CHAPTER 2

The Dynamic Environment of International Trade

CHAPTER OUTLINE

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CHAPTER LEARNING OBJECTIVES

What you should learn from Chapter 2:

- The basis for the reestablishment of world trade and investment following World War II
- The importance of balance-of-payment figures to a country's economy
- The effects of protectionism on world trade
- The seven types of trade barriers
- The Canadian Trade and Investment regime
- The provisions of the Omnibus Trade and Competitiveness Act
- The importance of GATT and the World Trade Organization
- The emergence of the International Monetary Fund and the World Bank Group

Global Perspective

WHAT DO STARBUCKS AND THE WTO HAVE IN COMMON? THE NEED FOR FAIR TRADE

Almost sixty years has passed since the end of the Second World War. We have witnessed a phenomenal growth in world prosperity during that time. Liberalizing international trading regimes around the world has been credited with establishing the foundation for our good fortune. In an interview with the *Financial Times* recently, United Nations Secretary Kofi Annan noted, “We are living through a crisis of the international system.” His words refer to the bold fact that prosperity has accrued to the industrial countries while the poor countries have not benefited substantially. He added that multilateral institutions, such as the WTO, IMF, World Bank, and the UN, among others, incur a “legitimacy deficit” because of the dominance exercised by large industrial nations in trade matters. WTO negotiations are not taking place among equals. Nor is the playing field level. Most poor countries cannot engage at the same level as their rich counterparts, due largely to the intellectual capital deficit prevalent in poor countries. Most poor countries have neither the right people nor the financial resources to prepare adequately for such talks. In order to legitimize themselves, these institutions must be “bound by common values and a common purpose that transcends narrow national interests.” Since WWII, most developing nations have opened their markets while developed nations have lagged in sectors most appealing to poorer nations—agriculture and non-capital intensive markets.

One step to achieving a common value and purpose is to cease the hypocrisy on trade issues. Harvard scholar, Stanley Hoffman, warns that globalization is “neither inevitable nor irresistible. So for it to be acceptable it must have an attractive and compelling value proposition beneficial to all.” He challenges world leaders to turn the planned trade meeting scheduled in Cancun into a successful turning point in rich-poor nation trading relations.

It is also vital that CEOs of multinationals operating in the developing world help to highlight the plight of developing countries, as have corporate officials at Unilever and British Petroleum. Starbucks and Transfair Canada, a fair trade advocacy group, formed an alliance in April 2002 to support the plight of coffee growers in developing countries. According to Starbuck’s Sandra Taylor, Senior Vice President, Corporate Social Responsibility, “Starbucks seeks equity and fairness with all farmers from whom it purchases coffee. The company wants to help farmers make a profit and sustain their business. Starbucks remains committed to paying premium prices for its coffee.” The company inaugurated a new program known as Coffee and Farmer Equity (CAFÉ) that offers preferred buying advantages to farms that perform best with respect to economic, social, and environmental conditions on coffee farms. According to Isaac Grody-Patinkin, national organizer with United Students for Fair Trade, “Students across the country are uniting in support of fair trade as the best way to ensure equity for small farmers.” He adds that Starbuck’s program has strengthened the relationship between students, producers, and business.

It is in the interests of business to have growth and prosperity in the developing world. Decisions made by major developed countries at the meeting in Cancun (in September 2003) can determine the extent to which developing countries benefit from international trade. Starbucks and other business concerns recognize that fair trade is a must in today’s marketplace. Their credibility, and that of multilateral institutions like the WTO, is at stake.

What do Starbucks and the WTO have in common? The title of this global perspective says it clearly—the need for fair trade. Both developing and developed countries benefit from fair trade. Fair trade works to open markets to companies from developing countries, thereby increasing local production, worker and producer incomes, and a higher standard of living and quality of life. Consumers and producers in developed countries benefit by having higher quality products at stable prices. Moreover, by framing the WTO trade negotiations as an issue of fairness as well as efficiency, the developed world behaves in a way that models its rhetoric—social responsibility and good global citizenship.

Source: Corporate Social Responsibility Press Release from Starbucks Corporation, “Fair Trade Certified Coffee Takes Center Stage as Starbucks ‘Coffee of the Week’ May 3–9,” Seattle, WA, April 29, 2004.

Yesterday's competitive market battles were fought in Western Europe, Japan, and the United States; tomorrow's competitive battles will extend to Latin America, Eastern Europe, Russia, India, Asia, and Africa as these emerging markets continue to open to trade. More of the world's people, from the richest to the poorest, will participate in the world's wealth through global trade and investment. The emerging global economy in which we live brings us into worldwide competition with significant advantages for both marketers and consumers. Marketers benefit from new markets opening and smaller markets growing large enough to become viable business opportunities. Consumers benefit by being able to select from the widest range of goods produced anywhere in the world at the lowest prices.

Bound together by satellite communications and global companies, consumers in every corner of the world are demanding an ever-expanding variety of goods. World trade and investment are important economic activities. Because of this importance, the inclination is for countries to control international activities to their own advantage. As competition intensifies, the tendency toward protectionism gains momentum. If the benefits of the social, political, and economic changes now taking place are to be fully realized, fair trade must prevail throughout the global marketplace.

The creation of the World Trade Organization (WTO) provides a positive force pushing for **free trade** among nations, although a growing number of countries and academic scholars are calling for **fair trade** as the basis for world trade, particularly for developing countries. Free trade relates to the conditions of market participation: equal access to country markets, non-discrimination in procurement (government and private), respect for property rights, transparency in legal systems, and the elimination of trade barriers. In essence, free trade focuses on efficiency and comparative advantage as critical objectives of exchange. As the global perspective to this chapter pointed out, fair trade is distinct from free trade in terms of the obligations incurred by each party to a transaction. Since it is often unlikely that trading partners will approach exchange relations with equal resource endowments, the negotiated outcome is likely to be biased in favour of the more resourced participant. This logic has led a number of scholars to question the free-trade approach to exchange between developed and developing nations and, instead, require a "level-playing-field" adjustment in order to compensate for the strategic advantages of large, resource-rich countries that have the potential of dominating their disadvantaged trade partners. A key tenet of fair trade is maximizing the likelihood that trade will enhance the ability of local citizens to earn a living wage, conduct work in safe and healthy conditions, and remain independent from external governments and private organizations in developing their livelihoods.[1]

[1] J. Bhagwati, "Coping with Anti-Globalization," *Foreign Affairs*, January/February 2002; and J. Bhagwati, "What Will It Take to Get Developing Countries into a Round of Multilateral Trade Negotiations?" World Trade Issues Group Seminar, Department of Foreign Affairs and International Trade (DFAIT), March 2000.

1000 First millennium ends; Y1K problem overblown—widespread fear of the end of the world proved unfounded
1000 Vikings first settle Newfoundland
1004 Chinese unity crumbles with treaty between the Song and the Liao giving the Liao full autonomy; China remains fractured until the Mongol invasion in the thirteenth century (see 1206)
1025 Navy of Cholas in Southern India crushes the empire of Srivijaya in modern Myanmar to protect their trade with China
1054 Italy and Egypt formalize commercial relations
1066 William the Conqueror is victorious over Harold II in the Battle of Hastings, establishing Norman rule in England and forever linking the country with the continent
1081 Venice and Byzantium conclude a commercial treaty (renewed in 1126)
1095 First of the crusades begins; Pope Urban II calls on Europe's noblemen to help the Byzantines repel the Turks; the crusaders' travel, stories, and goods acquired along the way help increase trade across Europe and with the Mediterranean and Asia; eighth major crusade ends, Syria expels the Christians
1100 Japan begins to isolate itself from the rest of the world, not really opening up again until the mid-nineteenth century (see 1858)
1100 China invents the mariner's compass and becomes a force in trade; widespread use of paper money also helps increase trade and prosperity
1100 Inca Empire in the Andes begins to develop, eventually encompassing about 12 million people until its destruction by the Spanish in 1553; cities specialize in certain farming and trade with others for what they don't make
1132 Corporate towns in France granted charters by Henry I to protect commerce
1189 German merchants conclude treaty with Novgorod in Russia
1200 Islam is introduced to Southeast Asia by spice traders
1200 More than 60,000 Italian merchants work and live in Constantinople
1206 Genghis Khan becomes the Great Khan, controlling

This chapter includes a brief survey of Canada's past and present role in global trade and some concepts important in understanding the relationship between international trade, investment, and national economic policy. A discussion of the logic and illogic of protectionism, the major impediment to trade, is followed by a review of the General Agreement on Tariffs and Trade (GATT) and its successor, the World Trade Organization (WTO), two multinational agreements designed to advance free trade.

The Twentieth to the Twenty-first Century

At no time in modern economic history have countries been more economically interdependent, had greater opportunities for international trade, or had the potential for increased demand than now, at the opening of the twenty-first century. In the preceding 100 years, world economic development has been erratic.

Bicycles and websites are both part of marketing in China. *(© AFP/CORBIS)*

The first half of the twentieth century was marred by a major worldwide economic depression that occurred between two world wars and all but destroyed most of the industrialized world. The last half of the century, while free of a world war, was marred by struggles between countries espousing the socialist Marxist approach and those following a democratic capitalist approach to economic development. As a result of this ideological split, traditional trade patterns were disrupted.

After World War II, the Marshall Plan, sponsored by the United States, was launched to assist in rebuilding Europe and Japan. Through the Agency for International Development and other support groups, additional monies were amassed for investment into underdeveloped countries to foster economic growth and help create a stronger world economy. The dissolution of colonial powers created scores of new countries in Asia and Africa. With the striving of these countries to gain economic independence and the financial assistance offered by multinational financial institutions, most of the noncommunist world's economies grew and new markets were created.

The benefits from the foreign economic assistance flowed both ways. For every dollar invested in the economic development and rebuilding of other countries after World War II, hundreds of dollars more returned to capital-supplying nations in the form of purchases of agricultural products, manufactured goods, and services. This overseas demand created by the Marshall Plan and other programs[2] was important to North American economies since the vast manufacturing base built to supply World War II and the swelling labour supply of returning military

[2]The Organization for Economic Cooperation and Development (OECD) was a direct result of the Marshall Plan. See Timothy Bainbridge, "A Brief History of the OECD," *OECD Observer,* Summer 2000, pp. 111–113.

most of northern China; after his death in 1227, the Khan clan conquers much of Asia by mid-century and promotes trade and commerce, reviving the ancient Silk Road that linked Chinese and Western traders
1215 Magna Carta, a pact between the English king and his subjects, is signed by King John, who becomes subject to the rule of law
1229 German merchants sign trade treaty with the Prince of Smolensk in Russia
1252 First gold coins issued in the West since the fall of Rome, in Florence
1269 England institutes toll roads
1270 Venetian Marco Polo and his father travel through Asia and the Middle East, becoming the first European traders to establish extensive links with the region
1279 Kublai Khan unites China and creates the Yuan (Origin) dynasty; by the time he dies in 1294, he has created a unified Mongul Empire extending from China to eastern Europe
1300 The early stirrings of the Renaissance begin in Europe as people are exposed to other cultures, primarily through merchants and trade
1300 Trade fairs are held in numerous European cities
1315 A great famine hits Europe, lasting two years, more widespread and longer than any before
1348 The plague (the Black Death) kills one-fourth to one-third of the population in Europe (25 million people) in just three years, disrupting trade as cities try to prevent the spread of the disease by restricting visitors; it likely started in Asia in the 1320s; massive inflation took hold, since goods could only be obtained locally; serfs were in high demand and began moving to higher wage payers, forever altering Europe's labour landscape
1358 German Hanseatic league officially formed by the Hansa companies of merchants for trade and mutual protection, eventually encompassing more than 70 cities and lasting nearly 300 years
1375 Timur Lang the Turk conquers lands from Moscow to Delhi
1381 English rioters kill foreign Flemish traders as part of the 100,000-strong peasant

personnel created a production capacity well beyond domestic needs. The major economic boom and increased standard of living North America experienced after World War II was fueled by fulfilling pent-up demand created by the rebuilding of the victorious North American economies and war-torn countries of Europe and Asia.

In addition to economic assistance, a move toward international cooperation among trading nations was manifest in the negotiation of the General Agreement on Tariffs and Trade (GATT).[3] International trade had ground to a halt following World War I when several nations raised average tariffs on imported goods to levels in excess of 60 percent. In retaliation, 60 other countries erected high tariff walls and international trade was stalled, along with most economies. A major worldwide recession catapulted the world's economies into the Great Depression when trade all but dried up after tariffs and other trade barriers were raised to intolerable heights.[4] Eventually, Canada and the United States agreed to tariff reductions on traded goods, but only after Canadian exports declined substantially. Both countries lowered tariffs in 1935, and again in 1938, as part of the multilateral reductions during that period.

Determined not to repeat the economic disaster that followed World War I, world leaders created GATT, a forum for member countries to negotiate a reduction of tariffs and other barriers to trade. The forum proved successful in reaching those objectives. With the rat-ification of the Uruguay Round agreements, the GATT became part of the World Trade Organization (WTO) and its 117 original members moved into a new era of free trade.

The First Decade of the Twenty-first Century and Beyond

The unprecedented and precipitous growth of the North American economies in the late 1990s has slowed dramatically in the last few years. Growth in most of the rest of the world has followed suit with the exception of China. The Organization for Economic Cooperation and Development (OECD) estimates that the economies of member countries will expand an average of 3 percent annually for the next 25 years, the same rate as in the past 25 years. Conversely, the economies of the developing world will grow at faster rates—from an annual rate of 4 percent in the past quarter century to a rate of 6 percent for the next 25 years. Their share of world output will rise from about one-sixth to nearly one-third over the same period. The World Bank estimates that five countries—Brazil, China, India, Indonesia, and Russia—whose share of world trade is barely a third of that of the European Union—will by 2020 have a share 50 percent higher than that of the EU. As a consequence, there will be movement in economic power and influence away from industrialized countries—Japan, the United States, and the European Union—to countries in Latin America, Eastern Europe, Asia, and Africa.

[3]Michael H. Hunt, "Free Trade, Free World: the Advent of GATT," *Business History Review,* summer 2000, 74(2), pp. 350–352.

