The Regulatory Framework – free trade occurs when governments do not intervene, in reality many nations are committed to free trade, but to protect the interests of important political groups, managed trade occurs.

Government Intervention is based on two views:

Political Arguments – protecting the interests of one group, often at the expense of another within a nation (i.e. producers over consumers).	**Economic Arguments** – boosting the overall wealth of a nation to benefit all groups
1. Protection Jobs and Industries – most common political reason for trade restrictions, due to pressures by unions or industries that are threatened by more efficient foreign producers, and have more political 'pull' than consumers (i.e. Australian Automotive Sector). 2. National Security - Industries deemed important for national security (e.g. aerospace, advanced electronics, weapons) are often protected. 3. Retaliating - When governments take, or threaten to take, specific actions in retaliation to unfair foreign competition *Threatened governments may remove trade barriers or not back down *Tensions can escalate and new trade barriers may be enacted in the latter case (e.g. US/Chinese governments and IPR) 4. Protecting Consumers - Protection from "dangerous/unsafe" products (e.g. mad cow disease, bird flu, genetic re-engineering) 5. Furthering Foreign Policy Objectives – providing preferential trade terms to countries to build strong relations, while it can also be used to punish 'rogue' states. 6. Protecting Human Rights – protecting the human rights of individuals in exporting countries (i.e. China MFN Status and sanctions against apartheid South Africa). 7. Protecting the Environment – reducing carbon emissions and trade sanctions.	1) The Infant Industry Argument – industries should be protected until it can develop and be viable and competitive internationally. 2) Strategic Trade Policy - In cases where there may be important first mover advantages, governments can help firms from their countries attain these advantages • U.S. government and Boeing in the 1950s and 1960s • Governments can help firms overcome barriers to entry into industries where foreign firms have an initial advantage

Instruments of Trade Policy

Instruments	**Implications**
1) **Tariffs** – oldest form of trade policy. Two Categories: a) Specific tariffs are a fixed charge for each unit b) Ad valorem tariffs are a proportion of the value of the imported goods.	– Increases government revenues – Force consumers to pay more for certain imports – Are pro-producer and anti-consumer – Reduce the overall efficiency of the world economy
2) **Subsidies** - Government payment to a domestic producer in order to encourage the production of goods and services (e.g. cash grants, low-interest loans, tax breaks)	Helps domestic producers: – Compete against low-cost foreign imports (e.g. Holden Australia) – Gain export markets Can lead to over-production and inefficiencies in production Consumers typically absorb the costs of subsidies
3) **Import Quotas** - Restricting the quantity of some good that may be imported into a country (e.g. Multi-Fiber Agreement)	• Tariff rate quotas: a hybrid of a quota and a tariff where a lower tariff is applied to imports within the quota than to those over the quota • Quota rent: the extra profit that producers make when supply is artificially limited by an import quota
4) **Voluntary Export Restraints** - Quotas on trade imposed by the exporting country, typically at the request of the importing country's government (e.g. Japanese vehicles and the US market)	
5) **Local Content** - Requires some specific fraction of a good to be produced domestically a) Percentage of component parts b) Percentage of the value of the good c) Initially used by developing countries to help shift from assembly to production of goods	– Developed countries beginning to implement – For a component parts manufacturer, local content acts the same as an import quota – Benefits producers, not consumers
6) **Anti-dumping Policies** - Selling goods in a foreign market below their costs of production, or selling goods in a foreign market below their "fair" market value. *Enables firms to unload excess production in foreign markets*	May result in predatory behavior > Governments use countervailing duties to punish foreign firms that engage in dumping and protect domestic producers from "unfair" foreign competition

Foreign Direct Investment & MNCs – FDI is when a firm invests directly in facilities to produce or market a product in a foreign country. Subsidiaries are created in different countries, and the parent company has significant control of its operations and can affect managerial decisions.

<u>Multinational Corporation</u> – is defined by Shapiro as a company with production and distribution facilities in more than one country (1) with a parent company located in the home country and (2) at least 5 or 6 foreign subsidiaries.

