Glossary

accommodating (compensating) transactions Those transactions necessary to account or compensate for differences between international payments and receipts. These transactions are used to eliminate international disequilibrium.

accounting (translation) exposure This measures the impact of exchange rate changes on a firm's published financial statement items.

acquisition The purchase of one company by another company.

advising bank A bank that notifies the beneficiary of a letter of credit without adding its own commitment to that of the issuing bank.

affiliate A foreign operation formed as either a branch or a subsidiary.

African Development Bank (AfDB) A regional development bank for Africa, established in 1964 and located in Abidjan, Ivory Coast.

agency An office established by a foreign bank to offer a limited range of banking services, such as loans in that area.

Agency for International Development (AID) An office within the US State Department, established in 1961 to carry out nonmilitary US foreign assistance programs.

agency theory A theory that deals with a conflict of interest between managers and stockholders.

agreement corporation A bank chartered by a state to operate in international banking under an agreement with the Board of Governors of the Federal Reserve System.

American Depository Receipt (ADR) A negotiable certificate that represents underlying shares of a foreign company from a country other than the United States.

American option An option that can be exercised at any time before its maturity date.

American terms Foreign-exchange quotations for the US dollar, expressed as the number of US dollars per unit of non-US currency.

antidumping duty A customs duty imposed on an imported product whose price is lower than that of the same product in the home market.

Arab League A political organization of 22 North African and Middle Eastern Arab countries.

arm's-length price The price that would take place between unrelated parties.
appreciation A rise in the value of a currency against other currencies.
arbitrage The purchase of something in one market and its sale in another market to take advantage of price differential.
Asian Development Bank (ADB) A regional development bank for Asia, formed in 1966 by several Asian countries in partnership with the USA, Canada, and a number of European countries.
Asian dollar market The market in Asia in which banks accept deposits and make loans denominated in US dollars.
ask price The price at which a trader of foreign exchange is willing to sell a particular currency.
Association of South East Asian Nations (ASEAN) An economic integration agreement among a group of Asian countries.
at the money A descriptive term implying that the strike price of any currency call or put option equals the current spot rate.
autonomous transaction A transaction that occurs due to self-interest. This includes exports, imports, unilateral transfers, and investments.
average rate of return The ratio of the average annual profit after taxes to the average net investment.
back-to-back loan A loan that involves an exchange of currencies between two parties, with a promise to reexchange the currencies at a specified exchange rate on a specified future date.
balance of payments A financial statement that records all transactions between a given country and the rest of the world during a specified period of time.
balance-sheet hedge A method designed to protect the value of a company's exposed assets. It involves the selection of the currency in which monetary assets and liabilities are denominated, so that an exchange rate change would make exposed assets equal to exposed liabilities.
Bank for International Settlements (BIS) A bank in Switzerland that facilitates transactions among central banks.
bankers' acceptance A draft accepted by a bank. When a bank accepts a draft, it promises to honor the draft at maturity.
barter An exchange of goods and services between two countries without the involvement of finance.
basis point One-hundredth of 1 percent, or 0.0001 percent.
bearer The person who holds an instrument.
Benelux countries The countries of Belgium, the Netherlands, and Luxembourg.
best method rule The method that provides the most accurate measure of an arm's-length result under the facts and circumstances of the transaction under review.
beta The second letter of Greek alphabet, used as a statistical measure of systematic risk in the capital asset pricing model.
bid price The price at which a trader is willing to buy a given item such as foreign exchange.
big bang A package of major reforms designed to free a country's financial markets from regulations, such as the 1986 liberalization of British capital markets and the 2001 liberalization of Japanese capital markets.
bilateral netting A netting method used for transactions between two related units.
bill of exchange (draft) An order written by an exporter that requires an importer to pay a specified amount of money at a specified time.
bill of lading A shipping document issued to the exporting firm or its bank by a common carrier that transports the goods.

black market An illegal foreign-exchange market.

bloc A group of countries tied by treaty or agreement for mutual support or interest.

blocked funds Financial assets that cannot be repatriated because the local monetary authorities forbid their conversion into foreign exchange.

book value The asset value recorded at historical cost.

Brady bond A loan converted into collateralized bonds with a reduced interest rate, devised to resolve the international debt crisis in the late 1980s. It is named after the US Treasury Secretary Charles Brady.

branch A foreign bank that provides a full range of banking services under the name and guarantee of the parent bank.

Bretton Woods Agreement An agreement signed by the representatives of 44 countries at Bretton Woods, New Hampshire, in 1944 to establish a system of fixed exchange rates.

broker An intermediary in the foreign-exchange market.

buy-American policy A policy that requires the recipients of American aid to buy goods and services from American companies.

call An option to buy a foreign currency or other financial assets.

call swaption The right to receive fixed-interest payments.

capital account In the balance of payments, the section that records the net changes in capital transfers and the acquisition or disposal of nonproduced, nonfinancial assets.

capital asset pricing model (CAPM) A theoretical model implying that the total risk of a security consists of systematic (undiversifiable) risk and unsystematic (diversifiable) risk.

capital budgeting The entire process of planning expenditures whose benefits are expected to extend beyond 1 year.

capital gains and losses Gains and losses on sales of capital assets such as stocks and property.

capital market The market for long-term funds such as bonds, common stock, and preferred stock.

capital structure The combination of long-term debt, preferred stock, common stock, paid-in surplus, and retained earnings.

cartel A formal written or oral agreement among firms or countries to set the price of the product and the outputs of individual cartel members, or to divide the market for the product geographically.

cash center A geographical location where all idle funds from the subsidiaries of a multinational company are maintained until they are needed.

cashier's check A bill of exchange (draft) issued by the cashier of a bank, for the bank, upon the bank.

