Module 2: International Trade and Investment

YOUR CONTENT

SUMMARY

This module provides an overview of trends and theories regarding international trade and foreign direct investment. International trade and foreign direct investment have grown dramatically over recent decades. Although new trading and investment patterns are emerging, developed nations tend to trade with and invest in other developed nations, not in developing countries. Much trade is conducted based on regional trade partners and bilateral or multilateral trade agreements. Trade theories attempt to explain why nations trade with each other. Mercantilists believed that trade should be a vehicle for accumulating gold and other precious minerals. Adam Smith, displeased with mercantilist ideas, showed that a nation could acquire what it does not produce by means of free, unregulated trade. A nation could gain most by producing only goods that it could produce with less labor than other nations. Ricardo carried Smith's argument a step farther by proving that a country that was less efficient in the production of all goods could still gain from trade by exporting those products in which it was less inefficient. Newer trade theories are also discussed, including differences in resource endowments, overlapping demand, international product life cycle, economies of scale and the experience curve, and national competitive advantage from regional clusters.

The traditional approach to international involvement was to begin with exporting, then setting up foreign sales companies and finally, where the sales volume warranted, establishing foreign production facilities. Increasingly, because countries have liberalized trade restrictions and IT has made communication instantaneous, companies are becoming involved in trade and FDI for many reasons. International investment theory attempts to explain why foreign direct investment occurs. Product and factor market imperfections as well as strategic behavior help explain foreign investment patterns and help explain why firms primarily from oligopolistic industries may develop advantages not open to indigenous companies. The internalization theory states that international firms will seek to invest in a foreign subsidiary rather than license their superior knowledge to receive a better return on investment used to produce the knowledge. Dynamic capabilities theory suggests that successful international investment requires firms to have an ability to dynamically create, sustain, and exploit unique knowledge or resources over time. There is a brief description of the Eclectic Theory of International Production.

LEARNING OBJECTIVES

LO 2-1	Describe the magnitude of international trade and how it has grown.
LO 2-2	Identify who participates in trade.
LO 2-3	Distinguish among the theories that explain why certain goods are traded internationally.
LO 2-4	Describe the size, growth, and direction of foreign direct investment.

LO 2-5 Explain several of the theories of foreign direct investment.

KEY TERMS AND DEFINITIONS

absolute advantage (p. 35)	A nation's ability to produce more of a good or service than another country for the same or lower cost of inputs
comparative advantage (p. 38)	When one nation is less efficient than another nation in the production of each of two goods, the less efficient nation has a comparative advantage in the production of that good for which its absolute disadvantage is less
cross-border acquisition (p. 50)	The purchase of an existing business in another nation
currency devaluation (p. 40)	A reduction in the value of a country's currency relative to other currencies
direct investment (p. 45)	The purchase of sufficient stock in a firm to obtain significant management control
dynamic capability theory (p. 51)	Theory that for a firm to successfully invest overseas, it must have not only ownership of unique knowledge or resources, but also the ability to dynamically create, sustain, and exploit these capabilities over time
eclectic theory of international production (p. 51)	Theory proposing that for a firm to invest in facilities overseas, it must have three kinds of advantages: ownership specific, location specific, and internalization
economies of scale (p. 43)	The predictable decline in the average cost of producing each unit of output as a production facility gets larger and output increases
exchange rate (p. 39)	The price of one currency stated in terms of another
experience curve (p. 43)	The rising scale on which efficiency improves as a result of cumulative experience and learning
greenfield investment (p. 50)	The establishment of new facilities from the ground up

internalization theory (p. 51)	Theory that to obtain a higher return on investment, a firm will transfer its superior knowledge to a foreign subsidiary that it controls, rather than sell it in the open market
international product life cycle (IPLC) (p. 41)	A theory explaining why a product that began as a nation's export eventually becomes its import
mercantilism (p. 34)	An economic philosophy based on the belief that (1) a nation's wealth depends on accumulated treasure, usually precious metals such as gold and silver; and (2) to increase wealth, government policies should promote exports and discourage imports
monopolistic advantage theory (p. 50)	Theory that foreign direct investment is made by firms in industries with relatively few competitors, due to their possession of technical and other advantages over indigenous firms
national competitiveness (p. 44)	A nation's relative ability to design, produce, distribute, or service products within an international trading context while earning increasing returns on its resources
oligopolistic industry (p. 51)	An industry with a limited number of competing firms
overlapping demand (p. 41)	The existence of similar preferences and demand for products and services among nations with similar levels of per capita income
perfect competition (p. 35)	A market situation in which there is a sufficiently large number of well-informed buyers and sellers of a homogeneous product, such that no individual participant has enough power to determine the price of the product, resulting in a marketplace that is efficient in production and allocation of products
portfolio investment (p. 45)	The purchase of stocks and bonds to obtain a return on the funds invested
product differentiation (p. 41)	Unique differences producers build into their products with the intent of positively influencing demand

resource endowment (p. 40)	The land, labor, capital, and related production factors a nation possesses
strategic behavior theory (p. 51)	Theory suggesting that strategic rivalry between firms in an oligopolistic industry will result in firms closely following and imitating each other's international investments in order to keep a competitor from gaining an advantage
trade deficit (p. 34)	The amount by which the value of imports into a nation exceeds the value of its exports
trade surplus (p. 34)	The amount by which the value of a nation's exports exceeds the value of its imports

CONTENT OUTLINE

The following section provides the flow of information using the LEARNING OBJECTIVES as a guide, KEY TERMS learners will need to take away from the course, and LECTURE NOTES to drive home teaching points.

LO 2-1	Describe the magnitude of international trade and how it has grown.
	• Introduction
	• International Trade
	  ○ Volume of International Trade
	  ○ How Evenly Has Trade Grown?
	  ○ Which Nations Account for the Most Exports and Imports?
		Key Terms:

I. Introduction

1. In this module, two topics are examined that relate directly to exporting and production in foreign countries: (1) international trade, which includes exports and imports, and (2) foreign direct investment.

II. International Trade

A. Volume of International Trade

1. The volume of international trade in goods and services was $4 trillion in 2000 and exceeded $23 trillion in 2017.
2. Trade in physical goods accounted for $17.5 trillion of the $23 trillion in 2017, while trade in services was $5.4 trillion.
3. While smaller in absolute terms, trade in services has grown faster in the past 20 years than has merchandise trade.
4. Nearly 60 percent of global output is now destined for international trade.

B. How Evenly Has Trade Grown?

1. The proportion of exports from North America, Latin America, Africa, and the Middle East has *decreased* since 1983.
2. The proportion of merchandise exports from Asia has nearly doubled since 1983, with China accounting for over 83 percent of the increase.
3. Rapid expansion of international trade has helped transform nations such as Singapore, Taiwan, and South Korea from poverty in the 1950s to developed country standards of living, and 500 million Chinese have been lifted out of poverty by China's trade-driven policies.

4. The European Union increased its proportion of world trade, though the increase is largely due to the EU's expansion to 28 member countries.
5. All regions and essentially all primary-world nations experienced an absolute increase in the dollar volume of their services exports, though the proportion of world exports of commercial services from Latin America, the EU, Africa, and the Middle East has declined since 1980.
6. The rapid increase of world exports since 1980 demonstrates that exporting is a viable growth strategy and one that can benefit exporting nations by creating jobs for their citizens.

C. Which Nations Account for the Most Exports and Imports?

1. Table 2.1 shows the ranking of the world's 10 leading exporters and importers of merchandise and services.
2. The top exporters and importers are generally developed countries, though China ranks in the top 5 for each list and India in the top 10 for imports and exports of services.
3. The 10 largest exporters and importers collectively account for over 50 percent of the world's exports and imports.

