

BUSN2019

International Business Context

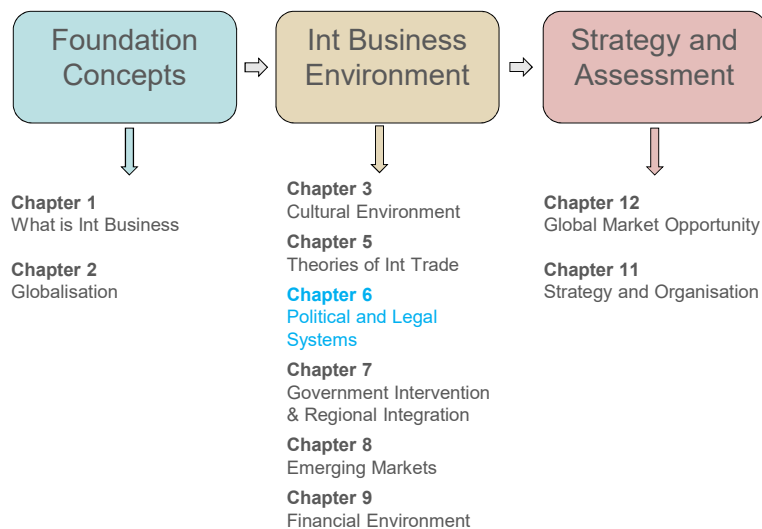
Lecture 7



Alicia Mitton
Topic Coordinator

1

Overview



2



Quiz

Which one of the following is not one of the types of country risk produced by the political system.

- A. Sanctions and embargoes
- B. Boycotts against firms or nations
- C. Government takeover of corporate assets
- D. Environmental scanning

Quiz

Which of the following is not a country risk arising from the host country legal environment?

- A. Command economy
- B. Laws regarding income repatriation
- C. Internet and e-commerce regulations
- D. Foreign investment laws

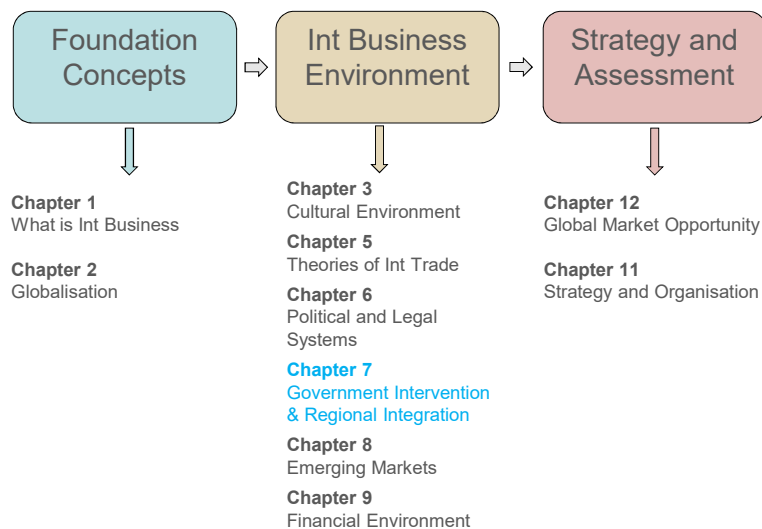
Quiz

Which of the following is not a strategy to minimize country risk?

- A. Strict adherence to ethical standards
- B. Sanctions and embargoes
- C. Alliances with qualified local partners
- D. Protection through legal contracts

5

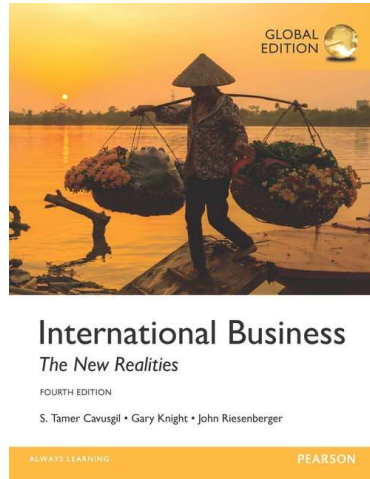
Overview



6

Chapter 7

Government Intervention and Regional Economic Integration

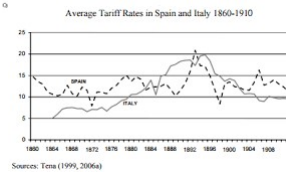
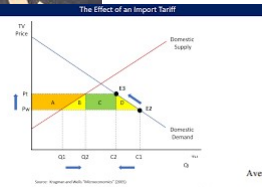


