International Marketing

Chapter 1

The Scope and Challenge of International Marketing

CHAPTER OUTLINE

CHAPTER LEARNING OBJECTIVES

What you should learn from Chapter 1:

LO1 The benefits of international markets

LO2 The changing face of U.S. business

LO3 The scope of the international marketing task

LO4 The importance of the self-reference criterion (SRC) in international marketing

LO5 The increasing importance of global awareness

LO6 The progression of becoming a global marketer

Global Perspective

GLOBAL COMMERCE CAUSES PEACE

Global commerce thrives during peacetime. The economic boom in North America during the late 1990s was in large part due to the end of the Cold War and the opening of the formerly communist countries to the world trading system. However, we should also understand the important role that trade and international marketing play in producing peace.

Boeing Company, America's largest exporter, is perhaps the most prominent example. Although many would argue that Boeing's military sales (aircraft and missiles) do not exactly promote peace, over most of the company's history, that business has constituted only about 20 percent of the company's commercial activity. Up until 2002, of Boeing's some $60 billion in annual revenues, about 65 percent came from sales of commercial jets around the world and another 15 percent from space and communications technologies. Unfortunately, these historical numbers are being skewed by U.S. military spending and the damage done to tourism by terrorism.[1] Even so, the company still counts customers in more than 90 countries, and its 158,000 employees work in 70 countries. The new 787 Dreamliner includes parts from around the world, including Australia, France, India, Italy, Japan, Russia, and Sweden.[2] Its more than 12,000 commercial jets in service worldwide carry about one billion travelers per year. Its NASA Services division is the lead contractor in the construction and operation of the 16-country International Space Station, first manned by an American and two Russians in the fall of 2000. The Space and Intelligence Systems Division also produces and launches communications satellites affecting people in every country.

All the activity associated with the development, production, and marketing of commercial aircraft and space vehicles requires millions of people from around the world to work together. Moreover, no company does more[3] to enable people from all countries to meet face-to-face for both recreation and commerce. All this interaction yields not just the mutual gain associated with business relationships but also personal relationships and mutual understanding. The latter are the foundation of global peace and prosperity.

Another class of companies that promotes global dialogue and therefore peace is the mobile phone industry. During 2007 the number of mobile phone subscribers exceeded 3.0 billion, and this number is expected to grow beyond 4.5 billion by 2012. Nokia (Finland), the market leader, is well ahead of the American manufacturers Motorola and Apple, Samsung (S. Korea), LG (S. Korea), and Sony Ericsson (Japan/Sweden).

Individuals and small companies also make a difference—perhaps a subtler one than large multinational companies, but one just as important in the aggregate. Our favorite example is Daniel Lubetzky's company, PeaceWorks. Mr. Lubetzky used a fellowship at Stanford Law School to study how to foster joint ventures between Arabs and Israelis. Then, following his own advice, he created a company that combined basil pesto from Israel with other raw materials and glass jars supplied by an Arab partner to produce the first product in a line he called Moshe & Ali's Gourmet Foods. The company now sells four different product lines in 5,000 stores in the United States and has its headquarters on Park Avenue in New York, as well as business operations in Israel, Egypt, Indonesia, Turkey, and Sri Lanka. Again, beyond the measurable commercial benefits of cooperation between the involved Arabs, Israelis, and others is the longer-lasting and more fundamental appreciation for one another's circumstances and character.

International marketing is hard work. Making sales calls is no vacation, even in Paris, especially when you've been there 10 times before. But international marketing is important work. It can enrich you, your family, your company, and

[1] Circa 2011, approximately half of Boeing's business is defense related (http://www.boeing.com).

[2] W.J. Hennigan, "Dreamliner is Causing Nightmares for Boeing," *Los Angeles Times*, October, 15, 2009, pp. B1–2.

[3] The European commercial aircraft manufacturer Airbus is beginning to catch up, employing 57,000 people around the world (http://www.airbus.com, 2010).

