Chapter 9
International Trade

Foreign exchange market

The market in which national currencies are traded for one another.

Foreign Exchange rate or Forex rate

The price of one currency in terms of the another is known as the exchange rate. E.g. 1 US$ = INR 80

Exchange rate regime

Fixed/Pegged exchange rate	When exchange rate is fixed by the Govt. **Gold standard** From around 1870 to the outbreak of the First World War in 1914, the prevailing system was the gold standard . **All Currencies were fixed (or pegged) to gold**. Each country guaranteed the free convertibility of its currency into gold at a fixed price. Exchange rates were determined by its worth in terms of gold. To maintain the official parity, each country needed an adequate stock of gold reserves. Amount of **money in circulation was tied to the amount of gold** in the economy. The gold standard ensured long-term price stability; high levels of inflation were seldom existed and “hyperinflation impossible” as the money supply can only grow at the rate of gold supply. **WW-1 saw the end of the gold standard** as many Countries suspended the convertibility of their currencies into gold, choosing to spend gold and print money to fund the war. By printing new money not backed by gold, nations devalued the market exchange rates of their currencies. During 1914-45, there was no maintained universal system but this period saw both the gold standard and a period of flexible exchange rates. **Bretton Woods system** The United Nations Monetary and Financial Conference was held in July 1944 at the Mount Washington Hotel in Bretton Woods, New Hampshire, US, where delegates from 44 nations created a new international monetary system known as the Bretton Woods system. 730 delegates at Bretton Woods agreed to **establish two new institutions**. The **International Monetary Fund (IMF)** would monitor exchange rates and lend reserve currencies to nations with balance-of-payments deficits. The International Bank for Reconstruction and Development, now known as the **World Bank Group**, was responsible for providing financial assistance for the reconstruction after World War II and the economic development of less developed countries. Bretton Woods system **reestablished a system of fixed exchange rates**. A two-tier system of convertibility was established **at the centre of which was the dollar.** The **US monetary authorities guaranteed the convertibility of the dollar** into gold at the fixed price of **$35 per ounce of gold** and monetary authority of each IMF member committed to convert their currency into dollars at a fixed price. The latter was called the official exchange rate. Such an elaborate system of convertibility was necessary because the distribution of gold reserves across countries was uneven with the **US having almost 70 per cent of the official world gold reserves**. Further, it was believed that the existing gold stock would be insufficient to sustain the growing demand for international liquidity. The Bretton Woods system was in place until persistent **US balance-of-payments deficits** led to foreign-held dollars exceeding the US gold stock, implying that the United States could not fulfill its obligation to redeem dollars for gold at the official price. British demanded that US guarantee

	the gold value of its dollar holdings. **In 1971, US President Richard Nixon ended the dollar's convertibility to gold**. Since the collapse of the Bretton Woods system in 1971, IMF members have been free to choose any form of exchange arrangement they wish (**except pegging their currency to gold**): allowing the currency to float freely, pegging it to another currency or a basket of currencies, adopting the currency of another country, participating in a currency bloc, or forming part of a monetary union.
Floating/Flexible (also known as Free/Clean floating)	When exchange rate is determined by the demand and supply in market (e.g. US). Central banks do not intervene in the foreign exchange market.
Managed/Dirty Floating	When exchange rate is determined by demand and supply in market but Central Banks also intervene to reduce excessive fluctuations in the exchange rate through buying and selling of foreign currency. (India introduced from March 1993) **Post-independence**, Indian rupee was pegged to the pound sterling due to its historic links with Britain. With the breakdown of the Bretton Woods system, and also the declining share of UK in India's trade, the rupee was delinked from the pound sterling in September 1975 to avoid the weaknesses associated with a single currency peg. During the period between 1975 to 1992, the exchange rate of the rupee was officially determined by the Reserve Bank within a nominal band of plus or minus 5 per cent of the weighted basket of currencies of India's major trading partners. In march 1992, the Liberalised Exchange Rate Management System (LERMS) involving **dual exchange rates** was introduced. Under this system, 40 per cent of exchange earnings had to be surrendered at an official rate determined by the Reserve Bank and 60 per cent was to be converted at the market determined rates. The **dual rates were converged into one** from March 1, 1993; this was an important step towards current account convertibility, which was finally achieved in August 1994 by accepting Articles of Agreement of the IMF.

