AAM

Business School

Global Business Environment

II SEMESTER

(Approved by Alagappa University)

23 Global Business Environment

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Textbook: International Economics by Robert Carbaugh (13th Edition)

INTERNATIONAL BUSINESS – AN OVERVIEW

INTRODUCTION

One of the most dramatic and significant world trends in the past two decades has been the rapid, sustained growth of international business. Markets have become truly global for most goods, many services, and especially for financial instruments of all types. World product trade has expanded by more than 6 percent a year since 1950, which is more than 50 percent faster than growth of output the most dramatic increase in globalization, has occurred in financial markets. In the global forex markets, billions of dollars are transacted each day, of which more than 90 percent represent financial transactions unrelated to trade or investment. Much of this activity takes place in the so-called Euromarkets, markets outside the country whose currency issued.

This pervasive growth in market interpenetration makes it increasingly difficult for any country to avoid substantial external impacts on its economy. In particular massive capital flows can push exchange rates away from levels that accurately reflect competitive relationships among nations if national economic policies or performances diverse in short run. The rapid dissemination rate of new technologies speeds the pace at which countries must adjust to external events. Smaller, more open countries, long ago gave up illusion of domestic policy autonomy. But even the largest and most apparently self-contained economies, including the US, are now significantly affected by the global economy. Global integration in trade, investment, and factor flows, technology, and communication has been tying economies together.

Why then are these changes coming about, and what exactly are they? It is in practice, easier to identify the former than interpret the latter. The reason is that during the past few decades, the emergence of corporate empires in the world economy, based on the contemporary scientific and technological developments, has led to globalization of production. As a result of international production, co operationamongglobalproductiveunits,thelarge-scalecapitalexports,–the export of production or –production abroad has come into prominence as against commodity export in world economy in recent years. Global corporations consider the whole of the world their production place, as well as their market and move factors of production to wherever they can optimally be combined. They avail fully of the revolution that has brought about instant worldwide communication, and near instant-transformation. Their ownership is transnational; their management is transnational. Their freely mobile management, technology and capital, the modern agent for stepped-up economic growth, transcend individual national boundaries. They are domestic in every place, foreign in none-a true corporate citizen of the world. The greater interdependence among nations has already reduced economic insularity of the peoples of the world, as well as their social and political insularity.

DEFINITION OF INTERNATIONAL BUSINESS:

International business includes any type of business activity that crosses national borders. Though a number of definitions in the business literature can be found but no simple or universally accepted definition exists for the term international business. At one end of the definitional spectrum, 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. At the other end of the spectrum, international business is equated only with those big enterprises, which have operating units outside their own country. In the middle are institutional arrangements that provide for some managerial direction of economic activity taking place abroad but stop short of controlling ownership of the business carrying on the activity, for example joint ventures with locally owned business or with foreign governments.

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.

SCOPE OF INTERNATIONAL BUSINESS ACTIVITIES

The study of international business focus on the particular problems and opportunities that emerge because 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.

The guiding principles of a firm engaged in (or commencing) international business activities should incorporate a global perspective. A firm‘s guiding principles can be defined in terms of three board categories products offered/market served, capabilities, and results. However, their perspective of the international business is critical to understand the full meaning of international business. That is, the firm‘s senior management should explicitly define the firm‘s guiding principles in terms of an international mandate rather than allow the firm‘s guiding principles in terms as an incidental adjunct to its domestic activities. Incorporating an international outlook into the firm‘s basic statement of purpose will help focus the attention of managers (at all levels of the organization) on the opportunities (and hazards) outside the domestic economy.

It must be stressed that the impacts of the dynamic factors unique to the playing field for international business are felt in all relevant stages of evolving and implementing business plans. The first broad stage of the process is to formulate corporate guiding principles. As outlined below the first step in formulating and implementing a set of business plans is to define the firm‘s guiding principles in the market place. The guiding principles should, among other things, provide a long-term view of what the firm is striving to become and provide direction to divisional and subsidiary manager’s vehicle, some firms use–thedecisioncircle whichissimplyaninterrelatedsetofstrategicchoices forced upon any firm faced with the internationalization of its markets. These choices have to do with marketing, sourcing, labor, management, ownership, finance, law, control, and public affairs. Here the first two marketing and sourcing-constitute the basic strategies that encompass a firm‘s initial considerations. Essentially, management is answering two questions: to whom are we going to sell what, and from where and how will we supply that market? We then have a series of input strategies-labor, management, ownership, and financial. They are in their efforts to develop their own business plans. As an obligation addressed essentially to the query, with what resources are we going to implement the basic strategies? That is, where will we find the right people, willingness to carry the risk, and the necessary funds? A third set of strategies- legal and control- respond to the problem of how the firm is to structure itself of implement the basic strategies, given the resources it can muster. A final strategic area, public affairs, is shown as a basic strategy simply because it places a restraint on all other strategy choices.

Each strategy area contains a number of subsidiary strategy options. The decision process that normally starts in the marketing strategy area is an iterative one. As the decision maker proceeds around the decision circle, previous selected strategies must be readjusted. Only a portion of the possible feedback adjustment loops is shown here.

Although these strategy areas are shown separately but they obviously do not stand-alone. There must be constant reiteration as one moves around the decision circle. The sourcing obviously influences marketing strategy, as well as the reverse. The target market may enjoy certain preferential relationships with other markets. That is, everything influences everything else. Inasmuch as the number of options a firm faces is multiplied as it moves into international market, decision-making becomes increasingly complex the deeper the firm becomes involved internationally. One is dealing with multiple currency, legal, marketing, economic, political, and cultural systems. Geographic and demographic factors differ widely. In fact, as one moves geographically, virtually everything becomes a variable: there are few fixed factors.

For our purposes here, a strategy is defined as an element in a consciously devised overall plan of corporate development that, once made and implemented, is difficult (i.e. costly) to change in the short run. By way of contrast, an operational or tactical decision is one that sets up little or no institutionalized resistance to making a different decision in the near future. Some theorists have differentiated among strategic, tactical, and operational, with the first being defined as those decisions, that imply multi-year commitments; a tactical decision, one that can be shifted in roughly a year‘s time; an operational decision, one subject to change in less that a year. In the international context, we suggest that the tactical decision, as the phrase is used here, is elevated to the strategic level because of the rigidities in the international environment not present in the purely domestic-for example, work force planning and overall distribution decisions. Changes may be implemented domestically in a few months, but if one is operating internationally, law, contract, and custom may intervene to render change difficult unless implemented over several years.

SPECIAL DIFFICULTIES IN INTERNATIONAL BUSINESS

What make international business strategy different from the domestic are the differences in the marketing environment. The important special problems in international marketing are given below:

a) **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. For example, the political and legal environment is not exactly the same in all the states ofIndia.

b) **CULTURALDIFFERENCES**

The cultural differences, is one of the most difficult problems in international marketing. Many domestic markets, however, are also not free from cultural diversity.

c) **ECONOMIC DIFFERENCES**

The economic environment may vary from country to country.

d) **DIFFERENCES IN THE CURRENCYUNIT**

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.

e) **DIFFERENCES IN THELANGUAGE**

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.

f) **DIFFERENCES IN THE MARKETINGINFRASTRUCTURE**

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.

g) **RADERESTRICTIONS**

A trade restriction, particularly import controls, is a very important problem, which an international marketer faces.

h) **HIGH COSTS OFDISTANCE**

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 also.

i) **DIFFERENCES IN TRADEPRACTICES**

Trade practices and customs may differ between two countries.

BENEFITS OF INTERNATIONAL BUSINESS SURVIVAL

Because most of the countries are not as fortunate as the United States in terms of market size, resources, and opportunities, they must trade with others to survive; Hong Kong, has historically underscored this point well, for without food and water from china proper, the British colony would not have survived along. The countries of Europe have had similar experience, since most European nations are relatively small in size. Without foreign markets, European firms would not have sufficient economies of scale to allow them to be competitive with US firms. Nestle mentions in one of its advertisements that its own country, Switzerland, lacks natural resources, forcing it to depend on trade and adopt the geocentric perspective. International competition may not be matter of choice when survival is at stake. However, only firms with previously substantial market share and international experience could expand successfully.

GROWTH OF OVERSEAS MARKETS

Developing countries, in spite of economic and marketing problems, are excellent markets. According to a report prepared for the U.S. CONGRESS by the U.S. trade representative, Latin America and Asia/Pacific are experiencing the strongest economic growth. American markets cannot ignore the vast potential of international markets. The world is more than four times larger than The U.S. market. In the case of Amway corps., a privately held U.S. manufacturer of cosmetics, soaps and vitamins, Japan represents a larger market than the United States.

SALES AND PROFIT

Foreign markets constitute a larger share of the total business of many firms that have wisely cultivated markets aboard. Many large U.S. companies have done well because of their overseas customers. IBM and Compaq, foe ex, sell more computers aboard than at home. According to the US dept of commerce, foreign profits of American firms rose at a compound annual rate of 10% between 1982 and 1991, almost twice as fast as domestic profits of the same companies.

DIVERSIFICATION

Demand for mast products is affected by such cyclical factors as recession and such seasonal factors as climate. The unfortunate consequence of these variables is sales fluctuation, which can frequently be substantial enough to cause layoffs of personnel. One way to diversify a companies‘ risk is to consider foreign markets as a solution for variable demand. Such markets, even out fluctuations by providing outlets for excess production capacity. Cold weather, for instance may depress soft drink consumption. Yet not all countries enter the winter season at the same time, and some countries are relatively warm year round. Bird, USA, inc., a Nebraska manufacturer of go carts, and mini cars, for promotional purposes has found that global selling has enabled the company to have year round production. It may be winter in Nebraska but its summer in the southern hemisphere-somewhere there is a demand and that stabilizes the business.

INFLATION AND PRICE MODERATION

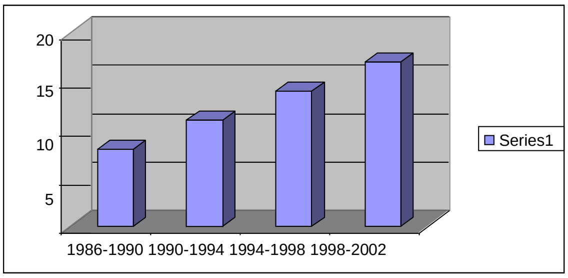
The benefits of export are readily self-evident. Imports can also be highly beneficial to a country because they constitute reserve capacity for the local economy. Without imports, there is no incentive for domestic firms to moderate their prices. The lack of imported product alternatives forces consumers to pay more, resulting in inflation and excessive profits for local firms. This development usually acts a s prelude to workers demand for higher wages, further exacerbating the problem of inflation.

Import quotas imposed on Japanese automobiles in the 1980‘s saved 46200 US production jobs but at a cost of $160,000 per job per year. This cost was a result of the addition of $400 to the prices of US cars, and $1000 to the prices of Japanese imports. This windfall for Detroit resulted in record high profits for US automakers. Not only do trade restrictions depress price competition in the short run, but they also can adversely affect demand for year to come.

EMPLOYMENT

Trade restrictions, such as high tariffs caused by the 1930‘s smoot-hawley bill, which forced the average tariff rates across the board to climb above 60%, contributed significantly to the great depression and have the potential to cause wide spread unemployment again. Unrestricted trade on the other hand improves the world‘s GNP and enhances employment generally for all nations.

Importing products and foreign ownership can provide benefits to a nation. According to the institute for international Economics-a private, non- profit research institute – the growth of foreign ownership has not resulted in a loss of jobs for Americans; and foreign firms have paid



their American workers the same, as have domestic firms.

STANDARDS OF LIVING

Trade affords countries and their citizen's higher standards of living than other wise possible. Without trade, product shortages force people to pay more for less, products taken for granted, such as coffee and bananas may become unavailable overnight. Life in most countries would be much more difficult were it not for the many strategic metals that must be imported. Trade also makes it easier for industries to specialize and gain access to raw materials, while at the same time fostering competition and efficiency. A diffusion of innovations across national boundaries is useful by-products of international trade. A lack of such trade would inhibit the flow innovative ideas.

FRAMEWORK FOR ANALYSING INTERNATIONAL BUSINESS ENVIRONMENT

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‖.

The definition of environmental analysis given above has been made in the context of the strategic management process for an existing firm. It is, however, quite obvious that environmental analysis is the cornerstone of new business opportunity analysis too.

Indeed, today a much more greater emphasis is given than in the past to the fact that environmental analysis is an essential prerequisite for strategic management decision-making. For instance, in his recent editions of Marketing Management, Philip Kotler, the world-renowned professor and author, describes Marketing Environment Audit as the first component of a Marketing Audit, whereas in the earlier editions of this book, the definition of Marketing Audit does not have any reference to the environment.

It is now unquestionably accepted that the prospects of a business depend not only on its resources but also on the environment. An analysis of the strengths, weaknesses, opportunities and threats (SWOT) is very much essential for the business policy formulation. 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, i.e. 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. The business environment comprises a microenvironment and a macro environment.

MICRO ENVIRONMENT

The micro environment consists of the actors in the company‘s immediate environment‖ that effect the performance of the company. These include the suppliers, marketing intermediaries, competitors, customers, and publics. –The macro environment consists of the larger societal forces that affect all the actors in the company‘s micro environment namely, the demographic, economic, natural, technological, political and cultural forces.

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

SUPPLIERS

An important force in the microenvironment of a company is the supplier, i.e., those who supply the inputs like raw materials and components to the company. The importance of reliable source/sources of supply to the smooth functioning of the business is obvious. Uncertainty regarding the supply or other supply constraints often compels companies to maintain high inventories causing cost increases. It has been pointed out that factories in India maintain indigenous stocks of 3-4 months and imported stocks of 9 months as against an average of a few hours to two weeks in Japan.

Because of the sensitivity of the supply, many companies give high importance to vendor development. Vertical integration, where feasible, helps solve the supply problem.