CBD Cash before delivery.

central bank The official bank of a government, such as the Federal Reserve Bank in the USA or the Bank of Japan.

CEO The chief executive officer of a company.

certainty equivalent approach A method used to adjust for project risk. It adjusts for risk in the numerator of the net-present-value formula.

certificate of deposits (CDs) A time deposit with a specific future maturity date.

CHIPS The Clearing House Interbank Payments System. A computerized clearing system used by banks in New York to settle interbank foreign-exchange obligations.

CHPAS The Clearing House Payments Assistance System. It is used to move funds between London offices of most financial institutions.

clearinghouse An institution through which financial obligations are cleared by the process of netting obligations of various members.

COD Cash on delivery.
coefficient of variation The standard deviation divided by the average return.
collecting bank Any bank that handles an item for collection.
common market A form of regional economic integration in which countries abolish internal tariffs among themselves, levy common external tariffs, and eliminate restrictions on the flow of factors of production.
comparable profits method The method allowed by the US Internal Revenue Service to determine the arm's-length price of intracompany transactions. Under this method, comparable companies' performance results are used to compute *pro forma* or benchmark operating income results for the taxpayer.
comparable uncontrolled price method The method allowed by the US Internal Revenue Service to determine the arm's-length price of intracompany transactions. Under this method, uncontrolled sales are comparable to controlled sales if their physical property and circumstances are identical with the physical property and circumstances of controlled sales.
comparative advantage The relative advantage of a country in producing goods or services.
compensation (buy-back) agreement A form of countertrade under which the initial seller receives compensation in products that arise out of the original sale.
competitive trade A practice whereby two countries buy from each other similar goods that both can produce.
confirmed letter of credit The letter of credit confirmed by a bank other than the opening bank. Thus, the confirmed letter of credit is a firm obligation between two banks.
confirming bank A bank that confirms a letter of credit issued by another bank.
consignment The delivery of goods into the possession of another for the purpose of sale.
consolidation An accounting process in which financial statements of related entities are added together to produce a unified set of financial statements.
consortium bank A bank formed by a group of banks from different countries to handle larger international loans.
contract manufacturing This occurs when multinational companies contract with a foreign manufacturer to produce products for them according to their specifications.
controlled corporation A foreign corporation in which more than 50 percent of the voting shares are owned by US shareholders.
convertibility The ability to exchange one currency for another currency.
convertible currency The currency which may be converted into other currencies without government restrictions.
corporate governance The way in which major stakeholders exert control over operations of a company. However, it is often narrowly defined as the prudent exercise of ownership rights.
correlation coefficient This measures the degree of correlation between two securities.
correspondent bank A bank located in any other city, state, or country that provides a service for another bank.
cost and freight (C&F) The FOB (free on board) value and the cost of transportation to the named point of destination.
cost, insurance, and freight (CIF) The FOB (free on board) value, the cost of transportation, insurance premium, and other costs incurred in connection with the shipment from the time of loading in the export country to its arrival at the named port of destination.

cost method The method used in consolidating the financial statements of affiliates into those of a US parent when the parent owns less than 20 percent of the affiliate. Under this method, the parent carries its affiliates at the initial investment plus its dividends received.

cost of capital The required rate of return that the company must earn on its projects for the market value of its common stock to remain unchanged.

cost plus method The method allowed by the Internal Revenue Service to determine the arm's-length price of intracompany transactions. Under this method, an arm's-length price is obtained by adding an appropriate markup to the seller's cost.

counterpurchase A form of countertrade that involves a standard hard-currency export, but the seller agrees to a return purchase with a minimum quantity of specified goods from the buyer.

countertrade International trade arrangements that are variations on the idea of barter.

countervailing duty An import charge used to offset an export subsidy by another country.

covered-interest arbitrage Portfolio investment in a foreign country that is "covered" by forward sale of the foreign currency to eliminate foreign-exchange risk.

covering The purchase or sale of foreign exchange forward to protect a foreign-exchange loss in the conversion from one currency to another.

crawling band A combination of a crawling peg and a trading band.

crawling peg A proposal for regular change in the par value according to an agreed-upon formula.

credit swap A hedging device that involves a simultaneous spot and forward loan transaction between a private company and a bank of a foreign country.

credit tranche The amount that a member country of the International Monetary Fund can borrow from the IMF above the gold tranche.

cross hedging A technique designed to hedge exposure in one currency by the use of futures or other contracts on another currency that is correlated with the first currency.

cross rate The exchange rate between two currencies when it is obtained from the rates of these two currencies in terms of a third currency.

crosslisting The listing of shares of common stock on two or more stock exchanges.

culture shock A generalized trauma that one experiences in a new or different culture.

currency board A monetary institution that only issues currency to the extent that it is fully backed by foreign reserves.

currency cocktail bond A bond denominated in a basket of currencies.

currency futures An obligation to buy and sell a specified amount of a foreign currency for delivery at a specified date.

currency futures option The right, but not the obligation, to buy or sell a futures contract of a foreign currency at any time through a specified period.

currency option The right, but not the obligation, to buy or sell a specified amount of a foreign currency at a specified price through a specified date.

currency swap An agreement made between parties to exchange one currency with another for a specified period of time and then exchange the latter currency with the former currency.

current account In the balance of payments, the section that includes merchandise exports and imports, earnings and expenditures for invisible trade items (services), income on investments, and current transfers.

current/noncurrent method A method that translates the financial statements of a foreign affiliate into the parent reporting currency. All current items are translated at the current exchange rate, and all noncurrent items are translated at their historical exchange rates.

