowers to repay the loan. Generally, banks insist on pleading adequate collateral before sanctioning export finance.

The major commercial risks in international trade transactions are as follows:

i. Non-payment by the importer at the end of the credit period or after some specified period after the expiry of credit term

ii. Non-acceptance of goods by the importer despite of its compliance with the export contract

iii. Insolvency of the purchaser

It has been observed that commercial risks have resulted in more losses in international transactions compared to political risks. Credit risk insurance provides protection to exporters who sell their goods on credit terms. It covers both political and commercial risks. Credit insurance also facilitates exporters in getting export finances from commercial banks.

The benefits provided by credit insurance to the exporters are:

i. Exporters can offer competitive payment terms to their buyers.

ii. It protects the exporters against the risk and financial costs of non-payment.

iii. Exporters also get covered against further losses from fluctuations in foreign exchange rates after the non-payment.

iv. It provides exporters a freer access to working capital.

v. The insurance cover reduces exporters' need for tangible security while negotiating credit with their banks.

14.6 EXPORT CREDIT GUARANTEE CORPORATION

Export Credit Guarantee Corporation (ECGC) of India, established in 1957 by the Government of India is the principal organization for promoting exports by covering the risks of exporting on credit. It functions under the administrative control of the Ministry of Commerce. ECGC is the world's fifth largest credit insurer in terms of coverage of national exports.

The ECGC mainly:

i. Provides a range of credit risk insurance covers to exporters against loss in export of goods and services

ii. Offers guarantees to banks and financial institutions to enable exporters obtain better facilities from them

iii. Provides overseas investment insurance to Indian companies investing in joint ventures abroad in the form of equity or loan.

14.7 NOTES

14.8 SUMMARY

What prescriptive conclusions may then be drawn regarding the optimal foreign trade strategy to be followed by developing countries? The issue of the appropriate foreign trade strategy was posed as early as the 1950s by some of the leading international economists of the day, with RagnarNurkse arguing for what would be described today as the import-substituting strategy on the grounds of elasticity pessimism and Gottfried Haberler, Jacob Viner, and others arrayed on the other side in favor of what might be described currently as the export-promoting strategy) Interestingly, Alex Cairncross, in reviewing the relative arguments of Nurkse and Haberler had ended on a somewhat neutral note between these two strategies, appealing for a verdict from empirical evidence in the following terms: At the end of it all, the reader may still feel that neither Nurkse nor Haberler has settled the primary issue: how far a shortage of foreign exchange (contrasted with capital, skilled labour, land, etc.) is a limiting factor in economic development. The majority of the under-developed countries are monocultures, dependent for their earnings of foreign exchange on a single commodity (or at most two or three). These earnings are highly inelastic except when exports of the principal commodity form a small fraction of the world's consumption. At the same time, nearly all the plant and machinery that they require has to be imported, so that the scale of industrial investment is limited by the foreign exchange available to pay for it. In those circumstances, what should be the policy of a country seeking to accelerate its development? We know what most countries have done; it would be interesting if we could be told, by an economist of the standing of Nurkse or Haberler, what the results have been and what they should have done.

14.9 KEYWORDS

EXIM policy

FTP

Export credit

Export incentives

ECGC

14.10 SELF ASSESSMENT QUESTIONS

1) Briefly explain the EXIM policy of India
2) What are the outcomes of EXIM policy of India
3) ECGC and other schemes for encouraging Export
4) Export credits.

14.11 REFERENCES

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UNIT-15: INSURANCE AND MARINE INSURANCE

Structure:

15.0 Objectives

15.1 Introduction to Insurance

15.2 Functions of Insurance

15.3 Principles of Insurance

15.4 Types of Insurance

15.5 Marine Insurance

15.6 Features of Marine Insurance

15.7 Operation of Marine Insurance

15.8 Notes

15.9 Summary

15.10 Keywords

15.11 Self Assessment Questions

15.12 References

15.0 OBJECTIVES

After studying this unit, you should be able to;

- To understand the meaning and features of Insurance
- To know the principles of Insurance
- To study the role Marine Insurance
- To study the Operation of Marine Insurance

15.1 INTRODUCTION TO INSURANCE

INSURANCE

Life is full of uncertainties. The chances of occurrence of an event causing losses are quite uncertain. There are risks of death and disability for human life; fire and burglary risk for property; perils of the sea for shipment of goods and, so on. If any of these takes place, the individuals and/or, organisations may suffer a great loss, sometimes beyond their capacities to bear the same. It is to minimize the impact of such uncertainties that there is a need for insurance. Investment in factory buildings or heavy equipments or other assets is not possible unless there is arrangement for covering the risks, with the help of insurance. Keeping this in mind, people facing common risks come together and make small contributions to a common fund, which helps to spread the loss caused to an individual by a particular risk over a number of persons who are exposed to it. Insurance is thus a device by which the loss likely to be caused by an uncertain event is spread over a number of persons who are exposed to it and who prepare to insure themselves against such an event. It is a contract or agreement under which one party agrees in return for a consideration to pay an agreed amount of money to another party to make a loss, damage or injury to something of value in which the insured has a pecuniary interest as a result of some uncertain event. The agreement/contract is put in writing and is known as 'policy'. The person whose risk is insured is called 'insured' and the firm which insures the risk of loss is known as insurer/ assurance underwriter.

15.2 FUNCTIONS OF INSURANCE

The various functions of insurance are as follows:

(i) Providing certainty:

Insurance provides certainty of payment for the risk of loss. There are uncertainties of happenings of time and amount of loss. Insurance removes these uncertainties and the assured receives payment of loss. The insurer charges premium for providing the certainty.

(ii) Protection:

The second main function of insurance is to provide protection from probable chances of loss. Insurance cannot stop the happening of a risk or event but can compensate for losses arising out of it.

(iii) Risk sharing:

On the happening of a risk event, the loss is shared by all the persons exposed to it. The share is obtained from every insured member by way of premiums.

(iv) Assist in capital formation:

The accumulated funds of the insurer received by way of premium payments made by the insured are invested in various income generating schemes.

15.3 PRINCIPLES OF INSURANCE

The principles of insurance are the rules of action or conduct adopted by the stakeholders involved in the insurance business. The specific principle of utmost significance to a valid insurance contract consists of the following:

(i) Utmost good faith:

A contract of insurance is a contract of *uberrimae fidei* i.e., a contract found on utmost good faith. Both the insurer and the insured should display good faith towards each other in regard to the contract. It is the duty of the insured to voluntarily make full, accurate disclosure of all facts, material to the risk being proposed and the insurer to make clear all the terms and conditions in the insurance contract. Thus, it is binding on the proposer to disclose all material facts about the subject matter of the proposed insurance. Any fact, which is likely to affect the mind of a prudent insurer in deciding to accept the proposal of

insurance or in fixing the rate of premium is material for this purpose. Failure to make disclosure of material facts by the insured makes the contract of insurance voidable at the discretion of the insurer.

(ii) Insurable Interest:

The insured must have an insurable interest in the subject matter of insurance. One fundamental fact of this principle is that 'it is not the house, ship, machinery, potential liability of life that is insured, but it is the pecuniary interest of the insured in them, which is insured.' Insurable interest means some pecuniary interest in the subject matter of the insurance contract. The insured must have an interest in the preservation of the thing or life insured, so that he/she will suffer financially on the happening of the event against which he/she is insured. In case of insurance of property, insurable interest of the insured in the subject matter of the insurance must exist at the time of happening of the event. In order to name insurable interest however, it is not necessary that one should be the owner of the property. For example, a trustee holding property on behalf of others has an insurable interest in the property.

(iii) Indemnity:

All insurance contracts of fire or marine insurance are contracts of indemnity. According to it, the insurer undertakes to put the insured, in the event of loss, in the same position that he occupied immediately before the happening of the event insured against. In other words the insurer undertakes to compensate the insured for the loss caused to him/her due to damage or destruction of property insured. The compensation payable and the loss suffered are to be measured in terms of money. The principle of indemnity is not applicable to life insurance.

(iv) Proximate Cause:

According to this principle, an insurance policy is designed to provide compensation only for such losses as are caused by the perils which are stated in the policy. When the loss is the result of two or more causes, the proximate cause means the direct, the most dominant and most effective cause of which the loss is the natural consequence. In case of loss arising out of any mishap, the most proximate cause of the mishap should be taken into consideration.

(v) Subrogation:

It refers to the right of the insurer to stand in the place of the insured, after settlement of a claim, as far as the right of insured in respect of recovery from an alternative source is involved. After the insured is compensated for the loss or damage to the property insured by him/her the right of ownership of such property passes on to the insurer. This is because the insured should not be allowed to make any profit, by selling the damaged property or in the case of lost property being recovered.

(vi) Contribution:

As per this principle it is the right of an insurer who has paid claim under insurance, to call upon other liable insurers to contribute for the loss of payment. It implies, that in case of double insurance, the insurers are to share the losses in proportion to the amount assured by each of them. In case there is a loss, when there is more than one policy on the same property, the insured will have no right to recover more than the full amount

of his actual loss. If the full amount is recovered from one insurer the right to obtain further payment from the other insurer will cease.

vii) Mitigation:

This principle states that it is the duty of the insured to take reasonable steps to minimise the loss or damage to the insured property. Suppose goods kept in a store housecatch fire then the owner of the goods should try to recover the goods and save them from fire to minimise the loss or damage. The insured must behave with great prudence and notbe careless just because there is an insurance cover. If reasonable care is not taken like any prudent person then the claim from the insurance company may be lost.

15.4 TYPES OF INSURANCE

Various types of insurance exist by virtue of practice of insurance companies and the influence of legal enactments controlling the insurance business. Broadly speaking, insurance may be classified as follows:

LIFE INSURANCE

Since life itself is uncertain, all individuals try to assure themselves of a certain sum of money in the future to take care of unforeseen events or happenings. Individuals in the

course of their life are always exposed to some kind of risks. The risk may be of an event which is certain that is death. In that case, what will happen to the other members of the family who are dependent on a particular individuals income. The other risk may be living too long in which an individual may become too old to earn i.e., retirement. In this case also, the earnings will decline or end. Under such circumstances, individuals seek protection against these risks and life insurance companies offer protection against such risks. A life insurance policy was introduced as a protection against the uncertainity of life. But gradually its scope has widened and there are various types of insurance policies available to suit the requirements of an individual. For example, disability insurance, health/medical insurance,annuity insurance and life insurance proper.

Life insurance may be defined as a contract in which the insurer in consideration of a certain premium, either in a lump sum or by other periodical payments, agrees to pay to the assured, or to the person for whose benefit the policy is taken, the assured sum of money, on the happening of a specified event contingent on the human life or at the expiry of certain period. Thus, the insurance company undertakes to insure the life of a person in exchange for a sum of money called premium. This premium may be paid in one lump sum, or periodically i.e., monthly, quarterly, half yearly or yearly. At the same time, the company promises to pay a certain sum of money either on the death of the person or on his attaining a certain age (i.e., the expiry of certain period). Thus, the person is sure that a specified amount will be given to him when he attains a certain age or that his dependents will get that sum in the event of his death.

This agreement or contract which contains all the terms and conditions is put in writing and such document is called the policy. The person whose life is insured is called the assured. The insurance company is the insurer and the consideration paid by the assured is the premium. The premium can be paid periodically in instalments. This insurance provides protection to the family at the premature death or gives adequate amount at old age when earning capacities are reduced. The insurance is not only a protection but is a sort of investment because a certain sum is returnable to the insured at the time of death or at the expiry of a certain period.

Life insurance also encourages savings as the amount of premium has to be paid regularly. It thus, provides a sense of security to the insured and his dependents.

The general principles of insurance discussed in the previous section apply to life insurance also with a few exceptions. The main elements of a life insurance contract are:

(i) The life insurance contract must have all the essentials of a valid contract. Certain elements like offer and acceptance, free consent, capacity to enter into a contract, lawful consideration and lawful object must be present for the contract to be valid;

(ii) The contract of life insurance is a contract of utmost good faith. The assured should be honest and truthful in giving information to the insurance company. He must disclose all material facts about his health to the insurer. It is his duty to disclose accurately all material facts known to him even if the insurer does not ask him;

(iii) In life insurance, the insured must have insurable interest in the life assured. Without insurable interest the contract of insurance is void. In case of life insurance, insurable interest must be present at the time when the insurance is affected. It is not necessary that the assured should have insurable interest at the time of maturity also. For example, a person is presumed to have an interest in his own life and every part of it, a creditor has an insurable interest in the life of his debtor, and a proprietor of a drama company has an insurable interest in the lives of the actors;

(iv) Life insurance contract is not a contract of indemnity. The life of a human being cannot be compensated and only a specified sum of money is paid. That is why the amount payable in life insurance on the happening of the event is fixed in advance. The sum of money payable is fixed, at the time of entering into the contract. A contract of life insurance, therefore, is not a contract of indemnity.

Types of life insurance policies

The document containing the written contract between the insurer and the insured along with the terms and conditions of insurance is called the Policy. After the proposal form is filled by the insured (or the proposer) and the insurer (insurance company) accepts the form and the premium, a policy is issued to the insurer. People have different requirements and therefore they would like a policy to fulfill all their needs. The needs of people for life insurance can be family needs, children's needs, old age and special needs. To meet the needs of people the insurers have developed different types of products such as Whole Life Assurance, Endowment type plans, combination of Whole Life and Endowment type plans, Children's Assurance plans and Annuity plans. Some of these are explained below:

(i) Whole Life Policy:

In this kind of policy, the amount payable to the insured will not be paid before the death of the assured. The sum then becomes payable only to the beneficiaries or heir of the deceased. The premium will be payable for a fixed period (20 or 30 years) or for the whole life of the assured. If the premium is payable for a fixed period, the policy will continue till the death of the assured.

(ii) Endowment Life Assurance Policy:

The insurer (Insurance Company) undertakes to pay a specified sum when the insured attains a particular age or on his death whichever is earlier. The sum is payable to his legal heir/s or nominee named therein in case of death of the assured. Otherwise, the sum will be paid to the assured after a fixed period i.e. till he/ she attains a particular age. Thus, the endowment policy matures after a limited number of years.

(iii) Joint Life Policy:

This policy is taken up by two or more persons. The premium is paid jointly or by either of them in instalments or lump sum. The assured sum or policy money is payable upon the death of any one person to the other survivor or survivors. Usually this policy is taken up by husband and wife jointly or by two partners in a partnership firm where the amount is payable to the survivor on the death of either of the two.

(iv) Annuity Policy:

Under this policy, the assured sum or policy money is payable after the assured attains a certain age in monthly, quarterly, half yearly or annual instalments. The premium is paid in instalments over a certain period or single premium may be paid by the assured. This is useful to those who prefer a regular income after a certain age.

(v) Children's Endowment Policy:

This policy is taken by a person for his/ her children to meet the expenses of their education or marriage. The agreement states that a certain sum will be paid by the insurer when the children attain a particular age. The premium is paid by the person entering into the contract. However, no premium will be paid, if he dies before the maturity of the policy.

FIRE INSURANCE

Fire insurance is a contract whereby he insurer, in consideration of the premium paid, undertakes to make good any loss or damage caused by fire during a specified period upto the amount specified in the policy. Normally, the fire insurance policy is for a period of one year after which it is to be renewed from time to time. The premium may be paid either in lump sum or instalments. A claim for loss by fire must satisfy the two following conditions:

(i) There must be actual loss; and

(ii) Fire must be accidental and non-intentional.

The risk covered by a fire insurance contract is the loss resulting from fire or some other cause, and which is the proximate cause of the loss. If overheating without ignition causes damage, it will not be regarded as a fire loss within the meaning of fire insurance and the loss will not be recoverable from the insurer.

A fire insurance contract is based on certain fundamental principles which have been discussed in general principles. The main elements of a fire insurance contract are:

(i) In fire insurance, the insured must have insurable interest in the subject matter of the insurance. Without insurable interest the contract of insurance is void. In case of fire insurance, unlike life insurance insurable interest must be present both at the time of insurance and at the time of loss. For example, a person has insurable interest in the property he owns, a businessman has insurable interest in his stock, plant, machinery and building, an agent has an insurable interest in the property of his principal, a partner has insurable interest in the property of a partnership firm, and a mortgagee has insurable interest in the property, which is mortgaged.

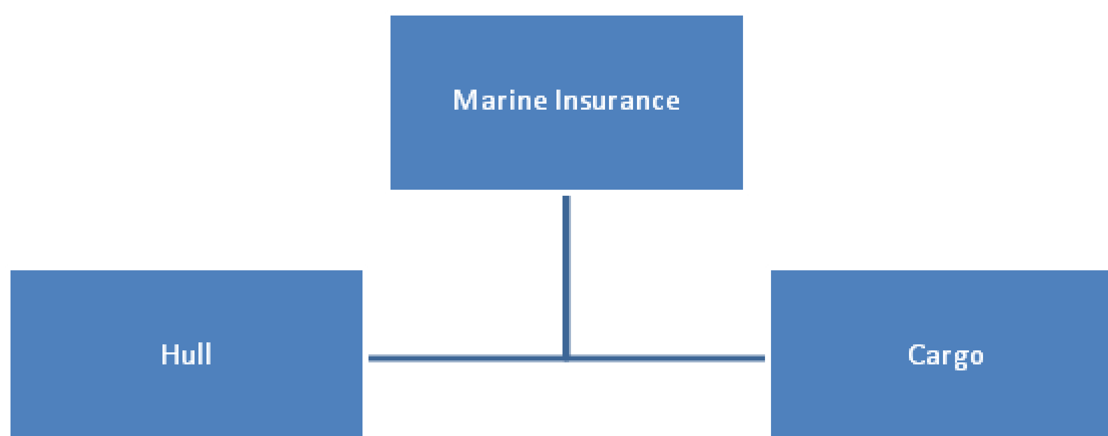
(ii) Similar to the life insurance contract, the contract of fire insurance is a contract of utmost good faith i.e., *uberrimae fidei*. The insured should be truthful and honest in giving information to the insurance company regarding the subject matter of the insurance. He is duty-bound to disclose accurately all facts regarding the nature of property and risks attached to it. The insurance company should also disclose the facts of the policy to the proposer.

(iii) The contract of fire insurance is a contract of strict indemnity. The insured can, in the event of loss, recover the actual amount of loss from the insurer. This is subject to the maximum amount for which the subject matter is insured. For example, if a person has insured his house for Rs. 4,00,000 the insurer is not necessarily liable to pay that amount, although the house may have been totally destroyed by fire; but he will pay the actual loss after deducting depreciation within the maximum limit of Rs. 4,00,000. The purpose being that a person should not be allowed to gain by insurance.

(iv) The insurer is liable to compensate only when fire is the proximate cause of damage or loss.

15.5 MARINE INSURANCE

This is the oldest branch of Insurance and is closely linked to the practice of Bottomry which has been referred to in the ancient records of Babylonians and the code of Hammurabi way back in B.C.2250. Manufacturers of goods advanced their material to traders who gave them receipts for the materials and a rate of interest was agreed upon. If the trader was robbed during the journey, he would be freed from the debt but if he came back, he would pay both the value of the materials and the interest. The first known Marine Insurance agreement was executed in Genoa on 13/10/1347 and marine Insurance was legally regulated in 1369 there.



MEANING OF MARINE INSURANCE

A contract of marine insurance is an agreement whereby the insurer undertakes to indemnify the insured, in the manner and to the extent thereby agreed, against transit losses, that is to say losses incidental to transit.

A contract of marine insurance may by its express terms or by usage of trade be extended so as to protect the insured against losses on inland waters or any land risk which may be incidental to any sea voyage.

In simple words the marine insurance includes

A. Cargo insurance which provides insurance cover in respect of loss of or damage to goods during transit by rail, road, sea or air.

Thus cargo insurance concerns the following:

1. export and import shipments by ocean-going vessels of all types,
2. coastal shipments by steamers, sailing vessels, mechanized boats, etc.,
3. shipments by inland vessels or country craft, and
4. consignments by rail, road, or air and articles sent by post.

