International Business

Lumen Learning: Adapted by Mucci Learning

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CONTENTS

MODULE 1: IT'S A SMALL WORLD

OVERVIEW

Module 1 is an overview of international business and will set down general information for the following modules.

VIDEO: Carl Sagan: Pale Blue Dot

Watch Carl Sagan: Pale Blue Dot online: https://www.youtube.com/watch?v=GO5FwsblpT8

VIDEO: GLOBALIZATION EXPLAINED

Discuss globalization of societies, markets, economies and jobs.

Watch Globalization Explained online: https://youtu.be/JJ0nFD19eT8

READING: WHAT IS INTERNATIONAL BUSINESS?

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- Know the definition of international business.
- Comprehend how strategic management is related to international business.
- Understand how entrepreneurship is related to international business.

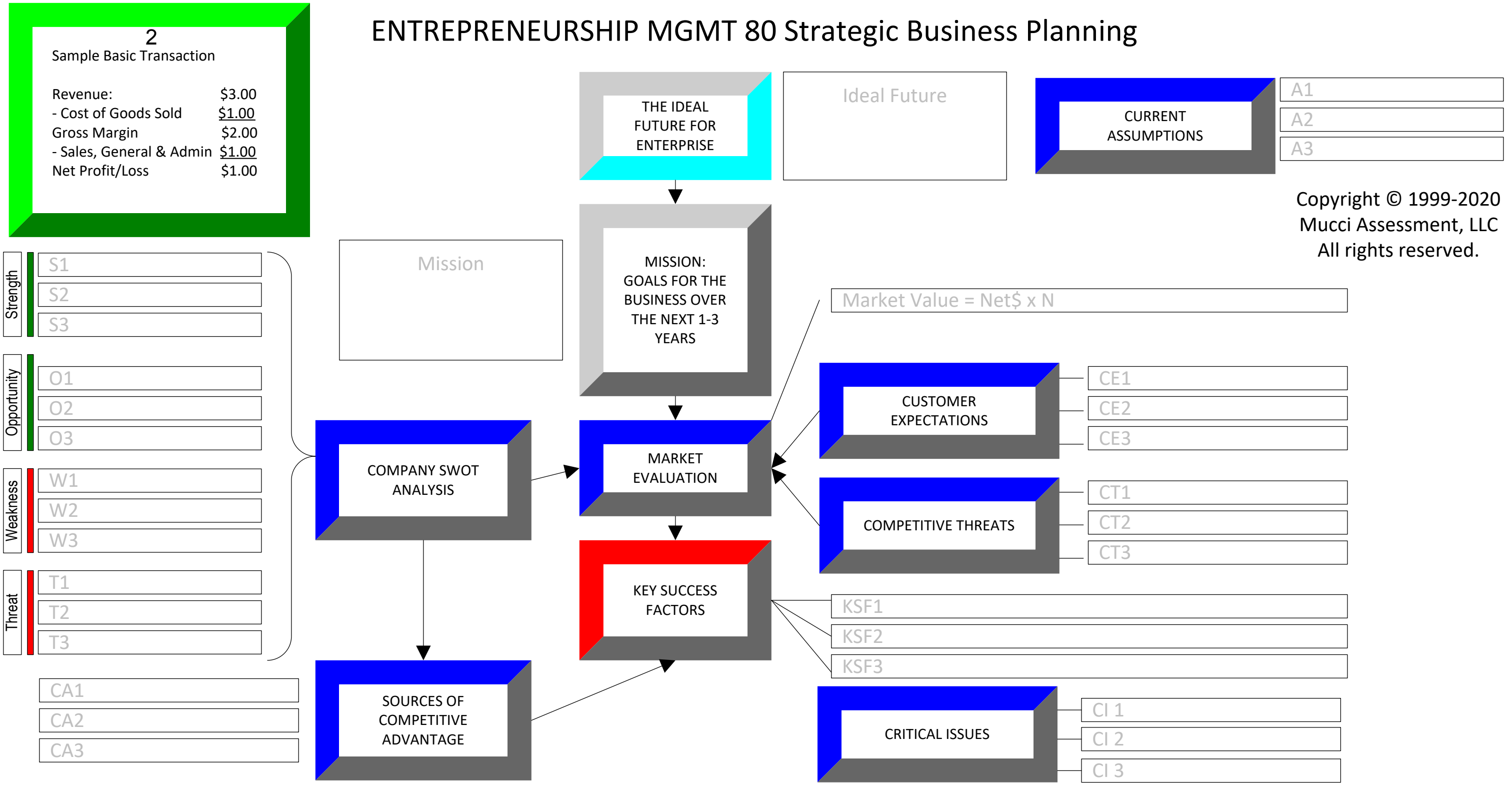
The Definition of International Business

International business relates to any situation where the production or distribution of goods or services crosses country borders. Globalization—the shift toward a more interdependent and integrated global economy—creates greater opportunities for international business. Such globalization can take place in terms of markets, where trade barriers are falling and buyer preferences are changing. It can also be seen in terms of production, where a company can source goods and services easily from other countries. Some managers consider the definition of international business to relate purely to “business,” as suggested in the Google case. However, a broader definition of international business may serve you better both personally and professionally in a world that has moved beyond simple industrial production. International business encompasses a full range of cross-border exchanges of goods, services, or resources between two or more nations. These exchanges can go beyond the exchange of money for physical goods to include international transfers of other resources, such as people, intellectual property (e.g., patents, copyrights, brand trademarks, and data), and contractual assets or liabilities (e.g., the right to use some foreign asset, provide some future service to foreign customers, or execute a complex financial instrument). The entities involved in international business range from large multinational firms with thousands of employees doing business in many countries around the world to a small one-person company acting as an importer or exporter. This broader definition of international business also encompasses for-profit border-crossing transactions as well as transactions motivated by nonfinancial gains (e.g., triple bottom line, corporate social responsibility, and political favor) that affect a business’s future.

Strategic Management and Entrepreneurship

A knowledge of both strategic management and entrepreneurship will enhance your understanding of international business. Strategic management is the body of knowledge that answers questions about the development and implementation of good strategies and is mainly concerned with the determinants of firm performance. A strategy, in turn, is the central, integrated, and externally oriented concept of how an organization will achieve its performance objectives. One of the basic tools of strategy is a SWOT (strengths, weaknesses, opportunities, threats) assessment. The SWOT tool helps you take stock of an organization’s internal characteristics—its strengths and weaknesses—to formulate an action plan that builds on what it does well while overcoming or working around weaknesses. Similarly, the external part of SWOT—the opportunities and threats—helps you assess those environmental conditions that favor or threaten the organization’s strategy. Because strategic management is concerned with organizational performance—be that social, environmental, or economic—your understanding of a company’s SWOT will help you better assess how international business factors should be accounted for in the firm’s strategy.

ENTREPRENEURSHIP MGMT 80 Strategic Business Planning



DEFINITION OF TERMS

IDEAL FUTURE: It is the vision for an organization. It is about creating at ideal preferred future with a grand purpose of greatness. It should stimulate economic, personal and customer growth.

MISSION: Addresses the scope and direction of the organization's activities. It should include the organization's 3-5 year goals. It should be understandable and memorable to all employees. It should come from the mind.

SWOT: Process to identify major strengths, weaknesses, opportunities and threats. It is the basis for identifying critical issues for an organization.

COMPETITIVE ADVANTAGE: Feature or competence of the organization that can not be readily copied by its competitors and could lead to market leadership. Usually involves an organization's strengths.

KEY SUCCESS FACTORS: What makes the difference between success and failure at market leadership in this business.

CRITICAL ISSUES: Major issues to be resolved to avoid lost revenues/profits or missed opportunities. They are few in number, high in priority and of strategic importance.

STRATEGY:A long term plan of action to achieve a particular goal. Strategy is differentiated from tactics or immediate actions with resources at hand by it's nature of being extensively premeditated, and often practically rehearsed. Strategies are used to make the problem easier to understand and solve.

Entrepreneurship, in contrast, is defined as the recognition of opportunities (i.e., needs, wants, problems, and challenges) and the use or creation of resources to implement innovative ideas for new, thoughtfully planned ventures. An entrepreneur is a person who engages in entrepreneurship. Entrepreneurship, like strategic management, will help you to think about the opportunities available when you connect new ideas with new markets. For instance, given Google's current global presence, it's difficult to imagine that the company started out slightly more than a decade ago as the entrepreneurial venture of two college students. Google was founded by Larry Page and Sergey Brin, students at Stanford University. It was first incorporated as a privately held company on September 4, 1998. Increasingly, as the Google case study demonstrates, international businesses have an opportunity to create positive social, environmental, and economic values across borders. An entrepreneurial perspective will serve you well in this regard.

Spotlight on International Strategy and Entrepreneurship

Hemali Thakkar and three of her fellow classmates at Harvard found a way to mesh the power of play with electrical power. The foursome invented "a soccer ball with the ability to generate electricity," Thakkar said. Every kick of the ball creates a current that's captured for future use. Fifteen minutes of play lights a lamp for three hours.

Called the sOccket, the soccer ball can bring off-grid electricity to developing countries. Even better, the soccer ball can replace kerosene lamps. Burning kerosene is not only bad for the environment because of carbon dioxide emissions but it's also a health hazard: according to the World Bank, breathing kerosene fumes indoors has the same effects as smoking two packs of cigarettes per day.

How did the idea of sOccket emerge? All four students (Jessica Lin, Jessica Matthews, Julia Silverman, and Hemali Thakkar) had experience with developing countries, so they knew that kids love playing soccer (it's the world's most popular sport). They also knew that most of these kids lived in homes that had no reliable energy.

As of November 2010, the sOccket prototype cost $70 to manufacture, but the team hopes to bring the cost down to $10 when production is scaled up. One ingenious way to bring costs down is to set up facilities where developing-world entrepreneurs assemble and sell the balls themselves.

At this point it's also important to introduce you to the concepts of intrapreneurship and the intrapreneur. Intrapreneurship is a form of entrepreneurship that takes place inside a business that is already in existence. An intrapreneur, in turn, is a person within the established business who takes direct responsibility for turning an idea into a profitable finished product through assertive risk taking and innovation. An entrepreneur is starting a business, while an intrapreneur is developing a new product or service in an already existing business. Thus, the ideas of entrepreneurship can be applied not only in new ventures but also in the context of existing organizations—even government.

KEY TAKEAWAYS

International business encompasses a full range of cross-border exchanges of goods, services, or resources between two or more nations. These exchanges can go beyond the exchange of money for physical goods to include international transfers of other resources, such as people, intellectual property (e.g., patents, copyrights, brand trademarks, and data), and contractual assets or liabilities (e.g., the right to use some foreign asset, provide some future service to foreign customers, or execute a complex financial instrument).

Strategic management is the body of knowledge that answers questions about the development and implementation of good strategies and is mainly concerned with the determinants of firm performance. Because strategic management is concerned with organizational performance, your understanding of a company's SWOT (strengths, weaknesses, opportunities, threats) helps you better assess how international business factors should be accounted for in the firm's strategy.

Entrepreneurship is the recognition of opportunities (i.e., needs, wants, problems, and challenges) and the use or creation of resources to implement innovative ideas. Entrepreneurship helps you think about the opportunities available when you connect new ideas with new markets.

Mucci Learning
Professor James Mucci

Entrepreneurship MGMT80
International Business IBUS1
Logistics IBUS75

REV	$1.00
COGS	$0.70
GM	$0.30
SG&A	$0.20
NET	$0.10

1. Patrick's Law: Revenue Certainty
2. Mucci's Law: Intimate Knowledge of the Basic Transaction
3. Jon's Law: Don't Mistake Understanding and Compassion for Weakness
4. McMullen's Law: Have an Exit Strategy
5. Mycha's Law: Customer will pay the Min amount to get their Basic Set of Needs met.
6. Bruce's Law: Adaptable Organizations have a Competitive Advantage
7. Sean's Law: Highly Reliable Cost Effective Logistics Networks
8. Block's Law: Service over Self Interest
9. Eddie's Law: Not that Complicated

James Mucci, MBA: www.muccilearning.com
"Think Globally & Participate" + "Steady as She Goes"

MODULE 2: TRADE THEORY, FROM MERCANTILISM TO FREE TRADE

OVERVIEW

In this module we will explore the reasons that nations trade and how they determine what to trade and with whom. As well as developing a corporate strategy and strategies for entering foreign markets.

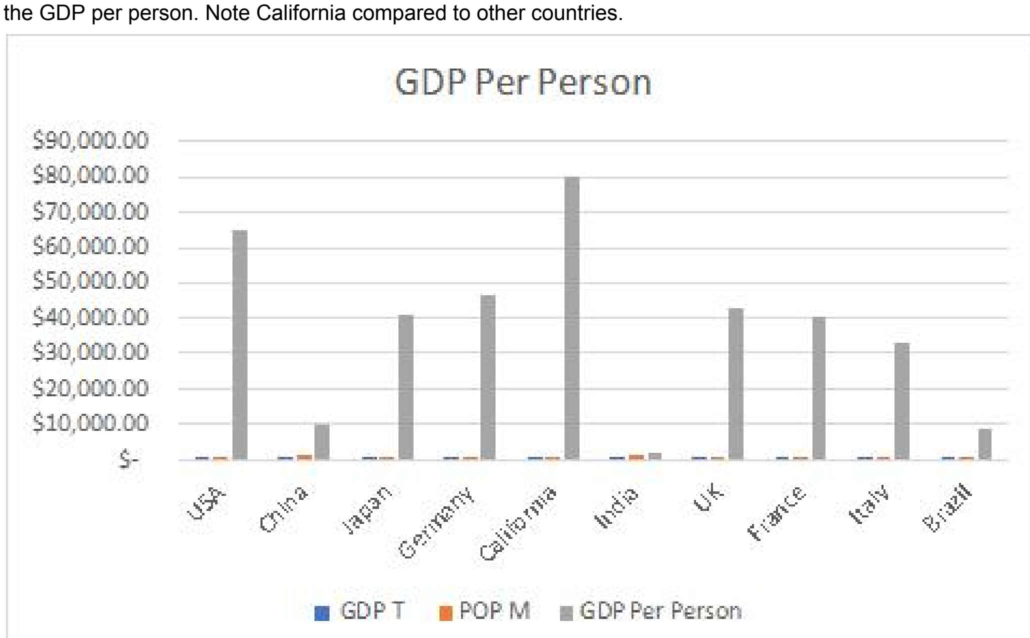
READING: WHY TRADE?

- Discuss globalization of markets, economies, and jobs.
- Explain international trade, foreign direct investments, and global monetary systems.

Read the article, “Why Trade?” from the Nobel Prize website linked below.

http://www.nobelprize.org/educational/economic-sciences/trade/ohlin.html

Graph showing the GDP per person. Note California compared to other countries.



VIDEO: COMPARATIVE ADVANTAGE AND TRADE

- Discuss globalization of markets, economies, and jobs.
- Explain international trade, foreign direct investments, and global monetary systems

Watch Comparative Advantage and Trade: https://youtu.be/38hvvAzgXZY

READING: COMPETITIVE ADVANTAGE

Competitive advantage is defined as the strategic advantage one business entity has over its rival entities within its competitive industry.

KEY Points
• A country is said to have a comparative advantage in the production of a good (say cloth) if it can produce cloth at a lower opportunity cost than another country. • Competitive advantage seeks to address some of the criticisms of comparative advantage. • Competitive advantage occurs when an organization acquires or develops an attribute or combination of attributes that allows it to outperform its competitors.

Terms

- *Comparative advantage:* The concept that a certain good can be produced more efficiently than others due to a number of factors, including productive skills, climate, natural resource availability, and so forth.
- *Opportunity cost:* The cost of an opportunity forgone (and the loss of the benefits that could be received from that opportunity); the most valuable forgone alternative.

Examples

- Opportunity cost – The opportunity cost of cloth production is defined as the amount of wine for example, that must be given up in order to produce one more unit of cloth.

Competitive advantage is defined as the strategic advantage one business entity has over its rival entities within its competitive industry. Achieving competitive advantage strengthens and positions a business better within the business environment.

Competitive advantage seeks to address some of the criticisms of comparative advantage. A country is said to have a comparative advantage in the production of a good (say cloth) if it can produce cloth at a lower opportunity cost than another country. The opportunity cost of cloth production is defined as the amount of wine that must be given up in order to produce one more unit of cloth. Thus, England would have the comparative advantage in cloth production relative to Portugal if it must give up less wine to produce another unit of cloth than the amount of wine that Portugal would have to give up to produce another unit of cloth.

Competitive Advantage
The 640GB drive has a competitive advantage over the 500GB drive in terms of both cost and value.

Michael Porter proposed the theory of competitive advantage in 1985. The competitive advantage theory suggests that states and businesses should pursue policies that create high-quality goods to sell at high prices in the market. Porter emphasizes productivity growth as the focus of national strategies. This theory rests on the notion that cheap labor is ubiquitous, and natural resources are not necessary for a good economy. The other theory, comparative advantage, can lead countries to specialize in exporting primary goods and raw materials that trap countries in low-wage economies due to terms of trade. The competitive advantage theory attempts to correct for this issue by stressing maximizing scale economies in goods and services that garner premium prices.

Competitive advantage occurs when an organization acquires or develops an attribute or combination of attributes that allows it to outperform its competitors. These attributes can include access to natural resources, such as high grade ores or inexpensive power or access to highly trained and skilled personnel human resources. New technologies, such as robotics and information technology, are either to be included as a part of the product or to assist making it. Information technology has become such a prominent part of the modern business world that it can also contribute to competitive advantage by outperforming competitors with regard to Internet presence. From the very beginning (i.e., Adam Smith's *Wealth of Nations*), the central problem of information transmittal, leading to the rise of middle men in the marketplace, has been a significant impediment in gaining competitive advantage. By using the Internet as the middle man, the purveyor of information to the final consumer, businesses can gain a competitive advantage through creation of an effective website, which in the past required extensive effort finding the right middle man and cultivating the relationship.

GLOSSARY

Business environment

The system within which companies exist.

Consumer

Someone who acquires goods or services for direct use or ownership rather than for resale or use in production and manufacturing. The consumer is the one who pays to consume the goods and services produced. As such, consumers play a vital role in the economic system of a nation. In the absence of their effective demand, the producers would lack a key motivation to produce, which is to sell to consumers.

Economy

Collective focus of the study of money, currency and trade, and the efficient use of resources. The system of production and distribution and consumption. The overall measure of a currency system; as the national economy.

Exporting

The act of selling to a foreign country the sale of capital, goods, and services across international borders or territories.

Good

An object produced for market.

Industry

The sector of the economy consisting of large-scale enterprises.

Lead

Potential opportunity for a sale or transaction, a potential customer.

Leading

To conduct or direct with authority the management function of determining what must be done in a situation and getting others to do it.

Market

A group of potential customers for one's product. One of the many varieties of systems, institutions, procedures, social relations and infrastructures whereby parties engage in exchange.

Premium

Bonus paid in addition to normal payments. The price above par value at which a security is sold. Something offered at a reduced price as an inducement to buy something else. The amount a policy-holder or his sponsor must pay to a health plan to purchase health coverage.

Price

The price is the amount a customer pays for the product. The quantity of payment or compensation given by one party to another in return for goods or services. The cost required to gain possession of something.

Product

Any tangible or intangible good or service that is a result of a process and that is intended for delivery to a customer or end user. Anything, either tangible or intangible, offered by the firm as a solution to the needs and wants of the consumer; something that is profitable or potentially profitable; goods or a service that meets the requirements of the various governing offices or society.

READING: ABSOLUTE ADVANTAGE

Absolute advantage and balance of trade are two important aspects of international trade that affect countries and organizations.

KEY Points
• *Absolute advantage:* In economics, the principle of absolute advantage refers to the ability of a party (an individual, or firm, or country) to produce more of a good or service than competitors, using the same amount of resources. • *Net exports:* The balance of trade (or net exports, sometimes symbolized as NX) is the difference between the monetary value of exports and imports of output in an economy over a certain period. It is the relationship between a nation's imports and exports. • *Advantageous trade:* Advantageous trade is based on comparative advantage and covers a larger set of circumstances while still including the case of absolute advantage and hence is a more general theory.

Terms

- *Absolute advantage*: The capability to produce more of a given product using less of a given resource than a competing entity.
- *Advantageous*: Being of advantage; conferring advantage; gainful; profitable; useful; beneficial; as, an advantageous position.

In the drive for international trade, it is important to understand how trade affects countries positively and negatively—both how a country's imports and exports affect its economy and how effectively the country's ability to create and exportvital goods effects the businesses within that country. Absolute advantage and balance of trade are two important aspects of international trade that affect countries and organizations .

European Free Trade Agreement

The European Free Trade Agreement has helped countries international trade without worrying about absolute advantage and increases net exports.

Absolute Advantage

In economics, the principle of absolute advantage refers to the ability of a party (an individual, a firm, or a country) to produce more of a good or service than competitors while using the same amount of resources. Adam Smith first described the principle of absolute advantage in the context of international trade, using labor as the only input. Since absolute advantage is determined by a simple comparison of labor productivities, it is possible for a party to have no absolute advantage in anything; in that case, according to the theory of absolute advantage, no trade will occur with the other party. It can be contrasted with the concept of comparative advantage, which refers to the ability to produce a particular good at a lower opportunity cost.

Balance of Trade

The balance of trade (or net exports, sometimes symbolized as NX) is the difference between the monetary value of exports and imports in an economy over a certain period. A positive balance is known as a trade surplus if it consists ofexporting more than is imported; a negative balance is referred to as a trade deficit or, informally, a trade gap. The balance of trade is sometimes divided into a goods and a services balance.

GLOSSARY

Balance of trade
The difference between the monetary value of exports and imports in an economy over a certain period of time.
Comparative advantage
The ability of a party to produce a particular good or service at a lower marginal and opportunity cost over another. The concept that a certain good can be produced more efficiently than others due to a number of factors, including productive skills, climate, natural resource availability, and so forth.
Economy
Collective focus of the study of money, currency and trade, and the efficient use of resources.The system of production and distribution and consumption. The overall measure of a currency system; as the national economy.
Export
To sell (goods) to a foreign country. Any good or commodity, transported from one country to another country in a legitimate fashion, typically for use in trade.
Exporting
The act of selling to a foreign country the sale of capital, goods, and services across international borders or territories.
Good
An object produced for market.
Input
Something fed into a process with the intention of it shaping or affecting the outputs of that process. Each participant's contributions that are viewed as entitling him/her to rewards or costs. Examples include time, effort, and loyalty.
Opportunity cost
The cost of an opportunity forgone (and the loss of the benefits that could be received from that opportunity); the most valuable forgone alternative. The cost of any activity measured in terms of the value of the next best alternative forgone (that is not chosen). The value forfeited by taking a particular route.
Output
Production; quantity produced, created, or completed. data sent out of the computer, as to output device such as a monitor or printer.
Productivity
Productivity is a measure of the efficiency of production and is defined as total output per one unit of a total input. The rate at which goods or services are produced by a standard population of workers. A ratio of production output to what is required to produce it (inputs). The state of being productive, fertile, or efficient. The rate at which products and services are produced relative to a particular workforce.
Resource
Something that one uses to achieve an objective, e.g. raw materials or personnel.
Services
That which is produced, then traded, bought or sold, then finally consumed and consists of an action or work.
Trade deficit
A negative balance of trade.
Trade surplus
A positive balance of trade.
Value
The degree of importance given to something. A value is extremely absolute or relative ethical value, the assumption of which can be the basis for ethical action. A customer's perception of relative price (the cost to own and use) and performance (quality)
Values
A collection of guiding principles; what one deems to be correct and desirable in life, especially regarding personal conduct.

VIDEO: PORTER'S NATIONAL DIAMOND FRAMEWORK EXPLAINED

Porter's National Diamond Framework explains why some countries tend to be stronger in different industries in relation to other countries.

1. Factor Conditions
2. Related and Supporting Industries
3. Structure, Strategy and Rivalry
4. Demand Conditions

Watch Porters National Diamond Framework Explained: https://youtu.be/OZ4IFJ7Z8D4

Filmed in Vaduz, Liechtenstein December 2008

Reading: What to stop, start, and accelerate

https://www.mckinsey.com/featured-insights/leadership/from-thinking-about-the-next-normal-to-making-it-work-what-to-stop-start-and-accelerate

VIDEO: INTERNATIONAL GLOBAL BUSINESS STRATEGY

This is a short film introducing the topic of global strategy. Watch International Global Business Strategy: https://youtu.be/9M5wWSA5vQQ

READING: INTERNATIONAL STRATEGY

LEARNING OBJECTIVES
By the end of this section, you will be able to:

- Know the trade-offs being made in terms of local responsiveness and global efficiency in regard to international strategies.
- Distinguish among multidomestic, global, and transnational strategies.
- Understand how the local environment can impact a firm’s international strategy.

At the corporate level, firms choose to use one of three international strategies: multidomestic, global, or transnational (transnational is a combination of multidomestic and global). These three strategies reflect trade-offs between local responsiveness and global efficiency. For firms to gain a competitive advantage, they have to devise strategies that take best advantage of the firm’s core competencies and that are difficult for competitors to copy.

Multidomestic Strategy

Multidomestic strategy maximizes local responsiveness by giving decentralizing decision-making authority to local business units in each country so that they can create products and services optimized to their local markets. A multidomestic strategy would be appropriate, for instance, where Thomas Friedman’s flat-world thesis is not applicable. A multidomestic strategy focuses on competition within each country and maximizes local responsiveness. It assumes that the markets differ and, therefore, are segmented by country boundaries. In other words, consumer needs and desires, industry conditions (e.g., the number and type of competitors), political and legal structures, and social norms vary by country. Using a multidomestic strategy, the firm can customize its products to meet the specific preferences and needs of local customers. As a result, the firm can compete more effectively in each local market and increase its local market share.

The disadvantage of a multidomestic strategy, however, is that the firm faces more uncertainty because of the tailored strategies in different countries. In addition, because the firm is pursuing different strategies in different locations, it cannot take advantage of economies of scale that could help decrease costs for the firm overall. The multidomestic strategy has been more commonly used by European multinational firms because of the variety of cultures and markets found in Europe.

As mentioned earlier, Yum! Brands has a strong incentive to compete internationally with its restaurant concepts (i.e., KFC, Pizza Hut, Taco Bell, A&W Restaurants, and Long John Silver’s). Yum! pursues a multidomestic strategy by trying to localize as much as possible. The firm doesn’t open restaurants using only the US model. Wherever the company has locations, it consistently adapts to local tastes and negotiates well when cultural and political climates change. According to journalist Brian O’Keefe writing in *Fortune* magazine, “In Japan, for instance, KFC sells tempura crispy strips. In northern England, KFC stresses gravy and potatoes, while in Thailand, it offers fresh rice with soy or sweet chili sauce. In Holland, the company makes a potato-and-onion croquette. In France, it sells pastries alongside chicken. And in China, the chicken gets spicier the farther inland you travel. More and more, if it’s only an American brand without a regional appeal, it’s going to be difficult to market.” Recognizing this constraint, Yum! introduces its products in those foreign markets that are the shortest “taste” distance from its traditional home markets. So, it sticks to high-population areas in which American culture has some appeal as well.

Global Strategy

In contrast to a multidomestic strategy, a global strategy is centralized and controlled by the home office and seeks to maximize global efficiency Under this strategy, products are much more likely to be standardized rather than tailored to local markets. One way to think about global strategies is that if the world is flat, you can sell the same products and services in the same way in every country on the planet. The strategic business units operating in each country are assumed to be interdependent, and the home office attempts to achieve integration across these businesses. Therefore, a global strategy emphasizes economies of scale and offers greater opportunities to utilize innovations developed at the corporate level or in one country in other markets.

Although pursuing a global strategy decreases risk for the firm, the firm may not be able to gain as high a market share in local markets because the global strategy isn’t as responsive to local markets. Another disadvantage of the global strategy is that it is difficult to manage because of the need to coordinate strategies and operating decisions across country borders. Consequently, achieving efficient operations with a global strategy requires the sharing of resources as well as coordination and cooperation across country boundaries, which in turn require centralization and headquartered control. Whether the world is flat or flattening can often depend on the industry. In most cases, the world isn't flat, but in a few industries the market characteristics are fairly common. The cement and concrete industry is an example of an industry where the flatteners have taken effect. CEMEX, a Mexico-based cement and building materials company founded in 1906, pursued an international business strategy that led to its growth and position as one of the top building materials companies in the world today. CEMEX acquired companies to grow rapidly, took advantage of economies of scale, and used the Internet to lower its cost structure. Perhaps most crucial to its international expansion success was foreseeing the shifts in distribution technologies that would bring previously disparate regional markets closer together. *Source: Daniel F. Spulber, Global Competitive Strategy (Cambridge, UK: Cambridge University Press, 2007), 217–18.*

In 2009, CEMEX CEO Lorenzo H. Zambrano wrote a message to stakeholders regarding sustainable development:

> *In 2009, as we coped with the worst crisis to hit the global economy, our industry, and our company in 75 years, we took important and decisive steps to strengthen not only our business model, but also our commitment to sustainable development. As a result, we are a stronger company, well positioned to take advantage of the recovery of the global economy. That is testimony to the quality of our employees, to our company's core values of collaboration, integrity, and leadership, and to the disciplined execution of sound strategies.*
>
> *We made several difficult decisions during the year to adjust to a rapidly evolving and extraordinarily challenging market environment. For example, we sold assets, most notably our Australian operations, and reorganized our business to improve efficiency and productivity. Together, these measures brought about an unfortunate, but necessary, reduction in our workforce. However, these steps enabled us to weather the crisis and will position our company for long-term success.*
>
> *Even as the economic crisis unfolded, we deepened our commitment to our stakeholders. We continued our efforts to ensure the safety of our employees, and many of our country operations recorded solid improvements in their safety performance. However, despite our ongoing efforts, I am deeply saddened to report that 33 people—including employees, contractors, and third parties—died in incidents related to our operations during 2009. This is tragic and unacceptable. We are working harder than ever to identify and address the root causes of all fatalities and serious injuries in order to prevent their recurrence. For example, we are expanding and strengthening our efforts in key areas such as safety training for drivers and contractors. Above all, we remain committed to our global long-term goal of zero incidents.*
>
> *On the environmental front, we continued to reduce our carbon footprint by improving the energy efficiency of our operations and expanding our use of alternative fuels. As a result, in 2009 we increased our use of alternative fuels to 16.4 percent, exceeding our target for 2015 ahead of time. In addition, Eurus, the wind farm project developed by ACCIONA Energía, became fully operational during the year and can supply 25 percent of our plants' electricity needs in Mexico.*
>
> *Finally, we engaged the communities in which we operate through open and ongoing dialogue, social initiatives, and volunteer efforts. We continued to find ways to promote access to housing and community infrastructure. For example, we launched our most successful low-income housing solution, Patrimonio Hoy, in the Dominican Republic.*
>
> *As a global company, we are deeply aware of our responsibility to address complex sustainability challenges. We are committed to further reducing our impact on the environment and recognize that we have many opportunities to improve. We reconfirm our commitment to address climate change and to the development of a low-carbon economy. We actively engage with our global panel of sustainability experts, who provide important and valuable advice. On a personal note, I thank them for their feedback and for continuously challenging us to make further progress.*
>
> *We present our 2009 sustainable development report within the framework of our overall sustainability website to better communicate our sustainability performance. We have provided an executive summary that highlights our performance on our key sustainability issues. We hope that you find the report engaging, transparent, and comprehensive, and we welcome your feedback.*
>
> *Sincerely, Lorenzo H. Zambrano*
> *CEMEX Chairman of the Board and Chief Executive Officer*

Source: Lorenzo H. Zambrano, "Addressing Complex Sustainability Challenges," CEMEX, accessed June 7, 2010, http://www.cemex.com/su/Su_oc_me.aspx.

Transnational Strategy

Transnational strategy seeks to combine the best of multidomestic strategy and a global strategy to get both global efficiency and local responsiveness. For many industries, given the differences across markets and the similarties being fostered by the flatteners, this form of strategy is highly desirable and appropriate. The difficulty is that combining the multidomestic and global strategies is hard to do because it requires fulfililng the dual goals of flexibility and coordination. Firms must balance opposing local and global goals. On the positive side, firms that effectively implement a transnational strategy often outperform competitors who use either the multidomestic or global corporate-level strategies.

The Ford Motor Company and BMW are examples of firms pursuing a transnational strategy. Ford, for example, is focusing on the "world car," building one core car that will be sold globally. This strategy lowers Ford's development costs, because rather than developing different cars for different countries or regions, Ford will sell the same car to all markets. The world car strategy, however, poses a major hurdle: how to design a car that appeals to consumers in many different countries. To tackle the issue, Ford took a page from BMW, which uses the concept of "fashion forward" when designing its 3 Series cars for multiple markets. The secret, according to Verena Kloos, president of BMW's DesignworksUSA studio in California, is to "show consumers what the next big thing is, not reflect what they think now." As James D. Farley, Ford's global marketing chief, sees it, the global appeal of the 3 Series rests on trust and aspiration. People worldwide see the same design, which builds trust through ubiquity and familiarity and leads them to aspire to own the car themselves.

International Strategy and the Local Environment

Sometimes, firms expanding into new geographic markets find that they must adapt certain components of their strategies to accommodate local environments. In the United States, for instance, Dell is famous for the business model that allows it to skip middlemen and go directly to suppliers and customers. In its early years, Dell experimented with a brick-and-mortar retail strategy but quickly retrenched. As it expanded into international markets, however, Dell has found that it has to suspend its direct model, at least temporarily. Why? Basically because it needs local intermediaries to help develop both a base of business and acceptable levels of customer awareness and sophistication. Such has been the case first in India and then in China, which constitute huge markets for Dell.

While Dell provides a good example of adaptation, most global firms tend to approach corporate strategy from the perspective of their domestic market constraint, which can be problematic. Microsoft is a case in point. The United States and the European Union (EU) have very different traditions and models of competition, which in turn means that strategies must vary across these important markets. Had you not been aware of these differences, you might think that Microsoft followed an ideal resource-based corporate strategy in its diversification into Europe. It bundled its Windows operating system with the Internet Explorer browser and other software to increase the company's perceived value and, therefore, customers' willingness to pay. It also used its extensive experience with home-computer software, operating systems, and applications to better penetrate the server market for software and operating systems, where customers are primarily businesses. Finally, Microsoft tried to lock out competitors by including its Windows Media Player as a standard feature in both its server and home PC operating systems.

The EU, however, has made these Microsoft tactics illegal: the bundling strategy "deters innovation and reduces consumer choice in any technologies which Microsoft could conceivably take an interest in and tie with Windows in the future." *Source: "EU Lowers Boom on Microsoft," Wired, March 24, 2004, accessed November 10, 2010, http://www.wired.com/techbiz/media/news/2004/03/62789.* The EU signaled its disapproval by imposing a fine of over $600 million and giving Microsoft ninety days to release versions of its Windows operating systems for home PCs and servers without the Windows Media Player and to begin providing rivals access to the details of the code underlying its proprietary server systems, used primarily in business settings. This is not the first time such differences in regulatory environments have been ignored or underestimated by global firms. Just a few years earlier, the European Commission's ruling dealt a fatal blow to the all-but-done merger between Honeywell and General Electric (GE), citing that the merger would reduce competition in the aerospace industry.

