Chapter 2

The Dynamic Environment of International Trade

Learning Objectives (1 of 2)

LO1 The basis for the reestablishment of world trade following World War II

LO2 The importance of balance-of-payment figures to a country's economy

LO3 The effects of protectionism on world trade

LO4 The several types of trade barriers

LO5 The provisions of the Omnibus Trade and Competitiveness Act

Learning Objectives (2 of 2)

LO6 The importance of GATT and the World Trade Organization

LO7 The emergence of the International Monetary Fund and the World Bank Group

Trade Barriers

- Barriers to trade are one of the major issues confronting international marketers
- They can be tariff or nontariff barriers
- Countries continue to use nontariff barriers for a variety of reasons
- Tariff barriers have reduced considerably in recent years

Exhibit 2.1

Top Ten 2014 U.S. Trading Partners ($ billions, merchandise trade)

Rank	Country	Total Trade	Exports	Imports	Balance
—	Total	3969.1	1623.3	2345.8	–722.5
1	Canada	658.1	312.0	346.1	–34.1
2	China	590.7	124.0	466.7	–342.7
3	Mexico	534.5	240.3	133.9	106.4
4	Japan	200.9	67.0	133.9	–66.9
5	Germany	172.6	49.4	123.2	–73.8
6	South Korea	114.1	44.5	69.6	–25.1
7	United Kingdom	107.9	53.9	54.0	–0.1
8	France	78.2	31.2	47.0	–15.8
9	Brazil	72.8	42.4	30.3	12.1
10	Taiwan	67.4	26.8	40.6	–13.8

Source: http://www.census.gov /foreign-trade/top, 2015.

The differences in global marketing

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Even though the John Deere tractors lined up for shipment from its Waterloo, Iowa, plant appear impressive, the Hyundai cars stacked up by the water in Ulsan, South Korea, headed for the United States dwarf their numbers. The juxtaposition of the two pictures aptly reflects the persistence of America's broader merchandise trade deficit.

World Trade and U.S. Multinationals

- Dominance of U.S. multinationals in the 1950s and 1960s
- Large investments by U.S. companies in Europe and Latin America
- Concern in Latin America resulting in expropriation of direct U.S. investments
- In Europe, there was strong public demand to limit foreign investment

Exhibit 2.3 (1 of 3)

The Nationality of the World's 100 Largest Industrial Corporations (size measured by annual revenues)

	1963	1979	1984	1996	2000	2005	2011	2014
United States	67	47	47	24	36	33	29	34
Germany	13	13	8	13	12	15	11	8
Britain	7	7	5	2	5	10	8	
United Kingdom								5
France	4	11	5	13	11	10	10	8
Japan	3	7	12	29	22	12	11	7
Italy	2	3	3	4	3	3	4	4
Netherlands–United Kingdom	2	2	2	2	2	1		
Netherlands	1	3	1	2	5	2	2	2
Switzerland	1	1	2	5	3	4	2	2
Luxembourg							1	

Source: "2011 Global 500," Fortune, http://www.fortune.com , 2012.

Exhibit 2.3 (2 of 3)

The Nationality of the World's 100 Largest Industrial Corporations (size measured by annual revenues)

	1963	1979	1984	1996	2000	2005	2011	2014
Belgium		1	1		1		1	
Norway						1	1	1
Finland								
Brazil		1					1	1
Canada		2	3					
India			1				1	1
Kuwait			1					
Mexico		1	1	1		1	1	1
Venezuela		1	1	1			1	1
South Korea			4	4		1	3	3
Sweden			1					

Source: "2011 Global 500," Fortune, http://www.fortune.com , 2012.

Exhibit 2.3 (3 of 3)

The Nationality of the World's 100 Largest Industrial Corporations (size measured by annual revenues)

	1963	1979	1984	1996	2000	2005	2011	2014
Spain						1	3	1
Russia							2	3
China					2	1	6	15
Malaysia							1	1
Taiwan							1	1
Thailand								1

Source: "2011 Global 500," Fortune, http://www.fortune.com , 2012.

