

BUSI (2701): Midterm Study Note

Chapter 1: Globalization

❖ The Interdependent Global Economy

- In an interdependent economic system:
 - **barriers** to cross-border trade and investment are falling,
 - **Perceived distance** is shrinking due to advances in transportation and telecommunications technology
 - **Material culture** is starting to look similar the world over, (ex: iPhone, Samsung)
 - National economies are merging into an interdependent global economic system (ex: EU)
- Example:
 - A Canadian might use a phone that was:
 - Designed in the **USA**
 - Manufactured from components made in **Japan, South Korea, EU**
 - Assembled in **China**

❖ Going Global is not without problem

- The hard reality is that for all the superficial similarities in material and popular culture and in business systems, **doing business in foreign nations still has unique challenges.**
- Because of different tastes and preferences, what sells in Canada may not sell in **Thailand.**
- Business processes that give a retailer a competitive advantage in Canada may be difficult to implement in **India.**
- A brand that means something in Canada may mean little in **Indonesia.**

❖ What is Globalization?

- **Globalization** refers to the shift towards a more integrated and interdependent world economy
- **Globalization has several different aspects, including:**
 - **Globalization of Markets**
 - The merging of separate national markets into one huge global marketplace
 - **Low-cost transportation** has made it more economical to ship products around the world, thereby helping to create global markets.
 - **Low-cost global communications networks** such as the World Wide Web are helping to create electronic global marketplaces
 - **Globalization of Production**
 - The sourcing of goods and services from locations around the world to **take advantage of national differences, costs, and quality of factors of production**
 - As **transportation costs** associated with the globalization of production declined, dispersal of production to geographically widespread locations became **more economical.**

❖ Common Terms

- **International Trade**
 - When a firm exports goods or services to consumers in another country
- **Foreign Direct Investment**
 - Direct investment of resources and business activities outside a firm's home country, that is, in a foreign country

❖ Global Institutions

- As markets globalize business activities and transcend national borders, institutions need to help manage and regulate the global marketplace
- **Including the following organizations:**
 - International Monetary Fund (IMF) - 1944
 - World Bank - 1944
 - United Nations (UN) - 1945
 - GATT - 1947 to 1994
 - World Trade Organization (WTO) - 1995
- **International Monetary Fund (IMF):** to maintain order in the international monetary system
 - The IMF is often seen as the **lender-of-last-resort** to nation-states whose economies are in turmoil and currencies are losing value against those of other nations.
 - The point being that if a country has a currency that is of a small value, it makes it hard for them to trade with other countries
 - And this affects global trade for everybody
 - Ex: Help countries deal with erratic exchange rates
 - **The IMF loans come with strings attached**
 - In return for loans, the IMF require countries to adopt specific policies aimed at returning their troubled economies to stability and growth
 - These “strings” have generated the most debate
 - Some critics argue that the IMF’s policy recommendations are often inappropriate
- **World Bank:** to promote economic development
 - Ex: Development after a war or natural disaster
 - is not one single entity but rather a group comprised of the following:
 - IBRD - the International Bank for Reconstruction and Development
 - IDA - International Development Association
 - IFC - International Finance Corporation
 - MIGA - Multilateral Investment Guarantee Agency
 - ICSID - International Centre for Settlement of Investment Disputes
- **United Nations**
 - **Purpose:**
 - To **keep peace** throughout the world;
 - To **develop friendly relations** among nations;
 - To **help nations work together** to improve the lives of poor people, to conquer hunger, disease and illiteracy, and to encourage respect for each other’s rights and freedoms;
 - To **be a centre for harmonizing the actions of nations** to achieve these goals.
- ❖ **World Trade Organization (WTO)**
 - Goal
 - The goal of the World Trade Organization (WTO) is to ensure that trade flows as smoothly, predictably and freely as possible.
 - WTO
 - Polices the world trading system
 - Makes sure that nation-states adhere to the rules laid down in trade treaties
 - Promotes lower barriers to trade and investment
 - Essentially a world trade referee for countries wanting to grieve that parties to trade agreements have broken the agreements
- ❖ **Drivers of Globalization**
 - 1. **Decline in barriers** to the free flow of goods, services, and capital, since the end of World War II

- The lowering of barriers to international trade enables firms to view the world, rather than a single country, as their market
 - The lowering of trade and investment barriers also **allows firms to base production at the optimal location for that activity**, serving the world market from that location.
 - A firm might design a product in one country,
 - Produce component parts in two other countries,
 - Assemble the product in yet another country,
 - And then export the finished product around the world.
 - 2. **Technological change** in communication, information processing, and transportation
 - The lowering of trade barriers made globalization of markets and production a theoretical possibility.
 - Technological change has made it a tangible reality.
 - **Since the end of World War II, the world has seen major advances in**
 - Communication
 - information processing
 - transportation technology
 - and the emergence of the Internet and World Wide Web.
 - Example:
 - In 1990, fewer than 1 million users were connected to the Internet.
 - By December 2017, there were approximately 4.2 billion Internet users, accounting for about 55% of the world's population.
 - ◆ The Internet has changed the way people communicate.
 - ◆ The Web makes it much easier for buyers and sellers to find each other, wherever they may be located and whatever their size.
 - ◆ It allows businesses, both small and large, to expand their global presence at a lower cost than ever before.
 - Transportation technology
 - Before the advent of **containerization**, it could take several days and several hundred men to unload a ship and reload goods onto trucks and trains
 - ❖ Changes in Foreign Direct Investment
 - Among developing nations, the largest recipient of FDI has been China, which in 2004 - 2010 received \$60 billion to \$100 billion a year in inflows.
 - In 2016, reached USD \$139 billion.
 - ❖ **The Changing World Order**
 - Throughout most of Latin America debt and inflation are down,
 - governments are selling state-owned enterprises to private investors,
 - foreign investment is welcomed,
 - and the region's economies are growing rapidly.
 - These changes have increased the attractiveness of Latin America, both as a market for exports and as a site for foreign direct investment.
 - ❖ **How does the Global Marketplace Affect Managers?**
 - Managing an international business differs from managing a domestic business because
 - **countries** are different
 - the range of **problems** confronted in an IB is wider and the problems more complex than those in a domestic business
 - firms have to find ways to work within the **limits imposed** by government intervention in the international trade and investment system
 - international transactions involve converting money into **different currencies**
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Chapter 2: Country Differences in Political Economy

❖ Country Differences

- **International business** is much more complicated than domestic business because countries differ in many ways
- **Countries have different:**
 - Political
 - Economic
 - Legal system
- Cultural practices can vary dramatically from country to country, as can the education and skill level of the population
- Countries are at different stages of economic development
- Collectively we refer to these systems as constituting the **political economy** of a country
- The political, economic, and legal systems of a country **are not independent of each other**
- They interact and influence each other, and affect the level of economic well being in a country

❖ What is a Political System?

- **The political system** refers to the **system of government** in a nation
- **Assessed according to two dimensions**
 - The degree to which the country emphasizes **collectivism** as opposed to **individualism**
 - The degree to which the country is **democratic or totalitarian**

❖ Political Systems

- **Collectivism**
 - The political system that emphasizes the collective goals over individuals goals.
 - Plato (427-347 BC) - Individual rights should be sacrificed for the good of society.
 - Socialism:
 - ◆ **1. Communism** – socialism by revolution and totalitarian dictatorships (1970s)
 - ◆ **2. Social Democrats** – socialism by democratic means (1970-80s)
- **Individualism**
 - **Political system that focuses on the interests of the individual over the interests of the state.**
 - Aristotle (384 – 322 BC) – Private property is more highly productive than communal property and will thus stimulate progress
 - **Individualism has two central beliefs:**
 - ◆ 1. Individual Freedom and self-expression
 - ◆ 2. Let people pursue their own economic self-interest
- **Democracy**
 - Political system in which the people elect representatives to form the government.
 - Democracy demands:
 - 1. Freedom of expression
 - 2. Free media
 - 3. Regular elections
 - 4. Limited terms for representatives
 - 5. Fair court system
 - 6. Non-political – police and army
- **Totalitarianism**