LO 2-2	Identify who participates in trade.	Key Terms:
	• Direction of Trade ○ The Increasing Regionalization of Trade ○ Major Trading Partners: Their Relevance for Managers ○ Major Trading Partners of the United States	• trade deficit • trade surplus

III. Direction of Trade

1. More than half the exports from developing nations go to developed countries, but this proportion has been declining, from 72 percent in 1970 to about 43 percent in 2015; about 2/3 of exports from developed countries go to other developed countries.

IV. The Increasing Regionalization of Trade

A. World Trade is dominated by exchanges within, not between, geographic regions.

1. In 2017, about half of exports from North American nations went to other nations in North America
2. A little more than half of Asian nations' exports were to other Asian nations.
3. Over 70 percent of exports from European nations went to other European nations.
4. Regionalization of trade is reinforced by the development of expanded regional trade associations and agreements such as ASEAN, Mercosur, the EU, and NAFTA.

5. There are more than 260 regional trade agreements in operation worldwide and the share of world trade they account for increased from 37 percent in 1980 to over 70 percent by 2018.

B. Growth of exports into developing country markets, and corresponding growth from developing countries to developed countries, are due in part to developing nations increased ability to export manufactured goods, but also due to growing intrafirm trade among international companies' affiliates around the world.

V. Major Trading Partners: Their Relevance for Managers

A. Advantages of focusing attention on a nation that is already a sizable purchaser of goods from the would-be exporter's country include:

1. Business climate in the importing nation is relatively favorable.
2. Export and import regulations are not insurmountable.
3. There should be no strong cultural objections to buying that nation's goods.
4. Satisfactory transportation facilities have already been established.
5. Import channel members are experienced in handling import shipments from the exporter's area.
6. Foreign exchange to pay for the exports is available.
7. A government may encourage its importers to buy from the countries that buy their exports.

VI. Major Trading Partners of the United States

A. Figure 2.2 shows the major trading partners of the United States.

1. The top 10 accounted for 66 percent of U.S. exports and 70 percent of US imports in 2017.
2. Mexico and Canada are major trading partners, sharing a common border with the U.S. and being partners in the NAFTA.
3. 7 of the top 15 nations the U.S. imports from have remained on the list over the past 45 years.
4. Rankings of America's trading partners are rapidly changing. Asian nations, like China, have become increasingly important, yet challenging, trade partners for both exports and imports.
5. Between 1991 and 2017, China rose from 6th to 1st place in exports to the U.S. and to 3rd place as an importer of U.S. goods, albeit with a substantial trade deficit for the U.S.

B. Many Asian countries are becoming major importers of American goods because:

1. Their rising standards of living enable their people to afford more imported products, and export earnings provide foreign exchange to pay for imports.

2. They are purchasing large amounts of capital goods to further their industrial expansion.
3. They are importing raw materials and components to assemble into subassemblies or finished goods to subsequently export, often to the U.S.
4. Their governments, sometimes under pressure from the U.S. government, have sent buying missions to the U.S. to seek products to import.

C. New international business opportunities can be identified by examining trade statistics from various governmental sources.

LO 2-3	Distinguish among the theories that explain why certain goods are traded internationally.	Key Terms:
	• Explaining Trade: International Trade Theories ○ Mercantilism ○ Theory of Absolute Advantage ○ Theory of Comparative Advantage ○ How Exchange Rates Can Change the Direction of Trade ○ Some Newer Explanations for the Direction of Trade ○ Summary of International Trade Theory	• mercantilism • absolute advantage • perfect competition • comparative advantage • exchange rate • currency devaluation • resource endowment • overlapping demand • product differentiation • international product life cycle (IPLC) • economies of scale • experience curve • national competitiveness

VII. Explaining Trade: International Trade Theories

1. International trade is large in volume and growing, and is also critical to the economic performance of most nations. International trade theory attempts to answer the question, “Why does this trade occur, both overall and between particular nations?”

A. Mercantilism

1. One of the first economic doctrines.
2. Central idea—precious metals were viewed as the only source of wealth and nations could accumulate these precious metals by exporting more goods than they import.
3. Governments should control foreign trade to ensure a favorable trade balance.

B. Theory of Absolute Advantage

1. Adam Smith (*The Wealth of Nations* – 1776) attacked mercantilism and said that to trade in order to accumulate gold and other precious metals was foolish. By means of free, unregulated trade, a nation could acquire what it did not produce.
2. He stated that a nation should produce only those goods in which it was most efficient (country specialization). The surplus could be traded to obtain the products that could not be produced advantageously.
3. Ask: "What are the limits within which both countries are willing to trade?" Discuss these topics: Terms of Trade (Ratio of International Prices) and Gains from Specialization and Trade to further explain Absolute Advantage Theory.
4. Use the examples in the text to explain Absolute Advantage Theory in depth.

C. Theory of Comparative Advantage

1. David Ricardo (1817) showed that if a nation were less efficient in the production of two products, it could still gain from international trade if it were not equally less efficient in the production of both goods.
2. Smith's and Ricardo's theories considered labor as the only important factor in calculating production costs and no thought was given to the possibility of producing the same goods with different combinations of factors.
3. Use the examples in the text to explain Comparative Advantage Theory in depth.

D. How Exchange Rates Can Change the Direction of Trade

1. Traders must know a price in domestic currency to determine if is better to produce locally or import.
2. Exchange rate is the price of one currency stated in terms of the other.
3. Countries can regain a competitive position through currency devaluation.
4. Use examples from the text to explain Exchange Rates.

E. Some Newer Explanations for the Direction of Trade

1. Differences in Resource Endowments

a. Some countries have more abundant resources than others, which can result in different opportunity cost of producing these resources and bringing them to market.

b. Difference in resource endowments suggest that developed countries would more likely trade with developing countries rather than other developed countries with similar factor endowments.

2. Overlapping Demand

    a. Consumers' tastes, preferences, and their nation's per capita income affect market demand in any country.

    b. Customers in countries with similar levels of per capita demand will demand similar goods and services.

    c. Unlike the theory of comparative advantage, overlapping demand theory does not specify the direction a given good will go.

3. International Product Life Cycle (IPLC)

    a. Developed by Raymond Vernon, this theory addresses the role of innovation in trade patterns by explaining why a product that begins as a nation's export may eventually become its import.

    b. Figure 2.3 illustrates the evolution of this life cycle.

    c. The IPLC may have less relevance for "born global" companies and under conditions of increased international competition and short product life cycles.

4. Economies of Scale and the Experience Curve

    a. Economies of scale refer to the predictable decline in the average cost of producing each unit of output as a production facility gets larger and output increases.

    b. Experience curve effects may also decrease production costs due to cumulative experience and learning.

    c. These concepts can help explain a nation's ability to become a low cost producer even without an abundance of resources like labor or minerals.

5. National Competitive Advantage from Regional Clusters

    a. National competitiveness results from a country's ability to complete the functions necessary to drive a product/service to market and while increasing ROI: design, produce, distribute, and service.

    b. Alfred Marshall explained that many industries or firms cluster together geographically because of three reasons:

        i. Advantages gained from pooling a common labor force.

ii. Gains attained from the development and pooling of specialized labor which can be coordinated with the needs of buyers.

iii. Benefits gained from the sharing of technological information and corresponding enhancement of the rate of innovation.

c. Porter's Diamond Model of National Advantage (Figure 2.4) identifies four variables that will have an impact on local firms' abilities to use a country's resources to gain competitive advantage:

i. Demand conditions, the nature of domestic demand within the country.

ii. Factor conditions, the level and makeup of production infrastructure.

iii. Availability of Related and supporting industries such as suppliers and support services.

iv. The Firm's strategy, structure and strategic rivalry, including the organization and management style of the firm, level of domestic competition and barriers to market entry.

v. Porter also claimed that competitiveness could be affected by government and chance.

F. Summary of International Trade Theory

International trade theory shows that nations will attain a higher level of living by specializing in goods for which they possess a comparative advantage and importing those for which they have a comparative disadvantage.