[4]Thomas A. Bailey and David M. Kennedy, *The American Pageant* (13th edition, Boston: Houghton Mifflin, 2004).

rebellion against Richard II, which was led by Wat Tyler in a failed attempt to throw off the yoke of feudalism

1392 England prohibits foreigners from retailing goods in the country

1400 Koreans develop movable-type printing (see 1450)

1404 Chinese prohibit private trading in foreign countries, but foreign ships may trade in China with official permission

1415 Chinese begin significant trading with Africa through government expeditions—some believe they sailed to North America as well in 1421

1425 Hanseatic city of Brugge becomes the first Atlantic seaport to be a major trading center

1427 Aztec Empire is created by Itzcotl; it encompasses about 6 million people until its destruction in 1519

1430 Portuguese Henry the Navigator explores west African coast to promote trade

1441 Mayan Empire collapses as the city of Mayapán is destroyed in a revolt

1450 Renaissance takes hold in Florence, its birthplace

1450 Gutenberg Bible is first book printed with movable type; the ability to mass-produce books creates an information revolution

1453 Byzantine Empire is destroyed as Muhammad II sacks Constantinople (renaming it Istanbul)

1464 French royal mail service established by Louis XI

1470 Early trademark piracy committed by Persians, who copy mass-produced Chinese porcelain to capitalize on its popularity in foreign countries

1479 Under the Treaty of Constantinople, in exchange for trading rights in the Black Sea, Venice agrees to pay tribute to the Ottoman Empire.

1482 England organizes a postal system that features fresh relays of horses every 20 miles

1488 Bartolomeu Dias sails around the coast of Africa; this, along with the voyages of Christopher Columbus, ushers in the era of sea travel

1492 Christopher Columbus "discovers" the New World

This does not mean that markets in Europe, Japan, and North America will cease to be important; those economies will continue to produce large, lucrative markets and the Canadian companies established in those markets will benefit. It does mean that if a company is to be a major player in the future, now is the time to begin laying the groundwork. How will these changes that are taking place in the global marketplace impact on international business? For one thing, the level and intensity of competition will change as companies focus on gaining entry into or maintaining their position in emerging markets, regional trade areas, and the established markets in Europe, Japan, and the United States.

Companies are looking for ways to become more efficient, improve productivity, and expand their global reach while maintaining an ability to respond quickly to deliver a product that the market demands. For example, large multinational companies such as Matsushita of Japan continue to expand their global reach. Nestlé is consolidating its dominance in global consumer markets by acquiring and vigorously marketing local-country major brands. Samsung of South Korea has invested $500 million in Mexico to secure access to markets in the North American Free Trade Area. Whirlpool, the U.S. appliance manufacturer that secured first place in the global appliance business by acquiring the European division of the appliance maker, N. V. Philip's, immediately began restructuring itself into its version of a global company. Nortel Networks, after decades of aggressively acquiring high tech firms, has established itself as a world enterprise. These are a few examples of changes that are sweeping multinational companies as they gear up for the future.

Global companies are not the only ones aggressively seeking new market opportunities. Smaller companies are using novel approaches to marketing and seeking ways to apply their technological expertise to exporting goods and services not previously sold abroad. For a small Canadian company, Warnex Inc. of Quebec, Germany is a focal point of attention. It is the largest centre in the world for the analysis of food products containing GMOs (genetically modified organisms). Warnex is developing a new technology called Genevision, which detects the presence of bacteria and GMOs in foods from their DNA. Its competitive advantage over other world producers is processing speed and low cost. Kryton International, located in Vancouver, specializes in manufacturing and distributing specialty chemical products. Its exports, roughly 98 percent percent of total sales, are sent to more than 40 countries. The company specializes in concrete admixtures, waterproofing material, coatings, and epoxies. Kryton's technologies are applied to foundations, rooftops, bridges, dams, and many other industrial applications. Recently, Japan applied Kryton's technology in its Tokyo subway tunnels. In Mexico, Krystol's sealants are protecting the Coatzacoalcos Bridge, one of the longest single-span, cable-suspended bridges in the world. Other examples of smaller companies include Nochar Inc., which makes a fire retardant it developed a decade ago for the Indianapolis 500. The company now gets 32 percent of its sales overseas, in 29 countries. The owner of Buztronics Inc., a maker of promotional lapel buttons, heard from a friend that his buttons, with their red blinking lights, would do great in Japan. He made his first entry in exporting to Japan and after only

1494 Portugal and Spain divide the unexplored world between them with the Treaty of Tordesillas

1500 Rise of mercantilism, the accumulation of wealth by the state to increase power, in Western Europe; states without gold or silver mines try to control trade to maintain a surplus and accumulate gold and silver; Englishman Thomas Mun was one of the great proponents in 1600, who realized that the overall balance of trade was the important factor, not whether each individual trade resulted in a surplus

1500 Slave trade becomes a major component of commerce

1504 Regular postal service established between Vienna, Brussels, and Madrid

1520 First chocolate brought from Mexico to Spain

1521 Mexico is conquered by Hernán Cortés after Aztec ruler Montezuma is accidentally killed

1522 Magellan's expedition completes its three-year sail around the world; it is the first successful circumnavigation

1531 Antwerp stock exchange is the first exchange to move into its own building, signifying its importance in financing commercial enterprises throughout Europe and the rising importance of private trade and commerce; Antwerp emerges as a trading capital

1532 Brazil is colonized by the Portuguese

1534 France dispatches an expedition to Atlantic Canada under the command of Jacques Cartier to explore Newfoundland, Labrador, and the Gulf of St. Lawrence.

1553 South American Incan Empire ends with conquest by Spanish; the Incas had created an extensive area of trade, complete with an infrastructure of roads and canals

1555 Tobacco trade begins after its introduction to Europe by Spanish and Portuguese traders

1557 Spanish crown suffers first of numerous bankruptcies, discouraging cross-border lending

1561 Dutch traders bring tulips to Europe from Near East for first time a year, 10 percent of Buztronics sales come from overseas. While a small number of the largest Canadian exporters account for the majority of merchandise exports, the rest come from middle-size and small firms like those mentioned above. There is a flurry of activity in the business world as companies large and small adjust to the internationalization of the marketplace at home and abroad.

International Trade Theories

Why do countries trade with one another? What motivates them to leave domestic markets and incur greater risks and uncertainties in more distant, perhaps hostile ones? Once they leave, what accounts for the strategies and behaviours firms adopt in the foreign markets they enter? These and other questions have stimulated academic researchers for many years. Without a doubt, marketers are keenly interested in the operational realities of the markets they compete in. They must understand consumer attitudes, preferences, and past habits in order to cater to their needs and wants. Marketers must also ascertain consumer and buyer price, advertising and service sensitivities—consumers who are very sensitive to price changes, for instance, will be less likely to remain loyal. And, given how increasingly important it is for companies to be integrated within efficient supply chains, logistics and distribution decisions are of paramount importance to the marketer. However, the best-laid plans come to nothing without a well thought-out strategy. While theory is helpful to marketers in informing choices on operational issues, it plays a crucial role in terms of strategic choices. For without a sound theory, or at least a clear understanding of the structure of a set of critical relationships, marketers are like a ship at sea without a rudder—adrift and redirected by the slightest winds. It is our belief that firms do not prosper by chance alone; they do best when they can foresee future forces that will impact upon them faster and more fully than their opponents can.

Over the years theorists have offered explanations for the reasons countries focus on specific sectors and products, and not others. Some employ explanations aimed at the country level, while others take a more micro approach, and view trade and production choices at the firm or strategic business unit level.

Adam Smith and Absolute Advantage. Many modern day textbooks begin the discussion of international trade theory with Adam Smith's theory of **absolute advantage**.[5] Smith recognized that countries produce products for which they have a cost or resource advantage. Certain countries can outperform other countries because they incur lower costs, or employ resources more efficiently at the same cost relative to other countries. His idea has stood the test of time as many present-day business strategists suggest countries should seek a low cost of production in order to establish a competitive advantage over other countries. Canada's natural resource industries—agriculture, forestry, mining, etc.—have contributed to its high standard of living because they are more abundant and less costly to exploit here than in other countries. For many natural resources, it simply costs Canada less to extract and distribute compared to, say, Argentina. Companies in search of markets would be wise to select locations where they can obtain absolute cost advantages

[5]Adam Smith. *The Wealth of Nations*. New York: Modern Library, 1937.

1564 William Shakespeare is born; many of his plays are stories of merchant traders
1567 Typhoid fever, imported from Europe, kills two million Indians in South America
1588 Spanish Armada defeated by Britain, heralding Britain's emergence as the world's greatest naval power; this power enables Britain to colonize many regions of the globe and leads to its becoming the world's commercially dominant power for the next 300 years
1596 First flush toilet is developed for Britain's Queen Elizabeth I
1597 Holy Roman Empire expels English merchants in retaliation for English treatment of Hanseatic League
1600 Potatoes are brought from South America to Europe where they quickly spread to the rest of world and become a staple of agricultural production
1600 Japan begins trading silver for foreign goods
1600 Britain's Queen Elizabeth I grants charter to the East India Company, which dominates trade with the East until its demise in 1857
1601 France makes postal agreements with neighboring states
1602 Dutch charter their own East India Company, which will dominate the South Asian coffee and spice trade
1607 British colony of Jamestown built
1610 Henry Hudson explores Hudson's Bay, is set adrift by mutinous crew, and dies.
1611 Japan gives Dutch limited permission to trade
1612 British East India Company builds its first factory in India

relative to producers of similar products elsewhere in the world. All products produced in excess of domestic consumption needs would be traded to others for products Canadians desired but do not, or could not, produce themselves. And, according to Smith, we would all be better off trading our superfluous stocks with others for their surpluses. Trade does result in net gains for everyone. The low-cost-producer strategy is a common approach many companies follow in conducting their international business.

David Ricardo and Comparative Advantage. David Ricardo introduced an explanation for the reasons countries focus on certain products and not others that differed from Smith's absolute advantage theory.[6] Ricardo was concerned not only with what a product cost to make, he was also interested in accounting for the alternative, or opportunity, value that was foregone by selecting a particular product to produce. Ricardo would not ask the question: What does it cost a Canadian compared to an Argentinian to produce a unit of wheat? Rather, he would ask: For the Canadian to produce a unit of wheat, how much does she forego in lost value for not producing another product besides wheat? In other words, what is the opportunity cost of producing wheat in Canada? The answer is: the value we could have had by producing something else besides wheat. Armed with the **opportunity cost** concept, Ricardo reasoned that countries should produce goods for which they possess a **comparative advantage**. The fact that Canada possesses an absolute advantage in producing wheat compared to other nations is not sufficient justification to claim Canada should produce wheat, or any other product for that matter. Ricardo would argue another condition should hold before we determine what to produce and where: Determine Canada's relative advantage in producing wheat versus, say, steel, and compare this advantage to that held by, say, Argentina for the same two products. If the ratio of the cost of producing wheat to steel in Canada is lower than Argentina's ratio, then Canada should produce wheat and Argentina steel, ceteris paribus. It is not the absolute cost level that is important, according to Ricardo; rather, the cost of producing one product versus another in one country compared to the costs of the two products in another country is the critical issue. Countries will be more efficient if they specialize in the products for which they possess comparative advantages, and trade with other countries for the products they do not produce.

Heckscher-Ohlin and Factor Endowments. Two Swedish economists, Eli Heckscher and Bertil Ohlin, followed the logic established by Ricardo and asked the question: What are the products in which a country is likely to possess a comparative advantage?[7] According to them, a country will possess a comparative advantage in products that require resources that are abundant in that country. Several examples dramatize the essence of **Factor Endowment Theory**: Argentina's comparative advantage in agriculture is due to its large areas of high-yielding land; China's comparative advantage lies in producing clothing products that require cheap, unskilled labour; and Saudia Arabia's comparative

[6] David Ricardo. "The Principles of Political Economy and Taxation," in *International Trade Theory: Hume to Ohlin*, ed. William Allen. (New York: Random House, 1965).

[7] Paul Krugman and Maurice Obstfeld. *International Economics: Theory and Policy*. 3rd edition, Harper Collins Publishers Inc., 1994.

1620 *Mayflower* sails for the New World
1620 Father of the Scientific Revolution, Francis Bacon, publishes *Novum Organum*, promoting inductive reasoning through experimentation and observation
1625 Dutch jurist Hugo Grotius, sometimes called the father of international law, publishes *On the Laws of War and Peace*
1637 Dutch tulip craze results in history's first boom-bust market crash
1642 Montreal is founded by Sieur de Maisonneure
1651 English pass first of so-called Navigation Acts to restrict Dutch trade by forcing colonies to trade only with English ships
1654 Spain and Germany develop hereditary land rights, a concept that will help lead to the creation of great wealth in single families and thus to the development of private commercial empires
1687 Apple falling on Newton's head leads to his publication of the law of gravity
1694 The Bank of England is established; it offers loans to private individuals at 8 percent interest
1698 First steam engine is invented
1719 French consolidate their trade in Asia into one company, the French East India Company; rival British East India Company maintains its grip on the region's trade, however, and French revert to individual company trading 60 years later
1725 Rise of Physiocrats, followers of the economic philosopher François Quesnay, who believed that production, not trade, created wealth and

advantage lies in oil production because of its bountiful supplies of crude oil. If we view Canada through the lens of factor endowment theory, we should expect it to possess comparative advantages in wheat production, timber, pulse crops, sunflower oil, hydroelectric power, and tourism because of its endowment of natural resources. Business strategists, therefore, will attempt to identify markets for their products and sources of supply for their production based on the resource endowments of particular countries.

Macro-level trade theories have a reasonable track record in explaining and predicting interindustry trade among countries. For example, comparative advantage theory explains the Canada's decision to produce wheat and trade it to China for textile products. Trading products of two different industries from two different countries is described as interindustry trade. Intraindustry trade, on the other hand, is the trade of goods between two countries from the same industry in the two countries. Macro-based theories, however, have not been very good at explaining or predicting intraindustry trade. Recognizing its limitations, theorists have sought to explain trade flows based on theories about the firm.

Country Similarity Theory. In the early 1960s, economist Steffen Linder argued that trade between nations for manufactured goods depended on the similarities in consumer preferences, production conditions, and economic development stage.[8] Thus, his **country similarity theory** explains trade flows as originating from demands of consumers from one country for products of another, economically similar country. Between Canada and the U.S., for example, intraindustry trade is quite large—nearly sixty percent. Trade within industries, such as automobiles, chemicals, retailing, and other sectors, accounts for the vast majority of international trade across the Canada-U.S. border. In each of these sectors, U.S. companies have plants and subsidiaries widely located in various states and provinces that trade with one another. For example, Cargill Canada Ltd. sells agricultural products to its parent and sibling subsidiaries in Minnesota and other states. In turn, these same recipients of Cargill Canada's products sell to Cargill Canada. Government agencies in the two countries treat each transaction either as an export or an import, depending on the country receiving or selling the products.

Product Life Cycle Theory. About the same time Linder developed the country similarity theory, Raymond Vernon of the Harvard Business School crafted the **international product life cycle theory** of international trade.[9] Vernon's theory accounts for many of the features marketers recognize in the diffusion of products into markets: innovation, growth, developing advantage during maturity, and managing decline. The international product life cycle includes these notions, but adds strategic response to global rivalry, and incentives to trade and investment internationally. The three stages contained in the theory are: new product, maturing product, and standardized product.