Q.1 CDS-2015
Under flexible exchange rate system, the exchange rate is determined
(a) predominantly mechanism by market (b) by the Central Bank
(c) as a weighted index of a group of Currencies (d) by the World Trade Organization

Q.2 CDS 2021
Exchange rates state the value of one currency in terms of other currencies. Which one of the following statements with respect to the exchange rate of currency is correct?
(a) Floating exchange rates are rates in which the Governments interfere by buying or selling their currencies.
(b) Fixed exchange rates are rates set by Government decisions and maintained by Government actions.
(c) Under the Bretton Woods System, the exchange rates are floated in terms of rise or fall in price of gold.
(d) Under the classical gold standard, the exchange rates are fixed in terms of price of dollar.

Devaluation

Devaluation means deliberate reduction in external value of domestic currency in terms of foreign currency by the Central Bank after the Govt approval.

Impact of devaluation -Export increases as domestic currency becomes cheaper for foreigners and import decreases as foreign currency becomes costly for indian importers.

Rupee devaluation

1. On 19th September,1949, Rupee devalued by 30.5 % as a defensive measure consequent to the devaluation by other 'sterling area' countries. Post-independence, Indian rupee was pegged to the pound sterling due to its historic links with Britain.

2. On 6th June, 1966, Rupee devalued by 36.5 % (External payments crisis- Foreign exchange reserves decreased sharply, India Pakistan War in 1965).

3. On 1st & 3rd July, 1991, Rupee Devalued in two stages (9% and 11%). In the beginning of the 1990s, the significant rise in oil prices and suspension of remittances from the Gulf region in the wake of the Gulf crisis led to severe balance of payments problems in India. India's foreign exchange reserves fell rapidly.

Recently on 8th March, 2022, Sri Lanka's central bank has devalued the rupee by up to 15%. Central Bank of Sri Lanka set an exchange rate from 200 rupees per US Dollar to 230 rupees per US dollar. Devaluation was likely done to encourage remittances, a major source of foreign exchange in Sri Lanka.

Q.3 Prelims 1994
Devaluation of a currency means
(a) reduction in the value of a currency vis-a-vis major internationally traded currencies
(b) permitting the currency to seek its worth in the international market
(c) fixing the value of the currency in conjunction with the movement in the value of a basket of predetermined currencies
(d) fixing the value of a currency in multilateral consultation with the IMF, the World Bank and major trading partners

Q.4 Prelims 1999
Assertion (A): Devaluation of a currency may promote export.
Reason (R): Price of the country's products in the international market may fall due to devaluation.
(a) Both A and R are true, and R is the correct explanation of A (b) Both A and R are true, but R is not a correct explanation of A
(c) A is true, but R is false (d) A is false, but R is true

Q.5 CDS 2017
Devaluation of currency will be more beneficial if prices of
(a) domestic goods remain constant (b) exports become cheaper to importers
(c) imports remain constant (d) exports rise proportionality

Q.6 Prelims 2021
Consider the following statements:
The effect of devaluation of a currency is that it necessarily
1. Improves the competitiveness of the domestic exports in the foreign markets
2. Increase the foreign value of domestic currency
3. Improves the trade balance
Which of the above statements is/are

a) 1 only b) 1 and 2 c) 3 only d) 2 and 3

Purchasing Power Parity (PPP) theory

As per PPP theory, as long as there are no barriers to trade like tariffs (taxes on trade) and quotas (quantitative limits on imports), exchange rates should eventually adjust so that the same product costs the same whether measured in rupees in India, or dollars in the US, yen in Japan and so on, except for differences in transportation.

PPP exchange rate is the rate at which the currency of one country would have to be converted into that of another country to buy the same amount of goods and services in each country. E.g. If selling price of HP laptop in India is Rs. 30,000/- and selling price of same HP laptop in US is $500/-, this would imply a PPP exchange rate of 1 US$ is Rs.60.

According to the PPP theory, differences in the domestic inflation and foreign inflation are a major cause of adjustment in exchange rates.

If one country has higher inflation than another, its exchange rate should be depreciating.

Suppose in the above example, price of HP laptop in India increases to Rs. 31,000/-, then PPP exchange rate of 1 US$ will be Rs.62. Hence rupee depreciated due to higher inflation.