LO 2-4	Describe the size, growth, and direction of foreign direct investment. • Foreign Investment ○ Portfolio Investment ○ Foreign Direct Investment (FDI) ○ Does Trade Lead to FDI?	Key Terms: • portfolio investment • direct investment

VIII. Foreign Investment

1. Divided into two components: (1) portfolio investment and (2) direct investment. The distinction between these two has begun to blur, particularly with growing size and number of international mergers, acquisitions, and alliances.

A. Portfolio Investment

1. Not directly concerned with the control of a firm but to gain ROI.

2. Nonresidents owned American stock and bonds with a value of $8.0 trillion in 2018. Americans owned $12.5 trillion in foreign securities in 2018.

B. Foreign Direct Investment (FDI)

1. The Outstanding Stock of FDI (Figure 2.5)

   a. The book value of all FDI worldwide was nearly $30.8 trillion at the beginning of 2018.

   b. The U.S. is the largest investor nation, with $7.8 trillion invested abroad, over 4 times the FDI of the next-largest investor, the Hong Kong.

   c. The proportion of FDI accounted for by the United States declined by over one-third in the past 20 years; the proportion accounted for by the EU increased, though at least partly due to inclusion of additional member countries. Developing countries increased their proportion of FDI, from 1 percent in 1980 to 22 percent in 2018.

2. Annual Outflows of FDI

   a. Outflows often fluctuate substantially across years, due to factors such as level of economic growth within and across nations and regions of the world.

   b. Outflows hit a historical high in 2000—$1.16 trillion, more than 3.25 times the level in 1995. Global economic slowdown in late 2000 resulted in subsequent decline in annual FDI flows to under $498 billion in 2002, then increasing to $2.17 trillion in 2007 before another economic slowdown resulted in a decline to $1.26 trillion in 2014. FDI outflows increased again thereafter, averaging over $1.5 trillion per year from 2015 through 2017.

   c. The volume of outward FDI from developing nations in 2017 was 29 times the level in 1990; the proportion of outward FDI worldwide from developing nations increased from under 5 percent in 1990 to over 27 percent in 2017.

   d. The vast proportion of outward FDI, about two-thirds, comes from developed nations.

   e. Much of outward FDI is associated with global mergers and acquisitions, because:

      i. U.S. corporate restructuring put underperforming businesses and assets on the market.

      ii. Foreign companies want rapid access to U.S. advanced technology.

      iii. Foreign firms felt that access to the lucrative U.S. market would be more successful through acquiring known brand names rather than promoting unknown foreign brands.

      iv. Increased international competition, including pursuit of economies of scale, led to restructuring and consolidation of many global industries and acquisition of firms in major markets like the U.S.

3. Annual Inflows of FDI

a. Industrialized nations invest and trade with one another, but this proportion has declined in recent years: from an average of 76 percent for 1998–2002 to 54 percent for 2013–2017.

b. FDI flowing into developing countries was 7 times larger in 2000 than 1990 and tripled again by 2017, although the proportion of FDI funds flowing to these nations fluctuates widely.

c. Asia has seen a dramatic increase in FDI inflows in recent years, accounting for over 60 percent of all investments not directed at the U.S. and the EU during 2013–2017.

4. Level and Direction of FDI

a. Difficult to accurately determine present value of foreign investments, but if a nation continues to receive growing amounts of FDI, its investment climate must be favorable and the political forces of that country are attractive.

b. If there is political instability and low levels of FDI inflow, little investment will occur.

C. Does Trade Lead to FDI?

1. Historically, FDI followed foreign trade because trade costs less and has less risk than FDI and business can be expanded in smaller, controllable increments rather than incurring large investments and larger risk. A firm would start exporting by using agents and then set up an export department with foreign sales personnel as business expanded.

2. However, FDI can now lead to trade. Significant changes in today's global business environment make FDI a possible first step into international trade.

LO 2-5	Explain several of the theories of foreign direct investment.	Key Terms:
	• Explaining FDI: Theories of International Investment ○ Monopolistic Advantage Theory ○ Strategic Behavior Theory ○ Internalization Theory ○ Dynamic Capabilities Theory ○ Eclectic Theory of International Production	• greenfield investment • cross-border acquisition • monopolistic advantage theory • oligopolistic industry • strategic behavior theory • internalization theory

		• dynamic capability theory • eclectic theory of international production

IX. Explaining FDI: Theories of International Investment

1. Accepted theories to explain FDI: FDI can either be greenfield investment, where new facilities are built from the ground up, or cross-border acquisition, the purchase of existing business facilities in another nation. Strategic motives for FDI include finding new markets, accessing raw materials, accessing new technologies or managerial expertise, achieving production efficiencies, enhance political safety of firm's operations, or respond to competition.

A. Monopolistic Advantage Theory

1. This theory is based on the premise that FDI is made by firms in oligopolistic industries possessing technical and other advantages over indigenous firms. These advantages could be economies of scale, superior technology, or superior knowledge of marketing, management, or finance, giving the MNE competitive advantage over local firms.

B. Strategic Behavior Theory

1. In oligopolistic industries, where there is a limited number of competing firms, the actions of one firm can strongly affect the performance of others in that industry, so firms closely follow and imitate each other's international investments to keep a competitor from gaining an advantage.

C. Internationalization Theory

1. To obtain a higher ROI, a firm will transfer its superior knowledge to a foreign subsidiary and not sell it in the open market. Firms transfer knowledge across borders without it leaving the firm.

D. Dynamic Capabilities

1. Ownership of specific knowledge or resources is necessary but not sufficient enough for success in FDI, but firm must also develop distinctive competitive advantages to complement their knowledge or resources.

E. Eclectic Theory of International Production

1. This theory states that for a firm to invest overseas, it must possess 3 types of advantages:
    a. Ownership specific – tangible and intangible assets not available to competitors but can be transferred abroad (e.g., a recognizable brand name).

b. Location specific – foreign market offers economic, social or political advantages which will let the firm exploit its ownership specific advantages (market size, tariff or nontariff barriers, or transportation cost advantages)

c. Internalization – firms have choice as to the way to enter foreign markets, ranging from arm's length market transactions to hierarchy via a wholly owned subsidiary. It is in the firm's interest to exploit ownership specific advantages through internalization in those situations where either the market does not exist or it functions inefficiently.

2. Eclectic Theory (also referred to as OLI Model) explains MNEs' choice of foreign production facilities.

F. The common factor for all three of these theories is that FDI is typically made by large, research-intensive firms in oligopolistic industries and is the reason why these companies find it profitable to invest overseas.

ENGAGEMENT & APPLICATION

BOXED TEXT DISCUSSION QUESTIONS WITH SUGGESTED ANSWERS

GLOBAL DEBATE: Comparative Advantage: Should Service Jobs Be Offshored to India?

This Global Debate box provides an overview of the use of outsourcing as a way for multinational corporations to improve profitability through comparative advantage offered by markets where the cost of labor is significantly less than in the home country of a multinational. However, this simple lesson in economics is quite controversial and serves as a starting point for a stimulating class discussion on such topics as:

- What are the profit motives for outsourcing? What advantages other than profit can be gained by outsourcing?
- How should a company manage outsourcing?
- How can outsourcing impact (help or hurt) a company's corporate image?
- Is there a potential for an "upward creep" where low level, low skill tasks start to move upward into higher skilled, higher level jobs being outsourced? What impact can this shift have on home country jobs? On host country jobs?
- Is there a risk of a country losing its innovative edge if higher skilled jobs are outsourced?
- Will outsourcing cause a shift in the home country's workforce by creating new job opportunities to replace those being outsourced?

Online and Hybrid: Virtual teams can be assigned questions and submit their work as a group. Alternatively, virtual teams can be assigned to take different roles or perspectives to argue for (or against) and these assignments can be submitted as a group and then opened up to discussion and debate on an online class discussion site or blog, or presented and debated in a face-to-face setting.

Face-to-Face: Students develop responses to the questions in class in teams/groups, or else assign perspectives and conduct an in-class debate and discussion.

