International Trade and Economic development

Trade is an economic activity. Trade is not an end itself, it is only a means an end; end being the satisfaction of human wants. Again, wants constitute the main spring of economic activities, including trade. Trade refers to the exchange of goods and services. It has been developed from simple barter to the complex international trade.

20th century witnessed so many revolutions. An important one is the commercial revolution. There has been close relationship between growth of trade and economic development. It is very difficult to establish an one sided relationship between trade and development; as one contributes to the other. In fact both of them are interrelated each other. Trade ensures development and development furthers trade.

Adam Smith said that "with specialization and division of labor it is possible to increase the welfare of the world community". International trade furthers the division of labor and in turn the maximization of welfare with the limited resources. There is unequal distribution of resources in the world. This unequal distribution economic resource with the peculiarity in climatic conditions, the specialization and division of labor arises. The trade was the result of this specialization and division of labor.

Trade leads to an increased satisfaction of human Wants. The resources to satisfy these unlimited wants are comparatively limited so the optimal utilization of resources can be achieved through the foreign trade.

Expansion of international trade can be regarded as both the cause as well as the effect of economic progress and vice versa. A developing country like India can ensure higher rate of economic development with the help of foreign trade. Now a day's economic development can be considered as the process of change, the change being the structural change. They are occupational changes, changes in the methods of production, social outlook administrative reforms etc. particularly, changing the economy from agricultural oriented to industrialized one. The foreign trade can help the developing countries like India in obtaining the following to achieve rapid industrialization.

1. Superior Technology and technical know how (Operational knowledge)
2. Import of raw materials and other goods
3. Inflow of foreign capital
4. Import of Automobiles
5. Administrative Reforms
6. Expansion of market
7. More employment opportunities and income generation.

Thus developing countries are experiencing increase in imports due to pressure on the rate of economic development. The increase in imports automatically leads to the efforts for increasing exports. The international trade equation is that export pays for imports. It would be a problem of making payments for imports with a corresponding increase in exports. Otherwise a country would be forced to restrict its imports; this reduces the rate of economic development. A developing country Like India should promote her exports considerably. Without exports India cannot insure rapid industrialization. Before Industrialization starts the country Imports mostly manufactured goods and exports mostly Food grains and agricultural raw materials (Cotton and oil Seeds etc.) Foreign trade plays an important role in the economic development of a developing country. It contributes largely to the growth of national income, creation of employment and raising the

standard of living. It is from the Imports that a country would be able to obtain plant machinery and equipment Technical know how etc., which are required for rapid economic growth.

Similarly exports also play a vital role in the economic development as mentioned earlier. A country has to exports to imports, for this purpose the country must be able to produce more than its requirement. When exports oriented industries expand, they provide more employment opportunities. Again, the benefits of large scale production can be obtained. The expansion of industries, Agriculture, trade, commerce etc, would observe the surplus labourers it will increase the employment, the level of income and standard of living.

Thus, foreign trade can be considered as an engine of economic development of developing countries.

Foreign trade and developed countries.

The developed countries also owe much to the foreign trade. The foreign trade enlarges market and much scope for selling their products. If they depend on the domestic market alone they could not produce and sell to their potentialities. So the foreign trade can help in the creation of employment and income.

In addition to income foreign trade can also help in increasing the level of consumption. They can use their higher level of income to import of wide variety of goods produced in different parts of the world. There by increases the level of consumption and standard of living. Thus the foreign trade leads to maximization of satisfaction and consumer's sovereignty.

Lastly, there are also other group countries which exclusively depend on foreign trade. They are OPEC and others which can produce only one or two products. Only through the export of such products, they can import all other products required for day to day life. Foreign trade means every thing for such countries.

With the above analysis one can presume that foreign trade is an engine of economic development. It acts as a driving force if economic development. The 20th century had witnessed the faster growth and commercial revolution together.

Explain the role of trade in economic development of developing countries? Or

"Foreign trade is an engine of development" discuss

Terms of Trade

In international trade, terms of trade is perhaps the widely used concepts by the policy makers to study the country's balance of payment difficulties. The rate at which one country's goods exchange against those of another is referred to as the terms of trade. In other words, ratio between export price and import price is known as terms of trade. Terms of trade are said to be favourable to a country when the prices of its exports are higher than the price of its imports. The terms of trade are unfavorable to a country when price of import are higher than its export price.

Therefore, the terms of trade does represent the conditions under which exports and imports are made. It does also represent gains from international trade.

Concepts of terms of trade

Gross Barter terms of trade:

An American economist Taussig introduced the concept of gross barter terms of trade. The gross barter terms of trade are the ratio of the total physical quantity of imports to the total physical quantity of exports of a country. Symbolically expressed as:

$$T_G = \frac{MQ}{XQ} \times 100$$

MQ – Import quantity index
XQ _ Export quantity index.
T_G _ Gross barter terms of trade.

Let us take numerical example to explain it. The quantity of index of imports and exports for the base year say 1970 will always be equal to 100. The base year will serve as the bench mark period with which we can measure changes in Gross barter trade. In any given subsequent year say 1971, 72 ,……….1980. Now let us look at the following imaginary sets.

Sets:
1970 - Base year $T_G = 100$

$$T_G = \frac{100}{100} \times 100 = 100 \text{ (Base year)}$$

1971 –

$$T_G = \frac{120}{100} \times 100 = 120 \text{ (Improvement)}$$

1972 –

$$T_G = \frac{120}{120} \times 100 = 100 \text{ (No change)}$$

1973 –

$$T_G = \frac{100}{120} \times 100 = 83.33 \text{ (deterioration)}$$

For 1971, the import quantity index is increased from 100 to 120, and export quantity is same. This means that in 1971 we export the same quantity as in 1971 than in 1970. There has been 20% improvement in gross barter terms of trade in 1971, as compared to the year 1970. However, in 1972 compare it with base year 1970, there has been no change in gross barter terms of trade.

In 1973 as compared to base year, 1970, there has been deterioration of gross barter terms of trade. The import quantity index is 100 for both 1973 and the base year 1970. But the export quantity index for 1973 is 120 as against the base period index of 100. This means that in 1973 we import the same quantity as in 1970. But we are paying more for these imports as indicated by the increase in export.

Net Barter Terms of Trade or commodity:

This concept is also introduced by Taussig. Net Barter Terms of Trade is popularly called as the commodity terms of trade. Commodity terms of trade are defined as the ratio between the import price and export price. Symbolically written as:

$$T_n = \frac{XP}{MP} \times 100$$

XP – Price index number of export
MP – Price index number of import
T_n – Net Barter terms of Trade.

The price index of imports and exports for the base year 1970 will always be equal to 100. We express commodity terms changes in subsequent years always with reference to the base year index. Following imaginary set shows changes in net barter terms of trade:

$$\text{In 1970 } T_n = \frac{100}{100} \times 100 = 100 \text{ (base year)}$$

$$\text{In 1971 , } T_n = \frac{120}{100} \times 100 = 120 \text{ (Improvement)}$$

$$\text{In 1972 , } T_n = \frac{100}{120} \times 100 = 83.33 \text{ (deterioration)}$$

$$\text{In 1973 , } T_n = \frac{120}{120} \times 100 = 100 \text{ (no change)}$$

In 1971, there is an improvement in commodity terms of trade by 20%, because we buy our imports at the same price as in 1970. But sell our exports at a higher price (20% higher than 1970). Now look at 1972, there is deterioration in commodity terms of trade because we sell our export at the same price but buy our imports at higher prices. In 1973,

however there has been an increase in both the export price and import price by the same 20%.

Income Terms of Trade:

Prof.Dorrance has revived the concept of the commodity terms of trade and developed a new concept known as the income terms of trade. Symbolically expressed as:

$$T_I = \frac{P_X . Q_X}{P_m}$$

T_I – Income terms of Trade
P_X – Price index of exports
P_m – Price index of imports
Q_X – Quantity of export.

Income terms of trade are the ratio of the total value of exports divided by the price index of imports. For classification let us take a look at the following sets.

