Course No. 301. BUSINESS ENVIRONMENT

Nature and significance of Business Environment; The external Environment; The Economic, Political, Legal, Technological and Social Environment; The Human Cultural Environment; influence on Trade and Investment Patterns; Recent World Trade and Foreign Investment Trends; Balance of Payments Accounts and Macroeconomic management; Theories and Institutions; Trade and Investment—Government influence on Trade Investment; Determination of Trading Partner's Independence, Interdependence and Dependence; World Financial Environment; Cross-national Cooperation and Agreements; Tariff and non-Tariff Barriers, WTO, Regional Blocks, Global Competitiveness; Export Management; Licensing; Joint and Ventures Technology; Global competition; Globalisation and Human Resource Development; Globalisation with Social Responsibility; Government policies; FEMA and MITP.

Business Environment: Nature and Significances of Business Environment

The word ‘Business Environment’ has been defined by various authors as follows,

“Business Environment encompasses the ‘climate’ or set of conditions, economic, social, political or institutional in which business operations are conducted.” — Arthur M. Weimer

“Environment contains the external factors that create opportunities and threatens to the business. This includes socio-economic conditions, technology and political conditions.” — William Gluck and Jauch

“Business environment is the aggregate of all conditions, events and influences that surround and affect it.” — Keith Davis

“The environment of business consists of all those external things to which it is exposed and by which it may be influenced directly or indirectly.” — Reinecke and Schoell

“The total of all things external to firms and industries that affect the function of the organisation is called business environment.” — Wheeler

“Civilisations require challenges to survive. Thus environment also contains hostilities and dangers that may be overcome by individuals and organisations.” — Arnold J. Toynbee

On the basis of the above definitions, it is very clear that the business environment is a mixture of complex, dynamic and uncontrollable external factors within which a business is to be operated.

Nature of Business Environment: The nature of Business Environment is simply and better explained by the following approaches:

(i) System Approach: In original, business is a system by which it produces goods and services for the satisfaction of wants, by using several inputs, such as, raw material, capital, labour etc. from the environment.

(ii) Social Responsibility Approach: In this approach business should fulfill its responsibility towards several categories of the society such as consumers, stockholders, employees, government etc.

(iii) Creative Approach: As per this approach, business gives shape to the environment by facing the challenges and availing the opportunities in time. The business brings about changes in the society by giving attention to the needs of the people.

Significance of Business Environment:

Business Environment refers to the “Sum total of conditions which surround man at a given point in space and time. In the past, the environment of man consisted of only the physical aspects of the planet Earth (air, water and land) and the biotic communities. But in due course of time and advancement of society, man extended his environment through his social, economic and political function.”

In a globalised economy, the business environment plays an important role in almost all business enterprises. The significance of business environment is explained with the help of the following points:

(i) Help to understand internal Environment: It is very much important for business enterprise to understand its internal environment, such as business policy, organisation structure etc. In such case an effective management information system will help to predict the business environmental changes.

(ii) Help to understand Economic System: The different kinds of economic systems influence the business in different ways. It is essential for a businessman and business firm to know about the role of capitalists, socialist and mixed economy.

(iii) Help to understand Economic Policy: Economic policy has its own importance in business environment and it has an important place in business. The business environment helps to understand government policies such as, export-import policy, price policy; monetary policy, foreign exchange policy, industrial policy etc. have much effect on business.

(iv) Help to understand Market Conditions: It is necessary for an enterprise to have the knowledge of market structure and changes taking place in it. The knowledge about increase and decrease in demand, supply, monopolistic practices, government participation in business etc., is necessary for an enterprise.

Important Characteristics of Business Environment

1. Totality of External Forces: Business environment is the sum totals of all those factors/forces which are available outside the business and over which the business has no control. It is the group of many such forces that is why, its nature is of totality.

2. Specific and General Forces: The forces present outside the business can be divided into two parts — specific and general.

(i) Specific: These forces affect the firms of an industry separately, e.g., customers, suppliers, competitive firms, investors, etc.

(ii) General: These forces affect all the firms of an industry equally, e.g., social, political, legal and technical situations.
(3) Interrelatedness: The different factors of business environment are co-related. For example, let us suppose that there is a change in the import-export policy with the coming of a new government. In this case, the coming of new government to power and change in the import-export policy are political and economic changes respectively. Thus, a change in one factor affects the other factor.

(4) Dynamic Nature: As is clear that environment is a mixture of many factors and changes in some or the other factors continue to take place. Therefore, it is said that business environment is dynamic.

(5) Uncertainty: Nothing can be said with any amount of certainty about the factors of the business environment because they continue to change quickly. The professional people who determine the business strategy take into consideration the likely changes beforehand. But this is a risky job. For example, technical changes are very rapid. Nobody can anticipate the possibility of these swift technical changes. Anything can happen, anytime. The same is the situation of fashion.

(6) Complexity: Environment comprises of many factors. All these factors are related to each other. Therefore, their individual effect on the business cannot be recognised. This is perhaps the reason which makes it difficult for the business to face them.

(7) Relativity: Business environment is related to the local conditions and this is the reason as to why the business environment happens to be different in different countries and different even in the same country at different places.

What are the Different Components of Business Environment?

A. Internal environment - Internal environment includes all those factors which influence business and which are present within the business itself. These factors are usually under the control of business. The study of internal factors is really important for the study of internal environment. These factors are:


Note: All the above factors do influence the decisions of business, but since all these factors are usually under the control of business, they cannot be wholly included in the business environment.

B. External Environment - External environment includes all those factors which influence business and exist outside the business. Business has no control over these factors. The information about these factors is important for the study of the external environment. Some of these factors are those with which a particular company has very close relationship. However, there are some other factors which influence the entire business community.

Micro environment means that environment which includes those factors with which business is closely related. These factors influence every industrial unit differently. These factors are as under:

(i) Customers (ii) Suppliers (iii) Competitors (iv) Public (v) Marketing Intermediaries.

(i) Customers: Customers of an industrial unit can be of different types. They include household, government, industry, commercial enterprises, etc. The number of different types of customers highly influences a firm.

For example, suppose a firm supplies goods only to the government. It means that firm has only one customer. If because of some reason their relations get soured, the supply of goods will stop and in that case the closure of that firm is certain.

This clearly indicates that the customers do influence business. Therefore, a firm should make efforts to have different kinds of customers,

(ii) Suppliers: Like the customers, the suppliers also influence business. If a business has only one supplier and he gets annoyed because of some reason, the supply of goods can be stopped and the very existence of the business can be threatened or endangered. Hence, efforts should be made to have various suppliers.

(iii) Competitors: The competing firms can influence business in a number of ways. They can do so by bringing new and cheap products in the market, by launching some sale promotion scheme or other similar methods.

(iv) Public: Public has different constituents like the local public, press or media, etc. The attitude or behaviour of these constituents can affect business units. For example, the local population can oppose some established firm whose business is excessively noisy.

Similarly, if the media gives some favourable report about a particular company the price of its share can register an increase on this count.

(v) Marketing Intermediaries: The marketing intermediaries play a significant role in developing any business unit. They are those persons who reduce the distance between the producers and agents.

For example, a company sells its goods with the help of agents and if because of some reason all the agents get annoyed with the company and refuse to sell its goods, there can be a crisis for the company.

Meaning of Business Environment: Environment of a business means the external forces influencing the business decisions. They can be forces of economic, social, political and technological factors. These factors are outside the control of the business. The business can do little to change them.

Following features:

1. Totality of external forces: Business environment is the sum total of all things external to business firms and, as such, is aggregative in nature.

2. (Specific and general forces): Business environment includes both specific and general forces. Specific forces (such as investors, customers, competitors and suppliers) affect individual enterprises directly and immediately in their day-to-day working. General forces (such
as social, political, legal and technological conditions) have impact on all business enterprises and thus may affect an individual firm only indirectly.

3. **Dynamic nature**: Business environment is dynamic in that it keeps on changing whether in terms of technological improvement, shifts in consumer preferences or entry of new competition in the market.

4. **Uncertainty**: Business environment is largely uncertain as it is very difficult to predict future happenings, especially when environment changes are taking place too frequently as in the case of information technology or fashion industries.

5. **Relativity**: Business environment is a relative concept since it differs from country to country and even region to region. Political conditions in the USA, for instance, differ from those in China or Pakistan. Similarly, demand for sarees may be fairly high in India whereas it may be almost non-existent in France.

**Importance of Business Environment**

1. **firm to identify opportunities and getting the first mover advantage**: Early identification of opportunities helps an enterprise to be the first to exploit them instead of losing them to competitors. For example, Maruti Udyog became the leader in the small car market because it was the first to recognize the need for small cars in India.

2. **firm to identify threats and early warning signals**: If an Indian firm finds that a foreign multinational is entering the Indian market it should give a warning signal and Indian firms can meet the threat by adopting by improving the quality of the product, reducing cost of the production, engaging in aggressive advertising, and so on.

3. **Coping with rapid changes**: All sizes and all types of enterprises are facing increasingly dynamic environment. In order to effectively cope with these significant changes, managers must understand and examine the environment and develop suitable courses of action.

4. **Improving performance**: the enterprises that continuously monitor their environment and adopt suitable business practices are the ones which not only improve their present performance but also continue to succeed in the market for a longer period.

**Dimensions of Business Environment**

What constitutes the general environment of a business?

The following are the key components of general environment of a business.

1. **Economic environment** economic environment consists of economic factors that influence the business in a country. These factors include gross national product, corporate profits, inflation rate, employment, balance of payments, interest rates consumer income etc.

2. **Social environment** It describes the characteristics of the society in which the organization exists. Literacy rate, customs, values, beliefs, lifestyle, demographic features and mobility of population are part of the social environment. It is important for managers to notice the direction in which the society is moving and formulate progressive policies according to the changing social scenario.

3. **Political environment** It comprises political stability and the policies of the government. Ideological inclination of political parties, personal interest on politicians, influence of party forums etc. create political environment. For example, Bangalore established itself as the most important IT centre of India mainly because of political support.

4. **Legal environment** This consists of legislation that is passed by the parliament and state legislatures. Examples of such legislation specifically aimed at business operations include the Trade mark Act 1969, Essential Commodities Act 1955, Standards of Weights and Measures Act 1969 and Consumer Protection Act 1996.

5. **Technological environment** It includes the level of technology available in a country. It also indicates the pace of research and development and progress made in introducing modern technology in production. Technology provides capital intensive but cost effective alternative to traditional labor intensive methods. In a competitive business environment technology is the key to development.

**Macro environment**

There are a number of common approaches how the external factors, which are mentioned in the definition of Kroon and which describe the macro environment, can be identified and examined. These factors indirectly affect the organization but cannot be controlled by it.

One approach could be the PEST analysis. PEST stands for political, economic, social and technological. Two more factors, the environmental and legal factor, are defined within the PESTEL analysis (or PESTLE analysis).

The segmentation of the macro environment according to the six presented factors of the PESTEL analysis is the starting point of the global environmental analysis.

**PESTEL analysis** The six environmental factors of the PESTEL analysis are the following:

- **Political factors** - The company/organization needs to consider the political environment when creating business strategies. The entire political environment includes looking at government policies and the risk and instability of current political factors. Political risks can include an unexpected loss of ownership due to government takeover (nationalization), or changes in labor laws which might increase the cost of the company’s workforce. However often business can anticipate issues by performing a political risk analysis. The political instability can influence the business and the duration of time that business/organization is profitable.

  - Taxation Policy
  - Trade regulations

- **Economical factors** - The economic factors of the business environment are all the variables that impact how the consumer spends their money and the power of that purchase. There are multiple factors that exist at any time. An example of an economic factor is the recent recession influenced people to spend less and save more which has impacted current consumer spending patterns. The economic development of a country is an important element when scanning the economic environment. Countries are often categorized as either ‘developing’ or ‘developed’. The exchange rate of a country can have an extensive impact on the profitability of a business. Relatively...
small changes in the exchange rate may be the difference between profit and loss. When promoting, selling a product it is important for an organization to consider the extra financial information including current rates, taxes etc. in the economy of the country.

- Interest rate
- Inflation rate
- Growth in spending power
- Rate of people in a pensionable age
- Balances of Sharing
- Recession or Boom
- Customer liquidations

**Socio-cultural** - The socio-cultural environment looks at the demographic characteristics of the current business environment. It looks at the values, customs and norms of the environment of which a company or organisation is placed. When looking at the socio-cultural environment it is important to consider the social values of the environment. Organizations look at the cultural characteristics of the society and consider all values and customs that are often associated with the culture while they try to market and sell the product or service, such as:

- values, beliefs
- religion
- literacy
- lifestyle
- language
- education
- time orientation

**Technological factors** - The technological environment is becoming a lot more important in the modern day business environment. New technology produces new opportunities for companies and organizations to create, sell and promote a product. Technology is rapidly growing and forever changing. Telecommunication technology e.g. cellphones and laptops are increasing the opportunity within an organization to promote and sell a product. The internet has made information available to the consumer to easily compare current prices of a product or service with the price of the competitors of the same product or service. The internet has also created more opportunity to market the product or service via the use of social media.

- Internet
- E-commerce
- Social Media
- Electronic Media
- Research and Development
- Rate of technological change.

**Environmental factors** - The environmental factors of the PESTLE analysis include natural resources that are affected by the processes of selling and marketing products or services. The two main environmental trends that need to be considered when evaluating the natural environment is the increased pollution and growing shortage of raw materials. Government regulations are creating practices that encourage environmental sustainability. A business might for example utilize recyclable and biodegradable packaging, thus making the most of the environmental opportunities to create a sustainable organizational in the current natural environment.

- Competitive advantage
- Waste disposal
- Energy consumption
- Pollution monitoring, etc.

**Legal factors** - The legal environment includes the laws and regulations of a state. The laws and regulations will influence the way in which an organization will market or sell the product and services. The legal factors influence trade agreements between different governments and states. The governments that have a well developed public policy about selling and marketing goods may limit competition and place other obligations on retailers.

- Employment law
- Product safety
- Product labeling
- Health and safety
- Advertising regulations
- Labor laws etc.

**Economic Environment in India**

In order to solve economic problems of our country, the government took several steps including control by the State of certain industries, central planning and reduced importance of the private sector. The main objectives of India’s development plans were:

1. Initiate rapid economic growth to raise the standard of living, reduce unemployment and poverty;
2. Become self-reliant and set up a strong industrial base with emphasis on heavy and basic industries;
3. Reduce inequalities of income and wealth;
4. Adopt a socialist pattern of development — based on equality and prevent exploitation of man by man.

As a part of economic reforms, the Government of India announced a new industrial policy in July 1991.

The broad features of this policy were as follows:

1. The Government reduced the number of industries under compulsory licensing to six.
2. Disinvestment was carried out in case of many public sector industrial enterprises.
3. Policy towards foreign capital was liberalized. The share of foreign equity participation was increased and in many activities 100 per cent Foreign Direct Investment (FDI) was permitted.
4. Automatic permission was now granted for technology agreements with foreign companies.
5. Foreign Investment Promotion Board (FIPB) was set up to promote and channelize foreign investment in India.

**Liberalization:**
- The economic reforms that were introduced were aimed at liberalizing the Indian business and industry from all unnecessary controls and restrictions.
- They indicate the end of the license-permit-quota raj.
1. Abolishing licensing requirement in most of the industries except a short list,
2. Freedom in deciding the scale of business activities i.e., no restrictions on expansion or contraction of business activities,
3. Removal of restrictions on the movement of goods and services,
4. Liberalization of the Indian industry has taken place with respect to:
5. Freedom in fixing the prices of goods services,
6. Reduction in tax rates and lifting of unnecessary controls over the economy,
7. Making it easier to attract foreign capital and technology to India.
Private: 
- The new set of economic reforms aimed at giving greater role to the private sector in the nation building process and a reduced role to the public sector.
- To achieve this, the government redefined the role of the public sector in the New Industrial Policy of 1991.
- The purpose of the sale, according to the government, was mainly to improve financial discipline and facilitate modernization.
- It was also observe that private capital and managerial capabilities could be effectively utilized to improve the performance of the PSUs.
- The government has also made attempts to improve the efficiency of PSUs by giving them autonomy in taking managerial decisions.

Globalisation: 
- Globalisations are the outcome of the policies of liberalisation and privatisation.
- Globalisation is generally understood to mean integration of the economy of the country with the world economy, it is a complex phenomenon.
- It is an outcome of the set of various policies that are aimed at transforming the world towards greater interdependence and integration.
- It involves creation of networks and activities transcending economic, social and geographical boundaries.
- Globalisation involves an increased level of interaction and interdependence among the various nations of the global economy.
- Physical geographical gap or political boundaries no longer remain barriers for a business enterprise to serve a customer in a distant geographical market.

Impact of Government Policy Changes on Business and Industry

1. Increasing competition: As a result of changes in the rules of industrial licensing and entry of foreign firms, competition for Indian firms has increased especially in service industries like telecommunications, airlines, banking, insurance, etc. which were earlier in the public sector.

2. More demanding customers: Customers today have become more demanding because they are well-informed. Increased competition in the market gives the customers wider choice in purchasing better quality of goods and services.

3. Rapidly changing technological environment: Increased competition forces the firms to develop new ways to survive and grow in the market. New technologies make it possible to improve machines, process, products and services. The rapidly changing technological environment creates tough challenges before smaller firms.

4. Necessity for change: In a regulated environment of pre-1991 era, the firms could have relatively stable policies and practices. After 1991, the market forces have become turbulent as a result of which the enterprises have to continuously modify their operations.

5. Threat from MNC: Massive entry of multi nationals in Indian marker constitutes new challenge. The Indian subsidiaries of multi-nationals gained strategic advantage. Many of these companies could get limited support in technology from their foreign partners due to restrictions in ownerships. Once these restrictions have been limited to reasonable levels, there is increased technology transfer from the foreign partners.

Economic and Non-Economic Environment of Business

Economic environment of business includes all those forces which have an economic impact on business. Business enterprise which has to play its role under the existing economic environment is an economic institution. It works, with the objective of profit maximization. Therefore, economic decisions of business enterprise are determined by both micro and macro-economic environment. But the economic environment of business normally reflects the prevailing economic system and thereby it gives more emphasis on macro-economic environment.

The economic environment of business of modern times is highly complex. Total economic environment is consisting of prevailing economic system, basic economic philosophy and economic policies of the government, stages of economic development, agricultural and industrial production, infrastructure, planning process, trade cycles, national income, savings, population, money supply and price level. Business decisions are always taken considering all these complex factors constituting economic environment of business.

Again, in a modern economic set up, broadly five sectors viz. the business sector, the household sector, the capital market, the external sector and the government sector usually work simultaneously. The business sector maintains close link with all the four other sectors. The structure of the economy is conditioned by the five sectors jointly. But the activities of all these sectors create an economic environment on which business firms are working. Although, individually the business firms cannot change the economic environment prevailing there on but collectively they can change the economic environment to their favour under capitalist and mixed economic system by putting pressure on the government through their associations. In India various organisations like Confederation of Indian Industry (CII), the Federation of Indian Chamber of Commerce (FICCI), ASSOCHAM are exercising considering influence on the government for changing the economic environment in their own favour. Thus, the economic environment is playing an important role in mobilizing the business enterprises towards its right direction.

Constituents: It would now be better to classify some of the important constituent elements of economic environment of business in the following manner:

1. Economic System: By economic system we mean the legal and institutional framework within which various economic activities are undertaken. Various economic activities like production, consumption, exchange, distribution and economic growth are all guided by institutional framework which includes laws, customs and social institutions of a particular country. At present there are three types of economic system prevalent in this world. These are—capitalism, socialism and mixed economy.
In a capitalist system, the major economic decisions, i.e., what to produce, how to produce and for whom to produce are taken by private business enterprise. But in socialist system, planning controls the entire economic decisions. While in a mixed economic structure both the private sector enterprises and public sector enterprise co-exist side by side. Thus business environment under capitalism is quite open while it is highly restrictive under socialism.

2. Macro-Economic Scenario: Macro-economic scenario of a country determines the prospects of business to a large extent. A healthy environment supported by rapid growth, high rates of saving and investment, stable price level, fiscal stability and favourable balance of payments, always opens a bright prospect of business growth in a country. Higher growth rate of income always raises the demand for various goods produced by business enterprise. Stable price level protects the interests of both consumers and business enterprises. Higher rate of savings and investment can push the business activities towards higher destinations.

3. Business Cycle and Stagflation: Economic environment of business is also influenced by ups and downs or cyclical fluctuations in business activity. Prosperity and recessions are the common phases through which the capitalist economy passes through periods. During the thirties, there was a great depression in business activities experienced by most of the countries of the world. Even in recent times, different economies of Asia, viz., Indonesia, Thailand, Malaysia. South Korea are facing the problems of recession, Even the countries like USA, Western Europe and Japan are facing the economic slowdown as a major hurdle in the path of their business expansion. During recession aggregate demand declines leading to fall in the demand for capital equipment. Moreover, another problem which started to show its ugly face over different countries is stagflation. Stagflation is characterized by poor growth rate, unemployment and inflation, which arises due to wrong policy of the government. Such ups and downs in business activity and stagflation has resulted a sense of insecurity in the minds of businessmen and thereby it disturbs the economic environment of business.

4. Financial System: The economic environment of business is also influenced by the efficacy of the financial system. Banks and non-banking financial institutions are an important source of fund for the corporate sector. The level of development of the financial system is having a crucial importance in business. In a country like India, the financial system is broadly divided into two parts, i.e., money market and capital market. Money market is a market for short term monetary assets. But the capital market is mostly concerned with long term funds and it has two broad constituents, i.e., the financial institutions and the securities market.

The securities market has again two constituents, i.e:

(a) The new issue market (the primary market) and (b) The stock exchange (the secondary market). The stock exchange arranges the scope to utilize the savings of the people for its utilization in the corporate business enterprises for long term utilization. In India, the number of stock exchanges had increased from 8 in 1975-76 to 23 in 1999-2000. During this period, the total number of listed companies increased from 1,872 to 9,871 and the volume of capital issues increased from Rs. 98 crore to Rs. 68,963 crore during the same period.

5. Economic Policies: The government of a country has to formulate different economic policies. All these economic policies, can be classified as:

(a) Industrial policy, (b) Monetary policy, (c) Trade policy and (d) Fiscal policy.

All these economic policies of the government are playing a significant role in determining the economic environment of business of a country. The Government of India has formulated all these four categories of economic policies and has also been making necessary revision and updating of its economic policies at regular interval considering the changes and requirements of the economy.

Non-Economic Environment of Business and its Importance: Non-economic environment is as important as economic environment for influencing the business activity of the country. All non-economic issues related to business are included in non-economic environment of a country. The non-economic environment of business can be classified broadly as— politico-legal, demographic, socio-cultural, technological and natural.

1. Politico-Legal Environment: In modern times, politico-legal environment is having a paramount importance in business. The politico-legal environment includes three political institutions viz., legislature, executive and judiciary which usually play useful role in shaping, directing, developing and controlling business activities. The legislature take decision on a particular course of action, the executive implements those decisions through government agencies and the judiciary serves as a watch-dog for ensuring public interest in all the activities of legislature and executive. Maintenance of political stability is an important condition of business, development. In countries like Afghanistan, Yugoslavia, Pakistan etc., business activity had suffered considerably due to political instability prevailing in those countries. The legal environment of business constitutes legislations related to property and business organisations, laws of contracts, bankruptcy, mutual obligations of labour and management and a host of laws of regulations concerning business activities. Economic legislations may be of two types—facilitatory and restrictive. MRTP and FERA Act are restrictive in nature. However, some stringent provisions of FERA has been replaced by FEMA. Thus politico-legal environment is quite important for maintaining a sound and meaningful business environment.

2. Demographic Environment: Demographic environment is also an important constituent of business environment. Accordingly, demographic factors like, rise and growth rate of population, age and sex composition of population, rural urban distribution of population, educational levels, religion, ethnicity, caste, language etc. are all relevant to business conditions.
Size of population, growth rate of population, age-composition etc. influences the demand pattern for various goods. Again, large labour force and rapid growth of labour supply affect the choice of techniques. Considering the labour supply position and the rate of wages, technologies of business is being finalized. In a labour surplus economy, labour intensive technology would be adopted. However, heterogeneity prevailing in respect of ethnicity, religion and language make the task of management quite complex.

3. Socio-Cultural Environment: Socio-cultural environment is another important element of non-economic environment of business. These include people’s attitude to work and wealth, ethical issues, role of family, marriage, religion and education and the social responsibilities of business. All the business firms usually operate in a definite socio-cultural environment and they have to formulate their business policies considering this factor.

Society may be either conservative or liberal. A successful business firm has to take care of these diversified societies and their cultural sensitivities if they really desire to capture the market for their products. The culture in each society is reflected by its habits, customs, beliefs, tradition, values, attitudes, language, art and all other forms of interaction between all the members of the society. As the culture of a society lasts for a long period and also changes gradually thus the business firms has to give due weightage to the culture while designing their products for getting good market response. While advertising their products the business firms have to give due weightage to the attitudes of the people, which may be liberal or conservative.

4. Technological Environment: Technological environment is an important element in business environment. Technology implies systematic application of scientific or other organized knowledge to practical tasks or activities. Francis Stewart observed, “The technology available to a particular country is all those techniques it knows about (or may with not too much difficulty obtain knowledge about) and could acquire, while the technology in use is that subset of techniques it has acquired.” Thus it is quite important for a business firm to make a compromise between the technology available and the technology in use. As the technology is changing fast thus businessmen should keep a close link on those technological changes for its adoption in their business activities.

5. Natural Environment: Natural environment also influences business in a diverse way. Industrial activity is no doubt influenced by scientific and technological development but natural endowments are still playing a dominant role in the establishment and maintenance of industrial activity.

In earlier times, the effects of industrial activities on ecology were not so serious. But in recent times, growing industrial activities have not only created serious damage to exhaustible natural resources, viz., minerals and forest resources but also contaminated water and polluted air to a considerable extent. All these have created a serious environmental damage. Moreover, suitable natural environment is also an important component of non-economic environment of business. Thus the business environment in the country also needs a natural support which includes suitable climate, balanced weather, suitable natural environment, i.e., free from flood and draught etc. Moreover, the maintenance of eco-friendly atmosphere is also quite important for the promotion of developmental activities in an economy.

Cultural Environment

Definition: Cultural Environment

To understand the consumers of a particular region, studying their social and cultural environment is very important. The environment shapes the values, behaviours, attitudes and aspirations of people. The study of social hierarchy, social norms and customs, regional/religion based groups and their behaviour helps us to understand the cultural environment of a place. This helps a marketer to position the products appropriately.

Q: What is a cultural environment?

A: A cultural environment is a set of beliefs, practices, customs and behaviors that are found to be common to everyone that is living within a certain population. Cultural environments shape the way that every person develops, influencing ideologies and personalities. Cultural environments are determined by the culmination of many different aspects of culture that influence personal choices and behaviours. Religious beliefs are an important building block of a specific cultural environment. For many cultures, a certain religion has been a critical part of everyday living for generations. Outsiders need to be aware of the customs and traditions related to specific religion in order to respectfully navigate a certain cultural environment.

Family and the relationship within the family are additional factors that determine a cultural environment. Many cultures are structured around families, while others promote individuality and self-sustainability. Like religion and family, language is the third most important element of a cultural environment. Outside of these components, educational and social systems affect the structure of a cultural environment. Social systems may determine customs or taboos that are important to a particular region, while education may determine what types of ideologies are publicly shared. When visiting a new country or region, it is important for visitors to understand the cultural environment in order to protect themselves from shame, embarrassment or the act of offending a stranger.