It is very risky to depend on a single because a strike, lock out or any other production problem with that supplier may seriously affect the company. Similarly, a change in the attitude or behavior of the supplier may also affect the company. Hence, multiple sources of supply often help reduce such risks.

The supply management assumes more importance in a scarcity environment.―Company purchasing agents are learning how to ―wine and dine‖ suppliers to obtain favorable treatment during periods of shortages. In other words, the purchasing department might have to ―market‖ itself to suppliers‖.

CUSTOMERS

As it is often, exhorted, the major task of a business is to create and sustain customers. A business exists only because of its customers. Monitoring the customer sensitivity is, therefore, a prerequisite for the business success.

A company may have different categories of consumers like individuals, households, industries and other commercial establishments, and government and other institutions. For example, the customers of a type company may include individual automobile owners, automobile manufacturers, public sector transport undertakings and other transport operators.

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

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

COMPETITORS

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

If the consumer decides to spend his discretionary income on recreation (or recreation cum education) he will still confronted with a number of alternatives choose from like T.V., stereo, two-in-one, three –in-one etc. The competition among such alternatives, which satisfy a particular category of desire, is called generic competition.

If the consumer decides to go in for a T.V. the next question is which form of the T.V. – black and white or colour, with remote-control or without it etc. In other words, there is a product form competition. Finally the consumer encounters the brand competition i.e., the competition between the different brands of the same product form.

An implication of these different demands is that a marketer should strive to create primary and selective demand for his products.

MARKETING INTERMEDIARIES

The immediate environment of a company may consist of a number of marketing intermediaries which are firms that aid the company in promoting, selling and distributing its goods to final buyers.

The marketing intermediaries include middlemen such as agents and merchants who –help the company find customers or close sales with them‖, physical distribution firms which –assist the company in stocking and moving goods form their origin to their destination‖ such as warehouses and transportation firms; marketing service agencies which –assist the company in targeting and promoting its products to the right markets‖ such as advertising agencies, marketing research firms, media firms and consulting firms; and financial intermediaries which finance marketing activities and insure business risks.

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

DEMOCRATIC

A company may encounter certain publics in its environment. –A public is any group that has an actual or potential interest in or impact on an organization's ability to achieve its interests. Media publics, citizen's action publics and local publics are some examples.

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

GROWTH OF CONSUMER PUBLIC IS AN IMPORTANT DEVELOPMENT AFFECTING BUSINESS.

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

MACRO ENVIRONMENT

As stated earlier, a company and the forces in its microenvironment operate in a larger macro environment of forces that shape opportunities and pose threats to the company. The macro forces are, generally, more uncontrollable than the micro forces. A sketch picture of the important macro-environmental forces is given below.

ECONOMIC ENVIRONMENT

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.

According to the industrial policy of the Government of India until July 1991, the development of 17 of the most important industries were 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 freedom of private enterprise is the greatest in the free market economy, which is characterized by the following assumptions:

(i) The factors of production (labor, land, capital) are privately owned, and production occurs at the initiative of the private enterprise.

(ii) Income is received in monetary form by the sale of services of the factors of production and from the profits of the private enterprise.

(iii) Members of the free market economy have freedom of choice in so far as consumption, occupation, savings and investment are concerned.

(iv) The free market economy is not planned controlled or regulated by the government. The government satisfies community or collective wants, but does not compete with private firms, nor does it tell the people where to work or what to produce.

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 number 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.

The economic system, thus, is a very important determinant of the scope of private business. The economic system and policy are, therefore, very important external constraints on business.

Markets and Competition

A market is a group of buyers and sellers of a particular product. A competitive market is one with many buyers and sellers, each has a negligible effect on price.

A perfectly competitive market:

all goods exactly the same buyers & sellers so numerous that no one can affect market price – each is a "price taker" In this chapter, we assume markets are perfectly competitive.

Demand

Demand comes from the behavior of buyers. The quantity demanded of any good is the amount of the good that buyers are willing and able to purchase.

Law of demand:

The claim that the quantity demanded of a good falls when the price of the good rises, other things equal

Example:

Helen's demand for lattes.

Notice that Helen's preferences obey the Law of Demand schedule:

A table that shows the relationship between the price of a good and the quantity demanded.

Price of lattes	Quantity of lattes demanded
$0.00	16
1.00	14
2.00	12
3.00	10
4.00	8
5.00	6
6.00	4

Demand Curve Shifters

The demand curve shows how price affects quantity demanded, *other things being equal*. These "other things" are non-price determinants of demand (*i.e.*, things that determine buyers' demand for a good, other than the good's price).

Changes in them shift the D curve…

Demand Curve Shifters: buyers

An increase in the number of buyers causes an increase in quantity demanded at each price, which shifts the demand curve to the right.

Demand Curve Shifters: income

Demand for a normal good is positively related to income. An increase in income causes increase in quantity demanded at each price, shifting the D curve to the right.

(Demand for an inferior good is negatively related to income. An increase in income shifts D curves for inferior goods to the left.)

Demand Curve Shifters: substitutes

prices of related goods Two goods are substitutes if an increase in the price of one causes an increase in demand for the other.

Example: pizza and hamburgers. An increase in the price of pizza increases demand for hamburgers, shifting hamburger demand curve to the right.

Other examples: Coke and Pepsi, laptops and desktop computers, compact discs and music downloads

Demand Curve Shifters: **complements**

Two goods are complements if an increase in the price of one causes a fall in demand for the other.

Example: computers and software. If price of computers rises, people buy fewer computers, and therefore less software. Software demand curve shifts left.

Other examples: college tuition and textbooks, bagels and cream cheese, eggs and bacon

Demand Curve Shifters: tast

prices of related good tast Anything that causes a shift in tastes *toward* a good will increase demand for that good and shift its D curve to the right.

Example:

The Atkins diet became popular in the '90s, caused an increase in demand for eggs, shifted the egg demand curve to the right.

Demand Curve Shifters: expectations

Expectations affect consumers' buying decisions.

Examples:

If people expect their incomes to rise, their demand for meals at expensive restaurants may increase now. If the economy turns bad and people worry about their future job security, demand for new autos may fall now.

The Concept of Supply

Supply is not just the amount of something there, but the willingness and ability of potential sellers to produce and sell it. Quantity supplied (Qs) is the total amount of a good that sellers would choose to produce and sell under given conditions. The given conditions include:

• price of the good
• prices of factors of production (labor, capital)
• prices of alternative products the firm could produce
• technology
• productive capacity
• expectations of future prices

We refer to all of these, with the exception of the price of the good, as determinants of supply.
When we talk about Supply, we're talking about the relationship between quantity supplied and the price of the good, while holding everything else constant. The Law of Supply states that "when the price of a good rises, and everything else remains the same, the quantity of the good supplied will also rise." In short,

$\uparrow P \rightarrow \uparrow Qs$

A Supply Curve is a graphical representation of the relationship between price and quantity supplied (ceteris paribus). It is a curve or line, each point of which is a price-Qspair. That point shows the amount of the good sellers would choose to sell at that price. Changes in supply or shifts in supply occur when one of the determinants of supply other than price changes.

Examples:

1. The price of a factor of production rises. This would cause a leftward shift the supply curve.
2. A rise in the price of an alternative good that could be provided with the same resources. This implies a leftward shift of supply.
3. An improvement in technology. This leads to a rightward shift of supply. Supply versus Quantity Supplied. Analogous to the demand versus quantity demanded distinction. "Change in quantity supplied" means a movement along the supply curve."Change in supply" refers to a shift of the supply curve, caused by something other than a change in price.

Complementary Good

A complement refers to a complementary good or service used in conjunction with another good or service. Usually, the complementary good has little to no value when consumed alone, but when combined with another good or service, it adds to the overall value of the offering. A product can be considered a compliment when it shares a beneficial relationship with another product offering, for example, an iPhone complements an app.

Complementary Goods Explained

The joint demand nature of complementary goods causes an interplay between the consumer need for the second product as the price of the first product fluctuates. In economics, this connection is called negative cross-elasticity of demand. So, as the cost of a product increase, the user's demand for the complement product decreases. Further, as consumer demand weakens, the market price of the complementary good or service may fall. For example, when the price of a good rise, the demand for its complement falls because consumers are unlikely to use the complement product alone.

General Examples of Complementary Goods

For example, should the price of hot dogs increase, it can cause a decrease in the demand for hot dog buns. Since the cost of hot dogs has an inverse relationship with the demand for hot dog buns, they are considered complementary products. Consumers may substitute hamburgers for their picnic, and weak complementary mustard and ketchup products will see little impact on the rising price of the hot dog.

Additionally, complementary pairs are not two-sided and often have one-sided effects. Using another example, if the price of car tires decreases, it will not necessarily increase the demand for cars. However, if the price of automobiles decreases, it will increase the demand for car tires as more are sold.

Generalized substitution vs. local substitution

In the neoclassical broad culture, everything can be exchanged and substituted with everything. Consumer goods can substitute each other, although usually imperfectly. Everything can be bought, in the sense that whatever you have, it's always possible to find alternative consumption bundles that you would accept as equivalent to your own. Indirectly, money can buy everything. Quantities are the key variables: you accept to change your consumption habits in exchange for enough quantity of substitutes.

More formally, the neoclassical model of general economic equilibrium presented in basic textbooks attributes to all consumer the same (or similar) Cobb-Douglas (or CES) indifference curves. On every market, quantities depends on relative prices of the given good with respect with all others. More sophisticated versions of these relationships are available inside the neoclassical tradition but "well-behaved" indifference curves usually lead to the same broad statements.

By contrast, in our conception of bounded rational consumer, substitution is limited to a small set of goods which are carefully compared, usually not only in terms of prices and quantities, but even more importantly in terms of quality and time.

Difference Between Absolute Advantage vs Comparative Advantage

Absolute Advantage is the inherent ability of a country that allows that country to produce specific goods in an efficient and effective manner at a relatively lower marginal cost. A country has an absolute advantage in producing a good if it can produce that good at lower marginal cost, lesser manpower, lesser time and lesser cost without compromising the quality. Comparative Advantage refers to the country's capability of producing the specific good at lower marginal cost and opportunity cost in comparison to other countries. In absolute advantage where the emphasis is only on marginal cost, comparative advantage takes into account both marginal and opportunity cost.

Example of Absolute Advantage

Countries	Production of Cars/Hour	No of Employees
Country 1	3	10
Country 2	5	10

So in this case, Country 2 has an absolute advantage over Country 1 as Country 2 can produce a number of cars per hour than County 1 with the same number of employees.

Example of Comparative Advantage

Let's take an example Country 1 and Country 2. Country 1 can produce either 10 cars or 20 computers whereas Country 2 can produce 22 cars or 30 computers with available resources.

Product	Country 1	Country 2
Computers	20	30
Cars	10	22

Opportunity Cost of Production

Product	Country 1	Country 2
1 Unit of Computer	0.5 Unit of Car	0.73 Unit of Car
1 Unit of Car	2 Unit of Computer	1.36 Unit of Computer

- The opportunity cost of producing 1 unit of the computer is higher for Country 2 than Country 1 and opportunity cost for producing 1 unit of a car is lower for country 1 than a country

- According to the concept of comparative advantage, Country 1 should produce computers and Country 2 should produce cars to optimize their cost.

The Basis Of Comparison Between Absolute Advantage vs Comparative Advantage	**Absolute Advantage**	**Comparative Advantage**
Definition	The Absolute Advantage is the inherent ability of a country to produce specific goods in an efficient manner at lower marginal cost in comparison to other Country.	The concept of Comparative Advantage refers to the country's capability of producing the specific good at lower marginal cost and opportunity cost in comparison to other Country
Basic Concept	It deals with the lower marginal cost of production of a specific good in comparison to competitor Country.	It deals with lower marginal and opportunity cost of production of a specific good in comparison to competitor Country.
Trade Benefits	The concept of absolute advantage may not always be mutually beneficial for both the countries involved in the trade transaction.	Both the Countries in transactions are mutually benefitted because of comparative advantage of each other.
Cost of Production	Absolute advantage refers to lowering the production cost of a specific good in comparison to competitors.	Comparative advantage specifically refers to the lower opportunity cost of production of specific goods in comparison to competitors.
Production of Goods	Countries having an absolute advantage of producing a good, produces a higher volume of that good with the same available resources	Countries with comparative advantage take into account the production of multiple goods in a country while deciding the production of a specific good and resource allocation for the same.
Resource allocation	An absolute advantage may not be very effective in deciding the resource allocation by a Country for production of a good as it doesn't take into account the opportunity cost of production.	Comparative advantage takes into account the opportunity cost of production, it is more effective in decisions for resource allocation, domestic production, and import of specific goods.
Benefits to Economies	Trades in the context of absolute advantage are not mutually	Trades decisions based on comparative advantage are

	beneficial in nature.	mutually beneficial in nature.
Effectiveness for Economy	The concept of absolute advantage may not be very effective as it focuses on maximizing production with the same available resources without considering the opportunity cost of production.	Comparative advantage is more effective in helping Countries taking decisions related to resource allocation, domestic productions and import/export of goods.

Classifying Economic Systems

Economic Systems usually are classified as capitalist, socialist, or mixed. No country is purely market or purely command.

As the economy moves to more balance, between market and command or between public and private ownership, it is considered mixed.

We can also classify economic systems according to two other criteria:

Type of property ownership
Method of resource allocation andcontrol

a) MarketEconomy:

The individual and the company play important roles. The market mechanism involves an interaction of price, quantity, supply and demand for resources and products.

The key factors that make the market economy work:

-consumer sovereignty

-freedom of the enterprise to operate in the market

In addition, freedom from government restrictions, and legal and Institutions frameworks to safeguard economic freedoms

b) Centrally PlannedEconomy:

The government coordinates the activities of the different economic sectors. Goals are set for every enterprise in the country.

The government determines how much is produced, by whom, and for whom.

c) MixedEconomy

Partly Free, Mostly Not Free

Government intervention can be classified in two ways:

- Government ownership of the means ofproduction

- Government influence in decisionmaking

Ex: MITI was organized to guide industrial development through "strategic planing and authority over investment and production priorities."

d) Political-Economic Synthesis

Clearly, numerous combinations of political and economic systems are possible Asian experience, Latin American experience, European, U.S.