current-rate method A method that translates the financial statements of a foreign affiliate into the parent reporting currency. All assets and liabilities are translated at the currency exchange rate.

customs union A form of regional economic integration that eliminates tariffs among member countries and establishes common external tariffs.

customs valuation The value on which customs authorities charge tariffs. If values are set arbitrarily high, tariffs will also be higher.

debit In the balance of payments, the part of an international transaction that increases assets of a country and reduces liabilities or net worth of the country.

debt–equity swap An exchange of foreign debt for equity in local companies.

delphi technique A technique that combines the views of independent experts in order to obtain the degree of political risk on a given foreign project or a particular foreign country.

depreciation A decrease in the foreign exchange market value of a currency.

devaluation An official reduction in the par value of a currency by the government of that currency.

development bank A bank established to support the economic development of underdeveloped areas through long-term loans.

direct investment Equity investment such as the purchase of stock, the acquisition of an entire firm, or the establishment of a new subsidiary. The US Department of Commerce defines direct investment as investment in either real capital assets or financial assets with a minimum of 10 percent equity ownership in a foreign firm.

direct quote A home-currency price per unit of a foreign currency, such as $1.65 per British pound for a US resident.

dirty (managed) floating system A system in which exchange rates are allowed to change according to market forces but governments intervene to prevent undesired fluctuations. The monetary system since 1973 is sometimes called a dirty floating system, because most industrial countries have permitted their currencies to fluctuate with frequent government intervention in the foreign-exchange market.

discounted cash flow approaches Net-present-value and internal-rate-of-return methods that take into account the time value of money.

diversification strategy A term used in international business to mean that a company produces or sells in many countries.

divestment Reduction in the amount of investment.

division of labor An economic theory that allows each person or nation to utilize any peculiar differences in skills and resources in the most economic manner. Division of labor is frequently called specialization of function.

documentary draft A draft that accompanies such documents as bills of lading, commercial invoices, and other documents.

double-entry accounting An accounting principle that requires each transaction to be recorded as debits and credits of an equal amount.

draft (bill of exchange) An order written by a seller that requires a buyer to pay a specified amount of money at a specified time.

drawee bank A bank upon which a draft is drawn and which thus must pay. Such a bank is often called a paying bank.

drawer bank A bank that draws (writes) a draft offering payment.

dumping A practice of selling a product in a foreign market at a price lower than that of the same product in the home market.

duty A government tax (tariff) levied on goods shipped internationally.

eclectic theory A theory that tries to combine both trade and investment theories.

economic exposure Expected future cash flows whose real values may be changed because of exchange rate changes.

economic integration Cooperation among different countries: the elimination of trade barriers among member countries and bringing separate economies together to form one large market.

economic union A form of regional economic integration that combines common market characteristics with harmonization of economic policy.

economies of scale A reduction in average cost per unit as sales volume or output increases.

Edge Act corporation A subsidiary of a US commercial bank created under the Edge Act of 1916.

efficient exchange market The exchange market in which exchange rates reflect available information and market prices adjust quickly to new information. In the efficient exchange market, market participants buy and sell foreign currencies in a way that eliminates all profits in excess of the minimum required to sustain their continued participation.

efficient frontier The locus of all efficient portfolios.

efficient portfolio A portfolio that provides the highest return for a given level of risk or the smallest amount of risk for a given level of return.

elasticity The degree of responsiveness in one variable to changes in another. For example, in international trade the price elasticity measures the degree of responsiveness in exports or imports to changes in prices.

embargo A practice that prohibits all trade.

equilibrium exchange rate The exchange rate at the intersection of the demand curve for and the supply curve of foreign exchange.

equity alliance An alliance whereby one company takes an equity position in another company.

equity method The method used in consolidating the financial statements of affiliates into those of a US parent when the parent owns between 20 and 50 percent of the affiliate. Under this method, the parent carries its affiliates at the initial cost of the investment plus its proportionate share of profits or losses.

euro A new currency unit designed to replace the individual currencies of European Union countries.

Eurobond A bond that is sold in a currency other than that of the country of issue.

Eurocommercial paper Unsecured short-term promissory notes sold in the Eurocurrency market by multinational companies.

Eurocurrency A currency deposited in a bank located in a country other than the country issuing the currency.

Eurodollar Dollar-denominated deposits in banks outside the USA. These banks may be foreign banks or foreign branches of a US bank.

Euro-medium-term note A medium-term note guaranteed by financial institutions with the short-term commitment by investors. These notes are issued outside the country in whose currency they are denominated.

Euronote A short- to medium-term debt instrument sold in the Eurocurrency market.

European Bank for Reconstruction and Development (EBRD) A regional development bank established in 1990 by 42 countries for emerging democracies in Eastern Europe.

European Community (EC), or European Economic Community (EEC) An organization formed in 1957 by France, Germany, Italy, Belgium, the Netherlands, and Luxembourg to remove trade barriers among the member countries. The United Kingdom, Ireland, Denmark, Greece, and Portugal, and Spain joined later.

European Currency Unit (ECU) A weighted average value of a basket of 12 EC currencies.

European Free Trade Association (EFTA) A form of regional economic integration involving a group of central European countries which are not members of the EC.

European Investment Bank (EIB) A regional development bank established in 1958 by members of the EC.

European Monetary System (EMS) A complex exchange rate and intervention system adopted in 1978 by EC countries to replace the snake.

European option An option that can be exercised only on the day on which it expires.

European terms Foreign-exchange quotations for the US dollar, expressed at the number of non-US currency units per US dollar.

