CHAPTER 2
INTERNATIONAL TRADE FRAMEWORKS AND POLICY

Chapter Outline

A. The Historical Dimension
   1. Global Division

B. Transnational Institutions Affecting World Trade
   1. World Trade Organization (WTO)
   2. International Monetary Fund (IMF)
   3. World Bank
   4. Regional Institutions

C. Trade Positions Compared
   1. A Diagnosis of the U.S. Trade Position

D. The Impact of Trade and Investment
   1. The Effect of Trade
   2. The Effect of International Investment

E. Policy Responses to Trade Problems
   1. Restrictions of Imports
   2. Export Promotion Efforts

F. A Strategic Outlook for Trade and Investment Policies
   1. A U.S. Perspective
   2. An International Perspective

Chapter Objectives

The chapter begins by discussing how trade has influenced human history. Recent trade developments are presented together with the role played by international institutions to regulate and facilitate trade. The chapter enumerates on the importance of world trade policy, with an analysis of the impact of changing positions in international trade. The chapter also includes various processes and strategies governments use to influence and manage trade.

Suggestions for Teaching

We find it very useful to spend some time on the historical dimension. An in-class discussion of additional impacts of international marketing on our history is usually very stimulating, particularly when foreign students are present and bring into the discussion their viewpoints. The building of scenarios is also very useful here. For example, students can be asked how life in the United States would be today if there were no international marketing.

After having understood the role played by various transnational institutions in world trade, it would be a good idea to have students summarize the key benefits offered by the various institutions. This would help reiterate the focus area of each institution in world trade.

When reviewing policy developments, it would be a good idea to initiate a discussion on how policymakers have to trade off conflicting priorities, e.g., domestic unemployment vs. international security needs. Lively debate usually results when one asks different groups to participate in role playing with one group, for example, advocating the need for U.S. bases abroad, and an other group taking the position of the foreign government which wants to extract trade concessions in exchange for giving permission to maintain bases.

It is also very useful to show conflicting domestic priorities. One good example which always is enthusiastically responded to is the issue of import restrictions. Taken together with the issue on steel import restrictions in the US (students can be asked to search and bring at least one article on this subject to discuss), students quickly understand that rational economic decision making is not the only criterion for setting international trade policy. In all of these discussions it is very useful to have either one individual (the instructor) or one group consistently take the side of the U.S. consumer, since in heavy policy discussions this group is most easily forgotten.

Chapter Summary

A. The Historical Dimension

One of the major world powers in ancient history, the Roman Empire, placed primary emphasis on encouraging international business activities. The principal approaches used to implement this emphasis were the Pax Romana, or the Roman Peace, and the common coinage. Rome developed a systematic law, central market locations, and an excellent communication system—measures that contributed to the functioning of the international marketplace. Soon, city-nations and tribes that were not part of the empire wanted to share in the benefits of belonging. They joined the empire as allies and agreed to pay tribute and taxes. When "barbaric" tribes overran the empire, they were actually attacking an empire that was already substantially weakened because it could no longer offer the benefits of affiliation. Former allies no longer saw any advantage in being associated with the Romans and willingly cooperated with the invaders rather than face prolonged battles.

One can interpret the evolution of European feudalism to be a function of trade and marketing. Profits from the spice trade through the Middle East created the wealth of Venice and other Mediterranean ports. Western European merchants in turn exported timber, arms, and woolen clothing. A remaining legacy of this trade is found in the many English and French words of Arabic origin, such as divan, bazaar, artichoke, orange, jar, and tariff.

The effect of turning away from international trade was highlighted during the 1930s. The Smoot-Hawley Act raised duties to reduce the volume of imports into the United States in the hopes that this would restore domestic employment. The result, however, was an increase of duties and other barriers to imports by most other trading nations. These measures were contributing factors in the subsequent worldwide depression, which in turn set the scene for World War II.

International marketing and international trade have also long been seen as valuable tools for foreign policy purposes. The use of economic coercion—for example, by nations or groups of nations—can be traced back as far as the time of the Greek city-states.

