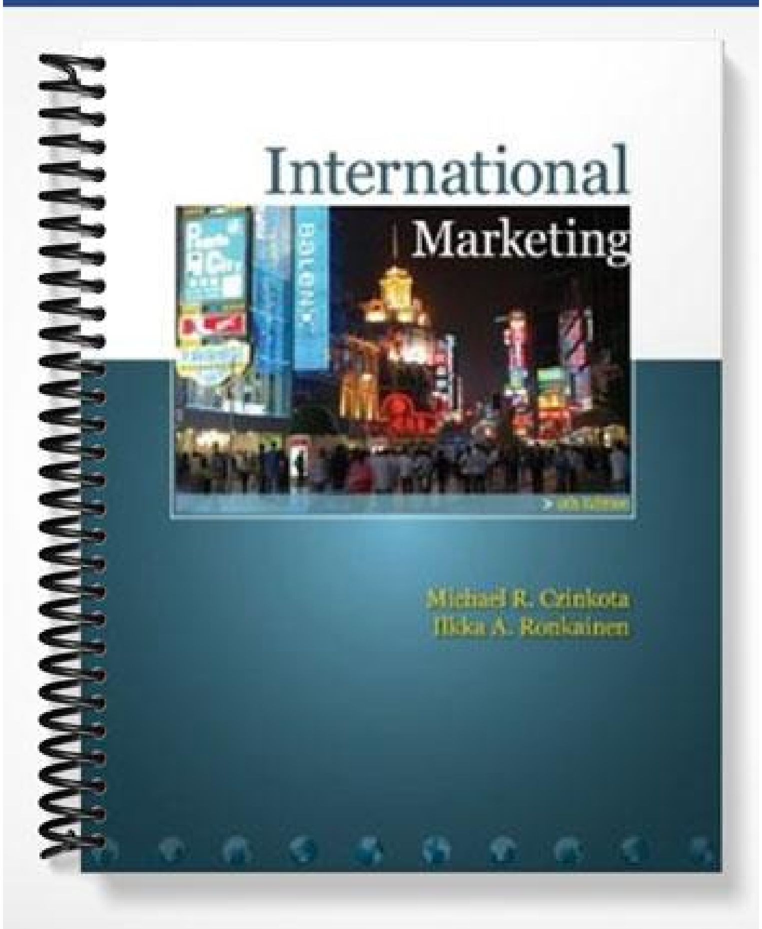
SOLUTIONS MANUAL



CHAPTER 2
TRADE INSTITUTIONS AND TRADE POLICY

Chapter Outline

A. The Historical Dimension
   1. Global Division
B. Transnational Institutions Affecting World Trade
   1. World Trade Organization (WTO)
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C. Trade Positions Compared
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D. The Impact of Trade and Investment
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E. Policy Responses to Trade Problems
   1. Restrictions of Imports
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F. A Strategic Outlook for Trade and Investment Policies
   1. A U.S. Perspective
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Chapter Objectives

This chapter begins by discussing the influence of trade on selected historic developments. It explains that trade, even though only one component of the broad spectrum of human activities has an over-proportional impact on all of our lives. Recent trade developments are presented, together with the international institutions that have emerged to regulate and facilitate trade. The chapter also describes world trade policy, with an analysis of the impact of changing positions in international trade. Further discussed are policy goals which both hinder and encourage international marketing activities.

Suggestions for Teaching

We find it very useful to spend some time on the historical dimension. An in-class discussion of additional impacts of international marketing on our history is usually very stimulating, particularly when foreign students are present and bring into the discussion their viewpoints. The building of scenarios is also very useful here. For example, students can be asked how life in the United States would be today if there were no international marketing.

After having understood the role played by various transnational institutions in world trade, it would be a good idea to have students summarize the key benefits offered by the various institutions. This would help reiterate the focus area of each institution in world trade.

When reviewing policy developments, it would be a good idea to initiate a discussion on how policymakers have to trade off conflicting priorities, e.g., domestic unemployment vs. international security needs. Lively debate usually results when one asks different groups to participate in role playing with one group, for example, advocating the need for U.S. bases abroad, and an other group taking the position of the foreign government which wants to extract trade concessions in exchange for giving permission to maintain bases.

