



Impact of Political Factors on International Trade and Global Markets

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Abstract

Government interventions in markets through changes in organisation establishment policies, taxes, tariffs, and trade regulations can directly affect businesses. For example, sudden increases in taxes, quotas tariffs increases the costs and affect profitability and imports / exports restrictions affect market access and changes in labor laws can disrupt international business operations and decrease investor confidence. Political instability, civil war, frequent changes in leadership can create uncertainty, which affects investor confidence. Countries experiencing such instability often see reduced foreign direct investment (FDI) and currency devaluation. Poor governance, corruption and lack of transparency are significant factors contributing to political risk often leading to economic instability and reduced investor confidence. When businesses face bribery demands, inconsistent law enforcement, or unfair legal systems they face higher operational costs and increased uncertainty which can deter investments. Civil unrest or movements against government policies can lead to market fluctuations, especially if they threaten to destabilize a country's economic foundations.

Political risk often leads to fluctuations in stock prices, bond yields, and foreign exchange rates. For example, the Brexit referendum led to sharp declines in the value of the British pound. If a major oil-producing country faces political instability, global oil prices may surge due to supply concerns, influencing markets around the globe.

Exchange rate fluctuations can create challenges for international businesses, making it more expensive to do business in certain regions and impacting the profitability of foreign investments. Political risks that lead to economic instability often cause fluctuations in interest rates and inflation rates. Central banks may raise interest rates to combat inflation or stabilize the economy during periods of political turmoil. Higher interest rates in one country can attract foreign investors seeking higher returns and encourage capital inflows, while lower interest rates can make investments in that country less

attractive and can result in capital outflows, thereby impacting global liquidity as capital flows respond to interest rate differentials between countries.

Key words: *International businesses, Political instability, Tariffs, Foreign Direct Investment*

Introduction:

Political risks in international trade refer to the possibility of losses, business disruptions, loss of investment value, damage to assets resulting from trade restrictions, changes in government policies, laws or regulations and political instability in a country.

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Geopolitical tensions often lead to fluctuations in commodity prices, especially in energy markets. Trade wars, tariffs, or changes in trade agreements, can disrupt global supply chains and trade routes.

Developing economies are particularly susceptible to political risk, as they often have less stable political environments, weaker institutions, and less mature financial systems. When political risks rise, investor confidence may fall, leading to shifts in investment portfolios, asset allocation, and capital flows.

Review of Literature:

The following are some of the relevant studies reviewed:

Helen V. Milner (1999), "*The Political Economy of International Trade*". This review examines how domestic preferences, political institutions, and international systems explain shifts toward free trade since the 1980s.

Mansfield, Milner & Rosendorff (2000–2002), in his article "*Democracies vs. Autocracies in Trade Cooperation*", investigates how democratic and autocratic leadership affects participation in international trade agreements.

Miikka Tolo (2014) His paper "*Political Risk-Literature Review*", Provides a comprehensive review of political risk frameworks affecting foreign investment and international commerce.

Rana & Kebewar (2014) ,"*Political Economy of FDI in Developing Countries*", His work finds that, deeper trade agreements coupled with democratic institutions attract more FDI, reinforcing trade credibility.

Goes & Bekkers (2022), "*The Impact of Geopolitical Conflicts on Trade, Growth, and Innovation*", uses a general equilibrium model to quantify welfare losses under trade “decoupling” scenarios, highlighting significant costs in lower-income regions.

Governments' Role in assessing the Economic Impact

When leaders or governments consider decisions or issue orders that impact the country’s growth, especially in the context of international financial management, they need to adopt a strategic approach that considers long-term implications and potential consequences, while also embracing a forward-thinking mindset that anticipates future challenges, opportunities, and trends.

- Leaders must evaluate how the decision will affect both domestic and global economic conditions.
- Will the decision lead to inflation or deflation. How the interest rates influence central bank decisions.
- Does the national currency value strengthen or weaken. How will it impact the flow of foreign capital into the country?
- A decision might affect the cost of borrowing, either by improving or harming the country’s credit rating.
- How might it affect relationships with international financial institutions like the IMF, World Bank, or regional development banks?
- How will it affect job creation or unemployment rates?
- How will the decision impact the adoption of new financial technologies or digital currencies?

- How will the decision impact national and international sustainability efforts, particularly in terms of energy use, carbon emissions, and resource management?

Organizations' Role

Organizations should adopt a strategic approach to mitigate the political impact by creating different financial scenarios—best-case, worst-case, and most likely case—based on the potential outcomes of political decisions. This enables the leadership team to anticipate challenges and plan strategically.