Balance of Trade (1 of 2)

- The balance of merchandise trade also reflected the changing role of the United States in world trade
- Between 1888 and 1971, the United States had a favorable balance of trade
- By 1971, the United States had a trade deficit of $2 billion that grew to $160 billion in 1987
- Trade deficit peaked in 2007, with the continued weakness in the U.S. dollar
- A positive consequence of the global financial crisis in 2008 in the United States was the halving of the U.S. trade deficit during 2009 from its high in 2007
- But in 2011, the deficit was again more than $700 billion

Balance of Trade (2 of 2)

- The continuing integration of the countries of the European Union, the creation of NAFTA and the American Free Trade Area (AFTA), and the rapid evolution of the Asia-Pacific Economic Cooperation Conference (APEC) are the beginnings of global trading blocks that many experts expect to dominate trade patterns in the future.
- Smaller companies are using novel approaches to marketing and seeking ways to apply their technological expertise to exporting goods and services not previously sold abroad.

Balance of Payments (1 of 5)

- When countries trade there are financial transactions among businesses or consumers of different nations
- Money constantly flows into and out of a country
- The system of accounts that records a nation's international financial transactions is called its balance of payments (BP)
- It records all financial transactions between a country's firms, and residents, and the rest of the world usually over a year
- The BP is maintained on a double-entry bookkeeping system

Balance of Payments (2 of 5)

- The assets and liabilities or the credits and debits must offset each other
- When they balance, it does not mean a nation is in particularly good or poor financial condition
- A balance of payments is a record of condition, not a determinant of condition
- Each of the nation's financial transactions with other countries is reflected in its balance of payments

Balance of Payments (3 of 5)

The BP is the difference between receipts and payments

Receipts

- merchandise export sales
- money spent by foreign tourists
- transportation
- payments of dividends and interest from FDI abroad
- new foreign investments in the U.S.

Payments

- costs of goods imported
- spending by U.S. tourists overseas
- new overseas investments
- cost of foreign military and economic aid

Balance of Payments (4 of 5)

- A balance-of-payments statement includes three accounts:
  - the **current account**, a record of all merchandise exports, imports, and services plus unilateral transfers of funds
  - the **capital account**, a record of direct investment, portfolio investment, and short-term capital movements to and from countries
  - the official **reserves account**, a record of exports and imports of gold, increases or decreases in foreign exchange, and increases or decreases in liabilities to foreign central banks
- Of the three, the current account is of primary interest to international business.

Balance of Payments (5 of 5)