KEY TAKEAWAYs

Multidomestic strategy maximizes local responsiveness by giving decentralizing decision-making authority to local business units in each country so that they can create products and services optimized to their local markets. This strategy allows firms to compete more effectively in the local market and increase their share in that

market. The disadvantage of a multidomestic strategy, however, is that the firm faces more uncertainty because of the tailored strategies in different countries. In addition, because the firm is pursuing different strategies in different locations, it cannot take advantage of economies of scale that could help decrease costs for the firm overall.
A global strategy is centralized and controlled by the home office and seeks to maximize global efficiency. Under this strategy, products are much more likely to be standardized rather than tailored to local markets. Although pursuing a global strategy decreases risk for the firm, the firm may not be able to gain as high a market share in local markets because the global strategy isn't as responsive to local markets.
A transnational strategy offers the advantages of both the multidomestic strategy (efficiency) and global strategy (responsiveness to local conditions) but has the disadvantage that it is difficult to simultaneously execute the dual goals of flexibility and coordination.

READING: MULTINATIONAL FIRMS

With the advent of improved communication and technology, corporations have been able to expand into multiple countries.

KEY Points

- Multinational corporations operate in multiple countries.
- MNCs have considerable bargaining power and may negotiate business or trade policies with success.
- A corporation may choose to locate in a special economic zone, a geographical region that has economic and other laws that are more free-market-oriented than a country's typical or national laws.

Term
- *Multinational corporation*: A corporation or enterprise that operates in multiple countries.

Example
- McDonalds operates in over 119 different countries, making it a fairly large MNC by any standard

A multinational corporation (MNC) or multinational enterprise (MNE) is a corporation registered in more than one country or has operations in more than one country. It is a large corporation which both produces and sells goods or services in various countries . It can also be referred to as an international corporation. The first multinational corporation was the Dutch East India Company, founded March 20, 1602.

Ford Motor Corp.
Ford is a MNC with operations throughout the world.

Corporations may make a foreign direct investment. Foreign direct investment is direct investment into one country by a company located in another country. Investors buy a company in the country or expand operations of an existing business in the country.

A corporation may choose to locate in a special economic zone, a geographical region with economic and other laws that are more free-market-oriented than a country's typical or national laws.

Multinational corporations are important factors in the processes of globalization. National and local governments often compete against one another to attract MNC facilities, with the expectation of increased tax revenue, employment and economic activity. To compete, political powers push toward greater autonomy for corporations. MNCs play an important role in developing economies of developing countries.

Many economists argue that in countries with comparatively low labor costs and weak environmental and social protection, multinationals actually bring about a "race to the top." While multinationals will see a low tax burden or low labor costs as an element of comparative advantage, MNC profits are tied to operationalefficiency, which includes a high degree of standardization. Thus, MNCs are likely to adapt production processes in many of their operations to conform to the standards of the most rigorous jurisdiction in which they operate.

As for labor costs, while MNCs pay workers in developing countries far below levels in countries where labor productivity is high (and accordingly, will adopt more labor-intensive production processes), they also tend to pay a premium over local labor rates of 10% to 100%.

Finally, depending on the nature of the MNC, investment in any country reflects a desire for a medium- to long-term return, as establishing a plant, training workers and so on can be costly. Therefore, once established in a jurisdiction, MNCs are potentially vulnerable to arbitrary government intervention like expropriation, sudden contract renegotiation and the arbitrary withdrawal or compulsory purchase of licenses. Thus both the negotiating power of MNCs and the “race to the bottom” critique may be overstated while understating the benefits (besides tax revenue) of MNCs becoming established in a jurisdiction.

GLOSSARY

Autonomy

The capacity to make an informed, uncoerced decision. Self-government; freedom to act or function independently.

Benefit

An advantage, help or aid from something Employee benefits and (especially in British English) benefits in kind (also called fringe benefits, perquisites, perqs or perks) are various non-wage compensations provided to employees in addition to their normal wages or salaries. An advantage, help, or aid from something.

Communication

The concept or state of exchanging information between entities. an instance of information transfer; a conversation or discourse the concept or state of exchanging data or information between entities.

Comparative advantage

The ability of a party to produce a particular good or service at a lower marginal and opportunity cost over another. The concept that a certain good can be produced more efficiently than others due to a number of factors, including productive skills, climate, natural resource availability, and so forth. The ability of a party to produce a particular good or service at a lower margin and opportunity cost over another.

Corporation

A group of individuals, created by law or under authority of law, having a continuous existence independent of the existences of its members, and powers and liabilities distinct from those of its members. a group of individuals, created by law or under authority of law, having a continuous existence independent of the existences of its members, and powers and liabilities distinct from those of its members.

Developing

Of a country: becoming economically more mature or advanced; becoming industrialized.

Economy

Collective focus of the study of money, currency and trade, and the efficient use of resources. The system of production and distribution and consumption. The overall measure of a currency system; as the national economy. The system of production and distribution and consumption. The overall measure of a currency system.

Efficiency

The extent to which a resource, such as electricity, is used for the intended purpose; the ratio of useful work to energy expended. The extent to which time is well used for the intended task. Improved efficiency was a principle goal of progressives, one they thought attainable by the application of scientific and rational thought to social problems.

Employment

The work or occupation for which one is used, and often paid.

Enterprise

A company, business, organization, or other purposeful endeavor.

Facility

The physical means or contrivances to make something (especially a service) possible; the required equipment, infrastructure, location etc.

Foreign direct investment

Investment into production or business in a country by an individual or company of another country. Foreign direct investment is investment directly into production in a country by a company located in another country, either by buying a company in the target country or by expanding operations of an existing business in that country.

Globalization

A common term for processes of international integration arising from increasing human connectivity and interchange of worldviews, products, ideas, and other cultural phenomena. In particular, advances in transportation and telecommunications infrastructure, including the rise of the Internet, represent major driving factors in globalization and precipitate the further interdependence of economic and cultural activities.

Good

An object produced for market.

Investment

A placement of capital in expectation of deriving income or profit from its use. The expenditure of capital in expectation of deriving income or profit from its use.

Jurisdiction

The limits or territory within which authority may be exercised The limits or territory within which authority may be exercised. the power, right, or authority to interpret and apply the law.

License

The legal terms under which a person is allowed to use a product.

Operation

The method or practice by which actions are done. A procedure for generating a value from one or more other values.

Premium

A bonus paid in addition to normal payments. the price above par value at which a security is sold Something offered at a reduced price as an inducement to buy something else. something offered at a reduced price as an incentive to buy something else. The premium is the amount a policy-holder or his sponsor must pay to a health plan to purchase health coverage.

Process

A series of events to produce a result, especially as contrasted to product. in reference to capabilities, a process is how the capability is executed. An outgrowth of tissue or cell.

Productivity

Productivity is a measure of the efficiency of production and is defined as total output per one unit of a total input. The rate at which goods or services are produced by a standard population of workers. A ratio of production output to what is required to produce it (inputs). The state of being productive, fertile, or efficient; the rate at which goods or services are produced by a standard population of workers. the rate at which goods or services are produced by a standard population of workers. The rate at which products and services are produced relative to a particular workforce.

Profits

Collective form of profit.

Revenue

Income that a company receives from its normal business activities, usually from the sale of goods and services to customers. The total income received from a given source.

Revenues

In business, revenue or turnover is income that a company receives from its normal business activities, usually from the sale of goods and services to customers.

Services

That which is produced, then traded, bought or sold, then finally consumed and consists of an action or work.

Standard

Something used as a measure for comparative evaluations. A level of quality or attainment. Standardization the process of setting certain norms or standards for a product with regard to shape, size, color, quantity, quality, weight etc.

Standardization

The process of setting certain norms or standards for a product with regard to shape, size, color, quantity, quality, weight etc.

READING: JOINT VENTURES

In a joint venture business model, two or more parties agree to invest time, equity, and effort for the development of a new shared project.

KEY TAKEAWAYs
• Joint business ventures involve two parties contributing their own equity and resources to develop a new project. The enterprise, revenues, expenses and assets are shared by the involved parties. • Since money is involved in a joint venture, it is necessary to have a strategic plan in place. • As the cost of starting new projects is generally high, a joint venture allows both parties to share the burden of the project as well as the resulting profits.

Term

- *Joint venture*: A cooperative partnership between two individuals or businesses in which profits and risks are shared.

Example

- Sony Ericsson is a joint venture between Swedish telecom corporation Ericsson and Japanese electronics manufacturer Sony to develop cellular devices.

Joint Ventures

A joint venture is a business agreement in which parties agree to develop a new entity and new assets by contributing equity. They exercise control over the enterprise and consequently share revenues, expenses and assets.

Joint Venture

Sony Ericsson is a joint venture between Swedish telecom corporation Ericsson and Japanese electronics manufacturer Sony to develop cellular devices.

When two or more persons come together to form a partnership for the purpose of carrying out a project, this is called a joint venture. In this scenario, both parties are equally invested in the project in terms of money, time and effort to build on the original concept. While joint ventures are generally small projects, major corporations use this method to diversify. A joint venture can ensure the success of smaller projects for those that are just starting in the business world or for established corporations. Since the cost of starting new projects is generally high, a joint venture allows both parties to share the burden of the project as well as the resulting profits. Since money is involved in a joint venture, it is necessary to have a strategic plan in place. In short, both parties must be committed to focusing on the future of the partnership rather than just the immediate returns. Ultimately, short term and long term successes are both important. To achieve this success, honesty, integrity and communication within the joint venture are necessary.

A consortium JV (also known as a cooperative agreement) is formed when one party seeks technological expertise, franchise and brand-use agreements, management contracts, and rental agreements for one-time contracts. The JV is dissolved when that goal is reached. Some major joint ventures include Dow Corning, MillerCoors, Sony Ericsson, Penske Truck Leasing, Norampac, and Owens-Corning.

GLOSSARY

Assets
Economic resources that represent value of ownership that can be converted into cash (although cash itself is also considered an asset). Any property or object of value that one possesses, usually considered as applicable to the payment of one's debts. A resource with economic value that an individual, corporation, or country owns or controls with the expectation that it will provide future benefit.

Asset
Something or someone of any value; any portion of one's property or effects so considered. Something or someone of any value; any portion of one's property or effects so considered. Any component, model, process, or framework of value that can be leveraged or reused. Items of ownership convertible into cash; total resources of a person or business, as cash, notes and accounts receivable; securities and accounts receivable, securities, inventories, goodwill, fixtures, machinery, or real estate (as opposed to liabilities).

Business model
The particular way in which a business organization ensures that it generates income, one that includes the choice of offerings, strategies, infrastructure, organizational structures, trading practices, and operational processes and policies.

Communication
The concept or state of exchanging information between entities. An instance of information transfer; a conversation or discourse the concept or state of exchanging data or information between entities.

Cooperative
A type of company that is owned partially or wholly by its employees, customers, or tenants. Abbreviation: co-op.

Corporation
A group of individuals, created by law or under authority of law, having a continuous existence independent of the existences of its members, and powers and liabilities distinct from those of its members. a group of individuals, created by law or under authority of law, having a continuous existence independent of the existences of its members, and powers and liabilities distinct from those of its members.

Enterprise
A company, business, organization, or other purposeful endeavor.

Equity
A legal tradition that deals with remedies other than monetary relief, such as injunctions, divorces and similar actions. Justice, impartiality or fairness. Internal and external equity relate to a comparative level of pay compared to both internal and external candidates. Ownership interest in a company as determined by subtracting liabilities from assets. Ownership interest in a company, as determined by subtracting liabilities from assets. Ownership interest in a company, as determined by subtracting liabilities from assets. Justice, impartiality or fairness. The residual claim or interest to investors in assets after all liabilities are paid. If liability exceeds assets, negative equity exists and can be purchased through stock. Ownership, especially in terms of net monetary value, of a business. Ownership, especially in terms of net monetary value of some business.

Expense
A spending or consuming. Often specifically an act of disbursing or spending funds. In accounting, an expense is money spent or costs incurred in an businesses efforts to generate revenue.

Franchise

The authorization granted by a company to sell or distribute its goods or services in a certain area.

Goal

A result that one is attempting to achieve A desired result that one works to achieve. A result that one is attempting to achieve.

Management

The act of getting people together to accomplish desired goals and objectives using available resources efficiently and effectively. administration; the process or practice of managing administration; the process or practice of managing. Administration; the process or practice of managing.

Money

A generally accepted means of exchange and measure of value. A generally accepted means of exchange and measure of value.

Partnership

An association of two or more people to conduct a business. A business owned by two or more people. A partnership is a form of business in which two or more people operate for the common goal of making profit. Each partner has total and unlimited personal liability of the debts incurred by the partnership.

Profits

Collective form of profit.

Resource

Something that one uses to achieve an objective. An examples of a resource could be a raw material or an employee. Something that one uses to achieve an objective, e.g. raw materials or personnel.

Revenue

Income that a company receives from its normal business activities, usually from the sale of goods and services to customers. The total income received from a given source. In business, revenue or turnover is income that a company receives from its normal business activities, usually from the sale of goods and services to customers.

READING: CONTRACT MANUFACTURING

In contract manufacturing, a hiring firm makes an agreement with the contract manufacturer to produce and ship the hiring firm's goods.

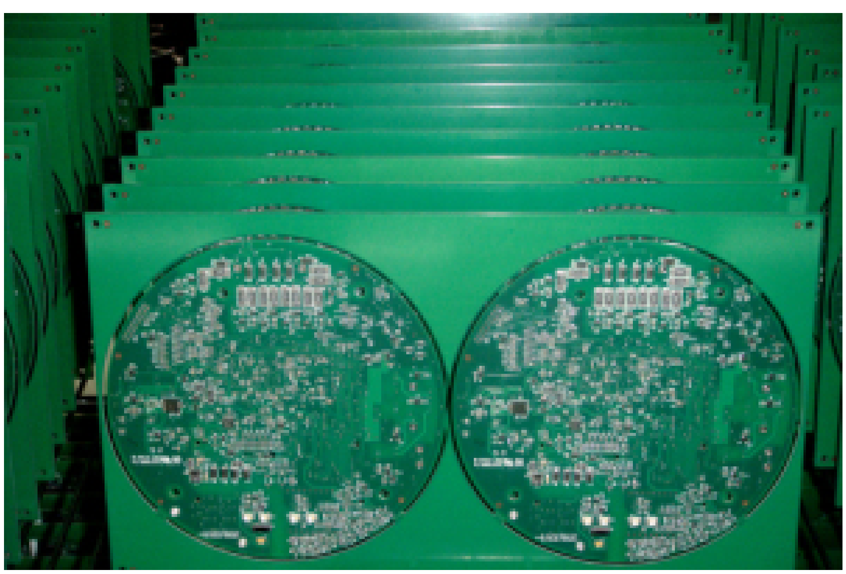
KEY Points

- A hiring firm may enter a contract with a contract manufacturer (CM) to produce components or final products on behalf of the hiring firm for some agreed-upon price.
- There are many benefits to contract manufacturing, and companies are finding many reasons why they should be outsourcing their production to other companies.
- Production outside of the company does come with many risks attached. Companies must first identify their core competencies before deciding about contract manufacture.

Terms

- *Contract manufacturing:* Business model in which a firm hires a contract manufacturer to produce components or final products based on the hiring firm's design. A business model where a firm hires another firm to produce components or products.

A contract manufacturer ("CM") is a manufacturer that enters into a contract with a firm to produce components or products for that firm . It is a form of outsourcing. In a contract manufacturing business model, the hiring firm approaches the contract manufacturer with a design or formula. The contract manufacturer will quote the parts based on processes, labor, tooling, and material costs. Typically a hiring firm will request quotes from multiple CMs. After the bidding process is complete, the hiring firm will select a source, and then, for the agreed-upon price, the CM acts as the hiring firm's factory, producing and shipping units of the design on behalf of the hiring firm.



Benefits

Contract manufacturing offers a number of benefits:

- **Cost Savings:** Companies save on their capital costs because they do not have to pay for a facility and the equipment needed for production. They can also save on labor costs such as wages, training, and benefits. Some companies may look to contract manufacture in low-cost countries, such as China, to benefit from the low cost of labor.
- **Mutual Benefit to Contract Site:** A contract between the manufacturer and the company it is producing for may last several years. The manufacturer will know that it will have a steady flow of business at least until that contract expires.
- **Advanced skills**: Companies can take advantage of skills that they may not possess, but the contract manufacturer does. The contract manufacturer is likely to have relationships formed with raw material suppliers or methods ofefficiency within their production.
- Quality: Contract Manufacturers are likely to have their own methods of quality control in place that help them to detect counterfeit or damaged materials early.
- Focus: Companies can focus on their core competencies better if they can hand off base production to an outside company.
- **Economies of Scale**: Contract Manufacturers have multiple customers that they produce for. Because they are servicing multiple customers, they can offer reduced costs in acquiring raw materials by benefiting from economies of scale. The more units there are in one shipment, the less expensive the price per unit will be.

Risks

Balanced against the above benefits of contract manufacturing are a number of risks:

- **Lack of Control:** When a company signs the contract allowing another company to produce their product, they lose a significant amount of control over that product. They can only suggest strategies to the contract manufacturer; they cannot force them to implement those strategies.
- Relationships: It is imperative that the company forms a good relationship with its contract manufacturer. The company must keep in mind that the manufacturer has other customers. They cannot force them to produce their product before a competitor's. Most companies mitigate this risk by working cohesively with the manufacturer and awarding good performance with additional business.
- Quality: When entering into a contract, companies must make sure that the manufacturer's standards are congruent with their own. They should evaluate the methods in which they test products to make sure they are of good quality. The company has to ensure the contract manufacturer has suppliers that also meet these standards.
- **Intellectual Property Loss**: When entering into a contract, a company is divulging their formulas or technologies. This is why it is important that a company not give out any of its core competencies to contract manufacturers. It is very easy for an employee to download such information from a computer and steal it. The recent increase in intellectual property loss has corporate and government officials struggling to improve security. Usually, it comes down to the integrity of the employees.
- **Outsourcing**: Although outsourcing to low-cost countries has become very popular, it does bring along risks such as language barriers, cultural differences, and long lead times. This could make the management of contract manufacturers more difficult, expensive, and time-consuming.
- Capacity Constraints: If a company does not make up a large portion of the contract manufacturer's business, they may find that they are de-prioritized over other companies during high production periods. Thus, they may not obtain the product they need when they need it.
- **Loss of Flexibility and Responsiveness**: Without direct control over the manufacturing facility, the company will lose some of its ability to respond to disruptions in the supply chain. It may also hurt their ability to respond to demand fluctuations, risking their customer service levels.

GLOSSARY
Benefit

An advantage, help or aid from something Employee benefits and (especially in British English) benefits in kind (also called fringe benefits, perquisites, perqs or perks) are various non-wage compensations provided to employees in addition to their normal wages or salaries. An advantage, help, or aid from something.

Business model

The particular way in which a business organization ensures that it generates income, one that includes the choice of offerings, strategies, infrastructure, organizational structures, trading practices, and operational processes and policies.

Capacity

The maximum that can be produced on a machine or in a facility or group.

Capital

Money and wealth. The means to acquire goods and services, especially in a non-barter system.The uppermost part of a column. Money and wealth; the means to acquire goods and services, especially in a non-barter system. Already-produced durable goods available for use as a factor of production, such as steam shovels (equipment) and office buildings (structures).

Corporate

An incorporated entity is a separate legal entity that has been incorporated through a legislative or registration process established through legislation.

Demand

The desire to purchase goods or services, coupled with the power to do so, at a particular price. The desire to purchase goods and services.

Design

To plan and carry out (a picture, work of art, construction etc.).

Economies of scale

A process where an increase in quantity will result in a decrease of average cost of production (per unit). The characteristics of a production process in which an increase in the scale of the firm causes a decrease in the long run, average cost of each unit. The cost advantages that an enterprise obtains due to expansion. As the scale of output is increased, factors such as facility size and usage levels of inputs cause the producer's average cost per unit to fall. The characteristics of a production process in which an increase in the scale of the firm causes a decrease in the long run average cost of each unit. The characteristics of a production process in which an increase in the scale of the firm causes a decrease in the long-run average cost of each unit.

Economy

Collective focus of the study of money, currency and trade, and the efficient use of resources. The system of production and distribution and consumption. The overall measure of a currency system; as the national economy. The system of production and distribution and consumption. The overall measure of a currency system.

Efficiency

The extent to which a resource, such as electricity, is used for the intended purpose; the ratio of useful work to energy expended. The extent to which time is well used for the intended task. Improved efficiency was a principle goal of progressives, one they thought attainable by the application of scientific and rational thought to social problems. The extent to which time is well used for the intended task.

Facility

The physical means or contrivances to make something (especially a service) possible; the required equipment, infrastructure, location etc.

Flexibility

The quality of being flexible; suppleness; pliability.fluctuation A motion like that of waves; a moving in this and that direction.

Good

An object produced for market.

Intellectual property

Any product of someone's intellect that has commercial value: copyrights, patents, trademarks, and trade secrets. Intellectual property (IP) is a juridical concept that refers to creations of the mind for which exclusive rights are recognized. Any product of someone's knowledge that has commercial value: copyrights, patents, trademarks and trade secrets.

Language barrier: A figurative phrase for the difficulties faced when people who have no language in common attempt to communicate with each other.

Lead

Potential opportunity for a sale or transaction, a potential customer.

Lead time

The amount of time between the initiation of some process and its completion, e.g. the time required to manufacture or procure a product; the time required before something can be provided or delivered.

Loss

The negative difference between revenue and expense.

Management

The act of getting people together to accomplish desired goals and objectives using available resources efficiently and effectively. administration; the process or practice of managing.administration; the process or practice of managing Administration; the process or practice of managing.

Manufacture

The action or process of making goods systematically or on a large scale.

Outsourcing

The transfer of a business function to an external service provider The transfer of a business function to an external service provider. The transfer of a business function to an external service provider.

Performance

The act of performing; carrying into execution or action; execution; achievement; accomplishment; representation by action; as, the performance of an undertaking of a duty. The act of performing; carrying into execution or action; achievement; accomplishment; representation by action, as the performance of undertaking a duty.

Price

The price is the amount a customer pays for the product. The quantity of payment or compensation given by one party to another in return for goods or services. The cost required to gain possession of something.

Process

A series of events to produce a result, especially as contrasted to product. in reference to capabilities, a process is how the capability is executed. An outgrowth of tissue or cell.

Product

Any tangible or intangible good or service that is a result of a process and that is intended for delivery to a customer or end user. a chemical substance formed as a result of a chemical reaction. Anything, either tangible or intangible, offered by the firm as a solution to the needs and wants of the consumer; something that is profitable or potentially profitable; goods or a service that meets the requirements of the various governing offices or society.

Quality control

Quality control (QC) is a procedure or set of procedures intended to ensure that a manufactured product or performed service adheres to a defined set of quality criteria or meets the requirements of the client or customer. A control, such as inspection or testing, introduced into an industrial or business process to ensure quality.

Raw materials

A raw material or feedstock is the basic material from which a good product is manufactured or made, frequently used with an extended meaning. For example, the term is used to denote material that came from nature and is in an unprocessed or minimally processed state; e.g., raw latex, iron ore, logs, crude oil or seawater. A raw material is the basic material from which a product is manufactured or made. Materials and components scheduled for use in making a product. A raw material is the basic material from which a good product is manufactured or made, frequently used with an extended meaning.

Risk

The potential (conventionally negative) impact of an event, determined by combining the likelihood of the event occurring with the impact, should it occur. The potential that a chosen action or activity (including the choice of inaction) will lead to a loss (an undesirable outcome). To incur risk [of something].

Security

The condition of not being threatened, especially physically, psychologically, emotionally, or financially. proof of ownership of stocks, bonds, or other investment instruments.

Services

That which is produced, then traded, bought or sold, then finally consumed and consists of an action or work.

Standard

Something used as a measure for comparative evaluations. A level of quality or attainment.
Strategy
A plan of action intended to accomplish a specific goal.

Supplier

One who supplies; a provider.

Supply provisions

The amount of some product that producers are willing and able to sell at a given price, all other factors being held constant.

Supply chain

A supply chain is a system of organizations, people, technology, activities, information and resources involved in moving a product or service from supplier to customer. A supply chain is a system of organizations, people, technology, activities, information, and resources involved in moving a product or service from the supplier to the customer. Supply chain activities transform natural resources, raw materials, and components into a finished product that is delivered to the end customer. A system of organizations, people, technology, activities, information, and resources involved in moving a product or service from the supplier to the customer. A system of organizations, people, technology, activities, information, and resources involved in moving a product or service from supplier to customer. A system of organizations, people, technology, activities, information and resources involved in moving a product or service from supplier to customer. is a system of organizations, people, technology, activities, information and resources involved in moving a product or service from suppliers to consumers. A system of organizations, people, technology, activities, information. and resources involved in moving a product or service from supplier to customer.

Wage

An amount of money paid to a worker for a specified quantity of work, usually expressed on an hourly basis.

READING: FRANCHISING

Franchising is the practice of licensing another firm's business model as an operator.

KEY Points

- Essentially, and in terms of distribution, the franchiser is a supplier who allows an operator, or a franchisee, to use the supplier's trademark and distribute the supplier's goods. In return, the operator pays the supplier a fee.
- Thirty three countries, including the United States, China, and Australia, have laws that explicitly regulate franchising, with the majority of all other countries having laws which have a direct or indirect impact on franchising.
- Franchise agreements carry no guarantees or warranties, and the franchisee has little or no recourse to legal intervention in the event of a dispute.

Terms

- *Franchisee*: A holder of a franchise; a person who is granted a franchise.
- *Franchising*: The establishment, granting, or use of a franchise.

- *Franchise:* The authorization granted by a company to sell or distribute its goods or services in a certain area.
- *Franchiser:* A franchisor, a company which or person who grants franchises.

Franchising is the practice of using another firm's successful business model. For the franchiser, the franchise is an alternative to building "chain stores" to distribute goods that avoids the investments and liability of a chain. The franchiser's success depends on the success of the franchisees. The franchisee is said to have a greater incentive than a direct employee because he or she has a direct stake in the business. Essentially, and in terms of distribution, the franchiser is a supplier who allows an operator, or a franchisee, to use the supplier's trademark and distribute the supplier's goods. In return, the operator pays the supplier a fee.

Subway Franchise – Russia
There are over 22,000 Subway restaurant franchises worldwide.

In short, in terms of distribution, the franchiser is a supplier who allows an operator, or a franchisee, to use the supplier's trademark and distribute the supplier's goods. In return, the operator pays the supplier a fee.

Each party to a franchise has several interests to protect. The franchiser is involved in securing protection for the trademark, controlling the business concept, and securing know how. The franchisee is obligated to carry out the services for which the trademark has been made prominent or famous. There is a great deal of standardization required. The place of service has to bear the franchiser's signs, logos, and trademark in a prominent place. The uniforms worn by the staff of the franchisee have to be of a particular design and color. The service has to be in accordance with the pattern followed by the franchiser in the successful franchise operations. Thus, franchisees are not in full control of the business, as they would be in retailing.

A service can be successful if equipment and supplies are purchased at a fair price from the franchiser or sources recommended by the franchiser. A coffee brew, for example, can be readily identified by the trademark if its raw materials come from a particular supplier. If the franchiser requires purchase from his stores, it may come under anti-trust legislation or equivalent laws of other countries. So too the purchase of uniforms of personnel, signs, etc., as well as the franchise sites, if they are owned or controlled by the franchiser.

Franchise agreements carry no guarantees or warranties, and the franchisee has little or no recourse to legal intervention in the event of a dispute. Franchise contracts tend to be unilateral contracts in favor of the franchiser, who is generally protected from lawsuits from their franchisees because of the non-negotiable contracts that require franchisees to acknowledge, in effect, that they are buying the franchise knowing that there is risk, and that they have not been promised success or profits by the franchiser. Contracts are renewable at the sole option of the franchiser. Most franchisers require franchisees to sign agreements that mandate where and under what law any dispute would be litigated.

GLOSSARY

Interest
The price paid for obtaining, or price received for providing, money or goods in a credit transaction, calculated as a fraction of the amount or value of what was borrowed. The price paid for obtaining, or price received for providing, money or goods in a credit transaction, calculated as a fraction of the amount of value of what was borrowed. The price paid for obtaining or price received for providing money or goods in a credit transaction, calculated as a fraction of the amount or value of what was borrowed. A great attention and concern from someone or something; intellectual curiosity.

Licensing
A business arrangement in which one company gives another company permission to manufacture its product for a specified payment.

Trademark
A word, symbol, or phrase used to identify a particular company's product and differentiate it from other companies' products. A trademark, trade mark, or trade-mark is a distinctive sign or indicator used by an individual, business organization, or other legal entity to identify for consumers that the products or services on or with which the trademark appears originate from a unique source, designated for a specific market. It also distinguishes its products or services from those of other entities. A word, symbol, or phrase used to identify a particular company's product and to differentiate it from other companies' products.

Business model

The particular way in which a business organization ensures that it generates income, one that includes the choice of offerings, strategies, infrastructure, organizational structures, trading practices, and operational processes and policies.

Controlling

The management function of checking progress against plans to exercise influence over, to suggest or dictate the behavior of, oversee.

Design

To plan and carry out (a picture, work of art, construction etc.).

Distribution

The process by which goods get to final consumers over a geographical market, including storing, selling, shipping, and advertising. The set of relative likelihoods that a variable will have a value in a given interval. A probability distribution; the set of relative likelihoods that a variable will have a value in a given interval.

Franchise agreement

A legal, binding contract that authorizes a company to sell or distribute another's goods and services in a certain area.

Good

An object produced for market.

Incentive

Something that motivates, rouses, or encourages. It is used to motivate employees for better performance by providing financial rewards. An anticipated reward or aversive event available in the environment. Something that motivates an individual to perform an action.

Investment

A placement of capital in expectation of deriving income or profit from its use. The expenditure of capital in expectation of deriving income or profit from its use.

Liabilities

Probable future sacrifices of economic benefits arising from present obligations to transfer assets or providing services as a result of past transactions or events. An amount of money in a company that is owed to someone and has to be paid in the future, such as tax, debt, interest, and mortgage payments. an obligation of an entity arising from past transactions or events, including any type of borrowing.

Operation

The method or practice by which actions are done. A procedure for generating a value from one or more other values.

Price

The price is the amount a customer pays for the product. The quantity of payment or compensation given by one party to another in return for goods or services. The cost required to gain possession of something.

Profits

Collective form of profit.

Raw materials

A raw material or feedstock is the basic material from which a good product is manufactured or made, frequently used with an extended meaning. For example, the term is used to denote material that came from nature and is in an unprocessed or minimally processed state; e.g., raw latex, iron ore, logs, crude oil or seawater. A raw material is the basic material from which a product is manufactured or made. Materials and components scheduled for use in making a product. A raw material is the basic material from which a good product is manufactured or made, frequently used with an extended meaning.

Risk

The potential (conventionally negative) impact of an event, determined by combining the likelihood of the event occurring with the impact, should it occur. The potential that a chosen action or activity (including the choice of inaction) will lead to a loss (an undesirable outcome). To incur risk [of something].

Services

That which is produced, then traded, bought or sold, then finally consumed and consists of an action or work.

Standardization

The process of setting certain norms or standards for a product with regard to shape, size, color, quantity, quality, weight etc

Supplier

One who supplies; a provider.

Supply provisions

The amount of some product that producers are willing and able to sell at a given price, all other factors being held constant.

READING: LICENSING

Licensing gives a licensee certain rights or resources to manufacture and/or market a certain product in a host country.

KEY Points
• Licensing is a business agreement involving two companies: one gives the other special permissions, such as using patents or copyrights, in exchange for payment. • An international business licensing agreement involves two firms from different countries, with the licensee receiving the rights or resources to manufacture in the foreign country. • Rights or resources may include patents, copyrights, technology, managerial skills, or other factors necessary to manufacture the good. • Advantages of expanding internationally using international licensing include: the ability to reach new markets that may be closed by trade restrictions and the ability to expand without too much risk or capital investment. • Disadvantages include the risk of an incompetent foreign partner firm and lower income compared to other modes of international expansion.

Terms

- *Licensing*: A business arrangement in which one company gives another company permission to manufacture its product for a specified payment.
- *License*: The legal terms under which a person is allowed to use a product.

Examples

- Suppose Company A, a manufacturer and seller of Baubles, was based in the US and wanted to expand to the Chinese market with an international business license. They can enter the agreement with a Chinese firm, allowing them to use their product patent and giving other resources, in return for a payment. The Chinese firm can then manufacture and sell Baubles in China.

Licensing

Licensing is a business arrangement in which one company gives another company permission to manufacture its product for a specified payment.

Licensing generally involves allowing another company to use patents, trademarks, copyrights, designs, and other intellectual in exchange for a percentage of revenue or a fee. It’s a fast way to generate income and grow a business, as there is no manufacturing or sales involved. Instead, licensing usually means taking advantage of an existing company’s pipeline and infrastructure in exchange for a small percentage of revenue.

An international licensing agreement allows foreign firms, either exclusively or non-exclusively, to manufacture a proprietor’s product for a fixed term in a specific market.

To summarize, in this foreign market entry mode, a licensor in the home country makes limited rights or resources available to the licensee in the host country. The rights or resources may include patents, trademarks, managerial skills, technology, and others that can make it possible for the licensee to manufacture and sell in the host country a similar product to the one the licensor has already been producing and selling in the home country without requiring the licensor to open a new operation overseas. The licensor's earnings usually take the form of one-time payments, technical fees, and royalty payments, usually calculated as a percentage of sales.

Batman
The Batman character has been licensed to many companies, such as Lego.

As in this mode of entry the transference of knowledge between the parental company and the licensee is strongly present, the decision of making an international license agreement depend on the respect the host government shows for intellectual property and on the ability of the licensor to choose the right partners and avoid having them compete in each other's market. Licensing is a relatively flexible work agreement that can be customized to fit the needs and interests of both licensor and licensee. The following are the main advantages and reasons to use an international licensing for expanding internationally:

- Obtain extra income for technical know-how and services.
- Reach new markets not accessible by export from existing facilities.
- Quickly expand without much risk and large capital investment.
- Pave the way for future investments in the market.
- Retain established markets closed by trade restrictions.
- Political risk is minimized as the licensee is usually 100% locally owned.

