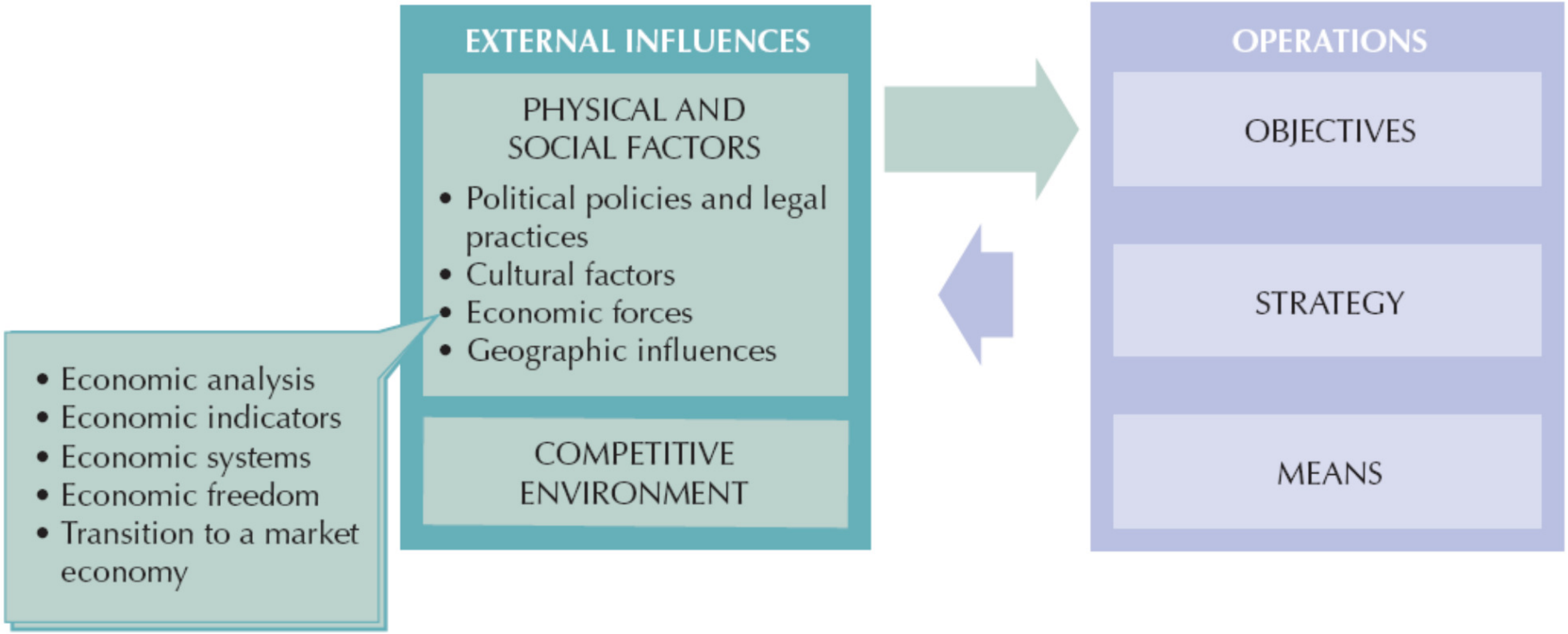
International Business Environments and Operations