LEARNING OBJECTIVES



- LO 1** Explain the rationale for government intervention in international business.
- LO2** Compare and contrast the instruments of government intervention.
- LO3** Recognise the evolution of government intervention over time.
- LO4** Analyse the response of firms to government intervention.
- LO5** Explain the reasons for why countries pursue regional integration and become part of economic blocs.
- LO6** Compare and contrast the different forms of regional integration.
- LO7** Recognise the success factors for regional integration.
- LO8** Analyse the drawbacks and ethical dilemmas of regional integration.

Government Intervention



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Question

- With the people around you, identify any examples of government intervention in trade that you are familiar with and why you think the government introduced them.

10

10

Government Intervention

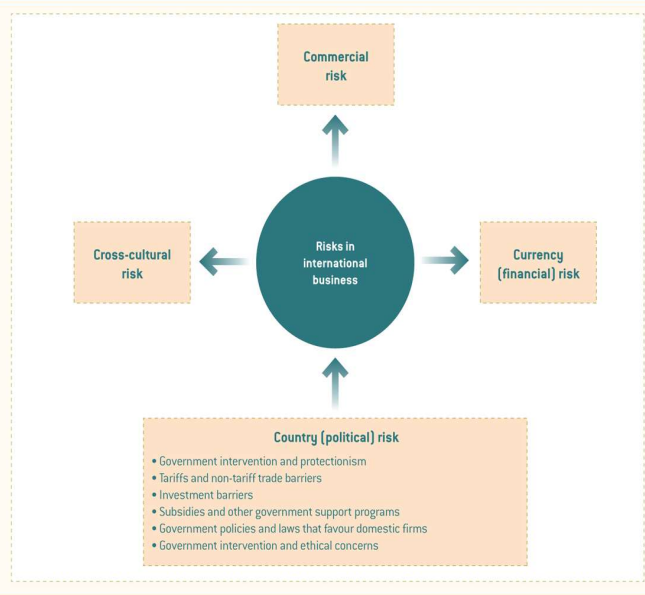


- Governments intervene in trade and investment to achieve political, social, or economic objectives.
- Governments impose trade and investment barriers that benefit interest groups, such as domestic firms, industries and labour unions.
- Government intervention alters the competitive landscape, by hindering or helping the ability of firms to compete internationally.
- Government intervention is an important dimension of *country risk*.

11

11

FIGURE 8.1
Government
intervention as a
component of
country risk



12

Six Types of Government Intervention

1. Protectionism

- National economic policies that restrict free trade. Usually intended to raise revenue or protect domestic industries from foreign competition.

2. Customs

- The checkpoint at national ports of entry where officials inspect imported goods and levy tariffs.



13

13

Six Types of Government Intervention

3. Tariff

- A tax on imports (e.g., autos, textiles)

4. Nontariff trade barrier

- Government policy, regulation, or procedure that impedes trade

5. Quota

- Quantitative restriction on imports of a specific product



6. Investment barriers

- Rules or laws that hinder foreign direct investment

14

14

Consequences of Protectionism

- Reduced supply of goods to buyers
- Price inflation
- Reduced variety, fewer choices available to buyers
- Reduced industrial competitiveness
- Various adverse unintended consequences

e.g., while the home country delays liberalising, other countries can race ahead



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15

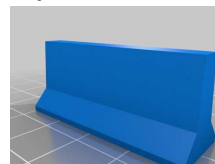
Two Types of Protectionist Barriers

Defensive barriers

- To safeguard industries, workers, special interest groups, protect infant industries and to promote national security (export controls).
- A reaction to what is happening

Offensive barriers

- To pursue a strategic or public policy objective, such as increasing employment or generating taxes.
- Making a positive strategic policy decision