1. Global Division

After 1945, the Soviet Union developed the Council for Mutual Economic Assistance (CMEA or COMECON), and the United States, in turn, created "Pax Americana," or American peace, for the Western world. Many months of international negotiations in London, Geneva, and New York culminated in the signing of the charter for an International Trade Organization (ITO) on March 24, 1948.
Even though the ITO incorporated many farsighted notions, most nations refused to ratify it, fearing its power, its bureaucratic size, and its threat to national sovereignty. However, other organizations conceived at the time are still in existence and have made major contributions toward improving international trade.

B. Transnational Institutions Affecting World Trade

1. World Trade Organization

The World Trade Organization (WTO) has its origins in the GATT. GATT began in 1947 as a set of rules for nondiscrimination, transparent procedures, and settlement of disputes in international trade and evolved into an institution that sponsored successive rounds of international trade negotiations with a key focus on a reduction of high tariffs.

In spite of making impressive gains, GATT became less effective over time as duties had already been drastically reduced and further reductions were unlikely to have a major impact on world trade. Many nations developed new tools for managing and distorting trade flows that were not covered under GATT rules. Also, as membership grew, operating through consensus often led to a stalemate of many GATT activities. After many years of contentious negotiations, the Uruguay Round accord was ratified in January of 1995 and the WTO was created.

- The WTO is responsible for the General Agreement on Trade in Services (GATS), agreements on trade-related aspects of intellectual property rights (TRIPS), and trade-related investment measures (TRIMS) and a broad variety of international trade and investment accords.
- The creation of the WTO has greatly broadened the scope of international trade agreements.
- The WTO has made major contributions to improved trade and investment flows around the world. A successful WTO may infringe on the sovereignty of nations.
- Negative WTO decisions affecting large trading nations are likely to be received with resentment. Outside groups such as nongovernmental organizations and special interest alliances believe that international trade and the WTO represent a threat to their causes.

In 2001, a new round of international trade negotiations, the "Doha Round," was initiated. The aim was to further hasten implementation of liberalization, particularly to help impoverished and developing nations. The negotiations have been largely marked by disagreement between developed and developing economies.

Unless trade advocates and the WTO are supported by their member governments and other outside stakeholders in trade issues, there is unlikely to be major progress on further liberalization of trade and investment. It will therefore be important to have the WTO focus on its core mission, which is the facilitation of international trade and investment.

2. International Monetary Fund

The IMF, conceived in 1944, was designed to provide stability for the international monetary framework. It obtained funding from its members and these funds were to be used to provide countries with protection against temporary fluctuations in the value of their currency. It was the original goal of the IMF to provide for fixed exchange rates between countries.

Over time, the IMF system has experienced substantial pressures. Major currency fluctuations among old customers have also stretched the resources of the IMF.
In view of the recent worldwide slowdown of economies and the financial crisis, the IMF needed to take on entirely new activities designed to stabilize the global financial system and to develop a global economic stimulus. Even already accomplished market economies required financial help. The overall goal of new short-term lending facilities changed to rapid establishment of liquidity and the development of new trust.

In her opening press conference in 2011, the managing director of the IMF, Christine Lagarde identified the sovereign debt issues facing euro-zone countries and the massive capital flows to emerging economies as investors were seeking higher rates of return than were available in the developed economies as the two most pressing issues for the IMF.

As a result of all these global financial needs, the future role of the IMF may be very different. New economic conditions that have not been experienced to date may require different types of approaches. Also, perhaps the link between economic and political stability will magnify but also change the mission of the IMF.

3. World Bank

The World Bank was formed in 1944 to aid countries suffering from the destruction of war. Since then, it has taken on the task of aiding world development. It has made major efforts to assist fledgling economies to participate in a modern economic trade framework. The bank has begun to participate actively with the IMF to resolve the debt problems of the developing world and to bring a market economy to the former members of the Eastern bloc.

Major debates surround the effectiveness of the bank's expenditures. The World Bank has tried to reorient its outlook, focusing more on capacity building and the development of human capital through investments into education and health. Key performance criteria are now the sustainability of growth and development, addressing higher commodity prices, agricultural assistance in times of higher food prices, opening world trade to all countries, and greater participation of rising economic powers and developing nations in the bank's governance.