During the past 50 years, world trade (exports of merchandise and commercial services) has declined three times: in 1973 by −3.1 percent after the OPEC oil crisis, in 1982 by −.3 percent, and in 2009 by −12.0 percent following the financial debacle of 2008. World trade grew at its fastest rate, 12.5 percent, in 2000. Even after the terrorist attacks on September 11, 2001, trade continued to grow until the global financial crisis began in 2008. We thought the temporary circumstance of a partial solar eclipse over Manila Bay in January 2009 was aptly symbolic of the times—especially, of the huge decline in container traffic during 2009–2010.[4]

your country. And ultimately, when international marketing is done well, by large companies or small, the needs and wants of customers in other lands are well understood, and prosperity and peace are promoted along the way.[5]

Sources: http://www.boeing.com and http://www.peaceworks.com—both are worth a visit; mobile phone sales data are available at http://www.gartner.com (all accessed in 2010).

LO1

The benefits of international markets

> Never before in American history have U.S. businesses, large and small, been so deeply involved in and affected by international business. A global economic boom, unprecedented in modern economic history, has been under way as the drive for efficiency, productivity, and open, unregulated markets sweeps the world. Powerful economic, technological, industrial, political, and demographic forces are converging to build the foundation of a new global economic order on which the structure of a one-world economic and market system will be built.

When we wrote those words ten years ago to open the eleventh edition of this book, the world was a very different place. The nation was still mesmerized by the information technology boom of the late 1990s. Most did not visualize the high-tech bust of 2001 or the Enron and WorldCom scandals. No one could have imagined the September 11, 2001, disasters, not even the perpetrators. The wars in Afghanistan and Iraq were not on the horizon. The major international conflict grabbing headlines then was the series of diplomatic dustups among China, Taiwan, and the United States. Who could have predicted the disruptions associated with the 2003 SARS outbreak in Asia? The great Indian Ocean tsunami of 2004 was perhaps impossible to anticipate. Oil priced at more than $100 per barrel was also unthinkable then—the price seemed to have peaked at about $40 per barrel in late 2000.[6] We wrote about the promise of the space program and the international

[4] Ronald D. White, "Shipping Industry in Deep Water," *Los Angeles Times*, July 8, 2009, pp. B1–2.

[5] In response to criticisms of globalization catalyzed by the riots in Seattle in 1999, a growing literature argues for trade as a fundamental cause of peace. For a variety of such arguments, see Jagdish Bhabwati, *In Defense of Globalization* (Oxford: Oxford University Press, 2004); Thomas L. Friedman, *The World Is Flat* (New York: Farrar, Straus, and Giroux, 2005); Clifford J. Schultz III, Timothy J. Burkink, Bruno Grbac, and Natasa Renko, "When Policies and Marketing Systems Explode: An Assessment of Food Marketing in the War-Ravaged Balkans and Implications for Recovery, Sustainable Peace, and Prosperity," *Journal of Public Policy & Marketing* 24, no. 1 (2005), pp. 24–37; William Hernandez Requejo and John L. Graham, *Global Negotiation: The New Rules* (New York: Palgrave Macmillan, 2008), Chapter 13.

[6] Niel King Jr., Chip Cummings, and Russell Gold, "Oil Hits $100, Jolting Markets," *The Wall Street Journal*, January 3, 2008, pp. A1, A6.

space station, whose future is now clouded by the demise of the space shuttle program and NASA budget cuts.

Through all these major events, American consumers had continued to spend, keeping the world economy afloat. Layoffs at industrial icons such as United Airlines and Boeing and a generally tough job market did not slow the booming American housing market until the fall of 2007. Lower government interest rates had yielded a refinancing stampede, distributing the cash that fueled the consumer spending, which finally began flagging in early 2008. Then in September and October of that year, the housing bubble burst, and the world financial system teetered on collapse. The ever faithful American consumer stopped buying, and world trade experienced its deepest decline in more than 50 years, a drop of 12.0 percent. And seeing into the future is harder now than ever. Most experts expect global terrorism to increase, and the carnage in Bali, Madrid, London, and Mumbai seem to prove the point. Finally, as the global economy tries to recover, international trade tensions take on new importance. Competition from new Chinese companies continues to raise concerns in the United States. Brazilian and Indian multinationals are stepping up competitive pressures as well, particularly as their and other emerging economies fared better during the most recent global downturn.[7] Perhaps the best news in these rather glum times is that we have not experienced a dramatic nationalistic rise of trade protectionism, as in the 1930s.[8] Additionally, the steady growth of the U.S. trade and balance of payments deficits dramatically abated during 2009, along with American consumer spending.

