Chapter 1 Notes

- Globalization is the merging of different countries/economics, a shift towards a more integrated world economy.

- Globalization makes countries seek other manufacturing countries where the production costs are lower, which brings benefits to the consumers (lower prices) and to the firms (grows demand), but it also has downsides, as assembly workers lose jobs. But, advocates of globalization say that is good, as the increase in economic growth would generate jobs elsewhere.

- In global products, such as a German car, the process of design, component part manufacture, and final assembly are located in different parts of the world. So, the company is the quality assurance platform.

- The world is becoming “flat”, as Thomas Friedman said. People in developed countries are not always at an advantage, and enterprising individuals in developing countries have the same, and even better, opportunities

- Globalization of markets refers to the merging of historically distinct and separate national markets into one huge global marketplace. A huge company that offers the same product worldwide helps create a global market, it doesn't have to be a giant like Apple and others.

- National Differences like consumer preferences and tastes requires companies to customize marketing strategies, features and operating practices. The most global of markets are the ones of commodities, like fuel and wheat

- Globalization of production: Firms source goods and services from locations around the globe to capitalize on national differences in the cost and quality of factors of production like land, labor, energy and capital. This allows them to compete more effectively, by providing better quality or lower overall costs. Example of time zone differences in India and US, for MRI scans.

- General Agreement onTariffs and Trade (GATT) is one of the many institutions that help global institutions perform their functions. GATT is responsible for policing the world trading system and to make sure that nations are following the trade treaties and rules.

- The International Monetary Fund (IMF) was established to maintain order in the international monetary system. It also lends money to troubled countries, in return, it requires countries to adopt specific economic policies.

- The World Bank was set up to promote economic development, by focusing on making low-interest loans to cash strapped governments in poor nations that were to undertake significant infrastructure investments.
- The Group of Twenty(G20) comprises the finance ministers and central bank governors of the 19 largest economies in the word + representatives from EU and European Central bank (ECB)

- The UN, United Nations, was related to preserving international peace and security. Its 4 purposes are to maintain international peace and security, develop friendly relations among countries, and cooperate in solving international problems/promoting respect. And to be the center for harmonizing the actions of nations.

- The international trade barriers are,in most cases, in the form of high tariffs on imported goods. Trade barriers are used to protect jobs and the overall situation at home.

- Globalization of production: Firms source goods and services from location around the globe to capitalize on national differences in the cost and quality of factors of production like land, labor, energy and capital

Role of technological change.

→ The lowering of trade barriers and globalization of markets and production is a theoretical possibility, and technology has a huge impact on that;The advancements on communication, information processing, and transportation technology (containerization for example). Moore's Law states that the power of microprocessor technology doubles and the cost of production is cut in half every 18 months.

→ The implications of that for the globalization of production. Due to the tech innovations, the real costs of info processing and communication fell a lot, making it possible for a firm to create and manage a globally dispersed production system. It helped outsourcing service operations to cheaper areas.

→ The implications of that for the globalization of markets. The cheaper shipping and lower cost for communications creates a form of convergence of consumer tastes and preferences.

Globalization caused dramatic changes in demographics of the world economy. Before, the US was the major economy, had the most influence from multinational companies, had the most FDI and the communist countries were off-limits to Western International Businesses.

Problems with Globalization

The main issues are:

- Job losses in industries under attack from foreign competitors, which also decreases income
- Downward pressure on the wage rates of unskilled workers
- Environmental Degradation
- Cultural imperialism of global media and multinational enterprises → countries try to make others like them
- National Sovereignty - WTO and UN type of organizations have the most power
- Globalization increases the gap between rich and poor

Globalization and National Sovereignty

A concern with globalization is that the increasingly interdependent global economy shifts global economic power away from national government, and toward supranational organizations such as the World Trade Organization (WTO) and the UN. So, it is up to these organizations to decide whether people in California can have carcinogenic pesticides banned from their food.
A poor country scenario. Considering a country part of the HIPCs (Highly Indebted Poor Countries), the average government debt burden had been as high as 85 percent of the valley of the economy. This means that even after the WTO's help, the country doesn't not have enough to invest in projects such as education, public infrastructure, health care, etc. This holds the country in a cycle of poverty, with a possible solution, but not solely enough, being free trade.

Managing in the Global Marketplace

→ Differences among countries require that IB practices ary country by country. Managers in IB must not only be sensitive to all the differences, but must adopt the appropriate policies and strategies for coping with them. Differences include marketing, different managing workers skills, difference in maintaining relationships, etc.

→ Managers must also know where,why and when to invest in different areas of the world, in order to minimize costs and maximize revenue. Understanding the rules and norms of each country is essential, government restrictions, etc. Finally, it is important to know that businesses that depend upon international trade face risks from low probability "Black Swan" events, such as wars and terrorism.

→ So, managing in IB differs in these at least 4 reasons:

1. Countries are different

2. The range of problems in IB is much wider and complex than those in a domestic business
3. An IB must find ways to effectively work within the limits imposed by government interventions
4. International transactions involve converting money into different currencies, which forces managers to know how and when to do so.

Chapter 2 Notes

Countries' differences have a profit impact on the benefits, costs, and risks associated with doing business in different countries. They way operations should be managed, strategies, etc. A country;s attractiveness is influenced by the political systems.

Political system is the system of government in a nation. It is assessed by two dimensions:

1. The degree to which they emphasize collectivism vs individualism
2. Democratic vs Totalitarian

Systems that emphasize collectivism tend to lean to totalitarianism, and high value on individualism tends to be more democratic. Regardless, these are not rules, and there can be a democratic society that emphasizes both collectivism and individualism.

Political economy is an economy where the political, economic and legal systems are interdependent, interacting and influencing each other, which affects the level of economic well-being.

Collectivism is a political system that stresses the primacy of collective goals over individual goals. Society's need > individuals' need. So, it is possible that someone's right to do something may be restricted as it is not beneficial for the good of society.

Socialism traces to Karl Max, who argued that in a capitalist society, where individual freedoms are not restricted, few benefit at the expense of many. According to him, the pay of workers does not reflect the value of their work. Socialism advocates state ownership of the means of production, so that the workers are fully compensated. This term splits into two broad camps:

1. Communists: ones who believe that a violent revolution, totalitarian dictatorship are necessary to achieve socialism.
2. Social Democrats: achieving socialism by democratic means

In many countries, experience demonstrated that state ownership of the means of production was not beneficial for the society as a whole, as the companies were protected and had guaranteed financial support.

