CHAPTER 2
TRADE AND INVESTMENT POLICIES

Chapter Objectives

- To see how trade and investment policies have historically been a subset of domestic policies
- To examine how traditional attitudes toward trade and investment policies are changing
- To see the effects of global links in trade and investment on policymakers
- To understand that nations must cooperate closely in the future to maintain a viable global trade and investment environment
- To understand what policies are needed to achieve a growing, viable global trade and investment environment

General Suggestions for Teaching

It has been useful to demonstrate to students how policy makers have to trade off conflicting priorities such as domestic unemployment vs. international security needs. Lively debate usually results when one asks different groups to participate in role playing. For example, one group can advocate the need for U.S. scrutinizing of imports while another group takes the position of a business group needing to expedite the transport of perishable goods.

We have also found it helpful to show students the conflicts among domestic priorities. One good example which is always enthusiastically responded to is the issue of import restrictions. Students should 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.

Opening Case
The Global Economic Crisis and Lessons from the Depression
Summary: In 2007, serious imbalances in the U.S. subprime mortgage market triggered the biggest worldwide economic recession and the first contraction in global output since World War II. Recognizing the severity of the global crisis, the leaders of the Group of Twenty (G-20) met in April 2009 to attempt a global solution. The major result of the meeting was the leaders; pledge to make available $1.1 trillion in new resources for the International Monetary Fund. Teaching Hint: To help students understand the outcomes of the recent G-20 summit, discuss the

following two questions:
1. What were some of the main concerns of the decisions made at the summit?
2. How are we reminded of the Smoot-Hawley Act of 1930?

Chapter Outline

I. Rationale and Goals of Trade and Investment Policies
   A. Government policies are designed to regulate, stimulate, direct, and protect national activities, resulting in **national sovereignty**
   B. The domestic actions of most governments aim to increase the **standard of living** and improve the **quality of life** of its citizens.
      1. Additional goals include stimulating national development and achieving full employment
      2. Quality of life and standard of living are closely interlinked
      3. All of these policy goals affect international trade and investment indirectly
   C. Nations develop **foreign policy** to provide domestic benefits and to exercise influence abroad
      1. National security is often a goal of foreign policy
      2. Nations may wish to improve trade and investment opportunities
      3. Providing foreign aid can help develop markets and increase influence
      4. Each country develops its own domestic policies, so policy aims vary from nation to nation

II. Global Trade Regulation Since 1945
   A. International Trade Organization (ITO)
      1. Signed in 1948 with 53 nation members
      2. To facilitate international trade
      3. It was never implemented because most nations refused to sign it fearing the power and size of the new organization would threaten national sovereignty
   B. The General Agreement on Tariffs and Trade (GATT)
      1. To facilitate trade and settle disputes
      2. Member nations agree to limit the level of tariffs on other members
      3. Each member grants every other member Most-Favored Nation (MFN) status
      4. Because the ITO never came into being, the GATT became the governing body for settling international trade disputes
   C. World Trade Organization (WTO)
      1. Took the place of GATT
      2. Reduce government subsidies to industries
      3. Replace nontariff barriers with more transparent tariffs

4. The latest round of negotiations, called the Doha Round, aim to further hasten implementation of liberalization to particularly help impoverished and developing nations
    a. The Doha Round has proven to be a very difficult series of negotiations
    b. Considerable disagreement between developed nations and developing WTO members

III. Changes in the Global Policy Environment
  A. Limits of Domestic Policy Influences
    1. You cannot isolate domestic economic activity from international market events
    2. Interdependencies among nations and a closer link between industries around the world are growing
    3. Currency flows set the exchange rates independent of trade
    4. It appears that a result of the global financial crisis will be increased coordination of economic policy by governments
    5. Domestic policy decisions often have major international repercussions
    6. Legislators around the world are continually confronted with the effects of international links

Focus on Politics
What's Your Beef?
Summary: In 2003, over 30 countries including Japan and Korea imposed a ban on most imports of U.S. and Canadian beef following reported cases of mad cow disease in both countries. This was a serious setback for North American beef growers. Australian beef growers quickly took advantage and seized a sizable chunk of the market in Japan. Although U.S. beef trade resumed by 2006 in Japan, it has yet to regain its former strength. In 2009, the United States became the number two beef exporter to Korea, trailing Australia. Teaching Hint: Ask students to consider how the mad cow epidemic contributed to lasting changes in global market share for beef. Are there industries that have experienced similar market shakeups as a result of products that are deemed to be potentially harmful?