International marketing is affected by and affects all these things. For the first time in history, McDonald's has pulled out of international markets in both Latin America and the Middle East.[9] Slow economies, increasing competition, and anti-Americanism have

Trade also is easing tensions between Taiwan and China[10] and among North Korea,[11] its close neighbors, and the United States. Here a rail link between North and South Korea has opened for the first time in nearly 60 years to provide transportation of raw materials and managers from the South, bound for a special economic development zone at Kaesong in the North.[12]

[7] "Counting Their Blessings," *The Economist*, January 2, 2010, pp. 25–28.

[8] Moises Naim, "It Didn't Happen," *Foreign Policy*, January/February 2010, pp. 95–96.

[9] Richard Gibson, "McDonald's Swings to Loss on Sale of Restaurants," *The Wall Street Journal*, July 24, 2007.

[10] Patrick Smith, "Taiwan and China Dance Ever Closer," *BusinessWeek*, November 10, 2008, p. 58; "Reunification by Trade," *The Economist*, August 8, 2009, pp. 37–38.

[11] "North Korea Fully Opens Border Crossing," Associated Press, March 17, 2009.

[12] Bruce Wallace, "2 Trains Cross Korean Border," *Los Angeles Times*, May 17, 2007, p. A4; Moon Ihlwan, "A Capitalist Toehold in North Korea," *BusinessWeek*, June 11, 2007, p. 45; Associated Press, "North Korea Says It Gave Nuclear-Program List to U.S.," January 4, 2008.

impacted sales in both regions. Indeed, the salient lesson for those involved in international commerce is to expect the unexpected. Any executive experienced in international business will verify that things never go as planned in global commerce. You still have to plan and forecast, but markets, particularly international ones, are ultimately unpredictable. The natural fluctuations in markets are best managed through building strong interpersonal and commercial relationships and broad portfolios of businesses. Flexibility means survival.

Perhaps now, more than ever, whether or not a U.S. company wants to participate directly in international business, it cannot escape the effects of the ever-increasing number of North American firms exporting, importing, and manufacturing abroad. Nor can it ignore the number of foreign-based firms operating in U.S. markets, the growth of regional trade areas, the rapid growth of world markets, and the increasing number of competitors for global markets.

Nations grow a little closer together. The European Parliament votes to start discussions with Turkey about joining the European Union. Trade is beginning to bridge the religious divide between Christian Europe and Muslim Asia Minor. Despite this positive vote, European equivocation is pushing Turkey toward building stronger trade links with its Arab neighbors. Ultimately, this may be a positive turn of events if Turkey is finally invited to join the European Union.[13]

Of all the events and trends affecting global business today, four stand out as the most dynamic, the ones that will influence the shape of international business beyond today's "bumpy roads" and far into the future: (1) the rapid growth of the World Trade Organization and regional free trade areas such as the North American Free Trade Area and the European Union; (2) the trend toward the acceptance of the free market system among developing countries in Latin America, Asia, and eastern Europe; (3) the burgeoning impact of the Internet, mobile phones, and other global media on the dissolution of national borders; and (4) the mandate to manage the resources and global environment properly for the generations to come.

Today most business activities are global in scope. Technology, research, capital investment, and production, as well as marketing, distribution, and communications networks, all have global dimensions. Every business must be prepared to compete in an increasingly interdependent global economic and physical environment, and all businesspeople must be aware of the effects of these trends when managing either a domestic company that exports or a multinational conglomerate. As one international expert noted, every American company is international, at least to the extent that its business performance is conditioned in part by events that occur abroad. Even companies that do not operate in the international arena are affected to some degree by the success of the European Union, the export-led growth in South Korea, the revitalized Mexican economy, the economic changes taking place in China, military conflicts in the Middle East, and climate change.

The challenge of international marketing is to develop strategic plans that are competitive in these intensifying global markets. For a growing number of companies, being international is no longer a luxury but a necessity for economic survival. These and other issues affecting the world economy, trade, markets, and competition are discussed throughout this text.

[13] "Looking East and South," *The Economist*, October 31, 2009, pp. 57–58.