It is also very useful to show conflicting domestic priorities. One good example which always is enthusiastically responded to is the issue of import restrictions. Taken together with the issue on steel import restrictions in the US (students can be asked to search and bring at least one article on this subject to discuss), students quickly understand that rational economic decision making is not the only criterion for setting international trade policy. In all of these discussions it is very useful to have either one individual (the instructor) or one group consistently take the side of the U.S. consumer, since in heavy policy discussions this group is most easily forgotten.

Key Terms

Pax Romana: One of the principle approaches to implementing international business activities; also known as Roman Peace.
Economic Blocs: Groups of nations that integrate economic and political activities.
Born Global: Newly founded firm that, from its inception, is established as an international business.
Trade Deficit: A trade deficit occurs when a country imports more goods and services than it exports.
Economies of Scale: Production condition where an increase in the quantity of the product results in the decrease of the production per unit; firms may achieve lower costs and higher profits both at home and abroad.
Foreign Direct Investment: Capital funds flow from abroad; company is held by noncitizens; foreign ownership is typically undertaken for longer-term participation in an economic activity.
Foreign Affiliate: A U.S. firm of which foreign entities own at least 10 percent.
Nontariff Barriers: Barriers to trade that are more subtle than tariff barriers, for example, these barriers may be government or private-sector "buy domestic" campaigns, preferential treatment of domestic bidders over foreign bidders, or the establishment of standards that are not common to foreign goods or services.
Mixed Aid Credits: Loans to domestic businesses designed to overcome barriers to export; composed partially of commercial interest rates and partially of highly subsidized developmental aid interest rates.
Export Consortia: Legislation that permits domestic firms to work together, in a manner similar to Japanese sogoshoshas; the basic idea is to provide the foreign buyer with a one-stop shopping center to avail a variety of complementary and competitive products.
Protectionistic Legislation: An important bargaining tool; however, legislated protectionism can result in the destruction of the international trade and investment framework.

Trade Promotion Authority: Gives Congress the right to accept or reject trade treaties and agreements, but reduces the amendment procedures; instrumental for new, large-scale trade accords.
Bilateral Negotiations: Trade agreements carried out mainly between two nations.
Multilateral Negotiations: Trade agreements carried out among a number of nations.

Questions for Discussion

1. Why is international trade important to a nation?

   International trade offers a larger market and a potential for larger profits and growth than domestic trade alone. It also allows a country to buy needed imports which must be funded by gold or foreign capital if there are no compensating exports.

   A nation as a whole must participate in international trade in order to balance its trade. If a trade deficit builds up, there is a negative impact on the long-term national welfare and domestic employment levels.

   Exports can affect currency values and the fiscal and monetary policies of governments, shape public perception of competitiveness, and determine the level of imports a country can afford.

   Economies of scale can be achieved by broadening market reach and serving customers abroad, thus producing larger quantities of goods more efficiently. Market diversification is possible by taking advantage of different growth rates in different markets and gaining stability by not being overly dependent on any particular market.

   International trade stimulates companies to learn new techniques of production, develop new products, and improve existing ones which can be marketed both internationally and domestically. This compels companies to gain the competitiveness required in order to remain viable. It is also a benefit to consumers, who have more choice, a larger product selection, better quality products, and lower prices due to the large number of competing firms.

   It is therefore important to improve the capability of firms to compete internationally and to provide an international trade framework that facilitates international marketing activities.

2. Give examples of the effects of the "Pax Americana."

   The period of post-World War II until the early 1970s can best describe the "Pax Americana" years. During the immediate post-war years, the United States spent billions of dollars revitalizing the devastated European economies by means of direct economic assistance or direct foreign investments. In other areas, the United States likewise poured billions into the coffers of third world treasuries or international institutions such as the IMF or World Bank, all under the proclamation of development. In economic terms, the United States dominated international trade with its wealth, tremendous level of production, and high level of innovation.

Its investments flowed throughout the Orient to the heart of Africa to its Latin neighbors. In short, the United States dictated the playing field of international economics.

Since the collapse of the Iron Curtain and the demise of the Soviet Union, the U.S. has again assumed a key role in the world - trying to assure peace and respect for American values around the globe.

3. Discuss the role of "voluntary import restraints" in international marketing.

“Voluntary import restraints" are formulated outside of the WTO and other formal trade agreements. They are implemented to aid domestic industries to reorganize, restructure, and recapture their trade prominence. Because they are a more "subtle" method than quotas and tariffs, they give nations the appearance of complying with international agreements. Other import restraints are sometimes in the form of time-consuming bureaucratic regulations, customs inspection rules and "buy domestic" promotions.