Chapter 4 Economic Environment

Economic Factors Affecting International Business Operations



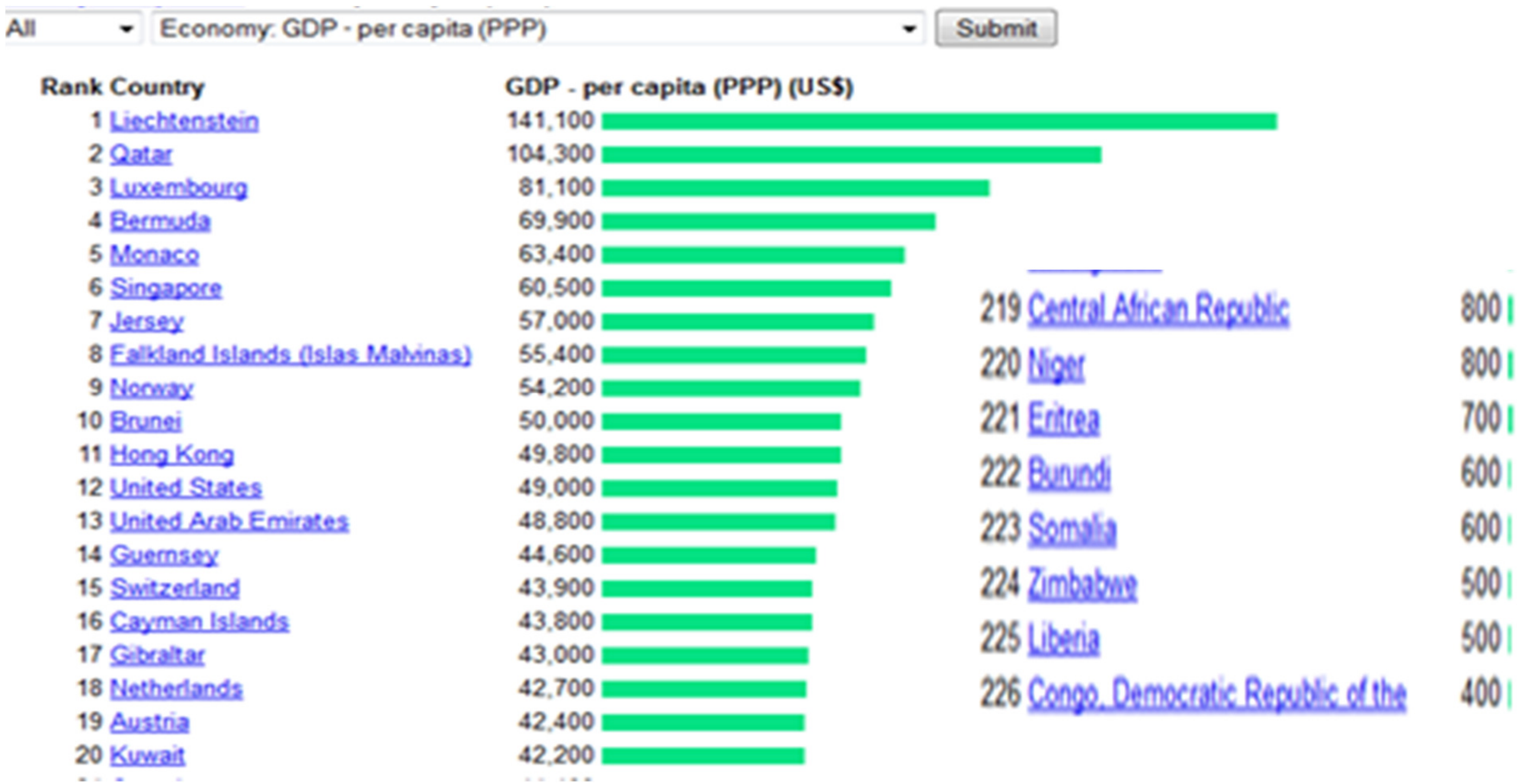
Features of an Economy

- GDP
- Inflation
- Unemployment
- Debt
- Income distribution
- Poverty
- Labor costs
- Productivity
- Balance of payments

Elements of the Economic Environment

- **GDP**: the total value of all final goods and services produced in a country in a given year

  = C+I+G+NX



- **Inflation** : rise in the general level of prices of products over a period of time. Thus, it is a measure of the increase in the

Elements of the Economic Environment

- **Internal Debt**: Portion of the government debt that is denominated in the country's own currency and held by domestic residents
- **External Debt**: Debt owed to foreign creditors and denominated in foreign currency.
- **Poverty:** the state of having little or no money and few or no material possessions

Poverty

- The World Bank defines
  - *extreme poverty* as living on less than $1.25 per day
  - *moderate poverty* as less than $2 per day
- This standard shows that, in 2008, 1.4 billion lived on less than $1.25 a day.
- 100 percent of Canadians have access to clean water, whereas only 13 percent of the people in Afghanistan do .

Ödemeler Dengesi (Balance of Payments)

- Bir ekonominin dış dünya ile yaptığı işlemler ödemler bilançosuna kaydedilir.
- Türkiye’de ÖD’ni aylık olarak TCMB hesaplar ve internette yayınlar.
- ÖD beş ana kalemden oluşur:
  1. Cari işlemler hesabı
  2. Sermaye hesabı
  3. Finans hesabı
  4. Net hata ve noksan
  5. Rezerv değişikleri

- Ödemeler Dengesi = Cari İşlemler Hesabı + Sermaye Hesabı + Finans Hesabı + Net Hata ve Noksan + Rezerv Varlıklar = 0

- 2013 yılı Kasım ayı itibariyle açıklanan ödemeler dengesi verileri:

- Ödemeler Dengesi (milyon USD) = -55.962 – 76 + 65.682 + 4.839 – 14.483 = 0

ÖDEMELER DENGESİ (Milyon USD)	2010	2011	2012	2013/11
CARİ İŞLEMLER HESABI	**-45.447**	**-75.092**	**-48.504**	**-55.962**
İhracat (FOB)	120.902	143.396	163.221	149.577
İthalat (FOB)	-177.315	-232.535	-228.553	-221.070
Mal Dengesi	**-56.413**	**-89.139**	**-65.332**	**-71.493**
Hizmetler Dengesi: Gelir	36.279	40.668	43.150	44.310
Hizmetler Dengesi: Gider	-19.621	-20.538	-20.548	-21.293
Mal ve Hizmet Dengesi	**-39.755**	**-69.009**	**-42.730**	**-48.476**
Gelir Dengesi: Gelir	4.477	3.952	5.034	3.974
Gelir Dengesi: Gider	-11.692	-11.793	-12.191	-12.449
Mal, Hizmet ve Gelir Dengesi	**-46.970**	**-76.850**	**-49.887**	**-56.951**
Cari Transferler	**1.523**	**1.758**	**1.383**	**989**