This is highly attractive for companies that are new in international business. On the other hand, international licensing is a foreign market entry mode that presents some disadvantages and reasons why companies should not use it, because there is:

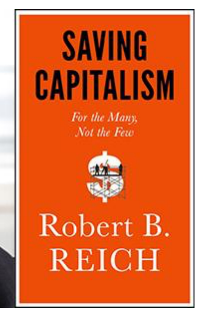
- Lower income than in other entry modes
- Loss of control of the licensee manufacture and marketing operations and practices leading to loss of quality
- Risk of having the trademark and reputation ruined by a incompetent partner
- The foreign partner also can become a competitor by selling its production in places where the parental company has a presence

GLOSSARY

Interest
The price paid for obtaining, or price received for providing, money or goods in a credit transaction, calculated as a fraction of the amount or value of what was borrowed. The price paid for obtaining, or price received for providing, money or goods in a credit transaction, calculated as a fraction of the amount of value of what was borrowed. The price paid for obtaining or price received for providing money or goods in a credit transaction, calculated as a fraction of the amount or value of what was borrowed. A great attention and concern from someone or something; intellectual curiosity.
Market
A group of potential customers for one's product. One of the many varieties of systems, institutions, procedures, social relations and infrastructures whereby parties engage in exchange.
Trademark
A word, symbol, or phrase used to identify a particular company's product and differentiate it from other companies' products. A trademark, trade mark, or trade-mark is a distinctive sign or indicator used by an individual, business organization, or other legal entity to identify for consumers that the products or services on or with which the trademark appears originate from a unique source, designated for a specific market. It also distinguishes its products or services from those of other entities. A word, symbol, or phrase used to identify a particular company's product and to differentiate it from other companies' products.
Capital
Money and wealth. The means to acquire goods and services, especially in a non-barter system.The uppermost part of a column. Money and wealth; the means to acquire goods and services, especially in a non-barter system. Already-produced durable goods available for use as a factor of production, such as steam shovels (equipment) and office buildings (structures).
Export
This term export is derived from the conceptual meaning to ship the goods and services out of the port of a country. to sell (goods) to a foreign country Any good or commodity, transported from one country to another country in a legitimate fashion, typically for use in trade.
Facility
The physical means or contrivances to make something (especially a service) possible; the required equipment, infrastructure, location etc.
Good
An object produced for market.
Intellectual property
Any product of someone's intellect that has commercial value: copyrights, patents, trademarks, and trade secrets. Intellectual property (IP) is a juridical concept that refers to creations of the mind for which exclusive rights are recognized. Any product of someone's knowledge that has commercial value: copyrights, patents, trademarks and trade secrets.
Investment
A placement of capital in expectation of deriving income or profit from its use. The expenditure of capital in expectation of deriving income or profit from its use.
Leading
To conduct or direct with authority the management function of determining what must be done in a situation and getting others to do it.
Loss
The negative difference between revenue and expense.
Manufacture
The action or process of making goods systematically or on a large scale.
Marketing
The process of communicating the value of a product or service to customers. Marketing is the process of communicating the value of a product or service to customers. The promotion, distribution and selling of a product or service; includes market research and advertising.
Operation

The method or practice by which actions are done. A procedure for generating a value from one or more other values.
Patent
A declaration issued by a government agency declaring someone the inventor of a new invention and having the privilege of stopping others from making, using or selling the claimed invention for a limited time; a letter patent.
Product
Any tangible or intangible good or service that is a result of a process and that is intended for delivery to a customer or end user. A chemical substance formed as a result of a chemical reaction. Anything, either tangible or intangible, offered by the firm as a solution to the needs and wants of the consumer; something that is profitable or potentially profitable; goods or a service that meets the requirements of the various governing offices or society.
Resource
Something that one uses to achieve an objective. An example of a resource could be a raw material or an employee. Something that one uses to achieve an objective, e.g. raw materials or personnel.
Revenue
Income that a company receives from its normal business activities, usually from the sale of goods and services to customers. The total income received from a given source.
Right
A legal or moral entitlement.
Risk
The potential (conventionally negative) impact of an event, determined by combining the likelihood of the event occurring with the impact, should it occur. The potential that a chosen action or activity (including the choice of inaction) will lead to a loss (an undesirable outcome). To incur risk [of something].
Royalty
Regular payment made from the franchisee to the franchisor for the right to be a franchisee.
Services
That which is produced, then traded, bought or sold, then finally consumed and consists of an action or work.

Reich-onomics:



Robert Reich's mission is to save American capitalism Baine, Wallace. Oakland Tribune; Oakland, Calif. [Oakland, Calif]04 Apr 2016.

ABSTRACT
[Robert Reich]'s address will be drawn from his most recent book "Saving Capitalism: For the Many, Not the Few." He is the author of 14 books on American economics and politics. His theories were at the center of the 2013 documentary "Inequality for All."

Capitalism as a system isn't inherently good or bad. Countries as different as Denmark and China are all moving toward systems of capitalism. The American economy isn't a perversion of some ideal concept of capitalism, it's simply one version of the system. Who capitalism benefits and how it is used depends on individual governments. In the U.S., the real issue we should be discussing is whether our form of capitalism should be organized for the benefit of society as a whole or for the benefit of a small group of people at the top. I argue that our current economic system is built to benefit those already at the top and that we need to change this situation for the well-being of our nation as a whole. We have the power to decide how our economy is organized and to determine who it should work for. As I've said before, the choice between a "free market" or "government" is illusory. Without government, the market wouldn't exist. It is not the market that determines how America is governed, but rather the government that determines the free market.

The Tuesday address at the Rio Theatre -- presented by the Blum Center on Poverty, Social Enterprise and Participatory Governance at UC Santa Cruz -- is free, but capacity has been reached. Reich will discuss economic and political issues with UCSC professor of psychology Heather Bullock. The event will be live streamed. Reich took the time to answer a few questions on his economic ideas and his role as a vocal political advocate in a contentious election season.

Q Is it fair to distill your message this election year to the notion that the economic system we're living under isn't capitalism but a perversion of capitalism? Much like gluttony is a perversion of healthy eating, or pornography a perversion of healthy sexuality?

A Capitalism as a system isn't inherently good or bad. Countries as different as Denmark and China are all moving toward systems of capitalism. The American economy isn't a perversion of some ideal concept of capitalism, it's simply one version of the system. Who capitalism benefits and how it is used depends on individual governments. In the U.S., the real issue we should be discussing is whether our form of capitalism should be organized for the benefit of society as a whole or for the benefit of a small group of people at the top. I argue that our current economic system is built to benefit those already at the top and that we need to change this situation for the well-being of our nation as a whole. We have the power to decide how our economy is organized and to determine who it should work for.

Q At the time of the Revolution, John Jay famously said, "Those who own the country ought to govern it," which suggests that economic stratification is baked into the American experiment. Do you feel that the one-person-one- vote standard of democracy is in contradiction to the economic realities of the free market? Can the case be made that one-dollar-one-vote is a more accurate reflection of how the country should be run?

A As I've said before, the choice between a "free market" or "government" is illusory. Without government, the market wouldn't exist. It is not the market that determines how America is governed, but rather the government that determines the free market.

Government creates and enforces the free market by making all the decisions necessary to its organization. Rather than saying that the democratic one-person-one-vote standard is a contradiction of the free market, it's more accurate to say that the market as it exists in America today (rife with vast income inequality, rules favoring the wealthy and coercive tactics) has developed in opposition to the founding ideal of democracy.

To fix the economy, we need to fix our governing model. A one-dollar-one-vote system is not how the country should be run. We should actively avoid such a system, and we can start by altering laws that concentrate power in the hands of the few and by taking money out of politics.

Q The economic inequality argument has a lot in common with the climate change argument, in that you have to convince the public that a powerful unseen force is real and potentially catastrophic before you can address what should be done. You've been making that argument for decades. Are you to the point where you feel you've convinced people that the problem is real and now must pivot to the solutions?

A My books, movie and the online videos I create through the nonprofit Inequality Media have reached many people, but more work still needs to be done. A large number of Americans may still not understand or even be aware of the ways that the market is rigged to work against them. The issue of economic inequality is critical, and I'm working to increase awareness and disseminate information about this crisis. Particularly with "Inequality for All" and videos for Inequality Media, my goal is to reach a broader audience that perhaps my books wouldn't.

Q There is at least a third of the U.S. electorate that, because of political beliefs, are functionally unreachable to your argument over economic inequality. Is it crucial that those folks are engaged in this argument? Or can something meaningful be done despite their resistance, even hostility?

A For meaningful change to happen, there needs to be some cooperation from all parts of the electorate, but I don't think that the resistance of a few will prevent a movement from taking place. The key target audience is average Americans, not the political elite. The potential to transform the system is in their hands. Enormous power can be generated if ordinary citizens band together and mobilize to regain control of our economy.

I also don't think that there is any ideological group that is completely unreachable. On the book tour for my newest book, "Saving Capitalism," many self-identified "conservative Republicans" agreed with almost all of the points I make about the harms of big money in politics, crony-capitalism and corporate welfare.

Q Finally, with your experience behind the megaphone of the mass media, do you have any insights on the structural impediments of the news media that might prevent them from genuinely working on behalf of the public interest? What, in your view, would a media environment that works on behalf of equality and democracy look like?

A Perhaps one of the most harmful impediments preventing news media from serving the public is inaccurate information. The average person relies on popular news sources for information and when these sources publish misleading or factually incorrect information without fact-checking the claims, then they aren't working in the public's best interest. Another dangerous impediment is bias. No news source will be completely neutral, but the blatant disregard for fair and objective coverage in American media is disconcerting.

A democratic and equal media environment would be one that propagates accurate and unbiased (to the extent that's possible) information. This kind of media environment should also work on behalf of the people, not the most powerful or the wealthiest. News media should empower people with knowledge and give them the tools to be engaged in their country. Mainstream media often doesn't have the interests of the vast majority of Americans at heart.

Robert Reich: 'Saving Capitalism: For the Many, Not the Few'.Oakland Tribune; Oakland, Calif.Apr 4, 2016. Bay Area News Group

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OFFICE of the UNITED STATES TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT

Summary of the Trans-Pacifc Partnership Agreement

10/04/2015

On October 4, 2015, Ministers of the 12 Trans-Pacifc Partnership (TPP) countries – Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, United States, and Vietnam – announced conclusion of their negotiations. The result is a high-standard, ambitious, comprehensive, and balanced agreement that will promote economic growth; support the creation and retention of jobs; enhance innovation, productivity and competitiveness; raise living standards; reduce poverty in our countries; and promote transparency, good governance, and enhanced labor and environmental protections. We envision conclusion of this agreement, with its new and high standards for trade and investment in the Asia Pacifc, as an important step toward our ultimate goal of open trade and regional integration across the region.

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KEY FEATURES

Five defning features make the Trans-Pacifc Partnership a landmark 21st-century agreement, setting a new standard for global trade while taking up next-generation issues. These features include:

Comprehensive market access. The TPP eliminates or reduces tariff and non-tariff barriers across substantially all trade in goods and services and covers the full spectrum of trade, including goods and services trade and investment, so as to create new opportunities and benefits for our businesses, workers, and consumers.

Regional approach to commitments. The TPP facilitates the development of production and supply chains, and seamless trade, enhancing efficiency and supporting our goal of creating and supporting jobs, raising living standards, enhancing conservation efforts, and facilitating cross-border integration, as well as opening domestic markets.

Addressing new trade challenges. The TPP promotes innovation, productivity, and competitiveness by addressing new issues, including the development of the digital economy, and the role of state-owned enterprises in the global economy.

Inclusive trade. The TPP includes new elements that seek to ensure that economies at all levels of development and businesses of all sizes can benefit from trade. It includes commitments to help small- and medium-sized businesses understand the Agreement, take advantage of its opportunities, and bring their unique challenges to the attention of the TPP governments. It also includes specific commitments on development and trade capacity building, to ensure that all Parties are able to meet the commitments in the Agreement and take full advantage of its benefits.

Platform for regional integration. The TPP is intended as a platform for regional economic integration and designed to include additional economies across the Asia-Pacific region.

SCOPE

The TPP includes 30 chapters covering trade and trade-related issues, beginning with trade in goods and continuing through customs and trade facilitation; sanitary and phytosanitary measures; technical barriers to trade; trade remedies; investment; services; electronic commerce; government procurement; intellectual property; labour; environment; ‘horizontal’ chapters meant to ensure that TPP fulfils its potential for development, competitiveness, and inclusiveness; dispute settlement, exceptions, and institutional provisions.

In addition to updating traditional approaches to issues covered by previous free trade agreements (FTAs), the TPP incorporates new and emerging trade issues and cross-cutting issues. These include issues related to the Internet and the digital economy, the participation of state-owned enterprises in international trade and investment, the ability of small businesses to take advantage of trade agreements, and other topics.

TPP unites a diverse group of countries – diverse by geography, language and history, size, 37 and levels of development. All TPP countries recognize that diversity is a unique asset, but also one which requires close cooperation, capacity-building for the lesser-developed TPP countries, and in some cases special transitional periods and mechanisms which offer some TPP partners additional time, where warranted, to develop capacity to implement new obligations.

MODULE 3:

Covid-19 the Global Economy

OVERVIEW

In module 3, we will explore the impact of the Covid-19 virus on the economy as well as its possible outcomes.

Chart from Mucci Learning Market Based Work Process

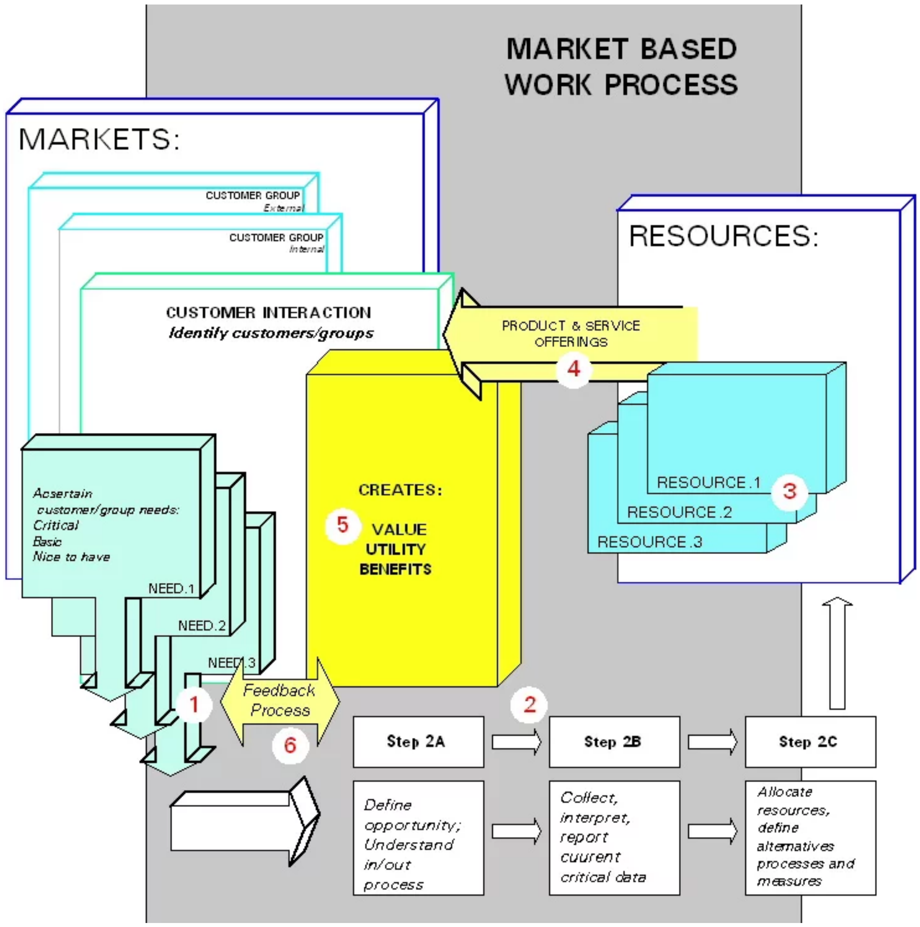


Table showing the Importance of Markets

	POOR MARKET	GOOD MARKET
GOOD OPERATOR	3	1
POOR OPERATOR	4	2

Mucci Learning

VIDEO: Businesses and the Virus

This is a short film introducing the topic of company survivability within the pandemic. Watch: Which businesses will survive the COVID-19 pandemic?: https://www.youtube.com/watch?v=f5MYR-VNpY4

READING: Direct Consequences of the virus

- Discuss how it impacts healthcare.
- Discuss which States you think will be impacted the most.

Read the article, “Here Are The Big Winners And Losers In Our New Post-Covid-19 World” from Forbes website linked below.

https://www.forbes.com/sites/jackkelly/2020/05/18/here-are-the-big-winners-and-losers-in-our-new-post-covid-19-world/#168cdc65d2c0

The pandemic has impacted all aspects of our lives and careers. On the other side of this disaster, we’ll soon see fast-growing new trends that will dramatically change things. This includes our health, the way we work, where we live, how we consume entertainment, shopping and dining habits.

Working From Home Is Here To Stay

The work-from-home experiment was an unexpected success. The ability of people to be productive and remain in contact with the colleagues and managers worked so well that companies such as Morgan Stanley, JPMorgan, Twitter, Google, Amazon and others have announced that they will continue this program. This is great news for many workers. They’ll no longer have to endure long, boring commutes—either stuck on the highway or squeezed into crowded busses and trains. They’ll enjoy a higher quality of work, as they take back three hours of time without the dreadful commute, spend quality time with their family, enjoy hobbies and attend events for the kids that they couldn't do in the past.

Corporate executives recognize that their companies will save a fortune in rent, as their workers won’t need to be clustered together in office buildings. There won’t be a need to spend tons of money on high-priced real estate in expensive cities. They could have considerably smaller offices for those who need to be present at the office or simply desire to work in an office environment.

The money saved by the corporations can be used to further their business interests—perhaps, provide employees some much-needed raises and hire new people.

The real estate market will be crushed as a consequence of this working-from-home trend. As big-paying clients keep their people at home, fail to renew leases and avoid signing long-term contracts for space, the prices of buildings in New York, Boston, Chicago, Los Angeles, San Francisco and other big cities will plummet.

This, in turn, will start triggering other events. The building owners will consider rehabbing their properties. They could turn the offices into rental properties or condominiums, which could help with the housing shortage. These office buildings could be turned into mixed-usage destinations that offer a combination of some office space, residential residences, stores, gyms and a host of other entertainment options.

As millions of people work out of their homes and spend all of their time there, they'll want to make home improvements. They'll look to buy the best computers, internet connections, desks, chairs, software and anything else that makes it easier to work and collaborate online with clients, colleagues and managers.

Companies that offer these types of products and services will greatly benefit from this fast-growing trend. Zoom, Slack, Google, Microsoft, Amazon, Best Buy and other similar companies will do very well.

In addition to the business aspect, as you're spending almost all of your waking hours at home, you'll start looking to improve everything to make it as comfortable as possible. People will buy the coolest televisions, upgrade their furniture, remodel kitchens, add on extensions, such as an office and other accoutrements.

Unintended Consequences

As there's less commuting, there will be fewer cars and buses on the roads. Business travel won't ever be the same. Why would a chief financial officer sign off on an expensive business trip, which entails air travel, renting a car, staying at a hotel and eating out for three meals a day, when you can easily hop on a video call? It's less money and less of a risk—relative to catching Covid-19 or whatever virus stalks us next.

Consequently, we'll spend less money on gasoline. The airlines have already admitted that they will be grounded for the foreseeable future. Families will be reluctant to take flights in fear of a Covid-19 resurgence. This trend will hurt the oil industry that's already reeling from a price war—started by Russia and Saudi Arabia—and a decreased global demand, as businesses around the world have grounded to a near halt.

On a positive note, the environment will be a big beneficiary of the work-from-home trend, coupled with the cessation of air travel. There will be less pollution generated into the atmosphere. We've all seen the photos online that juxtapose the air quality in major cities today compared to how smoggy and polluted things looked before Covid-19.

The Great Migration Away From Big Crowded Cities

Suburbs and exurbs will soon benefit—so will states that offer nice climates, low taxes and open space. People will question the need to live in crowded cities where people are on top of each and more susceptible to catching viruses. New York City is an example of this. The city has been the hardest hit and it's the most densely populated place in the country. It's also an extremely expensive place to live.

One of the allures of big cities is the social aspect. This will change too. Eating out at restaurants, going to crowded clubs and bars and attending music and concerts won't be happening for a while. When they do start up, there will be draconian measures put in place at these venues, which will make the outings feel weird and unpleasant. How much fun can you really have while wearing a mask and gloves and told to stay six feet apart from your friends?

Once people realize that they don't have to pay exorbitant rents or a ridiculous amount for a house—along with crazy real estate taxes—just to be close to work and lament the degraded social experience, they'll seek out new locations and move there.

They'll relocate to cities and states that are cheaper, cleaner and nicer. Why remain in a cold, heavily taxed state when you're no longer chained to your job because of the close proximity to work? You'll soon be able to work at a company you'd like from wherever you want to reside.

It's logical that sunny, less-crowded locations with lower costs of living and small tax bills will attract those who want to flee expensive, crowded, dirty and high-tax rate states. We'll see a revitalization of smaller cities, suburbs and towns, as people will continue feeling leery of large crowds.

Some States Will Suffer

Many states were in bad financial straits before the pandemic. With companies forced to close down and millions of Americans unemployed, tax revenue for states precipitously plummeted. New York, New Jersey, California, Illinois and other states have been hit hard. They've been squeezed, having to spend money on fighting the outbreak while receiving less money in taxes that's needed to keep things running.

The only solution for states is to both raise taxes and make some drastic cost cuts. Just like what happened to New York City in the 1970s, police officers, firemen and teachers will be let go to reduce expenditures. This resulted in the degradation of the city. There was a spike in crime, the schools became overcrowded and garbage piled up on the streets.

Cities and states that raise taxes—in addition to already high tax rates— along with a deteriorating quality of life will prompt people to move. They'll migrate to states that are more accommodating. This will cause more pressure on the citizens who remain. They'll need to pay even more taxes and receive less services, as the tax base flees elsewhere.

Healthcare Will Be A Priority

We've collectively realized that we're not indestructible, can get very sick and die any day. It's a sobering awareness. In the past, most people would wave off health concerns and feel it could never happen to them. Covid-19 made us painfully aware of the cold, harsh reality.

The healthcare and pharmaceutical industries will boom as we're hyper-focused on our health and safety. We'll worry about new diseases arising and a premium will be paid on ensuring that we can stay safe and live long, healthy lives. Companies that offer products and services that offer healthcare solutions will benefit from our heightened awareness and desire for medical assistance.

Telemedicine has gained wide adoption during Covid-19 and will garner even more attention. Patients will love the fact that they won't be forced to sit in a crowded doctor's offices along with dozens of sick people breathing, sneezing and coughing.

We all know that the 1 p.m. appointment means the doctor will see you at around 2:30 p.m. or so. It's rude, annoying and subjects you to catching whatever the other waiting patients have.

Compared to endlessly sitting in an uncomfortable waiting room with six-month-old magazines that everyone's pawed over, getting a text alert while at home is a game changer. You can go about your business and life, get the notice that your doctor is ready to see you and your time is well spent.

The Losers

A lot of small businesses won't recover from being closed for so long. They unfortunately don't have the money needed to keep their doors open and pay rent, utilities, salaries, insurance and carrying inventories of products without receiving any revenues. The huge companies, such as Amazon, Walmart and Costco, will keep getting bigger. They've been open while their small competition, which were deemed nonessential, stayed closed and missed out on all of the potential business. The beleaguered small chains don't stand a chance against these monsters. Already, we've seen once-vaulted retailers, such as J.C. Penney, Neiman Marcus and J. Crew, file for bankruptcy.

The airlines, hotels, resorts and restaurants will take a long time to recover. Some companies in these sectors will file for bankruptcy or become ghosts of what they once were. People will eventually venture out, but it will take a long time to feel completely comfortable again. Many people have fallen into the habit of purchasing everything online. Once these habits have been set, it's hard to change them.

All of the companies that are in the supply chain for industries that are in the decline, such as airlines, will be financially hurt. If passengers aren't showing up, there's no need for United Airlines to buy Boeing's planes. The parts suppliers to Boeing will see their business wither away.

Colleges Will Be Impacted

A large number of colleges will fail. Parents will balk at paying $30,000 to $70,000 for their kids to take glitchy online Zoom, pre-taped or YouTube classes. They'll tell them to take a gap year or start out at a less expensive school and wait and see what happens next.

With the universities closed, they'll lose revenue from sporting events and other activities that require large groups of people congregating together. Professors and staff will be fired. Colleges will be forced to reinvent themselves to keep their current students and lure in new ones.

Restaurants And Shopping Malls Will Suffer

With millions of people unemployed and those who have jobs worried about the safety of their positions, they'll spend less money. This entails taking fewer vacations, holding off on buying a new car, iPhone, dining out and other other expenditures.

Restaurants will hurt as potential customers may not have the money to eat out. New rules will be restrictive and turn off customers. It's not a pleasant experience to drop $100 on a meal with your family when everyone is wearing a mask and gloves, you're made to stay far away from other customers and the waitstaff furiously disinfects everything in sight.

Shopping malls will be seen as a breeding ground for viruses due to people wandering around the place close to one another, touching and trying on garments that other people wore that day. Stores may not even allow you to try on the clothes. Similar to restaurants, it will be awkward and uncomfortable to stroll down the aisles at the mall where everyone wears a mask and gloves and most likely a security person will be monitoring your adherence to social distancing.

The new normal will benefit companies that offer products and services that help people who are working from home and make them feel safer and healthier. Those that depend upon travel and being in close proximity with a number of other people will have a hard time. The work-from-home trend will be a game changer in that it allows people more freedom and mobility, which will result in the depopulation of some cities and states and reinvigorate others.

READING: Saving lives and the economy

- Discuss shutting down the economy vs lives saved/impacted.
- Explain how "flattening the curve" works.

Read the article, "Paying to stop the pandemic" from The Economist website linked below.

https://www.economist.com/leaders/2020/03/19/paying-to-stop-the-pandemic

PLANET earth is shutting down. In the struggle to get a grip on covid-19, one country after another is demanding that its citizens shun society. As that sends economies reeling, desperate governments are trying to tide over companies and consumers by handing out trillions of dollars in aid and loan guarantees. Nobody can be sure how well these rescues will work.

But there is worse. Troubling new findings suggest that stopping the pandemic might require repeated shutdowns. And yet it is also now clear that such a strategy would condemn the world economy to grave—perhaps intolerable—harm. Some very hard choices lie ahead.

Barely 12 weeks after the first reports of people mysteriously falling ill in Wuhan, in central China, the world is beginning to grasp the pandemic's true human and economic toll. As of March 18th SARS-CoV-2, the virus behind covid-19, had registered 134,000 infections outside China in 155 countries and territories. In just seven days that is an increase of almost 90,000 cases and 43 countries and territories. The real number of cases is thought to be at least an order of magnitude greater.

Spooked, governments are rushing to impose controls that would have been unimaginable only a few weeks ago. Scores of countries, including many in Africa and Latin America, have barred travelers from places where the virus is rife. Times Square is deserted, the City of London is dark and in France, Italy and Spain cafés, bars and restaurants have bolted their doors. Everywhere empty stadiums echo to absent crowds.

It has become clear that the economy is taking a much worse battering than analysts had expected (see Briefing). Data for January and February show that industrial output in China, which had been forecast to fall by 3% compared with a year earlier, was down by 13.5%. Retail sales were not 4% lower, but 20.5%. Fixed-asset investment, which measures the spending on such things as machinery and infrastructure, declined by 24%, six times more than predicted. That has sent economic forecasters the world over scurrying to revise down their predictions. Faced with the most brutal recession in living memory, governments are setting out rescue packages on a scale that exceeds even the financial crisis of 2007-09.

This is the backdrop for fundamental choices about how to manage the disease. Using an epidemiological model, a group from Imperial College in London this week set out a framework to help policymakers think about what lies ahead. It is bleak.

One approach is mitigation, “flattening the curve” to make the pandemic less intense by, say, isolating cases and quarantining infected households. The other is to suppress it with a broader range of measures, including shutting in everybody, other than those who cannot work from home, and closing schools and universities. Mitigation curbs the pandemic, suppression aims to stop it in its tracks.

The modellers found that, were the virus left to spread, it would cause around 2.2m deaths in America and 500,000 in Britain by the end of summer. In advanced economies, they concluded, three months of curve-flattening, including two-week quarantines of infected households, would at best prevent only about half of these. Moreover, peak demand for intensive care would still be eight times the surge capacity of Britain’s National Health Service, leading to many more deaths that the model did not attempt to compute. If that pattern holds in other parts of Europe, even its best-resourced health systems, including Germany’s, would be overwhelmed.

No wonder governments are opting for the more stringent controls needed to suppress the pandemic. Suppression has the advantage that it has worked in China. On March 18th Italy added 4,207 new cases whereas Wuhan counted none at all. China has recorded a total of just over 80,000 cases in a population of 1.4bn people. For comparison, the Imperial group estimated that the virus left to itself would infect more than 80% of the population in Britain and America.

But that is why suppression has a sting in its tail. By keeping infection rates relatively low, it leaves many people susceptible to the virus. And since covid-19 is now so widespread, within countries and around the world, the Imperial model suggests that epidemics would return within a few weeks of the restrictions being lifted. To avoid this, countries must suppress the disease each time it resurfaces, spending at least half their time in lockdown. This on-off cycle must be repeated until either the disease has worked through the population or there is a vaccine which could be months away, if one works at all.

This is just a model, and models are just educated guesses based on the best evidence. Hence the importance of watching China to see if life there can return to normal without the disease breaking out again. The hope is that teams of epidemiologists can test on a massive scale so as to catch new cases early, trace their contacts and quarantine them without turning society upside down. Perhaps they will be helped by new drugs, such as a Japanese antiviral compound which China this week said was promising.

But this is just a hope, and hope is not a policy. The bitter truth is that mitigation costs too many lives and suppression may be economically unsustainable. After a few iterations governments might not have the capacity to carry businesses and consumers. Ordinary people might not tolerate the upheaval. The cost of repeated isolation, measured by mental well-being and the long-term health of the rest of the population, might not justify it.

In the real world there are trade-offs between the two strategies, though governments can make both more efficient. South Korea, China and Italy have shown that this starts with mass-testing. The more clearly you can identify who has the disease, the less you must depend upon indiscriminate restrictions. Tests for antibodies to the virus, picking up who has been infected and recovered, are needed to supplement today’s which are only valid just before and during the illness (see article). That will let immune people go about their business in the knowledge that they cannot be a source of further infections.

A second line of attack is to use technology to administer quarantines and social distancing. China is using apps to certify who is clear of the disease and who is not. Both it and South Korea are using big data and social media to trace infections, alert people to hotspots and round up contacts. South Korea changed the law to allow the state to gain access to medical records and share them without a warrant. In normal times many democracies might find that too intrusive. Times are not normal.

Last, governments should invest in health care, even if their efforts take months to bear fruit and may never be needed. They should increase the surge capacity of intensive care. Countries like Britain and America are desperately short of beds, specialists and ventilators. They should define the best treatment protocols, develop vaccines and test new therapeutic drugs. All this would make mitigation less lethal and suppression cheaper.

Be under no illusions. Such measures might still not prevent the pandemic from extracting a heavy toll. Today governments seem to be committed to suppression, whatever the cost. But if the disease is not conquered quickly, they will edge towards mitigation, even if that will result in many more deaths. Understandably, just now that is not a trade-off any government is willing to contemplate. They may soon have no choice.

READING: A dollars weight

- Discuss banks turning to the Feds for bailouts.
- Explain how important the dollar is today.

Read the article, “Multi-colored swap shop” from The Economist website linked below.

https://www.economist.com/finance-and-economics/2020/03/21/the-dollar-is-in-high-demand-prone-to-dangerous-appreciation

America’s currency was not always as coveted as it is in today’s troubled times. In the 1960s European central banks had more dollars than they felt comfortable holding. To discourage them from converting their greenbacks into gold, the Federal Reserve introduced its first “swap line” in 1962, allowing foreign central banks to obtain dollars in exchange for their own currency, then swap them back at a later date. Combined with the Fed’s purchases of dollars, the swaps helped protect nervous foreign central banks from the dangers of a dollar devaluation.

The world now faces the opposite problem: a dollar in high demand, prone to dangerous appreciation. It has, unsurprisingly, strengthened against the currencies of emerging markets, which have suffered brutal capital outflows since late January (see chart). But the dollar has, more surprisingly, also strengthened against safe-haven currencies such as the yen and the Swiss franc, and pushed currencies like the pound and the Norwegian krone to their weakest level in decades. On March 18th Bloomberg’s dollar spot index, which measures the greenback against a basket of currencies, hit an all-time high, its seventh consecutive rise. Anyone seeking to swap their yen, francs or euros for dollars (and then swap them back again after a few months) must pay a premium, known as the cross-currency basis, which is deducted from any interest they earn. That premium has risen sharply on several occasions in the past two weeks.

One reason for this scarcity may be the dollar’s global role. Zoltan Pozsar and James Sweeney of Credit Suisse, a bank, have pointed out that supply chains are payment chains in reverse. When the flow of parts, components and assembly is interrupted, so is the flow of payments in the other direction. In East Asia, where the pandemic began, these payments are often made in dollars.

Some hospitals overwhelmed by covid-19 cases have reported a lull before the storm, a period when emergency rooms fall quiet, because people with other ailments are staying away, but the people who cannot breathe have yet to arrive en masse. Something similar befell the dollar funding markets in February. China’s shutdown reduced the need for trade finance, point out Mr Pozsar and Mr Sweeney, removing one source of demand for dollar lending. But as companies’ dollar earnings have dried up, more of them have turned to their banks for help. Companies with pre-arranged credit lines have drawn them down. Large firms that are accustomed to obtaining money directly from the capital markets, through bonds or commercial paper, have also turned to the banks instead.

The banks themselves can turn to the Fed, which can lend them dollars they cannot obtain on their own. But the Fed is less able to help banks that lack a presence in America. Last year non-American banks had $13trn-worth of dollar liabilities, according to calculations by Iñaki Aldasoro and Torsten Ehlers of the Bank for International Settlements. Only 22% of this total was booked with branches or subsidiaries in America. The rest was out of the Fed’s immediate reach.

The Fed can, however, reach out to its fellow central banks. And they, in turn, can help commercial banks within their own bailiwicks. On March 15th the Fed eased the terms of its swap lines with central banks in the euro area, Japan, Britain, Switzerland and Canada. Two days later, the Bank of Japan offered over $30bn in 12-week loans, the largest amount since the 2007-09 global financial crisis. The European Central Bank followed up with $112bn. That narrowed the “basis” that must be paid to obtain dollars through foreign-exchange swaps.

Fed-watchers immediately began wondering if it would expand its swap lines to include prominent emerging markets. There is precedent. The Fed's first swap line to Mexico dates back to 1967. And in October 2008 it also offered lines to Singapore (which even then was overqualified for the role of emerging market), South Korea and Brazil (the "dodgiest of the lot", according to Richard Fisher, then president of the Dallas Fed). But Fed officials back then were, and still are today, reluctant to serve as central bank to the world. Transcripts of the October 2008 meeting indicate that several other emerging markets (their identities remain redacted) had already inquired about joining the Fed's magic circle.
"We have done everything we possibly can to discourage such approaches," said one Fed economist. "We're not advertising."