European Union (EU) The official name of the former European Economic Community (EEC) as of January 1, 1994.

excise tax A tax on various commodities within a country, such as tobacco and alcoholic beverages.

exchange rate The price of one currency expressed in terms of another currency.

exchange rate risk The variability in a company's earnings that may occur due to uncertain exchange rate changes.

exercise (strike) price The price at which the owner of a currency call option is allowed to buy a foreign currency or the price at which the owner of a currency put option is allowed to sell a foreign currency.

expatriates Noncitizens of the country in which they are working.

Export–Import Bank (Ex–Im Bank) A US government agency established to promote US exports.

export trading company A trading company sanctioned by law to become involved in international trade as an agent or a direct outlet. The US Trading Company Act of 1982 relaxed the antitrust law and the bank holding company act.

external debt Public debt owed to foreign citizens, firms, and institutions.

factor A financial institution that buys a company's accounts receivable on a nonrecourse basis.

factors of production Those things necessary for producing finished goods. Factors of production consist of land, capital, labor, and technology.

FASB 133 Under this rule, issued in 1998, companies are required to report the fair market value of their derivatives in their balance sheets and to include derivative gains and losses in their income statements.

FASB 52 Under this rule, the current exchange rate is used in translating foreign-currency financial statements into US dollars.

FASB 8 Under this rule, monetary items of a foreign affiliate are translated at the current exchange rate, and nonmonetary items are translated at the historical exchange rate.

filter rule One form of technical analysis suggesting that investors buy a currency when it rises more than a given percentage above its recent lowest value and sell the currency when it falls more than a given percentage below its highest recent value.

financial account In the balance of payments, the section that records the net change in foreign direct investments, foreign portfolio investments, and other investments.

Financial Accounting Standards Board (FASB) The private-sector organization in the USA that sets financial accounting standards.

financial assets Claims on such wealth as stocks, bonds, and other securities.

financial market The market that deals in financial assets.

financial risks In international finance, those risks which may occur because of varying exchange rates, divergent tax laws, different interest and inflation rates, and balance-of-payments problems.

Fisher effect This theory assumes that the nominal interest rate consists of a real interest rate and an expected rate of inflation.

fixed exchange rate An exchange rate that does not fluctuate or that changes within a predetermined band.

flexible (floating or fluctuating) exchange rate An exchange rate that fluctuates according to market forces.

foreign base company A corporation whose base or registration is in a country in which it does not conduct active operations.

foreign bond A bond sold outside the borrowing country but in the country of the currency in which the bond is denominated.

Foreign Corrupt Practices Act The US law that makes it illegal for American companies and managers to make payments to foreign government officials for the purpose of obtaining business.

Foreign Credit Insurance Association (FCIA) An association of insurance companies in the USA which provide credit insurance to export sales.

foreign-currency swap An agreement between two parties to exchange local currency for hard currency at a specified future date.

foreign-currency translation The expression of balance-sheet items denominated in a foreign currency into a local currency.

foreign direct investment (FDI) The acquisition of physical assets in a foreign country to be managed by the parent company.

foreign exchange Any currency other than the currency used internally in a given country.

foreign-exchange exposure The possibility that a firm will gain or lose due to changes in exchange rates.

foreign tax credit The amount by which a domestic company may reduce domestic income taxes for income tax payments to a foreign government. This credit is used to avoid international double taxation.

forfaiting The purchase of financial obligations such as promissory notes with no recourse to the exporters. This technique is used to finance medium-term export financing.

forward discount or premium An annualized percentage by which the forward exchange rate is less or more than the spot rate.

forward exchange rate An exchange rate for a currency to be delivered at a future date.

franchising agreement An agreement whereby a multinational company (franchiser) allows a foreign company (franchisee) to sell products or services under a highly published brand name and a well-proven set of procedures.

free alongside (FAS) A price that includes the delivery of the goods alongside overseas vessel within reach of its loading tackle.

free float An exchange rate system characterized by the absence of government intervention.

free on board (FOB) The price of the goods to the foreign buyer, which includes all costs, charges, profits, and expenses accruing up to the point at which the goods are deposited on board the exporting vessel or aircraft.

free trade The absence of artificial barriers to trade among individuals and firms in different countries.

free trade area A form of regional economic integration that eliminates tariffs among member countries and establishes common external tariffs.

free trade zone An area within a country into which foreign goods may be brought duty free for purposes of additional manufacture, inventory storage, or packaging.

freely floating exchange rate system A system that allows exchange rates to move on the basis of market forces, without government intervention.

functional currency The currency of the primary economic environment in which the entity operates.

fundamental analysis A forecast based on fundamental relationships between economic variables and exchange rates.

futures contract A contract that specifies an exchange rate in advance of the future exchange of the currency.

futures option The right to buy or sell the futures contract of a specified currency at a specified price by a specified expiration date.

gap analysis A tool used to estimate why a market potential for a given product is less than a company's sales in a country.

General Agreement on Tariffs and Trade (GATT) An agreement signed in 1947 by 23 countries, to liberalize world trade.

generalized system of preferences Arrangements through which industrialized countries grant preferential import duty rates to products from developing countries.

geographical arbitrage A practice in which a currency is bought in a market where its price is lower and then sold in another market where its price is higher.

global bond A bond sold inside as well as outside the country in whose currency it is denominated.

global company A generic term used to describe an organization that attempts to standardize and integrate operations worldwide in all functional areas.

global fund A mutual fund that can invest anywhere in the world, including the country of issue.

gold standard A system whereby a country uses gold as a medium of exchange and a store of value.

gold tranche The amount that each IMF member country contributes in gold or dollars as a part of its membership quota in the IMF. The gold tranche is usually 25 percent of a country's quota.

grand tour A political risk-forecasting technique that relies on the opinions of company executives visiting the country where investment is considered.

grandchild subsidiary A so-called second-tier subsidiary, which is under a tax-haven subsidiary.

gross national product (GNP) The total market value of all final goods and services produced in the economy during a year.