1. Can a company gain advantages besides profit by offshoring? If so, what are they? If not, why not?

The answer to this question will vary, and it is intended to help people think through the issue. Certainly, students are likely to focus on the profit motives as a key driver, and many times their responses will relate at least in part to profit-based drivers. However, by probing on this topic it may be possible to extract comments about enhancing the capabilities of a company, through expanding into new and attractive markets or incorporating a more diverse workforce with different ideas (e.g., on how to design or manage a product or process). Offshoring may enable the firm to be more competitive when faced with new or existing competitors who also have operations abroad in lower cost locations. Companies may also offshore activities in order to help disperse risks such as those associated with currency fluctuations, differences in economic growth rates within and across regions, shortages of home country labor, or political risk factors. To the extent that offshoring might also help to promote economic and social development in other nations, a company might feel that offshoring enables them to enhance their reputation and to engage in meaningful, socially responsible investment activity intended to enhance human welfare. Of course, outsourcing can also bring challenges for companies. By moving activities abroad, it may expose the company to loss of capabilities (e.g., going from experienced workers located close to each other to workers located in distant locations), challenges managing different workforces and institutional contexts, challenges with logistics of globally dispersed operations, etc. Offshoring may damage a company's reputation in the home country, due to strikes or other responses to moving jobs away. Many companies find that moving activities to a foreign location where labor costs are lower may expose them to a higher level of overall costs, due to factors such as increased transportation costs, increased uncertainty in logistics and scheduling, exposure to a range of political, economic and other risks, etc.

2. Does a company face ethical considerations in deciding whether to offshore activities? Why or why not?

This question raises an issue that almost always generates strong opinions and a variety of perspectives. Some students may feel that companies have a primary responsibility to maximize their returns to shareholders, so going abroad to a lower cost location may be argued to be the ethical responsibility of managers. Some students may also argue that failure to be cost-competitive on key dimensions of the company's activities, especially when faced with competitors who have lower cost structures, may put the entirety of the company's operations at risk: "it is better to sacrifice a portion of the home country business for the benefit of the overall operations" might be the theme here. Other students will often raise the notion of the harm that a company may cause to workers and their communities when their jobs and associated activities are moved from the home country to another host country. Exploring the variety of perspectives and allowing the debate to blossom can yield a rich and insightful learning experience for the participants.

3. What might be the long-term implications of offshoring, from the perspective of the home country? The host country?

This question also raises issues that almost always generates strong opinions and a variety of perspectives. Some students may feel that the home country is being hollowed out, with jobs, knowledge, and growth opportunities moving abroad to where costs are lower. In some cases, this can be argued to be a "race to the bottom," as companies seek those places where lax health or environmental standards, weak labor protection, and other factors will enable the weakest and most inexpensive and powerless to be exploited, with corresponding damage to the stakeholders in the home country. This could also be argued to be an initial step toward an "upward creep," where low level, low skill tasks that are offshored can start a process whereby higher skill jobs will subsequently be outsourced as host country labor builds competencies. Other students will often raise the notion of moving low value added jobs abroad, thereby enhancing the competitiveness of the overall company and creating the opportunity to create new, better jobs in the home country. Students may very well link some of this discussion to the theoretical perspectives of the module, whereby international companies develop and exploit dynamic capabilities in order to gain international advantage. Students might also argue that going abroad may enable the company to access new, better resources, capabilities, growth opportunities, and other advantages that can enhance the company's long term competitiveness, as well as enhance the benefits flowing back to the home country through the success of companies headquartered within its borders. Exploring the variety of perspectives and allowing the debate to blossom can yield a rich and insightful learning experience for the participants.

When examining this perspective from the host country, some students may suggest that it is essential for economic and social development that the host country encourage foreign investment and/or job creation associated with bringing in offshored jobs. These jobs can help promote economic growth, transfer knowledge and skills, and provide the foundation for a virtuous cycle of enhanced opportunities for more and better job prospects and the benefits that accompany them. Others might argue that the "race to the bottom" syndrome may cause countries to try to undercut each other, through less rigorous health or environmental practices or lax enforcement, or through devaluation of their currency or economic mercantilist behavior, in order to attract the offshored jobs. In so doing, this may stunt rather than promote the economic and social well-being of the host countries, according to these perspectives.

IB IN PRACTICE: Are Trade Deficits Good or Bad for a Country?

Arguing that trade balances are akin to a scorecard on international competitiveness, President Donald Trump suggests that the existence of trade deficits indicates the United States is losing in trade and is a major problem that needs fixing. Are trade deficits necessarily bad for a country?

Most economists do not consider trade deficits to be inherently bad or good. At its simplest, a trade deficit indicates that a country is purchasing more products or services from other countries than it sells to those countries. What happens in such a situation? There would have to be a corresponding flow of capital to make up the difference in trade, such as investments in stocks, bonds, currency, or companies. Essentially, the deficit in trade would have to be "paid for" by a surplus of inflows of foreign investment.

Trade balances are affected by a variety of macroeconomic factors, including the relative strength of countries' currencies, their rates of saving and investment, their relative rates of growth, and tax policies. Alternatively, a strengthening national currency can cause foreign-made products—for example, cars, food, or clothing—to be more affordable relative to domestically produced products. An increase in consumption of cheaper foreign-made products might help raise the standard of living in a country, giving its citizens access to a broader range of more competitively priced goods and services. Yet, these foreign-made goods might contribute to a loss of jobs in domestic industries impacted by growing imports, although such an outcome is not guaranteed.

Whether a trade deficit creates more or fewer jobs depends on what the country with the deficit does with the inflows of capital. Is the money being invested in activities with long-lasting economic returns, such as better roads and ports, new factories and machinery, improved worker education, and so forth? Is it helping to reduce the cost of debt, allowing money to be redirected to other value- creating activities? Or does the money fuel unsustainable bubbles in housing or financial markets, high levels of consumer spending fueled by access to low-cost debt, or excessive public expenditures?

Online and Hybrid: Assign questions to be prepared in virtual teams and submitted as a team assignment, or submitted individually and then discussed in a blog or group discussion site.

Face-to-Face: Students develop responses to the questions in class in teams/groups

1. Why might a country be concerned about the level of its trade deficit?

Although many might think that a trade deficit is always bad, one must look deeper to know if the trade deficit is truly bad for the country. A trade deficit causes a greater inflow of capital into the country. If that capital is invested in ways that will grow the economy, then the trade deficit does no harm. If it used to raise the price of real estate, company stocks, or consumer spending then it might be bad for the country.

2. What actions should a country encourage or discourage in order to minimize potential concerns about a trade deficit?

A country should make sure that the capital flowing into the country as a result of the trade deficit is used for investments that can grow the economy. Infrastructure, R&D, and education are examples of investments that could have a positive impact on an economy. Such an inflow may lower interest rates for consumers, but a country should discourage simple increased consumer spending. The increased capital could feed a bubble in real estate or financial markets. Governments should do what they can to avoid such bubbles.

GET THAT JOB! FROM BACKPACK TO BRIEFCASE: Mark Haupt: A Central California-Based International Career

Mark Haupt discusses how he developed a career in international business while still living in California. He discusses his preparation for international travel and gives advice for those that are interested in going abroad or working with others abroad.

Online and Hybrid: Virtual teams evaluate Haupt's advice for their own career development and their ability to work with people from another culture, particularly one that is quite different from one's home culture. Share conclusions with class, either online or in face-to-face setting.

Face-to-Face: Students evaluate their own career strategy in light of Haupt's example.

1. What do you think of Haupt's goal to be involved in international business while living in California instead of abroad? What kinds of international jobs would require living in the U.S. and what kinds would require living abroad? What qualifications would be the same and what would be different for domestic-based and foreign-based jobs?