As per PPP exchange rate of US dollars, India is the **third largest economy** (GDP) in the world. (China 1st and US 2nd)

As per Current exchange rate of US dollars, India has become the **fifth largest economy** (GDP) in the world after overtaking the UK. (US 1st, China 2nd, Japan 3rd, Germany 4th,)

Q.7 Prelims 2019
Consider the following statements
1. Purchasing Power Parity (PPP) exchange rates are calculated by comparing the prices of the same basket of goods and services in different countries.
2. In terms of PPP dollars, India is the sixth largest economy in the world.
Which of the statements given above is / are correct?
(a) 1 only (b) 2 only (c) Both 1 and 2 (d) Neither 1 nor 2

NEER and REER Index of the Indian Rupee

Nominal Effective Exchange Rate (NEER)	Effective exchange rate (EER) is a summary indicator of movements of the home currency against a basket of currencies of trading partners. Effective exchange rates serve as a gauge for assessing the fair value of a currency, the external competitiveness of an economy and even serve as guideposts for setting monetary and financial conditions. The nominal effective exchange rate (NEER) is an index of the weighted average of bilateral exchange rates of home currency vis-à-vis currencies of trading partners, with weights derived from their shares in the trade basket of the home currency.
Real Effective Exchange Rate (REER)	A real effective exchange rate (REER) is the NEER adjusted by relative prices or costs, typically captured in inflation differentials between the home economy and trading partners. Conceptually, EERs are founded on the purchasing power parity (PPP) hypothesis. The REER is the NEER adjusted for **inflation**. REER is computed using inflation differential based on CPI-Combined (base year is 2015-16) Reserve Bank is providing the **monthly** NEER and REER index (6 currencies trade weighted and 40 currencies trade weighted as well as export weighted). **Increase in indices indicates appreciation of rupee and vice versa.** In order to calculate the weights, the geometric average of India's bilateral trade (exports plus imports) with countries/regions represented by the 6 currencies/ 40 currencies is taken.
REER-6 currencies	REER-6 is calculated with reference to the basket of six major trading currencies representing 1. US Dollar 2. Hong Kong dollar 3. Euro 4. Pound sterling 5. Japanese Yen 6. Chinese Renminbi
Increase/ Decrease in REER	The competitiveness of exports is determined by the REER as it reflects the movements in relative price levels. The higher India's REER, lower India's Export growth NEER index of Indian ruppe-trade weighted in September 2022 was 93.05 (40 currencies) and 88.27 (6 currencies) REER index of Indian ruppe-trade weighted in September 2022 was 104.87 (40 currencies) and 105.23 (6 currencies) i.e. more than 100. it means **Rupee is still overvalued** and has room to depreciate further. An increase in REER implies that exports become more expensive and imports become cheaper; therefore, an increase indicates a loss in trade competitiveness. If the change in the REER is negative, then the economy is gaining competitiveness compared to its trading partners

Q.8 Prelims 2022
With reference to the Indian economy, consider the following statements:
1. An increase in Nominal Effective Exchange Rate (NEER) indicates the appreciation of rupee.
2. An increase in the Real Effective Exchange Rate (REER) indicates an improvement in trade competitiveness.
3. An increasing trend in domestic inflation relative to inflation in other countries is likely to cause an increasing divergence between NEER and REER.

Which of the above statements are correct?
(a) 1 and 2 only (b) 2 and 3 only (c) 1 and 3 only (d) 1, 2 and 3

Currency manipulation

Currency manipulation is a policy used by governments and central banks to artificially lower the value of their currency (in turn lowering the cost of their exports) to gain an unfair competitive advantage. In order to weaken its currency, a country sells its own currency and buys foreign currency – usually U.S. dollars.

Balance of Payments (BoP)

BoP record the transactions in goods, services and assets between residents of a country with the rest of the world for a specified time period typically a year.

RBI releases BoP data quarterly basis. (e.g. April-June, July-Sept, Oct-Dec and Jan-Mar)

RBI presents the BoP data in **Two Format**.

1. Old Format
2. BPM6 ((published by IMF in 2009)

The sixth edition of the Balance of Payments and International Investment Position Manual (BPM6) of the International Monetary Fund (IMF) defines the Balance of Payments (BoP) as a statistical statement that summarises economic transactions between residents and non-residents during a specific time period.

Old Format

There are two main accounts in the BoP. Current account and Capital account.

A. CURRENT ACCOUNT

1 Exports

2 Imports

3 **Balance of Trade/Merchandise** (1-2)

4 Invisibles (as no port entry like import-export)

- a) Services (e.g. Software services, Financial services, Travel, Transport, Insurance etc.)
- b) Transfers (e.g. Gift, Remittance, Grant)
- c) Income (e.g. Investment income -interest, dividend, profit etc., Compensation of Employees)

Current Account Balance (3+4)

B. CAPITAL ACCOUNT

1 Foreign Investment:

- a) Foreign Direct Investment (FDI)
- b) Portfolio Investment

2 Loans:

- a) External Assistance
- b) Commercial Borrowings
- c) Short Term Loan (e.g. Suppliers' credit, Buyers' credit)

3 Banking Capital (e.g. Commercial Banks' Assets and Liabilities like Non-Resident Deposits)

4 Rupee Debt Service

5 Other Capital*

Total Capital Account (1 to 5)

Overall balance (A+B) (i.e. Increase/Decrease in Foreign Exchange Reserves)

* “Other Capital” includes SDR allocation, leads and lags in exports receipts (difference between the custom data and the banking channel data), funds held abroad, India’s subscription to international institutions, advances received pending issue of shares under FDI and capital receipts not included elsewhere.