Horizontal Direct Investment	Vertical Direct Investment
– FDI in the same industry abroad as company operates at home (e.g. Toyota Australia) – FDI is expensive and risky ('liability of foreignness')	– Backward - Investments into industry that provides inputs into a firm's domestic production (typically extractive industries) – Forward - Investment in an industry that utilizes the outputs from a firm's domestic production (typically sales and distribution)

Forms of FDI

<u>Greenfield Investment</u>	<u>Mergers & Acquisitions</u>
• Investment in a new facility • Mostly in developing nations • Best for transferring specialized hard to imitate resources • Greater control possible compared to exporting or licensing • Few coordination problems (compared to mergers and acquisitions)	• Merge with an existing firm or acquire an existing firm • More prevalent in developed nations • Quicker to execute than Greenfield investments • Easier and perhaps less risky for a firm to acquire desired assets than build them from the ground up • Firms believe that they can increase the efficiency of an acquired unit by transferring capital, technology, or management skills

Rationale for FDI:

1. <u>Over Exporting</u> – producing at home and then shipping them to the receiving country for sale. It can be limited by transportation costs and trade barriers. FDI may be a response to actual or threatened trade barriers such as import tariffs.
2. <u>Over Licensing</u> – granting a foreign entity the right to produce and sell the firm's product in return for a royalty fee on every unit the foreign entity sells.
    a. <u>Internalisation Theory</u> (Aka Market Imperfection Theory) – suggests that licensing has three major drawbacks = (1) losing valuable technological know-how to a potential foreign competitor, (2) limited control over manufacturing, marketing and strategy in the foreign country and (3) the firm's competitive advantage may be based on its management, marketing and manufacturing capabilities.

Dunning's Eclectic (OLI) Paradigm - British economist John Dunning attempted to develop a theory that explained why firms undertook FDI. paradigm states that **all 3** of these three conditions need to be present for FDI to occur:

- **Ownership advantages** –The competitive advantages of the enterprises seeking to engage in FDI - E.g. Trademarks, production techniques, entrepreneurial skills
- **Location advantages** – Country- or region-specific advantages - E.g. Raw materials, low wages, tax rates
- **Internalization advantages** – Net benefits of internalizing cross-border intermediate product markets - E.g. Efficiency-related coordination/standardization advantages, protection of IP

How Host Countries Influence FDI	
Incentives	Disincentives
– Subsidies – Tax incentives – Low interest rates – Stable government and economic policies – Establishment of special economic zones (e.g. Free Trade Zones)	– Political restrictions on investing in certain industries – Ownership restraints – Performance requirements

Globalisation & International Business **(Chapter 1)** – Mcgrew, Goldblatt and Perraton (1999) defined globalisation as the *"widening, deepening and speeding up of worldwide interconnectedness in all aspects of contemporary social life"* – The liberalisation and integration of factors of production and distribution globally.

Globalization of Markets	Globalization of Production
• The merging of (previously nationally based) markets into one global marketplace - Falling barriers to trade and investment • Less prominent in consumer products, National tastes remain important, However, converging consumer tastes • It is more important in the markets for industrial goods and materials (Oil, aluminium, microprocessors) • Global firms are usually WINNERS of globalization - As well as the DRIVERS of globalisation	• Reflects the tendency among firms to source goods and services from countries with lower factor costs (i.e. land, labour and capital) and/or higher quality (GAP, Nike, Apple, Pacific Brands etc.) • Where is 'value' being added? = Product design, marketing, manufacturing, sales? • It is becoming less relevant to speak of national products - Global products, not Australian • However, government regulations through formal and informal barriers to trade impedes this process

Drivers of Globalisation:

1. Declining Trade and Investment Barriers and MNEs – free flow of capital, factors of production, goods and services, but not labour.
2. Technological Factors – internet and telecommunication services and technology, and e-commerce systems have driven globalisation.
3. Environmental Standards – firm's responsibilities? – Carroll's pillars of responsibility (Economic, Legal, Ethical and Philanthropic).
4. Civil Society – Greenpeace, Amnesty
5. Globalisation of Culture – homogenisation through cultural institutions such as music literature, social media (e.g. Facebook, Twitter, YouTube).

Globalisation Debate

Benefits for Jobs	Costs for Jobs
> In developed economies, job gains in higher-value added industries (e.g. semiconductor) requiring higher skill and educational levels > In developing economies, job gains in lower-value added industries > Increasing wages in higher-value added industries > Job creation in industries where a comparative advantage exists leading to greater efficiency in the use of factors of production	> In developed economies, job losses in import sensitive lower-value added industries such as apparel, footwear, motor vehicles > Developing economies unable to create jobs in higher-value added industries > Lower wages in low skilled lower-value added industries > Increase in unemployment due to offshoring of jobs

Benefits for the Natural Environment	Costs for the Natural Environment
• Global debate on environmental standards • Global environmental standards (e.g. Kyoto protocol) • Global public pressure groups forcing governments and MNEs to move towards more energy efficient infrastructure and cleaner energy sources	• Over the past 30 years more than 30% of the world's natural environment destroyed = (1) Populations of fresh water plant and animal species reduced by 50%, (2) Natural forests declined by 10% • Conspicuous consumption increasing greenhouse gas emissions and toxic waste • Developing nations exploited for cheaper natural resources by over-consumptive developed nations