Student responses will vary, but some may think that you must live abroad to have an international job, rather than living in your home country. Small companies often cannot afford international locations, so they need to have employees based in the home country that travel abroad for sales, marketing, sourcing, and production. These jobs can lead to international posting when the companies grow larger. Companies that engage in international projects (such as infrastructure development and construction) often need people for international assignments that last a few months to a few years. Government jobs, such as with the U.S. State Department, have many careers that have foreign postings. Whether one is based in the home country or abroad, international business requires an understanding and sensitivity to other cultures and their business environments. However, being posted abroad increases the need to learn the local language to be able to work with locals.

2. What do you think of Haupt's efforts to prepare himself for international trips? Is there anything else he should do? What does it mean to "assume nothing" about international encounters?

Students will have various answers depending on their own experiences or those that they know who travel. Other things one might do in preparing for a trip is to research more about the culture, especially related to business meetings, meals, tipping, etc. Many people have different routines to adjust to new time zones, including some very interesting ones. These often include: getting as much sun as possible upon arriving in the new location, staying awake until the nighttime, taking sleeping pills on the flight over, and eating lots of pasta.

"Assuming nothing" is often much easier said than done because we are often not aware of what we are assuming, and double checking every word and action is not feasible. Haupt's advice to go over something twice is especially useful for any agreed plan or action. Otherwise, be attuned to things that do not seem to go as you expected and then inquire into the cultural or other reasons for the differences. As you gain experience you will become more and more comfortable engaging people from different countries and cultures.

END OF MODULE EXERCISES

CRITICAL THINKING QUESTIONS

1. Discuss and explain how international trade in merchandise and services has changed over the past two decades and what the major trends are. What future trends can you speculate about? How might this information be of value to a manager?

The answers to this question may vary. The introductory vignette, "Firms invest overseas, but they also export," shows how exports of both goods and services have grown since 2000. Except for a significant drop in 2009, and a slight decline during the 2000 to 2003 period, both associated with a worldwide economic slowdown and mainly affecting demand for goods, the curve has basically been continuously upward sloping. The text also states that services growth has been greater on a percentage basis in recent decades than has the growth of goods exports. The growth in export demand is attributable to global competition, liberalized trade policies of various national governments, and advances in technology, among other factors, and the two slowdowns shown on Figure 2.1 suggests that the growth in goods and services exports is likely to continue, except during periods of significant worldwide economic slowdown. This trend will also be encouraged by international companies as they not only develop markets in foreign locations but also establish increasingly international supply chains. As the text discusses, most of the trade has been occurring within regional trade agreements, rather than on a global basis per se. Certain areas, particularly Asia, have exhibited an increasing proportion of world trade. Although developed countries have historically dominated international trade, we also see that an increasing portion of world trade involves developing countries, both as sources and as destinations for trade. This information will be of value to managers who want to serve international companies as customers, as well as in identifying which areas within and across regions might be more or less likely to experience an increase in trade.

2. Where do merchandise exports come from, and where do they typically go? How and why has this been changing over time, and do you think these trends are likely to continue? Why or why not? Why might this information be valuable to a marketing analyst?

The answers to this question may vary. More than half the exports from developing nations go to developed nations, but this proportion has been declining, from 72 percent in 1970 to about 43 percent by 2015. About two-thirds of exports from developed countries go to other industrialized nations. Trade is dominated by exchanges within, rather than between, geographic regions, reinforced by expanded regional trade associations and agreements. Indeed, about 70 percent of world trade in 2013 was accounted for by trade involving countries who are partners in regional trade agreements. There may be differences of opinion about whether these trends will continue. Proliferation of regional trade agreements may suggest continued growth in regional trade. Interregional trade agreements such as occur between Europe and some of the former colonies around the world, or the proposed Transpacific Partnership between Australasia and the Americas, may create a basis for increased regional trade. The internationalization of supply chains by international companies may also promote continued growth in trade, as companies ship products among their international affiliates as well as to international customers. Some may argue that the pendulum may swing back from international trade, due to protectionism, costs of transportation, and so forth, although evidence suggests that growth of trade tends to be associated with economic and social benefits for countries that have liberalized their trade policies. A marketing analyst could find the information about not merely the level of trade but the regionalization of trade and the internationalization of supply chains to be valuable when identifying where to focus efforts for market development or expansion.

3. Describe mercantilism, and explain why some call it a poor approach to promoting economic development and prosperity. Given the criticisms, why do some countries continue to rely on practices based on mercantilism?

Mercantilism is an economic philosophy based on the belief that (1) a nation's wealth depends on accumulated gold and (2) to increase wealth, government policies should promote exports and discourage imports. As a means of promoting economic development and prosperity mercantilism has a poor record. Mercantilism views trade as a zero-sum game with one specific winner. It has been proven that the markets, not the government should determine the direction, volume and composition of world trade.

4. Explain Adam Smith's theory of absolute advantage. What are the potential limitations of this theory for helping policy makers when making decisions related to international trade? How does Ricardo's theory of comparative advantage differ from the theory of absolute advantage?

According to Adam Smith's theory of absolute advantage, each nation should specialize in producing the goods it can produce most efficiently. Some of them can be exported to pay for imports of goods that can be produced more efficiently elsewhere. Ricardo showed that even though a nation did not hold an absolute advantage in producing any good, it could still trade with another with advantages for each as long as the less efficient nation was not equally less efficient in producing both goods. Absolute advantage may have some limited value for policy makers, especially when a country does not have a condition of absolute advantage, or where its absolute advantage may erode or disappear over time due to developments elsewhere, such as devaluation of currency, economies of scale that emerge in other nations, competitive declines in one or more areas of advantage within a regional competitive cluster, and so forth.

5. "Sending service jobs to low-cost nations, such as India, is good for America." What are the arguments in support of such an assertion? Under what circumstances might such an assertion be viewed as false?

The answers to this question may vary. For example, there may be situations in which a country does not have, or cannot maintain, competitive advantage in one or more activities. By outsourcing these activities to another country that might have advantage, it may allow the company to avoid this competitive disadvantage and to make the remaining activities more competitive globally, thereby enhancing prospects for the company and its various stakeholders. These outsourcing efforts may promote international trade and even open new or expanded market opportunities abroad for American companies, both in the country where activities are being outsourced to, and perhaps elsewhere as well. On the other hand, outsourcing may result in job losses that cannot be quickly and fully replenished through the creation of other jobs, due to the different skills required and the time needed to acquire such skills. Job losses may also result in the loss of domestic competencies, and result in a continuing migration of increasingly skilled jobs from America to the foreign locations, especially if the destination nations have the policies and competencies to acquire and enhance their human capital or otherwise enable the development of internationally competitive regional clusters.

6. Name some products that you believe have passed through the four stages of the international product life cycle. Try to identify industries or products for which the international product life cycle still helps explain international trade and investment. Can you identify industries or products for which this concept does not apply?

The answers to this question may vary. Microwave ovens and athletic shoes are two examples of products that have passed through the four stages of the international product life cycle. Other examples include ships, automobiles and computer chips, the latter two being sectors where the life cycle process appears to still be occurring. Students might identify sectors where the IPLC does not apply, such as those where transportation poses a barrier to locating operations abroad (e.g., due to extreme perishability) or where government-driven barriers to trade inhibit the movement of production across borders (e.g., due to national security or other policy priorities).

7. Use Porter's diamond model of national advantage to explain why an emerging market such as Indonesia would be expected to experience great difficulty in achieving global competitiveness in a new industry sector such as smartphones or hybrid electric-gasoline automobile engines.