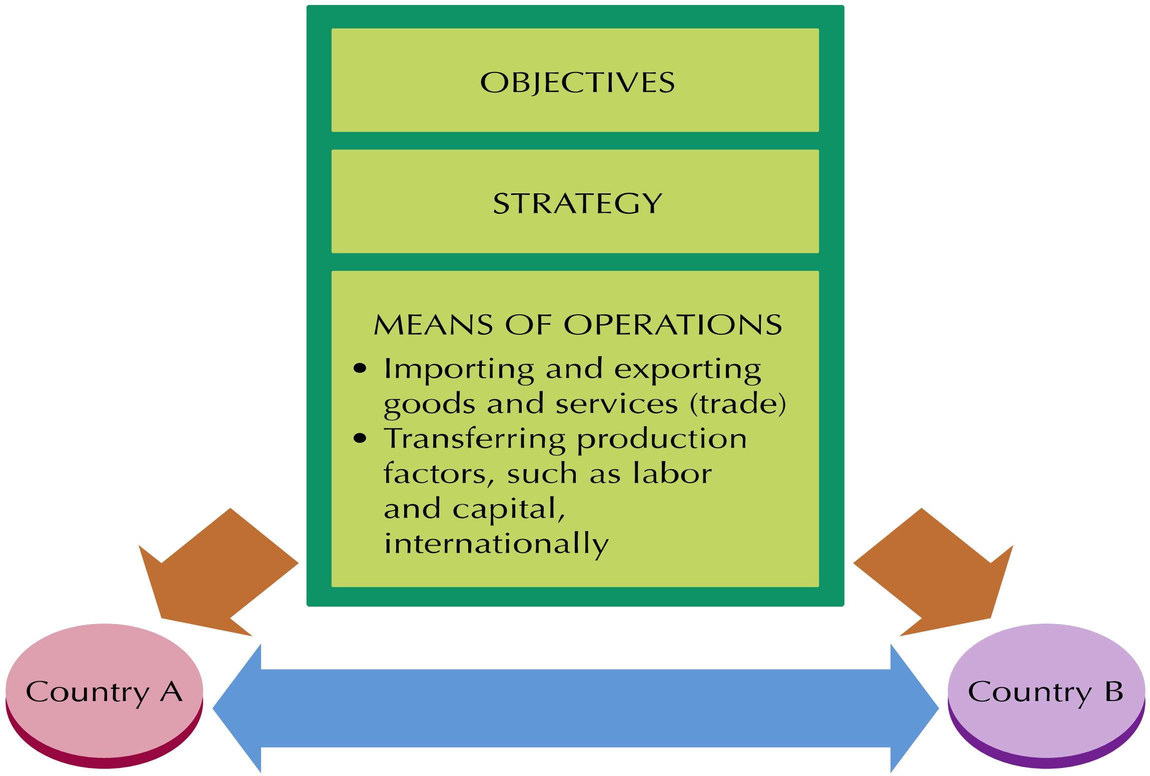
SERMAYE HESABI	**-51**	**-25**	**-44**	**-76**
FİNANS HESABI	**59.061**	**66.698**	**70.172**	**65.682**
Yurtdışında Doğrudan Yatırım	-1.464	-2.349	-4.074	-2.666
Yurtiçinde Doğrudan Yatırım	9.036	16.047	13.016	10.394
Portföy Hesabı (Varlıklar)	-3.524	2.688	2.657	2.689
Portföy Hesabı (Yükümlülükler)	19.617	19.298	38.132	21.235
Diğer Yatırımlar (Varlıklar)	7.012	11.136	-569	1.188
Diğer Yatırımlar (Yükümlülükler)	28.384	19.878	21.010	32.842
Cari, Sermaye, Finansal Hesaplar	13.563	-8.419	21.624	9.644
NET HATA VE NOKSAN	**1.405**	**9.433**	**1.197**	**4.839**
GENEL DENGE	**14.968**	**1.014**	**22.821**	**14.483**
REZERV VARLIKLAR	**-14.968**	**-1.014**	**-22.821**	**-14.483**
Resmi Rezervler	-12.809	1.813	-20.814	-13.631
Uluslararası Para Fonu Kredileri	-2.159	-2.827	-2.007	-852
Bilgi için:				
GSYH	**731.600**	**774.000**	**786.000**	**823.000**
Cari Açık GSYH (%)	-6,2	-9,7	-6,0	-7,4
12 Aylık Bazda Cari Açık	**-45.447**	**-75.092**	**-46.935**	**-60.838**

Chapter 5

International Trade and Factor Mobility

Laissez-Faire vs. Intervention

International Operations and Economic Connections



Learning Objectives

- To understand theories of international trade
- To understand why production factors, especially labor and capital, move internationally
- To explain the relationship between foreign trade and international factor mobility

Laissez-Faire vs. Intervention

- Trade theory helps answer
  - What products should we import and export?
  - How much should we trade?
  - With whom should we trade?
- Laissez-faire approach
  - Free trade theories – absolute advantage and comparative advantage
- Intervention approach
  - Mercantilism and neomercantilism

Interventionist Theories

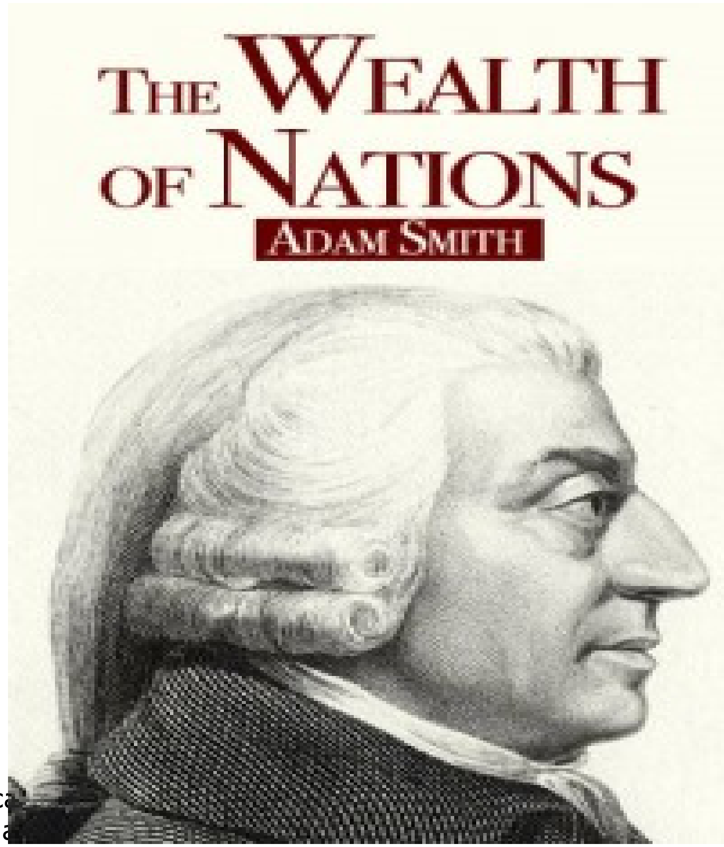
- Theories that support government intervention in the flow of trade
  - Mercantilist theory proposed that a country should try to achieve a favorable balance of trade (export more than it imports)
  - Neomercantilist policy also seeks a favorable balance of trade, but its purpose is to achieve some social or political objective