India suffers from an overall trade/current account deficit. India is dependent on capital flows for financing the current account deficit.

BPM6 Format

Transactions are divided into three accounts: Current account, Capital account and Financial account

A. CURRENT ACCOUNT

1 Goods and Services

2 Primary Income (Compensation of employees, Investment income like interest, dividend, profit etc.)

3 Secondary Income (Current Transfers like Gift, Remittance, Grant, external assistance)

B. CAPITAL ACCOUNT

1 Gross acquisitions/disposals of non-produced non-financial assets (land sold to embassies and sales of leases and licences)

2 Capital transfers (e.g. Investment grants for financing costs of acquiring fixed assets, transfers of funds for acquisition of fixed assets)

C. FINANCIAL ACCOUNT (reflects net acquisition and disposal of financial assets and liabilities.)

1 Foreign Direct Investment (FDI)

2 Portfolio Investment

3 Financial derivatives (other than reserves) and employee stock options

4 Other investment

- Other equity (ADRs/GDRs)
- Currency and deposits (NRI Deposits)
- Loans (External Assistance, ECBs and Banking Capital)
- Insurance, pension, and standardized guarantee schemes
- Trade credit and advances
- Other accounts receivable/payable—other
- Special drawing rights
- Reserve assets **(i.e. Increase/Decrease in Foreign Exchange Reserves)**

The sum total of net transactions under the current and capital account represents net lending (surplus) or net borrowing (deficit) by the economy from the rest of the world, which is reflected in the financial account as net outflow or inflow of capital. Thus, the financial account shows how the net lending to or borrowing from the rest of the world has occurred.

Financial account shows how the current account surplus is used or the current account deficit is financed.

Q.9 Prelims 1992
Invisible trade is a trade
(a) Of corporate and financial institutions with government
(b) Of government with public institutions
(c) Of government with other countries
(d) Of the services like the banks, marine companies and shipping companies

Q.10 CISF-LDC-2013
Which one of the following describes Current Account Deficit in India ?
(a) Value of imports is more than value of exports in a year
(b) Value of exports is more than value of imports in a year
(c) Depreciation of rupee value against US dollar during the financial year
(d) A government falling into a debt trap

Q.11 Prelims 2014
With reference to Balance of Payments, which of the following constitutes/constitute the Current Account?
1. Balance of trade
2. Foreign assets
3. Balance of invisibles
4. Special Drawing Rights

Select the correct answer using the code given below.
A. 1 only
B. 2 and 3
C. 1 and 3
D. 1, 2 and 4

Q.12 Prelims 2013
The balance of payments of a country is a systematic record of
a. all import and export transactions of a country during a given period of time, normally a year
b. goods exported from a country during a year
c. economic transaction between the government of one country to another
d. capital movements from one country to another

Q.13 Prelims 2013
Which of the following constitute Capital Account?
1. Foreign Loans
2. Foreign Direct Investment
3. Private Remittances
4. Portfolio Investment

Select the correct answer using the codes given below.
a. 1, 2 and 3
b. 1, 2 and 4
c. 2, 3 and 4
d. 1, 3 and 4

Q.14 CDS-2014
Which of the following does not form part of current account of Balance of Payments ?
(a) Export and import of goods (b) Export and import of services
(c) Income receipts and payments (d) Capital receipts and payments

Q.15 Prelims 2006
The following item consists of two statements, one labeled as the Assertion (A) and the other as Reason (R).

You are to examine these two statements carefully and select the answers to these item using the code given below:

Assertion (A): Balance of Payments represents a better picture of a country's economic transactions with the rest of the world than the Balance of Trade.
Reason (R) : Balance of Payments takes into account the exchange of both visible and invisible items whereas Balance of Trade does not.
(a) Both A and R are individually true and R is the correct explanation of A.
(b) Both A and R are individually true but R is not the correct explanation of A.
(c) A is True but R is false
(d) A is false but R is true

Q.16 Prelims 2020
With reference to the international trade of India at present, which of the following statements is/are correct?
1. India's merchandise exports are less than its merchandise imports.
2. India's imports of iron and steel, chemicals, fertilisers and machinery have decreased in recent years.
3. India's exports of services are more than its imports of services.
4. India suffers from an overall trade/current account deficit.