In 1970 , $T_I = \frac{100 \text{ X } 100}{100} = 100$ (base year)

In 1971 , $T_I = \frac{90 \text{ X} 120}{100} = 108$ (Improvement)

In 1972 , $T_I = \frac{110 \text{ X } 80}{100} = 88$ (decrease)

For the base year 1970, we assign a value of 100 for all the three variables 1.8 export price index, import price index and export quality. So income terms of trade also are the 100 for the base year 1970. Now in 1971 there has been a fall in the export price index and will no change in the import price index. But there has been an increase in the export quantity index from 100 to 120 in 1971. A 10% decrease in export price index is therefore matched by 20% increase in the export quantity. In

1972 as compared with 1970 however the situation is appreciative in 1972 export price index increased by 10%. But the export quantity index decreased by 20%, so 10% increase in export, is matched by 20% decrease in export quantity causes deterioration of income terms of trade.

Single Factor terms of trade:

There is another attempt to correct commodity terms of trade for changes in the productivity in producing export goods. The concept of single factor terms of trade was developed by Zocob, Viner in 1937. The single factor terms of trade is the ratio of the export price index and import price index a distinguished for changes in productivity of country's factors of production involved in the production of export commodity. Symbolically expressed as :

$$T_{FS} = \frac{X_P . X_n}{M_P}$$

T_{FS} – Single Factor terms of Trade
X_P – Export productivity index of export industry.

This is clear by following sets:

In 1970 , $T_{FS} = \frac{100 \text{ X } 100}{100} = 100$ (base year)

In 1971 , $T_{FS} = \frac{90 \text{ X} 100}{100} = 90$ (deterioration)

In 1972 , $T_{FS} = \frac{90 \text{ X } 120}{100} = 108$ (Improvement)

For the base year 1970 we give a value of 100 for export price index and import price index and export productivity index respectively. Therefore index of 'S' must also have a value of 100 for the base year. In1971 there has been a drop in export price index by 10% which is not compensated by an increase in export productivity index. So that single factor terms of trade have deteriorated by 10%. Now look at 1972,

situation export price reduced by 10%, but the export productivity index increased by 20%. Therefore single Factor terms of trade index is improved by 8% compared with 1970.

Double factor terms of trade:

This concept is also developed by Jacob.Viner in 1937. The concept of double factor terms of trade takes into account, the productivity of factors of production entering into the production of country's exports as well as the productivity factors of production producing country's imports. Symbolically expressed as:

$$T_{FD} = \frac{X_P}{M_P} X \frac{X_Z}{M_Z}$$

X_P – Export price index
X_Z – Index of factors productivity in export
M_P – Import price index
M_Z – Index of factor productivity in import.

Real cost terms of trade:

To measure real gain from international terms Jacob Viner used real cost terms of trade. The amount of utility lost or sacrifice per unit of resources employed in producing export constitute real cost of producing export.

Utility terms of trade:

This concept was developed by D.H.Robertson. the utility terms of trade are obtained by multiplying the real cost terms of trade with the index of the relative utility of imports as compared with the goods that could have been produced at home.

Factors influencing terms of trade:

1. ***Nature of goods*** that a country produces and export determines the terms of trade. If a country produces primary product and export them, then the country will have to experience unfavorable terms of trade. The reason is that these primary products will get less price. On the other hand, if a country producing manufacturing goods and export they will

get better prices. Then exporting country's terms of trade will be favourable.

2. ***Reciprocal demand***: The terms of trade of a country are determined by the relative intensities of import demand and export demand compared with those of other country. Suppose a country's export demand is inelastic import demand is perfectly elastic. Then terms of trade are favourable to a country, For ex. India and Malaysia producing cloth and rubber respectively. Suppose Malaysia's demand for Indian cloth is highly inelastic. Then terms of trade are favourable to India. The reason is that Indian cloth gets higher prices but now terms of trade are unfavorable to Malaysia, because India's demand for Malaysian rubber is highly elastic.

3. ***Devaluation*** lowers the value of home currency in terms of foreign currency. Due to the effects of devaluation of home currency terms of trade will deteriorate because price of home country's export falls, while price of imports rise.

4. ***Imposition of tariffs*** can influence terms of trade. Suppose a country imposes tariffs on her imports, if there is no retaliation from exports Country, then terms of trade are favourable to tariff imposing country, on the other hand if Exporting country also retaliated, then terms of trade will not be favourable to tariff imposing country.

5. ***If substitutes*** of import goods are available in the country the terms of trade will be unfavorable for the exporting country. On the other hand if substitutes of import goods are not available, the bargaining power of exporting country will be strong. Consequently terms of trade will be favourable for the exporting country.

Tariffs

Tariffs include all customs duties: imports duties, export duties and transit duties. Amongst these, as a restrictive measure, import duties are the most common.

Classification of tariffs;

There are different ways of classifying tariffs or customs duties, using the levy criterion, tariffs may be classified into: (1) specific duties, (2) ad valorem duties, (3) combined specific and ad valorem duties, and (4) sliding scale duties.

Specific duties are flat levies per physical unit (metre, kilo, ton, etc.) of the commodity imported.

Ad valorem duties are, on the other hand, levied as fixed percentage of the value of the imported commodity.

Sliding scale duties are those which tend to vary with the price of the commodity imported. These may be either specific or ad valorem. Specific sliding scale duties are, however, common in practice.

Another important classification of tariffs is based on the purpose they serve. Using the objective criterion, tariffs are distinguished as: (1) Revenue Duties, and (2) Protective Duties.

Revenue tariffs are those whose primary purpose is to provide revenue to the state. These are generally at a lower rate and not intended to exclude imports. They are usually levied on imports of consumption.

Protective tariffs, on the other hand, are designed to curtail imports of certain goods to protect domestic production.

Single-column tariff: irrespective of the origin of imports of goods when only one rate of tariff duty is imposed by law on all the goods, it is referred to as a single-column tariff. It is a very simple system which can be easily designed and administered.

Multiple-column tariffs: In multiple-column tariffs, two or more duties are levied by law on each class of commodity. India, for instance, has adopted the double-column tariff policy since the acceptance of the Commonwealth Preference Agreement in 1932. Under this scheme, imports from the Commonwealth countries bear lower duties than from other countries.

Traditional tariffs: Under a traditional convectional tariff, a basic duty is determined by law for each class of commodity, with the proviso that each such duty may be reduced reciprocally under international treaties.

If under international negotiations tariffs are widely generalized, the traditional tariffs are reduced to a single column tariff.

Effects of Tariffs:

Tariffs can affect import volume, prices, production and consumption. They also affect the terms of trade, the balance payment etc. the various effects of tariffs have been discussed in the following sections.

Price Effect

Assuming that the foreign price of a commodity is unchanged, we find that the price in the tariff-imposed nation would rise by the full amount of the tariff duty. In this case, the incidence of tariff falls on the domestic consumers.

But this need not happen always. Sometimes price may not rise at all or it may rise by less than the amount of duty. When the price does not rise at all, it means that the entire burden of tariff is shouldered by the exporters: hence the incidence falls on them. Otherwise, when the rise in price is less than the full amount of duty, the tax burden is shared by both importers and exporters.

The protective Effect:

A tariff is a restrictive measure which seeks to control the quantity of import so that domestic industry may be protected. A tariff duty is purely protective onlu if it is so high as to prohibit total imports of a commodity.

Revenue effect

Tariff which are not totally prohibitive certainly bring some revenue equal to the duty multiplied by the volume of imports.

Transfer or Redistribution effect

After the imposition of a tariff, domestic prices will rise: hence receipts of producers will increase, while consumer’s surplus to that extent declines. This is called transfer effect. Thus, the increase in receipts which is in excess of marginal costs is an “economic rent” to the producers, which is derived by subtraction from consumer’s surplus.

Consumption effect

A tariff generally reduces the total consumption of a commodity because of the rise in its price.

It should be noted that the improvement in the terms of trade through tariffs depends upon the extent of the price rise in the importing country and the extent of the price fall in the exporting country, which in

turn depends upon the elasticity's of reciprocal demand of the trading countries.

Following Kindleberger, we elucidate the terms of trade effect of tariff with the help of Marshallian offer curves. In technical parlance, it must be remembered that a tariff can improve the terms of trade of a country only if the offer curve of the opposite country is less than perfectly elastic.