Q: What is the difference between culture and society?

A: Culture refers to the traits of a population’s behavior, values, practices, beliefs and religion, while society is the environment or community that surrounds an individual. While culture is the total practices of a people, society is the general humanity. Examples of culture are fashion, language, traditional products, music, art and ideals. Examples of society are villages, small towns and big cities. In the United States, for example, it is a cultural trait that people shake hands as a way of greeting. In Japan, people bow when greeting each other. The Maasai of Eastern Africa touch each other’s heads. The culture of one society can differ significantly from other societies.

Q: What are examples of cultural practices?
Economic Conditions

Changes in worldwide affluence have affected the total value of world trade and investment, the types of products involved, and the proportionate value of international business accounted for by individual countries. Definitive figures on the changes in historic world output are unavailable, but indications are that international trade has remained a fairly constant percentage of gross world product (GWP) over a long period. This does not mean that trade and production will be related in exactly the same way every year. During economic booms, as in much of the 1970s, trade tends to grow more rapidly than production. Conversely, a slow economic growth rate, as in the early 1980s, causes trade to increase more slowly than production. In the late 1980s, trade and production both grew at about the same moderate rate. The reason for this cyclical relationship is that consumers and government policy-makers consider many foreign goods marginal and thus curtail imports as the economy slackens. Producers may also attempt to export only when they have surpluses and will add capacity to serve foreign markets only if the foreign demand is sustained for a long period of time.

Changing world affluence has affected the types of products and their relative importance in world trade. In the mid-nineteenth century, Ernst Engel, a German political economist and statistician, observed that as family incomes increase, the percentage spent on food tends...
to decrease, whereas the percentage spent on other items tends to remain fairly constant or increase. This is true even though the absolute amount spent on food increases due to substitution of more expensive food items. When the human body has reached the limit of its intake capacity, food purchases are replaced by nonfood items. This trend has decreased the proportion of world trade and investment accounted for by agricultural products and increased the proportion accounted for by the manufacturing sector. In addition to traditional goods and services, the world mass market now has access to commodities that once were luxuries, such as watches and foreign travel.

Technology - Rapid technological changes in this century have created new products, displaced old ones, and altered the relative positions of countries in world trade and investment. The most obvious examples of change are new products, such as jets, computers, and transistor radios, which make up a large portion of international business. Products that existed in earlier periods have increased their share in world trade because of technological changes in the production process, as with automobiles, or because new uses have been found for them, as with soybeans and fish meal. Other products have been at least partially displaced by substitutes, such as artificial fibres for cotton, wool, and silk and synthetic rubber and synthetic nitrates for the natural products. Still other products have experienced reduced growth in demand because technology has resulted in methods of conservation. Thinner tin cans and copper wiring that can carry more telephone messages simultaneously have moderated demand for these metals. Because most technical advances have emanated from the most industrialized (richer) countries, firms from these countries control a greater share of the trade and investment in the manufacturing sector, which has been the major growth area. As a result, many of the poorer countries have had a proportionately smaller share of international business.

Factors That Influence Settlement Patterns

Settlement patterns are the ways in which human settlements are distributed across the earth’s land, including the locations of cities, towns and even individual homes. Where people settle is determined by a wide range of factors related to both nature and human society. Examining the reasons behind different settlement patterns is an important part of understanding the geography of the world we live in.

Physical Environment - One of the most basic factors affecting settlement patterns is the physical geography of the land. Climate is key, because if a place is too dry, too cold or too hot, it’s more difficult for large numbers of people to settle there, especially if they make their living from farming. The land itself is important too because some types of soil are much better for agriculture than others, or they support different types of crops. Though modern transportation allows people to settle farther from where their food is farmed, places with wet, mild climates are still more densely populated than places that are very dry or very cold.

Transportation Systems - Settlement patterns have always been affected by the technology available to settlers, and especially by methods of transportation. In the past, when boats were the best way to transport goods and people, most major settlements were located next to the sea or rivers. In fact, the world’s biggest cities today are still located next to water, though transportation technology has allowed inland regions to be populated too. In the 1800s, the American West and other parts of the world saw settlements spring up along the newly built railroads, and today highways and roads form an even bigger factor.

Economic Concerns - Economics often drive settlers to seek opportunity in new places, creating their own settlements or increasing the size of existing ones. Historically, settlers often came in search of places to start farms, and later they came to cities to look for jobs. If economies in the countryside collapse, that can drive even more people into the cities. It’s also possible for jobs to move from cities to the suburbs, leading immigrants to settle in suburban neighborhoods more often than city centers.

Government Policies - The government’s land policies can also have a lasting effect on settlement patterns. Today many city governments enforce zoning rules, controlling the growth of settlements by allowing people to live in some areas but not others. Similarly, when the United States and Canada were expanding west across North America, they each instituted rules that allowed settlers to claim land for farms. Huge areas of land were divided into grids of square plots on official maps, resulting in a checkerboard of square fields, straight-line roads, county lines and state borders across much of the Great Plains. This top-down settlement policy often destroyed the settlement patterns -- and livelihoods -- of the Native American people already living there.

Recent Trends in World Trade and International Negotiations

World trade in 2009 was dominated by the worst financial and economic crisis in decades. Global output shrank. So did the volume of international trade. Despite bearing no responsibility for the crisis, the poorer developing countries have fared the worst. China, Brazil and India saw exports drop by between a fifth and a third in the second half of 2008, but countries not belonging to the top 20 developing country exporters were hit even harder. Trade and GDP growth have started to pick up again, but some economists fear a “dip” recession. If unemployment continues to grow, it may become harder for governments to resist protectionist pressures. In terms of the WTO negotiations, the crisis cuts both ways. Governments are preoccupied with more immediate concerns. But the crisis has shatered the sense that protectionism was unthinkable, making a trade deal seem more valuable. The G-20 major economies have called for concluding the Doha Round in 2010, but it remains to be seen whether this pledge will amount to anything.

The number of bilateral trade deals continues to grow, with Switzerland an enthusiastic participant. Some of these deals have been criticized for “WTO-plus” obligations, particularly regarding intellectual property. Meanwhile, there are real grounds for arguing that the Doha Round agenda does not reflect many current problems, especially climate change. With the US and the EU threatening to impose tariffs on exports from emerging economies with no hard emissions caps, it is clear that governments need to find some way of discussing the new challenges confronting the global economy.

2. The global context
The context for global trade in 2009 was dominated by the world’s most severe financial and economic crisis since the 1930s. Global economic output shrank for the first time since the Second World War. Growth in the developing world as a whole remained positive but was far below the levels seen in recent years.

Between plummeting demand and the drying up of trade finance as a result of the financial crisis, global trade volumes shrank after decades of steady growth. “Trade”, as WTO Director-General Pascal Lamy said, “has become another casualty of the global economic crisis” (Lamy 2009). World merchandise trade was set to contract by 10% in 2009, according to WTO projections. This has occurred despite a recovery from June onwards, which serves to underline the depth of the collapse. Services trade took less of a battering, but this sector accounts for a minority of commercial activity.

Although the crisis had its origins primarily in the United States (US), developing countries have been hit especially hard. The World Bank estimates that the economic downturn will add an additional 53 million people to the ranks of those living on less than USD 1.25 a day and 64 million to those living on less than USD 2 a day (World Bank 2009b). Exports from the developing world were projected to fall by 33% in 2009, as the foreign demand that had underpinned the growth of many countries evaporates.

Sadly, it is the less successful developing country exporters, the very countries that were largely left out of the export boom of the past three decades, that fared the worst. London’s Centre for Economic Policy Research demonstrates that although China, India and Brazil saw exports decline by between 19% and 33% in the second half of 2008, countries not belonging to the top 20 developing country exporters (for those where data are available) saw exports fall by even more (Hubauer and Stephenson 2009). Ecuador and Zambia, for instance, saw exports drop by over 50%. In volume terms too, including for manufactures, these generally poorer countries are doing worse than the 20 most successful developing country exporters. And people in those countries are likely to be particularly vulnerable to still-high food prices and declining remittances from abroad.

At the time of writing in October 2009 there was an increasing sense that a catastrophic collapse of the global financial system had been averted, although some experts remain wary of a “double-dip” recession. In its World Economic Outlook, released in October 2009, the International Monetary Fund (IMF) revised its growth estimates for 2010 upwards from April 2009. Rich country output should increase by 1.7% for advanced countries in 2010, according to the IMF. The figure for emerging market and developing countries was 5.5%, for a global average of 3.2%. However, the IMF warned that much of this growth was the result of government spending and emphasised risks arising from high government debt (IMF 2009).

### 2.1. The Swiss context

Switzerland has not been immune to the crisis. The Swiss Federal Department of Finance described the country’s trade performance in the first quarter of 2009 as the “worst result in ages”. Exports declined by 13.3% in real terms, imports by 4.3% though 10.6% in nominal terms (FDF 2009). Swiss imports from most developing country regions were not spared. Imports from Africa fell by 73.1% compared to the first quarter of 2008, although most of this was accounted for by oil. Imports from Brazil fell by 14.8% and those from Latin America as a whole fell by 8.7%. Indian exports to Switzerland fell by nearly 9% and Korea’s decreased by over 30%. Exports from Asia as a whole were up, but much of the increase was due to some CHF 1.8 billion worth of gold ornaments, principally from Vietnam, to be melted down and recast.

As for the Least Developed Countries (LDCs), they have never been a significant source of imports for Switzerland. In the first quarter of 2009 imports from LDCs represented only 0.15% of Switzerland’s total imports, in keeping with their share in recent years. That said, LDC exports to Switzerland actually increased by 13.3% over the same period the year before, with Bangladeshi textiles accounting for over half of the CHF 66.7 million worth of merchandise imported. LDCs’ generally poor export performance is not due to tariff barriers since Switzerland offers duty-free and quota-free access to all LDC exports. However, LDCs have not been able to take advantage of these considerable tariff advantages to boost agricultural exports, principally due to their difficulty overcoming sanitary and phytosanitary requirements and other non-tariff barriers, according to research by Christian Häberli, a former Swiss trade official (Häberli 2008). This has prompted observers to question the real value of current preferential market access schemes provided by Switzerland.

The economic crisis has been accompanied by widespread fears of protectionism. Governments facing heat over heavy job losses, the thinking goes, would come under tremendous pressure to erect barriers to trade. The Great Depression of the 1930s was marked by a spiral of trade protection and competitive devaluation, both of which served primarily to make people poorer still. Heads of State from the Group of 20 (G-20) leading industrialised and developing nations spoke to these concerns at their summit in Washington in November 2008, pledging to “refrain from raising new barriers to investment or to trade in goods and services” for 12 months (G-20 2008). But only a few months later the World Bank found that some 17 members of the G-20 had implemented measures that “restrict trade at the expense of other countries” (World Bank 2009c). Thus far, however, it seems that trade-restricting measures have been relatively modest in scope. A March 2009 report by the WTO Director-General’s office found “no indication of an imminent descent into high intensity protectionism involving widespread resort to trade restriction and retaliation” (WTO 2009a, 1).

Switzerland did not figure in the report’s list of countries that took measures to either restrict or facilitate trade. Its aid to the troubled bank UBS was mentioned, alongside a description of financial sector bailouts undertaken by other governments. The Economist magazine, however, suggested that Switzerland was guilty of financial protectionism. The country’s new leverage restrictions for UBS and Crédit Suisse exclude domestic lending from calculations of capital, thus privileging it over foreign lending. This is part of a more general worldwide trend for banks to lend more at home than abroad, in response to market and political pressures (The Economist 2009). Despite the lack of cause for serious alarm, WTO investigations into countries’ trade policies since autumn 2008 did find evidence of increased tariffs, new non-tariff measures and use of trade remedies such as anti-dumping duties on imported goods. It warned of the risk of “an incremental build-up of restrictions that could slowly strangle international trade” and undermine worldwide attempts to boost
demand and restore growth (WTO 2009a, 1). Past downturns in the 1970s and 1980s were marked by such measures, and supposedly temporary subsidies and protective measures to protect jobs and businesses in fact took years to unwind, during which they underwrote uncompetitive industries and sectoral overcapacity.

2.2. The political environment

If governments have not been scrambling to raise new barriers to trade, they have not exactly been rushing to agree to new liberalisation either. The Doha Round of trade talks at the WTO continues to languish, despite assorted governmental promises, including by the G-20, to bring them to conclusion. This is understandable. Since the collapse of Lehman Brothers in September 2008 governments, particularly that of the US, have had more pressing preoccupations: saving the financial system from a catastrophic breakdown and stimulating domestically economies mired in a deep recession.

Within this grim context, however, the political circumstances for negotiated trade liberalisation have become somewhat more propitious. For one, the crisis has shattered impressions that global trade was flourishing without a Doha agreement, and thus there was no point making unpopular choices to secure a trade deal. Meanwhile, as President of the US, Barack Obama has stepped back from the trade-sceptic rhetoric he employed on the campaign trail, quietly dropping pledges to renegotiate the North American Free Trade Agreement (NAFTA) and pushing Congress to make the fiscal stimulus package’s “Buy American” clauses WTO-compliant. Ron Kirk, the new US trade representative, has moved to re-engage with other countries on the Doha Round and stressed that the Obama administration will be committed to open trade.

The new distribution of power in Washington should also simplify US trade politics. Relations between the Congressional Democratic leadership and the current President are far better than under George W. Bush, increasing the chances that trade deals will secure lawmakers’ approval. Nevertheless, the Obama administration would need to win support for trade legislation from some Republican members of Congress since several representatives from Obama’s own party would be unlikely to support any trade agreement.

India, whose clash with the US over protections for developing country farmers helped doom a July 2008 mini-ministerial summit on the Doha Round, has also come out of the April-May elections better positioned to pursue economic reforms. The Congress-led ruling coalition substantially expanded its share of seats in the country’s parliament, meaning it will no longer be reliant on the fickle support of communist parties. Nevertheless, the government is also aware that its gradual approach to reform and canny welfare spending over the past five years won it votes. Dramatic shifts in policy may not be on the agenda. Finally, although the European Commission will continue under Jose Manuel Barroso’s leadership, Brazil, one of the few vocal supporters of the Doha Round, faces a political shake-up in its presidential elections in 2010.

3. Recent developments in WTO negotiations

For the third summer in a row, a push for breakthrough WTO accords on agriculture and manufacturing trade at a mini-ministerial meeting in July 2008 ended in failure. However, the most surprising thing about the summit was not that it broke down but rather how close ministers came to reaching an agreement. By WTO Director-General Pascal Lamy’s reckoning, they made it “80-85% of the way” to “modalities” deals with formulae and figures for future subsidy and tariff ceilings during the nine days of gruelling discussions, the longest such meeting in the WTO’s history (ICTSD 2008a). Of the some 20 issues in the talks related to agriculture and non-agricultural market access (NAMA), Lamy indicated that positions had converged on 18. Differences on the ease with which developing countries should be allowed to raise tariffs beyond current legal limits to protect farmers from import surges under a “special safeguard mechanism” proved “irreconcilable”, Lamy conceded. The 20th issue, cotton, was never discussed, to the irritation of African countries especially, some of which have seen already-meagre earnings severely hit by the effects of US cotton subsidies in particular (ICTSD 2008b).

Since then negotiations among trade diplomats have moved slowly, while the unlikelihood of an agreement forced Pascal Lamy to abandon plans to bring ministers back to Geneva in December 2008 for yet another try at a deal on “modalities”, i.e. the formulae and figures for reductions and exceptions that will determine countries’ future tariff and subsidy levels. While some members envisaged the possibility of an “early harvest” (if it can be called early after over seven years of negotiations), under which agreements would be reached and implemented on individual issues potentially including trade facilitation, duty-free and quota-free access for LDC exports, cotton subsidy and tariff cuts, and banana trade, nothing concrete has emerged yet from this process.

3.1. The negotiations on industrial goods

In the NAMA negotiations the principal division is over so-called sectoral liberalisation initiatives, i.e. proposals to eliminate or deeply cut tariffs across entire industrial sectors ranging from bicycles, motor vehicles and auto parts to chemicals, electronics, forestry products, sports equipment and toys. To compensate for what they see as weak levels of overall tariff reduction for developing countries, industrialised nations like the US, Canada and Japan want to be sure that major markets like China, Brazil and India will participate in some sectoral liberalisation initiatives.

But the negotiating mandate explicitly states that participation in such initiatives is “non-mandatory”, a point on which the targeted developing countries have been adamant. The governments of the fast-growing markets are willing to commit to no more than a discussion of how a sectoral approach might work in terms of product coverage, exceptions and future tariff levels for developed and developing countries. Proponents of sectoral initiatives are eager to secure the participation of larger developing countries, especially China, for two reasons. First, countries that together account for a high proportion of total world trade would need to sign on for the extra tariff cuts to kick in. Second, even if a sectoral initiative managed to get off the ground without China, Chinese exporters would benefit from low tariffs elsewhere without being comparably exposed to international competition.

The draft negotiating text, released in December 2008 by the chair of the negotiating committee, recognises the conflicting objectives. But US manufacturers were unimpressed with the committee’s proposal to simply have countries commit to negotiate the terms of how
a particular initiative would operate, with participation remaining optional. The sharpness of the disagreement obscures how much differences have narrowed on what were previously thought to be the central aspects of the negotiations: the "coefficients" linked to the formula that will determine the future tariff levels of most major economies and the figures governing the extent of "flexibilities" for developing nations to shield some products from full duty cuts.

As per the terms of a compromise suggested by Pascal Lamy during the July mini-ministerial meeting, the text provides for the industrialised country coefficient to be eight. For the 30-odd developing countries that would have to apply the tariff reduction formula there is a three-option "sliding scale", i.e. the higher the coefficient they choose, the less freedom they have to shelter products from tariff reduction.

In the negotiations Switzerland has pushed for relatively deep tariff cuts and is a co-sponsor of sectoral initiatives on chemical sector products, forest products, gems and jewellery, health care products, industrial machinery and sports equipment. Switzerland’s tariffs on manufactured goods are generally quite low and thus do not stand to be heavily affected. However, a WTO secretariat review of Swiss trade policy found that most favoured nation (MFN) tariffs on textiles and clothing products remain relatively high, averaging 12.8% on cordage and 9.1% on made-up textile goods. Used clothing faced an applied tariff of 45% (WTO 2008a). These would be cut to below 8% by a Doha Round deal along the terms outlined above, i.e. a 9.1% tariff would be cut to 4.25% by a coefficient of eight.

3.2. The agriculture negotiations

According to the text that was released by the chair of the WTO agriculture negotiations on 6 December 2008 (WTO 2008b), the US would cut its agriculture trade-distorting subsidies by 70%, to roughly USD 14.4 billion, while the European Union (EU) would make cuts of 80%, to around EUR 22 billion. However, along with other WTO members, both would be allowed to maintain and even increase billions of dollars of "green box" subsidies if such payments cause not more than minimal trade distortions. In the area of cotton subsidies reduction, a long-standing issue of importance for West African countries, delegates remain in the dark about possible US concessions. In the absence of counter-proposals, the text still reflects the cuts put forward by the “cotton 4” African producers (Benin, Burkina Faso, Chad and Mali). Some trade sources have suggested, however, that recent Democratic victories in the US congressional and presidential elections may leave the US more room to manoeuvre on this issue.

As shown in table 1, in terms of tariff cuts developed countries’ highest tariffs would be reduced by up to 70%, although the numerous opt-out clauses envisaged in the text such as for “sensitive products” might result in only limited cuts and quota expansion for products of key importance to developing country exporters such as beef, dairy and sugar. Developing countries would make cuts of up to 46.7% on tariffs higher than 130%.

However, they would be allowed to select a limited number of tariff lines as special products (SPs) on the basis of food security, livelihood security and rural development criteria and apply gentler tariff cuts on those products. This concept, introduced by a coalition of developing countries called the Group of 33 (G-33), comes from the recognition that opening markets to competition from cheap and often highly subsidised foreign agriculture imports may affect the livelihood of small and resource-poor farmers, particularly in countries where agriculture still accounts for a large share of gross domestic product (GDP) and employment. The chairperson of the agriculture negotiations, Ambassador Crawford Falconer, proposed draft modalities, according to which developing countries will be entitled to self-designate 12% of their agricultural tariff lines as SPs, guided by an illustrative list of indicators of food security, livelihood security and rural development. For recently acceded members, including China and Vietnam, the maximum entitlement is 13%. These numbers reflect a compromise between the G-33 position, which asked that 20% of agricultural tariff lines be subject to the SP exemption, and the US position, which proposed to limit SPs to five tariff lines.

Overall the studies identified more than 40 different product categories susceptible to being categorised as SPs. While several of them were specific to one or two countries, figure 1 shows 19 were common to at least 25% of the studies.

Chicken was the most commonly identified product and was recommended as a potential SP by 94% of the studies, followed by rice, dairy products, bovine meat, sugar, maize, pork, potatoes, vegetable oils and wheat. Not surprisingly, these are often products that receive the highest amounts of subsidies in OECD countries. With respect to the number of agricultural tariff lines represented by SPs, the findings of the studies vary considerably, from 3% to 20%, reflecting large disparities among developing countries related to the size of the economy or the level of agricultural diversification. Figure 2 shows SP as a percentage of tariff lines for countries where data were available at the Harmonised System (HS) six digit level. Overall out of the 12 countries studied, four exceed the 12% limit envisaged in Falconer’s text.

3.2.1. Switzerland’s contribution in agriculture: implications for developing countries

Since the introduction of the new Agriculture Act in 1999 legislative changes and funding for Swiss agriculture have been granted by parliament for four-year periods. For the 2008-11 period Swiss agricultural policy (AP) 2011 aims to continue the shift from price support to de-coupled payment, with a further reduction of 50% in market price support. The savings thus made will be used for direct payments, or non-trade-distorting subsidies in WTO parlance. All remaining export subsidies for agricultural commodities are to be eliminated by 2010. Between 2008 and 2011 total expenditure on agriculture will amount to CHF 13,499 million (OFDA 2006). This is more than the total amount of official development assistance (ODA) disbursed by Switzerland between 2003 and 2008.

As shown in figure 3, in spite of Switzerland’s gradual efforts to remove protection and trade distortion, the country’s level of agriculture support remains proportionately one of the highest in the world. The Producer Support Estimate, as calculated by OECD, suggests that support to producers still amounted on average to around 50% of farm income in Switzerland (OECD 2007). This figure represents the cost to taxpayers (who pay for the AP budget) and to consumers (who pay more for their food). As illustrated in figure 3, while the share of producers’ income coming from such support has declined, from 73% in 1990 to roughly 50% in 2007, this remains 2.1 times higher...
than the average level of support in OECD countries. In this respect several developing countries have argued that the high amount of support provided in Switzerland has contributed to the overproduction of cheap, subsidised exports in the North, depressing world markets and ultimately undermining developing countries’ productive capacities and investment in agriculture.

3.2.2. The elimination of export subsidies

35 One of the main deliverables of the Doha Round may possibly be the total elimination of export subsidies as the most trade-distorting kind of agriculture payments. Figure 4 shows the evolution of Switzerland’s export subsidies by product as notified in the WTO since 1997 and reflects significant cuts in the dairy sector where subsidies went down from nearly CHF 300 million in 1997 to less than CHF 13 million in 2007.6 As far as food aid is concerned, it is provided solely in response to humanitarian needs and on full-grant terms. Overall it appears the total elimination of export subsidies will not require any major effort from Switzerland, not least because AP 2011 already envisaged the elimination of such subsidies by 2010.

3.2.3. Reduction in domestic support

With roughly CHF 6 billion a year of support notified to the WTO,7 Switzerland provides significant levels of domestic support and, in spite of conforming to Uruguay Round requirements, this amount has remained fairly constant over the last ten years, as shown in figure 5. Support to farmers includes green and amber box subsidies. Green box subsidies refer to non- or minimally trade-distorting subsidies. They are mainly provided through direct payments that are de-coupled from production. They amount to roughly CHF 3.6 billion a year. Amber box payments are linked to production and are expressed as aggregate measurement of support (AMS) in WTO parlance. In the case of Switzerland they essentially refer to market price support. Overall nearly 40% of total support remains linked to production, which is slightly lower than EU support but considerably higher than support in the US or Japan. Current levels of AMS stand at around CHF 2.3 billion, far below the maximum of CHF 4.2 billion allowed under current WTO rules. This means a 52% cut in AMS will only imply limited effective reduction in applied levels of amber box measures, as illustrated in figure 7. When one considers OTDS, the limit envisaged under the current text is still higher than applied levels and would in theory allow Switzerland to increase its OTDS compared to current levels. For these reasons, proposed disciplines under current agriculture drafts will not result in significant cuts in trade-distorting domestic support in Switzerland and therefore are unlikely to effectively benefit developing country exporters. If one takes into account the reduction in price support already envisaged in AP 2011, Switzerland could even accept much deeper cuts in domestic support without having to operate an effective reduction in its applied levels. Finally, a reduction in the more trade-distorting types of supports will likely be accompanied by increases in direct payments, or green box subsidies in WTO parlance. While such payments are much preferable from a developing country perspective in the sense that they do not encourage overproduction, most experts tend to agree that such payments still generate distortions, for example by discouraging farmers from getting out of the business of production.

3.2.4. Market access

Agriculture has traditionally remained the most tariff-protected sector in Switzerland. Tariffs are particularly high in the dairy sub-sector and on products such as poultry, beef, pork, onions, sugar, potatoes and grape juice, reaching over 1,000% on certain meat products. To further complicate matters, 77.3% of bound agricultural tariffs are “specific tariffs” expressed in non ad valorem terms (WTO, ITC, and UNCTAD 2008). This means they are not defined as a percentage of import prices but, for example, as a specific amount per tonne. This makes comparison with other tariff rates impossible unless specific tariffs are converted into ad valorem equivalent (AVE). Finally, Switzerland applies tariff quotas on 26 product categories, including beef, pork, dairy products, eggs, vegetables, fruits and some cereals, covering a total of 287 tariff lines (WTO 2008a).

While competitive agricultural exporters such as Argentina, Brazil, Thailand and even South Africa appear as current and potential exporters in many of the products, it is interesting to note that less advanced developing countries like Namibia, Swaziland, Bolivia, Peru and Guatemala also have an interest in exporting more to Switzerland.

From a development policy perspective, therefore, the numerous caveats, exceptions and flexibilities envisaged in the Falconer text for developed countries might have the potential to significantly dilute opportunities for new market access to developing country exporters resulting from a Doha deal. Combined with the limited gains that these countries can expect from reduction in domestic support, this explains why many developing members have been reluctant to reduce their own agricultural tariffs, let alone accept ambitious cuts in industrial tariffs as envisaged in the NAMA negotiations.

4. Bilateral free trade agreements with developing countries

Despite the financial crisis, Switzerland has continued to move forward in its pursuit of bilateral FTAs, many of them with developing countries. In the absence of progress at the multilateral level, FTAs are often seen as a faster and more flexible way to secure preferential market access in the South.