Economic Trade Policies(Protectionism)

Protectionism is the economic policy of restraining trade between nations, through methods such as high tariffs on imported goods, restrictive quotas, and anti-dumping laws in an attempt to protect domestic industries in a particular nation from foreign take-over or competition. This contrasts with free trade, where no artificial barriers to entry are instituted. The term is mostly used in the context of economics, where protectionism refers to policies or doctrines which "protect" businesses and living wages by restricting or regulating trade between foreign nations:

Subsidies - *To protect existing businesses from risk associated with change, such as costs of labour, materials, etc.*

Tariffs - *to increase the price of a foreign competitor's goods. (Including restrictive quotas, and anti-dumping measures.) on par or higher than domestic prices.*

Quotas - to prevent dumping of cheaper foreign goods that would overwhelm the market.

Tax cuts- *Alleviation of the burdens of social and business costs.*

Intervention - *The use of state power to bolster an economic entity.* Protectionism has frequently been associated with economic theories such as mercantilism, the belief that it is beneficial to maintain a positive trade balance, and import substitution. There are two main variants of protectionism, depending on whether the tariff is intended to be collected (traditional protectionism) or not (modernprotectionism).

Modern protectionism

In the modern trade arena many other initiatives besides tariffs have been called protectionist. For example some commentators, such as Jagdish Bhagwati, see developed countries' efforts in imposing their own labor or environmental standards as protectionism. Also, the imposition of restrictive certification procedures on imports are seen in this light.

Recent examples of protectionism are typically motivated by the desire to protect the livelihoods of individuals in politically important domestic industries. Whereas formerly blue-collar jobs were being lost to foreign competition, in recent years there has been a renewed discussion of protectionism due to offshore outsourcing and the loss of white-collar jobs. Most economists view this form of protectionism as a disguised transfer payment from consumers (who pay higher prices for food or other protected goods) to local high-costproducers.

Traditional Protectionism

In its historic sense, protectionism is the economic policy of relying on revenue tariffs for government funding in order to reduce or eliminate taxation on domestic industries and labor (e.g., corporate and personal incometaxes). Inprotectionist theory, emphasis is placed on reducing taxation on domestic labor and savings at a cost of higher tariffs on foreign products. This contrasts with the free trade model, in which first emphasis is placed on exempting foreign products from taxation, with the lost revenue to be compensateddomestically.

Traditional protectionism sees revenue tariffs as a source of government funding, much like a sales tax, that can be used to reduce other domestic forms of taxes. The goal of traditional protectionism is to maximize tax revenue from the purchase of foreign products with the goal of being able to reduce or eliminate other forms of domestic taxation (income taxes, sales taxes, etc.) as a result. Tariffs were the predominant source of tax revenue in the United States from its founding through World War II, allowing the country to operate through most of that period without income and sales taxes. Traditional protectionism remains highly dependent on large amounts of imports. It also requires tariffs to be kept at reasonable rates to ensure maximum government revenue.

a) Dumping

A practice of charging a very low price in a foreign market for such economic purposes as putting rival suppliers out of business.

If a company exports a product at a price lower than the price it normally chargeson its own home market, it is said to be –dumping‖the product. Is this unfair competition? The WTO agreement does not pass judgement. Its focus is on how governments can or cannot react to dumping — it disciplines anti- dumpingactions, and it is often called the –Anti-dumping Agreement‖.

Legal Framework

Based on Article VI of GATT 1994

Customs Tariff Act, 1975 - Sec 9A, 9B (as amended in1995)

Anti-Dumping Rules [Customs Tariff (Identification, Assessment andCollection of Anti Dumping Duty on Dumped Articles and for Determination of Injury) Rules,1995] Investigations and Recommendations by Designated

Authority, Ministry of Commerce Imposition and Collection by Ministryof Finance

b) Subsidies

In economics, a subsidy is generally a monetary grant given by government to lower the price faced by producers or consumers of a good, generally because it is considered to be in the public interest. Subsidies are also referred to as corporate welfare by those who oppose their use. The term *subsidy* may also refer to assistance granted by others, such as individuals or non-government institutions, although this is more usually described as charity. A subsidy normally exemplifies the opposite of a tax, but can also be given using a reduction of the tax burden. These kinds of subsidies are generally called *tax expenditures* or *tax breaks*.

Subsidies protect the consumer from paying the full price of the good consumed, however they also prevent the consumer from receiving the full value of the thing not consumed – in that sense, a subsidized society is a consumption society because it unfairly encourages consumption more than conservation. Under free-market conditions, consumers would make choices which optimize the value of their transactions; where it was less expensive to conserve, they would conserve. In a subsidized economy however, consumers are denied the benefit of conservation and as a result, subsidized goods have an artificially higher value than expenditures which do not consume. Subsidies are paid for by taxation which creates a deadweight loss for that activity which is taxed

International Trade

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. People or entities trade because they believe that they benefit from the exchange. They may need or want the goods or services. While at the surface, this many sound very simple, there is a great deal of theory, policy, and business strategy that constitutes international trade.

In this section, you'll learn about the different trade theories that have evolved over the past century and which are most relevant today. Additionally, you'll explore the factors that impact international trade and how businesses and governments use these factors to their respective benefits to promote their interests.

What Are the Different International Trade Theories?

"Around 5,200 years ago, Uruk, in southern Mesopotamia, was probably the first city the world had ever seen, housing more than 50,000 people within its six miles of wall. Uruk, its agriculture made prosperous by sophisticated irrigation canals, was home to the first class of middlemen, trade intermediaries…A cooperative trade network…set the pattern that would endure for the next 6,000 years."Matt Ridley, "Humans: Why They Triumphed,"

In more recent centuries, economists have focused on trying to understand and explain these trade patterns. discussed how Thomas Friedman's flat-world approach segments history into three stages: Globalization 1.0 from 1492 to 1800, 2.0 from 1800 to 2000, and 3.0 from 2000 to the present. In Globalization 1.0, nations dominated global expansion. In Globalization 2.0, multinational companies ascended and pushed global development. Today, technology drives Globalization 3.0.

To better understand how modern global trade has evolved, it's important to understand how countries traded with one another historically. Over time, economists have developed theories to explain the mechanisms of global trade. The main historical theories are called *classical* and are from the perspective of a country, or country-based. By the mid-twentieth century, the theories began to shift to explain trade from a firm, rather than a country, perspective. These theories are referred to as *modern* and are firm-based or company-based. Both of these categories, classical and modern, consist of several international theories.

THEORIES OF FOREIGN DIRECT INVESTMENT

Classical or Country-Based Trade Theories

Mercantilism

Developed in the sixteenth century, mercantilism was one of the earliest efforts to develop an economic theory. This theory stated that a country's wealth was determined by the amount of its gold and silver holdings. In it's simplest sense, mercantilists believed that a country should increase its holdings of gold and silver by promoting exports and discouraging imports. In other words, if people in other countries buy more from you (exports) than they sell to you (imports), then they have to pay you the difference in gold and silver. The objective of each country was to have a trade surplus, or a situation where the value of exports are greater than the value of imports, and to avoid a trade deficit, or a situation where the value of imports is greater than the value of exports.

A closer look at world history from the 1500s to the late 1800s helps explain why mercantilism flourished. The 1500s marked the rise of new nation-states, whose rulers wanted to strengthen their nations by building larger armies and national institutions. By increasing exports and trade, these rulers were able to amass more gold and wealth for their countries. One way that many of these new nations promoted exports was to impose restrictions on imports. This strategy is called protectionism and is still used today.

Nations expanded their wealth by using their colonies around the world in an effort to control more trade and amass more riches. The British colonial empire was one of the more successful examples; it sought to increase its wealth by using raw materials from places ranging from what are now the Americas and India. France, the Netherlands, Portugal, and Spain were also successful in building large colonial empires that generated extensive wealth for their governing nations.

Although mercantilism is one of the oldest trade theories, it remains part of modern thinking. Countries such as Japan, China, Singapore, Taiwan, and even Germany still favor exports and discourage imports through a form of neo-mercantilism in which the countries promote a combination of protectionist policies and restrictions and domestic-industry subsidies. Nearly every country, at one point or another, has implemented some form of protectionist policy to guard key industries in its economy. While export-oriented companies usually support protectionist policies that favor their industries or firms, other companies and consumers are hurt by protectionism. Taxpayers pay for government subsidies of select exports in the form of higher taxes. Import restrictions lead to higher prices for consumers, who pay more for foreign-made goods or services. Free-trade advocates highlight how free trade benefits all members of the global community, while mercantilism's protectionist policies only benefit select industries, at the expense of both consumers and other companies, within and outside of the industry.

In order to conduct empirical investigations on the issues pertaining to comparative conducts and performance of FCFs and DFs as well as for efficiency and export spillovers from FCFs to DFs, we require a theoretical framework for deriving various hypotheses. In view of this, the objective of the present chapter is to review the major theories of FDI and MNEs which are generally used for deriving hypotheses in such types of empirical research. Thus, the plan of this chapter is as

follow. Section-2 discusses the major characteristics of FDIIMNEs. Section-3 briefly reviews the select micro economic theories of FDIIMNEs, including industrial organisation (IO), transaction cost and internalization (TCI) and eclectic theory, and the resource-based view of the firm (RBV). These theories generally used for deriving hypothesis for conducting the empirical research. Section-4 presents a discussion on the comparative features of the theories of FDI and thereby selects the eclectic theory of FDI as the most suitable framework for deriving hypothesis for the empirical research to be taken up in the later chapter. Section-S presents the conclusions and implications of the FDI theories for the development.

Balance of Payments

According to Kindle Berger, "The balance of payments of a country is a systematic record of all economic transactions between the residents of the reporting country and residents of foreign countries during a given period of time". It is a double entry system of record of all economic transactions between the residents of the country and the rest of the world carried out in a specific period of time *when we say "a country's balance of payments" we are referring to the transactions of its citizens and government*.

Balance Of Payment : Definition

The balance of payments of a country is a systematic record of all economic transactions between the residents of a country and the rest of the world. It presents a classified record of all receipts on account of goods exported, services rendered and capital received by residents and payments made by them on account of goods imported and services received from the capital transferred to non-residents or foreigners. **- Reserve Bank of India**

Features

oIt is a systematic record of all economic transactions between one country and the rest of the world.

oIt includes all transactions, visible as well as invisible.

oIt relates to a period of time. Generally, it is an annual statement.

oIt adopts a double-entry book-keeping system. It has two sides: credit side and debit side. Receipts are recorded on the credit side and payments on the debit side.

Balance of Trade

The difference between a country's imports and its exports. Balance of trade is the largest component of a country's balance of payments. **Debit** items include imports, foreign aid, domestic spending abroad and domestic investments abroad. **Credit** items include exports, foreign spending in the domestic economy and foreign investments in the domestic economy. When exports are greater than imports than the BOT is **favourable** and if imports are greater than exports then it is **unfavourable**

Balance of Trade V/s Balance of Payment

The Balance of Payment takes into account all the transaction with the rest of the worlds

The Balance of Trade takes into account all the *trade* transaction with the rest of the worlds

BOP

1. It is a broad term.
2. It includes all transactions related to visible, invisible and capital transfers.
3. It is always balances itself.
4. BOP = Current Account + Capital Account + or - Balancing item (Errors and omissions)
5. Following are main factors which affect BOP a)Conditions of foreign lenders. b)Economic policy of Govt. c) all the factors of BOT

BOT

1. It is a narrow term.
2. It includes only visible items.
3. It can be favorable or unfavorable.
4. BOT = Net Earning on Export - Net payment for imports.
5. Following are main factors which affect BOT a) cost of production b) availability of raw materials c) Exchange rate d) Prices of goods manufactured at home

Importance of Balance Of Payments

1. BOP records all the transactions that create demand for and supply of a currency.
2. Judge economic and financial status of a country in the short-term
3. BOP may confirm trend in economy’s international trade and exchange rate of the currency. This may also indicate change or reversal in the trend.
4. This may indicate policy shift of the monetary authority (RBI) of the country.
5. BOP may confirm trend in economy’s international trade and exchange rate of the currency. This may also indicate change or reversal in the trend.

The General Rule in BOP Accounting

a. If a transaction earns foreign currency for the nation, it is a
credit and is recorded as a plus item.
b. If a transaction involves spending of foreign currency it is
a debit and is recorded as a negative item.

The various components of a BOP statement

1. Current Account
2. Capital Account
3. Reserve Account
4. Errors & Omissions

Current Account Balance

•BOP on current account is a statement of actual receipts and payments in short period.

•It includes the value of export and imports of both visible and invisible goods. There can be either surplus or deficit in current account.

•The current account includes:- export & import of services, interests, profits, dividends and unilateral receipts/payments from/to abroad.

•BOP on current account refers to the inclusion of three balances of namely – Merchandise balance, Services balance and Unilateral Transfer balance

Types of Balances Trade Balance
Merchandise: exports - imports of goods
Services: exports - imports of services Income Balance
Net investment income: net income receipts from assets
Net international compensation to employees: net compensation of Employees Net Unilateral Transfers
Gifts from foreign countries minus gifts to foreign countries

Disequilibrium In The Balance Of Payments

A disequilibrium in the balance of payment means its condition of Surplus Or deficit

✓ **A Surplus in the BOP** occurs when Total Receipts exceeds Total Payments. Thus,

BOP= CREDIT>DEBIT

✓ **A Deficit in the BOP** occurs when Total Payments exceeds Total Receipts. Thus,

BOP= CREDIT<DEBIT

Causes of Disequilibrium In The Bop

➢ Cyclical fluctuations
➢ Short fall in the exports
➢ Economic Development
➢ Rapid increase in population
➢ Structural Changes
➢ Natural Calamites
➢ International Capital Movements

✓ cash assistance, subsidies can be given to exporters to increase exports ✓ goods meant for exports can be exempted from all types of taxes. *b) Import Substitutes*

Steps may be taken to encourage the production of import substitutes. This will save foreign exchange in the short run by replacing the use of imports by these import substitutes.