4. Regional Institutions

Regional changes have taken place based on the notion that trade between countries needs to be encouraged. Of particular importance was the formation of economic blocs that integrated the economic and political activities of nations. The European Union (EU) now represents a formidable market size internally and market power externally, and the well-being of all EU members has increased substantially since the bloc's formation.

Some examples of economic blocs are the North American Free Trade Agreement (NAFTA), the MERCOSUR in Latin America, and the Gulf Cooperation Council (GCC). These unions were formed for different reasons and operate with different degrees of cohesiveness as appropriate for the specific environment. They focus on issues such as forming a customs union, a common market, an economic union, or a political union.

The private sector has also begun to develop international trade institutions of its own. Particularly when governments are not quick enough to address major issues of concern to global marketers, business has taken the lead by providing a forum for the discussion of such issues. One example is the Transatlantic Business Dialogue (TBD), which is a nongovernmental organization composed of business leaders from Europe and the United States

The activities of all these institutions demonstrate that the joining of forces internationally permits better, more successful international marketing activities, results in an improved standard of living, and provides an effective counterbalance to large economic blocs.

C. Trade Positions Compared

Over the years, international trade positions have changed substantially when measured in terms of world market share. U.S. export growth was not able to keep pace with total world export growth as other trade partners entered the picture and aggressively obtained a larger world market share.
Exhibit 2.1 shows the world share of exports and imports of various trading countries and

regions.
Another development is the rise of China's trade position.
Exhibit 2.2 highlights the dramatic rise of China. In 2010, China was the number one trading partner of six of the G20 nations and the number two partner of five other G20 countries.

1. A Diagnosis of the U.S. Trade Position

   The U.S. pursued a policy of continuing effort to aid countries abroad in their economic development while at the same time; no particular attention was paid to U.S. domestic firms. This policy was well conceived and well intentioned and resulted in spectacular successes.

   The availability of a large U.S. domestic market and the relative distance to foreign markets resulted in U.S. manufacturers simply not feeling a compelling need to seek business beyond national borders. Subsequently, the perception emerged within the private sector that exporting and international marketing were too risky, complicated, and not worth it.

   U.S. education did not make knowledge about the global business environment, foreign languages, and cultures an area of major priority. Lack of global interest, inadequacy of information, unfamiliarity with foreign market conditions, and complicated trade regulations made the private sector fearful of conducting international business activities.

   However, conditions have changed. Most institutions have recognized the responsibilities and obligations that world leadership brings with it. Universities are emphasizing the international dimension, not only in theory but also in practice. Managers have also grown more intense in their international commitment. Many newly founded firms are global from very early on, giving rise to the term born global. In effect, the interest given to international markets as both an opportunity for finding customers and sources of supply is growing.

D. The Impact of Trade and Investment

1. The Effect of Trade

   Exports are important in terms of balancing the trade account. Exports can affect currency values and the fiscal and monetary policies of governments, shape public perception of competitiveness, and determine the level of imports a country can afford. The steady erosion of the U.S. share of total world exports has resulted in a merchandise trade deficit, which has been continuous since 1975. These trade deficits indicate that a country, in its international activities, is consuming more than it is producing.

   - One key way to reduce trade deficits is to increase exports. Such an approach is highly beneficial for various reasons.

- Exports can be instrumental in creating jobs. Through exporting firms can achieve economies of scale.
- By broadening its market reach and serving customers abroad, a firm can produce more and do so more efficiently. As a result, the firm may achieve lower costs and higher profits both at home and abroad.
- Through exporting, the firm also benefits from market diversification.
- Exporting also lets the firm learn from the competition, makes it sensitive to different demand structures and cultural dimensions, and proves its ability to survive in a less-familiar environment in spite of higher transaction costs.

On the import side, firms become exposed to new competition, which may offer new approaches, better processes, or better products and services. Consumers in turn receive more choices when it comes to their selection. The competitive pressures exerted by imports also work to keep quality high and prices low.