Individualism (Opposite of Socialism) is a philosophy (by Aristotle) that an individual should have freedom in economic and political pursuits. Interest of individual > Interest of Society. He claimed that communal property receives little care, whereas property that is owned by an individual will receive the greatest care and therefore be the most productive. Individualism is built on central aspects:

1. Emphasis on the importance of guartenting individual freedom and self-expression.
2. The well-being of society is best served by letting people pursue their own economic self interest

Democracy is a political system in which government is by the people, either directly or through representative elections. It is based on the belief that citizens should be directly involved in decision making. Society elects, periodically, someone to represent them, and whose function is to make decisions on behalf of its supporters. Safeguards to guarantee that elected representatives can be held accountable for their actions exist, these include:

- Right to freedom of expression, opinion, and organization
- Free media
- Regular elections where all citizens can vote
- Universal adult suffrage
- Limited terms for elected representative
- Fair court system, independent from the political system
- Non Political state bureaucracy
- Relative free access to state information

Totalitarianism is a system where one person/political party exercises absolute control over all spheres of human life and prohibits opposing political parties. Rights to freedom of expression and organization, free media and regular elections are denied to citizens. There are 4 main:

1. **Communist Totalitarianism:** states that deny basic civil liberties to the population.
2. **Theocratic Totalitarianism:** states where political power is monopolized by a party, group or individual that governs according to religious principles. There is a limit on freedom of political and religious expression.
3. **Tribal Totalitarianism:** Political party that represents the interest of a particular tribe and has the power monopolized.
4. **Right-wing Totalitarianism**: It permits some individual economic freedom, but limits individual political freedom. It is common to have an overt hostility to socialist and/or communist ideas. Usually backed by the military, and in some cases, the government is formed by military officers.

Pseudo-Democracies are between pure democracies and totalitarian systems. They have authoritarian elements that capture some or much of the machinery of the state, and use it to try and deny basic political and civil liberties. Russia

Legal systems are the set of a country's rules and laws that regulate behavior and processes by which laws are enforced. This defines the business practices, and it is influenced by the political system. Different legal systems:

1. Common Law: it's based on tradition, precedent and custom. Tradition refers to a country's legal history, precedent refers to cases that have come before the courts in the past, and custom to the ways the laws are applied in specific cases. Judges in common law have the power to interpret the law and apply it based on the needs of that specific situation.

2. Civil Law: based on a detailed set of laws organized into codes.Tends to be less adversarial than the common law system, as the judges rely on detailed legal codes, and have less flexibility and only have the power to apply the law, not interpret it.

3. Theocratic Law: the law is based on religious teachings. Like Islamic law, where the foundation of the law is based on the Quran and Sunnah. Also, because these are holy documents, the laws cannot be changed.

Difference between common law and civil law. This can be illustrated by each one's approach to contract law (body of law that governs contract enforcement). In common law, these contracts tend to be very detailed and specific. In civil law, contracts are shorter and less specific, as many of the issues are already covered in a civil code. Because of this, in IB, when there is a contract dispute, there is always a question of which country's laws to apply.

So, there's the UN Convention on Contracts for the International Sale of Goods (CISG), that established a set of rules governing certain aspects of the making and performance of everyday commercial contracts between international sellers and buyers. The CISG automatically applies to all international contracts of people in countries that ratified the convention. If a company doesn't want to accept the CISG, they can opt for arbitration by a recognized arbitration court to settle the contract dispute.

Property rights are the 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. Stronger property rights are needed for companies to protect their innovations, but it can be violated by both private action and public action.

- Private Action refers to theft, privacy, blackmail, etc. This occurs in every country but much more in a place with weak property rights. Russia's rich people "protect money".

- Public Action and Corruption refers to public officials extorting income, resources, or the property itself from property holders. This can be done by both legal and illegal means (Ex: excessive taxation vs demanding bribes for the operation).

Corruption. In some countries, they try to minimize it through the rule of law. In others, is it so endemic that politics and bureaucracy regard it as a perk of office. Transparency International is a non-profit that is dedicated to exposing and fighting corruption, by measuring the level of corruption among public officials internationally.
→ High corruption = Lower FD, international trade and economic growth rate

Foreign Corrupt Practices Act (FCPA) makes it illegal to bribe a foreign government official to obtain or maintain business, and requires publicly traded companies to keep detailed records. But, this allows exceptions for facilitating and/or expediting payments, that could help securing or speeding up a routine governmental action.

Intellectual property is the one that is the product of intellectual activity, such as software. Patents, copyrights, and trademarks establish ownership rights. A patent grants exclusivity. Copyrights are the exclusive legal rights to publish/disperse the work as they see fit. Trademarks are designs/names officially registered by which products are identified. Protecting intellectual property is important to reward the inventor, which stimulates innovation and creative work.

→ Although 192 countries signed the Intellectual Property Organization, the enforcement of these are often lax. Weak enforcement encourages piracy. IB businesses must have responses to violations of it, through lobbying their respective government to push for international agreements that ensure protection.

Trade-Related Aspects of Intellectual Property Rights (TRIPS), 1995, is to oversee stricter intellectual property regulations, and oblige WTO members to grant patents lasting at least 20 years, and copyrights lasting 50 years after the creator's death.

Product safety laws set safety standards to which a product must adhere. Product Liability involves holding a firm and its officers responsible when a product causes injury, death or damage. It can be much greater if a product is not within required safety standards, which could lead to civil laws calling for payments and monetary damages.

<u>Chapter 3 Notes</u>

Different countries have different levels of economic development

Gross National Income (GNI) per capita measures economic development through income per head of population, but it doesn't consider differences in the costs of living.

Purchase Power Parity (PPP) is used to compare the differences in costs of living, so that GMO can be adjusted.

Black Shadow economies are used to avoid taxes. Transactions are made in the form of unrecorded cash or barter agreements.