[8] Paul Krugman and Maurice Obstfeld. *International Economics: Theory and Policy*, 3rd edition. Harper Collins Publishers Inc., 1994.

[9] Raymond Vernon, "International Investment and International Trade in the Product Cycle," *Quarterly Journal of Economics*, 80 (1966), pp. 190–207

that natural law should rule, which meant producers should be able to exchange goods freely; movement influenced Adam Smith's ideas promoting free trade

1740 Maria Theresa becomes Empress of the Holy Roman Empire (until 1780); she ends serfdom and strengthens the power of the state

1748 First modern, scientifically drawn map, the Carte Géométrique de la France, comprising 182 sheets, was authorized and subsequently drawn by the French Academy; Louis XV proclaimed that the new map, with more accurate data, lost more territory than his wars of conquest had gained

1750 Industrial Revolution begins and takes off with the manufacture, in 1780, of the steam engine to drive machines; increased productivity and consumption follow (as do poor working conditions and increased hardships for workers)

1755 Britain scatters the Nova Scotia Acadians throughout the North American colonies.

1760 China begins strict regulation of foreign trade, to last nearly a century, when they permit Europeans to do business only in a small area outside Canton and only with appointed Chinese traders

1764 British victories in India begin Britain's dominance of India, Eastern trade, and trade routes

1764 British begin numbering houses, making mail delivery more efficient and providing the means for the development of direct mail merchants centuries later

In stage one, the *new product stage*, entrepreneurs have launched a new product, often in a developed country where R&D is available and where information exists on customer responsiveness to the new offering. In Canada, the launch of Western Glove's brand of denim jeans, *Silver Jeans*, is a classic example. The product was innovative in the sense that styling and customization was different than for standard jeans because of advanced textile technology. Together with timely feedback from customers, the company was able to position the product uniquely in the Canadian marketplace. Initial investments into the new product concept were limited at first, given the uncertainties surrounding market acceptance of the product. Sales locations were selected that were well understood, and where minimal risk was perceived to exist.

In the second stage, referred to as the *mature product stage*, demand for the product expands faster than supply as consumers alter their choices and adopt the new styling. Western Glove now begins expanding jeans making capacity at its original location as well as at new locations in the home country and abroad. Demand is met from the original Winnipeg facility as well as from the new production facilities in Mexico. Foreign plants begin seeking a broader customer base in the new host countries, Mexico in Western Glove's case, and competition intensifies in the home as well as local markets. The increased competition adds momentum to the sales efforts, particularly in the newer production locations, as more and more sales units are required to cover fixed investments related to the expansion. Thus, many foreign markets become major economic activities for the firm, and some even surpass the home production units in sales and profits.

In the final stage of the cycle, the *standardized product stage*, demand for the product stabilizes. The innovative features of the product no longer exist, as jeans styling and design capabilities are available to many producers and the product becomes more of a commodity to consumers. With the drop off in sales growth, firms move to a low-cost strategy and produce jeans at the most efficient facilities, cutting back on those incurring higher production and distribution costs. As a result, the product begins to be imported from cheaper offshore facilities to buyers in the original home market. In Western Glove's case with Silver Jeans, Mexico and Asian facilities now produce product that is imported into Canada.

International trade theory, both macro- and micro-based, provides the marketer with notions about how to strategize actions in international markets. Macro-based theories are most appropriate for interindustry trade, and emphasize cost and resource advantages. Micro-based theories, on the other hand, are much more effective dealing with intraindustry trade. Although they recognize the importance of costs and resources as major factors in developing strategy, nonetheless, micro-based theories are not exclusively focused on supply-side considerations—demand factors are important as well. Both country similarity and international product life cycle theories explain the motivation to exploit international markets because of demand opportunities as well as cost and supply drivers. They also recognize the creative element in firm decision-making, and attribute much of the decision to relocate production and sales internationally to entrepreneurial foresight and the benefits of focusing on customers and competitors.

1776 American Declaration of Independence proclaims the colonies' rights to determine their own destiny, particularly their own economic destiny
1776 Theory of modern capitalism and free trade expressed by Adam Smith in *The Wealth of Nations;* he theorized that countries would only produce and export goods that they were able to produce more cheaply than could trading partners; he demonstrates that mercantilists were wrong; it is not gold or silver that will enhance the state, but the *material* that can be purchased with it
1783 Investors and traders from Grand Portage (in present-day Minnesota) and Montreal meet to form the Northwest Company.
1783 Treaty of Paris officially ends the American Revolution following British surrender to American troops at Yorktown in 1781
1789 French Revolution begins; it alters the power structure in Europe and helps lead to the introduction of laws protecting the individual and to limited democracy in the region
1791 With the rise in the number of English-speaking Loyalists in Quebec, the Constitutional Act divides Quebec into Upper and Lower Canada (Modern-day Ontario and Quebec).
1792 Gas lighting introduced; within three decades most major European and North American cities use gas lights
1804 Steam locomotive introduced; it becomes the dominant form of transport of goods and people until the

Canada's Trade and Investment Patterns

When Americans, Germans, and Egyptians watch a CanWest Global TV program or read the latest novel published by Thomson Corporation, they are purchasing from a Canadian multinational firm. When you drop in at a 7-Eleven convenience store or buy Firestone tires, you are buying directly from a Japanese company. Your automobile, insurance, and CD purchases are more and more transacted with U.S., German, and Japanese businesses. Some well-known brands no longer owned by Canadian companies are Canada Dry and Canadian Club (now U.K.-owned). Canadian businesses conduct international trade in goods and services on a regular basis with customers across the globe and, in turn, Canadians buy from foreign firms. The absolute magnitude of trade between Canada and other nations is very large. Canada ranked seventh behind the United States, Germany, Japan, France, China, and the United Kingdom in total merchandise exports in 2002.[10] The total volume traded in that year exceeded $252 billion, which accounted for approximately 4 percent percent of the value of total world exports. It ranked eighth in total imports behind the aforementioned leading exporters and Italy. Canada imported in excess of $222 billion in merchandise during 2002, or slightly more than 3 percent of total world exports. The trade figures, both exports and imports, calculate to approximately 40 percent of total GDP for 2002.[11]

Balance of Payments

When countries trade, financial transactions among businesses or consumers of different nations occur. Products and services are exported and imported, monetary gifts are exchanged, investments are made, cash payments are made and cash receipts received, and vacation and foreign travel occurs. In short, over a period of time there is a constant flow of money into and out of a country. The system of accounts that records a nation's international financial transactions is called its **balance of payments**.

Exhibit 2.1 illustrates the distribution of trade in terms of both exports and imports between Canada and other trading nations. Statistics are presented for the year 1995 as well as 2002 in order to provide a basis of comparison for the most current period. A cursory inspection of the data reveals a rather clear pattern: merchandise exports from Canada flow largely to markets in the United States. Today, nearly 90 percent of the value of Canadian exports is with American buyers. Furthermore, between 1995 and 2002, the U.S. share increased by 8 percent, indicating that export sales are becoming more concentrated in U.S. markets and are being diverted from Asian and European markets over time. The share of Canadian exports destined for Asia decreased from 10 percent to 5 percent of the total, while the drop in Western Europe was from 7 percent to 5 percent. Canadian exports to Mexico, Latin America, Africa, the Middle East, and other developing countries are insignificant today and largely unchanged compared to levels achieved over the previous several years.

Exhibit 2.1 also illustrates a pattern for imports that is similar to merchandise exports, although trade is not being redirected toward the U.S. Most merchandise imported into Canada from abroad in 2002 originated in the United States, although imports are more diversified in terms of country of origin relative to exports. Interestingly, the developed markets in Asia and Western Europe are key sources of imports for Canadian buyers, and,

[10] Statistics Canada, CANSIM, tables 376-0001 and 376-0002, March 18, 2004.

[11] World Competitiveness Yearbook 2003, IMD, Lausanne, Switzerland, 2003.

mid-twentieth century when the airplane becomes commercially viable

1804 Napoleon crowns himself emperor, overthrowing the French revolutionary government, and tries to conquer Europe (after already occupying Egypt as a means of cutting off British trade with the East), the failure of which results in the redrawing of national boundaries in Europe and Latin America

1807 French Napoleonic Code issued; it becomes a model of civil law adopted by many nations around the world

1810 Frenchman Nicolas Appert successfully cans food and prevents spoilage

1810 Following Napoleon's invasion of Spain and Portugal, Simón Bolivar begins wars of independence for Spanish colonies in Latin America, leading to new governments in Bolivia, Colombia, Ecuador, Peru, and Venezuela

1814 First practical steam locomotive is built by George Stephenson in England, leading to the birth of railroad transportation in 1825, with the first train carrying 450 passengers at 15 miles per hour

Exhibit 2.1
Canadian Merchandise Trade by Region and Economy, 2002 (Billions of dollars)

Source: Adapted from the Statistics Canada publication, "Canada's International Investment Position," Catalogue no. 67-202-XPB, Fourth Quarter 2003.

Region	Exports	Imports	Balance	Export 1995	Share 2002	Import 1995	Share 2002
All Countries	252	222	+30				
North America	250 (87%)	139 (63%)	+81	79	87	67	63
Asia	14 (6%)	34 (15%)	−20	10	5	14	15
Western Europe	12 (5%)	29 (13%)	−17	7	5	12	13
Latin America	4 (2%)	13 (6%)	−9	2	2	4	6
Africa	1 (−)	2 (−)	−1	1	.5	1	1
Middle East	1 (−)	2 (−)	−1	.5	.5	.5	1
Eastern Europe.	.5 (−)	1 (−)	−.5	−	−.5	.5	
Economy	**Exports**	**Imports**	**Balance**	**Export 1995**	**Share 2002**	**Import 1995**	**Share 2002**
U.S.	220 (87%)	139 (63%)	+81	79	87	67	63
EU	11 (5%)	25 (11%)	−14	6	4	10	11
Japan	5 (2%)	10 (5%)	−5	5	2	5	4
China	3 (1%t)	10 (5%)	−7	1	1	2	5
Mexico	1.5 (.5%)	8 (4%)	−6.5	.5	.5	2	4

unlike exports, the relative shares of total imports did not change radically between 1995 and 2002. What is interesting, however, is that the reduction in the U.S. share over the period appears to have been due to a shift away from U.S. and Japanese suppliers to merchandise sources in the European Union, China, and Mexico. Over the 1995–2002 period, however, imports from Canada's other trading partners declined as a proportion of total imports while trade originating in other big emerging markets changed very little.

Foreign investment is another way Canadian companies deal in the international marketplace. The Balance of Payments Division of Statistics Canada compiles data on **foreign direct investment** (FDI) for Canada and the rest of the world. According to the latest available report, in 2002 the stock of foreign investment in Canada was in excess of $349 billion, while the stock of outbound FDI totaled almost $432 billion.[12] Although differences exist among countries about how FDI is defined, we report Statistics Canada's interpretation that, "FDI is any cross-border investment made by an investor with a view to establishing a lasting financial interest in an enterprise and exerting a significant management influence."[13] Canada's investment participation with the rest of the world is substantial, averaging almost 30 per cent of GDP.[14]

Exhibit 2.2 displays the relative investment proportions by development level, region, and primary investing country. During 2002, inward FDI into Canada was over $350 billion with 97 percent of the total accounted for by investors from developed countries. By far, the largest foreign investor in Canada was the United States representing 64 percent of total inward FDI. Western European investors accounted for 29 per cent of total inward FDI led by France, the U.K. and Netherlands. Japanese FDI into Canada during the period was scant, amounting to approximately 3 percent of the total. Similarly, Latin American

[12]Statistics Canada, CANSIM, tables 376-0001 and 376-0002, March 18, 2004.

[13]Statistics Canada, Canada's Balance of International Payments, 2002.

[14]Statistics Canada, CANSIM, tables 376-0001 and 376-0002, March 18, 2004.

1815 Napoleon defeated at Battle of Waterloo and gives up throne days later
1815 British build roads of crushed stone, greatly improving the quality and speed of road travel
1817 David Ricardo publishes *Principles of Political Economy and Taxation,* in which he proposes modern trade theory; that comparative advantage drives trade, and that countries will produce and export goods for which they have a *comparative* advantage as opposed to Adam Smith's *absolute* advantage (see 1776)
1818 Canada's shared border with the U.S. is defined as the 49th Parallel and ranges westward from Lake of the Woods to the Rocky Mountains.
1821 Britain is first to adopt gold standard to back value of its currency
1837 Reign of Britain's Queen Victoria begins; she oversees the growth of the British Empire and Britain's emergence as an industrial power (she dies in 1901)
1837 Electronic telegraph begins wide commercial use, transmitting information,

Exhibit 2.2

Canada's Foreign Direct Investment Position, 2002 (Billions of dollars)

Source: Adapted from the Statistics Canada publication, "Canada's International Investment Position," Catalogue no. 67-202-XPB, Fourth Quarter 2003.

	Outbound FDI		Inbound FDI	
Economy	**Value**	**%**	**Value**	**%**
Total World	432	100	350	100
Developed	327	76	338	97
Developing	105	24	12	3
Major Countries				
U.S.	202	47%	224	64%
U.K.	45	10%	26	7%
Ireland	17	4%	2	.5%
Netherlands	14	3%	14	4%
Germany	9	2%	7	2%
Switzerland	6	1%	6	2%
France	5	1%	32	9%
Barbados	24	6%	0	0
Bermuda	9	2%	3	1%
Cayman Is.	6	1%	0	0
Chile	6	1%	0	0
Brazil	4	1%	1	0
Mexico	3	.5%	0	0
Japan	9	2%	9	3%
Australia	8	2%	2	0
Singapore	5	1%	0	0
Indonesia	4	1%	0	0
Hong Kong	3	.5%	5	1.5%
Hungary	11	2.5%	0	0

and Asian investments were very small as indicated in the exhibit. In summary, FDI into Canada during 2002 was from a rather small number of highly developed countries. Approximately 84 percent was from American, French, British, and Dutch investors.

Canadian outward FDI was more diversified than inward FDI in 2002. Exhibit 2.2 reports that Canadian investments into developed economies are proportionately higher than into developing economies by a ratio of 3 to 1. The United States received approximately 64 percent of the total, with Western Europe accounting for another 25 percent. Major European recipients were the U.K., Ireland, and Netherlands. Neither Japan nor Australia was significant investment partners. Interestingly, Barbados accounted for 6 percent (roughly $24 billion) of Canada's total investments for the year. Singapore, Indonesia, and Hong Kong accounted for approximately 4 percent of Canadian foreign direct investments while Hungary received approximately 3 percent ($11 billion). Although outward FDI was more diversified than inward FDI, nonetheless nearly 65 percent of foreign investments leaving Canada went to either the United States or Western Europe.