Together with Iceland, Norway and Liechtenstein, its partners in EFTA, Switzerland is currently negotiating trade agreements with Algeria, the Gulf Cooperation Council (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates) and India. Similar talks with Thailand started but are currently on hold. Agreements have already entered into force with Chile, Egypt, Korea, Israel, Tunisia, Morocco and the Southern African Customs Union (SACU). EFTA has also explored negotiations with Albania, Indonesia and Malaysia. Negotiations with Peru have been concluded, but the text is currently undergoing legal review before it can be formally signed, paving the way for ratification. A similar agreement with Colombia was signed in late 2008. Despite calls from more than 30 Swiss non-governmental organisations to withhold ratification, citing human rights violations in Colombia (Alliance Sud, Déclaration de Berne, and Groupe de Travail Suisse-Colombie 2009), the Swiss parliament approved it in May 2009, followed by the senate in September.
Alliance Sud, an umbrella group of Swiss development advocacy organisations, has been highly critical of EFTA FTAs with developing countries, arguing that they are of dubious economic value and could harm people in developing countries by raising drug costs and flooding their markets with low-cost imports with which local businesses would be unable to compete. It has also complained that the FTAs go well beyond WTO demands on issues such as tariff liberalisation and protection for intellectual property and foreign investment and could weaken developing country solidarity in WTO negotiations (Alliance Sud and Déclaration de Berne 2008).

In general EFTA’s trade agreements cover a wide range of subjects, not all of which come under the purview of existing WTO rules. Since most EFTA countries have heavily protected farm sectors, agriculture usually receives special treatment, with each EFTA member negotiating farm trade concessions separately. On industrial goods, the agreements largely phase out tariffs, albeit with a longer adjustment period for developing countries. They also cover trade in services (going beyond commitments locked in for all trading partners at the WTO), public procurement (either modelled on or going beyond the WTO’s plurilateral agreement on government procurement), protections for foreign investors (often including the right of establishment) and competition rules.

4.1. Intellectual property provisions in EFTA agreements

Intellectual property provisions in EFTA FTAs have evolved from a model that basically follows the content and structure of NAFTA and the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) to a model that contains very detailed provisions providing for higher intellectual property protection standards than the minimum requirement of the TRIPS Agreement, e.g. EFTA agreements with Chile, Egypt, Morocco, Korea and Colombia. These are often referred to as FTAs containing TRIPS-plus obligations. More recently issues that fall outside the scope of TRIPS, such as genetic resources and the promotion of research, technology and innovation, are starting to arise, for example in the EFTA-Colombia agreement.

4.1.1. Baseline provisions

EFTA agreements establish a baseline through a series of general provisions and the subscription and incorporation of several multilateral intellectual property agreements. They reaffirm obligations under the Paris, Bern and Rome Conventions and require parties to adhere to several World Intellectual Property Organization (WIPO) treaties, including the Nice and Budapest agreements and that with the International Union for the Protection of New Varieties of Plants. Subscription to the Patent Cooperation Treaty and the Patent Law Treaty has also become an obligation in recent models. Finally, the WIPO Internet treaties of 1996 have also been incorporated in recent FTAs, e.g. with Chile and Egypt. With the exception of the first three agreements, these treaties are not directly covered by the TRIPS Agreement and therefore imply internal modification of patent, trademark, copyright legislation and administrative procedures.

4.1.2. TRIPS-plus obligations

Specific obligations are usually found in a special annex, with the exception of the FTAs with Canada and SACU. The annexes tend to cover a wide variety of intellectual property provisions which, by nature, go beyond the minimum standards provided in the TRIPS Agreement (TRIPS-plus). This is particularly the case in areas such as patents, undisclosed information, copyrights, designs, geographical indications and enforcement.

With respect to undisclosed test data, the FTAs follow the basic TRIPS obligations but, instead of reaffirming the protection against unfair competition, a period of exclusivity of five years for pharmaceutical products and ten years for agrochemicals from the day of marketing approval is required. Test data protection has been heavily criticised as one of the TRIPS-plus provisions that most affects access to medicines because such measures generate delays in the entry of generic, and thereby cheaper, products. In order to balance these features, EFTA FTAs incorporate a reference to the right of the parties to take measures to protect public health in light of relevant WTO Declarations, Decisions and Amendments. This allows some level of coherence with recent developments in the WTO on the TRIPS and public health front.

In the case of geographical indications the scope of protection has recently been expanded to include both goods and services, whereas the TRIPS Agreement only covers goods. This reflects the interest of the Swiss government in expanding the use of geographical indications to certain services as a brand of quality. In the case of the Swiss financial services, for example, this extension is applied both as a means of protection against unfair competition and as an enforcement measure.

Finally, enforcement provisions have been emphasised in recent FTAs. They include stronger corrective measures, inspection rights and border measures. This strengthening of enforcement measures follows previous trends in US and EU FTAs, thus limiting application to counterfeiting and piracy.

4.1.3. New issues

The recent FTA between EFTA and Colombia contains several relevant new issues that were not covered in any previous EFTA FTA. The most relevant is probably the section dealing with “measures related to biodiversity”. This section constitutes without doubt a landmark towards generating coherence and balance between intellectual property agreements and the Convention on Biological Diversity (CBD). It recognises the importance of existing obligations under the CBD, basic principles such as sovereign rights over genetic resources, as well as access and benefit-sharing rights as reflected in national and international law. It also recognises the contributions of indigenous peoples and their knowledge to economic and social development. More specifically, the parties to the agreement shall require, according to their national law, that patent applications contain a declaration of the origin or source of genetic resources to which the inventor has had access. Mentions of civil and administrative enforcement measures are also incorporated.

Overall this shows that it is possible to generate synergies between intellectual property provisions and CBD objectives and principles without affecting the rights of patent holders. For the first time it includes precise measures backed by enforcement provisions in an FTA. Beyond the unclear economic value of such provisions, the precedent they create could be used as a reference in other bilateral and multilateral negotiations addressing biodiversity and intellectual property issues.
5. Climate change and trade

The global effort to address climate change requires a fundamental transformation of our economies and the ways in which we use energy. Internalising the cost of carbon will have deep-seated effects on what we produce, how we produce it and on what we trade. In the aftermath of the Conference of the parties to the United Nations Framework Convention on Climate Change (UNFCCC) in Copenhagen in December 2009 trade and trade-related issues have emerged as a key element of the trade-offs required by climate change considerations. This chapter provides information on the most salient and pressing policy linkages between trade and climate change.

Switzerland does not address climate change with a unique policy, but rather with a combination of economic instruments, regulation, public investments and voluntary approaches in sectors such as agriculture, energy and transportation. Under the Kyoto Protocol, Switzerland has committed to reduce its “greenhouse gas” (GHG) emissions by 8% by the end of 2012 from 1990 emission levels. The main spearheads of its strategy are the Federal Law on the reduction of CO2 emissions and the Federal Energy Law.

5.1. Agriculture, trade and climate change

Agriculture is a major source of GHGs, currently contributing to 10-12% of global anthropogenic GHG emissions (excluding deforestation). While the Swiss AP 2011 does not aim to address climate change as such, it indirectly contributes to this objective through the shift it promotes from intensive agriculture to integrated or organic farming and limited chemical treatment of plants. It also gives priority to exports manufactured using sustainable methods and in particular organic certification and good agricultural practices.

5.2. The food miles debate

Action to address climate change in industrialised countries is leading to a range of standards and certification schemes. These schemes seek to measure and account for the carbon content of goods that are produced and traded internationally. Many of the emerging standards and certification schemes are private sector and consumer-driven initiatives, making it challenging for public policy to fully address their trade and development implications. In 2008 Switzerland initiated its first carbon labelling scheme for products sold in the retail chain Migros.

The role of voluntary carbon labelling schemes is likely to grow in the future, providing consumers with the option of decreasing their personal carbon footprint. A major concern in this area, however, has been the focus on air transport, which only accounts for a negligible share of GHG emissions when compared with those generated by agricultural products, often providing misleading information to consumers. In this respect the debate on food miles needs to be expanded not just to include road and sea transport but also to look at the total carbon emissions of products throughout the supply chain, using life-cycle analysis, and to evaluate how to reduce emissions at each stage of the chain to achieve low carbon ratings.

From a sustainable development perspective, carbon schemes would also need to balance the need for accurate and useful data with equity concerns and the need to be simple, transparent, and involve sufficiently low transaction costs to include small producers. While labelling schemes provide opportunities to access niche markets, many producers are concerned that such standards may become a vehicle for green protectionism. In Switzerland, for example, the Bio Suisse label excludes organic air-freighted products. This provision directly affects fruit and vegetable producers in East Africa that would otherwise qualify as organic producers.

5.3. The liberalisation of environmental goods and services

Trade is an important channel for the diffusion of climate mitigation technologies and goods. Lowering trade barriers might, in theory, make them more affordable to consumers and bring down climate mitigation costs overall. Lowering tariffs on climate mitigation goods can also contribute to UNFCCC technology transfer mandates by facilitating access to these goods. The WTO’s Doha Ministerial Declaration calls for a reduction of tariffs and non-tariff barriers on “environmental goods and services”. However, there is no universally accepted definition of these. Complexities also exist with regard to their classification for customs purposes, making selective liberalisation of climate-friendly goods challenging.

Many developing countries want to safeguard sensitive industries and domestic capacity, which may discourage them from pursuing full liberalisation in climate mitigation goods. Overall the liberalisation of those goods would likely bring benefits mainly to developed countries and a few middle-income developing countries, such as China, Singapore, Hong Kong, Mexico and India, but may not lead to significant environmental benefits in the LDCs that lack purchasing power. As part of the Friends of Environmental Goods group at the WTO, Switzerland supports the establishment of a list of environmental goods for which tariffs would be removed. Joining with Canada, the EU, Japan, Korea, New Zealand, Norway, Chinese Taipei and the US, it has submitted a list of 153 environmental goods with categories such as renewable energy products, solid waste management and heat and energy management products. A recent ICTSD study has shown, however, that by and large the proposed products do not really match developing countries’ environmental concerns. Furthermore, it appears that tariff reduction might only play a marginal role in enhancing trade in the list of 153 goods, with other factors such as environmental regulations, feed-in tariffs and the general level of industrialisation playing a much greater role as drivers of trade in this area (Jha 2008).

5.4. Intellectual property rights and transfer of the general technology

The UNFCCC and the Kyoto Protocol require parties to promote and cooperate in the development and diffusion of technology, including transfer of technologies that control, reduce or prevent GHG emissions. As recognised in the Bali “road map”, enhanced action on technology development and transfer will be necessary to enable the full, effective and sustained implementation of the UNFCCC beyond 2012.

Intellectual property rules, particularly those established in the WTO context, have been at the heart of the UNFCCC debate on transfer of technology. Some developing countries are concerned that strict intellectual property rules might prevent the effective transfer of climate-friendly technologies. Initial research found that the impact of patents on access to solar, wind and biofuel technologies in develop-
ing countries would not be significant, largely because the level of concentration in those industries is still limited, in contrast with the pharmaceutical industry where patents play a much greater role (Barton 2007). More research is needed, however, to fully understand the role of intellectual property rights, particularly on licensing practices which are likely to play a more important role than patents in the diffusion of climate-friendly technologies.

5.5. Carbon leakage and border tax adjustments
Countries set to take on mandatory climate mitigation obligations worry that doing so may affect the international competitiveness of their energy-intensive and carbon-intensive industries. Concerns centre on the economic and social implications of the real or perceived costs of relocating industries to countries without such obligations. In addition, such relocation may lead to higher overall carbon emissions from the same volume of production of goods in countries with less efficient processes.

In response to such concerns, politicians have been considering legislation instituting carbon-related “competitiveness provisions” in the form of mandatory carbon offsetting allowances on imports or border tax adjustments. Draft legislation in the US contains provisions for carbon barriers targeting emerging economies among non-Annex I countries that are currently not obliged to make emissions reductions. In Europe border measures were left out of draft climate and energy legislation (at least at the time of writing in October); however, they are very much part of the debate. The European parliament has been calling for border measures against climate “free riders”. French President Nicolas Sarkozy has expressed support for the idea of tariffs on imports from countries that do not place a cap on carbon emissions. Carbon-related border measures are controversial; their legality under the WTO has also been questioned. Recent studies have pointed to the potential ineffectiveness of unilateral trade measures to encourage action on climate change (Houser, Bradley, and Childs 2008).

6. Conclusion
It is difficult to argue that the tariff and subsidy concessions arising out of a Doha Round deal would help the world economy recover from the crisis. The currently proposed cuts to maximum allowable subsidy and tariff levels have, to a great extent, already been superseded by reality; domestic reforms mean that “applied” rates are already near or below the future caps under discussion. Of course a WTO trade deal would provide an example of multilateral economic cooperation at a time when such cooperation is badly needed for a future global climate agreement. Locking in autonomous liberalisation reforms would also be a useful bulwark against backsliding, but it does not excite businesses or developing countries looking for new export opportunities.

More generally the Doha agenda reflects concerns from the world of the late 1990s, not from the world of today in which regional and bilateral FTAs continue to mushroom, in which high, not low, food prices are the worry and in which key trade policy concerns involve overcoming the current economic recession and addressing competitiveness concerns related to attempts to curb GHG emissions. If the system is not able to address today’s trade concerns, it runs the risk of becoming irrelevant. Worse still, if these issues cannot find a home at the multilateral level, they will be addressed through bilateral or unilateral measures, as illustrated by the debate surrounding border tax adjustment in the US.

In these circumstances there might be a case for rethinking the negotiating agenda of the WTO. The system can probably not afford to wait for the next round of trade negotiations to start discussing possible ways to respond to pressing trade concerns emerging from the climate change debate, the food crisis or the proliferation of FTAs. For most WTO members, however, reopening the negotiating mandate in Doha is a “non-starter” as this would most probably kill the Doha Round of negotiations.

A possible third way would consist in establishing a parallel track, at the WTO, where emerging issues could be addressed, both at the political and technical level, outside of the Doha Round and initially in a non-negotiating setting. The recent establishment of a WTO task force and monitoring system to deal with the trade dimension of financial crisis provides an interesting precedent in this respect, as a creative way through which new issues can be addressed outside of the ongoing negotiating mandate. In the same line the holding of a largely overdue formal ministerial conference to reflect on the future of the multilateral trading system and discuss a common vision for the WTO beyond on-going negotiations could provide a useful venue to address the new challenges confronting the global economy.

Balance of Payments

Meaning of Balance of Payments:
A country’s balance of payments (BoP) is defined as the summary of all its economic transactions that have taken place between the country’s residents and the residents of other countries during a specified time period. It is used as an indicator of a country’s political and economic stability.

A consistently positive BoP reflects more foreign investment and money coming into the country and not much of its currency being exported. On the other hand, adverse or negative BoP indicates more outflows of money compared to inflows.

Thus, a surplus or positive BoP implies that a country has more funds from trade and investment coming in compared to what it pays out to other countries. It has a positive impact on a country’s currency appreciation.

Conversely, a deficit BoP implies an excess of imports over exports, a dependence on foreign investors, and an overvalued currency. BoP deficits need to be made up by a country by exporting its hard currency foreign exchange reserves or gold.

The balance of payment is generally computed on a monthly, quarterly, or yearly basis. The balance of payments includes both visible and invisible transactions. The balance of payments reports the country’s international performance in trading with other nations and the volume of capital flowing in and out of the country.
Balance of payments accounting uses the system of double-entry bookkeeping, which means that every debit or credit in the account is also represented as a credit or debit somewhere else. In a balance-of-payment sheet, currency inflows are recorded as credits (plus sign), whereas outflows are recorded as debits (minus sign).

**Accounts Used for Computing Balance of Payments:**

- **Current account:** It includes import and export of goods and services and the unilate-ral transfer of goods and services.
- **Capital account:** It includes the transactions that lead to changes in financial assets and liabilities of the country.
- **Reserve account:** It includes only the ‘reserve assets’ of the country. These are the assets that the monetary authority of the country uses to settle the deficits and surpluses that arise when the two categories are taken together. Since the crisis of 1991, India’s BoP has strengthened in the post-reform period.

India’s current account balance witnessed surpluses from 2001-02 to 2003-04 and exhibited a reverse trend (Table 3.14) since 2004-05 of the current account deficit, along with a burgeoning trade deficit, primarily due to the steep rise in the prices of petroleum products. In spite of large re-payments of India Millennium Deposits (IMD) under external commercial borrowings, India has maintained a strong balance in the capital account even after financing the current account deficit.

Foreign investments, both direct and portfolio, and inflow of non-resident deposits had been on the rise. The invisibles (net), comprising non-factor services (such as travel, transportation, software, and business services) for investment income, and transfers have traditionally compensated to a large extent the trade deficit.

As a per cent of GDP, India’s current account balance improved from a deficit of 3.1 per cent in 1990-91 to a surplus of 2.3 per cent in 2003-04 but declined subsequently to 1.1 per cent in 2005-06. India’s invisibles (receipts) grew remarkably from 2.4 per cent of GDP in 1990-91 to 11.5 per cent of GDP in 2005-06.

The current and capital accounts both have witnessed surpluses over the recent years. Most economies in developing Asia, such as Indonesia, Malaysia, the Philippines, and Thailand, have also witnessed surpluses in their current accounts from the later part of the 1990s.

The capital account has also continued to strengthen over the last few years. Earlier, the capital account surplus in India’s balance of payments used to be partially offset by the current account deficit, leading to lower overall surpluses. However, since 2001-02, surpluses in both the current and capital accounts have resulted in larger overall surpluses, which has led to the accumulation of the foreign exchange reserves of the country.

The balance of payments profile also reveals some interesting trends at a micro level. In recent years, the deficits in the trade account have been more than made up by the large invisibles surpluses sustained by the large inflows of private transfers and non-factor services, resulting in positive current account balances.

On the other hand, the growing strength of the capital account has arisen largely from the steady growth in non-debt creating foreign investment inflows. External commercial borrowings and external assistance have been showing net outflows in recent years.

The trends indicate that the fast-growing invisibles and non-debt creating foreign investment inflows are the main factors behind the accumulation of foreign exchange reserves.

**Balance of Trade:**

The difference between the value of exports and imports is termed as the balance of trade. India had negative balance of trade over the years except during two financial years, i.e., a positive trade balance of US$134 million in 1972-73 and US$77 million in 1996-97.

Although India’s trade deficit grew over the years from US$4 million in 1950-51, it significantly increased after 1995-96. There has been a steep rise in trade deficit from US$5.98 billion in 2000-01 to US$80.39 billion in 2007-08 mainly due to the steep rise in the unit value prices of India’s import products, especially petroleum products and fertilizers, besides domestic demand.

**What Is The Balance Of Payments?**

The balance of payments (BOP) is the method countries use to monitor all international monetary transactions at a specific period of time. Usually, the BOP is calculated every quarter and every calendar year. All trades conducted by both the private and public sectors are accounted for in the BOP in order to determine how much money is going in and out of a country. If a country has received money, this is known as a credit, and if a country has paid or given money, the transaction is counted as a debit. Theoretically, the BOP should be zero, meaning that assets (credits) and liabilities (debits) should balance, but in practice this is rarely the case. Thus, the BOP can tell the observer if a country has a deficit or a surplus and from which part of the economy the discrepancies are stemming.

**The Balance of Payments Divided**

The BOP is divided into three main categories: the current account, the capital account, and the financial account. Within these three categories are sub-divisions, each of which accounts for a different type of international monetary transaction.

- **The Current Account**: The current account is used to mark the inflow and outflow of goods and services into a country. Earnings on investments, both public and private, are also put into the current account.

  Within the current account are credits and debits on the trade of merchandise, which includes goods such as raw materials and manufactured goods that are bought, sold or given away (possibly in the form of aid). Services refer to receipts from tourism, transportation (like the levy that must be paid in Egypt when a ship passes through the Suez Canal), engineering, business service fees (from lawyers or management consulting, for example) and royalties from patents and copyrights. When combined, goods and services together make up a country’s balance of trade (BOT). The BOT is typically the biggest bulk of a country’s balance of payments as it makes up total imports and exports. If a country has a balance of trade deficit, it imports more than it exports, and if it has a balance of trade surplus, it exports more than it imports.
Receipts from income-generating assets such as stocks (in the form of dividends) are also recorded in the current account. The last component of the current account is unilateral transfers. These are credits that are mostly worker’s remittances, which are salaries sent back into the home country of a national working abroad, as well as foreign aid that is directly received.

The **Capital Account** is where all international capital transfers are recorded. This refers to the acquisition or disposal of non-financial assets (for example, a physical asset such as land) and non-produced assets, which are needed for production but have not been produced, like a mine used for the extraction of diamonds.

The capital account is broken down into the monetary flows branching from debt forgiveness, the transfer of goods, and financial assets by migrants leaving or entering a country, the transfer of ownership on fixed assets (assets such as equipment used in the production process to generate income), the transfer of funds received to the sale or acquisition of fixed assets, gift and inheritance taxes, death levies and, finally, uninsured damage to fixed assets.

The **Financial Account** in the financial account, international monetary flows related to investment in business, real estate, bonds and stocks are documented. Also included are government-owned assets such as foreign reserves, gold, special drawing rights (SDRs) held with the International Monetary Fund (IMF), private assets held abroad and direct foreign investment. Assets owned by foreigners, private and official, are also recorded in the financial account.

The **Balancing Act** The current account should be balanced against the combined-capital and financial accounts; however, as mentioned above, this rarely happens. We should also note that, with fluctuating exchange rates, the change in the value of money can add to BOP discrepancies. When there is a deficit in the current account, which is a balance of trade deficit, the difference can be borrowed or funded by the capital account.

If a country has a fixed asset abroad, this borrowed amount is marked as a capital account outflow. However, the sale of that fixed asset would be considered a current account inflow (earnings from investments). The current account deficit would thus be funded. When a country has a current account deficit that is financed by the capital account, the country is actually foregoing capital assets for more goods and services. If a country is borrowing money to fund its current account deficit, this would appear as an inflow of foreign capital in the BOP.

**Liberalizing the Accounts** The rise of global financial transactions and trade in the late-20th century spurred BOP and macroeconomic liberalization in many developing nations. With the advent of the emerging market economic boom - in which capital flows into these markets tripled from USD$50 million to $150 million from the late 1980s until the Asian crisis - developing countries were urged to lift restrictions on capital and financial-account transactions in order to take advantage of these capital inflows. Many of these countries had restrictive macroeconomic policies, by which regulations prevented foreign ownership of financial and non-financial assets. The regulations also limited the transfer of funds abroad.

With capital and financial account liberalization, capital markets began to grow, not only allowing a more transparent and sophisticated market for investors, but also giving rise to foreign direct investment (FDI). For example, investments in the form of a new power station would bring a country greater exposure to new technologies and efficiency, eventually increasing the nation’s overall GDP by allowing for greater volumes of production. Liberalization can also facilitate less risk by allowing greater diversification in various markets.

**The Bottom Line** The balance of payments is divided into the current account, capital account, and financial account. Theoretically, the BOP should be zero.

**Macroeconomic Management: An Overview**

Since its establishment in 1964, the IMF Institute has trained more than 13,000 officials from 183 member countries in Washington and over 8,000 officials overseas. The training focuses on such subjects as financial programming and policies, monetary and exchange operations, public finance, financial sector issues, and macroeconomic statistics. This book includes some of the background material that the IMF Institute uses in the training of country officials. Although IMF Institute courses also cover structural issues—such as banking system, public enterprises, and labour market reform (which are also critical to the achievement of economic policy objectives), this book deals only with macroeconomic issues. Specifically, it addresses some of the key questions policymakers face in managing national economies:

- What is the appropriate mix of monetary, fiscal, and exchange rate policies for redressing domestic and external financial imbalances?
- Do policies pursued under IMF-supported programs lead to higher growth, lower inflation, and reduced external imbalances?
- What policies help to promote economic growth?
- What is the importance of current account sustainability, and how can it be determined? What indicators help policymakers to detect risk factors that affect current account sustainability and that contribute to financial crises?
- How should monetary policy be designed? Does inflation targeting enhance the performance of monetary policy?
- How should fiscal policy be used to achieve policy objectives? What are the criteria for assessing the fiscal balance?
- What are the determinants of nominal exchange rates? How can the long-run equilibrium real exchange rate be assessed and measured?

An understanding of the issues involved in these questions is at the heart of effective economic policymaking. The chapters in this book show that there are no definitive answers, but rather a variety of options. In particular, they make explicit the pros and cons involved in any specific course of policy action.

**Program Design and Effectiveness** - The first part of the book focuses on the broader issues of economic adjustment, growth, program effectiveness, and current account sustainability. In Chapter 2, Chorng-Huey Wong reviews the design of macroeconomic adjustment programs in the context of a framework for determining the mix of monetary, fiscal, and exchange rate policies for restoring economic
balance. Wong explains that both internal balance and external balance depend on two fundamental variables—the level of real domestic demand and the real exchange rate. Accordingly, various combinations of internal and external imbalances can be identified, depending on whether an excess or deficient real domestic demand exists and whether the real exchange rate is overvalued or depreciated. Each combination of imbalances requires a different combination of corrective measures.

Wong focuses on the mix of policies required to deal with a situation in which excess real domestic demand and an overly appreciated real exchange rate combine to produce domestic inflation and a current account deficit. Although the combination of tight monetary and fiscal policies could be used in this case to restore internal and external balance, the combination could also adversely affect production and unemployment. Another approach would be to induce a nominal depreciation to improve the current account position, but that action could increase domestic inflation, unless it is implemented by demand-restraint monetary and fiscal policies. Wong points out that whether a nominal depreciation is required depends, among other things, on the size of the real exchange rate misalignment. This leads to the discussion of the concept and measurement of the macroeconomic balance real exchange rate, which corresponds to the simultaneous attainment of internal and external balance.

Wong considers the relative effectiveness of monetary and fiscal policies in influencing domestic output and prices and the external sector position, which depend largely on the exchange rate regime adopted. He shows that an appropriate mix of policies, whereby each policy is "assigned" to address the particular imbalance for which it has a comparative advantage, will make adjustment convergent.

In Chapter 3, Nadeem Ul Haque and Mohsin S. Khan focus more narrowly on the empirical evidence for the effects that IMF-supported adjustment programs have on inflation, economic growth, and the external sector. They examine the methodologies used in, and the results obtained by, evaluations of IMF-supported programs, with a view to assessing the effectiveness of past programs and ways of improving future evaluations. They note that assessment results can provide an important input into the design of IMF-supported programs. They emphasize that the proper standard for measuring program effectiveness is to compare the macroeconomic outcomes under a program with the outcomes that would have emerged in the absence of a program, or under a different set of policies—the counterfactual case.

Their study points to two important conclusions. First, the methodology of more recent studies, which applied the counterfactual criteria to evaluating program performance by estimating the policy-reaction functions for program and nonprogram countries, have yielded more reliable results than those from earlier studies. Haque and Khan are critical of the earlier studies, because these studies attempted to gauge program effectiveness by comparing macroeconomic outcomes in program countries with performance before the implementation of the program, or with the observed performance of nonprogram countries. Consequently, they failed to measure the counterfactual properly.

Second, Haque and Khan conclude that IMF-supported programs do improve the current account balance and the overall balance of payments. Although the rate of inflation in most cases falls, the change is generally found not to be statistically significant. With regard to growth, output is depressed in the short run as the demand-reducing elements of a policy package dominate, but, as macroeconomic stability returns, growth recovers. Haque and Khan point out that for future work, even though the counterfactual is the most appropriate way of judging program effects, there are serious difficulties in using this criterion. They see some benefit in conducting case studies, as opposed to large multicountry studies, because case studies permit a deeper analysis of program implementation, but they caution that case studies are useful primarily as a means of supplementing the results from cross-country studies.