How to stabilize the organization financially when a political decision is going to hit the organization growth.

- Analyze the impact of regulatory changes, tariffs, taxes, trade policies on organisations due to political decision and estimate the potential area of impact.
- If organisation growth is reliant(**dependent on someone or something**) on a specific market then consider diversify revenue into new geographical markets or customer segments that are less influenced by the political decision.
- Review current expenses and focus on reducing unnecessary overheads and if possible outsource non-core functions.
- Strengthen Financial Reserves by reducing discretionary spending and accumulate savings.
- Forecasting various financial models with different scenarios (best-case, worst-case, and baseline) to understand potential outcomes.
- If possible, collaborate with industry groups or lobbying organizations to advocate for changes or support from the government in response to the decision.
- Review investment strategy by delaying non-essential capital expenditures and reconsider major investments that may be too risky or unnecessary under the new circumstances.
- In uncertain times, employee morale can take a hit. Ensure strong internal communication and offer reassurance.
- Continuously monitor the political and economic environment and remain flexible. Decisions that seem difficult today may change, and it is essential to adapt strategies accordingly.

The most affected areas when a political decision made Revenue Generation, cost of operations, Risk management, Stakeholder confidence. These areas are highly impacted in terms of Sales volume, market access, import/export costs, hedging needs, Stoke pricing, credit rating etc. So, organization need to rethink in these areas due to high impact and may secure if these areas are handled due to poor political decisions.

There are few other areas where there is medium impact areas like profits, investment strategy, currency exposure is impacted in terms of net margins, Fines, reporting costs, exchange rate fluctuations etc. The organization can put a second thought on these areas but primarily focus on high impact areas.

The strategic implications for organizations should be proactive political risk monitoring, Scenario Planning and Stress Testing, Geographic Diversification, Building Political Capital and Hedging Financial Risk (currency, interest rates, etc.)

Case Studies of Different Countries Political Factors Impact on International Trade and Global Markets:

1. The Brexit referendum was held on **June 23, 2016**. This was a political decision where the UK voted to leave the European Union (EU), which had significant implications on trade, investment, and the overall economy. This was an immediate effect on the United Kingdom economy after the referendum vote, the **British pound (GBP)** dropped sharply. The pound lost around **10-15%** of its value in the months following the referendum result.

The currency depreciation made British exports cheaper for foreign buyers, which was a short-term benefit for UK exporters. However, it also made imports more expensive, driving up costs for businesses reliant on foreign goods, especially in industries like manufacturing, retail, and energy. The uncertainty surrounding Brexit led to a decline in **foreign direct investment (FDI)** in the UK, as businesses postponed investments until the future relationship with the EU was clearer. This uncertainty also led to concerns over **supply chains**, especially in sectors like agriculture and automotive, where access to the EU single market was crucial for UK exports.

Post-Brexit, the UK faced **higher inflation**, especially driven by the higher costs of imported goods due to the weak pound. This began to accelerate around **2017-2018** and continued into the early years of the 2020s. The increase in import prices, especially for food and raw materials, hurt businesses and consumers. For example, food prices rose significantly as many food products were imported from the EU. On the other hand, the weaker pound benefited UK exporters in the short term by making their products more competitive abroad.

2. The Russia-Ukraine war, which began in February 2022, provides a prominent example of how political decisions can impact global financial stability and trade, affecting not only the countries directly involved but also the global economy. In response to the Russia's invasion of Ukraine, the United States, the European Union and many other countries imposed severe economic sanctions on Russia. Some of the impacted areas in Russia include, freezing assets of Russian banks and individuals, Banning major Russian banks from the SWIFT international payment system, Blocking the export of key technologies (e.g., semiconductors, aviation parts), Banning oil and gas imports from Russia in certain countries, Restrictions on foreign investments in Russia.

Russia faced a rise in **inflation**, particularly in imported goods, due to sanctions disrupting its access to international markets and critical goods. Russia's GDP contracted sharply in 2022 and 2023 as industries dependent on foreign technology, machinery and investments suffered. While oil and gas exports initially

took a hit, Russia adapted by redirecting exports to **China** and **India** but at discounted prices. However, long-term global oil prices also fluctuated as a result of reduced Russian exports.

Not only Russia but also Ukraine has faced financial impact due to Political decisions. Ukraine's economy was heavily impacted by the war, with extensive damage to infrastructure, including roads, bridges, and energy facilities. Cities like **Kyiv**, **Mariupol**, and **Kharkiv** saw widespread destruction. Ukraine's industrial production, including agriculture and manufacturing, faced severe declines as factories were destroyed, and farmland was damaged or turned into military zones. Ukraine's people flee the country, creating a labor shortage and further disrupting the economy.