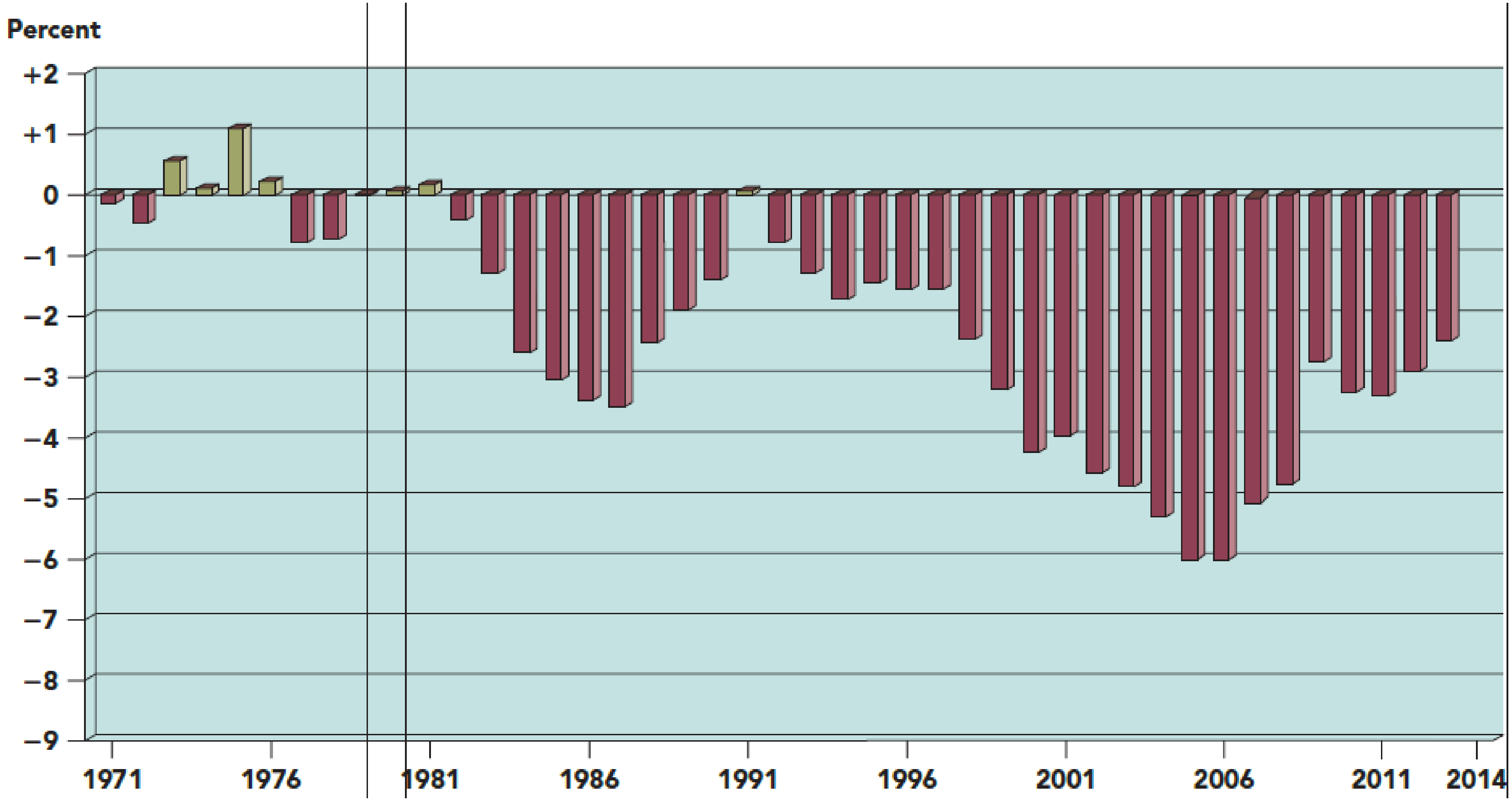
- When the wealth of a country whose expenditures exceed its income has been exhausted, that country, like an individual, must reduce its standard of living.
- If its residents do not do so voluntarily, the rates of exchange of its money for foreign monies decline, and through the medium of the foreign exchange market, the purchasing power of foreign goods is transferred from that country to another.

Exhibit 2.4
U.S. Current Account by Major Components, 2014 ($ billions)

Exports	
Goods	$ 1635
Services	709
Income receipts	813
Imports	
Goods	–2371
Services	–478
Income payments	–586
Unilateral current transfers, net	164
Current account balance	–114

Exhibit 2.5

U.S. Current Account Balance (% of GDP)



Source: World Bank, 2015.

Exhibit 2.6

What Would One U.S. Dollar Buy?

	1985	1988	1992	1995	1999	2000	2005	2010	2012
British Pound	0.86	0.54	0.56	0.63	0.62	0.68	0.57	0.63	0.63
French Franc	9.6	5.4	5.29	4.95	6.49	7.28			
Japanese Yen	250.23	123.7	126.7	93.96	102.58	112.21	112.3	89.9	76.3
Swiss Franc	2.25	1.29	1.41	1.18	1.58	1.68	1.31	0.96	0.92
Euro			1.01	0.90	0.92	1.08	0.79	0.71	0.88
Mexico Peso	0.37	2.28	3.12	6.45	9.43	9.47	10.8	13.0	13.1

Source: *The Wall Street Journal*, 2012

Protectionism

- The reality of trade is that this is a world of tariffs, quotas, and nontariff barriers designed to protect a country's markets from foreign investment
- Although the World Trade Organization has been effective to some extent in reducing tariffs, countries still resort to measures of **protectionism**
- Countries use legal barriers, exchange barriers, and psychological barriers to restrict the entry of unwanted goods

Arguments for Protectionism (1 of 2)

- Protection of an infant industry
- Protection of the home market
- Need to keep money at home
- Encouragement of capital accumulation
- Maintenance of the standard of living and real wages
- Conservation of natural resources
- Industrialization of a low-wage nation

Arguments for Protectionism (2 of 2)

