International Business
Unit 3

Regional Economic Co-operation and International Financial Environment

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Contents

Regional Economic Integration

- Regional economic integration refers to cooperation between various countries of a particular region in order to develop that particular area.
- It includes economic integration of various trading areas of different countries it is also known as **Regional Trade Block, Regional Economic Forces and Regional Grouping.**
- A regional trade block is a type of intergovernmental agreement, in which barriers to trade are reduced or eliminated among participating countries.
- Regional Economic Integration is a collaborative arrangement between different countries in order to take advantage of market opportunities and to promote economic growth and stability.

Regional Economic Integration

- **Levels of regional economic integration**

- **Preferential Trade Agreement**
- **Free Trade Agreement**
- **Custom Union**
- **Common Market**
- **Economic Union**
- **Political Union**

Regional Economic Integration

- **Preferential Trade Agreement:** It is the losers to form of economic integration where a group of countries make a formal agreement to trade goods and services on preferential terms. It results in reduced tariff and sometimes a special quota is allowed for preferential access. These agreements are generally made between developed and developing countries to promote economic development of developing nations.
- **Free Trade Agreement:** It is a permanent arrangement usually between the neighbouring countries. It involves complete removal of tariffs on goods. However, it is not applied to Agricultural sector, fishing or services. The member countries are free to charge their own external terrace from countries outside the free trade area. Therefore, each member country has full freedom over trade with external countries.
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Regional Economic Integration

- **Custom Union**: Just like the members of Free Trade Area, the members of Custom Union also remove barriers among themselves. In addition they also have a common trade policy with respect to non-member countries. Due to the common trade policy, a common external tariff is charged from non member countries and revenue is shared among the member countries.
- **Common Market: T**he common market has no barriers to trade among the member countries and there is a common external policy for trade with non-member countries in addition the restrictions on movement of the factors of production is also remove. Factor of production includes labour, technology, and capital at Sector. The restriction is abolished on immigration and emigration and cross-border investment this is done to employ the best resources in the best possible manner
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Regional Economic Integration

- **Economic Union:** Economic Union involves full integration between two or more economies. There are no trade restrictions between member countries, they follow a common external tariff policy and the restrictions on the mobility of factors of production is also abolished. In addition, there is coordination between the member countries on their economic policies such that the nations have coordinated monetary policy, fiscal policy, social welfare programs etc. and usually a common currency is used in trading.
- **Political Union: P**olitical Union involves all features of Economic Union and also complete political integration between member countries. The member countries share a common decision making and judicial body and there is complete Unity between the member Nations

South Asian Association for Regional Cooperation (SAARC)

- The South Asian Association for Regional Cooperation (SAARC) is an economic and political organization of eight countries in Southern Asia.
- The South Asian Association for Regional Co-operation (SAARC) is an organisation of South Asian nations, which was **established on 8 December 1985** when the government of **Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka** formally adopted its charter providing for the promotion of economic and social progress, cultural development within the South Asia region and also for friendship and cooperation with other developing countries.
- It is dedicated to economic, technological, social and cultural development emphasising collective self- reliance. In terms of population, its sphere of influence is the largest of any regional organisation: almost 1.5 billion combined population of its member states. **In April 2007, Afghanistan became its eighth member**.


SAARC
South Asian Association
for Regional Cooperation
Afghanistan
Bangladesh
Bhutan
India
Maldives
Nepal
Pakistan
Sri Lanka


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Prime Minister of India

Objectives of SAARC

- To promote the welfare of the peoples of South Asia and to improve their quality of life;
- To accelerate economic growth, social progress and cultural development in the region and to provide all individuals the opportunity to live in dignity and to realize their full potential;
- To promote and strengthen collective self-reliance among the countries of South Asia;
- To contribute to mutual trust, understanding and appreciation of one another's problems
- To promote active collaboration and mutual assistance in the economic, social, cultural, technical and scientific fields;
- To strengthen cooperation with other developing countries;
- To strengthen cooperation among themselves in international forums on matters of common interest; and
- To cooperate with international and regional organizations with similar aims and purposes.

