International Trade, Finance, and Business

Chapter Summary

This chapter focuses on the economic aspect of hard power. In particular, it looks at three features of the global economic system: **international trade**, **international finance**, and **international business**. The explanation of the fundamental drivers of economic growth includes six factors: natural resources, human resources, productivity, technology and inventions, research and knowledge, and social institutions (that protect, enable, and incentivize). Next, the equation for calculating the **Gross Domestic Product (GDP)** is examined: C + I + G + (X – M) = GDP, where *C* represents consumer spending, *I* stands for business investment, *G* is for government spending, *X* stands for exports, and *M* represents imports. Finally, two additional key components of the economy are considered: interest rates and the value of a national currency.

When it comes to international trade the most basic reason for pursing it is the theory of **comparative advantage**, centred around the principle of **division of labour**. The modern global economy has been built on this very idea. When approaching international trade, there are generally three sets of policies countries can adopt. First, countries can adopt **autarchy**, wherein the country tries to be as self-sufficient as possible and minimize foreign relations or trade. The national government usually plays a leading role in economic policy, a doctrine called **mercantilism**. Today, this approach is generally viewed as outdated and not good for the wealth of the people. Next, countries can follow the path of **free trade** and **internationalism**, by becoming fully interconnected participants in the global economy and eschewing most forms of **protectionism**. This approach is viewed more favourably today, as it tends to increase the wealth of the people, though "pure free trade" remains an ideal that does not really exist anywhere. Or finally, countries can utilize **export-led development**, where the tools of mercantilism and protectionism are used to prepare domestic industries for global competition before free trade is aggressively pursued and large revenues are generated via exports. Asian countries like Japan and South Korea are presented as case studies to better explore this third pathway.

The impact of **globalization** and international institutions on international trade are then considered before some potential problems with the current status quo (of free trade/internationalism) are discussed. These include rivalries between big regional **trading blocs**, divide in the distribution of benefits from free trade between (relative) winners and losers, participants versus non-participants in international trade, and the discrepancy in trade activity between the Global North and Global South.

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International finance is examined in the context of the **bond market**, the regulation of international economic growth, and the **balance of payments**. Lastly, the section on international business tackles three interrelated subjects: how standard business practices and conventions differ across major world regions; the role of **multinational corporations (MNCs)** in international trade and business; and the new industry of **fair trade** and its connection to international development.

Key Concepts

Appreciates: when the value of a country's national currency goes up. (p. 194)

Asian Dragons: also known as the "Asian Tigers," these are countries in Asia that have successfully followed the path of export-led development. They include Japan, South Korea, Singapore, Taiwan, and China. (p. 205)

Autarchy: a policy of determined self-sufficiency in economic matters. Based on the principle of being "beholden to none," autarchy is the drive for a nation to provide as much as it can for itself while minimizing any dependency on foreign relations or international trade. As economic policy, autarchy is viewed today as a dated doctrine that is generally not good for the wealth of the people. (p. 198)

Balance of payments (BOP): a catch-all balance sheet reflecting the sum total of all of a country's economic interactions with the rest of the world. It includes the current account (a major part of which is the international trade deficit or surplus that the country has with the rest of the world) and the capital account (which includes flows of money and investments across borders). (p. 214)

Bond market: a bond is a "debt instrument" used by governments to raise significant amounts of money. Essentially, a bond is a promise from "A" that in exchange for a lump-sum payment from "B" right now, "A" will, over a certain length of time (e.g., 30 years), repay the lump-sum payment plus considerable interest every year until the term is over. Anyone can buy government bonds, but many national governments buy each other's bonds in huge quantities, tying the world economy together in an additional way. (p. 213)

Business cycle: the recurrent flow of economic activity between periods of expansion and contraction (or "boom" and "bust"). When a country's GDP goes up, the economy is in an expansion phase (growing phase); when GDP goes down, the economy is in a contraction phase (shrinking economic growth, or a recession). Almost all economies experience this business cycle. (p. 192)