Sources of Growth - the sources of growth in rich countries and the causes of slow growth in countries that have lagged behind. To address these questions, he introduces some of the tools used in analyzing the growth performance of countries. He notes that the central element of the neoclassical theory of economic growth is the neoclassical production function, which assumes that all of the inputs for production can be aggregated into three basic ones: capital, labor, and technology.

In neoclassical theory, the production function exhibits constant returns to scale and diminishing returns to production can be aggregated into three basic ones: capital, labor, and technology. Martin notes, the neoclassical researchers left unexplained the process by which technological progress. But, Sala-i-Martin notes, the neoclassical researchers left unexplained the process by which technological progress occurs, by assuming that technology grows at an exogenous rate. This, he points out, is clearly unsatisfactory from a theoretical standpoint because it is tantamount to saying that the ultimate source of growth is unexplained. Accordingly, since the mid-1980s, a large number of researchers have worked to determine the sources of growth. The resulting studies are known as the "new growth literature." Sala-i-Martin divides the research into three broad categories: human capital, technology, and government, viewed within the context of the legal system, the macroeconomic environment, the imposition of taxes, and government spending. He examines the models for analyzing the effects of these issues on growth and the empirical evidence on its determinants. The evidence shows several variables to be strongly correlated with growth: the quality of government (positive); market distortions (negative); investment (positive); openness (positive); market-type economy (positive); education (positive); and sound macroeconomic policies (positive). Surprisingly, some variables appear unimportant for growth: for example, government spending, financial sophistication, scale effects (measured by total area and total labor force), and ethno linguistic fractionalization (supposed to capture the level of internal strife among ethnic groups).

Current Account Sustainability - Sala-i-Martin links growth to sound macroeconomic policies, which, as Luis Carranza explains in Chapter 5, are also critical to the achievement of a sustainable external current account position. Carranza defines the current account balance and its determinants and explores the relationship between the current account and the key underlying variables such as investment, saving, and capital flows. He points out that the recent econometric literature on determining current account sustainability focuses on issues of intertemporal solvency and other crucial factors, such as macroeconomic policy (including policy reversals and credibility) and the willingness of international investors to lend to countries with large deficits. Carranza examines the set of leading indicators (struc-
tural, macroeconomic, and overborrowing factors) proposed in the literature to help predict external crises and detect whether current account deficits could become unsustainable over the long term. He analyzes the various types of policy responses, concluding with a review of the structural characteristics and macroeconomic policy stances of five countries (Argentina, Canada, Chile, Mexico, and Thailand) that had experienced large current account deficits.

**Monetary Policy** - The second half of the book turns more specifically to monetary, fiscal, and exchange rate policies. In Chapter 6, Richard C. Barth describes the general framework for formulating monetary policy. He focuses on the objectives of monetary policy, the instruments available to attain those objectives, the basic elements of the relationship between exchange rate policy and monetary policy, and alternative views of the transmission process of monetary policy.

Monetary policy objectives traditionally include economic growth, employment, and price stability. Depending on the country, monetary policy may assign equal weights to these objectives, or as is more common now, place greater emphasis on the objective of price stability. There are, of course, other objectives, such as the stability of long-term interest rates and financial markets, or the level of economic activity in particular sectors of the economy. Barth distinguishes between intermediate targets and operating targets, as well as direct and indirect monetary policy instruments. He also explains the difference between the money view of the transmission mechanism and the credit view, arguing that, in practice, most central banks that use indirect monetary instruments have been unable to exercise a high degree of control over credit aggregates in the short term, and monetary aggregates have been more popular as intermediate variables. Barth also reviews issues pertaining to the role of the central bank in conducting monetary policy: the inflationary bias of monetary policy, rules versus discretion in monetary policy implementation, and central bank independence. He provides examples of how various countries have operated under several types of monetary regime: exchange rate targeting, monetary targeting, inflation targeting, and discretionary policy with an implicit nominal anchor.

Scarlata explains that the inflation-targeting framework is an operational regime intended to enhance the performance of monetary policy. In this type of regime, price stability is the primary goal of monetary policy, and the central bank has discretion in determining how monetary goals are attained and is accountable for achieving those goals. She notes that the inflation-targeting framework was adopted primarily to resolve conflicts among competing monetary policy objectives.

Many countries adopted the framework to address the problems experienced with previous monetary regimes, such as those that used exchange rate pegs or monetary aggregates as the intermediate target. In a few countries, inflation targeting was used where earlier inflation stabilization efforts consisting of heterodox programs and crawling exchange rate bands had conflicted with efforts to maintain the official exchange rate regime and to control inflation. Scarlata argues that the inflation-targeting framework avoids these conflicts by serving as a clear statement that inflation fighting is the primary goal of monetary policy and by giving the central bank the freedom to conduct monetary policy independently of the influence of political cycles, thus making the central bank accountable for achieving monetary goals. She provides an overview of issues associated with the design of monetary policy rules. She assesses the rationale for, and the theory of, inflation targeting, including the prerequisites for adopting an inflation-targeting framework and the operational steps involved in implementing inflation targeting. Finally, Scarlata attributes the success of Israel, New Zealand, and the United Kingdom in reducing inflation directly to their policy of inflation targeting.

**The Role of Fiscal Policy:**

- the allocation function—the process of dividing total resource use between private and social goods and choosing the mix of social goods;
- the distribution function—the process of adjusting the distribution of income or wealth in conformity with what society considers fair; and
- the stabilization function—the achievement of the main macroeconomic objectives of economic growth, price stability, and sustainable external accounts.

El-Khoury focuses on the function that is directly related to macroeconomic management: stabilization. He uses the traditional open-economy IS-LM model to assess the short-run effects of fiscal policy on output, prices, and the current account balance of payments, as well as the interactions between fiscal policy and monetary and exchange rate policies. He explores several issues specific to fiscal policy and macroeconomic management, such as methods for assessing the fiscal stance, cyclical and structural deficits, the sustainability of the fiscal deficit, and policies for managing debt and fiscal surpluses. El-Khoury concludes by exploring how tax policy, expenditure policy, and overall budgetary policy can affect a country’s long-term growth.

The role of fiscal policy in price stabilization in the context of a sustainable balance of payments is the focus of Enzo Croce’s discussion in Chapter 9. Croce explains that for successful stabilization to be achieved the public sector finances need to be balanced against the demand for investment and the supply of savings by the private sector and available external financing flows. Countries facing major macroeconomic difficulties are often associated with substantial disequilibria in public finances. Reducing the fiscal imbalance thus becomes a necessary condition for improving the macroeconomic situation in such countries.

In defining the role of fiscal policy in adjustment programs, two key issues arise. First, a correct measure of the fiscal position is needed to calculate the true extent to which the public sector is preempting resources. However, since no single comprehensive and complete measure of the underlying fiscal position exists, policymakers must rely on a series of alternative indicators, each with its advantages and disadvantages. Second, once an operational measure of the fiscal position is set, the size of the needed fiscal adjustment has to be determined.

Croce discusses how the stance of fiscal policy can be defined and estimated and reviews the use of various indicators and how they can provide a basis for assessing the impact of fiscal policy on macroeconomic variables. He explains how government operations interact with other macroeconomic variables within the framework of the intertemporal budget constraint of the public sector. In this context, Croce discusses how specific indicators, mainly associated with the dynamics of the debt-to-GDP ratio, can be useful parameters for tar-
getting a timeline for reducing fiscal deficits. He concludes by examining the criteria for fiscal solvency and sustainability and the framework for determining the amount of fiscal adjustment needed to achieve sustainable domestic and external balances within a set time frame.

**Exchange Rate Policy and Issues** - the issues involved in determining nominal exchange rates. Her survey of the econometric literature on the determinants of nominal exchange rates notes that traditional models of exchange rate determination have focused on three types of explanatory variable: national price levels, interest rates, and the balance of payments. She begins with a discussion of the fundamental hypotheses underlying the models—purchasing power parity (PPP) and interest rate parity—and reviews the models' empirical validity. She examines early models of the current account and the asset-pricing equilibrium models of the balance of payments under fixed exchange rates. The latter became the basis for modeling the behavior of flexible exchange rates after the collapse of the Bretton Woods system.

Del Castillo analyzes models of exchange rate dynamics during the transition to flexible regimes and reviews the models that have adopted the modern asset-markets approach to determining exchange rates during transition. She explains the testing of the models under both flexible-price and sticky-price assumptions and argues that the asset-market models offer a more refined portfolio-balance approach to exchange rate determination.

the theory and measurement of the long-run equilibrium real exchange rate (LRER). He focuses on why it is important to get this particular macroeconomic relative price right and on how the value of the equilibrium real exchange rate can be estimated empirically. These questions have been at the center of macroeconomic policy advice that officials of developing and transition economies have received over the past decade—namely the importance of "getting prices right." The need to get relative prices right, Montiel points out, also has a macroeconomic dimension. The two central macroeconomic relative prices are the price of goods in the present relative to the price of goods in the future (the real interest rate) and the price of domestic goods relative to the price of foreign goods (the real exchange rate). These relative prices guide the broad allocation of production and consumption between today's and tomorrow's goods, as well as between domestic and foreign goods. Montiel explains that identifying conceptually or empirically the right level of these macroeconomic relative prices is not easy.

Montiel reviews the conceptual and empirical issues that arise in defining the actual real exchange rate, as well as the conceptual issues involved in the definition of the appropriate real exchange rate. He concludes that the relevant measure is the LRER and sets out a theoretical model designed to identify the relevant set of fundamental determinants of the LRER. After discussing the theory, Montiel examines the measurement issues and reviews the state of the art in the empirical measurement of the LRER. He concludes that the techniques for estimating the LRER are lagging behind the theory, noting that there is no wide agreement on methodology. Montiel, thus, imparts a clear sense of urgency to further research on identifying and measuring the LRER.

The concepts and issues discussed in this book are indicative of the complexities involved in macroeconomic policymaking. The chapters reflect some of the most recent advancements in the literature on macroeconomic management, including the identification of the sources of growth, inflation targeting, and the application of time-series methods to estimating the equilibrium real exchange rate. The chapters highlight the theoretical and empirical considerations that need to be considered when designing a macroeconomic adjustment program. They show clearly that there can and should be a variety of policy packages for achieving a country's key economic objectives. But designing an effective macroeconomic adjustment program requires a good understanding of how such policies affect the economy. The chapters in this book are an attempt to aid in the deepening of that understanding.

**How Governments Influence Markets**

In the 1920s, very few people would have identified the government as the major player in the markets. Today, very few people would doubt that statement. In this article, we will look at how the government affects the markets and influences business in ways that often have unexpected consequences.

**Monetary Policy:** The Printing Press Of all the weapons in the government's arsenal, monetary policy is by far the most powerful. Unfortunately, it is also the most imprecise. True, the government can do some fine control with tax policy to move capital between investments by granting favorable tax status (municipal government bonds have benefited from this). On the whole, however, governments tend to go for large, sweeping changes by altering the monetary landscape.

**Currency Inflation** - Governments are the only entities that can legally create their respective currencies. When they can get away with it, governments always want to inflate the currency. Why? Because it provides a short-term economic boost as companies charge more for their products and it also reduces the value of the government bonds issued in the inflated currency and owned by investors. Inflated money feels good for awhile, especially for investors who see corporate profits and share prices shooting up, but the long-term impact is an erosion of value across the board. Savings are worth less, punishing savers and bond buyers. For debtors, this is good news because they now have to pay less value to retire their debts - again, hurting the people who bought bank bonds based off those debts. This makes borrowing more attractive, but interest rates soon shoot up to take away that attraction.
Fiscal Policy: Interest Rates - Interest rates are another popular weapon, even though they are often used to counteract inflation. This is because they can spur the economy separately from inflation. Dropping interest rates via the Federal Reserve - as opposed to raising them - encourages companies and individuals to borrow more and buy more. Unfortunately, this leads to asset bubbles where, unlike the gradual erosion of inflation, huge amounts of capital are destroyed, which brings us neatly to the next way the government can influence the market.

Bailouts - After the financial crisis from 2008-2010, it is no secret that the U.S. government is willing to bailout industries that have gotten themselves into problems. Truth be told, this fact was known even before the crisis. The savings and loan crisis of 1989 was eerily similar to the bank bailout of 2008, but the government even has a history of saving non-financial companies like Chrysler (1980), Penn Central Railroad (1970) and Lockheed (1971). Unlike the direct investment under Troubled Asset Relief Program (TARP), these bailouts came in the form of loan guarantees.

Bailouts can skew the market by changing the rules to allow poorly run companies to survive. Often, these bailouts can hurt shareholders of the rescued company and/or the company's lenders. In normal market conditions, these firms would go out of business and see their assets sold to more efficient firms in order to pay creditors and - if possible - shareholders. Fortunately, the government only uses its ability to protect the most systemically important industries like banks, insurers, airlines and car manufacturers.

Subsidies and Tariffs - Subsidies and tariffs are essentially the same thing from the perspective of the taxpayer. In the case of a subsidy, the government taxes the general public and gives the money to a chosen industry to make it more profitable. In the case of a tariff, the government applies taxes to foreign products to make them more expensive, allowing the domestic suppliers to charge more for their product. Both of these actions have a direct impact on the market.

Government support of an industry is a powerful incentive for banks and other financial institutions to give those industries favorable terms. This preferential treatment from government and financing means that more capital and resources will be spent in that industry, and even if the only competitive advantage it has is government support. This resource drain affects other, more globally competitive industries that now have to work harder to gain access to capital. This effect can be more pronounced when the government acts as the main client for certain industries, leading to the well-known examples of over-charging contractors and chronically delayed projects. (Everything you need to know - from the different types of tariffs to their effects on the local economy,)

Regulations and Corporate Tax - The business world rarely complains about bailouts and preferential treatment to certain industries, perhaps because they all harbor a secret hope of getting some. When it comes to regulations and tax, however, they howl - and not unjustly. What subsidies and tariffs can give to an industry in the form of a comparative advantage, regulation and tax can take away from many more.

Lee Iacocca was the CEO of Chrysler during its original bailout. In his book, "Iacocca: An Autobiography," Iacocca points at the higher costs of ever-increasing safety regulations as one of the main reasons Chrysler needed the bailout. This trend can be seen in many industries. As the regulations increase, smaller providers get squeezed out by the economies of scale the larger companies enjoy. The end result is a highly-regulated industry with a few large companies that are necessarily intertwined with the government.

High taxes on corporate profits have a different effect in that they discourage companies from coming into the country. Just as states with low taxes can lure away companies from their neighbors, countries that tax less will tend to attract any corporations that are mobile. Worse yet, the companies that can't move end up paying the higher tax and are at a competitive disadvantage in business as well as for attracting investor capital.

The Bottom Line - Governments may be the most terrifying figures in the financial world. With a single regulation, subsidy or switch of the printing press, they can send shockwaves around the world and destroy companies and whole industries. For this reason, Fisher, Price and many other famous investors considered legislative risk as a huge factor when evaluating stocks. A great investment can turn out to be not that great when the government it operates under is taken into consideration.

### International Trade and Foreign Direct Investment

**What Is International Trade Theory?**

**What Is 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.

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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?**

main historical theories are called classical and are from the perspective of a country, or country-based. By the mid-twentieth century, the theo-
ries 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.

### 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 its 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.

#### Absolute Advantage

In 1776, Adam Smith questioned the leading mercantile theory of the time in *The Wealth of Nations*. Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (London: W. Strahan and T. Cadell, 1776). Recent versions have been edited by scholars and economists. Smith offered a new trade theory called absolute advantage, which focused on the ability of a country to produce a good more efficiently than another nation. Smith reasoned that trade between countries shouldn't be regulated or restricted by government policy or intervention. He stated that trade should flow naturally according to market forces. In a hypothetical two-country world, if Country A could produce a good cheaper or faster (or both) than Country B, then Country A had the advantage and could focus on specializing on producing that good. Similarly, if Country B was better at producing another good, it could focus on specialization as well. By specialization, countries would generate efficiencies, because their labor force would become more skilled by doing the same tasks. Production would also become more efficient, because there would be an incentive to create faster and better production methods to increase the specialization.

Smith’s theory reasoned that with increased efficiencies, people in both countries would benefit and trade should be encouraged. His theory stated that a nation’s wealth shouldn’t be judged by how much gold and silver it had but rather by the living standards of its people.

#### Comparative Advantage

The challenge to the absolute advantage theory was that some countries may be better at producing both goods and, therefore, have an advantage in many areas. In contrast, another country may not have any useful absolute advantages. To answer this challenge, David Ricardo, an English economist, introduced the theory of comparative advantage in 1817. Ricardo reasoned that even if Country A had the absolute advantage in the production of both products, specialization and trade could still occur between two countries.

Comparative advantage occurs when a country cannot produce a product more efficiently than the other country; however, it can produce that product better and more efficiently than it does other goods. The difference between these two theories is subtle. Comparative advantage focuses on the relative productivity differences, whereas absolute advantage looks at the absolute productivity.

Let’s look at a simplified hypothetical example to illustrate the subtle difference between these principles. Miranda is a Wall Street lawyer who charges $500 per hour for her legal services. It turns out that Miranda can also type faster than the administrative assistants in her office, who are paid $40 per hour. Even though Miranda clearly has the absolute advantage in both skill sets, should she do both jobs? No. For every hour Miranda decides to type instead of do legal work, she would be giving up $460 in income. Her productivity and income will be higher if she specializes in the higher-paid legal services and hires the most qualified administrative assistant, who can type fast, although a little slower than Miranda. By having both Miranda and her assistant concentrate on their respective tasks, their overall productivity as a team is higher. This is comparative advantage. A person or a country will specialize in doing what they do relatively better. In reality, the world economy is more complex and consists of more than two countries and products. Barriers to
trade may exist, and goods must be transported, stored, and distributed. However, this simplistic example demonstrates the basis of the comparative advantage theory.

**Heckscher-Ohlin Theory (Factor Proportions Theory)**
The theories of Smith and Ricardo didn’t help countries determine which products would give a country an advantage. Both theories assumed that free and open markets would lead countries and producers to determine which goods they could produce more efficiently. In the early 1900s, two Swedish economists, Eli Heckscher and Bertil Ohlin, focused their attention on how a country could gain comparative advantage by producing products that utilized factors that were in abundance in the country. Their theory is based on a country’s production factors—land, labor, and capital, which provide the funds for investment in plants and equipment. They determined that the cost of any factor or resource was a function of supply and demand. Factors that were in great supply relative to demand would be cheaper; factors in great demand relative to supply would be more expensive. Their theory, also called the factor proportions theory, stated that countries would produce and export goods that required resources or factors that were in great supply and, therefore, cheaper production factors. In contrast, countries would import goods that required resources that were in short supply, but higher demand.

For example, China and India are home to cheap, large pools of labor. Hence these countries have become the optimal locations for labor-intensive industries like textiles and garments.

**Modern or Firm-Based Trade Theories**
In contrast to classical, country-based trade theories, the category of modern, firm-based theories emerged after World War II and was developed in large part by business school professors, not economists. The firm-based theories evolved with the growth of the multinational company (MNC). The country-based theories couldn’t adequately address the expansion of either MNCs or intrade industry trade, which refers to trade between two countries of goods produced in the same industry. For example, Japan exports Toyota vehicles to Germany and imports Mercedes-Benz automobiles from Germany.

Unlike the country-based theories, firm-based theories incorporate other product and service factors, including brand and customer loyalty, technology, and quality, into the understanding of trade flows.

**Country Similarity Theory**
Swedish economist Steffan Linder developed the country similarity theory in 1961, as he tried to explain the concept of intradustry trade. Linder’s theory proposed that consumers in countries that are in the same or similar stage of development would have similar preferences. In this firm-based theory, Linder suggested that companies first produce for domestic consumption. When they explore exporting, the companies often find that markets that look similar to their domestic one, in terms of customer preferences, offer the most potential for success. Linder’s country similarity theory then states that most trade in manufactured goods will be between countries with similar per capita incomes, and intraindustry trade will be common. This theory is often most useful in understanding trade in goods where brand names and product reputations are important factors in the buyers’ decision-making and purchasing processes.

**Product Life Cycle Theory**
Raymond Vernon, a Harvard Business School professor, developed the product life cycle theory in the 1960s. The theory, originating in the field of marketing, stated that a product life cycle has three distinct stages: (1) new product, (2) maturing product, and (3) standardized product. The theory assumed that production of the new product will occur completely in the home country of its innovation. In the 1960s this was a useful theory to explain the manufacturing success of the United States. US manufacturing was the globally dominant producer in many industries after World War II.

It has also been used to describe how the personal computer (PC) went through its product cycle. The PC was a new product in the 1970s and developed into a mature product during the 1980s and 1990s. Today, the PC is in the standardized product stage, and the majority of manufacturing and production process is done in low-cost countries in Asia and Mexico.

The product life cycle theory has been less able to explain current trade patterns where innovation and manufacturing occur around the world. For example, global companies even conduct research and development in developing markets where highly skilled labor and facilities are usually cheaper. Even though research and development is typically associated with the first or new product stage and therefore completed in the home country, these developing or emerging-market countries, such as India and China, offer both highly skilled labor and new research facilities at a substantial cost advantage for global firms.

**Global Strategic Rivalry Theory**
Global strategic rivalry theory emerged in the 1980s and was based on the work of economists Paul Krugman and Kelvin Lancaster. Their theory focused on MNCs and their efforts to gain a competitive advantage against other global firms in their industry. Firms will encounter global competition in their industries and in order to prosper, they must develop competitive advantages. The critical ways that firms can obtain a sustainable competitive advantage are called the barriers to entry for that industry. The barriers to entry refer to the obstacles a new firm may face when trying to enter into an industry or new market. The barriers to entry that corporations may seek to optimize include:

- research and development,
- the ownership of intellectual property rights,
- economies of scale,
- unique business processes or methods as well as extensive experience in the industry, and
- the control of resources or favorable access to raw materials.

**Porter’s National Competitive Advantage Theory**
In the continuing evolution of international trade theories, Michael Porter of Harvard Business School developed a new model to explain national competitive advantage in 1990. Porter’s theory stated that a nation’s competitiveness in an industry depends on the capacity of
the industry to innovate and upgrade. His theory focused on explaining why some nations are more competitive in certain industries. To explain his theory, Porter identified four determinants that he linked together. The four determinants are (1) local market resources and capabilities, (2) local market demand conditions, (3) local suppliers and complementary industries, and (4) local firm characteristics.

1. **Local market resources and capabilities (factor conditions).** Porter recognized the value of the factor proportions theory, which considers a nation’s resources (e.g., natural resources and available labor) as key factors in determining what products a country will import or export. Porter added to these basic factors a new list of advanced factors, which he defined as skilled labor, investments in education, technology, and infrastructure. He perceived these advanced factors as providing a country with a sustainable competitive advantage.

2. **Local market demand conditions.** Porter believed that a sophisticated home market is critical to ensuring ongoing innovation, thereby creating a sustainable competitive advantage. Companies whose domestic markets are sophisticated, trendsetting, and demanding forces continuous innovation and the development of new products and technologies. Many sources credit the demanding US consumer with forcing US software companies to continuously innovate, thus creating a sustainable competitive advantage in software products and services.

3. **Local suppliers and complementary industries.** To remain competitive, large global firms benefit from having strong, efficient supporting and related industries to provide the inputs required by the industry. Certain industries cluster geographically, which provides efficiencies and productivity.

4. **Local firm characteristics.** Local firm characteristics include firm strategy, industry structure, and industry rivalry. Local strategy affects a firm’s competitiveness. A healthy level of rivalry between local firms will spur innovation and competitiveness. In addition to the four determinants of the diamond, Porter also noted that government and chance play a part in the national competitiveness of industries. Governments can, by their actions and policies, increase the competitiveness of firms and occasionally entire industries.

Porter’s theory, along with the other modern, firm-based theories, offers an interesting interpretation of international trade trends. Nevertheless, they remain relatively new and minimally tested theories.

**Which Trade Theory Is Dominant Today?**

The theories covered in this chapter are simply that—theories. While they have helped economists, governments, and businesses better understand international trade and how to promote, regulate, and manage it, these theories are occasionally contradicted by real-world events. Countries don’t have absolute advantages in many areas of production or services and, in fact, the factors of production aren’t neatly distributed between countries. Some countries have a disproportionate benefit of some factors. The United States has ample arable land that can be used for a wide range of agricultural products. It also has extensive access to capital. While its labor pool may not be the cheapest, it is among the best educated in the world. These advantages in the factors of production have helped the United States become the largest and richest economy in the world. Nevertheless, the United States also imports a vast amount of goods and services, as US consumers use their wealth to purchase what they need and want—much of which is now manufactured in other countries that have sought to create their own comparative advantages through cheap labor, land, or production costs.

As a result, it’s not clear that any one theory is dominant around the world. This section has sought to highlight the basics of international trade theory to enable you to understand the realities that face global businesses. In practice, governments and companies use a combination of these theories to both interpret trends and develop strategy. Just as these theories have evolved over the past five hundred years, they will continue to change and adapt as new factors impact international trade.

**KEY TAKEAWAYS**

- **Trade is the concept of exchanging goods and services between two people or entities.** International trade is the concept of this exchange between people or entities in two different countries. While a simplistic definition, the factors that impact trade are complex, and economists throughout the centuries have attempted to interpret trends and factors through the evolution of trade theories.

- **There are two main categories of international trade—classical, country-based and modern, firm-based.**

- **Porter’s theory states that a nation’s competitiveness in an industry depends on the capacity of the industry to innovate and upgrade.** He identified four key determinants: (1) local market resources and capabilities (factor conditions), (2) local market demand conditions, (3) local suppliers and complementary industries, and (4) local firm characteristics.

**INTERDEPENDENCE**

**Interdependence** is the mutual reliance between two or more groups. This concept differs from the reliance in a dependent relationship, where some members are dependent and some are not. There can be various degrees of interdependence.

In an interdependent relationship, participants may be emotionally, economically, ecologically and/or morally reliant on and responsible to each other. An interdependent relationship can arise between two or more cooperative autonomous participants (e.g. a co-op). Some people advocate freedom or independence as the ultimate good; others do the same with devotion to one’s family, community, or society. Interdependence can be a common ground between these aspirations.

**Measuring international interdependence**

International disintegration is entirely consistent with a high degree of international interdependence. For interdependence exists when one country by unilateral action can inflict harm on (or provide benefits to) other countries. Competitive protectionism, devaluation, deflation, or pollution of the air and sea beyond national boundaries are instances.
Interdependence is measured by the costs of severing the relationship (or the benefits of developing it). The higher the costs to one country, the greater is the degree of dependence of that country. If a small country benefits more from the international division of labor than a large country, its dependence is greater. If both partners to a transaction were to incur high costs from severing economic links, there would be interdependence.

**Role of interdependence in feminist philosophy**
In the *ethics of care* approach to morality, *Neil Noddings* emphasizes the interdependence of people. She saw it as a hidden fact not often seen or discussed in male-dominated, justice-based, and judgment-based approaches to ethics. *Carol Gilligan* was an early proponent of the view that interdependence, rather than rules, underlay the basis of morality.

**Interdependencies in organizational structures**
There is a view that computer technology has allowed greater communication, interaction and interdependence. It is thought that this has massively helped the introduction and start up of new ideas and enterprises. This is supported by the work of *Stephen Covey*. Covey maintains that we function best as innovators when we recognise, and work towards, the role of interdependence.