Group of Five (G-5) Five industrial countries: France, Germany, Japan, the UK, and the USA.

Group of Seven The G-5 countries plus Canada and Italy.

Group of Ten Ten major industrial countries that pledged in 1962 to lend their currencies to the IMF under the so-called General Agreement to Borrow. These ten countries are the Group of Seven countries plus Belgium, the Netherlands, and Sweden.

hard currency A currency that may be used in international trade.

hedge funds Private partnerships with a general manager and a number of limited partners. Unlike other investment pools, such as stocks and mutual funds, these hedge funds are largely unregulated investment pools, open only to wealthy investors.

hedging device An approach designed to reduce or offset a possible loss. For example, a multinational company may sell forward exchange or use other means such as a credit swap to offset or reduce possible losses from exchange rate fluctuations that affect values of assets and liabilities.

horizontal expansion A combination of firms engaged in the same line of business.

host country The nonheadquartered country in which an international firm operates.

import quota The maximum amount of a given product to be imported during a specified period of time.

import substitution An industrialization policy whereby new industrial developments emphasize products that would otherwise be imported.

in the money A descriptive term implying that the current spot rate exceeds (is less than) the strike price on a currency call (put) option.

indexing The practice of adjusting assets, liabilities, or payments by some measure of inflation to preserve the purchasing power of the original amounts.

indirect quote A foreign-currency price per unit of a home currency, such as SFr1.35 per US dollar for a US resident.

inflation The overall rate of increase in prices for a group of goods and services in a given country.

initial margin The amount that futures market participants must deposit at the time they enter into a futures contract.

Inter-American Development Bank (IDB) A regional development bank founded in 1959 by the USA and 19 Latin American countries, to further the economic development of its member countries.

interbank market The foreign-exchange market among banks.

interbank transactions Foreign-exchange transactions that take place between banks, as opposed to those between banks and nonbank clients.

interest arbitrage A practice of lending or investing in another currency to take advantage of higher interest rates.

interest parity line A line that describes the equilibrium position for the relationship between interest differentials and forward premium or discount. Every point on the line represents a situation in which the interest differential equals the forward premium or discount.

interest parity theory A theory stating that the difference between the spot rate and the forward rate equals the difference between the domestic interest rate and the foreign interest rate.

interest rate cap A maximum rate on floating rate interest payments.

interest rate collar A combination of an interest rate cap and an interest rate floor.

interest rate floor A minimum rate on floating rate interest payments.

interest rate swap Under this swap, companies exchange cash flows of a floating rate for cash flows of a fixed rate, or exchange cash flows of a fixed rate for cash flows of a flexible rate.

internal rate of return The discount rate that equates the present value of expected net cash flows to the present value of the net investment.

International Accounting Standards Committee The international private-sector organization established to set financial accounting standards that can be used worldwide.

International Bank for Reconstruction and Development (IBRD) The World Bank, which is a companion institution to the IMF.
international banking facilities (IBFs) Vehicles that enable bank offices in the USA to accept time deposits in either dollars or foreign currency from foreign customers, free of reserve requirements and of other limitations.
international bonds Those bonds that are initially sold outside the country of the borrower.
International Development Association (IDA) An affiliate of the IBRD, established to make long-term "soft" loans for development.
International Finance Corporation (IFC) An affiliate of the IBRD, established to make development loans in forms that could be sold to other investors and converted into equity.
international Fisher effect A theory that the spot exchange rate should change by an amount equal to the difference in interest rates between two countries.
International Monetary Fund (IMF) An international monetary organization created at the Bretton Woods Conference in 1947, to make the new monetary system feasible and workable.
international monetary reserves Assets held by central banks or governments, which can be used to settle international payments.
international monetary system A system of such elements as laws, rules, institutions, instruments, and procedures that include international money.
international mutual fund A mutual fund that contains securities of foreign companies.
intervention The buying and selling of currencies by central banks to influence the exchange rate.
intrinsic value The difference between the exchange rate of the underlying currency and the strike price of a currency option.
irrevocable letter of credit A letter of credit that cannot be changed without the consent of all parties involved in the letter.
issuing bank The bank that issues a letter of credit, usually the importer's bank.
J-curve Following a currency devaluation, an initial decrease in the trade balance followed by an increase.
joint venture A business venture in which two or more parties – for example, a foreign firm and a local firm – have equity interest.
just-in-time (JIT) inventory system A manufacturing system that reduces inventories by having components and parts delivered as they need to be used in production.
keiretsu A Japanese word that stands for the large, financially linked groups of companies that play a significant role in the country's economy.
Kennedy Round The trade negotiations concluded in 1967, as part of the GATT, to reduce trade barriers between the USA and the EEC countries.
law of one price A law stating that all goods sell for the same price worldwide when converted to a common currency.
leads and lags Payment of financial obligations earlier (leads) or later (lags) than is expected or required.
less developed country (LDC) A country characterized by relatively low levels of economic output and income per capita, limited industrial activity, and a lack of adequate health, educational, and other social services.
letter of credit A document issued by a bank at the request of the importer. In the document, the bank agrees to honor a draft drawn on the importer if the draft accompanies specified documents.