GATT

The General Agreement on Tariffs and Trade (GATT) is neither an organisation nor a court of justice. It is simply a multinational treaty which now covers eighty per cent of the world trade. It is a decision making body with a code of rules for the conduct of international trade and a mechanism for trade liberalisation. It is a forum where the contracting parties meet from time to time to discuss and solve their trade problems, and also negotiate to enlarge their trade. The GATT rules provide for the settlement of trade disputes, call for consultations, waive trade obligations, and even authorize retaliatory measures.

The GATT has been a permanent international organisation having a permanent Council of Representative with headquarters at Geneva. 25 governments have signed it. Its function is to call International conferences to decide on trade liberalizations on a multilateral basis.

GATT 'Rounds' of Global Trade Negotiations

The brief particulars of the various GATT Rounds'(conferences) for global trade

First Round:- The earlier rounds of GATT have achieved a limited measure of success. In the first round of talks held in Havana in 1947, 23 countries, which had formed GATT, exchanged tariff concessions on 45,000 products worth 10 billion US dollars of trade perannum.

1. **Second Round:-** Ten more countries had joined GATT when its second round was held in Annecy (France) in 1949. In this round, customs and tariffs on 5000 additional items of international trade were reduced.
2. **Third Round:-** The Third round was organized in Torquay (England) in 1950-51. 38 member countries of GATT participated in it and they adopted tariff reduction on 8700items.
3. **Fourth Round:-** The fourth round of world trade negotiations were held in Geneva in 1955-56. In this round countries decided to further cut duties on goods entering international trade. The value of merchandise trade subjected to tariff cut was estimated at $2.5b.
4. **Fifth Round:-** The fifth round took place during 1960-62 at Geneva. In this round the negotiations covered the approval of common external tariff (CET) of the European countries and cut in custom duties amounting to US $ 5 billion on 4400 items. Twenty-six countries participated in this round.
5. **Sixth Round or the Kennedy Round:-** With the formation EEC, the US had been put at a disadvantage. As a reaction to this, the US Congress passed the Trade Expansion Act in October 1962 which authorised the Kennedy administration to make 50 per cent tariff reduction in all commodities. This paved the way for the opening of the Kennedy round of trade negotiations at Geneva in May 1964, which were to be completed by 30 June1967.

WORLD TRADE ORGANISATION (WTO)

The WTO was established on January 1, 1995. It is the embodiment of the Uruguay Round results and the successor to GATT. 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.

The General Council (GC) is an executive forum composed of representatives of all the Members. The GC discharges the functions of MC during the intervals between meetings of MC. The GC has three functional councils working under its guidance and supervision namely:

Council for Trade in Goods.

Council for Trade in Services.

Council for Trade Related Aspects of Intellectual Property Rights (TRIPs).

Director-General heads the secretariat of WTO. He is responsible for preparing budgets and financial statements of the WTO. WTO has now become the third pillar of United Nations Organization (UNO) after World Bank and International Monetary Fund.

Objectives Of WTO

In its preamble, the Agreement establishing the WTO lays down the following objectives of the 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 liberalisation 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.

Functions of WTO

The following are the functions of the 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.

Differences between GATT and WTO

The WTO is not an extension of the GATT but succession to the GATT. It completely replaces GATT and has a very different character. The major differences between the two are:

1. The GATT had no status whereas the WTO has a legal status. It has been created a by international treaty ratified by governments and legislatures of member states.

2. The GATT was a set of rules and procedures relating to multilateral agreements of selective nature. There were separate agreements on separate issues, which were not binding on members. Any member could stay out of the agreement. The agreements, which form part of the WTO, are permanent and binding on all members.

3. The GATT dispute settlement system was dilatory and not binding on the parties to the dispute. The WTO dispute settlement mechanism is faster and binding on all parties.

4. GATT was a forum where the member countries met once in a decade to discuss and solve world trade problems. The WTO, on the other hand, is a properly established rule based World Trade Organization where decisions on agreement are time bound.

5. The GATT rules applied to trade in goods. Trade in services was included in the Uruguay Round but no agreement was arrived at. The WTO covers both trade in goods and trade in-services.

6. The GATT had a small secretariat managed by a Director General. But the WTO has a large secretariat and a huge organizational setup

INTERNATIONAL COMMODITY AGREEMENTS (ICA)

International commodity agreements are inter-governmental arrangements concerning the production and trade of certain primary products. Many developing countries which have embarked upon ambitious development programmes are in need of large foreign exchange resources to finance some of their development requirements like capital goods imports. But they have been facing the important problem of wide-fluctuations in the export prices of the primary goods i.e. agricultural products and minerals, which form a major part of their total exports. Apart form making the export earnings unstable, it has also been causing a deterioration in their terms of trade. Hence, there has been a growing demand for adopting stabilization measures to protect especially the interests of developing countries. International commodity agreements, it is believed, can help stabilize prices of the respective commodities.

Objectives of ICA

The main objectives of the international commodity agreements are:-

1. **Price Stabilization:** Price stabilization is a very important purpose for which commodity agreements have been entered into.
2. **The Promotion of Health and Morals:** The outstanding example of international agreements for the purpose of promoting health and morals is the international regulation of trade in opium and narcotics.
3. **Security Objectives:** Inter governmental commodity agreements may also be useful as a preventive of war by preventing scramble for scarce strategic materials for national stock-piling or other security purposes.
4. **The Conservation of Resources:** The conservation of natural resources is a direct or indirect objective of nearly all international raw material schemes.
5. **The management of surplus:** Commodity agreements are sometimes entered into to manage the surplus during times of bumper crops, there may arise a problem of surplus. Such should be properly handled to avoid serious adverse effects on price and also to hold stock for the lean period.

INTERNATIONAL MONETARY FUND(IMF)

The International Monetary Fund, A Global Institution, is frequently in the news, but its role and functions are often misunderstood.

The Origins of the IMF

The IMF was conceived in July 1944 at an international conference held at Bretton Woods, New Hampshire, U.S.A. Delegates from 44 governments agreed on a framework for economic cooperation partly designed to avoid a repetition of the disastrous economic policies that had contributed to the Great Depression of the1930s.

During that decade, as economic activity in the major industrial countries weakened, countries attempted to defend their economies by increasing restrictions on imports; but this just worsened the downward spiral in world trade, output, and employment. To conserve dwindling reserves of gold and foreign exchange, some countries curtailed their citizens' freedom to buy abroad, some devalued their currencies, and some introduced complicated restrictions on their citizens' freedom to hold foreign exchange. These fixes, however, also proved self-defeating, and no country was able to maintain its competitive edge for long. Such "beggar-thy-neighbor" policies devastated the international economy; world trade declined sharply, as did employment and living standards in many countries.

As World War II came to a close, the leading allied countries considered various plans to restore international monetary. The country representatives drew up the charter (or Articles of Agreement) of an international institution to oversee the international monetary system and to promote both the elimination of exchange restrictions relating to trade in goods and services, and the stability of exchange rates.

The IMF came into existence in December 1945, when the first 29 countries signed its

Articles of Agreement.

The statutory purposes of the IMF today are the same as when they were formulated in 1944. Since then, the world has experienced unprecedented growth in real incomes. And although the benefits of growth have not flowed equally to all—either within or among nations—most countries have seen increases in prosperity that contrast starkly with the interwar period, in particular. Part of the explanation lies in improvements in the conduct of economic policy, including policies that have encouraged the growth of international trade and helped smooth the economic cycle of boom and bust. The IMF is proud to have contributed to these developments.

In the decades since World War II, apart from rising prosperity, the world economy and monetary system have undergone other major changes-changes that have increased the importance and relevance of the purposes served by the IMF, but that have also required the IMF to adapt and reform. Rapid advances in technology and communications have contributed to the increasing international integration of markets and to closer linkages among national economies. As a result, financial crises, when they erupt, now tend to spread more rapidly among countries.

In such an increasingly integrated and interdependent world, any country's prosperity depends more than ever both on the economic performance of other countries and on the existence of an open and stable global economic environment. Equally, economic and financial policies that individual countries follow affect how well or how poorly the world trade and payments system operates. Globalization thus calls for greater international cooperation, which in turn has increased the responsibilities of international institutions that organize such cooperation—including the IMF.

The IMF's purposes have also become more important simply because of the expansion of its membership. The number of IMF member countries has more than quadrupled from the 44 states involved in its establishment, reflecting in particular the attainment of political independence by many developing countries and more recently the collapse of the Soviet bloc.

The expansion of the IMF‘s membership, together with the changes in the world economy, has required the IMF to adapt in a variety of ways to continue serving its purposes effectively.

Countries that joined the IMF between 1945 and 1971 agreed to keep their exchange rates pegged at rates that could be adjusted, but only to correct a "fundamental disequilibrium" in the balance of payments and with the IMF's concurrence. This so-called Bretton Woods system of exchange rates prevailed until 1971 when the U.S. government suspended the convertibility of the U.S. dollar (and dollar reserves held by other governments) into gold.

At the same time as the IMF was created, the International Bank for Reconstruction and Development (IBRD), more commonly known as the World Bank, was set up to promote long-term economic development, including through the financing of infrastructure projects, such as road-building and improving water supply.

The IMF and the World Bank Group—which includes the International Finance Corporation (IFC) and the International Development Association (IDA)complement each other's work. While the IMF's focus is chiefly on macroeconomic performance, and on macroeconomic and financial sector policies, the World Bank is concerned mainly with longer-term development and poverty reduction issues. Its activities include lending to developing countries and countries in transition to finance infrastructure projects, the reform of particular sectors of the economy, and broader structural reforms. The IMF, in contrast, provides financing not for particular sectors or projects but for general support of a country's balance of payments and international reserves while the country takes policy action to address its difficulties.

When the IMF and World Bank were established, an organization to promote world trade liberalization was also contemplated, but it was not until 1995 that the World Trade Organization was set up. In the intervening years, trade issues were tackled through the General Agreement on Tariffs and Trade (GATT).

The Purposes of IMF

The purposes of the International Monetary Fund are:

I. To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.

II. To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.

III. To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

IV. To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.

V. To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustment in their balance of payments without resorting to measures destructive of national or international prosperity.

VI. In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.

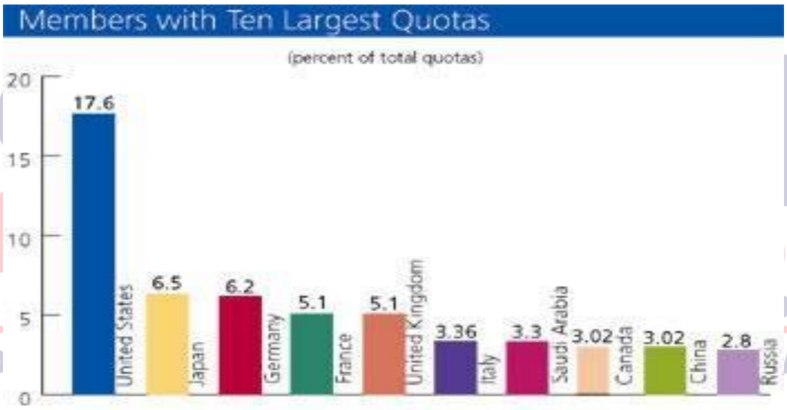
Funding of IMF

The IMF's resources come mainly from the quota (or capital) subscriptions that countries pay when they join the IMF, or following periodic reviews in which quotas are increased. Countries pay 25 percent of their quota subscriptions in Special Drawing Rights or major currencies, such as U.S. dollars or Japanese yen; the IMF can call on the remainder, payable in the member's own currency, to be made available for lending as needed. Quotas determine not only a country's subscription payments, but also the amount of financing that it can receive from the IMF, and its share in SDR allocations. Quotas also are the main determinant of countries' voting power in the IMF.

Quotas are intended broadly to reflect members' relative size in the world economy: the larger a country's economy in terms of output, and the larger and more variable its trade, the higher its quota tends to be. The United States of America, the world's largest economy, contributes most to the IMF, 17.5 percent of total quotas; Palau, the world's smallest, contributes 0.001 percent. The most recent (eleventh) quota review came into effect in January 1999, raising IMF quotas (for the first time since 1990) by about 45 percent to SDR 212 billion (about $300 billion).

If necessary, the IMF may borrow to supplement the resources available from its quotas. The IMF has two sets of standing arrangements to borrow if needed to cope with any threat to the international monetary system:

- the General Arrangements to Borrow (GAB), set up in 1962, which has 11 participants (the governments or central banks of the Group of Ten industrialized countries and Switzerland),and
- the New Arrangements to Borrow (NAB), introduced in 1997, with25
- Participating countries and institutions. Under the two arrangements combined, the IMF has up to SDR 34 billion (about $50 billion) available to borrow.



Concept of SDR

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

SDRs—sometimes known as "paper gold" although they have no physical form—have been allocated to member countries (as bookkeeping entries) as a percentage of their quotas. So far, the IMF has allocated SDR 21.4 billion (about$32 billion) to member countries. The last allocation took place in 1981, when SDR 4.1 billion was allocated to the 141 countries that were then members of the IMF. Since 1981, the membership has not seen a need for another general allocation of SDRs, partly because of the growth of international capital markets. In September 1997, however, in light of the IMF's expanded membership—which included countries that had not received an allocation—the Board of Governors proposed a Fourth Amendment to the Articles of Agreement. When approved by the required majority of member governments, this will authorize a special one-time "equity" allocation of SDR 21.4 billion, to be distributed so as to raise all members' ratios of cumulative SDR allocations to quotas to a common benchmark.

IMF member countries may use SDRs in transactions among themselves, with 16 "institutional" holders of SDRs, and with the IMF. The SDR is also the IMF's unit of account. A number of other international and regional organizations and international conventions use it as a unit of account, or as a basis for a unit of account.