An emerging market such as Indonesia would be expected to experience great difficulty in achieving global competitiveness in a new industry sector such as "smart" cell phones or hybrid electric-gasoline automobile engines because: (a) The nature of demand conditions would be unlikely to include the most sophisticated and demanding customers, who would pressure companies to produce high-quality, innovative, competitively viable products. (b) Factor conditions are likely to be deficient, since these new sectors are likely to depend on highly skilled, highly educated workforces, advance communication systems, the most advanced design and production equipment, and so forth. (c) Related and supporting industries are likely to be deficient, since an emerging market is unlikely to have strong computer hardware and software industries, venture capital markets, a pool of highly experienced entrepreneurs and business people in similar or related advanced sectors, etc. (d) The extent of domestic competition is likely to be limited due to the emerging nature of the market, hindering the beneficial competitive rivalry that is key to innovation and success. (e) There could be beneficial government policies oriented toward nurturing new industry sectors, and an emerging market could, by chance, achieve a breakthrough in technology or design. However, in the absence of the above 4 factors, it will be difficult for competitors from the emerging market to sustain this position long term, especially in the face of vigorous competition from competitors in nations with stronger profiles on the above factors.

8. What are the possible explanations for the observed decline in the proportion of FDI accounted for by the United States and Japan? What are the implications of such a decline? Do you expect that this decline will continue in the future? Why or why not?

The answers to this question may vary quite a bit across students. The United States only accounts for about 5 percent of the world's population, and Japan only about half that much. Therefore, as economic development occurs around the world, it can be expected that more wealth and other resources will be built up within industrially developed and newly industrialized nations. This enhanced wealth and desire for international competitiveness is likely to encourage multinational companies from emerging and newly industrialized nations like the BRICs (Brazil, Russia, Indonesia, China), Mexico and South Korea to expand their investments abroad in order to build globally viable scale and scope. Much of this investment will likely be made via mergers and acquisitions, as companies try to acquire brands, technology, and other capabilities to enhance international competitiveness. While the percentage of FDI accounted for by the United States and Japan may decline, that does not mean that the absolute level of outstanding stock of FDI will decline. Indeed, as global competition continues to escalate, it is likely that the overall level of FDI worldwide will increase over time. On the other hand, some students may suggest that globalization may reverse course over time, due to environmental, political, military, or other factors, and they may also suggest that the emergence of China and other countries as major economic forces will erode the scale and importance of developed countries in global trade and investment. They may even suggest that either the absolute level of global FDI will decline, or that the U.S. and Japanese (and perhaps European, as well) proportions will shrink as the power of developed countries wanes and the power of emerging markets grows. This can be an interesting discussion to have within class.

9. How has the level and direction of FDI changed over the past two to three decades, both overall and in terms of annual outflows and inflows? What might explain why these changes have occurred? Why would this information be of relevance to managers?

The answers to this question may vary. The proportion accounted for by the United States has declined by over 1/3 during the past 20 years, although the U.S. still accounts for more than 3 times the level of the next-largest investor. The European Union's proportion of FDI has increased, but that is at least partially due to the enlargement of the EU through adding new member countries. Developing nations have dramatically increased their proportion of FDI, growing from 1 percent in 1980 to over 22 percent in 2018, largely reflecting the increasing internationalization that has occurred in emerging markets such as China, Mexico, Brazil, India, and other nations. Overall, as shown in Figure 2.5, the level of FDI worldwide has continued to rise significantly over the past 38 years. Increasing internationalization of competition, economic liberalization (especially in emerging markets), growth in the international financial markets, developments in technology and transportation, and the development of regional trade and investment agreements, among other factors, have favored this growth in FDI, both in absolute level and in the sources and destination of investments. This information is of great potential value to managers, in terms of identifying potential sources of new or increased competition (or collaboration) as well as new sources of supply or of customers.

10. According to theories presented in this module, why might companies engage in foreign direct investment rather than international trade?

The answers to this question may vary. Each of the trade theories presented in this chapter offer an explanation for why companies engage in foreign direct investment, because each of the theories helps to explain why production costs differ across national borders or how competitive responses are necessary in a globalized economy. However, in some cases there may not be sufficient market mechanisms in place to protect a company's assets (e.g., inability to protect a company's intellectual assets if it tries to license its technology to a foreign company to serve international market opportunities) or to enable the company to adequately capture the value of its competencies. The Eclectic Theory discusses factors that might be relevant to this argument. In addition, it might be agrued that corporations, especially those in oligopolistic industries, may engage in foreign direct investment in order to imitate or counterbalance the actions of their international competitors.

The answers to this question may vary. Some techniques and concepts can be applied to operations in other nations. However, the differences among the environmental forces often require that these techniques are altered and in some cases, they cannot be used at all.

GLOBALEDGE RESEARCH TASK

Exercise 1

globalEDGE 'Global Insights' is where profiles of trade blocs, countries, U.S. states, and industries can be found. When navigated as described in the exercise (i.e. globalEDGE > Global Insights > by Country > 'country of choice'), each country's profile page will be displayed individually from where 'Indices' sub-section of countries can be accessed on the left column menu.

Search Phrase: Indices

Resource Name: Global Insights by Country

Resource Link: https://globaledge.msu.edu/global-insights/by/country

Exercise 2

globalEDGE 'Global Insights' is where profiles of trade blocs, countries, U.S. states, and industries can be found. When navigated as described in the exercise (i.e. globalEDGE > Global Insights > by Country > 'country of choice'), each country's profile page will be displayed individually from where 'Economy', 'Statistics', and 'Trade Statistics' sub-sections of countries can be accessed on the left column menu.

Search Phrase: by Country

Resource Name: Global Insights by Country

Resource Link: https://globaledge.msu.edu/global-insights/by/country

MINICASE: Brazil: A Global Competitor in Information Technology Outsourcing?

This minicase explores the issue of outsourcing and how countries may compete to be the destination for outsourced activities. The specific example is of Brazil and how it has emerged as an alternative to countries such as India, China, or various Central or Eastern European nations for the outsourcing of sophisticated IT activities. Brazil has an advanced telecommunications and network services infrastructure, sometimes rated above those of nations such as India or China. Brazil has a large base of jobs in the IT sector and a strong tradition of producing competent graduates from engineering schools. Brazil's banking sector is highly automated and a dynamic marketplace for IT software and support services, helping to encourage domestic demand for advanced IT services. Brazilian wage rates are significantly below those in the USA, and recent devaluations of the real, Brazil's currency, may further enhance the country's competitiveness in this regard. With lower employee turnover rates and attractive levels of total operating costs, as well as less time zone difference than found for European or Asian outsourcing countries, Brazil can be attractive for real-time services. Brazilian culture and business practices also tend to be more similar to those in the U.S. than may be the case for China, for example.

1. Use the theories of international trade and investment in this module to help explain Brazil's intentions and actions regarding the international information technology sector.

Answers are likely to vary quite a bit on this question. Students may refer to absolute or comparative advantage theories to show why Brazil is a superior site to the U.S. (absolute advantage), and to other potential offshoring sites (e.g., China, India), based on labor cost, labor quality, and other factors. Students may refer to Porter's diamond model to show how Brazil has developed a cluster that has internationally competitive competencies, enabling it to compete effectively with other sites internationally. Some students might refer to Linder's theory of overlapping demand, arguing that the culture and business practices are similar, but this would probably be an incorrect application of the theory as Linder refers to countries with similar income levels and Brazil and the U.S. are quite different. Students might use resource endowment theory, arguing that Brazil has an ample supply of talented IT specialists and engineers, helping to compensate for shortages in the U.S. Some students might even use the IPLC (International Product Life Cycle) to explain the situation, arguing that advanced IT services often begin in a lead market such as the U.S., get exported from the U.S., and then as skills develop abroad there may be replacement of export market supply from the lower cost foreign sites (displacing U.S. exports of these services) and ultimately replacing these services in the U.S. as well. Strategic behavior theory, for example, might help explain why firms from the U.S. or elsewhere might set up operations to exploit the talented, low cost labor available in Brazil, in order to service U.S. demand in a more cost competitive manner. Dynamic capabilities theory might also suggest that firms might invest in Brazil in order to participate in the development and exploitation of cost competitive centers of excellence in emerging markets such as Brazil. The variety of positions and theoretical perspectives that are likely to be presented can provide the basis for a lively discussion or even debate within the classroom and provide a strong link to the concepts of internationalization of businesses, economic globalization, and offshoring.