Amartya Sen, the nobel prize economist, argues that development should be asset by less material output measures (like GNI, and etc), and more by capabilities and opportunities enjoyed by people. Not only economic progress, but also political progress. People cannot develop their capabilities if they are chronically ill or ignorant/dumb.

Human Development Index (HDI) measures the quality of life in different nations. It measures 3 aspects:

1. Life expectancy at birth
2. Education attainment
3. Is average income sufficient for basic needs?

Innovation and entrepreneurship help increase economic activity by creating new products//markets. But, **what is necessary for there to be innovation and entrepreneurship?**

1. **Economic Freedom and Market Economies.**
   → Anyone with a great idea is free to try and make money with a new business.

Economic Freedom vs Economic Growth: countries with higher economic freedom, between 1975-1995, experienced high economic growth, meaning richer citizens.

2. **Strong Property Rights**
   → Without strong property rights, businesses and individuals are exposed to high risks of being expropriated by criminals and/or the state. De Soto says that much of the developing world will fail until property rights are defined and protected. This is because no determined lands means no turning assets into capital, so there's no bank loans, furthermore, no development.
3. **Democracy**
   → Countries with totalitarian governments may experience growth, but the majority see the leaders using national and "public" resources for personal gains. Consequences of progress include South Korea and Taiwan.
4. **Geography**

→ A country in the coastal areas is more likely to engage in international trade, which helps increase economic growth. Countries with adverse geographical conditions may have lower levels of economic growth. These include poor soil, high rate of disasters, and etc,

5. **Education**
→ Investment in education jae positive and statistically significant impact on economic growth. A more educated population is a more productive ones, such as South Korea (96% educated) vs Taiwan (<30%)
6. **Demographics**
→ A country with a younger and growing population has better potential than one with an aging population. A growing/rising population means a growing labor force. Also, younger people consume more than old people, which increases demand for consumption goods. Older people mean higher costs for the government, in the forms of SSN, health etc. A possible solution is to increase immigration.

Spread of Democracy is the spread of democratic political institutions worldwide, and happened for 3 main reasons. The first is that several totalitarian regimes failed to deliver economic progress to the majority of the population, as with the failing economic success, the population noticed that the strongest economies were representative democracies. The second reason is new information and technology (+ communication), as the population gets access to more uncensored information. The third reason is the increasingly prosperous middle east, where minimally educated people are able to understand the circumstances and push for democratic reforms.

Spread of Market Based Systems is the transformation from centrally-planned command economies to a market based economy. This happened because of the failure to deliver the kind of sustained economic performance achieved by market based systems. This shift includes several steps:
1. **Deregulation**. Removing legal restriction to the free play markets, the establishment of private enterprises, and the manner in which these private enterprises operate. This includes removing price controls, by letting Demand and supply decide price, the abolishment of regulatory operating laws on private companies, and relaxing/removing restrictions on FDI and international trade.
2. **Privatization**. Transferring the ownership of state property to private individuals stimulates economic growth, as entrepreneurship creates new products/markets. For it to work, this must be accompanied by a more general deregulation and opening of the economy. Subsidies for “recent private organizations” are also helpful
3. **Legal Systems**. Without a legal system that protects property rights, and without the machinery to enforce that. The incentive to engage in economic activity by private

entities can be hella reduced, as there is risk of organized crime and the government taking the profits generated by the efforts of private-sector entrepreneurs

The overall attractiveness of doing IB. A country's overall attractiveness as a market/investment site depends on balancing the likelihood of the long-term benefits, costs and risks. It is a function of the free market systems and the country's capacity for growth. Here:

1. **Benefits**. These depend on the size of the market, the present wealth (purchase power), and the likely future purchasing power. An early entrance in such a market could mean greater brand loyalty and greater experience on the business practices. A late entrance means there might be a lack of brand loyalty and experience.

2. **Costs**. These are determined by a series of policial, economic and legal factors. Doing business in underdeveloped countries could mean a need to self provide the infrastructure and resources necessary.
3. **Risks**. These are determined by a series of policial, economic and legal factors. Political risk is the risk of changes caused by political factors that affect profits and goods of the enterprise. Economic risk is the risk that economic mismanagement will cause changes in the business environment, hurting profits and goods. Legal risk is the risk a having a business partner break contract, opportunistically, or expropriate property rights, as a consequence of weak legal system

Chapter 4 Notes

Pg 98-103
Edward Tylor definition of culture is a "complex whole which includes knowledge, belief, art, morals, law, custom, and other capabilities acquired by man as a member of society.

Geert Hofstede defined culture as " the collective programming of the mind which distinguishes the members of one human group from another. Includes a system of values, and values are among the building blocks of culture. "

Culture is a system of values and norms that are shared among a group of people and that when taken together constitute a design for living. Values are ideas about the belief in what is good, right and desirable. Norms are social rules and guidelines. Society refers to a group of people who share the same set of sets and norms.

Norms can be split into Folkways vs Mores. **Folkways** are the routine conventions of everyday life, the actions of little moral significance that define how people are expected to behave. The evolution of norms now demand that business partners at least try to behave according to the country’s folkways when doing business. **<u>Mores</u>** are the norms that are more widely observed, have greater moral significance, and are central to the function of a society and its social life. Often, these are so important that they become laws, such as laws against theft, adultery, incest, and cannibalism.

Nation-states are political creations, and may contain a single culture or several subcultures. Because of this, many IB scholars argue, in a cultural argument, that multinational companies should not target countries in strategic approaches, but instead should focus on dividing the world’s 195 countries into like-minded and culturally similar business regions.

Pg 119-219
Spoken language. Counties may speak more than one language, therefore, having more than one culture. The language of a society can direct the attention of its members to certain features, rather than others.

Unspoken Language refers ot nonverbal communication and personal space, which are culturally influenced.

Culture and Business. How a society’s culture affects the values found in the workplace are important for corporations. Hofstede measured this by spleen culture in 4 dimensions he believed summarized the different cultures. The scores range from 0-100

1. **Power distance**: focuses on how a society deals with the fact that people are unequal in physical and intellectual capabilities.
2. **Uncertainty avoidance**: measures the extent to which different cultures socialized their member into accepting the ambiguous situations and tolerating uncertainty
3. **Individualism vs collectivism**: focuses on the relationship between the individual and their fellows.
4. **Masculinity vs femininity**: focuses on the relationship between gender and work roles.
5. **Long-term vs short-term orientation**: focuses on the extent to which a culture programs its citizens to accept delayed gratification of their material, social, and emotional needs. This captures attitudes towards time, persistence, protection of face, respect for tradition, and reciprocation of gifts and favors.