- Maintenance of employment and reduction of unemployment
- National defense
- Enhancement of business size
- Retaliation and bargaining

Trade Barriers

- Governments establish tariffs and a variety of nontariff barriers
  - To encourage development of domestic industry
  - To protect existing industry
  - Include quotas, boycotts, monetary barriers, and market barriers
  - Against imports and against foreign businesses

The Impact of Tariff (Tax) Barriers (1 of 2)

- Tariff barriers tend to **increase**:
  - Inflationary pressures
  - Special interests’ privileges
  - Government control and political considerations in economic matters
  - The number of tariffs they beget via reciprocity

The Impact of Tariff (Tax) Barriers (2 of 2)

- Tariff barriers tend to **weaken**:
  - Balance-of-payments positions
  - Supply-and-demand patterns
  - International relations (they can start trade wars)
- Tariff barriers tend to **restrict**:
  - Manufacturers' supply sources
  - Choices available to consumers
  - Competition

Six Types of Nontariff Barriers (1 of 3)

- (1) Specific Limitations on Trade:
  - Quotas
  - Import licensing requirements
  - Proportion restrictions of foreign to domestic goods (local content requirements)
  - Minimum import price limits
  - Embargoes
- (2) Customs and Administrative Entry Procedures:
  - Valuation systems
  - Antidumping practices
  - Tariff classifications
  - Documentation requirements
  - Fees

Six Types of Nontariff Barriers (2 of 3)

- (3) Standards:
  - Standard disparities
  - Intergovernmental acceptances of testing methods and standards
  - Packaging, labeling, and marking
- (4) Government Participation in Trade:
  - Government procurement policies
  - Export subsidies
  - Countervailing duties
  - Domestic assistance programs

Six Types of Nontariff Barriers (3 of 3)

- (5) Charges on Imports:
  - Prior import deposit subsidies
  - Administrative fees
  - Special supplementary duties
  - Import credit discriminations
  - Variable levies
  - Border taxes
- (6) Others:
  - Voluntary export restraints
  - Orderly marketing agreements

Quotas and Import Licenses

- A quota is a specific unit or dollar limit applied to a particular type of good.
- As a means of regulating the flow of exchange and the quantity of a particular imported commodity, countries often require import licenses.
- The fundamental difference between quotas and import licenses as a means of controlling imports is the greater flexibility of import licenses over quotas. Quotas permit importing until the quota is filled; licensing limits quantities on a case-by-case basis.

Voluntary Export Restraints

- Similar to quotas are the **voluntary export restraints (VERs) or orderly market agreements (OMAs).**
- A VER is called voluntary because the exporting country sets the limits; however, it is generally imposed under the threat of stiffer quotas and tariffs being set by the importing country if a VER is not established.

Boycotts and Embargoes

- A government boycott is an absolute restriction against the purchase and importation of certain goods and/or services from other countries.
- An embargo is a refusal to sell to a specific country.
- A public boycott can be either formal or informal and may be government sponsored or sponsored by an industry.

Monetary Barriers

- A government
  - can effectively regulate its international trade position by various forms of exchange-control restrictions
  - may enact such restrictions to preserve its balance-of-payments position specifically for the advantage or encouragement of particular industries

Two Types of Monetary Barriers

- **Blocked currency**: Blockage is accomplished by refusing to allow importers to exchange its national currency for the sellers' currency
- **Government approval**: In countries where there is a severe shortage of foreign exchange, an exchange permit to import foreign goods is required from the government. This encourages the importation of goods the government deems desirable and discourages importation of goods the government does not want by adjusting the exchange rate.

Standards

- Nontariff barriers of this category include standards to protect health, safety, and product quality.
- The standards are sometimes used in an unduly stringent or discriminating way to restrict trade, but the sheer volume of regulations in this category is a problem in itself.

Antidumping Penalties

- Historically, tariffs and nontariff trade barriers have impeded free trade, but over the years, they have been eliminated or lowered through the efforts of the GATT and WTO.
- Antidumping laws were designed to prevent foreign producers from "predatory pricing," a practice whereby a foreign producer intentionally sells its products in another country for less than the cost of production to undermine the competition and take control of the market. This barrier was intended as a kind of antitrust law for international trade.