- Political system based on collectivism, which advocates that socialism can be achieved only through a totalitarian dictatorship.
 - Form of government in which **one person or political party exercises absolute control** over all spheres of human life and opposing political parties are prohibited. (North Korea)
- ❖ **Economic Systems**
 - **Market Economy**
 - **Interaction of supply and demand** determines price and production
 - **Command Economy**
 - The **government** determines the allocation of resources including the determination of production and prices
 - **Mixed Economy**
 - **Certain sectors** are left to private ownership and free market mechanism, while other sectors are owned and managed by the government
- ❖ **Legal Systems**
 - Rules or laws that regulate people's behavior and business practices
 - **Types of legal systems: (Know These Three)**
 - **Common Law** (Interpret customs, traditions)
 - **Civil Law** (Apply written laws and codes)
 - **Theocratic** (Based on religious teachings)
- ❖ **Contract**
 - Is a document that specifies the conditions under which an exchange is to occur and details the rights and obligations of the parties involved
 - **Contract Law**
 - **International Trade and Contract Disputes**
 - United Nations Convention on Contracts for the International Sale of Goods (CIGS)
- ❖ **Property**
 - A resource over which an individual or business holds a legal title, meaning it owns the resource
 - **Resources include:**
 - Land & real estate
 - Equipment
 - Capital
 - Mineral rights
 - Businesses
 - Intellectual property
 - **Property Rights**
 - Bundle of legal rights over the use to which a resource is put and over the use made of any income that may be derived from that resource
- ❖ **Actions against Property Rights**
 - **Private Action**
 - An action by private individuals or groups against property holders including actions such as:
 - Theft
 - Piracy
 - Blackmail
 - Any criminal activity against property rights
 - **Public Action and Corruption**
 - Public Action violates property rights when public officials extort income from property holders, such as:
 - Bribes
 - Levying excessive taxation
 - Requiring expensive licenses or permits from property holders
- ❖ **Corruption**
 - USA: **The Foreign Corrupt Practices Act** (1970s)

- Makes it illegal for U.S. companies to bribe foreign government officials to obtain or maintain business over which that foreign official has authority
 - **Canada's Bill S-21**
 - Also known as the **Corruption of Foreign Public Officials Act** that entered into force in 1999
 - It has long been illegal to bribe officials in Canada
 - Now it is illegal for Canadian officials to bribe officials in another country
 - The Canadian Bill S-21 does have "loophole" provisions to cover for those instances in which a bribe might be solely a perception, due to cultural considerations of gift giving, in other countries
 - Bill S-21 sets out a lawful exception that an accused could use as a defence. Namely, that the payment was lawful in the foreign state or public international organization for which the foreign public official performs duties or functions
- ❖ The Protection of Intellectual Property
 - **Intellectual Property**
 - property that is the product of intellectual activity.
 - **Ex: computer software, music, formulas etc.**
 - **Ownership rights are established through:**
 - **1. Patents**
 - gives the inventor of a new product or process exclusive rights to manufacture, use or sell the invention, for **20 years**.
 - **2. Copyrights**
 - is the exclusive right of authors, composers, artists, and publishers to publish and dispose of their work as they see fit, for **50 years**.
 - **3. Trademarks**
 - is a design or name that may be **officially registered**, that allows merchants or manufacturers to designate or differentiate their products.
- ❖ **Trade Related Aspects of Intellectual Property Rights (TRIPS)**
 - **TRIPS Agreement (1995)**
 - Agreement among member states of the **World Trade Organization** to oversee the enforcement of stricter intellectual property regulations.
- ❖ **Product Safety and Product Liability**
 - **Product Safety Laws**
 - Set safety standards to which products must adhere, where it is going to be commercialized.
 - **Product Liability**
 - involves holding a firm and its officers responsible when a product causes injury, death or damage.
- ❖ **Determinants of Economic Development**
 - **Gross National Income (GNI)**
 - Total income (domestic and foreign) of all citizens of a country.
 - **Does not take into account cost of living differences**
 - **Purchasing Power Parity (PPP)**
 - Adjustment in gross domestic product per capita for a comparison of living standards in different countries.
- ❖ **Human Development Index**
 - measures the quality of human life in different countries
 - **Based on three measures:**
 - **1. Life expectancy at birth**
 - (which is a function of healthcare)
 - **2. Educational attainment**
 - (which is measured by a combination of the adult literacy rate and enrolment in primary, secondary, and tertiary education)
 - **3. Average incomes**

- based on PPP estimates, if they are sufficient to meet the basic needs of life in a country ([adequate food, shelter, and healthcare](#)).
- ❖ **Long-run economic growth**
 - **Innovation** and **entrepreneurial activity** are the engines of long-run economic growth
 - Innovation and entrepreneurial activity require **strong property rights**
 - [If you invent something, people should not be able to copy it and make money off of you](#)
- ❖ Political Economy and Economic Progress
 - Innovation and Entrepreneurship are the engines of growth. For this purpose, these are needed:
 - 1. Market economy
 - 2. Strong property rights
 - 3. Political system (ex. Democracy)
- ❖ **Geography** And **Education** Influence Economic Development
 - Countries with **favorable geography** are more likely to engage in trade, and so, be more open to market-based economic systems, and the economic growth they promote ([Ex: Japan vs Mongolia](#)).
 - Countries that invest in **education** have higher growth rates because the workforce is more productive ([Ex: South Korea, Japan](#))
- ❖ The Spread of Market-Based Systems
 - Paralleling the spread of democracy since the 1980s has been the transformation from centrally planned command economies to market-based economies.
 - More than 30 countries that were in the former Soviet Union or the Eastern European communist bloc are now changing their economic systems.
 - **Deregulation**
 - **removing legal restrictions** to the free play of markets, the **establishment of private enterprises**, and the manner in which private enterprises operate.
 - Hand in hand with deregulation has come a sharp increase in privatization
 - **Privatization**
 - transfers the ownership of state property into the hands of private individuals
 - **Laws protecting private property rights**
 - are required for a well-functioning market economy.
- ❖ The overall attractiveness of a country as a market and/or investment site depends on balancing the likely long-term benefits of doing business in that country against the likely costs and risks
 - **Benefits**
 - The long-run monetary benefits of doing business in a country are a function of the
 - **size of the market**
 - the **present wealth** (purchasing power) of consumers in that market
 - the **likely future wealth of consumers**
 - **Costs**
 - It may be more costly to do business in relatively undeveloped economies because of the lack of **infrastructure, supporting businesses, and adequate protection for intellectual property**
 - One of the most important variables is the **sophistication of a country's economy**
 - **Risks**
 - Risks of doing business in a country are determined by a number of
 - **political**, ex: [revolution, change of government](#)
 - **economic**, ex: [new taxes, tariffs, trade restrictions, high inflation](#)
 - **legal factors**. ex: [low patent or trademark enforcement](#).
- ❖ Country Differences (**Ethics**)
 - Country differences give rise to some important and contentious ethical issues.
 - Three important issues that have been the focus of much debate in recent years are:

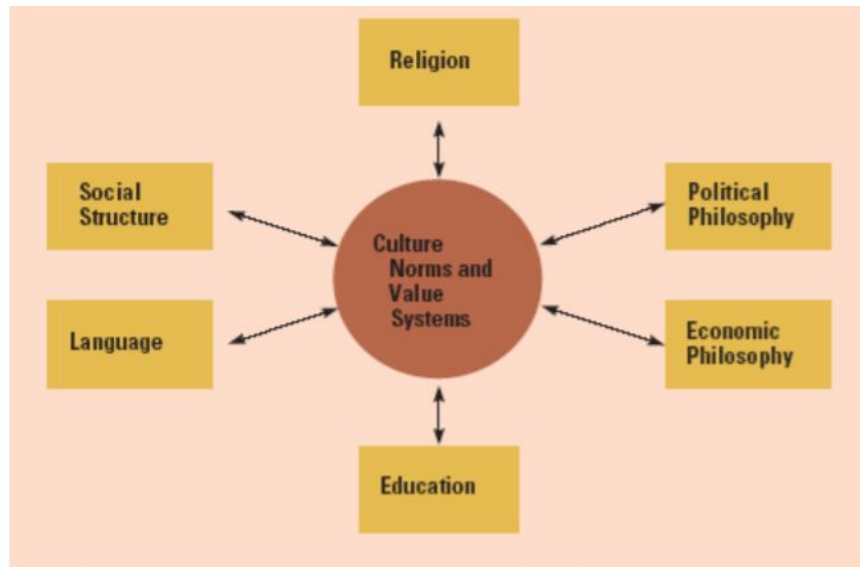
- 1. the ethics of doing business in nations that violate **human rights**;
- 2. the ethics of doing business in countries with very **lax labour** and **environmental regulations**
- 3. the ethics of **corruption**