Central bank: a public institution (like the Federal Reserve of the United States or the Bank of Canada) in charge of (a) printing the national currency, and (b) managing interest rates. (p. 192)

Comparative advantage: a theory that suggests when we trade, everyone benefits because everyone can specialize in what they do best and take full advantage of the principle of division of labour. (p. 195)

Current account balance: a country's exports minus its imports. (p. 196)

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Deflation: a decrease in the price of goods and services within a country. A high rate of deflation is associated with recession (negative economic growth). It is the opposite of inflation. (p. 193)

Depreciates: when the value of a country's national currency goes down. (p. 194)

Division of labour: specializing in one's comparative advantage (what you do best), and then trading one's surplus for the surplus of others who have done the same thing. (p. 196)

Economics: how goods and services are produced, distributed, and used. (p. 189)

Export-led development: large-scale strategy for growing the national economy, using the tools of mercantilism and protectionism to subsidize and grow select local industries until they are strong enough to compete on the world stage; at that point, tariffs are dropped and the country aggressively engages in free trade to maximize revenues from export sales. These revenues are then used to develop society further, making it richer and more sophisticated. The most successful model of this approach in modern history is Japan following World War II; more recently, other Asian countries (e.g., China and South Korea) have copied this success. (p. 202)

Exports: goods produced for sale to another country. The opposite of imports. (p. 191)

Fair trade: a movement designed to help independent farmers, especially in the Global South, earn a living wage by charging fair prices for products such as coffee, cocoa, sugar, tea, cotton, honey, bananas, chocolate, wine, and flowers. The movement appeals to consumers not on the basis of price (because the price is typically higher than the free trade, mass-market price), but rather, on the basis of how good the products are and how important it is for everyone to support independent farmers. (p. 220)

Fiscal policy: how governments spend money; reflected in the official budget, the rate of taxation, new spending measures, and so on. This is in the direct control of the (elected) government, whereas monetary policy is not. (p. 192)

Foreign trade sector: part of the national economy that focuses on exports and imports. (p. 192)

Free trade: trade of goods and services between countries where the countries do not adopt any forms of protectionism. This means trade that is tariff-free, quota-free, product ban-free, and subsidy-free; what gets traded, and at what prices and quantities, is determined solely by the market forces of supply and demand and not by any government regulation or intervention. A free trade area is a group of countries, often sharing a common geographical region, that have agreed to engage in free trade with one another; examples include the European Union and the North American Free Trade Agreement. (p. 201)

General Agreement on Tariffs and Trade (GATT): founded in 1947, the GATT was the focal point for several global rounds of multilateral negotiations on reducing tariffs and increasing international trade. Highly successful, it was succeeded by the World Trade Organization in 1995. (p. 205)

Globalization: the recent and increasing strengthening of ties between countries, mainly in the economic sense of international trade and the spread of free-market capitalism, but also socio-culturally,

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in regard to the increasing immigration/migration of individuals, travel and transportation, information technology, social media, and pop culture. (p. 206)

Gold Standard: from 1944 until the early 1970s (under the terms of the Bretton Woods agreement), when the value of the US dollar was tied (fixed) to the price of gold. When US gold reserves ran low in the early 1970s, this system was ended, and the value of all major national currencies today are floating (based on their relative value to other world currencies and to world demand). (p. 194)

Gross Domestic Product (GDP): a measure of national wealth, summarizing the condition of, and level of activity in, a country's economy; it is the total value of goods produced and services provided in a country in one year. (p. 190)

Hyperinflation: very rapid and unpredictable price increases, generally above the target band. (p. 193)

Imports: good produced in another country and purchased in your country. The opposite of exports. (p. 191)

Inflation: an increase in the price of goods and services within a country. A high rate of inflation is associated with economic growth, but if it becomes too accelerated, it can cause serious problems. Most countries aim for small, controlled amounts of inflation (e.g., 1–3 per cent, per year). Inflation is the opposite of deflation. (pp. 192–193)