Balance of Payments Effects:

When a tariff affects the volume of imports and prices, it also affects the country's balance of payments position. A country having a deficit balance of payments position can restore and maintain equilibrium by means of tariff restrictions upon imports.

Tariffs restrict imports through price rise and contraction in demand, and may lead to improvement in terms of trade also under appropriate circumstances, which helps in bringing about a balance of merchandise accounts.

Income and employment:

It was firmly believed in the thirties that imposition of tariff would lead to expansion of employment and incomes.

By reducing imports, tariffs stimulate employment and output in the import-competition industries. A new flow of income will be generated with its 'multiplier effect'. In an expanding economy, more capital goods investments will also be made which produces 'acceleration effect'. Thus under conditions of less than full employment, the interaction of multiplier-accelerator will lead to a cumulative expansion of investment, employment, output and income in the country.

Quotas
(Quantitative Restrictions)

Quantitative restrictions or quotas are an important means of restricting imports and exports. A quota represents a ceiling on the physical volume of the import / export of a commodity.

Types of Import quota:

There are four different types of import quotas, including import licensing. These are:

Tariff Quota;

A tariff quota combines the features of the tariff as well as of the quota. Under a tariff quota, the imports of a commodity up to a specified volume are allowed duty free or at a special low rate: but any imports in excess of this limit are subject to duty – a higher rate of duty.

Unilateral quota:

In a unilateral quota, a country unilateral fixes a ceiling on the quantity of the import of a particular commodity.

Bilateral Quota:

A bilateral quota results from negotiations between the importing country and a particular supplier country, or between the importing country and export groups within the supplier country.

Mixing quota:

Under the mixing quota, the producers are obliged to utilize domestic raw materials up to a certain proportion in the production of the finished product.

Import licensing

Quota regulations are generally administered by means of import licensing. In India, for instance, the import of almost all the items is prohibited except under, and in accordance with, a license or a customs clearance permit issued under the imports (control) Order, 1955, or an Open General License issued by the government or under any other provision under the above order.

Under the import licensing system, the perspective importers are obliged to obtain a license from the licensing authorities: the possession of an import license is necessary to obtain the foreign exchange to pay for the imports. In a large number of countries, import licensing has become a very powerful device for controlling the quantity of imports – either of particular commodities or aggregate imports.

Impact of Quotas:

Like fiscal controls, the quantitative restrictions on imports have a number of effects on the economy. The following are, in general, the important economic effects of quotas:

Balance of Payments Effect

As quotas enable a country to restrict the aggregate imports within specified limits, quotas are helpful in improving its balance of payments position.

Price Effect:

As Quotas limit the total supply, they may cause an increase in domestic price.

Consumption Effect:

If quotas lead to an increase in prices, people may be constrained to reduce their consumption of the commodity subject to quotas or some other commodities.

Protective Effect:

By guarding domestic industries against foreign competition to some extent, quotas encourage the expansion of domestic industries.

Redistributive Effect:

Quotas also have a redistributive effect if the fall in supply due to important restrictions enables the domestic producers to raise prices. The rise in prices will result in the redistribution of income between the producers and consumers in favour of the producers.

Revenue Effect:

Quotas may also have a revenue effect. As quotas are administered by means of licenses, the government may obtain some revenue by charging a license fee.

Terms of trade Effect;

Quotas may effect the terms of trade of the country imposing them. The effect of quotas on the terms of trade depends upon the elasticity of the foreign offer curves.

Balance of Trade and Balance of Payments

The Balance of Trade and Balance of Payments are the two concepts used in accounting external transactions of a country. If, the visible merchandise items say goods exported and goods imported are taken into account, it is termed as Balance of Trade.

The Balance of Payments is a very comprehensive accounting of international Trade. It is taken into account both visible and invisible items into account. Again, Balance of Payments considers A to Z or all types of transactions between a citizen of one country and rest of the world. It has got two sides' credit and debit or receipts and payments.

Components of Balance of Payments:

A balance of payments of a country contains two broad categories. They are:

1. Current Account
a. Visible Items (goods)
b. Invisible Items (services)
2. Capital Account

Visible Items include all types of goods exported and imported between countries. Invisible items or services include: Travel, Transportation, Insurance, Software services. Under invisible transfers: (Officials and private), Income flows (Profits and compensation) can also be included.

Under Capital Account one can include the following items:

- Investments – FDI
  -- Equity

- Loans – External Services – IMF, IBRD or the world bank, ADB, etc.
  Foreign Governments, Commercial Borrowings, Banking Capital.

The debt servicing, loan repayments, capital outflow represent the debit side of the balance of payments. The inflow of capital, Foreign aid, grants represent credit side or receipts of a country. The two sides of the balance of payment must be necessarily balanced.

Disequilibrium in Balance of Payments:

A position of disequilibrium in the balance of payment of a country exists when the demand for Foreign exchange exceeds its supply or vice versa. When the demand exceeds supply, it is called deficit in the balance of payments. When the supply of Foreign Exchange exceeds its demand it is called Surplus. It is very seldom (rare) that there is a perfect equilibrium in the country's balance of payments. The surplus disequilibrium is not so bad for a country, as the deficit disequilibrium is. The deficit creates the burden of adjustments in the balance of payments.

Types of Disequilibrium in Balance of Payment:

The deficit or disequilibrium in balance of payment may be a cyclical, structural, short-run and long-run disequilibrium. The changing phases of trade cycles can bring about changes in output, income, employment and price level. Accordingly the foreign trade activity can change.

The structural disequilibrium refers to the deficit or surplus in trade due to the structural changes in the economies – internally and externally. For example decline in the jute products and cotton textiles demand due to substitutes. It will leads to shifting of capital from Jute and cotton industries to other sectors. Therefore, it affects the export supplies of jute and cotton textiles, similarly the changes due to the change in taste and preferences.

If deficit or disequilibrium remains for very short period it is called short run disequilibrium. On the other hand, if, deficit sustains for longer period, it is called long run or secular deficits. These type of disequilibrium are the result of short term and long run factors. The population growth, industrialization, and natural calamities may end up in long run disequilibrium's.

Methods of correcting adverse Balance of Payments:

1. Deflation
2. Devaluation
3. Exchange Control
4. Trade Restrictions
5. Tariffs
6. Export Bounties
7. Commercial Agreements
8. Import Quotas
9. Import Prohibitions

1. Deflation: Deflation means contraction of the home currency through clear money and credit policy and consequently fall in the costs and prices of domestic goods. Naturally in foreign markets our goods become relatively cheaper and demand for them will rise so that exports will increase. Moreover, deflation attempts to restrict home consumption. Through reduction of income, demand for goods at home will be reduced and more surpluses may become available for export purposes, so that export may be increased. Thus exports increase and import decline has an impact of deflationary monetary policy.

2. Devaluation: A most commonly adopted method consist in devaluation of the currency of a country faced with an adverse balance of payment. Devaluation means the lowering of the eternal value that is exchange rate of a country's currency, either in relation to the currency of all the country's or in terms of gold or in relation to the currencies of only a few selected countries.

For example, the Indian rupee on June 6th 1966 was devalued. Both devaluation and depreciation produced similar effects, increase exports by making local goods cheaper to Foreign, curtail imports by making foreign goods expensive and ultimately correct, an adverse balance of payments and make it a favourable one. Generally, a country resorts to devaluation of its currency when it tends to correct chronic and fundamental dis- equilibrium in its balance of payments. However, the success of devaluation depends upon the following conditions:

a. A Fairly elastic demand: This for imports and exports will ease the way or the successful functioning of devaluation to achieve its desired goal.

Structure of Imports and exports: if the devaluing countries exports consists of non-traditional items and has a large demand from the rest of the world, it can gain by improving terms of trade due to an increase in world's demand for its product, induced by devaluation.

c. Domestic price stability: Maintenance of internal purchasing power of devaluing country is very essential to realize fruitful effects of devaluation.

d. International co-operation: Devaluation will serve its purpose only if other countries do not retaliate by resorting to simultaneous devaluation. The rest of the world must be prepared to co-operate fully with the country devaluing its currency.