2. What recommendations would you give to the Brazilian government and its outsourcing industry in order to improve their prospects for success in building a strong international competitive position in the information technology outsourcing business?

This question can prove to be difficult for some students to answer, and there can be a range of alternative responses. Policy actions might be taken to enhance the absolute advantage of Brazil versus the U.S., through continued investment in skilled labor, or encouragement of economies of scale and experience curve benefits, for example. Monetary policy may also be managed so that the Brazilian currency, the real, is kept at a lower valuation and therefore Brazilian labor is quite inexpensive versus U.S. labor, and perhaps versus labor costs in China or India or elsewhere as well. Providing evidence of political and economic stability might also make Brazil a more attractive offshoring location versus other emerging markets. Emphasis on the similarities of culture, business practices, and time zone, among other factors, might also help to encourage potential customers to consider Brazil as a more attractive location for offshoring, versus other locations that may be more geographically or culturally distant.

BONUS ACTIVITIES

This section provides you with support of your course above and beyond what is found in the text. We have developed these resources to support your course, to support your traditional, hybrid, online, or flipped class.

VIDEO SUGGESTIONS

McGraw Hill's collection of international business videos is available at http://bit.ly/MHEIBVideo. The International Trade Theory board is rich and varied and is updated monthly, as is the Foreign Direct Investment board.

See www.pbs.org/newshour/show/euro-greece-2 for a discussion of "will falling euro end up boosting Europe's economy" to discuss how currency fluctuations affect international competitiveness of nations.

The video on "World Bank: Let Africa Trade with Africa" helps to highlight regional trade opportunities as well as potential growth of trade between developing countries (rather than between developing and developed countries); this video can be found at: www.youtube.com/watch?v=4f9aZrWdnFc&feature=youtu.be.

The video "How Currency Choices 'Made in China' have Big Impact on U.S. Economy," at www.youtube.com/watch?v=pXH-Up2sB24&feature=youtu.be, helps to highlight currency fluctuations and economic mercantilism.

The video "India Economy to Overtake China but Many Still in Poverty," at www.bbc.com/news/world-asia-india-31668217, discusses issues of economic growth and social welfare.

MapsofWorld.com has an interesting series of facts and discussion about international trade, which you can find at www.mapsofworld.com/answers/tag/trade.

globalEDGE and the Academy of International Business provide links to a number of organizations that offer videos about international business. You can find these links at https://aib.msu.edu/resources/videodepositories.asp.

YouTube has many international business-related videos in its collection. For example, you can find a 31 minute video on How Beneficial is World Trade at https://youtu.be/xRJZWfqWcs0?list=PL9E6D9764746EA546.

TEAM EXERCISES

These may be done individually or in groups or teams, either in or out of class, for later class presentation. Some are also appropriate for hybrid and online courses.

1. Investment Inducements

Ask the students to check advertisements in *The Wall Street Journal*, the *Financial Times* and *New York Times*, for ads in which investment inducements are offered by foreign governments. Similar ads also appear in *The Economist, Business Week*, and *Fortune*. Students can also search the web to find such inducements for various countries. What kinds of inducements are offered? Does your city and state offer foreign firms inducements to invest in your area? How successful have they been in attracting foreign FDI into your state, region, or local area?

2. Importing and Exporting Services

Students typically understand that products are exported and imported because of their tangible nature and the benefits derived through their consumption are apparent. The import and export of services are more difficult for students to grasp. Have students research this and explain their findings. Have them rank the volume of U.S. services' imports and exports, the countries, and the top 10 types of services involved. Have them do the same for an EU and an Asian country and compare their findings. hen, have them answer the question, "Why export services?"

3. Trade Theory Activity

You can check the students' comprehension of trade theory through the following activity:

This is the output of cigars and calculators for countries A and B.

Output/Man/Day

Country:	**A**	**B**
Calculators:	6	2
Cigars:	20	10

Country A:

Calculators: $\frac{\$30}{6 \text{ calculators}}$ = $5/calculator

Cigars: $\frac{\$30}{20 \text{ cigars}}$ = $1.50/cigar

Country B:

Calculators: $\frac{120 \text{ pesos}}{2}$ = 60 pesos/calculator

Cigars: $\frac{120 \text{ pesos}}{10}$ = 12 pesos/cigar

a. Would it be advantageous for B and A to trade?

b. What would be the range of values within which trading of cigars for calculators would make economic sense?

- Answer: 3-1/3 cigars/calculator to 5 cigars/calculator

c. Total production costs per day are $30 in A and 120 pesos in B. If the exchange rate is 10 pesos in B = $1 in A, will trade still place in the same direction as for part a?

Converting to dollars:

Country:	**A**	**B**
Calculators:	$5/Calculator	$6/calculator
Cigars:	$1.50/cigar	$1.20/cigar

d. What change must be made in the exchange rate to change the flow of trade?

- Answer:

  (1) If rate goes to 12 pesos = $1, calculator will cost $5 in B, which is the same price as in A, so based on price alone, B will not import from A. B can still sell cigars to A because their price has improved and gives them a greater price advantage.

  (2) If the rate goes to 8 pesos = $1, then B's cigars will cost A $1.50 and B will lose its price advantage. Calculators in B will cost $7.50 to produce.

e. If rate goes to 8 pesos or even 7 pesos = $1, will B sell any cigars to A?

- Answer: They probably will if their cigars taste better or are handmade, if A's are machine made. Cigars, like most products, are not bought purely on the basis of price.

SUPPLEMENTAL ACTIVITIES

Case Studies

Case studies that focus on intercultural issues and their effects in business environments are available through Ivey Publishing and Harvard Business School. Ivey's catalog is available for browsing (www.iveycases.com); the cases are downloadable for review, and pricing is around $3.75. Harvard Business Publishing (https://cb.hbsp.harvard.edu/cbmp/pages/home) requires an account and offers downloadable review copies for educators. The case prices begin at $7.50.

Harvard Cases

"Free Trade vs. Protectionism: The Great Corn-Laws Debate" examines the conflict that arose between those advocating free trade and those advocating protectionism in 19th century

Britain. The Corn Laws were a series of acts that protected British agricultural interests for nearly 200 years, and the decision on whether to repeal the acts had significant implications for industrialists and landowners. There is also an abridged version available.

"Yue Yuen Industrial (Holdings) Limited: (A) Making 200 Million Pair of Shoes a Year and Growing" describes the industry for outsourcing shoes by companies such as Nike and Adidas. Yue Yuen has become the largest contract footwear maker in the world, five times larger than its next largest competitor. The case allows students to understand the decisions for offshoring parts of a company's value chain, such as manufacturing, and the challenges that a company faces in not only achieving competitiveness as an offshore supplier but being able to remain competitive as the environment changes over time. This is a University of Hong Kong case distributed by Harvard.

"Background and Agreements on Foreign Direct Investment" provides a brief history of foreign direct investment, including various conflicts, issues associated with FDI-related legal frameworks, and international agreements and principles for resolving FDI-related disputes. It can provide a useful basis for discussing the "whys" and "hows" of FDI. This is a Harvard case.

"Foreign Direct Investment in China" examines the role that FDI has played in China in helping that nation to achieve rapid economic growth since 1978. This is a University of Hong Kong case distributed by Harvard.

CONTROVERSIAL ISSUES

1. Global Debate: Comparative Advantage: Should the United States be Sending Service Jobs to India?

This boxed feature described earlier in this module's Instructor Guide provides an excellent foundation for debating some of the issues raised in the text.

Online and Hybrid: Virtual teams can be assigned questions and submit their work as a group. Alternatively, virtual teams can be assigned to take different roles or perspectives to argue for (or against) and these assignments can be submitted as a group and then opened up to discussion and debate on an online class discussion site or blog, or presented and debated in a face-to-face setting.