Chapter 3: The Cultural Environment

- ❖ **What is Culture?**
 - **Culture** is a system of **values** and **norms** that are shared among a group of people (**ex: society**) and that when taken together constitute a design for living.
- ❖ **Definitions of culture**
 - **Edward Taylor**: “that complex whole which includes **knowledge, belief, art, morals, law, custom** and other capabilities acquired by man as member of society”
 - **Geert Hofstede**: “the **collective programming of the mind** which distinguishes the members of one human group from another... culture, **includes systems of values**”
- ❖ **Cultural Awareness - why it is important**
 - Knowing about the cultural circumstances of your target country can either help you save money, or prevent making mistakes
 - no consumer product’s company can afford to make mistakes in an intensely competitive cultural market.
 - **Germany** - Unions (Walmart in Germany)
 - **China** - Guanxi (Reciprocal gifts)
- ❖ **Culture includes systems of Values and Norms**
 - **Society**
 - a group of people who share a common set of values and norms.
 - **Values**
 - abstract ideas about what a group believes to be good, right, and desirable. (**ex: society’s attitudes toward individual freedom, loyalty, marriage**)
 - **Norms**
 - the social rules that govern people’s actions toward one another. • Folkways • Mores
- ❖ **Norms**
 - **Folkways** are the routine conventions of everyday life.
 - A good example of folkways concerns attitudes toward time in different countries.
 - People are very time conscious in Canada and Germany
 - In other countries (**ex: France, Brazil**), some people are very “relaxed” about time, and arriving on time
 - **Mores**
 - Mores are norms that are seen as central to the functioning of a society and to its social life.
 - **They have much greater significance than folkways.**
 - **Violating mores can bring serious retribution.**
 - There are many differences between cultures as to what is perceived as mores.
 - **Ex: Drinking alcohol in public?**
 - Canada
 - China
 - Saudi Arabia
- ❖ **Culture, Society and the Nation State**
 - There is not a strict one-to-one correspondence between a society and a nation-state
 - **Nation-states are political creations**
 - They may contain a single culture or several cultures
 - Canada (English, French, First Nations)
 - Iraq (Sunni, Shiite)

- India
- China

❖ Determinants of Culture



❖ What Is A Social Structure?

➤ **Social structure**

- a society's basic social organization

➤ **Consider**

- the degree to which the basic unit of social organization is the **individual**, as opposed to the **group**
- the degree to which a society is **stratified into classes**

❖ Individuals and Groups

➤ **Individual**

- In Western societies, the individual is the basic building block of social organization.
- **Example:**
 - In the **United States** and **Canada**, the emphasis on individual performance finds expression in an admiration of “rugged **individualism**” and **entrepreneurship**.

❖ Individuals and Groups

- **Group** is the association of two or more individuals who have a **shared sense of identity** and who interact with each other in structured ways on the basis of a common set of expectations about each other's behavior.
- One central value of some Asian cultures is the importance attached to group membership. (**Japan, China**)
- **Karoshi** – “to die from overwork”

❖ Social Stratification

- **Social Strata** is defined on the basis of characteristics such as family background, occupation, and income. Individuals are **born into a particular stratum**.
- **Social Mobility** refers to the extent to which individuals can move out of the strata into which they are born.
- **Caste System** is a **closed system of stratification** in which social position is determined by the family into which a person is born, and **change in that position is usually not possible** during an individual's lifetime. Often a caste position carries with it a specific occupation.

- **Class System** of social stratification in which **social status is determined by the family into which a person is born and by subsequent socioeconomic achievements**.
Mobility between classes is possible through his or her own achievements and/or luck.
- ❖ **Language**
 - Language does far more than just enable people to communicate with each other.
 - Language **shapes the way people perceive the world** and **helps define culture**.
 - In countries with more than one language, one also often finds more than one culture.
 - **Chinese** is the “mother tongue” of the largest number of people, followed by **Spanish** and **English**.
 - **English** is the most widely spoken language in the world, followed by **Spanish, Russian, and Arabic**.
- ❖ **Culture and the Workplace**
 - How a society’s culture affects the values found in the workplace is of considerable importance to an international business with operations in different countries.
 - **Hofstede identified six dimensions that he claimed summarized different cultures: Know These**
 - 1. Power distance
 - 2. Individualism vs Collectivism
 - 3. Uncertainty avoidance
 - 4. Masculinity vs femininity
 - 5. Long-term vs short-term orientation
 - 6. Indulgence vs restraint
- ❖ **Cultural Change**
 - **Culture is not a constant; it evolves over time**
 - Several studies have suggested that **economics** may be an important factor in societal change.
 - The cultures of societies may also **change as they become richer** because economic progress affects a number of other factors, which in turn influence culture.
- ❖ **Cross-Cultural Literacy**
 - Doing business in different cultures requires adaptation to conform with the value systems and norms of that culture.
 - **Adaptation** embraces all aspects of an international firm's operations in a foreign country, including:
 - The way deals are negotiated
 - The appropriate incentive and pay systems for salespeople
 - The structure of the organization
 - The name of a product
 - The tenor of relations between management and the workforce
 - The manner in which the product is promoted (ex: [IKEA](#))

Chapter 5: International Trade Theories

- ❖ **What is Trade?**
 - The act or process of buying, selling, or exchanging
- ❖ **What is Free Trade?**
 - A situation where a government does not attempt to influence through quotas or duties what its citizens can buy from another country or what they can produce and sell to another country.
 - The absence of barriers (restrictions) to the free flow of goods and services between countries. Ex: [EU](#)
- ❖ **Is Free Trade Beneficial?**
 - **International trade allows a country**

- To **specialize** in the manufacture and export of products that it can produce efficiently
 - **Import** products that can be produced more efficiently in other countries
 - **Trade theory shows why it is beneficial for a country to engage in international trade even for products it is able to produce for itself**
 - ❖ **Why Do Certain Patterns Of Trade Exist?**
 - Some Patterns of trade are fairly easy to explain:
 - Saudi Arabia -> Oil
 - Costa Rica -> Bananas
 - Brazil -> Coffee
 - ❖ **Theory - Practice**
 - **The economic arguments surrounding the benefits and costs of free trade in goods and services are not abstract academic ones.**
 - **International trade theory has shaped the economic policy of many nations for the past 50 years.**
 - It was the driver behind the **World Trade Organization** and regional trading blocs such as
 - The **European Union**
 - The **North American Free Trade Agreement (NAFTA)**.
 - ❖ **7 Selected International Trade Theories**
 - **#1: Mercantilism**
 - Mercantilism is an economic philosophy advocating that countries should simultaneously encourage exports and discourage imports.
 - The flaw with mercantilism was that it viewed trade as a **zero-sum game**.
 - **Ex: China criticized as following neo-mercantilist policy**
 - **#2: Adam Smith's theory of absolute advantage**
 - Proposed in 1776, Smith's theory was the first to explain why unrestricted free trade is beneficial to a country.
 - Adam Smith argued that a country has an **absolute advantage** in the production of a product when it is more efficient than any other country in producing it
 - So countries should **specialize** in the production of goods for which they have an absolute advantage and then trade these goods for the goods produced by other countries.
 - **How Does The Theory of Absolute Advantage Work?**

Two countries, Ghana and South Korea, both have **200 units of resources** (land, labour, and capital) to produce **rice** or **cocoa**

 - **In Ghana:**
 - 1 ton of cocoa = 10 units of resources**
 - 1 ton of rice = 20 units of resources**

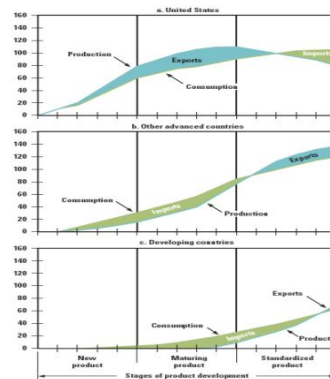
Ghana could produce 20 tons of cocoa and no rice, 10 tons of rice and no cocoa, or some combination of rice and cocoa between the two extremes.