2. The Effect of International Investment

International direct investment activities can be crucial to a firm's success in new and growing markets. Foreign direct investment is extensive in many U.S. industries. Almost one of every seven U.S. manufacturing employees works for a foreign affiliate. As a result of foreign investment, some individuals and policymakers may grow concerned about dependency on foreign owners even though firm proof for the validity of such concern has been difficult to establish.

To some extent, these foreign direct investments substitute for trade activities. As a result, firms operating only in the domestic market may be surprised by the onslaught of foreign competition and, unprepared to respond quickly, may lose their domestic market share. However, the substitution for trade is far from complete. In many instances, foreign affiliates themselves are major participants in trade.

Even then some degree of uneasiness exists about the rapid growth of such investment. In many countries the governments primarily scrutinize foreign investment activities from the standpoint of their impact on national security, and occasionally deny them.

While restrictions may serve national security or policy goals, they also impose a cost on society. Domestic industries may be preserved, but only at great peril to the free flow of capital and at substantial cost to consumers. A restriction of investments may permit more domestic control over industries, yet it also denies access to foreign capital and often innovation. This in turn can result in a tightening up of credit markets, higher interest rates, and a decrease in willingness to adapt to changing world market conditions.

E. Policy Responses to Trade Problems

The word policy implies that there is a coordinated set of continuous activities in the legislative and executive branches of government to attempt to deal with U.S. international trade. Policy responses have consisted mainly of political ad hoc reactions, which over the years have changed from deep regret to protectionism.

1. Restrictions of Imports

   In light of persistent trade deficits, growing foreign direct investment, and the tendency by some firms and industries to seek legislative redress for failures in the marketplace, the U.S. Congress has increasingly been willing to provide the president with more powers to restrict trade. A tendency has also existed to disregard the achievements of past international negotiations. There has also been a tendency to seek short-term political favors domestically in lieu of long-term international solutions.

   Yet in spite of all these developments, most nations around the world strongly advocate free trade, at least officially. Governments have become very creative in designing and implementing trade barriers, examples of which are listed in Exhibit 2.3.

   - One typical method consists of "voluntary" import restraints that are applied selectively against trading partners. Voluntary restrictions are intended to aid domestic industries to reorganize, restructure, and recapture their trade prominence of years past.
   - If countries do not use the subtle mechanism of voluntary agreements, they often resort to old-fashioned tariffs. Even though average tariffs have been substantially reduced, their specific application can still have a major effect on trade flows.
   - A third major method by which trade has been restricted is through nontariff barriers. They are much more difficult to detect, prove, and quantify than tariffs or voluntary restrictions. The primary result of all of these trade restrictions is that many actions are taken that are contrary to what we know is good for the world and its citizens. Industries are preserved, but only at great peril to the world trade framework and at substantial cost to consumers.

2. Export Promotion Efforts

   Many countries provide export promotion assistance to their firms. Key reasons for such assistance are:

   - the national need to earn foreign currency
   - the encouragement of domestic employment
   - the increase in domestic economic activity

   Many forms of export promotion can be seen as a government distortion of trade. Government support can be appropriate if it annuls unfair foreign practices, increases market transparency, and therefore contributes to the better functioning of markets.

A new focus has come about in the area of export financing. Policymakers have increasingly recognized that U.S. business may be placed at a disadvantage if it cannot meet the subsidized financing rates of foreign suppliers. The Export-Import Bank of the United States has in recent years even resorted to offering mixed aid credits. These take the form of loans composed partially of commercial interest rates and partially of highly subsidized developmental aid interest rates.

One other export-promotion development was the passage of the Export Trading Company Act of 1982. This legislation permits firms to work together to form export consortia. The basic idea was to provide the foreign buyer with a one-stop shopping center in which a group of U.S. firms could offer a variety of complementary and competitive products.

F. A Strategic Outlook for Trade and Investment Policies

The importance and visibility of international trade and investment policies have grown dramatically as international trade and investment flows have become more relevant to the well-being of most countries.

1. A U.S. Perspective

The United States needs a positive trade policy rather than reactive, ad hoc responses to specific situations. Protectionistic legislation can be helpful and useful as bargaining chips in international negotiations, provided it is not enacted. It has been suggested that a variety of regulatory agencies could become involved in administering U.S. trade policy. Although such agencies could be useful from the standpoint of addressing narrowly defined grievances, they carry the danger that commercial policy will be determined by a new chorus of discordant voices.