→ **Critics of Hofstede research** argue that Hofstede assumes there is a one-to-one correspondence between culture and the nation-state, but many countries have more than one culture. Another argument is that the research may have been culturally bound, as the questions and answers were made by only Europeans and Americans, which may have shaped the analysis of the answers based on their own cultural biases and concerns.

Cultural Literacy and Competitive Advantage. Societies differ because their cultures vary, due to the social structure, religion, language, education, economic philosophy, and political philosophy. There are 3 implications for IB than flow from these differences:

1. **Need to develop Cross Cultural Literacy**. Understanding the cultural differences is important, but understanding what the differences mean for IB is essential.
2. **Connection between culture and national competitive advantage**
3. **Connection between culture and ethics in decision making.**

Cross cultural literacy is the cultural differences across/within counties that affect the way of doing business. Doing business internationally requires adaptation to conform to the vaye systems and norms of that culture. Being ill-informed is a danger for first timers in IB. For example, Russia vs USA: the difference in accepting hierarchy.

Culture and Competitive Advantage. The value system and norms of a country influence the costs of doing business, affecting the ability of firms to establish a competitive advantage. This is important for 2 reasons:

1. The connection suggests which countries are likely to produce the most viable competitors.
2. The connection has important implications for the choice of countries in which to locate production facilities and do business. For example, the lack of a good education system can hold back attainment of business goals.

→ Overall, cultural differences are significant, but its importance should not be overemphasized in the economic sphere.

Chapter 5 Notes

Ethics refers to accepted principles or right/wrong that governor the conduct of a person, the members of profession, or the actions of an organization

Business Ethics are the accepted principles of right or wrong governing the conduct of business people.

Ethical Strategy is one that doesn't violate ethics or business ethics.

Ethical Dilemma are situations in which none of the available alternatives seems ethically acceptable. From an IB perspective, some argue that it is ethical depending on one's cultural perspective. Example, the USA executed murderers, others think it's an affront to human dignity. Example of the Chinese girl working (6 year brother , orphan, only breadwinner for them).

7 actions IB and its managers can take to make sure ethical issues are considered in business decisions.

1. **Hiring and Promotion.** Hiring and promoting people with a well-grounded sense of personal ethics. Businesses can give potential employees psychological tests to try and discern their ethical predispositions, they can also check with prior employers.
2. **Organizational Culture and Leadership**. Build an organizational culture and exemplify leadership behaviors that place a high value on ethical behavior. 3 things are important. First, the business must explicitly articulate values that emphasize ethical behavior, specifically through a code of ethics. Secondly, leaders must give life and meaning to that, by emphasizing importance and acting on them. Thirdly, incentives and rewards system, including promotion for ethical behavior and sanctioning those who are unethical.
3. **Decision-Making Processes**. Put decision making processes in place that require people to consider the ethical dimension of business decisions.
4. **Ethics Officers**. Institute ethics officer in the organization, who will be responsible for managing organization's ethics and legal complicate programs
5. **Moral Courage**. Develop Moral Courage, which enables managers to walk away from a decision that is profitable but unethical. Moral courage gives power for a worker to say no to a boss that instructed unethical actions.
6. **Corporate Social responsibility (CSR**). Make this a cornerstone of enterprise policy. CSR refers to the idea that businesspeople should consider the social consequences of economic actions when making business decisions, and that should be a presumption in favor of decisions that have both good economic and social consequences. Example of PB, oil company, building pure water sources for a community in Algeria.
7. **Sustainability**. Pursue strategies that are sustainable. These are strategies that help the firm make good profits without harming the environment, while also making sure that the firm's acts are socially responsible in regard to its stakeholders. "An organization, through its actions, should not have a negative impact on the ability of future generations to meet their own economic needs.

Chapter 6 Notes

Mercantilism advocated that countries should simultaneously encourage exports and discourage imports. Adam smith attacks the idea of mercantilism, as countries differ in their ability to efficiently produce goods.

Theory of Absolute Advantage, by Adam Smith, explains why free trade is beneficial to a country. Free trade is when the government doesn;t try to influence what citizens can buy from another country, or what they could produce and sell to another country. Smith argues that the invisible hand should determine a country's imports and exports.

Benefits of Trade. Common sense suggests that some international trade is beneficial. Smith and Ricado tell us that a country's economy may gain if the citizens buy certain national products and certain international ones. This is because international trade allows a country to specialize in the production of something that can be most efficiently produced, while importing the other goods like this. A key insight of international trade theory is that limits on imports are often in the interest of domestic producers, but not consumers.

Pattern of International Trade. The reason why a country exports X and imports Y is explained in terms of international differences in labor productivity. **Life-cycle theory** says that most new products are produced and exported from the country of development, but once it becomes popular, production starts in other countries. As a result, the product may ultimately be exported back to the original country. **New trade theory** suggests that in some cases, countries specialize in the production and export of certain products because in certain industries, the world market can support only a limited number of firms (So, early firms = strong competitive advantage).

Absolute Advantage. A country has an absolute advantage in the production of a product when it is more efficient than any other country at producing it, so they should specialize in the production of it.
Comparative Advantage. A country has comparative advantage when it can produce a good at a lower opportunity cost, not necessarily at a greater volume or quality. So, the country should specialize in the production of the goods it produces most efficiently, and import the others. The message of this concept is that potential world production is greater with unrestricted free trade than it is with restricted trade.

→ Using both absolute and comparative advantage, two countries in a trade can benefit at the same time. By importing products that would be inefficient to produce domestically, and exporting your efficient products.

Immobile Resources. Resources cannot always be easily shifted, like going from producing cocoa in Ghana, to producing rice on that same soil.

Diminishing Returns to specialization are when more units of resources are required to produce each additional unit . Having constant returns to specialization means that, regardless of where in the PPF the country is, the resources required to produce a good will remain constant. It is more realistic to assume diminishing returns because (1)not all resources are of the same quality, meaning that it could require more resources to produce an equal increase in output. (2) Because different goods use resources in different proportions. Like growing cocoa and rice, you can get more rice than cocoa in the same size of farm.