Secretariat of SAARC

- The SAARC Secretariat was established in Kathmandu on 16 January 1987 and was inaugurated by Late King Birendra Bir Bikram Shah of Nepal.
- It is headed by a Secretary General appointed by the Council of Ministers from Member Countries in alphabetical order for a three-year term. He is assisted by the Professional and the General Services Staff and also an appropriate number of functional units called Divisions assigned to Directors on deputation from Member States.
- The Secretariat coordinates and monitors implementation of activities, prepares for and services meetings and serves as a channel of communication between the Association and its Member States as well as other regional organizations.
- The Memorandum of Understanding on the establishment of the Secretariat which was signed by Foreign Ministers of member countries on 17 November 1986 at Bangalore, India contains various clauses concerning the role, structure and administration of the SAARC Secretariat as well as the powers of the Secretary-General.
- In several recent meetings the heads of state or government of member states of SAARC have taken some important decisions and bold initiatives to strengthen the organization and to widen and deepen regional co-operation.
- The SAARC Secretariat and Member States observe 8 December as the SAARC Charter Day.

Free Trade Agreement

- Over the years, the SAARC members have expressed their unwillingness on signing a free trade agreement.
- Though India has several trade pacts with Maldives, Nepal, Bhutan and Sri Lanka, similar trade agreements with Pakistan and Bangladesh have been stalled due to political and economic concerns on both sides.
- India has been constructing a barrier across its borders with Bangladesh and Pakistan.
- In 1993, SAARC countries signed an agreement to gradually lower tariffs within the region, in Dhaka.
- Eleven years later, at the 12th SAARC Summit at Islamabad, SAARC countries devised the South Asia Free Trade Agreement which created a framework for the establishment of a free trade area covering 1.4 billion people. This agreement went into force on January 1, 2006. Under this agreement, SAARC members will bring their duties down to 20 per cent by 2007.

Economic Co-operation

- The acceleration of economic growth is a Charter objective of SAARC. Cooperation in the core economic areas among SAARC Member Countries was initiated following the Study on Trade, Manufactures and Services (TMS), which was completed in June 1991.
- **Currently, the following important processes of SAARC are promoting cooperation in the field of Trade, Economy and Finance and related areas:**
- **Committee on Economic Cooperation: Overall Coordination of cooperation in economic areas;**
- **South Asian Free Trade Area (SAFTA) Committee of Experts and SAFTA Ministerial Council: Administration and implementation of SAFTA;**
- **Finance Ministers Mechanism: Cooperation in the field of Finance and related areas;**
- **Standing Group on Standards and SAARC Standards Coordination Board: Cooperation in the field of harmonization of Standards;**
- **Group on Customs Cooperation is dealing with issues related to harmonization of Customs rules and procedures.**

- **SAARC Preferential Trading Arrangements (SAPTA):**
- SAPTA which came into operations in'1995 heralds a new chapter of economic co-operation among the SAARC countries. IT concretises the first step towards creation of a trade bloc in the South Asian Region. Under the SAPTA mechanism, the SAARC countries, to begin with, have identified 226 items for exchange on tariff concessions ranging from 10 per cent to 100 per cent.
- India has agreed to extend tariff concessions on 106 items, while Bangladesh has agreed to offer tariff concessions on 12 items, Maldives on 17, Nepal 14, Pakistan 35, Sri Lanka 31 and Bhutan 11. Out of 106 items offered by India for tariff concessions, 62 items would be for the least developed countries in the SAARC.
- **SAPTA to SAFTA:**
- The South Asian Free Trade Area (SAFTA) agreement came into force from July 1, 2006. With this, the earlier SAPTA established in 1995 had paved the way to SAFTA. The South Asian developed countries are well endowed with labour and natural resources.
- Further, with growing openness among themselves, higher production and expansion of labour, intensive exports, increased employment, increased wages and thereby helping in reducing poverty, the region is poised to play an important role in the growing international trade relations.

North American Free Trade Agreement (NAFTA)

- On August 12, 1992, a trilateral agreement between **United States of American (USA), Canada and Mexico** took place which declared North American region as Free Trade Area.
- This Agreement is known as NAFTA.
- USA played the dominant role in this established.
- NAFTA was the world's largest free trade agreement when it was established on Jan. 1, 1994.
- NAFTA was the first time two developed nations signed a trade agreement with an emerging market country.
- Through NAFTA, the three signatories agreed to remove trade barriers between them.
- By eliminating tariffs, NAFTA increased investment opportunities.

The North American Free Trade Agreement (NAFTA) was implemented in 1994 to encourage trade between the U.S., Mexico, and Canada.