U.S. trade policy does need to change. It must be recognized that domestic economic performance mainly determines global competitiveness.

- First, the nation must improve the quality and amount of information government and business share to facilitate competitiveness.
- Second, policy must encourage collaboration among companies in such areas as goods and process technologies.
- Third, U.S. industry collectively must overcome its export reluctance and its short-term financial orientation. Fourth, the United States must invest in its people, providing education and training suited to the competitive challenges of the twenty-first century.
- Finally, the executive branch must be given authority by Congress to negotiate international agreements with a reasonable certainty that the negotiation outcome will not be subject to minute amendments.

Therefore, renewal of trade promotion authority (TPA), which retains Congress' right to accept or reject trade treaties and agreements but reduces the amendment procedures, is quite important.

2. An International Perspective

From an international perspective, trade and investment negotiations must continue. Bilateral negotiations are carried out mainly between two nations, while multilateral negotiations are carried out among a number of nations.

In order to address narrowly defined trade issues, bilateral negotiations and a specific approach seem quite appealing. Multilateral negotiations can operate on a broad scale, where concessions can be traded off among countries, and which make it possible for all participants to emerge and declare themselves as winners.

Policymakers must be willing to trade off short-term achievements for long-term goals. All too often, measures that would be beneficial in the long term are sacrificed to short-term expediency to avoid temporary pain and the resulting political cost. Given the increasing links among nations and their economies, however, such adjustments are inevitable.

New mechanisms to evaluate restraint measures will also need to be designed. The total cost of policy measures affecting trade and investment flows must be assessed, must be communicated, and must be taken into consideration before such measures are implemented.

Key Terms

Pax Romana: Translated as 'Roman Peace' in Latin, Pax Romana in historical terms refers to the period of peace and stability under the Roman Empire that facilitated trading activities.
Economic Bloc: Economic blocs consist of nations tied together by common trade agreements that aim at facilitating free trade and reducing trade barriers. Economic blocs integrate the economic and political activities of nations.
Born Global: A firm established as an international business from its inception.
Trade Deficit: A trade deficit occurs when a country imports more goods and services than it exports.
Economies of Scale: Production condition where an increase in quantity of the product results in decrease of production per unit; firms may achieve lower costs and higher profits both at home and abroad.
Foreign Direct Investment: Capital funds flow from abroad; company is held by noncitizens; foreign ownership is typically undertaken for longer-term participation in an economic activity.
Foreign Affiliate: A firm in which at least 10 percent is owned by foreign entities.
Nontariff Barrier: Barriers to trade that restricts imports through subtler means other than tariffs, for example, these barriers may be government or private-sector "buy domestic" campaigns, preferential treatment of domestic bidders over foreign bidders, or the establishment of standards that are not common to foreign goods or services.
Mixed Aid Credit: Loans to domestic businesses designed to overcome barriers to export; composed partially of commercial interest rates and partially of highly subsidized developmental-aid interest rates.

Export Consortia: Legislation that permits domestic firms to work together, in a manner similar to Japanese sogoshoshas; the basic idea is to provide the foreign buyer with a one-stop shopping center to avail a variety of complementary and competitive products.
Protectionistic Legislation: Refers to legal provisions aimed at protecting domestic businesses. It functions as an important bargaining tool in international negotiations provided that it is not enacted; however, legislated protectionism can result in the destruction of the international trade and investment framework.
Trade Promotion Authority (TPA): Gives Congress the right to accept or reject trade treaties and agreements, but reduces the amendment procedures; instrumental for new, large-scale trade accords.
Bilateral Negotiation: Trade agreement carried out mainly between two nations.
Multilateral Negotiation: Trade agreement carried out among a number of nations.

Questions for Discussion

1. Why is international trade important to a nation?

   International trade offers a larger market and potential for larger profits and growth than domestic trade. It also allows a country to buy needed imports which must be funded by gold or foreign capital if there are no compensating exports.

   A nation as a whole must participate in international trade in order to balance its trade. Building up trade deficits can have a negative impact on national welfare and domestic employment levels in the long term.