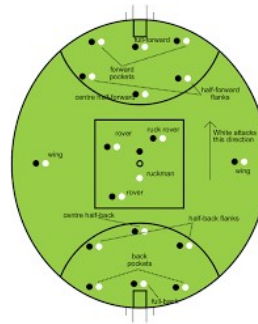


16

16

Defensive Rationale for Government Intervention

1. Protection of the national economy
2. Protection of an infant industry
3. National security
4. National culture and identity



17

17

1. Protection of the National Economy

For example,

- In advanced economies, governments impose trade barriers to block imports as local producers cannot compete with those in developing countries that employ low-cost labour.



Consequences?

- Against principle of comparative advantage, engage in more not less of trade.
- Choice and cost for consumers
- Can trigger retaliation

18

18

2. Protecting an Infant Industry

- Emerging industry firms may lack experience, technological expertise and economies of scale.
- An infant industry may need protection from foreign competitors, e.g. temporary trade barriers on foreign imports.
- Infant industry protection has allowed some countries to develop modern industrial sectors.

Drawbacks:

- Difficult to remove - tend to persist indefinitely.
- Tend to remain dependent on government protection.
- Industry inefficiencies result in higher prices.



19

19

3. National Security Arguments

- Countries impose trade restrictions on products viewed as critical to national defence and security, such as military technology and advanced specialised computers
- Trade barriers can help retain domestic production in security-related products- computers, weaponry, and certain transportation equipment.



20

20

4. Preserving National Culture and Identity

Governments seek to protect certain occupations, industries and public assets central to national culture:

- Switzerland imposed trade barriers to preserve its long-established tradition in watch making.
- Japan restricts the import of rice because it is central to the nation's diet and food culture.
- France and China do not allow foreign ownership of their TV stations because of concerns that foreign influences will taint French culture and spread inappropriate social or political messages in China.



21

Offensive Rationale for Government Intervention

1. National strategic priorities
2. To increase employment



22

22

1. National Strategic Priorities

Intervention encourages the development of industries that improve the nation's economy.

- Deciding which industries to support is challenging;
- It is difficult to predict
 - Which industries will produce comparative advantages?
 - Which industries may result in continuous subsidisation of underperforming industries?



23

23

2. Increasing Employment



- Import barriers may be imposed to protect employment in designated industries.
- By insulating domestic firms from foreign competition, national output is stimulated, leading to more jobs in the protected industries.
- **Unintended consequences?**

24

24

Intervention type	Definition	Practical effect on customers, firms, or government	Contemporary examples
Tariff	Tax imposed on imported products.	Increases cost to the importer, exporter and usually the buyer of the product. Discourages product imports. Generates government revenue.	Switzerland charges a 37% tariff on imported agricultural products. Bolivia charges a 35% tariff on most apparel and textiles.
Quota	Quantitative restriction on imports of a product during a specified period of time.	Gives early importers monopoly power and the ability to charge higher prices. Harms late importers. Usually results in higher prices to the buyer.	Japan maintains strict quotas on the import of leather shoes and various types of seafood.
Local content requirements	Requirement that firms include a minimum percentage of locally sourced inputs in the production of given products or services.	Discourages imports of raw materials, parts and supplies, which harms manufacturers' sourcing options. May result in higher costs and lower product quality for buyers.	At least 50% of the value of all cars assembled in Venezuela must be from parts or other inputs produced in Venezuela.
Regulations and technical standards	Safety, health or technical regulations; labelling requirements.	May hinder the entry of imported products, and reduce the quantity of available products, resulting in higher costs to importers and buyers.	Saudi Arabia bans imports of firearms and used clothing. The EU requires extensive testing on thousands of imported chemicals.

TABLE 8.1 Types and effects of government intervention

SOURCE: Based on the Office of the United States Trade Representative.