Intellectual property (IP): a kind of law and legal right, referring to the properly-like ownership of ideas and other products of creativity, ranging from new books, music, and movies to formulas for new medications and the design of machinery. A dispute in international trade wherein the developed North wants the developing South to improve measures for respecting IP. (p. 212)

Interest rates: these represent the price of money. They are what lenders (e.g., banks) charge when they lend you money to buy a house or a car. When interest rates go up, money becomes more expensive, people tend to spend less, which translates into a shrinking economy (the opposite is also true: when interest rates go down, money becomes cheaper, people spend more, and the economy grows). (p. 192)

International finance: broadly speaking, refers to how entire national economies interrelate, which includes international trade. More narrowly however, international finance involves how the financial industry (banks, stock markets, trust and insurance companies) has become increasingly interconnected and globalized over the past 30 years, in particular. (p. 213)

International trade: movement of goods and services across national borders in exchange for money. (p. 195)

Internationalism: a country that is a fully interconnected participant in the global economy. (p. 201)

Mercantilism: doctrine that sees the national government playing a leading role in economic policy, by maximizing resources to further develop and strengthen the country. Closely linked to the autarchy approach to international trade. (pp. 198–199)

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Monetary policy: policies designed to control a country's supply of money, set out and overseen by a semi-autonomous central bank, aloof from party politics in democratic countries (p. 192)

Money supply: how much money there is in a given country; determined by that country's central bank. (p. 192)

Multinational corporations (MNCs): a large business operating in several countries. (p. 215)

Living wage: an important feature of the fair trade movement, this means an income consistent with the standard of living that will actually pay the bills. (p. 220)

Overnight rate: leading national interest rate, managed by central banks and which sets the tone for all other lending institutions inside the country. (p. 192)

Product ban: totally prohibit certain goods from entering a country; a type of protectionism. (p. 202)

Productivity: economic output per worker. (p. 190)

Protectionism: use of government power in a manner inconsistent with free trade. These are measures that are hurdles or obstacles placed by the government on imports in order to protect certain domestic goods or industries. Examples include tariffs, quotas, product bans, and subsidies. (p. 202)

Public good: something that benefits everyone, for instance, stability and predictability within the international financial sector. (p. 214)

Quotas: limits a country places on the number of foreign-produced goods that it is willing to allow to be imported for sale into its country; a type of protectionism. (p. 202)

Recession: shrinking economic growth, the contraction phase of a business cycle. (p. 192)

Reserve currency: a currency that central banks of other countries are comfortable holding as part of their foreign exchange reserves. Since World War II, the US dollar has been the world's principal reserve currency. (p. 194)

Subsidies: government investments (using domestic tax dollars) into domestic companies and industries, with the goal of giving them an advantage over foreign competitors and creating jobs at home; a type of protectionism. (p. 202)

Sweat-shop manufacturing: characterized by very low pay, very long hours, demanding physical work, and unsafe, cramped conditions; examples include the clothing industry in Central America and Southeast Asia. (p. 218)

Target band: the target level of inflation that countries (via their central banks) tend to aim for: generally, around 1–3 per cent, per year. (p. 193)

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Tariffs: a tax on foreign, imported goods, which increases the price of these goods, making them more unattractive to consumers (relative to competing local or domestic goods); a type of protectionism. (p. 202)

Trade deficit: when a country imports more than it exports; this tends to draw down the country's economy. (p. 196)

Trade surplus: when a country exports more than it imports; this tends to grow the country's economy. (p. 196)

Trade wars: characterized by a downward spiral of mutual tariffs, quotas, non-engagement, and even sanctions between disputing countries. It can create much ill will, cost the people of the two countries substantially, and lead to further bad feelings that, at worst, might spark an armed conflict. (p. 206)

Trading blocs: grouped countries that practice free trade internally with each other but that are fiercely protectionist externally towards non-members and other blocs. The blocs most frequently identified are Europe, North America, and the Pacific Rim centered around China. (p. 207)

World Trade Organization (WTO): the successor to the GATT, the WTO is a permanent institution, a watchdog of sorts, with powers of oversight, mediation, and enforcement over global trade issues and rules. (p. 205)

Study Questions

Scroll to the end for answers.