Free Trade Theories

- Two theories that support free trade
  - Absolute advantage theory
  - Comparative advantage theory
- Market forces should determine trade
  - specialization

Theory of Absolute Advantage

- Theory of **absolute advantage**
  - different countries produce some goods more efficiently than others
- Free trade brings
  - Specialization
    - **natural advantage**
    - **acquired advantage**
      - product technology
      - process technology



Production Possibilities under Conditions of Absolute Advantage

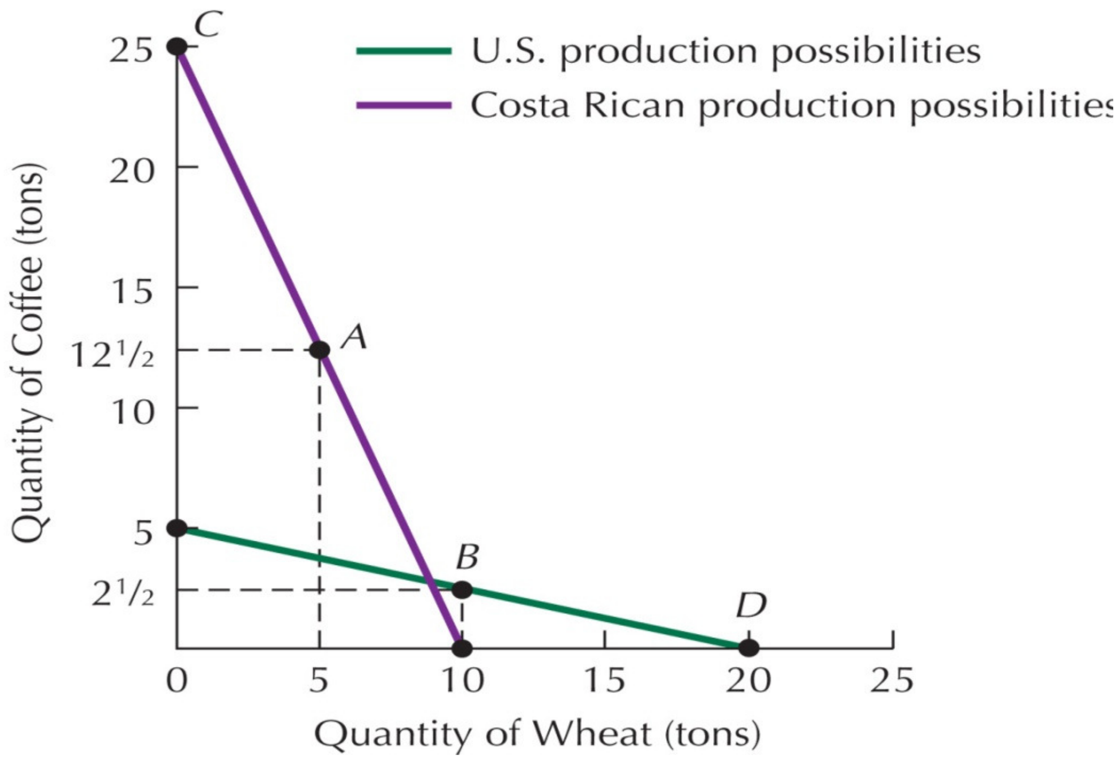
ASSUMPTIONS
for Costa Rica

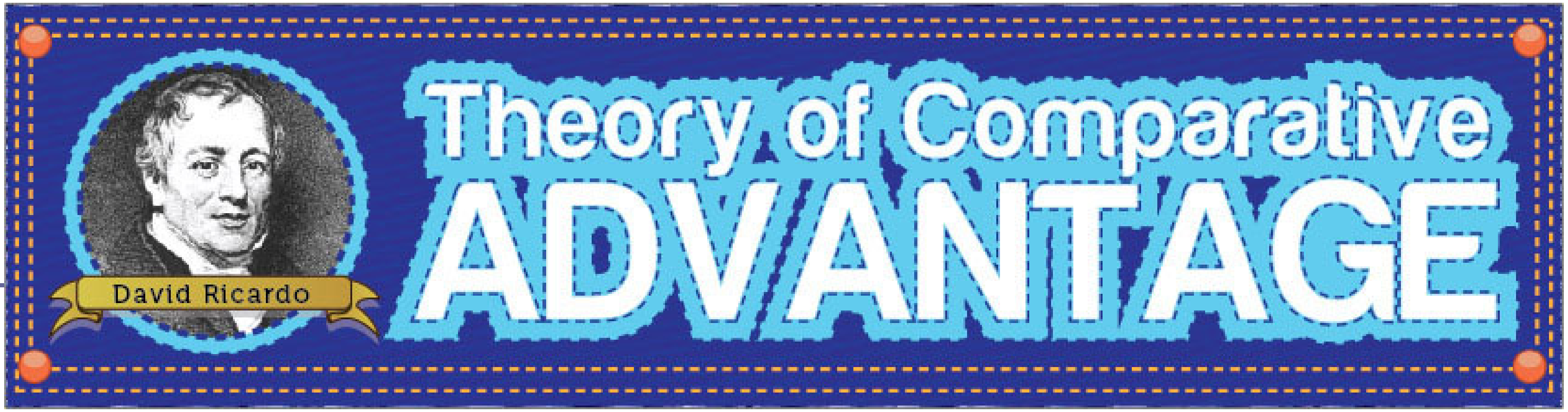
1. 100 units of resources available
2. 10 units to produce a ton of wheat
3. 4 units to produce a ton of coffee
4. Uses half of total resources per product when there is no foreign trade