3. Exchange control: Another most commonly used method for correcting the balance of payment is exchange control. This method usually adopted by the government of a country to correct dis-equilibrium. Under this method all the exporters are directed by the exchange control authority usually the central bank to surrender their foreign exchange earnings to it and foreign exchange is rationed out

among the incensed importers. Thus, under exchange control the license holders are allowed to import goods, a quota for different items of imports is also fixed from time to time by the authority. And more fundamental adjustments are made to restore equilibrium in the balance of payment.

Non-monetary measures: Among this, import duties and quotas are generally used for correcting an adverse balance of payment.

Import duties and quotas: As restrictive measure i.e. import duties are commonly imposed. When such duties are levied on selected imported items, their prices would rise so that contraction in import demand would occur. If exports quantum remaining the same are being increased and the volume of imports decline the adversity in the balance of payment is reduced or eliminated. Fixing of import quotas is another and perhaps a better devices used for correcting an adverse balance of payments. Under the quota system, the government may fix and permit the maximum quantity or value of a commodity to be imported during a given period. By restricting imports through quota system, deficit is reduced or eliminated and there by balance of payment position is improved. As a direct method of correcting die-equilibrium in the balance of payment import quotas are assumed to be better than import duties. Therefore, tariff will not be very effective in reducing imports. When the demand for imports is in elastic, further tariffs are rigid and les flexible, because tariffs are budgetary phenomena subject to government control.

Export promotion policy programmes: The government of a deficit country has to formulate and implement export promotion policy and programmes. Export duties may be provided and subsidies to exporting industries may be given as incentives for exports and import. Substitution producing industries may be induced and encouraged by the government to be more effective, self sufficient and less reliant on imports. Therefore, fixing up import quotas and tariffs to check imports and launching upon export Programmes perhaps the best solution of correcting the dis-equilibrium or adverse balance of payment.

Exchange depreciation: Another important method of correcting an adverse balance of payment is to depreciate the external exchange value of the home currency. This device assumes that the country has adopted flexible exchange rate policy. Thus exchange depreciation is feasible exchange depreciation means a decline in the rate of exchange of one country in terms of another’s. Exchange depreciation of a country will tend to cheapen its domestic goods for the foreign so that its exports will be boosted up and imports will be costlier. Thus the country may achieve a favourable Balance of payment.

Free Trade

Introduction; The trade policy of a country can be classified into free trade and protection. Here we discuss the meaning and arguments in favour of both free trade and protectionism.

A Trade policy of placing no restrictions on the movement of goods and between countries is known as the policy of 'Free Trade'.

According to Adam Smith, the term 'Free Trade' is used to denote 'that system of commercial policy which draws no distinction between domestic and foreign commodities and, therefore, neither imposes additional burdens on the latter, nor grants any special favour to the former.

Classical economists like Adam Smith, Ricardo etc., encouraged free trade.

Merits or arguments for Free trade

1. Comparative advantage.

It permits an allocation of resources and manpower in accordance with the principle of comparative advantage, which is just an extension of the principle of division of labour. Because of natural and other facilities, each country is suited for the production of some particular commodities. When countries are freely engaged in trade, the price mechanism under competition automatically ensures that each country specializes in producing those commodities which it is relatively best suited to produce and imports those commodities which it can be obtain more cheaply than by producing them itself. Further, when there is specialization, the labour and capital of a country tend to move into those channels of industry where they have optimum use and can produce maximum.

2. Better price for factors.

Under free trade, factors of production also will be able to earn more, as they will be employed for better use. Hence, wages, interest and rent will be higher under free trade than otherwise.

3. Consumers satisfaction

Free trade procures imports at cheap rate. It seems to be an attractive argument in favour of free trade at least from the consumer's point of view.

4. Specialization and division of labour;

Free trade widens the size of the market as a result of which greater specialization and a more complex division of labour become possible. This brings about optimum production with costs reduced

everywhere, benefiting the world as a whole. Restrictions on free trade reduce the scope of specialization and in consequences there is a reduction of the total world supply, there by making the world as a whole so much the poorer economically.

5. Increases competition;

Free trade also widens the area of competition as a result of which the industrial techniques of the trading countries lend to be improved. Home producers are spurred by foreign competition to become more efficient and to adopt quickly any improvement in methods of production. In this way free trade has an educative effect.

6. avoids the growth of monopolies;

Another incidental advantage of free trade is that it prevents, or at least makes more difficult, the establishment of injurious monopolies by preserving competition.

Demerits of free trade;

1. Under the system of free trade the underdeveloped countries suffer very much in competition with the advanced countries. Free trade policy in India adopted by the British Government has proved that the one time flourishing industries of India were completely wiped out due to foreign competition.

2. On account of economic interdependence in implementing free trade policy, many government experienced political handicaps, especially during war times. Hence, for maintaining political independence, it was thought desirable to seek economic independence with the abandonment of free trade.

3. Countries cannot allow free import of injurious and harmful products, hence trade restrictions become necessary.

4. Free trade led to cut-throat competition in the world market, so that exporters resorted to dumping, which no government can allow beyond a limit; thus restrictions became inevitable.

5. Free entry of goods produced by powerful combines inflicts a permanent injury on the economic interests of a country. Hence restrictions on such items were thought inevitable.

6. Backward countries have to protect their infant industries and hence cannot adopt the policy of free trade.

Protectionism

Protectionism refers to the foreign trade policy of encouraging home industries by paying bounties (or giving subsides) to domestic producers, or more usually by imposing customs duties, Quotas, licensing prohibition etc. on foreign products.

Economic Arguments for protection: The main arguments in favour of protection are:

1. 'Infant Industry' Argument:

Many economists including Alexander Hamilton (USA), F.List (Germany) and J.S.Mill (England) held that infant industries during the early stages of their development require protection from keen competition from long established foreign industries. Such an industry, in the initial stages of its growth, needs full protection from the state without which it cannot survive.

However, the exponents of the infant industry argument emphasized that protection should be temporary and should be removed immediately after it has performed its function of 'nursing'. In this regard, 'nurse the baby, protect the child, and leave that adult' is a well-known saying. It is also held that protection should not be given indiscriminately but only to those infant industries, which have potentialities to develop fast and become self-financing and efficient in the long run'.

2. 'Diversification of Industry' Argument:

Protection is advocated by List and other economists to diversify the industries of a country, when there is unbalanced economy as a result of excessive specialization. Excessive specialization leads to over dependence of a country on other countries. This is dangerous, politically as well as economically.

3. 'Promotion of Employment' Argument:

It is believed that imposition of tariff leads to expansion of employment and incomes. Imposition of tariff restricts certain imports so that some money is saved in the domestic economy which will be spent upon the purchase of the products of protected home industries. As the protected industries expand, employment there in increases and income of the community increases. This generation of income will have a 'multiplier effect'. There will be an expansion of employment and income in other sectors of the economy as well.

4. ‘Balance of Payments’ Argument:

Since World War II, tariff duty has been advocated as one of the most effective implements to correct disequilibrium in the balance of payments. Restrictions on imports through tariffs may become inevitable in a country if it does not posses sufficient reserves of gold or foreign exchange to make disbursement with the surplus country.

Compared to devaluation, as a means of correcting disequilibrium in the balance of payments, tariff seems to be better, since unlike devaluation it will not have any side repercussion.

5. ‘Terms of Trade’ Argument:

The terms of trade can be improved by making foreigners pay whole or part of the tariffs. For, the imposition of tariff duty will lead to a rise in the price of the importing country and a fall in the price of the exporting country and if demand for the commodity is elastic, then the price in the exporting country will fall to a greater extent. Thus, the burden of tariff duty is borne by the exporting (foreign) country. Hence tariff duty moves to more favourable terms of trade for the importing country.

6. ‘Retaliation’ Argument:

Tariff is also a weapon to beat foreign duties that affect a country’s exports. Tariff so imposed is called ‘retaliation’. A country surrounded by neighbors who have all armed themselves with tariff weapons cannot afford a liberal trade policy. In these circumstances, the country following a free trade policy is in a weak bargaining position because it has no duties to impose and it cannot offer any concessions to its neighbors to reduce them to lower their tariff upon its exports. This one-sided free trade is harmful, and there will be no alternative for the country but to arm itself with tariff weapons, i.e., to retaliate.