The war caused significant volatility in **global energy prices**, particularly in **oil** and **natural gas**. As Russia is a major supplier of energy to Europe, sanctions and disruptions in supply led to a sharp increase in prices. European countries, which were heavily dependent on Russian energy supplies, faced **energy shortages** and sky-high prices. In response, European governments scrambled to find alternative energy sources, leading to inflationary pressures across the continent. Ukraine, often called the "**breadbasket of Europe**", is a major exporter of wheat, corn, and sunflower oil. The war disrupted Ukraine's ability to produce and export these goods, leading to a **global food crisis**, particularly in developing countries reliant on Ukrainian grain. Many countries worldwide, including in **Europe** and **North America**, saw increases in **cost of living** due to higher prices for gas, oil, food, and other basic goods. For example, **European Union** inflation spiked to its highest levels in decades, driven largely by the soaring cost of energy and food imports. Currency depreciation in Ukraine is about 50-60% and Russia is about 30-40% due to war.

3. Venezuela is a country in South America. It has a rich history, abundant natural resources, and a complex political and economic landscape.

The Venezuelan government, under President **Carlos Andrés Pérez**, nationalized the oil industry. This decision marked a pivotal shift in the country's oil policy and was intended to give the state greater control over its oil revenues.

As one of the world's largest oil producers, Venezuela's oil industry, plays a critical role in the global oil market. The nationalization solidified Venezuela's oil export dominance in the 1970s and 1980s but also led to inefficiencies, lack of investment, and corruption over time. Global markets were influenced by fluctuations in Venezuelan oil production, which impacted oil prices.

The Venezuelan government, under Chavez and his successor **Nicolás Maduro**, repeatedly devalued the Venezuela's currency, '**Bolivar**' in response to inflation and economic pressure. Official rates diverged significantly from the black market, which caused a massive gap and created uncertainty in financial markets. The devaluation of Bolívar led to a sharp fall in the currency's value, which created significant inflation and led to the erosion of purchasing power for Venezuelans. International markets lost confidence in Venezuela's economic policies, and the country's sovereign debt was downgraded.

Venezuela was increasingly seen as a high-risk economy, making it difficult to attract foreign investment and contributing to financial instability in the region.

4. Argentina has a history of frequent changes in economic and trade policies, often tied to shifts in political leadership. This inconsistency creates uncertainty for foreign investors and trade partners.

In the early 1900s, Argentina was one of the world's wealthiest nations, with a stable democratic government. Argentina was a major agricultural (wheat, corn, beef) exporter to Europe and also known as the "granary of the world," as it was a key player in global food security.

Juan Domingo Peron, president of Argentina in 1946, promoted a populist, nationalist model. The state took control of many industries, and implemented protectionist policies that restricted imports and reduced foreign investment. Inefficiencies in state-run enterprises weakened Argentina's ability to compete in export markets and declining productivity in agriculture and manufacturing reduced Argentina's role in global trade. Argentina was facing an escalating financial crisis characterized by high public debt, a banking crisis, and social unrest. The Argentine government, under President Fernando de la Rúa, had implemented a convertibility plan in the early 1990s, pegging the Peso to the U.S. dollar at a 1:1 rate, which was intended to stabilize the economy after years of hyperinflation. However, by 2001, the country was in severe economic distress, with growing debt and a shrinking economy. In 2015, Mauricio Macri aimed to reintegrate Argentina into the global economy with liberal reforms by reducing trade barriers. In 2023, Javier Milei, an economist and self-described libertarian, was elected on a radical pro-market, anti-statist platform, proposing dollarization, major deregulation, and deep spending cuts—moves that sparked initial investor optimism, short-term instability, and the potential for stronger long-term integration with global markets if successful.

Argentina's shift from populism to neoliberalism and now to libertarian reform has resulted in frequent policy swings that have significantly influenced international trade and global markets. Despite its abundant resources and strong potential, ongoing political instability and economic mismanagement have consistently hindered Argentina's ability to establish itself as a reliable player in global trade.

Conclusion

Political factors play a critical role in shaping international trade and global market dynamics. From changes in government policies, regulations and trade agreements to political instability, the political environment of a country can either foster global economic integration or create barriers to trade. Nations with stable, transparent, and market-friendly political systems tend to attract foreign investment and maintain strong trade relationships, while those facing political uncertainty or interventionist policies often experience reduced competitiveness and investor confidence. As global trade becomes increasingly interconnected, understanding and anticipating political developments has become essential for

businesses, investors, and policymakers aiming to navigate risks and seize opportunities in the international marketplace.

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