CH

2

The Evolution of International Busine

After studying this chapter, you should be able to:

LO-1 Briefly explain why trade and foreign investment are good for society as a whole.

LO-2 Describe the major international trade theories and how they operate.

LO-3 Evaluate trade policy, the main instruments of trade policy, and their impact on business, consumers, and governments.

LO-4 Explain the rationale behind a country's choice of managing trade.

The United States has maintained a trade embargo against Cuba for almost 50 years. The United States wants to put pressure on the Cuban government to move toward democratization and bring greater economic and political freedom to its citizens. More recently, United States trade embargoes have been imposed upon Iran and Sudan.

REALITY CHECK LO-4

Boeing is the single largest exporter for the United States, yet it is restricted from exporting sensitive military equipment to all countries. What specific restrictions does the U.S government impose upon defense contractors such as Boeing?

SUMMARY

Trade has influenced culture, shaped history, affected living standards, and opened society to new ways of thinking. Open trade and investment creates "winners" and "losers," but the gains from open trade and investment are always greater than the losses. Trade enhances the quality of life of consumers, brings with it cultural and technological riches, and makes the world a more peaceful place because of national interdependence. Trade generates jobs both in the export and import sectors of an economy. The disruptive nature of trade can be softened by retraining and re-educating the negatively affected workforce and enabling workers to learn new skills in order to become more productive and gainfully employed.

Three major economic ideas comprise trade theory. Mercantilism, the oldest, was based upon the idea of wealth accumulation (i.e., countries striving to generate trade surpluses so that their holdings of gold and silver would increase, making them rich and powerful). Second, theories based on specialization in the production of goods and services include the theories of absolute and comparative advantage. Finally, H-O and factor price-equalization theories emphasize factor abundance as the fundamental reason behind exports and trade.

Porter's model of National Competitive Advantage is based upon the trade theories mentioned above. The robustness of Porter's model can be attributed to his integration of the theory and structure of a firm's behavior to trade theory. Porter looked more closely at the theory of firm and industry specifics to identify characteristics that made firms and industries in countries "winners" or "losers" in international trade. Porter's hybrid model was designed to operate within an environment of government actions and unforeseen external events—external shocks, positive or negative.

Trade policy refers to government actions that seek to alter the free flow of merchandise or services from and to a country. The primary instruments of trade policy include tariffs (specific, ad valorem, and GSP) and export subsidies; however, non-tariff barriers such as import quotas, voluntary export restraint, and domestic content provisions have become equally important.

Managed trade aims to replace free global-market forces with government actions to determine trade outcomes. Policymakers may use various socio-economic or geo-political rationales to protect specific companies, industries, or countries to achieve certain strategic objectives. Socio-economic rationale may include countertrade, export cartels, infant industry argument, or ethical considerations such as labor and environmental practices, and health and safety issues. Geo-political justification could include considerations of national security, strategic industries, and embargoes.

Develop an International Strategy for Your Own Small Business: Your Idea for Exporting

Using the data sources listed earlier, as well as other sources you may find on your own, develop a strategy and make a convincing case for why you would like to produce a particular product or service and export it to a target country. It is important that you identify in detail the comparative advantage of sourcing the product or service in your home country. You should look into supply as well as demand for your product or service. You should focus sales to one target country and its currency. The following questions will help you define your objectives:

1) What product or service do you plan to produce at home and sell abroad? What is your rationale and what competitive advantages do you have?

2) What foreign country do you plan to target and why? What is its demand for your product or service?

3) Identify factors such as tariffs and quotas that can affect trade in goods or services between your home and the target country. Explain how they could affect the demand for your product or service, and how you could overcome those challenges.

CHAPTER NOTES

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[17] Section 421 of U.S. Trade Act of 1974 which was added to the U.S. China Relations Act of 2000 as a safeguard provision to China's accession to the World Trade Organization.
[18] www.wto.org/english/thewto_e/acc_e/acc_e.htm
[19] The World Bank, *Atlas of Global Development* (Glasgow, U.K.: HarperCollins Publishers, 2007).
[20] The communist nations closely allied with the Soviet Union, including Bulgaria, Cuba, Czechoslovakia, East Germany, Hungary, Poland, and Romania, whose foreign policies depended on those of the former Soviet Union.
[21] Formally called the United States Tariff Act of 1930, also called Hawley-Smoot Tariff Act raised import tariffs to protect American business and farmers that led to retaliation and adding considerable economic strain to the Great Depression.

KEY TERMS

international business *p. 36*
trade, *p. 36*
foreign direct investment, *p. 37*
outsourcing, *p. 38*
mercantilism, *p. 40*
factors of production, *p. 40*
trade surplus, *p. 40*
absolute advantage, *p. 42*
comparative advantage, *p. 42*
trade policy, *p. 47*
tariffs, *p. 47*
custom duties, *p. 47*
specific tariff, *p. 47*
ad valorem tariff, *p. 47*
preferential duties, *p. 47*
generalized system of preferences (GSP), *p. 47*
export subsidy, *p. 47*
export taxes, *p. 47*
most favored nation (MFN), *p. 48*
import quotas, *p. 49*
voluntary export restraint (VER), *p. 49*
domestic content provisions, *p. 49*
managed trade, *p. 49*
countertrade, *p. 50*
export cartel, *p. 50*
infant industry argument, *p. 51*
embargoes, *p. 52*

CHAPTER QUESTIONS

1. How would you make a convincing case that open trade in goods and services as well as free flow of foreign direct investment will enhance the well being of (a) consumers, (b) pro-ducers, and (c) the government of countries? Give specific examples to prove your position.
2. What trade theories support the recent rise of China and India on the global stage? Explain your views in detail.
3. Some believe there is a disconnect between trade theory and trade policy. What rationale could the United States use to support its trade policies? Give specific examples.
4. When would a country such as France use socio-economic rather than geo-political rea-sons to support its trade policy? Can you provide some examples?

MINI CASE: ECONOMIC NATIONALISM

Buy American! Buy Spanish! British jobs for British workers! The ideology of economic nationalism seeks to implement trade policies that help to keep jobs and investment at home, while ignoring the advantages of open international trade and investment. Economic nationalism was popular during the Great Depression of 1929–33, when it served to protect domestic firms from international competition. However, this led to curtailing international business activity, making the global economic slowdown worse. Widely recognized as a myopic policy, economic nationalism nevertheless re-emerged during the global financial crisis that originated in the United States in 2008, prompting many analysts to wonder whether the public has learned anything from international business history.

Soon after the U.S. stock market crash of 1929, Willis Hawley and Reed Smoot, two Republicans in the U.S. Congress, sponsored a bill to raise import tariffs to the highest level in U.S. history.[21] Given the high rate of U.S. unemployment at that time, the bill was passed in order to keep jobs at home. This resulted in retaliation from other nations as they raised tariffs on exports from the United States and other countries. The net result was a ruinous fall in global trade and a worldwide depression.

In late-2008 and early-2009, when the United States faced the worst recession since the Great Depression, the call for a new round of trade barriers was being debated