In business people and departments must rely on one another to share information, financial resources, equipment and more, making interpersonal communication highly valuable to a company and oneself in order for a successful outcome.

Interdependencies exist when actions in one sub-unit of the *organization* affect important outcomes in another sub-unit. In a *business* or *firm* this can occur for example in terms of *product quality*, *product cost* and *customer satisfaction*.

According to the definition of *complexity* by Eppinger, interdependencies increase organizational *complexity*. He illustrated this by means of a *design structure matrix*. The reason Eppinger gives for increased complexity is that many cross-unit interdependencies require frequent coordination and *information exchange*. Managers of sub-units need to manage these interdependencies.

**Four levels of interdependence in organizational structure**

*Pooled interdependence* is the lowest form of interdependence resulting in the least amount of conflict. Departments do not directly depend or interact with one another, however they do draw resources from a shared source. Every separate department contributes to an overall goal, the outputs of each department are then pooled at an organizational level. Although the success and failure of each department do not directly affect one another, it does affect the overall success of the company therefore indirectly affecting one another.

Pooled interdependence requires standardization in rules and operating procedures. An example of pooled interdependence is the clothing retail store The Gap. Each store acts as its own separate department with its own resources (operating budget, staff, etc.) While each store rarely interacts with one another, the success or failure of each store affects the company overall, which then affects each individual store.

*Sequential interdependence* is an asymmetrical chain of one way interactions. The output of one unit become the input for another unit. There is an increase in communication increasing the potential for conflict. People in the early part of the chain would remain more independent but the people in the latter part of the chain would be highly dependent on the first part. A major concern would be performance variability in the first part of the chain because it has a direct effect on the productivity of the later parts. Managing an environment with sequential interdependence would require adaptive planning and scheduling. An example of sequential interdependence would be Nissan. The engine and other separate parts of the car are assembled in separate plants and then are shipped to one site to build the final product. If the engine plant is running behind and not shipped in time, it affects the final product being completed.

*Reciprocal interdependence* has the highest potential for conflict because it requires the most amount of communication having the output and input of activities flow both ways between units. This network of two way relationships requires departmental dependency to create a successful outcome. The direct interaction between co-workers can cause a tight interconnection causing high level of productivity or can cause a high level of conflict. Managing a reciprocal interdependent work environment would require thorough constant information sharing. An example would be the Marriott hotel. The front desk is dependent on housekeeping to provide clean rooms to guests when they arrive and housekeeping is dependent on the front desk to share the information on what rooms need to be cleaned.

*Comprehensive interdependence* is an even tighter network of reciprocal interdependence. The potential for conflicts is very high due to the complexity of the interdependence. With an increase in frequent and intense communication, and a greater duration of time spent with one another, a difference in opinions or goals is very likely. The loss or addition of a team member can greatly affect the performance of the group. An example would be a brand management firm that depends on the all the departments for information. The marketing department would need to work with product design as well as the sales department and vice versa to achieve effective and efficient productivity.

**Factors to determine the degree of work process interdependence**

• **Criticality**: For example, how large is the effect of the actions taken in the *IT* department of an organization on the important outcomes in the Engineering department?

• **Uncertainty**: This is related to both *dependability* and *ambiguity*. For example, can the Engineering department rely on the promises that the IT department has made to them? Moreover, to what level do the two departments have the same understanding of their respective roles and responsibilities?

If interdependencies are low of uncertainty and importance, then sub-units enjoy stable and isolated conditions. As uncertainty and importance increase, so does the intensity of communication and collaboration between sub-units and the possibility of conflict.

If interdependencies are very high in both uncertainty and importance, then they are likely to produce chaotic situations.

**Managing work process interdependencies between sub-units**

There are four options to manage interdependencies between sub-units.

1. Eliminate an interdependency
2. Add a new interdependency
3. Change the degree of an interdependency between sub-units by altering its uncertainty and/or criticality. Hereby, the need for coordination is reduced.

4. Introduce coordination mechanisms, such as phone calls, fax, emails, occasional meetings, regular meetings, committees, liaison officers or integration managers, and cross-functional teams.

Usually, the main advice for handling an interdependency has been to introduce a coordination mechanism. The right coordination mechanism needs to be chosen depending on the degree of criticality and uncertainty.

- Interdependencies that are relatively low in criticality and uncertainty, only require managers of the respective sub-units to exchange information (e.g., via email or phone).
- Interdependencies that are considered at least moderately critical and uncertain may require managers of sub-units to meet regularly to coordinate between them. Moreover, an integrator role (or liaison) can be created by making one employee responsible for coordinating work between the two sub-units.
- Higher degrees of interdependency may require more extensive integration.

**Types of interdependencies**

1. Activity interdependencies
2. Commitment interdependencies
3. Resource interdependencies
4. Governance interdependencies
5. Social network interdependencies

**Activity interdependencies**

- Are inherent to the actions between sub-units.
- Are inherent to the degree of physical input from or between sub-units or the need for information.
- **Criticality**: whether or not the activity interdependency is critical, can be established by measuring the effect of removing the interdependency on the performance of the sub-unit: if, for example, its performance drops heavily when specific information is withheld, criticality could be considered high.
- **Uncertainty**: whether or not it is likely for sub-units to deliver data, goods or services and its accuracy thereof, indicates the uncertainty.

**Steps to describe them**

1. Describe the various tasks or actions involved in a specific work process.
2. Put in a flow chart the routing of information among sub-units.

**Managing activity interdependencies**

- Adding interdependencies. Example: weekly reports by one sub-unit to another.
- Removing interdependencies, which is the principle of **modularity** as proposed by Baldwin and Clark. EG: making use of standard interfaces.

**Commitment interdependencies**

- To commit to a contract between sub-units is key for a commitment interdependency (eg, a contract of purchase between suppliers and clients).
- Use of contracts like spot, classical and relational contracts.
- Commitments are established by negotiations in an ongoing, authorizing process.
- **Criticality**: high when interdependency has a direct and significant impact on key work outcomes that a sub-unit is responsible for.
- **Uncertainty**: low (for the client) when a supplier faces and accepts consequential accountability for delivering a product or service.

**Managing commitment interdependencies**

- Consequential accountability (“no cure no pay”).
- Reducing ambiguity with more detailed **service-level agreements** and contracts.
- Clarifying upstream dependencies.
- Specifying interdependencies (“who owes what to whom”) is complicated.

**Governance interdependencies**

- Concerns interdependencies related to authority relations in organizations.
- Arise because of a need for formal approval of a sub-unit’s plans or activities by some party or because of a requirement to conduct an activity in conformance with a policy set by superiors.
- **Criticality**: whether or not a sub-unit’s governance interdependency is critical, depends on the potential effects of decisions made by other sub-units on the work process of the sub-unit.
- **Uncertainty**: the level of uncertainty of a governance interdependency is indicated by its degree of stability and ambiguity.

**Managing governance interdependencies**

It is possible that there are either too few (underrepresentation) or too many interdependencies (micromanagement – loss of autonomy). The strategies that are then to be undertaken are:

- Clearly define roles and responsibilities, since often in large organizations it is not clear who is responsible for making decisions or solving key business problems.
- Make sure that adequate representation is guaranteed.
- Make sure that governance maintains or increases trust.

**Resource interdependencies**

- Exist within the transaction of resources between units or when units share their resources. Example: financial resource budgeting.
- Are mostly based on financial resources, but can also be based on knowledge, human resources, equipment, etc.
- **Criticality**: whether or not a resource interdependency is critical, depends on the percentage of a sub-unit’s contribution to another sub-unit’s total resources.
Why Economic Dependence on Others Is a Good Thing

In public policy discussions, the words independence and dependence make frequent appearances. Given that American political ideology has in many ways been defined by the Declaration of Independence, Americans naturally think of independence as good and dependence as bad. As a consequence, arguments to implement government policies to reduce our dependence on others — dependence on “foreign oil” being the most common current manifestation — often find a receptive audience.

Unfortunately, our understanding of dependence and independence in political and economic contexts is confused.

Economic Dependence Is Limited by the Availability of Other Choices - Economic dependence is not the same as political dependence. Say that you wanted to buy widgets and sell them in your store. Assume that the best offer you received to supply the widgets was $3, and the next best offer was $5. The freedom to choose the lower-cost option is economic independence. Which ever supplier you choose, you become economically dependent on that supplier, in this case, the lower-cost supplier. Let’s say the supplier of the $5 widget has a sterling reputation for delivering quality widgets, and on time. But you choose the supplier with the $3 widget, taking the risk that the supply of widgets won’t be interrupted, the cost won’t change, or he stops selling to you altogether. You become dependent on that seller’s choices (concerning his own business operations), and his continued willingness to sell to you at the original price. The potential harm or risk to you is the $2 difference between the best offer and the next best offer.

In other words, economic independence — the power to choose among offers — will typically coincide with you becoming dependent, to some degree, on the exchange partner you choose. In this case, you accept the risk that you could be harmed by changes to the original agreement (a willing offer).

It is important, however, to understand the limits on potential harm. When arrangements are voluntary, the availability of other willing offers places an upper limit on damages from dependence on a particular trading partner. In our example, if $3 widgets disappear, you can turn to the seller of $5 widgets. Thanks to economic independence, an alternative is available, and the harm has been limited to that $2 difference between the two types of widgets. To that extent, the potential “damage” is the extent to which the current gains you are making from a partnership — relative to your alternatives — may be reduced or eliminated in the future. If one remains free to choose among competitors, however, the availability of voluntary arrangements with others (i.e., competitors) guarantees that there will be no “harm” beyond that.

Political Dependence Is Not About Choice, But Coercion - Dependence on government stands in sharp contrast to economic dependence. Since governments have the power to coerce you, they can take away options that others would willingly offer you. And not only can they take away the best options you have, they can also take away the alternatives that would protect you from harm in voluntary arrangements. That is, they can take away everything. As Barry Goldwater memorably put it, “A government big enough to give you everything you want is big enough to take everything you have.”

Dependence Is Fine, If Voluntary - So given that economic independence is perfectly consistent with voluntary dependence on trading partners who benefit us the most, the important choice is not between independence and dependence. The real choice we face is between the dependence that results from voluntary arrangement and the dependence that results from government control.

Oil Independence and Other Fallacies - It is also important to note that dependence arguments, such as “reducing our dependence on foreign oil,” are generally misleading excuses for imposing political restrictions that harm citizens. For example, protectionism that is sold as a choice between “good” American producers and “evil” foreigners ignores the fact that we deal with those foreigners because they make us better off than our domestic alternatives. And taking those superior options away can seriously harm Americans. A better way to view the results of this argument is as a conspiracy between American producers and the American government to harm American consumers and the foreign suppliers that most benefit them.

Finally, we must question the way dependence arguments are usually framed — as if it is never a problem to depend on other Americans, but always at least a potential problem to depend on foreigners. Do we really trust other Americans that much? If so, why do we have so
many laws and prisons to deter our neighbors from harming us? The fact is, the best thing we can do to facilitate trust in our domestic neighbors is denying them the ability to coerce us. But that same defense of our self-ownership would equally allow us to trust non-American trading partners, as well. In contrast, the damaging power of government coercion that is repeatedly employed in the service of some, while necessarily harming others, puts us almost totally at our rulers’ mercy, while giving us very little reason to trust them.

**Cross-national cooperation and agreements**

Integration is a political and economic agreement among countries that gives preference to member countries to the agreement. General integration can be achieved in three different approachable ways: through the World Trade Organization (WTO), bilateral integration, and regional integration. In bilateral integration, only two countries economically cooperate with one and other; whereas in regional integration, several countries within the same geographic distance become joint to form organizations such as the European Union (EU) and the North American Free Trade Agreement (NAFTA). Indeed, factors of mobility like capital, technology and labour are indicating strategies for cross-national integration along with those mentioned above.

**The World Trade Organization**

The WTO is one of the most effective trade agreements among nations. The WTO replaced the General Agreement on Tariffs and Trade (GATT) in 1995 and has 125 member nations. Currently 153 member are part of WTO. Many believe GATT initiated rampant liberalization in trade in 1947 and its move contributed to the expansion of trade all over the world by eliminating tariff and quotas. Moreover, WTO continued GATT’s principle with more multilateral forum, which enables governments to settle agreements or to dispute them regarding trade.

Rapid growth of trade among nations has forced the agreement to be acknowledged as a fundamental basis for the member nations to follow certain rules and regulations as the signatories of the agreement. As a result, WTO expanded its mission to include trade in services, investments, intellectual property, sanitary measures, plant health, agriculture, and textiles, as well as technical barriers to trade.

**The European Union (EU)**

The largest and most comprehensive regional economic group is the EU. It began as a free trade agreement with the goal to become a customs union and to integrate in other ways. The formation of the European Parliament and the establishment of a Euro the common currency make EU the most ambitious in comparison to other regional trade groups. It progressed from being the European Economic Community (EEC) to the European Community (EC) to finally the European Union. Iceland, Liechtenstein, Norway, and Switzerland who decided not to leave European Free Trade Area are linked together with the EU as a customs union. The EU comprises 28 countries, including 12 countries from mostly Central and Eastern Europe that joined since 2004. The EU abolished trade barriers on intra-zonal trade, instituted a common external tariff, created a common currency, the euro.

**The implications of the EU for corporate strategy are:**

- Companies need to determine where to produce products.
- Companies need to balance the commonness of the EU with national differences.

**North American Free Trade Agreement (NAFTA)**

NAFTA is designed to eliminate tariffs and liberalize investment opportunities and trade in services. NAFTA includes Canada, Mexico, and the United States, where went into effect in 1994. The United States and Canada historically have had various forms of mutual economic cooperation. They signed the Canada-United States Free Trade Agreement effective January 1, 1989, which eliminated all tariffs on bilateral trade by January 1, 1998. In February 1991, Mexico approached the United States to establish a free trade agreement. The formal negotiations that began in June 1991 included Canada. The resulting North American Free Trade Agreement became effective on January 1, 1994.

**The main provisions in NAFTA are:**

- the harmonization of trade rules,
- the liberalization of restrictions on services and foreign investment,
- the enforcement of intellectual property rights,
- a dispute settlement process,
- regional labor laws and standards, and
- strengthened environmental stand

**Regional economic integration in the Americas**

There are six major regional economic groups in the Americas and they can be further divided into Central America and South America. The major reason for these different groups in Central and South America entering into collaboration was market size. The Caribbean Community and Common Market (CARICOM) and the Central American Common Market (CACM) are both found in Central America. The two major blocs in South America are the Andean Community (CAN) and the Southern Common Market (MERCOSUR) which is the major trade group. MERCOSUR comprises Brazil, Argentina, Paraguay, and Uruguay. It generates 75 percent of South America’s GDP and this makes MERCOSUR the fourth largest trading bloc in the world after the EU, NAFTA, and the Association of Southeast Asian Nations (ASEAN).

Since August 23, 2008, there exists another integration initiative, the Union of South American Nations (UNASUR). It includes all independent states of South America with about 400 Million people and intends to create a level of integration similar to the European Union by 2025.

**Regional economic integration in Asia**

Regional economic integration has not been as successful in Asia as in the EU or NAFTA because most Asian countries have relied on U.S. and European markets for their exports. The Association of Southeast Asian Nations (ASEAN), formed in 1967, consisted of the following countries: Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam. The ASEAN Free Trade
Regional economic integration in Africa - There are several regional trade groups in Africa that are registered with the WTO, including:
- the Southern Africa Development Community (SADC),
- the Common Market for Eastern and Southern Africa (COMESA),
- the Economic and Monetary Community of Central Africa (CEMAC),
- the West African Economic and Monetary Union (WAEMU).

Created in 2002 by 53 African nations, the African Union took the place of the Organization of African Unity (OAU). The OAU was established in 1963 and focuses its energy and resources on political issues in Africa (notably colonialism and racism) and the pursuit of market liberalization and economic growth in Africa.

### The Basics Of Tariffs And Trade Barriers

International trade increases the number of goods that domestic consumers can choose from, decreases the cost of those goods through increased competition, and allows domestic industries to ship their products abroad. While all of these seem beneficial, free trade isn’t widely accepted as completely beneficial to all parties. This article will examine why this is the case, and look at how countries react to the variety of factors that attempt to influence trade. (To start with a discussion on trade,

What is a Tariff?

In simplest terms, a tariff is a tax. It adds to the cost of imported goods and is one of several trade policies that a country can enact.

Why Are Tariffs and Trade Barriers Used?

Tariffs are often created to protect infant industries and developing economies, but are also used by more advanced economies with developed industries. Here are five of the top reasons tariffs are used:

1. **Protecting Domestic Employment** - The levying of tariffs is often highly politicized. The possibility of increased competition from imported goods can threaten domestic industries. These domestic companies may fire workers or shift production abroad to cut costs, which means higher unemployment and a less happy electorate. The unemployment argument often shifts to domestic industries complaining about cheap foreign labour, and how poor working conditions and lack of regulation allow foreign companies to produce goods more cheaply. In economics, however, countries will continue to produce goods until they no longer have a comparative advantage (not to be confused with an absolute advantage).

2. **Protecting Consumers** – A government may levy a tariff on products that it feels could endanger its population. For example, South Korea may place a tariff on imported beef from the United States if it thinks that the goods could be tainted with disease.

3. **Infant Industries** - The use of tariffs to protect infant industries can be seen by the Import Substitution Industrialization (ISI) strategy employed by many developing nations. The government of a developing economy will levy tariffs on imported goods in industries in which it wants to foster growth. This increases the prices of imported goods and creates a domestic market for domestically produced goods, while protecting those industries from being forced out by more competitive pricing. It decreases unemployment and allows developing countries to shift from agricultural products to finished goods.

Criticisms of this sort of protectionist strategy revolve around the cost of subsidizing the development of infant industries. If an industry develops without competition, it could wind up producing lower quality goods, and the subsidies required to keep the state-backed industry afloat could sap economic growth.

4. **National Security** - Barriers are also employed by developed countries to protect certain industries that are deemed strategically important, such as those supporting national security. Defence industries are often viewed as vital to state interests, and often enjoy significant levels of protection. For example, while both Western Europe and the United States are industrialized, both are very protective of defense-oriented companies.

5. **Retaliation** - Countries may also set tariffs as a retaliation technique if they think that a trading partner has not played by the rules. For example, if France believes that the United States has allowed its wine producers to call its domestically produced sparkling wines "Champagne" (a name specific to the Champagne region of France) for too long, it may levy a tariff on imported meat from the United States. If the U.S. agrees to crack down on the improper labeling, France is likely to stop its retaliation. Retaliation can also be employed if a trading partner goes against the government’s foreign policy objectives.

### Types of Tariffs and Trade Barriers

There are several types of tariffs and barriers that a government can employ:

- **Specific tariffs**
- **Licenses**
- **Voluntary export restraints**
- **Import quotas**
- **Local content requirements**

**Specific Tariffs** - A fixed fee levied on one unit of an imported good is referred to as a specific tariff. This tariff can vary according to the type of good imported. For example, a country could levy a $15 tariff on each pair of shoes imported, but levy a $300 tariff on each computer imported.

**Ad Valorem Tariffs** - The phrase ad valorem is Latin for "according to value", and this type of tariff is levied on a good based on a percentage of that good’s value. An example of an ad valorem tariff would be a 15% tariff levied by Japan on U.S. automobiles. The 15% is a price increase on the value of the automobile, so a $10,000 vehicle now costs $11,500 to Japanese consumers. This price increase protects domestic producers from being undercut, but also keeps prices artificially high for Japanese car shoppers.
Non-tariff barriers to trade include:

**Licenses** - A license is granted to a business by the government, and allows the business to import a certain type of good into the country. For example, there could be a restriction on imported cheese, and licenses would be granted to certain companies allowing them to act as importers. This creates a restriction on competition, and increases prices faced by consumers.

**Import Quotas** - An import quota is a restriction placed on the amount of a particular good that can be imported. This sort of barrier is often associated with the issuance of licenses. For example, a country may place a quota on the volume of imported citrus fruit that is allowed.

**Voluntary Export Restraints (VER)** - This type of trade barrier is "voluntary" in that it is created by the exporting country rather than the importing one. A voluntary export restraint is usually levied at the behest of the importing country, and could be accompanied by a reciprocal VER. For example, Brazil could place a VER on the exportation of sugar to Canada, based on a request by Canada. Canada could then place a VER on the exportation of coal to Brazil. This increases the price of both coal and sugar, but protects the domestic industries.

**Local Content Requirement** - Instead of placing a quota on the number of goods that can be imported, the government can require that a certain percentage of a good be made domestically. The restriction can be a percentage of the good itself, or a percentage of the value of the good. For example, a restriction on the import of computers might say that 25% of the pieces used to make the computer are made domestically, or can say that 15% of the value of the good must come from domestically produced components.

In the final section we'll examine who benefits from tariffs and how they affect the price of goods.

### Non-tariff barriers to trade

**Non-tariff barriers to trade (NTBs) or sometimes called "Non-Tariff Measures (NTMs)"** are trade barriers that restrict imports or exports of goods or services through mechanisms other than the simple imposition of tariffs. The SADC says, "a Non-Tariff Barrier is any obstacle to international trade that is not an import or export duty. They may take the form of import quotas, subsidies, customs delays, technical barriers, or other systems preventing or impeding trade." According to the World Trade Organisation, non-tariff barriers to trade include import licensing, rules for valuation of goods at customs, pre-shipment inspections, rules of origin (‘made in’), and trade prepared investment measures.

### Types of Non-Tariff Barriers

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

**Quotas** - Licensing of foreign trade is closely related to quantitative restrictions – quotas - on imports and exports of certain goods. A quota is a limitation in value or in physical terms, imposed on import and export of certain goods for a certain period of time. This category includes global quotas in respect to specific countries, seasonal quotas, and so-called "voluntary" export restraints. Quantitative controls on foreign trade transactions carried out under one-time licenses.

Quantitative restriction on imports and exports is a direct administrative form of government regulation of foreign trade. Licenses and quotas limit the independence of enterprises with a regard to entering foreign markets, narrowing the range of countries, which may be entered into transaction for certain commodities, regulate the number and range of goods permitted for import and export. However, the system of licensing and quota imports and exports, establishing firm control over foreign trade in certain goods, in many cases turns out to be more flexible and effective than economic instruments of foreign trade regulation. This can be explained by the fact, that licensing and quota systems are an important instrument of trade regulation of the vast majority of the world.

The consequence of this trade barrier is normally reflected in the consumers’ loss because of higher prices and limited selection of goods as well as in the companies that employ the imported materials in the production process, increasing their costs. An import quota can be unilateral, levied by the country without negotiations with exporting country, and bilateral or multilateral, when it is imposed after negotiations and agreement with exporting country. An export quota is a restricted amount of goods that can leave the country. There are different reasons for imposing of export quota by the country, which can be the guarantee of the supply of the products that are in shortage in the domestic market, manipulation of the prices on the international level, and the control of goods strategically important for the country. In some cases, the importing countries request exporting countries to impose voluntary export restraints.

**Agreement on a "voluntary" export restraint**

In the past decade, a widespread practice of concluding agreements on the "voluntary" export restrictions and the establishment of import minimum prices imposed by leading Western nations upon weaker in economical or political sense exporters. The specifics of these types of restrictions is the establishment of unconventional techniques when the trade barriers of importing country, are introduced at the border of the exporting and not importing country. Thus, the agreement on "voluntary" export restraints is imposed on the exporter under the threat of sanctions to limit the export of certain goods in the importing country. Similarly, the establishment of minimum import prices should be strictly observed by the exporting firms in contracts with the importers of the country that has set such prices. In the case of reduction of export prices below the minimum level, the importing country imposes anti-dumping duty, which could lead to
withdrawal from the market. “Voluntary” export agreements affect trade in textiles, footwear, dairy products, consumer electronics, cars, machine tools, etc.

Problems arise when the quotas are distributed between countries because it is necessary to ensure that products from one country are not diverted in violation of quotas set out in second country. Import quotas are not necessarily designed to protect domestic producers. For example, Japan, maintains quotas on many agricultural products it does not produce. Quotas on imports is a leverage when negotiating the sales of Japanese exports, as well as avoiding excessive dependence on any other country in respect of necessary food, supplies of which may decrease in case of bad weather or political conditions.

Export quotas can be set in order to provide domestic consumers with sufficient stocks of goods at low prices, to prevent the depletion of natural resources, as well as to increase export prices by restricting supply to foreign markets. Such restrictions (through agreements on various types of goods) allow producing countries to use quotas for such commodities as coffee and oil; as the result, prices for these products increased in importing countries.

A quota can be a tariff rate quota, global quota, discriminating quota, and export quota.

**Embargo** - Embargo is a specific type of quotas prohibiting the trade. As well as quotas, embargoes may be imposed on imports or exports of particular goods, regardless of destination, in respect of certain goods supplied to specific countries, or in respect of all goods shipped to certain countries. Although the embargo is usually introduced for political purposes, the consequences, in essence, could be economic.

**Standards** - Standards take a special place among non-tariff barriers. Countries usually impose standards on classification, labeling and testing of products in order to be able to sell domestic products, but also to block sales of products of foreign manufacture. These standards are sometimes entered under the pretext of protecting the safety and health of local populations.

**Administrative and bureaucratic delays at the entrance**

Among the methods of non-tariff regulation should be mentioned administrative and bureaucratic delays at the entrance, which increase uncertainty and the cost of maintaining inventory.

**Import deposits** - Another example of foreign trade regulations is import deposits. Import deposits is a form of deposit, which the importer must pay the bank for a definite period of time (non-interest bearing deposit) in an amount equal to all or part of the cost of imported goods.

At the national level, administrative regulation of capital movements is carried out mainly within a framework of bilateral agreements, which include a clear definition of the legal regime, the procedure for the admission of investments and investors. It is determined by mode (fair and equitable, national, most-favored-nation), order of nationalization and compensation, transfer profits and capital repatriation and dispute resolution.

**Foreign exchange restrictions and foreign exchange controls**

Foreign exchange restrictions and foreign exchange controls occupy a special place among the non-tariff regulatory instruments of foreign economic activity. Foreign exchange restrictions constitute the regulation of transactions of residents and nonresidents with currency and other currency values. Also an important part of the mechanism of control of foreign economic activity is the establishment of the national currency against foreign currencies.

**Types of Non-Tariff Barriers to Trade**

1. **Specific Limitations on Trade:**
   1. Import Licensing requirements
   2. Proportion restrictions of foreign domestic goods (local content requirements)
   3. Minimum import price limits
   4. Fees
   5. **Embargoes**

2. **Customs and Administrative Entry Procedures:**
   1. Valuation systems
   2. Anti-dumping practices other than punitive tariffs
   3. Tariff classifications
   4. Documentation requirements
   5. Fees
   3. **Standards:**
      1. Standard disparities
      2. Sanitary and phytosanitary measures
      3. Intergovernmental acceptances of testing methods and standards
      4. Packaging, labeling, and marking

4. **Government Participation in Trade:**
   1. Government procurement policies
   2. Export subsidies
   3. Countervailing duties
   4. Domestic assistance programs
   5. Charges on imports:
      1. Prior import deposit subsidies
      2. Administrative fees
      3. Special supplementary duties
      4. Import credit discrimination
      5. Variable levies
   6. Border taxes
   6. **Others:**
      1. Voluntary export restraints
      2. Orderly marketing agreements

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**WTO: The World Trade Organisation: Features, Structures, Objective and Function of the WTO**

**Introduction:**

The establishment of the World Trade Organisation (WTO) as the successor to the GATT on 1 January 1995 under the Marrakesh Agreement places the global trading system on a firm constitutional footing with the evolution of international economic legislation resulted through the Uruguay Round of GATT negotiations.