   Exports can affect currency values and the fiscal and monetary policies of governments, shape public perception of competitiveness, and determine the level of imports a country can afford.

   Economies of scale can be achieved by broadening market reach and serving customers abroad, thus producing larger quantities of goods more efficiently. Market diversification is possible by taking advantage of different growth rates in different markets and gaining stability by not being overly dependent on any particular market.

   International trade stimulates companies to learn new techniques of production, develop new products, and improve existing ones which can be marketed both internationally and domestically. This compels companies to gain the competitiveness required in order to remain viable. It also benefits the customers with more choices, a larger product selection, better quality products, and lower prices due to the large number of competing firms.

   It is therefore important to improve the capability of firms to compete internationally and to provide an international trade framework that facilitates international marketing activities.

2. How did the GATT lead to the creation of the WTO?

   The World Trade Organization (WTO) has its origins in the GATT. GATT began in 1947 as a set of rules for nondiscrimination, transparent procedures, and settlement of disputes in international trade. Over time, the GATT evolved into an institution that sponsored successive rounds of international trade negotiations with a key focus on a reduction of high tariffs.

Early in its existence, the GATT achieved the liberalization of trade in products amounting to two-thirds of the value of the trade among its participants. Later, special GATT negotiations further reduced trade barriers and developed improved dispute-settlement mechanisms, better provisions dealing with subsidies, and a more explicit definition of rules for import controls.

In spite of these impressive gains, GATT became less effective over time. Duties had already been drastically reduced and further reductions were therefore unlikely to have a major impact on world trade. Most imports either enter the United States duty free or are subject to low tariffs. Many nations developed new tools for managing and distorting trade flows, nontariff tools that were not covered under GATT rules.

Also, the GATT, which was founded by 24 like-minded governments, was designed to operate by consensus. As membership grew, this consensus rule often led to a stalemate of many GATT activities. After many years of contentious negotiations, the Uruguay Round accord was ratified in January of 1995. As part of this ratification, a new institution, the World Trade Organization, was created, which now is the umbrella organization responsible for overseeing the implementation of all the multilateral agreements negotiated in the Uruguay Round and those that will be negotiated in the future. The GATT has ceased to exist as a separate institution and has become part of the WTO.

3. What is the current status of the Doha Round of multilateral trade negotiations? Is the agreement moving forward?

   Past negotiations of the Doha round have been marked by disagreement between developed and developing economies. The most divisive issues continue to be agricultural tariffs and subsidies in the EU and United States, and tariffs on merchandise goods in developing countries.

   In a recent meeting of the Agriculture Committee, it was broadly acknowledged by the negotiators that considering the present global economic climate, progress on many issues might not be possible. While some called for a new approach, others felt that it would lead losing large amount of conciliation achieved thus far. In a recent meeting of the U.S. Trade Representatives, many agreed that the Doha Round has ceased to exist and trading nations should move on.

   Many feel that bilateral and regional agreements are the reasons behind the dismal progress of Doha Round negotiations. In a recent meeting of G20 members in Mexico, Chinese Commerce Minister Chen Deming stressed on resuming negotiations and push for a comprehensive balanced outcome of the Doha round.

4. How do consumer preferences for different products affect a country's trade position?

Consumer demand abroad has stimulated foreign companies to increase their competitively priced exports and is compelling industries at home to develop more competitively priced and higher-quality products. This is advantageous to the consumer, as both domestic and foreign companies must compete to meet their demands. In the United States, the auto, textile, and shoe industries are examples of imports challenging domestic industries based on the buying preferences of consumers.

5. What are the different roles of the WTO, the IMF, and the World Bank?

   The WTO was created for overseeing the implementation of all the multilateral agreements negotiated in the Uruguay Round and those that will be negotiated in the future. The WTO is responsible for the General Agreement on Trade in Services (GATS), agreements on trade-related aspects of intellectual property rights (TRIPS), and trade-related investment measures (TRIMS) and administers a broad variety of international trade and investment accords. Its core mission is the facilitation of international trade and investment, while ensuring that an effective forum exists to afford a hearing and subsequent achievements for concerns surrounding the core.

