K.J. SOMAIYA INSTITUTE OF MANAGEMENT STUDIES & RESEARCH

PGDM (FS) – 2017 – 19 BATCH – IV TRIM

International Business

Marks : 50 **Time : 3 hours** **Date : 24/09/2018**

Note:-

i) Question No 1 is compulsory and carries 20 marks

ii) Answer any three questions from the rest(Each question carries 10 marks)

Qn 1.Read the following case study and answer the questions given below:-

Discriminatory trade policy is the defining characteristic of a trade bloc. The different types of trade blocs (or PTAs) can be broadly distinguished in three categories: (1) a free trade agreement (FTA) where trade barriers among member countries are removed, but where each member remains responsible for the determination of its trade policy vis-à-visnon-member countries;

(2) a customs union (CU), with liberalised intra-bloc trade, as
well as the adoption of a external tariff structure and trade barriers towards outsiders common to all members of the CU;

(3) a common market, which entails a CU with deeper integration between its members (such as free movements of goods, services factors of production, common economic policies, etc.).

Most of the analyses on the effects of trade blocs focus on FTAs and/or CUs.

The **effects of a PTA are of two types: The trade effects and the welfare effects**.

The trade effects comprise the impact of a PTA on the volume and quantity of trade, on the terms of trade (i.e. prices) and on the level of protection (generally tariffs) for PTA members and excluded countries. In analysing the welfare effects of a PTA, it is important to distinguish between the impact of trade bloc(formation and expansion) on the welfare of **each of its member, (2) the trade bloc as a whole and (3) the countries excluded from the trade bloc.**

A standard result of international trade theory is that, in a competitive environment and in the absence of market distortions and externalities, free trade will maximise global welfare. Removing trade barriers between a subset of countries could therefore appear to be, *a priori*, a move in the right direction. Yet, the 'theory of second best' points out that removing a distortion while others remain in place may not increase welfare. Trade blocs are examples of second best since a distortion is removed, i.e. trade barriers between member countries, while another distortion is created in the form of a discrimination between members and non-members (the latter facing trade barriers from the PTA), as well as other market imperfections. Hence, the welfare implications of a trade bloc are ambiguous as they depend on many factors.

The demonstration of the theory of second best situation entailed by a PTA was derived from the seminal work of Jacob Viner (1950), which shows that while liberalising trade between a group of countries can lead to 'trade creation' between members (which should increase welfare), it can also reduce trade between the CU and its trading partners.

This 'trade diversion' can potentially reduce welfare for all as a member switches from a relatively efficient, low cost producer outside the CU to less efficient, higher cost producer within the CU, leading to a global misallocation of resources. Most of the debate on the static impacts of trade blocs on the global economy rests on the theoretical and empirical evaluations of whether a PTA is more trade-creating or trade-diverting. Another important element in assessing the trade impact of a PTA are the price, or 'terms of trade', effects of a trade bloc. Again, as intra-bloc trade is liberalised while extra-bloc trade is not. PTA members buy more from each other (trade creation) and less from third countries. If the PTA is not economically small, world prices will be affected as the demand for (and thus the price of) non-member exports decreases, creating a positive terms of trade effect for PTA members and a likely deterioration of the terms of trade for third countries. Hence, trade blocs allow member countries to exploit their joint market power over their terms of trade.

This capacity to influence its terms of trade is an important element in the analysis of the trade policy determination and welfare effects of a PTA. Due to their increased market power, the members of a trade bloc can extract rents from the excluded trading partners by setting 'optimal tariffs' and behaving in a co-ordinated strategic way. Such considerations also led to some predictions with regards the dynamics of trade blocs. In particular, it is expected that, if countries are symmetric, trade diversion and optimal tariffs increase as the world integrates in a smaller number of expanding trading blocs. Although the level of optimal tariffs with expanding trade blocs depends on the factor endowments (i.e. comparative advantages) of the member countries, the welfare losses associated to trade bloc formation and expansions seem to be due more to trade diversion than to potential increases in optimal tariffs.13 Ultimately, the optimal number of trade blocs in the world depends on the one hand on the potential positive welfare effects resulting from trade creation, and on the other hand on the potential negative welfare impacts resulting from trade diversion and adverse changes in the terms of trade.

Besides, a larger market resulting from the creation and extension of trade blocs does not only increase the market power of its members, but it also provides opportunities for greater productivity efficiency for industries facing economies of scale and increased competition within the PTA market. This in turn may contribute to reduce distortions within the trade bloc. In this respect, it is worth noting that small countries could benefit more from joining a PTA than larger countries, in particular if the trade bloc is initially formed by large members, as small countries will derive relatively larger economic advantages from gaining access to the potentially large market of the bloc.

Answer the following questions:-

a) The welfare implications of a trade bloc are ambiguous as they depend on many factors .Do you agree? Give reasons

b) Explain the theory of 'Second Best Situation' in trade blocs

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Qn 2.What are the features of International money and debt Markets? Explain in detail

Qn 3. Explain the following concepts with reference to Forex markets☹Give examples

a) Spot & Forward Rates

b) Direct &indirect rates

4.Explain the important aspects of international primary and secondary capital markets

5.Describe the functions of IMF &World Bank and critically examine their functions from the point of view of developing countries

6.What are the different forms of trade Finance? Describe their advantages and disadvantages

7.What are the reasons for the depreciation of rupee against US dollar? How does it affect international Business in India?