A remarkable feature of the Uruguay Round was that it paved the way for further liberalisation of international trade with the fundamental shift from the negotiation approach to the institutional framework envisaged through transition from GATT to WTO Agreement.

The GATT 1947 and the WTO co-existed for the transitional period of one year in 1994. In January 1995, however, the WTO completely replaced the GATT. The membership of the WTO increased from 77 in 1995 to 127 by the end of 1996.

**Features of the WTO:** The distinctive features of the WTO are:
i. Unlike the GATT, it is a legal entity.
ii. Unlike the International Monetary Fund (IMF) and the World Bank (WB) it is not an agent of the United Nations.
iii. Unlike the IMF and the World Bank, there is no weighted voting, but all the WTO members have equal rights.
iv. Unlike the GATT, the agreements under the WTO are permanent and binding to the member countries.
v. Unlike the GATT, the WTO dispute settlement system is based on dilatory but automatic mechanism. It is also quicker and binding on the members. As such, the WTO is a powerful body.
vi. Unlike the GATT, the WTOs approach is rule-based and time-bound.
vii. Unlike the GATT, the WTOs have a wider coverage. It covers trade in goods as well as services.
viii. Unlike the GATT, the WTOs have a focus on trade-related aspects of intellectual property rights and several other issues of agreements.
ix. Above all, the WTO is a huge organisational body with a large secretariat.

Structure of the WTO: The Ministerial Conference (MC) is at the top of the structural organisation of the WTO. It is the supreme governing body which takes ultimate decisions on all matters. It is constituted by representatives of (usually, Ministers of Trade) all the member countries.

The General Council (GC) is composed of the representatives of all the members. It is the real engine of the WTO which acts on behalf of the MC. It also acts as the Dispute Settlement Body as well as the Trade Policy Review Body.

There are three councils, viz.: the Council for Trade in Services and the Council for Trade-Related Aspects of Intellectual Property Rights (TRIPS) operating under the GC. These councils with their subsidiary bodies carry out their specific responsibilities.

Further, there are three committees, viz., the Committee on Trade and Development (CTD), the Committee on Balance of Payments Restrictions (CBOPR), and the Committee on Budget, Finance and Administration (CFA) which execute the functions assigned to them by the WTO Agreement and the GC.

The administration of the WTO is conducted by the Secretariat which is headed by the Director General (DG) appointed by the MC for the tenure of four years. He is assisted by the four Deputy Directors from different member countries. The annual budget estimates and financial statement of the WTO are presented by the DG to the CBFA for review and recommendations for the final approval by the GC.

Objectives of the WTO: The purposes and objectives of the WTO are spelled out in the preamble to the Marrakesh Agreement.

In a nutshell, these are:
1. To ensure the reduction of tariffs and other barriers to trade.
2. To eliminate discriminatory treatment in international trade relations.
3. To facilitate higher standards of living, full employment, a growing volume of real income and effective demand, and an increase in production and trade in goods and services of the member nations.
4. To make positive effect, which ensures developing countries, especially the least developed, secure a level of share in the growth of international trade that reflects the needs of their economic development.
5. To facilitate the optimal use of the world’s resources for sustainable development.
6. To promote an integrated, more viable and durable trading system incorporating all the resolutions of the Uruguay Round’s multilateral trade negotiations.

Above all, to ensure that linkages trade policies, environmental policies with sustainable growth and development are taken care of by the member countries in evolving a new economic order.

Functions of the WTO: The WTO consisting a multi-faceted normative framework: comprising institutional substantive and implementation aspects.

The major functions of the WTO are as follows:
1. To lay-down a substantive code of conduct aiming at reducing trade barriers including tariffs and eliminating disciplines in international trade relations.
2. To provide the institutional framework for the administration of the substantive code which encompasses a spectrum of norms governing the conduct of member countries in the arena of global trade.
3. To provide an integrated structure of the administration, thus, to facilitate the implementation, administration and fulfillment of the objectives of the WTO Agreement and other Multilateral Trade Agreements.
4. To ensure the implementation of the substantive code.
5. To act as a forum for the negotiation of further trade liberalisation.
6. To cooperate with the IMF and WB and its associates for establishing a coherence in trade policy-making.
7. To settle the trade-related disputes.

Principals of the WTO: In its broad perspective, the WTO was to strive at creating a liberal and open trading environment by which enterprises could trade under conditions of fair and undistorted competition.

Towards the achievement of this, the four principles that were laid down to guide the trading rules of its members are as follows:

i. Most Favoured Nation (MFN) Treatment: - The principle of MFN treatment laid that tariffs and regulations must be applied to imports or exports without discrimination among members. In other words, no member country was to be accorded a treatment of ‘a favoured nation’;
ii. National Treatment: - It prevents discrimination between imported products and equivalent domestically produced goods, especially in levying internal taxes and domestic regulations;
Regional Trading Arrangements: Different Levels, Features and Benefits!

Regional Trade Arrangements (RTAs) are agreements between any two or more of sovereign nations of geographical proximity for the purpose of economic and trade promotion.

Regional trade agreements (RTAs) cover more than half of international trade and operate alongside global multilateral agreements under the World Trade Organisation (WTO). The first eleven years (1995-2005) of the WTO were paralleled by a tripling of RTAs officially notified to the WTO and in force.

In other words, the different forms of economic integration between countries, across continents or within a region are known as regional trading arrangements (RTAs). There are different degrees or levels of economic integration.

With globalisation, regionalism is on the rise. This is in fact ironical and inconsistent with the spirit of multilateralism. Hence, initially, the Director General of WTO was opposed to the proliferation of regional arrangements, after WTO was launched in 1995. The number of regional trading agreements (RTAs) notified to the WTO stands at about 200.

An estimated 70 per cent of the world trade is now covered by RTAs. For instance, the Americas-North and South, all of Europe, including the transition economies of the eastern part, most of Africa, Asia, Australia and New Zealand are signatories to free trade areas, customs unions and partial scope agreements. The new trends in regionalism, however, can be accepted as a supplement to globalisation.

Features of RTAs: The major features of the RTAs are as follows:

i. Almost all RTAs show an inherent dynamism towards greater liberalisation and open market. For instance: European Union (EU) where a single market and a common currency have been introduced to strengthen internal competition and external competitiveness.

ii. The new regionalism brings with it an increase in the size of regional groupings.

iii. There is emergence of overlapping regionalism. Countries belong to more than one RTA. There is an inherent scope that these RTAs may turn the world trade system into what Jagdish Bhagwati calls a ‘noodle blow’ of overlapping and potentially inconsistent and unmanageable RTAs.

iv. In the current practice, regionalism covers many issues beyond the removal of barriers to trade in goods and services, such as social policy, environmental policy and competition policy.

v. RTAs thus exist in all regions of the world. They follow a strategy that combines internal liberalisation with external agreements. Thus, in general, currently regionalism is a benign and dynamic initiative compatible with the overall aims of the multilateral trade order.

Benefits of RTAs: The important benefits of RTAs are:

i. Members see economic benefits from a more efficient production structure by exploiting economies of scale. In addition to spreading fixed costs over larger regional markets, it enhances economic growth from foreign direct investment, and research and development.

ii. Members value non-economic benefits such as strengthening political ties and managing migration blocs.

iii. Smaller countries seek increased security of market access by forming regional trading blocs and joining with associations of larger countries.

iv. Countries may want to lock-in unilateral domestic policy reforms.

v. Members’ bargaining power in multilateral trade negotiations is improved where they can more effectively express in pursuance of their regional interests.

vi. Members can promote industries that are not viable without a protected regional market – e.g. regional infant industries – the idea being that they would be internationally competitive if given sufficient time and scope to develop.

vii. Open regionalism i.e. agreements with low external trade barriers, service markets and a dominant focus on reducing transaction costs at borders, help get around the complexity of the international trading system.

Efficiency and Limitations of Regional Trade Agreements (Trade Blocs)

Trade blocs, free trade areas, and bilateral agreements are emerging fare and wide in international trade. In 2001, regional trade agreements (RTAs) accounted for 43 per cent of world trade. The emergence of RTAs has added diversity and complexity thereby creating a web in international trade relation.

Growth in trade is observed as a result of these negotiation but are they really the best method of liberalising trade on a global level? The rapid surfacing of RTAs evokes concerns for the future of free trade, and in general the welfare of the world economy in the long run.

There are six dominant concerns involving the efficiency and limitations of RTAs.

Trade Diversion:

Efficiency is great concern surrounding the creation of trade blocs. Trade diversions can be the unfortunate effect of these preferential trade agreements. Trade diversions are created when trade barriers are lowered in a bloc or region, thus making prices on imports from outsiders comparatively higher, even if they are the low-cost supplier. Trade is then diverted away from the low-cost supplier, to the less efficient incumbent. These breaches in efficiency have welfare effects.

“Competitive Regionalism”, Costly Negotiation Process and Overlapping Agreements Establishment of regional trade agreements has gained momentum. Small countries in particular are vulnerable to pressures to join trade blocs in order not to be left out of benefits from
increased trade volume. This tendency is referred to as “competitive regionalism”. The pressure to quickly regionalise may also distract efforts from the greater goal of multilateral liberalisation of trade.

Since the pace of multilateral talks is generally slow (the Uruguay Round took seven years) requiring extensive negotiations; countries that would prefer liberalisation of trade on a multilateral level are, in the mean time, scrambling to regionalise. Furthermore, the negotiation process is costly,” particularly to smaller countries, and given the “cost of non-participation” in RTAs efforts are concentrated on quick regional agreements. Given the pressures to regionalise, and limited negotiation resources, countries may hastily create trade blocs. This “competitive regionalism” can ultimately divert efforts away from greater free trade, and rather create complex barriers among blocs.

The rapid creation of regional agreements may also hinder the greater goal of free trade by creating a complex web of agreements, thus posing a challenge to and complicating multilateral solutions through the WTO. Agreements with too much red tape can initially look attractive, but if not in harmony with greater global negotiations; the participants can find themselves at a disadvantage in the future. In this light, it is warned that the benefits given by the preferential treatment through regionalisation, may be short lived, and unable to exceed the costs of continuous administration of the bloc.

Preferential Liberalisation Can Potentially Increase Vulnerability Entering into a trade bloc makes all parties vulnerable to the decisions and practices of all countries involved. For political or other reasons an incumbent of the region may revoke or modify the preferential treatment granted by the agreement.

This situation is particularly dangerous when there is a dominant trade partner in the bloc that may shift its weight around for political gains. Furthermore, the preferential agreement may shelter industries and hamper inefficiencies within the bloc.

In the case that the bloc should expand, or the terms of the agreement change, the margins of preference are eroded, and the countries are worse off. A more stable system would be multilateral reduction of barriers within a common set of rules.

Inclusion of Additional Elements in RTAs:
It is common for RTAs to include elements unrelated to trade, that may in fact serve to restrict trade rather than promote trade in the long run. RTAs, especially many involving the US, oftentimes contain parameters on labour standards, environmental issues; intellectual property rights, and capital movements.

In some cases non-compliance with the agreed parameters results in trade sanction or other forms of punishment. These types of standards could be detrimental to trade growth especially for countries in which institutions are weak.

**Trade bloc**

A **trade bloc** is a type of *intergovernmental agreement*, often part of a regional *intergovernmental organization*, where regional barriers, (tariffs and non-tariff barriers) are reduced or eliminated among the participating states.

**Description** - Stages of economic integration around the World (each country colored according to the most integrated form that it participates with):

- **Economic and Monetary Union** (CSME/ECS, EU/€, Switzerland–Liechtenstein/CHF)
- **Economic union** (CSME, EU, EAEU, MERCOSUR, GCC, SICA)
- **Customs and Monetary Union** (CEMAC/XAF, UEMOA/XOF)
- **Common market** (EEA–Switzerland, ASEAN)

**Advantages**

There are five major advantages of trade bloc agreements: foreign direct investment, economies of scale, competition, trade effects, and market efficiency.

- **Foreign Direct Investment**: An increase in foreign direct investment results from trade blocs and benefits the economies of participating nations. Larger markets are created, resulting in lower costs to manufacture products locally.
- **Economies of Scale**: The larger markets created via trading blocs permit economies of scale. The average cost of production is decreased because mass production is allowed.
- **Competition**: Trade blocs bring manufacturers in numerous countries closer together, resulting in greater competition. Accordingly, the increased competition promotes greater efficiency within firms.
- **Trade Effects**: Trade blocs eliminate tariffs, thus driving the cost of imports down. As a result, demand changes and consumers make purchases based on the lowest prices, allowing firms with a competitive advantage in production to thrive.
- **Market Efficiency**: The increased consumption experienced with changes in demand combines with a greater amount of products being manufactured to result in an efficient market.

**Disadvantages**

The disadvantages, on the other hand, include: regionalism vs. multinationalism, loss of sovereignty, concessions, and interdependence.

- **Regionalism vs. Multinationalism**: Trading blocs bear an inherent bias in favor of their participating countries. For example, NAFTA, a free trade agreement between the United States, Canada, and Mexico, has contributed to an increased flow of trade among these three countries. Trade among NAFTA partners has risen to more than 80 percent of Mexican and Canadian trade and more than a third of U.S. trade, according to a 2009 report by the Council on Foreign Relations. However, regional economies establish tariffs and quotas that protect intra-regional trade from outside forces, according to the University of California Atlas of Global Inequality. Rather than pursuing a
The Role and Importance of Trading Blocs (8 Points) | Business

Trading blocs have played a positive role in the development of international trade. This can be explained with the help of following points:

1. Economic integration:
   Trading blocs have resulted in economic integration. It represents various forms of economic integration in a region like SAARC, OPEC, ASEAN, EU etc. Trading blocs unifies different independent economies and bring the nations closer.
   Trading blocs helps in enhancing degree of regional co-operation and interrelationship. It brings the nation closer by unifying independent economies and facilitates economic cooperation among the members of the group.

2. Free transfer of resources:
   Trading blocs helps in elimination of tariff, and non-tariff barriers and facilitates free transfer of resources across the border of member countries. This help in optimum utilisation of available resources.
   This is because no country in the world is self-sufficient and they need to depend upon one another for the fulfillment of their requirement.

3. Increase in Trade:
   Free transfer of resources helps in increasing the productivity of member nations. They eliminate trade barriers and encourage free trade. This increase import and export activities of member nations, which results into increase in trade revenues.
   Trading blocs are sound and efficient to create sustainable economic growth. Trading blocs are created to encourage trading partners to buy and sell goods already made in their home countries. It also encourages economies of scale.

4. Employment opportunities:
   Large-scale production and distribution leads to an increase in employment opportunities directly and indirectly. This results into increase in income level of the people, which enhances the standard of living of the economy.
   Trading blocs tend to increase in income and employment level of the member countries. Capital is required to generate more and more employment opportunities. Trading blocs lead to free transfer of resources viz natural, human and capital resources, which are optimally utilised for creating employment opportunities.

5. Benefit to the consumers:
   Formation of trading blocs enables transfer of technologies across borders resulting into improvement in productivity and quality of goods and services ultimately benefiting the consumers to a greater extent.
   Removal of trade barriers and free transfer of resources have resulted into mass production and distribution. This facilitates provision of quality product in competitive prices to the consumers.

6. Cooperative spirit:
   Trading blocs leads to economic, political and cultural integration of member -countries. This develops a spirit of cooperation and coordination among member nations. This helps in maintaining good relations among the member nations.

7. Competition:
   Trading blocs has resulted into increase in competition between companies of entire region. It also facilitates to face competition effectively. Trading blocs gives competitive advantage not only to large establish firms but also to the newly emerging firm.

8. Development of region:
Trading bloc plays an important role in contributing the development, industrialisation and economic growth of whole region. Trading blocs are a sound and efficient way to create sustainable economic growth.

Liberal policies and removal of trade barriers has resulted in the growth of industries in those regions. This in turn increased the production and distribution activities leading to economic growth of those regions.

Global Competitiveness Export Management

License

A license may be granted by a party ("licensor") to another party ("licensee") as an element of an agreement between those parties. A shorthand definition of a license is "an authorization (by the licensor) to use the licensed material (by the licensee)."

In particular, a license may be issued by authorities, to allow an activity that would otherwise be forbidden. It may require paying a fee and/or proving a capability. The requirement may also serve to keep the authorities informed on a type of activity, and to give them the opportunity to set conditions and limitations.

A licensor may grant a license under intellectual property laws to authorize a use (such as copying software or using a (patented) invention) to a licensee, sparing the licensee from a claim of infringement brought by the licensor. A license under intellectual property commonly has several components beyond the grant itself, including a term, territory, renewal provisions, and other limitations deemed vital to the licensor.

Term: many licenses are valid for a particular length of time. This protects the licensor should the value of the license increase, or market conditions change. It also preserves enforceability by ensuring that no license extends beyond the term of the agreement.

Territory: a license may stipulate what territory the rights pertain to. For example, a license with a territory limited to "North America" (Mexico/United States/Canada) would not permit a licensee any protection from actions for use in Japan.

A shorthand definition of license is "a promise by the licensor not to sue the licensee." That means without a license any use or exploitation of intellectual property by a third party would amount to copying or infringement. Such copying would be improper and could, by using the legal system, be stopped if the intellectual property owner wanted to do so.

Intellectual property licensing plays a major role in business, academia and broadcasting. Business practices such as franchising, technology transfer, publication and character merchandising entirely depend on the licensing of intellectual property. Land licensing (proprietary licensing) and IP licensing form sub-branches of law born out of the interplay of general laws of contract and specific principles and statutory laws relating to these respective assets.

Mass licensing of software

Mass distributed software is used by individuals on personal computers under license from the developer of that software. Such license is typically included in a more extensive end-user license agreement (EULA) entered into upon the installation of that software on a computer. Typically, a license is associated with a unique code, that when approved grants the end user access to the software in question. Under a typical end-user license agreement, the user may install the software on a limited number of computers.

The enforceability of end-user license agreements is sometimes questioned.

Patent license

Trademark and brand licensing

A licensor may grant permission to a licensee to distribute products under a trademark. With such a license, the licensee may use the trademark without fear of a claim of trademark infringement by the licensor. The assignment of a license often depends on specific contractual terms. The most common terms are, that a license is only applicable for a particular geographic region, just for a certain period of time or merely for a stage in the value chain. Moreover, there are different types of fees within the trademark and brand licensing. The first form demands a fee independent of sales and profits, the second type of license fee is dependent on the productivity of the licensee.

Artwork and character licensing

A licensor may grant a permission to a licensee to copy and distribute copyrighted works such as "art" (e.g., Thomas Kinkade's painting "Dawn in Los Gatos") and characters (e.g., Mickey Mouse). With such license, a licensee need not fear a claim of copyright infringement brought by the copyright owner.

Artistic license is, however, not related to the aforementioned license. It is a euphemism that denotes freedom of expression, the ability to make the subject appear more engaging or attractive, by fictionalising part of the subject.

Academia[edit]

National examples of the license are listed at Licentiate

A license is an academic degree. Originally, in order to teach at a university, one needed this degree which, according to its title, gave the bearer a license to teach. The name survived despite the fact that nowadays a doctorate is typically needed in order to teach at a university. A person who holds a license is called a licentiate.

In Sweden, Finland, and in some other European university systems, a license or 'licentiate' is a postgraduate degree between the master's degree and the doctorate. The licentiate is a popular choice in those countries where a full doctoral degree would take five or more years to achieve.

In some other major countries, such as France, Belgium or Poland, a license is achieved before the master's degree (it takes three years of studies to become licentiate and two additional years to become Master) in France, while in Belgium the license takes four years while the master itself takes two more years. In Switzerland, a license is a four-year degree then there is a DEA degree which is equivalent to
Virtually every business needs some form of license or permit to operate legally. However, knowing which one you need, however, can be a little tricky. It depends on the type of business you are operating, where it’s located, and what government rules apply. The problem is that many businesses overlook this basic requirement of starting a business often because they simply aren’t aware of what the law requires. This can lead to costly penalties, tax problems, and even the closure of your operation. The good news is that getting the right license or permit isn’t difficult and doesn’t cost much. Here’s a quick overview of the process of obtaining a license or permit for your new business.

Why Do Businesses Need Licenses and Permits?
One of the biggest reasons business owners need licenses is so the government can track revenue for taxation purposes. However, licenses and permits are also used to protect the public.

For example, if you are engaged in a federally regulated industry such as aviation, alcohol, or agriculture, you will need to obtain specific federal licenses or permits.

Other licenses, known as professional licenses, signify the level of expertise that an employee or business owner has - dentists, hairdressers, veterinarians, and doctors must have professional licenses.

If you are selling goods or services, you may need to get a sales tax license or permit.

Even home-based businesses and sole proprietors typically need a permit from their local government to operate legally.

Finding the Right Licenses and Permits
Because every business has different licensing and permit requirements depending on its location and industry, it can be intimidating to know where to start.

To help business owners navigate the process, SBA.gov offers links to state-specific license and permit information.

What About Tax Permits?
While the IRS doesn’t license your business, it does require that certain businesses register to receive a federal tax identification number (this link helps you determine whether your need an EIN or not). You’ll also need to register with state and local government agencies for applicable tax permits such as a sales tax license, income tax withholding, and unemployment insurance tax. The Permit Me tool can point you to your local state revenue office.

What about Home-Based Businesses?
Home-based businesses are often the most susceptible to permit violations. Why? Often, sole proprietors, consultants, or other home businesses aren’t aware they need a permit to operate out of their own home.

So what do you need? At a basic level, your state or local government may require that you hold a Home Occupation Permit. If you are a consultant or freelancer, this may be all you need. However, if you operate a business that involves or directly impacts the public, such as an in-home childcare facility or at-home food production business, you will need an additional permit or license according to your type of business.

Read Licensing Requirements for Home Based Businesses for more guidance on what you need to legally operate out of your home.

If you live in a community managed by a home owner’s association (HOA), it’s a good idea to check whether it can restrict you based on your business activities.

Managing and Maintaining Your License or Permit
Once you have your license or permit, you’ll need to manage and maintain it. SBA.gov has the following advice:

- Keep track of renewal dates.
- Maintain a copy of all licensing applications and forms in your business records.
- Display your licenses or permits correctly. Most states and localities require businesses to prominently display their business licenses so customers can see them.
- If you expand your business, whether it’s expanding your building or launching a new product or service, you may need additional business licenses.

Brand licensing
Licensing means renting or leasing of an intangible asset. It is a process of creating and managing contracts between the owner of a brand and a company or individual who wants to use the brand in association with a product, for an agreed period of time, within an agreed territory. Licensing is used by brand owners to extend a trademark or character onto products of a completely different nature. Examples of intangible assets include a song (“Somewhere Over The Rainbow”), a character (Donald Duck), a name (Michael Jordan), or a brand (The Ritz-Carlton). An arrangement to license a brand requires a licensing agreement. A licensing agreement authorizes a company which markets a product or service (licensee) to lease or rent a brand from a brand owner who operates a licensing program (a licensor).

Reasons for licensing
A company may choose to license its brand(s) when they believe there is strong consumer acceptance for brand extensions or products. For example, when Apple launched the iPod there was an immediate need for accessories such as headphones, charging and syncing sta-
A joint venture (“JV”) begins when the parties enter into a contract or “joint venture agreement,” the specific terms of which are of crucial importance to both parties. The formation of a joint venture is referred to as an “international joint venture.”

Joint Venture Agreement

Parties enter into joint venture contracts in order to combine strengths and increase competitive advantage while minimizing risk. For example, a tech firm may collaborate with a manufacturing company to bring a new high-tech idea to the marketplace. One party provides the product expertise, the other provides the means for production. Additionally, joint ventures provide a way for companies to enter foreign markets. For example, a foreign company enters into a joint venture with a U.S. company for sale of its product. The foreign company then benefits from the domestic company’s governmental approval and business relationships in the industry. This is referred to as an “international joint venture.”

Definition of Joint Venture

An association of two or more individuals or entities for the purpose of engaging in a specific business enterprise for profit.

Purpose of a Joint Venture

When two or more parties, whether individuals or entities, enter into an agreement to combine resources for a specific business undertaking, it is referred to as a “joint venture.” The organization of a joint venture serves as a short term partnership for the duration of the project, in which each participant shares responsibility for the project’s associated costs, profits, and losses. Although the parties share responsibility, the joint venture is its own legal entity that remains separate from the parties’ other business interests. To explore this concept, consider the following joint venture definition.

Joint Venture Agreement

A joint venture (“JV”) begins when the parties enter into a contract or “joint venture agreement,” the specifics of which are of crucial importance for avoiding problems later on. In creating the agreement, the parties should state specifically the purpose and goal of the ven-
tire, as well as the venture’s limitations. The agreement should be very specific in outlining each party’s duties and rights under the agreement, taking into account that all parties are entitled to share in the profits as well as the losses incurred in the venture.

Each party to a JV has a responsibility to act in “good faith” in all matters regarding the venture, taking care to uphold the interests of all parties involved. This amounts to a legal fiduciary duty to the venture, even if it becomes necessary for a party to place individual interests below those of the group.

The joint venture agreement should specify both the formation and termination dates, or that the venture terminates when its purpose has been accomplished. Some JV agreements specify that the venture will automatically terminate if one of the members dies.

More specifically, a JV agreement should specifically detail the following:

- Structure – whether the JV will be a separate business entity in its own right, or simply a short term project
- Objective – the purpose and goals of the JV
- Confidentiality – an agreement for the parties to protect any trade and commercial secrets disclosed during the venture
- Financial Contributions – how much each party will contribute to the venture
- Assets and Employees – whether each party will contribute assets, and whether they will assign employees to, or hire new employees for the venture
- Intellectual Property Ownership – which party will have ownership of any intellectual property created by the venture
- Management – specific responsibilities of each party, and the procedures to be followed in operations of the venture
- Profits, Losses, and Liabilities – specifics of how any profits and losses are to be distributed or shared among the parties, as well as the assignment of liabilities
- Disputes – specific instructions for the resolution of disputes that may arise between the parties
- Exit Strategy – specific details on when and how the JV will end, including the final distribution of assets and debts

**Benefits of a Joint Venture**

- Creating a JV provides an opportunity for the parties to benefit from one another’s expertise. Other benefits include:
- Enables the parties to offer their customers new products and services
- Helps the parties to save money in operating, marketing, and advertising costs
- Helps the parties save time
- Helps the parties acquire new business associates and referrals
- Enables the parties to gain new technological know-how or new geographical market territories
- Does not require a long-term commitment

**Joint Venture Examples**

Since two of the nation’s burgeoning railroads entered into a joint venture to expand rail service to a rapidly growing West Coast population in the 1800s, the concept has experienced phenomenal growth. The idea of being able to join forces with another individual or company solely for the purpose of taking on a single business enterprise offers solutions to companies large and small. Below are two famous joint venture examples.

**Kellogg Company Joins with Wilmar International Limited**

Anticipating China’s rise to the top of the food and beverage global market, Kellogg Company entered into a joint venture agreement with Wilmar International Limited for the purpose of selling and distributing cereal and snack foods to consumers in China. While Kellogg brings to the table an extensive collection of globally renowned products as well as their expertise in the industry, Wilmar offers marketing and sales infrastructure in China, including an extensive distribution network and supply chain. Joining together allows both companies to profit from a synergistic relationship.