(Continue

25

(Continued)

Intervention type	Definition	Practical effect on customers, firms, or government	Contemporary examples
Administrative and bureaucratic procedures	Complex procedures or requirements imposed on importers or foreign investors that hinder trade and investment.	Slows the import of products or services. Hinders or delays firms' investment activities.	Russia imposes extensive inspections and bureaucratic procedures on the import of alcoholic beverages.
FDI and ownership restrictions	Rules that limit the ability of foreign firms to invest in certain industries or acquire local firms.	Limits how much foreigners can invest in a country, and/or the proportion of ownership that foreigners can hold in firms in the country.	In Switzerland, foreign-owned insurance companies must be managed by a Swiss national, and most board members must be European citizens.
Subsidy	Financing or other resources that a government grants to a firm or group of firms, to ensure their survival or success.	Increases the competitive advantage of the grantee, while diminishing the competitive advantages of those that do not receive the subsidy.	Turkey gives export subsidies of up to 20% to local Turkish producers of wheat and sugar.
Countervailing duty	Duties imposed on products imported into a country to offset subsidies given to producers in the exporting country.	Reduces or eliminates the competitive advantages provided by subsidies.	India imposes countervailing duties on the import of numerous products.
Anti-dumping duty	Tax charged on an imported product whose price is below usual prices in the local market or below the cost to manufacture the product.	Reduces or eliminates the competitive advantage of imported products priced at abnormally low levels.	The United States has imposed anti-dumping duties on imports of low-cost steel, to support US-based steel manufacturers.

TABLE 8.1 Types and effects of government intervention

SOURCE: Based on the Office of the United States Trade Representative.

26

Import and Export Tariffs

- **Export tariff:** tax levied on exported products
- **Import tariff:** tax levied on imported products.
 1. **Ad valorem tariff**
 - Tariff is assessed as a percentage of the value of the imported product.
 2. **Specific tariff**
 - A flat fee or fixed amount per unit of the imported product
 - based on weight, volume, or surface area
 - such as Kg, MT or square metres of fabric

27

27

The Reduction of Tariffs

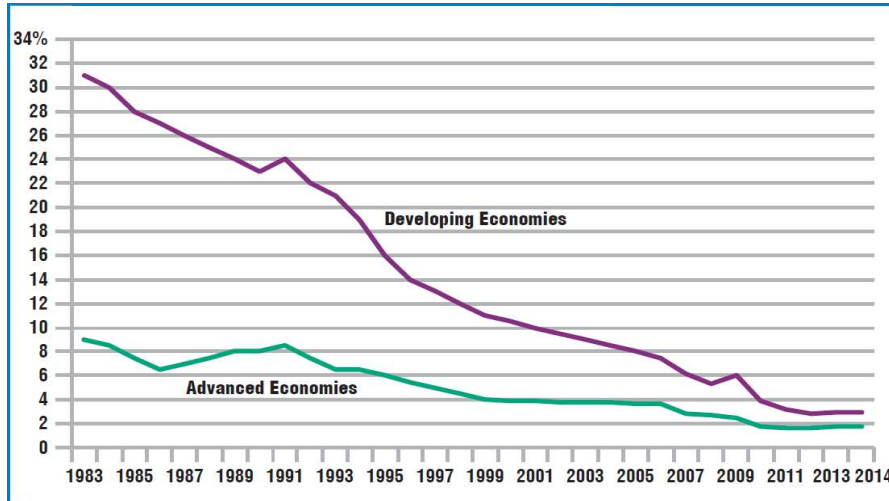
- Governments have tended to reduce tariffs over time
- This is the primary goal of the World Trade Organisation (WTO)
- China reduced its tariffs since joining the WTO in 2001.
- For Australia, import tariffs are mainly between 0 and 5%
- Based on historic analysis, trade liberalisation has increased world trade and helps countries reduce poverty

28



28

Decline in Average Tariff Rates



Source: Based on the World Bank, <http://data.worldbank.org>.

29

Evolution of Government Intervention

- Protectionist tendencies, the Great Depression, and isolationism shaped early 20th century world trade.
- The Smoot-Hawley Act (1930) raised U.S. tariffs to more than 50% (compared to about 3% today).
- Progressive trade policies reduced tariffs after WWII.
- In 1947, 23 nations signed the General Agreement on Tariffs and Trade (GATT).
- The GATT:
 - reduced tariffs via continuous worldwide trade negotiations;
 - created an agency to supervise world trade; and
 - created a forum for resolving trade disputes.