The statistical overview of Canadian FDI highlights several distinct patterns. First, outward FDI exceeds inward FDI, thus representing a net positive foreign investment position for Canada. Beginning in year 2000, Canada became a net recipient of foreign investment and the pattern has continued since then. As we will discuss in a later section of this chapter, a net foreign investment balance has a positive effect on a country's financial status. Second, Canada's major partner is the United States, both for inward and outward FDI.

including production orders, swiftly
1839 Process for recording negative images on paper is introduced in England, the precursor to modern film technology
1841 An Act of Union unites Upper and Lower Canada as the Province of Canada.

1841 Briton David Livingstone begins 30 years of exploring in Africa
1842 Hong Kong ceded to Britain with the treaty of Nanjing following the Opium War; the city becomes a financial and trading center for Asia

1844 Chinese open five ports to foreign ships
1847 First government-backed postage stamps issued by U.S. leading to more certain and efficient communication by post
1848 Robert Baldwin outlines the principles of Responsible Government.

1848 John Stuart Mill publishes *Principles of Political Economy,* completing the modern theory of trade by stating that gains from trade are reflected in the strength of the *reciprocal* demand for imports and exports and that gains would come from

Canadian investors have focused on opportunities within the hemisphere rather than venturing into less certain investments in other areas of the globe, avoiding developing countries in particular. In ventures outside North America, Canadians have historically opted for deals in highly developed and more culturally proximate countries such as the U.K., France, and the Netherlands. Third, Canadian investors are substantially under-represented in big emerging markets relative to their economic size among major world economies. Canada is usually ranked among the top ten nations in terms of various measures of economic performance, yet its proportion of FDI (inward and outward) with India, China, Russia, Indonesia, Mexico, and the Philippines is well below what would be expected from such a large and wealthy economy. Critics have used these data to argue that Canadian investors are reluctant to take risks, that they do not respond to economic opportunities as rapidly as their competitors, and that they lack the risk-taking innovativeness to change.[15] In summary, international investment patterns for Canadian companies appear to be quite similar to their international merchandise trade patterns. First, key foreign buyers and sellers live in the United States or the European Union. Second, developing economies account for a small share of total Canadian exports, imports, or foreign direct investment. Finally, Canadian companies are not responding to the lure of the big emerging markets, as less than 5 percent of the value of all exports and FDI, and less than 10 percent of imports, are partnered with developing countries.

Who are the Canadian and foreign companies that are behind the investment and trade statistics we have just discussed? Which industries are they involved in and what is their size? To begin with, a large proportion of total foreign direct investment (inward and outward) and trade (imports and exports) between Canada and its partners results from the activities of a relatively small number of large Canadian firms. Many of these companies are Canadian originals; others are transplants largely from the United States, Japan, and Europe, (i.e., the United Kingdom, Germany, the Netherlands, and France). It is instructive for the student to gain an awareness of the identity of these companies as well as the industries within which they operate. In later chapters we will discuss several of their marketing strategies.

Onex Corporation and Celestica Inc. are two of Canada's leading providers of electrical equipment with combined sales of over $50 billion. Their foreign investments span the globe, although they are focused on lucrative U.S. and European markets. In the food and beverage sectors, The Seagram Company Ltd. and George Weston Ltd. comprise a formidable set of competitors. Combined sales volume in 2002 for the two organizations was $60 billion. Their foreign investment and trade volumes are substantial. Other firms of note are Bombardier Inc., Magna International Inc., Celestica Inc., Alcam Inc., Quebecor Inc., Petro-Canada, Noranda Inc., Alberta Energy Company Ltd., Nova Chemicals Corporation, and Abitibi-Consolidated Inc. Companies in the consumer product and service sector are: Nortel Networks Corporation, Transcanada Pipelines Ltd., BCE Inc., Empire Company, Air Canada, Westcoast Energy Inc., Canadian Pacific Ltd., Canadian National Railway Company, Canadian Tire Corporation Ltd., Laidlaw Inc., Teleglobe Inc., Rogers Communication Inc., Atco Ltd., Aliant Inc., Transat A.T. Inc., Extendicare Inc. These firms account for the major portion of Canadian companies in the finance and insurance

[15] R. Martin and M. Porter, "Canadian Competitiveness: A Decade After the Crossroads," Institute for Competitiveness & Prosperity, Toronto, Ontario, May 2001.

better terms of trade (see 1817)
1848 The Communist Manifesto, authored by Germans Karl Marx and Friedrich Engels, is issued; it becomes the basis for the communist movements of the twentieth century

1854 Canada and the U.S. sign a Reciprocity Treaty, ensuring reduced customs duties.
1856 Declaration of Paris recognizes the principle of free movement for trade, even in wartime—blockades could only extend along the enemy's coast; it also establishes the practice of allowing the accession to treaties of nations other than the original signatories
1857 Russia and France sign trade treaty
1858 Ansei Commercial Treaties with Japan open the formerly closed country to trade with the West.

1860 The Cobden Treaty aims to create free trade by reducing or eliminating tariffs between Britain and France; also leads to most-favored-nation status in bilateral agreements and eventually to multilateral agreements sector and are world players based on size and global span. The five chartered Canadian banks—Royal Bank, CIBS, TD, Bank of Montreal, and the Bank of Nova Scotia—are dominant in the home market, but function profitably in foreign markets as well. In recent years, several of these banks proposed to merge into larger entities for the purpose of expanding their global capabilities. The rationale provided for the integration was that it would allow them to compete in markets that required larger financial strengths than any one Canadian bank possessed. Neither political leaders nor the general public, however, endorsed their integration plans, and merger discussions ceased. Nonetheless, all five banks are engaged in foreign investment transactions to a considerable degree and account for a major proportion of FDI originating within Canada. In the financial sector, the chartered banks are accompanied by several equally large and influential insurance and financial service organizations: Manulife Financial Corporation, Caisse Centrale Desjardins, the National Bank of Canada, Power Corporation of Canada, Great-West Lifeco Inc., Canada Life Financial Corporation, and Sun Life Financial Services of Canada.

While Canadian companies are important to the country in terms of their impact on employment, export and import sales, foreign direct investments, profits, and general economic well being, Canadian affiliates of foreign companies play an equally important role. Almost all of the top 100 multinational enterprises have offices or production or distribution facilities in Canada. Companies like Sara Lee Corporation, Imperial Oil, Weyerhaeuser Company, General Motors, Ford, Toyota, and Imperial Tobacco, to name a few, account for a major portion of Canada's foreign trade and investment. Thus, trade and investment between the foreign parent and Canadian affiliate commonly referred to as **intra-firm trade** and **intra-firm investment**, accounts for the largest volume of total trade and investment between Canada and its major partners. OECD estimates place the proportion of inter-firm trade between U.S. and Canadian affiliates at 43 percent of total exports as of 2002.[16] Exhibit 2.3 summarizes the importance of foreign-owned companies in the Canadian economy.

A nation's balance-of-payments statement records all financial transactions between its residents and those of the rest of the world during a given period of time—usually one year. Because the balance-of-payments record is maintained on a double-entry bookkeeping system, it must always be in balance. As on an individual's financial statement, the assets and liabilities or the credits and debits must offset each other. And like an individual's statement, the fact that they balance does not mean a nation is in particularly good or poor financial condition. A balance of payments is a record of condition, not a determinant of condition. Each of the nation's financial transactions with other countries is reflected in its balance of payments.

A nation's balance of payments presents an overall view of its international economic position and is an important economic measure used by treasuries, central banks, and other government agencies whose responsibility is to maintain external and internal economic stability. It is also an excellent source of information for marketing researchers in understanding the macroeconomic factors included in a country analysis. A balance of payments represents the difference between receipts from foreign countries on one side

[16]OECD Economic Outlook, 2002, pp. 159–170.

1860 Passports are introduced in the U.S. to regulate foreign travel
1866 The principle of the electric dynamo is found by German Werner Siemens, who produces the first electric power transmission system
1866 The trans-Atlantic cable is completed, allowing nearly instant (telegraphic) communication between North America and Europe
1867 Confederation! Britain's North American colonies are united by means of the British North America Act to become the Dominion of Canada.
1869 Suez Canal completed after 11 years of construction; the canal significantly cuts the time for travel between Europe and Asia, shortening, for example, the trip between Britain and India by 4,000 miles
1869 Canada purchases Rupert's Land from the Hudson's Bay Company. Threatened by Canadian purchases of Hudson's Bay, Louis Riel leads the Métis in occupying Fort Garry on the site of Winnipeg.
1875 Canada establishes its Supreme Court. Alexander Graham Bell displays the marvels of the first telephone in Boston. A woman, Jennie Trout, becomes Canada's first female legally licensed to practice medicine in the country. Emily Stowe, however, worked without a licence in Toronto, beginning in 1867.
1881 Zoopraxiscope, which shows pictures in motion, is developed

Exhibit 2.3
Top 200 Canadian and Foreign-Owned Companies in Canada, 2003

Source: Globe and Mail Top 200 Private Companies. Bell Globemedia Publishing Company. March 28, 2004. Reprinted with permission from *The Globe and Mail.*

Country	Number of Firms	Percent of Top 200
U.S.	58	29.0
U.K.	12	6.0
Japan	7	3.5
Netherlands	5	2.5
France	3	1.5
Germany	3	1.5
Switzerland	2	1.0
Spain	1	.5
Australia	1	.5
Canada	108	54.0

and payments to them on the other. On the plus side of the balance of payments are merchandise export sales, money spent by foreign tourists, payments for insurance, transportation, and similar services, payments of dividends and interest on investments abroad, return on capital invested abroad, new foreign investments in the local economy, and foreign government payments to the domestic government.

On the minus side are costs of goods imported, spending by tourists overseas, new overseas investments, and the cost of foreign military and economic aid. A deficit results when international payments are greater than receipts. It can be reduced or eliminated by increasing a country's international receipts (i.e., gain more exports to other countries or more tourists from other countries) and/or reducing expenditures in other countries.

A balance-of-payments statement includes three accounts: the **current account**—a record of all merchandise exports, imports, and services plus unilateral transfers of funds; the **capital account**—a record of direct investment, portfolio investment, and short-term capital movements to and from countries; and the official **reserves account**—a record of exports and imports of gold, increases or decreases in foreign exchange, and increases or decreases in liabilities to foreign central banks. Of the three, the current account is of primary interest to exporters, although researchers investigating country markets are interested in the volumes and sources of foreign direct and portfolio investments. It is important to distinguish between the **trade balance** and the **current account balance**. The net trade balance is a reflection of the difference between total exports and total imports. The current account balance, on the other hand, is a more complete picture of the financial flows into and from a local economy. It includes the net trade balance, but also the net income receipts from Canadian operations in other countries as well as the net transfers of gifts between Canadian citizens and others in the world. In essence, compared to the trade balance, the current account balance provides a more accurate representation of the health of an economy.

The current account is important because it includes all international merchandise trade and service accounts, that is, accounts for the value of all merchandise and ser-vices imported and exported and all receipts and payments from investments. Exhibit 2.4 gives the current account calculations for Canada in 2002.

The capital and financial accounts measure net foreign direct investment (outward and inward) and **portfolio investment** (outward and inward). Whereas foreign direct

1884 Eaton's issues first transcontinental mail order catalogue.
1884 The basis for establishing standard time and measuring the longitude of any spot in the world is created with the designation of Greenwich, England, as the prime meridian (0° longitude)
1885 Riel leads the North-West rebellion. The Métis are defeated and Riel is hanged in Regina. The Canadian Pacific Railroad is completed.
1901 Italian Guglielmo Marconi sends the first radio message; the radio could be said to spark the start of globalization because of the speed with which information is able to be transmitted
1903 First successful flight of an airplane, piloted by Orville Wright, takes place at Kitty Hawk, North Carolina
1904 First vacuum tube is developed by John Fleming, allowing alternating current to become direct current and helping to create widespread use of the radio
1913 Assembly line introduced by Henry Ford; it will revolutionize manufacturing
1914 The first war to involve much of the world begins with the assassination of Archduke Franz Ferdinand and lasts four years; construction of Panama Canal completed, making trade faster and easier
1917 Lenin and Trotsky lead Russian revolution, creating a living economic model that will affect trade (adversely) for the rest of the century

Exhibit 2.4
Current Account by Major Components, 2002 ($ millions)

Source: Adapted from the Statistics Canada CANSIM database, http://cansim2.statcan.ca, Table 228-0003.

Exports	
Goods	414
Services	58
Income receipts	32
Imports	
Goods	−356
Services	−67
Income payments	−59
Unilateral current transfers, net	1
Current account balance	23

investment represents a substantial foreign investor impact upon the governance of the companies involved in the investment, portfolio investments are made by Canadians in foreign stocks, bonds, and other financial assets, usually for a period of less than one year for the purpose of enhancing short-term returns. Just like any company's financial books, the accounts must balance. If more money is leaving Canada than coming in, regardless of its foreign direct or portfolio investment, the balance of payments shows a deficit, and the difference needs to be financed. In other words, a current account deficit must be matched by an equivalent amount of foreign capital entering Canada or by borrowing from other countries. In principle, the current account and capital account should balance each other out. If Canada buys more goods, services and the like than it sells (i.e., if it has a current account deficit), it has to sell its assets to finance the spending (i.e., run a capital account surplus) or go into debt. In theory, therefore, the balance of payments is always zero. Since Canada traditionally sells more goods than it buys, the balance of trade for merchandise is usually positive. Historically, the positive trade balance (surplus) for goods each year is almost entirely a result of trade with the United States. The current account surplus for goods stood at $92.0 billion in 2002, down from an all time high of $97.1 billion in 2001. Agriculture, fishing, energy, forestry and automotive sectors earned positive trade balances in 2002, which was consistent with their performance for much of the 1990s. Negative merchandise trade balances occurred in 2002 for machinery and equipment goods and consumer goods.[17]

Current account surpluses or deficits may or may not be a matter of concern, depending on specific circumstances. For example, as a relatively new and rapidly growing country in the 20th century, Canada often experienced strong inflows of direct investment. These inflows helped Canada grow and prosper, although they tended to cause a capital account surplus and a corresponding current account deficit. As capital flowed into the country, other materials and resources were imported from other countries to accommodate the new capital. Also, as the economy expanded, Canadians become richer and demanded greater volumes of goods and services from other countries. In contrast, there have also been occasions when Canadians have substantially increased their investment abroad. Such circumstances can lead to a capital account deficit, which would be balanced

[17]OECD Economic Outlook, 2002, pp. 159–170.