Such restraints protect individual industries, but the protection comes at a cost to consumers and international trade relations. Although import restraints protect certain industries from import competition, imports may not be the only reason for an industry's declining market share. The import restraints may save them in the short run, but companies must change to meet the competition to survive.

4. Provide examples of multilateral versus bilateral trade agreements.

Multilateral negotiations take place between several nations, in contrast to bilateral negotiations, which involve just two nations. The North America Free Trade Agreement (NAFTA) is an example of a multilateral trade agreement that comprises of the United States, Canada, and Mexico. The European Union (EU) is another example of a multilateral trade agreement which consists of 25 countries in Europe currently. Havana and Caracas signed a bilateral trade agreement under which Cuba purchased more than 412 million dollars worth of Venezuelan products. The signing of the accord was presided over by Cuban President Fidel Castro and his Venezuelan counterpart Hugo Chavez on April 28, 2005.

5. How have consumer demands changed international trade?

Consumer demand abroad has stimulated foreign companies to increase their competitively priced exports and is compelling industries at home to develop more competitively priced and higher-quality products. This is advantageous to the consumer, as both domestic and foreign companies must compete to meet their demands. In the United States, the auto, textile, and shoe industries are examples of imports challenging domestic industries based on the buying preferences of consumers.

6. Discuss the impact of import restrictions on consumers.

Import restrictions in the form of duties and tariffs keep prices higher than they would be in a free trade environment. On account of these restrictions, domestic industries are preserved, but only at great peril to the world trade framework and at substantial cost to consumers. Quotas result in waiting lists of consumers waiting to buy imports and offer the opportunity to domestic producers to raise prices. Restrictions on imports to the United States may appear to benefit consumers indirectly by minimizing the U.S. trade deficit, thereby keeping more jobs and revenues within the United States. However, often technological progress, competitiveness, and consumer choices are hurt by such measures. Restrictions that cause ill will between countries also can increase the volatility of the international trade environment and lead to political instability, which affects the consumers as citizens.

7. Does foreign direct investment have an effect on trade?

   Foreign direct investment has tremendous effects on trade for the home and host countries. In terms of the home country, the positive aspects of the investment may include increased exports, increased experience in foreign business practices, and increased expertise in international economic negotiations. Some costs for the home country may include a displacement of jobs, loss of exports, and loss of political control over the management of the firm based abroad.

   For the host country, the investment by the foreign corporation implies technology transfer, skills transfer, increased employment, increased revenue, and possibly even increased foreign exchange. While these benefits may seem very appealing, the host government faces a whole range of problems, such as a foreign exchange outflow due to profit repatriation and importing of scarce materials; lack of political control over the foreign management; and the transfer of values and culture.

Internet Exercises

1. What is the major role played the World Bank today? Check http://www.worldbank.org to report on key projects.

   The World Bank calls itself "the world's largest source of development assistance" with its credit outlay for the fiscal 2006 amounting to $23.6 billion in annual. It sees the alleviation of poverty as its key role. The site has in-depth information on current World Bank projects as well as a wealth of economic data and publications. The Development Forum is a feature that allows individuals from around the world to share their ideas online.

2. Determine the latest exports per capita for a country of your choice not listed in Exhibit 2.2 (use data from http://www.imf.org and http://www.un.org)

   The IMF provides detailed reports and statistics for individual countries. Students may be asked to research the position of a developing country of their choice within the fund. The UN

Conference on Trade and Development has published detailed reports on Trade and Development, World Investment, and the Least Developed Countries. The UN Statistics Division provides international economic statistical data. Students may be asked to compare and contrast the information provided by both of these sites.

3. Compare the discussion of industry/country trade barriers from the perspective of the European Union and the United States (http://ec.europa.eu/trade/issues/index_en.htm and www.ustr.gov).

   The EU is committed to promoting open and fair trade with all its trading partners. In addition to multilateral negotiations, the EU concludes bilateral agreements and devises specific trading policies with third world countries and regional areas. The EU website contains information on some key issues affecting international trade, as well as the impact of trade on environment, social welfare and human rights. The USTR negotiates with foreign governments to create trade agreements, resolve disputes and participate in global trade policy organizations. The National Trade Estimate Report on Foreign Trade Barriers (2006) available in the USTR website provides information on significant foreign barriers to U.S. exports along with the actions taken by the U.S. to eliminate such barriers.