 - **In South Korea:**
 - 1 ton of cocoa = 40 units of resources**
 - 1 ton of rice = 10 units of resources**

South Korea could produce 5 tons of cocoa and no rice, 20 tons of rice and no cocoa, or some combination in between
- ◆
 - **Without trade, and devoting resources half and half:**
 - ◆ Ghana would produce 10 tons of cocoa and 5 tons of rice
 - ◆ South Korea would produce 10 tons of rice and 2.5 tons of cocoa
 - **With specialization and trade**
 - ◆ Ghana would produce 20 tons of cocoa
 - ◆ South Korea would produce 20 tons of rice

- ◆ Ghana could trade 6 tons of cocoa to South Korea for 6 tons of rice
 - **After trade**
 - ◆ Ghana would have 14 tons of cocoa left, and 6 tons of rice
 - ◆ South Korea would have 14 tons of rice left and 6 tons of cocoa
 - **If each country specializes in the production of the good in which it has an absolute advantage and trades for the other, both countries gain!**
- **#3: Ricardo's Theory of Comparative Advantage**
 - Building on Adam Smith's work
 - Ricardo's work was refined by Heckscher and Ohlin, whose theory is known as the HO theory
 - The great strength of the theories of Smith, Ricardo, and Heckscher–Ohlin is that **they identify with precision the specific benefits of international trade**
 - **David Ricardo** asked what might happen when one country has an absolute advantage in the production of all goods
 - Countries should **specialize in the production of goods and services they can produce most efficiently.**
 - A country is said to have a **comparative advantage** in the production of such goods and services.
 - **How Does The Theory Of Comparative Advantage Work?**
 - **With trade**
 - ◆ Ghana could export 4 tons of cocoa to South Korea in exchange for 4 tons of rice
 - ◆ Ghana will still have 11 tons of cocoa, and 4 additional tons of rice
 - ◆ South Korea still has 6 tons of rice and 4 tons of cocoa
 - ◆ if each country specializes in the production of the good in which it has a comparative advantage and trades for the other, both countries gain
 - **Comparative advantage** theory provides a strong rationale for encouraging free trade
- **#4: Heckscher-Ohlin Theory (HO)**
 - **The HO theory predicts that countries will export those goods that make intensive use of factors that are locally abundant, while importing goods that make intensive use of factors that are locally scarce.**
 - Like Ricardo's theory, the HO theory argues that free trade is beneficial.
 - **Ex: Japan (high-tech) vs China (labour intensive)**
 - **Factor Proportions Theory (Heckscher & Ohlin)**
 - **Also known as the Factor Endowments Theory**
 - ◆ Argues that each country should produce & export products that intensively use relatively abundant production factors, & import goods that intensively use relatively scarce factors of production
 - **Is Unrestricted Free Trade Always Beneficial?**
 - ◆ **Unrestricted free trade is beneficial**, BUT gains may not be as great as the simple model of comparative advantage would suggest, due to:
 - immobile resources
 - diminishing returns
 - exchange rates
 - transportation costs between countries
 - **Dynamic Effects and Economic Growth**
 - ◆ **Opening a country to trade could increase:**

- a country's stock of resources
 - (ex: supplies of labour and capital from abroad)
- the efficiency of resource utilization
 - (ex: better technology from abroad)
- economic growth
 - (ex: larger production)
- #5: Raymond Vernon (Product Life-Cycle Theory)
 - Product and their manufacturing technologies go through 3 stages of evolution: **introduction, maturity, and standardization**
 - In the **introduction stage**, the inventor country enjoys a monopoly both in manufacturing and exports (ex: TV set in US)
 - In the **maturity stage**, the product's manufacturing becomes relatively standardized; other countries start producing & exporting the product
 - In the **standardization stage**, manufacturing ceases in the original innovating country, who then becomes a net product importer
 - **Today, due to globalization, the cycle occurs quickly for many products (ex: smartphone)**



Mid 1960s
 Raymond Vernon's theory argues that early in the life cycle of a typical new product, while **demand is starting to grow rapidly in the US**, **demand in other advanced countries is limited to high-income groups.**

- ◆
- **Does The Product Life Cycle Theory Hold?**
 - The product life cycle theory accurately explains what has happened for products like **photocopiers** and a number of other high technology products developed in the US in the **1960s and 1970s**
 - But, the globalization and integration of the world economy has made this theory less valid today
 - ◆ The theory is **ethnocentric** (U.S.)
 - ◆ Production today is dispersed globally
 - ◆ Products today are introduced in multiple markets simultaneously (ex: new smartphones, computers)

- #6: Paul Krugman (New Trade Theory)
 - The **New Trade Theory** began to emerge in the late 1970s when a number of economists were arguing that increasing returns to specialization might exist in some industries.
 - Firms that achieve **first mover advantages** will develop **economies of scale**, and create barriers to entry for other firms.
 - **Economies of scale:**
 - Represent one particularly important source of increasing returns.
 - Economies of scale are unit cost reductions associated with a large scale of output.
- #7: Michel Porter (National Competitive Advantage)
 - Michael Porter's Theory (The Competitive Advantage of Nations, 1990) determines that **4 broad attributes of a nation shape the environment in which**

local firms compete, and these attributes promote or impede the creation of competitive advantage.

- 1. Demand conditions
- 2. Relating and supporting industries
- 3. Factor endowments
- 4. Firm strategy, structure, and rivalry

■ Porter's Diamond Model



■ Porter's Diamond of Competitive Advantage

- **Factor conditions or endowments** - a nation's position in factors of production necessary to compete in a given industry
 - ◆ can lead to competitive advantage
 - ◆ can be either **basic** (natural resources, climate, location, demographics) or **advanced** (skilled labor, infrastructure, technological know-how)
- **Demand conditions** - the nature of home demand for the industry's product or service
 - ◆ influences the development of capabilities
 - ◆ **sophisticated and demanding customers** pressure firms to be competitive
- **Relating and supporting industries** - the presence or absence of supplier industries and related industries that are internationally competitive (ex: Japan - keiretsu)
 - ◆ can spill over and contribute to other industries
 - ◆ **successful industries tend to be grouped in clusters in countries**
- **Firm strategy, structure, and rivalry** - the conditions governing how companies are created, organized, and managed, and the nature of domestic rivalry
 - ◆ different management ideologies affect the development of national competitive advantage
 - ◆ vigorous **domestic rivalry creates pressures to innovate**, to improve quality, to reduce costs, and to invest in upgrading advanced features

■ Does Porter's Theory Hold?

- **Government policy can**
 - ◆ Affect demand through product standards
 - ◆ Influence rivalry through regulation and antitrust laws
 - ◆ Impact the availability of highly educated workers and advanced transportation infrastructure.