1919 First nonstop trans-Atlantic flight completed, paving the way for cargo to be transported quickly around the globe
1920 League of Nations created, establishing a model for international cooperation (though it failed to keep the peace)
1923 Vladimir Zworykin creates first electronic television, which will eventually help integrate cultures and consumers across the world
1928 The Supreme Court of Canada rules that the BNA Act does not define women as "persons" and are therefore not eligible to hold public office. The British Privy Council reversed the Supreme Court decision the following year, and women were legally declared "persons."
1929 Great Depression starts with crash of U.S. stock market
1930 Hawley-Smoot Tariff passed by U.S. Senate, plunging the world deeper into the Great Depression
1935 Radar developed in Britain; it allows travel on ships and planes even when there is no visibility, enabling the goods to keep to a transport schedule (eventually allowing the development of just-in-time and other cost-savings processes)

by a current account surplus. Similarly, as Canadians transfer capital to other countries they also tend to increase goods and services trading with their investing partners.

Balance of Payments and Foreign Exchange

Canada's transactions with the rest of the world involve the exchange of Canadian dollars for the currency of the other country involved in the purchase or sale. For example, when people in foreign countries invest heavily in Canada, the inward investment flows may put upward pressure on the value of the Canadian dollar, as the investors seek to put their investment plans into effect by exchanging their foreign currency for Canadian dollars. The **exchange rate** refers to the value of the Canadian dollar against the currencies of other countries. Among other things, it helps determine how much Canadians pay for imported goods and services and how much they receive for what they export.

When the value of the Canadian dollar falls, imported goods become more expensive, and Canadians tend to reduce their demand for imports. At the same time, other countries pay less for Canadian products and services, and that tends to boost export sales. The exchange rate plays a particularly important role in our economy because, compared with other countries, imports and exports are a relatively large part of Canada's economy. Most of our trade is with the United States, which is why the value of our dollar against the U.S. dollar is especially important. To compare living standards across countries, **Purchasing Power Parity (PPP)** exchange rates are constructed by assessing the prices of a national consumption basket of goods to an identical consumption basket in another nation. Purchasing power parity is defined as the number of units of a foreign country's currency required in order to purchase an identical quantity of goods and services in the local market. Adjusting nominal exchange rates with the PPP ratio offsets differences in national price levels and provides comparable measures of purchasing power.

Factors affecting the exchange rate. Canada has a **floating exchange rate**. That means there is no set value for our currency compared with any other currency. The exchange rate is affected by supply and demand for Canadian dollars in international exchange markets. If demand exceeds supply, the value of the dollar will go up. If the supply exceeds demand, its value will go down. On an average day, $52 billion is bought and sold on the international exchange markets.[18]

Several factors influence the supply of, and demand for, Canadian dollars. If *interest rates* are higher in Canada than in other countries, investors may choose to invest in Canada, increasing demand for the dollar, provided that the expected rate of *inflation* is not higher in Canada than among our trading partners. If our inflation rate is higher, investors are less likely to prefer Canada—even with higher interest rates—because of the expectation that the value of the dollar will be eroded by inflation. Our *trade balance* also affects our dollar. If world prices for what we export rise in comparison with the cost of our imports, we will be earning more for our exports than we pay for our imports. The more favourable these "terms of trade," the more demand there will be for the Canadian dollar. If *investors are confident* that the Canadian economy will be strong, they will be more likely to buy Canadian assets, pushing up the dollar's value. Finally, the relative *productivity* of Canadian capital, labour, and other resources relative to that of their major trading

[18]D. Longworth, "Money in the Bank (of Canada)," Bank of Canada, *Technical Report No. 93*, February 2003.

1938 American Chester Carlson develops dry copying process for documents (xerography) (which, among other things, enables governments to require that multiple forms be filled out to move goods)
1939 World War II begins with German invasion of Poland; over 50 million people die
1943 The first programmable computer, Colossus I, is created in England at Bletchley Park; it helps to crack German codes
1944 Bretton Woods Conference creates basis for economic cooperation among 44 nations and the founding of the International Monetary Fund to help stabilize exchange rates
1945 Atomic weapons introduced; World War II ends; United Nations founded
1947 General Agreement on Tariffs and Trade (GATT) signed by 23 countries to try to reduce barriers to trade around the world
1948 Transistor is invented; itreplaces the vacuum tube, starting a technology revolution
1949 People's Republic of China founded by Mao Zedong, which restricts access to the largest single consumer market on the globe

partners will help to determine the exchange rate between the Canadian and other currencies. Higher relative productivity will be associated with a greater demand for the currency, and therefore a higher relative value, while lower productivity will result in the opposite effect. These five factors—interest rates, inflation, trade balance, investor expectations, and factor productivity—help to determine the relative value of the Canadian dollar in terms of foreign currencies.

International marketers are neither economists nor financial analysts, but they are interested in understanding the factors that affect a firm's likelihood for success in foreign markets. Determining the best way to enter the country, configuring the appropriate distribution arrangement for product or service delivery, determining a pricing strategy, and defining a product that will fit in the local market are all dependent upon possessing a clear understanding of the often uncontrollable factors that make up the foreign competitive environment. A country's balance of payments position, as well as its current account balance, foreign direct and portfolio investment balances, merchandise and service trade balances, relative exchange rate, relative interest rates, and the stability of other macroeconomic indictors reflect the degree of economic stability in the economy. A key concern in conducting a country analysis is to identify the threats and opportunities posed in the proposed market environment. A thorough understanding of the balance of payments framework and its constituent elements will aid the researcher in collecting and interpreting data relevant to the foreign entry decision.

Protectionism

International business must face the reality that this is a world of **tariffs**, **quotas**, and **non-tariff barriers** designed to protect a country's markets from intrusion by foreign companies. Although the General Agreement on Tariffs and Trade (GATT) has been effective in reducing tariffs, countries still resort to measures of **protectionism**. Nations utilize legal barriers,[19] exchange barriers, and psychological barriers to restrain entry of unwanted goods. Businesses work together to establish private market barriers while the market structure itself may provide formidable barriers to imported goods. The complex distribution system in Japan is a good example of a market structure creating a barrier to trade. However, as effective as it is in keeping some products out of the market, in a legal sense it cannot be viewed as a trade barrier.

Protection Logic and Illogic

Countless reasons to maintain government restrictions on trade are espoused by protectionists, but essentially all arguments can be classified as follows: (1) protection of an infant industry, (2) protection of the home market, (3) need to keep money at home, (4) encouragement of capital accumulation, (5) maintenance of the standard of living and real wages, (6) conservation of natural resources, (7) industrialization of a low-wage nation, (8) maintenance of employment and reduction of unemployment, (9) national defense, (10) increase of business size, and (11) retaliation and bargaining. Economists in general recognize as valid only the arguments for infant industry, national defence, and industrialization of underdeveloped countries. The resource conservation argument becomes increasingly valid in an era of environmental consciousness and worldwide shortages of raw materials and agricultural commodities. There might be a case for tem-

[19]Matt Pottinger, "Software Firms Face Setback In China—Proposed Rules Would Force Regional Governments to Use Domestic Vendors," *Wall Street Journal,* March 7, 2003, p. B5.

1957 European Economic Community (EEC) established by Belgium, France, West Germany, Italy, Luxembourg, and the Netherlands, the precursor to today's European Union
1961 Berlin Wall is erected, creating Eastern and Western Europe with a physical and spiritual barrier
1964 Global satellite communications network established with INTELSAT (International Telecommunications Satellite Organization)
1965 Canada and the U.S. sign the AutoPact agreement which liberalizes cross-border trade within the auto industries of the two countries.
1967 European Community (EC) established by uniting the EEC, the European Coal and Steel Community, and the European Atomic Energy Community
1967 French President de Gaulle says "Vive le Québec libre" in Montreal.
1971 The federal government officially adopts a policy of multiculturalism.
1971 The gold standard is abandoned allowing the international monetary system to

CROSSING BORDERS 2.1 A Word for Open Market

Bastiat's century-old farcical letter to the French Chamber of Deputies points up the ultimate folly of tariffs and the advantages of utilizing the superior production advantage of others.

To the Chamber of Deputies:

We are subjected to the intolerable competition of a foreign rival, who enjoys such superior facilities for the production of light that he can inundate our national market at reduced price. This rival is no other than the sun. Our petition is to pass a law shutting up all windows, openings, and fissures through which the light of the sun is used to penetrate our dwellings, to the prejudice of the profitable manufacture we have been enabled to bestow on the country.

Signed: Candlestick Makers,
F. Bastiat

porary protection of markets with excess productive capacity or excess labour when such protection could facilitate an orderly transition. Unfortunately, such protection becomes long term and contributes to industrial inefficiency while detracting from a nation's realistic adjustment to its world situation.

Most protectionists argue the need for tariffs on one of the three premises recognized by economists, whether or not these arguments are relevant to their products. Proponents are likely also to call on the maintenance-of-employment argument because it has substantial political appeal. When arguing for protection, the basic economic advantages of international trade are ignored. The fact that the consumer ultimately bears the cost of tariffs and other protective measures is conveniently overlooked. Sugar[20] and textiles are good examples of protected industries in the United States that cannot be justified by any of the three arguments. U.S. sugar prices are artificially held higher than world prices for no sound economic reason.

To give you some idea of the cost to the consumer, consider the results of a recent study of 21 protected U.S. industries. The research showed that consumers pay about $70 billion per year in higher prices because of tariffs and other protective restrictions. On average, the cost to consumers for saving one job in these protected industries was $170,000 per year, or six times the average pay (wages and benefits) for manufacturing workers. Those figures represent the average of 21 protected industries, but the cost is much higher in selected industries. In the steel industry, for example, countervailing duties and antidumping penalties on foreign suppliers of steel since 1992 have saved the jobs of 1,239 steelworkers at a cost of $835,351 each. Unfortunately, protectionism is politically popular, but it rarely leads to renewed growth in a declining industry. And the jobs that are saved are saved at a very high cost, which constitutes a hidden tax that consumers unknowingly pay.

Trade Barriers

To encourage development of domestic industry and protect existing industry, governments may establish such barriers to trade as tariffs, quotas, boycotts, monetary barriers, nontariff barriers, and market barriers. Barriers are imposed against imports and against

[20]"Brazil Highlights Importance of Reform for U.S. Sugar Program," *World Trade,* January 2003, p. 14.

base exchange rates on perceived values instead of ones fixed in relation to gold
1973 Arab oil embargo jolts industrial world into understanding the totally global nature of supply and demand
1975 Toronto's CN Tower becomes the world's tallest free-standing structure. The Foreign Investment Review Agency screens applications for foreign investment in Canada.
1980 "O Canada" is officially adopted as Canada's national anthem.
1987 ISO issues ISO 9000 to create a global quality standard
1989 Berlin Wall falls, symbolizing the opening of the East to the West for ideas and commerce
1991 Soviet Union formally abandons communism, as most formerly communist states move toward capitalism and the trade it fosters; Commonwealth of Independent States (CIS) established between Russia, Ukraine, and Belarus
1993 NAFTA ratified by Canadian Parliament; European Union created from the European Community, along with a framework for

foreign businesses. While the inspiration for such barriers may be economic or political, they are encouraged by local industry. Whether or not the barriers are economically logical, the fact is they exist.

Tariffs. A **tariff**, simply defined, is a tax imposed by a government on goods entering at its borders. Tariffs may be used as a revenue-generating tax or to discourage the importation of goods, or for both reasons.[21] In general, tariffs:

Increase	Inflationary pressures. Special interests' privileges. Government control and political considerations in economic matters. The number of tariffs (they beget other tariffs via reciprocity).
Weaken	Balance-of-payments positions. Supply-and-demand patterns. International relations (they can start trade wars).
Restrict	Manufacturers' supply sources. Choices available to consumers. Competition.

In addition, tariffs are arbitrary, discriminatory, and require constant administration and supervision. They often are used as reprisals against protectionist moves of trading partners. In a dispute with the European Union (EU) over pasta export subsidies, the United States ordered a 40 percent increase in tariffs on European spaghetti and fancy pasta. The EU retaliated against U.S. walnuts and lemons. The pasta war raged on as Europe increased tariffs on U.S. fertilizer, paper products, and beef tallow, and the United States responded in kind. The war ended when the Europeans finally dropped pasta export subsidies. More recently the European Union and the United States have been battling a similar trade war over bananas! Most recently, less-developed countries are increasingly voicing complaints about American and European tariffs on agricultural products.[22]

U.S. lumber companies were successful in encouraging the U.S. administration to impose a countervailing duty and an anti-dumping duty on Canadian softwood lumber exporters. American lumber interests claimed Canadian competitors were unfairly subsidized by provincial forest policies, especially low Crown stumpage fees, and selling into the U.S. market at below production costs or Canadian prices. After the duty was applied, Canadian softwood lumber prices skyrocketed by 27 percent and substantial market share was lost. Canadian producers appealed the U.S. action to the World Trade Organization (WTO) as well as the dispute settlement panel of the NAFTA. Although the WTO and the NAFTA sided with Canada, nonetheless the process has dragged on for years. Tariffs are causing massive damage, especially in British Columbia where half the province's GDP is at stake, and in Manitoba, where a new sawmill at Pine Falls has been indefinitely postponed, threatening hundreds of jobs in an area wracked with high unemployment levels.[23]

Imports are restricted in a variety of ways other than tariffs. These nontariff barriers include quality standards on imported products, sanitary and health standards, quotas,

[21]Herbert Dieter, "Free Trade and Pick-Up Trucks," *Far Eastern Economic Review,* February 6, 2003, p. 20.

[22]George Pitcher, "Trade War Looms as West Faces Third World Uprising," *Marketing Week,* April 3, 2003, p. 29.

[23]"The Hard Facts About Softwood Lumber," Frontier Centre for Public Policy, Winnipeg, Manitoba, September 4, 2002.

joint security and foreign policy action, by the 1991 Maastricht Treaty on European Union; the EEC is renamed the EC
1994 The Chunnel (Channel Tunnel) is opened between France and Britain, providing a ground link for commerce between the Continent and Britain
1995 World Trade Organization (WTO) set up as successor to GATT; by 2000 more than 130 members account for over 90 percent of world trade
1997 Hong Kong, a world trading and financial capital and bastion of capitalism, is returned to communist Chinese control; Pathfinder lands on Mars, and rover goes for a drive but finds no one with whom to trade
1998 The federal government of Canada issues a formal apology to Native

Exhibit 2.5
Types of Nontariff Barriers

Specific Limitations on Trade
Quotas
Import licensing requirements
Proportional restrictions of foreign to domestic goods (local-content requirements)
Minimum import price limits
Embargoes

Customs and Administrative Entry Procedures
Valuation systems
Antidumping practices
Tariff classifications
Documentation requirements
Fees

Standards
Standards disparities
Intergovernmental acceptances of testing methods and standards
Packaging, labeling, marking standards

Governmental Participation in Trade
Government procurement policies
Export subsidies
Countervailing duties
Domestic assistance programs

Charges on Imports
Prior import deposit requirements
Administrative fees
Special supplementary duties
Import credit discriminations
Variable levies
Border taxes

Others
Voluntary export restraints
Orderly marketing agreements

Source: Reprinted from *Journal of World Business,* A. D. Cao, "Nontariff Barriers to U.S. Manufactured Exports," p. 94, copyright (1980) with permission from Elsevier.

embargoes, boycotts, and antidumping penalties. Exhibit 2.5 gives a complete list of nontariff barriers.