Opening an economy to trade is likely to generate dynamic gains of two sorts:

1. Free trade might increase the stock of resources and increase supplies of labor and capital from abroad become available to use domestically.
2. Free trade might also increase the efficiency of using the resources, it might be better technology that can increase labor productivity or even the land's productivity.

→ So, dynamic gains are a country's resources and efficiency of using resources will cause the PPF to shift outward, meaning the country can produce more than before free trade.

The Samuelson Critique looks at what happens when a rich country enters into a free trade agreement with a poor country that rapidly improved its productivity after the free trade regime. The rapid rise of the poor country could mean large adjustment costs, that in the short run, can significantly reduce gains from trade.

Trade and Growth Relationship. Countries that are more open to international trade enjoy higher growth rates than those who are less open/closed. "Adopt an open economy and embrace free trade, and your nation will be rewarded with higher economic growth rates., which will raise income levels and living standards.

Heckscher-Ohlin theory argues that comparative advantage arises from differences in national factor endowments. Factor endowment is the extent to which a country is endowed("born") with such resources as land, labor and capital. This theory predicts that countries will export goods that make intensive use of factors that are abundant, while importing goods that make intensive use of factors that are locally scarce. So, the pattern of international trade is determined by differences in factor endowments, rather than productivity differences.

The Leontief Paradox is a theory that claimed that because the US had abundant capital, compared to others, it would be an exporter of capital-intensive goods and an importer of labor-intensive goods, but this claim was wrong. The US exports were less intensive than US imports, and because of this variance with the prediction, it got known as the Leontief Paradox.

The Product Life-Cycle Theory says that just because a new product is developed in the US, by a US firm, it doesn't mean that it must be produced in the US. In the beginning of a product, only high-income people in other countries will have access to it, but once the product starts growing, it becomes worthwhile for foreign producers to begin manufacturing in those countries where demand is growing. So, the US would shift from being the exporter of that product, to being the importer, as production will be concentrated in lower-cost foreign locations.

The New Trade Theory. Economies of scale are unit cost reduction associated with a large scale of output. This theory makes two important points: (1) though its impact on economies of scale, trade can increase the variable of goods available ad decrease the average costs, (2) in the industries where the required output to attain economies of scale represent a significant proportion of total world demand, the global market may be able to support only a small number of enterprises. This means that world trade in certain products may be dominated by countries whose firms were first movers in their production.

New trade theory has important implications. The theory suggests that nations may benefit from trade even when they do not differ in resource endowments or technology. Trade allows a nation to specialize in the production of certain products, attaining scale economies and lowering the costs of producing those products, while buying products that it does not produce from other nations that specialize in the production of other products. By this mechanism, the variety of products available to consumers in each nation is increased, while the average costs of those products should fall, as should their price, freeing resources to produce other goods and services.

First-Mover Advantages are the economic and strategic advantages that accrue to early entrants into an industry. The ability to capture scale economies ahead of later entrants, benefiting from lower cost structure, is essential.

Implications of New Trade Theory. It generates government intervention and strategic trade policy. Through the use of subsidies, a government could increase the chances of its domestic firms becoming first movers in newly emerging industries? The theory suggests this might be possible, if it is, there is an economic rationale for a proactive trade policy that is at variance with free trade prescriptions of the trade theories we have reviewed so far.

Porter's theory says that the degree to which a nation is likely to achieve international success in an industry is a function of the combined impact of: factor endowment, domestic demand conditions, related and supporting industries, and domestic rivalry. The presence of these four components is required for the "diamond" to boost competitive performance. Government can influence each one of the components, through subsidies, regulations, and policies. If the model is correct, countries should be exporting products from those industries where all four components are favorable, while importing in those areas where they are not favorable.

There are 4 main implications:

1. **Location Implications**. If something can be performed most efficiently in the US, the facilities should be located there. If this doesn't happen, the firm may find itself at a competitive disadvantage relative to competitors.

2. **First Mover Implications**. Being early to a new market means a possible subsequent dominance of global trade for that product.
3. **Government Policy Implications**. It is in the best interest of a business to invest in upgrading advanced factors of production and to increase its commitment to research and development. Also, it is in their best interest to lobby governments to adopt policies that have a favorable impact on each component of the national “diamond”
4. **Implications for business investment and enterprise strategy changes that flow from government policy**. Changes in trade policy can create uncertainty about the future, which raises the risks of cross-border events to support international trade. When this happens, businesses usually do 3 things. (1) Reduce in basement risky projects, (2) hedge their bets, through source components from several locations and increase domestic production(even if it raises costs, (3) counteract all of this, by lobbying the government to encourage them to resolve disputes and create a more stable and predictable environment.

Chapter 7 Notes

The trade theories of Smith, Ricardo and Heckscher-Ohlin showed that in a world without trade barriers, the trade patterns are determined by the relative productivity of different factors of production in different countries.

Political reality of international trade is that although many nations are nominally committed to free trade, they tend to intervene in international trade to protect interests of politically important groups or promote the interests of key domestic producers, by using a range of policy instruments.

7 Main Instruments of Trade Policies

1. **Tariffs**

→ Tariffs are the oldest and simplest instrument of trade policy. There are **specific tariffs**, levied as a fix4ed charge for each unit of a good imported, and Ad Valorem **tariffs** that are levied as a proportion of the value.

→ In most cases, tariffs are used to protect domestic producers from foreign competition by raising the price of imported goods, but they also serve to produce revenue for the government. Import tariffs are paid by the importer, and vice versa with export tariffs.

→ (1)Tariffs are pro-producer and consumer. (2) Import Tariffs reduce the overall efficiency of the world economy, as it encourages the domestic production of goods that would be more efficiently produced abroad (inefficient utilization of resources)

→ **Export tariffs** have two objectives: (1)raise revenue for the government, (2) reduce exports from a sector, often for political reasons.

2. **Subsidies**
   → Subsidies are government payments to domestic producers. They have many forms, such as cash grants, low interest loans, tax breaks, and government equity participation in domestic firms.