READING: Commodities

- Discuss how oil prices affect the economy.

Read the article, "Free Exchange" from The Economist website linked below.

https://www.economist.com/finance-and-economics/2020/03/05/commodity-economies-face-their-own-reckoning-due-to-covid-19

The reward for providing the world economy with the raw materials it needs to grow is perpetual vulnerability. The hyperglobalisation of recent decades, and the associated Chinese growth miracle, yielded large benefits to commodity producers of all sorts. Now, as the shock of the covid-19 pandemic works its way through the world's new, tangled economic plumbing, commodity-dependent economies find themselves exposed. The dangers faced by this group—unctad, a United Nations trade-and-investment body, classifies 102 economies as commodity-dependent—differ from those of countries wired tightly into manufacturing supply chains. For them, falling commodity prices instantly put a strain on public finances, just as the burden of coping with a public-health crisis is likely to increase.

Managing a commodity-based economy is never easy. When prices rise, governments must worry about excessive spending and financial risk-taking. When they fall, budgets bust and foreign investors take flight, even as the need for domestic spending and easy credit grows. Commodity exporters have faced more bad times than good of late. They have been battered by a slowdown in China's materials-hungry economy, a shale revolution in America which upended global oil markets in the middle of the 2010s, and growth-sapping trade wars. The tide looked like it was turning late last year, as a trade detente between America and China lent support to an unsteady revival in global manufacturing. Scarcely had producers begun to hope for better times when covid-19 threw a sopping wet blanket on their fortunes.

Markets have fallen dramatically as the pandemic has gained strength. Soyabean prices are off by nearly 6% from January highs, copper by more than 10%, and oil by around 30%. Brent crude fetched $74 per barrel in April of last year and $69 as recently as January, but is now trading at around $52. Prices could fall further if the outlook for the economy deteriorates further, and travel and trade dwindle. Better news out of China, where the number of new cases of covid-19 continues to fall, is encouraging. The Chinese economy accounts for roughly half of global demand for industrial metals and more than 10% of global demand for oil. But a return to economic normality in China could be delayed by the boomerang effect of a spread of the disease elsewhere.

Tumbling prices hit government revenues at a time when higher government spending means public finances are already under strain in countries like Saudi Arabia. The imf estimates the fiscal breakeven price of oil for many large oil-exporting economies—the price which balances the government's budget—to be well above current levels: more than $100 a barrel in Algeria and Iran, for example, and over $80 per barrel in Saudi Arabia. Even Russia, with a breakeven price of about $42, may soon feel a squeeze. A recent imf analysis of the economies of the Persian Gulf notes that while most built up savings as oil prices rose between 1997 and 2007, spending grew faster than revenue over the subsequent seven years. Fiscal reforms implemented between 2014 and 2018, when oil prices entered a prolonged slump, have helped, but most Gulf economies continued to draw down their sovereign-wealth funds and accumulate debt. As The Economist went to press, opec producers and allies such as Russia were meeting in Vienna to discuss ways to lift oil prices. Capital Economics, a consultancy, expected them to agree to an emergency output cut of 1m barrels per day for at least three months. Under stress, co-operation could prove short-lived.

Cutbacks in production because of sagging demand for raw materials also affect the strength of the domestic economy: there is less work, and less money to be spent on local goods and services. Growth forecasts are already being revised down for mineral-rich countries like Russia and South Africa. Analysts at Goldman Sachs, a bank, reckon that a 10% drop in commodity prices might shave more than a percentage point from gdp growth in Peru and Chile: both are exporters of industrial commodities such as copper that rely heavily on demand from China.

The rising fiscal pressure on commodity economies could hardly come at a worse time. Managing the viral threat will be expensive. The burden in some countries such as Iran, where almost 3,000 cases of the virus have already been confirmed, could be crushing. In other commodity-producing regions, such as Latin America and sub-Saharan Africa, far fewer cases have been confirmed as yet, and hot and dry climates could limit the virus' transmissibility. But it is too soon to assume they will be unaffected.

Raw deals

A severe but temporary economic shock seems a perfectly reasonable excuse for a government to borrow more than planned. Commodity-based economies with a history of capable macroeconomic management can run larger deficits without fear of a market backlash; indeed, the yields on bonds issued by Australia have fallen sharply over the past month, reducing the cost of borrowing for a government grappling with a dual public-health and economic threat. Other big commodities producers will need to be more careful. In those with a history of recent financial stress, like Argentina and Venezuela, the covid-19 pandemic could pile misery upon misery. Brazil only recently escaped a cycle of fiscal incontinence, market skepticism and accelerating inflation.

Least predictable of all are the political effects of a potential pandemic. In good times, commodity wealth can blunt the complaints of political malcontents, while straitened circumstances expose all manner of ills. The slump of the past few years has already bred public disaffection across commodity economies, from Russia to Bolivia. The shock from covid-19 will test political systems around the world. Among commodity producers, especially those with little fiscal room for manoeuvre, fractures will be exposed more quickly and, occasionally, more destructively.

READING: 90% Economy

- Discuss the difficulties of maintaining a 90% economy.
- Discuss what businesses may arise with this economy

Read the article, “Life After Lockdowns” from The Economist website linked below.

https://www.economist.com/leaders/2020/04/30/life-after-lockdowns

In many things 90% is just fine; in an economy it is miserable, and China shows why. The country started to end its lockdown in February. Factories are busy and the streets are no longer empty. The result is the 90% economy. It is better than a severe lockdown, but it is far from normal. The missing bits include large chunks of everyday life. Rides on the metro and on domestic flights are down by a third. Discretionary consumer spending, on such things as restaurants, has fallen by 40% and hotel stays are a third of normal. People are weighed down by financial hardship and the fear of a second wave of covid-19. Bankruptcies are rising and unemployment, one broker has said, is three times the official level, at around 20%.

If the post-lockdown rich world suffers its own brand of the 90% economy, life will be hard—at least until a vaccine or a treatment is found (see Briefing). A plunge in gdp in America of anything like 10% would be the largest since the second world war. The more suffering covid-19 causes, the more profound and enduring its economic, social and political effects are likely to be.

How lockdowns ease will itself affect the scale of economic damage. For instance, the cost-benefit calculus points towards opening schools first (see article). But, however sensibly restrictions are eased, powerful forces will hold economies back.

For a start, leaving lockdown is a process, not an event. Even when the worst is over, cases ebb slowly. A month after Italy's deaths peaked at about 900 a day, the toll is still over 300. With the virus still present, some social distancing is bound to stay.

A second reason is uncertainty. After lockdowns cease, much about the disease will remain unknown, including the chances of a second peak, whether immunity endures and the prospects for a vaccine or a cure. This inhibits those who fear the disease. Even as some states ease social distancing, a third of Americans say they would be uncomfortable visiting a mall. When Germany allowed small shops to open last week customers stayed away. Danes under lockdown cut household spending on services, such as travel and entertainment, by 80%. Danish economists reckon that people in next-door Sweden, which didn't lock down, cut spending by about as much.

Many businesses will emerge from lockdown short of money, with strained balance-sheets and facing weak demand. In a survey for Goldman Sachs, almost two-thirds of American small-business owners said that their cash would run out in under three months. In Britain the share of commercial tenants who have fallen behind on their rent has risen by 30 percentage points. This week the boss of Boeing warned that air travel would not match the level of 2019 for two or three years. Investment, which accounts for roughly a quarter of gdp, will fall, not just to conserve cash, but also because risk cannot be priced (one reason to think a recent stockmarket rally has weak foundations).

Struggling firms will deepen people's financial worries. Over a third of respondents in America told Pew Research that, if they lost their main source of income, their savings, new borrowings or the sale of assets would sustain them for no more than three months. Because the hardest-hit industries in the 90% economy employ a lot of low-wage people, joblessness will be high and casual work hard to come by. Even now in Europe's five largest economies, over 30m workers, a fifth of the labour force, are in special schemes where the state pays their wages. These can be generous, but nobody knows how long they will last.

The economy will also suffer from scarring. Firms that adapt to covid-19 by cutting costs and finding new ways of working may increase productivity. But if people mix less after lockdowns lift or if they are idle for months on end, they will become detached from professional networks and may lose skills. America's unemployed could face a lost decade (see Free exchange). Government schemes will save businesses in the short term, which is welcome. But those designed to preserve jobs risk eventually creating zombie firms that neither thrive nor go bankrupt, slowing the recycling of labour and capital.

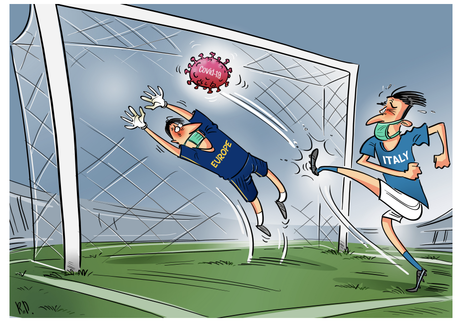
The longer the world has to endure a 90% economy, the less likely it is to snap back after the pandemic. After the Spanish flu a century ago and sars almost two decades ago, the overwhelming desire was for life to return to normal. But neither had such a large economic effect as covid-19, and citizens' expectations of government were more modest in 1918 than they are today.

A deep, long recession will stoke anger, because the pandemic has held up an unflattering mirror to rich societies. Ill-run care homes for the elderly, high rates of death among minorities, the extra demands holding back working women and, especially in America, health care that is hard to reach for many, will all lead to calls for reform. So might the realisation that an unfair burden has fallen on ordinary people. Americans earning less than $20,000 a year are twice as likely to have lost their job to covid-19 as someone earning over $80,000. Much will depend on how fast they are rehired.

The popular demand for change could radicalise politics faster than it did after the financial crisis in 2007-09. The task for those who believe in open markets and limited government is to ensure that this energy is channelled towards the right sort of change. If the pandemic lowers the barrier to reform it will offer a rare chance to recast the social contract to favour those who have been shut out, and to peg back those who today enjoy entrenched privileges through the tax system, education and regulation. Perhaps the pandemic will enhance a sense of national and global solidarity. Perhaps the success of countries like Germany and Taiwan that have dealt with the disease thanks to strong institutions will contrast with places where populist showmen have spent their time theatrically deriding expertise.

Yet that may prove to be wishful thinking. In the next 18 months everyone with an agenda will argue that the pandemic proves their point. After 2007-09 politicians failed to deal with the grievances of ordinary people and the demand for change led to a surge in populism. The 90% economy threatens even greater suffering. The anger it creates may end up feeding protectionism, xenophobia and government interference on a scale not seen in decades. If, like this newspaper, that is an outcome you would reject, it is time to start arguing for something better.

READING: Europe and the virus



- Discuss the difference between how the US borrow money compared to the EU nations.
- Discuss Spanish Flu compared to Covid-19.

Read article, “EU says pandemic recession will be worst in its history” From The Washington Post linked below:

https://www.washingtonpost.com/world/european-union-says-pandemic-recession-will-be-worst-in-its-history/2020/05/06/e787a70e-8f96-11ea-9322-a29e75effc93_story.html

BRUSSELS — The European Union warned Tuesday of a massive hit to Europe's economy from the coronavirus lockdowns, saying the contraction this year could be the worst in the continent's post-World War II history.

E.U. policymakers offered a grim forecast, predicting that even if the handling of the crisis goes smoothly and societies do not need to shutter again now that many have started easing restrictions, the economy of the European Union is expected to shrink by 7.4 percent in 2020. By comparison, Europe’s economy declined by just 4.4 percent in 2009, the worst year of the global financial crisis.

The forecast made clear that the pandemic has obliterated Europe’s slow recovery from that crisis. After a partial bounceback next year, the bloc’s economy will still be 3 percent below the previously forecast level by the end of 2021.

“It is now quite clear that the E.U. has entered the deepest economic recession in its history,” said Paolo Gentiloni, the top E.U. economic official, outlining a grim picture of rising unemployment and dashed opportunities.

Despite the expectation that the economy will grow by 6.1 percent next year, the forecast said that if infections rise again, another three percentage points could be shaved off the economy this year, worsening the crisis even more. If E.U. countries fail to coordinate their economic response, Gentiloni said, the crisis could also intensify.

Deep divides have emerged among E.U. members about how to fight the crisis. Southern European countries that have been hit hardest by the virus have pushed for transfers of money from the stronger nations in the bloc and for a collective effort to fend off the recession. Northern countries including the Netherlands and Germany are more skeptical.

The projections also made clear that the economic consequences of the pandemic will be unequally spread across Europe. Spain, Greece and Italy will be walloped by the crisis, with their tourism-dependent economies shrinking by more than 9 percent this year and recovering more slowly, since elements of the tourism sector may take a permanent hit. France would also take a blow, with a decline of 8.2 percent, while Germany would be relatively better off, shrinking 6.5 percent. Poland would be the least-affected country in Europe, with a drop of 4.3 percent.

The unequal blow may make a coordinated response more difficult among E.U. nations, with some countries feeling the crisis more keenly than others. The bloc was also somewhat hamstrung in 2008 and especially during the euro crisis that started two years later, when Greece needed multiple bailouts to keep afloat amid dissension about how generous other countries should be.

Unlike the United States, which can print and borrow an almost unlimited amount of money to finance its goals, countries that use the euro currency are more limited in their responses because they share control over the European Central Bank instead of directing monetary policy on a national level.

READING: Germany's response

- Discuss how you would ease lock-down restrictions.

Merkel says Germany has made progress as states take the lead on easing lockdowns.

Chancellor Angela Merkel of Germany on Wednesday laid out plans for restarting public life after meeting the heads of the country's 16 states, with those regions taking the lead in navigating the next steps of the response.

"I think that we can say today that we have the very first phase of the pandemic behind us," Ms. Merkel said.

In the second major phase of lifting Germany's lockdown, schools and day cares, restaurants and hotels, stores and nursing homes will be allowed to resume business in the coming days, although not necessarily as usual.

Citing numbers of new infections that had continued to drop since the country began reopening two weeks ago, the chancellor said that students could return to classrooms in staggered shifts, that children could go to day care facilities, and that some visitors would be allowed at nursing and care homes. Members of two separate households will be allowed to meet in public, so long as they keep a distance.

Based on plans to be drawn up by the governments of each state, all retailers, cafes and restaurants will be allowed to reopen, with hotels to follow by the end of the month. The country's professional soccer league will also be allowed to resume games, though stadiums will remain empty.

But even with the easing of the restrictions, people are required to practice social distancing and, in many places, wear masks. If at any point, the rate of new infections in a region reaches more than 50 per 100,000 people, a strict lockdown will be reimposed.

"We must be aware that we are still at the start of the pandemic and will continue to have to deal with the virus for a long time," Ms. Merkel said.

READING: Problems in Italy

Read the article linked below from Politico - Alitalia: Too Italian to fail
https://www.politico.com/news/2020/05/31/alitalia-too-italian-to-fail-293474

Italy just can't break up with Alitalia.

And it's an expensive relationship. After at least six failed rescue plans over the past 12 years, the Italian government has once again stepped in to prop up its flag carrier, now bludgeoned by the coronavirus crisis. Rome has decided to renationalize it with more than €3 billion of public money.

For both ordinary Italian voters and European Commission officials policing government subsidies, questions about how long Italy can keep treating an airline as the most sacred of cows (and keep shoveling money into a black hole) are only growing louder.

"Italians see Alitalia as a spaghetti strainer — you pour in money and it comes straight out," said one former manager. Indeed, the company has burned through an eye-watering €10 billion in bailouts and loans since it was privatized in 2008. "You could say the coronavirus has been both the worst thing and the best thing for Alitalia," the manager continued. "The losses have been enormous, but it has given the government an excuse to nationalize."

This nationalization, however, is triggering criticism not only from opposition parties, which favored a private investor, but also from some politicians inside the governing majority, who are questioning the wisdom of yet another rescue package.

In Brussels, the big question is whether Italy has violated the rulebook on state aid and a new framework specifically on coronavirus-related aid.

Alitalia has enjoyed a peculiarly talismanic status under successive Italian governments.

Prime ministers from Silvio Berlusconi to Matteo Renzi, representing both left and right-leaning administrations, have battled to keep the carrier in the skies, despite losses of €200 million-€300 million a year for the past five years.

Alitalia first took flight in 1946, later becoming the airline of choice for popes and film stars during the golden postwar reconstruction years. In Federico Fellini's "La Dolce Vita," Anita Ekberg flies Alitalia.

Its branding has long sought to embody the sexy Italy, a leader in food, fashion and design. Uniforms, created by designers including Giorgio Armani and Alberta Ferretti, are presented at catwalk fashion shows.

Politicians like to claim a national carrier is vital to Italy's strategic interests, facilitating business and tourism. But this has been overstated. Italy's air traffic is now dominated by no-frills airlines, with Alitalia transporting only around 10 percent of international passengers in 2018.

While almost never profitable, in the early 1990s the airline was among the European leaders. About 4 in 10 of Italy's international passengers used Alitalia.

But when the aviation market was liberalized, it failed to adapt to the competition: Unprofitable routes were kept running as convenient commuter routes for regional politicos and unionized staff prevented cuts. Its supposed inefficiency has long been the butt of jokes like "What does Alitalia stand for? Arrived Late In Tokyo. All Luggage in Athens."

Despite its shortcomings, Alitalia has always been too Italian to fail. To let it do so would be for Italy to concede that its status in the postwar economic primacy had declined irreversibly.

Besides the prestige that a national carrier affords, the airline is a significant employer — another reason successive governments have always been ready with the bailout bucket.

Entire commuter belt communities such as Ostia and Fiumicino, on the coast near Alitalia's Roman hub and key strongholds for the anti-establishment 5Star Movement in next year's election for mayor of Rome, would suffer severe economic damage if the airline collapsed.

The hub generates thousands more jobs around the airport, in ancillary services like food and maintenance, according to Giulia Lupo, a 5Star Movement senator and former air stewardess with Alitalia. "You see a company with 11,000 employees, but I see a large system that generates significant satellite activity," she wrote on Facebook.

With nothing to show for the years of bridging loans, bankruptcies and bailouts, the news that Alitalia is coming back like a bad boyfriend is deeply unwelcome.

At a time when resources are desperately needed in Italy, the scale of the bailout, equal to the amount to be spent on health care and twice what is earmarked for education, has played badly with ordinary Italians, under severe economic pressure in the lockdown.

There are numerous groups on Facebook with names like "Enough public money to Alitalia." One Twitter user wrote: "To waste more money now to keep [Alitalia] going would be like spitting in the face of those who are facing difficulty in the crisis. It is time to pull the plug."

The latest rescue plan, involving German carrier Lufthansa, failed in December, after unions wouldn't accept job cuts. The coalition government was still taking proposals from potential private investors when the coronavirus hit in March and sales dropped off a cliff, decreasing 76 percent year on year.

Even now there is still interest in buying Alitalia, whole or in part, from private players, including Bolivian-born billionaire Germán Efromovich's Synergy.

But some are skeptical that the government is listening. Opposition parties such as center-right Forza Italia oppose a takeover and say a new private investor can be found. Giorgio Mulé, Forza Italia transport spokesman, told POLITICO that renationalizing private companies "is part of 5Star's belief system ... This is a government that hates the free market. They have never explored the possible partnership offers from private business, rather they have treated them as an annoyance."

Even inside the governing majority, not everyone is convinced. Raffaella Paita of Italia Viva said the complete lack of any industrial strategy, on restructuring, routes, or joining a group of airlines, made the investment of more resources "incomprehensible," at a time when Italians are suffering.

Competitors claim that by helping Alitalia, the government could actually damage the Italian tourism industry. A Ryanair spokesman said the takeover "distorts the market, drives away business, creates higher prices for consumer and less connectivity."

Professor Andrea Giuricin, a transport economist at Milano Bicocca University, agrees. It risks "destroying air travel as we know it, returning it to a 1980s monopoly with only a few rich people who travel," he said.

The government's support of Alitalia may also be in violation of EU internal market rules on state aid. Ryanair Chief Executive Michael O'Leary has described airlines such as Lufthansa, Air France and Alitalia as "subsidy junkies running around Europe hoovering up state aid."

Ryanair told POLITICO it had raised the new state takeover with the Commission, but any decision will take years. The new aid is unlikely to be cleared under a new EU framework which says that funds can only go to companies that were in good health in December 2019.

The EU is already investigating Italy for two loans to Alitalia in 2017 and January this year totaling €1.3 billion. At the conclusion, Alitalia could be ordered to repay the total to Italy. But thanks to the restructuring, the old dead Alitalia would likely retain the debts and the new nationalized Alitalia would not be obliged to pay back the state, according to a state aid expert and former Commission official.

For Giuricin, the economist, the EU's failure to react promptly has been a "grave error" which "has given Alitalia the chance to distort the market with taxpayers' money. It is totally absurd."

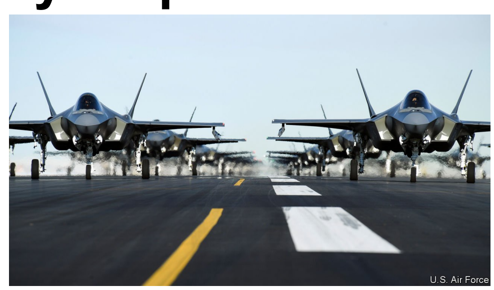
Italian Minister for Economic Development Stefano Patuanelli has claimed that the coronavirus has leveled the playing field in aviation, and that Alitalia"can once again be the feather in Italy's cap."

And there are signs that the new Alitalia could gain further advantages over competitors, such as imposed minimum wages for cabin-staff from foreign airlines travelling through Italy. Airport tax will now be diverted to help Alitalia with redundancy and other transition costs.

During the coronavirus outbreak, Alitalia is benefiting from running repatriation flights to and from Italy. It has also been awarded without any tender and with favorable conditions, the contract for operating off-season routes to Sardinia and other islands. But Alitalia's long-term problems are unlikely to be solved by a €3 billion cash injection. It is limited by having its hub in Rome, a tourist destination, rather than in the wealthy catchment area of northern Italy, and a lack of large jets for long-haul flights.

Already weak before the coronavirus, it is likely to need even more billions to keep running for the next few years. A different government, perhaps including the far-right League, Italy's most popular party, is no more likely to be the one to say Arrivederci. As the former Alitalia manager put it: "Every government passes the problem onto their successor; that's the way it has always been."

READING: How the military responds



- Discuss cutting the military budget.
- Discuss the importance of the military.

Read the article, "Peak Gun" from The Economist linked below.

https://www.economist.com/international/2020/04/26/global-arms-spending-is-rising-but-covid-19-will-trim-budgets

ACROSS THE world, the face of pandemic response has been not just the doctor, nurse and scientist, but also the soldier. Armies have built hospitals, enforced lockdowns and joined the hunt for a vaccine. That is not the usual business of soldiering, but armed forces must earn their substantial keep. Over \$1.9trn was lavished on military spending globally in 2019, the most in inflation-adjusted terms in more than three decades, according to a report published on April 27th by the Stockholm International Peace Research Institute (SIPRI), a think-tank. But as the world economy slumps and debt piles up, guns may lose out to butter.

Global military spending slumped after the end of the cold war, hitting a low of a little over \$1trn in the late 1990s (in 2018 dollars). It then shot up again in the 2000s, as America tooled up for its "war on terror" and China's economy took off. After a brief dip, spending has climbed each year since 2015, driven by competition between America and China, European fears of Russian aggression and an Arab arms-buying spree. But the league table has been shuffled over time.

America remains comfortably on top, despite some lean years. Total military spending, including the cost of operations around the world, declined continuously, by over a fifth, between 2010 and 2017, and remains 15% below its peak in 2010. But a heavyweight on a diet still packs a punch; the numbers are dizzying. America's outlay in 2019 grew by 5.3% to $732bn, almost two-fifths of the world's total and more than the next ten countries combined. Its year-on-year increase alone was equivalent to the entire annual military expenditure of Germany, notes SIPRI.

Moreover, America also widened the gap with second-placed China, which upped spending by 5.1% to $261bn, equivalent to just over a third of America's total. However, some experts argue that China's opaque military budgeting means that its spending is consistently underestimated, and that SIPRI's use of market exchange rates disguises the lower wages and cheaper prices available to lower-income countries.

Factor all that in and China's defense budget may in fact have reached around 87% of America's, suggests Frederico Bartels of the Heritage Foundation, a think-tank. Raw spending disguises technological advances, too. "China appears to be driving the military-technical competition in critical areas such as quantum science, biotechnology, hypersonics, and ballistic and cruise missiles," warns Robert Work, a former deputy secretary of defense in America.

Everyone else is a straggler by comparison. India, which has climbed from ninth place in 2010 to third in 2019, spent a relatively modest $71.1bn while Russia, whose long spending boom on tanks, missiles and warships is drawing to a close, splashed out $65.1bn (though, as with China, using exchange rates adjusted for purchasing power suggests a figure two or three times higher). Saudi Arabia's spending fell by 16%, but, at $61.9bn, remains formidable.

Notably, no western European country stands in the top five. Britain and France, once reliably in the top rank, and Germany, which is gradually rearming, each spent around $50bn or so. But closer to Russia's borders, budgets are swelling. Spending in central Europe was up by 14%, driven in large part by free-spending Poland. Despite NATO's various diplomatic travails—the alliance has been criticised by Donald Trump and Emmanuel Macron—its member states, excluding America, spent $303bn last year, more than even the most generous estimate of Russian expenditure.

That so many countries are spending so much on the means of war is little surprise. Tensions between America and China have worsened in recent years, and the pandemic has deepened mistrust. The breakneck pace of Chinese armament has driven up defence investment across Asia, from Vietnam to Australia. At the same time, arms-control regimes are collapsing and last year saw missiles criss-cross the Persian Gulf. Those trends look likely to continue. But for all that, military spending now faces some serious headwinds.

Bomb and bust?

Oil prices have crumbled to their lowest in decades, as global demand crashes. Even if a Saudi-brokered deal among producers to cut output holds, the collapse is likely to pummel petrostates who piled up weaponry during the fat years. Russia is expected to lose around $165bn in oil-and-gas export revenue in 2020 (based on an average oil price of $30 a barrel), about a third of its total exports, notes Tatiana Evdokimova, chief economist of Nordea, a bank. Saudi Arabia, Qatar and the United Arab Emirates, all big arms-buyers in recent years, are expected to cut government spending.

But democracies have little to cheer about, because the wider economic consequences of the covid-19 pandemic will be more severe still. The IMF forecasts that the world economy will shrink by 3% this year, the worst contraction since the Depression. America, Britain, Canada, France, Germany and Italy—the six largest spenders in NATO—are projected to be among the very worst-hit. Emergency spending to cushion the blow already runs to $8trn globally, or 9.5% of world output, and will leave a mountain of debt.

In these circumstances, political leaders are likely to face pressure to spend more on health and social safety-nets, and less on weapons. “We’re seeing signs that governments might begin delaying major acquisitions,” says Michael Formosa of Renaissance Strategic Advisors, a consultancy, which would leave smaller firms short of cash. “There's a very good chance that key parts of the supply chain will be distressed or in trouble in the very near term.”

South Korea has said that it will trim next year’s defense budget by 2% ($738m) and Thailand by 8% ($557m), with the money going instead to a disaster-relief fund and stimulus package respectively. Others are certain to follow. European cuts “could sound the death knell” to NATO’s target that allies spend 2% of GDP on defense, note Christopher Skaluba and Ian Brzezinski of the Atlantic Council, a think-tank. “That could reignite a burden-sharing debate damaging to transatlantic solidarity, and by consequence, the willingness of the United States to keep forces in Europe.”

But America will not emerge unscathed itself. The RAND Corporation, another think-tank, estimates that even if American defense spending remains steady at 3.2% of GDP, the Pentagon might have $350bn-600bn less than forecast under current plans over the next decade, about the same amount ($500bn) as under a massive budget sequestration initiated in 2011. That is probably a lower bound, says RAND, because input prices for American arms are likely to rise as post-pandemic production moves out of China.

National priorities “will lean first and foremost towards improved income and health security, and better resilience and infrastructure”, says Frank Hoffman of the National Defense University in Washington. In a worst-case scenario, he says, defense spending could fall to about $610bn, “a level that could require force reductions, reduce US basing and exercises overseas, and cuts in modernization plans”. If covid-19 is a war against the virus then the peace dividend will, as usual, go to the civilians.

READING: Leaders "Seize the Moment" A new opportunity to tackle climate change COVID-19

Following the pandemic is like watching the climate crisis with your finger jammed on the fast-forward button. Neither the virus nor greenhouse gases care much for borders, making both scourges global.

Both put the poor and vulnerable at greater risk than wealthy elites and demand government action on a scale hardly ever seen in peacetime. And with China’s leadership focused only on its own advantage and America’s as scornful of the World Health Organisation as it is of the Paris climate agreement, neither calamity is getting the co-ordinated international response it deserves. The two crises do not just resemble each other. They interact. Shutting down swathes of the economy has led to huge cuts in greenhouse-gas emissions. In the first week of April, daily emissions worldwide were 17% below what they were last year. The International Energy Agency expects global industrial greenhouse-gas emissions to be about 8% lower in 2020 than they were in 2019, the largest annual drop since the second world war.

That drop reveals a crucial truth about the climate crisis. It is much too large to be solved by the abandonment of planes, trains and automobiles. Even if people endure huge changes in how they lead their lives, this sad experiment has shown, the world would still have more than 90% of the necessary decarbonisation left to do to get on track for the Paris agreement's most ambitious goal, of a climate only 1.5°C warmer than it was before the Industrial Revolution.

But as we explain this week (see article) the pandemic both reveals the size of the challenge ahead and also creates a unique chance to enact government policies that steer the economy away from carbon at a lower financial, social and political cost than might otherwise have been the case. Rock-bottom energy prices make it easier to cut subsidies for fossil fuels and to introduce a tax on carbon. The revenues from that tax over the next decade can help repair battered government finances. The businesses at the heart of the fossil-fuel economy—oil and gas firms, steel producers, carmakers—are already going through the agony of shrinking their long-term capacity and employment. Getting economies in medically induced comas back on their feet is a circumstance tailor-made for investment in climate-friendly infrastructure that boosts growth and creates new jobs. Low interest rates make the bill smaller than ever. Take carbon-pricing first. Long cherished by economists (and The Economist), such schemes use the power of the market to incentivise consumers and firms to cut their emissions, thus ensuring that the shift from carbon happens in the most efficient way possible. The timing is particularly propitious because such prices have the most immediate effects when they tip the balance between two already available technologies. In the past it was possible to argue that, although prices might entrench an advantage for cleaner gas over dirtier coal, renewable technologies were too immature to benefit. But over the past decade the costs of wind and solar power have tumbled. A relatively small push from a carbon price could give renewables a decisive advantage—one which would become permanent as wider deployment made them cheaper still. There may never have been a time when carbon prices could achieve so much so quickly. Carbon prices are not as popular with politicians as they are with economists, which is why too few of them exist. But even before covid-19 there were hints their time was coming. Europe is planning an expansion of its carbon-pricing scheme, the largest in the world; China is instituting a brand new one. Joe Biden, who backed carbon prices when he was vice-president, will do so again in the coming election campaign—and at least some on the right will agree with that. The proceeds from a carbon tax could raise over 1% of gdp early on and would then taper away over several decades. This money could either be paid as a dividend to the public or, as is more likely now, help lower government debts, which are already forecast to reach an average of 122% of gdp in the rich world this year, and will rise further if green investments are debt-financed.

Carbon pricing is only part of the big-bang response now possible. By itself, it is unlikely to create a network of electric-vehicle charging-points, more nuclear power plants to underpin the cheap but intermittent electricity supplied by renewables, programmes to retrofit inefficient buildings and to develop technologies aimed at reducing emissions that cannot simply be electrified away, such as those from large aircraft and some farms. In these areas subsidies and direct government investment are needed to ensure that tomorrow's consumers and firms have the technologies which carbon prices will encourage.

Some governments have put their efforts into greening their covid-19 bail-outs. Air France has been told either to scrap domestic routes that compete with high-speed trains, powered by nuclear electricity, or to forfeit taxpayer assistance. But dirigisme disguised as a helping hand could have dangerous consequences: better to focus on insisting that governments must not skew their bail-outs towards fossil fuels. In other countries the risk is of climate-damaging policies. America has been relaxing its environmental rules further during the pandemic. China—whose stimulus for heavy industry sent global emissions soaring after the global financial crisis—continues to build new coal plants. The covid-19 pause is not inherently climate-friendly. Countries must make it so. Their aim should be to show by 2021, when they gather to take stock of progress made since the Paris agreement and commit themselves to raising their game, that the pandemic has been a catalyst for a breakthrough on the environment. Covid-19 has demonstrated that the foundations of prosperity are precarious. Disasters long talked about, and long ignored, can come upon you with no warning, turning life inside out and shaking all that seemed stable. The harm from climate change will be slower than the pandemic but more massive and longer-lasting. If there is a moment for leaders to show bravery in heading off that disaster, this is it. They will never have a more attentive audience.

A new projection finds the virus costing the U.S. economy $7.9 trillion. Poor countries face a debt crisis.

The Congressional Budget Office projected on Monday that the pandemic would inflict a devastating long-term blow to the United States economy, costing $7.9 trillion over the next decade, or a 3 percent loss in "real" gross domestic product.

Without adjusting for inflation, the agency said, the pandemic would cost $16 trillion over the next 10 years. The estimates were an official tally of the damage from the crisis, reflecting expectations of dampened consumer spending and business investment in the years to come. Much of the diminished output was projected to be a result of weaker inflation, as prices for energy and transportation are expected to increase more slowly than they otherwise would have as Americans pull back on travel.

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Phillip L. Swagel, the director of the budget office, cautioned that "an unusually high degree of uncertainty surrounds these economic projections," because it remained unknown how the pandemic would unfold during the remainder of the year or how social distancing and any future relief measures enacted by the federal government might affect its impact.

Around the world, developing countries, from Angola to Ecuador to Zambia, have also seen their finances shredded by the pandemic.

The low interest rates of the last decade allowed poor countries to raise money relatively cheaply to finance their growth. As a result, developing countries now owe record amounts of money to investors, governments and others outside their borders: $2.1 trillion for countries ranked as "low income" and "lower-middle income" by the World Bank.

The president of Tanzania has called on "our rich brothers" to cancel his country's debt. Belarus veered toward a default when a promised $600 million loan from Russia fell through. Lebanon, troubled even before the pandemic, has embarked on its first debt restructuring. And Argentina has defaulted for the ninth time in its history.

Cochrane, Emily. June 1st 2020. New York Times.
link: https://www.nytimes.com/2020/06/01/us/politics/coronavirus-economy.html

MODULE 4: Regional and International Trade

OVERVIEW

In module 4, we will look at different cultural aspects of international trade as well as ethical and legal issues that may arise. Furthermore, we will explore the political challenges of operating a company in a global market and understand how important NAFTA is for regional economic integration.