**The Joint Venture of Hulu**

The 2008 joint venture launched by NBC Universal Television Group (Comcast), Fox Broadcasting Company (21st Century Fox), and Disney-ABC Television Group (The Walt Disney Company) to create the enormously popular video streaming website “Hulu” is one example of a large scale partnering of companies that has been very profitable.

Though individually the companies are competitors over the U.S. airwaves, combining their efforts to provide streaming content to billions of homes, computers, and mobile devices proved a powerful way to increase revenues. The success of Hulu has potential buyers lining up with offers topping $1 billion.

**Joint Venture Accounting**

Setting up accurate Joint Venture accounting is crucial, and best assigned to a professional. For accounting purposes, there are three main types of JV, each of which recognizes assets and liabilities a bit differently:

1. Jointly Controlled Operations – while the JV with jointly controlled operations utilizes the resources and assets of each of the parties, each party incurs its own expenses, raises its own financing, and contributes its own assets to the venture.
2. Jointly Controlled Assets – the parties jointly own and control the assets contributed to the JV, as well as the assets acquired by the venture, each receiving a share of the income and expenses of the venture.
3. Jointly Controlled Entities – this type of JV requires the formation of a separate legal entity in which each party owns an interest. The newly created entity then controls the assets, liabilities, revenues, and expenses, of the venture. This jointly controlled entity maintains its own records for accounting purposes, preparing financial statements on a regular basis. If a party to the venture contributes money or other assets to the jointly controlled entity, the contribution is regarded as an investment.
The Qualified Joint Venture

IRS law permits certain joint venture businesses owned by a married couple to file business taxes as a Qualified Joint Venture (QJV), rather than a standard partnership. When filing as a partnership on IRS Schedule C, only one spouse is credited for social security and Medicare coverage. Filing as a Qualified Joint Venture, with each spouse reporting a share of the business profits and losses, enables both spouses to receive social security and Medicare coverage credit. In order to qualify as a Qualified Joint Venture, the business must meet the following three conditions:

1. The only members of the JV are a married couple who file a joint IRS tax return
2. Both spouses actively participate in the business
3. Both spouses choose not to treat the business as a partnership

Working With a Joint Venture Broker

An individual experienced in creating, participating in, and dissolving joint ventures may become a joint venture broker (JV broker), using his expertise to pair up the right projects with the right people. The JV broker has been specially trained to assist businesses in the creation and management of Joint Ventures, increasing the chance the venture will be profitable. In addition to offering suitable partners for a JV, a broker often offers supportive services in marketing and other strategies for success.

A JV broker generally has a large database of companies in a variety of industries, each looking for joint venture opportunities. By gathering all of the relevant information and doing the necessary research, a JV broker saves the individual or company time and money.

Related Legal Terms and Issues

- **Asset** – Any valuable thing or property owned by a person or entity, regarded as being of value.
- **Intellectual Property** – Anything created by the human intellect, such as artistic and literary works, designs, images, symbols, and names.
- **Liabilities** – A company’s legal obligations or debts that come up during the course of business.
- **Legal Entity** – An individual, company, association, trust, or other organization that is legally recognized in the eyes of the law. A legal entity is able to enter into contracts, take on obligations, pay debts, be sued, and be held responsible for its actions

Global marketing

Global marketing is "marketing on a worldwide scale reconciling or taking commercial advantage of global operational differences, similarities and opportunities in order to meet global objectives".

Worldwide competition

One of the product categories in which global competition has been easy to track in U.S.is automotive sales. The increasing intensity of competition in global markets is a challenge facing companies at all stages of involvement in international markets. As markets open up, and become more integrated, the pace of change accelerates, technology shrinks distances between markets and reduces the scale advantages of large firms, new sources of competition emerge, and competitive pressures mount at all levels of the organization. Also, the threat of competition from companies in countries such as India, China, Malaysia, and Brazil is on the rise, as their own domestic markets are opening up to foreign competition, stimulating greater awareness of international market opportunities and of the need to be internationally competitive. Companies which previously focused on protected domestic markets are entering into markets in other countries, creating new sources of competition, often targeted to price-sensitive market segments. Not only is competition intensifying for all firms regardless of their degree of global market involvement, but the basis for competition is changing. Competition continues to be market-based and ultimately relies on delivering superior value to consumers. However, success in global markets depends on knowledge accumulation and deployment. Today, more and more marketing companies specialize in translating products from one country to another.

Evolution to global marketing

Global marketing is not a revolutionary shift, it is an evolutionary process. While the following does not apply to all companies, it does apply to most companies that begin as domestic-only companies. International marketing has intensified and is evident for approximately nearly all aspects of consumer’s daily life. Local regions or national boundaries no longer restricted to the competitive forces. To be successful in today's globalized economy, it is a must for the companies to simultaneously be responsive to local as well as global market conditions and varying aspect’s related to the international marketing process. Hence, international marketing skills are an important ingredient for every company, whether or not it is currently involved in exporting the activities for the endorsement of the brand or the company. The internationalized marketplace has been transformed very quickly in recent years by shifts in trading techniques, standards and practices. These changes have been reinforced and retained by new technologies and evolving the economic relationships between the companies and the organizations which are working for the trade across the globe. This assignment project work is just an attempt to get integrate these developments and attempts in the field of the market journalism into the burgeoning literature on international marketing process as well as on recent research findings on the International marketing. The research emphasis within the subject has evolved alongside changes in the stress given to key aspects of international trade market. The pre-occupation of early researchers with exports and selling is being replaced by a more balanced view which gives increasing weight to other aspects of international marketing such as licensing, joint ventures, and overseas subsidiaries. In effect, the traditional ethnocentric conceptual view of international marketing is being counterbalanced by a more accurate global view of markets. This process of change is tracked in this paper and the growing importance of a strategic and organizational approach to international marketing is emphasized in this article theory. Focused attention is paid to the heterogeneous nature of international marketing process. The diversity of the globalized situations is matched by the variety of enterprises which play a vital part in the marketing exploration process. There is also explanation focuses on the matching of the available company resources and marketing goals in successful international marketing trade. The concept which unveils the paper
brings out the importance of effective marketing procedures to success in international markets and trade over the international markets.

Domestic marketing
A marketing restricted to the political boundaries of a country is called 'Domestic Marketing'. A company marketing only within its national boundaries only has to consider domestic competition. Even if that competition includes companies from foreign markets, it still only has to focus on the competition that exists in its home market. Products and services are developed for customers in the home market without thought of how the product or service could be used in other markets. All marketing decisions are made at headquarters. The biggest obstacle these marketers face is being blindsided by emerging global marketers. Because domestic marketers do not generally focus on the changes in the global marketplace, they may not be aware of a potential competitor who is a market leader on three continents until they simultaneously open 20 stores in the Northeastern U.S. These marketers can be considered ethnocentric as they are most concerned with how they are perceived in their home country.

The domestic market is a large market that every nation needs. These markets are all restricted to be under control of certain boundaries in that company or country. This type of marketing is the type of marketing that takes place in the headquarters. In domestic markets it helps reduce the cost of competition. By reducing competition the company has a better shot of being more successful in the long run. Also if the company’s competition is not a big factor that will affect their business, they have a good shot at making prices higher and people will still purchase that product.

A firm operating in a domestic market also gets the opportunity to operate in different areas and this gives the company an opportunity to have bigger markets to advertise to. Even in domestic markets, businesses are still trying to trade with each other to promote their business to other businesses in the area. An advantage to marketing domestically is that the firm may be entitled to tax benefits for offering jobs to the nation and for giving people opportunities for work. A firm that markets domestically helps countries by offering more jobs, bringing in additional business to the market and stimulates trading within the market.

International marketing
International marketing is the export, franchising, joint venture or full direct entry of an organization's product or services into another country. This can be achieved by exporting a company's product into another location, entry through a joint venture with another firm in the target country, or foreign direct investment into the target country. The development of the marketing mix for that country is then required - international marketing. It can be as straightforward as using existing marketing strategies, mix and tools for export on the one side, to a highly complex relationship strategy including localization, local product offerings, pricing, production and distribution with customized promotions, offers, website, social media and leadership. Internationalization and international marketing meets the needs of selected foreign countries where a company's value can be exported and there is inter-firm and firm learning, optimization and efficiency in economies of scale and scope. The firm does not need to export or enter all world markets to be considered an international marketer.

Global marketing
Global marketing is a firm's ability to market to almost all countries on the planet. With extensive reach, the need for a firm’s product or services is established. The global firm retains the capability, reach, knowledge, staff, skills, insights, and expertise to deliver value to customers worldwide. The firm understands the requirement to service customers locally with global standard solutions or products, and localizes that product as required to maintain an optimal balance of cost, efficiency, customization and localization in a control-customization continuum to best meet local, national and global requirements to position itself against or with competitors, partners, alliances, substitutes and defend against new global and local market entrants per country, region or city. The firm will price its products appropriately worldwide, nationally and locally, and promote, deliver access and information to its customers in the most cost-effective way. The firm also needs to understand, research, measure and develop loyalty for its brand and global brand equity (stay on brand) for the long term.

At this level, global marketing and global branding are integrated. Branding involves a structured process of analyzing "soft" assets and “hard” assets of a firm’s resources. The strategic analysis and development of a brand includes customer analysis (trends, motivation, unmet needs, segmentation), competitive analysis (brand image/brand identity, strengths, strategies, vulnerabilities), and self-analysis (existing brand image, brand heritage, strengths/capabilities, organizational values).

Further, Global brand identity development is the process establishing brands of products, the firm, and services locally and worldwide with consideration for scope, product attributes, quality/value, uses, users and country of origin; organizational attributes (local vs. global); personality attributes (genuine, energetic, rugged, elegant) and brand customer relationships (friend, adviser, influence, trusted source); and importantly symbols, trademarks metaphors, imagery, mood, photography and the company's brand heritage. In establishing a global brand, the brand proposition (functional benefits, emotional benefits and self-expressive benefits are identified, localized and streamlined to be consistent with a local, national, international and global point of view. The brand developed needs to be credible. A global marketing and branding implementation system distributes marketing assets (website, social media, Google PPC, PDFs, sales collateral, press junkets, kits, product samples, news releases, local mini-sites, flyers, posters, alliance and partner materials), affiliate programs and materials, internal communications, newsletters, investor materials, event promotions and trade shows to deliver an integrated, comprehensive and focused communication, access and value to the customers, that can be tracked to build loyalty, case studies and further establish the company’s global marketing and brand footprint.

Global marketing specialization
Global marketing is a field of study in general business management to provide valuable products, solutions and services to customers locally, nationally, internationally and worldwide.
Elements of the global marketing

Not only do standard marketing approaches, strategies, tactics and processes apply, global marketing requires an understanding of global finance, global operations and distribution, government relations, global human capital management and resource allocation, distributed technology development and management, global business logic, interfirm and global competitiveness, exporting, joint ventures, foreign direct investments and global risk management.

The standard “Four P’s” of marketing: product, price, place, and promotion are all affected as a company moves through the five evolutionary phases to become a global company. Ultimately, at the global marketing level, a company trying to speak with one voice is faced with many challenges when creating a worldwide marketing plan. Unless a company holds the same position against its competition in all markets (market leader, low cost, etc.) it is impossible to launch identical marketing plans worldwide. Nisant Chakram (Marketing Management)

Product - A global company is one that can create a single product and only have to tweak elements for different markets. For example, Coca-Cola uses two formulas (one with sugar, one with corn syrup) for all markets. The product packaging in every country incorporates the contour bottle design and the dynamic ribbon in some way, shape, or form. However, the bottle can also include the country’s native language and is the same size as other beverage bottles or cans in that same country. Luxury products, high-tech products, and new innovations are the most common products in the global marketplace. They are easier to market in a standardized way than other products because there are no traditional cultural values attached to their meanings.

Price - Price will always vary from market to market. Price is affected by many variables: cost of product development (produced locally or imported), cost of ingredients, cost of delivery (transportation, tariffs, etc.), and much more. Additionally, the product’s position in relation to the competition influences the ultimate profit margin. Whether this product is considered the high-end, expensive choice, the economical, low-cost choice, or something in-between helps determine the price point.

Place - How the product is distributed is also a country-by-country decision influenced by how the competition is being offered to the target market. Using Coca-Cola as an example again, not all cultures use vending machines. In the United States, beverages are sold by the pallet via warehouse stores. In India, this is not an option. Placement decisions must also consider the product’s position in the marketplace. For example, a high-end product would not want to be distributed via a “dollar store” in the United States. Conversely, a product promoted as the low-cost option in France would find limited success in a pricey boutique.

Promotion - After product research, development and creation, promotion (specifically advertising) is generally the largest line item in a global company’s marketing budget. At this stage of a company’s development, integrated marketing is the goal. The global corporation seeks to reduce costs, minimize redundancies in personnel and work, maximize speed of implementation, and to speak with one voice. If the goal of a global company is to send the same message worldwide, then delivering that message in a relevant, engaging, and cost-effective way is the challenge.

Effective global advertising techniques do exist. The key is testing advertising ideas using a marketing research system proven to provide results that can be compared across countries. The ability to identify which elements or moments of an ad are contributing to that success is how economies of scale are maximized. Market research measures such as Flow of Attention, Flow of Emotion and branding moments provide insights into what is working in an ad in any country because the measures are based on visual, not verbal, elements of the ad.

Advantages and Disadvantages

Advantages The advantages of global market include:

- Economies of scale in production and distribution
- Lower marketing costs
- Power and scope
- Consistency in brand image
- Ability to leverage good ideas quickly and efficiently
- Uniformity of marketing practices
- Helps to establish relationships outside of the "political arena"
- Helps to encourage ancillary industries to be set up to cater for the needs of the global player
- Benefits of eMarketing over traditional marketing

Reach - The nature of the internet means businesses now have a truly global reach. While traditional media costs limit this kind of reach to huge multinationals, eMarketing opens up new avenues for smaller businesses, on a much smaller budget, to access potential consumers from all over the world.

Scope - Internet marketing allows the marketer to reach consumers in a wide range of ways and enables them to offer a wide range of products and services. E-Marketing includes, among other things, information management, public relations, customer service and sales. With the range of new technologies becoming available all the time, this scope can only grow.

Interactivity - Whereas traditional marketing is largely about getting a brand’s message out there, e-Marketing facilitates conversations between companies and consumers. With a two way communication channel, companies can feed off of the responses of their consumers, making them more dynamic and adaptive.

Immediacy - Internet marketing is able to, in ways never before imagined, provide an immediate impact. Imagine you’re reading your favorite magazine. You see a double-page advert for some new product or service, maybe BMW’s latest luxury sedan or Apple’s latest iPod offering. With this kind of traditional media, it’s not that easy for you, the consumer, to take the step from hearing about a product to actual acquisition. With e-marketing, it’s easy to make that step as simple as possible, meaning that within a few short clicks you could have booked a test drive or ordered the iPod. And all of this can happen regardless of normal office hours. Effectively, Internet marketing makes business hours 24 hours per day, seven days per week for every week of the year. By closing the gap between providing information and eliciting a consumer reaction, the consumer’s buying cycle is sped up.
**Demographics and targeting** - Generally speaking, the demographics of the Internet are a marketer’s dream. Internet users, considered as a group, have greater buying power and could perhaps be considered as a population group skewed towards the middle-classes. Buying power is not all though. The nature of the Internet is such that its users will tend to organize themselves into far more focused groupings. Savvy marketers who know where to look can quite easily find access to the niche markets they wish to target. Marketing messages are most effective when they are presented directly to the audience most likely to be interested. The Internet creates the perfect environment for niche marketing to targeted groups.

**Cross cultural negotiation** - The dimensions of culture, such as power distance, the context of the culture and the local work ethic is an area of marketing and social science that is closely related to Global marketing. The ability to discern cultural differences through initial assessment of another market is considered a critical enabler to progress in Global marketing. Effective marketing requires adapting to cultural values, and Hofstede’s five cultural dimensions theory helps compare practices of consumption and consumer motivations for buying products and services. When a company can advertise effectively to its foreign markets, it brings benefits to both sides. The company gains more revenue and relations, and the foreign markets have access to better products and services. Hofstede, through the five cultural dimensions, reveals how cultures are different and value different things. Typically, the west is different from the rest. The west typically values individualism, high need for autonomy, modernity, and a more explicit use of sexuality whereas eastern values include family oriented, respect for elderly, submission to authority, traditional collectivism, and Confucianism. When designing an advertisement, cultural value differences must be considered to be effective since advertising campaigns do not work the same way in different countries.

**Adaptively and closed loop marketing** - Closed Loop Marketing requires the constant measurement and analysis of the results of marketing initiatives. By continuously tracking the response and effectiveness of a campaign, the marketer can be far more dynamic in adapting to consumers’ wants and needs. With eMarketing, responses can be analyzed in real-time and campaigns can be tweaked continuously. Combined with the immediacy of the Internet as a medium, this means that there’s minimal advertising spend wasted on less effective campaigns. Maximum marketing efficiency from eMarketing creates new opportunities to seize strategic competitive advantages. The combination of all these factors results in an improved ROI and ultimately, more customers, happier customers and an improved bottom line.

**Disadvantages**
- Differences in consumer needs, wants, and usage patterns for products
- Differences in consumer response to marketing mix elements
- Differences in administrative procedures
- Differences in product placement.
- Differences in the legal environment, some of which may conflict with those of the home market
- Differences in the institutions available, some of which may call for the creation of entirely new ones (e.g. infrastructure)

**Effects of Globalization on Human Resources Management**

Globalization is making the world a smaller place and HRM must respond appropriately. Globalization is a term in business that refers to the integration of an organization’s operations, processes and strategies into diverse cultures, products, services and ideas. Because of its emphasis on diversity, globalization also has a deep impact on the way companies manage their employees. Understanding the effects of globalization on human resources can help managers to better equip their organizations for the increasingly global business environment.

**Diversity Recruitment**

With the rise of globalization, companies of all sizes are now interacting with customers and stakeholders from diverse cultures, languages and social backgrounds. In response, many human resources managers seek to hire employees from equally diverse backgrounds. Companies engaging in this diversity recruitment recognize the value of having people on staff that their customers can relate to, and they know that having a team of diverse people contributes to the range of ideas and influences within the organization.

**Push for Professional Development**

A further effect of globalization on HR management is a push for professional development. Professional development is concerned with providing employees opportunities to achieve their career-related goals. Some organizations provide resources for their employees to earn a university degree, others send their employees to conferences or networking events and training days. Professional development is important to globalization because it creates a win-win situation. The employees feel as though the organization is concerned with providing a range of skills and competencies for their employees. Likewise, the organization benefits from the added skills and connections that the employees who take advantage of professional development programs acquire.

**Greater Emphasis on Training**

Similar to professional development, a greater emphasis on training has resulted because of globalization in human resources management. Training, however, tends to be focused on the needs and professional competencies of groups of employees within the organization. The company might, for instance, host language classes to give its call center staff an edge in telephone sales. It might also teach its employees how to use a new global software platform. This emphasis on training seeks to give the company a competitive edge in the global marketplace by honing the employees’ diversity emphasis.

**Management of Laws Across Jurisdictions**
A final effect of globalization on human resources management is the need for businesses to understand and apply the laws of many different jurisdictions to the particular business. The federal government sets out a number of tax and labor laws that businesses operating in the United States must comply with, but there may also be local and regional laws that apply to companies that operate in different states or different countries. Selling products in Europe, for example, might mean that a company has to impose a Value-Added Tax on its goods. Hiring employees at branch locations in different locations might change the requirements on minimum wage, tax allowances or working hours. Understanding these laws is vitally essential to the organization because any breach of them will have a serious impact not only on the business’s financial well-being but also on its reputation.

**Globalization and human resource development: theoretical approach.**

Globalization is a non-stop economic process. Individuals, companies or governments are always on the lookout for new processes or innovations—and so the economic and power structure of the world is never stagnant. It is clear that in creation of innovations not only technology is important, but also people, culture and communication. Under going globalization process the necessity to investigate global human resource development and its differences from domestic human resource development appears. It this paper authors analyze factors impacting global human resource development, positive and negative influence of globalization on human resource, globalization’s impact on human resource development process, migration process and its impact on unemployment rate in Lithuania. Mostly authors emphasize influence of culture and speak about opportunities of acculturation. The main aim of this paper is to explore the impact of globalization on human resource development.

1. **INTRODUCTION**

Globalization is not a new factor in the world but it is very important for all countries which were more involved in this process not far ago. Such countries are Lithuania, Latvia, Estonia, Poland, Czech Republic, Slovakia, Hungary, Cyprus, Malta and Slovenia, which entered European Union (EU) in 2004. Looking specifically at economic globalization, it can be measured in different ways. These centre on the four main economic flows that characterize globalization:

- Goods and services (exports plus imports as a proportion of national income or per capita of population);
- Capital (inward or outward direct investment as a proportion of national income or per head of population);
- Technology (international research and development flows; proportion of populations and rates of change thereof) using particular inventions (especially ‘factor-neutral’ technological advances such as the telephone, motorcar, broadband);
- Labor/people (net migration rates; inward or outward migration flows, weighted by population).

It becomes very topically to response challenges of the globalization, referring to the experience of the West countries or creating and looking for individual ways. Increasing amount of the information form all around, importance of the technologies the topicality of the human resource development (HRD) in the organizations is more and more growing. And attention to the global human resource development should be paid in national organizations as well, even if they did not face directly globalization influence, but representatives of various nationalities work in them, and they first or last will face globalization impact. Also the attention must be paid promptly to global human resource development in international enterprises and enterprises having divisions in different countries of the world indeed. Therefore authors want to discuss one of the above shown characteristics—labor—as human resource and its development in globalization process.

2. **DEFINITION OF GLOBAL HUMAN RESOURCE DEVELOPMENT**

The perception of globalization among the European public and certainly as expressed by many voters in America’s current election cycle is very different. Among large groups of the traditional middle classes on both sides of the Atlantic, globalization is rather perceived as a transfer of existing jobs, know-how, and wealth from developed countries to the new and rapidly growing economies, especially China and India. In other words, not an integrative process, which new participants join, but rather a zero-sum type process of transferring opportunities for an economically secure life from one part of the world to another (Kirkegaard, 2008).

According to McClean (2001), Bates (2003), Marquardt and Berger (2003), the HRD must include not only economic development and workplace learning, but it must also be committed to the political, social, environmental, cultural, and spiritual development of people around the world. Global success depends on utilizing the resources and diverse talents and capabilities of the broadest possible spectrum of humanity. While speaking to the broader context of research that explores concepts and theories of the field in a cross-cultural context, it is likewise important to look at a definition of HRD that may not fit in the context of a specific culture or in a specific national environment, but rather relates to how we understand the field when it is applied in an international or cross-national context.

3. **POSITIVE AND NEGATIVE ASPECTS OF GLOBALIZATION**

Globalization is highly controversial issue and the concept has acquired a considerable emotive force. Globalization, however, does not affect countries or people alike. In considering the issue of globalization and HRD, one first needs to address a number of questions. Is globalization a benefit or a detriment to the development of human resources? Globalization has already harmed the environment and can certainly threaten it more in the future. Traditionally, the environment has been a tangential issue but not a focus for HRD professionals, beyond those directly involved in environmental instruction. HRD professionals need to search for ways in which they can help their organizations to become more supportive of a sustainable environment, be it because the organization may gain a competitive advantage through ecological efforts (Arnold and Day, 1998) or as a pro-bono, meaning of work opportunity for workers. Every organization also should look for ways in which it could partner with others to undertake activities such as the following (Marquardt, 1999):

* Encouraging national and educational institutions to integrate environmental and developmental issues into existing training curricula and promote the exchange of their methodologies and evaluations;
* Encouraging all sectors of society, such as industry, universities, government officials and employees, and community organizations, to include an environmental management component in all relevant training activities, with emphasis on meeting immediate skill requirements through short-term formal and in-plant vocational and management training;
* Strengthening in-house environmental management training capacities;
* Establishing specialized "training of trainers" programs to support training at the national and enterprise levels;
* Developing new training approaches for existing environmentally sound practices that create employment opportunities and make maximum use of local resource–based methods;
* Supporting efforts to develop a service of locally trained and recruited environmental technicians able to provide local people and communities, particularly in deprived urban and rural areas, with the services they require, starting from primary environmental care;
* Preparing environment and development training resource guides with information on training programs, curricula, methodologies, and evaluation results at the local, national, regional, and international levels;
* Assisting governments, industry, trade unions, and consumers in promoting an understanding of the interrelationship between a healthy environment and sound business practices.

4. FACTORS INFLUENCING GLOBAL HUMAN RESOURCE DEVELOPMENT

According to reviewed literature in this paper, factors impacting global HRD are provided in Table 2. We can see that all authors mark cross-cultural importance. International and comparative HRD research, regardless of specific topics studied, continually refers to culture (Marquardt and Berger (2003), Losey, Meisinger and Ulrich (2005), Bates (2003) et al). Culture shapes the group’s and each member’s conscious and subconscious values, assumptions, perceptions and behavior (Marquardt, Berger and Loan, 2004).

- Communicate respect;
- Display empathy;
- Tolerate ambiguity.
- Be non-judgmental;
- Practice role flexibility;
- Personalize knowledge and perceptions;
- Demonstrate reciprocal concern;

It provides the group with systematic guidelines for how they should conduct their thinking, actions, rituals, and business. Since HRD professionals may come from several different cultures, the cultural dynamic impacts every aspect of global HRD. This means that culture is a matter of central importance for global HRD. Variations in HRD practices and systems are directly linked to the socio-cultural variations among countries and regions around the world (Dirani, 2006). Marquardt, Berger and Loan (2004) state that the seven steps of the Global Training Model are similar to those followed to develop domestic training programs.

Global human resource development practitioners may choose between:
* The easy road of simply transposing a successful domestic training program from one cultural setting to another or
* The difficult, time-consuming road of "acculturizing" the program to fit the culture of the learners.

A relatively small percentage of human resource professionals are able to express early career interests in global human resource and/or gain orderly development. Unlike finance, accounting engineering, technology, manufacturing, and even sales, global human resource is much more attuned to a nation's history, language, and culture, which greatly precludes or limits the utilization of human resource professionals as expatriates (Losey, Meisinger and Ulrich, 2005).

5. GLOBALIZATION PROCESS IN LITHUANIA

According to the index, the world's most globalized country is Belgium, followed by Austria, Sweden, the United Kingdom and the Netherlands. The least globalized countries according to the KOF-index (Drejer et al, 2008) are Rwanda, Myanmar and Burundi and Saudi Arabia. Places of new EU countries (entered in 2004) according to the KOF-index of globalization are shown in Table 3. Czech Republic looks the best from the list of 122 countries. It is on the 8th place by total globalization index, 12th by economic globalization, 10th by social globalization and 30th by political globalization. Lithuania’s situation is one of the worst from all countries listed in Table 3. It is 45 according to globalization index (only Latvia goes bellow it, 47th place), 28th by economic globalization, going after Slovenia (24th) and Slovakia (26th), and the last (42th) according to social globalization. Such situation impacted immigration process in Lithuania.