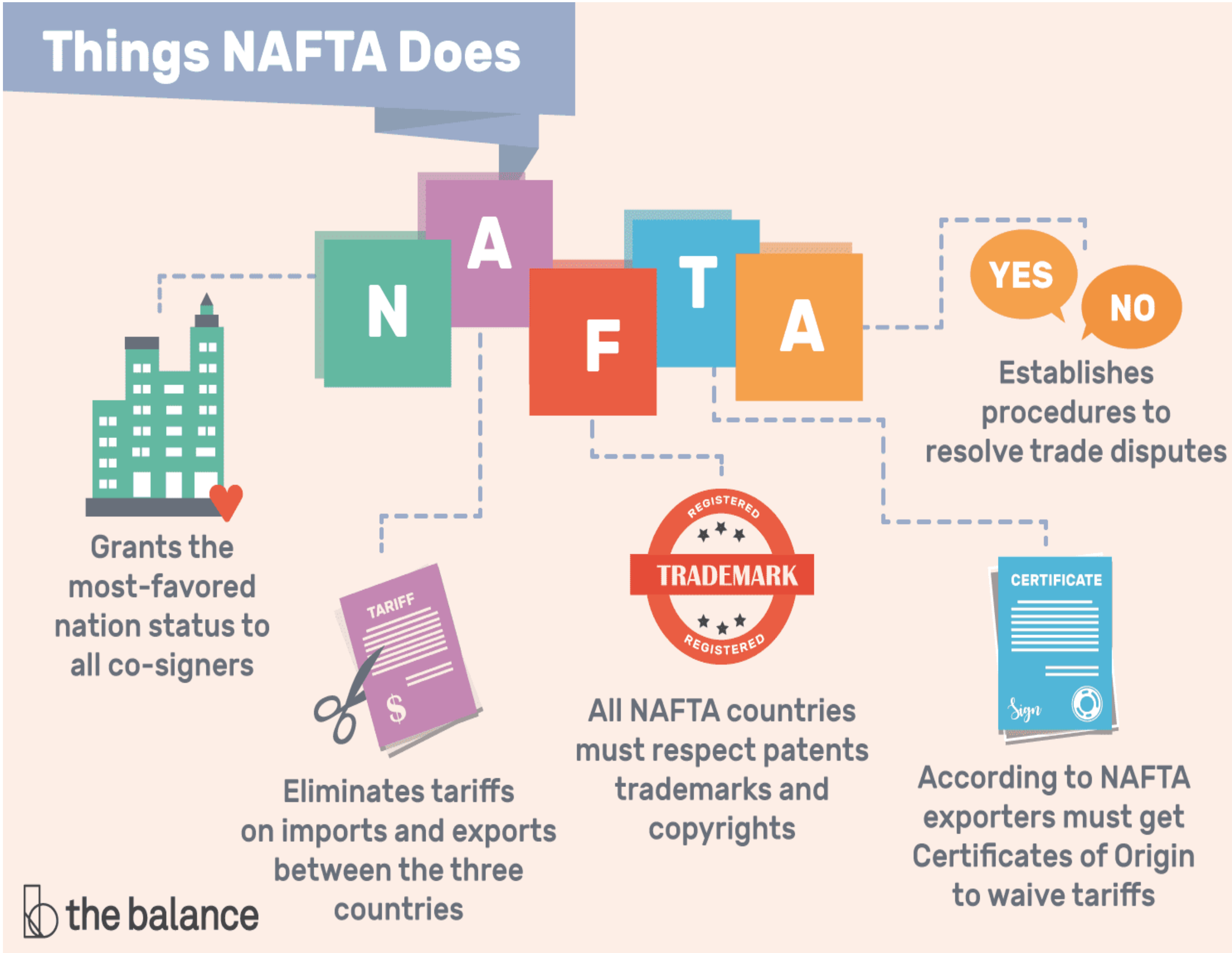
Type	Free trade area
Member states	Canada Mexico United States
History	
• Effective	January 1, 1994
• USMCA in force	July 1, 2020

NAFTA

- NAFTA was constituted mainly to meet the challenges of European Economic Community (EEC) and Japanese economic policies.
- Before NAFTA, free trade was already taking place between USA and Canada but this free grade facility was now extended to Mexico.
- The main objective of NAFTA is to utilize economic resource of North American region for developing the area in a better way.
- NAFTA has generated economic growth and rising standards of living for the people of all three member countries since 1994.
- By strengthening the rules and procedures governing trade and investment throughout the continent, NAFTA has proved to be a solid foundation for building Canada’s future prosperity.

- NAFTA accomplished six things for the participating countries.
- **First**, NAFTA granted **most-favored-nation status** to all co-signers. That means each country treated the other two fairly and couldn't give better treatment to domestic investors than foreign ones. They also couldn't offer a better deal to investors from non-NAFTA countries and they had to offer federal contracts to businesses in all three NAFTA countries.
- **Second,** NAFTA eliminated many **tariffs on imports and exports between the three countries.** Tariffs are taxes used to make foreign goods more expensive. NAFTA created specific rules to regulate trade in farm products, automobiles, and clothing.
- **Third**, **exporters were required to get Certificates of Origin to waive tariffs.** That meant the export had to originate in the United States, Canada, or Mexico. A product made in Peru but shipped from Mexico would still pay a duty when it entered the United States or Canada.