30

30

The GATT (cont')

- The GATT introduced the concept of **most favored nation** (renamed **normal trade relations**), according to which each member nation agreed to extend the tariff reductions covered in a trade agreement with one country to all other countries. A concession to one became a concession to all.
- In 1995 the GATT was superseded by the **World Trade Organization** (WTO),
 - 159 member nations.
- The GATT and WTO influenced the greatest global decline in trade barriers in history.



31

Intervention and the Global Financial Crisis

- The crisis raised new questions about government's role in business and the world economy.
- The crisis arose largely from inadequate regulation and enforcement of current regulations in the banking and finance sectors in US and Europe.
- In response, governments around the world are increasing regulation and examining ways to improve enforcement.
 - But few prosecutions
- Rising calls to reverse economic liberalisation where economies are suffering and unemployment rising



32

How Firms Can Respond to Government Intervention

Six Strategies for Managers:

1. Research to gather knowledge and intelligence.
2. Choose the most appropriate entry strategies.
3. Take advantage of foreign trade zones.
4. Seek favorable customs classifications for exported products.
5. Take advantage of investment incentives and other government support programs.
6. Lobby for freer trade and investment



33

33

How Firms can Respond to Government Intervention

1. Research to gather knowledge and intelligence.

- Understand trade and investment barriers abroad.
- Scan the business environment to identify the nature of government intervention.

2. Choose the most appropriate entry strategies.

- If tariffs are low- exporting is usual initial strategy,
- If tariffs are high - consider other strategies such as FDI
 - Joint Venture
 - Licensing

34

34

How Firms Can Respond to Government Intervention

3. *Take advantage of foreign trade zones.*

- FTZs (or *free ports*) create jobs and stimulate local economic development.
- FTZs are areas where imports receive preferential tariff treatment.



4. *Seek favorable customs classifications for exported products.*

- Reduce exposure to trade barriers by appropriately classifying products according to the harmonised product code used by major trading countries.

35

35

How Firms Can Respond to Government Intervention

5. *Take advantage of investment incentives and other government support programs.*

- Government assistance in the form of subsidies and incentives helps reduce the impact of protectionism.

Eg The government of Hong Kong put up much of the cash to build the Hong Kong Disney Park.

Mercedes-Benz received several hundred million dollars in subsidies to build a plant in the U.S. state of Alabama

6. *Lobby for freer trade and investment.*



- Increasingly, nations are liberalising markets in order to create jobs and increase tax revenues
- Firms should work with their public-sector decision makers who negotiate with foreign governments.

36

36

Regional Economic Integration



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37

Question

- With the people around you, identify any examples of regional economic integration that you are familiar with. What benefits do you think the countries receive by cooperating together?

38

38

Regional Economic Integration

The growing economic interdependence that results when nations within a geographic region form an alliance aimed at reducing barriers to trade and investment.

- Over 50 percent of world trade today occurs under some form of preferential trade agreements signed by groups of countries.
- Cooperating nations obtain:
 - increased product choices, productivity, living standards
 - lower prices, and
 - more efficient resource use.