- The four attributes, government policy, and chance work as a reinforcing system, complementing each other and in combination creating the conditions appropriate for competitive advantage
 - So far, **Porter's theory has not been sufficiently tested to know how well it holds up**
- ❖ **Implications for International Businesses**
- **Location Implications**
 - different countries have particular advantages in different productive activities
 - it makes sense for a firm to **disperse its productive activities to those countries** where, according to the theory of international trade, **they can be performed most efficiently**
 - **First-mover Implications**
 - Firms that establish a first-mover advantage with regard to the production of a particular new product **may subsequently dominate global trade in that product**
 - It pays to invest substantial financial resources in trying to build a first-mover, or early-mover, advantage, **even if that means several years of substantial losses before a new venture becomes profitable**
 - **Policy Implications**
 - Because of their critical role in international trade, businesses can influence government trade policy, lobbying to promote free trade or trade restrictions.
 - **Example:**
 - In the early 1990s U.S. government intended to place a tariff on Japanese imports of LCD screens
 - IBM and Apple Computers protested (both used Japanese screen in their own computers)
 - U.S government reversed its position

Chapter 6: The Political Economy of IB

- ❖ **Importance of International Trade**
- Overview
 - In a world without trade barriers, trade patterns are determined by the relative productivity of different factors of production in different countries.
 - Countries will specialize in products that they can make most efficiently, while importing products that they can produce less efficiently
 - International trade has grown significantly in the last 30 years
 - **Trade of Merchandises and Commercial Services**
 - In 2017,
 - the dollar value of world **merchandise exports**: \$17.9 trillion
 - ◆ (ex: coffee, cars, oil, computers, toys)
 - the value of world **commercial services exports**: \$5.3 trillion
 - ◆ (ex: travel, transportation, financial and computer services, consulting)
 - **Free Trade** refers to a situation where a government does not attempt to restrict what its citizens can buy from another country, or what they can sell to another country
 - The **Political reality** is that while many nations are committed to free trade, they **tend to intervene in international trade to protect the interests of politically important groups**
 - When governments intervene, they often do so by **restricting imports** of goods and services into their nation, while adopting policies that **promote exports**.

- Normally their motives are to **protect domestic producers and jobs** from foreign competition while **increasing the foreign market** for products of domestic producers.

❖ How Governments Intervene (Instruments of Trade Policy)

➤ #1: Tariffs (Tax on Imports)

- Oldest and simplest instrument
 - **Specific tariffs** = fixed charge/unit (\$) (ex. \$3 per barrel of oil)
 - **Ad valorem tariffs**: proportion of the value of the imported good (%) (ex. China 25% on cars, Japan 50% on Bananas)
- But also the easiest for the WTO to limit
- Impacts on governments: increase revenues
- Protect domestic producers by reducing imports
- Reduce the overall efficiency of the world economy
- 'pro-producer, but anti-consumer'

➤ #2: Subsidies (A government payment to a domestic producer)

- Can take many forms including:
 - cash grants,
 - low-interest loans,
 - tax breaks,
 - and government equity participation.
- By **lowering production costs**, subsidies help domestic producers in two ways:
 - They help them compete against foreign imports
 - They help them gain export markets.
- **Governments pay for subsidies by taxing: individuals and corporations**
- **Examples Of Subsidies**
 - Car Makers:
 - ◆ In 2008-2009: \$45B in developed nations
 - Agriculture:
 - ◆ In 2009, 31 developed countries paid over \$250B
 - Aerospace:
 - ◆ Boeing (tax credits), Airbus (low-interest rate loans)

➤ #3: Import Quotas & Voluntary Export Restraints

- **Import quotas** - a direct restriction on the quantity of some good that may be imported into a country
 - (ex: the US has a quota on cheese imports. The only firms allowed to import cheese are certain trading companies)
- **Tariff rate quota** - a hybrid of a quota and a tariff
 - (ex: 10% tariff on rice imports into South Korea for 1 million tons, after which an out-of-quota rate of 80%)
- **Voluntary export restraints** - imposed by exporting country at the request of importing country usually
 - (ex: Japan 1.85 million cars per year)

➤ #4: Local Content Requirements

- Demands that some specific fraction of a good be produced domestically.
 - The requirement can be expressed either in **physical terms**,
 - ◆ (ex: 75% of component parts for this product must be produced locally)
 - **In value terms**
 - ◆ (ex: 40% of the value of this product must be produced locally)
 - **Buy America Act**, specifies that government agencies must give preference to American products when putting contracts for equipment

➤ #5: Administrative Policies

- Bureaucratic rules designed to make it difficult for imports to enter a country.

- **Ex: Federal Express** has had a tough time expanding its global express shipping services into Japan because Japanese customs inspectors insist on opening a large proportion of express packages to check for pornography, a process that can delay an “express” package for days. It also gives the Japanese competitor to Federal Express an advantage
- **Ex: The Netherland tulip bulbs in Japan.** (Japanese customs inspectors check every tulip bulb by cutting it)

➤ **#6: Antidumping Policies**

- Dumping is **selling goods in a foreign market at below their costs of production**, or as selling goods in a foreign market **at below their “fair” market value.**
 - **Ex: Buying Nikon Cameras in New York for a cheaper price than in Japan - where they make them**
- **Antidumping Duties**
 - If a domestic producer believes that a foreign firm is dumping production in the local market, it can file a petition
 - ◆ In Canada, companies can complain to the CBSA (Canada Border Services Agency)
 - ◆ The CBSA may investigate and, if appropriate, initiate a tax on the imported item.
 - ◆ **Ex: There was a suspicion that women's leather boots were being shipped into Canada, from China, at very, very low prices and this was creating an unfair competitive situation for Canadian boot manufacturers.**
 - CBSA investigated the Chinese manufacturers
 - The Chinese manufacturers did not co-operate,
 - So the CBSA put a 72% tariff on the incoming boots from China.

❖ **The Case for Government Intervention**

➤ **Political Arguments for Intervention**

- 1. Protecting jobs and industries
- 2. National security (*military, high tech.*)
- 3. Retaliation
- 4. Protecting consumers (*safety, EU hormone-treated beef*)
- 5. Furthering foreign policy objectives (*Cuba, North Korea*)
- 6. Protecting human rights

➤ **Economic Arguments for Intervention**

- 1. The **Infant industry argument**
 - ◆ new manufacturing industries cannot initially compete with well-established industries in developed countries.
 - ◆ To allow manufacturing to get a toehold, the argument is that governments should temporarily support new industries
 - with tariffs
 - import quotas
 - subsidies
 - ◆ **Until they have grown strong enough to meet international competition.**
- 2. **Strategic trade policy**
 - ◆ Government can help raise national income
 - ◆ Government might intervene in an industry if it helps domestic firms **to overcome the barriers to entry** created by foreign firms that have already reaped **first-mover advantages**

- Ex: Bombardier in Quebec has benefited greatly from support from the federal government and the Quebec provincial government
- Ex: Airbus, \$13.5 billion subsidy from the governments of Great Britain, France, Germany, and Spain

❖ The World Trade Organization

➤ Development of World Trade System

- From Smith to Great Depression
 - In 1846, Great Britain officially embraced Free Trade as government policy, **but most countries resisted**
 - In 1930, the US Congress passed the Smoot Hawley Tariff **to protect domestic industries**. Other countries retaliated by rising their own tariff barriers. The world slid further into the Great Depression.
- **1947 - 1979: GATT, Trade Liberalization, and Economic Growth (Ex: Tariff reduction)**
- From 1953 to 1963, world trade grew at an annual rate of 6%
- **1980 – 1993: GATT under pressure**
 - During the 80s and 90s GATT came under pressure due to:
 - ◆ 1. Economic success of Japan (ex. **administrative trade barriers**)
 - ◆ 2. Persistent trade deficit in the world's largest economies (ex. **1987, U.S. trade deficit: over \$170 billion**)
 - ◆ 3. Countries found ways to get around GATT regulations, such as VERs (**Voluntary Exports Restraints**)
- The **Uruguay Round** and the WTO
 - 1995 the agreement was formally signed.
 - ◆ (ex. **reduce and remove tariffs, increase intellectual property protection**)
 - The World Trade Organization was created to implement the GATT agreement.