The SDR's value is set daily using a basket of four major currencies: the euro, Japanese yen, pound sterling, and U.S. dollar. On July 1, 2004, SDR 1 = US$1.48. The composition of the basket is reviewed every five years to ensure that it is representative of the currencies used in international transactions, and that the weights assigned to the currencies reflect their relative importance in the world's trading and financial systems.

The IMF helps its member countries by:

- reviewing and monitoring national and global economic andfinancialdevelopments and advising members on their economic policies;lending them hard currencies to support adjustment and reform policies designed to correct balance of payments problems and promote sustainable growth; and
- Offering a wide range of technical assistance, as well as training for government and central bank officials, in its areas ofexpertise.

WORLD BANK

Introduction

A need arises to finance various projects in various countries to promote the development of economically backward regions. The United States and other countries have established a variety of development banks whose lending is directed to investments that would not otherwise be funded by private capital. The investments include dams, roads, communication systems, and other infrastructural projects whose economic benefits cannot be computed and/or captured by private investors, as well as projects, such as steel mills or chemical plants, whose value lies not only in the economic terms but also, significantly in the political and social advantages to the nation. The loans generally are medium-term to long-term and carry concessional rates.

Even though most lending is done directly to a government, this type of financing has two implications for the private sector. First, the projects require goods and services which corporations can produce. Secondly, by establishing an infrastructure, new investment opportunities become available for multinational corporations.

The World Bank or the International Bank for Reconstruction and Development (IBRD) was established in 1945 under the Bretton Woods Agreement of 1944. An International Monetary and Financial Conference was held at Bretton Woods, New Hampshire during July 1-

22, 1944. The main purpose of the conference was finalisation of the Articles of Association of IMF and establishment of an institution for the reconstruction of the war shattered world economies. Thus, the conference has given birth to World Bank or International Bank for Reconstruction and Development (IBRD). World Bank was established to provide long-term assistance for the reconstruction and development of the economies of the member countries while IMF was established to provide short- term assistance to correct the balance of payment disequilibrium.

The World Bank is an inter-governmental institution, corporate, in form, the capital stock of which is entirely owned by its members-governments. Initially, only nations that were members of the IMF could be members of the World Bank. This restriction on membership was subsequently relaxed. The World Bank makes loans at nearly conventional terms for projects of high economic priority. To qualify for financing, a project must have costs and revenues that can be estimated with reasonable accuracy. A government guarantee is a necessity for World Bank funding. The Bank‘s main emphasis has been on large infrastructure projects such as roads, dams, power plants, education and agriculture. However, in recent years the Bank has laid greater emphasis on quick loans to help borrower countries to alleviate their balance of payments problems.Theseloansaretiedtothewillingnessofthedebtornationstoadopteconomic policies that will spur growth, free trade, more open investment, and a more vigorous private sector. Besides its member's subscriptions, the World Bank raises funds by issuing bonds to private sources.

Functions of the World Bank

The principal functions of the IBRD are set forth in Article I of the agreement and are as follows :

1. To assist in the reconstruction and development of the territories of its members by facilitating the investment of capital for productive purposes.
2. To promote private foreign investment by means of guarantee of participation in loans and other investments made by private investors and, when private capital is not available on reasonable terms, to make loans for productive purposes out of its own resources or from funds borrowed byit.
3. To promote the long term balanced growth of international trade and the maintenance of equilibrium in balance of payments by encouraging international investment for the development of the productive resources ofmembers.
4. To arrange loans made or guaranteed by it in relation to international loans through other channels so that more useful and urgent projects, large and small a like, will be dealt first. It appears that the World Bank was created to promote and not to replace private foreign investment. In this respect the Bank considers its role to be a marginal one, to supplement and assist private foreign investment in the member countries.

Membership of the World Bank

All the members of the IMF are also the members of the World Bank. Any country can join as a member of the IBRD by signing in the Charter of the Bank as its subscriber. It had 184 members in 2003. Bank has the authority to suspend any member, if the country concerned fails to discharge its responsibilities to the IBRD. Similarly, every member is free to resign from the membership but it has to pay back all loans with interest on due dates. The member is also required topay its share of the loss on demand if the Bank incurs a financial loss in the year in which a member resigns.

Capital Structure of the World Bank

The World Bank or IBRD started with an authorised capital of US $ 10 billion divided into 1,00,000 shares of US $ 1,00,000 each. The subscribed capital at that at time was US $9.4 billion. The authorised capital was increased to 7,16,500 shares of the par value of SDR 1,00,000 each in 1985. In July 1992, the totalauthorisedcapitalofthebankwas$14.1billionwithacapitalincreaseof$9.3 billion. This increase of 77,159 shares was subscribed by the republics of the former Soviet Union. The bank has raised capital worth $23 billion in 2002.

The member countries contribute their share capital to the Bank as follows:

(1) 2% of the share in the form of gold and US dollars. The World Bank utilizes this amount freely for granting loans.

(2) 18% of the share capital in the form of own currency. This amount is also used by Bank for granting loans.

(3) 80% of the share capital is payable at the request of the Bank. This amount is also used by Bank for granting loans. But it can use this amount in discharging its responsibilities.

Organisation Structure of the World Bank

The World Bank like IMF is also managed by a three-tier structure including Board of Governors, Executive Directors and President.

(1) Board of Governors: The Board of Governors has full authority and control over the Bank's activities. Normally, each country appoints its Finance Minister as a Governor and the Governor of its Central Bank as Alternate Governor on the Board of Governors for a period of 5 years. The strength of the voting rights to the Governors depends upon the subscribed capital by the member country.Inthe absence of Governor, the Alternate Governor can exercise the voting right. Normally the Board of Governors meets annually.

(2) Executive Directors: The bank has 24 Executive Directors. They supervise the entire operations of the Bank. Out of these 24 Directors, are appointed by USA, UK, Germany, Finance and Japan. The remaining 19 Directors are elected by the remaining member countries. The Executive Directors normally meet regularly once in a month. The 24 Directors elect the President of the Bank who presides over the meetings of the Board of Executive Directors.

(3) **The Scope of Decisions** of the Executive Directors Include:

(a) Policy making within the framework of the Articles of Agreement.

(b) Loans and credit proposals.

(4) **Function of Board of Executive Directors**

(a) To Present audited annual reports.

(b) To prepare administrative budget.

(c) To prepare and present to Board of Governors annual reports on the operation and policies of the Bank.

(5) **President:** Normally the president does not have any voting right except in case of exercising equal rights. He is assisted by senior Vice-Presidents and Directors of various departments and regions.

Funding Strategy of the World Bank

There are the four basic objectives of the World Bank‘s funding strategy:

(1) To make sure availability of funds in the market.

(2) To provide the funds at the lowest possible cost to the borrowers through appropriate currency mix of its borrowing and opting to borrow when interest rates are expected torise.

(3) To control volatility in net income and overall loan changes.

(4) To provide an appropriate degree of maturity transformation between its lending and the borrowing. Maturity transformation depicts the Bank‘s capacity to lend for longer period than it borrows.

Bank’s Borrowings

Bank‘s main function is to lend the money to the needy member. For lending activities, it needs money and therefore it has to borrow.

Sources: The bank borrows from the following sources:

(1) The Bank borrows from international market both for long-term and short-term periods.

(2) The Bank also borrows under currency swap agreements(CSA).

(3) The Bank also borrows under the Discount-Note Programme by two methods. First, it places bonds and notes directly wich its member countries. Second, it offer issues to investors and in public markets.

Two new borrowings instruments were evolved by the Bank. The first one is Central Bank Facility and US Dollar Dominated Facility. The second instrument is Floating Rate Notes. The World Bank borrows from the commercial banks and other financial institutions with the help of this instrument.

Bank's Lending Activities

The Bank grants loans to members in any one or more of the following ways:

(1) by participating or granting indirect loans out of its own funds;

(2) by granting loans out of funds raised in the market of a member or otherwise borrowed by the Bank; and

(3) by guaranteeing in whole or part, loans made by private investors through the investment channels.

The total outstanding amount of the total direct and indirect loans made or guaranteed by the Bank is not to exceed 100 per cent of its total unimpaired subscribed capital, resources and surpluses. Bank imposes following conditions in granting loans:

(1) The bank is satisfied that the borrower is unable to borrow under reasonable conditions in the prevailing market conditions.

(2) The project for which loan is required should be recommended by the competent authority in the form of a written report after careful examination of the project.

(3) The loan is required for productive purpose.

(4) The borrower or guarantor has reasonable prospects of repaying loans and interest on loans.

(5) If the project is located on the territory of the member but itself is not a borrower, then the member or its central bank has to guarantee the repayment of loan, interest on loans and other charges on loan.

In 1991, the Executive Board of the Bank modified the repayment terms which include extension of repayment period from 3 to 5 years for middle income countries and review of repayment terms for middle income countries within 3 years. The cumulative lending of the Bank is of $ 383 billion and in the fiscal year 2003, it has lended $ 11.2 billion for 99 new operations in 37 countries.

India and the World Bank

India is the founder member of the Bank and held a permanent seat for number of years on its Board of Executive Directors. India is one of the largest receiver of assistance since 1949. Upto June 2002, cumulative lendings of the World Bank to India amounted to $ 26.69 billion in 187 loans. The total amount borrowed by India from the World Bank and the IDA till June 2002 amounted to$ 58.54 billion in 434 loans. This amounted to 11.6 per cent of the total loans and credits approved by the World Bank groups. During 2001-02, India received$ 893 million from the World Bank accounting for 11.22 per cent of its total loans.

India is helped by the World Bank in its planned economic development through granting loans, conducting field surveys, sending study terms and missions and through rendering expert advice. The Bank also provides training to Indian personnel at EDI. There is also a Chief of Missions of the Bank at New Delhi. He is representing the Bank for its aided projects in India for monitoring and consultations. The Bank has been helping India in various objects like development of ports, oil exploration including the Bombay high and gas power projects, aircrafts, coal, iron, aluminum, fertilizers, railway modernisation and technical assistance etc. It also helped India to solve its river water dispute with Pakistan. The benefits desired by India from the World bank are:

(i) India has received a lot of assistance from the World Bank for its development projects.

(ii) Aid India Club was founded in 1950 by the efforts of the World Bank with a view to help India. This club is now called India Development Forum. This Forum had decided to give loans amounting to $ 600 core to India for implementing its structural adjustment.

(iii) The bank's role in solving the Indus water dispute between India and Pakistan has been invaluable.

(iv) General loans have also been granted by the World Bank to India, to be utilised as per its own discretion.

(v) As a member of the World Bank, India has become the members of International Finance Corporation, International Development Association and Multilateral Investment Guarantee Agency also.

(vi) India has received technical assistance from time to time from the World Bank for its various projects. The Expert Team of the Bank has visited India and given valuable suggestions also.

(vii) The massive population of India has always created problems in the economic development of the country. World Bank has been helping India in the population control programmes and urban development. For this purpose loans amounting to $ 495 crore have also been given to India.

(viii) World Bank has been giving financial assistance to NGOs operating in India e.g. Leprosy Elimination, Education Projects, Child development service projects etc.

On the other hand, critics argue that the World Bank have endangered the economic freedom of India. The basic points of criticism are as follows:

(i) The World Bank has laid a great deal of emphasis on measures of economic liberalisation and more free play of market forces.

(ii) A lot of stress has been laid on going very slow on the setting up of public sector enterprises including financial intermediaries and encouraging private sector.

(iii) India‘s dependence on World Bank has been increasing which is adversely affecting its economic freedom.

(iv) The attitude of World Bank reflects the preference for free enterprise and a market oriented economy. It shows dissatisfaction with the general performance of economies which are based on planning and regulation. At different occasions the Bank has tried to undermine the Significance of our Planning Commission.

(v) The devaluation of Indian rupee in 1966 and 1991 was done at the insistence of the World Bankonly.

India‘s main problem till now has been the government‘s incapacity to act rightly, firmly and effectively in time, on account of being more emotional to set ideologies and compromising attitude to safeguard the political party‘s interest more than the national interest.

Affiliates to the World Bank

The Bank has four affiliates. These are:

International Development Association (IDA)

The IDA was set up in 1960 as a subsidiary of the World Bank to provide ―soft loans‖ to the member countries. Thus, the object of the IDA is to provide loans to member countries on liberal terms with regard to the rate of interest and the period of repayment. Another attraction of the IDA loans is that they can be repaid in the currency of the member country.

In approving an IDA credit, *three criteria* are observed:

1. **Poverty Test :** IDA‘s assistance is limited to the poorest of those countries classified as Part II countries, and which continue to face such severe handicaps as excessive dependence on volatile primary products markets, heavy debt servicing burden, and often, rates of population growth eat outweigh the gains of production.
2. **Performance Test:** Within the range of difficulties of establishing objective standards of performance, the following factors serve as the yardstick for an adequate performance test: satisfactory overall economic policies and past success in project execution.
3. **Project Test:** The purpose of the IDA is soft loans, not soft projects. IDA projects are appraised according to the same standard as that applied to the Bank projects – the test essentially requires that proposed projects promise to yield financial and economic returns adequate to justify the use of scarce capital.

The Objective of IDA are:

1. To provide development finance on easy terms to less developed member countries; and
2. To promote economic development, increase productivity and thus raise standards of living in the underdeveloped areas.
3. Since the IDA charges nominal rates of interest on its loans, it has also been nicknamed the –soft-loan windows‖.

Membership: All the members of the World Bank are the members of the IDA. It had 164 members in June, 2003. There are two types of members. In IDA- Part I members are the developed countries which are 24 in number and therefore are called as G-24 countries. Part II members are the developing countries.

Organisation: The organisation of IDA is same as that of the World Bank. Generally, the staff of the World Bank operates this association with few separate sections.

Loans: IDA loans are known as IDA credits. Only a member country can borrow from IDA with a restriction that a member country is eligible to borrow from IDA only if its per capita income is less than US $ 695 at 1990 price index. Those projects get assistance from IDA which are not financed by the World Bank. IDA observes the poverty criterion, performance criterion and project criterion while approving the projects.