7. ‘Revenue’ Argument:

Protection is also advocated on fiscal grounds. Tariffs are a very good source of revenue to a government, especially because it is the foreigners who pay tariff duties. In India, customs duties have been a very productive source of state revenue.

8. The ‘Pauper Labour’ Argument:

Protection is sometimes advocated, especially in industrially advanced countries, in order to safe guard the interest of labour. It is argued that in the absence of protection, there will be unhealthy competition between countries having dear labour economy and those

having cheap labour. The product of high wage labour of these countries will be undersold by the ‘pauper labour’ countries. Thus, in the advanced countries where the people enjoy high real wages, it is often felt that their standard of living will be undermined if cheap goods are imported from low wage countries. Hence, to protect a country’s high standard of living and maintain high wages, tariffs become essential to meet competition from a pauper labour country.

9. ‘Conservation of National Resources’ Argument:

Carely, Patten and Jevons have argued that protection is essential to conserve the national resources of a country. This argument is particularly applicable to countries which export minerals and other essential raw materials.

10. ‘Key Industry’ Argument:

For rapid economic development, a country should have a stable and sound industrial structure. To achieve this, it must develop its key and basic industries like iron and steel, heavy chemical, metallurgical etc.

11. ‘Anti-dumping Measures’ Argument:

Protection is also advocated as an anti-dumping measure. A foreign country may resort to dumping with a view to capturing markets in another country. Thus, a high tariff may become necessary in order to protect home producers against dumping of foreign goods on the home market at a much lower price than the foreign monopolist charges in his own country.

4. Non-Economic Arguments

1. Defence:

From the standpoint of national defence each country should be self-sufficient as far as possible. It should avoid too much dependence upon other countries, even if such avoidance involves an economic loss. ‘Defence is better than opulence’. Therefore, it is essential to make a country military strong even though it may not be economically prosperous. No nation can prosper if its defence is weak. And, defence goods producing industries cannot develop unless they are protected.

2. Patriotism:

Protection is essential to arouse and satisfy patriotism of the people. It is the duty of every citizen to prefer homemade (Swadeshi)

goods to foreign goods. As such homemade goods should be available in the right quantity and quality. This is not possible without such home industries being developed with the aid of protection.

3. Preservation:

Protection has been advocated in some countries for the purpose of preserving certain classes of population or certain occupations. This argument was particularly applied to agricultural duties, to the preservation of an agricultural community or farming industry of the country for political and social reasons.

IMF (International Monitory Fund)

IBRD and IMF are the twins of Bratton woods system (1944). The IMF was constituted in 1946 by the subscription from members. The establishment of the fund is a great landmark in International Monetary co-operation.

After the II world war International Monetary system was of matter of concern. A system has to be devised to provide the durability, stability and flexibility required of the available monitory mechanism. A wide variety of economic condition a conference called as Bratton woods new Hampshire USA in 1944 to come to grips with this problem. The International Monetary system that evolved embodies 6 main ideas.

1. The value of national currencies should be defined in terms of gold exchange rate between currencies of the world should be fixed.
2. International results of gold and foreign currencies should some how be increased in such a manner that short term balance of payments disturbances need not make a country to face potentially damaging necessities immediately exchange rate adjustments. The nation established a pool of currencies upon which nations would draw in terms of balance of payments.
3. Crisis the restriction to international trade and payment should be eliminated to the greatest possible extent in the interest of world economic welfare.
4. International institution should be created which is in co-operation with the IMF world to promote trade and development.
5. International capital flows should be facilitated to long term self liquidating loans (IBRD).
6. Adjustment of the balance of payment: under this the countries which are having surplus responsibilities to help the countries facing deficits.

Hopefully, achieving short term stability combine long term stability, International resources consists of foreign currencies and IMF borrowing rights in addition to gold.

Functions of the Fund:

1. ***It Serves as a Short-term credit institutions:*** If any country is in a temporary difficulty in liquidating an adverse balance of payments, the fund will come to its aid. The fund is not intended to supplement them but to provide only a second line of defence in case of emergency. The borrowing country has to pay interest and maintain its quota intact. Should a country borrow unnecessarily, the rate of interest rises as the

amount of loan increases. Lower rates are charged if a loan is taken for a short period. If the amount of the loan and its duration are such as to raise the rate of interest to 5 percent, the fund can then raise the rate to any level by way of penalty, for this is regarded as an abuse of the privilege of membership.

2. ***The fund provides a mechanism for improving short-term balance of payments position:*** For this purpose, its rules provide for orderly adjustment of exchange. No member-country can indulge in irresponsible and competitive exchange depreciation thus introducing the law of the jungle in international monetary relations. Whenever a country feels that its rate of exchange is out of line with its economy, the rate can be altered but only after due deliberation between the country and the authorities of the fund.

3. ***The fund provides machinery for international conclusion:*** It brings together representatives of the principal countries of the world and affords an excellent opportunity for reconciling their conflicting claims. This constructive approach and the measure of international co-operation have also led to the expansion and balanced development of world trade and world production.

4. It provides a reservoir of the currencies of the member-countries and enables members to borrow one another's currency.

5. It promotes orderly adjustment of exchange rates to promote exchange stability.

The I.M.F and the Gold Standard

There is no doubt that the I.M.F does posses certain characteristics of the gold standard. Hence, it is often referred to as the shadow of the gold standard. But, at the same time, the I.M.F has also certain dissimilarities with the gold standard, or what comes to the same thing, it has certain similarities with the paper standard.

The I.M.F has certain resemblances with the Gold standard. They are as follows:

1. Link with Gold
2. Importance of Gold
3. Multinational Trade and Payments System
4. Exchange Rate Stability
5. Mechanism of Expansion and contraction of Currency

6. Non-imposition of Exchange Control.

They are also certain dissimilarities between the Gold standard and the I.M.F. They are as follows:

1. The par values of national currencies are not rigidly fixed in terms of gold under the I.M.F as it happened under the Gold Standard.

2. Under the Gold standard, gold was the basis of the expansion and contraction of currency in the country. Fluctuations in gold production do not have their repercussions on the volume of currency in the country.
3. Under the gold Standard, there was complete rigidity in the foreign exchange rates. As against this, there is no such rigidity in the foreign exchange rates under the I.M.F dispensation. Etc.

Special drawing rights (SDR):

The SDR is an international reserve assets created by the fund taking into account the global need to supplement the existing results. It is also called paper gold. The SDR is only a book entry in the special drawing account of IMF. The allocation of the SDR takes the form of a credit entry in the name of participating countries. In the special drawing account the total SDR's created by the IMF are allocated the participating countries in proportion quotas in with IMF, the allocation from a participant doesn't involve any payment to the IMF. The recipient of the SDR also doesn't give collateral security to the IMF. These are freely used by the country for meeting payments deficit. One disliking characteristic of the SDR is its unconditional use.
The value of each SDR is expressed in terms of US dollar or gold.
1. The creation of SDR every time requires the approval of 85% of the rights of the member countries.
2. These SDR's accepts by the official monetary agencies.
3. Since the voting rights are concentrated at the hands of rich countries, inequality can be seen in the distribution of SDRs . Therefore, it became unequal. Therefore with every creation of SDRs rich countries will get higher quotas than the poor countries, since their subscriptions are very low.

Write a note on the special drawing rights (SDR).
The most important function of the international monetary fund is providing international liquidity to the member countries. International liquidity refers to availing resources of a country to set rights its short term disequilibrium in the balance of payments. Though the IMF evolved various schemes to provide international liquidity to the member

countries, It could not redress the twin problems of the inadequate and the apt distribution of international liquidity. In order to overcome these 2 problems and to augment the supply of international liquidity, the IMF came out with a novel plan the special Drawing Right Scheme.