Quotas. A **quota** is a specific unit or dollar limit applied to a particular type of good. There is a limit on imported television sets in Great Britain, and there are German quotas on Japanese ball bearings, Italian restrictions on Japanese motorcycles, and U.S. quotas on sugar, textiles,[24] and, of all things, peanuts. Quotas put an absolute restriction on the quantity of a specific item that can be imported. When the Japanese first let foreign rice into their country it was on a quota basis, but since 2000 the quotas have been replaced by tariffs.[25] Even more complicated, the banana war between the United States and the European Union appears at this date to be headed to a mixed system wherein a quota of bananas is allowed into the EU with a tariff, then a second quota comes in tariff-free. Like tariffs, quotas tend to increase prices. U.S. quotas on Canadian sales of softwood lumber are expected to reduce Canada's market share from 35 percent to 27 percent of U.S. consumption.

Voluntary Export Restraints. Similar to quotas are the **voluntary export restraints** (VERs) or **orderly market agreements** (OMAs). Common in textiles, clothing, steel, agriculture, and automobiles, the VER is an agreement between the importing country and the exporting country for a restriction on the volume of exports. Japan has a VER on automobiles to the United States; that is, Japan has agreed to export a fixed number of automobiles annually. When televisions were still manufactured in the United States, Japan signed an OMA limiting Japanese colour television exports to the United States to 1.56 million units

[24]"Deal Limits Vietnamese Imports," *Los Angeles Times,* April 7, 2003, p. A34.
[25]See the USA Rice Federation's website for details—www.usarice.com.

Peoples for past injustices related to taking of lands and the creation of the residential school system.
1999 Euro introduced in 11European Union nations, paving the way for the creation of a true trade union and trade bloc
1999 Seattle Round of WTO negotiations pits United States versus European Union; first great protest against globalization
2000 Second millennium arrives, predicted computer problems do not occur
2001 September 11 terrorist attack on the World Trade Centre in New York City and the Pentagon in Washington, D.C.
2002 United States attacks Taliban in Afghanistan
2003 United States attacks regime of Saddam Hussein in Iraq. Canada refuses to participate

CROSSING BORDERS 2.2 Crossing Borders with Monkeys in His Pants

Robert Cusack smuggled a pair of endangered pygmy monkeys into the United States—in his pants! On June 13, 2002 a U.S. Fish and Wildlife Service special agent was called to Los Angeles International Airport after Cusack was detained by U.S. Customs on arrival from Thailand. Officials soon also discovered that Cusack had four endangered birds of paradise and 50 protected orchids with him. "When one of the inspectors opened up his luggage, one of the birds flew out," tells one official. "He had to go catch the bird." After finding the other purloined birds and exotic flowers, the inspectors asked, "Do you have anything else you should tell us about?" Cusack answered, "Yes, I have monkeys in my pants." The monkeys ended up in the Los Angeles Zoo, and the smuggler ended up in jail for 57 days. He also paid a five-figure fine.

Richard Connors, a Chicago lawyer, should have known better. He was caught smuggling thousands of Cuban cigars into the United States in violation of the 40-year-old trade embargo against Castro's Cuba. Connors, who had made monthly trips to Cuba via Canada and Mexico, faces up to five years in prison for his transgressions.

Smuggling isn't just a game played by sneaky individuals. Multinational companies can also get into the act. During this past year alone, convictions were obtained for smuggling cell phones into Vietnam, cigarettes into Iraq and Canada, and platinum into China. In perhaps the biggest ever corporate case, after a nine-year lawsuit Amway Corporation agreed to pay the Canadian government $38.1 million dollars to settle charges they had avoided customs duties by undervaluing merchandise it exported from the United States to Canadian distributors over a six-year period. Indeed, as long as there have been trade barriers, smuggling has been a common response. One-hundred years ago Rudyard Kipling wrote:

> Five and twenty ponies trotting through the dark—
> Brandy for the Parson, 'baccy for the clerk;
> Laces for a lady, letters for a spy;
> And watch the wall, my darling, while the
> Gentlemen go by!

Sources: "Amway Pays $38 Million to Canada," *Los Angeles Times*, September 22, 1989, p. 3; "Conviction in Cigar Smuggling," *New York Times*, October 11, 2002, p. 27; Patricia Ward Biederman, "Smuggler to Pay for Pocketing Monkeys," *Los Angeles Times*, December 19, 2002, p. B1; and Barry Wain, "Two Vietnamese Brothers Fall Victim to Their Success," *Wall Street Journal*, May 15, 2003, p. A15.

per year. However, as a result of the OMA, Japanese companies began investing in television manufacturing in the United States and Mexico, and as a result they regained the entire market share that had been lost through the OMA, eventually dominating the entire market. A VER is called voluntary because the exporting country sets the limits; however, it is generally imposed under the threat of stiffer quotas and tariffs being set by the importing country if a **VER** is not established. Canada does not employ VERS. Its export restrictions and export licensing requirements are consistent with its WTO obligations.

Boycotts and Embargoes. A government **boycott** is an absolute restriction against the purchase and importation of certain goods from other countries. An **embargo** is a refusal to sell to a specific country. A public boycott can be either formal or informal and may be government sponsored or sponsored by an industry. In July of 2001, officials at Health Canada imposed an embargo on the importation of an ornamental lily known as Lucky Bamboo (Dracaena). The decision occurred after reports that a Tiger Mosquito was released from a container that held the Lucky Bamboo plants newly arrived from Asia. Canada's embargo stated that all shipments containing Dracaena would be seized and detained. These actions were taken to protect Canadians from a potentially dangerous invading species.[26]

Embargos are used in international commerce and politics to prohibit commerce and trade with other countries. In the case of the Tiger Mosquito, the embargo was specific for

[26] "Embargo Issued Against the Importation of Lucky Bamboo (Dracaena) in Standing Water," Health Canada Online, July 5, 2001.

the Dracaena plants. Embargos, however, may also be declared by a group of nations in order to isolate a nation and place it in a difficult internal situation. This economic action may be used to aggressively persuade a country to change its policies. It may be used as a form of political punishment to force agreement on international issues.

For example, Cuba, Iran, and Iraq had or still have sanctions imposed by the United States. There is rising concern, however, that government-sponsored sanctions cause unnecessary harm for the boycotting country and the country being boycotted without reaching desired results. It is not unusual for the citizens of a country to boycott goods of other countries at the urging of their government or civic groups. Nestlé products were boycotted by a citizens group that considered the way Nestlé promoted baby milk formula misleading to mothers and harmful to their babies in less-developed countries. Unfortunately, the economic implications of an embargo may also present opportunities for other nations to profit from an increased demand in embargoed commodities. The economic forces of supply and demand provide countries that are not under oil embargos to enjoy increased oil prices and therefore greater revenue.

Monetary Barriers. A government can effectively regulate its international trade position by various forms of exchange-control restrictions. A government may enact such restrictions to preserve its balance-of-payments position or specifically for the advantage or encouragement of particular industries. There are three barriers to consider: blocked currency, differential exchange rates, and government approval requirements for securing foreign exchange.

Blocked currency is used as a political weapon or as a response to difficult balance-of-payments situations. In effect, blockage cuts off all importing or all importing above a certain level. Blockage is accomplished by refusing to allow importers to exchange its national currency for the sellers' currency.

The differential exchange rate is a particularly ingenious method of controlling imports. It encourages the importation of goods the government deems desirable and discourages importation of goods the government does not want. The essential mechanism requires the importer to pay varying amounts of domestic currency for foreign exchange with which to purchase products in different categories. For example, the exchange rate for a desirable category of goods might be one unit of domestic money for one unit of a specific foreign currency. For a less-desirable product, the rate might be two domestic currency units for one foreign unit. For an undesirable product, the rate might be three

Cracker Jack invented the toy-with-candy promotion back in 1912. However, the Italian chocolatier, Ferrero, took things much further. Their milk chocolate Kinder eggs contain "sopresas" (surprises) that kids enjoy in 37 countries around the world, including Canada. The product pictured is produced in Argentina for sale in Mexico, and it includes a warning label regarding kids under three. Cracker Jack has had to eliminate many of the small toys it put in the packages for the same reason. Nestlé introduced a product similar to Kinder eggs in the U.S. market in the late 1990s, but had to withdraw it for safety reasons. Wonderball is the latest version, but it has edible chocolate figures inside. See www.ferrero.com.ar and www.crackerjack.com for more details. Toys must be larger than the diameter of the plastic tube pictured on the right to meet safety standards. *(left: © Sharon Hoogstraten; right: AP/Wide World Photos)* domestic units for one foreign unit. An importer of an undesirable product has to pay three times as much for the foreign exchange as the importer of a desired product.

Government approval to secure foreign exchange is often used by countries experiencing severe shortages of foreign exchange. At one time or another, most Latin American and East European countries have required all foreign exchange transactions to be approved by a central minister. Thus importers who want to buy a foreign good must apply for an exchange permit, that is, permission to exchange an amount of local currency for foreign currency.

The exchange permit may also stipulate the rate of exchange, which can be an unfavorable rate depending on the desires of the government. In addition, the exchange permit may stipulate that the amount to be exchanged must be deposited in a local bank for a set period prior to the transfer of goods. For example, Brazil has at times required funds to be deposited 360 days prior to the import date. This is extremely restrictive because funds are out of circulation and subject to the ravages of inflation. Such policies cause major cash flow problems for the importer and greatly increase the price of imports. Needless to say, these currency-exchange barriers constitute a major deterrent to trade.

Standards. Nontariff barriers of this category include standards to protect health, safety, and product quality. The standards are sometimes used in an unduly stringent or discriminating way to restrict trade, but the sheer volume of regulations in this category is a problem in itself.[27] A fruit content regulation for jam varies so much from country to country that one agricultural specialist says, "A jam exporter needs a computer to avoid one or another country's regulations." Different standards are one of the major disagreements between Canada and its trading partners. For example, standards in Kuwait are based on those adopted from the United Kingdom, Germany, the United States, and other countries. Additional standards are applied on goods to suit local requirements. Among the most relevant standards Canadian businesses must adhere to are that owner's manuals must be translated into Arabic, food labeling must be clear and in Arabic and English, and electrical appliances must run on 250 V.[28]

A number of countries require some products (automobiles in particular) to contain a percentage of "local content" to gain admission to their markets. The North American Free Trade Agreement (NAFTA) stipulates that all automobiles coming from member countries must have at least 62.5 percent North American content to deter foreign car makers from using one member nation as the back door to another.

Trade restrictions abound, and Canada is one of the governments using them. Nonetheless, Canadian tariff and non-tariff barriers have steadily declined over the past three decades. Canada implemented the market access initiative that provides duty free and quota free access to imports from 48 of the world's least developed countries. Tariffs on agricultural products and textiles, however, are high by developed country standards. Nontariff restrictions have received substantial attention since the ending of the Uruguay Round in 1994. Canada's export restrictions and export licensing requirements are consistent with its WTO obligations. Further, it does not maintain any WTO-inconsistent quantitative export restrictions. Voluntary export restraints and export subsidies are not used as they are prohibited under several WTO Agreements. On agricultural products, the WTO Agreement on Agriculture contains disciplines and reduction commitments. In general, Canada is ranked as one of the more open economies and relatively free from trade restrictions, but agriculture, clothing and textiles, and transportation are sectors that are in need of liberalized reform.[29]

[27]Sabrina Tavernise, "Russia Revokes Licenses for All Imports of Meat and Poultry," *New York Times,* February 1, 2003, p. C3.

[28]"National Trade Estimate on Foreign Trade Barriers—Arab League," *Market Access Report*, Agriculture and Agri-Food Canada, Department of Foreign Affairs and International Trade, Ottawa, Ontario, October 31, 2003.

[29]Department of Foreign Affairs and International Trade online information. Available at: http://www.dfait-maeci.gc.ca/tna-nac/framework-e.asp.

According to the U.S. government, you can't call it a "catfish" unless it's grown in America. Vietnamese are producing filets in flooded rice paddies at about $1.80 a pound at wholesale. American fish farmers are charging about $2.80. Neither consumers nor ichthyologists can tell the difference between the Asian and American fish, but Uncle Sam has stepped in anyway. The Congressional claim on the "catfish" name has forced the U.S. to stifle its own protests about Europeans claiming exclusive rights to the name "herring." *(© Tom McHugh/Photo Researchers, Inc.)*

Antidumping Penalties. Historically tariffs and nontariff trade barriers have impeded free trade, but over the years they have been eliminated or lowered through the efforts of GATT and WTO. Now there is a new nontariff barrier: antidumping laws that have emerged as a way of keeping foreign goods out of a market.[30] Antidumping laws were designed to prevent foreign producers from using **predatory pricing**, a practice whereby a foreign producer would intentionally sell their products in a foreign market for less than the cost of production to undermine the competition and take control of the market. It was intended as a kind of antitrust law for international trade. Violators are assessed antidumping duties for selling below cost or are assessed countervailing duties to prevent the use of foreign government subsidies to undermine local industry. Many countries have similar laws, which are allowed under WTO rules.

Canada applies anti-dumping and countervailing legislation in a non-discriminatory manner. Imports from Chile are excluded from anti-dumping measures if the tariff rate for the goods is zero. As of 2003, all goods from Chile are exempt from anti-dumping duties. In total, 91 Canadian anti-dumping measures plus three price undertakings remain in force. Some 37 countries are affected by these measures with over 70 percent of all duties involving steel products from the EU and the U.S. New investigations have recently been launched dealing with footwear and chemicals from China and Viet Nam. A recent WTO study found that dumped imports from all the investigated countries put together represent a relatively small share of the Canadian market.[31]

Canada's Trade and Investment Regime

Canada's objective in devising its trade and investment policy is to increase economic growth and social prosperity for the benefit of all Canadians by easing restrictions and enhancing cooperation among nations in the multilateral trading system. Responsibilities for achieving this objective are shared by a number of federal and provincial departments The Department of Foreign Affairs and International Trade (DFAIT) is the leading federal agency for international trade and investment policy formulation. It coordinates with the Department of Finance and with Industry Canada for international investment policy issues.[32]

DFAIT regularly consults trade departments in the provinces and territories, as a number of matters covered by WTO provisions (e.g. subsidies, procurement, technical regulations, services regulations) are subject to provincial legislation. Under the Constitution, only the federal parliament is authorized to legislate on the regulation of international trade. The federal government is free to enter into international agreements without prior consultations with the provinces. The latter, however, have legislative jurisdiction over property and all local and private matters. This gives them considerable leeway to enact legislation and conduct policies that affect trade or investment. Furthermore, certain areas have been recognized as being under shared jurisdiction, either expressly in the Constitution, e.g., agriculture (subject to supremacy of federal legislation) or through court rulings, e.g., the environment. As a result, cooperation by the provinces is often indispensable to implement international agreements.