Select the correct answer using the code given below:
(a) 1 and 2 only (b) 2 and 4 only (c) 3 only (d) 1, 3 and 4 only

BoP Surplus and Deficit

- A surplus current account means that the nation is a lender to other countries and a deficit current account means that the nation is a borrower from other countries.
- A country that has current account deficit must finance it by selling assets or by borrowing abroad. Thus, **any current account deficit must be financed by a capital account surplus**, that is, a net capital inflows. Alternatively, the country could use its foreign exchange reserves. The reserve bank sells foreign exchange when there is a deficit. This is called **official reserve sale**. The decrease (increase) in official reserves is called the overall balance of

payments deficit (surplus). The monetary authorities are the ultimate financiers of any deficit in the balance of payments (or the recipients of any surplus).

- A deficit may be planned for the purpose of helping an economy's development and growth.
- When the economy has both current account deficit and fiscal deficit, it is said to be facing **twin deficits**.
- Trade deficits need not be alarming if the country invests the borrowed funds yielding a rate of growth higher than the interest rate.

Q.17 Prelims 2011
Consider the following actions which the government can take:
1. Devaluing the domestic currency.
2. Reduction in the export subsidy.
3. Adopting suitable policies which attract greater FDI and more funds from FIIs.
Which of the above action/actions can help in reducing the current account deficit?
(a) 1 and 2 (b) 2 and 3 (c) 3 only (d) 1 and 3

Convertibility of the rupee

Means	freely permitting the conversion of rupee to other major currencies and vice versa
Current account convertibility	India currently has full convertibility of the rupee in current accounts such as for exports and imports
Capital account convertibility	India does not have full convertibility of the rupee for capital transactions. There are ceilings on government and corporate debt, external commercial borrowings and equity. Currently, there are limitations to how much capital can flow in and out of the country. So, India's capital account is only partially convertible. When there are no restrictions, our capital account would be fully convertible. India has been using capital controls to effectively manage the flows as open capital account can lead to drastic volatility in the rupee exchange rate.

Q.18 CAPF-2013
Which of the following statements is correct with respect to the convertibility of Indian rupee?
(a) It is convertible on capital account (b) It is convertible on current account
(c) It is convertible both on current and capital account (d) None of the above

Q.19 Prelims 2002
Consider the following statements:
Full convertibility of the rupee may mean
1. its free float with other international currencies.
2. its direct exchange with any other international currency at any prescribed place inside and outside the country.
3. it acts just like any other international currency.
Which of these statements are correct? (a) 1 and 2 (b) 1 and 3 (c) 2 and 3 (d) 1, 2 and 3

Q.20 Prelims 2000
Consider the following statements :
The Indian rupee is fully convertible
I. in respect of Current Account of Balance of Payment.
II. in respect of Capital Account of Balance of Payment.
III. into gold.
Which of these statements is/are correct ? (a) I alone (b) III alone (c) I and II (d) I, II and III

Q.21 Prelims 1994 & 2015
Convertibility of the rupee implies
(a) being able to convert rupee notes into gold
(b) allowing the value of the rupee to be fixed by market forces
(c) freely permitting the conversion of rupee to other major currencies and vice versa
(d) developing an international market for currencies in India

Q.22 Prelims 1996
One of the important goals of the economic liberalisation policy is to achieve full convertibility of the Indian rupee. This is being advocated because
(a) convertibility of the rupee will stabilize its exchange value against major currencies of the world
(b) it will attract more foreign capital inflow in India
(c) it will help promote exports

(d) it will help India secure loans from the world financial markets at attractive terms

Q.23 Prelims 1998
Capital Account Convertibility of the Indian Rupee implies
(a) that the Indian Rupee can be exchanged by the authorised dealers for travel
(b) that the Indian Rupee can be exchanged for any major currency for the purpose of trade in goods and services
(c) that the Indian Rupee can be exchanged for any major currency for the purpose of trading financial assets
(d) None of the above

Q.24 Prelims 2020
If another global financial crisis happens in the near future, which of the following actions/policies are most likely to give some immunity to India ?