Terms of Loans: Conditions for IDA loans are:

(1) Repayment period is 35-40years.

(2) Grace period is 10years.

(3) Interest rate varies between zero to 0.5% which is waived now.

(4) Administrative fee is 0.75% on the loan amount disbursed.

Gross disbursement by IDA during the year 2002-03 were $8.1 billion. India received $686.6 million interest free loan during the year 2002-03. The cumulative commitments of IDA were of $ 142 billion and commitments of $7.3 billion for 141 new operations in 55 countries were made in fiscal year 2003.

International Finance Corporation (IFC)

The International Finance Corporation (IFC) is the private sector arm of the World Bank family which was established in July 1956. It is the major multilateral agency promoting productive private investment in developing private investment in developing countries. It helps finance private sector projects to mobilise finance for them in the international financial markets, and provides advice and technical assistance to businesses and governments.

Membership

The Articles of Agreement of the IFC are similar to that of the World Bank. A country has to be a member of the World Bank in order to join the IFC. In June 2003, it had 175 members.

Objectives

The objectives for which the IFC was set up have been laid down in Article 1 of its Articles of Agreement as under:

The purpose of the Corporation is to further economic development by encouraging the growth of productive private enterprise in member countries, particularly in the less developed areas, thus supplementing the activities of the International Bank for Reconstruction and Development. In carrying out this purpose, the Corporation shall:

(i) in association with private investors, assist in financing the establishment, improvement and expansion of productive private enterprise which would contribute to the development of its member countries by making investments, without guarantee of repayment by the member Government concerned, in cases where sufficient private investment is not available on reasonable terms;

(ii) seek to bring together investment opportunities, domestic and foreign private capital, and experienced management; and

(iii) Seek to stimulate, and to help create conditions conducive to the flow of private capital, domestic and foreign, into productive investment in member countries‖.

IFC is the largest multinational source of loan and equity financing for private sector projects in the developing world. It offers a full array of financial products and services to companies in its developing member countries:

- Long-term loan in major currencies, at fixed or variable rates.
- Equity investment.
- Quasi-equity instruments (subordinated loans, preferred stock, income rates).
- Guarantees and standby financing.
- Risk management (intermediation of currency and interest rate swaps, provision of hedging facilities).

IFC has approved $3.9 billion in financing 204 project in various sectors in 64 developing countries in the fiscal year 2003. IFC invested in 11 projects involving an amount of $48.1 million in India. It is composed to $25.4 million in the form of loan and $ 22.7 million in the form of equity.

In recent years, greater emphasis has been placed by the corporation on helping to develop resources and to increase the availability of foodstuffs.

The special feature of the IFC is that, unlike commercial financial institutions, it judges potential ventures in terms of both their financial viability and their contribution to the economic development of the country concerned. At the same time, unlike other official development institutions, it participates directly with the private sector in both the developed and developing worlds. Unlike both types of institutions, it provides both equity and fixed rate financing.

FOREIGN INVESTMENT AND FDI CONTENT OUTLINE
INTRODUCTION

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

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

THE ROLE OF FOREIGN INVESTMENT

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

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

The creation and diffusion of productive knowledge have become central to growthanddevelopment.–Knowledgeincludesnotonlytechnicalknowledge (research and development, design, process engineering), but also knowledge of organisation, management and inter-firm and international relationships. Much of this knowledge is tacit. Today, the resources devoted to such knowledge exceed investment in tangible machinery and equipment in many of the world‘s most dynamic firms, and the costs of generating new knowledge are rising constantly. The importance of knowledge is not limited to modern or high-tech activities but pervades all sectors and industries, including traditional activities in the primary sector (for instance, vegetable and flower exports), manufacturing (such as textiles, clothing and footwear), and services (such as tourism and banking). As a result, achieving development objectives is, more than ever, a continuous learning process.

The sheer pace of technological change, in particular, is unprecedented arid is accelerating. This means that enterprises that want to be competitive internationally reed both the knowledge to use technologies efficiently and to keep pace with developments. Innovators need to invest more in creating new knowledge, but even followers need the capacity - difficult to acquire - to access and use this new knowledge, or in fortuitous circumstances, to identify windows of opportunity for technological caps. The skills required for this are changing concomitantly, as are institutions and their relations with productive enterprises; one development is the closer linking of science with technology-generation in industry. An important result of this new –technological paradigm‖ is that research-intensive activities are growing more rapidly than others in production and trade; thus, sustained economic growth calls increasingly not just for the application of new technology to existing activities, but also for a shift of activities up the value-added chain.

The most profound technological changes today emanate from a merger of communications and information processing technologies. While the telegraph, telephone and computer were significant technological achievements; they pale in comparison with emerging technologies based on the interface between microprocessors arid telecommunications. These are generic technologies that affect practically the whole range of economic and even social and cultural activities. Information can now be transmitted across the globe at very low cost.

ii) Shrinking economic space and changing competitive conditions

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

iii) Changing attitudes and policy regimes

Most developing and transition countries have moved to market-oriented and private sector led economies. This shift reflects disillusionment with past strategies and growing. Difficulties in pursuing them in the new technological and competitive setting. The shrinking of economic space has itself rendered elements of traditional strategies absolute while the flow of information has made governments more aware of policies a performance in other countries. Policy benchmarking in all areas is becoming more common which, in turn, puts more pressure on countries to innovate in the policy arena. There is widespread reduction and removal of trade barriers, deregulation of internal markets, privatisation and liberalization of technology and investment flows at the national level. At the international level, regulation has intensified and is being harmonized. For instance, the TRIPS agreement of the Uruguay Round has introduced a common more rigorous, system of intellectual property protection; the TRIMs agreement established disciplines over certain performance requirements; and quality requirements such as ISO standards are becoming prerequisites for participating in international production and trade.

Perhaps nowhere is the policy change more striking than in the changing attitude o governments to TNCs. Why have governments changed their attitudes to TNCs? There are several reasons for the change in attitudes towards TNCs and the intensification of competition for PD Governments recognize that TNCs can provide a packag4 external resources that can contribute to development. There is also now an increasing number of TNCs from developing countries, reflected in the fact that the share c developing countries in PD outflows has increased from about two per cent at h beginning of the 1980s to approximately 15 per cent of a much higher total in the mid, 1990s; their home governments want access for their firms to foreign markets and locations. At the same time, many governments have improved their administrative capabilities and feel more comfortable in dealing with TNCs. Efficient FDI screening has been difficult even for countries with sophisticated bureaucracies, given the need to relate it to changing country and sectoral advantages, changing firm strategies a competition, and political pressures from other countries. On the aggregate 1evel external financing has shifted from official to private sources, especially towards FDI. Finally, the liberalisation of FDI (and trade) policy is often part of the conditionality in IMF and World Bank adjustment programmes, and is promoted by many leading aid donors.

Reflecting this change of attitude, FDT is now not just permitted - it is avidly sought governments and, indeed, many sub- national public sector entities at all levels, from provinces to individual communities. Apart from active promotion (which has led to the establishment of investment promotion agencies in a great number of counties, having their disposal an array of incentives), policy liberalisation is the principal tool. Liberalisation has been extended to such service industries as telecommunication, transportation and power generation and distribution, previously closed to foreign investors. Many developing countries and economies in transition have concluded bilateral treaties to protect FDI and avoid double taxation. A number of regional schemes (notably the European Union, NAFTA, ASEAN and MERCOSUR) have reduced barriers to FDI or are in the process of doing so, facilitating intra-regional investment trade flows. At the multilateral level, the General Agreement on Trade in Services has contributed to the liberalisation of EDT in services, and the TRIMs Agreement has r the use of certain performance requirements. The FDI global regime that has emerged after these changes, though uneven, is much more friendly towards foreign investors than in the past.

FOREIGN DIRECT INVESTMENT

Direct investment abroad is a complex venture. As distinct from trade, licensing or investment, EDT involves a long-term commitment to a business endeavour in a foreign country. It often involves the engagement of considerable assets and resources I that need to be coordinated and managed across countries and to satisfy the principal of successful investment, such as sustainable profitability andacceptablerisk/profitabilityratios.Typically,therearemanyhostcountry factors involved in deciding where an FDI project should be located and it is often difficult to pinpoint the most decisive factor. However, it is widely agreed that FDI takes place when three sets of determining factors exist simultaneously: the presence of ownership-specific competitive ages in a transnational corporation (MNC), the presence of locational advantages in a host country, and the presence of superior commercial benefits in an intra-firm as against an arm‘s-length relationship between investor and recipient .The ownership-specific advantages (e.g. proprietary technology) of a firm if exploited optimally can compensate for the additional costs of establishing production facilities in a foreign environment and can overcome the firm‘s disadvantages vis-a-vis local firms.

The ownership-specific advantages of the firm should be combined with the locational advantages of host countries (e.g. large markets or lower costs of resources or superior infrastructure). Finally, the firm finds greater benefits in exploiting both ownership specific and locational advantages by internalisation, i.e. through FDI rather than arm‘s length transactions. This may be the case for several reasons. For one, markets for assets or production inputs (technology, knowledge or management) may be imperfect, if they exist at all, and may involve significant transaction costs or time-lags. For another, it may be in a firm‘s interest to retain exclusive rights to assets (e.g., knowledge) which confer upon it a significant competitive advantage (e.g. monopoly rents).

While the first and third conditions are firm-specific determinants of FIJI, the second is location-specific and has a crucial influence on a host country‘s inflows of FDI. If only the first condition is met, firms will rely on exports, licensing or the sale of patents to service a foreign market. If the third condition is added to the first, FDI becomes preferred mode of servicing foreign markets, but only in the presence of boa specific advantages. Within the trinity of conditions for FDI to occur, locational determinants are the only ones that host governments can influence directly.

To explain differences in FDI inflows among countries and to formulate poll capture inbound investment, it is necessary to understand how MNCs choose investment locations. The relative importance of different location-specific determinants depends on at least four aspects of investment: the motive for investment (e.g. resource-see or market seeking FDI, the type of investment (e.g. new or sequential FDI), the sector investment (e.g. services or manufacturing) and the size of investors (small and medium sized MNCs or large MNCs). The relative importance of different determinants also changes as the economic environment evolves over time. It is therefore entirely pos that a set of host country determinants that explains FDI in a particular country at a given time changes as the structures of its domestic economy and of the international economy evolve. At the same time, there are also location determinants remain constant. Therefore, there is need to review the location-specific (host-country) determinants of FDI flows and stocks and to analyse how these have changed in a liberalising and globalising world economy. The review of host country determinants begins with the role of national policies and especially the liberalisation of policies key factor in globalization) as FDI determinants. Then follows a review of business facilitation measures: as the world economy becomes more open to international bus transactions, countries compete increasingly for FDI not only by improving their policy and economic determinants, but also by implementing pro-active facilitation measures that go beyond policy liberalisation. While not as important as the other two determinants, these measures are receiving increased attention. Economic determinants and, in particular, their changing significance in the context of liberalisation, global and issues related to the impact of international investment frameworks have bet all the more topical as discussions and negotiations whether at the bilateral, regional or multilateral levels have gathered momentum and the possibility of a multilateral framework on investment has raised questions as to whether, why and how international investment agreements matter for the location of FDI and the activities of MNCs. In particular, a key question (one similar to that faced by the creators of the post-Second World War multilateral trading system) is what effect, if any, a multilateral framework on investment might have for the growth and pattern of FDI.

THE NATIONAL FDI POLICY FRAMEWORK

As a general principle, host countries that offer what MNCs are seeking, and/or host countries whose policies are most conducive to MNC activities, stand a good chance attracting FDI.

But firms also see locational determinants in their interaction ownership-specific and internalisation advantages in the broader context of their corpora strategies. These strategies aim, for example, at spreading or reducing risks, pursuing, oligopolistic, competition, and matching competitors‘ actions or looking for distinct sources of competitive advantage. In the context of different strategies, the same motive and the corresponding host country determinants can acquire different meanings. For example, the market-seeking motive can translate, in the case of one MNC, into the need to enter new markets to increase the benefits arising from multi plant operations; in the case of another MNC, it can translate into the desire to acquire market power; and for N‘ another MNC, it can aim at diversifying markets as part of a risk strategy.

Core FDT policies consist of rules and regulations governing the entry and operations of foreign investors, the standards of treatment accorded to them, and the functioning of the markets within which they operate. These policies can range from outright prohibition of FDI entry to non-discrimination in the treatment of foreign and domestic firms and even preferential treatment of foreign firms. They typically satisfy various objectives reducing or increasing FDI, influencing its sectoral composition or geographical origin, encouraging specific contributions to the economy and affecting ways in which these contributions are made. To achieve these objectives, PD policies are usually accompanied by other policies that also influence investors‘ decisions Among these supplementary policies used to influence locational decisions, trade policy plays the most prominent role. For example, to attract FDI and to maximise its contributions to their import-substituting development strategies, countries in Latin America used a mix of protectionist trade policies combined with policies allowing FDI manufacturing. Asian countries, in contrast, used both FDI and trade policies (e.g. exemptions from import duties) to encourage MNCs to contribute to their export oriented economic strategies. For example, Hong Kong, China pursued laissez-faire trade and FDI policies. On the other hand, the FDI policies of such economies as the Republic of Korea, Taiwan Province of China and Japan were embedded in a broader set of industrial policies guiding and selectively inducing MNCs to link up with local firms to help increase local innovative and exportcapacities.Other related policies may include Privatisation policies and policies determined by the international agreements a country has signed:

i) . Privatisation is a special case of acquisition, as it involves purchases of firms from the state. It has two dimensions: an FDI-policy dimension and a competition F policy dimension. If privatisation welcomes foreign investors, it broadens the scope of FDI. The competition-policy dimension becomes relevant if, in industries characterised as natural or near-natural monopolies, the sale of a privatised company to a domestic or foreign investor only means the transfer of a monopoly from the state to a private agent.

ii) International investment agreements provide an international dimension to national FDI policies. Some of them focus on insurance and, protection, while others deal with broader issues.