The Omnibus Trade and Competitiveness Act (OTCA) of 1988 (1 of 2)

- Many countries are allowed to trade freely with the United States but do not grant equal access to U.S. products in their countries.
- To ease trade restrictions, the OTCA focused on correcting perceived injustices in trade practices.
- It dealt with trade deficits, protectionism, and the overall fairness of our trading partners.

The Omnibus Trade and Competitiveness Act (OTCA) of 1988 (2 of 2)

- Covers three areas for improving U.S. trade:
  - market access
  - export expansion
  - import relief

General Agreement on Tariffs and Trade (GATT)

- Covers three basic areas:
  - Trade shall be conducted on a nondiscriminatory basis
  - Protection shall be afforded domestic industries through customs tariffs, not through such commercial measures as import quotas
  - Consultation shall be the primary method used to solve global trade problems

General Agreement on Trade in Services (GATS)

- GATS was the first multilateral, legally enforceable agreement covering trade and investment in the services sector.
- It provides a legal basis for future negotiations aimed at eliminating barriers that discriminate against foreign services and deny them market access.
- Specific market-opening concessions from a wide range of individual countries were achieved, and provision was made for continued negotiations to liberalize telecommunications and financial services further.

Trade-Related Investment Measures (TRIMs)

- It established the basic principle that investment restrictions can be major trade barriers and therefore are included, for the first time, under GATT procedures.

Trade-Related Aspects of Intellectual Property Rights (TRIPs)

- The TRIPs agreement establishes substantially higher standards of protection for a full range of intellectual property rights (patents, copyrights, trademarks, trade secrets, industrial designs, and semiconductor chip mask works) than are embodied in current international agreements, and it provides for the effective enforcement of those standards both internally and at the border.

World Trade Organization (WTO)

Unlike GATT, WTO is an institution, not an agreement

- It sets many rules governing trade between its 160 members
- WTO provides a panel of experts to hear and rule on trade disputes between members, and, unlike GATT, issues binding decisions

WTO (1 of 2)

- The Internet exposed protected industries to global competition
- WTO was established January 1, 1995 through the Uruguay round of GATT (1986–1993)
- Statutory powers to adjudicate trade disputes

WTO (2 of 2)

- Permanent international organization
- New legal and institutional foundation
- Platform for trade relations: collective debate, negotiation, and adjudication
- Dispute settlement faster
- Evolution of GATS, TRIMS, TRIPS

The IMF and the World Bank

- The **International Monetary Fund (IMF)** and the **World Bank Group** are two global institutions created to assist nations in becoming and remaining economically viable.
- These organizations play important roles in international trade by:
  - helping maintain stability in the financial markets
  - assisting countries that are seeking economic development and restructuring

The World Bank (1 of 2)

- The World Bank Group has five institutions, each of which performs the following services:
  - lending money to the governments of developing countries to finance development projects in education, health, and infrastructure
  - providing assistance to governments of the poorest developing countries (per capita incomes of $925 or less) for developmental projects
  - lending directly to help strengthen the private sector in developing countries with long-term loans, equity investments, and other financial assistance

The World Bank (2 of 2)

- providing investors with investment guarantees against “noncommercial risk,” such as expropriation and war, to create an environment in developing countries that will attract foreign investment
- promoting increased flows of international investment by providing facilities for the conciliation and arbitration of disputes between governments and foreign investors; it also provides advice, carries out research, and produces publications in the area of foreign investment law

Protests against global institutions

"Globalization" by Gifford Myers. Photo by John Graham.

© Jane Mingay/AP Images

Gifford Myers showed the sculpture *Object (Globalization)–2001*, in the photo to the left, in Faenza, Italy, as a peaceful protest. In the photo above, protest of the deadly sort. Terrorists maim and kill those aboard the classic red London double-decker bus (you can see the pieces in the street).

Summary

- Heightened competition around the world has created increased pressure for protectionism from every region at a time when open markets are needed if world resources are to be developed and utilized in the most beneficial manner.
- Free international markets help underdeveloped countries become self-sufficient.
- The changing economic and political realities are producing unique business structures that continue to protect certain major industries.
- The future of open global markets lies with the controlled and equitable reduction of trade barriers.