  B. Revitalizing International Institutions
    1. WTO problems
      a. Since the WTO has been so successful in reducing tariffs, other trade disputes may be more sharply debated and difficult to resolve
      b. A greater challenge may be the future of the overall multilateral trading system

c. Trying to solve social causes can cause divisiveness
d. The WTO should focus on its core mission, which is the support of international trade and investment

2. International Monetary Fund (IMF)
   a. Lending policies are seen as austere and inflexible, with many who believe that the IMF does not consider situations and needs
   b. Lack of authority and resources to manage imbalances in financial and trade flows
   c. It does not have enough funds for all needs
   d. At the 2009 G-20 Summit, international financial institutions were strengthened via a tripling of the IMF's lending capacity
3. World Bank
   a. Not completely successful in helping the developing world and former Soviet bloc nations
   b. Some claim that its policies may have even created poverty
   c. The G-20 has committed to strengthening international institutions for the new array of economic challenges emanating from a more globalized world

C. Sharpening of the Conflict Between Industrialized and Developing Nations
   1. With increased transfer of technology and major infusions of funds, it was once hoped that the developmental gap between industrialized and less-developed nations would gradually be closed
   2. Many nations remain in debt with political instability and very fragile economies
   3. An increase in environmental awareness has contributed to a further sharpening of the conflict

IV. Policy Responses to Changing Conditions

A. Restrictions of Imports
   1. **Tariffs**—taxes on the value of imported goods and services
   2. **Quotas**—restrictions on the number of foreign products that can be imported
   3. **Nontariff barriers**—measures that restrict imports through testing, certification, or bureaucratic hurdles
   4. **Voluntary restraint agreements** are designed to help domestic industries reorganize, restructure, and recapture production prominence
   5. **Anti-dumping laws** that prohibit the selling of products in foreign markets below the domestic price

Focus on Politics
Mexican Trucks and American Safety
Summary: Under NAFTA, the U.S. and Mexican governments agreed to give trucks from each country equal access to deliver goods in the neighboring country and return home with new goods. However, American labor unions, environmentalists, and other activists objected to this provision, citing safety issues, environmental risks, and threats to American jobs. For years the issue was brought to court. In September 2007, a one year pilot study was announced that would allow approved Mexican trucking companies to enter into the United States. When this program was ended in 2009, Mexico retaliated by imposing $2.4 billion in tariffs on 89 U.S. products entering Mexico. By March 2010, the issue was still being disputed. Teaching Hint: Ask students if they were aware of this situation. Some of your students may assume that NAFTA always benefits Mexico and not the United States. What solutions would the students recommend to this conflict?

6. The Effects of Import Restriction
    a. Controls exact a huge price from domestic consumers
    b. There is a downstream change in the composition of imports that may result
    c. Controls may lead to inefficiency because they create a cushion of increased income, which may cause the industry to lag behind
    d. Governments may retaliate against restrictions by erecting similar barriers at home
    e. Corporations can make strategic use of such barriers by incorporating them into business plans
    f. Corporations can use foreign direct investment to circumvent restrictions

B. Restrictions of Exports—most often for national security concerns
    1. Reasons to control exports include short supply, national security, foreign policy purposes, or desire to retain capital
    2. Provide local consumers with access to agricultural products and commodities at lower prices

C. Export Promotion
    1. Promotion programs help domestic firms enter and maintain their position in international markets
    2. Most governments supply some support to their firms participating or planning to participate in international trade
    3. Approaches include:
        a. Knowledge transfer to enable greater competence within firms
        b. Direct or indirect subsidization of export activities

        c. Reduction of government red tape for exporters
        d. Export financing by governments