READING: DUNKIN' BRANDS - DUNKIN' DONUTS AND BASKIN-ROBBINS - MAKING LOCAL GLOBAL

High-tech and digital news may dominate our attention globally, but no matter where you go, people still need to eat. Food is a key part of many cultures. It is part of the bonds of our childhood, creating warm memories of comfort food or favorite foods that continue to whet our appetites. So it's no surprise that sugar and sweets are a key part of our food focus, no matter what the culture. Two of the most visible American exports are the twin brands of Dunkin' Donuts and Baskin-Robbins.

Owned today by a consortium of private equity firms known as the Dunkin' Brands, Dunkin' Donuts and Baskin-Robbins have been sold globally for more than thirty-five years. Today, the firm has more than 14,800 points of distribution in forty-four countries with $6.9 billion in global sales.

After an eleven-year hiatus, Dunkin' Donuts returned to Russia in 2010 with the opening of twenty new stores. Under a new partnership, "the planned store openings come 11 years after Dunkin' Donuts pulled out of Russia, following three years of losses exacerbated by a rogue franchisee who sold liquor and meat pies alongside coffee and crullers." [1] Each culture has different engrained habits, particularly in the choices of food and what foods are appropriate for what meals. The more globally aware businesses are mindful of these issues and monitor their overseas operations and partners. One of the key challenges for many companies operating globally with different resellers, franchisees, and wholly owned subsidiaries is the ability to control local operations.

This wasn't the first time that Dunkin' had encountered an overzealous local partner who tried to customize operations to meet local preferences and demands. In Indonesia in the 1990s, the company was surprised to find that local operators were sprinkling a mild, white cheese on a custard-filled donut. The company eventually approved the local customization since it was a huge success. [2]

Dunkin' Donuts and Baskin-Robbins have not always been owned by the same firm. They eventually came under one entity in the late 1980s—an entity that sought to leverage the two brands. One of the overall strategies was to have the morning market covered by Dunkin' Donuts and the afternoon-snack market covered by Baskin-Robbins. It is a strategy that worked well in the United States and was one the company employed as it started operating and expanding in different countries. The company was initially unprepared for the wide range of local cultural preferences and habits that would culturally impact its business. In Russia, Japan, China, and most of Asia, donuts, if they were known at all, were regarded more as a sweet type of bakery treat, like an éclair or cream puff. Locals primarily purchased and consumed them at shopping malls as an "impulse purchase" afternoon-snack item and not as a breakfast food.

In fact, in China, there was no equivalent word for "donut" in Mandarin, and European-style baked pastries were not common outside the Shanghai and Hong Kong markets. To further complicate Dunkin' Donuts's entry into China, which took place initially in Beijing, the company name could not even be phonetically spelled in Chinese characters that made any sense, as Baskin-Robbins had been able to do in Taiwan. After extensive discussion and research, company executives decided that the best name and translation for *Dunkin' Donuts* in China would read *Sweet Sweet Ring* in Chinese characters.

Local cultures also impacted flavors and preferences. For Baskin-Robbins, the flavor library is controlled in the United States, but local operators in each country have been the source of new flavor suggestions. In many cases, flavors that were customized for local cultures were added a decade later to the main menus in major markets, including the United States. Mango and green tea were early custom ice cream flavors in the 1990s for the Asian market. In Latin America, *dulce de leche* became a favorite flavor. Today, these flavors are staples of the North American flavor menu.

One flavor suggestion from Southeast Asia never quite made it onto the menu. The durian fruit is a favorite in parts of Southeast Asia, but it has a strong, pungent odor. Baskin-Robbins management was concerned that the strong odor would overwhelm factory operations. (The odor of the durian fruit is so strong that the fruit is often banned in upscale hotels in several Asian countries.) While the durian never became a flavor, the company did concede to making ice cream flavored after the *ube*, a sweetened purple yam, for the Philippine market. It was already offered in Japan, and the company extended it to the Philippines. In Japan, sweet corn and red bean ice cream were approved for local sale and became hot sellers, but the two flavors never made it outside the country.

When reviewing local suggestions, management conducts a market analysis to determine if the global market for the flavor is large enough to justify the investment in research and development and eventual production. In addition to the market analysis, the company always has to make sure they have access to sourcing quality flavors and fruit. Mango proved to be a challenge, as finding the correct fruit puree differed by country or culture. Samples from India, Hawaii, Pakistan, Mexico, the Philippines, and Puerto Rico were taste-tested in the mainland United States. It seems that the mango is culturally regarded as a national treasure in every country where it is grown, and every country thinks its mango is the best. Eventually the company settled on one particular flavor of mango.

A challenging balance for Dunkin' Brands is to enable local operators to customize flavors and food product offerings without diminishing the overall brand of the companies. Russians, for example, are largely unfamiliar with donuts, so Dunkin' has created several items that specifically appeal to Russian flavor preferences for scalded cream and raspberry jam.[3]

In some markets, one of the company's brands may establish a market presence first. In Russia, the overall "Dunkin' Brands already ranks as a dessert purveyor. Its Baskin-Robbins ice-cream chain boasts 143 shops there, making it the No. 2 Western restaurant brand by number of stores behind the hamburger chain McDonald's Corp." [4] The strength of the company's ice cream brand is now enabling Dunkin' Brands to promote the donut chain as well.

[1] Kevin Helliker, "Dunkin' Donuts Heads Back to Russia," Wall Street Journal, April 27, 2010, accessed February 15, 2011,http://online.wsj.com/article/SB10001424052748704464704575208320044839374.html.

[2] David Jenkins (former director, International Operations Development, Allied-Domecq QSR International Ltd.), interview with the author, 2010.

[3] Kevin Helliker, "Dunkin' Donuts Heads Back to Russia," Wall Street Journal, April 27, 2010, accessed February 15, 2011,http://online.wsj.com/article/SB10001424052748704464704575208320044839374.html.

[4] Kevin Helliker, "Dunkin' Donuts Heads Back to Russia," Wall Street Journal, April 27, 2010, accessed February 15, 2011,http://online.wsj.com/article/SB10001424052748704464704575208320044839374.html.

Global Business Ethics

The field of ethics is a branch of philosophy that seeks virtue and morality, addressing questions about "right" and "wrong" behavior for people in a variety of settings; the standards of behavior that tell how human beings ought to act. is a branch of philosophy that seeks to address questions about morality—that is, about concepts such as good and bad, right and wrong, justice, and virtue. Ethics impacts many fields—not just business—including medicine, government, and science, to name a few. We must first try to understand the "origins of ethics—whether they come from religion, philosophy, the laws of nature, scientific study, study of political theory relating to ethical norms created in society or other fields of knowledge." The description below on the field of ethics shows how people think about ethics in stages, from where ethical principles come from to how people should apply them to specific tasks or issues.

This approach will be used in this chapter to help you understand global business ethics in a modern and current sense. As with this chapter's review of culture, this section on global business ethics is less about providing you with a tangible list of dos and don'ts than it is about helping you understand the thinking and critical issues that global managers must deal with on an operational and strategic basis.

Where Do Our Values Come From?

Just as people look to history to understand political, technical, and social changes, so too do they look for changes in thinking and philosophy. There is a history to how thinking has evolved over time. What may or may not have been acceptable just a hundred years ago may be very different today—from how people present themselves and how they act and interact to customs, values, and beliefs.

Ethics can be defined as a system of moral standards or values. Cultural beliefs and programming influence our values. A sense of ethics is determined by a number of social, cultural, and religious factors; this sense influences us beginning early in childhood. People are taught how to behave by their families, exposure to education and thinking, and the society in which they live. Ethical behavior also refers to behavior that is generally accepted within a specific culture. Some behaviors are universally accepted—for example, people shouldn't physically hurt other people. Other actions are less clear, such as discrimination based on age, race, gender, or ethnicity.

Culture impacts how local values influence global business ethics. There are differences in how much importance cultures place on specific ethical behaviors. For example, bribery remains widespread in many countries, and while people may not approve of it, they accept it as a necessity of daily life. Each professional is influenced by the values, social programming, and experiences encountered from childhood on. These collective factors impact how a person perceives an issue and the related correct or incorrect behaviors. Even within a specific culture, individuals have different ideas of what constitutes ethical or unethical behavior. Judgments may differ greatly depending on an individual's social or economic standing, education, and experiences with other cultures and beliefs. Just as in the example of bribery, it should be noted that there is a difference between ethical behavior and normal practice. It may be acceptable to discriminate in certain cultures, even if the people in that society know that it is not right or fair. In global business ethics, people try to understand what the ethical action is and what the normal practice might be. If these are not consistent, the focus is placed on how to encourage ethical actions.

While it's clear that ethics is not religion, values based on religious teachings have influenced our understanding of ethical behavior. Given the influence of Western thought and philosophy over the world in the last few centuries, many would say that global business has been heavily impacted by the mode of thinking that began with the Reformation and post-Enlightenment values, which placed focus on equality and individual rights. In this mode of thinking, it has become accepted that all people in any country and of any background are equal and should have equal opportunity. Companies incorporate this principle in their employment, management, and operational guidelines; yet enforcing it in global operations can be both tricky and inconsistent.

Did You Know?

What Are the Reformation and Enlightenment?

Modern political and economic philosophies trace their roots back to the Reformation and Enlightenment. The Reformation was a period of European history in the sixteenth century when Protestant thinkers, led by Martin Luther, challenged the teachings of the Roman Catholic Church. As a result of the Reformation, the Catholic Church lost its control over all scientific and intellectual thought. While there were a number of debates and discussions over the ensuing decades and century, the Reformation is widely believed to have led to another historical period called the Age of Enlightenment, which refers to a period in Western philosophical, intellectual, scientific, and cultural life in the eighteenth century. The Enlightenment, as it is commonly called, promoted a set of values in which reason, not religion, was advocated as the primary source for legitimacy and authority. As a result, it is also known as the Age of Reason.

It's important to understand the impact and influence of these two critical historical periods on our modern sense of global business ethics. The prevailing corporate values—including those of institutional and individual equality; the right of every employee to work hard and reap the rewards, financial and nonfinancial; corporate social responsibility; and the application of science and reason to all management and operational processes—have their roots in the thoughts and values that arose during these periods.

Impact of Ethics on Global Business

At first, it may seem relatively easy to identify unethical behavior. When the topic of business ethics is raised, most people immediately focus on corruption and bribery. While this is a critical result of unethical behavior, the concept of business ethics and—in the context of this book—global business ethics is much broader. It impacts human resources, social responsibility, and the environment. The areas of business impacted by global perceptions of ethical, moral, and socially responsible behavior include the following:

- Ethics and management
- Ethics and corruption
- Corporate social responsibility

Ethics and Management Practices

Ethics impacts various aspects of management and operations, including human resources, marketing, research and development, and even the corporate mission.

The role of ethics in management practices, particularly those practices involving human resources and employment, differs from culture to culture. Local culture impacts the way people view the employee-employer relationship. In many cultures, there are no clear social rules preventing discrimination against people based on age, race, gender, sexual preference, handicap, and so on. Even when there are formal rules or laws against discrimination, they may not be enforced, as normal practice may allow people and companies to act in accordance with local cultural and social practices.

Culture can impact how people see the role of one another in the workplace. For example, gender issues are at times impacted by local perceptions of women in the workplace. So how do companies handle local customs and values for the treatment of women in the workplace? If you're a senior officer of an American company, do you send a woman to Saudi Arabia or Afghanistan to negotiate with government officials or manage the local office? Does it matter what your industry is or if your firm is the seller or buyer? *In theory*, most global firms have clear guidelines articulating antidiscrimination policies. *In reality*, global businesses routinely self-censor. Companies often determine whether a person—based on their gender, ethnicity, or race—can be effective in a specific culture based on the prevailing values in that culture. The largest and most respected global companies, typically the *Fortune* Global 500, can often make management and employment decisions regardless of local practices. Most people in each country will want to deal with these large and well-respected companies. The person representing the larger company brings the clout of their company to any business interaction. In contrast, lesser-known, midsize, and smaller companies may find that *who* their representative is will be more important. Often lacking business recognition in the marketplace, these smaller and midsize companies have to rely on their corporate representatives to create the professional image and bond with their in-country counterparts.

Cultural norms may make life difficult for the company as well as the employee. In some cultures, companies are seen as "guardians" or paternal figures. Any efforts to lay off or fire employees may be perceived as culturally unethical. In Japan, where lifelong loyalty to the company was expected in return for lifelong employment, the decade-long recession beginning in the 1990s triggered a change in attitude. Japanese companies finally began to alter this ethical perception and lay off workers without being perceived as unethical.

Global corporations are increasingly trying to market their products based not only on the desirability of the goods but also on their social and environmental merits. Companies whose practices are considered unethical may find their global performance impacted when people boycott their products. Most corporations understand this risk. However, ethical questions have grown increasingly complicated, and the "correct" or ethical choice has, in some cases, become difficult to define.

For example, the pharmaceutical industry is involved in a number of issues that have medical ethicists squirming. First, there's the well-publicized issue of cloning. No matter *what* choice the companies make about cloning, they are sure to offend a great many consumers. At the same time, pharmaceutical companies must decide whether to forfeit profits and give away free drugs or cheaper medicines to impoverished African nations. Pharmaceutical companies that *do* donate medicines often promote this practice in their corporate marketing campaigns in hopes that consumers see the companies in a favorable light.

Tobacco companies are similarly embroiled in a long-term ethical debate. Health advocates around the world agree that smoking is bad for a person's long-term health. Yet in many countries, smoking is not only acceptable but can even confer social status. The United States has banned tobacco companies from adopting marketing practices that target young consumers by exploiting tobacco's social cache. However, many other countries don't have such regulations. Should tobacco companies be held responsible for knowingly marketing harmful products to younger audiences in other countries?

Ethics and Corruption

To begin our discussion of corruption, let's first define it in a business context. Corruption is "giving or obtaining advantage through means which are illegitimate, immoral, and/or inconsistent with one's duty or the rights of others. Corruption often results from patronage.

Our modern understanding of business ethics notes that following culturally accepted norms is not always the ethical choice. What may be acceptable at certain points in history, such as racism or sexism, became unacceptable with the further development of society's mind-set. What happens when cultures change but business practices don't? Does that behavior become unethical, and is the person engaged in the behavior unethical? In some cultures, there may be conflicts with global business practices, such as in the area of gift giving, which has evolved into bribery—a form of corruption.

Paying bribes is relatively common in many countries, and bribes often take the form of *grease payments*, which are small inducements intended to expedite decisions and transactions. In India and Mexico, for example, a grease payment may help get your phones installed faster—at home or at work. Transparency International tracks illicit behavior, such as bribery and embezzlement, in the public sector in 180 countries by surveying international business executives. It assigns a CPI (Corruption Perceptions Index) rating to each country. New Zealand, Denmark, Singapore, and Sweden have the lowest levels of corruption, while the highest levels of corruption are seen in most African nations, Russia, Myanmar, and Afghanistan.

Even the most respected of global companies has found itself on the wrong side of the ethics issue and the law. In 2008, after years of investigation, Siemens agreed to pay more than 1.34 billion euros in fines to American and European authorities to settle charges that it routinely used bribes and slush funds to secure huge public-works contracts around the world. "Officials said that Siemens, beginning in the mid-1990s, used bribes and kickbacks to foreign officials to secure government contracts for projects like a national identity card project in Argentina, mass transit work in Venezuela, a nationwide cell phone network in Bangladesh and a United Nations oil-for-food program in Iraq under Saddam Hussein. 'Their actions were not an anomaly,' said Joseph Persichini Jr., the head of the Washington office of the Federal Bureau of Investigation. 'They were standard operating procedures for corporate executives who viewed bribery as a business strategy.'"

Ethics in Action

Each year Transparency International analyzes trends in global corruption. The following is an excerpt from their 2010 Global Corruption Barometer report.

“Corruption has increased over the last three years, say six out of 10 people around the world. One in four people report paying bribes in the last year. These are the findings of the 2010 Global Corruption Barometer.

The 2010 Barometer captures the experiences and views of more than 91,500 people in 86 countries and territories, making it the only world-wide public opinion survey on corruption.

Views on corruption were most negative in Western Europe and North America, where 73 per cent and 67 per cent of people respectively thought corruption had increased over the last three years.

“The fall-out of the financial crises continues to affect people’s opinions of corruption, particular in North America and Western Europe. Institutions everywhere must be resolute in their efforts to restore good governance and trust,” said Huguette Labelle, Chair of Transparency International.

In the past 12 months one in four people reported paying a bribe to one of nine institutions and services, from health to education to tax authorities. The police are cited as being the most frequent recipient of bribes, according to those surveyed. About 30 per cent of those who had contact with the police reported having paid a bribe.

More than 20 countries have reported significant increases in petty bribery since 2006. The biggest increases were in Chile, Colombia, Kenya, FYR Macedonia, Nigeria, Poland, Russia, Senegal and Thailand. More than one in two people in Sub-Saharan Africa reported paying a bribe—more than anywhere else in the world.

Poorer people are twice as likely to pay bribes for basic services, such as education, than wealthier people. A third of all people under the age of 30 reported paying a bribe in the past 12 months, compared to less than one in five people aged 51 years and over.

Most worrying is the fact that bribes to the police have almost doubled since 2006, and more people report paying bribes to the judiciary and for registry and permit services than five years ago.

Sadly, few people trust their governments or politicians. Eight out of 10 say political parties are corrupt or extremely corrupt, while half the people questioned say their government’s action to stop corruption is ineffective.

“The message from the 2010 Barometer is that corruption is insidious. It makes people lose faith. The good news is that people are ready to act,” said Labelle. “Public engagement in the fight against corruption will force those in authority to act—and will give people further courage to speak out and stand up for a cleaner, more transparent world.” *Source: Transparency International, “Global Corruption Barometer 2010,” accessed February 22, 2011, http://www.transparency.org/policy_research/surveys_indices/gcb/2010.*

Gift giving in the global business world is used to establish or pay respects to a relationship. Bribery, on the other hand, is more commonly considered the practice in which an individual would benefit with little or no benefit to the company. It’s usually paid in relation to winning a business deal, whereas gift giving is more likely to be ingrained in the culture and not associated with winning a specific piece of business. Bribery, usually in the form of a cash payment, has reached such high proportions in some countries that even locals express disgust with the corruption and its impact on daily life for businesses and consumers.

The practice of using connections to advance business interests exists in just about every country in the world. However, the extent and manner in which it is institutionalized differs from culture to culture.

In Western countries, connections are viewed informally and sometimes even with a negative connotation. In the United States and other similar countries, professionals prefer to imply that they have achieved success on their own merits and without any connections. Gift giving is not routine in the United States except during the winter holidays, and even then gift giving involves a modest expression. Businesses operating in the United States send modest gifts or cards to their customers to thank them for business loyalty in the previous year. Certain industries, such as finance, even set clear legal guidelines restricting the value of gifts, typically a maximum of $100.

In contrast, Asian, Latin American, and Middle Eastern cultures are quick to value connections and relationships and view them quite positively. Connections are considered essential for success. In Asia, gift giving is so ingrained in the culture, particularly in Japan and China, that it is formalized and structured.

For example, gift giving in Japan was for centuries an established practice in society and is still taken seriously. There are specific guidelines for gift giving depending on the identity of the giver or recipient, the length of the business relationship, and the number of gifts exchanged. The Japanese may give gifts out of a sense of obligation and duty as well as to convey feelings such as gratitude and regret. Therefore, much care is given to the appropriateness of the gift as well as to its aesthetic beauty. Gift giving has always been widespread in Japan.

Today there are still business gift-giving occasions in Japan, specifically *oseibo* (year's end) and *ochugen* (midsummer). These are must-give occasions for Japanese businesses. Oseibo gifts are presented in the first half of December as a token of gratitude for earlier favors and loyalty. This is a good opportunity to thank clients for their business. *Ochugen* usually occurs in mid-July in Tokyo and mid-August in some other regions. Originally an occasion to provide consolation to the families of those who had died in the first half of the year, ochugen falls two weeks before *obon*, a holiday honoring the dead.

Businesses operating in Japan at these times routinely exchange oseibo and ochugen gifts. While a professional is not obligated to participate, it clearly earns goodwill. At the most senior levels, it is not uncommon for people to exchange gifts worth $300 or $400. There is an established price level that one should pay for each corporate level.

Despite these guidelines, gift giving in Japan has occasionally crossed over into bribery. This level of corruption became more apparent in the 1980s as transparency in global business gained media attention. Asians tend to take a very different view of accountability than most Westerners. In the 1980s and 1990s, several Japanese CEOs resigned in order to apologize and take responsibility for their companies' practices, even when they did not personally engage in the offending practices. This has become an accepted managerial practice in an effort to preserve the honor of the company. While Japanese CEOs may not step down as quickly as in the past, the notion of honor remains an important business characteristic.

Long an established form of relationship development in all business conducted in Asia, the Arab world, and Africa, gift giving was clearly tipping into outright bribery. In the past two decades, many countries have placed limits on the types and value of gifts while simultaneously banning bribery in any form. In the United States, companies must adhere to the Foreign Corrupt Practices Act, a federal law that specifically bans any form of bribery. Even foreign companies that are either listed on an American stock exchange or conduct business with the US government come under the purview of this law.

There are still global firms that engage in questionable business gift giving; when caught, they face fines and sanctions. But for the most part, firms continue with business as usual. Changing the cultural practices of gift giving is an evolving process that will take time, government attention, and more transparency in the awarding of global business contracts.

Companies and their employees routinely try to balance ethical behavior with business interests. While corruption is now widely viewed as unethical, firms still lose business to companies that may be less diligent in adhering to this principle. While the media covers stories of firms that have breached this ethical conduct, the misconduct of many more companies goes undetected. Businesses, business schools, and governments are increasingly making efforts to deter firms and professionals from making and taking bribes. There are still countless less visible gestures that some would argue are also unethical. For example, imagine that an employee works at a firm that wants to land a contract in China. A key government official in China finds out that you went to the business school that his daughter really wants to attend. He asks you to help her in the admission process. Do you? Should you? Is this just a nice thing to do, or is it a potential conflict of interest if you think the official will view your company more favorably? This is a gray area of global business ethics. Interestingly, a professional's answer to this situation may depend on his or her culture. Cultures that have clear guidelines for right and wrong behavior may see this situation differently than a culture in which doing favors is part of the normal practice. A company may declare this inappropriate behavior, but employees may still do what they think is best for their jobs. Cultures that have a higher tolerance for ambiguity, as this chapter discusses, may find it easier to navigate the gray areas of ethics—when it is not so clear.

Most people agree that bribery in any form only increases the cost of doing business—a cost that is either absorbed by the company or eventually passed on to the buyer or consumer in some form. While businesses agree that corruption is costly and undesirable, losing profitable business opportunities to firms that are less ethically motivated can be just as devastating to the bottom line. Until governments in every country consistently monitor and enforce anticorruption laws, bribery will remain a real and very challenging issue for global businesses.

Corporate Social Responsibility

Corporate social responsibility (CSR) is defined in Wikipedia as “the corporate conscience, citizenship, social performance, or sustainable responsible business, and is a form of corporate self-regulation integrated into a business model. CSR policy functions as a built-in, self-regulating mechanism whereby business monitors and ensures its active compliance with the spirit of the law, ethical standards, and international norms.”

CSR emerged more than three decades ago, and it has gained increasing strength over time as companies seek to generate goodwill with their employees, customers, and stakeholders. “Corporate social responsibility encompasses not only what companies do with their profits, but also how they make them. It goes beyond philanthropy and compliance and addresses how companies manage their economic, social, and environmental impacts, as well as their relationships in all key spheres of influence: the workplace, the marketplace, the supply chain, the community, and the public policy realm.” *Source: “Defining Corporate Social Responsibility,” Corporate Social Responsibility Initiative, Harvard Kennedy School, last modified 2008, accessed March 26, 2011, http://www.hks.harvard.edu/m-rcbg/CSRI/init_define.html*.

Companies may support nonprofit causes and organizations, global initiatives, and prevailing themes. Promoting environmentally friendly and green initiatives is an example of a current prevailing theme.

Coca-Cola is an example of global corporation with a long-term commitment to CSR. In many developing countries, Coca-Cola promotes local economic development through a combination of philanthropy and social and economic development. Whether by using environmentally friendly containers or supporting local education initiatives through its foundation, Coca-Cola is only one of many global companies that seek to increase their commitment to local markets while enhancing their brand, corporate image, and reputation by engaging in socially responsible business practices.

Companies use a wide range of strategies to communicate their socially responsible strategies and programs. Under the auspices of the United Nations, the Global Compact “is a strategic policy initiative for businesses that are committed to aligning their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption.”

Enforcement of Ethical Guidelines and Standards

The concept of culture impacting the perception of ethics is one that many businesspeople debate. While culture does impact business ethics, international companies operate in multiple countries and need a standard set of global operating guidelines. Professionals engage in unethical behavior primarily as a result of their own personal ethical values, the corporate culture within a company, or from unrealistic performance expectations

In the interest of expediency, many governments—the US government included—may not strictly enforce the rules governing corporate ethics. The practice of gift giving is one aspect of business that many governments don’t examine too closely. Many companies have routinely used gifts to win favor from their customers, without engaging in direct bribery. American companies frequently invite prospective buyers to visit their US facilities or attend company conferences in exotic locales with all expenses paid. These trips often have perks included. Should such spending be considered sales and marketing expenses, as they are often booked, or are these companies engaging in questionable behavior? It’s much harder to answer this question when you consider that most of the company’s global competitors are likely to engage in similarly aggressive marketing and sales behavior.

Governments often do not enforce laws until it’s politically expedient to do so. Take child labor, for example. Technically, companies operating in India or Pakistan are not permitted to use child labor in factories, mines, and other areas of hazardous employment. However, child labor is widespread in these countries due to deep-rooted social and economic challenges. Local governments are often unable and unwilling to enforce national rules and regulations. Companies and consumers who purchase goods made by children are often unaware that these practices remain unchecked.

The Evolution of Ethics

Ethics evolves over time. It is difficult for both companies and professionals to operate within one set of accepted standards or guidelines only to see them gradually evolve or change. For example, bribery has been an accepted business practice for centuries in Japan and Korea. When these nations adjusted their practices in order to enter the global system, the questionable practices became illegal. Hence a Korean businessman who engaged in bribery ten or twenty years ago may not do so today without finding himself on the other side of the law. Even in the United States, discrimination and business-regulation laws have changed tremendously over the last several decades. And who can know what the future holds? Some of the business practices that are commonly accepted today may be frowned on tomorrow.

It's clear that changing values, as influenced by global media, and changing perceptions and cultures will impact global ethics. The most challenging aspect is that global business does not have a single definition of "fair" or "ethical." While culture influences the definitions of those ideas, many companies are forced to navigate this sensitive area very carefully, as it impacts both their bottom line and their reputations.

KEY TAKEAWAYs

- Culture impacts how local values influence the concept of global business ethics. Each professional is influenced by the values, social programming, and experiences he or she has absorbed since childhood. These collective factors impact how a person perceives an issue and the related correct or incorrect behavior. For some cultures, the evolution of international business and culture sometimes creates a conflict, such as what is seen in gift-giving practices or views on women in the workplace.
- Ethics impacts global business in the areas of management, corruption, and corporate social responsibility.

VIDEO: LESSONS ABOUT TRUST LEARNED FROM GLOBALIZATION

This video was prepared by the Institute for Corporate Ethics, presented by Andrew Wicks of UVA's Darden School of Business.

Watch Optimal Trust on the Interpersonal Level: https://youtu.be/BRn_HSjt37g

VIDEO: TYPES OF TRADE RESTRICTIONS

From YouTube description: "In this video, I go over the types of tools that might be used to restrict trade, and the effects of trade restrictions."

Watch Types of Trade Restrictions: https://youtu.be/_e2gQxN1OBg

READING: INTERNATIONAL ECONOMIC COOPERATION AMONG NATIONS

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- Understand the global trading system.
- Explain how and why the GATT was created and what its historical role in international trade is.
- Know what the WTO is and what its current impact on international trade is.

In the post–World War II environment, countries came to realize that a major component of achieving any level of global peace was global cooperation—politically, economically, and socially. The intent was to level the trade playing field and reduce economic areas of disagreement, since inequality in these areas could lead to more serious conflicts. Among the initiatives, nations agreed to work together to promote free trade, entering into bilateral and multilateral agreements. The General Agreement on Tariffs and Trade (GATT) resulted from these agreements. In this section, you'll review GATT—why it was created and what its historical successes and challenges are. You'll then look at the World Trade Organization (WTO), which replaced GATT in 1995, and study the impact of both these organizations on international trade. While GATT started as a set of rules between countries, the WTO has become an institution overseeing international trade.

General Agreement on Tariffs and Trade (GATT)

The General Agreement on Tariffs and Trade (GATT) is a series of rules governing trade that were first created in 1947 by twenty-three countries. By the time it was replaced with the WTO, there were 125 member nations. GATT has been credited with substantially expanding global trade, primarily through the reduction of tariffs.

The basic underlying principle of GATT was that trade should be free and equal. In other words, countries should open their markets equally to member nations, and there should be neither discrimination nor preferential treatment. One of GATT's key provisions was the most-favored-nation clause (MFN). It required that once a benefit, usually a tariff reduction, was agreed on between two or more countries, it was automatically extended to all other member countries. GATT's initial focus was on tariffs, which are taxes placed on imports or exports.

Did You Know?

MFN Is Everywhere

As a concept, MFN can be seen in many aspects of business; it's an important provision. Companies require MFN of their trading partners for pricing, access, and other provisions. Corporate or government customers require it of the company from which they purchase goods or services. Venture capitalists (VC) require it of the companies in which they invest. For example, a VC wants to make sure that it has negotiated the best price for equity and will ask for this provision in case another financier negotiates a cheaper purchase price for the equity. The idea behind the concept of MFN is that the country, company, or entity that has MFN status shouldn't be disadvantaged in comparison with others in similar roles as a trading partner, buyer, or investor. In practice, the result is that the signing party given MFN status benefits from any better negotiation and receives the cheaper price point or better term. This terminology is also used in sales contracts or other business legal agreements.

Gradually, the GATT member countries turned their attention to other nontariff trade barriers. These included government procurement and bidding, industrial standards, subsidies, duties and customs, taxes, and licensing. GATT countries agreed to limit or remove trade barriers in these areas. The only agreed-on export subsidies were for agricultural products. Countries agreed to permit a wider range of imported products to enter their home markets by simplifying licensing guidelines and developing consistent product standards between imports and domestically produced goods. Duties had to result from uniform and consistent procedures for the same foreign and domestically produced items.

The initial successes in these categories led some countries to get more creative with developing barriers to trade as well as entering into bilateral agreements and providing more creative subsidies for select industries. The challenge for the member countries of GATT was enforcement. Other than complaining and retaliating, there was little else that a country could do to register disapproval of another country's actions and trade barriers.

Gradually, trade became more complex, leading to the Uruguay Round beginning in 1986 and ending in 1994. These trade meetings were called rounds in reference to the series of meetings among global peers held at a "roundtable." Prior to a round, each series of trade discussions began in one country. The round of discussions was then named after that country. It sometimes took several years to conclude the topic discussions for a round. The Uruguay Round took eight years and actually resulted in the end of GATT and the creation of the World Trade Organization (WTO). The current Doha Development Round began in 2001 and is actually considered part of the WTO.

World Trade Organization (WTO)

Brief History and Purpose

The World Trade Organization (WTO) developed as a result of the Uruguay Round of GATT. Formed officially on January 1, 1995, the concept of the WTO had been in development for several years. When the WTO replaced GATT, it absorbed all of GATT's standing agreements. In contrast to GATT, which was a series of agreements, the WTO was designed to be an actual institution charged with the mission of promoting free and fair trade. As explained on its website, the WTO "is the only global international organization dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments. The goal is to help producers of goods and services, exporters, and importers conduct their business."

The global focus on multilateral trade agreements and cooperation has expanded trade exponentially. "The past 50 years have seen an exceptional growth in world trade. Merchandise exports grew on average by 6 percent annually. Total trade in 2000 was 22-times the level of 1950. GATT and the WTO have helped to create a strong and prosperous trading system contributing to unprecedented growth." *Source: "The Multilateral Trading System—Past, Present and Future," World Trade Organization, accessed December 29, 2010, http://www.wto.org/english/thewto_e/whatis_e/inbrief_e/inbr01_e.htm.*

The WTO's primary purpose is to serve as a negotiating forum for member nations to dispute, discuss, and debate trade-related matters. More than just a series of trade agreements, as it was under GATT, the WTO undertakes discussions on issues related to globalization and its impact on people and the environment, as well as trade-specific matters. It doesn't necessarily establish formal agreements in all of these areas but does provide a forum to discuss how global trade impacts other aspects of the world.

Headquartered in Geneva, Switzerland, the current round is called the Doha Round and began in 2001. With 153 member nations, the WTO is the largest, global trade organization. Thirty nations have observer status, and many of these are seeking membership. With so many member nations, the concept of MFN has been eased into a new principle of normal trade relations (NTR). Advocates say that no nation really has a favored nation status; rather, all interact with each other as a normal part of global trade.

The biggest change from GATT to the WTO is the provision for the settlement of disputes. If a country finds another country's trade practices unfair or discriminatory, it may bring the charges to the WTO, which will hear from both countries and mediate a solution.

The WTO has also undertaken the effort to focus on services rather than just goods. Resulting from the Uruguay Round, the General Agreement on Trade in Services (GATS) seeks to reduce the barriers to trade in services. Following the GATT commitment to nondiscrimination, GATS requires member nations to treat foreign service companies as they would domestic ones. For example, if a country requires banks to maintain 10 percent of deposits as reserves, then this percentage should be the same for foreign and domestic banks. Services have proven to be more complex to both define and regulate, and the member nations are continuing the discussions.

Similar to GATS is the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). Intellectual property refers to just about anything that a person or entity creates with the mind. It includes inventions, music, art, and writing, as well as words, phrases, sayings, and graphics—to name a few. The basic premise of intellectual property rights (IPR) law is that the creator of the property has the right to financially benefit from his or her creation. This is particularly important for protecting the development for the creation, known as the research and development (R&D) costs. Companies can also own the intellectual property that their employees generate. This section focuses on the protection that countries agree to give to intellectual property created in another country.

Over the past few decades, companies have become increasingly diligent in protecting their intellectual property and pursuing abusers. Whether it's the knock-off designer handbag from China that lands on the sidewalks of New York or the writer protecting her thoughts in the written words of a book (commonly understood as content), or the global software company combating piracy of its technical know-how, IPR is now formally a part of the WTO agreements and ongoing dialogue.