B. Hull insurance which is concerned with the insurance of ships (hull, machinery, etc.).

15.6 FEATURES OF MARINE INSURANCE

1) Offer & Acceptance:

It is a prerequisite to any contract. Similarly the goods under marine (transit) insurance will be insured after the offer is accepted by the insurance company. Example: A proposal submitted to the insurance company along with premium on 1/4/2011 but the insurance company accepted the proposal on 15/4/2011. The risk is covered from 15/4/2011 and any loss prior to this date will not be covered under marine insurance.

2) Payment of premium:

An owner must ensure that the premium is paid well in advance so that the risk can be covered. If the payment is made through cheque and it is dishonored then the coverage of risk will not exist. It is as per section 64VB of Insurance Act 1938- Payment of premium in advance.(Details under insurance legislation Module).

3) Contract of Indemnity:

Marine insurance is contract of indemnity and the insurance company is liable only to the extent of actual loss suffered. If there is no loss there is no liability even if there is operation of insured peril. Example: If the property under marine (transit) insurance is insured for Rs 20 lakhs and during transit it is damaged to the extent of Rs 10 lakhs then the insurance company will not pay more than Rs 10 lakhs.

4) Utmost good faith:

The owner of goods to be transported must disclose all the relevant information to the insurance company while insuring their goods. The marine policy shall be voidable at the option of the insurer in the event of misrepresentation, mis-description or non-disclosure of any material information. Example: The nature of goods must be disclosed i.e whether the goods are hazardous in nature or not, as premium rate will be higher for hazardous goods.

5) Insurable Interest:

The marine insurance will be valid if the person is having insurable interest at the time of loss. The insurable interest will depend upon the nature of sales contract. Example: Mr A sends the goods to Mr B on FOB(Free on Board) basis which means the insurance is to be arranged by Mr B. And if any loss arises during transit then Mr B is entitled to get the compensation from the insurance company.

Example: Mr A sends the goods to Mr B on CIF (Cost, Insurance and Freight) basis which means the insurance is to be arranged by Mr A. And if any loss arises during transit then Mr A is entitled to get the compensation from the insurance company.

6) Contribution:

If a person insures his goods with two insurance companies, then in case of marine loss both the insurance companies will pay the loss to the owner proportionately. Example; Goods worth Rs. 50 lakhs were insured for marine insurance with Insurance company A and B. In case of loss, both the insurance companies will contribute equally.

7) Period of marine Insurance:

The period of insurance in the policy is for the normal time taken for a particular transit. Generally the period of open marine insurance will not exceed one year. It can also be issued for the single transit and for specific period but not for more than a year.

8) Deliberate Act:

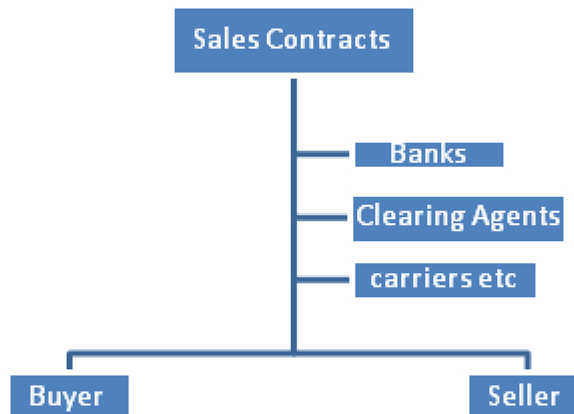
If goods are damaged or loss occurs during transit because of deliberate act of an owner then that damage or loss will not be covered under the policy.

9) Claims:

To get the compensation under marine insurance the owner must inform the insurance company immediately so that the insurance company can take necessary steps to determine the loss.

15.7 OPERATION OF MARINE INSURANCE

Marine insurance plays an important role in domestic trade as well as in international trade. Most contracts of sale require that the goods must be covered, either by the seller or the buyer, against loss or damage.Who is responsible for affecting insurance on the goods, which are the subject of sale? It depends on the terms of the sale contract. A contract of sale involves mainly a seller and a buyer,apart from other associated parties like carriers, banks, clearing agents, etc.



The principal types of sale contracts, so far as Marine insurance is directly concerned, are as follows:

Type of contract	Responsibility for insurance
Free on Board(F.O.B. Contract)	The seller is responsible till the goods are placed on board the steamer. The buyer is responsible thereafter. He can get the insurance done wherever he likes.
Free on Rail (F.O.R. Contract)	The provisions are the same as in above. This is mainly relevant to internal transactions.
Cost and Freight (C&F Contract)	Here also, the buyer's responsibility normally attaches once the goods are placed on board. He has to take care of the insurance from that point onwards.
Cost, Insurance & Freight (C.I.F. Contract)	In this case, the seller is responsible for arranging the insurance up to destination. He includes the premium charge as part of the cost of goods in the sale invoice.

Practice in International trade

The normal practice in export /import trade is for the exporter to ask the importer to open a letter of credit with a bank in favour of the exporter. As and when the goods are ready for shipment by the exporter, he hands over the documents of title to the bank and gets the bill of exchange drawn by him on the importer, discounted with the bank. In this process, the goods which are the subject of the sale are considered by the bank as physical security against the monies advanced by it to the exporter. A further security by way of an insurance policy is also required by the bank to protect its interests in the event of the goods suffering loss or damage in transit, in which case the importer may not make the payment. The terms and conditions of insurance are specified in the letter of credit.

For export/import policies, the-Institute Cargo Clauses (I.C.C.) are used. These clauses are drafted by the Institute of London Underwriters (ILU) and are used by insurance companies in a majority of countries including India.

PROCEDURE TO INSURE UNDER MARINE INSURANCE

A) Submission of form

B) Quotation from the Insurance Company

C) Payment of Premium

D) Issue of cover note/Policy

A) Submission of form

a. The form will have the following information:

b. Name of the shipper or consignor (the insured).

c. Full description of goods to be insured:

The nature of the commodity to be insured is important for rating and underwriting. Different types of commodities are susceptible for different types of damage during transit-sugar, cement, etc are easily damaged by sea water; cotton is liable to catch fire; liquid cargoes are susceptible to the risk of leakage and crockery, glassware to breakage; electronic items are exposed to the risk of theft, and so on.

d. Method and type of packing:

The possibility of loss or damage depends on this factor. Generally, goods are packed in bales or bags, cases or bundles, crates, drums or barrels, loose packing, paper or cardboard cartons, or in bulk etc.

e. Voyage and Mode of Transit:

Information will be required on the following points :

i. the name of the place from where transit will commence and the name of the place where it is to terminate.

ii. mode of conveyance to be used in transporting goods, (i.e.) whether by rail, lorry, air, etc., or a combination of two or more of these. The name of the vessel is to be given when an overseas voyage is involved. In land transit by rail, lorry or air, the number of

the consignment note and the date there of should be furnished. The postal receipt number and date thereof is required in case of goods sent by registered post.

iii. If a voyage is likely to involve a trans-shipment it enhances the risk. This fact should be informed while seeking insurance. Trans-shipment means the change of carrier during the voyage.

f. Risk Cover required:

The risks against which insurance cover is required should be stated. The details of risks are discussed subsequently in this chapter.

B) Quotation by insurance company

Based on the information provided as above the insurance company will quote the premium rate. In nutshell, the rates of premium depends upon :

a. Nature of commodity.

b. Method of packing.

c. The Vessel.

d. Type of insurance policy.

C) Payment of premium

On accepting the premium rates, the concerned person will make the payment to the insurance company. The payment can be made on the consignment basis.

D) Issue of cover note /Policy document

a. Cover Note

A cover note is a document granting cover provisionally pending the issue of a regular policy. It happens frequently that all the details required for the purpose of issuing a policy are not available. For instance, the name of the steamer, the number and date of the railway receipt, the number of packages involved in transit, etc., may not be known.

b. Marine Policy

This is a document which is an evidence of the contract of marine insurance. It contains the individual details such as name of the insured, details of goods etc. These have been identified earlier. The policy makes specific reference to the risks covered. A policy covering a single shipment or consignment is known as specific policy.

3. Open Policy

An open policy is also known as 'floating policy'. It is worded in general terms and is issued to take care of all "shipments" coming within its scope. It is issued for a substantial amount to cover shipments or sending during a particular period of time. Declarations are made under the open policy and these go to reduce the sum insured. Open policies are normally issued for a year. If they are fully declared before that time, a fresh policy may be issued, or an endorsement placed on the original policy for the additional amount. On the other hand, if the policy has run its normal period and is cancelled, a proportionate premium on the unutilised balance is refunded to the insured if full premium had been earlier collected. On receipt of each declaration, a separate certificate of insurance is issued. An open policy is a stamped document, and, therefore, certificates of insurance issued thereunder need not be stamped. Open policies are generally issued to cover inland consignments.

There are certain advantages of an open policy compared to specific policies. These are:

i. Automatic and continuous insurance protection.

ii. Clerical labour is considerably reduced.

iii. Some saving in stamp duty. This may be substantial, particularly in the case of inland sendings.

d. Open Cover

An open cover is particularly useful for large export and import firms-making numerous regular shipments who would otherwise find it very inconvenient to obtain insurance cover separately for each and every shipment. It is also possible that through an oversight on the part of the insured a particular shipment may remain uncovered and should a loss arises in respect of such shipment; it would fall on the insured themselves to be borne by them. In order to overcome such a disadvantage, a permanent form of insurance protection by means of an open cover is taken by big firms having regular shipments.

An open cover describes the cargo, voyage and cover in general terms and takes care automatically of all shipments which fall within its scope. It is usually issued for a period of 12 months and is renewable annually. It is subject to cancellation on either side, i.e., the insurer or the insured, by giving due notice.

Since no stamps are affixed to the open cover, specific policies or certificates of insurance are issued against declaration and they are required to be stamped according to the Stamp Act.

There is no limit to the total number or value of shipments that can be declared under the open cover.

The following are the important features of an open policy/ open cover.

(a) Limit per bottom or per conveyance

The limit per bottom means that the value of a single shipment declared under the open cover should not exceed the stipulated amount.

(b) Basis of Valuation

The 'Basis' normally adopted is the prime cost of the goods, freight and other charges incidental to shipment, cost of insurance, plus 10% to cover profits, (the percentage to cover profits may be sometimes higher by prior agreement with the clients).

(c) Location Clause

While the limit per bottom mentioned under (a) above is helpful in restricting the commitment of insurers on any one vessel, it may happen in actual practice that a number of different shipments falling under the scope of the open cover may accumulate at the port of shipment. The location clause limits the liability of the insurers at any one time or place before shipment. Generally, this is the same limit as the limit per bottom or conveyance specified in the cover, but sometimes it may be agreed at an amount, say, upto 200% thereof.

(d) Rate

A schedule of agreed rates is attached to each open cover.

(e) Terms

There may be different terms applying to different commodities covered under the open cover, and they are clearly stipulated.

(f) Declaration Clause

The insured is made responsible to declare each and every shipment coming within the scope of the open cover. An unscrupulous insured may omit a few declarations to save premium, especially when he knows that shipment has arrived safely. Hence the clause.

(g) Cancellation Clause

This clause provides for cancellation of the contract with a certain period of notice, e.g., a month's notice on either side. In case of War & S.R.C.C. risks, the period of notice is much shorter.

Distinction between "Open policy" and "Open cover"

The open policy differs from an open cover in certain important respects. They are:

(a) The open policy is a stamped document and is, therefore, legally enforceable in itself, whereas an open cover is unstamped and has no legal validity unless backed by a stamped policy/certificate of insurance.

(b) An open policy is issued for a fixed sum insured, whereas there is no such limit of amount under any open cover. As and when shipments are made under the open policy, they have to be declared to the insurers and the sum insured under the open policy reduces by the amount of such declarations. When the total of the declarations amounts to the sum insured under the open policy, the open policy stands exhausted and has to be replaced by a fresh one.

(h) Certificate of Insurance

A certificate of insurance is issued to satisfy the requirements of the insured or the banks in respect of each declaration made under an open cover and / or open policy. The certificate, which is substituted for specific policy, is a simple document containing particulars of the shipment or sending. The number of open contract under which it is issued is mentioned, and occasionally, terms and conditions of the original cover are also mentioned. Certificates need not be stamped when the original policy has been duly stamped.

Types of Marine Insurance

a) Special Declaration Policy

This is a form of floating policy issued to clients whose annual estimated dispatches (i.e. turnover) by rail / road / inland waterways exceed Rs 2 crores. Declaration of dispatches shall be made at periodical intervals and premium is adjusted on expiry of the policy based on the total declared amount. When the policy is issued sum insured should be based on previous year's turnover or in case of fresh proposals, on a fair estimate of annual dispatches.

A discount in the rates of premium based on turnover amount (e.g. exceeding Rs.5 crores etc.) on a slab basis and loss ratio is applicable.

b) Special Storage Risks Insurance

This insurance is granted in conjunction with an open policy or a special declaration policy. The purpose of this policy is to cover goods lying at the Railway premises or carrier's godowns after termination of transit cover under open or special declaration policies but pending clearance by the consignees. The cover terminates when delivery is taken by the consignee or payment is received by the consignor, whichever is earlier.

c) Annual Policy

This policy, issued for 12 months, covers goods belonging to the insured, which are not under contract of sale, and which are in transit by rail / road from specified depots / processing units to other specified depots / processing units.

d) "Duty" Insurance

Cargo imported into India is subject to payment of Customs Duty, as per the Customs Act. This duty can be included in the value of the cargo insured under a Marine Cargo Policy, or a separate policy can be issued in which case the Duty Insurance Clause is incorporated in the policy. Warranty provides that the claim under the Duty Policy would be payable only if the claim under the cargo policy is payable.

e) "Increased Value" Insurance

Insurance may be 'goods at destination port' on the date of landing if it is higher than the CIF and Duty value of the cargo.

PROCEDURE OF CLAIM SETTLEMENT:

The risk coverages are different for import/export and inland (with in India) consignments, the procedure of claim settlement for Import/Export consignments are explained below.

Claims Documents

Claims under marine policies have to be supported by certain documents which vary according to the type of loss as also the circumstances of the claim and the mode of carriage. The documents required for any claim are as under:

a) Intimation to the Insurance company:

As soon as the loss is discovered then it is the duty of the policyholder to inform the Insurance company to enable it to assess the loss.

b) Policy:

The original policy or certificate of insurance is to be submitted to the company. This document establishes the claimant's title and also serves as an evidence of the subject matter being actually insured.

c) Bill of Lading :

Bill of Lading is a document which serves as evidence that the goods were actually shipped. It also gives the particulars of cargo.

d) Invoice:

An invoice evidences the terms of sale. It also contains complete description of the goods, prices, etc. The invoice enables the insurers to see that the insured value of the cargo is not unreasonably in excess of its cost, and that there is no gross overvaluation. The original invoice (or a copy thereof) is required in support of claim.

e) Survey Report:

Survey report shows the cause and extent of loss, and is absolutely necessary for the settlement of claim. The findings of the surveyors relate to the nature and extent of loss or damage, particulars of the sound values and damaged values, etc. It is normally issued with the remarks "without prejudice," i.e. without prejudice to the question of liability under the policy.

f) Debit Note:

The claimant is expected to send a debit note showing the amount claimed by him in respect of the loss or damage. This is sometimes referred to as a claim bill.

g) Copy of Protest:

If the loss or damage to cargo has been caused by a peril of the sea, the master of the vessel usually makes a protest on arrival at destination before a Notary Public. Through this protest, he informs that he is not responsible for the loss or damage. Insurers sometimes require to see the copy of the protest to satisfy themselves about the actual cause of the loss.

h) Letter of Subrogation :

This is a legal document (supplied by insurers) which transfers the rights of the claimant against a third party to the insurers. On payment of claim, the insurers may wish to pursue recovery from a carrier or other third party who, in their opinion, is responsible for the loss. The authority to do so is derived from this document. It is required to be duly stamped.

i) Bill of entry:

The other important document is bill of entry issued by the customs authorities showing therein the amount of duty paid, the date of arrival of the steamer, etc., account sales showing the proceeds of the sale of the goods if they have been disposed of; repairs or replacements bills in case of damages or breakage; and copies of correspondence exchanged between the carriers and the claimants for compensation in case of liability resting on the carriers.

RISK COVERAGE

For export/import policies, the-Institute Cargo Clauses (I.C.C.) are used. These clauses are drafted by the Institute of London Underwriters (ILU) and are used by insurance companies in a majority of countries including India.

15.8 NOTES

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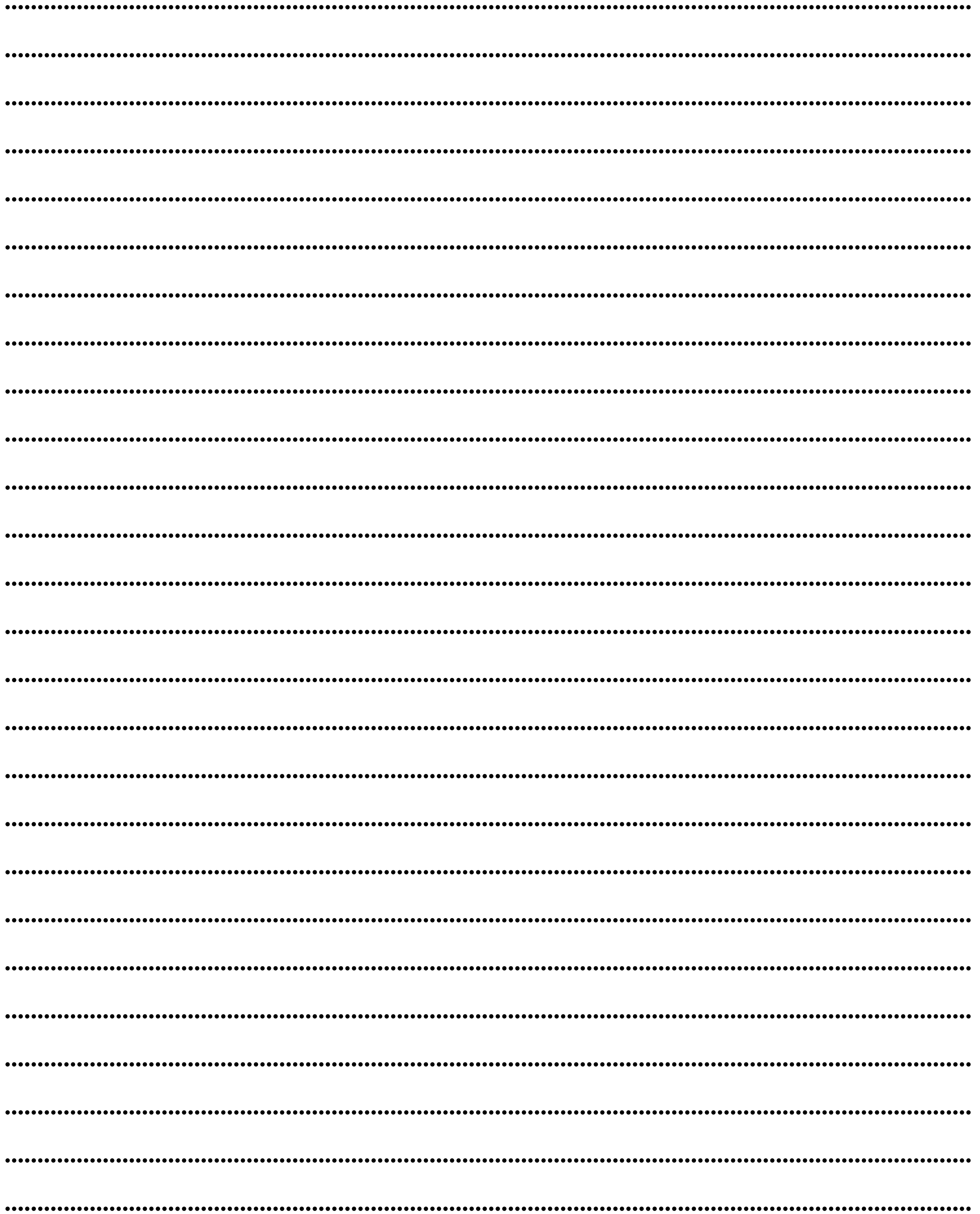

15.9 SUMMARY

An insurance policy is a financial contract between a policyholder and an insurer, which is almost always an insurance company. The insurer agrees to pay in the event that the person or property insured suffers a type of loss named in the policy. For example, an auto liability policy will pay for the damage sustained by another vehicle and any injuries to its occupants in an accident where you are at fault. A renters policy may pay for damage to your stereo as a result of a water leak in your apartment. The protection remains in force for a specified "policy term," typically six months or a year, after which you´ll need to renew the policy in order to continue the coverage.