- **Fourth**, NAFTA established procedures to **resolve trade disputes**. Parties would start with a formal discussion, followed by a discussion at a Free Trade Commission meeting if needed. If the disagreement wasn't resolved, a panel reviewed the dispute. The process helped all parties avoid costly lawsuits in local courts and helped them interpret NAFTA's complex rules and procedures. These trade dispute protections applied to investors as well.
- **Fifth**, all NAFTA countries were required to **respect patents, trademarks, and copyrights**. At the same time, the agreement ensured that these intellectual property rights didn't interfere with trade.
- **Sixth**, **the agreement allowed business travelers easy access throughout all three countries**.


Things NAFTA Does
N
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YES
NO
Establishes procedures to resolve trade disputes
Grants the most-favored nation status to all co-signers
TARIFF
$
Eliminates tariffs on imports and exports between the three countries
REGISTERED
TRADEMARK
REGISTERED
All NAFTA countries must respect patents trademarks and copyrights
CERTIFICATE
Sign
According to NAFTA exporters must get Certificates of Origin to waive tariffs
the balance

USMCA

- North American Free Trade Agreement (NAFTA) was a treaty between Canada, Mexico, and the United States that eliminated most tariffs between the counties. It was replaced by the United States-Mexico-Canada Agreement (USMCA) on July 1, 2020.
- President Trump made a campaign promise to repeal NAFTA, and in August 2018, he announced a new trade deal with Mexico to replace it.
- In September 2018, Canada joined the deal: the United States-Mexico-Canada Agreement (USMCA), which was signed into effect on November 30, 2018.

What Is NAFTA's Purpose?

- According to NAFTA's article 102 of the agreement, there are 6 declared objectives of the treaty.

- **Eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the parties.**
- **Promote conditions of fair competition in the free trade area.**
- **Increase substantially investment opportunities in the territories of the parties.**
- **Provide adequate and effective protection and enforcement of intellectual property rights in each party's territory.**
- **Create effective procedures for the implementation and application of this agreement, for its joint administration and for the resolution of disputes.**
- **Establish a framework for further trilateral, regional and multilateral cooperation to expand and enhance the benefits of this agreement.**
- However, in simpler terms, NAFTA was designed to encourage economic growth and integration among the North American countries, and was thought to actually stimulate job growth, boost the three countries' respective economies, and increase imports.

Association of South East Asian Nations (ASEAN)

- The Association of South-east Asian Nation (ASEAN) is an association of nations dedicated to economic and political co-operation in South-east Asia countries.
- ASEAN was established on **8th August 1967 in Bangkok, Thailand** with the signing of the ASEAN Declaration (Bangkok Declaration) by the Founding Members of ASEAN, **Indonesia, Philippines, Malaysia, Singapore and Thailand.**
- Brunei Darussalam then joined on 7 January 1984, Vietnam on 28 July 1995, Lao PDR and Myanmar on 23 July 1997 and Cambodia on 30 April 1999 making up what is today the **ten Member States of ASEAN.**

Association of South East Asian Nations (ASEAN)

Headquarters: Jakarta, Indonesia

Founded: 8 August 1967, Indonesia

Members: Indonesia, Thailand, Singapore, Malaysia, Philippines, Vietnam, Brunei, Cambodia, Myanmar (Burma), Laos

Objectives of ASEAN

- ASEAN is a non-military and non-security economic and cultural regional association of the South East Asian member states.
- **Its main objectives are:**
- **to accelerate economic growth, cultural development and social progress in the region,**
- **to promote regional peace and stability,**
- **to promote active collaboration and mutual assistance on matters of common interests in various fields**,
- **to promote mutual cooperation and assistance in providing training and research facilities to their people;**
- **to promote South East Asian studies**;
- **to collaborate in the development of agriculture, trade and industries; and to maintain close and beneficial cooperation with existing international and regional organisations with similar aims and purposes.**

Organisational Structure of ASEAN

- The organisational structure of the ASEAN consists of the Ministerial Conference, the Standing Committee, the Secretariat and a number of permanent and ad-hoc committees. The Ministerial Conference consists of the Foreign Ministers of the member states. The Conference holds periodic consultations with regard to various matters of mutual interests.
- The Standing Committee meets as and when required and between the meeting of the conference, it holds consultations among members. It consists of the Foreign Minister of the host country where the meeting is held and the ambassadors of other member countries.
- The meetings are held in all the countries by rotation. In 1976, a secretariat was added to its organisation. Its headquarters are at Jakarta which looks after the administrative affairs of the ASEAN. Further, the ASEAN has nine permanent and eight ad-hoc committees.