→ By lowering production costs, it helps domestic producers in two ways: (1) competing against foreign imports, and (2) gaining export markets.

→ Subsidies can help a firm achieve a first-mover advantage in an emerging industry, which would bring gains to the domestic economy that arise from employment and tax revenue of a company.

3. **Import Quota**
   → Import Quota is a direct restriction of the quantity of some goods that may be imported into a country, and it is usually enforced by issuing import licenses to groups/individuals/firms.
   → **Tariff rate quota** is a lower tariff rate applied to imports within the quota and those over the quota. A variant on import quotas is the **voluntary export restraint (VER)**, that is a quota on trade composed by the exporting country, typically at request of the importing country's government.
   → Both import quotas and VERs benefit domestic producers by limiting import competition, but do not benefit consumers. Quota rent is the extra profit to producers when supply is artificially limited by an important quota called quota rent. If a domestic country can't meet the demand, an import quota can raise prices of both domestically produced and imported goods.

4. **Export Tariffs and Bans**

→ Export tariffs is a tax placed on the export of a good, and the goal is to discriminate against exporting in order to ensure that there is sufficient supply of a good within a country.

→ Export ban is a policy that restricts the export of a good (partially or entirely). This is a way of ensuring sufficient supply at home, thereby helping to keep the domestic price down and boost national security.

5. **Local Content Requirements (LCR)**
   → LCR is a requirement that some specific fraction of a good be produced domestically, and can be expressed in either physical or value terms. These are widely used by developing countries to shift their manufacturing base from the assembly of products whose parts are produced elsewhere. They are also used in developed countries to protect local jobs and industry from foreign competition.
   → LCR regulations provide protection for domestic producers of parts in the same way an import quota does, by limiting foreign competition. So, domestic producers benefit,

but consumers have to pay higher prices for the imported components. Concluding, these tend to benefit producers and not consumers.

6. **Administrative Policies**
   → Administrative trade policies are bureaucratic rules designed to make it difficult for imports to enter a country.

7. **Antidumping Policies**
   → Antidumping policies, also called **countervailing duties**, are designed to punish foreign firms that engage in dumping. The objective is to protect domestic producers from unfair foreign competition.

Government intervention can take two paths:

1. **Political**: this type of arguments for intervention are concerned with both protection in the interest of certain groups within a nation, often at the expense of other groups, and/or achieving political objectives that lie outside the sphere of economic relationships, such as protecting the environment/human rights.
2. **Economic**: this type of argument is typically concerned with boosting the overall wealth of a nation, benefiting both producers and consumers.
   Political arguments for intervention cover a range of issues:
   - **Protecting jobs and industries**: Competition is often viewed as unfair when foreign exporting producers are subsidized in some way by their government.
   - **Protecting National Security**: countries argue that it is necessary to protect certain industries because they are important for national security.
   - **Retaliating**: some argue that the government should use threats to intervene in trade policies as a bargaining tool to help open foreign markets and force trading partners to play by the rules. If this works, it may liberalize trade and bring with it economic gains.
   - **Protecting Consumers**: the indirect effect trade policies is often to limit or ban the importation of such goods,
   - **Furthering Foreign Policy Objectives**: governments often use trade policies to support their foreign policy objectives, for example by granting preferential trade terms to a country with which it wants to build strong relations. It can also be used to pressure/punish “rogue states” that do not abide by international law or norms.
   - **Protecting Human Rights**: governments sometimes use trade policies to improve the human rights policies of trading patterns.

Economic arguments for international:

- **The Infant Industry Argument**: according to this argument, many developing countries have a potential comparative advantage in manufacturing, but new manufacturing industries cannot initially compete with established industries in developed countries. So, the argument is that governments should temporarily support new industries until they have grown strong enough to meet international competition.

  → critics of this argument say that (1)protection of manufacturing from foreign competition does no good unless the protection helps make the industry efficient. They also say that (2) the infant industry argument relies on an assumption that firms are unable to make efficient long-term investments by borrowing money from the domestic or international capital market, which makes the government subsidize long-term investments.
- **Strategic Trade policy**: The new trade theory argues that in industries where the existence of substantial economies of scale implies that the world market will profitably support only a few firms, counties may predominate in the export of certain products simply because they have firms that were able to capture first-mover advantages. This argument has two components:
  1. It is argued that by appropriate actions, a government can help raise national income if it can somehow ensure that the firm/firms that gain first-mover advantages in an industry are domestic rather than foreign firms.
  2. It might pay a government to intervene in an industry by helping domestic firms overcome the barriers to entry created by foreign firms that already have all the first-mover advantages.

→ if these arguments are correct, they support a rationale for government intervention in international trade. Governments should target technologies that may be important in the future, and use subsidies to support development work aimed at commercializing those technologies. Furthermore, government should provide export subsidies

Retaliation and Trade war. Krugman argues that a strategic trade policy aimed at establishing domestic firms in a dominant position in a global industry is pretty much a policy that boosts national income at the expense of other countries. Therefore, it may provoke retaliation that can result in a trade war that can leave both countries worse than before.

→ He says that then, the correct way to respond to such actions would be by helping establish rules of the game that minimize the use of trade-distorting subsidies.

Development of the World Trading System. The essence of the argument that supports unrestricted free trade is valuable, but the main problem between two countries deciding whether to lower trade barriers or not is the lack of trust, as both countries recognize the mutual benefits, but one government is scared of lowering barriers and the other not. In order to solve this, they can negotiate a set of rules and have it monitored by an independent body that will serve as a referee to monitor trade, make sure there are no side cheats, and impose sanctions on a country if it cheats.

The Smoot-Hawley Act. This act was aimed at avoiding rising unemployment by protecting domestic industries and diverting consumer demand away from foreign products. The act erected a normal wall of trade barriers, and almost every industry was rewarded with its “made-to-order” tariff. Overall, the act had a damaging effect on employment abroad, as other countries reacted by raising their own tariff barriers.