The salient features of SDRs scheme:
1. The SDR's are a form of international reserve asset which are allocated by the fund to members choosing to participate in the special drawing account in proportion to their quotas in the fund.
2. The SDR's can be used unconditionally by the participating countries.
3. An important feature of the SDR's is that they are not backed by any assets. The participants do not have to transfer currency or other resources against the SDR are received in allocations.
4. Under the SDR scheme a country can transfer its SDR holdings to another country designated by the fund and obtain currency convertible in fact the fund has listed eight countries as the designated countries which can accepts SDR's from the other participating countries.
5. Originally the value of one SDR was equal to one US dollar. Now the value of one SDR is equal to the average value of a basket of five key currencies of the world. US dollar, British pound sterling, French Frank, German mark and the Japanese Yen.
6. The participants designated by the fund to receive SDR's in transactions are those who are considered to have sufficiently strong balance of payments and reserve positions.
7. The country which transfers SDR's has to pay interest to the country and reserve positions.
8. A country can transfer only particular point of time.
9. The SDR scheme is called "paper gold". It is just a book entry in the ledgers of the fund.

The creation of the SDR's has been a novelty on the point of the fund it has. Certainly helped augment the supply of international liquidity, it has been acting as an international unit of account. It has been helpful to the less developed countries.

Through the fund has conferred certain advantages upon its member countries by introducing the SDR scheme. It is not free from criticism, the defect of the scheme is that the allocation of SDR's is made on the basis of the quotas of the member countries in the fund. Obviously the less developed countries do not have a significant share in the allocation of SDR's what is needed is a need based on approach in the distribution pf SDR's.

Unless the fund links the distribution of SDR's to the developmental requirements of the member countries. The purpose of introducing the SDR' scheme will be defeated the fund should be guided

by an egalitarian approach test the problem of international liquidity continues to haunt the member countries. Especially the less developed countries. Therefore it is called upon to reorient its policies regarding allocation of SDR's.

Working and Evaluation of the Fund:

It is clear that the fund can pay a vital role in achieving international economic stability and in promoting health international monetary relations. However, the I.M.F. failed to achieve its objectives in the early years of its operations.

a. For many years, the fund was not able to achieve its fundamental objectives of pulling down grade barriers. Agricultural protection dominates fiscal policies in Europe and the U.S.A. It is a pity that the U.S.A still clings to the protectionist policy in spite of her tremendous competitive strength. These policies are repugnant to the underlying objectives of the fund. Lack of international co-ordination of monetary, import and stockpiling policies has aggravated the difficulties.

b. The Fund is helpless in restraining inflationary pressures in a country and in maintaining monetary stability.

c. The I.M.F was unable to promote exchange stability in the member-countries.

d. The Fund was unable to prevent dollar shortage in the late forties. It should have declared dollar as a scarce currency and adopted measures to make the dollar freely available. But it did nothing of the kind.

e. The Fund has suffered all along from inadequacy of funds. Funds of the I.M.F may not be sufficient to cope with the sudden movements of hot money when there are no exchange controls to stop them.

IBRD (THE WORLD BANK)

INTERNATIONAL BANK FOR RECONSTRUCTON AND DEVELOPMENT (1944):

The IBRD popularly known as “The World Bank” owes its birth (origin) to Bretton woods confeence held in 1944. The World Bank was established on December 25th 1944, The World Bank was established with the twin objectives of “post war reconstruction” and for increasing the living standard of people in underdeveloped countries.

Membership and organization (structure):

Any country is eligible for membership of the bank, if it subscribes to the character of the bank. A member can withdraw at any time. Its membership can automatically gets cancelled if it fails to fulfill its obligations towards the bank.. The bank has a board of governors, executive directors, a president and other staffs. All the powers of the bank are lies in the board of governors.

The USA with her subscription standing at US dollar 27,255 million has 17.9% of the total votes. The board of governors meets once in every year. of the total of 22 executive directors who direct the banks general operations, 5 are appointed by the biggest share holders, they are U.S.A, U.K, Germany, Japan, and France, and remaining 17 are elected from others. The total membership of the bank at the end of June 1992 was 160. At present 182.

Capital: At the time of establishment, the authorized capital of World Bank was $ 10 billion. It was divided into 1 lakh shares of dollar 1 lakh each. The member’s total subscription in the capital of bank is divided into 3 parts.

1. 2% of the subscription is payable in Gold or U.S dollars and is freely available for lending.
2. 18% of the subscription is payable in member’s own currency and is available for lending with the consent of the member.
3. The remaining 80% of subscription is not payable for lending and is subject to call as and when required to be the bank’s obligations.

Thus the subscribed capital of the World Bank has been increased to 152.248 billion dollars out of which 10066 million dollars has been paid. As on June 1992; the authorized capital of IBRD was 184.05 billion US dollars ($).

Objectives and functions:

The principal objectives of World Bank are:

1. To lend to member countries for re-construction of their economic system which were destroyed during the II World war.
2. To lend for productive purposes for long run economic development.
3. To promote foreign private investment, to provide guaranty.
4. To promote long range growth of international trade and the maintenance of equilibrium in the balance of payment of member countries, To increase the production capacity, standard of living in the countries and improving the condition of labour class (child labours).

Functions:

The main function of the World Bank is to provide loans to the member countries for that its main primary function concern is that loans granted by the bank should increase the productive capacity and living standard of the borrowing countries.

In its early years, most of the bank's lending was in hard ware projects, which include dams, roads and power plants. Today, however banks lending in soft ware, education, population, planning, urbanization, water supply and sewerage and project preparation.

Lending operations:

While lending the bank follows certain criteria. They are:

1. It grants direct loans out of its own funds.
2. By granting loans out of the funds raised in the market of a member or otherwise borrowed by the bank and by granting in whole or part loans made by private investors.
3. The total outstanding amount of the loans made by the bank is not to exceed 100% of its total subscribed capital.
4. Project must be carefully examined by a competent committee.
5. Borrower must have repayment capacity.
6. Loan is given for productive purposes only.
7. Except in specific circumstances the loans is made to finance the foreign exchange requirements in case of construction and development projects.

The World Bank normally makes medium and long term loans. The term loans related to the estimated useful life of the equipment or plant being financed.

The interest charged by the bank on its loans is the estimated cost to the bank of borrowing money by comparable term in the money

market. In addition the bank also charges on all loans 1% of commission to built reserves to meet the losses, again ½ % is charged for meeting the administrative expenses.

Achievements and progress:

During the past 5 decades the World Bank provided 3414 loans amounting to 218,210 million $ dollars to 145 countries. These loans are long term loans granted at conventional rate of interests for the projects of high economic priority.

Apart from giving massive loans assistance the bank has also giving technical assistance to members. The technical assistance provided with reference to defining priorities among different projects, modification in the technical plans power projects designed to reduce its cost or to make it more efficient and administered arrangements for a project in financing and raising of local capital. The bank has provided technical assistance in development programmes to survey missions which make intensive studies of national resources of developing countries.

World bank and India:

India is a founder member of the bank. She had the privilege of presiding at the annual general meeting of the bank held in Paris in September 1950. The bank has sent several missions to India to assess he development programmes and also for the field survey of various projects.

India is the biggest single Brower of the bank. Beginning from august 1948 up to the end of June 1992, the World Bank has lent India 20599.2 U.S dollars In 147 loans. out of this more than 50% was given to transportation (railways) 20% for electricity, 28% for industry and 8% for agriculture. In addition to this the bank had helped India by raising dollar 5472 million from aid India consortium countries for India the bank means many things. The bank has not been merely a lending institution but also served as worthy counsel. She has also successfully playing a mediatory role in solving canal water dispute with Pakistan.

Appraisal

The functions of the World Bank has been criticized on so many grounds, the main criticisms are that:

1. It changes a very high rate of interest on loans.
2. The precondition of repaying capacity in granting loans is not proper because the transfer capacity follows rather than preceding the utilization of the loans.
3. The loans have not been given purely on merit and economic considerations. For instance: Europe and western hemisphere have

smaller population and rich that they have received more loans than Asia and Africa.

Asia and Africa taken together have the largest population and unexploited economic resources in the world. There is actual poverty amidst potential plenty.

Although the World Bank may have failed in fulfilling the expectations of some nations, in appraising the bank's role one should not forget the limitations with in which the bank works. The bank has been largely instrumental in accelerating the rate of economic development in different countries of the world.