➤ WTO

- **The WTO acts as an umbrella organization that encompasses the following bodies:**
 - 1. GATT
 - 2. GATs (General Agreement on Trade in Services)
 - 3. TRIPs (Trade-Related Aspects of Intellectual Property Rights)
- **WTO has taken the responsibility for arbitrating trade disputes and monitoring the trade policies of member countries**
 - Canada - 1995
 - China - 2001
 - Vietnam - 2007
 - Russia - 2012
 - Kazakhstan - 2015
 - Afghanistan - 2016
- **Simple basics of the WTO**
 - When two countries have a trade dispute, the WTO looks at the various trade agreements these countries have had over the years, and rules which is the best outcome of a current situation

➤ The Future of WTO: **Unresolved Issues**

- **Some of the key issues at the forefront of the WTO agenda:**
 - 1. The rise of **antidumping policies**
 - 2. The high level of **protectionism in agriculture**
 - 3. The lack of strong **protection for intellectual property rights**

➤ The Future of WTO: **The Doha Round**

- In 2001, at Doha, Qatar, member states agreed to launch a new round of talks
 - The agenda agreed upon at Doha includes:
 - 1. Cutting tariffs on industrial goods and services
 - 2. Phasing out subsidies to agricultural producers
 - 3. Reducing barriers for cross-border investment (FDI)
 - 4. Limiting the use of antidumping laws
 - Negotiations are still in progress although essentially stalled since about 2008
- ❖ Agriculture Trade & Canada's Food Trade
 - Agriculture is one of the economic sectors where subsidies are most extensively used
 - In 2009, 31 developed countries paid over \$250B in subsidies to farmers
 - Agricultural subsidies
 - Allow inefficient farmers to stay in business
 - Encourage overproduction
 - Encourage production of products that could be grown more efficiently somewhere else
 - Reduce international trade in agricultural products
 - Non-tariff barriers to trade
 - Technical Barriers to trade
 - Ex: size, package, performance, labelling (English and French in Canada)
 - Sanitary standards
 - Ex: food safety, health of animals and plants (EU ban on hormone-treated beef, GMO)

Chapter 7: Foreign Direct Investment

- ❖ Forms of FDI
 - Green Field Investment
 - Establishment of a wholly new operation in a foreign country
 - Mergers and acquisitions
 - Acquisition of, or a merger with, an existing firm in the foreign country
 - Forms of Acquisitions
 - Minority: 10-49%
 - Majority: 50-99%
 - Full outright stake: 100%
- ❖ Mergers and Acquisitions (M&A)
 - The Majority of cross-border investment is in the form of **mergers and acquisitions** rather than greenfield Investments.
 - Why?
 - M&A tend to be **quicker to execute** than greenfield investments
 - It's usually **easier to acquire assets than build** them from the ground up
 - Firms **believe they can increase the efficiency** of acquired assets by transferring capital, technology, or management skills
- ❖ FDI in the World Economy
 - **Flow of FDI** refers to the amount of FDI undertaken over a given time period (Normally a year)
 - **Stock of FDI** refers to the total accumulated value of foreign-owned assets at a given time
 - **Outflows of FDI**: flow of FDI out of a country

- Ex: This would mean Canadian companies buying property and/or setting up operations in another country
 - Ex: TD Bank in Canada buying Commerce Bancorp in the U.S. in 2007 and acquiring all of their branches
- **Inflows of FDI: Flow of FDI into a country**
 - In 2006, Saudi Prince acquired Fairmont Hotels for \$3.9B.
 - In 2011, Polish mining company KGHM International Ltd. acquired Canadian mining company Quadra FNX Mining Ltd for over \$3B.
 - In 2014, Burger King acquired Tim Hortons Inc. for \$12.5B
- ❖ **What Are The Patterns of FDI?**
 - **Over the last 30 years FDI has grown rapidly**
 - **Why?**
 - firms still fear the threat of protectionism
 - (ex: Japanese automakers)
 - democratic political institutions and free market economies have encouraged FDI
 - (ex: changes in in the economic and political policies in Eastern Europe, Latin America, Asia)
 - more efficient production, cheap labor and resources, new technologies, more customers
- ❖ **The Direction of FDI**
 - Historically, most FDI has been directed at the **developed nations** around the world, as firms based in these countries invested in each others' markets.
 - During the past few decades, the **U.S. has been the favourite target of FDI inflows.**
 - The U.S. is the only country in the world with a population over 300 million AND a comparatively high GDP per capita
 - Which simply means there are a lot of Americans, and they have a lot of money to buy stuff
- ❖ **Source of FDI**
 - Since World War II, the U.S. has been the largest source country for FDI, a position it retained during the late 1990s and throughout the 2000s.
 - Ex: American companies going to other countries and buying up other companies and resources
 - Other important source countries include
 - France
 - China
 - The United Kingdom
- ❖ **Canada - U.S.**
 - Until 2007, Canada and the US shared the largest bilateral flow of goods, services, people, capital, and investments between any two countries in the world.
 - In 2008, China passed Canada as top exporter to the U.S.
 - A large part of Chinese exports to the U.S. are in fact from American companies in China, like Nike exporting to Nike USA, and subsidiary companies of Wal-Mart exporting to Wal-Mart USA
- ❖ **Why Foreign Direct Investment**
 - **When two alternatives are available?**
 - **Exporting**
 - **Licensing**
 - (granting a foreign entity the right (license) to produce and sell the firm's product in return for a royalty fee on every unit that the foreign entity sells)
 - **Licensors** (ex: home company) vs. **Licensees** (ex: foreign company)
 - The question is an important one given that **FDI can be both expensive and risky** when compared to exporting and licensing.
- ❖ **Limitations of Exporting**

- Exporting is **constrained by transportation costs and trade barriers**. When transportation costs are added to production costs, it becomes unprofitable to ship some products over a large distance.
- Products of **low value-to-weight ratio** typically produced locally
 - (ex: cement, soft drinks)
- Products with a **high value-to-weight ratio**: transport costs are normally a very minor component of total landed cost.
 - ex: smartphones, personal computers, computer software
- ❖ **Licensing**
 - In the late 1990s, Starbucks opened stores in China, Singapore, Thailand, New Zealand, South Korea, and Malaysia. In Asia, Starbucks' most common strategy was to license its format to a local operator in return for initial licensing fees and royalties on store revenues
 - **Limitations of Licensing**
 - Licensing has **three major drawbacks** as a strategy for exploiting foreign market opportunities.
 - 1. licensing may result in a **firm's giving away valuable technological know-how** to a potential foreign competitor
 - 2. licensing **does not give a firm the tight control** over manufacturing, marketing, and strategy
 - 3. the problem with licensing arises when the firm's **competitive advantage is based** not as much **on its products as on the management, marketing, and manufacturing capabilities** that produce those products
- ❖ **Pattern of FDI: Three Theories**
 - **Strategic Behaviour**
 - Oligopoly
 - (ex: Toyota and Nissan respond to investments by Honda)
 - Multipoint competition
 - (match each other's moves in different markets or industries, ex: Samsung and iPhone)
 - **The Product Life Cycle**
 - (Raymond Vernon - firms will change their strategy as a product moves through its life cycle)
 - **Eclectic Paradigm**
 - Location-specific advantage
 - (ex: advantages from using resource endowments or assets that are tied to particular foreign location and that a firm finds valuable to combine with its own unique assets)
 - Externalities
 - (knowledge spillovers - ex: Silicon Valley)
- ❖ **How Political Ideology Impacts FDI?**
 - Government policy toward FDI has typically been driven by political ideology.
 - Historically, ideology toward FDI has ranged from a **radical stance that is hostile to all**, to the non-interventionist principle of **free-market economics**
- ❖ **The Political Environment and FDI**
 - **The radical view**
 - Argues that the **MNE is an instrument of imperialist domination**
 - They see the **MNE as a tool for exploiting host countries** to the exclusive benefit of their capitalist imperialist home countries
 - They argue that **MNEs extract profits from the host country** and take them to their home country
 - Ex: Venezuela, Bolivia
 - The Free Market view

- argues that international production should be distributed among countries according to the theory of comparative advantage.
- countries should specialize in the production of those goods and services that they can produce most efficiently.
- **Ex:** if Ford moves the assembly of some of its cars to Mexico to take advantage of cheaper labor costs:
 - Ford is **freeing up resources in the US** which could then be used in activities in which the US has a comparative advantage
 - Ford is also **transferring technology, skills, and capital to Mexico.**