1980-1993 Protectionist Trends. In this period, the trading system erected by GATT came under strain as pressures for greater protectionism increased around the world. There were 3 reasons for this:

1. The economic success of Japan during that time strained the world trading system, through its automobile and semiconductors industries, and things were made worse by the West's perception that despite the low tariff rates and subsidies, Japanese markets were closed to imports and foreign investment by administrative trade barriers.
2. The world trading system was strained by the persistent trade deficit in the world’s largest economy, the US. This forced the US to include painful adjustment in industries such as automobiles, machine tools, and other industries where domestic producers steadily lost market share to foreign competitors. This resulted in unemployment, which forced the Congress to protect against imports.
3. Many countries found ways to get around GATT regulations. The bilateral voluntary export restraints (VERs) bypassed GATT agreements, as neither the importing or exporting countries complained to the GATT, so it could do nothing. The exporting countries agreed to VErs to avoid more damaging punitive tariffs.

The Uruguay Round. This was a round of negotiation to reduce tariffs. In the Uruguay round, member countries sought to extend GATT rules to cover trade in services, and also sought to write rules governing the protection of intellectual property, to reduce agricultural subsidies, and to strengthen the GATT’s monitoring and enforcement mechanisms. This contained several provisions and created the World Trade Organization(WTO) to be implemented to the GATT agreement.

The World Trade Organization (WTO). WTO acts as an umbrella organization that encompasses the GATT along with two bodies, one one services and the other on intellectual property. The organization is responsible for arbitrating trade disputes and monitoring trade policies of member countries.

WTO: Experience to date. By 2020, there were 164 members, and it is the foreign of efforts to promote global free trade. The hope was that WTO would emerge as an effective advocate and facilitator of future trade deals, particularly in areas such as services, but this was not quite correct. There has been slow progress with the current round of trade talks, and there was also a shift back toward some limited protection following the global financial crisis of 2008-2009.

Important Issues to the WTO include:

- **Controlling Antidumping actions**
- **Protectionism in Agriculture**
- **Protection of Intellectual Property**
- **Market Access for Non Agricultural Goods and Services**: the goal is to bring down tariff rates on imports of nonagricultural goods in developing nations, as there are the ones who usually have high tariff rates, and use the infant industry argument to justify their conceited imposition of high tariffs (reduce the scope for the selective use of high tariff rates, aiming substantial gains).

Doha rounds of talk. It was a 2001 round of talk launched by the WTO between member states, and aimed to further liberalize the global trade and investment framework. The agenda includes cutting tariffs on industrial goods and services, phasing out subsidies to agricultural producers, reducing barriers to cross-border investment, and limiting the use of antidumping laws. As of 2018, the goal was to reduce tariffs for manufactured and agricultural goods by 60% to 70%, and to cut subsidies to half of their current level. But, getting countries to agree to these goals was proving exceedingly difficult.

Multilateral and Bilateral Trade Agreements. In response to the failure of the Doha round, many nations pushed forward with multilateral and bilateral trade agreements, which are reciprocal trade agreements between two or more partners. These agreements are designed to capture gain from trade beyond those agreements currently attainable under WTO treaties. Multilateral and Bilateral Trade Agreements are under the WTO rules, and countries entering into these are required to notify the WTO.

The World Trade System Under Threat. In 2016, both the British withdrawal from the EU and Trump's election were events that challenged the global idea to embrace free trade and lower barriers to the cross-border flow of goods and services. The British withdrawal was a stepback because it was arguably one of the most successful free trade zones in the world, and Trump's election was also a stepback due to his Mercantilist views on trade. Because the US and the British were two leaders in the global push to free trade, their "oppositions" to free trade could make other countries follow away from free trade. If this happens, there will be a negative impact for the world economy, with greater protectionism, slower economic growth, and higher unemployment globally.

Trade Barriers and Firm Strategy. Trade barriers constrain a firm's ability to disperse its productive activities in areas where it would be most efficient.

- First, the tariff barriers raise the costs of exporting products to a country, putting the firm at a competitive disadvantage, compared to those strong competitors in that country. So, the firm may then find it economical to locate production facilities in that country, so that it can compete on even footing.
- Secondly, quotas may limit a firm's ability to serve a country from outside locations, so the firm might have to set up production facilities in that country, even though it may result in higher production costs.
- Thirdly, to conform to local regulations, a firm may have to locate more production activities in a given market than it would elsewhere. The consequence might be to raise costs above the level that could be achieved if each production activity were dispersed to its optimal location. Also, a firm may still want to locate some production activities in a given country to reduce the threat of trade barriers imposed in the future.

To conclude, the threat of antidumping action limits the ability of a firm to use aggressive pricing to gain market share in a country. Firms in a country can also strategically use antidumping measures to limit aggressive competition from lost-cost producers.

Policy Implications. Because of a company's huge role in international trade, they can exert strong influence on government policy toward trade, which can increase protectionism or support the WTO push for open market and free trade, and therefore, these policies can have a direct impact on business.

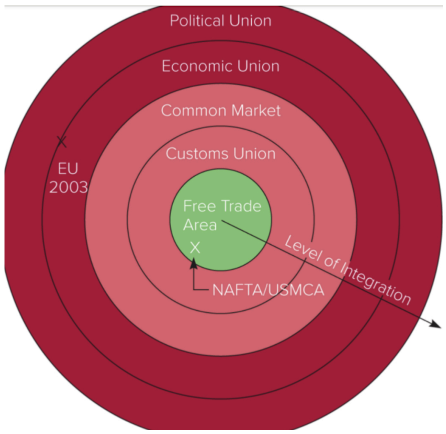
→ in our world, many firms all around the world increasingly depend on globally dispersed production systems for their competitive advantage, and such aspects are results of freer trade. Free trade has brought great advantages to firms that have exploited it and to consumers who benefit from the lower price. By encouraging governments to engage in protectionism, their own overseas sales and activities can be jeopardized if other governments retaliate. So, a firm should **always** review its options and carefully think through the larger consequences.

Chapter 9 Notes

Regional Economic Integration are agreements among countries in a region to reduce and remove tariff and non tariff barrier to the free flow of goods, services, and factors of production between each other.

Agreements designed to promote freer trade within regions are believed by economists to produce gains from trade for all members. The GATT and WTO also seek to reduce barriers, however, it is extremely difficult for 164 countries to reach an agreement. By entering into regina agreements, groups of countries can reduce trade barriers more rapidly and can achieve greater gains from trade than allowed for under WTO rules

Levels of Economic Integration.