Whatever the policy type, it will generally only pay for losses that are specifically named in the policy. Therefore, you should always read any insurance policy carefully before you purchase it.

In return for coverage, you pay the insurer a specified amount, called the "premium." Premiums are typically paid in monthly installments, but may also be paid all at once or in other intervals. Insurance companies use a process called "underwriting" to evaluate your risk factors and estimate the statistical likelihood that you´ll suffer a covered loss and file a claim. The higher a company determines your risk factors to be, the more it will charge in premium (as the company believes it is more likely that it will have to pay you). If your risk factors are too high, a company may decline to sell you a policy. Each insurance company uses its own underwriting formula for assessing risk factors. If one company turns you down, keep shopping; another company may be willing to cover you.

Almost all types of insurance policies have a "deductible." A deductible is an amount you must pay out of your own pocket before the policy will pay anything toward a covered loss. For example, assume you have an auto policy with a $1,000 deductible. If you have an accident that results in $5,000 in damages to your car, you´ll have to pay $1,000 toward the cost of your repairs. The insurance company will pay the remaining $4,000. You can normally choose the deductible you want. The higher your deductible, the lower your premium will be. Keep in mind, however, that if you have a high deductible, you´ll have to pay more if you have a claim. A high-deductible policy with a lower premium may seem like a good deal until you´re involved in an accident and have to pay the higher deductible all at once.

For some types of insurance, the insurer will pay a percentage of the cost of a claim, and you must pay the remaining amount. For instance, if you have surgery, an insurer might pay 80 percent of the cost of the surgery, leaving you to pay the remaining 20 percent. This cost sharing is called "coinsurance." Many health plans also have "copays." These are amounts you pay each time you receive a covered health service. You might have to pay a $20 copay each time you go to the doctor, for example.

Almost all insurance policies will have a "coverage limit." This is the maximum amount it will pay toward any covered loss, regardless of the actual costs you incur.

Many people pay insurance premiums for years and never file a claim. This can lead some people to think they´re wasting money and cause them to cancel their coverage. In the event they suffer a loss, however, they must pay the full cost themselves.

When you buy an insurance policy, you´re buying protection. You´re protected against unexpected financial losses, whether you ever actually use the coverage or not.

15.10 KEYWORDS

Insurance

Marine Insurance

International Insurance

Insurance agency

Risk

Risk coverage

Procedure for Claims

15.11 SELF ASSESSMENT QUESTIONS

1. Meaning of Insurance, types and advantages of Insurance
2. Explain briefly Marine Insurance
3. Explain the procedure for Insurance claims
4. Explain types of Risks in Insurance

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UNIT-16: FOREIGN DIRECT INVESTMENT

Structure:

16.0 Objectives

16.1 Introduction

16.2 Advantages and Disadvantages of FDI

16.3 Determinants of FDI

16.4 Trends in FDI and forms of FDI

16.4.1 Horisonsal FDI

16.4.2 Vertical FDI

16.5 Case study

16.6 Notes

16.7 Summary

16.8 Keywords

16.9 Self Assessment Questions

16.10 References

16.0 OBJECTIVES

After studying this unit, you should be able to;

- To understand the meaning of FDI
- To know determinants of FDI
- To study the trends in FDI

16.1 INTRODUCTION

Foreign investment involves capital flows from one country to another, granting extensive ownership stakes in domestic companies and assets. Foreign investment denotes that foreigners have an active role in management as a part of their investment. A modern trend leans toward globalization, where multinational firms have investments in a variety of countries.

Foreign investments can be made by individuals, but are most often endeavors pursued by companies and corporations with substantial assets looking to expand their reach. As globalization increases, more and more companies have branches in countries around the world. For some companies, opening new manufacturing and production plants in a different country is attractive because of the opportunities for cheaper production, labor and lower or fewer taxes.

Governments seek to promote FDI when they are eager to expand their domestic economy and attract new technologies, business know-how, and capital to their country. In these instances, many governments still try to manage and control the type, quantity, and even the nationality of the FDI to achieve their domestic, economic, political, and social goals.

♦ **Financial incentives.** Host countries offer businesses a combination of tax incentives and loans to invest. Home-country governments may also offer a combination of insurance, loans, and tax breaks in an effort to promote their companies' overseas investments. The opening case on China in Africa illustrated these types of incentives.

♦ **Infrastructure.** Host governments improve or enhance local infrastructure - in energy, transportation, and communications - to encourage specific industries to invest. This also serves to improve the local conditions for domestic firms.

- **Administrative processes and regulatory environment.** Host-country governments streamline the process of establishing offices or production in their countries. By reducing bureaucracy and regulatory environments, these countries appear more attractive to foreign firms.
- **Invest in education.** Countries seek to improve their workforce through education and job training. An educated and skilled workforce is an important investment criterion for many global businesses.
- **Political, economic, and legal stability.** Host-country governments seek to reassure businesses that the local operating conditions are stable, transparent (i.e., policies are clearly stated and in the public domain), and unlikely to change.

16.2 ADVANTAGES OF FOREIGN DIRECT INVESTMENT

The Following are the advantages of FDI;

1. Economic Development Stimulation:

Foreign direct investment can stimulate the target country's economic development, creating a more conducive environment for you as the investor and benefits for the local industry.

2. Easy International Trade:

Commonly, a country has its own import tariff, and this is one of the reasons why trading with it is quite difficult. Also, there are industries that usually require their presence in the international markets to ensure their sales and goals will be completely met. With FDI, all these will be made easier.

3. Employment and Economic Boost.:

Foreign direct investment creates new jobs, as investors build new companies in the target country, create new opportunities. This leads to an increase in income and more buying power to the people, which in turn leads to an economic boost.

4. Development of Human Capital Resources:

One big advantage brought about by FDI is the development of human capital resources, which is also often understated as it is not immediately apparent. Human capital is the competence and knowledge of those able to perform labor, more known to us as the

workforce. The attributes gained by training and sharing experience would increase the education and overall human capital of a country. Its resource is not a tangible asset that is owned by companies, but instead something that is on loan. With this in mind, a country with FDI can benefit greatly by developing its human resources while maintaining ownership.

5. Tax Incentives:

Parent enterprises would also provide foreign direct investment to get additional expertise, technology and products. As the foreign investor, you can receive tax incentives that will be highly useful in your selected field of business.

6. Resource Transfer:

Foreign direct investment will allow resource transfer and other exchanges of knowledge, where various countries are given access to new technologies and skills.

7. Reduced Disparity between Revenues and Costs:

Foreign direct investment can reduce the disparity between revenues and costs. With such, countries will be able to make sure that production costs will be the same and can be sold easily.

8. Increased Productivity:

The facilities and equipment provided by foreign investors can increase a workforce's productivity in the target country.

9. Increment in Income:

Another big advantage of foreign direct investment is the increase of the target country's income. With more jobs and higher wages, the national income normally increases. As a result, economic growth is spurred. Take note that larger corporations would usually offer higher salary levels than what you would normally find in the target country, which can lead to increment in income.

Disadvantages of Foreign Direct Investment

The following are the disadvantages of FDI

1. **Hindrance to Domestic Investment:** As it focuses its resources elsewhere other than the investor's home country, foreign direct investment can sometimes hinder domestic investment.

2. **Risk from Political Changes**: Because political issues in other countries can instantly change, foreign direct investment is very risky. Plus, most of the risk factors that you are going to experience are extremely high.
3. **Negative Influence on Exchange Rates**: Foreign direct investments can occasionally affect exchange rates to the advantage of one country and the detriment of another.
4. **Higher Costs**: If you invest in some foreign countries, you might notice that it is more expensive than when you export goods. So, it is very imperative to prepare sufficient money to set up your operations.
5. **Economic Non-Viability:** Considering that foreign direct investments may be capital-intensive from the point of view of the investor, it can sometimes be very risky or economically non-viable.
6. **Expropriation:** Remember that political changes can also lead to expropriation, which is a scenario where the government will have control over your property and assets.
7. **Negative Impact on the Country's Investment:** The rules that govern foreign exchange rates and direct investments might negatively have an impact on the investing country. Investment may be banned in some foreign markets, which means that it is impossible to pursue an inviting opportunity.
8. **Modern-Day Economic Colonialism:** Many third-world countries, or at least those with history of colonialism, worry that foreign direct investment would result in some kind of modern day economic colonialism, which exposes host countries and leave them vulnerable to foreign companies' exploitations.

16.3 DETERMINANTS OF FDI

Let's look at why and how companies choose to invest in foreign markets. Simply purchasing goods and services or deciding to invest in a local market depends on a business's needs and overall strategy. Direct investment in a country occurs when a company chooses to set up facilities to produce or market their products; or seeks to partner with, invest in, or purchase a local company for control and access to the local market, production, or resources. Many considerations influence its decisions:

Factors affecting foreign direct investment

1. Wage rates

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

However, wage rates alone do not determine FDI, countries with high wage rates can still attract higher tech investment. A firm may be reluctant to invest in Sub-Saharan Africa because low wages are outweighed by other costs.

2. Labour skills

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

3. Tax rates

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

4. Transport and infrastructure

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

5. Size of economy / potential for growth.

Foreign direct investment is often targeted to selling goods directly to the country involved in attracting the investment. Therefore, the size of the population and scope for

economic growth will be important for attracting investment. For example, Eastern European countries, with a large population, e.g. Poland offer scope for new markets. This may attract foreign car firms, e.g. Volkswagen, Fiat to invest and build factories in Poland to sell to the growing consumer class. Small countries may be at a disadvantage because it is not worth investing for a small population. China will be a target for foreign investment as the new emerging Chinese middle class could have very strong demand for the goods and services of multinationals.

6. Political stability / property rights

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

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

7. Commodities

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

8. Exchange rate

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

9. Clustering effects

Foreign firms often are attracted to invest in similar areas to existing FDI. The reason is that they can benefit from external economies of scale – growth of service industries and transport links. Also, there will be greater confidence to invest in areas with a good track record. Therefore, some countries can create a virtuous cycle of attracting investment and then these initial investments attracting more. It is also sometimes known as an agglomeration effect.

10. Cost.

Is it cheaper to produce in the local market than elsewhere?

11. Logistics.

Is it cheaper to produce locally if the transportation costs are significant

12. Natural resources.

Is the company interested in obtaining access to local resources or commodities?

13. Know-how.

Does the company want access to local technology or business process knowledge

14. Customers and competitors.

Does the company's clients or competitors operate in the country

15. Policy.

Are there local incentives (cash and noncash) for investing in one country versus another

16. Impact.

How will this investment impact the company's revenue and profitability

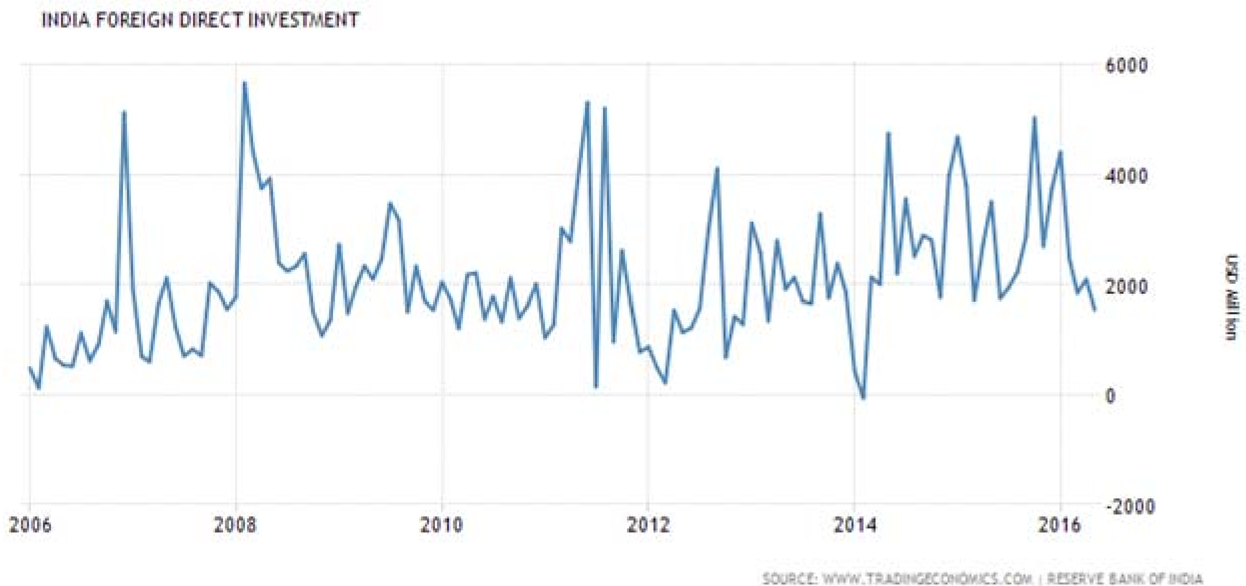
17. Expatriation of funds.

Can the company easily take profits out of the country, or are there local restrictions

18. Exit.

Can the company easily and orderly exit from a local investment, or are local laws and regulations cumbersome and expensive.

16.4 TRENDS IN FDI AND FORMS OF FDI



There are two forms of FDI - horizontal and vertical.

16.4.1 Horizontal FDI

When a company is trying to open up a new market that is similar to its domestic markets. occurs when a company is trying to open up a new market - a retailer.

In other words Horizontal FDI refers to the type of direct investment between industrialized countries as ways to avoid trade barriers, gain better access to the local economy, or draw on technical expertise in the area by locating near other established firms.

for example, that builds a store in a new country to sell to the local market.

16.4.2 Vertical FDI

When a company invests internationally to provide input into its core operations usually in its home country. A firm may invest in production facilities in another country. If the firm brings the goods or components back to its home country (acting as a supplier), then it is called backward vertical FDI. If the firm sells the goods into the local or regional market (acting more as a distributor), then it is referred to as forward vertical FDI. when a company invests internationally to provide input into its core operations - usually in its home country.

A firm may invest in production facilities in another country. When a firm brings the goods or components back to its home country (i.e., acting as a supplier), this is referred to as backward vertical FDI. When a firm sells the goods into the local or regional market (i.e., acting as a distributor), this is termed forward vertical FDI. The largest global companies often engage in both backward and forward vertical FDI depending on their industry.

In other words Vertical FDI, by contrast, occurs when a firm in an industrialized country lowers cost by relocating the production process to low-wage countries.

16.5 A CASE STUDY — COCA-COLA IN INDIA

Coca-Cola's exploitation of labour and resources in India is the perfect example of the destructive powers of transnational corporations, and when Coca-Cola began to set up its factories in India many problems occurred shortly after. Once the factories started being built in India, land had to be cleared for the factories, and this resulted in a devastating loss of agricultural land. Since Coca-Cola is a transnational corporation, they definitely have the power to take the land from agricultural workers, taking away their livelihood, and leaving them with no source of income. This caused the agricultural market of India to plummet, and the consumers have become dependent on other transnational corporations to purchase food from – which adds to the vicious cycle of exploitation due to transnational corporations. Many farmers have also been driven to suicide because they were unable to make a living with their farm land taken away, and the loss of human lives is probably the greatest tragedy that results from globalization. After Coca-Cola had set up their factories, the nightmare was not over for India just yet. Now that the factories were set up Coca-Cola had to hire workers to work in their dreadful factories where the working conditions were appalling; many of the workers were forced to work on dangerous assembly lines, where the Coca-Cola products were package, which could cause them serious physical pain and the tedious tasks they were forced to perform were said to be physiologically damaging as well. Now that Coca-Cola had its workers to work for them, they intended to keep them in their factories for as long as possible – regardless of the age or gender of the worker. This meant that the child labourers in Coca-Cola factories would not be permitted to attend school, and when the future generation of India is left uneducated, there is a low chance of India stabilizing in the future. The lack of women being educated in India also contributes to the inequality between men and women because when a woman cannot be properly educated, it is difficult

for her to gain independence, and she will continue to be suppressed in society. The workers that are being forced to work for Coca-Cola are also making very little money, and they are subject to many types of abuse; they are basically slaves for Coca-Cola, but they continue to work for Coca-Cola because it is the only way they can make money. Coca-Cola continues to exploit the labour in India, and, if this pattern continues, the future for India does not seem bright.

Coca-Cola also exploits the resources in India, and the most critical example of the resources they are exploiting is water. Coca-Cola factories are very water inefficient, and they take advantage of this resource without considering how it will affect the citizens of India. Nine years prior to the opening of a Coca-Cola factory the level of ground water fell three meters, which is only natural because people in India continue to use it in their daily lives, and nine years after the opening of the factory the level of ground water had dropped a shocking amount – 22.36 meters. The level of ground water was so low that it was, usually, inaccessible to the people of India, and the remaining ground water that they are able to attain is almost always polluted with the factory's waste so it is no longer fit for drinking. However, many people in India to not have the luxury of simply finding a cleaner water source, and they must drink the contaminated water, which causes them many health problems, just so they can survive.

Transnational corporations have so much power in a country,and they can bring so much pain or prosperity to the countries that support them. However, when a transnational corporation does damage a country, like Coca-Cola is damaging India, they refuse to take responsibility or use some of their fortune to repent for the damage they have caused unless they are forced to. In Coca-Cola's case, they had decided to turn a blind eye to all of the problems that they were causing for India, and they only considered paying the government of India compensations after they officially demand them. This is the case for many transnational corporations – many of them will not make an effort to make up to the communities that they have taken advantage of unless they are forced to.

16.6 NOTES

16.6 SUMMARY

It can be summed up by saying that to attract FDI, India should use its advantages such as large domestic market, abundant supply of trained and low-wage labor, vast pool of technical professional, second largest nation, etc. FDI is a panacea for the economic ills of any country. Economic development strongly depends on FDI. Mauritius, US, Netherlands, Japan, UK, Germany, France, Singapore and Switzerland are the top foreign investors in India. At present, Maharashtra rank first with 17.5 percent of FDI inflows, Delhi second with 12.1 percent. After Delhi , Karnataka and Gujarat occupy next position respectively. India attracted 25 billion Dollar in 2007 and in 2008 FDI inflow in India was 43.4 billion dollar. FDI in India has contributed effectively to the overall growth of the economy in the recent times. FDI Policy permits FDI up to 100 percent from foreign/NRI investor without prior approval in most of the sectors including the services sector under automatic route. FDI in sectors/activities under automatic route does not require any prior approval either by the Government or the RBI. Market oriented policies are boosting economic activity, all round development and economic growth rate. As the Indian economy gears up for competition in the international market, overseas investors clearly see the potential for attractive returns from investment in India, which is also evident from the already achieved FDI success stories.