[30]Pascal Lamy, "Come on, America, Play by the Rules!" *Wall Street Journal,* March 3, 2003, p. A16.

[31]World Trade Organization, *Canada's Trade Policy Review*, March 2003.

[32] Industry Canada Online Information. Available at: http://www.ic.gc.ca.

Team Canada's trip to Moscow in 2002 was a major success. Canadian enterprises signed 77 new business deals totaling $337.151 million. The group's success signals a substantial rise in Canada's profile in Russia's international business dealings. *(CP/Fred Chartrand)*

Significant differences exist in trade and investment policies and practices between the federal, provincial and territorial governments, as well as across provinces and territories. In order to reduce the effect of these differences, the **Agreement on Internal Trade (AIT)** seeks to reduce rules and procedures that create barriers to effective trade. As part of the AIT, the several government levels agreed to focus on key areas of procurement, investment incentives, labour mobility, consumer-related standards, transportation, and environmental protection.

The private sector is central in Canada's trade policy formulation process, so as to maximize the effectiveness of government support to trade and investment. **Team Canada** is a network of more than 20 federal departments and agencies working with the provinces, territories, and other partners to provide services to exporters, with a view to enhancing export capability and preparedness in international market development.

Team Canada trade missions bring together business and government representatives in visits to various priority countries to ensure that companies take full advantage of international opportunities. Consultations with the business community and the general public enhance communications with Canadian citizenry and inform policymakers on the priorities from the grassroots level.

The Office of Consumer Affairs at Industry Canada, together with the Competition Bureau, analyze the impact of trade and investment policy changes on consumers. The Bureau aims to prevent excessive market concentration, monopolistic pricing, and other anti-competitive conduct that could cause a reduction in consumer welfare. No single agency is responsible for formulating or implementing investment regulations in Canada; however, the three federal departments with direct responsibility for investment are Finance, Foreign Affairs and International Trade, and Industry Canada. Foreign direct investment in Canada takes place within the framework provided by the Investment Canada Act (ICA) of 1985, which is administered by Industry Canada and Canadian Heritage (for matters relating to Canada's cultural industries). Investments are judged by criteria such as their impact on competition, productivity, compatibility with national and provincial policies, and the participation of Canadians.

The current international trade and investment regime in Canada focuses on helping businesses to be more competitive in world markets as well as on correcting perceived injustices in trade practices. Although protectionism is present in Canada, nonetheless its presence is minimal and isolated in a few well-defined sectors. Canada considers the multilateral trading system as the cornerstone of its trade policy. It is an original member of the WTO, IMF, World Bank Group, and various other collective associations working to resolve global trade and investment issues. As the global marketplace evolves, trading countries have focused on ways of eliminating tariffs, quotas, and other barriers to trade. Commitment to the principles and practices of the multilateral organizations, predicated as they are on market access, transparency in trade and investment, fairness in government procurement opportunities, and protection of individual rights of national sovereignty and self-determination, will enhance Canada's economic and social fortunes in the years ahead.

General Agreement on Tariffs and Trade

Historically, trade treaties were negotiated on a bilateral (between two nations) basis, with little attention given to relationships with other countries. Further, there was a tendency to raise barriers rather than extend markets and restore world trade. Twenty-three countries signed the *General Agreement on Tariffs and Trade* (**GATT**) shortly after World War II. Although not all countries participated, this agreement paved the way for the first effective worldwide tariff agreement. The original agreement provided a process to reduce tariffs and created an agency to serve as a watchdog over world trade. GATT's agency director and staff offer nations a forum for negotiating trade and related issues. Member nations seek to resolve their trade disputes bilaterally; if that fails, special GATT panels are set up to recommend action. The panels are only advisory and have no enforcement powers.

The GATT treaty and subsequent meetings have produced agreements significantly reducing tariffs on a wide range of goods. Periodically, member nations meet to reevaluate trade barriers and establish international codes designed to foster trade among members. In general, the agreement covers these basic elements: (1) trade shall be conducted on a nondiscriminatory basis; (2) protection shall be afforded domestic industries through customs tariffs, not through such commercial measures as import quotas; and (3) consultation shall be the primary method used to solve global trade problems.

Since GATT's inception there have been eight "rounds" of intergovernmental tariff negotiations. The most recently completed was the **Uruguay Round** (1994), which built on the successes of the **Tokyo Round** (1974)—the most comprehensive and far-reaching round undertaken by GATT up to that time. The Tokyo Round resulted in tariff cuts and set out new international rules for subsidies and countervailing measures, antidumping, government procurement, technical barriers to trade (standards), customs valuation, and import licensing. Although the Tokyo Round addressed nontariff barriers, some areas were not covered, which continued to impede free trade.

In addition to market access, there were issues of trade in services, agriculture, and textiles; intellectual property rights; and investment and capital flows. Canada and the United States were especially interested in addressing services trade and intellectual property rights since neither had been well protected. Based on these concerns, the eighth set of negotiations (Uruguay Round) was begun in 1986 at a GATT trade minister's meeting in Punta del Este, Uruguay, and finally concluded in 1994. By 1995, 80 GATT members, including the United States, the European Union (and its member states), Japan, and Canada, had accepted the agreement.

The market access segment (tariff and nontariff measures) was initially considered to be of secondary importance in the negotiations, but the final outcome went well beyond the initial Uruguay Round goal of a one-third reduction in tariffs. Instead, virtually all tariffs in ten vital industrial sectors were eliminated with key trading partners. This resulted in deep cuts (ranging from 50 to 100 percent) on electronic items and scientific equipment, and the harmonization of tariffs in the chemical sector at very low rates (5.5 to 0 percent).

Canadian exporters of paper products serve as a good example of the opportunities that opened up as a result of these changes. Currently, foreign companies competing for a share of the paper products market in the European Community have to pay tariffs as high as 9 percent while European competitors enjoy duty-free access within the EU. When the Uruguay Round market-access package was implemented, these high tariffs were eliminated. Another example is Korean tariffs as high as 20 percent on scientific equipment, which were reduced to an average of 7 percent, permitting foreign exporters to be more competitive in that market.

An important objective of Canada in the Uruguay Round was to reduce or eliminate barriers to international trade in services. The General Agreement on Trade in Services (GATS) was the first multilateral, legally enforceable agreement covering trade and investment in the services sector. It provides a legal basis for future negotiations aimed at eliminating barriers that discriminate against foreign services and deny them market access.

CROSSING BORDERS 2.3 Not a Single Grain of Foreign Rice Shall Ever Enter Japan

For Japan, rice is a near-sacred product, deeply embedded in history, culture, economics, politics, and symbolism. For the Japanese, rice is "our Christmas tree," and rice-producing land is reverently called "our holy land." In Japanese eyes, rice—far more than beef, citrus fruit, or textiles—represents the ultimate nonnegotiable market-access topic. "Not a single grain of foreign rice shall ever enter Japan" was the solemn vow of Japanese politicians of all stripes, backed by public opinion, the press, the business community, academics, and the bureaucracy. Opposition to imported rice reflected a national consensus.

Small wonder that international demands in 1986 for opening the Japanese rice market were seen as a threat to Japanese culture itself. There is some irony in criticizing Japan's inefficient rice-farming system. After all, it was the foreign occupation after World War II that had broken up existing large land holdings into the small tracts that would become the bastions of rice farmers whose votes politicians rewarded with generous subsidies perpetuating these economically inefficient plots.

Negotiations lasted some eight years with the result that the rice issue became part of the larger GATT negotiations on farming subsidies. Japanese resistance to rice imports finally buckled under pressure from Canada, the EU, and the United States as the 1994 due date for GATT passage approached. Internally, the Japanese politicians representing the interests of the farm lobby yielded to the interests of the country's huge exporting interests in automobiles and electronics. The final agreement reached included quotas on rice imports until 2000, with tariffs being applied after that date. Now, Japan imports some $150 million worth of rice every year—much more than a single grain. Even so, the price paid for rice by Japanese consumers is raised by a whopping 490 percent tariff on imports.

Source: One of the single best cases written on the Japanese style of negotiation is Michael Blaker's, "Negotiating on Rice: 'No, No, a Thousand Times No'" in Peter Berton, Hiroshi Kimura, and I. William Zartman (eds.), *International Negotiation: Actors, Structure/Process, Values* (New York: St. Martin's Press, 1999); www.usarice.com; and Ken Belson, "Global Talks on Farming Begin Friday," *New York Times*, February 13, 2002, p. W1.

For the first time, comprehensive multilateral disciplines and procedures covering trade and investment in services have been established. Specific market-opening concessions from a wide range of individual countries were achieved, and provision was made for continued negotiations to further liberalize telecommunications and financial services.

Equally significant were the results of negotiations in the investment sector. Trade-Related Investment Measures (**TRIMs**) established the basic principle that investment restrictions can be major trade barriers and therefore are included, for the first time, under GATT procedures. As a result of TRIMs, restrictions in Indonesia that prohibit foreign firms from opening their own wholesale or retail distribution channels can be challenged. So can investment restrictions in Brazil that require foreign-owned manufacturers to buy most of their components from high-cost local suppliers and that require affiliates of foreign multinationals to maintain a trade surplus in Brazil's favor by exporting more than they sell within the country.

Another objective for the Uruguay Round was achieved by an agreement on Trade-Related Aspects of Intellectual Property Rights (**TRIPs**). The TRIPs agreement establishes substantially higher standards of protection for a full range of intellectual property rights (patents, copyrights, trademarks, trade secrets, industrial designs, and semiconductor chip mask works) than are embodied in current international agreements, and it provides for the effective enforcement of those standards both internally and at the border.

The Uruguay Round also provided for a better integration of the agricultural and textiles areas into the overall trading system. The reductions of export subsidies, internal supports, and actual import barriers for agricultural products are included in the agreement. The Uruguay Round also includes another set of improvements in rules covering antidumping, standards, safeguards, customs valuation, rules of origin, and import licensing. In each case, rules and procedures were made more open, equitable, and predictable, thus leading to a more level playing field for trade. Perhaps the most notable achievement of the Uruguay Round was the creation of a new institution as a successor to the GATT—the World Trade Organization.[33]

World Trade Organization (WTO)

At the signing of the Uruguay Round trade agreement in Marrakech, Morocco, in April 1994, country representatives pushed for an enormous expansion of the definition of trade issues.[34] The result was the creation of the World Trade Organization, which encompasses the GATT structure and extends it to new areas not adequately covered in the past. The **WTO** is an institution, not an agreement as was GATT. It sets many rules governing trade between its 132 members, provides a panel of experts to hear and rule on trade disputes between members, and, unlike GATT, issues binding decisions. It requires, for the first time, the full participation of all members in all aspects of the current GATT and the Uruguay Round agreements, and, through its enhanced stature and scope, provides a permanent, comprehensive forum to address the trade issues of the twenty-first-century global market.

All member countries have equal representation in the WTO's ministerial conference, which meets at least every two years to vote for a director general who appoints other officials. Trade disputes, such as the one about genetically modified foods,[35] are heard by a panel of experts selected by the WTO from a list of trade experts provided by member countries. The panel hears both sides and issues a decision; the winning side will be authorized to retaliate with trade sanctions if the losing country does not change its practices. Although the WTO has no actual means of enforcement, international pressure to comply with WTO decisions from other member countries is expected to force compliance. The WTO ensures that member countries agree to the obligations of all the agreements, not just those they like.[36] For the first time, member countries, including developing countries (the fastest-growing markets of the world), are undertaking obligations to open their markets and be bound by the rules of the multilateral trading system.

There was some resistance to the World Trade Organization provision of the Uruguay Round before it was finally ratified by the three super powers, Japan, the European Union, and the United States. A legal wrangle between European Union countries centered on whether the EU's founding treaty gives the European Commission the sole right to negotiate for its members in all areas covered by the WTO.

In the United States, ratification was challenged because of concern for the possible loss of sovereignty over its trade laws to the WTO, the lack of veto power (the U.S. could have a decision imposed on it by a majority of the WTO's members), and the role the United States would assume when a conflict arises over an individual state's laws that might be challenged by a WTO member. The GATT agreement was ratified by the U.S. Congress; soon after, the EU, Japan, Canada, and more than 60 other countries followed. All 117 members of the former GATT supported the Uruguay agreement. Since its inception on January 1, 1995, the WTO's agenda has been full, with issues ranging from threats of boycotts and sanctions to the membership of China and Russia.[37] Indeed, a major event in international trade during recent years was China's 2001 entry into the WTO.[38] Instead of waiting for various rounds of negotiations to iron out problems, the WTO offers a framework for a continuous discussion and resolution of issues that retard trade.

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[33]See www.wto.org.

[34]Jean-Emile Denis, "Making International Marketing Decisions under WTO Rules," *Thunderbird International Business Review,* 45(2), March/April 2003, pp. 185–210.

[35]Michael Schroeder and Scott Miller, "U.S. to Ask WTO to Halt EU's Ban on Modified Food," *Wall Street Journal,* May 14, 2003, p. A2.

[36]Michael Schroeder, "U.S. Trade: Olive Branch or Big Stick?" *Wall Street Journal,* May 7, 2003, A4.

[37]Kara Josephberg, Jane Pollack, Jenna Victoriano, and Oriyan Gitig, "Russia Increases Anti-piracy Efforts, Enhances Trademark Protection," *Intellectual Property & Technology Law Journal* 15(3), March 2003, pp. 22–27.

[38]Lara Wozniak, "DHL and FEDEX Race to Integrate China," *Far Eastern Economic Review,* February 27, 2003, p. 8.

The WTO has its detractors, but most indications are that it is gaining acceptance by the trading community. The number of countries that have joined and those that want to become members are good measures of its importance. Another indicator is the accomplishments since its inception: It has been the forum for successful negotiations to open markets in telecommunications and in information technology equipment, something the United States had sought for the last two rounds of GATT. It also has been active in settling trade disputes and it continues to oversee the implementation of the agreements reached in the Uruguay Round. But with its successes come other problems, namely, how to counter those countries that want all the benefits of belonging to the WTO but also want to protect their markets.