ASSUMPTIONS
for United States

1. 100 units of resources available
2. 5 units to produce a ton of wheat
3. 20 units to produce a ton of coffee
4. Uses half of total resources per product when there is no foreign trade

PRODUCTION	Coffee (tons)	Wheat (tons)
Without Trade:		
Costa Rica (point *A*)	$12\frac{1}{2}$	5
United States (point *B*)	$2\frac{1}{2}$	10
Total	15	15
With Trade:		
Costa Rica (point *C*)	25	0
United States (point *D*)	0	20
Total	25	20





- Theory of **comparative advantage**
  - free trade can increase global output even if one country has an absolute advantage in the production of all products

Theory of Comparative Advantage

Production Possibilities under Conditions of Comparative Advantage

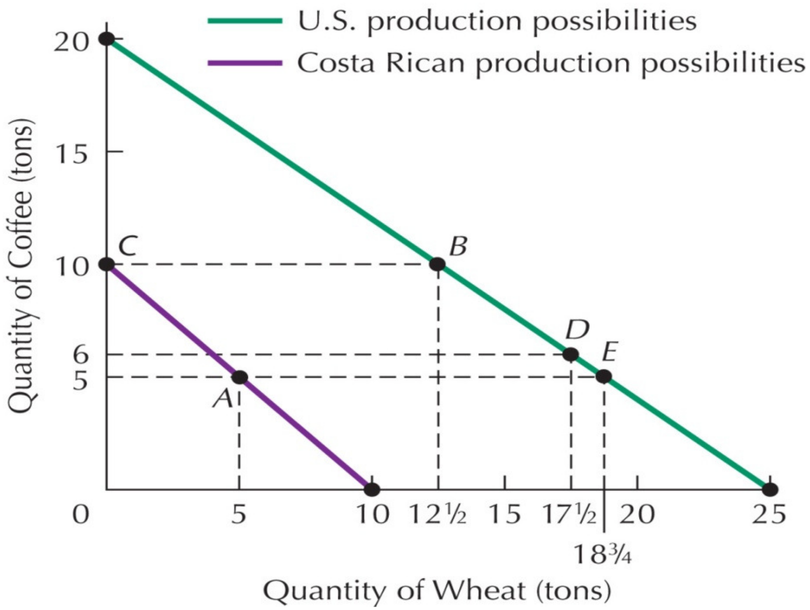
ASSUMPTIONS
for Costa Rica

1. 100 units of resources available
2. 10 units to produce a ton of wheat
3. 10 units to produce a ton of coffee
4. Uses half of total resources per product when there is no foreign trade

ASSUMPTIONS
for United States

1. 100 units of resources available
2. 4 units to produce a ton of wheat
3. 5 units to produce a ton of coffee
4. Uses half of total resources per product when there is no foreign trade

PRODUCTION	Coffee (tons)	Wheat (tons)
Without Trade:		
Costa Rica (point *A*)	5	5
United States (point *B*)	10	12½
Total	15	17½
With Trade (increasing coffee production):		
Costa Rica (point *C*)	10	0
United States (point *D*)	6	17½
Total	16	17½
With Trade (increasing wheat production):		
Costa Rica (point *C*)	10	0
United States (point *E*)	5	18¾
Total	15	18¾



Theories of Specialization: Assumptions and Limitations

- Theories of specialization make assumptions that may not be valid
  - full employment
  - economic efficiency
  - two countries, two commodities
  - transport costs
  - mobility

In-class activity

100 units of resources available

- Assumptions for <u>YOUR NAME</u>

1. Xxxxxx***<u>xx</u>*** (student number) units to produce a ton of wheat
2. Xxxx***<u>xx</u>***xx units to produce a ton of coffee

- Assumptions for Costa Rica
- 10 units to produce a ton of wheat
- 5units to produce a ton of coffee

Uses half of resources per product when there is no trade

Questions

1. Draw production possibilities curve
2. Determine which product should Costa Rica and you produce and trade
3. Calculate total production with and without trade

How Much Does A Country Trade?

- **Theory of country size**
  - large countries depend less on trade than small countries
    - Geographically

What Does A Country Trade?