Organisational Structure of ASEAN

- The ASEAN has been playing a very useful role in promoting cooperation and in securing collaboration among the member states. It is fast developing into a distinct regional entity in international relations. It provides a good example of economic and social cooperation among the countries of South East Asia.
- The establishment of SAARC (The South Asian Association for Regional Cooperation), involving India, Pakistan, Bangladesh, Sri Lanka, Nepal, Bhutan and Maldives stands definitely influenced by the ASEAN. Recently, the members of the ASEAN have undertaken several important and helpful steps for invigorating its working. Its machinery has been refined and it is now fast developing into a functional regional organisation which merits attention as a model of regional cooperation for development.

ASEAN Member Countries

ASEAN

- On August 8, 1997 the ASEAN completed thirty years of its existence as a regional association for promoting socio-economic cooperation for development of its members. It is trying to emerge as a strong and integrated regional association. It has enabled its members to attain an economic growth rate of around 7 to 8 per cent.
- It is now trying to strengthen the infrastructure for undertaking a concerted programme for development in the South East Asia and Indo-China regions. It is trying hard to take and maintain a lead in this era of increasing competition and globalisation.
- ASEAN is currently acting as an important, active and useful agency of regional cooperation for development among the member countries. Human Resources, infrastructure and information technology are the three areas in which the ASEAN countries are now trying to increase their cooperation. Now ASEAN members have been trying to develop increasing cooperation at all levels for fighting trans-national crimes like piracy, terrorism, illegal migration, drug trafficking, cyber crimes and others.

Relationship between India and ASEAN

- Since its start about decades ago, the partnership between India and the Association of South East Asian Nations (ASEAN) comprising Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand arid Vietnam has been developing at quite a fast pace.
- **India became a sectoral dialogue partner of ASEAN in 1992**.
- Mutual interest led ASEAN to invite India to become its **full dialogue partner during the fifth ASEAN Summit in Bangkok in 1995**.
- India also became a member of the ASEAN Regional Forum (ARF) in 1996.
- India and ASEAN have been holding summit-level meetings on an annual basis since 2002.
- In August 2009, India signed a Free Trade Agreement (FTA) with the ASEAN members in Thailand. Under the ASEAN-India FTA, ASEAN member countries and India will lift import tariffs on more than 80 per cent of traded products between 2013 and 2016, according to a release by the Ministry of Commerce and Industry.
- In January 2010, Singapore, Malaysia and Thailand accepted the FTA on goods.
- The other seven ASEAN countries are expected to operationalise the FTA by August 2010.
- India and ASEAN are currently negotiating agreements on trade in services and investment. The services negotiations are taking place on a request-offer basis, wherein both sides make requests for the openings they seek and offers are made by the receiving country based on the requests.

Organization of the Petroleum Exporting Countries (OPEC)

- The organization brings together most of the world’s oil exporting countries to co-ordinate their petroleum policies and provides them with technical and economic aid.
- The OPEC **headquarters in Vienna (Austria).** The member countries are Algeria. Indonesia and Iran. Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, UAE and Venezuela.
- The objectives of OPEC are to co-ordinate and unify petroleum policies of member countries and devise ways to ensure stabilization of internal oil prices in order to eliminate ‘harmful and unnecessary’ price and supply fluctuations.

- **Headquarters: Vienna, Austria**
- **Founded: September 1960, Baghdad, Iraq**
- **Type of business: International cartel**

Origin and Development of OPEC

- The organization of the Petroleum Exporting Countries (OPEC) was established in September 1960 at Baghdad (IRAQ) and was formally constituted by Iran, Iraq, Kuwait, Saudi Arabia and Venezuela in 1961.
- The other members are jointed one by one later. The headquarters initially in Geneva were shifted to Vienna in 1965.
- OPEC accounts for almost a third of the world's oil production and posses over three-quarters of the total oil reserves.