Asian development Bank

(ADB) December 1966:

The ADB is a multi-national regional development bank established in the year dec.1966. It has been established for the purpose of lending funds promoting investment and providing technical assistance to the developing member countries, it is for generally fastening the economic growth (increase) and cooperation in the Asia and pacific countries.

The ADB operates under the aegises of ECAFE. That means the idea of ADB was first proposed and established by U.N's ECAFE. Its head quarters are located in the ECAFE region in Manila (Philippines).

The ADB's capital is subscribed by its 36 regional members and 16 countries from outside the region. The president and 7 of the 10 directors also comes from the region. Unlike other regional financial institutions the ADB's membership extends beyond the regions. Consequently many countries outside Asia have contributed to the capital of the bank. The ADB is engaged in promoting the economic and social progress of Asia and pacific regions.

<u>Functions and objectives</u>:

The following are the specific objectives and functions of the ADB:

1. To promote the investment in the ECAFE region, both public and private.
2. To utilize the available resources for financial development giving priority to such projects, that will contribute most effectively to the harmonious economic growth.
3. To meet the request from the members in the region to assist them in co-ordination of their development policies of the projects.
4. To promote an orderly expansions of the international trade particularly the interregional trade.
5. To provide technical assistance for preparation, financing and expansion of development projects and programmes.
6. To co-operate with united nations and its organs and subsidiary bodies including ECAFE.
7. To under take other activities that is anything which advances development in the region.

<u>Sources of funds</u>:

In the beginning Asian development bank been established with the authorized capital of $ 2985.71 million U.S.dollars. The bank accepts paid in capital in portion, in 5 equal annual installments, ½ of each installment must be paid in local convertible currency. The bank of may

also accepted non interest bearing demand notes. Its authorized capital was for the first time increased in Nov 1972 by 150% the 2nd general increase in Nov 1976. At the end of 1992the ADB's authorized capital was $ 24.2 billion of which paid in capital was 2788.80 million. The may increase its funds by increasing its capital issuing bonds or accepting contribution (special funds).

The membership of Asian development bank is open to

1. Member of ECAFE
2. Associate members of ECAFE
3. Other countries in the ECAFE region which are member of United Nations any of its agencies.

ADB in its lending operations gives ordinary and special loans. Ordinary loan consists of foreign exchange or local currency component of the cost structure of specific projects. It also gives direct loans for particular development projects. It also lends through national development banks.

On the other hand special lending operations are financed from the various special funds, such as technical assistance special fund, Asian development fund, agricultural special fund and multipurpose special fund. The bank has received contributions to its special fund from the USA, U.K, Japan, Germany, Australia, Denmark, India, Pakistan, the Netherlands (Holland), Finland, Switzerland and Canada
.

In addition to the lending operations the ADB also provides technical assistance in its member countries, their agencies private firms, regional institutions.

In addition to lending and technical assistance, the ADB also organizes technical assistance mission to study the potentiality of recipient member countries.

The birth of the ADB is an important milestone In the First development decade the ADB is a living example of mutual co-operation independence and complimentary efforts based on multi lateral co-ordination necessary for the development of the Asian member countries.

In 1988 ADB has lend $291 crores for 56 projects belong to 18 member countries. Again in 1989 it has lent dollar $370 crores in 60 projects belonged to 50 countries. From its special funds it has lend $ 24.5 crores interest free loans.

India and ADB:

India was the founder member of ADB. After Japan, India has the largest shares. As the regional member country, it has 6% of votes. still 1986 India was not included under eligibility list to get aid. The single reason for that, India was the largest beneficiary from IDA. However in the year 1986 India has also been included under special category. Between 1986 & 89, India has received dollar 160 crores for 14 projects.

Foreign Capital

Foreign capital represents the flow of funds, technology and other inputs from outside the country. one can see the flow of these from the developed countries towards the developing countries. The foreign capital has been playing an important role in the economic development of the developing countries, including India. At the same time, foreign capital may cause unhealthy consequences.

The foreign capital has entered the country in various forms:
It may be on government account or on private account. It may be for long term purposes and short term needs. The long term capital refers to capital that has maturity of more than a year; the short term capital has maturity of one year or less.

In broader terms, the flow of foreign capital may come in the following forms:

1. Foreign aid (help):

The greater portion of foreign capital is coming in the form of foreign aid. A major part of foreign capital has been available at soft or concessional terms. This is known as external assistance or foreign aid. Foreign aid has mostly been given by foreign governments or institutions like IBRD or World Bank. The recipient in the country is mostly the government. Foreign aid can take two forms they are loans or grants. The former involves the problem of repayment where as the latter doesn't.

2. Tied and untied Aid;

If a donor country puts a lot of conditions on the use of aid, it is called tied aid; on the other hand, the flow of aid with out any conditions is called untied aid.

3. Bi-lateral and multi-lateral;

The transactions between two countries directly are called bi-lateral. For e.g. America giving aid to India. Where as, the group of countries giving aid jointly is called multi-lateral aid. For e.g. aid India consortium countries giving aid to India.

4. Public and private Foreign Capital;

The flow of capital between governments of respective countries and between the governments and international monetary institutions are called public foreign capital.

Where as the flow of capital from private companies and individuals are called private foreign capital.

5. Commercial borrowings: The commercial borrowings are the raising loans from the international capital market. The rate of interest is higher than the foreign aid and the repayment period is shorter. Some financial intuitions, public sector undertakings, and private companies in India raised funds through the issue of bonds in the international market (mutual funds).

6. Collaborations

If any production unit are started with joint efforts of domestic and foreign governments is called collaborations; for eg. In India the big steel plants like Bokaro, Durgapur, and Rourkela are established with foreign collaborations.

.Importance or merits of Foreign Capital

Foreign capital has been playing an important role in economic development of a country. In case of developing countries the foreign capital is having strategic role. One can justify the use of foreign capital on the following grounds:

1. To increase investments: All most all the developing countries are having low propensity to save i.e. to say , propensity to consume is very high. Consequently, the rate of capital formation will be very low. According to experts nearly 25% of national income (GNP) has to be saved and re-invested to achieve a sustained economic development. Therefore to build this gap, i.e, the domestic savings and required rate of investment, foreign capital is crucial. In India during planning period, foreign capital has become an important component of planned investment.

2. Industrialization: The countries like India are tried to bring about the rapid industrialization. From beginning industries requires external assistance this is in the form of technology, technique know how and funds. It is very difficult to industrialize an economy without the foreign capital.

3. To establish big industries: There are certain projects which have high linkage effects. The establishment of these projects will bring about overall impact on economy, but such industries require very large amount of capital or huge investment (Iron & steel fertilizers, coach factories (Perambur), ship building, etc.). The foreign capital has become gift to start such industries.

4. Projects with high risks: There are certain projects which involve high risks; one can't throw away the capital which is in short supply on such projects or ventures (projects). Therefore one can invite foreign capital on such projects; for example, mining, petroleum extraction, space research etc.
5. Projects which have high import intensity: There are certain projects which require the import of raw materials and other equipments. with out import, one can't start such industry. The foreign capital has become very useful.
6. To meet the contingencies (emergences): This may come in the form of floods, famine, earthquakes, war, etc. Foreign capital can help a nation to overcome such difficulties. In India the failure on agricultural front will force the government to import food grains. Some times to maintain the balance of power, a country will be forced to import defense goods.
7. To adjust balance of payments short comings: Sometimes exports may not be able to cover the payments of imports. This represents shortages of foreign currencies, foreign capital used to bring about the adjustment in the balance of payments.
Thus it is clear that the foreign capital has been occupying an important place in the economic development of a country, particularly in case of developing countries.

Limitations or demerits of foreign capital:

Though foreign capital is going to benefit a country, one should not forget the problems created by the flow of the foreign capital. Depending substantially for capital on foreign sources has sometimes resulted in difficulties and constraints. On the part of government, it can't undertake decisions freely in the best interest of the country. Though the pressure from foreign governments or world institutions are not expectations nor in written form. They are certainly implicit in the sense that the country has to confirm to the conditions of aid taking. The following are the important weaknesses of foreign capital:

1. Threatens the sovereignty of the country:
The consortium countries and the world Bank get information about economic development of a country. They review and make their own assessments about credit worthiness of the aid seeking country. So as the government has to share the inter-economic development to fulfill the obligation of donor or the World Bank. The pressure, sometimes, become open and seems to threaten the very sovereignty of the recipient country; one standing example was the threat of the U.S government to stop all aid to India during the Indo-Pak conflict in 1971.