- **Factor proportions theory**
  - factors in relative abundance are cheaper than factors that are relatively scarce
  - capital versus labor

Source: Jeff Zenner Photography/Shutterstock.com

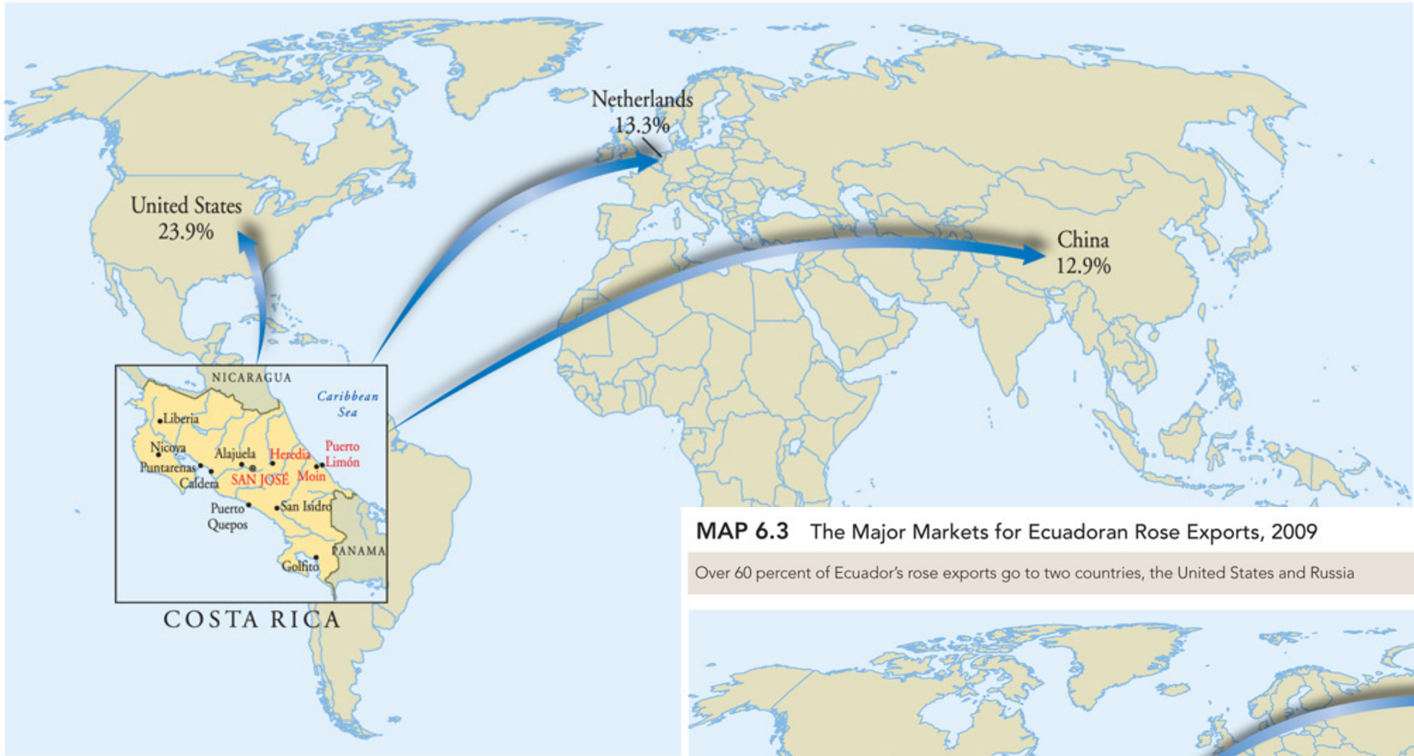
Source: Rubengutierrez | Dreamstime.com

Choosing Trading Partners

- **Country similarity theory**
- Most trade occurs among high-income countries because they share similar market segments
- Much of the pattern of two-way trading partners may be explained by cultural similarity between the countries, political and economic agreements, and by the distance between them

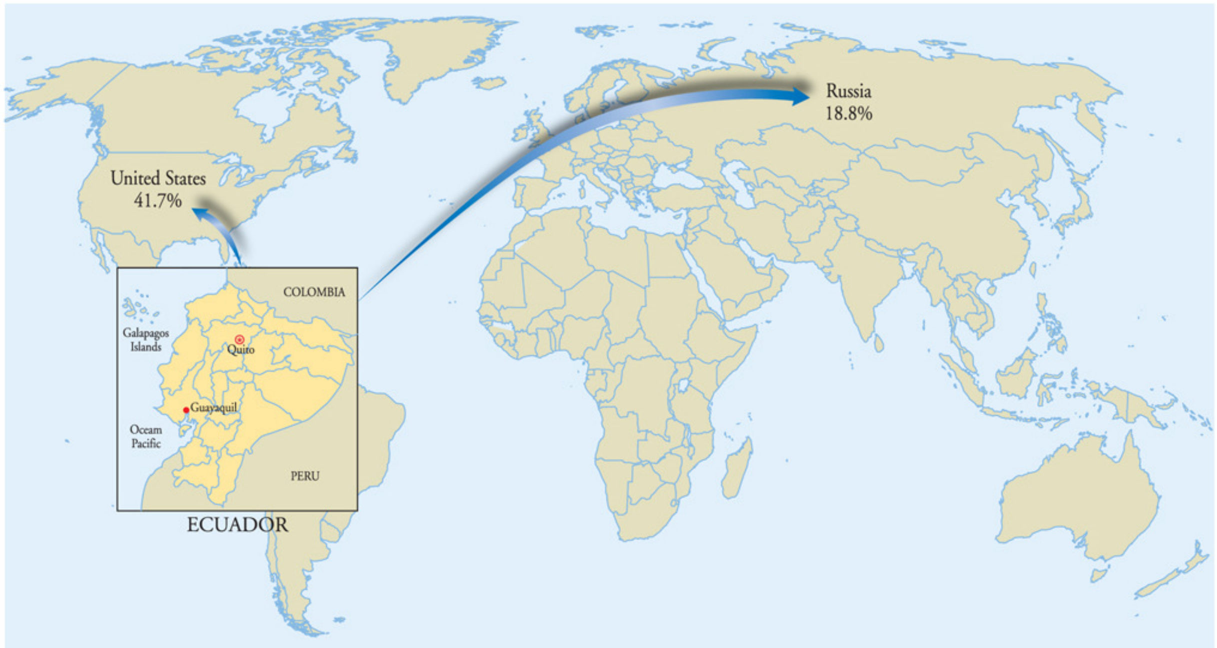
MAP 6.1 Costa Rica

In 2009, about 50 percent of Costa Rica's exports went to three countries.