leveraged buy-out (LBO) A large amount of loan to buy a controlling interest in a company.
licensing agreement An agreement whereby one firm gives rights to another for the use of such assets as trademarks, patents, or copyrights.
lifetime employment A customary Japanese situation in which workers are effectively guaranteed employment with the company for their working lifetime.
link financing An arrangement that commercial banks in strong-currency countries help subsidiaries in weak-currency countries to obtain loans by guaranteeing repayment of the loans.
local currency The currency of the country to which reference is made.
London Interbank Offered Rate (LIBOR) The arithmetic average of the interest rates offered by 16 major banks in London on 6-month Eurodollar time deposits at a certain time during the morning. This is the reference rate in London for interbank Eurocurrency deposits.
long position An agreement to buy a futures contract.
mail float The mailing time involved in payments sent by mail.
maintenance margin A set minimum margin that futures market participants must always maintain in their accounts.
managed float Also known as a dirty float, a system that floats exchange rates with central bank intervention to reduce currency fluctuations.
margin Money deposited with a broker to finance futures trading.
margin call A broker's request for an additional deposit when the funds in his client's account fall below the minimum amount.
marginal cost of capital The cost of the last dollar of funds raised. It is assumed that each dollar is financed in proportion to the firm's optimum capital structure.
market-based forecast A forecast based on market indicators, such as forward rates or spot rates.
market economy An economic philosophy in which resources are allocated and controlled by consumers who "vote" by buying goods.
market portfolio A well-diversified group of risky securities with little or no unsystematic risk.
Marshall Plan The European Economic Recovery Program established by the USA in 1948, to restore the productive capacity of European industry and agriculture destroyed during World War II.
merchandise trade balance The net of merchandise imports and exports within a country's balance of payments.
merger A situation whereby two companies combine their operations to form a new company.
monetary/nonmonetary method Under this method of translation, all monetary accounts are translated at the current exchange rate, and all nonmonetary accounts are translated at the historical exchange rate.
money market The financial market where short-term securities such as commercial paper and bankers' acceptances are sold and bought.
money market hedge A hedging device that involves a contract and a source of funds to carry out that contract. If an American firm has a British pound import payable in 60 days, it may borrow in dollars, convert the proceeds into pounds, buy a 60-day British Treasury bill, and pay the import bill with the funds derived from the sale of the Treasury bill.
most-favored nation (MFN) A nation that receives the most favored treatment in application of duties from another country. The MFN clause requires that if a member country of the World Trade Organization grants a tariff reduction to one country, it must grant the same concession to all other WTO member countries.

multicurrency clause A clause that gives a Eurocurrency borrower the right to switch from one currency to another when the loan is rolled over.

multinational (transnational) corporation A company that conducts business operations in several countries. It usually consists of a parent firm and a number of affiliates.

multiple exchange rate system Under this system, a government sets different exchange rates for different transactions.

mutual funds Corporations that accept money from savers and then use these funds to buy a variety of securities issued by businesses or government units

negotiating bank A bank that negotiates such things as discounts or purchases of drafts drawn by exporters.

net exposure The difference between exposed assets and liabilities.

net present value The present value of future net cash flows minus the present value of the net investment for a project.

netting A method designed to reduce the foreign-exchange transaction cost through the consolidation of accounts payable and accounts receivable. For example, if subsidiary A buys $1 million worth of goods from subsidiary B and B in turns buys $3 million worth of parts from A, the combined flows are $4 million. But on a net basis, subsidiary A would pay subsidiary B only $2 million.

newly industrialized country (NIC) A Third World country in which the cultural and economic climate has led to a rapid rate of industrialization and growth since the 1960s.

Nikkei Index A measure of the level of stock prices on the Tokyo Stock Exchange, based on the prices of a group of Japanese securities.

nominal interest rate The rate of interest that consists of a real interest rate and an expected rate of inflation.

nonmarket, or centrally planned, economy An economy in which resources are allocated and controlled by government decision.

nontariff barriers Restrictive practices in trade other than custom duties used by governments or by private firms. Nontariff barriers used by governments include import quotas, voluntary restrictions, exceptional customs valuation procedures, and health regulations. Nontariff barriers used by private firms include price control, division of markets, restriction of supplies, patent agreements, or control of technology.

North American Free Trade Agreement (NAFTA) A trade agreement that allows free trade and investment between Canada, Mexico, and the USA.

notifying (advising) bank A bank that notifies the beneficiary of the opening of a letter of credit.

offer price The price at which a trader is willing to sell a given item.

official reserves Government-owned assets that consist of gold, SDRs, and convertible foreign exchange.

offset agreement Trade demanded by a foreign buyer to produce parts, source parts, or assemble the product in the importing country.

offshore banking Banking activities that accept deposits and make loans in foreign currency – the Eurocurrency market.

offshore funds Funds that use the currency of a country but are located outside that country for tax and other purposes.

oligopoly model This model assumes that business firms make foreign investments to exploit their quasi-monopoly advantages.

opening bank A bank that opens a letter of credit.

opportunity cost The rate of return that funds could earn if they were invested in the best available alternative project.

optimal portfolio A portfolio found at the tangency point between the efficient frontier and the security market line. This is the portfolio that has, among all possible portfolios, the largest ratio of expected return to risk.

optimum capital budget The amount of investment that will maximize a company's total profits.

optimum capital structure The combination of debt and equity that yields the lowest cost of capital or maximizes the overall value of the company.

option The right to buy or sell a given amount of foreign exchange or other financial asset at a fixed price for a specified time period.

option premium (price) The price that the option buyer must pay the option seller.

Organization for Economic Cooperation and Development (OECD) An organization of 29 countries, most of which are industrialized countries.