D. Import Promotion—to allay fears of other nations over continued imbalances
E. Investment Policies
    1. Countries attempt to influence investment capital flows to protect ownership, control, and development of domestic industries
    2. Major foreign investments in the U.S. may be reviewed by the Committee on Foreign Investments in the United States
F. The Host-Country Perspective
    1. Appreciates the contributions that foreign direct investment makes
    2. Fears dominance, interference, and dependence (See Table 2.4 on page 52)
    3. The positive impact – Foreign direct investment:
        a. Is closely linked to knowledge transfer
        b. Can be used in developing a geographical region or an industry sector
        c. May intensify competition
        d. Spurs job creation
    4. The negative impact
        a. Foreign direct investment is concentrated in technology – intensive industries
        b. Foreign direct investment contributes to brain drain
        c. Capital inflows are accompanied with capital outflows
        d. Multinationals may not be welcome by governments of some countries
G. The Home-Country Perspective
    1. Addition to gross domestic product
    2. Stimulant to economic growth
    3. Access to raw materials and other factors of production
    4. Job loss can also develop
    5. Transfer of technology and knowledge to other countries
H. Restrictions on Investment due to **capital flight**
I. Investment Promotion to attract foreign direct investment
    1. **Fiscal incentives**—tax measures
    2. **Financial incentives**—special funding for the investor
    3. **Nonfinancial incentives**—such as guaranteed government purchase and protection measures

Focus on Politics
Money Buys Investments
Summary: The southern states of Alabama, Tennessee, and Mississippi offered millions of dollars in incentives to attract foreign automobile manufacturers to locate in their states. To control competition among European countries, the EU has passed regulations to prevent member nations from unfairly attracting investments from each other. The offering of financial incentives has spread to other industries as well. Today, governments compete for green industries and high-tech computer and electronic companies. Teaching Hint: Make this vignette come alive by giving students an assignment such as those listed below: 1. Determine how many foreign companies are doing business within your market area. Discuss these findings in your next class meeting. 2. Are there any local companies importing products from abroad? 3. What is the impact on employment of the foreign companies operating in your area?

J. Management of the Policy Relationship
   1. The bargaining positions and power of the multinational corporation and the host country change over time (see Figure 2.2 on page 57)
   2. Bargaining power can be strengthened by:
      a. Developing a local support system through local financing, procurement, and business contracts
      b. Maintaining control over access to technology and markets
   3. Host countries try to enhance their role by instituting control policies and performance requirements
   4. Host country policies on **intellectual property rights** can have an important influence on foreign direct investment

V. A Strategic Outlook for Trade and Investment Policies
   A. A U.S. Perspective
      1. A positive trade policy rather than reactive responses
      2. Proposals for **protectionistic legislation** can be helpful as bargaining chips
      3. Trade policy must become more domestically oriented while domestic policy must become more international in vision
         a. Improve the quality and amount of information shared by government and business
         b. Encourage collaboration among companies in technologies
         c. U.S. industry must overcome its export reluctance and short-term financial orientation
         d. Invest in training and education of people

    e. Executive branch needs **trade promotion authority**
    f. More collaboration is needed between all trading parties, particularly due to the growing economic and trade concerns

B. An International Perspective
    1. Trade and investment negotiations must continue
    2. **Bilateral negotiations**—two nations
    3. **Multilateral negotiations**—several nations
    4. Emphasize long-term goals
    5. New mechanisms to evaluate restraint measures are needed

Questions for Discussion

1. Discuss the role of voluntary import restraints in international business.

Voluntary import restraints are formulated between nations outside of the WTO and other formal trade agreements and are therefore not subject to the limitations imposed by the official agreements. They are applied selectively in attempts to protect specific industries. Because they are more subtle than quotas or tariffs, they give nations the appearance of complying with international agreements.

Voluntary import restrictions are designed to help domestic industries reorganize, restructure, and recapture production prominence. Generally they result in decreased economic efficiency, higher consumer prices, and greater profits for domestic firms.

2. What is meant by multilateral negotiations?

Multi-lateral negotiations take place between several nations, in contrast to bilateral negotiations which involve just two countries. Usually, the involvement of several nations means that a wide variety of issues will be discussed and countries will most likely have favorable results on some points and unfavorable results on others. This is a productive negotiation process because all participants emerge with some degree of victory.

3. Discuss the impact of import restrictions on consumers.

Import restrictions in the form of duties and tariffs keep prices higher than they would in a free trade environment. Quotas result in waiting lists of consumers who want to buy the restricted import while offering domestic producers the opportunity to raise prices on the comparable product. Restrictions on imports to the United States may appear to benefit consumers indirectly by minimizing the 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 can also increase the volatility of the international trade environment and lead to political instability which may affect consumers as citizens.