16.7 KEYWORDS

FDI

Trends in FDI

Horizontal FDI

Vertical FDI

16.8 SELF ASSESSMENT QUESTIONS

1. Explain FDI
2. Types of FDI and it's impact
3. Forms of FDI
4. Advantages and disadvantages of FDI
5. Impact of FDI

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MODULE- V
INTERNATIONAL E-BUSINESS

UNIT-17: INTRODUCTION TO E-COMMERCE AND E-BUSINESS

Structure:

17.0 Objectives

17.1 Introduction

17.2 Meaning of E-Commerce

17.3 Types of E-Commerce

17.4 Factors affecting E-Commerce

17.5 Business dimensions and Technological dimensions of E-Commerce

17.6 E-Business

17.7 Mobile Commerce

17.8 Notes

17.9 Summary

17.10 Keywords

17.11 Self Assessment Questions

17.12 References

17.0 OBJECTIVES

After studying this unit, you should able to;

- To understand the meaning and features of E-Commerce and E-Business
- To know the objectives and factors of E-Commerce and E-Business
- To study the role and history of E-Commerce and E-Business
- To study the functions of E-Commerce and E-Business

17.1 INTRODUCTION

As social media, app stores and global availability become standard, many companies are looking to enhance the online customer experience. And while retail and other transactions via Internet are customary, more than ever companies are simplifying the ways in which customers interact with their website and ultimately make online purchases. Here are eight trends happening right now in global e-commerce that seek to enhance the user experience

17.1.1 Micro-payments

Among the most revolutionary changes in the coming months—not years—is the use of micro-payment systems from a variety of financial firms, e.g., Paypal, Visa, Western Union, among others, including banks. This trend is facilitated by the W3C working group that approved these protocols and technical standards for the interworking. These systems will change not only how we carry money but how we value money and think about purchases. (Consider how a purchase of $4.99 feels in a mobile app store vs. at Dunkin' Donuts.) Payment systems that make it easier to buy online, coupled with mobile technologies will accelerate the usage of global e-commerce applications.

17.1.2 Mobile technologies

More people access the Internet on their mobile devices than on any other device. We are rapidly approaching the time (if we are not already there) where designs must be created for the mobile web first, and for the desktop second. Mobile technologies facilitate comparison shopping; with the advent of barcode reader apps and price-comparison databases, a consumer could snap a bar code in Walmart and quickly reference product reviews and prices on walmart.com (or compare prices with Walmart competitors). Mobile

technologies also facilitate impulse buys – especially with the advent of micro-payments tied to the mobile device. Just recently, Starbucks customers can not only place an order with their Smartphone, but also make a purchase.

17.1.3 Social media

As Facebook has become the most visited site on the Web, the role of social media, including Facebook and its local clones such as Twitter, is increasingly important. Social media sites increasingly act as points of entry to e-commerce sites, and vice versa, as e-commerce sites build rating, loyalty and referral systems tied to social media. Group buying (e.g., Groupon) is also gaining mainstream ground, with many "deal of the day" sites competing for an increasingly savvy consumer base, but improvements lie ahead as the social aspects and user experience are refined.

17.1.4 Fulfilments options

I believe that users will want to have multiple fulfillments and return options when interacting with a vendor: ship to address, courier, pick-up in store, return to store, etc. Having many fulfillment options is how customers view their overall customer experience. Some companies have made a business proposition online by being exceptional in service to the online channel (e.g., Zappos).

17.1.5 Global availability

Increasingly, consumers want the availability to buy products from foreign sites and have them delivered locally. Thus, currency and customs will be of growing concern to many online retailers. Along with this, there will be concerns with local privacy laws and restrictions on related data collection and storage.

17.1.6 Localization

While the trend is to globalize, what's often more important is to localize. User Centric's (now GfK's User Experience team) research clearly shows that sites that 'feel' local – with proper imagery, language, time/date, weights/measures, currency, etc. – resonate far more than sites that seem culturally distant or sterile.

17.1.7 Customizability

Consumers want control, and want to be able to design the details of the items they purchase.

17.1.8 Time-based availability

Some of the hottest and most successful sites are those that have a time-critical response component. Sites like Groupon, Gilt and others capitalize on the perception of limited-time availability. Creating a sense of urgency drives traffic and purchase behavior.

17.2 MEANING OF E-COMMERCE

E-commerce (electronic commerce or EC) is the buying and selling of goods and services, or the transmitting of funds or data, over an electronic network, primarily the Internet. These business transactions occur business-to-business, business-to-consumer, consumer-to-consumer or consumer-to-business. The terms *e-commerce* and *e-business* are often used interchangeably. The term *e-tail* is also sometimes used in reference to transactional processes around online retail.

E-commerce is business transactions through electronic means, including the internet, telephones, televisions and computers.

17.3 TYPES OF E-COMMERCE

E-commerce business models can generally categorized in following categories.

a) Business - to - Business (B2B)

b) Business - to - Consumer (B2C)

c) Consumer - to - Consumer (C2C)

d) Consumer - to - Business (C2B)

e) Business - to - Government (B2G)

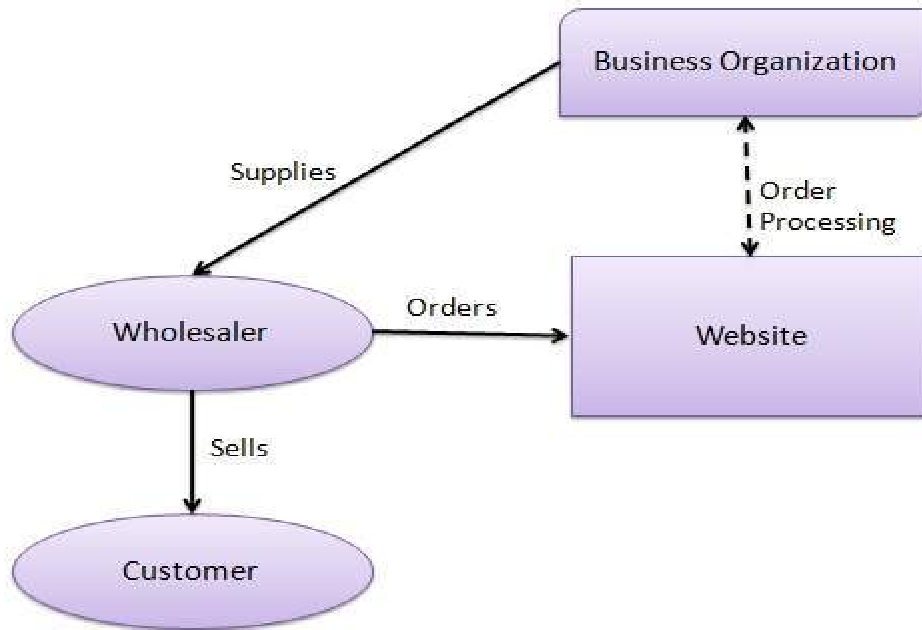
f) Government - to - Business (G2B)

g) Government - to - Citizen (G2C)

h) Peer to Peer (P2P)

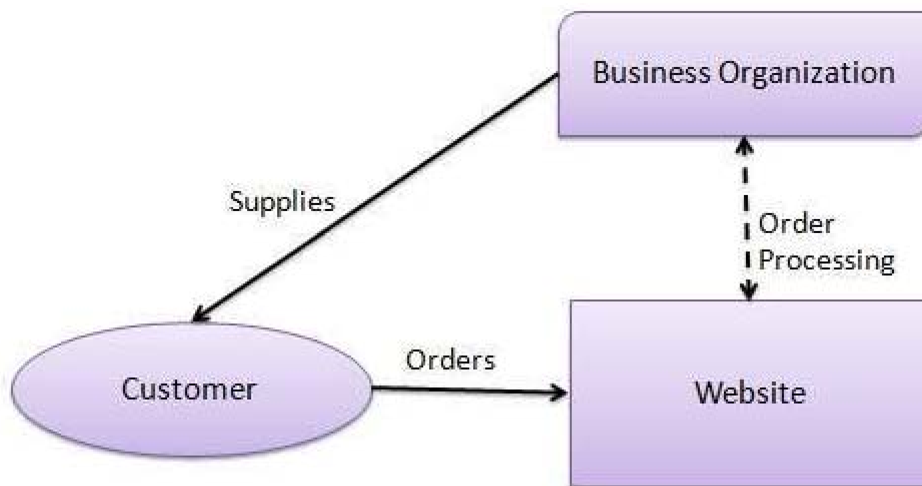
a) Business - to - Business (B2B)

Website following B2B business model sells its product to an intermediate buyer who then sells the product to the final customer. As an example, a wholesaler places an order from a company's website and after receiving the consignment, sells the end product to final customer who comes to buy the product at wholesaler's retail outlet.



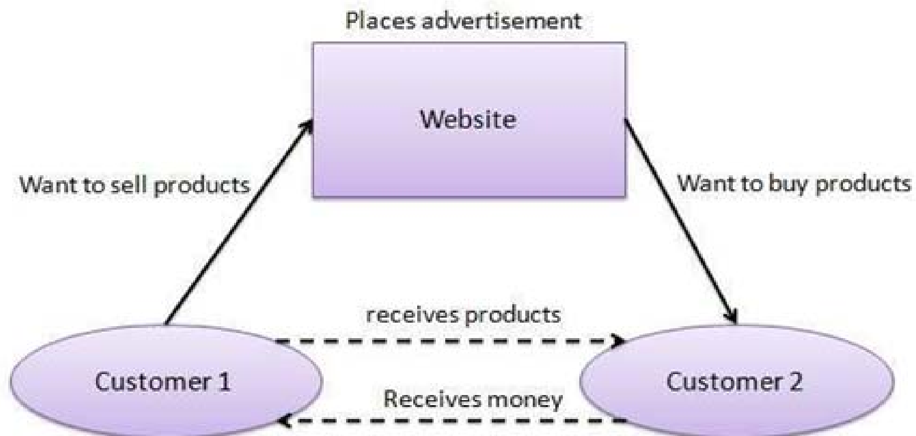
b) Business - to - Consumer(B2C)

Website following B2C business model sells its product directly to a customer. A customer can view products shown on the website of business organization. The customer can choose a product and order the same. Website will send a notification to the business organization via email and organization will dispatch the product/goods to the customer.



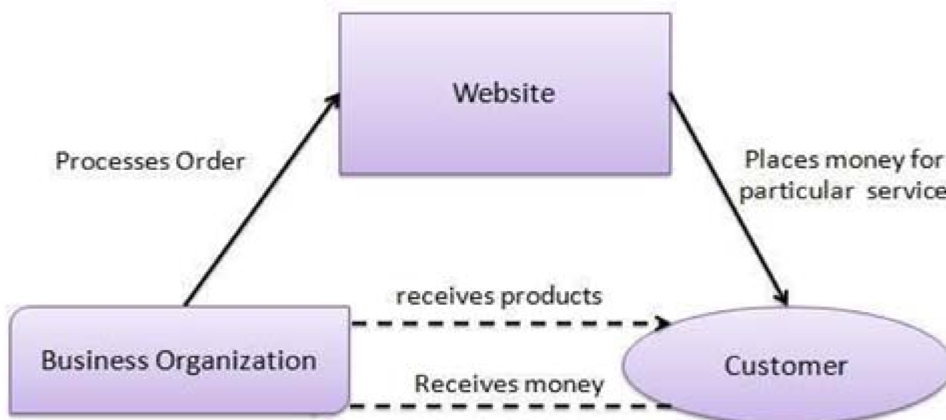
c) Consumer - to - Consumer (C2C)

Website following C2C business model helps consumer to sell their assets like residential property, cars, motorcycles etc. or rent a room by publishing their information on the website. Website may or may not charge the consumer for its services. Another consumer may opt to buy the product of the first customer by viewing the post/advertisement on the website.



d) Consumer - to - Business (C2B)

In this model, a consumer approaches website showing multiple business organizations for a particular service. Consumer places an estimate of amount he/she wants to spend for a particular service. For example, comparison of interest rates of personal loan/ car loan provided by various banks via website. Business organization who fulfills the consumer's requirement within specified budget approaches the customer and provides its services.



e) Business - to - Government (B2G)

B2G model is a variant of B2B model. Such websites are used by government to trade and exchange information with various business organizations. Such websites are accredited by the government and provide a medium to businesses to submit application forms to the government.

f) Government - to - Business (G2B)

Government uses B2G model website to approach business organizations. Such websites support auctions, tenders and application submission functionalities.

g) Government - to - Citizen (G2C)

Government uses G2C model website to approach citizen in general. Such websites support auctions of vehicles, machinery or any other material. Such website also provides services like registration for birth, marriage or death certificates. Main objectives of G2C website are to reduce average time for fulfilling people requests for various government services.

h) Peer-to-Peer (P2P)

Peer-to-peer (P2P) is a decentralized communications model in which each party has the same capabilities and either party can initiate a communication session. Unlike the client/server model, in which the client makes a service request and the server fulfills the request, the P2P network model allows each node to function as both a client and server.

P2P systems can be used to provide anonymized routing of network traffic, massive parallel computing environments, distributed storage and other functions. Most P2P programs are focused on media sharing and P2P is therefore often associated with software piracy and copyright violation.

Typically, peer-to-peer applications allow users to control many parameters of operation: how many member connections to seek or allow at one time; whose systems to connect to or avoid; what services to offer; and how many system resources to devote to the network. Some simply connect to some subset of active nodes in the network with little user control, however.

Although uses for the P2P networking topologies have been explored since the days of ARPANET, the advantages of the P2P communications model didn't become obvious to the general public until the late 1990s, when music-sharing P2P applications like Napster appeared. Napster and its successors — like Gnutella, and more recently, BitTorrent — cut into music and movie industry profits and changed how people thought about acquiring and consuming media.

17.4 FACTORS AFFECTING E-COMMERCE

a. Trust

Johnson-George and Swap (1982: 1306) asserted that "willingness to take risks may be one of the few characteristics common to all trust situations." Kee and Knox (1970) argued that to appropriately study trust there must be some meaningful incentives at stake and that the trustor must be cognizant of the risk involved. The definition of trust proposed in this research is the willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor, irrespective of the ability to monitor or control that other party (Park and Kim, 2003). Trust can be a vital factor in business to consumer (B2C) E-Commerce. It gives

consumers faith to buy products or services even if an e-trader is unknown. It encourages more use of E-Commerce technologies, makes the e-transaction process easier, enhances the level of acceptance and adoption of E-Commerce, leads to the improvement of consumer commitment, raise customer satisfaction, introduces the concept of loyalty, sustains long-term relationships with customers and assists the acquiring of a competitive benefit. Future purchases can be motivated and increased prices tolerated. It reduces customer worries about information privacy, and helps customers to tolerate the irregular mistakes made by the e-trader (Pittayachawan, 2008). Trust is a complicated concept and has a multitude of sides to be addressed. There are a number of researchers who have continually approached the 'trust' issue from a technical side such as Internet and network security and even web interface design (Fernandes, 2001; Clifford et al., 1998; Pittayachawan, 2008). Nonetheless, according to Klang (2001) and Ratnasingham and Kumar (2000), considering just the technical perceptions will not guarantee trust in e-commerce.

b. Security, Fraud and Hacking

It is widely acknowledged by both government and industrial organizations that, from a consumer point of view, issues of information security are a major obstacle to the growth of E-Commerce. The perception of risk regarding Internet security has also been recognized as a concern for both experienced and inexperienced users of Internet technologies (Miyazaki and Fernandez, 2001). Furthermore, Miyazaki and Fernandez (2001) have identified the fraudulent behavior by online retailers as a key concern for Internet users and, therefore, E-Commerce users Rose et al. (1999) identifies hackers as an obvious security threat to E-Commerce.

This happens because the online availability and accessibility of the stored data of many corporations gives any hacker on the Internet the chance to steal data from these corporate databases. These threats have been identified in several new studies (Aleid et al., 2009; Al-Ghaith et al., 2010). Dixit and Datta (2010) studied the acceptance of e-banking among adult customers in India. The findings depicted that many factors like security and privacy, trust, innovativeness, familiarity, and awareness level increase the acceptance of e-banking services among Indian customers.

c. Awareness and Perceived Usefulness

Within the context of the information systems (IS) domain, much research has outlined the significance of the influence of perceived usefulness on attitude towards the use of e-commerce.

The real reason why customers would use E-Commerce is that they find it a useful facility for conducting shopping online (Alghamdi, 2011). Furthermore, according to Sathye's (1999) research, the use of online banking services, which is a good example of e-commerce, is new knowledge to many customers, and the lack of awareness of online banking is a crucial factor in preventing customers from adopting it. In his study of 500 Australian customers, he concluded that customers were not aware of the potential benefits of online banking. This was supported by another study by Howcroft et al., (2002) in which they found that the issue of lack of awareness and knowledge of online banking services contributes e-commerce adoption challenges. Suki and Ramayah (2010) studied user acceptance of the e-Government services in Malaysia. Their results indicate that the important determinants of user acceptance of the e-Government services are perceived usefulness, ease of use, compatibility, interpersonal influence, external influence, self-efficacy, facilitating conditions, attitude, subjective norms, perceived behavioral control, and intention to use e-Government services/system.

d. Accessibility

As the internet is fast becoming a major source of information and services, a well-designed e-commerce website has become essential so that citizens can access public information and improve their participation. E-commerce websites can serve as a tool for both communication and relations for the customers and general public. Information and data can easily be shared with and transferred to external stakeholder (Moon, 2002). Henry (2006) defines web accessibility as getting people to use, perceive, understand, direct and interact with the web. The International Standards Organizations (ISO) has defined accessibility as "the usability of a product, service, environment or facility by people with the widest range of capabilities".

Gummerus et al. (2004) define the user interface as the channel through which customers are in contact with the e-service provider. Park and Kim (2003) found that the quality of the user interface affects customer satisfaction directly, since it provides physical

evidence of the service provider's competence as well as facilitating effortless use of the service. Because of its importance to customer satisfaction, Tan, Tung, and Xu (2009) identified fourteen key factors for developing effective B2C e-commerce websites. Also, Cyr (2008) investigated the effect of B2C e-commerce website user interface design factors (such as information design, navigation design, and visual design) on trust and satisfaction across three developed countries; Canada, Germany, and China. Cyr found that these user interface design variables are key antecedents to website trust and website satisfaction across cultures.

e. Perceived Quality

The perceived quality of a service has two dimensions; the technological dimension, which refers to what is delivered, and the functional dimension, which refers to how the service is delivered. Speed of response, offer updates, and site effectiveness, refers to the technical quality (Rust & Lemon, 2009). Interactive communication, personalization of the communication and of the service, as well as new forms of customer access refers to the functional aspect of quality. Product/service quality is defined as the customer perception of the quality of information about the product/service that is provided by a website (Park & Kim, 2003). According to Mcknightetal., 2002, website content quality has been argued to be an antecedent of online customer trust on quality. In addition, Park and Kim (2003) found that the information quality affects customer satisfaction directly. Karunasena and Deng (2012) have identified the critical factors for evaluating the public value of e-Government in Sri Lanka. The study showed that the deliveries of quality information and services, user-orientation of information and services, efficiency and responsiveness of public organizations and contributions of public organizations to the environmental sustainability are the critical factors for evaluating the public value of e-Government in Sri Lanka.

f. Role of Government

The government's role in developing countries as an important one that facilitates the essential requirements for the development of E-Commerce such as providing robust secure online payment options, ensuring a solid ICT infrastructure, providing educational programs and building up awareness using different means such as media and education institutions. The results of their study show the significance of government promotion and support as a crucial factor (AlGhamdi et al., 2011). According to Molla and Licker (2005),

state that the government demonstrates strong commitment to promoting E-Commerce. In Saudi Arabia, Eid (2011) posit in his study that the Saudi Government's support was recognized as an important element in the development and growth of local E-Commerce. According to Eid's study, some Saudi citizens believe in the importance of the government's role. Interviewee 8 commented on the diffusion of E-Commerce by government and private accreditation in providing the basic facilities such as a house address for every citizen, to be used online for accurate delivery of products and documents and special services. If there is no reliable postal service, there will be no e-government.

17.5 BUSINESS DIMENSIONS AND TECHNOLOGICAL DIMENSIONS OF E-COMMERCE

Industry standards help to define common operational practices for **information security management**. As a part of a competent information security program**penetration testing** is often relied upon to identify*technical weaknesses* in applications. However information security must take this approach into the third dimension by engaging the business, thoroughly understanding the application, and preventing *non-technical weaknesses* that abuse allowable parameters; **fraud**. This article will describe a few ways to protect an eCommerce system including a list of controls that may help reduce fraud.