Policies used intentionally to influence FDI and its location constitutes the Innerring ofthepolicyframeworkforFDI.Thefeaturesofsuchaframework vary among countries and also vary over time in the same country. This has becomeobvioussincethebroadfrontadvanceofmoremarket-basedeconomicpolicies began in the mid- 1980s. Core FDI policies themselves have become more liberal and, coupled with more liberal trade policies; have contributed to a more cohesive policy framework.

FOREIGN PORTFOLIO INVESTMENT (FPI)

While FPI has traditionally been concentrated in developed markets, new interest has been sparked by the so-called ‒emerging capital markets. The emerging markets have at least three attractive qualities, two of which are their high average returns and their low correlations with developed markets. Diversification into these markets in expected to give higher expected returns and lower overall volatility.

Many individual investors, as well as portfolio and pension fund managers, are reexamining their basic investment strategies. The 1990s, fund managers realized that significant performance gains could be obtained by diversifying into high-quality global equity markets. These gains are limited, however, by the fairly high cross-correlations returns in these markets. The resulting investment strategy reflects current information.

In terms of portfolio theory, adding low-correlation portfolios to an optimization enhances the reward-to-risk profile by shifting the mean-variance frontier to the left.

The portfolio optimisation problem requires important inputs—the expected returns and the variance-covariance matrix. In principal, all of these measures should be forward-looking. That is, the returns, volatilities, and correlations should be forecasted.

An upsurge in portfolio investment in developing countries has marked the end of the debt crisis, or perhaps even helped to end it. Using the World Bank‘s definition of portfolio flows as consisting of bonds, equity (comprising direct stock market purchases, American Depository Receipts (ADRs), and country funds), and money market instruments (such as certificates of deposits (CDs) and commercial paper. Broadly speaking, there are six groups of investors in the emerging markets, each having a tolerance for different degrees of risks and returns:

i) Domestic residents of developing countries with overseas holdings and other private foreign investors, who constitute the dominant category of portfolio investors who are currently active in the major emerging markets. These investors keep abreast of developments in their country on a regular basis and monitor change in government policy. Their investments in emerging markets are motivated by expected short-term high yields. Preference is given to instruments that are in bearer form and provide returns in hard currency. These external fund as ‒Hot Money which are kept in the ‒Latin American Bank which mayor may not be beneficial to the long-term growth prospects of developing country depending on the manner in which they are invested.

ii) Managed funds (closed-end country funds and mutual funds), whose portfolio managed buy and sell shares and high-yield bonds in one or more of the emerging markets for performance-based trading purposes.

iii) Foreign banks and brokerage firms, who allocate their portfolio for inventory and trading purposes.

iv) Retail clients of Eurobonds houses who are involved in emerging securities markets due to portfolio diversification motives. They are generally interested in high-yield, high portfolio investments in the emerging markets.

v) Institutional investors (such as pension funds, life insurance companies), who have a longer time horizon for expected gains from their portfolio and look for stability and long-term growth prospects in the market in which they invest.

vi) Non resident nationals of developing countries, who could be a potential source of portfolio investment from abroad (as opposed to flight capital).

The first three groups are active in the emerging securities markets primarily because of expectations of short-term returns and have been observed to move funds among different branches frequently. Purely speculative traders also continuously move funds between the emerging markets and the developed markets (primarily the United States).

The lower degree of integration of the emerging markets in the global capital markets , often makes them better avenues for achieving higher yields relative to the more globally integrated developed securities markets. Since all listed companies in the ESMs are not very well researched by foreign investors and their market information may be limited, there exists the potential for finding undervalued stocks which may yield high returns to potential investors. In general, P/E ratios in several ESMs may be lower than those in developed markets. Therefore, one expects to see larger inflows of portfolio investments into the emerging markets from institutional investors worldwide.

The integration of international equity markets observed in recent years can be attributed to several factors:

(a) the emergence of international banking syndicates and brokerage houses which have the necessary information technology and communication facilities to be able to place large international equity issues within shorter periods of time at lower syndication and distribution fees than domestic issues;

(b) the introduction of foreign equity-based instruments, such as ADRs and Rule 144A issues in the United States, which have significantly reduced the regulatory and physical impediments that in the past hindered such investments; and

(c) and widespread practice of multiple listing of shares across different stock exchange in different countries have become widespread. The globalisation of the international capital markets has resulted in global allocation of portfolios in a relatively inexpensive manner.

It should be understood, however, that at the earlier stages of –openness‖ of the ESMs, the return of flight capital that is observed is generally motivated by short-term speculative motives. Significant movements of such funds in and out of these markets give rise to increased volatility in stock prices as well as potential problems for domestic monetary management. Rapid increases of international reserves due to these large capital inflows have to be dealt with carefully by policymakers. These rising international reserves will strengthen the domestic currencies of the countries where these large inflows occur and have lowered inflationary expectations. Investors have observed the underutilised capacity, especially in the infrastructure sector of the emerging markets, and expect increased demand for manufactured products as a result of –impending free trade agreements.‖

It is crucial for developing countries that the experiencing such large capital inflows in the short term to endeavor to continue to attract these private financing flows in the long term. Given the increasing integration of the international financial markets and the increasingly advanced communication and information technology facilities that are emerging today, the task of maintaining–financialcompetitiveness‖intheinternationalcapitalmarketsisa challenge that the emerging markets must face. To this end, the role of appropriate market-oriented domestic policy reforms and an Endeavour to maintain a sustained growth performance in the developing countries concerned will go a long way in keeping the repatriated capital with their boundaries. From the long-term point of view it has been observed that flight capital is the last to return. This makes the task at hand for the emerging markets very challenging.

If developing countries wish to attract a sustained inflows of portfolio investment from abroad rather than short-term speculative movements of funds in and out of their countries, it is crucial to address some of the major constraints that inhibit such flows. These constraints exist both on the demand as well as the supply side of ESM securities.

On the demand side for emerging market securities, the most important hurdle inhibiting institutional investors abroad from investing in these markets are regulatory impediments imposed by source country governments and restrictions on investment practices imposed by the trustees of these institutions. Some governments have imposed restrictions on foreign investment by their institutional investors because they feel that possible large foreign exchange outflows may have an adverse impact on the country‘s balance of payments, by institutionalising capital flight. However, institutional investors need to be strictly monitored in the absence of a strong and transparent pension system and when pension fund managers lack a thorough understanding of the complexities of their investment in the international financial markets. The role of the domestic securities and exchange commissions and regulatory agencies for institutional investors in the emerging markets is crucial in maintaining a steady inflow of foreign capital and ensuring responsible behavior on the part of domestic institutional investors.

Tight regulation of investment decisions by institutional investors (in both developed and developing countries) is not necessary for ensuring for safety of contractual savings.

In the United Kingdom, for example pension funds and life insurance companies are only expected to demonstrate that their portfolio of assets, when prudently valued, meet the requirements for technical reserves and solvency margins. This enables these institutions to appropriately manage their portfolios by ensuring flexibility in matching assets and liabilities. Excessively strict investment limits may undermine the private management of a portfolio and, in effect, result in government-directed investment. Nevertheless, pension funds and insurance companies of most developed countries are still subject to restrictive regulations on their foreign investment. These include Canada, Germany, and the Netherlands.

The introduction of Rule 144A ADRs in the U.S. stock exchanges has considerably simplified trading in foreign equities by eliminating costly settlement delays, registration difficulties, and divided payment problems.

Under Rule 144A, Qualified Institutional Buyers (QIBs) in the United States also no longer need to hold the securities they traded the private placement market for a two-year period before they can be sold. Foreign issues can now gain access to a relatively large number of U.S. institutional investors. The credit rating standards for public placements of bonds have also been relaxed.

On the supply side of the emerging market securities, institutional fund managers are concerned about the illiquidity of most of the emerging markets due to restrictions on direct entry by foreigners, the small number of players (and therefore inefficient market making), poor accounting practices, high transaction costs, and unreliable settlement systems. Almost all ESMs suffer from the shortage of good-quality, large capitalization shares. This results in quick overheating (i.e.

rapid increases in market capitalization) once domestic and international interest is generated in these markets due to regulatory changes or other factors. The relatively small turnover of most stock in the emerging markets also makes it difficult for large foreign investors to consider substantial portfolio investment in these markets In fact, larger institutional investors often prefer that companies they may invest in have a domestic market turnover of at least $1 million per week. Custodial services in ESMs also continue to be a major constraint to increased participation by large foreign institutional investors.

Another concern among U.S. institutional investors is that the management staff of the newly privatised firms may not be sufficiently concerned about enhancing the value of their company's shares (i.e. There appears to be an ―agency‖ problem). This will have adverse implications for attractiveness of these investments from the long-term point of view. Under these circumstances, short- term yields would be high (which may interest a different group of investors private investors and performance-based traders). Regulatory constraints and the tower level of sophistication of the capital markets in the developing countries were cited by U.S. institutional investors as other impediments to greater portfolio flows to emerging markets. U.S. institutional investors are expected to take advantage of Rule 144A and significantly increase their investment in private equity and debt offerings by non-U.S. entities.

Development:

Three different strategies that can lead to successful development:

1. Find oil and limit the negative effects from the resource curse
2. Find a niche in the world market
3. Produce cheaply and use this price advantage for technological upgrading, supported by industrial policy.

The question is now why some countries have managed to employ a strategy bringing them onto the path of successful development while many other countries have not. From the arguments above, there are some important lessons for the design and implementation of successful development strategies. First, one size clearly does not fit all when it comes to development approaches. Especially when we talk about niches in the world market, it is imperative that not all developing countries try to fill the same niche, as a niche does not provide sufficient space for all. A country that has found oil does not need to worry about which markets to serve, but rather how to manage the oil windfall in a way that does not hinder development beyond the single sector. It is also striking that the strategy of big bang liberalization of as many markets as possible and government retrenchment is not a strategy that seems to be empirically promising when one wants to belong among the top growth performers. With the possible (and disputable) exception of Hong Kong (China), none of the top performers has managed a leading position with such a strategy.

The second point is that a comprehensive strategy is needed. While many countries have passed documents that supposedly define a "development strategy" or an "industrial strategy", many do not implement them beyond the creation of an investment promotion agency. However, what all of the Asian economies depicted above share in common is that a wide range of instruments has been applied with the goal of reaching the targets set in their development strategy, including capital controls, exchange rate and wage policies to sustain a competitive real exchange rate and create domestic savings, which could subsequently be funneled as credit supply to certain sectors. Furthermore, industrial policies have been widely used with selective protectionism and preferential treatment for potential export industries.10 These instruments need to be well coordinated and there must not be conflicts with other policy goals holding potentially higher priority.11 The third point is that a strategy requires more than simply being called "a strategy". To understand this point, one needs to briefly think about what a "development strategy" is. Given that countries have been pushed by the IMF, the World Bank and the Organisation for Economic Co-operation and Development into formulating their own poverty reduction and development strategies and including them in "poverty reduction strategy papers", many countries have formally adopted such strategies by now. However, these strategies are often not very far reaching when it comes to the economic part. Even though most of these papers feature an explicit section on a "growth strategy", the discussion of many policy fields, including the macroeconomic variables in the different countries' strategies, are extremely similar and not necessarily specific to a country's problems or conditions. The macroeconomic discussion usually only covers a few pages of documents of several hundred pages and thus lack depth. A good example here is Cameroon's poverty reduction strategy paper (IMF, 2003: 33), which states (and continues in a similar tone): "Macroeconomic stability fosters growth and welfare improvement in the medium term. It alleviates the burdens of debt, inflation, and high interest rates that penalize all economic actors and more particularly the poorest households. It reduces the level of uncertainty and country risks and hence decreases the cost of capital. It contributes to maintaining a stable real exchange rate. The latter three factors help improve overall economic competitiveness and foster investment, production, and export diversification, thereby accelerating growth, reducing the volatility of the economy, and maximizing welfare."

Another example is the discussion of monetary policy in the Republic of Bolivia's (2001: 195) strategy paper: "The low inflation rates anticipated in the BPRS [Bolivian Poverty Reduction Strategy] are an important factor in avoiding distortions in the allocation of resources; they also reduce redistribution effects harmful to society's poorest members given that most of them have neither the information they need nor the ability to shield themselves against inflation by allocating their limited resources to financial instruments that are indexed or maintain their value." Hence, macroeconomic recommendations hardly ever go beyond the goal of guaranteeing stable prices, low budget deficits and stable exchange rates. Country specifics here are usually limited to the description of recent inflation trends and expected reactions of the central bank, or a description of the overall fiscal deficit and instruments to reduce it. When it comes to the external sector and tariffs, the poverty reduction strategy papers usually proclaim the goal of further liberalizing the external sector, but they hardly ever spell out which sequencing of liberalization might be most sensible to promote domestic industrial development. If one compares this to the approach chosen and applied by the top growth performers, the difference quickly becomes clear: it is not sufficient to broadly identify that a country wants economic growth and poverty reduction. Instead, a proper strategy needs a vision of where a country wants to go. A successful strategy might include "picking winners" in the sense that the government might decide to prioritize certain sectors or devises a business model for the whole country in the case of a small country. Moreover, a successful strategy clearly requires the employment of all available instruments, including the most powerful macroeconomic instruments influencing credit availability, interest rates and real exchange rates. Finally, one clearly important result from this simple exercise is to observe that becoming one of the top growth performers seems possible with a wide variety of institutional structures and features. Any development strategy here needs to be country specific, looking at not only existing comparative advantages but also the specific institutions that exist, as well as asking the question of how far comparative advantages can be changed for the advantage of the country in question. In such a strategy, priorities need to be set. Accordingly, it is possible that bringing institutions to a Western standard reaching high index values in widely used measurements for democracy and rule of law does not need to be the first priority. Further research is clearly needed, which needs to go beyond employing cross-country or panel regressions at a global level. Instead, carefully crafted case studies or comparative country studies could prove very useful towards better understanding what are the crucial elements of a successful development strategy.