4. Why would policy makers sacrifice major international progress for minor domestic policy gains?

Policymakers sacrifice major international progress for minor domestic policy gains because the results are felt domestically. They feel it is their sovereign right to implement any policy that is beneficial to their nation. In addition, as policymakers are for the most part elected officials, any domestic gain can only help them in their respective careers, while international benefits may leave their electorate unimpressed.

5. Discuss the varying inputs to trade and investment restrictions by beneficiaries and by losers.

The beneficiaries of trade and investment restrictions are industries and/or companies. The benefits of such restrictions are clearly visible as they are reflected in the performance of the respective industries and/or companies. These industries more often than not have connections with the policymakers either through personal contact or through lobbyists. Consequently, they are able to voice their concerns and stress the need for import restrictions. On the other hand, the losers are the consumers who have to pay higher prices and who may have to settle for fewer choices and lower quality goods. Because the total cost of import restrictions is spread out over a country's consumer population, the cost burden is relatively small on an individual basis. As a result, the opposition to such restrictive measures is considerably less vocal. Due to the differing amount of input, policy makers have in the past almost completely disregarded the effect of import restrictions on the consumers.

6. Discuss the effect of foreign direct investment on trade.

Foreign direct investment has major effects on both the home and host countries. For the home country, the positive aspects of the investment may include increased exports, increased experience in foreign business practices, and increased expertise in international negotiations. The costs may include a displacement of jobs, loss of exports, and loss of political control over the management of the firm based abroad.

The benefits for the host country may include 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 potential problems such as 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.

7. Do investment promotion programs of state (or provincial) governments make sense from a national perspective?

Typically, a country benefits from FDI. Through investment incentive programs, a country can lure new industries, and in doing so, provide more jobs for domestic workers. In addition, these investments spur the country's economic growth, leading to a rise in national income.
In a situation where states or provinces compete against each other in attracting FDI, the economic benefit of such competition is less clear. Typically, the foreign investor has already made the decision to invest in a particular country. Any benefits offered by localities are then "icing" on the cake. However, there are clear political benefits associated with such local competition for investment—perhaps leading to the (re)election of a mayor or a governor. Therefore, such local investment programs are likely to continue.

Internet Exercises

1. Go to the World Bank web site (www.worldbank.org) to obtain an overview of the bank's purpose and programs. Search for criticism of bank programs on other web sites and prepare a short report on the key issues accounting for the "World Bank Controversy."

The following are some sample search websites:
1) http://www.corpwatch.org
2) http://www.lexisnexis.com
4) http://www.globalpolicy.org
5) www.brettonwoodsproject.org
6) http://findarticles.com

The purpose of the World Bank is to provide loans and help poor countries. Many claim that the World Bank has failed to help developing countries get out of poverty.

2. For the country of your choice, please find the web site of the export promotion agency and identify the key programs offered to exporters. Which ones do you find most helpful to firms?

A search for "export promotion agency" on the web brings up a number of web sites for export agencies in developing nations. Below are some of the top hits:

- Export Promotion Agency of Afghanistan - http://www.epaa.org.af/
    - Featured exportable products, including carpets, marbles, fresh and dry fruits

    - Links for news and events
    - Step-by-step instructions for exporting
- Rwanda Development Board http://www.rwandainvest.com/
    - Reasons to invest in Rwanda
    - Export opportunities by sector
    - Investor and exporter resources
    - News center
- Jamaica Trade and Investment http://www.jamaicatradeandinvest.org/
    - Investing, trading, and doing business in Jamaica
    - Latest news
    - Export publications

Take a Stand

Summary:
Since the 1980s, the EU has placed increasing restrictions on imports of meat from animals that had been treated with hormones, citing health safety concerns. U.S. and Canadian ranchers regularly use hormones to promote animal growth. Given the EU inaction to change its policies, the U.S. has imposed punitive tariffs on Roquefort cheese and other products that in some cases were as high as 300 percent. While there was a compromise on the agreement, the EU still bans many hormone-fed beef imports, and tariffs on Roquefort remain at 100 percent.

Discussion Question:
1. Are punitive tariffs effective, or do they mainly trigger retaliations?
2. Is it better to cut the cheese or the tariff?

Teaching Hint:
Ask students how many are concerned about hormones and other additives in foods such as beef. Would they be willing to pay three times more for imported cheese as a result? How does this type of retaliation sit with students, and would it affect their purchase decisions and business in general?