Firstly, the three dimensions:

1. Industry standards such as ISO 27001, PCI DSS and SAS 70 can provide a level of assurance of operational practices (security policy, vulnerability management etc). This approach is sometimes known as top-down.
2. Penetration testing provides a level of assurance that tested (and corrected) applications are less likely to succumb to known technical vulnerabilities and common coding weaknesses. This approach is referred to as bottom-up.
3. Dimensions 1 + 2 may help an organisation appear security conscious however without examining controls in detail with a business mindset, the application may inadvertently allow non-technology based vulnerabilities i.e. fraud.

While the first dimension is addressed in the relevant documentation of each standard, there are specific areas that are relevant to E-Commerce. These practices normally form good vulnerability management and are priorities for an E-Commerce system:

- Patching (e.g. update for known vulnerabilities)
- Hardening (e.g. remove unnecessary software)
- Encryption (e.g. use strong encryption algorithms)
- Secure configuration (e.g. enforce strong passwords)

Technical weaknesses in the E-Commerce system may be identified by penetration testing. These will vary from system to system however the following are common focal points for reports relating to the second dimension:

- Shopping cart price/quantity manipulation
- Identification and authentication to secure areas
- Authorisation (access control) to resources in secure areas
- Session management (and encryption) to secure areas
- Protection of resources (Digital Rights Management)

Finally, let's enter the third dimension! Guidance to address fraud is less common than in areas pertaining to the first and second dimensions. This may because the controls are more specialized and must be tailored to the needs of the organization.

17.6 E-BUSINESS

E-Buisness: Distributing, buying, selling and marketing products and services over electronic systems. E-business for commercial transactions Involves supply chain management, e-marketing, online marketing, EDI.

Uses electronic technology such as:

- Internet
- Extranet/Intranet
- Protocols

17.7 MOBILE COMMERCE

Mobile commerce, also referred as m-commerce, is the use of wireless handheld devices such as cellular phones and laptops to conduct commercial transactions online. Mobile commerce transactions continue to grow, and the term includes the purchase and sale of a wide range of products and services, such as online banking, bill payment and information delivery.

17.8 NOTES

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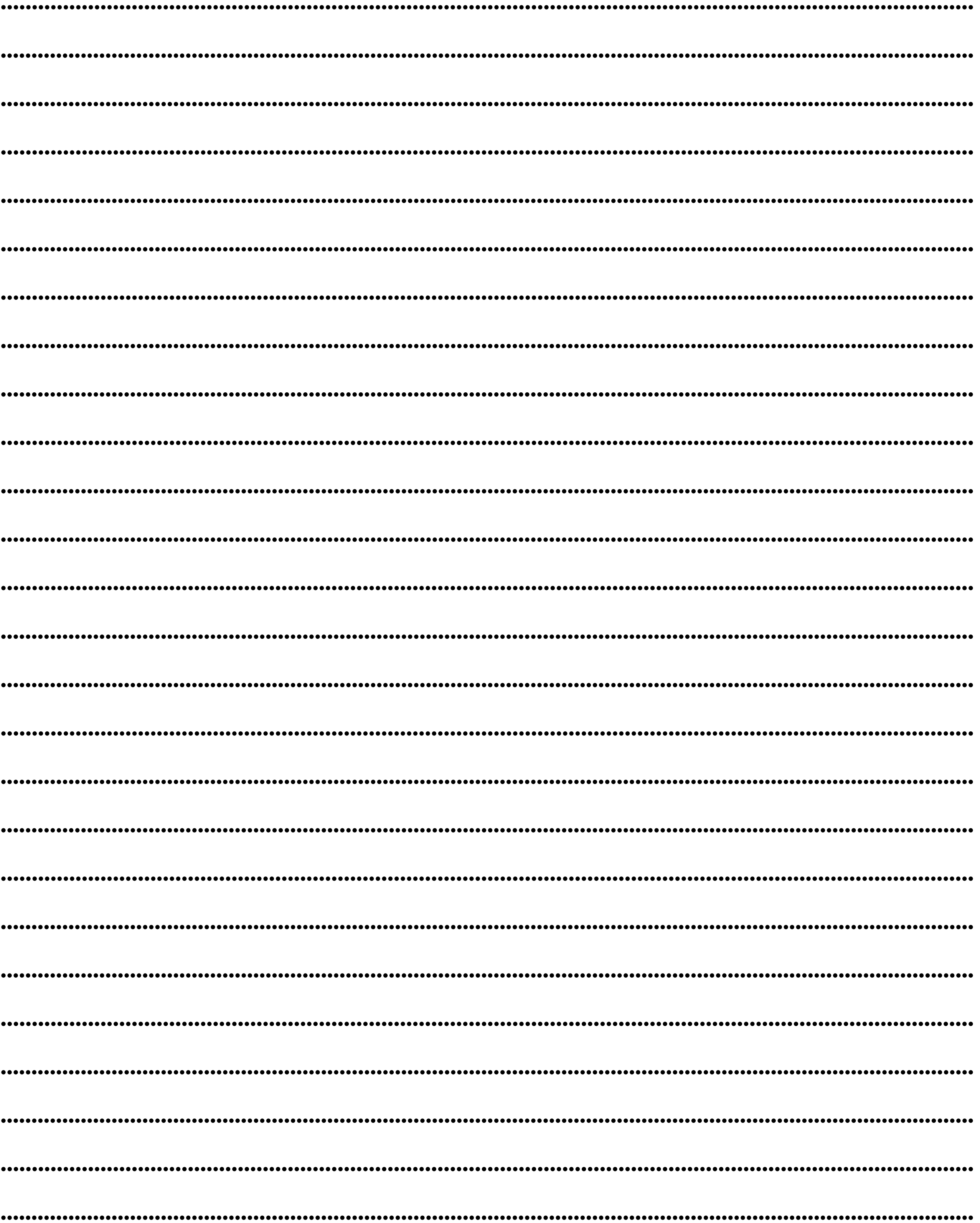

17.9 SUMMARY

This module discussed the elements of e-commerce can change practices within your company, and potentially in your entire industry or market. Specifically, you learned how to create market demand, draw attention to B2C sites, and keep online customers happy through good customer service. In addition, you learned the distinctions between B2B, B2C, and e-marketplace style e-commerce sites, and the types of business considerations you should apply to each type of e-commerce site. We briefly discussed personalization, portals, and banner ads, and how they can be used to create one-to-one market experiences for your site visitors. We compared e-procurement and supplier enablement B2B solutions, and how they appeal to buyers and sellers in the supply chain.You also learned about the basic forms of payment processing. Finally, we discussed the impact of e-marketplaces, and how they can change entire markets. We stressed how establishing and/or retaining brand is particularly important in e-commerce, whether you are a dot-com or a click-and-mortar.

In conclusion, the key to e-commerce remains good basic business sense. Investments in e-commerce should be pursued aggressively, but wisely, and should reflect the overall goals of theorganization.

Having completed the exercises in this module, you should now be able to:

1. Describe the basics of creating demand and drawing attention to e-commerce Web sites
2. Explain the importance and implementation impact of customer service for e-commerce
3. Describe the effect of using e-commerce one-to-one marketing techniques like personalization and portals
4. Differentiate B2B from B2C sites
5. Define supply chain and third-party service provider roles in e-business fulfillment processes
6. Identify the advantages and disadvantages of payment processing for e-commerce sites
7. Justify your company's participation in e-marketplaces

17.10 KEYWORDS

E-Commerce

E-Business

B2B

B2C

C2C

Intranet

Extranet

17.11 SELF ASSESSMENT QUESTIONS

1) E-Commerce and types of E-Commerce
2) E-Business and its functions
3) Intranet and Extranet
4) Advantages and Disadvantages of E-Commerce

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UNIT-18: INTRODUCTION TO INTERNET, INTERNET AND EXTRANETS BUSINESS APPLICATIONS ON INTERNET AND E-SHOPPING

Structure:

18.0 Objectives

18.1 Introduction and meaning of internet

18.2 Advantages of Internet

18.3 Disadvantages of Internet

18.4 Intranet

18.5 Extranet

18.6 Business applications of Internet

18.7 E-Shopping, advantages and disadvantages

18.8 Impact of reviews on consumer behavior

18.9 Notes

18.10 Summary

18.11 Keyword

18.12 Self Assessment Questions

18.13 References

18.0 OBJECTIVES

After studying this unit, you should able to;

- To understand the meaning and features Internet
- To know the business applications of Internet
- To study the role and history of E-Shopping
- To study the impact of reviews on consumer behavior

18.1 INTRODUCTION

The **internet** is an informal term for the world-wide communication network of computers. Internet is used to send information quickly between computers around the world. It is the global system of interconnected computer networks that use the Internet protocol suite (TCP/IP) to link billions of devices worldwide. It is a network of networks that consists of millions of private, public, academic, business, and government networks of local to global scope, linked by a broad array of electronic, wireless, and optical networking technologies.

The internet is used for many things, such as electronic mail, online chat, file transfer, and the interlinked web pages and other documents of the World Wide Web.

The most used service on the internet is the World Wide Web (which is also called the “Web”). The Web contains websites, blogs, and also wikis like Wikipedia. Webpages on the internet can be seen and read by anyone (unless the page needs a password, or it is blocked).

The second biggest use of the internet is to send and receive e-mail. E-mail is private and goes from one user to another. Instant messaging (such as AIM or ICQ) is similar to email, but allows two or more people to chat to each other much faster.

The internet can also be a dangerous place. Information that people put on the internet is not always checked, and some may not be true. Some may even be harmful. Also, if someone sends information through the internet, sometimes other people can read it even when they are not supposed to. For example, Facebook has had some problems with privacy settings. A person can post information on a website, but this is often a bad idea unless the person is very sure of what they are doing. A good way to check for a secure

website is to make sure the URL starts with https:// instead of http://, this means it is a secure site. (This only stops other people from reading what a user types. It does not mean the website is safe)

- Some websites may trick people into downloading viruses that can harm a computer or spyware that spies on its users (looks at what they are doing and tells someone else). E-mails can also have harmful files with them as “attachments”.[4]
- In internet chatrooms, people might be preying on others or trying to stalk or abuse them.
- The internet contains content that many people find offensive such as pornography, as well as content intended to be offensive.
- Criminals may steal people’s personal information or trick people into sending them money.

18.2 ADVANTAGES OF INTERNET

1) Information on almost every subject imaginable.
2) Powerful search engines
3) Ability to do research from your home versus research libraries.
4) Information at various levels of study. Everything from scholarly articles to ones directed at children.
5) Message boards where people can discuss ideas on any topic. Ability to get wide range of opinions. People can find others that have a similar interest in whatever they are interested in.
6) The internet provides the ability of emails. Free mail service to anyone in the country.
7) Platform for products like SKYPE, which allow for holding a video conference with anyone in the world who also has access.
8) Friendships and love connections have been made over the internet by people involved in love/passion over similar interests.
9) Things such as Yahoo Answers and other sites where kids can have readily available help for homework.

10) News, of all kinds is available almost instantaneously. Commentary, on that news, from every conceivable viewpoint is also available.

18.3 DISADVANTAGES OF INTERNET

The following are the dis advantages:

1) There is a lot of wrong information on the internet. Anyone can post anything, and much of it is garbage.

2) There are predators that hang out on the internet waiting to get unsuspecting people in dangerous situations.

3) Some people are getting addicted to the internet and thus causing problems with their interactions of friends and loved ones.

4) Pornography that can get in the hands of young children too easily.

5) Easy to waste a lot of time on the internet. You can start surfing, and then realize far more time has passed than you realized. Internet and television together of added to the more sedentary lifestyles of people which further exacerbates the obesity problem.

6) Internet has a lot of "cheater" sites. People can buy essays and pass them off as their own far more easily than they used to be able to do.

7) There are a lot of unscrupulous businesses that have sprung up on the internet to take advantage of people.

8) Hackers can create viruses that can get into your personal computer and ruin valuable data.

9) Hackers can use the internet for identity theft.

10) It can be quite depressing to be on the internet and realize just how uneducated so many people have become in today's society.

18.4 INTRANET

A private TCP/IP internetwork within an organization that uses Internet technologies such as Web servers and Web browsers for sharing information and collaborating. Intranets can be used to publish company policies and newsletters, provide sales and marketing staff with product information, provide technical support and tutorials, and just about anything else you can think of that fits within the standard Web server/Web browser environment. Intranet Web servers differ from public Web servers in that the public must have the proper permissions and passwords to access the intranet of an organization. Intranets are designed to permit users who have access privileges to the internal LAN of the organization. Within an intranet, Web servers are installed in the network. Browser technology is used as the common front end to access information on servers such as financial, graphical, or text-based data.

18.5 EXTRANET

Extranets refer to applications and services that are Intranet based, and use extended, secure access to external users or enterprises. This access is usually accomplished through passwords, user IDs, and other application level security. An extranet is the extension of two or more intranet strategies with a secure interaction between participant enterprises and their respective intranets. Part of a Company's Intranet that is extended to users outside the company (eg. Normally over the Internet). In its simplest form, a private TCP/IP network that securely shares information using Hypertext Transfer Protocol (HTTP) and other Internet protocols with business partners such as vendors, suppliers, and wholesale customers. An extranet is thus a corporate intranet that is exposed over the Internet to certain specific groups that need access to it. Extranets built in this fashion follow the client/server paradigm, with Web servers such as Apache. Extranets are a powerful tool because they let businesses share resources on their own private networks over the Internet with suppliers, vendors, business partners, or customers. Extranets are typically used for supporting real time supply chains, for enabling business partners to work together, or to share information such as catalogs with customers. The power of the extranet is that it leverages the existing technology of the Internet to increase the power, flexibility, and competitiveness of businesses utilizing well-known and easily used tools such as Web servers and Web browsers. Extranets also save companies money by allowing them to establish business-to-business connectivity

over the Internet instead of using expensive, dedicated leased lines. Extranets can also save money by reducing phone and fax costs.

18.6 BUSINESS APPLICATIONS OF INTERNET

Business applications of Internet can perform complex business processes on either the client or the server. In a server-based Internet application, the application uses the Internet protocol to receive requests from a client, typically a Web browser, process associated code, and return data to the browser.

In Visual Basic Internet programming, you can add active content to Web pages with little effort. Visual Basic Internet applications link Visual Basic code to one or more HTML pages and handle events raised in those pages by interacting with programs on either a client or a server. There are two types of Internet applications in Visual Basic: server-based IIS applications and client-based DHTML applications.

The user interface in a Visual Basic Internet application can be a series of HTML pages, a mix of HTML pages and Visual Basic forms, or a Visual Basic form that makes use of special components such as the Web Browser control to take advantage of some of the power of the Internet. Regardless of the type of user interface, the application handles events, calls methods, and sets and retrieves properties based on elements in the HTML page.

The Web pages that make up the user interface for Visual Basic Internet applications are generally produced by a Web designer, rather than a developer. If you prefer to create your own HTML pages you can, but you do not have to. Instead, you can focus on your talents as a Visual Basic programmer by writing Visual Basic code that interacts with and uses HTML. Using your skills as a developer, you can easily produce dynamic, powerful applications for the Web.

For example, using Visual Basic Internet technology, you might create an application that can be used entirely on the browser to let salespeople track their status on the road, then link up to the central server when they return to the office. Or, you might create a sophisticated database-driven system that presents a catalog of selections to your end users, through their browser. Users could choose products from the catalog and your application would run associated Visual Basic code to retrieve product detail from a database record set and send that information to the user.

Some of the business applications of Internet are:

1. **Communication:** it is used for sending and receiving message from one and other through internet by using electronic mail. Some of the web sites providing this service are yahoomail.com Hotmail.com rediffmail.com etc.

2. **Job searches:** getting information regarding availability of job in different sectors and areas. You can publish your resume in online for prospective job. Some of the web sites providing this service are naukri.com, monster.com, summerjob.com, recuritmentindia.com etc.

3. **Finding books and study material:** books and other study material stored around the world can be easily located through internet. Latest encyclopedias' are available online.

4. **Travel:** one can use internet to gather information about various tourist place. It can be used for booking Holiday tours, hotels, train and flights. Some of the web sites providing this service areindiatravelog.com, rajtravel.com, makemytrip.com.

5. **Shopping:** internet is also used for online shopping. By just giving accounts details you can perform the transaction. You can even pay your bills and perform bank related transaction.

6. **Stock market updates:** you can sell or buy shares while sitting on computer through internet. Several websites like ndtvprofit.com, moneypore.com, provide information regarding investment

7. **Research:** a large number of people are using internet for research purposes you can download any kind information by using internet

8. **Business use of internet:** different ways by which internet can be used for business are:

- Information about the product can be provided can be provided online to the customer.
- Provide market information to the business
- It help business to recruit talented people
- Help in locating suppliers of the product.
- Fast information regarding customers view about companies product

- Eliminate middle men and have a direct contact with contact with customer.
- Providing information to the investor by providing companies back ground and financial information on web site.

18.7 E-SHOPPING ADVANTAGES AND DISADVANTAGES

E-shopping is a form of electronic commerce which allows consumers to directly buy goods or servicesfrom a seller over the Internet using a web browser. Consumers find a product of interest by visiting the website of the retailer directly or by searching among alternative vendors using a shopping search engine, which displays the same product's availability and pricing at different e-retailers.

An E-shop evokes the physical analogy of buying products or services at a regular "bricks-and-mortar"retailer or shopping centre; the process is called business-to-consumer (B2C) online shopping. When an online store is set up to enable businesses to buy from other businesses, the process is called business-to-business (B2B) online shopping. A typical online store enables the customer to browse the firm's range of products and services, view photos or images of the products, along with information about the product specifications, features and prices.

Payment

Online shoppers commonly use a credit card or a PayPal account in order to make payments. However, some systems enable users to create accounts and pay by alternative means, such as:

- Billing to mobile phones and landlines
- Cash on delivery (C.O.D.)
- Cheque/ Check
- Debit card
- Direct debit in some countries
- Electronic money of various types
- Gift cards
- Postal money order

- Wire transfer/delivery on payment
- Invoice, especially popular in some markets/countries, such as Switzerland

Some online shops will not accept international credit cards. Some require both the purchaser's billing and shipping address to be in the same country as the online shop's base of operation. Other online shops allow customers from any country to send gifts anywhere. The financial part of a transaction may be processed in real time (e.g. letting the consumer know their credit card was declined before they log off), or may be done later as part of the fulfillment process.

Product delivery

Once a payment has been accepted, the goods or services can be delivered in the following ways. For physical items:

- ♦ Shipping: The product is shipped to a customer-designated address. Retail package delivery is typically done by the public postal system or a retail courier such as FedEx,UPS, DHL, or TNT.
- ♦ Drop shipping: The order is passed to the manufacturer or third-party distributor, who then ships the item directly to the consumer, bypassing the retailer's physical location to save time, money, and space.
- ♦ In-store pick-up: The customer selects a local store using a locator software and picks up the delivered product at the selected location. This is the method often used in the bricks and clicks business model.

For digital items or tickets:

- ♦ Downloading/Digital distribution: The method often used for digital media products such as software, music, movies, or images.
- ♦ Printing out, provision of a code for, or e-mailing of such items as admission tickets and scrip (e.g., gift certificates and coupons). The tickets, codes, or coupons may be redeemed at the appropriate physical or online premises and their content reviewed to verify their eligibility (e.g., assurances that the right of admission or use is redeemed at the correct time and place, for the correct dollar amount, and for the correct number of uses).

- Will call, COBO (in Care Of Box Office), or “at the door” pickup: The patron picks up pre-purchased tickets for an event, such as a play, sporting event, or concert, either just before the event or in advance. With the onset of the Internet and e-commerce sites, which allow customers to buy tickets online, the popularity of this service has increased.

Design

Customers are attracted to online shopping not only because of high levels of convenience, but also because of broader selections, competitive pricing, and greater access to information. Business organizations seek to offer online shopping not only because it is of much lower cost compared to bricks and mortar stores, but also because it offers access to a worldwide market, increases customer value, and builds sustainable capabilities.