1. Not depending on short-term foreign borrowings
2. Opening up to more foreign banks
3. Maintaining full capital account convertibility

Select the correct answer using the code given below :

(a) 1 only (b) 1 and 2 only (c) 3 only (d) 1, 2 and 3

Valuation of Imports and Exports

Valuation basis is f.o.b. at the custom frontier of the exporting country for exports and c.i.f. at the customs frontier of the importing country for imports.

F.O.B. (Free on Board or Freight on Board) value: The value in the market at the customs frontier of a country of her exports of merchandise and other goods including all costs of transporting the goods to the custom frontier, export duties and the cost of loading the goods on the carrier unless the latter cost is borne by the carrier.

C.I.F. (Cost, Insurance and Freight) value: The value in the market at the custom frontier of a country of her imports of merchandise, other goods, etc. including all charges for transporting and insuring the goods from the country of export and the given country but excluding the cost of unloading from ship, aircraft, etc., unless it is borne by the carrier.

Import substitution

Means replacing or substituting imports with domestic production.

For example, instead of importing vehicles made in a foreign country, industries would be encouraged to produce them in India itself. In this policy the government protected the domestic industries from foreign competition.

Protection from imports took two forms: tariffs and quotas.

Tariffs are a tax on imported goods; they make imported goods more expensive and discourage their use.

Quotas specify the quantity of goods which can be imported.

The effect of tariffs and quotas is that they restrict imports and, therefore, protect the domestic firms from foreign competition.

Removing barriers or restrictions set by the government is what is known as **liberalisation**. With liberalisation of trade, businesses are allowed to make decisions freely about what they wish to import or export. The government imposes much less restrictions than before and is therefore said to be more liberal.

Q.25 CAPF-2011
Import substitution implies
(a) importing new items in place of old items of import.
(b) gradual reduction of imported goods to save foreign exchange
(c) increasing domestic supply of goods by imposing import restrictions
(d) replacing import items by domestic production of such items

Q.26 ES 2020
Which one of the following control policies leaves no freedom to private enterprise to buy plant, machinery, raw materials from the country of its choice?
(a) Import control (b) Export control (c) Exchange control (d) Physical control

Credit Rating

Credit rating is an assessment of the **probability of default** on payment of interest and principal on a debt instrument. It is **not a recommendation** to buy, sell or hold a debt instrument.

Rating only provides an additional input to the investor and the investor is required to make his own independent and objective analysis before arriving at an investment decision.

Uses and Impact of Credit Rating

Sovereign ratings gives investors insight into the level of risk associated with investing in a particular country including political risks.

Ratings play a critical role in determining the interest rate on loan. High credit rating means an assurance about the safety of the money and that it will be paid back with interest on time. Higher the credit rating, lower will the rate of interest.

From a company's or a government's perspective, a **better rating helps raise funds at a cheaper rate**. The agencies do this on a continuous basis, either upgrading or downgrading the rating based on performance, prospects, or events likely to have an impact on the balance sheet of a company or on the fiscal position of a government.

Rating upgrade will improve foreign debt inflows and in turn strengthen the rupee, instilling confidence in the economy.

Rating downgrade may influence foreign investors to pull out of money from Indian Market. Rupee will weaken. Borrowing cost will be increased for Indian companies.

Credit rating agencies of World

As per Ministry of Finance Annual Report, India's sovereign debt is rated by 6 major Sovereign Credit Rating Agencies.

Standard and Poor's (S&P) (based in US)

Moody's Investor Services, (based in US)

Fitch Ratings, (based in US & UK i.e dual HQ)

Japanese Credit Rating Agency (JCRA) (based in Tokyo) and

Rating and Investment Information (R&I) (based in Tokyo)

DBRS MorningStar (based in Canada)

S&P, Moody's and Fitch ratings are the big three credit rating agencies of the World controlling approximately 95% of the ratings business.

These Credit ratings agencies were criticized after the global financial crisis of 2008, when they were exposed after the collapse of highly rated banks and other institutions.