Current Challenges and Opportunities

Agriculture and textiles are two key sectors in which the WTO faces challenges. Trade in agriculture has been impacted by export-country subsidies, import-country tariffs and restrictions, and nontariff barriers. Whether the United States provides low-cost loans and subsidies to its farmers or Japan restricts the beef imports, agriculture trade barriers are an ongoing challenge for the WTO. Global companies and trade groups that support private-sector firms seek to have their governments raise critical trade issues on their behalf through the WTO.

For example, Japan's ban of beef imports in response to mad cow disease had a heavy impact on the US beef industry during the first decade of the 21st century. Japan was the largest foreign buyer of U.S. beef before it banned all imports when the first case of the brain-wasting disease, also known bovine spongiform encephalopathy [i.e., mad cow disease], was discovered in the U.S.

Japanese restrictions on U.S. beef created distance between Japan and the U.S. Japan Agriculture Minister Hirotaka Akamatsu told reporters in 2010 after meeting [US Agriculture Secretary Tom] Vilsack in Tokyo. "For us, food safety based on Japan's scientific standards is the priority. The OIE standards are different from the Japanese scientific ones."

During the beef export ban, the U.S. beef industry lost about $1 billion a year in sales because of the restrictions, according to the National Cattlemen's Beef Association, [a trade group supporting the interests of American beef producers].

The ban was eased in 2005 to allow meat from cattle aged 20 months or less, which scientists say are less likely to have contracted the fatal illness. … Japan was the third-largest destination for U.S. beef [in 2009], with trade totaling $470 million, up from $383 million in 2008, according to the U.S. Meat Export Federation. That compares with $1.39 billion in 2003.
Mexico and Canada were the biggest buyers of U.S. beef [in 2009]. *Source: Jae Hur and Ichiro Suzuki, "Japan, U.S. to Continue Dialogue on Beef Import Curbs (Update 1)," BusinessWeek, April 7, 2010, accessed December 29, 2010, http://www.businessweek.com/news/2010-04-07/japan-u-s-to-continue-dialogue-on-beef-import-curbs-update1-.html.* Restrictions were further eased in 2013.

The role of the WTO is to facilitate agreements in difficult bilateral and multilateral trade disputes, but this certainly isn't easy. Japan's reluctance for American beef may have appeared to be the result of mad cow disease, but business observers note Japan's historical cultural preference for Japanese goods, which the country often claims are superior. A similar trade conflict was triggered in the 1980s when Japan discouraged the import of rice from other countries. The prevailing Japanese thought was that its local rice was easier for the Japanese to digest. After extensive discussions in the Uruguay Round of trade talks, on "December 14, 1993 the Japanese government accepted a limited opening of the rice market under the GATT plan." Source: "Japan Rice Trade,"

case study on American University website, accessed January 2, 2010, http://www1.american.edu/ted/japrice.htm.

Antidumping is another area on which the WTO has focused its attention. Dumping occurs when a company exports to a foreign market at a price that is either lower than the domestic prices in that country or less than the cost of production. Antidumping charges can be harder to settle, as the charge is against a company and not a country. One example is in India, which has, in the past, accused Japan and Thailand of dumping acetone, a chemical used in drugs and explosives, in the Indian market. In an effort to protect domestic manufacturers, India has raised the issue with the WTO. In fact, India was second only to Argentina among the G-20 (or Group of Twenty) nations in initiating antidumping investigations during 2009, according to a WTO report.

Future Outlook

The future for the WTO and any related organizations remains strong. With companies and countries facing a broader array of trade issues than ever before, the WTO plays a critical role in promoting and ensuring free and fair trade. Many observers expect that the WTO will have to emphasize the impact of the Internet on trade. In most cases, the WTO provides companies and countries with the best options to dispute, discuss, and settle unfair business and trade practices.

KEY TAKEAWAYs

- The General Agreement on Tariffs and Trade (GATT) is a series of rules governing trade that were first created in 1947 by twenty-three countries. It remained in force until 1995, when it was replaced by the WTO.
- The World Trade Organization (WTO) is the only global, international organization dealing with the rules of trade between nations. The WTO agreements that have been negotiated and signed by the organization's 153 member nations and ratified in their parliaments are the heart of the organization. Its goal is to help the producers, exporters, and importers of goods and services conduct business. The latest round of the WTO trade negotiations is called the Doha Round.

READING: INTERNATIONAL TRADE BARRIERS

Trade barriers are government-induced restrictions on international trade, which generally decrease overall economic efficiency.

KEY points
• Trade barriers cause a limited choice of products and, therefore, would force customers to pay higher prices and accept inferior quality. • Trade barriers generally favor rich countries because these countries tend to set international trade policies and standards. • Economists generally agree that trade barriers are detrimental and decrease overall economic efficiency, which can be explained by the theory of comparative advantage.

Terms

- *Tariff:* A system of government-imposed duties levied on imported or exported goods; a list of such duties, or the duties themselves.
- *Quota:* A restriction on the import of something to a specific quantity.

Examples

Trade barriers are government-induced restrictions on international trade. Man-made trade barriers come in several forms, including:

- Tariffs
- Non-tariff barriers to trade
- Import licenses
- Export licenses
- Import quotas
- Subsidies
- Voluntary Export Restraints
- Local content requirements
- Embargo
- Currency devaluation
- Trade restriction

Most trade barriers work on the same principle–the imposition of some sort of cost on trade that raises the price of the traded products. If two or more nations repeatedly use trade barriers against each other, then a trade war results.

Economists generally agree that trade barriers are detrimental and decrease overall economic efficiency. This can be explained by the theory of comparative advantage. In theory, free trade involves the removal of all such barriers, except perhaps those considered necessary for health or national security. In practice, however, even those countries promoting free trade heavily subsidize certain industries, such as agriculture and steel. Trade barriers are often criticized for the effect they have on the developing world. Because rich-country players set trade policies, goods, such as agricultural products that developing countries are best at producing, face high barriers. Trade barriers, such as taxes on food imports or subsidies for farmers in developed economies, lead to overproduction and dumping on world markets, thus lowering prices and hurting poor-country farmers. Tariffs also tend to be anti-poor, with low rates for raw commodities and high rates for labor-intensive processed goods. The

Commitment to Development Index measures the effect that rich country trade policies actually have on the developing world. Another negative aspect of trade barriers is that it would cause a limited choice of products and, therefore, would force customers to pay higher prices and accept inferior quality.

In general, for a given level of protection, quota-like restrictions carry a greater potential for reducing welfare than do tariffs. Tariffs, quotas, and non-tariff barriers lead too few of the economy's resources being used to produce tradeable goods. An export subsidy can also be used to give an advantage to a domestic producer over a foreign producer. Export subsidies tend to have a particularly strong negative effect because in addition to distorting resource allocation, they reduce the economy's terms of trade. In contrast to tariffs, export subsidies lead to an over allocation of the economy's resources to the production of tradeable goods.

Singapore
The Port of Singapore is one of the busiest in the world because Singapore must import most of its foodstuffs and consumer goods.

International trade barriers can take many forms for any number of reasons. Generally, governments impose barriers to protect domestic industry or to "punish" a trading partner.

GLOSSARY

Agriculture

The art or science of cultivating the ground, including the harvesting of crops, and the rearing and management of livestock; tillage; husbandry; farming.

Comparative advantage

The ability of a party to produce a particular good or service at a lower marginal and opportunity cost over another. The concept that a certain good can be produced more efficiently than others due to a number of factors, including productive skills, climate, natural resource availability, and so forth.

Currency

Money or other items used to facilitate transactions. In economics, currency is a generally accepted medium of exchange. These are usually the coins and banknotes of a particular government, which comprise the physical aspects of a nation's money supply. Paper money.

Developing

Of a country: becoming economically more mature or advanced; becoming industrialized.

Economy

Collective focus of the study of money, currency and trade, and the efficient use of resources. The system of production and distribution and consumption. The overall measure of a currency system; as the national economy.

Efficiency

The extent to which a resource, such as electricity, is used for the intended purpose; the ratio of useful work to energy expended. The extent to which time is well used for the intended task. Improved efficiency was a principle goal of progressives, one they thought attainable by the application of scientific and rational thought to social problems.

Export

This term export is derived from the conceptual meaning to ship the goods and services out of the port of a country. To sell (goods) to a foreign country. Any good or commodity, transported from one country to another country in a legitimate fashion, typically for use in trade.

Free trade

Free trade is a policy by which a government does not discriminate against imports or interfere with exports by applying tariffs (to imports) or subsidies (to exports) or quotas. International trade free from government interference, especially trade free from tariffs or duties on imports.international trade free from government interference, especially trade free from tariffs or duties on imports

Good

An object produced for market.

Import

Something brought in from an exterior source, especially for sale or trade. To bring (something) in from a foreign country, especially for sale or trade.

Industry

The sector of the economy consisting of large-scale enterprises.

Lead

Potential opportunity for a sale or transaction, a potential customer.

License

The legal terms under which a person is allowed to use a product.

Market

A group of potential customers for one’s product. One of the many varieties of systems, institutions, procedures, social relations and infrastructures whereby parties engage in exchange.

Potential

Currently unrealized ability. A curve describing the situation where the difference in the potential energies of an object in two different positions depends only on those positions.

Price

The price is the amount a customer pays for the product. The quantity of payment or compensation given by one party to another in return for goods or services. The cost required to gain possession of something.

Product

Any tangible or intangible good or service that is a result of a process and that is intended for delivery to a customer or end user. Anything, either tangible or intangible, offered by the firm as a solution to the needs and wants of the consumer; something that is profitable or potentially profitable; goods or a service that meets the requirements of the various governing offices or society.

Resource

Something that one uses to achieve an objective. An example of a resource could be a raw material or an employee. Something that one uses to achieve an objective, e.g. raw materials or personnel.

Resource allocation

Resource allocation is used to assign the available resources in an economic way. It is part of resource management. In project management, resource allocation is the scheduling of activities and the resources required by those activities while taking into consideration both the resource availability and the project time.

Security

The condition of not being threatened, especially physically, psychologically, emotionally, or financially. proof of ownership of stocks, bonds, or other investment instruments.

Standard

Something used as a measure for comparative evaluations. A level of quality or attainment.

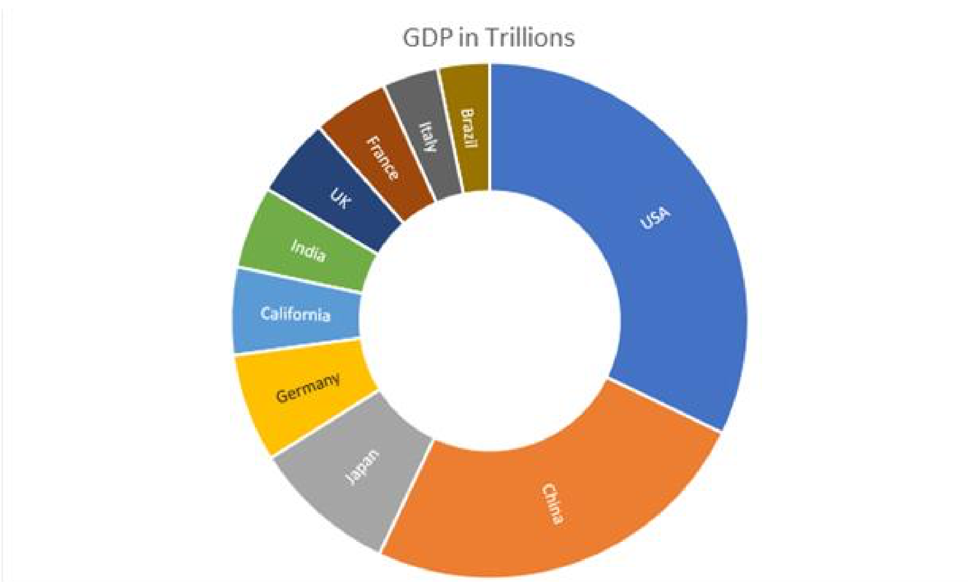
Trade war

The practice of nations creating mutual tariffs or similar barriers to trade.

VIDEO: EU CRISIS

Please watch the following video:

Watch Euro Crisis explained: https://youtu.be/ttuXQWV_dtQ



Reading: Brexit Pros and Cons

Please read the following article: Benefits of being in the EU: the debate
https://www.ig.com/uk/financial-events/brexit/pros-and-cons-of-brexit

The Brexit process began with the United Kingdom (UK) voting to leave the European Union (EU) in a 2016 referendum. Since then, there has been heated debate from both the remain and leave camps about the best scenario for Britain moving forwards.

With speculation playing a part in almost every claim for or against the EU, it's sometimes difficult to distinguish between legitimate risks and doom-mongering. As the process of negotiating a withdrawal agreement nears its end, there is still uncertainty surrounding the UK's exit from the EU, and the debate on the pros and cons of Brexit continues.

Remain

Though unsuccessful in garnering enough votes in the referendum, the remain camp have continued to advocate for a close relationship with the EU in the form of a departure from the EU with a deal in place.

The arguments for remaining in the EU focus on the benefits of being part of a wider union, and the security and favourable trading relationship made possible through EU membership.

Foreign affairs
As part of a community of 500 million people, Britain has greater influence over international matters as a member of the EU.

Sovereignty
Britain has proved that it can opt out of some EU policies which it considers counterintuitive, such as adoption of the euro, the Schengen Agreement and enforced migrant quotas.

Security
A union better equips Britain to tackle threats to security, including terrorism and cross-border crime.

Money
European businesses invest billions of pounds in the UK every year, both in the public sector and private sector.

Trade
EU membership gives Britain access to the European single market, which is invaluable for trade and enables the easy movement of goods, services and people across member states.

Business
Free trade within the EU reduces barriers and enables UK companies to grow.

Jobs
Millions of jobs linked to Britain's membership would be put at risk. Some sectors such as nursing and manufacturing could experience a slump in skilled labour.

Consumer goods
The average person in Britain saves hundreds each year thanks to lower prices of goods and services facilitated by the EU.

Leave

While the leave campaign succeeded in the referendum, there has been less success in negotiating with the EU. To dissuade other members considering their own withdrawals, the EU have been firm in their approach to the negotiation process so far.

Leave supporters are unyielding in their resolve that the referendum result is final, and that the UK must now leave the EU. However, while some on the leave side advocate a hard Brexit – gaining more sovereignty, taking control over immigration and reducing red tape – others are more moderate.

Foreign affairs
EU membership limits Britain's international influence, ruling out an independent seat at the World Trade Organisation (WTO).

Sovereignty
Britain would have more control of its laws and regulations, without risk of having counterintuitive policies forcefully imposed.

Security
Britain's domestic security could benefit from full border controls, which it would gain outside the political union.

Money
Britain contributes billions of pounds in membership fees to the EU every year.

Trade
Membership of the EU keeps Britain from fully capitalising on trade with other major economies such as Japan, India and the US.

Business
The EU subjects Britain to slow and inflexible bureaucracy, making it more prohibitive for smaller companies to do business.

Jobs
Improved global trade agreements and more selective immigration could have a positive effect on the British job market.

Consumer goods
The average person in Britain loses hundreds of pounds each year due to EU VAT contributions and agricultural subsidies policies.

from website: IG link: https://www.ig.com/uk/financial-events/brexit/pros-and-cons-of-brexit

READING: COMMON MARKETS

A common market is the first stage towards a single market and may be limited initially to a free trade area.

KEY Points
• A common market is the first stage towards a single market and may be limited initially to a free trade area, with relatively free movement of capital and ofservices. However, it is not to a stage where the remaining trade barriers have been eliminated. • The European Economic Community (EEC) (also known as the Common Market in the English-speaking world and sometimes referred to as the European Community even before it was renamed as such in 1993) was an international organization created by the 1957 Treaty of Rome. • The main aim of the EEC, as stated in its preamble, was to “preserve peace and liberty and to lay the foundations of an ever closer union among the peoples of Europe.”

Term

- *Free trade*: International trade free from government interference, especially trade free from tariffs or duties on imports.

Example

- The European Economic Community was the first example of a both common and single market, but it was an economic union since it had additionally a customs union. The European Economic Community (EEC) was an international organization created by the 1957 Treaty of Rome. Its aim was to bring about economic integration, including a common market, among its six founding members: Belgium, France, Germany, Italy, Luxembourg and the Netherlands. Upon the entry into force of the Maastricht Treaty in 1993, the EEC was renamed the European Community (EC) to reflect that it covered a wider range of policy. This was also when the three European Communities, including the EC, were collectively made to constitute the first of the three pillars of the European Union (EU). For the customs union, the treaty provided for a 10% reduction in custom duties and up to 20% of global import quotas. Progress on the customs union proceeded much faster than the twelve years planned.

A common market is a first stage towards a single market and may be limited initially to a free trade area with relatively free movement of capital and of services, but not so advanced in reduction of the rest of the trade barriers.

The European Economic Community (EEC) (also known as the Common Market in the English-speaking world and sometimes referred to as the European Community even before it was renamed as such in 1993) was an international organization created by the 1957 Treaty of Rome. Its aim was to bring about economic integration, including a common market, among its six founding members: Belgium, France, Germany, Italy, Luxembourg, and the Netherlands.

It gained a common set of institutions along with the European Coal and Steel Community (ECSC) and the European Atomic Energy Community (EURATOM) as one of the European Communities under the 1965 Merger Treaty (Treaty of Brussels).

Upon the entry into force of the Maastricht Treaty in 1993, the EEC was renamed the European Community (EC) to reflect that it covered a wider range of policy. This was also when the three European Communities, including the EC, were collectively made to constitute the first of the three pillars of the European Union (EU), which the treaty also founded. The EC existed in this form until it was abolished by the 2009 Treaty of Lisbon, which merged the EU's former pillars and provided that the EU would "replace and succeed the European Community. " The main aim of the EEC, as stated in its preamble, was to "preserve peace and liberty and to lay the foundations of an ever closer union among the peoples of Europe. " Calling for balanced economic growth, this was to be accomplished through:

- The establishment of a customs union with a common external tariff
- Common policies for agriculture, transport, and trade
- Enlargement of the EEC to the rest of Europe

For the customs union, the treaty provided for a 10% reduction in custom duties and up to 20% of global import quotas. Progress on the customs union proceeded much faster than the 12 years planned. However, France faced some setbacks due to its war with Algeria.

The six states that founded the EEC and the other two communities were known as the "inner six" (the "outer seven" were those countries who formed the European Free Trade Association). The six were France, West Germany, Italy, and the three Benelux countries: Belgium, the Netherlands, and Luxembourg. The first enlargement was in 1973, with the accession of Denmark, Ireland, and the United Kingdom. Greece, Spain, and Portugal joined in the 1980s. Following the creation of the EU in 1993, it has enlarged to include an additional 15 countries by 2007.

There were three political institutions that held the executive and legislative power of the EEC, plus one judicial institution and a fifth body created in 1975. These institutions (except for the auditors) were created in 1957 by the EEC but from 1967 on, they applied to all three communities. The council represents governments, the Parliament represents citizens, and the commission represents the European interest.

European Economic Community
Original member states (blue) and later members (green)

GLOSSARY

European Union

A supranational organization created in the 1950s to bring the nations of Europe into closer economic and political connection. At the beginning of 2007, 27 member nations were Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, The Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, United Kingdom. A supranational organization created in the 1950s to bring the nations of Europe into closer economic and political connection. At the beginning of 2012, 27 member nations were Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, The Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, United Kingdom.

Import

Something brought in from an exterior source, especially for sale or trade. To bring (something) in from a foreign country, especially for sale or trade.

Services

That which is produced, then traded, bought or sold, then finally consumed and consists of an action or work.

READING: NAFTA

NAFTA is an agreement signed by Canada, Mexico, and the United States, creating a trilateral trade bloc in North America.

KEY Points

- The North American Free Trade Agreement (NAFTA) is an agreement signed by the governments of Canada, Mexico, and the United States, creating a trilateral trade bloc in North America.
- NAFTA came into effect on January 1, 1994 and superseded the Canada – United States Free Trade Agreement.
- Within 10 years of the implementation of NAFTA, all U.S.-Mexico tariffs are to be eliminated except for some U.S. agricultural exports to Mexico which will be phased out within 15 years.
- Most U.S. – Canada trade was duty free before NAFTA.
- NAFTA also seeks to eliminate non-tariff trade barriers and to protect the intellectual property right of the products.
- When viewing the combined GDP of its members, as of 2010 NAFTA is the largest trade bloc in the world.

Terms

- *Trade bloc*: A trade bloc is a type of intergovernmental agreement, often part of a regional intergovernmental organization, where regional barriers to trade, (tariffs and non-tariff barriers) are reduced or eliminated among the participating states.
- *Free trade:* International trade free from government interference, especially trade free from tariffs or duties on imports.
- *Tariff:* A system of government-imposed duties levied on imported or exported goods; a list of such duties, or the duties themselves.

The North American Free Trade Agreement (NAFTA)

The North American Free Trade Agreement (NAFTA) is an agreement signed by the governments of Canada, Mexico, and the United States, creating a trilateral trade bloc in North America. The agreement came into force on January 1, 1994. It superseded the Canada – United States Free Trade Agreement between the U.S. and Canada.

In terms of combined GDP of its members, the trade bloc is the largest in the world as of 2010. NAFTA has two supplements: the North American Agreement on Environmental Cooperation (NAAEC) and the North American Agreement on Labor Cooperation (NAALC). The goal of NAFTA was to eliminate barriers to trade and investment among the U.S., Canada, and Mexico.

The implementation of NAFTA on January 1, 1994 brought the immediate elimination of tariffs on more than one-half of Mexico's exports to the U.S. and more than one-third of U.S. exports to Mexico. Within 10 years of the implementation of the agreement, all U.S.–Mexico tariffs would be eliminated except for some U.S. agricultural exports to Mexico that were to be phased out within 15 years. Most U.S.–Canada trade was already duty free. NAFTA also seeks to eliminate non-tariff trade barriers and to protect the intellectual property rightof the products.

The agreement opened the door for open trade, ending tariffs on various goods and services, and implementing equality between Canada, America, and Mexico. NAFTA has allowed agricultural goods such as eggs, corn, and meats to be tariff-free. This allowed corporations to trade freely and import and export various goods on a North American scale .

NAFTA countries
NAFTA member countries

GLOSSARY

Bloc

A group of countries acting together for political or economic goals, an alliance (e.g., the eastern bloc, the western bloc, a trading bloc). a group of voters or politicians who share common goals.

Corporation

A group of individuals, created by law or under authority of law, having a continuous existence independent of the existences of its members, and powers and liabilities distinct from those of its members. a group of individuals, created by law or under authority of law, having a continuous existence independent of the existences of its members, and powers and liabilities distinct from those of its members.

Ending

A termination or conclusion.

Export

This term export is derived from the conceptual meaning to ship the goods and services out of the port of a country. to sell (goods) to a foreign country Any good or commodity, transported from one country to another country in a legitimate fashion, typically for use in trade.

GDP

Gross domestic product (GDP) is the market value of all officially recognized final goods and services produced within a country in a given period of time. Gross Domestic Product (Economics). A measure of the economic production of a particular territory in financial capital terms over a specific time period.

Goal

A desired result that one works to achieve. A result that one is attempting to achieve. a result that one is attempting to achieve.

Good

An object produced for market.

Import

Something brought in from an exterior source, especially for sale or trade. To bring (something) in from a foreign country, especially for sale or trade.

Intellectual property

Any product of someone’s intellect that has commercial value: copyrights, patents, trademarks, and trade secrets. Intellectual property (IP) is a juridical concept that refers to creations of the mind for which exclusive rights are recognized.

Investment

The expenditure of capital in expectation of deriving income or profit from its use.

Product

Any tangible or intangible good or service that is a result of a process and that is intended for delivery to a customer or end user. Anything, either tangible or intangible, offered by the firm as a solution to the needs and wants of the consumer; something that is profitable or potentially profitable; goods or a service that meets the requirements of the various governing offices or society.

Right

A legal or moral entitlement.

Services

That which is produced, then traded, bought or sold, then finally consumed and consists of an action or work.

READING: New NAFTA

- Understand what changes are made in the New NAFTA

Read the article from the New York Times: Trump Just Signed the U.S.M.C.A. Here's What's in the New NAFTA. Link: https://www.nytimes.com/2020/01/29/business/economy/usmca-deal.html

WASHINGTON — President Trump signed the revised North American Free Trade Agreement into law on Wednesday, fulfilling a campaign promise to rewrite "one of the worst trade deals" in history.

"Today we are finally ending the NAFTA nightmare," Mr. Trump said during a White House signing ceremony, calling the new trade deal a "colossal victory" for farmers, factory workers and other countries.

Much of the new United States-Mexico-Canada Agreement simply updates the 25-year-old North American Free Trade Agreement, with new laws on intellectual property protection, the internet, investment, state-owned enterprises and currency.

But the 2,082-page pact also includes significant changes in several key areas, including incentives to make cars in North America and open Canadian markets for American dairy farmers.

It rolls back a special system of arbitration for corporations that has drawn bipartisan condemnation, and includes additional provisions designed to help identify and prevent labor violations, particularly in Mexico. Some of those changes were inserted at the insistence of Democrats, who used their control of the House to secure long-desired policy changes.

Steering more car production to the United States

NAFTA required automakers to produce 62.5 percent of a vehicle's content in North America to qualify for zero tariffs. The new agreement raises that threshold, over time, to 75 percent. That's meant to force automakers to source fewer parts for an "Assembled in Mexico" car from Germany, Japan, South Korea or China. The pact also requires 70 percent of a vehicle's steel and aluminum to originate in North America, with steel being both melted and poured on the continent.

For the first time, the new agreement also mandates that 40 to 45 percent of the parts for any tariff-free vehicle must come from a so-called high-wage factory. Those factories must pay a minimum of $16 an hour in average salaries for production workers. That's about triple the average wage in a Mexican factory right now, and administration officials hope the provision will either force automakers to buy more supplies from Canada or the United States or cause wages in Mexico to rise.

However, critics caution that factories may be able to game the rules by including some high-paid managers in their calculations. And there are risks to the changes.

Automotive analysts have warned that the wage provision could raise costs for American car companies and car buyers, slowing the auto market and weighing on economic growth over all.
The final provision, as written, could also prove relatively ineffective at shifting production, because it is not indexed to inflation. An average wage of $16 an hour will be less constraining in 2023 dollars than it is today.

Stronger labor rules in Mexico

The U.S.M.C.A. includes expansive changes that, at least on paper, should help level the playing field among workers in the United States, Canada and Mexico.

NAFTA's original provisions on labor and environment were added as side letters after the original agreement was signed, to win the support of Democrats and ensure the deal's passage during the Clinton administration. The U.S.M.C.A. moves these chapters into the main body of the trade agreement, meaning issues like the right to organize are now subject to the pact's normal procedures for settling disputes.

The deal also expands those commitments, requiring more protections for workers, blocking imports of goods made with forced labor, and setting up mechanisms to ensure that those rules are enforced.

In response to the concerns of congressional Democrats, it sets up an independent panel that can investigate factories accused of violating labor rights and stop shipments of that factory's goods at the border. It establishes an interagency committee to monitor Mexico's labor reforms, as well as American attachés who will report to Congress on the progress.

In an annex to the agreement, Mexico also committed to enact sweeping legal changes to combat forced labor and violence against workers, and allow for independent unions and labor courts. The International Trade Commission has estimated that, if the changes are made, they will increase wages for Mexico's unionized workers and decrease their pay gap with American workers.

Less protection for drug companies

In a major concession to Democrats, the Trump administration agreed to pare back certain protections for an advanced and very expensive class of drugs called biologics. The final agreement removes a provision that had offered the drugs 10 years of protection from cheaper alternatives in both Canada and Mexico.

The agreement expands other protections for intellectual property rights, for example, extending the 50 years of protection for copyrights in NAFTA to 70 years. It also includes new criminal penalties for theft of trade secrets, including cybertheft.

In a major win for tech firms, it gives internet companies like Facebook and YouTube certain protections from lawsuits related to the user content posted on their platforms. It also sets new standards by prohibiting governments from asking tech companies to disclose their source code or put duties on electronic transmissions.

Wins for American cheese (and wine)

The agreement gives American farmers some additional access to foreign markets, particularly in Canada. It does not dismantle Canada's "supply management system," which dictates how much Canadian farmers should produce so they can be profitable. But Canada did agree to eliminate a program that helps sellers of certain milk products, at home and abroad, and open its market to American milk, cream, butter, cheese and other products. In return, the United States expanded access to its market for Canadian dairy and sugar.

It also creates a list of cheese names that Mexico and the United States agree can be marketed without restriction in their countries, and it forces grocery stores in British Columbia to stop their practice of selling British Columbia-only wines on certain shelves, and stock American wines alongside them.

Ending a special system of arbitration for companies

One of the biggest areas of contention stemmed from the mechanisms that companies and governments could turn to when they believed another party had violated NAFTA.

article from the New York Times, author: Ana Swanson and Jim Tankersley, date: 29th Jan. 2020

READING: EUROPEAN UNION

The European Union (EU) is an economic and political union made up of 27 member states that are located primarily in Europe.

KEY TAKEAWAY

- The European Union (EU) is an economic and political union made up of 27 member states that are located primarily in Europe.
- Members of the EU include Austria, Belgium, Bulgaria, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom.
- The EU operates through a system of supranational independent institutions and intergovernmental negotiated decisions by the member states.
- Within the Schengen Area (which includes EU and non-EU states) passport controls have been abolished.
- The creation of a single currency became an official objective of the European Economic Community (EEC) in 1969. On January 1, 2002 euro notes and coins were issued and national currencies began to phase out in the eurozone.
- The ECB is the central bank for the eurozone, and thus controls monetary policy in that area with an agenda to maintain price stability. It is at the center of the European System of Central Banks, which comprises all EU national central banks and is controlled by its General Council, consisting of the President of the ECB, who is appointed by the European Council, the Vice-President of the ECB, and the governors of the national central banks of all 27 EU member states.

Terms

- *Euro*: The currency unit of the European Monetary Union. Symbol: €
- *Transparency:* Open, public; having the property that theories and practices are publicly visible, thereby reducing the chance of corruption.
- *European Union:* A supranational organization created in the 1950s to bring the nations of Europe into closer economic and political connection. At the beginning of 2012, 27 member nations were Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, The Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, United Kingdom.

Examples

- The euro is designed to help build a single market by easing travel of citizens and goods, eliminating exchange rate problems, providing price transparency, creating a single financial market, stabilizing prices, maintaining low interest rates, and providing a currency used internationally and protected against shocks by the large amount of internal trade within the eurozone. It is also intended as a political symbol of integration.

The European Union

The European Union (EU) is an economic and political union or confederation of 27 member states that are located in Europe, including:

Austria, Belgium, Bulgaria, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, and the United Kingdom.

The EU operates through a system of supranational independent institutions and intergovernmental decisions negotiated by the member states. Important institutions of the EU include the European Commission, the Council of the European Union, the European Council, the Court of Justice of the European Union, and the European Central Bank. The European Parliament is elected every five years by EU citizens. The EU has developed a single market through a standardized system of laws that apply in all member states. Within the Schengen Area (which includes EU and non-EU states) passport controls have been abolished. EU policies aim to ensure the free movement of people, goods, services, and capital, enact legislation in justice and home affairs, and maintain common policies on trade, agriculture, fisheries, and regional development. A monetary union, the eurozone, was established in 1999, and as of January 2012, is composed of 17 member states. Through the Common Foreign and Security Policy the EU has developed a limited role in external relations and defense. Permanent diplomatic missions have been established around the world. The EU is represented at the United Nations, the WTO, the G8 and the G-20.

The Euro

The creation of a single European currency became an official objective of the European Economic Community in 1969. However, it was only with the advent of the Maastricht Treaty in 1993 that member states were legally bound to start the monetary union. In 1999 the euro was duly launched by eleven of the then fifteen member states of the EU. It remained an accounting currency until 1 January 2002, when euro notes and coins were issued and national currencies began to phase out in the eurozone, which by then consisted of twelve member states. The eurozone (constituted by the EU member states that have adopted the euro) has since grown to seventeen countries, the most recent being Estonia, which joined on 1 January 2011. All other EU member states, except Denmark and the United Kingdom, are legally bound to join the euro when the convergence criteria are met, however only a few countries have set target dates for accession. Sweden has circumvented the requirement to join the euro by not meeting the membership criteria.

The euro is designed to help build a single market by easing travel of citizens and goods, eliminating exchange rate problems, providing price transparency, creating a single financial market, stabilizing prices, maintaining low interest rates, and providing a currency used internationally and protected against shocks by the large amount of internal trade within the eurozone. It is also intended as a political symbol of integration. The euro and the monetary policies of those who have adopted it in agreement with the EU are under the control of the European Central Bank (ECB). The ECB is the central bank for the eurozone, and thus controls monetary policy in that area with an agenda to maintain price stability. It is at the center of the European System of Central Banks, which comprises all EU national central banks and is controlled by its General Council, consisting of the President of the ECB, who is appointed by the European Council, the Vice-President of the ECB, and the governors of the national central banks of all 27 EU member states. The monetary union has been shaken by the European sovereign-debt crisis since 2009.

European Union
European Union member countries

GLOSSARY

Good
An object produced for market.
Justice
The ideal of fairness, impartiality, etc., especially with regard to the punishment of wrongdoing.
Mission
A set of tasks that fulfills a purpose or duty; an assignment set by an employer.
Services
That which is produced, then traded, bought or sold, then finally consumed and consists of an action or work.

READING: APEC

APEC is a forum for 21 Pacific Rim countries that seeks to promote free trade and economic cooperation throughout the Asia-Pacific region.

KEY TAKEAWAY

- Asia-Pacific Economic Cooperation (APEC) is a forum for 21 Pacific Rim countries that seeks to promote free trade and economic cooperation.
- APEC was established in 1989 in response to the growing interdependence of Asia-Pacific economies and the advent of regional economic blocs.
- APEC member countries include Australia, Brunei, Canada, Chile, China, Hong Kong (Hong Kong, China), Indonesia, Japan, South Korea, Mexico, Malaysia, New Zealand, Papua New Guinea, Peru, Philippines, Russia, Singapore, Taiwan (Chinese Taipei), Thailand, United States, and Vietnam.
- During the meeting in 1994 in Bogor, Indonesia, APEC leaders adopted the Bogor Goals which aim for free and open trade and investment in the Asia-Pacific by 2010, for industrialized economies and by 2020, for developing economies.

Term

- *Bloc:* A group of countries acting together for political or economic goals, an alliance (e.g., the eastern bloc, the western bloc, a trading bloc).

The Asia-Pacific Economic Cooperation (APEC) is a forum for 21 Pacific Rim countries (formally Member Economies) that seeks to promote free trade and economic cooperation throughout the Asia-Pacific region. Established in 1989 in response to the growing interdependence of Asia-Pacific economies and the advent of regional economic blocs (such as the European Union) in other parts of the world, APEC works to raise living standards and education levels through sustainable economic growth and to foster a sense of community and an appreciation of shared interests among Asia-Pacific countries.