Both countries gain!
- **Pragmatic Nationalism**
 - In practice, many countries have adopted neither a radical policy nor a free market policy toward FDI, but instead a policy that can best be described as pragmatic nationalism.
 - The pragmatic nationalist view is that **FDI has both benefits and costs.**
 - FDI can benefit a host country (**ex: capital, skills, technology, and jobs**), but those benefits often come at a cost (**ex: the repatriation of profits and negative balance of payments effects**)
 - **Pragmatic nationalism** - FDI should only be allowed **if the benefits outweigh the costs**
- ❖ **Home-Country Effects:**
 - **Benefits**
 - Home country MNE **learns skills transferable in technologies** for use in the home country
 - **Positive employment effects** - when a subsidiary demands home country exports of capital equipment
 - **Balance of payments** - from inward flow of foreign earnings
 - **Costs**
 - **Employment effect** - FDI replaces home country production •
 - **Balance of payments** - from capital outflow
- ❖ **Host-Country Effects**
 - **Benefits**
 - **Resource-transfer effects** - FDI brings new capital, technology, and management skills, helping the country to increase its economic growth
 - **Employment effects** - FDI brings jobs to a host country
 - **Balance of payment effects** - FDI is a substitute for imports of goods and services (**ex: produce Toyota cars in Canada vs. import Toyota cars from Japan**).
 - **Competition** - improved efficiency, lower prices
 - **Costs**
 - **Adverse effects on competition** - Foreign subsidiaries have strong economic power to put local competitors out of market
 - **Adverse effects on the balance of payments** - Against the initial capital inflow that comes with FDI must be the outflow of earnings to be repatriated
 - **Perceived loss of national sovereignty and autonomy** MNE have no particular commitment to the host country
- ❖ **How Does Government Influence FDI?**
 - **Home-Country Policies:**
 - Governments can **encourage** outward FDI:
 - **government-backed insurance** programs to cover major types of foreign investment risk
 - Governments can **restrict** outward FDI:
 - limit capital outflows, outright prohibit FDI or manipulate tax rules (**ex: tax foreign earnings at a higher rate than domestic earnings**)
 - **Host-Country Policies:**

- Governments can **encourage** inward FDI
 - offer incentives (ex: subsidies and/or tax incentives to foreign firms to invest in their countries)
 - ◆ gain from the resource-transfer and employment effects of FDI, and **capture FDI away from other potential host countries**
 - Governments can **restrict** inward FDI • use ownership restraints and performance requirements (ex: Japan, prohibited FDI unless the foreign firm had valuable technology)
- ❖ **What Does FDI Mean For Managers?**
 - A host government's attitude toward FDI is an important variable in decisions about **where to locate foreign production facilities** and where to make a FDI
 - Managers need to consider what trade theory implies about FDI, and the **link between government policy and FDI**
 - The direction of FDI can be explained through the **location-specific advantages**

Chapter 8: Regional Economic Integration

- ❖ **Regional Economic Integration:**
 - Agreements among countries in a geographic region to reduce, and ultimately remove, tariff and nontariff barriers to the free flow of goods, services, and factors of production between each other.
 - **Examples:**
 - **NAFTA** (North American Free Trade Agreement)
 - **EU** (European Union)
 - **BRICS:** BRIC (2006) + South Africa (2010)
- ❖ **Levels of Economic Integration**
 - **Free trade area:** no barriers to the trade of goods and services among member countries, members determine their **own policies toward nonmembers**. (Ex: NAFTA)
 - **Customs union:** eliminates trade barriers between members and adopts a **common external trade policy**. (Ex: ACON, early EU)
 - **Common market:** also allows the free **movement of the factors of production**.
 - **Economic union:** also requires a common currency, harmonization of tax rates, and a common monetary and fiscal policy. (Ex: EU today)
 - **Political Union:** independent states are combined into a single union where the economic, social, and foreign policy of members is coordinated. (Ex: U.S., Canada)
- ❖ **The Case for Regional Integration**
 - **Economic Case for Integration**
 - Regional economic integration can be seen as an attempt to achieve **additional gains from the free flow of trade and investment between countries**.
 - **Political Case for Integration**
 - Linking neighboring economies and making them **increasingly dependent on each other creates incentives for political cooperation** between neighboring states.
- ❖ **Impediments to Integration**
 - 1. Although economic integration benefits the majority, **it has its costs**.
 - While a nation as a whole may benefit significantly from a regional free trade agreement, **certain groups may lose**.
 - Moving to a free trade regime **involves some painful adjustments**.
 - 2. A second impediment to integration arises from concerns over **national sovereignty**.
 - Ex: Mexico's concerns about maintaining control of its oil interests resulted in an agreement with Canada and the United States to exempt the Mexican oil industry from any liberalization of foreign investment regulations achieved under NAFTA.
- ❖ **The Case Against Regional Integration**

- In recent years, some economists have expressed concern that the **benefits of regional integration have been oversold, while the costs have often been ignored**
- The benefits of regional integration are determined by the extent of **trade creation**, as opposed to **trade diversion**
 - ✓ **Trade creation** occurs when high-cost domestic producers are replaced by low-cost producers within the free trade area.
 - ○ **Trade diversion** occurs when lower-cost external suppliers are replaced by higher cost suppliers within the free trade area.

❖ **European Union (Who are the members)**

- The European Union was initially composed of 15 member states representing 374 million people:
 - Belgium (1950), Germany (1950), France (1950), Italy (1950)
 - Luxembourg (1950), Netherlands (1950), Denmark (1973)
 - Ireland (1973), United Kingdom (1973), Greece (1981)
 - Spain (1986), Portugal (1986), Austria (1995), Finland (1995)
 - Sweden (1995).

❖ **Political Structure of the EU**

- The five main institutions are:
 - 1. The European Commission (propose)
 - 2. The Council of Ministers (legislate)
 - 3. The European Council
 - 4. The European Parliament
 - 5. The Court of Justice
- The **European Commission** is responsible for proposing EU legislation, implementing it, and monitoring compliance with EU laws by member states.
- The **Council of Ministers** legislate.

❖ **The Euro**

By January 1, 1999, the European Union adopted the Euro as a common currency in the Union.

Benefits	Costs
<ul style="list-style-type: none"> • Individuals and businesses will realize significant savings from having only one currency • A common currency makes it easy to compare prices across Europe • European producers will be forced to look for ways to reduce their production costs to maintain profits • Supports the development of the pan-European capital market 	<ul style="list-style-type: none"> • The Maastricht Treaty called for establishment of an independent European Central Bank (ECB) • National authorities have lost control over monetary policy • ECB has the responsibility to set interest rates and determine monetary policies for the euro zone

❖ **NAFTA**

- **The Case FOR NAFTA**
 - Proponents argue that NAFTA should be viewed as an **opportunity to create an enlarged and more efficient productive base for the entire region.**
 - One likely effect of NAFTA will be that many U.S. and Canadian firms will move some production to Mexico to take advantage of lower labour costs.
- **The Case AGAINST NAFTA**