Skirting the Spirit of GATT and the WTO

Unfortunately, as is probably true of every law or agreement, since its inception there have been those who look for loopholes and ways to get around the provisions of the WTO. For example, China was asked to become a member of the WTO, but to be accepted it had to show good faith in reducing tariffs and other restrictions on trade. To fulfill the requirements to join the WTO, China reduced tariffs on 5,000 product lines and eliminated a range of traditional nontariff barriers to trade, including quotas, licenses, and foreign exchange controls. At the same time, North American companies have begun to notice an increase in the number and scope of technical standards and inspection requirements. As a case in point, China recently has applied safety and quality inspection requirements on such seemingly benign imported goods as jigsaw puzzles. It also has been insisting that a long list of electrical and mechanical imports undergo an expensive certification process that requires foreign companies but not domestic companies to pay for on-site visits by Chinese inspection officials. Under WTO rules, China now must justify the decision to impose certain standards and provide a rationale for the inspection criteria. However, the foreign companies will have to request a review before the WTO will investigate. The WTO recognizes the need for standards (safety, health, and so on) although it advocates worldwide harmonization of product standards.

Antidumping duties are becoming another favorite way for nations to impose duties, under the justification that a foreign company is selling at unfair prices. Most nations have dumping laws that ostensibly are designed to keep foreign companies from dumping product, that is, selling below cost to unfairly gain a share of market and lessen competition. This law always has been difficult to interpret because "selling below cost" is difficult to measure; most countries have defined it whatever way necessary to serve their purpose. When companies are found to be dumping, the country places an extra tax on the product to offset the advantage of the lower price. If the government has subsidized the company that is found guilty of dumping, an additional countervailing duty is collected to offset the subsidy.

In an attempt to standardize the definition, the WTO defines dumping as selling at a lower price in the foreign market than in other markets or selling at below average total costs. The interpretation and calculation of average total costs creates the most difficulty in evaluating cases. Antidumping actions do not require evidence of predatory behavior, or intentions to monopolize, or of any other efforts to drive competitors out of business.

Following the example of the United States (the region's most prolific user of antidumping cases)[39] Mexico and other Latin American countries have increased their use of antidumping and countervailing duties as protectionist measures. As one Mexican official involved in antidumping cases noted, "We have learned our trade in the United States and learned it well." Despite the clever tactics used by some countries to skirt its provisions, the WTO is considered to have a positive effect on international trade.

Finally, frustrated with the slow progress of the most recent round of WTO trade negotiations,[40] several countries are negotiating bilateral trade agreements. For example, Canada has entered into preliminary talks with the Andean Community (Bolivia, Colom-

[39]Elizabeth Becker, "WTO Rules against U.S. on Steel Tariff," *New York Times,* March 27, 2003, p. C1.

[40]Ken Belson, "Global Talks on Farming Begin on Friday," *New York Times,* February 13, 2003, p. W1.

bia, Ecuador, Peru and Venezuela), the Dominican Republic, El Salvador, Guatemala, Honduras, Nicaragua, Singapore, Jamaica, and Trinidad and Tobago. It recently entered into free trade agreements with Chile, Israel, and Costa Rica.

The International Monetary Fund and World Bank Group

The International Monetary Fund[41] (**IMF**) and the World Bank Group[42] are two global institutions created to assist nations in becoming and remaining economically viable. Each plays an important role in the environment of international trade by helping to maintain stability in the financial markets and by assisting countries that are seeking economic development and restructuring.

Inadequate monetary reserves and unstable currencies are particularly vexing problems in global trade. So long as these conditions exist, world markets cannot develop and function as effectively as they should. To overcome these particular market barriers that plagued international trading before World War II, the International Monetary Fund (IMF) was formed. Originally 29 countries signed the agreement; now there are 181 countries as members. Among the objectives of the IMF are the stabilization of foreign exchange rates and the establishment of freely convertible currencies to facilitate the expansion and balanced growth of international trade. Member countries have voluntarily joined to consult with one another in order to maintain a stable system of buying and selling their currencies so that payments in foreign money can take place between countries smoothly and without delay. The IMF also lends money to members having trouble meeting financial obligations to other members. Argentina[43] and Turkey[44] have recently received such help from the IMF, but the results have been mixed.

To cope with universally floating exchange rates, the IMF developed **special drawing rights** (SDRs), one of its more useful inventions. Because both gold and the U.S. dollar have lost their utility as the basic medium of financial exchange, most monetary statistics relate to SDRs rather than dollars. The SDR is in effect "paper gold," and represents an average base of value derived from the value of a group of major currencies. Rather than being denominated in the currency of any given country, trade contracts are frequently written in SDRs because they are much less susceptible to exchange-rate fluctuations. Even floating rates do not necessarily accurately reflect exchange relationships. Some countries permit their currencies to float cleanly without manipulation (clean float), whereas other nations systematically manipulate the value of their currency (dirty float), thus modifying the accuracy of the monetary marketplace. Although much has changed in the world's monetary system since the IMF was first established, it still plays an important role in providing short-term financing to governments struggling to pay current-account debts.

The IMF has been heavily criticized for its ideological leanings and interventionist practices within recent years.[45] Joseph Stiglitz, a Nobel laureate in economics and former World Bank senior vice president and chief economist, has written a scathing critique of the IMF. Stiglitz claims that the IMF has become derailed from its primary responsibilities, established in the immediate post-WWII period, and has become a strong exponent of neo-liberal ideology and the economic policies that are consistent with that ideology.[46] Market-based approaches to resolving financial instability in developing economies have worsened the plight of a number of countries, particularly Thailand, Indonesia, and the Philippines. Instead of attempting to erect the ideal economic system, based on principles

41 www.imf.org.

42 www.worldbank.org.

43 Larry Rohter, "Peso Policy is Overturned in Argentina," *New York Times,* March 6, 2003, p. C1.

44 Claudia Rosett, "How the IMF Lost Turkey," *Wall Street Journal,* April 2, 2003, p. A14.

45 Mary Locke, "Funding the IMF: The Debate in the U.S. Congress," *Finance & Development*, September 2000, 37(3), pp. 56–59; and Sadanand Dhume, "Calling the IMF," *Far Eastern Economic Review*, January 23, 2003, p. 18.

46 Joseph Stiglitz, *Globalization and Its Discontents*. W.W. Norton & Company, 2002.

of perfect competition, efforts may be better spent working within the institutional structures that are native to the countries involved. According to neo-liberals, however, if an economy cannot generate its own prosperity, economic logic suggests therefore it should not be rescued. Stiglitz once accused an IMF managing director of saying that for a people to recover economically, "they must suffer."[47] During the financial crisis in Asia, the IMF provided loans to several countries, including Thailand, Indonesia, and South Korea. It is believed that had these countries not received aid ($60 billion to Korea alone), the economic reverberations may have led to a global recession. Martin Feldstein, former chairman of the Council of Economic Advisors under President Reagan and president of the National Bureau of Economic Research, nonetheless criticized the actions (or inactions) of the IMF during the Asian crisis of 1997 for reacting too late, using inappropriate policies that prolonged the problem in the affected countries, and failing to halt the spread of investor paranoia in other developing countries.[48] Furthermore, Feldstein points out that developing nations face an almost insurmountable task of working through currency crises since they have no lender of last resort. The IMF has criteria that restrict lending to nations that do not meet those criteria—namely, strong economic fundamentals, stable governments, and the capability of protecting property, none of which are present with the most challenged developing nations. In summary, it is generally believed the IMF has performed a commendable role in stabilizing financial markets in the post-WWII period and is generally well regarded by many people. At the same time, the institution has been sharply criticized by several prominent and influential detractors and an army of antiglobalization critics.

Sometimes confused with the IMF, the World Bank Group[49] is a separate institution that has as its goal the reduction of poverty and the improvement of living standards by promoting sustainable growth and investment in people. The World Bank provides loans, technical assistance, and policy guidance to developing-country members to achieve its objectives. There are five institutions in the World Bank Group, each of which performs the following services: (1) lending money to the governments of developing countries to finance development projects in education, health, and infrastructure; (2) providing assistance to governments for developmental projects to the poorest developing countries (per capita incomes of $925 or less); (3) lending directly to the private sector to help strengthen the private sector in developing countries with long-term loans, equity investments, and other financial assistance; (4) providing investors with investment guarantees against "noncommercial risk," such as expropriation and war, to create an environment in developing countries that will attract foreign investment; and (5) promoting increased flows of international investment by providing facilities for the conciliation and arbitration of disputes between governments and foreign investors. The World Bank also provides advice, carries out research, and produces publications in the area of foreign investment law. Since their inception, these institutions have played a pivotal role in the economic development of countries throughout the world and thus contributed to the expansion of international trade since World War II.

Protests against Global Institutions

Beginning in 1999, what some are calling "anti-capitalist protestors" began to influence the workings of the major global institutions described previously.[50] The basic complaint against the WTO, IMF, and others is the amalgam of unintended consequences of globalization: environmental concerns, worker exploitation,

[47]"Michael Camdessus Responds to Joseph Stiglitz: A Comment," International Monetary Fund, *Views and Comments*, September 12, 2002.

[48]Martin Feldstein, "A Self-Help Guide for Emerging Markets," *Foreign Affairs*, March/April 1999 issue, Vol. 78, No. 2, pp 93–109.

[49]Warren Vieth, "World Bank, IMF Say Third-World Development Lags," *Los Angeles Times,* April 14, 2003, p. A17.

[50]"Anti-Capitalist Protests: Angry and Effective," *Economist,* September 23, 2000, pp. 85–87.

domestic job losses,[51] cultural extinction, higher oil prices, and diminished sovereignty of nations. The antiglobalization protests first caught the attention of the world press during a WTO meeting in Seattle in November 1999. Then came the World Bank and IMF meetings in April 2000 in Washington, D.C., the World Economic Forum in Melbourne, Australia, in September 2000, and IMF/World Bank meetings in Prague, also in September 2000. Some 10,000 protestors faced some 11,000 police in Prague. The protestors have established websites associated with each event, which are labeled according to the respective dates. You might also check www.destroyIMF.org to see the ominous tone represented. The websites and the Internet have proved to be important media aiding organizational efforts. The protests and violence have continued at other meetings of world leaders regarding economic issues, such as the G-8 meetings in Evian, France, in 2003 and in individual countries affected by the IMF.[52]

The protest groups, some of them with responsible intent, have affected policy. For example, "anti-sweatshop" campaigns have had effects beyond college campuses. A coalition of nongovernmental organizations, student groups, and UNITE, the textile workers' union, recently sued clothing importers, including Calvin Klein and Gap, over working conditions in the American commonwealth of Saipan in the Pacific. Faced with litigation and extended public campaigns against their brands, 17 companies settled, promising better working conditions. Similarly, a World Bank project in China, which involved moving poor ethnic Chinese into lands that were traditionally Tibetan, was abandoned after a political furor led by a relatively small group of pro-Tibetan activists. Given the apparent successes associated with these grass-roots efforts to influence policy at these global institutions we must expect more of the same in the future.

Summary

Regardless of the theoretical approach used in defense of international trade, it is clear that the benefits from absolute or comparative advantage can accrue to any nation. Heightened competition from around the world has created increased pressure for protectionism from every region of the globe at a time when open and fair markets are needed if world resources are to be developed and utilized in the most beneficial manner for all countries. It is true that there are circumstances when market protection may be needed and may be beneficial to national defense or the encouragement of infant industries in developing nations, but the consumer seldom benefits from such protection.

Canada is a major economic force in both international trade and investment. Its major partners tend to be major industrialized countries, and little trade occurs with non-industrialized nations. Furthermore, a substantial proportion of its trade and investment is with the U.S. Canada's balance of trade with the world has been positive and it is attracting a sizeable amount of foreign direct investment. Much of the foreign direct investment into Canada occurs between foreign parents and Canadian subsidies. Canadian multinational companies operate in numerous industries and across the majority of nations of the world, yet they are small in comparison to U.S., European, and Asian multinational firms.

Although free international markets may help underdeveloped countries become self-sufficient, it is also evident that a need is present in commercial policies of developed nations to invoke fairness criteria as well. Protectionist actions of developed nations in sectors most important to developing nations e.g., agriculture and non-capital intensive industries, remain heavily protected despite a lack of solid economic support for such protection. Industrialized nations have been working to establish freer markets since World War II; however, a strong plea is being made to supplant free trade with fair trade as a major strategic thrust to encourage developing countries to prosper.

Questions

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[51]Pete Engardio, Aaron Bernstein, and Manjeet Kripalani, "Is Your Job Next?" *BusinessWeek,* February 3, 2003, pp. 50–60

[52]"What Will the IMF Say Now? Bolivia," *The Economist,* February 22, 2003, p. 33.

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2. Discuss the globalization of the Canadian economy.
3. Differentiate among the current account, balance of trade, and balance of payments.
4. Explain the role of price as a free market regulator.
5. "Theoretically, the market is an automatic, competitive, self-regulating mechanism which provides for the maximum consumer welfare and which best regulates the use of the factors of production." Explain.
6. Interview several local businesspeople to determine their attitudes toward world trade. Further, learn if they buy or sell goods produced in foreign countries. Correlate the attitudes and report on your findings.
7. What is the role of profit in international trade? Does profit replace or complement the regulatory function of pricing? Discuss.
8. Why does the balance of payments always balance even though the balance of trade does not?
9. Enumerate the ways in which a nation can overcome an unfavorable balance of trade.
10. Support or refute each of the various arguments commonly used in support of tariffs.
11. France exports about 18 percent of its gross domestic product, while neighboring Belgium exports 46 percent. What areas of economic policy are likely to be affected by such variations in exports?
12. Does widespread unemployment change the economic logic of protectionism?
13. Review the economic effects of major trade imbalances such as those caused by petroleum imports.
14. Describe the nature of foreign ownership of Canadian assets. Who are the major nations investing in Canada?
15. Which nations does Canada trade with? Which are its major investment partners?
16. Explain the role played by exchange rates and interests in the Balance of Payments account.
17. Describe the recent criticisms aimed at the IMF. Do you feel they are valid? Explain your answer by writing a brief essay.
18. The Tokyo Round of GATT emphasized the reduction of nontariff barriers. How does the Uruguay Round differ?
19. Discuss the impact of GATS, TRIMs, and TRIPs on global trade.
20. Discuss the evolution of world trade that led to the formation of the WTO.
21. The GATT has had a long and eventful history. Visit www.wto.org/wto/about/about.htm and write a short report on the various rounds of GATT. What were the key issues addressed in each round?
22. Describe Canada's international trade regime.
23. Explain the country-based and firm-based theories of international trade. How do they differ? In what way are they similar?

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