User interface

The most important factors determining whether customers return to a website are ease of use and the presence of user-friendly features. Usability testing is important for finding problems and improvements in a web site. Methods for evaluating usability include heuristic evaluation, cognitive walkthrough, and user testing. Each technique has its own characteristics and emphasizes different aspects of the user experience.

Advantages of E-shopping

a. Convenience

E- stores are usually available 24 hours a day, and many consumers in Western countries have Internet access both at work and at home. Other establishments such as Internet cafes, community centres and schools provide internet access as well. In contrast, visiting a conventional retail store requires travel or commuting and costs such as gas, parking, or bus tickets, and must typically take place during business hours.

b. Information and reviews

E-stores must describe products for sale with text, photos, and multimedia files, whereas in a physical retail store, the actual product and the manufacturer’s packaging will be available for direct inspection (which might involve a test drive, fitting, or other experimentation). Some E-stores provide or link to supplemental product information, such as instructions, safety procedures, demonstrations, or manufacturer specifications. Some provide background information, advice, or how-to guides designed to help consumers decide which product to buy.

c. Price and selection

One advantage of shopping online is being able to quickly seek out deals for items or services provided by many different vendors (though some local search engines do exist to help consumers locate products for sale in nearby stores). Search engines, online price comparison services and discovery shopping engines can be used to look up sellers of a particular product or service.

Disadvantages E-shopping

a. Fraud and security concerns

Given the lack of ability to inspect merchandise before purchase, consumers are at higher risk of fraud than face-to-face transactions. When ordering merchandise online, the item may not work properly, it may have defects, or it might not be the same item pictured in the online photo. Merchants also risk fraudulent purchases if customers are using stolen credit cards or fraudulent repudiation of the online purchase.

Although the benefits of online shopping are considerable, when the process goes poorly it can create a thorny situation. A few problems that shoppers potentially face include identity theft, faulty products, and the accumulation of spyware. If users are required to put in their credit card information and billing/shipping address and the website is not secure, customer information can be accessible to anyone who knows how to obtain it. Most large online corporations are inventing new ways to make fraud more difficult. However, criminals are constantly responding to these developments with new ways to manipulate the system.

b. Lack of full cost disclosure

The lack of full cost disclosure may also be problematic. While it may be easy to compare the base price of an item online, it may not be easy to see the total cost up front. Additional fees such as shipping are often not be visible until the final step in the checkout process. The problem is especially evident with cross-border purchases, where the cost indicated at the final checkout screen may not include additional fees that must be paid upon delivery such as duties and brokerage

c. Privacy

Privacy of personal information is a significant issue for some consumers. Many consumers wish to avoid spam and telemarketing which could result from supplying contact

information to an online merchant. In response, many merchants promise to not use consumer information for these purposes.Many websites keep track of consumer shopping habits in order to suggest items and other websites to view.

18.8 IMPACT OF REVIEWS ON CONSUMER BEHAVIOUR

One of the great benefits of online shopping is the ability to read product reviews, written either by experts or fellow online shoppers. The Nielsen Company conducted a survey in March 2010 and polled more than 27,000 Internet users in 55 markets from the Asia-Pacific, Europe, Middle East, North America, and South America to look at questions such as "How do consumers shop online?", "What do they intend to buy?", "How do they use various online shopping web pages?", and the impact of social media and other factors that come into play when consumers are trying to decide how to spend their money on which product or service.

Advantages of E-Shopping

- **Save Time –** Do you have the specific list that you want to buy? With just a couple of clicks of the mouse, you can purchase your shopping orders and instantly move to other important things, which can save time.
- **Save Fuel –** The market of fuel industries battles from increasing and decreasing its cost every now and again, but no matter how much the cost of fuel are it does not affect your shopping errands. One of the advantages of shopping online is that there is no need for vehicles, so no purchase of fuel necessary.
- **Save Energy –** Admit it, it is tiresome to shop from one location and transfer to another location. What is worse is that there are no available stocks for the merchandise you want to buy. In online shopping, you do not need to waste your precious energy when buying.
- **Comparison of Prices –** The advanced innovation of search engine allows you to easily check prices and compare with just a few clicks. It is very straightforward to conduct price comparisons from one online shopping website to another. This gives you the freedom to determine which online store offers the most affordable item you are going to buy.

- **24/7 Availability –** Online shopping stores are open round the clock of 24/7, 7 days a week and 365 days. It is very rare to find any conventional retail stores that are open 24/7. The availability of online stores give you the freedom to shop at your own pace and convenience.
- **Hate Waiting in Lines –** When buying items online, there are no long lines you have to endure, just to buy your merchandise. The idea of shopping online is cutting down those bad habits of standing in a long line and just waiting. Every online store is designed with unique individual ordering features to purchase the item.
- **Too Ashamed to Buy –** There are times that you want to purchase something out of the ordinary that can be a bit embarrassing when seen by other people. Items like weird ornaments, sexy lingerie, adult toys, etc. In online shopping, you do not need to be ashamed; your online transactions are basically done privately.
- **Easy to Search Merchandise You Want to Buy –** You are able to look for specific merchandise that includes model number, style, size, and colour that you want to purchase. In addition, it is easy to determine whether the products are available or out of stock.

Disadvantages of E-Shopping

If there are advantages, most likely there will be disadvantages. Despite the success of purchasing through online shopping stores, there are still some disadvantages that most people complain about. These include:

- **Personally Check the Item –** If you are one of those shoppers who want to touch, see, and test the product personally, at online shopping, you are not able to do so. Online stores are only showing product description and photos of the merchandise, which can be a disadvantage for many online shoppers.
- **Diminished Instant Satisfaction –** Unlike buying at retail stores, you are able to use the product instantly after you buy it, which can be satisfying. However, online shopping requires patience to wait for the item to arrive at your door step about 2 to 3 days or even longer depending on the location you've ordered it from.

Online shopping is continuously becoming more popular and improving every single day. Knowing the advantages of online shopping and its disadvantages is additional knowledge for a lot of online shoppers that are useful before shopping online.

18.9 NOTES

18.10 SUMMARY

Because of the world on going forward evolution, the Development of Technologyis getting modern in order to serve human needs. Previously, scientists have invented theway of transportation, which is one of human needs such as Motorcycles, cars, airplanes.But at the present time, with the modern technology, that have discovered a new way of communication called „Internet . Itis not only able to contact in the country butoverseas as well. With its easiness and fast communication, the use of Internet is adoptedby all over the world. Apart, in Cambodia, Internet just gets popularity recently.Because of itscommunicating in government, institution, business man, NGO stuffs,students, especially, among teenager nowadays. Numbers of Internet users areincreasing numerous. At the same time the number of Internet provider are also gettingmuch more than before with their small shops along the streets in Phnom Penh. Thesedays Internet plays a very important role for the Cambodian people while Cambodia isdeveloping into the outside world as a crucial member in social events such as ASEAN,AIPO and the Organization member. All these factors require all Cambodians tounderstand how to use Internet in order to be with the new age of Technology as othercountries.

18.11 KEYWORDS

Internet

Intranet

Extranet

E-Shopping

E-Cart

Consumer behavior

18.12 SELF ASSESSMENT QUESTIONS

1) Importance of Internet in current scenario

2) Intranet and extranet

3) Advantages and disadvantages of Internet

4) E-Shopping advantages and disadvantages

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UNIT–19 : ELECTRONIC PAYMENT SYSTEM

Structure:

19.0 Objective

19.1 Introduction

19.2 Meaning of Electronic payment system

19.3 Types of Electronic payment system

19.4 Disadvantages of Electronic Payment system

19.5 E -Signature

19.6 Smart cards

19.7 Electronic Fund Transfer

19.8 Privacy in the networked environment

19.9 Government regulations

19.10 Notes

19.11 Summary

19.12 Keywords

19.13 Self Assessment Questions

19.14 References

19.0 OBJECTIVES

After studying this unit, you should able to;

- To understand the meaning and features of Electronic Payment system
- To know the objectives and factors of EPS
- To study the role and history of EFT and EPS
- To study the various types of EPS

19.1 INTRODUCTION

Electronic payment is a subset of an e-commerce transaction to include electronic payment for buying and selling goods or services offered through the Internet. Generally we think of electronic payments as referring to online transactions on the internet, there are actually many forms of electronic payments. As technology developing, the range of devices and processes to transact electronically continues to increase while the percentage of cash and check transactions continues to decrease.

The Internet has the potential to become the most active trade intermediary within a decade. Also, Internet shopping may revolutionize retailing by allowing consumers to sit in their homes and buy an enormous variety of products and services from all over the worlds. Many businesses and consumers are still wary of conducting extensive business electronically. However, almost everyone will use the form of E Commerce in near future.

Development of Internet technologies has contributed to emergence of electronic money and online business. For those who work on the internet resources, e-currency is important, and the choice of e-payment system is particularly responsible.

Over time, the chip for payment can be expected to move onto other devices. A smart card might then become the computer chip in a phone, other device that can perform the same function as chip in a plastic card, eliminating the need for the actual plastic card. Smart cards could thus evolve into smart phones, or other smart devices.

19.2 MEANING OF ELECTRONIC PAYMENT SYSTEM

An electronic payment is any kind of non-cash payment that doesn't involve a paper check. Methods of electronic payments include credit cards, debit cards and the ACH (Automated Clearing House) network. The ACH system comprises direct deposit, direct debit and electronic checks (e-checks).

ELECTRONIC PAYMENT SYSTEMS – IN SHORT

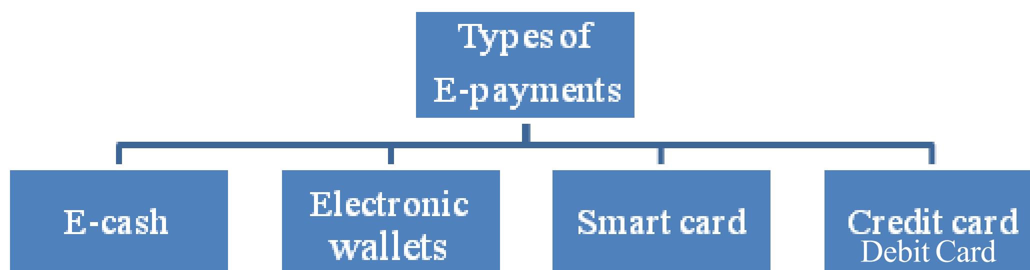
- **To transfer money over the Internet**
- **Methods of traditional payment**
  - Check, credit card, or cash
- **Methods of electronic payment**
  - Electronic cash, software wallets, smart cards, and credit/debit cards

DEFINITION OF ELECTRONIC PAYMENT SYSTEM

The definition of an electronic payment system is a way of paying for a goods or services electronically. Instead of using cash or cheque, in person or by mail. An example of an electronic payment system is a pay pal and also the use of a credit card.

Electronic payment is a financial exchange that takes place online between buyers and sellers. The content of this exchange is usually some form of digital financial instrument such as encrypted credit card numbers, electronic cheques or digital cash that is backed by a bank or an intermediary, or by a legal lender.

19.3 TYPES OF ELECTRONIC PAYMENT SYSTEM



I. Electronic Cash (E-Cash)

E-cash Concept

1. Consumer buys e-cash from Bank
2. Bank sends e-cash bits to consumer (after charging that amount plus fee)
3. Consumer sends e-cash to merchant
4. Merchant checks with Bank that e-cash is valid (check for forgery or fraud)
5. Bank verifies that e-cash is valid
6. Parties complete transaction: e.g., merchant present e-cash to issuing back for deposit once goods or services are delivered

ADVANTAGES AND DISADVANTAGES OF ELECTRONIC CASH

- **Advantages**

1. More efficient, eventually meaning lower prices
2. Lower transaction costs
3. Anybody can use it, unlike credit cards, and does not require special authorization

- **Disadvantages**

1. Susceptible to forgery

II. Eelectronic Wallets

1. Stores credit card, electronic cash, owner identification and address

2. Makes shopping easier and more efficient

3. Eliminates need to repeatedly enter identifying information into forms to purchase

4. Works in many different stores to speed checkout

5. Amazon.com one of the first online merchants to eliminate repeat form-filling for purchases

DIFFERENT FORMS OF ELECTRONIC WALLETS

- **Agile Wallet**

– Developed by Cyber Cash

– Allows customers to enter credit card and identifying information once, stored on a central server

– Information pops up in supported merchants' payment pages, allowing one-click payment

– Does not support smart cards or Cyber Cash, but company expects to soon

- **Ewallet**

– Developed by Launch pad Technologies

– Free wallet software that stores credit card and personal information on users' computer, not on a central server; info is dragged into payment form from E-Wallet

– Information is encrypted and password protected

– Works with Netscape and Internet Explorer

MICROSOFT WALLET

– Comes pre-installed in Internet Explorer 4.0, but not in Netscape

– All information is encrypted and password protected

– Microsoft Wallet Merchant directory shows merchants setup to accept Microsoft Wallet

iii. Credit Cards and Debit Cards

A. Credit Card

A credit card allows you to borrow money from your bank to make your purchases, whether you're buying a burger or a round-trip ticket to France. As long as you pay back the money you bosrrowed withing the "grace period"of 25-30 days, you don't have to pay extra. If you don't pay it back in that time period. you'll have to pay interest - a percentage of the money you owe the bank- on top of what you borrowed.

Credit card pros and cons

Pros	Cons
• You can Make a large purchase now and pay it off in smaller chunks	• You can easily dig yourself into debt if you're not careful about your spending
• Your csrsedit card Statement makes budgeting easier	• The Ease of using credit cards can cause you to overspend
• It's easier than carrying around a wad of cash	• Interest rates can make even a small debt seem larger over time
• You can build up your credit score, which will be useful late on	

ADVANTAGES OF CREDIT CARDS

1. Used for the majority of Internet purchases
2. Has a preset spending limit
3. Currently most convenient method
4. Most expensive e-payment mechanism

DISADVANTAGES

1. Does not work for small amount (too expensive)

B. Debit Card

A **debit card** is a plastic card which provides an alternative payment method to cash when making purchases. Physically the card is an ISO 7810 card like a credit card;

Depending on the store or merchant, the customer may swipe or insert their card into the terminal, or they may hand it to the merchant who will do so. The transaction is authorized and processed and the customer verifies the transaction either by entering a PIN or, occasionally, by signing a sales receipt.

CREDIT CARD VS DEBIT CARD

1. You can obtain credit in credit card but not in debit card.
2. Credit card charges interest for using the bank's money. (debit card is free from this problem)

ADVANTAGES OF ELECTRONIC PAYMENT SYSTEM

1. **Atomicity** - Money is not lost or created during a transfer
2. **Good atomicity** - Money and good are exchanged atomically
3. **Non-repudiation** - No party can deny its role in the transaction

DESIRABLE PROPERTIES OF DIGITAL MONEY

1. Universally accepted
2. Transferable electronically
3. Divisible
4. Private (no one except parties know the amount)
5. Anonymous (no one can identify the payer)
6. No known system satisfies all

19.4 DISADVANGES OF ELECTRONIC PAYMENT SYSTEM

1. **Low security**

LEGAL FRAMEWORK FOR E-COMMERCE

A number of recent EU legal acts aim at fostering electronic commerce and ensuring a legally safe and sound conduct of e-payments:

1. E-commerce Directive
2. E-money Directives
3. E-signature Directive
4. Prudential supervision and related Directives

Commission is currently consulting the public on a possible legal framework for the Single Payment Area in the Internal Market.

19.5 E-SIGNATURE

Electronic signatures, a means of verifying the identity of the user of a computer system to control access or authorize a transaction, are increasingly being used in electronic commerce. Several technologies can be used to produce electronic signatures, the most prominent being digital signatures, which use cryptographic techniques to provide data integrity and non-repudiation. Other legislation introduced but not enacted was intended to promote federal agency use of electronic signatures to enable electronic filing of information.

DEFINITIONS AND TECHNOLOGIES USED FOR ELECTRONIC SIGNATURES

Electronic signatures are methods used to provide *electronic authentication*, a process of verifying the identity of users of a computer in order to control access or authorize transactions. In many states and industry sectors, electronic signatures attached to *electronic records* are legally recognized in the same manner as handwritten signatures on paper. Electronic signatures are used to establish identity in electronic commerce, and to control access to facilities or systems. Electronic signatures are either being implemented or planned for medical and financial records, and various government transactions. The following technologies are forms of electronic signatures at various levels

- **Passward or Personal Identification Number (PIN)** a set of numbers or characters shared only by the system and the user, and usually encrypted if the authentication occurs over an open network
- **Smart Card :** a plastic card similar to a credit card, except that it contains a microprocessor that can generate, store, and process data, and can be programmed to be activated only when the user enters a PIN or other identifier. Together with a reader device, electronic cash payments, access to ATMs, and to store medical or financial data for individuals, and provide greater security than a PIN, because the user must have both the card and the PIN
- **Biometrics** : technologies for measuring and analyzing human body characteristics such as fingerprints, eye retinas and irises, voice patterns, facial patterns and hand

measurements to authenticate their identity. Biometric devices consist of a reader or sensor, software that converts the received information into digital form (i.e., a series of binary digits or bits), and if the data are analyzed, a database to store an individual's known biometric data with the entered biometric data

- **Digitized Signature** : A graphical image of a handwritten signature, usually entered using a special digital pen and pad input device. The input signature is automatically compared with a stored copy of the digitized signature of the user, and authenticated if the two signatures meet specifications for similarity
- **Digital Signature :** an electronic signature that is produced on a message using a key that is known only by the signer, and a signature algorithm that is publicly known. The digital signature is unique to each message and key combination. It can be used to verify the identity of the signer and to provide *data integrity*. It can also be used to prove to a third party that the signature was in fact signed by the signatory known as non-repudiation.

19.6 SMART CARDS

INTRODUCTION

Smart card is one of the greatest achievements in the world of information technology. Similar in size to today's plastic payment card, the smart card has a microprocessor or memory chip embedded in it that, when coupled with a reader, has the processing power to serve many different applications.

Smart cards help businesses evolve and expand their products and services in a changing global marketplace. The scope of uses for a smart card has expanded each year to include applications in a variety of markets and disciplines. In recent years, the information age has introduced an array of security and privacy issues that have called for advanced smart card security applications. Along with magnetic stripe cards, smart cards are and will increasingly be used for payments. Smart cards are at present overwhelmingly plastic credit cards with an embedded computer chip. Until recently, many smart cards operated using proprietary rather than common standards. A standard set of specifications, EMV, has been developed and is being used increasingly so that the chips on smart cards are interoperable. Korea and Japan are among the most advanced countries in Asia for smart card payments, with Malaysia catching up fast due to government mandates for banks to issue smart cards.

The rest of the paper is organized as follows; the next section briefly discusses the history of smart card development and the current and future market analysis. Section three looks into some application areas, their limitations and strengths. This section addresses the future directions of smart card technology giving more emphasis to security consideration and memory management among others. The section also discusses some areas that need further studies in order to improve the current state of smart cards so that they can fit into the future needs. Like smart cards, biometric is also an approach used in identification protocol.