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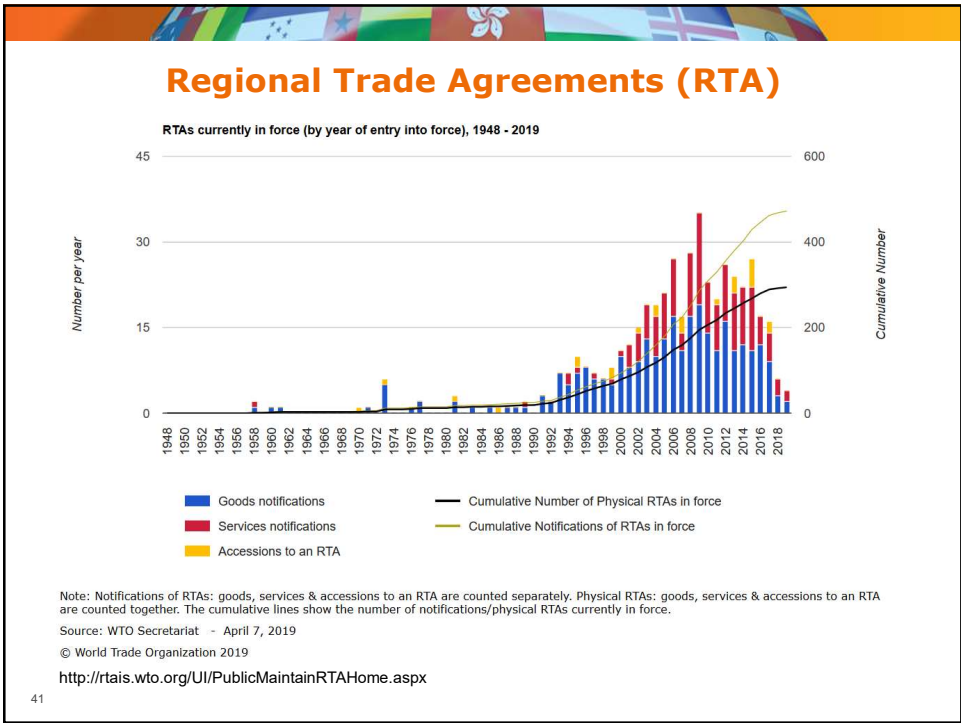
Economic Bloc

A geographic area consisting of two or more countries that agree to pursue economic integration by reducing tariffs and other barriers to the cross-border flow of products, services, capital, and, in more advanced cases, labor

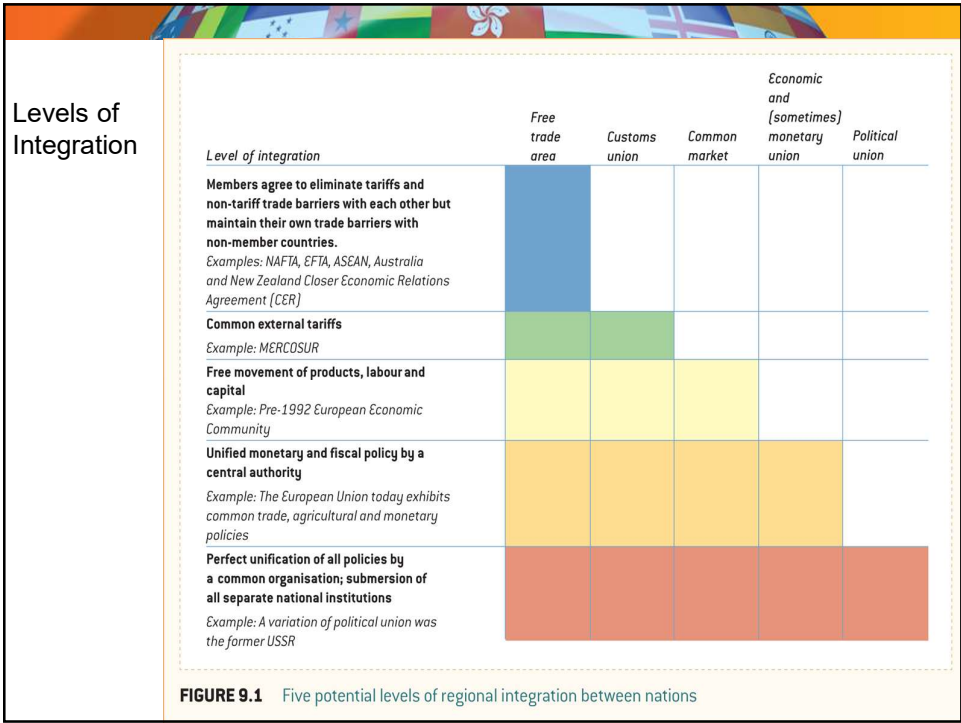
- Examples: European Union, NAFTA, MERCOSUR, APEC, ASEAN, and many others
- Free Trade Agreement (FTA) a formal arrangement between two or more countries to reduce or eliminate tariffs, quotas and barriers to trade in products and services
- There are five possible levels of economic integration

40

40



41



42



Five Levels of Regional Integration

1. **Free trade area:** Simplest, most common arrangement. Member countries agree to gradually eliminate formal trade barriers *within* the bloc, while each member maintains an independent international trade policy with countries *outside* the bloc.
 - NAFTA is an example
2. **Customs union:** Similar to a free trade area except the members harmonise their trade policies toward nonmember countries, by enacting *common* tariff and nontariff barriers on imports from nonmember countries.
 - MERCOSUR is an example.