Member countries are: Australia, Brunei, Canada, Chile, China, Hong Kong (Hong Kong, China), Indonesia, Japan, South Korea, Mexico, Malaysia, New Zealand, Papua New Guinea, Peru, Philippines, Russia, Singapore, Taiwan (Chinese Taipei), Thailand, United States, and Vietnam.

APEC member countries
Map of APEC member countries as of 2009

During the meeting in 1994 in Bogor, Indonesia, APEC leaders adopted the Bogor Goals that aim for free and open trade and investment in the Asia-Pacific by 2010, for industrialized economies and by 2020, for developing economies. In 1995, APEC established a business advisory body named the APEC Business Advisory Council (ABAC), composed of three business executives from each membereconomy. To meet the Bogor Goals, APEC carries out work in three main areas:

1. Trade and investment liberalization
2. Business facilitation
3. Economic and technical cooperation

APEC is considering the prospects and options for a Free Trade Area of the Asia-Pacific (FTAAP), which would include all APEC member economies. Since 2006, the APEC Business Advisory Council, promoting the theory that a free trade area has the best chance of converging the member nations and ensuring stable economic growth under free trade, has lobbied for the creation of a high-level task force to study and develop a plan for a free trade area. The proposal for a FTAAP arose due to the lack of progress in the Doha round of World Trade Organization negotiations, and as a way to overcome the “spaghetti bowl” effect created by overlapping and conflicting elements of the umpteen free trade agreements. There are approximately 60 free trade agreements, with an additional 117 in the process of negotiation in Southeast Asia and the Asia-Pacific region.

GLOSSARY

Community

A group of interdependent organisms inhabiting the same region and interacting with each other. A group sharing a common understanding and often the same language, manners, tradition and law.

Developing

Of a country: becoming economically more mature or advanced; becoming industrialized.

Economy

Collective focus of the study of money, currency and trade, and the efficient use of resources. The system of production and distribution and consumption. The overall measure of a currency system; as the national economy.

Free trade

Free trade is a policy by which a government does not discriminate against imports or interfere with exports by applying tariffs (to imports) or subsidies (to exports) or quotas. International trade free from government interference, especially trade free from tariffs or duties on imports.

Goal

A desired result that one works to achieve. A result that one is attempting to achieve. a result that one is attempting to achieve.

Interdependence

The condition of being interdependent.

Interest

The price paid for obtaining, or price received for providing, money or goods in a credit transaction, calculated as a fraction of the amount or value of what was borrowed. A great attention and concern from someone or something; intellectual curiosity.

Investment

A placement of capital in expectation of deriving income or profit from its use. The expenditure of capital in expectation of deriving income or profit from its use.

Process

A series of events to produce a result, especially as contrasted to product. In reference to capabilities, a process is how the capability is executed.

Prospect

The potential things that may come to pass, often favorable. A potential customer.

Standard

Something used as a measure for comparative evaluations. A level of quality or attainment.

Task force

A group of people working toward a particular task, project, or activity, especially assigned in a particular capacity.

WTO REGIONAL TRADE AGREEMENT DATABASE

WTO Regional Trade Agreement Database

Regional trade agreements (RTAs) have become increasingly prevalent since the early 1990s. As of 31 July 2013, some 575 notifications of RTAs (counting goods, services and accessions separately) had been received by the GATT/WTO. Of these, 379 were in force. What all RTAs in the WTO have in common is that they are reciprocal trade agreements between two or more partners. Information on RTAs notified to the WTO is available in the RTA Database.

The WTO also receives notifications from WTO members regarding preferential trade arrangements (PTAs). In the WTO, PTAs are unilateral trade preferences. Information on PTAs notified to the WTO is available in the PTA Database.

MODULE 5: Finance and Investment

OVERVIEW

In module 5 we will look at the value of the dollar against other currencies and understand the international monetary system. We will see how prices of food and objects differ from country to country as well as recognize the importance of the IMF.

READING: WHAT IS THE INTERNATIONAL MONETARY SYSTEM

Why do economies need money? This module defines *money* as a unit of account that is used as a medium of exchange in transactions. Without money, individuals and businesses would have a harder time obtaining (purchasing) or exchanging (selling) what they need, want, or make. Money provides us with a universally accepted medium of exchange.

Before the current monetary system can be fully appreciated, it’s helpful to look back at history and see how money and systems governing the use of money have evolved. Thousands of years ago, people had to barter if they wanted to get something. That worked well if the two people each wanted what the other had. Even today, bartering exists.

History shows that ancient Egypt and Mesopotamia—which encompasses the land between the Euphrates and Tigris Rivers and is modern-day Iraq, parts of eastern Syria, southwest Iran, and southeast Turkey—began to use a system based on the highly coveted coins of gold and silver, also known as bullion, which is the purest form of the precious metal. However, bartering remained the most common form of exchange and trade.

Gold and silver coins gradually emerged in the use of trading, although the level of pure gold and silver content impacted the coins value. Only coins that consist of the pure precious metal are bullions; all other coins are referred to simply as *coins*. It is interesting to note that gold and silver lasted many centuries as the basis of economic measure and even into relatively recent history of the gold standard, which we’ll cover in the next section. Fast-forward two thousand years and bartering has long been replaced by a currency-based system. Even so, there have been evolutions in the past century alone on how—globally—the monetary system has evolved from using gold and silver to represent national wealth and economic exchange to the current system.

Did You Know: Dominant Currencies in History

Throughout history, some types of money have gained widespread circulation outside of the nations that issued them. Whenever a country or empire has regional or global control of trade, its currency becomes the dominant currency for trade and governs the monetary system of that time. In the middle of a period that relies on one major currency, it’s easy to forget that, throughout history, there have been other primary currencies—a historical cycle. Generally, the best currency to use is the most liquid one, the one issued by the nation with the biggest economy as well as usually the largest import-export markets. Rarely has a single currency been the exclusive medium of world trade, but a few have come close. Here’s a quick look at some of some of the most powerful currencies in history:

- Persian daric: The daric was a gold coin used in Persia between 522 BC and 330 BC.
- Roman currency: Currencies such as the aureus (gold), the denarius (silver), the sestertius (bronze), the dupondius (bronze), and the as (copper) were used during the Roman Empire from around 250 BC to AD 250.
- Thaler: From about 1486 to 1908, the thaler and its variations were used in Europe as the standard against which the various states’ currencies could be valued.
- Spanish American pesos: Around 1500 to the early nineteenth century, this contemporary of the thaler was widely used in Europe, the Americas, and the Far East; it became the first world currency by the late eighteenth century.
- British pound: The pound’s origins date as early as around AD 800, but its influence grew in the 1600s as the unofficial gold standard; from 1816 to around 1939 the pound was the global reserve currency until the collapse of the gold standard.
- US dollar: The Coinage Act of 1792 established the dollar as the basis for a monetary account, and it went into circulation two years later as a silver coin. Its strength as a global reserve currency expanded in the 1800s and continues today.
- Euro: Officially in circulation on January 1, 1999, the euro continues to serve as currency in many European countries today.

Let's take a look at the last century of the international monetary system evolution. International monetary system refers to the system and rules that govern the use and exchange of money around the world and between countries. Each country has its own currency as money and the international monetary system governs the rules for valuing and exchanging these currencies.

Until the nineteenth century, the major global economies were regionally focused in Europe, the Americas, China, and India. These were loosely linked, and there was no formal monetary system governing their interactions. The rest of this section reviews the distinct chronological periods over the past 150 years leading to the development of the modern global financial system. Keep in mind that the system continues to evolve and each crisis impacts it. There is not likely to be a final international monetary system, simply one that reflects the current economic and political realities. This is one main reason why understanding the historical context is so critical. As the debate about the pros and cons of the current monetary system continues, some economists are tempted to advocate a return to systems from the past. Businesses need to be mindful of these arguments and the resulting changes, as they will be impacted by new rules, regulations, and structures.

Pre–World War I

As mentioned earlier in this section, ancient societies started using gold as a means of economic exchange. Gradually more countries adopted gold, usually in the form of coins or bullion, and this international monetary system became known as the gold standard. This system emerged gradually, without the structural process in more recent systems. The gold standard, in essence, created a fixed exchange rate system. An exchange rate is the price of one currency in terms of a second currency. In the gold standard system, each country sets the price of its currency to gold, specifically to one ounce of gold. A fixed exchange rate stabilizes the value of one currency vis-à-vis another and makes trade and investment easier.

Our modern monetary system has its roots in the early 1800s. The defeat of Napoleon in 1815, when France was beaten at the Battle of Waterloo, made Britain the strongest nation in the world, a position it held for about one hundred years. In Africa, British rule extended at one time from the Cape of Good Hope to Cairo. British dominance and influence also stretched to the Indian subcontinent, the Malaysian peninsula, Australia, New Zealand—which attracted British settlers—and Canada. Under the banner of the British government, British companies advanced globally and were the largest companies in many of the colonies, controlling trade and commerce. Throughout history, strong countries, as measured mainly in terms of military might, were able to advance the interests of companies from their countries—a fact that has continued to modern times, as seen in the global prowess of American companies. Global firms in turn have always paid close attention to the political, military, and economic policies of their and other governments.

In 1821, the United Kingdom, the predominant global economy through the reaches of its colonial empire, adopted the gold standard and committed to fixing the value of the British pound. The major trading countries, including Russia, Austria-Hungary, Germany, France, and the United States, also followed and fixed the price of their currencies to an ounce of gold.

The United Kingdom officially set the price of its currency by agreeing to buy or sell an ounce of gold for the price of 4.247 pounds sterling. At that time, the United States agreed to buy or sell an ounce of gold for $20.67. This enabled the two currencies to be freely exchanged in terms of an ounce of gold. In essence,

£4.247 = 1 ounce of gold = $20.67.

The exchange rate between the US dollar and the British pound was then calculated by

$20.67/£4.247 = $4.867 to £1.

The Advantages of the Gold Standard

The gold standard dramatically reduced the risk in exchange rates because it established fixed exchange rates between currencies. Any fluctuations were relatively small. This made it easier for global companies to manage costs and pricing. International trade grew throughout the world, although economists are not always in agreement as to whether the gold standard was an essential part of that trend.

The second advantage is that countries were forced to observe strict monetary policies. They could not just print money to combat economic downturns. One of the key features of the gold standard was that a currency had to actually have in reserve enough gold to convert all of its currency being held by anyone into gold. Therefore, the volume of paper currency could not exceed the gold reserves.

The third major advantage was that gold standard would help a country correct its trade imbalance. For example, if a country was importing more than it is exporting, (called a trade deficit), then under the gold standard the country had to pay for the imports with gold. The government of the country would have to reduce the amount of paper currency, because there could not be more currency in circulation than its gold reserves. With less money floating around, people would have less money to spend (thus causing a decrease in demand) and prices would also eventually decrease. As a result, with cheaper goods and services to offer, companies from the country could export more, changing the international trade balance gradually back to being in balance. For these three primary reasons, and as a result of the 2008 global financial crises, some modern economists are calling for the return of the gold standard or a similar system.

Collapse of the Gold Standard

If it was so good, what happened? The gold standard eventually collapsed from the impact of World War I. During the war, nations on both sides had to finance their huge military expenses and did so by printing more paper currency. As the currency in circulation exceeded each country’s gold reserves, many countries were forced to abandon the gold standard. In the 1920s, most countries, including the United Kingdom, the United States, Russia, and France, returned to the gold standard at the same price level, despite the political instability, high unemployment, and inflation that were spread throughout Europe.

However, the revival of the gold standard was short-lived due to the Great Depression, which began in the late 1920s. The Great Depression was a worldwide phenomenon. By 1928, Germany, Brazil, and the economies of Southeast Asia were depressed. By early 1929, the economies of Poland, Argentina, and Canada were contracting, and the United States economy followed in the middle of 1929. Some economists have suggested that the larger factor tying these countries together was the international gold standard, which they believe prolonged the Great Depression. The gold standard limited the flexibility of the monetary policy of each country’s central banks by limiting their ability to expand the money supply. Under the gold standard, countries could not expand their money supply beyond what was allowed by the gold reserves held in their vaults.

Too much money had been created during World War I to allow a return to the gold standard without either large currency devaluations or price deflations. In addition, the U.S. gold stock had doubled to about 40 percent of the world’s monetary gold. There simply was not enough monetary gold in the rest of the world to support the countries’ currencies at the existing exchange rates.

By 1931, the United Kingdom had to officially abandon its commitment to maintain the value of the British pound. The currency was allowed to float, which meant that its value would increase or decrease based on demand and supply. The U.S. dollar and the French franc were the next strongest currencies and nations sought to peg the value of their currencies to either the dollar or franc. However, in 1934, the United States devalued its currency from $20.67 per ounce of gold to $35 per ounce. With a cheaper U.S. dollar, U.S. firms were able to export more as the price of their goods and services were cheaper vis-à-vis other nations. Other countries devalued their currencies in retaliation of the lower U.S. dollar. Many of these countries used arbitrary par values rather than a price relative to their gold reserves. Each country hoped to make its exports cheaper to other countries and reduce expensive imports. However, with so many countries simultaneously devaluing their currencies, the impact on prices was canceled out. Many countries also imposed tariffs and other trade restrictions in an effort to protect domestic industries and jobs. By 1939, the gold standard was dead; it was no longer an accurate indicator of a currency’s real value.

Post–World War II

The demise of the gold standard and the rise of the Bretton Woods system pegged to the U.S. dollar was also a changing reflection of global history and politics. The British Empire’s influence was dwindling. In the early 1800s, with the strength of both their currency and trading might, the United Kingdom had expanded its empire. At the end of World War I, the British Empire spanned more than a quarter of the world; the general sentiment was that “the sun would never set on the British empire.” British maps and globes of the time showed the empire’s expanse proudly painted in red. However, shortly after World War II, many of the colonies fought for and achieved independence. By then, the United States had clearly replaced the United Kingdom as the dominant global economic center and as the political and military superpower as well.

Did You Know: U.S. Companies Going Global

Just as the United States became a global military and political superpower, U.S. businesses were also taking center stage. Amoco (today now part of BP), General Motors (GM), Kellogg's, and Ford Motor Company sought to capitalize on U.S. political and military strength to expand in new markets around the world. Many of these companies followed global political events and internally debated the strategic directions of their firms. For example, GM had an internal postwar planning policy group.

Notwithstanding the economic uncertainties that were bound to accompany the war's end, a few of the largest U.S. corporations, often with considerable assets seized or destroyed during the war, began to plan for the postwar period. Among these was General Motors. As early as 1942 the company had set up a postwar planning policy group to estimate the likely shape of the world after the war and to make recommendations on GM's postwar policies abroad.

In 1943 the policy group reported the likelihood that relations between the Western powers and the Soviet Union would deteriorate after the war. It also concluded that, except for Australia, General Motors should not buy plants and factories to make cars in any country that had not had facilities before the conflict. At the same time, though, it stated that after the war the United States would be in a stronger state politically and economically than it had been after World War I and that overseas operations would flourish in much of the world. The bottom line for GM, therefore, was to proceed with caution once the conflict ended but to stick to the policy it had enunciated in the 1920s—seeking out markets wherever they were available and building whatever facilities were needed to improve GM's market share. *Source: Encyclopedia of the New American Nation, s.v. "Multinational Corporations—Postwar Investment: 1945–1955," accessed February 9, 2011, http://www.americanforeignrelations.com/E-N/Multinational-Corporations-Postwar-investment-1945-1955.html#ixzz18TCwg8VJ.*

Bretton Woods

In the early 1940s, the United States and the United Kingdom began discussions to formulate a new international monetary system. John Maynard Keynes, a highly influential British economic thinker, and Harry Dexter White, a U.S. Treasury official, paved the way to create a new monetary system. In July 1944, representatives from forty-four countries met in Bretton Woods, New Hampshire, to establish a new international monetary system.

"The challenge," wrote Ngaire Woods in his book *The Globalizers: The IMF, the World Bank, and Their Borrowers*, "was to gain agreement among states about how to finance postwar reconstruction, stabilize exchange rates, foster trade, and prevent balance of payments crises from unraveling the system." *Source: Ngaire Woods, Globalizers: The IMF, the World Bank, and Their Borrowers (Ithaca, NY: Cornell University Press, 2006), 16.*

Did You Know: Outcomes of Bretton Woods

Throughout history, political, military, and economic discussions between nations have always occurred simultaneously in an effort to create synergies between policies and efforts. A key focus of the 1940s efforts for a new global monetary system was to stabilize war-torn Europe.

In the decade following the war the administrations of both Harry Truman and Dwight Eisenhower looked to the private sector to assist in the recovery of western Europe, both through increased trade and direct foreign investments. In fact, the $13 billion Marshall Plan, which became the engine of European recovery between 1948 and 1952, was predicated on a close working relationship between the public and private sectors. Similarly, Eisenhower intended to bring about world economic recovery through liberalized world commerce and private investment abroad rather than through foreign aid. Over the course of his two administrations (1953–1961), the president modified his policy of "trade not aid" to one of "trade and aid" and changed his focus from western Europe to the Third World, which he felt was most threatened by communist expansion. In particular he was concerned by what he termed a “Soviet economic offensive” in the Middle East, that is, Soviet loans and economic assistance to such countries as Egypt and Syria. But even then he intended that international commerce and direct foreign investments would play a major role in achieving global economic growth and prosperity.

The resulting Bretton Woods Agreement created a new dollar-based monetary system, which incorporated some of the disciplinary advantages of the gold system while giving countries the flexibility they needed to manage temporary economic setbacks, which had led to the fall of the gold standard. The Bretton Woods Agreement lasted until 1971 and established several key features.

Fixed Exchange Rates

Fixed exchange rates are also sometimes called pegged rates. One of the critical factors that led to the fall of the gold standard was that after the United Kingdom abandoned its commitment to maintaining the value of the British pound, countries sought to peg their currencies to the US dollar. With the strength of the U.S. economy, the gold supply in the United States increased, while many countries had less gold in reserve than they did currency in circulation. The Bretton Woods system worked to fix this by tying the value of the U.S. dollar to gold but also by tying all of the other countries to the U.S. dollar rather than directly to gold. The par value of the U.S. dollar was fixed at $35 to one ounce of gold. All other countries then set the value of their currencies to the U.S. dollar. In reflection of the changing times, the British pound had undergone a substantial loss in value and by that point, its value was $2.40 to £1. Member countries had to maintain the value of their currencies within 1 percent of the fixed exchange rate. Lastly, the agreement established that only governments, rather than anyone who demanded it, could convert their U.S. dollar holdings into gold—a major improvement over the gold standard. In fact, most businesspeople eventually ignored the technicality of pegging the U.S. dollar to gold and simply utilized the actual exchange rates between countries (e.g., the pound to the dollar) as an economic measure for doing business.

National Flexibility

To enable countries to manage temporary but serious downturns, the Bretton Woods Agreement provided for a devaluation of a currency—more than 10 percent if needed. Countries could not use this tool to competitively manipulate imports and exports. Rather, the tool was intended to prevent the large-scale economic downturn that took place in the 1930s.

Creation of the International Monetary Fund and the World Bank

“What Is the Role of the IMF and the World Bank?” looks at the International Monetary Fund and the World Bank more closely, as they have survived the collapse of the Bretton Woods Agreement. In essence, the IMF’s initial primary purpose was to help manage the fixed rate exchange system; it eventually evolved to help governments correct temporary trade imbalances (typically deficits) with loans. The World Bank’s purpose was to help with post–World War II European reconstruction. Both institutions continue to serve these roles but have evolved into broader institutions that serve essential global purposes, even though the system that created them is long gone. “What Is the Role of the IMF and the World Bank?” explores them in greater detail and addresses the history, purpose, evolution, and current opportunities and challenges of both institutions.

Collapse of Bretton Woods

Despite a fixed exchange rate based on the US dollar and more national flexibility, the Bretton Woods Agreement ran into challenges in the early 1970s. The U.S. trade balance had turned to a deficit as Americans were importing more than they were exporting. Throughout the 1950s and 1960s, countries had substantially increased their holdings of U.S. dollars, which was the only currency pegged to gold. By the late 1960s, many of these countries expressed concern that the U.S. did not have enough gold reserves to exchange all of the U.S. dollars in global circulation. This became known as the Triffin Paradox, named after the economist Robert Triffin, who identified this problem. He noted that the more dollars foreign countries held, the less faith they had in the ability of the U.S. government to convert those dollars. Like banks, though, countries do not keep enough gold or cash on hand to honor all of their liabilities. They maintain a percentage, called a reserve. Bank reserve ratios are usually 10 percent or less. (The low reserve ratio has been blamed by many as a cause of the 2008 financial crisis.) Some countries state their reserve ratios openly, and most seek to actively manage their ratios daily with open-market monetary policies—that is, buying and selling government securities and other financial instruments, which indirectly controls the total money supply in circulation, which in turn impacts supply and demand for the currency.

The expense of the Vietnam War and an increase in domestic spending worsened the Triffin Paradox; the US government began to run huge budget deficits, which further weakened global confidence in the U.S. dollar. When nations began demanding gold in exchange for their dollars, there was a huge global sell-off of the U.S. dollar, resulting in the Nixon Shock in 1971.

The Nixon Shock was a series of economic decisions made by the US President Richard Nixon in 1971 that led to the demise of the Bretton Woods system. Without consulting the other member countries, on August 15, 1971, Nixon ended the free convertibility of the US dollar into gold and instituted price and wage freezes among other economic measures.

Later that same year, the member countries reached the Smithsonian Agreement, which devalued the US dollar to $38 per ounce of gold, increased the value of other countries' currencies to the dollar, and increased the band within which a currency was allowed to float from 1 percent to 2.25 percent. This agreement still relied on the U.S. dollar to be the strong reserve currency and the persistent concerns over the high inflation and trade deficits continued to weaken confidence in the system. Countries gradually dropped out of system—notably Germany, the United Kingdom, and Switzerland, all of which began to allow their currencies to float freely against the dollar. The Smithsonian Agreement was an insufficient response to the economic challenges; by 1973, the idea of fixed exchange rates was over.

Before moving on, recall that the major significance of the Bretton Woods Agreement was that it was the first formal institution that governed international monetary systems. By having a formal set of rules, regulations, and guidelines for decision making, the Bretton Woods Agreement established a higher level of economic stability. International businesses benefited from the almost thirty years of stability in exchange rates. Bretton Woods established a standard for future monetary systems to improve on; countries today continue to explore how best to achieve this. Nothing has fully replaced Bretton Woods to this day, despite extensive efforts.

Post–Bretton Woods Systems and Subsequent Exchange Rate Efforts

When Bretton Woods was established, one of the original architects, Keynes, initially proposed creating an international currency called Bancor as the main currency for clearing. However, the Americans had an alternative proposal for the creation of a central currency called unitas. Neither gained momentum; the U.S. dollar was the reserve currency. Reserve currency is a main currency that many countries and institutions hold as part of their foreign exchange reserves. Reserve currencies are often international pricing currencies for world products and services. Examples of current reserve currencies are the U.S. dollar, the euro, the British pound, the Swiss franc, and the Japanese yen.

Many feared that the collapse of the Bretton Woods system would bring the period of rapid growth to an end. In fact, the transition to floating exchange rates was relatively smooth, and it was certainly timely: flexible exchange rates made it easier for economies to adjust to more expensive oil, when the price suddenly started going up in October 1973. Floating rates have facilitated adjustments to external shocks ever since.

The IMF responded to the challenges created by the oil price shocks of the 1970s by adapting its lending instruments. To help oil importers deal with anticipated current account deficits and inflation in the face of higher oil prices, it set up the first of two oil facilities. *Source: "The End of the Bretton Woods System (1972–81)," International Monetary Fund, accessed July 26, 2010, http://www.imf.org/external/about/histend.htm.*

After the collapse of Bretton Woods and the Smithsonian Agreement, several new efforts tried to replace the global system. The most noteworthy regional effort resulted in the European Monetary System (EMS) and the creation of a single currency, the euro. While there have been no completely effective efforts to replace Bretton Woods on a global level, there have been efforts that have provided ongoing exchange rate mechanisms.

Jamaica Agreement

In 1976, countries met to formalize a floating exchange rate system as the new international monetary system. The Jamaica Agreement established a managed float system of exchange rates, in which currencies float against one another with governments intervening only to stabilize their currencies at set target exchange rates. This is in contrast to a completely free floating exchange rate system, which has no government intervention; currencies float freely against one another. The Jamaica Agreement also removed gold as the primary reserve asset of the IMF. Additionally, the purpose of the IMF was expanded to include lending money as a last resort to countries with balance-of-payment challenges.

The Gs Begin

In the early 1980s, the value of the U.S. dollar increased, pushing up the prices of US exports and thereby increasing the trade deficit. To address the imbalances, five of the world's largest economies met in September 1985 to determine a solution. The five countries were Britain, France, Germany, Japan, and the United States; this group became known as the Group of Five, shortened to G5. The 1985 agreement, called the Plaza Accord because it was held at the Plaza Hotel in New York City, focused on forcing down the value of the U.S. dollar through collective efforts.

By February 1987, the markets had pushed the dollar value down, and some worried it was now valued too low. The G5 met again, but now as the Group of Seven, adding Italy and Canada—it became known as the G7. The Louvre Accord, so named for being agreed on in Paris, stabilized the dollar. The countries agreed to support the dollar at the current valuation. The G7 continued to meet regularly to address ongoing economic issues.

The G7 was expanded in 1999 to include twenty countries as a response to the financial crises of the late 1990s and the growing recognition that key emerging-market countries were not adequately included in the core of global economic discussions and governance. It was not until a decade later, though, that the G20 effectively replaced the G8, which was made up of the original G7 and Russia. The European Union was represented in G20 but could not host or chair the group.

Keeping all of these different groups straight can be very confusing. The news may report on different groupings as countries are added or removed from time to time. The key point to remember is that anything related to a G is likely to be a forum consisting of finance ministers and governors of central banks who are meeting to discuss matters related to cooperating on an international monetary system and key issues in the global economy.

The G20 is likely to be the stronger forum for the foreseeable future, given the number of countries it includes and the amount of world trade it represents. "Together, member countries represent around 90 per cent of global gross national product, 80 per cent of world trade (including EU intra-trade) as well as two-thirds of the world's population." *Source: "About G-20," G-20, accessed July 25, 2010, http://www.g20.org/en.*

Did You Know: G-ology

"At present, a number of groups are jostling to be the pre-eminent forum for discussions between world leaders. The G20 ended 2009 by in effect replacing the old G8. But that is not the end of the matter. In 2010 the G20 began to face a new challenger—G2 [the United States and China]. To confuse matters further, lobbies have emerged advocating the formation of a G13 and a G3." *Source: Gideon Rachman, "A Modern Guide to G-ology," Economist, November 13, 2009, accessed February 9, 2011, http://www.economist.com/node/14742524.*

The G20 is a powerful, informal group of nineteen countries and the European Union. It also includes a representative from the World Bank and the International Monetary Fund. The list developed from an effort to include major developing countries with countries with developed economies. Its purpose is to address issues of the international financial system.

So just who's in the current G20?

G20 Countries	
Argentina	Japan
Australia	Mexico
Brazil	Russia
Canada	Saudia Arabia
China	South Africa
France	South Korea
Germany	Turkey
India	United Kingdom
Indonesia	United States
Italy	European Union

Today's Exchange Rate System

While there is not an official replacement to the Bretton Woods system, there are provisions in place through the ongoing forum discussions of the G20. Today's system remains—in large part—a managed float system, with the U.S. dollar and the euro jostling to be the premier global currency. For businesses that once quoted primarily in U.S. dollars, pricing is now just as often noted in the euro as well.

Ethics in Action

The *Wall Street Journal*'s July 30, 2010, edition noted how gangsters are helping provide stability in the euro zone. The highest denomination of a euro is a €500 bill, in contrast to the United States, where the largest bill is a $100 bill.

The high-value bills are increasingly "making the euro the currency of choice for underground and black economies, and for all those who value anonymity in their financial transactions and investments," wrote Willem Buiter, the chief economist at Citigroup…. When euro notes and coins went into circulation in January 2002, the value of €500 notes outstanding was €30.8 billion ($40 billion), according to the ECB [European Central Bank]. Today some €285 billion worth of such euro notes are in existence, an annual growth rate of 32 percent. By value, 35 percent of euro notes in circulation are in the highest denomination, the €500 bill that few people ever see. In 1998, then-U.S. Treasury official Gary Gensler worried publicly about the competition to the $100 bill, the biggest U.S. bank note, posed by the big euro notes and their likely use by criminals. He pointed out that $1 million in $100 bills weighs 22 pounds; in hypothetical $500 bills, it would weigh just 4.4 pounds.

Police forces have found the big euro notes in cereal boxes, tires and in hidden compartments in trucks, says Soren Pedersen, spokesman for Europol, the European police agency based in The Hague. "Needless to say, this cash is often linked to the illegal drugs trade, which explains the similarity in methods of concealment that are used." *Source: Stephen Fidler, "How Gangsters Are Saving Euro Zone," Wall Street Journal, July 30, 2010,* *accessed February 9, 2011, http://online.wsj.com/article/SB10001424052748704532204575397543634034112.html.*

While you might think that the ECB should just stop issuing the larger denominations, it turns out that the ECB and the member governments of the euro zone actually benefit from this demand. The profit a central bank gains from issuing currency—as well as from other privileges of a central bank, such as being able to demand no-cost or low-cost deposits from banks—is known as seigniorage. It normally accrues to national treasuries once the central banks account for their own costs. The ECB's gains from seigniorage are becoming increasingly important, with profits from issuing new paper currency upwards of €50 billion annually.

Some smaller nations have chosen to voluntarily set exchange rates against the dollar while other countries have selected the euro. Usually a country makes the decision between the dollar and the euro by reviewing their largest trading partners. By choosing the euro or the dollar, countries seek currency stability and a reduction in inflation, among other various perceived benefits. Many countries in Latin America once dollarized to provide currency stability for their economy. Today, this is changing, as individual economies have strengthened and countries are now seeking to dedollarize.

Spotlight on Dollarizing and Dedollarizing in Latin America

Many countries in Latin America have endured years of political and economic instability, which has exacerbated the massive inequality that has characterized the societies in modern times. Most of the wealth is in the hands of the white elite, who live sophisticated lives in the large cities, eating in fancy restaurants and flying off to Miami for shopping trips. Indeed, major cities often look much like any other modern, industrialized cities, complete with cinemas, fast-food restaurants, Internet cafés, and shopping malls.

But while the rich enjoy an enviable lifestyle, the vast majority of the continent's large indigenous population often lives in extreme poverty. While international aid programs attempt to alleviate the poverty, a lot depends on the country's government. Corrupt governments slow down the pace of progress.

Over the past two decades, governments in Ecuador and Peru—as well as others in Latin America including Bolivia, Paraguay, Panama, El Salvador, and Uruguay—have opted to dollarize to stabilize their countries' economies. Each country replaced its national currency with the US dollar. Each country has struggled economically despite abundant natural resources. Economic cycles in key industries, such as oil and commodities, contributed to high inflation. While the move to dollarize was not always popular domestically initially, its success has been clearly evident. In both Ecuador and Peru, dollarizing has provided a much needed benefit, although one country expects to continue aligning with the US dollar and the other hopes to move away from it.

In Ecuador, for example, a decade after dollarizing, one cannot dismiss the survival of dollarization as coincidence. Dollarization has provided Ecuador with the longest period of a stable, fully convertible currency in a century. Its foremost result has been that inflation has dropped to single digits and remained there for the first time since 1972. The stability that dollarization has provided has also helped the economy grow an average of 4.3 percent a year in real terms, fostering a drop in the poverty rate from 56 percent of the population in 1999 to 35 percent in 2008. As a result, dollarization has been popular, with polls showing that more than three-quarters of Ecuadorians approve of it.

However, this success could not protect the country from the effects of the 2008 global financial crisis and economic downturn, which led to falling remittances and declining oil revenue for Ecuador. The country "lacks a reliable political system, legal system, or investment climate. Dollarization is the only government policy that provides Ecuadorians with a trustworthy basis for earning, saving, investing, and paying." *Source: Pedro P. Romero, "Ecuador Dollarization: Anchor in a Storm," Latin Business Chronicle, January 23, 2009, accessed February 9, 2011, http://www.latinbusinesschronicle.com/app/article.aspx?id=3096.*

Peru first opted to dollarize in the early 1970s as a result of the high inflation, which peaked during the hyperinflation of 1988−90. "With high inflation, the U.S. dollar started to be the preferred means of payments and store of value." *Source: Mercedes García-Escribano, "Peru: Drivers of De-dollarization," International Monetary Fund, July 2010, accessed May 9, 2011, http://www.bcrp.gob.pe/docs/Publicaciones/Documentos-de-Trabajo/2010/Documento-de-Trabajo-11-2010.pdf.* Dollarization was the only option to stabilize prices. A key cost of dollarizing, however, is losing monetary independence. Another cost is that the business cycle in the country is tied more closely to fluctuations in the US economy and currency. Balancing the benefits and the costs is an ongoing concern for governments.

Despite attempts to dedollarize in the 1980s, it was not until the recent decade that Peru has successfully pursued a market-driven financial dedollarization. Dedollarization occurs when a country reduces its reliance on dollarizing credit and deposit of commercial banks. In Peru, as in some other Latin American countries—such as Bolivia, Uruguay and Paraguay—dedollarization has been "driven by macroeconomic stability, introduction of prudential policies to better reflect currency risk (such as the management of reserve requirements), and the development of the capital market in soles" (the local Peruvian currency). *Source: Mercedes García-Escribano, "Peru: Drivers of De-dollarization, International Monetary Fund," July 2010, accessed May 9, 2011, http://www.bcrp.gob.pe/docs/Publicaciones/Documentos-de-Trabajo/2010/Documento-de-Trabajo-11-2010.pdf.*

Dedollarizing is still a relatively recent phenomenon, and economists are still trying to understand the implications and impact on businesses and the local economy in each country. What is clear is that governments view dedollarizing as one more tool toward having greater control over their economies.

KEY TAKEAWAYs

- The international monetary system had many informal and formal stages. For more than one hundred years, the gold standard provided a stable means for countries to exchange their currencies and facilitate trade. With the Great Depression, the gold standard collapsed and gradually gave way to the Bretton Woods system.
- The Bretton Woods system established a new monetary system based on the US dollar. This system incorporated some of the disciplinary advantages of the gold system while giving countries the flexibility they needed to manage temporary economic setbacks, which had led to the fall of the gold standard.
- The Bretton Woods system lasted until 1971 and provided the longest formal mechanism for an exchange-rate system and forums for countries to cooperate on coordinating policy and navigating temporary economic crises.
- While no new formal system has replaced Bretton Woods, some of its key elements have endured, including a modified managed float of foreign exchange, the International Monetary Fund (IMF), and the World Bank—although each has evolved to meet changing world conditions.

VIDEO: WHAT IS THE WORLD BANK?

Explain the foreign exchange market, the method in which in which exchange rates are determined, and the international monetary system.