As an access-control device, smart cards can be used to access server remotely over the Internet and they can make personal and business data available only to the appropriate users. Smart cards provide data portability, security, convenience and the like. According to Gemplus (ref. [19]), smart cards can be categorized into the following:

i. **Memory and Microprocessor -** Memory cards simply store data and can be viewed as a small floppy disk with optional security. A microprocessor card, on the other hand, can add, delete and manipulate information in its memory on the card.

ii. **Contact and Contactless -** Contact smart cards are inserted into a smart card reader, making physical contact with the reader. However, contactless smart cards have an antenna embedded inside the card that enables communication with the reader without physical contact. A combi card combines the two features with a very high level of security

iii. **Plastic Card Containing an Embedded Microchip**

iv. **Available for over 10 years VAILABLE FOR OVER 10 YEARS**

v. **So far not successful in U.S., but Popular in Europe, Austrialia, and Japan**

vi. **Smart Cards Gradually Reappearing in U.S.; Success Depends on :**

   a. Critical mass of smart cards that support applications

   b. Compatibility between smart cards, card-reader devices, and applications

HISTORICAL PERSPECTIVE

♦ Smart card was invented at the end of the seventies by Michel Ugon (Guillou, 1992). The French group of bankcards CB (Carte Bancaire) was created in 1985 and has allowed the diffusion of 24 million devices (Fancher, 1997). For the physical characteristics the first draft proposal was registered in 1983. A long discussion resulted in the

standardization of the contact location. Next was the standardization of signals and protocols which resulted in standards ISO/IEC 7816/1-4. Logical security came next, as it was clear from the beginning that there was a need for cryptographic capabilities, though this was a bit difficult due to the limited computing power and the few bytes of RAM available at that time (Quisquater, 1997). Nowadays, smart cards are used in several applications.

♦ A survey completed by Card Technology Magazine (http://www.cardtechnology.com) indicated that the industry had shipped more than 1.5 billion smart cards worldwide in 1999. Over the next five years, the industry will experience steady growth, particularly in cards and devices to conduct electronic commerce and to enable secure access to computer networks. A study by Dataquest in March, 2000, predicts almost 28 million smart card shipments (microprocessor and memory) in the U.S. According to this study, an annual growth rate of 60% is expected for U.S. smart card shipments between 1998 and 2003. Smart Card Forum Consumer Research, published in early 1999, provides additional insights into consumer attitudes towards application and use of smart cards. The market of smart card is growing rapidly due to its wide range of applications.

MEANING OF SMART CARDS

Smart card a plastic card similar to a credit card, except that it contains a microprocessor that can generate, store, and process data, and can be programmed to be activated only when the user enters a PIN or other identifier. Together with a reader device, electronic cash payments, access to ATMs, and to store medical or financial data for individuals, and provide greater security than a PIN, because the user must have both the card and the PIN

ADVANTAGES OF SMART CARDS

1. Atomic, debt-free transactions
2. Feasible for very small transactions (information commerce)
3. (Potentially) anonymous
4. Security of physical storage
5. (Potentially) currency-neutral

DISADVANTAGES SMART CARDS

1. Low maximum transaction limit (not suitable for B2B or most B2C)
2. High Infrastructure costs (not suitable for C2C)
3. Not (yet) widely used

19.7 ELECTRONIC FUND TRANSFER

Introduction

Can you imagine trying to shop on the Internet and the only way to pay is by sending a check in the mail? How about not being able to use a credit or debit card when you went out to eat or put gas in your car? The way in which we transfer money has advanced tremendously over the last several years. PayPal, online bill pay, and mobile payments are all examples of recent advancements. These changes are referred to as electronic funds transfer, or the electronic transfer of money from one account to another. Electronic funds transfer uses computer systems to move funds without the need for paper documents. Yes, people sometimes still use paper checks, but electronic funds transfer methods are now the preferred way to do business.

Electronic funds transfer (EFT) is the electronic transfer of money from one bank account to another, either within a single financial institution or across multiple institutions, through computer-based systems and without the direct intervention of bank staff.

Meaning and Efinition

The electronic fund transfersystem(EFT - Electronic Funds Transfer)represent a set of devices and specific proceduresused to make possible the movement ofthe monetary flux from the payer to thepayee, in an exclusive electronic medium.[Patriciu et. all,2004]

Electronic funds transfer (EFT) is the electronic transfer of money from one bank account to another, either within a single financial institution or across multiple institutions, through computer-based systems and without the direct intervention of bank staff. EFTs are known by a number of names. In the United States, they may be referred to as electronic checks or e-checks

Eelectronic Funds Transfer Process

When you use your card at a store, money is electronically transferred from your account and then it is simultaneously deposited in the store account. This may involve an automated clearing house or sometimes a central electronic processor, which could add a day to process, but it is still much quicker.

The process for a consumer to set up online bill pay, direct deposit, or direct debit is fairly simple. It usually involves providing data to the financial institutions, including your bank routing and account numbers, vendor account numbers you want to pay and dates of payments. It can usually be done online or by filling out a simple form.

Advantages od Electronic Fund Transfer

There are many benefits to electronic funds transfer. Let's explore them more in detail.

i. **CHEAPER -** The cost savings are numerous. For example, by using online bill pay every month to pay bills such as water, gas, electricity, and credit card, you could save the postage rate on every bill paid Plus, it takes only a few minutes to pay all of your bills online. Writing out checks and delivering them to the post office could take you much more time. So add in the value of your time saved!

ii. **FASTER -** Electronic funds transfer has made buying and selling on the Internet much simpler. Money can be sent between accounts in real time. For example, when you sell something online, you can see when money has been deposited into your account within minutes or seconds of the other person sending it. A paper check could have taken five days.

COMMON USES FOR ELECTRONIC FUNDS TRANSFER

Let's look at several ways that you may currently use electronic funds transfer:

i. **Using Credit or Debit Card -** Using this method, money is transferred electronically from your account to the seller's account. This is one of the most widely used forms of payment.

ii. **Online Bill Payment -** Often referred by many as online banking, this has become very popular as a quick and easy way to pay monthly bills. More than two out of every

three bills are now paid in an electronic form. This has recently further evolved into the ability to pay bills directly from your mobile device or phone.

iii. **Direct Debit** - This is often referred to as electronic checks or monthly auto draft. Individuals can set up a recurring schedule and payment instructions for companies to automatically pull money from their bank account to pay for bills or services. Many people pay their house or car payments this way. The method simply requires sending the institution avoided check with your routing and account number.

iv. **Direct Depost** -This form of employee payment is now the preferred way to get paid from your employer and is often the only way for some jobs. Your pay check enters your bank account quicker, and the employer saves hundreds or thousands of dollars in not printing and delivering checks.

DISADVANGES OF ELECTRONIC FUND TRANSFER

i. Traditional V/s Electronic

Because the electronic funds process is simplified and entirely electronic, the cycle of transferring and paying money is much faster. let's compare both traditional and electronic processes side by side.

ii. Writing Paper Check

The store manually deposits the check at their bank, and the bank sends the check to a clearing house, or an establishment where checks and bills are exchanged. The clearing house sends the check to the customer's bank to be posted. This is an older process that contains no electronic money transfer and would usually take at least a week to complete the cycle.

19.8 PRIVACY IN THE NETWORKED ENVIRONMENT

It is essential to assure personal privacy in the networked environment if people are to feel comfortable doing business across this new medium. Data gatherers should tell consumers what information they are collecting and how they intend to use it. Consumers should have meaningful choice with respect to the use and re-use of their personal information. Parents should be able to choose whether or not personal information is collected from their children. In addition, redress should be available to consumers who are harmed by improper use or disclosure of personal information or if decisions are based on inaccurate, outdated, incomplete, or irrelevant personal information.

The administration supports private sector efforts now underway to implement meaningful, user friendly, self-regulatory privacy regimes. These include mechanisms for facilitating awareness and the exercise of choice online, private sector adoption of and adherence to fair information practices, and dispute resolution. The government will work with industry and privacy advocates to develop appropriate solutions to privacy concerns that may not be fully addressed by industry through self-regulation and technology.

19.9 GOVERNMENT REGULATIONS

Various government agencies have been active in the development of the internet privacy policies or principles. Recent public outcries regarding online privacy have accelerated government's involvement. In Europe, there are laws protecting the privacy of citizen.

The task force recommended that the proposed principles for privacy apply to both public and commercial uses of private information.

- **Awareness** - Individuals have a personal responsibility to obtain information about which data are collected and how they will be used.
- **Empowerment** - Individuals should have a way to access, correct, and technically control their information, and be anonymous in certain cases.
- **Redress -** Individuals should take action when harm occurs.
- **Impact assessment** - Users of information should evaluate the impact on information providers of using their information.
- **Only reasonably necessary** - Users should only use information that is necessary.
- **Notice** - Users should provide information on why information is collected, what information is collected, which protections are offered, what consequences could result, and what redresses are available to the providers of information.
- **Security** - Users of information should provide security measures to protect the data.
- **Limited use** - Users of information should limit their use to the level of the individuals' understanding of that use.
- **Education** - User of information should provide education for providers of information and the public in general regarding privacy and collection of data.

19.10 NOTES

19.11 SUMMARY

Electronic cash systems offer vast opportunities for the consumer and the merchant. In business to business transactions, electronic cash allows businesses to verify cash transactions instantly – and to covert from one currency to another. In consumer to business transactions, it is easier for the customer because there is no need to carry physical currency, and transactions can be made over the Internet. Electronic cash offers security, through authentication, and offers non-repudiation of transactions. Furthermore, the micro-payment model allows previously unsaleable items and services to be paid for, because there isn't a limit on the size of the transaction. When fractions of cents can be transferred between parties, publishers of content can charge extremely small fees and still receive just compensation for their efforts, because the number of people who can afford their content will increase. Provided that an electronic cash system standard evolves, the future for e-cash is bright!

19.12 KEYWORDS

Electronic Payment system

E Signature

Smart cards

Electronic fund transfer

Privacy

Networked environment

Government regulations

19.13 SELF ASSESSMENT QUESTIONS

1) Explain the EPS

2) Types of EPS

3) E-Signature

4) Government regulations on EPS

5) Privacy risk on EPS

5) Electronic Fund Transfer

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UNIT - 20 : SECURITY ISSUES IN E-BUSINESS

Structure :

20.0 Objectives

20.1 Security overview

20.2 Security issues

20.3 Threats in E-Commerce

20.4 Digital Signature

20.5 Digital Certificates

20.6 Types of Digital certificates

20.7 HTTP, SSL

20.8 Case Study

20.9 Notes

20.10 Summary

20.11 Keywords

20.12 Self assessment

20.13 References

20.0 OBJECTIVES

After studying this unit, you should able to;

- To understand the Security issues
- To know the threats in E-Commerce
- To study the Digital Signature and Digital certificates
- To study the functions of HTTP and SSL

20.1 SECURITY OVERVIEW

In an e-Commerce system security hardware, software, and environment are the main critical and vulnerable points. Hardware security includes any devices used in running the e-Commerce website like network devices, web servers, database servers and client's computer. Securing the network with a properly configured firewall device that is only allowing ports needed for accessing the e-Commerce website is an essential part of network security. The web server and database server should be isolated from other networks using a network DMZ to reduce possible intrusion from compromised computers on other networks behind the firewall. A DMZ or demilitarized zone is a separate network added between a protected network and an external network, in order to provide an additional layer of security. Any software used in running the e-Commerce system such as the operating system, web server software (IIS, Apache) and database software and web browser are part of software security .

The operating system is the main component of security that should be configured properly so as to take care of security vulnerability. Software and routinely released patches should be regularly updated to fix holes in security. The website development itself should ensure protection against attacks like cookie poisoning, hidden-field manipulation, parameter tampering, buffer overflow, and cross-site scripting. Website pages, where confidential information is being entered, should be secured with strong cryptography algorithm. Environment security refers to secure physical access to network and server devices by using manual guard, CCTV, locks, or other methods. Network, server and software access credentials should be highly complex and well-guarded.

20.2 SECURITY ISSUES

The various security features which lies in e-commerce and for which the rapid development of e-commerce is stagnated are as listed below:

- **Data Confidentiality:** The information stored on a system is protected against unintended or unauthorized access.
- **Data Integrity:** It services assure or give assurance that data received are exactly as sent by an authorized entity.
- **Data Authentication:** It is an assurance that communicating entity is the one that it claims to be.
- **Access Control:** It is the prevention of unauthorized use of resources.
- **Non Repudiation:** Provides protection against denial by one of the entities involved in communication having participated in all part of the communication.

Day by day E-commerce is expanding in a wide rate. It is increasing throughout the world but the various security features which is failing to give assurance to the privacy and security in e-commerce and as a result it has become interruption to the improvement in the environment for the development of E-commerce and also to the future development of E-Commerce. The common various E-Commerce Security Tools are as follows:

- Firewalls – Software and Hardware.
- Public Key infrastructure.
- Encryption software.
- Digital certificates.
- Digital Signatures.
- Biometrics – retinal scan, fingerprints, voice etc.
- Passwords.
- Locks and bars – network operations centres.

20.3 THREATS IN E-COMMERCE

Threat means any potential for violation of security which exists when there is a circumstances or an event that malicious insiders reach the security and cause harm. E-Commerce tends to be at higher risk and threats. The E-Commerce is the market place where all kind of transaction takes place over the server level. Therefore the most severe threats which led harmful result in ecommerce are Technological Failure and Malicious Code Attacks.

As E-Commerce is totally internet based business procedure and anything based on internet and service through internet is threat prone. If the website for E-Commerce is developed by the poorly written programming code it is highly susceptible to threat. In the wireless environment mostly data get lost for the network not properly configured. Threats are basically of two types' **Active and Passive**.

- **Passive Threat:** The passive threat is to change the actual data for the transmission and send fraud data directly to the E-Commerce server which can be also called man in the middle code attack.
- **Active Threat:** The active threat is to eavesdrop the transmission of data.
- **Malicious Code Attack :** Under this category most severe threats lies which are worms and viruses.
- **Worms :** Worms are very much different from viruses. Worms replicate itself through the internet .It just take matter of worm cause harm to the millions of computers globally. It cause harm to the resources of the computer. As we heard about Trojan horse which is a dangerous programming code. It is a malware program which is of non-self-replicating type. The program contain malicious code when executed, carries out actions determined by the nature of the Trojan, typically causing loss or theft of data and possible System harm. Logic Bomb is a version of Trojan horse which is time specific. In E-Commerce this logic bomb releases rough malicious code which cause harmful attack to the server on which the E-Commerce is based while it is processing.
- **Viruses :** Viruses need a file to in which to attach itself to it. Viruses basically need a host file. It get attach with the code and cause harm while the program in running. It need some kind of host to cause attack. And as a result the loss of important files,

resources take place. Viruses and worms are very much different from each other. But we cannot say which is more harmful. It depend on the business environment.

DENIAL OF SERVICE ATTACK

The denial of service attack basically comes under the Transmission attack. The server deals with enormous amount of data flow and so the server fail to realize the over Flow of data and also the attack of fraud data. Denial of service intent to deny customer that is provided from the Ecommerce server. The goal of a denial of service attack is to deny legal users access to a particular resource.

Cryptography

SSL protects conûdential information through the use of cryptography. Sensitive data is encrypted across public networks to achieve a level of conûdentiality. There are two types of data encryption: symmetric cryptography and asymmetric cryptography.

Symmetric cryptography uses the same key for encryption and decryption. An example of symmetric cryptography is a decoder ring. Alice has a ring and Bob has the same ring. Alice can encode messages to Bob using her ring as the cipher. Bob can then decode the sent message using his ring. In cryptography, the "decoder ring" is considered a pre-shared key. The key is agreed upon by both sides and can remain static. Both sides must know each other already and have agreed upon what key to use for the encryption and decryption of messages. Remember that the same key is used for encoding as well as decoding messages—thus the term symmetric cryptography.

Asymmetric algorithms use one key for encryption of data, and then a separate key for decryption. Asymmetric algorithms are more favorable than symmetric algorithms because even if the encryption key is learned in one direction, the third party still needs to know the other key in order to decrypt the message in the other direction.

Differences between Symmetric Cryptography and Asymmetric Cryptography

Symmetric Cryptography Symmetric cryptography uses a single key for encryption and decryption. • Symmetric cryptography requires that both parties have the key. • Key distribution is the inherent weakness in symmetric cryptography. • Minimal CPU cycles are required to verify keys. • Symmetric ciphers are fortiûed by algorithmic strength and key lengths. • SSL symmetric key lengths range from 40 to 168 bits.**Asymmetric**

Cryptography (PKI) Asymmetric cryptography was designed in response to the limitations of symmetric cryptography. • Information encrypted with one key can be decrypted only with another key. • Public key infrastructure (PKI) cryptography is up to 1000 times more CPU intensive than symmetric cryptography. • The Rivest, Shamir, Adelman (RSA) algorithm uses modular arithmetic to enable the concept of public and private keys. • All SSL transactions begin with an asymmetric key exchange.

20.4 DIGITAL SIGNATURE

The digital certificate was digitally signed. The holder of a digital certificate can also use it to digitally sign other digital documents, for example, purchase orders, grant applications, financial reports or student transcripts. A digital signature is not an image of your pen and ink signature— it is an attachment to a document that contains an encrypted version of the document created using the signer's private key. Once a document is signed, no part of that document can be changed without invalidating the signature. Thus if someone obtained a copy of your digital certificate and changed the name in it to be their own name, any application receiving that modified certificate would see immediately that the signature on it was not valid. In this sense, a digital credential is much better than a traditional ID card to prove that the holder is really the person to whom it was issued. In fact, digital signatures in general are much more useful than pen and ink signatures since anyone checking the signature also can find out something about the signer in order to know whether the signature is meaningful.

Meaning of Digital signature:

A digital signature is a mathematical scheme for demonstrating the authenticity of a digital message or documents. A valid digital signature gives a recipient reason to believe that the message was created by a known sender, that the sender cannot deny having sent the message (authentication and non-repudiation), and that the message was not altered in transit (integrity).

Digital signatures are a standard element of most cryptographic protocol suites, and are commonly used for software distribution, financial transactions, contract management software, and in other cases where it is important to detect forgery or tampering.

A digital signature scheme typically consists of three algorithms;

- A key generation algorithm that selects a private key uniformly at random from a set of possible private keys. The algorithm outputs the private key and a corresponding public key.
- A signing algorithm that, given a message and a private key, produces a signature.
- A signature verifying algorithm that, given the message, public key and signature, either accepts or rejects the message's claim to authenticity.

Two main properties are required. First, the authenticity of a signature generated from a fixed message and fixed private key can be verified by using the corresponding public key. Secondly, it should be computationally infeasible to generate a valid signature for a party without knowing that party's private key. A digital signature is an authentication mechanism that enables the creator of the message to attach a code that acts as a signature.

Digital Signature and Verification:

Digital signature is a mechanism by which a message is authenticated i.e. proving that a message is effectively coming from a given sender, much like a signature on a paper document. For instance, suppose that Mr. A wants to digitally sign a message to Mr. To do so, he uses his private-key to encrypt the message; then he sends the message along with his public-key (typically, the public key is attached to the signed message). Since Mr. A public-key is the only key that can decrypt that message, a successful decryption constitutes a Digital Signature Verification, and meaning that there is no doubt that it is Mr. A private key that encrypted the message.

Applications of Digital Signatures

As organizations move away from paper documents with ink signatures or authenticity stamps,digital signatures can provide added assurances of the evidence to provenance, identity, and status of an electronic document as well as acknowledging informed consent and approval by a signatory. The United States Government Printing Office (GPO) publishes electronic versions of the budget, public and private laws, and congressional bills with digital signatures. Universities including Penn State, University of Chicago, and Stanford are publishing electronic student transcripts with digital signatures. Below are some common reasons for applying a digital signature to communications:

- **Authentication:**

Although messages may often include information about the entity sending a message, that information may not be accurate. Digital signatures can be used to authenticate the source of messages. When ownership of a digital signature secret key is bound to a specific user, a valid signature shows that the message was sent by that user. The importance of high confidence in sender authenticity is especially obvious in a financial context. For example, suppose a bank's branch office sends instructions to the central office requesting a change in the balance of an account. If the central office is not convinced that such a message is truly sent from an authorized source, acting on such a request could be a grave mistake.

- **Integrity:**

In many scenarios, the sender and receiver of a message may have a need for confidence that the message has not been altered during transmission. Although encryption hides the contents of a message, it may be possible to change an encrypted message without understanding it. (Some encryption algorithms, known as nonmalleable ones, prevent this, but others do not.) However, if a message is digitally signed, any change in the message after signature invalidates the signature. Furthermore, there is no efficient way to modify a message and its signature to produce a new message with a valid signature, because this is still considered to be computationally infeasible by most cryptographic hash functions

- **Non-repudiation:**

Non-repudiation, or more specifically non-repudiation of origin, is an important aspect of digital signatures. By this property, an entity that has signed some information cannot at a later time deny having signed it. Similarly, access to the public key only does not enable a fraudulent party to fake a valid signature.