Face-to-Face: Students develop responses to the questions in class in teams/groups, or else assign perspectives and conduct an in-class debate and discussion.

2. Debate on Whether Deficits Are Good or Bad for a Country

Drawing from the content in the IB in Practice box, "Are Trade Deficits Good or Bad for a Country?," you can ask students to take opposing perspectives to argue that trade deficits mean lost jobs and a weak economy that cannot produce products that other countries want, as well as arguments that accompanying investment can be used to improve the country's competitiveness and increase the standard of living.

Online and Hybrid: Virtual teams can be assigned to take different perspectives to argue if trade deficits are good or bad and these assignments can be submitted as a group and then opened up to discussion and debate on an online class discussion site or blog, or presented and debated in a face-to-face setting.

Face-to-Face: Students can be assigned to take different perspectives to argue the pros and cons of trade deficits and then they can be asked to argue their positions within an in-class debate and discussion.

3. Current Events

A focus on current events that are relevant to the module's topics is a good way to bring home the concepts, review their application, and build news-review habits. Ask everyone to come prepared with an article for every meeting. If a meaningful percentage of the final grade is allocated to discussion (10-15), motivation is there. Devote five minutes at the beginning of class to discussion of current events. Recent relevant current events include the on-going controversy in in the U.S. about whether free trade agreements such as NAFTA or the Trans-Pacific Partnership will promote domestic job creation and improved economic prosperity, or whether they send jobs abroad and harm American workers and the overall economy. Depending on the online interface, this activity may be done in chat forums (Blackboard) or discussion boards, before class begins. This activity also works well in large lecture classes.

TEACHING SUGGESTIONS

1. Students often are unaware of the rapid growth of international trade, so we discuss Figure 2.1 in class. We point out that there have been numerous changes in trade relationships as Table 2.1 illustrates. Most students believe that the major trade direction is between developed and developing nations (exchanging raw materials for finished goods). Figure 2.2 shows the major trading partners of the United States, which shows that there are several Asian trading partners in addition to the traditional European and NAFTA trade partners among the key export markets for U.S. goods, as well as for imports into the U.S.

2. The material on Theories of International Trade is somewhat difficult for many students and it is easy to lose their interest when discussing theories from the 17th century. We emphasize in class that there are good, practical reasons for knowing the essentials as we have also emphasized in the text. We recommend that you go slowly in discussing comparative advantage. If you whip through it, you will probably lose most of the class. We commonly ask a student to come to the board and create a table to explain the theory and we give him or her all of the help required. We came across a short haiku-like summary of comparative advantage that might help students get the general idea: Do what you do best and trade the rest.

3. We find it advantageous to follow the discussion of comparative advantage with the example in which we introduce money because the students learn quickly about the importance of exchange rates and they are better prepared when we examine the financial markets.

4. Generally students are surprised to learn that the United States' share in total foreign investment is still as large as it is (see Figure 2.5). They often believe that China's share is largest, due to all of the press that China's growth has received and the number of Chinese firms that have entered foreign markets through acquisitions. Do you want to see how many read the assignment? Ask them which country has the largest share of foreign direct investment (answer: the U.S.).

5. The Global Debate box, "Comparative Advantage: Should Service Jobs Be Offshored to India?," is generally a good way to generate many different perspectives on globalization, offshoring, and the movement of jobs to foreign locations.

6. We often find it useful to use the International Product Life Cycle, illustrated in Figure 2.3, to stimulate discussion. We ask questions such as, "Can you identify any products or services that have completed the IPLC?" "Can you identify any products or services which are still in the early stages of the IPLC but that you would expect to continue evolving along the lines of this model? Can you explain why you expect this evolution to occur and the implications for business managers?"

7. You may be interested in discussing the IB in Practice box, "Are Trade Deficits Good or Bad for a Country?" Many students think that a trade deficit is automatically bad and that a trade surplus is good. This section explains what happens when there is a trade deficit and when it can be good for a country.

8. Guest lecturer who could contribute to the material in this module would be:

- Someone in the technical department of a multinational to talk about licensing and contract manufacturing arrangements that the firm has with overseas licensees.
- Product manager of the international division of a multinational who should be knowledgeable about licensing and all the means for entering a market. Such a person can also explain why the firm went overseas.
- Financial person in the international division who can discuss the points mentioned in questions 1 and 2 plus the ROI obtained from these arrangements.
- Representatives from a foreign-owned subsidiary in your area. Ask them to tell the class what motivated their company to come to the United States and your area.
- If you have an economic development department in your state that is active in attracting foreign investors, you may be able to get a representative to explain to the class what it does to attract foreign investors and what foreign investors are looking for. Your chamber of commerce director of economic development may have had visits from foreign company representatives that he or she is willing to share.
- If you are in an area with foreign consuls, you might invite a member of the consulate to discuss his or her government's policy with respect to trade restrictions and economic development, especially as it affects foreign investment in that

country. The representative could also be asked about that government's efforts to promote foreign trade.

CONNECT TOOLS FOR ASSESSEMENT OF LEARNING

Connect Content Matrix

For every chapter, please refer to the Connect Content Matrix to see what application exercises are available, what Learning Objectives they help reinforce/assess.

Title	Assignment Type	Topic(s)	Learning Objective(s)	AACSB Accreditation Tagging	Bloom's Taxonomy
Volume and Direction of International Trade	Case Analysis	Overview of Trade	02-01; 02-02; 02-04	Analytical Thinking	Remember
International Trade Theories	Click and Drag	Trade Theories and Their Implications	02-03	Reflective Thinking	Understand
Trade, Investment, and Economic and Social Development in Ethiopia	Video Case	Overview of Foreign Direct Investment	02-04; 02-05	Analytical Thinking	Understand
Exporting, Licensing, or FDI	Case Analysis	Theories of Foreign Direct Investment	02-04; 02-05	Analytical Thinking	Apply
International Trade	Click and Drag	International Trade	02-01; 02-02	Reflective Thinking	Remember/ Understand

CONNECT ACTIVITIES

1. Volume and Direction of International Trade

Activity Summary: This case analysis activity describes an undergraduate business student learning about important trade partners for the U.S. It is then followed by multiple-choice questions.

How to Use Activity: For online and hybrid classes, assign this as part of the module’s homework. For an in-class assignment, have the students do this individually before class and then discuss the answer. This can then be used to launch into further discussion about the volume and direction of trade.

2. International Trade Theories

Activity Summary: This is a click and drag activity in which general characteristics of international trade theories are matched to the theory that it is most associated with.

How to Use Activity: This can be given for individual work at home for online or live classes. For live classes, have students do this in teams in class. Walk around to the various teams to answer any questions that arise. Then lead a general class discussion, focusing on those theories that the individual groups struggled with.

3. Trade, Investment, and Development in Ethiopia

Activity Summary: This is a video case on foreign direct investment in Ethiopia's agricultural sector, with accompanying multiple-choice questions.

How to Use Activity: This can be assigned for students to do at home, where in an online or live class. For online classes, students could be required to watch the video, answer a question, and then have a separate assignment for making posts with classmates about the video. For live classes, have students complete the assignment before class, then lead a discussion on the topic in class.

4. Exporting, Licensing, or FDI

Activity Summary: This is a case analysis activity in which students are asked to decide whether exporting, licensing, or foreign direct investment strategies would be the most appropriate for the situation.

How to Use Activity: The multiple-choice questions are broad and can be used as the basis for a short written assignment to be done at home. For live classes, have students discuss this case in groups and report to the rest of the class the key points they discussed.

5. International Trade

Activity Summary: This is a click and drag activity in which boxes of statements about international trade are matched to the correct term.

How to Use Activity: For online and hybrid classes, assign this as part of the module's homework. For an in-class assignment, divide the class into small groups and have them do the assignment as a team. Monitor the team discussions to clarify any confusing terms. Or have students do this individually and then in class discuss any choices that were confusing and why.