- **The 1960s:** These were OPEC's formative years, with the Organization, which had started life as a group of five oil-producing, developing countries, seeking to assert its Member Countries' legitimate rights in an international oil market dominated by the 'Seven Sisters' multinational companies.
- Activities were generally of a low-profile nature, as OPEC set out its objectives, established its Secretariat, which moved from Geneva to Vienna in 1965, adopted resolutions and engaged in negotiations with the companies. Membership grew to ten during the decade.
- **The 1970s:** OPEC rose to international prominence during this decade, as its Member Countries took control of their domestic petroleum industries and acquired a major share in the pricing of crude oil on world markets.
- There were two oil pricing crises, triggered by the Arab oil embargo in 1973 and the outbreak of the Iranian Revolution in 1979, but fed by fundamental imbalances in the market; both resulted in oil prices rising steeply. The first Summit of OPEC Sovereigns and Heads of State were held in Algiers in March 1975. OPEC acquired its 11th Member, Nigeria, in 1971.

- **The 1980s:** Prices peaked at the beginning of the decade, before beginning a dramatic decline, which culminated in a collapse in 1986, the third oil pricing crisis. Prices rallied in the final years of the decade, without approaching the high levels of the early-1980s, as awareness grew of the need for joint action among oil producers if market stability with reasonable prices was to be achieved in the future. Environmental issues began to appear on the international agenda.
- **The 1990s:** A fourth pricing crisis was averted at the beginning of the decade, on the outbreak of hostilities in the Middle East, when a sudden steep rise in prices on panic-stricken markets was moderated by output increases from OPEC Members.
- Prices then remained relatively stable until 1998, when there was a collapse, in the wake of the economic downturn in South-East Asia. Collective action by OPEC and some leading Non-OPEC producers brought about a recovery.
- As the decade ended, there was a spate of mega mergers among the major international oil companies in an industry that was experiencing major technological advances. For most of the 1990s, the ongoing international climate change negotiations threatened heavy decreases in future oil demand.

Structure of OPEC

- OPEC operates through its Conference, Board of Governors, Economic Commission Board and Secretariat. The supreme authority of the organization is the conference, consisting of the representatives (generally oil ministers) of all the member countries each with one vote.
- It meets twice a year to formulate policy, approve the budget and consider the recommendations of the Board of Governors. All decisions (except those concerned with procedural matters) are adopted unanimously.
- The resolutions of the conference become effective 30 days after the conclusion of the meeting at which they are adopted, unless one or more members submit their opposition to the resolution to the secretariat.
- The Board of Governors, headed by a Chairman, submits the annual budget, reports and recommendations to the conference. It meets atleast twice a year and adopts its decisions by a simple majority of attending members.
- The governors, nominated by member countries and approved by the conference, have a two year term. The executive functions are carried out by the secretariat which is headed by a Secretary-General. Within the Secretariat are departments and divisions for specific tasks.

International Financial Environment

INTRODUCTION

- An international financial environment represents the conditions for activity in the economy or in the financial markets around the world. It can be influenced by something major, such as the credit worthiness of one country's debt.
- Sometimes, macroeconomic events occur that cause a ripple effect throughout the **international financial environment**. Even if a condition or event unfolds in a single country, the influence of that country's economy has the potential to move the markets around the world.
- This could be due to the fact that other countries are creditors of the nation where an event, positive or negative, has occurred or is likely to unfold. The influence of a major global economy or an emerging market has the potential to cause a stir in the financial environment, which could impact borrowing costs, cross-border deals, and profit opportunities.

INTRODUCTION

- Just as an international financial environment can be influenced in a negative way, it can also be impacted in a positive fashion.
- An attractive international financial environment is one where investment and **economic growth** are ripe or already happening. When an economy is growing, it leads to greater infrastructure development and often a greater number of available jobs.
- Subsequently, international investors might recognize an opportunity to allocate capital to these growth initiatives in an attempt to profit, while corporations could develop partnerships or create new locations in the overseas markets. All of this activity is likely to create a good financial environment.

- International financial system relates to the management of and trading in international money and monetary assets.
- These monetary assets are claims on foreign currency, foreign deposits and investments and/or foreign assets.
- The claims may be denominated in various foreign currencies purchased and sold and involve exchange as between various currencies.
- Thus, these transactions give rise to
  - ✓ Borrowing and lending operations in foreign currencies or trading in financial assets denominated in foreign currencies and
  - ✓ A foreign exchange transaction involving an exchange of one currency for another.
- The first is called the **foreign currency market** and the second is the **foreign exchange market**.

- International financial environment is totally different from domestic financial environment.
- International financial management is subject to several external forces, like **foreign exchange market, currency convertibility, international monetary system, balance of payments, and international financial markets.**
- 1**. Foreign Exchange Market**
- Foreign exchange market is the market in which money denominated in one currency is bought and sold with money denominated in another currency. It is an over the counter market, because there is no single physical or electronic market place or an organized exchange with a central trade clearing mechanism where traders meet and exchange currencies.
- The foreign exchange market consists of two tiers:
- the **inter bank market** or
- **wholesale market, and retail market or client market.**
- The participants in the wholesale market are commercial banks, investment banks, corporations and central banks, and brokers who trade on their own account.
- On the other hand, the retail market comprises of travelers, and tourists who exchange one currency for another in the form of currency notes or traveler cheques.