Modernisation theories(1950’s, early 1960's) The modernisation school of thought was the first attempt to articulate the problem of development in terms of the need to transform the backward "traditional" nature of third world economies into “modern” economies. Drawing from the historical experience of the Western Europe after the Second World War, under the Marshal Plan, it advocated the need for accelerated economic growth through an import substitution form of industrialisation, a process seen to entail securing the right quantity and mix of saving investment and foreign aid. Given the relatively low levels of new capital formation in most third world countries, one obvious policy implication was the need for massive capital investment through foreign aid. There is wide agreement that economic development based on modernisation theories failed to bring about the much hoped for rapid growth, dynamic industrial sectors, the expansion of modern wage economy and the alleviation of the impoverished rural subsistence sectors. The most incisive blow to themodernisation theories came from the Marxist and neo-Marxist “dependence or “underdevelopment” theories, as well as those of the Structuralist writers.

Dependency theories

(late 1960's, early 1970's). The theoretical trust of the dependency perspectives was that capitalist penetration leads to and reproduces a combined and unequal development of its constitutive parts. The policy implication is that indigenous economic and social development in third world social formations must be fundamentally predicted upon the removal of industrial capitalist penetration and dominance.

World economy view

(late 1970’s, early 1980's), The third school of thought, the world economy school, poses the problem of development, not in terms of desired self sustained autonomous growth and not in terms of undesired dependency, but in terms of necessary global interdependence. Just as third world countries depend on developed countries of aid, private investment, technology and trade, so do the latter depend on third world markets and natural resources. The policy implication is that a restructuring of the interdependent relations between the developed North and under-developed South is necessary in order to achieve a ‘New Economic Order'.

Basic needs approaches

(late 1970's). The other school of thought, the basic needs approach, shifts development emphasis from a singular concern with restructuring of the world economy to that of restructuring the domestic economy towards a new internal economic order', primarily aimed at the eradication of mass poverty and social injustices.

The third word problem of mass poverty is seen as the consequence more of the pattern of economic growth, rather than the rate of growth, as such. The implication is contrary to Kuznets 'hypothesis, that there is no justifiable economic rationale for high and increasing income inequality as the basis for rapid economic growth in third world countries.5)

Alternative modes of production perspective

(1980's) Counter-poised against the foregoing four schools of thought are the newly emerging AMP perspective. Under this perspective, contemporary third world societies are seen essentially characterised by the coexistence of sharply contrasting sectors. On the one hand, there is the overwhelmingly dominant (in population terms) traditional sector, geographically constituted in the rural sector and distinguished by its predominant engagement in backward, low-productivity subsistence agriculture. On the other hand, there is also the overwhelmingly dominant (but now in economic and political terms) modern sector, geographically constituted in both the urban(industrial) sector and the rural enclaves engaged in large-scale extra-active and cash crop agricultural sub-sector. While the traditional sector is socially and economically organized predominantly along non-capitalist lines, reflecting the unity of production and consumption, the modern sector is organised on the basis of the capitalist mode of production, in which the direct producers are separated from their means of production. It is this coexistence of (at least) two modes of production that forms the theoretical object of investigation for the AMP perspective. The contemporary realities of third world societies must be analysed from within historical materialism as a social formation which is dominated by an articulation of (at least) two modes of production-a capitalist and a non-capitalist mode -in which the capitalist mode is or is becoming increasingly dominant over the other. In general, from within historical materialism third world social formation are viewed as transitional. The specificity of this transition lies in it being brought about largely by capitalist penetration, and, more particularly, by one of its forms, imperialist penetration, the specific economic of which is the separation of direct producers from their means of production. The object of imperialist penetration is to ensure the increasing dominance of capitalist mode of production. But this means that the transition will be characterised by a series of economic, political and ideological dislocations both between and within the different articulated modes of production, as imperialist penetration intervenes to guarantee the reproductive requirements of the capitalist mode. Moreover, the specific pattern of imperialist penetration has the effect of creating uneven and restricted forms of economic development, specific to third world social formations.

MIGRATION AND DEVELOPMENT

Migration is a powerful driver of sustainable development, for migrants themselves and their communities. It brings significant benefits in the form of skills, strengthening the labour force, investment and cultural diversity, and contributes to improving the lives of communities in their countries of origin through the transfer of skills and financial resources. The benefits of migration should not only be seen only from the perspective of what migrants can bring to any given territory. The relationship between migration and development is much more complex: the political, social and economic processes of potential destination countries will also determine how, where and when migration occurs. If migration is poorly governed, it can also negatively impact on development. Migrants can be put at risk and communities can come under strain.

As outlined in the Global Compact for Safe, Orderly and Regular Migration, “migration is a multi-dimensional reality that cannot be addressed by one government policy sector alone”. IOM therefore applies a whole-of-government approach to migration governance, striving to ensure that migration and migrants’ needs are considered across all policy areas, laws and regulations from health to education and from fiscal policies to trade.

A Comprehensive Approach to Migration and Development

A whole-of-government approach:

IOM supports governments in understanding how all of these governance areas are interrelated and are affected by migration and to what extent other sectoral policies facilitate or impede migrants’ ability to contribute to society.

To achieve this, IOM supports governments ‘mainstreaming’ migration into local and national policy planning.

This means amending or developing new national, regional and local laws, policies and plans that take into consideration these interlink ages and the needs of and challenges faced by migrants.

This ensures that policies ranging from health to education and from urban planning to housing are inclusive of migrants and coherent with migration governance priorities.

IOM also assists governments to then pilot and implement these policies and plans as needed.

A whole-of-community approach:

While policy making on migration governance tends to take place at the national level, a national-only approach fails to consider that the development impact of migration is most profoundly felt at the community level. In order to be able to mainstream migration into community development plans for a more cohesive society, IOM supports the development of local migration profiles and community mapping exercises to facilitate this. In addition, IOM supports its Member States to strengthen the capacities of their community leaders and sub-national authorities to set up conducive environments at the community level to ensure social cohesion and development impact that benefits all of society. This entails empowering local and regional authorities as ‘first responders to migration’ and closest to their constituents as crucial actors in migration governance for development.

Engaging, empowering and enabling migrants as development actors:

The extent to which migrants can contribute to development is directly linked to their ability to access services, integrate into society and stay connected to with their communities of origin.

Migrants can face many barriers that limit their ability to reach their full development potential. IOM works with its member states to promote the protection of migrants’ rights and empower them through the provision of services and support they need to become an integral part of their new society as well as contribute to their home communities. This means helping governments engage, enable and empower their Diaspora and migrants' in development efforts.

FRONTIERS IN THE GLOBL ECONOMY

Introduction

The United Nations remains the world's pre-eminent forum for managing global crises. Australia's commitment to the United Nations is one of the three pillars of Australian foreign policy and stems from the belief that no country can address today's major challenges on its own. Australia has been instrumental in expanding the scope of the organisation from one of collective security, to being an agent for economic and social progress, and a protector of human rights. Increasing globalisation, the onset of multiple crises, and the shifting balance of global power to our region the Asia-Pacific, are just some of the major challenges we face today. These challenges are increasingly complex, demanding new links between institutions and policymaking. The need for effective, global responses to these challenges is more urgent and necessary than ever before.

Australia believes global problems require global solutions. Australia is committed to working with the UN and its agencies, as well as working across national boundaries to forge creative solutions to common challenges.

1. Relevance of global economic governance for development An efficient and relevant architecture for global economic governance is key to achieving international development goals. There is no question that despite increases in global aid commitments and good progress in implementing the aid effectiveness agenda, aid alone cannot achieve the Millennium Development Goals and address other critical development challenges. Other sources of public and private development finance are increasingly significant, including foreign direct investment, remittances and private flows.

The 2002 Monterrey Conference on Financing for Development, its follow-up meeting in Doha in 2008 and international climate change negotiations have signalled a tide change in international thinking on financing for development. In addition, new players (including emerging economies and private funds) and ways of delivering development assistance (for example, South-South and triangular cooperation) have redefined previous parameters for international development. The UN, with its broad system of global governance, has an important role in pursuing global economic governance that addresses these approaches to development. In particular, the UN's Economic and Social Council (ECOSOC) plays an important policy review role and facilitates dialogue on issues of economic and social development, as well as for implementation of the international development goals agreed at major United Nations conferences and summits, including the Millennium Development Goals. It also works to implement the global partnership for development set out in the United Nations Millennium Declaration, the Monterrey Consensus of the

International Conference on Financing for Development and the Plan of Implementation of the World Summit on Sustainable

Development (“Johannesburg Plan of Implementation”) and other major United Nations

conferences and summits. It is important, however, to also acknowledge ‘the current range of institutions and forums and their functions in global economic governance.’ The existing multilateral system has made important contributions to economic growth that many countries have enjoyed since the end of the Second World War. But new economic challenges and the pursuit of strong, balanced and sustainable growth and development require new responses and, sometimes, new fora for decision-making, for example, the Group of 20 (G20) Leaders’ process.

2. The United Nations and the G20 relationship

We see a number of important complementarities in the relationship between the UN and the G20. Australia recognises the UN as the primary universal forum of states, while at the same time defining the G20 as the premier forum for international economic cooperation. G20 Leaders in Pittsburgh (2009) agreed on the G20 as the premier forum for global economic cooperation. The members of the G20 account for 85 per cent of the global economy, 80 per cent of global trade, and two-thirds of the world's population. It maintains a balance between representativeness and effectiveness as a decision-making body. Its ability to react to rapid global economic developments and the decisiveness that is has displayed in coordinating global responses during the global financial and economic crisis have demonstrated its effectiveness as a forum for global economic cooperation. Importantly, this has been underscored by a spirit of cooperation and a sense of accountability. This common sense of purpose among all G20 member countries has been the cornerstone of its success. Outreach to non-member countries is a significant and evolving priority for the G20. In addition to the five discretionary invitations to non-G20 countries by the G20 President each year, invitations to G20 events are also extended on an ad-hoc basis. The G20 President and individual G20 member countries also conduct outreach to non-G20 countries and to other regional and multilateral fora such as the 3G (Global Governance Group), PIF (Pacific Islands Forum) and CHOGM (Commonwealth Heads of Government Meeting) on issues under consideration in the G20.

As a G20 member, Australia actively engages in extensive outreach to non-G20 countries,

bilaterally, both here in New York and by our Ministers and officials through our diplomatic network, and through regional and multilateral fora. Australia supports a structured program of outreach, including ensuring that important reforms agreed on by the G20 Leaders are implemented effectively and expeditiously. Australia will continue to conduct outreach, including through APEC (Asia Pacific Economic Cooperation), ASEAN (Association of South East Asian Nations), the EAS (East Asia Summit), the PIF (Pacific Islands Forum), CARICOM (Caribbean Community and Common Market) and CHOGM (Commonwealth Heads of Government Meeting), as well as being active within multilateral mechanisms such as the UN, IMF, World Bank, the OECD and WTO to ensure the concerns and voices of nonG20 countries, particularly those of small states, are recognised by the G20.

The G20 has demonstrated its effectiveness in providing political impetus at the highest level of Leaders. A sense of accountability for its promises continues to ensure that the G20 delivers on its commitments. This political will has driven the G20’s implementation efforts. These efforts have been undertaken or supported by existing mechanisms within the UN system such as the IMF and the World Bank.

3. G20 and Development Australia also sees value in, and has been supportive of, a discrete role for the G20 in development, focused on economic cooperation and coordination. For the G20 to maximise its development impact and maintain its legitimacy with non-G20 countries, it must focus on areas where coordinated actions will deliver tangible outcomes. The G20 should not duplicate efforts of traditional aid and development forums (such as the UN and OECD), or regional or bilateral activities targeting reform at the individual country level. Rather the opportunity exists for the G20 to carve its own niche in the development

arena, where it has the most impact, influence and capacity, not limited to systemic challenges

requiring coordinated action to promote sustainable economic growth. While the G20 remains vigilant in light of the still fragile global economy, discussions have also shifted to achieving strong, sustainable and balanced global growth and 'how to reduce the impacts of global economic shocks on the world's most vulnerable communities'. In these discussions, there is widespread agreement that a focus on development is critical.

First, there is agreement that non-G20 countries have a clear role to play in global rebalancing. Second, there is a recognition that the G20 needs to pay more attention to global equity concerns, including a focus on 'shared growth', jobs, food security, social protection and financial inclusion.

As part of its efforts to improve the G20's specific added-value on development, Australia has

prioritised three out of the nine G20 development 'pillars' endorsed in the Seoul Development Consensus (the framework for taking forward G20 action on development): infrastructure,

food security, and growth with resilience (which covers social protection and remittances).

These three 'pillars' play to the G20's strengths as a forum that delivers economic coordination and ensure that the G20 development work includes areas that are relevant to low income countries, such as food security and social protection.

The IMF and the World Bank play important roles in the G20 Framework Mutual Assessment Process. The G20 Framework for Growth forms the foundation for coordinated efforts to generate strong, sustainable and balanced global growth. The World Bank in particular continues to play a key role in helping to deliver the G20 development agenda. In addition to the IMF and World Bank, several other UN agencies (including the International Labour Organisation, the Food and Agriculture Organisation and the United Nations Development Programme) are involved in, and provide valuable inputs to the G20's Development work, complementing activities undertaken in other international fora.

4. The IMF and World Bank

As membership based organisations, each representing a near-universal membership of 187

countries, the IMF and World Bank are accountable to their member countries. Much has been achieved in enhancing this accountability. The recently agreed governance reforms at The IMF and the World Bank, achieved with the assistance of the G20, are an important step to enhance the voice and representation of emerging market and developing countries in those institutions. This will more accurately reflect their changing weight in the world economy.

More generally, these historic reforms will help strengthen the relevance, effectiveness and legitimacy of the two institutions. However, further governance reforms at the IMF and World Bank remain a priority, including enhancing the engagement of ministers in decision-making at these institutions. This is a process that must continue to be driven by the membership of the IMF and World Bank.

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