1. What are the foundations of economic growth?

2. What is the difference between fiscal and monetary policy?

3. What are the four most common examples of protectionist measures?

4. What are the five main arguments criticizing multinational corporations (MNCs)?

5. What are the major counter-arguments in support of multinational corporations (MNCs)?

Short Answer Answers

1. The foundations of economic growth are natural resources, productivity, human resources, technology and inventions, research and knowledge, and social institutions (that protect, enable, and incentivize). (p. 191)

2. Fiscal policy refers to how governments spend money; reflected in the official budget, the rate of taxation, new spending measures, and so on. Monetary policy is designed to control a

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country's supply of money. Fiscal policy is directly controlled by the elected government whereas monetary policy is overseen by a semi-autonomous central bank that is aloof from party politics. (p. 192)

3. The four most common examples of protectionist measures are tariffs, quotas, product bans, and subsidies (p. 202)

4. The most common criticisms are that MNCs cooperate with and support repressive regimes, take advantage of lax employment standards and regulations, contribute to uneven development in underdeveloped societies, create inequalities within developing societies, and exploit the relative neediness of developing societies, especially in terms of labour. (p. 218)

5. Governments are to blame for historical injustices like colonialism and imperialism; MNCs do not support repressive regimes because MNCs are businesses that must obey local laws; development falls under the purview of governments and not MNCs; MNCs do not exploit local labour because their wages tend to be higher than comparable domestic industries. (p. 219)

Weblinks

Two *Foreign Policy* articles about globalization and the backlash against globalization
https://foreignpolicy.com/2009/09/30/think-again-globalization/
https://foreignpolicy.com/2009/11/17/think-again-the-globalization-backlash/

- Excellent pieces by well-known and respected scholars that tackle the conventional wisdom about and against globalization

Three articles that discuss Brexit
https://www.vox.com/2016/6/24/12025514/brexit-cartoon (*Vox* piece, summary video at the end)
https://www.theguardian.com/politics/2016/jun/24/how-did-uk-end-up-voting-leave-european-union (*Guardian* piece, more discussion of the vote itself)
https://www.bbc.com/news/uk-politics-32810887 (*BBC* primer about Brexit, very detailed)

- Arguably the biggest challenge to international trade and globalization, these articles help shed some light on Brexit, Britain's decision to leave the European Union

Foreign Policy article about globalization's impact on contemporary politics
https://foreignpolicy.com/2016/12/06/its-the-globalization-stupid/

- Good analysis that links the impact of globalization on surprising recent events, like the election of Donald Trump in the United States and the Brexit decision in Britain

Further Readings

Freeland, Chrystia. 2012. *Plutocrats: The Rise of the New Global Super-Rich and the Fall of Everyone Else*. Toronto, ON: Doubleday Canada.

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- An excellent and insightful look at the rise of the wealthy .01% in the world and their impact on the global economic system. Freeland is a business journalist and the current Minister of Foreign Affairs for the government of Canada (2018).

Friedman, Thomas. 2006. *The World Is Flat: A Brief History of the Twenty-First Century*. New York, NY: Farrar, Straus and Giroux.

- A well-written analysis of globalization in the twenty-first century by Pulitzer Prize–winning writer and journalist for the *New York Times*, Thomas Friedman. One of the original, classical works on the trend and impact of globalization.

Lewis, Michael. 2010. *The Big Short: Inside the Doomsday Machine*. New York, NY: W.W. Norton & Company.

- An excellent look inside the 2006–2008 financial and mortgage crisis in the United States (a nice supplemental to the short discussion of the crisis in the "Studies in Technology" section of the chapter).

Klein, Naomi. 2007. *The Shock Doctrine: The Rise of Disaster Capitalism*. Toronto, ON: Vintage Canada.

- An alternative perspective on how free market capitalism spread throughout the world. Klein attempts to debunk the myth that this triumph occurred democratically and that democracy and capitalism necessarily go together all the time.

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