- **2. Currency Convertibility**: Foreign exchange market assumes that currencies of various countries are freely convertible into other currencies. But this assumption is not true, because many countries restrict the residents and non-residents to convert the local currency into foreign currency, which makes international business more difficult. Many international business firms use “counter trade” practices to overcome the problem that arises due to currency convertibility restrictions.
- **3. International Monetary System**: Any country needs to have its own monetary system and an authority to maintain order in the system, and facilitate trade and investment. India has its own monetary policy, and the Reserve Bank of India (RBI) administers it. The same is the case with world, its needs a monetary system to promote trade and investment across the countries. International monetary system exists since 1944. The International Monetary Fund (IMF) and the World Bank have been maintaining order in the international monetary system and general economic development respectively.

- **4. International Financial Markets**: International financial markets comprises of **international banks, Eurocurrency market, Eurobond market, and international stock market.**
- International banks play a crucial role in financing international business by acting as both commercial banks and investment banks. Most international banking is undertaken through reciprocal correspondent relationships between banks located in different countries. But now a days large bank have internationalized their operations they have their own overseas operations so as to improve their ability to compete internationally.
- **Eurocurrency market** originally called as **Eurodollar market**, which helps to deposit surplus cash efficiently and conveniently, and it helps to raise **short-term bank loans** to finance corporate working capital needs, including imports and exports.
- **Eurobond** market helps to MNCs to raise **long-term debt** by issuing bonds. International bonds are typically classified as either **foreign bonds or eurobonds**. A foreign bond is issued by a borrower foreign to the country where the bond is placed. On the other hand Eurobonds are sold in countries other than the country represented by the currency denominating them.

Foreign exchange risk

- **Foreign exchange risk** (also known as **FX risk**, **exchange rate risk** or **currency risk**) is a financial risk that exists when a financial transaction is denominated in a currency other than the domestic currency of the company.
- The exchange risk arises when there is a risk of an unfavourable change in exchange rate between the domestic currency and the denominated currency before the date when the transaction is completed.
- Foreign exchange risk also exists when the foreign subsidiary of a firm maintains financial statements in a currency other than the domestic currency of the consolidated entity.
- Investors and businesses exporting or importing goods and services, or making foreign investments, have an exchange-rate risk but can take steps to manage (i.e. reduce) the risk.

Types of foreign exchange risk

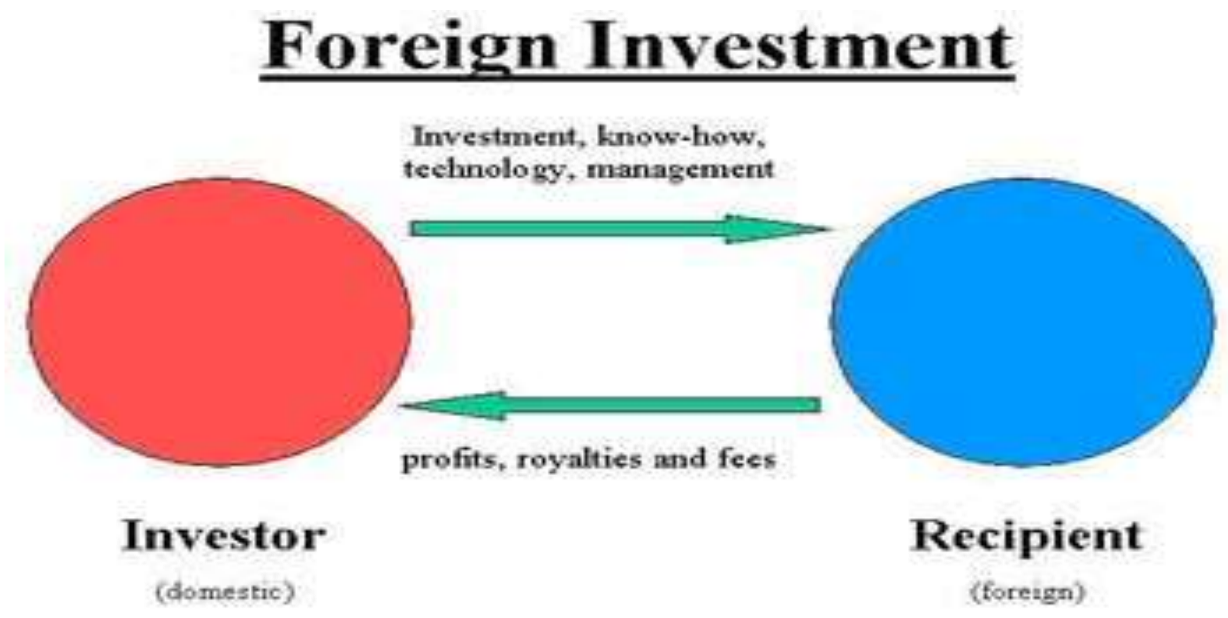
- **ECONOMIC RISK**: A firm has *economic risk* (also known as *forecast risk*) to the degree that its market value is influenced by unexpected exchange-rate fluctuations, which can severely affect the firm's market share with regard to its competitors, the firm's future cash flows, and ultimately the firm's value. Economic risk can affect the present value of future cash flows. An example of an economic risk would be a shift in exchange rates that influences the demand for a good sold in a foreign country.
- **CONTINGENT RISK:** A firm has *contingent risk* when bidding for foreign projects, negotiating other contracts, or handling direct foreign investments. Such a risk arises from the potential of a firm to suddenly face a transnational or economic foreign-exchange risk contingent on the outcome of some contract or negotiation. For example, a firm could be waiting for a project bid to be accepted by a foreign business or government that, if accepted, would result in an immediate receivable. While waiting, the firm faces a contingent risk from the uncertainty as to whether or not that receivable will accrue.