FTA or Customs Union

Source: **Free trade area, not customs union** [Dan Hannan](https://www.youtube.com/watch?v=poZhO0lvzfs) <https://www.youtube.com/watch?v=poZhO0lvzfs>

43

43



Levels of Regional Integration (cont)

3. **Common market:** Like a customs union, except products, services, and *factors of production* such as capital, labor, and technology can move freely among the member countries.
 - EU countries are an example.
4. **Economic union:** Like a common market, but members also aim for common fiscal and monetary policies, and standardised commercial regulations.
 - The EU moved toward an economic union by forming a monetary union with a single currency, the euro.
5. **Political union:** nations agree to merge with one central government.
 - No modern example

44

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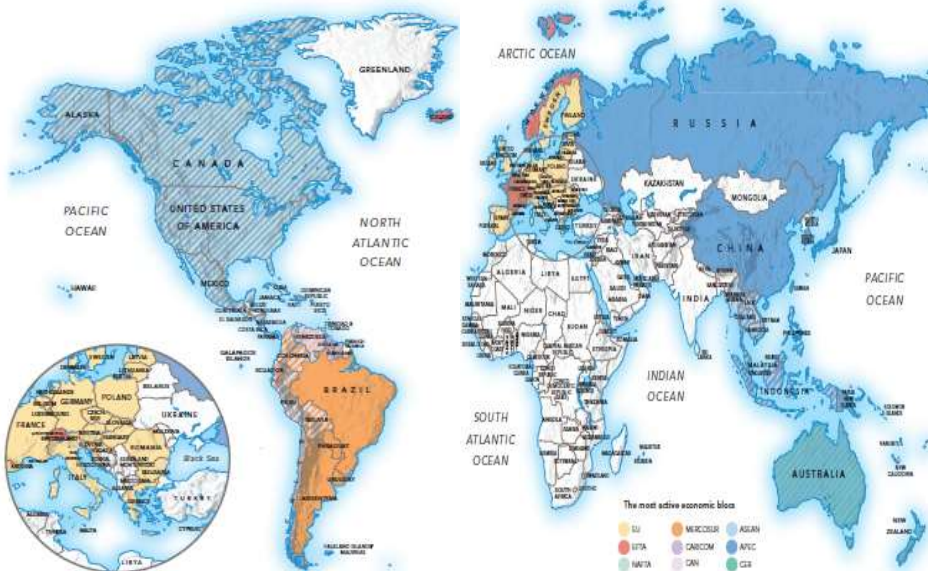
Examples of economic integration

- European Union
- NAFTA
- APEC
- ASEAN
- Pacific Islands Forum
- Cooperation Council for the Arab States (GCC)
- South Asian Association for Regional Cooperation (SAARC)
- South America
- African regional trade agreements
- Australia's trade and economic agreements

45

45

The Most Active Economic Blocs



735

46

The EU: A Full-Fledged Economic Union

1. **Market access.** Tariffs and most nontariff barriers have been eliminated.
2. **Common market.** Barriers to cross-border movement of production factors—labor, capital, and technology.
3. **Trade rules.** Cross-national customs procedures and regulations have been eliminated, which has streamlined transportation and logistics within Europe.
4. **Standards harmonization.** Technical standards, regulations, and enforcements have been harmonized.
5. **Common fiscal, monetary, taxation, and social welfare policies** is the ultimate goal over time.



47

The European Union Today



- 27 members. Founders members are Belgium, Italy, France, Germany, Luxembourg, and the Netherlands.
- New members such as Poland, Hungary, Czech Republic – are low-cost manufacturing sites.
 - Peugeot, Citroën (France) – factories in Czech Republic
 - Hyundai (South Korea) – Kia plant in Slovakia
 - Suzuki (Japan) – factory in Hungary
- Most new EU entrants are in Eastern Europe – one-time satellites of the Soviet Union, most are emerging markets with fast economic growth rates.