Watch What is the World Bank?: https://youtu.be/kvjo8Ur1IGE

VIDEO: ABOUT THE IMF

Explain the foreign exchange market, the method in which in which exchange rates are determined, and the international monetary system.

Watch About the IMF: https://youtu.be/XYkUkTkN060

VIDEO: FIXED VS. FLOATING EXCHANGE RATES

Watch Floating VS Fixed Exchange Rates: http://vimeo.com/40448527

ECON333 Floating VS Fixed Exchange Rates from PSULiberalArts on Vimeo.

VIDEO: EXCHANGE RATES

From YouTube description: “How do currency values rise and fall? Why would a country want to manipulate the value of its own currency?”

Watch Exchange Rates: https://youtu.be/xwtgByffoUw

Reading: Currency Speculation

- Understand how speculation works

http://www.dollarsandsense.org/archives/1998/0598weller.html

XE CURRENCY CONVERTER

XE Currency Converter

This is a link to a FAST and EASY currency converter website (XE). Simply select the two currencies and the exchange rate will be calculated in real time!

BUYING A "BIG MAC"

ABSTRACT

According to the Big Mac index, our patty-powered currency guide, it is now undervalued by 45.7% against the dollar. According to the Big Mac index, the euro and the pound are undervalued against the dollar by 19.7% and 26.3%, respectively. The deluxe Big Mac index has typically made rich-world currencies look more expensive.
Because western Europeans have higher costs of living and lower incomes than Americans, the euro has traded at around a 25% premium against the dollar in income-adjusted burger terms since the euro's inception.

Burgernomics gets to grips with a strong greenback

It is perhaps not surprising that the worst-performing major currency in the world this year is the Turkish lira. Many emerging-market currencies have taken a battering since the election in November of Donald Trump raised expectations of faster monetary tightening in America and sent the dollar soaring. But the lira has many other troubles to contend with, too: terrorist bombings, an economic slowdown, alarm over plans by the president, Recep Tayyip Erdogan, to strengthen his powers, and a central bank reluctant to raise interest rates to defend the currency. It has plunged to record lows. According to the Big Mac index, our patty-powered currency guide, it is now undervalued by 45.7% against the dollar.

The Big Mac index is built on the idea of purchasing-power parity, the theory that in the long run currencies will converge until the same amount of money buys the same amount of goods and services in every country. A Big Mac currently costs $5.06 in America but just 10.75 lira ($2.75) in Turkey, implying that the lira is undervalued. However, other currencies are even cheaper. In Big Mac terms, the Mexican peso is undervalued by a whacking 55.9% against the greenback. This week it also plumbed a record low as Mr Trump reiterated some of his campaign threats against Mexico. The peso has lost a tenth of its value against the dollar since November. Of big countries, only Russia offers a cheaper Big Mac, in dollar terms, even though the rouble has strengthened over the past year.

The euro zone is also prey to political uncertainty. Elections are scheduled this year in the Netherlands, France and Germany, and possible in Italy. The euro recently fell to its lowest level since 2003. Britain's Brexit vote has had an even bigger effect on the pound, which has fallen to $1.21, a 31-year low. According to the Big Mac index, the euro and the pound are undervalued against the dollar by 19.7% and 26.3%, respectively.

One of the drawbacks of the Big Mac index is that it takes no account of labour costs. It should surprise no one that a Big Mac costs less in Shanghai than it does in San Francisco, since Chinese workers earn far less than their American counterparts. So in a slightly more sophisticated version of the Big Mac index, we take account of a country's average income.

Historically, this adjustment has tended to raise currencies' valuations against the dollar, so emerging-market currencies tend to look more reasonably priced. The Chinese yuan, for example, is 44% undervalued against the dollar according to our baseline Big Mac index, but only 7% according to the adjusted one. The deluxe Big Mac index has typically made rich-world currencies look more expensive. Because western Europeans have higher costs of living and lower incomes than Americans, the euro has traded at around a 25% premium against the dollar in income-adjusted burger terms since the euro's inception.

But what once seemed to be an immutable axiom of burgernomics is true no longer. So strong is the dollar that even the adjusted Big Mac index finds the euro undervalued. The dollar is now trading at a 14-year high in trade weighted terms. Emerging-world economies may struggle to pay off dollar-denominated debts. American firms may find themselves at a disadvantage against foreign competition. And American tourists will get more burgers for their buck in Europe.

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READING: FOREIGN DIRECT INVESTMENT

FDI is practiced by companies in order to benefit from cheaper labor costs, tax exemptions, and other privileges in that foreign country.

KEY TAKEAWAYs

- Foreign Direct Investment (FDI) is the flow of investments from one company to production in a foreign nation, with the purpose of lowering labor costs and gaining tax incentives.
- FDI can help the economic situations of developing countries, as well as facilitate progressive internal policy reforms.
- A major contributing factor to increasing FDI flow was internal policy reform relating to trade openness and participation in international trade agreements and institutions.

Term

- *Foreign direct investment:* Investment directly into production in a country by a company located in another country, either by buying a company in the target country or by expanding operations of an existing business in that country.

Example

- Intel is headquartered in the United States, but it has made foreign direct investments in a number of Southeast Asian countries where they produce components of their products in Intel-owned factories.

Foreign direct investment (FDI) is investment into production in a country by a company located in another country, either by buying a company in the target country or by expanding operations of an existing business in that country.

FDI is done for many reasons including to take advantage of cheaper wages in the country, special investment privileges, such as tax exemptions, offered by the country as an incentive to gain tariff-free access to the markets of the country or the region. FDI is in contrast to portfolio investment which is a passive investment in the securities of another country, such as stocks and bonds.

One theory for how to best help developing countries, is to increase their inward flow of FDI. However, identifying the conditions that best attract such investment flow is difficult, since foreign investment varies greatly across countries and over time. Knowing what has influenced these decisions and the resulting trends in outcomes can be helpful for governments, non-governmental organizations, businesses, and private donors looking to invest in developing countries.

A study from scholars at Duke University and Princeton University published in the *American Journal of Political Science*, "The Politics of Foreign Direct Investment into Developing Countries: Increasing FDI through International Trade Agreements," examines trends in FDI from 1970 to 2000 in 122 developing countries to assess what the best conditions are for attracting investment. The study found the major contributing factor to increasing FDI flow was internal policy reform relating to trade openness and participation in international trade agreements and institutions. The researchers conclude that, while "democracy can be conducive to international cooperation," the strongest indicator for higher inward flow of FDI for developing countries was the number of trade agreements and institutions to which they were party.

Sao Paulo
Sao Paulo, Brazil, home to a growing middle class and significant direct investments.

GLOSSARY
Developing Of a country: becoming economically more mature or advanced; becoming industrialized. **Outcomes** The positive and negative consequences that an individual perceives to be a result of his/her actions. Examples include praise, bonuses, and promotions. **Passive** Being subjected to an action without producing a reaction. **Wage** An amount of money paid to a worker for a specified quantity of work, usually expressed on an hourly basis.

OCED LIBRARY

OECD iLibrary

This link accesses the OECD iLibrary. OECD iLibrary is the online library of the Organisation for Economic Cooperation and Development (OECD) featuring its books, papers and statistics and is the gateway to OECD's analysis data on FDI.

Both the IMF and the World Bank act as global outreach partners to assist both developed and developing countries in areas that range from Economic Management to Rule of Law to Human Development. Although controversial at times, these two organizations and their over 180 members have touched almost every country on the globe, either directly or indirectly. In this module we will examine the difference between the two organizations and look at some of the projects they have undertaken.

VIDEO: GTT/WTO

From the YouTube description: "Just a quick overview of the history of GATT (General Agreement on Tariffs and Trade), which eventually became the WTO (World Trade Organization)."

Watch GATT/WTO video: https://youtu.be/27J3CByXKow

READING: WHAT IS THE ROLE OF THE IMF AND THE WORLD BANK?

LEARNING OBJECTIVES

By the end of this section, you will be able to:

- Understand the history and purpose of the IMF.
- Describe the IMF's current role and major challenges and opportunities.
- Understand the history and purpose of the World Bank.
- Describe the World Bank's current role and major challenges and opportunities.

"What Is the International Monetary System?" discusses how, during the 1930s, the Great Depression resulted in failing economies. The fall of the gold standard led countries to raise trade barriers, devalue their currencies to compete against one another for export markets and curtail usage of foreign exchange by their citizens. All these factors led to declining world trade, high unemployment, and plummeting living standards in many countries. In 1944, the Bretton Woods Agreement established a new international monetary system. The creation of the International Monetary Fund (IMF) and the World Bank were two of its most enduring legacies.

The World Bank and the IMF, often called the Bretton Woods Institutions, are twin intergovernmental pillars supporting the structure of the world's economic and financial order. Both have taken on expanding roles, and there have been renewed calls for additional expansion of their responsibilities, particularly in the continuing absence of a single global monetary agreement. The two institutions may seem to have confusing or overlapping functions. However, while some similarities exist (see the following figure), they are two distinct organizations with different roles.

Similarities Between the IMF and World Bank

- ✓ Owned and directed by the governments of member nations
- ✓ Almost every country on earth is a member of both institutions
- ✓ Both concern themselves with economic issues
- ✓ Both focus on broadening and strengthening the economies of their member nations
- ✓ Hold joint annual meetings
- ✓ Headquartered in Washington DC, USA
- ✓ Share joint task forces, sessions and research efforts

“Despite these and other similarities, however, the Bank and the IMF remain distinct. The fundamental difference is this: the Bank is primarily a *development* institution; the IMF is a *cooperative* institution that seeks to maintain an orderly system of payments and receipts between nations. Each has a different purpose, a distinct structure, receives its funding from different sources, assists different categories of members, and strives to achieve distinct goals through methods peculiar to itself.” *Source: David D. Driscoll, “The IMF and the World Bank: How Do They Differ?,” International Monetary Fund, last updated August 1996, accessed February 9, 2011, http://www.imf.org/external/pubs/ft/exrp/differ/differ.htm (emphasis added).* This section explores both of these institutions and how they have evolved in the almost seventy years since their creation.

International Monetary Fund

History and Purpose

Figure 6.1 IMF Headquarters in Washington, DC

Source: International Monetary Fund, 2011.

The architects of the Bretton Woods Agreement, John Maynard Keynes and Harry Dexter White, envisioned an institution that would oversee the international monetary system, exchange rates, and international payments to enable countries and their citizens to buy goods and services from each other. They expected that this new global entity would ensure exchange rate stability and encourage its member countries to eliminate the exchange restrictions that hindered trade. Officially, the IMF came into existence in December 1945 with twenty-nine member countries. (The Soviets, who were at Bretton Woods, refused to join the IMF.)

In 1947, the institution’s first formal year of operations, the French became the first nation to borrow from the IMF. Over the next thirty years, more countries joined the IMF, including some African countries in the 1960s. The Soviet bloc nations remained the exception and were not part of the IMF until the fall of the Berlin Wall in 1989. The IMF experienced another large increase in members in the 1990s with the addition of Russia; Russia was also placed on the IMF’s executive committee. Today, 187 countries are members of the IMF; twenty-four of those countries or groups of countries are represented on the executive board.

The purposes of the International Monetary Fund are as follows:

1. To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.
2. To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.
3. To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.
4. To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade.
5. To give confidence to members by making the general resources of the Fund temporarily available to them under adequate safeguards, thus providing them with opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity.
6. In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members. *Source: "Articles of Agreement: Article I—Purposes," International Monetary Fund, accessed May 23, 2011, http://www.imf.org/external/pubs/ft/aa/aa01.htm.*

In addition to financial assistance, the IMF also provides member countries with technical assistance to create and implement effective policies, particularly economic, monetary, and banking policy and regulations.

Special Drawing Rights (SDRs)

A Special Drawing Right (SDR) is basically an international monetary reserve asset. SDRs were created in 1969 by the IMF in response to the Triffin Paradox. The Triffin Paradox stated that the more U.S. dollars were used as a base reserve currency, the less faith that countries had in the ability of the US government to convert those dollars to gold. The world was still using the Bretton Woods system, and the initial expectation was that SDRs would replace the U.S. dollar as the global monetary reserve currency, thus solving the Triffin Paradox. Bretton Woods collapsed a few years later, but the concept of an SDR solidified. Today the value of an SDR consists of the value of four of the IMF's biggest members' currencies—the U.S. dollar, the British pound, the Japanese yen, and the euro—but the currencies do not hold equal weight. SDRs are quoted in terms of U.S. dollars. The basket, or group of currencies, is reviewed every five years by the IMF executive board and is based on the currency's role in international trade and finance. The following chart shows the current valuation in percentages of the four currencies.

Currency	Weighting
U.S. dollar	44 percent
Euro	34 percent
Japanese yen	11 percent
British pound	11 percent

The SDR is not a currency, but some refer to it as a form of IMF currency. It does not constitute a claim on the IMF, which only serves to provide a mechanism for buying, selling, and exchanging SDRs. Countries are allocated SDRs, which are included in the member country's reserves. SDRs can be exchanged between countries along with currencies. The SDR serves as the unit of account of the IMF and some other international organizations, and countries borrow from the IMF in SDRs in times of economic need.

The IMF's Current Role and Major Challenges and Opportunities

Criticism and Challenging Areas for the IMF

The IMF supports many developing nations by helping them overcome monetary challenges and to maintain a stable international financial system. Despite this clearly defined purpose, the execution of its work can be very complicated and can have wide repercussions for the recipient nations. As a result, the IMF has both its critics and its supporters. The challenges for organizations like the the IMF and the World Bank center not only on some of their operating deficiencies but also on the global political environment in which they operate. The IMF has been subject to a range of criticisms that are generally focused on the conditions of its loans, its lack of accountability, and its willingness to lend to countries with bad human rights records.

These criticisms include the following:

1. **Conditions for loans.** The IMF makes the loan given to countries conditional on the implementation of certain economic policies, which typically include the following:
    - Reducing government borrowing (higher taxes and lower spending)
    - Higher interest rates to stabilize the currency
    - Allowing failing firms to go bankrupt
    - Structural adjustment (privatization, deregulation, reducing corruption and bureaucracy)

    The austere policies have worked at times but always extract a political toll as the impact on average citizens is usually quite harsh. The opening case in Chapter 2 "International Trade and Foreign Direct Investment" presents the current impact of IMF policies on Greece. Some suggest that the loan conditions are "based on what is termed the 'Washington Consensus,' focusing on liberalisation—of trade, investment and the financial sector—, deregulation and privatisation of nationalised industries. Often the conditionalities are attached without due regard for the borrower countries' individual circumstances and the prescriptive recommendations by the World Bank and IMF fail to resolve the economic problems within the countries. IMF conditionalities may additionally result in the loss of a state's authority to govern its own economy as national economic policies are predetermined under IMF packages."
2. **Exchange rate reforms.** "When the IMF intervened in Kenya in the 1990s, they made the Central bank remove controls over flows of capital. The consensus was that this decision made it easier for corrupt politicians to transfer money out of the economy (known as the Goldman scandal). Critics argue this is another example of how the IMF failed to understand the dynamics of the country that they were dealing with—insisting on blanket reforms."
3. **Devaluations.** In the initial stages, the IMF has been criticized for allowing inflationary devaluations.
4. **Free-market criticisms of the IMF.** "Believers in free markets argue that it is better to let capital markets operate without attempts at intervention. They argue attempts to influence exchange rates only make things worse—it is better to allow currencies to reach their market level." They also assert that bailing out countries with large debts is morally hazardous; countries that know that there is always a bailout provision will borrow and spend more recklessly.
5. **Lack of transparency and involvement.** The IMF has been criticized for "imposing policy with little or no consultation with affected countries."
6. **Supporting military dictatorships.** The IMF has been criticized over the decades for supporting military dictatorships.

Source: "Criticism of IMF," Economics Help, accessed June 28, 2010, http://www.economicshelp.org/dictionary/i/imf-criticism.html.

Opportunities and Future Outlook for the IMF

The 2008 global economic crisis is one of the toughest situations that the IMF has had to contend with since the Great Depression.

For most of the first decade of the twenty-first century, global trade and finance fueled a global expansion that enabled many countries to repay any money they had borrowed from the IMF and other official creditors. These countries also used surpluses in trade to accumulate foreign exchange reserves. The global economic crisis that began with the 2007 collapse of mortgage lending in the United States and spread around the world in 2008 was preceded by large imbalances in global capital flows. Global capital flows fluctuated between 2 and 6 percent of world GDP between 1980 and 1995, but since then they have risen to 15 percent of GDP. The most rapid increase has been experienced by advanced economies, but emerging markets and developing countries have also become more financially integrated.

The founders of the Bretton Woods system had taken for granted that private capital flows would never again resume the prominent role they had in the nineteenth and early twentieth centuries, and the IMF had traditionally lent to members facing current account difficulties. The 2008 global crisis uncovered fragility in the advanced financial markets that soon led to the worst global downturn since the Great Depression. Suddenly, the IMF was inundated with requests for standby arrangements and other forms of financial and policy support.

The international community recognized that the IMF's financial resources were as important as ever and were likely to be stretched thin before the crisis was over. With broad support from creditor countries, the IMF's lending capacity tripled to around $750 billion. To use those funds effectively, the IMF overhauled its lending policies. It created a flexible credit line for countries with strong economic fundamentals and a track record of successful policy implementation. Other reforms targeted low-income countries. These factors enabled the IMF to disburse very large sums quickly; the disbursements were based on the needs of borrowing countries and were not as tightly constrained by quotas as in the past.

Many observers credit the IMF's quick responses and leadership role in helping avoid a potentially worse global financial crisis. As noted in the Chapter 5 "Global and Regional Economic Cooperation and Integration" opening case on Greece, the IMF has played a role in helping countries avert widespread financial disasters. The IMF's requirements are not always popular but are usually effective, which has led to its expanding influence. The IMF has sought to correct some of the criticisms; according to a Foreign Policy in Focus essay designed to stimulate dialogue on the IMF, the fund's strengths and opportunities include the following (*Source: Martin S. Edwards, "The IMF's New Toolkit: New Opportunities, Old Challenges," Foreign Policy in Focus, September 17, 2009, accessed June 28, 2010, http://www.fpif.org/articles/the_imfs_new_toolkit_new_opportunities_old_challenges)*:

1. **Flexibility and speed.** "In March 2009, the IMF created the Flexible Credit Line (FCL), which is a fast-disbursing loan facility with low conditionality aimed at reassuring investors by injecting liquidity…Traditionally, IMF loan programs require the imposition of austerity measures such as raising interest rates that can reduce foreign investment…In the case of the FCL, countries qualify for it not on the basis of their promises, but on the basis of their history. Just as individual borrowers with good credit histories are eligible for loans at lower interest rates than their risky counterparts, similarly, countries with sound macroeconomic fundamentals are eligible for drawings under the FCL. A similar program has been proposed for low-income countries. Known as the Rapid Credit Facility, it is front-loaded (allowing for a single, up-front payout as with the FCL) and is also intended to have low conditionality."
2. **Cheerleading.** "The Fund is positioning itself to be less of an adversary and more of a cheerleader to member countries. For some countries that need loans more for reassurance than reform, these changes to the Fund toolkit are welcome." This enables more domestic political and economic stability.
3. **Adaptability.** "Instead of providing the same medicine to all countries regardless of their particular problems, the new loan facilities are intended to aid reform-minded governments by providing short-term resources to reassure investors. In this manner, they help politicians in developing countries manage the downside costs of integration."
4. **Transparency.** The IMF has made efforts to improve its own transparency and continues to encourage its member countries to do so. Supporters note that this creates a barrier to any one or more countries that have more geopolitical influence in the organization. In reality, the major economies continue to exert influence on policy and implementation.

To underscore the global expectations for the IMF's role, China, Russia, and other global economies have renewed calls for the G20 to replace the U.S. dollar as the international reserve currency with a new global system controlled by the IMF.

The *Financial Times* reported that Zhou Xiaochuan, the Chinese central bank's governor, said the goal would be to create a reserve currency that is disconnected from individual nations and is able to remain stable in the long run, thus removing the inherent deficiencies caused by using credit-based national currencies. "'This is a clear sign that China, as the largest holder of US dollar financial assets, is concerned about the potential inflationary risk of the US Federal Reserve printing money,' said Qu Hongbin, chief China economist for HSBC." Although Mr. Zhou did not mention the U.S. dollar, the essay gave a pointed critique of the current dollar-dominated monetary system: “The outbreak of the [current] crisis and its spillover to the entire world reflected the inherent vulnerabilities and systemic risks in the existing international monetary system,” Mr Zhou wrote.

China has little choice but to hold the bulk of its $2,000bn of foreign exchange reserves in U.S. dollars, and this is unlikely to change in the near future. To replace the current system, Mr. Zhou suggested expanding the role of special drawing rights, which were introduced by the IMF in 1969 to support the Bretton Woods fixed exchange rate regime but became less relevant once that collapsed in the 1970s…. Mr Zhou said the proposal would require “extraordinary political vision and courage” and acknowledged a debt to John Maynard Keynes, who made a similar suggestion in the 1940s. *Source: Jamil Anderlini, “China Calls for New Reserve Currency,” Financial Times, March 24, 2009, accessed February 9, 2011, http://www.ft.com/cms/s/0/7851925a-17a2-11de-8c9d-0000779fd2ac.html#axzz1DTvW5KyI.*

China is politically and economically motivated to recommend an alternative reserve currency. Politically, the country whose currency is the reserve currency is perceived as the dominant economic power, as Section 6.1 “What Is the International Monetary System?” discusses. Economically, China has come under increasing global pressure to increase the value of its currency, the renminbi.

The World Bank and the World Bank Group

History and Purpose

Figure 6.2 World Bank Headquarters in Washington, DC

The World Bank came into existence in 1944 at the Bretton Woods conference. Its formal name is the International Bank for Reconstruction and Development (IBRD), which clearly states its primary purpose of financing economic development. The World Bank’s first loans were extended during the late 1940s to finance the reconstruction of the war-ravaged economies of Western Europe. When these nations recovered some measure of economic self-sufficiency, the World Bank turned its attention to assisting the world's poorer nations. The World Bank has one central purpose: to promote economic and social progress in developing countries by helping raise productivity so that their people may live a better and fuller life:

[In 2009,] the World Bank provided $46.9 billion for 303 projects in developing countries worldwide, with our financial and/or technical expertise aimed at helping those countries reduce poverty. The Bank is currently involved in more than 1,800 projects in virtually every sector and developing country. The projects are as diverse as providing microcredit in Bosnia and Herzegovina, raising AIDS-prevention awareness in Guinea, supporting education of girls in Bangladesh, improving health care delivery in Mexico, and helping East Timor rebuild upon independence and India rebuild Gujarat after a devastating earthquake.

Today, the World Bank consists of two main bodies, the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA), established in 1960. The World Bank is part of the broader World Bank Group, which consists of five interrelated institutions: the IBRD; the IDA; the International Finance Corporation (IFC), which was established in 1956; the Multilateral Investment Guarantee Agency (MIGA), which was established in 1988; and the International Centre for Settlement of Investment Disputes (ICSID), which was established in 1966. These additional members of the World Bank Group have specific purposes as well. The IDA typically provides interest-free loans to countries with sovereign guarantees. The IFC provides loans, equity, risk-management tools, and structured finance. Its goal is to facilitate sustainable development by improving investments in the private sector. The MIGA focuses on improving the foreign direct investment of developing countries. The ICSID provides a means for dispute resolution between governments and private investors with the end goal of enhancing the flow of capital.

The current primary focus of the World Bank centers on six strategic themes:

1. **The poorest countries.** Poverty reduction and sustainable growth in the poorest countries, especially in Africa.
2. **Postconflict and fragile states.** Solutions to the special challenges of postconflict countries and fragile states.
3. **Middle-income countries.** Development solutions with customized services as well as financing for middle-income countries.
4. **Global public goods.** Addressing regional and global issues that cross national borders, such as climate change, infectious diseases, and trade.
5. **The Arab world.** Greater development and opportunity in the Arab world.
6. **Knowledge and learning.** Leveraging the best global knowledge to support development.

The World Bank provides low-interest loans, interest-free credits, and grants to developing countries. There's always a government (or "sovereign") guarantee of repayment subject to general conditions. The World Bank is directed to make loans for projects but never to fund a trade deficit. These loans must have a reasonable likelihood of being repaid. The IDA was created to offer an alternative loan option. IDA loans are free of interest and offered for several decades, with a ten-year grace period before the country receiving the loan needs to begin repayment. These loans are often called soft loans.

Since it issued its first bonds in 1947, the IBRD generates funds for its development work through the international capital markets. The World Bank issues bonds, typically about $25 billion a year. These bonds are rated AAA (the highest possible rating) because they are backed by member states' shared capital and by borrowers' sovereign guarantees. Because of the AAA credit rating, the World Bank is able to borrow at relatively low interest rates. This provides a cheaper funding source for developing countries, as most developing countries have considerably low credit ratings. The World Bank charges a fee of about 1 percent to cover its administrative overheads.

What Are the World Bank's Current Role and Major Challenges and Opportunities?

Like the IMF, the World Bank has both its critics and its supporters. The criticisms of the World Bank extend from the challenges that it faces in the global operating environment. Some of these challenges have complicated causes; some result from the conflict between nations and the global financial crisis. The following are four examples of the world's difficult needs that the World Bank tries to address:

1. Even in 2010, over 3 billion people lived on less than $2.50 a day.
2. At the start of the twenty-first century, almost a billion people couldn't read a book or sign their names.
3. Less than 1 percent of what the world spends each year on weapons would have put every child into school by the year 2000, but it didn't happen.
4. Fragile states such as Afghanistan, Rwanda, and Sri Lanka face severe development challenges: weak institutional capacity, poor governance, political instability, and often ongoing violence or the legacy of past conflict.

According to the *Encyclopedia of the New American Nation* and the *New York Times*, the World Bank is criticized primarily for the following reasons:

- **Administrative incompetence.** The World Bank and its lending practices are increasingly scrutinized, with critics asserting that "the World Bank has shifted from being a 'lender of last resort' to an international welfare organization," resulting in an institution that is "bloated, incompetent, and even corrupt." Also incriminating is that "the bank's lax lending standards have led to a rapidly deteriorating loan portfolio."
- **Rewarding or supporting inefficient or corrupt countries.** The bank's lending policies often reward macroeconomic inefficiency in the underdeveloped world, allowing inefficient nations to avoid the types of fundamental reforms that would in the long run end poverty in their countries. Many analysts note that the best example is to compare the fantastic growth in East Asia to the deplorable economic conditions of Africa. In 1950 the regions were alike—South Korea had a lower per capita GDP than Nigeria. But by pursuing macroeconomic reforms, high savings, investing in education and basic social services, and opening their economies to the global trading order, the "Pacific Tigers" have been able to lift themselves out of poverty and into wealth with very little help from the World Bank. Many countries in Africa, however, have relied primarily on multilateral assistance from organizations like the World Bank while avoiding fundamental macroeconomic reforms, with deplorable but predictable results.

Conservatives point out that the World Bank has lent more than $350 billion over a half-century, mostly to the underdeveloped world, with little to show for it. One study argued that of the sixty-six countries that received funding from the bank from 1975 to 2000, well over half were no better off than before, and twenty were actually worse off. The study pointed out that Niger received $637 million between 1965 and 1995, yet its per capita GNP had fallen, in real terms, more than 50 percent during that time. In the same period Singapore, which received one-seventh as much World Bank aid, had seen its per capita GNP increase by more than 6 percent a year.

- **Focusing on large projects rather than local initiatives.** Some critics claim that World Bank loans give preference to "large infrastructure projects like building dams and electric plants over projects that would benefit the poor, such as education and basic health care." The projects often destroy the local environment, including forests, rivers, and fisheries. Some estimates suggest "that more than two and a half million people have been displaced by projects made possible through World Bank loans." Failed projects, argue environmentalists and antiglobalization groups, are particularly illustrative: "The Sardar Sarovar dam on the Narmada River in India was expected to displace almost a quarter of a million people into squalid resettlement sites. The Polonoroeste Frontier Development scheme has led to large-scale deforestation in the Brazilian rain forest. In Thailand, the Pak Mun dam has destroyed the fisheries of the Mun River, impoverishing thousands who had made their living fishing and forever altering the diet of the region." Further, the larger projects become targets for corruption by local government officials because there is so much money involved.Another example was in 2009, when an internal audit found that the IFC had "ignored its own environmental and social protection standards when it approved nearly $200 million in loan guarantees for palm oil production in Indonesia…Indonesia is home to the world's second-largest reserves of natural forests and peat swamps, which naturally trap carbon dioxide—the main greenhouse gas that causes climate change. But rampant destruction of the forests to make way for palm oil plantations has caused giant releases of CO_2 into the atmosphere, making Indonesia the third-largest emitter of greenhouse gases on the planet…'For each investment, commercial pressures were allowed to prevail,' auditors wrote." *Source: Lisa Friedman, "How the World Bank Let 'Deal Making' Torch the Rainforests," New York Times, August 19, 2009, accessed February 9, 2011, http://www.nytimes.com/cwire/2009/08/19/19climatewire-how-the-world-bank-let-deal-making-torch-the-33255.html.* However, as this article goes on to point out, such issues are not always as clear-cut as they may seem. The IFC responded to the audit by acknowledging "shortcomings in the review process. But the lender also defended investment in palm oil production as a way to alleviate poverty in Indonesia. 'IFC believes that production of palm oil, when carried out in an environmentally and socially sustainable fashion, can provide core support for a strong rural economy, providing employment and improved quality of life for millions of the rural poor in tropical areas,' it said."
- **Negative influence on theory and practice.** As one of the two Bretton Woods Institutions, the World Bank plays a large role in research, training, and policy formulation. Critics worry that because "the World

Bank and the IMF are regarded as experts in the field of financial regulation and economic development, their views and prescriptions may undermine or eliminate alternative perspectives on development." *Source: "What Are the Main Concerns and Criticism about the World Bank and IMF?," Bretton Woods Project, January 25, 2007, accessed February 9, 2011, http://www.brettonwoodsproject.org/item.shtml?x=320869.*

- **Dominance of G7 countries.** The industrialized countries dominate the World Bank (and IMF) governance structures. Decisions are typically made and policies implemented by these leading countries—the G7—because they are the largest donors, some suggest without sufficient consultation with poor and developing countries. *Source: "What Are the Main Concerns and Criticism about the World Bank and IMF?," Bretton Woods Project, January 25, 2007, accessed February 9, 2011, http://www.brettonwoodsproject.org/item.shtml?x=320869.*

Opportunities and Future Outlook for the World Bank

As vocal as the World Bank's critics are, so too are its supporters. The World Bank is praised by many for engaging in development projects in remote locations around the globe to improve living standards and reduce poverty. The World Bank's current focus is on helping countries achieve the Millennium Development Goals (MDGs), which are eight international development goals, established in 2000 at the Millennium Summit, that all 192 United Nations member states and twenty-three international organizations have agreed to achieve by the year 2015. They include reducing extreme poverty, reducing child mortality rates, fighting disease epidemics such as AIDS, and developing a global partnership for development. The World Bank is focused on the following four key issues:

1. **Increased transparency.** In response to the criticisms over the decades, the World Bank has made progress. More of the World Bank's decision making and country assessments are available publicly. The World Bank has continued to work with countries to combat corruption both at the country and bank levels.
2. **Expanding social issues in the fight on poverty.** In 2001, the World Bank began to incorporate gender issues into its policy. "Two years later the World Bank announced that it was starting to evaluate all of its projects for their effects on women and girls," noting that "poverty is experienced differently by men and women" and "a full understanding of the gender dimensions of poverty can significantly change the definition of priority policy and program interventions." *Source: Robert J. Brym et al., "In Faint Praise of the World Bank's Gender Development Policy," Canadian Journal of Sociology Online, March–April 2005, accessed May 23, 2011, http://www.cjsonline.ca/articles/brymetal05.html*.
3. **Improvements in countries' competitiveness and increasing exports.** The World Bank's policies and its role as a donor have helped improve the ability of some countries to secure more of the global revenues for basic commodities. In Rwanda, for example, reforms transformed the country's coffee industry and increased exports. Kenya has expanded its exports of cut flowers, and Uganda has improved its fish-processing industry. World Bank efforts have also helped African financial companies develop. *Source; Shanta Devarajan, "African Successes—Listing the Success Stories," Africa Can…End Poverty (blog), The World Bank Group, September 17, 2009, accessed May 23, 2011, http://blogs.worldbank.org/africacan/african-successes-listing-the-success-stories.*
4. **Improving efficiencies in diverse industries and leveraging the private sector.** The World Bank has worked closely with businesses in the private sector to develop local infrastructure, including power, transportation, telecommunications, health care, and education. In Afghanistan, for example, small dams are built and maintained by the locals themselves to support small industries processing local produce. *Source: Shanta Devarajan, "African Successes—Listing the Success Stories," Africa Can…End Poverty (blog), The World Bank Group, September 17, 2009, accessed May 23, 2011, http://blogs.worldbank.org/africacan/african-successes-listing-the-success-stories.*

The World Bank continues to play an integral role in helping countries reduce poverty and improve the well-being of their citizens. World Bank funding provides a resource to countries to utilize the services of global companies to accomplish their objectives.

KEY TAKEAWAYs

- The IMF is playing an expanding role in the global monetary system. The IMF's key roles are the following:

  - To promote international monetary cooperation
  - To facilitate the expansion and balanced growth of international trade
  - To promote exchange stability
  - To assist in the establishment of a multilateral system of payments
  - To give confidence to members by making the IMF's general resources temporarily available to them under adequate safeguards
  - To shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members
- The World Bank consists of two main bodies, the IBRD and the International Development Association (IDA).
- The World Bank Group includes the following interrelated institutions:
  - IBRD, which makes loans to countries with the purpose of building economies and reducing poverty
  - IDA, which typically provides interest-free loans to countries with sovereign guarantees
  - International Finance Corporation (IFC), which provides loans, equity, risk-management tools, and structured finance with the goal of facilitating sustainable development by improving investments in the private sector
  - Multilateral Investment Guarantee Agency (MIGA), which focuses on improving the foreign direct investment of the developing countries
  - International Centre for Settlement of Investment Disputes (ICSID), which provides a means for dispute resolution between governments and private investors, with the end goal of enhancing the flow of capital

READING: IMF AND THE WORLD BANK: HOW DO THEY DIFFER?

If you have difficulty distinguishing the World Bank from the International Monetary Fund, you are not alone. Most people have only the vaguest idea of what these institutions do, and very few people indeed could, if pressed on the point, say why and how they differ. Even John Maynard Keynes, a founding father of the two institutions and considered by many the most brilliant economist of the twentieth century, admitted at the inaugural meeting of the International Monetary Fund that he was confused by the names: he thought the Fund should be called a bank, and the Bank should be called a fund. Confusion has reigned ever since.

The attached document explains, in detail the difference.

Source: http://www.imf.org/external/pubs/ft/exrp/differ/differ.htm

WEBSITES: IMF AND WORLD BANK

Website: IMF

Website: World Bank