Organization of Petroleum Exporting Countries (OPEC) An organization established by a number of oil-exporting countries to formulate uniform policies such as selling prices on their oil-export sales. Full members with vote and veto include Algeria, Ecuador, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, the United Arab Emirates, and Venezuela.

out of the money A descriptive term implying that the current exchange rate is less than (exceeds) the strike price on a currency call (put) option.

outright forward rate A forward-exchange rate expressed in terms of the amount of one currency required to buy a unit of another currency.

outsourcing A situation in which a domestic company uses foreign suppliers for components or finished products.

over-the-counter (OTC) market A market in which participants privately trade securities, options, foreign exchange, or other financial contracts with each other, often using a bank as an intermediary. The OTC market has no physical location and thus is differentiated from organized exchanges with a physical location where trading takes place.

overdraft A line of credit that permits the customer to write checks beyond deposits.

Overseas Private Investment Corporation (OPIC) A US government agency established in 1969 to insure American overseas investors against political risks.

par (mint) value The value of a currency specified by the government of the currency.

parallel loan A loan that involves an exchange of currencies between four parties, with a promise to reexchange the currencies at a specified exchange rate and future date.

parent A company that controls another (its subsidiary).

payback period The number of years required for the net cash flows of a project to return its cost.

payee The party to whom payment is made. The drawer may also be a payee of a draft.

paying bank The drawee bank on which a draft is drawn.

peg To fix the value of a currency to some benchmark such as the US dollar.

petrodollars OPEC deposits of dollars in the Eurocurrency market.

piracy The unauthorized use of property rights protected by patents, trademarks, or copyrights.

plain vanilla swap The basic form of a swap – the simplest kind.

political risk Potential changes in political conditions that may cause company operating positions to deteriorate.

pooling-of-interest method A method in the case of a merger under which the items on the balance sheets of the two companies are added together so that the merger will not create goodwill.

portfolio effect The extent to which the variations or risks of individual assets tend to offset each other.

portfolio investment Investment in foreign financial assets without significant management control of the real assets.

portfolio theory A theory that indicates that a company is often able to improve its risk–return performance by holding an internationally diversified portfolio of assets as opposed to a domestically diversified portfolio.

possessions corporation A US firm engaged in business within US possessions such as Guam and American Samoa. The possessions corporation obtains tax advantages if it meets certain requirements.

premium The excess of the forward exchange rate over the spot exchange rate.

Private Export Funding Corporation (PEFCO) A corporation established in 1970 at the initiation of the Bankers' Association for Foreign Trade, to mobilize private capital in order to finance US exports of big-ticket items.

privatization A situation in which government-owned assets are sold to private individuals or groups.

product differentiation The development of a product that is different from those produced by competitors to maintain or improve market share.

product life cycle theory A theory that attempts to explain both world trade and foreign investment patterns on the basis of stages in a product's life. The product life cycle is the time that it takes to bring new and improved products to markets.

production efficiency The production of goods in the least costly way.

profit split method A new transfer pricing method adopted by the US Internal Revenue Service in 1994. This method consists of two steps in estimating an arm's-length return: (1) by comparing the relative economic contributions that the parties make to the success of a venture; and (2) by dividing the returns from that venture between them on the basis of the relative value of such contributions.

project finance A way for a project sponsor to raise nonrecourse financing for a specific project. Most often, a separate legal entity is formed to operate the project.

protectionism A political attitude or policy intended to prohibit the import of foreign goods and services.

proxy The assignment of the voting right to management or a group of outsiders.

Public Law 480 The US law that permits less developed countries to purchase surplus American agricultural products and to pay for them with their own currencies rather than with dollars.

purchase-of-assets method A method in the case of a merger under which the acquired assets or companies are usually recorded in the accounts of the acquiring company at the market value of assets given in exchange.

purchasing power parity theory An economic theory that, in the long run, exchange rates reflect the relative purchasing power of currencies.

put An option to sell foreign exchange or financial contracts.

put swaption The right to make fixed interest payments.

quality control circle A production system in which small groups of workers meet regularly to detect and solve problems in their area.

quota A limit set on the import of a product.

real interest rate The nominal (quoted) interest rate minus the inflation rate.

recourse The right of an intermediary to claim reimbursement from a drawer of a draft if the drawee fails to pay.

regional development bank A development bank that makes loans only to countries in particular regions.

reinvoicing center A subsidiary that takes title to all goods sold by one corporate unit to other affiliates or independent customers. The center pays the seller and in turn is paid by the buyer.

reporting currency The currency in which the parent firm prepares its own financial statements.

required rate of return The minimum rate of return required by the investors.

resale price method The method allowed by the US Internal Revenue Service to determine the arm's-length price of intracompany transactions. Under this method, an arm's-length price is obtained by subtracting an appropriate markup from the applicable sale price.

reserve, or official reserve, account In the balance of payments, the section that represents the changes in official reserves such as SDRs and convertible foreign exchange.

reserve country A country whose currency is held as a reserve asset by central banks or governments of other countries.

reserve currency A currency held as a reserve asset by central banks or governments of countries other than the country of the currency.

return on investment (ROI) Profits divided by the amount of investment, usually total assets.

revaluation Either an upvaluation or a devaluation.

revocable letter of credit A letter of credit that can be canceled at any time without prior notification to the beneficiary.

risk The variability of return associated with a project.

risk-adjusted discount rate A rate that consists of the riskless rate of return plus a risk premium.

risk analysis An analysis of the different outcomes under different assumptions that each of these outcomes will occur.

royalties The payment for use of assets abroad.

safe harbor A rule set in legislation that guarantees favorable treatment to the party.

safeguard clause A clause for conditions under which tariffs and nontariff barriers may be reintroduced.