Types of foreign exchange risk

- **TRANSACTION RISK**: This is the risk that a company faces when it's buying a product from a company located in another country. The price of the product will be denominated in the selling company's currency.
- If the selling company's currency were to appreciate versus the buying company's currency then the company doing the buying will have to make a larger payment in its base currency to meet the contracted price.
- **TRANSLATION RISK**: A parent company owning a subsidiary in another country could face losses when the subsidiary's financial statements, which will be denominated in that country's currency, have to be translated back to the parent company's currency.

What Is Foreign Investment?

- Foreign investment involves capital flows from one country to another, granting the foreign investors extensive ownership stakes in domestic companies and assets.
- Foreign investment denotes that foreigners have an active role in management as a part of their investment or an equity stake large enough to enable the foreign investor to influence business strategy. A modern trend leans toward globalization, where multinational firms have investments in a variety of countries.



What Is Foreign Investment?

- Foreign investment refers to the investment in domestic companies and assets of another country by a foreign investor.
- Large multinational corporations will seek new opportunities for economic growth by opening branches and expanding their investments in other countries.
- Foreign direct investments include long-term physical investments made by a company in a foreign country, such as opening plants or purchasing buildings.
- Foreign indirect investment involves corporations, financial institutions, and private investors that purchase shares in foreign companies that trade on a foreign stock exchange.
- Commercial loans are another type of foreign investment and involve bank loans issued by domestic banks to businesses in foreign countries or the governments of those countries.

What Are the Different Kinds of Foreign Investment?

- International investment or capital flows fall into four principal categories:
- commercial loans,
- official flows,
- foreign direct investment (FDI), and
- foreign portfolio investment (FPI).

- Commercial loans, which primarily take the form of bank loans issued to foreign businesses or governments.

- Official flows, which refer generally to the forms of development assistance that developed nations give to developing ones.

What Are the Different Kinds of Foreign Investment?

- Foreign direct investment (FDI) pertains to international investment in which the investor obtains a lasting interest in an enterprise in another country. Most concretely, it may take the form of buying or constructing a factory in a foreign country or adding improvements to such a facility, in the form of property, plants, or equipment.
- FDI is calculated to include all kinds of capital contributions, such as the purchases of stocks, as well as the reinvestment of earnings by a wholly owned company incorporated abroad (subsidiary), and the lending of funds to a foreign subsidiary or branch. The reinvestment of earnings and transfer of assets between a parent company and its subsidiary often constitutes a significant part of FDI calculations.

What Are the Different Kinds of Foreign Investment?

- Foreign portfolio investment (FPI), on the otherhand is a category of investment instruments that is more easily traded, may be less permanent, and do not represent a controlling stake in an enterprise.
- These include investments via equity instruments (stocks) or debt (bonds) of a foreign enterprise which does not necessarily represent a long-term interest.

- Stocks:
- dividend payments
- holder owns a part of a company
- possible voting rights
- open-ended holding period

- Bonds:
- interest payments
- ownership of bond rights only
- no voting rights
- specific holding period