6. THE FUTURE OF HRD IN THE AGE OF GLOBALIZATION

Culture influences every aspect of HRD. Diagnosing and understanding learner’s cultural values is as important as understanding their training needs. Hofstede (1991) says that national culture is the strongest influence on the behavior of employers and employees, customers and citizens—stronger than differences in professional roles, education, age, or gender. And these cultural differences do not go away if one is employed in a global corporation. Laurant (1983) discovered that the impact of culture was greater in global companies than in domestic ones, that a multinational environment causes people to cling even more strongly on their own cultural values.

In the future, HRD professionals in all parts of the world could strengthen their role in helping individuals, organizations and nations to (Marquardt & Berger, 2003):
* Acquire knowledge—encourage the creation of knowledge locally through research and development as well as tapping and adapting knowledge available elsewhere in the world;
* Absorb knowledge—ensure universal basic education with special emphasis on extending education to girls and other traditionally disadvantaged groups; create opportunities for lifelong learning; support tertiary education, especially in science and engineering;
* Communicate knowledge—take advantage of new information and communications technology—through increased competition, private sector provision, and appropriate regulation—to ensure that all people have access.

HRD must also reflect deeply about the effects of globalization on all aspects of work and culture and only then proceed in developing specific methods for workplace learning and organizational change. Globalization and its implications are large and far-reaching and is a prominent feature of futures literature (Flanagan, 1999, Hodgest et al., 1999, Wright et al., 1999).
According to Marquardt et al (2004) HRD professionals have to pay attention to:

- Skills for understanding global business opportunities, including the ability to recognize and connect trends, technological innovation, and business strategy;
- Skills for setting an organization’s direction—creating vision, mission and purpose;
- Skills for implementing this direction in an ethically and culturally sensitive way;
- Skills for mutual person understanding and effectiveness with multicultural teams and alliances in a global context;
- Ability to think with global mindset.

7. CONCLUSION

Globalization presents many challenges to an organization. A key issue for domestic and global human resource development is how to have people gain more confidence, competency, and control in an uncertain world.

Different scientists give both positive and negative aspects of globalization and its effects. However, authors of this paper envisage more positive sides of this process, and they would assess negative ones only as possible threats (e.g. inequality within and between nations; famine, threat for employment and living standards or decline of social progress), which could be only under specific conditions and only in some countries (Kumpikaite and Sakalas, 2007).

Domestic and global human resource development has some basic differences, which we could classify as political economic and cultural environment. Culture is very important in working with people and developing them. So it is very important to pay attention to such factors as language, cross-cultural communication, religion, family, class structure, geography and history. Therefore, in this situation as Marquardt, Berger and Loan (2004) suggest, domestic—traditional human resource development programs should be acculturized—adapted and modified to the target audience. New EU countries should pay attention to this possibility and to learn how to provide correct acclimatization to reach company’s goals.

Impact of globalization increased in EU8 countries after they entered to European Union in 2004. Migration processes, changes rates of unemployment became very important in all new and old European Union countries. Language aspect is very important in these countries, because they are countries that do not speak English. Therefore, here the key to success in a foreign training session is preparation. Basically looking at Lithuanian companies it seems they choose the easy road of simply transposing a domestic training program to international companies as well. The authors of this paper have the idea to explore acclimatization’s of human resource development possibilities and perspectives in Lithuanian organizations in nearest future.

**The effect of globalization on functions of Human Resource Management**

A powerful force impacting organisations worldwide is the process of globalization, which refers to the intensification of worldwide economic and social inter dependencies and the multiplicity of linkages and interconnections between states, societies and organisations. Globalization describes the process by which events, decisions and activities in one part of the world come to have significant consequences for individuals and groups in distant parts of the globe. Processes of globalization accelerate change, lead to turmoil in the markets in which organisations operate and set the stage for intra- and inter-organisational change as a reflection of the turbulent environment.

As a result, domestic and international competition has increased and so the human resource management is being given a key role. The following changes in human resource policies and programmes are observed.

1. With manpower costs going up, and the need to bring product prices down to meet competition, manpower productivity has become a central issue in organizations. Human resource professionals will have to play a critical role to fulfill this need.
2. Another area of intervention would be in the case of joint ventures where professional will have to predict and manage culture-fit policies. Companies are focusing on people with the right profiles as also those who are more capable.
3. There is increasing emphasis on training, retraining, and to tap latent talent and its retention.
4. Companies have started paying attention to career growth and career planning for employee.
5. Companies are showing increasing willingness to retain talent and redeploy manpower when necessary. In some industries, Indian employees are being sought after abroad. This, coupled with competition for employees among Indian companies, has led to an alarming attrition rate for some companies. To meet ambitious career aspirations and salary expectations, human resource departments are using industry-wise benchmarking for salary revisions.
6. Employee compensation is being linked and programmes are becoming more focused, responsive and are also constantly reviewed against the external environment.
7. Contemporary practices, policies and programmes are becoming more focused, responsive and are also constantly reviewed against the external environment.
8. Globalization has resulted in an influx of foreign managers to India. There is evidence of greater mobility both within India and abroad. Furthermore, there is greater integration with world market dynamics and practices.
9. Corporate restructuring and redefining of roles are areas also under focus.
10. As many organisations are expanding into markets outside their national bases, research into conflict around work and organisations needs to address both cross-border ventures and cooperation in multinational teams within domestic organisations. By entering into cross-border Greenfield investments, joint ventures, cross-border alliances, mergers and acquisitions, organisations seem to be severing their geographical ties with one national economy and are transforming into multinational or even transnational corporations. While advantages of such moves are an increase in scale, organisational growth and innovation, increased risks of conflict and failure have a countervailing effect. Market failure arising from asymmetric information in different environments, clashing legal systems and cumbersome bureaucracies, as well as miscalculations caused by unfamiliar business practices and cultural differences, are more likely in the case of
cross-border transactions than in purely domestic transactions. Much depends on the ways in which members of the organisations in question respond to the fact that such challenges upset intra-organisational management practices, work routines, group cohesion and identification. In sum, multinational cooperation in cross-border ventures and multinational teams implies intra- and inter-organisational change with a potential for conflict at different levels.

At the contextual level, it manifests itself in complex relationships between multinational organisations and their socio-economic and political environments.

At the institutional and professional level, it manifests itself through the rearrangement of work units and the formation of new teams, comprising staff from different professional backgrounds, levels of training and experience, and organisational cultures and sub-cultures. At the social and cultural level, it manifests itself in terms of increasing diversity within organisations with teams including individuals who represent different ages, gender and ethnic, religious and cultural groups.

Human Resource Management has been affected by a number of trends including globalisation, changes in technology, demographics of the workforce, ethical issues and pressures to show that its practitioners add value to the organization.

Globalization has resulted in specific challenges to HRM including:

(i) How to enhance global business strategy,
(ii) How to align HRM with business strategy,
(iii) How to design and lead change,
(iv) How to build global corporate culture,
(v) How to develop leaders.

The Effect Of Globalisation On Corporate Social Responsibility

The Understanding of Corporate Social Responsibility and Globalisation

Most firms take ethical and moral behaviours and activities expressing the concerns of consumers' and shareholders’ interests or increase the investment in the corporate social responsibility projects. However, the previous aspects are not the true understandings of corporate social responsibility. Baker (2003) proposed that corporate social responsibility is about how firms employ and control their business activities and processes producing a positive outcome for the whole society. Moreover, the definition from the European Commission (2011) is more comprehensive and meaningful, which is that companies incorporate social and environmental concerns into their business activities and the interaction with their shareholders and consumers to benefit the whole society. These definitions on corporate social responsibility concentrate on the improvement of social welfare and society. However, the definition from the European Commission further indicates that environmental, social and ethical issues are embedded in the business processes. In this study, the true meaning of corporate social responsibility is that firms integrate environmental, social and ethical issues in business processes and decision making process with the motivation of benefiting the stakeholders.

The concept of globalisation is described as one of the most leading thoughts considerably affecting modern business theories and practices. This concept significantly make most scholars and practitioners concentrate on its influences on every aspect of human living and modern business, such as economic restructuring, firm’s business operation, environment sustainability, culture, technology and governance (Bhargwati, 2004). Scherer and Palazzo (2008) proposed that globalisation is defined as a process of amplification and acceleration of social activities and economic cooperation across areas and countries. This process makes multinational corporations gain more free space and flexible to employ international business and trade for more profits. However, without more restrictions on law, regulation and social influence in a specific area or country, new global problems and challenges are produced during this process, such as climate change, distribution of income and welfare and terrorism (Scherer and Palazzo, 2008).

In early stage, globalisation involves the transformation and development of technologies in host countries, information sharing in different economies or continents, human resource mobility, and foreign investment from developed economies to less developed countries. However, both developed economies and developing economies have critically encountered religious, environmental and social issues resulting from globalisation (Elizabeth, 2005; Miles, 2007; Lauder et al., 2006). Under the influence of globalisation, economic liberalization, international cooperation between different countries and the previous aspects, such as the transformation of technologies and others, considerable countries have experienced the benefits from globalisation. Furthermore, these countries also need more efforts to be encountered with the challenges and threats created by globalisation.

The Impact Of Globalisation on Corporate Social Responsibility

For multinational corporates, globalisation not only brings more opportunities and benefits for multinational corporates, but also makes multinational corporates adapt to the changing environment and accept the unprecedented challenges in the global level, industrial level and other levels. Corporate social responsibility is considered as one of the most significant aspects facing firms employing international business. In other words, multinational corporates reconsiders the fact that the moral, ethical, environmental and social issues should be incorporated into the process of decision making on business strategies and operations.

Globalisation to a great extent promotes this evolution of corporate social responsibility, which makes the public and organizations recognize and understand the negative consequences, such as the increasing income inequality, exploitation of labour, and environmental unsustainability (Thomson, 2002). Since multinational corporates and their business further deepen this trend of the negative consequences, corporate responsibility is paid more attention to by the public and international community. However, on the other hand, the development of international business and the activities of multinational firms are considered as the solution of global problems, such as the supplier of public goods and the protection of citizenship rights and human rights (Matten and Crane, 2005). Corporate social responsibility is to some extent viewed as one of the considerable forces to solve the negative conse-
In accordance with the theoretical perspective, there are two aspects of the effect of globalisation on corporate social responsibility. First, economic growth not only makes the public and national governments concentrate on welfare augmentation and its benefits for the society, but also makes them recognize that economic development is the consequence of the combination of social, economic and moral implications (Friedman, 2006). In ideal environment, economic growth will provide the equal distribution of income and welfare, the respect and protection of human rights and other aspects, which all people will share. However, globalisation to a certain extent further intensifies the phenomenon on inequality. During this process, who to be responsible for the balance between economic growth and inequality is considered as the significant path of coping with the negative consequences of globalisation. This study argues that governments, firms, consumers are described as the principal undertaker. For firms, they are significant undertakers responsible for the public and social interests and moral issues. The firms incorporate social, environmental and moral issues into the process of their decision making and take the rational responsible behaviour and activities, which brings more and more profits for their shareholders and interests for their stakeholders in the long term. However, some firms made some decision and illegal and immoral and were responsible for the bad consequences. For instance, Enron scandal is considered as the most important example on illegal operation and misbehaviour making shareholders responsible for the huge loss (Healy and Palepu, 2003).

Second, during the process of globalisation, the firms can maximize the efficiency and the performance of firms’ business through the worldwide allocation of resources. Nevertheless, the firms encounter the fierce competition beyond the spectrum of country or area. The competition not only brings more value and interests for their consumers, but also makes firms rethink their concerns of social, ethical and environmental issues and decision making process. There is a fact that more and more consumers concern the perception of firms’ environmental and social issues and socially responsible behaviours. Furthermore, the shareholders and stakeholders also focus on the implementation of the strategies on environment and social communities. They will invest in the responsible and sustainable companies that produce the benefits and profits in the long term. Based on these facts from consumers and shareholders, more and more companies concentrate on the implementation and development of social responsibility.

In summary, during the process of globalisation, there are the emergence of the global problems and negative consequences, such as global warming and climate change, the increasing unequal distribution of income and welfare, the abuse and invasion of human rights and others. These elements promote the focus and implement of corporate social responsibilities when multinational corporates employ international business and trade. Moreover, the worldwide competition and consumers’ and shareholders’ perception make the firms recognize and rethink corporate social responsibility and decision making process concerning environmental, social and ethical issues.

The Practice of Corporate Social Responsibility in China

China is considered as the second largest economy experiencing the rapid and stable economic growth and development, even in the term of financial crisis. The annual growth of China’s economy is over 9 per cent, which is the worldwide fastest growing economy because of the implement of Open Door policy in 1978. Moreover, the economic development of China to a great extent is benefited from globalisation. Since implementing the trade and finance liberalisation and foreign investment policies, China is described as one of the most significant destinations of foreign direct investment.

However, this process of globalisation results in the increasing pressure on environment and resource, labour relations and work conditions, human rights and community development because of the foreign firms seeking the labour force of cheaper cost and natural resource. Ho and Welford (2006) indicated that environmental pollution and community press in China made local communities and society stop new plants with environmental pollution and other projects. During the past three decades, the leading foreign companies are the dominated drive force to implement corporate social responsibility in China. Today, the Chinese Government recognized and understood the environmental pressure and the effect on the further development of economy and society. In terms of See (2008), a ‘Harmonious Society’ policy proposed by Chinese President Hu Jintao is dedicated to develop a Chinese own development approach. One element of this policy is the sustainable development and social responsibility. Moreover, the Chinese Government has encouraged the private sector to implement corporate social responsibility. The following will focus on the two aspects of corporate social responsibility including the environment and the labour.

In accordance with Liu and Diamond (2005), air pollution, water pollution, severe biodiversity situation and energy waster make China responsible for the worst environment and development pressure. This fact indicates that environmental issues may be considered as the most significant challenge or opportunity facing firms in China. For example, the leading milk production and packing firm-Mengniu cooperating with World Wide Fund for Nature aims to further reduction of carbon emission (China CSR, 2010). Furthermore, the Chinese Government promote corporate social responsibility and environment sustainable and protection from several aspects, such as the supervision and regulation making of the Government’s State Environmental Protection Agency (SEPA) and the environmental requirement of IPO (Initial Public Offering) from the China Securities Regulatory Commission (CSRC).

Referring to the labour, the rights of migrant workers and other labour issues in China cannot be effectively protected and at risk of exploitation (Welford and Frost, 2006). There are a huge number of migrant workers from home to southern cities to obtain better wages and others. Chan (2001) indicated that Shenzhen, as the first city of implementing the Open Door policy, has 12 million migrant workers, which account for over 92 per cent of the total population in Shenzhen city. Although there are some laws and regulation on labour relations and protection, the exploitation of labour exists in many provinces and may worsen. For instance, more than 13 workers employed by Foxconn Company in China committed suicide in 2010 because of labour rights (Pomfret et al., 2010). The severe labour rights and their work conditions are the most significant aspects facing the firms implementing corporate social responsibility.
Foreign Exchange Management Act

The Foreign Exchange Management Act, 1999 (FEMA) is an Act of the Parliament of India "to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India". It was passed in the winter session of Parliament in 1999, replacing the Foreign Exchange Regulation Act (FERA). This act makes offences related to foreign exchange civil offenses. It extends to the whole of India, replacing FERA, which had become incompatible with the pro-liberalization policies of the Government of India. It enabled a new foreign exchange management regime consistent with the emerging framework of the World Trade Organisation (WTO). It also paved the way for the introduction of the Prevention of Money Laundering Act, 2002, which came into effect from 1 July 2005.

Description

Unlike other laws where everything is permitted unless specifically prohibited, under the FERA act of 1973 (predecessor to FEMA) everything was prohibited unless specifically permitted. Hence the tenor and tone of the Act was very drastic. It required imprisonment even for minor offences. Under FERA, a person was presumed guilty unless he proved himself innocent, whereas under other laws a person is presumed innocent unless he is proven guilty.

FEMA is a regulatory mechanism that enables the Reserve Bank of India and the Central Government to pass regulations and rules relating to foreign exchange in tune with the Foreign Trade policy of India.

Switch from FERA

FERA, in place since 1974, did not succeed in restricting activities such as the expansion of Multinational Corporations. The concessions made to FERA in 1991-1993 showed that FERA was on the verge of becoming redundant. After the amendment of FERA in 1993, it was decided that the act would become the FEMA. This was done in order to relax the controls on foreign exchange in India, as a result of FEMA served to make transactions for external trade and easier – transactions involving current account for external trade no longer required RBI’s permission. The deals in Foreign Exchange were to be ‘managed’ instead of ‘regulated’. The switch to FEMA shows the change on the part of the government in terms of for the capital.

- The buying and selling of foreign currency and other debt instruments by businesses, individuals and governments happens in the foreign exchange market. Apart from being very competitive, this market is also the largest and most liquid market in the world as well as in India. It constantly undergoes changes and innovations, which can either be beneficial to a country or expose them to greater risks. The management of foreign exchange market becomes necessary in order to mitigate and avoid the risks. Central banks would work towards an orderly functioning of the transactions which can also develop their foreign exchange market.
- Foreign Exchange Market Whether under FERA or FEMA’s control, the need for the management of foreign exchange is important. It is necessary to keep adequate amount of foreign exchange from Import Substitution to Export Promotion.

Main Features

- Activities such as payments made to any person outside India or receipts from them, along with the deals in foreign exchange and foreign security is restricted. It is FEMA that gives the central government the power to impose the restrictions.
- Without general or specific permission of the MA restricts the transactions involving foreign exchange or foreign security and payments from outside the country to India – the transactions should be made only through an authorised person.
- Deals in foreign exchange under the current account by an authorised person can be restricted by the Central Government, based on public interest generally.
- Although selling or drawing of foreign exchange is done through an authorized person, the RBI is empowered by this Act to subject the capital account transactions to a number of restrictions.
- Residents of India will be permitted to carry out transactions in foreign exchange, foreign security or to own or hold immovable property abroad if the currency, security or property was owned or acquired when he/she was living outside India, or when it was inherited by him/her from someone living outside India.

Regulations/Rules under FEMA

- Foreign Exchange Management (Current Account Transactions) Rule, 2000
- Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000
- Foreign Exchange Management (Transfer or Issue of any Foreign Security) regulations, 2004
- Foreign Exchange Management (Foreign currency accounts by a person resident in India) Regulations, 2000
- Foreign Exchange Management (Acquisition and transfer of immovable property in India) regulations, 2000
- Foreign Exchange Management (Establishment in India of branch or office or other place of business) regulations, 2000
- Foreign Exchange Management (Manner of Receipt and Payment) Regulations, 2000
- Foreign Exchange Management (Export of Goods and Services) regulations, 2000
- Foreign Exchange Management (Realisation, repatriation and surrender of Foreign Exchange) regulations, 2000
- Foreign Exchange Management (Possession and Retention of Foreign Currency) Regulations, 2000
- Foreign Exchange (g proceedings) rules, 2000

FEMA: Provisions of Foreign Exchange Management Act - Provisions of Foreign Exchange Management Act (FEMA) provides free transaction on current account subject to the guidelines by the RBI. Enforcement of Foreign Exchange Management Act (FEMA) is entrusted to a separate directorate, which undertakes investigations on contraventions of the Act.
Provisions of FEMA are grouped under four heads. Important provisions under each of the four heads, having a bearing on promoting economic development through foreign investment with enabling provisions to ensure the curtailing of inflationary trends from such transactions, are outlined below.

**Regulation for Current Account Transactions:** Any person can sell or draw foreign exchange to or from an authorised dealer (if such sale or withdrawal is a current account transaction) except for certain prohibited transactions like remittance of lottery winnings, remittance of interest income on funds held in Non-Resident Special Rupee (NRSR) account scheme, etc.

Besides these cases, there are certain other transactions, for which specific RBI approval will be required. For instance, Reserve Bank approval is required for importers availing of Supplier’s Credit beyond 180 days and Buyer’s Credit irrespective of the period of credit. Authorised dealers are permitted remittance of surplus freight/passage collections by shipping/airline companies or their agents, multimodal transport operators, etc., after verification of documentary evidence in support of the remittance.

**Regulations Relating to Capital Account Transactions:**

- i. Foreign nationals are not allowed to invest in any company or partnership firm or proprietary concern, which is engaged in the business of Chit Fund or in Agricultural or Plantation activates or in Real Estate business (other than development of township, construction of residential/commercial premises, roads or bridges) or construction of farm houses or trading in Transferable Development Rights (TDRs). Listing of permissible classes of Capital account transaction for a person resident in India and also by a person resident outside India has been provided in the regulations.

- ii. Detailed rules and regulations are provided on borrowing and lending in Foreign Currency as well as India Rupee by a person resident in India form/to a person resident outside India either on non-repatriation or repatriation basis.

- iii. Authorised dealers are now permitted to grant rupee loans to NRIs against security of shares or immovable property in India, subject to certain terms and conditions. Authorised dealers or housing finance institutions approved by National Housing Bank can also grant rupee loans to NRIs for acquisition of residential accommodations subject to certain terms and conditions.

- iv. General permission has been granted to Indian company (including Non-Banking Finance Company) registered with Reserve Bank to accept deposits from NRIs on repatriation basis subject to the terms and conditions specified in the schedule.

Indian proprietorship concern/firm or a company (including Non-Banking Finance Company) registered with Reserve Bank can also accept deposits from NRIs on non-repatriation basis subject to the terms and conditions specified in the schedule.

**Regulations relating to export of goods and services:**

Export proceeds are required to be realised within a period of 6 months from the date of shipment. In the case of exports to a warehouse established abroad with the approval of Reserve Bank, the proceeds have to be realised within 15 months from the date of shipment. An enabling provision has been made in this regulation to delegate powers to authorised dealers to allow extension of time. Export of goods on elongated credit terms beyond six months requires prior approval of Reserve Bank.

**Other Regulations:**

- i. A person resident in India to whom any foreign exchange is due or has accrued is obligated to take reasonable steps to realise and repatriate to India such foreign exchange unless an exemption has been provided in the Act or regulations made under the general or special permission of Reserve Bank.

- ii. Any foreign exchange due or accrued as remuneration for services rendered or in settlement of any lawful obligation or an income on assets held outside India or as inheritance, settlement or gift to a person resident in India should be sold to an authorised person within a period of seven days of its receipt and in all other cases within 90 days of its receipt.

- iii. Any person who has drawn exchange for any purpose but has not utilised it for the same or any other purpose permissible under the provisions of the Act should surrender such foreign exchange or un-utilised foreign exchange to an authorised person within a period of 60 days from the date of acquisition.

Where, however, exchange was drawn for travel abroad, the un-utilised exchange in excess of the limit up to which foreign exchange is permitted to be retained, should be surrendered to an authorised person within 90 days from the date of return of the traveller to India if unspent exchange is in the form of travellers cheques.

- iv. The Reserve Bank has specified the limit for possession and retention of foreign currency by a person resident in India. There is no restriction on possession of foreign coins by any person. Any person resident in India is permitted to retain in aggregate foreign currency not exceeding US $2 k or its equivalent in the form of currency notes/bank notes or travellers cheques acquired by him from approved sources.

- v. The Reserve Bank has granted general permission to any person to receive any payment:

  - made in rupees by order or on behalf of a person resident outside India during his stay in India by converting the foreign exchange into rupees by sale to an authorised person;
  - made by means of a cheque drawn on a bank outside India or a bank draft or travellers cheques issued outside India or made in foreign currency notes directly, provided the cheques, drafts or foreign currency is sold to an authorised person within seven days of its receipt;
  - by means of a postal order or money order issued by a post office outside India.

- vi. Reserve bank has also granted general permission to a person resident in India to make payment in rupees;

  - a) for extending hospitality’

**Determination of Trading Partner’s Independence**

**Essential Factors that Determines the Gains from International Trade**

Some of the important factors that determine the gains from international trade are as follows:
1. Differences in Cost Ratios: The gains from international trade depend on differences in comparative cost ratios in the two trading countries. “A country gains by foreign trade, if and when, the traders find that there exists abroad a ratio of prices very different from that to which they are accustomed at home. They buy what to them seems cheap and sell what to them seems dear. The bigger the gap between what to them seems low profits and high profits, and the more important the article affected, the greater will be the gain from trade.” It country A has a comparative advantage in the production of wheat and country B has a comparative advantage in the production of cotton, both countries will gain from trade.

The size of the gain will depend on the cost of production of each commodity in both countries. If with increase in efficiency of labour the cost of production of wheat in country A falls, then country B shall gain more from trade. Contrary will be the case if the cost of production of cotton in country B falls, then country A will gain from trade. Thus the greater the differences in comparative cost ratios, the larger are the gain from trade.

2. Reciprocal Demand: - The terms of trade, in turn, depend upon reciprocal demand, i.e., the relative strength and elasticity of demand of one country for the product of the other in exchange for its product. To carry out above example further, if A’s demand for commodity Y is more intense (inelastic), then the terms of trade will be nearer 1X = 1Y. The terms of trade will move in favour of B and against country A. B will gain more and A less. On the other hand, if A’s demand for commodity Y is less intense (more elastic), then the terms of trade will be nearer 1X = 1.33 T. The terms of trade will move in favour of A and against B. A will gain more from trade and B less. Thus a country gains the most from trade whose demand for foreign goods is highly elastic while the other country’s demand for its goods is highly inelastic.

3. Level of Income: - The level of money income of a country is another factor which determines the gains and the share of trade. A country whose goods have a constant demand in other countries will have a high level of money income. If the demand for its exports is high, it export industries will expand. Consequently, the level of money wages will rise in these industries.

Competition for labour will force other industries to raise money wages to the level of export industries. Thus the overall level of money incomes will tend to be high in the country. But the prices of foreign goods being imported into the country will be low, while the money incomes of the people will be high. So people of the country will gain as consumers of cheap imported goods. On the contrary, a country having high demand for foreign goods will have low money incomes. As it will have high demand for foreign goods, their prices will be high. Consequently, its people will lose as consumers of those imported goods.

4. Terms of Trade: - The most important factor which determines the gains from trade is the terms of trade. The terms of trade refer to the rate at which one commodity of a country is exchanged for another commodity of the other country. This refers to the barter terms of trade which Mill used to determine the gains as well as the distribution of the gains from international trade. In the modern analysis also, it is the terms of trade that determine the gains from trade. But when international trade takes place, the terms of trade change and are different from the domestic terms of trade. It is the international terms of trade that determine the gains from trade.

5. Productive Efficiency: - An increase in the productive efficiency of a country also determines its gain from trade. It lowers costs of production and prices of goods in the home country. As a result, the other country gains by importing cheap goods and its terms of trade improve but that of the home country deteriorate. On the other hand, if productive efficiency increases in the foreign country, its goods will be cheaper. The home country will increase its imports of these goods. Its terms of trade will improve and it will gain from trade.

6. Nature of Commodities Exported: - Another factor is the nature of commodities exported by a country. A country which exports mainly primary products has unfavourable terms of trade. Consequently, its gain from trade will be smaller. On the contrary, a country exporting manufactured goods has favourable terms of trade and its gain from trade will be larger.

7. Technological Conditions: - A country which is technologically advanced and has an abundance of capital, its volume of foreign trade will be large and so will be its gain from international trade. On the other hand, if a country is technologically backward with abundant labour, its volume of foreign trade will be small and so will be its gain from trade.

8. Size of the Country: - The gain from trade also depends on the size of the country. A small country which specialises in the production of those commodities in which it enjoys a comparative advantage, exchanges them with a large country. Under conditions of constant opportunity cost and different demand patterns, the more foreign market prices differ from domestic prices, the greater will be the gain from trade for the small country.