Section 482 A provision of the US Internal Revenue Code regulating transfer pricing practices.

Securities and Exchange Commission (SEC) A US government agency that regulates securities brokers, dealers, and markets.

semistrong-form efficiency When related to foreign-exchange markets, this theory implies that current exchange rates reflect all publicly available information, thereby making such information useless for forecasting exchange rate movements.

short position An agreement to sell a futures contract.

sight draft A draft payable on demand (at sight).

Smithsonian Agreement An agreement reached in December 1971, to widen the band up to 2.25 percent on either side of the par value.

snake within a tunnel A system that EEC countries agreed to allow their currencies to fluctuate a maximum of 2.25 percent against one another and that permitted a 4.5 percent band against other countries. The tunnel disappeared in 1973 and the snake ended in 1978.

Society for Worldwide Interbank Financial Telecommunications (SWIFT) An interbank communication network that carries messages for financial transactions.

sovereign risk The risk of a country that will impose foreign-exchange regulations or the risk of government default on a loan made to it or guaranteed by it.

sovereignty The power of a country to act as it wishes within its own borders.

special drawing rights (SDRs) A reserve asset created in 1967 by the IMF. SDRs are rights to draw on the IMF.

specific duty A duty imposed as a fixed charge per unit, such as $2 per ton.

spot rate A foreign-exchange rate paid for delivery of a currency within 2 days from the date of the trade.

spread The difference between the bid and ask prices in a price quote, or the difference between the spot rate and the forward rate.

strategic alliance A formal relationship between two companies to obtain economies of scale.

strike price The price at which a currency can be sold or bought in an option contract.

strong-form efficiency When related to foreign-exchange markets, this theory suggests that current exchange rates reflect all pertinent information, whether publicly available or privately held.

Subpart F Foreign-source "unearned income" taxed by the Internal Revenue Service whether or not it is remitted to the USA.

subsidiary A foreign-based affiliate that is separately incorporated under the host country's law.

subsidy Direct or indirect governmental assistance to companies, thereby making them more competitive with imports.

swap An agreement between two parties who exchange sets of cash flows over a period of time in the future.

swap loan A loan made by a local bank based on deposit of funds in offices of that bank in another country.

swaption An option to enter into a plain vanilla interest rate swap.

switch trading A practice whereby payments for exports to the Eastern bloc and nonmarket countries are made through clearing units, in which sales are balanced with purchases from other countries.

syndicated loan A credit in which a group of banks makes funds available on common terms and conditions to a particular borrower.

synergistic effect A situation in which the combined company is worth more than the sum of its parts.

systematic risk The risk common to all assets or all countries, which cannot be diversified away.

tariff A duty or tax imposed on imported commodities.

tariff harmonization The process of making tariffs more homogeneous by eliminating disparities in tariff rates on the same commodity.

tax haven A country that promises permanent tax inducements to attract multinational companies.

tax holiday The form of a complete tax exemption for the first few years given by a country when multinational firms invest their money in that country.

technical analysis A currency forecasting technique that uses historical prices or trends.

temporal method A method that translates the financial statements of a foreign affiliate into the parent reporting currency. Monetary assets and liabilities are translated at current exchange rates; nonmonetary assets, nonmonetary liabilities, and owners' equity are translated at historical exchange rates.

tender offer An offer to buy a certain number of shares at a specific price and on a specific date for cash, stock, or a combination of both.

Third World A term used to mean those countries other than the industrial countries and the nonmarket (centrally planned) economies.

time draft A draft payable a specified number of days after presentation to the drawee.

trade acceptance A draft accepted by an importer or a business enterprise.

trademark A name or logo that distinguishes a company or product.

transaction exposure The possibility that gains or losses may result from the settlement of transactions whose terms are stated in foreign currency.

transfer price The price of goods and services sold between related parties such as parent and subsidiary.

translation exposure Exchange gains or losses that will occur when a company translates its foreign-currency operations into its home currency.

triangular arbitrage The process of buying and selling foreign exchange at a profit due to price discrepancies where three different currencies are involved.

unilateral transfer In the balance of payments, the account that covers gifts by domestic residents to foreign residents, or gifts by the domestic government to foreign governments.

unit of account A benchmark on which to base the value of payments.

unitary tax A method of taxing a company on its worldwide profits rather than on its profits in the area where the taxing authorities are located.

unsystematic risk The risk unique to a particular company or country, which can be diversified away.

upvaluation An official increase in the par value of a currency by the government.

US–Canada Free Trade Agreement A 1988 agreement between the USA and Canada to remove their trade barriers.

value-added tax (VAT) A sales tax assessed at one or more stages in the production process, but only on the value added during that production stage.

vertical integration The integration of different stages in which the special drawing rights of a product move from the earliest production to the final distribution.

weak-form efficiency This theory implies that all information contained in past exchange rate movements is fully reflected in current exchange rates.

withholding tax A tax collected from income to employees, stockholders, and others; it is collected before receipt of the income.

World Bank A multinational financial institution established in 1944, to enhance economic development.

World Trade Organization (WTO) The new organization that has replaced the General Agreement on Tariffs and Trade (GATT) since the Uruguay Round accord became effective on January 1, 1995.

Yankee bonds Dollar-denominated bonds issued within the USA by a foreign borrower.

yield The actual rate of return on a financial asset. It depends on the price paid for the security and the stated rate of interest or dividend.

zero-coupon bond A bond that pays no coupon interest and simply returns the face value at maturity.