Credit Rating Scale-Investment Grade

<table>
<tr><th>Moody's</th><th>S&P</th><th>Fitch</th><th>Credit worthiness</th></tr>
<tr><td>Aaa</td><td>AAA</td><td>AAA</td><td>Extremely strong capacity to meet financial commitments. Highest rating.</td></tr>
<tr><td>Aa1</td><td>AA+</td><td>AA+</td><td rowspan="3">Very strong capacity to meet financial commitments</td></tr>
<tr><td>Aa2</td><td>AA</td><td>AA</td></tr>
<tr><td>Aa3</td><td>AA−</td><td>AA−</td></tr>
<tr><td>A1</td><td>A+</td><td>A+</td><td rowspan="3">Strong capacity to meet financial commitments, but somewhat susceptible to adverse economic conditions and changes in circumstances.</td></tr>
<tr><td>A2</td><td>A</td><td>A</td></tr>
<tr><td>A3</td><td>A−</td><td>A−</td></tr>
<tr><td>Baa1</td><td>BBB+</td><td>BBB+</td><td rowspan="3">Adequate capacity to meet financial commitments, but more subject to adverse economic conditions. Considered lowest investment-grade by market participants.</td></tr>
<tr><td>Baa2</td><td>BBB</td><td>BBB</td></tr>
<tr><td>Baa3</td><td>BBB−</td><td>BBB−</td></tr>
</table>

A bond is considered investment grade if its credit rating is BBB- or higher by Fitch Ratings or S&P, or Baa3 or higher by Moody's. Generally they are bonds that are judged by the rating agency as likely enough to meet payment obligations that banks are allowed to invest in them.

Speculative Grade (Vulnerable to adverse business, financial and economic conditions)
Ba1, BB+, B1, B+, Caa, CCC, C, D etc

Bonds that are not rated as investment-grade bonds are known as high yield bonds or as junk bonds.

India's Credit Rating
India is in lowest investment-grade. Moody's rating is Baa3 with Stable outlook from 05-10-2021. S&P rating is BBB- with Stable outlook from 26-09-2014. Fitch rating is BBB- with stable outlook from 10-06-2022.

What India should do to improve its Rating
The growth slowdown and its effects on the fiscal deficit and borrowings are the main worries.

- Improve the Tax collection.
- Stimulate GDP Growth
- Reduce Debt to GDP ratio
- Reduce the Fiscal Deficit

Credit rating agencies in India

Credit rating agencies are regulated by SEBI. Credit rating agencies registered with SEBI are:

- ACUITE RATINGS & RESEARCH LIMITED
- BRICKWORK RATINGS INDIA PRIVATE LIMITED
- CARE RATINGS LIMITED
- CRISIL RATINGS LIMITED
- ICRA LIMITED
- INDIA RATINGS AND RESEARCH PVT. LTD. (FORMERLY FITCH RATINGS INDIA PVT. LTD.)
- INFOMERICS VALUATION AND RATING PVT. LTD

On October 6, 2022, SEBI cancelled the Certificate of Registration granted to Brickwork Ratings India Private Limited as a Credit Rating Agency (CRA) due to failure to follow a proper rating process and failure to exercise due diligence while providing ratings.

SEBI also ordered the Brickwork ratings to wind down its operations within a period of six months from the date of the aforesaid Order and not to take any new clients from the date of Order.

Q.27 Prelims 2022
Consider the following statements :
1. In India, credit rating agencies are regulated by Reserve Bank of India.
2. The rating agency popularly known as ICRA is a public limited company.
3. Brickwork Ratings is an Indian credit rating agency.
Which of the statements given above are correct?
(a) 1 and 2 only (b) 2 and 3 only (c) 1 and 3 only (d) 1, 2 and 3

Directorate General of Trade Remedies (DGTR) under Dept of Commerce, Ministry of Commerce and Industry

DGTR is the apex National Authority for administering all trade remedial measures including anti-dumping, countervailing duties and safeguard measures.

DGTR is a **quasi-judicial body** functioning under the aegis of the Department of Commerce, Ministry of Commerce and Industry, Government of India.

The DGTR **serves as a watchdog against** unfair trade practices resorted by the producers/ exporters in foreign countries and aims to create a level playing for the Indian industry.

The unfair trade practices that the DGTR acts against are in the form of dumped imports or subsidised imports or imports that circumvent existing anti-dumping/countervailing duties. DGTR also protects the domestic industry from surge in imports that harm the Indian industry.

The function of the DGTR is to conduct an elaborate investigation into the complaint filed by the Indian domestic producers allegedly injured by the unfair trade practices adopted by foreign producers/ exporters and then take a decision on whether or not to recommend imposition of duty.

Final decision regarding imposition of duty recommended by the DGTR is taken by the Ministry of Finance, Govt of India.

Dumping

If a company exports a product at a price lower than the price it normally charges on its own home market, it is said to be “dumping” the product. This is an unfair trade practice which can have a distortive effect on international trade.

Anti dumping

Anti dumping is a measure to rectify the situation arising out of the dumping of goods and its trade distortive effect.