A Free Trade area has all barriers to the trade of goods and services among member countries removed. Nothing is allowed to disport trade members (no discriminatory tariffs, quotas, subsidies, etc). However, each country is allowed to determine its own trade policies. European Free Trade Area (EFTA) is the most enduring free trade area in the world.

Custom Union. In a custom union area, there are no trade barriers between member countries and there is an adopted common external trade policy, which necessitates significant administrative machinery to oversee trade relations with non members.

Common Market. A common market has no barriers to trade among members, includes a common external trade, and allows factors of production to move freely among members, as there are no restrictions on immigration, emigration, or cross-borders from capital among member countries.

Economic Union. There is free flow of products and factors of production among member countries, and the adoption of a common external policy. But, it also requires a common currency, harmonization of members' tax rate, and a common monetary and fiscal policy. Example: European Union

Political Union. The move toward economic union raises the issue of how to make a coordinating bureaucracy accountable to the citizens of member nations. In a political union, a central political apparatus coordinates the economic, social, and foreign policy of the member states.

The Economic Case for Integration. Opening a country to FDI is also likely to stimulate economic growth, and in sum, economic theories suggest that free trade and investment is a positive-sum game, in which all participating countries stand to gain. Because many governments have accepted part of all of the cases for intervention, unrestricted trade and FDI have proved to be only an ideal, as it is very difficult to get all countries to agree to a common set of rules.

The Political Case for Integration. Linking neighboring economies and making them increasingly dependent on each other creates incentives for political cooperation between the neighboring states, and reduces the potential for violent conflict. Also, by grouping their economies, the countries can enhance their political weight in the world.

Impediments for Integration. (1) Although economic integration aids the majority, it has its costs. Moving to a free trade regime can involve painful adjustments, as while a nation might benefit from a regional free trade agreement, certain groups will lose. (2) Another impediment for integration arises from concerns over national security, as close economic integration demand countries to give up some control over such key issues as monetary, fiscal, and trade policies.

The Case Against Regional Integration. Even though the tide has been running in favor of regional free trade agreements, it is pointed out that the benefits of it 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.
→ In theory, WTO rules should ensure that free trade agreements do not result in trade diversion, as the rules allow free trade areas to be formed only if the members set tariffs that are not higher or more restrictive to outsiders than to ones previously in effect. But, because it doesn't cover nontariff barriers, regional trade blocs could emerge, whose markets are protected from outside competition by high nontariff barriers. The only way to guard against this is to increase the scope of the WTO so it covers non tariff barriers to trade.

Evolution of the European Union (EU). The EU is the product of the devastation of western Europe during two world wars and the desire for a lasting peace, and the European nations' desire to hold their own political and economic stage. The **Treaty of Rome** provided for the creation of a common market.To facilitate the free movement, the treaty provided for any necessary harmonization of the member states' laws. Through the enlargement of the EU, it has become a global economic power.

Political structure of the EU. There are four main institutions.

1. **The European Commision** that is responsible for proposing legislation, implementing it, and monitoring compliance with EU laws by member states.
2. **The European Council** represents the interests of member states and it's the controlling authority within EU because draft legislation form the commission and became EU law only if the council agrees.
3. **The European Parliament** is primarily a consultative rather than legislative body. It debates legislation proposed by the commission and forwarded by the council. It can propose amendments for legislation, which the commission and the council are not obliged to take, but usually do.
4. **The Court of Justice** is the supreme appeal court for EU law. The judges are required to act as independent officials, rather than as representatives of national interest.

British Exit From the EU (Brexit). This created an existential problem for the EU, as it could be a trigger for other countries rushing for the exits. By exiting, in the short/medium runs, Britain is less likely to attract inward investment from foreign multinationals, London risks losing its position as the financial capital of Europpe, and economic growth may be lower than what it would have been otherwise. In the long run, Britain benefits from the exit depending on its ability to negotiate trade deals with the EU and other major economic powers.

The North American Free Trade Agreement (NAFTA). The US and Canada have agreed to enter into a free trade agreement in 1988. The goal is to eliminate all tariffs on bilateral trade between both countries. Mexico became part of it in 1994.

The Case Against NAFTA. Opposition parties claim that ratification would be followed by a mass exodus of jobs from the US and Canada into Mexico, as the lower wages there and less strict labor and environmental laws. There was also opposition in Mexico from those who feared loss of national sovereignty, as critics argued that their country would be dominated by US firms and wouldn't really contribute to economic growth, rather just use Mexico as a lower-cost assembly while keeping their high-paying and high-skilled jobs outside.

NAFTA Results. Overall, impacts have been small but positive. Canada and Mexico are among the top three trade partners of the US, and all 3 countries experienced strong productivity growth in the first 10 years of NAFTA. Also, the employment effects of NAFTA have been moderate to small, not having big impacts.

The US-Canada-Mexico Agreement (USCMA). Both sides of politicians claim that free trade areas have been responsible for significant job losses in the US. So, the USCMA is an updated erosion of NAFTA, with some key changes. NAFTA requires automakers to produce 62.5% of vehicle's content in North America to qualify for zero tariff, and the USCMA raises that to 75%.

The idea is to compel automakers to source fewer parts for a car assembled in North America from German, Joan, South Korea and China. It also mandates that by 2023, 40% of parts for any tariff-free vehicle must come from a so-called high-wage factory.

Regional Economic Integration Threats.

→ Opportunities

- Regional economic integration gas created significant opportunities for businesses to grow the market for their goods/services and lower their factory costs. Markets that were formerly protected from foreign competition have become more open, and the costs of business have fallen.

→ Threats

- The business environment of each grouping has become more competitive, as the working of barriers to trade and investment has led to increased price competition throughout the EU and NAFTA/USCMA. Over time, price differentials across nations will decline, which is a direct threat to any firm doing business in the EU or US/Mexico/Canada. So, to survive, firms must take advantage of opportunities offered by the creation of a single market to rationalize their production and reduce their costs, otherwise, they would be at disadvantage.
- Another threat arises from the likely long-term improvement in the competitive position of many firms within the areas. The creation of a single market and the resulting increased competition in the EU produced serious attempts by many EU firms to reduce their cost structure by rationalizing production. So, non EU firms must respond to the emergence of more capable European competitors by reducing their own cost structures.