2. Uncertainty of aid:
The uncertainty has taken various forms, there has been uncertainty about the limiting of the aid givers go by their conveniences, It may leads to harmful consequences, for example the finalization of the 4th plan was considerably delayed because of the delayed in the announcement of aid by some donor countries. Then there are uncertainties about the amount of foreign aid. The countries may have relation with the donor country on account of which it deems necessary to stop, reduce, postpone, or change the character of the aid. Such development creates complications and sometimes put the entire plan out of gear.

3. Restricted use of aid: Most of the aid or loans are tied ones. This is the aid which has to be used for the purchase goods for specific projects or used in specific country. It will leads to higher costs of the planned Projects. Tied aid has restricted our choice in respect of its use; therefore in possibility of making optimum use of freely available resources.

4. Complaisance and dampening of initiative: it has discouraged local initiative in matters connected with saving and indigenous technology.

5. Low utilization rate: the utilization of foreign capital requires certain infrastructural facilities, quick decisions and stability of economic condition. Unfortunately the country like India is facing under utilization of foreign capital due to procedural delays and lack of infrastructure and experience. In 1964 a community on utilization assistance was formed under the chairmanship of V.K.R V. Rao.

Debt servicing burden too much dependence on external assistance increases the burden of debt servicing (interest payments). Sometimes the repayment of capital becomes difficult. At the moment, a substantial part of our gross foreign aid being used to meet these obligations. Again improper use of foreign aid may put a country under debt trap.

Conclusion: while one recognizes the important of foreign capital it needs also to be stressed that the entry of foreign capital has to be under safe guards. Several examples have proved that unrestricted entry of foreign capital has often led to harmful consequences for recipient countries. The prominence of capital from capital resources sometimes create complications, unnecessary delay, and imposing conditions etc., there by reduces effects of foreign capital. It is therefore important to emphasize that the recipient country should vigilant (careful) with the amount, the nature of foreign capital and the sources from which it is sought.

Multi National Corporations (MNC's)

Multi National Corporation is a company or an enterprise which operates in number of countries and which have production and facilities outside the country of its origin. It is also called Trans-National corporations. Such company's decisions are having global impact.

Any business corporation which has holdings, management, production and market extended to several countries, owns huge resources and extensive potentially and encourage collective potentiality between various countries with a view increasing profitability under centralized ownership and control can be called as a multinational corporation. Every MNC which has its Head quarters in its home country, plans potential operations in several country, plans potential operation in several host countries. According to the International Labour Organization (I.L.O) "the essential nature of the Multinational Enterprises lies in the fact that its managerial Head quarters are located in one country (The Home Country) while the enterprises carries out operations in a number of other countries as well (host country). The multinational corporations are involved in commercial business operation around the globe and not limited to one or two countries.

Companies are now making their efforts to operate in the international market. Even small company has to tap new potential avenues abroad as a result of extensive competition in the local market. International trade has crossed US Dollars 40000 billion mark. The share of India has gradually been increasing. Developing countries like India chalk out strategies to open up the door for foreign investment through global companies' multinational business firms and transnational enterprise to welcome large inflow of technology machinery, equipments and technical know-how. In the context of emerging trends of globalization of business, multinational corporations (MNCs) come into existence in the global arena. The MNCs are playing a great role in the changing global business scenario.

The growth of MNC's is the mere extension of monopolies and concentration of economic power at the global level. They also represent internationalization of production as well as investment. There has been a growing oligopolisation of market. In brief, MNC's is an international monopoly and the contraction of economic power is at world level.

With regard to the ownership of MNC's it is an wide spread phenomenon, that means both developed and developing countries are having MNC's. However, almost all big MNC's are controlled by big (rich) countries like USA Japan & USSR.

If we combined all the assets of Indian MNC's it would not be equal to the total assets value of 1 MNC owned by developed country. More over developing countries are invested in some other developing countries. At large MNC's are very much controlled by developed countries.

The MNC's are to be carried on variety of activities like capital, technology, research and developing of know how, marketing of products. etc in addition to the dynamic sections minerals and petroleum are operated food complex, baby food, pharmaceuticals, electrical machinery, chemicals, aluminum, metal and its products, heavy engineering goods etc. The operation and growth of MNC's created both merits and demerits.

Merits or advantages of MNC's:

In spite of fear over the advent of MNC's the countries like India can expect the following benefits from the MNC's

1. Flow of capital: The LDC's in the eagerness of faster development tries to bring about the industrialization; huge investments are needed for the creation of infra-structure facilities. Unfortunately LDC's had lesser (few) sources of capital. so coming of MNC's means additional supply of capital.

2. Technological developments: There is lot of technological gap between LDC and advanced countries. Consequently the rate of growth of has been slower in LDC's. The process of development requires the technological and structural changes. There was an attempt to influence the advanced countries for transfer of technique to LDC's. But, the developed countries had transferred, out dated technology and unsuitable technology. It is of no use to the LDC's. The MNC's when they establish their own industries, bring sophisticated technology. Again to get advantage of cheap labor and other resources they developed labor intensive technology.

3. Research and development: allied to technology is the question of expenditure on research and development. It is not much easy for LDC's to spent on research with their huge capital base MNC's can spent on research and development. The units established in developing countries can get that benefit from its parent company.

4. Marketing facilities; MNC's are very helpful for the developing countries to conduct exports and imports. The international trade is a very complex one. The marketing again is not a single line of activities. It involves so many stages. Such as, transportation, storage, licensing, consumer's survey, advertisements etc. these MNC's are very efficient to conduct such operations for that they expect commissions. since they

have operational network in so many countries, it becomes cheaper to provide such operations.

Demerits or disadvantages of MNC's:

The welcome of MNC's is not an unmixed blessing. One should be careful about their eyes before accepting them in certain fields. The following are some of the evil effects of the MNC's:

1. Harmful fro producers and consumers: The MNC's are having such potentialities to eliminate any competitions. Their techniques to impose will on producers and consumers are many. They manipulate future markets, differentiate their products, and through creative advertising etc. these are used to maximize global profit. In this process both producers and consumers suffers large, now there is almost oligopolisation of global market.
2. Evil of transfer pricing: This includes mutual agreements among different firms to share market, monopolization of market etc. These intra company transaction are commonly refers to as transfer pricing. Sometimes MNC's establish dummy trading companies in low tax countries.
3. Currency manipulations: the MNC's with world wide operations involved in financial dealing in several national currencies. They are accumulating the strong currencies and dispose dead and weak currencies. The MNC's are responsible for creating the serious currency crisis.
4. Bad business ethics: The MNC's even capable of up selling the legal system of a country. Sometimes they have indulged in bribing to influence the people to get done the things. They disturb the process of government or political stability in the countries of Asia, Africa and Europe.

Thus it is clear that more than their benefits the MNC's are very dangerous. One has to be careful in dealing with MNC's that an appreciate policy towards them is necessary to derive the best out of MNC's and loose the least from them.

Future of MNCs

In the context of the emerging globalization and Internationalization of business, MNCs would enjoy greater prominence in the developing and under developed countries for technology transfer on the one hand and resource mobilization and capital formation on the other. As they are expected to maintain a potential link between developed home countries and under developed and developing home countries, their role in the developed countries would also substantially increase in maintaining growth with stability thus giving global economy a solid base.

The host government's policies and approach to foreign investments are vital issues which MNCs seriously consider before taking considerable investment decisions. Frequent political changes in the host countries influence the investment division of foreign companies.

Reserve Bank of India (RBI) provides single window clearance which gives Indian companies to multinationalise their operations. This means that the opportunity now exists even for Indian Companies to act as multinational corporations in future.

MNCs will be instrumental to accelerate generation of wealth globally in the years to come. If such wealth is properly distributed to countries where it is the most needed, the existence of multinational corporations will be meaningful and the developing countries will stand to benefit by this “goose that lays the golden egg”.