Note that these authentication, non-repudiation etc. properties rely on the secret key not having been revoked prior to its usage. Public revocation of a key-pair is a required ability, else leaked secret keys would continue to implicate the claimed owner of the key-pair. Checking revocation status requires an "online" check; e.g., checking a "Certificate Revocation List" or via the "Online Certificate Status Protocol". Very roughly this is parallel to a vendor who receives credit-cards first checking online with the credit-card issuer to find if a given card has been reported lost or stolen. Of course, with stolen key pairs, the theft is often discovered only after the secret key's use, e.g., to sign a bogus certificate for surveillance purpose.

20.5 DIGITAL CERTIFICATES

Digital Certificates provide a means of proving your identity in electronic transactions, much like a driver license or a passport does in face-to-face interactions. With a Digital Certificate, you can assure friends, business associates, and online services that the electronic information they receive from you are authentic. This document introduces Digital Certificates and answers questions you might have about how Digital Certificates are used. For information about the cryptographic technologies used in Digital Certificates.

Digital certificates are the equivalent of a driver's license, a marriage license, or any other form of identity. The only difference is that a digital certificate is used in combination with a public key encryption system. Digital certificates are electronic files that simply work as an online passport. Digital certificates are issued by a third party known as a **Certification Authority such as VeriSign or Thawte**. These third party certificate authorities have the responsibility to confirm the identity of the certificate holder as well as provide assurance to the website visitors that the website is one that is trustworthy and capable of serving them in a trustworthy manner.

Digital certificates have two basic functions. The first is to certify that the people, the website, and the network resources such as servers and routers are reliable sources, in other words, who or what they claim to be. The second function is to provide protection for the data exchanged from the visitor and the website from tampering or even theft, such as credit card information.

Users of Digital Certificates:

Digital Certificates can be used for a variety of electronic transactions including e-mail, electronic commerce, groupware and electronic funds transfers. Netscape's popular Enterprise Server requires a Digital Certificate for each secure server. For example, a customer shopping at an electronic mall run by Netscape's server software requests the Digital Certificate of the server to authenticate the identity of the mall operator and the content provided by the merchant. Without authenticating the server, the shopper should not trust the operator or merchant with sensitive information like a credit card number.

The Digital Certificate is instrumental in establishing a secure channel for communicating any sensitive information back to the mall operator Virtual malls, electronic banking, and other electronic services are becoming more commonplace, offering the

convenience and flexibility of round-the-clock service direct from your home. However, your concerns about privacy and security might be preventing you from taking advantage of this new medium for your personal business.

Encryption alone is not enough, as it provides no proof of the identity of the sender of the encrypted information. Without special safeguards, you risk being impersonated online. Digital Certificates address this problem, providing an electronic means of verifying someone's identity. Used in combination with encryption, Digital Certificates provide a more complete security solution, assuring the identity of all parties involved in a transaction. Similarly, a secure server must have its own Digital Certificate to assure users that the server is run by the organisation it claims to be affiliated with and that the content provided is legitimate.

20.6 TYPES OF DIGITAL CERTIFICATE

♦ **Identity Certificates:**

An Identity Certificate is one that contains a signature verification key combined with sufficient information to identify (hopefully uniquely) the key holder. This type of certificate is much indirect than might first be imagined and will be considered in more detail later.

♦ **Accreditation Certificates:**

This is a certificate that identifies the key holder as a member of a specified group or organisation without necessarily identifying them. For example, such a certificate could indicate that the key holder is a medical doctor or a lawyer. In many circumstances, a particular signature is needed to authorise a transaction but the identity of the key holder is not relevant.

For example, pharmacists might need to ensure that medical prescriptions are signed by doctors but they do not need to know the specific identities of the doctors involved. Here the certificate states in effect that the key holder, whoever they are, has 'permission to write medical prescriptions'.

Accreditation certificates can also be viewed as authorisation (or permission) certificates. It might be thought that a doctor's key without identity would undermine the ability to audit the issue of medical prescriptions. However, while such certificate might not contain key holder identity data, the certificate issuer will know this so such requirements can be met if necessary.

♦ **Authorisation and Permission Certificates:**

In these forms of certificate, the certificate signing authority delegates some form of authority to the key being signed. For example, a Bank will issue an authorisation certificate to its customers saying 'the key in this certificate can be used to authorise the withdrawal of money from account number 1234556'. In general, the owner of any resource that involves electronic access can use an authorisation certificate to control access to it. Other examples include control of access to secure computing facilities and to World Wide Web pages. In banking an identity certificate might be used to set up an account but the authorisation certificate for the account will not itself contain identity data. To identify the owner of a certificate a bank will typically look up the link between account numbers and owners in its internal databases. Placing such information in an authorisation certificate is actually undesirable since it could expose the bank or its customers to additional risks.

Parties to a Digital Certificate:

♦ **The Requesting Party:**

The party who needs the certificate and will offer it for use by others – they will generally provide some or all of the information it contains.

♦ **The Issuing Party:**

The party that digitally signs the certificate after creating the information in the certificate or checking its correctness.

♦ **The Verifying Party (or Parties):**

Parties that validate the signature on the certificate and then rely on its contents for some purpose. For example, a person – the requesting party – might present paper documents giving proof of identity to a government agency – the issuing party – who will then provide an identity certificate that could then be used by a bank – the verifying party – when the requesting party opens a bank account. The term 'relying party' is sometimes uses instead of 'verifying party' but this can be misleading since the real purpose is to identify a party who checks the certificate before relying on it.

In a credit card transaction many parties might handle a certificate and hence rely on it in some way but only a few of these might actually check the validity of the certificate. Hence a 'verifying party' is a party that checks and then relies on the contents of a certificate,

not just one that depends on it without checking its validity. The actual parties involved in using a certificate will vary depending on the type of certificate.

Public and Private Key:

Public-key refers to a cryptographic mechanism. It has been named public-key to differentiate it from the traditional and more intuitive cryptographic mechanism known as: symmetric-key, shared secret, secret-key and also called private-key.

Symmetric-key cryptography is a mechanism by which the same key is used for both encrypting and decrypting; it is more intuitive because of its similarity with what you expect to use for locking and unlocking a door: the same key. This characteristic requires sophisticated mechanisms to securely distribute the secret-key to both parties.

Public-key on the other hand, introduces another concept involving key pairs: one for encrypting, the other for decrypting. This concept, as you will see below, is very clever and attractive, and provides a great deal of advantages over symmetric-key:

- Simplified key distribution
- Digital Signature
- Long-term encryption.

Encryption and Decryption:

Encryption is a mechanism by which a message is transformed so that only the sender and recipient can see. For instance, suppose that Alice wants to send a private message to Bob. To do so, she first needs Bob's public-key; since everybody can see his public-key, Bob can send it over the network in the clear without any concerns. Once Alice has Bob's public-key, she encrypts the message using Bob's public-key and sends it to Bob. Bob receives Alice's message and, using his private-key, decrypts it.

Digital certificate contains:

A digital certificate contains among other things:

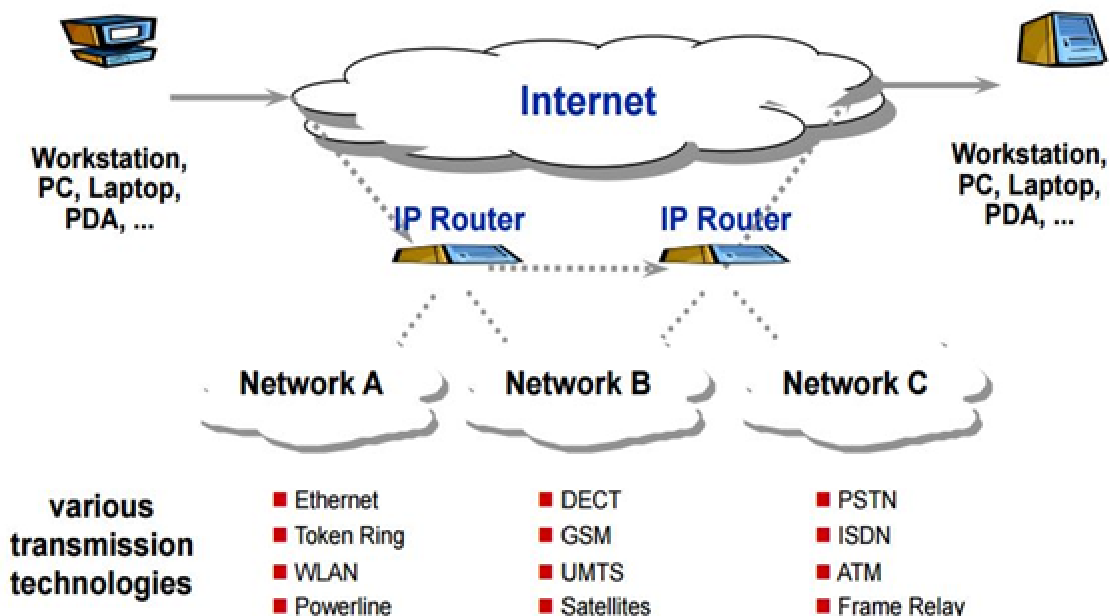
- The CA's identity
- The owner's identity
- The owner's public-key
- The certificate expiry date

- The CA's signature of that certificate With a certificate instead of a public-key, a recipient can now verify a few things about the issuer to make sure that the certificate is valid and belongs to the person claiming its ownership:

- Compare the owner's identity
- Verify that the certificate is still valid
- Verify that the certificate has been signed by a trusted CA
- Verify the issuer's certificate signature, hence making sure it has not been altered.

Security Protocols over Public Networks

Network security protocols are a type network protocol that ensures the security and integrity of data in transit over a network connection. Network security protocols define the processes and methodology to secure network data from any illegitimate attempt to review or extract the contents of data.Network security protocols are primarily designed to prevent any unauthorized user, application, service or device from accessing network data. This applies to virtually all data types regardless of the network medium used.Network security protocols generally implement cryptography and encryption techniques to secure the data so that it can only be decrypted with a special algorithm, logical key, mathematical formula and/or a combination of all of them. Some of the popular network security protocols include Secure File Transfer Protocol (SFTP), Secure Hypertext Transfer Protocol (HTTPS) and Secure Socket Layer (SSL).



20.7 HTTP, SSL

A. HTTP :

The Hypertext Transfer Protocol (HTTP) is an application protocol for distributed, collaborative, hypermedia information systems. HTTP is the foundation of data communication for the World Wide Web. Hypertext is structured text that uses logical links (hyperlinks) between nodes containing text. HTTP is the protocol to exchange or transfer hypertext.

HTTP is an application layer protocol designed within the framework of the Internet Protocol Suite. Its definition presumes an underlying and reliable transport layer protocol, and Transmission Control Protocol (TCP) is commonly used. However HTTP can be adapted to use unreliable protocols such as the User Datagram Protocol (UDP), for example in HTTPU and Simple Service Discovery Protocol (SSDP).

Development of HTTP was initiated by Tim Berners-Lee at CERN in 1989. Standards development of HTTP was coordinated by the Internet Engineering Task Force (IETF) and the World Wide Web Consortium (W3C), culminating in the publication of a series of Requests for Comments (RFCs). A later version, the successor HTTP/2, was standardized in 2015, then supported by major web browsers and already supported by major web servers.

HTTP functions as a request–response protocol in the client–server computing model. A web browser, for example, may be the client and an application running on a computer hosting a web site may be the server. The client submits an HTTP request message to the server. The server, which provides resources such as HTML files and other content, or performs other functions on behalf of the client, returns a response message to the client. The response contains completion status information about the request and may also contain requested content in its message body.

HTTP is designed to permit intermediate network elements to improve or enable communications between clients and servers. High-traffic websites often benefit from web cache servers that deliver content on behalf of upstream servers to improve response time. Web browsers cache previously accessed web resources and reuse them when possible to reduce network traffic. HTTP proxy servers at private network boundaries can facilitate communication for clients without a globally routable address, by relaying messages with external servers.

HTTP resources are identified and located on the network by uniform resource locators (URLs), using the uniform resource identifier (URI) schemes http and https. URIs and hyperlinks in Hypertext Markup Language (HTML) documents form inter-linked hypertext documents.

HTTP/1.1 is a revision of the original HTTP (HTTP/1.0). In HTTP/1.0 a separate connection to the same server is made for every resource request. HTTP/1.1 can reuse a connection multiple times to download images, scripts, style sheets, etc. after the page has been delivered. HTTP/1.1 communications therefore experience less latency as the establishment of TCP connections presents considerable overhead.

B. Secure Sockets Layer (SSL) :

SSL (Secure Sockets Layer) is the standard security technology for establishing an encrypted link between a web server and a browser. This link ensures that all data passed between the web server and browsers remain private and integral.

Due to the fact that nearly all businesses have websites (as well as government agencies and individuals) a large enthusiasm exists for setting up facilities on the Web for electronic commerce. Of course there are major security issues involved here that need to be addressed. Nobody wants to send their credit card number over the Internet unless they have a guarantee that only the intended recipient will receive it. As businesses begin to see the threats of the Internet to electronic commerce, the demand for secure web pages grows.

A number of approaches to providing Web security are possible. The various approaches are similar in many ways but may differ with respect to their scope of applicability and relative location within the TCP/IP protocol stack. For example we can have security at the IP level making it transparent to end users and applications. However another relatively general-purpose solution is to implement security just above TCP. The foremost example of this approach is the Secure Sockets Layer (SSL) and the follow-on Internet standard known as Transport Layer Security (TLS). The Internet standard, TLS, can be viewed essentially as SSLv3.1 and is very close to and backward compatible with SSLv3. We will mainly be interested in SSLv3 at present.

As mentioned, the Secure Sockets Layer (SSL) is a method for providing security for web based applications. It is designed to make use of TCP to provide a reliable end-to-end secure service. SSL is not a single protocol but rather two layers of protocols as

illustrated in ûgure 11.1. It can be seen that one layer makes use of TCP directly. This layer is known as the **SSL Record Protocol** and it provides basic security services to various higher layer protocols. An independent protocol that makes use of the record protocol is the Hypertext Markup Language (HTTP) protocol. Another three higher level protocols that also make use of this layer are part of the SSL stack. They are used in the management of SSL exchanges and are as follows:

1. Handshake Protocol.
2. Change Cipher Spec Protocol.
3. Alert Protocol.

20.8 CASE STUDY

Qualys Sweetens Security for Candy E-Commerce at Jelly Belly

The Jelly Belly Candy Company started in 1869 with the American immigration of two German brothers. Their venture was ice cream and candy sold from a horse drawn wagon in Illinois. By 1900 the company began making new buttercream candies, including Candy Corn. American troops overseas got most of the U.S. chocolate during World War II so the company began making common candy store jelly beans for domestic sales.

The idea for Jelly Belly, the world's most famous jelly bean, came in 1976 when the family owned company began making "true-to-life" flavored jelly beans using natural ingredients. The best known customer was President Ronald Reagan, who served jelly beans to national politicians and foreign dignitaries in the White House. With more than 670 employees, Jelly Belly now produces about 13 billion jelly beans a year. Headquarters are in Fairfield, Calif. with manufacturing plants in Fairfield and Chicago, and a distribution center in Wisconsin.

Like many manufacturers with traditional distribution and retail sales channels, Jelly Belly also sells products directly to consumers through its website. Jelly Belly used to have its e-commerce website hosted by a company on the East Coast but grew leery of integration required between its internal production and order processing applications and the hosting service provider. Company executives sought to simplify e-commerce operations by bringing them in house.

Jelly Belly already had a high availability infrastructure at its headquarters, including redundant power and multiple T1s for Internet connectivity but security was a big concern. The IT department had recently begun using the on demand Qualys vulnerability management service to find and fix network vulnerabilities. Executives approved the e-commerce simplification initiative when they learned of Qualys' capabilities to manage security threats against internal e-commerce operations and personal information of Jelly Belly customers. Qualys remains the trusted foundation of Jelly Belly's network security audit and remediation program.

On Demand Service Model Made Deployment of Qualys 'Painless'

Prior to implementing Qualys in mid-2003, Jelly Belly had no comprehensive testing plan for vulnerabilities, according to Gary Praegitzer, Network Administrator and Security Specialist at the candy company. Ad hoc scans for vulnerabilities were done with various open source tools. Jelly Belly required an effective, comprehensive vulnerability management solution that would not tax the company's small IT staff of sixteen.

"The fact that Qualys is a web-based service, and that everything is automatic and updated is a huge plus for us," says Praegitzer. He cites benefits of not having to buy, maintain, update and manage another piece of software. "We don't want the hassles of maintaining this type of software. It's pretty much hands-off to get the benefits with Qualys."

Praegitzer says getting started was painless. "Deployment of Qualys was incredibly easy—just a matter of giving our IPs and proof of ownership to Qualys, entering the numbers and clicking the start button."

The Jelly Belly infrastructure protected by Qualys includes more than 30 servers and 400 PCs. Jelly Belly uses Qualys to monitor security for its external-facing servers and resources including routers, firewall, website and email.

Case Study 2

The CIS Critical Security Controls for Effective Cyber Defense:

The CIS Critical Security Controls are a recommended set of actions for cyber defense that provide specific and actionable ways to stop today's most pervasive and dangerous attacks. A principle benefit of the Controls is that they prioritize and focus a smaller number of actions with high pay-off results. The Controls are effective because

they are derived from the most common attack patterns highlighted in the leading threat reports and vetted across a very broad community of government and industry practitioners. They were created by the people who know how attacks work - NSA Red and Blue teams, the US Department of Energy nuclear energy labs, law enforcement organizations and some of the nation's top forensics and incident response organizations - to answer the question, "what do we need to do to stop known attacks." That group of experts reached consensus and today we have the most current Controls. The key to the continued value is that the Controls are updated based on new attacks that are identified and analyzed by groups from Verizon to Symantec so the Controls can stop or mitigate those attacks.

The Controls take the best-in-class threat data and transform it into actionable guidance to improve individual and collective security in cyberspace. Too often in cyber security, it seems the "bad guys" are better organized and collaborate more closely than the "good guys." The Controls provide a means to turn that around.

20.9 NOTES

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20.10 SUMMARY

Cyberspace and its underlying infrastructure are vulnerable to a wide range of risk stemming from both physical and cyber threats and hazards. Sophisticated cyber actors and nation-states exploit vulnerabilities to steal information and money and are developing capabilities to disrupt, destroy, or threaten the delivery of essential services. A range of traditional crimes are now being perpetrated through cyberspace. This includes the production and distribution of child pornography and child exploitation conspiracies, banking and financial fraud, intellectual property violations, and other crimes, all of which have substantial human and economic consequences.

Cyberspace is particularly difficult to secure due to a number of factors: the ability of malicious actors to operate from anywhere in the world, the linkages between cyberspace and physical systems, and the difficulty of reducing vulnerabilities and consequences in complex cyber networks. Of growing concern is the cyber threat to critical infrastructure, which is increasingly subject to sophisticated cyber intrusions that pose new risks. As information technology becomes increasingly integrated with physical infrastructure operations, there is increased risk for wide scale or high-consequence events that could cause harm or disrupt services upon which our economy and the daily lives of millions of Americans depend. In light of the risk and potential consequences of cyber events, strengthening the security and resilience of cyberspace has become an important homeland security mission.

20.11 KEYWORDS

Privacy, Security

Digital signature

Security issues

Threats in E-Commerce

Digital Certificates

Types of Digital certificates

HTTP

SSL

20.12 SELF ASSESSMENT QUESTIONS

1. Security issues in E-Commerce
2. Digital signature advantages and disadvantages
3. Threats in E-Commerce
4. Digital certificates and its uses

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