MAP 6.3 The Major Markets for Ecuadoran Rose Exports, 2009

Over 60 percent of Ecuador's rose exports go to two countries, the United States and Russia



Product Life Cycle Theory

- The **product life cycle theory**
  - the production location of certain manufactured products shifts as they go through their life cycle
- Four stages
  - Introduction
  - Growth
  - Maturity
  - Decline

Product Life Cycle Theory

Life Cycle of the International Product

During its life cycle, focus on a product's production and market locations often shifts from industrial to developing markets. The process is accompanied by changes in the competitive factors affecting both production and sales, as well as in the technology used to produce the product.

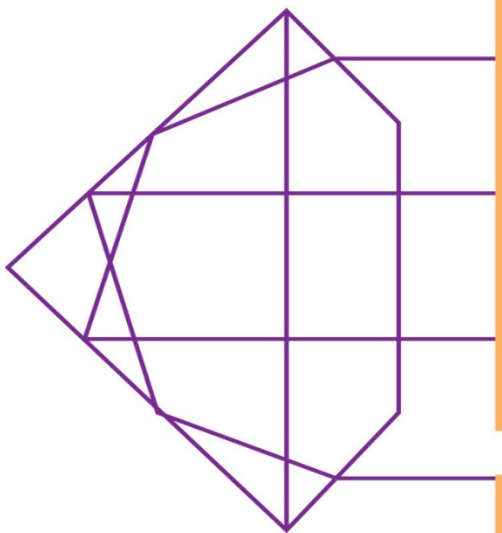
Life Cycle Stage

	1: Introduction	2: Growth	3: Maturity	4: Decline
Production location	• In innovating (usually industrial) country	• In innovating and other industrial countries	• Multiple countries	• Mainly in developing countries
Market location	• Mainly in innovating country, with some exports	• Mainly in industrial countries • Shift in export markets as foreign production replaces exports in some markets	• Growth in developing countries • Some decrease in industrial countries	• Mainly in developing countries • Some developing country exports
Competitive factors	• Near-monopoly position • Sales based on uniqueness rather than price • Evolving product characteristics	• Fast-growing demand • Number of competitors increases • Some competitors begin price cutting • Product becoming more standardized	• Overall stabilized demand • Number of competitors decreases • Price is very important, especially in developing countries	• Overall declining demand • Price is key weapon • Number of producers continues to decline
Production technology	• Short production runs • Evolving methods to coincide with product evolution • High labor input and labor skills relative to capital input	• Capital input increases • Methods more standardized	• Long production runs using high capital inputs • Highly standardized • Less labor skill needed	• Unskilled labor on mechanized long production runs

Diamond of National Advantage

The Diamond of National Competitive Advantage

The Diamond of National Competitive Advantage



Factor conditions: Are sufficient quantities and combinations of the quality of labor, capital, and raw materials available at acceptable prices?

Demand conditions: Are consumers likely to buy what we can produce with the factor conditions above and at the price we can deliver to them?

Related and supporting industries: Can we outsource production of sufficient components and services to allow us to concentrate our efforts on what we can do best?

← Development

Firm strategy, structure, and rivalry: Will competitive conditions and our reactions to them enable us to evolve our operations to sustain and improve our market position?

← Sustainability

Trade Theories and Business

What Major Trade Theories Do and Don't Discuss: A Checklist

A check mark indicates that a theory of trade concerns itself with the question asked at the head of the column; if there's a dash, it doesn't. In columns 4-7, you can see how each theory responds to the specific question; again, a dash indicates that the theory does not address the question.

	Description of Natural Trade			Prescription of Trade Relationships			
Theory	How Much Is Traded	What Products Are Traded?	With Whom Does Trade Take Place?	Should Government Control Trade?	How Much Should Be Traded?	What Products Should Be Traded?	With Whom Should Trade Take Place?
Mercantilism	—	—	—	yes	✓	✓	✓
Neomercantilism	—	—	—	yes	✓	—	—
Absolute advantage	—	✓	—	no	—	✓	—
Comparative advantage	—	✓	—	no	—	✓	—
Country size	✓	✓	—	—	—	—	—
Factor proportion	—	✓	✓	—	—	—	—
Country similarity	—	✓	✓	—	—	—	—
Product life cycle (PLC)	—	✓	✓	—	—	—	—
Diamond of national advantage	—	✓	—	—	—	—	—

Chapter 6

Governmental Influence on Trade

Learning Objectives

- To explain the rationales for governmental policies that enhance and restrict trade
- To illustrate the major means by which trade is restricted and regulated

Why Governments Intervene in Trade

Economic Rationales	Noneconomic Rationales
Preventing unemployment	Maintaining essential industries
Protecting infant industries	Dealing with unfriendly countries
Promoting industrialization	Maintaining or extending spheres of influence
Improving comparative position	Preserving national identity