48

European Union

- EU is based on the rule of law
- Everything EU does is based on treaties
- A treaty must be agreed to by every Member State before it comes into force in the EU
 - That is, decision making is democratic
- Membership has been restricted to European countries
- Movement to broaden membership (or Brexit?)
- The largest import-export market in the world



Watch out for Asterisks

Source: <https://www.youtube.com/watch?v=O37yJBFRrfq>

Source: <https://www.youtube.com/watch?v=E08Ht8CkC9A>

49

49

Why Nations Pursue Economic Integration

1. **Expand market size**

- Increases size of the marketplace for firms inside the economic bloc. Belgium has a population of just 10 million; the EU has a population of nearly 500m
- Buyers can access larger selection of goods

2. **Enhance productivity and economies of scale**

- Bigger market facilitates economies of scale
- Internationalisation inside the bloc helps firms learn to compete outside the bloc
- Competition and efficient resource usage inside the bloc leads to lower prices for bloc consumers



50

50

Why Nations Pursue Economic Integration (cont).

3. *Attract investment from outside the bloc*

Compared to investing in stand-alone countries, foreign firms prefer to invest in countries belonging to an economic bloc. General Mills, Samsung, and Tata have invested heavily in EU-member countries. (forced to become one of them)

4. *Acquire stronger defensive and political posture*

Belonging to a bloc provides member countries with a stronger defensive posture relative to other nations and world regions. This was a key motive for formation of the European Union.



51

51

Factors that Help Regional Integration Succeed

1. **Economic similarity.** Strong similarity on wage rates, economic conditions, and other factors helps ensure success. Most EU countries are similar in this way. BEWARE: need complementarity...



2. **Political similarity.** Countries should have similar political systems, share aspirations, and be willing to surrender national autonomy. This is a key success factor of the EU.
3. **Similarity of culture and language.** MERCOSUR and Australia/New Zealand CER are similar in this way.
4. **Geographic proximity.** Facilitates intra-bloc movement of products, labor, and other factors. Often, neighboring countries share a common history, culture and language.

52

52

Drawbacks of Regional Integration (1)

- **Trade diversion** – As within-bloc trade becomes more attractive, member countries discontinue some trade with nonmember countries
- **Reduced global free trade** – National trade patterns are altered. More trade occurs inside bloc; less trade occurs with countries outside the bloc
- A bloc can become an 'economic fortress' leading to more *within-bloc* trade and less *between-bloc* trade, which can reduce *global* free trade.



53

53

Drawbacks of Regional Integration (2)



- **Loss of national identity.** Increased cross-border contact makes members more similar to each other. In response to NAFTA, Canada has restricted the ability of U.S. movie and TV producers to invest in the Canadian film and broadcasting industries.
- **Sacrifice of autonomy.** In later stages, a central authority is set up to manage the bloc's affairs. Members must sacrifice some autonomy to the central authority, such as control over their own economy. e.g. Britain in the EU.

54

54



Drawbacks of Regional Integration (3).

- **Transfer of power to advantaged firms.** Integration can concentrate economic power in the hands of fewer, larger firms, often in the most advantaged member countries.
- **Failure of small or weak firms.** As barriers fall, protections are eliminated that previously shielded smaller or weaker firms from foreign competition.
- **Corporate restructuring and job loss.** Restructuring and increased competitive pressures may lead to layoffs or re-assigning employees to distant locations, disrupting workers and entire communities

55

55



Regional Economic Integration: Future Prospects

- In 1990, there were about 50 regional economic integration agreements worldwide.
- Today there are about 400, in various stages of development.
- Governments continue to liberalise trade policies, encourage imports, and restructure regulatory regimes, largely via regional cooperation.
- Many nations belong to several free trade agreements.
- The evidence suggests regional economic integration will gradually give way to a system of global free trade worldwide. Or will it?

59

59

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60

Week 8

Chapter 8

Understanding Emerging Markets

61

61