   The IMF was designed to provide stability for the international monetary framework. It obtained funding from its members and these funds were to be used to provide countries with protection against temporary fluctuations in the value of their currency. Therefore, it was the original goal of the IMF to provide for fixed exchange rates between countries. In view of the recessionary global economy, the IMF needed to take on entirely new activities designed to stabilize the global financial system and to develop a global economic stimulus. Even already accomplished market economies required financial help. In order to ensure that a local stimulus would not be suffocated by global restrictions, the IMF worked to ensure simultaneous expansions in economies. The overall goal of new short-term lending facilities changed to rapid establishment of liquidity and the development of new trust.

   The World Bank was formed to aid countries suffering from the destruction of war. Since then, it has taken on the task of aiding world development. It has made major efforts to assist fledgling economies to participate in a modern economic trade framework. The bank has begun to participate actively with the IMF to resolve the debt problems of the developing world and to bring a market economy to the former members of the Eastern bloc. The World Bank tries now to reorient its outlook, focusing more on capacity building and the development of human capital through investments into education and health. Key performance criteria are now the sustainability of growth and development, addressing higher commodity prices, agricultural assistance in times of higher food prices, opening world trade to all countries, and greater participation of rising economic powers and developing nations in the bank's governance.

6. Should countries restrict foreign direct investment in their domestic industries?

   International direct investment activities can be crucial to a firm's success in new and growing markets. As a result of foreign investment, some individuals and policymakers may grow concerned about dependency on foreign owners even though firm proof for the validity of such concern has been difficult to establish.

Even then, some degree of uneasiness exists about the rapid growth of such investment. Therefore, many countries review major incoming investment projects as to their effect and desirability. Governments primarily scrutinize foreign investment activities from the standpoint of their impact on national security, and occasionally deny them.

While restrictions may serve national security or policy goals, they also impose a cost on society. Domestic industries may be preserved, but only at great peril to the free flow of capital and at substantial cost to consumers. A restriction of investments may permit more domestic control over industries, yet it also denies access to foreign capital and often innovation. This in turn can result in a tightening up of credit markets, higher interest rates, and a decrease in willingness to adapt to changing world market conditions.

To some extent, these foreign direct investments substitute for trade activities. As a result, firms operating only in the domestic market may be surprised by the onslaught of foreign competition and, unprepared to respond quickly, may lose their domestic market share. However, the substitution for trade is far from complete. In many instances, foreign affiliates themselves are major participants in trade. They may import raw materials or components and export some of their output.

Internet Exercises

1. What are the five major branches of the World Bank, and what are their missions? (Use information from www.worldbank.org.)

   The five major branches of the World Bank are:

   - The International Bank for Reconstruction and Development (IBRD). Its mission is to reduce poverty in middle-income and creditworthy poorer countries by promoting sustainable development through loans, guarantees, risk management products, and analytical and advisory services.

   - The International Development Association (IDA). Its mission is to reduce poverty by providing interest-free credits and grants for programs that boost economic growth, reduce inequalities and improve people's living conditions.

   - International Finance Corporation (IFC). Its vision is that people should have the opportunity to escape poverty and improve their lives.

   - Multilateral Investment Guarantee Agency (MIGA). Its mission is to promote foreign direct investment into developing countries to help support economic growth, reduce poverty, and improve people's lives.

   - International Centre for Settlement of Investment Disputes (ICSID). Its mission is to provide facilities for conciliation and arbitration of international investment disputes.

2. For the latest year, what are the five leading country exporters of world merchandise? What are the five leading country exporters of commercial services? (Use data from www.wto.org.)

   The five leading country exporters of world merchandise are United States, China, Germany, Japan and France.

   The five leading country exporters of commercial services are Extra-EU, United States, China, Japan, and India.

3. What countries are negotiating to join the Trans Pacific Partnership (TPP)? What countries may be interested in joining this group? (Use information from http://ustr.gov and the international trade agencies of other TPP negotiating countries.)

   Malaysia, Japan, Canada, and Mexico are in negotiations to join the TPP.

   India, Brazil, and South Korea may be interested in joining this group.