Fighting Unemployment

- The unemployed are the most effective pressure group
- But, import restrictions
  - can lead to retaliation by other countries
    - less likely retaliated against effectively by small economies
    - The impact of retaliation varies according to factor intensives.
- May cause loss of jobs because of price increases for components
- May cause loss of import handling jobs

Protecting ‘Infant Industries’

- The **infant industry argument**
  - government protection of import competition is necessary to help certain industries evolve from high-cost to low-cost production

Developing an Industrial Base

- Countries promote industrialization because it
  - brings faster growth than agriculture
  - brings in investment funds
  - diversifies the economy
  - brings more income than primary products do
  - reduces imports and promotes exports
  - helps the nation-building process

Developing an Industrial Base

- Assumptions
  - Surplus Workers
  - Investment Inflows
  - Diversification
  - Growth in Manufactured Goods
  - Import Substitution and Export-Led Development

Economic Relationships With Other Countries

- Trade controls can be used
  - to improve the balance of payments
  - to gain fair access to foreign markets
    - **comparable access argument**
  - to control prices
    - **dumping**
    - **optimum-tariff theory**

Why Governments Intervene in Trade

Economic Rationales	Noneconomic Rationales
Preventing unemployment	Maintaining essential industries
Protecting infant industries	Dealing with unfriendly countries
Promoting industrialization	Maintaining or extending spheres of influence
Improving comparative position	Preserving national identity

Maintaining Essential Industries

- The **essential industry argument**
  - protect essential industries so the country is not dependent on foreign supplies during war
- Countries must
  - determine which industries are essential
  - consider costs and alternatives
  - consider political consequences

Promoting Acceptable Practices Abroad

- Import trade controls can be used
  - to promote changes in foreign countries' political policies or capabilities
  - as a foreign policy weapon
  - to pressure governments to alter their stances on a variety of issues
    - human rights
    - environmental protection

Maintaining or Extending Spheres of Influence

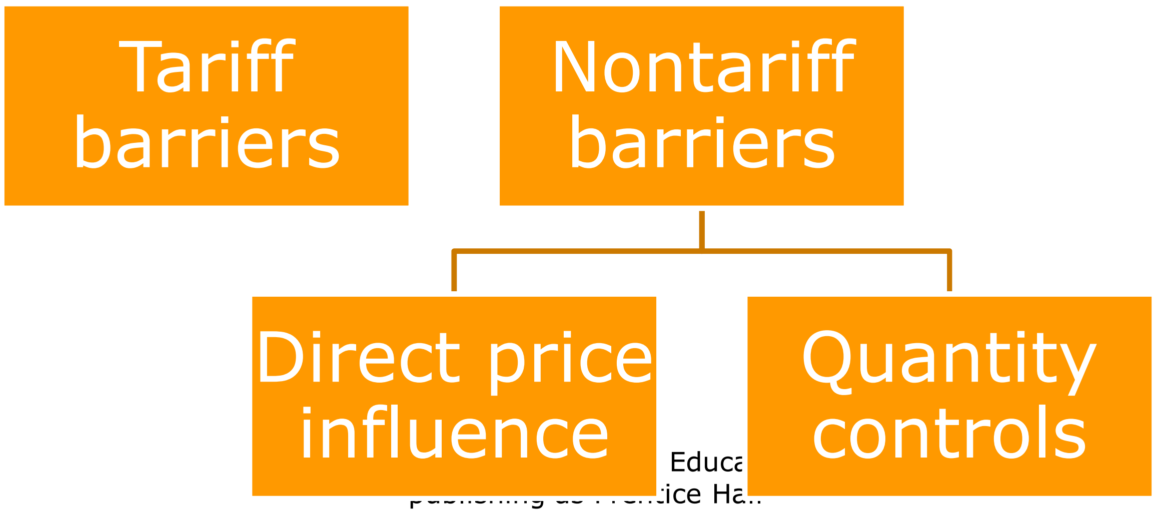
- Governments provide assistance and encourage imports from countries that join a political alliance or vote a preferred way within international bodies
  - Cotonou Agreement
- A country's trade restrictions may coerce governments to follow certain political actions or punish companies whose governments do not

Preserving National Culture

- In order to preserve national culture, countries
  - limit foreign products and services in certain sectors
    - Canada’s cultural sovereignty
  - prohibit exports of art and historical items deemed important to national heritage

Instruments of Trade Control

- Two types of trade controls
  - those that indirectly affect the amount traded by directly influencing prices of exports or imports
  - those that directly limit the amount of a good that can be traded



Tariffs

- **Tariffs** are also known as **duties**
  - refer to a government levied tax on goods shipped internationally
    - import tariff
    - Export tariff
    - Transit tariff
    - Spesific duty
    - Advalorem duty
    - Compound duty

Nontariff Barriers: Direct Price Influencers

- Subsidies: direct assistance to companies in form of government funds, low interest government loans
- Aid and Loans: given to other countries by government

Nontariff Barriers: Direct Price Influencers

- Aid and loans
  - tied
  - untied
- Customs valuation
- Other direct-price influences
  - special fees and requirements

Nontariff Barriers: Quantity Controls

- Trade controls that directly affect quantity and indirectly affect price include:
  - quotas
  - voluntary export restraint (VERs)
  - "buy local" legislation
  - standards and labels
  - specific permission requirements
  - administrative delays
  - reciprocal requirements
  - restrictions on services