- Those who opposed NAFTA claimed that ratification would be followed by a mass exodus of jobs from the United States and Canada into Mexico as employers sought to profit from Mexico's lower wages and less strict environmental and labour laws.
 - The period since NAFTA took effect has had little impact on trends already in place.
 - **NAFTA: Experience So Far**
 - Research indicates that NAFTA's early impact was subtle, and both advocates and detractors may have been guilty of exaggeration
 - NAFTA is credited with helping create increased political stability in Mexico
 - Other Latin American countries would like to join NAFTA
 - ❖ **The Andean Community of Nations (ACON)**
 - **The Andean Pact:**
 - formed in 1969 using the EU model ([Bolivia](#), [Chile](#), [Ecuador](#), [Columbia](#), and [Peru](#))
 - had more or less failed by the mid-1980s
 - was re-launched in 1990, and now operates as a customs union
 - signed an agreement in 2003 with **MERCOSUR** to restart negotiations towards the creation of a free trade area
 - **Mercosur**
 - Originated in 1988 as a free trade pact between [Brazil and Argentina](#)
 - The pact was expanded in March 1990 to include [Paraguay and Uruguay](#)
 - [Venezuela](#) in July 2012 suspended on December 1, 2016
 - The five countries have a combined population of 275 million
 - ❖ **Caricom**
 - **Caribbean Community: established in 1973. Failed repeatedly and very little progress.**
 - In early 2006, six CARICOM members established the Caribbean Single Market and Economy (CSME). Modelled on the EU's single market, the goal of CSME is to lower trade barriers.
 - ❖ **ASEAN** (Association of South East Asian Nations)
 - ASEAN members are countries that do NOT include the big economies of China, Japan, and South Korea
 - ❖ **What is in this TPP?**
 - The **goal** of the TPP is **to eliminate all tariffs on goods and services** among participating countries, as well as:
 - negotiate more open government procurement
 - better intellectual property protection
 - increased regulatory coherence
 - labour and environmental rights
 - ❖ **What's good about the TPP?**
 - Open up markets in Asia for Canadian companies
 - Access to market totaling \$20 trillion, with 750 million consumers
 - Facilitates amending NAFTA, without re-opening NAFTA ([supersedes previous agreement](#)) on intellectual property, state-owned companies, government procurement
 - ❖ **What Does Economic Integration Mean For Managers?**
 - Regional economic integration
 - Most significant developments: EU and NAFTA
 - **opens new markets**
 - **allows firms to realize cost economies** by centralizing production in those locations where the mix of factor costs and skills is optimal
-

Midterm Practice Question

❖ Chapter 1

The shift toward a more integrated and interdependent world economy is referred to as

- **c) globalization**
- d) internationalization

The merging of historically distinct and separate national markets into one huge global marketplace is known as

- a) global market facilitation
- **d) the globalization of markets**

The sourcing of goods and services from around the world to take advantage of national differences in the cost and quality of factors of production is called

- a) economies of scale
- **b) the globalization of production**

Which organization is responsible for policing the world trading system?

- a) the International Monetary Fund
- b) the United Nations
- **c) the World Trade Organization**
- d) the World Bank

❖ Chapter 2

A political system that stresses the primacy of collective goals over individual goals is called

- a) individualism
- **b) collectivism**

...believe(s) that socialism can only be achieved through violent revolution and totalitarian dictatorship.

- **a) communists**

A form of government in which one person or political party exercises total control over all spheres of human life and prohibits opposing political parties is

- **c) totalitarianism**
- d) socialism

In which type of economic system are all productive activities privately owned?

- a) a mixed economy
- **d) a market economy**

Which type of law is based on tradition, precedent, and custom?

- a) civil law
- **b) common law**
- c) theocratic law
- d) contract law

Which country is not among the most corrupt countries in the world?

- a) Somalia
- **b) Australia**
- c) Uzbekistan
- d) Nigeria

Design and names by which merchants or manufacturers designate and differentiate their products are called

- **a) trademarks**
- b) copyrights
- c) patents
- d) name brands

Which is not a primary determinant of a nation's rate of economic development?

- a) its political system
- **d) its currency**

❖ Chapter 3

- Abstract ideas about what a group believes to be good, right, and desirable are called
 - a) norms
 - **b) values**
 - c) folkways
 - d) mores
- The basic social organization of a society is its
 - a) culture
 - b) social strata
 - **c) social structure**
 - d) caste system
- The group is the primary unit of social organization in
 - **a) Japan**
 - b) the United States
 - c) Switzerland
 - d) Mexico
- Which of the following is not characteristic of individualism?
 - a) individual achievement
 - **b) low managerial mobility**
 - c) low company loyalty
 - d) entrepreneurial behavior
- The most widely spoken language in the world is
 - **d) English**
- ...are the two central components of culture.
 - a) Ethics and laws
 - **b) Values and norms**
 - c) Religious beliefs and family tradition

❖ Chapter 5

- All of the following theories advocated free trade except
 - a) Mercantilism
 - b) Comparative Advantage
 - c) Absolute Advantage
 - d) Heckscher-Ohlin
- Which theory suggested that comparative advantage arises from differences in national factor endowments?
 - a) mercantilism
 - b) absolute advantage
 - c) Heckscher-Ohlin
 - d) Product life-cycle
- Which theory suggests that as products mature the optimal production location will change?
 - a) Mercantilism
 - b) Comparative Advantage
 - c) Absolute Advantage
 - d) Product life-cycle
- Economies of scale and first mover advantages are important to which trade theory?
 - a) Mercantilism
 - b) Product lifecycle
 - c) New trade theory
 - d) Comparative advantage
- Porter's diamond of competitive advantage includes all of the following except
 - a) Factor endowments
 - b) Demand conditions
 - c) First-mover advantages

- d) Firm strategy, structure, and rivalry
- ...refer to the nature of home demand for the industry's product or service.
 - a) Demand conditions
 - b) Factor endowments
 - c) Firm strategy, structure, and rivalry
 - d) Related and supporting industries
- The belief in the superiority of one's own culture is known as:
 - a) ethnocentrism
 - b) egocentrism
 - c) polycentrism
 - d) theocentricism

❖ Chapter 6

- When tariffs are levied as a fixed charge for each unit of a good imported, they are called
 - a) Specific tariffs
 - b) Ad valorem tariffs
 - c) Tariff rate quotas
 - d) Transit tariffs
- A _____ demands that some specific fraction of a good be produced domestically
 - a) subsidy
 - b) quota rent
 - c) voluntary export requirement
 - d) local content requirement
- Which of the following is not a political argument for government intervention?
 - a) protecting jobs
 - b) protecting infant industries
 - c) protecting industries deemed important for national security
 - d) protecting consumers from "dangerous" products
- What is the most common political reason for trade barriers?
 - a) To protect infant industries
 - b) Strategic trade policy
 - c) To protect jobs
 - d) To protect industries that are important for national security
- All of the following except _____ are key issues on the table at the Doha Round.
 - a) Anti-dumping policies
 - b) Protectionism in agriculture
 - c) Intellectual property rights
 - d) Infant industry protection

❖ Chapter 7

- The amount of FDI undertaken over a given time period is known as
 - a) the flow of FDI
 - b) the stock of FDI
 - c) FDI outflow
 - d) FDI inflow
- Advantages that arise from using resource endowments or assets that are tied to a particular location and that a firm finds valuable to combine with its own unique assets are
 - a) First mover advantages
 - b) Location advantages
 - c) Externalities
 - d) Proprietary advantages
- Benefits of FDI include all of the following except
 - a) The resource transfer effect
 - b) The employment effect
 - c) The balance of payments effect

- d) National sovereignty and autonomy
 - The total accumulated value of foreign-owned assets at a given time is known as
 - a) the flow of FDI
 - b) the stock of FDI
 - c) FDI outflow
 - d) FDI inflow
- ❖ Chapter 8
 - All barriers to the free flow of goods and services between member countries are removed, and a common policy toward nonmembers is established in a
 - a) Free trade area
 - b) Customs union
 - c) Common market
 - d) Economic union
 - NAFTA is an example of a(n)
 - a) Free trade area
 - b) Customs union
 - c) Common market
 - d) Economic union
 - When higher cost suppliers within the free trade area replace lower cost external suppliers
 - a) The bloc as a whole benefits
 - b) There is trade creation
 - c) There is trade diversion
 - d) External suppliers benefit
 - _ is responsible for proposing EU legislation.
 - a) Council of the European Union
 - b) European Parliament
 - c) Court of Justice
 - d) European Commission
 - In the BRICS countries, what country stands for 'S'?
 - a) South Africa
 - b) Singapore
 - c) South Korea
 - d) Sweden

Five of the Real Midterm Questions and Answers

Question 1: Besides the U.S., the other important source country for FDI today is

Answer: China

Question 2: There are four major forms of totalitarianism in the world today. These are:

Answer: Communists, theocratic, tribal, and right

Question 3: (...) set certain safety standards to which a product must adhere

Answer: Product safety laws

Question 4: A common hybrid of a quota and a tariff is known as a(n):

Answer: Tariff rate quota

Question 5: Some would argue that ... is the master of administrative trade policies

Answer: Japan