Thus, the purpose of **anti dumping duty** is to rectify the trade distortive effect of dumping and re-establish fair trade.The use of anti dumping measure as an instrument of fair competition is **permitted by the WTO**. In fact, anti dumping is an instrument for ensuring fair trade and is not a measure of protection per se for the domestic industry. It provides relief to the domestic industry against the injury caused by dumping.

Countervailing Duties

Countervailing Duties (CVDs) are levied on imported goods **to offset subsidies** made to producers of these goods in the exporting country.

CVDs are meant to level the playing field between domestic producers of a product and foreign producers of the same product who can afford to sell it at a lower price because of the subsidy they receive from their government.

Subsidies can be in form of subsidized loans, tax exemptions, indirect payments, etc., because of which exporters are able to export at lower prices.

Safeguard measures

When imports of a particular product suddenly increase to a point that they cause or threaten to cause serious injury to domestic producers of like or directly competitive products, a safeguard duty is used as temporary relief.

Safeguard duties give domestic producers a period of grace to become more competitive vis-à-vis imports.

Arbitrage

Simultaneous buying and selling of securities, currency, or commodities in different markets in order to take advantage of prices difference for the same asset.

Classification of Economies by World Bank

<table>
<tr><td>Four categories</td><td>World Bank assigns the world’s economies to four income groups on the basis of GNI per capita. The classifications are updated each year on July 1. Present classification is as per GNI per capita of 2022.
Low-income economies-When GNI per capita is <= $1135 (Afghanistan $390)
Lower middle-income economies- When GNI per capita is between $1136 and $4465 (Myanmar $1210, Nepal $1340, Pakistan $1580, India $2380, Bangladesh $2820, Bhutan $3040, Sri Lanka $3610)
Upper middle-income economies- When GNI per capita is between $4466 and $13845 (Maldives $11030, Russia $12830, China $12850)
High-income economies- When GNI per capita is more than $13845 (Japan $42440, UK $48890, US $76370)</td></tr>
</table>

UN list of Least developed countries (LDCs)

There are currently 46 economies designated by the United Nations as the least developed countries (LDCs), entitling them to preferential market access, aid, special technical assistance, and capacity-building on technology among other concessions.

Least developed countries (LDCs) are low-income countries confronting severe structural impediments to sustainable development. They are highly vulnerable to economic and environmental shocks and have low levels of human assets.

India's neighbouring countries in LDC are Afghanistan, Bangladesh, Bhutan, Myanmar and Nepal.

Four modes of supply of service under The General Agreement on Trade in Services (GATS) of WTO

The GATS distinguishes between four modes of supplying services: cross-border trade, consumption abroad, commercial presence, and presence of natural persons.

Cross-border supply is defined to cover services flows from the territory of one Member into the territory of another Member (e.g. banking or architectural services transmitted via telecommunications or mail);

Consumption abroad refers to situations where a service consumer (e.g. tourist or patient) moves into another Member's territory to obtain a service;

Commercial presence implies that a service supplier of one Member establishes a territorial presence, including through ownership or lease of premises, in another Member's territory to provide a service (e.g. domestic subsidiaries of foreign insurance companies or hotel chains); and

Presence of natural persons consists of persons of one Member entering the territory of another Member to supply a service (e.g. accountants, doctors or teachers).

Bound Tariff

The bound tariff is the maximum MFN tariff level for a given commodity line that governments apply to imports from other WTO members. Each country agrees to these commitments when they join the WTO.

Nations are permitted the flexibility to apply lower tariff levels to certain imports but they may not exceed their bound limits.

If one WTO member raises applied tariffs above their bound level, other WTO members can take the country to dispute settlement.

Miscellaneous

1. RIC means trilateral of Russia, India, China
2. POL in international trade stand for (Petroleum, Oil and Lubricants).
3. An increase in foreign income leads to increased exports and increases domestic output. It also improves the trade balance.
4. Foreign economic agents accept a national currency only if they are convinced that the currency will maintain a stable purchasing power.
5. **Asian Premium is the extra charge** per barrel collected by OPEC countries from Asian buyers when compared to western buyers. India is looking to form buyers' alliance with China, Japan and South Korea to end 'Asian premium'.
6. Baltic Dry Index is a **shipping freight index** reported daily by the Baltic Exchange in London. The index provides a benchmark for the price of moving the major raw materials **by sea.**

Answers of MCQs

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
a	b	a	a	b	a	a	c	d	a	c	a	b	d	a	d	d	b
19	**20**	**21**	**22**	**23**	**24**	**25**	**26**	**27**	**28**	**29**	**30**	**31**	**32**	**33**	**34**	**35**	**36**
a	a	c	a	c	a	d	a	b									

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