CROSSING BORDERS 1.1 What Do French Farmers, Chinese Fishermen, and Russian Hackers Have in Common?

They can all disrupt American firms' international marketing efforts.

Thousands of supporters and activists gathered recently to show support for a French sheep farmer on trial for vandalizing a local McDonald's. Jose Bove has become an international legend of antiglobalization. Leader of the French Peasant Confederation, he has demonized the fast-food chain as the symbol of American trade "hegemony" and economic globalization. He and nine other farmers served six weeks in jail and paid fines for partially destroying the restaurant. Most recently, Bove has been thrown in jail again, this time for 10 months, for damaging fields of genetically modified rice and corn.

Local fishermen demanded suspension of the reclamation and dredging of a bay near Hong Kong, where Disney has built Hong Kong Disneyland. The fishermen claimed that the work has plunged water quality near the site to levels much worse than predicted, killing huge numbers of fish. The spokesman for the fishermen claims they have lost some $30 million because of depleted and diseased fish stocks.

St. Petersburg has, in a decade, become the capital of Russian computer hackers. These are the same folks that are reputed to have invaded Microsoft's internal network. Russia's science city has become the natural hub for high-tech computer crime. Dozens of students, teachers, and computer specialists hack into computers, seeing themselves as members of an exciting subculture that has flourished since the fall of communism. Programs are copied on the black market; the latest Windows pirate always arrives in Russia months before it appears in the West. Yes, fines and prison terms are consequences if caught. But computers are readily accessible at universities and increasingly in homes.

Sources: Agnes Lam, "Disney Dredging Killing Fish," South China Morning Post, November 5, 2000, p. 4; John Tagliabue, "Activist Jailed in Attack on Modified Crops," The New York Times, February 27, 2003, p. 6; "Citi Expands Denial of Summer Breach," American Banker, December 28, 2009, p. 8; Ben Worthen, "Private Sector Keeps Mum on Cyber Attacks," The Wall Street Journal, January 19, 2010, p. B4.

The Internationalization of U.S. Business

LO2

The changing face of U.S. business

Current interest in international marketing can be explained by changing competitive structures, coupled with shifts in demand characteristics in markets throughout the world. With the increasing globalization of markets, companies find they are unavoidably enmeshed with foreign customers, competitors, and suppliers, even within their own borders. They face competition on all fronts—from domestic firms and from foreign firms. A huge portion of all consumer products—from CD players to dinnerware—sold in the United States is foreign made. Sony, Norelco, Samsung, Toyota, and Nescafé are familiar brands in the United States, and for U.S. industry, they are formidable opponents in a competitive struggle for U.S. and world markets.

Many familiar U.S. companies are now foreign controlled or headed in that direction. When you drop in at a 7-Eleven convenience store or buy Firestone tires, you are buying directly from Japanese companies. Some well-known brands no longer owned by U.S. companies are Carnation (Swiss), *The Wall Street Journal* (Australian), and the all-American Smith & Wesson handgun that won the U.S. West, which is owned by a British firm. The last U.S.-owned company to manufacture TV sets was Zenith, but even it was acquired by South Korea's LG Electronics, Inc., which manufactures Goldstar TVs and other products. Pearle Vision, Universal Studios, and many more are currently owned or controlled by foreign multinational businesses (see Exhibit 1.1). Foreign investment in the United States is more than $23.4 trillion.[14] Companies from the United Kingdom lead the group of investors, with companies from the Netherlands, Japan, Germany, and Switzerland following, in that order.

Other foreign companies that entered the U.S. market through exporting their products into the United States realized sufficient market share to justify building and buying manufacturing plants in the United States. Honda, BMW, and Mercedes are all manufacturing

[14] http://www.bea.gov (accessed June 2010).

Exhibit 1.1
Foreign Acquisitions of U.S. Companies

Sources: Compiled from annual reports of listed firms, 2010.

U.S. Companies/Brands	Foreign Owner
Firestone (tires)	Japan
Ben & Jerry's (ice cream)	U.K.
CITGO	Venezuela
Burger King (fast food)	U.K.
Random House (publishing)	Germany
The Wall Street Journal	Australia
Oroweat (breads)	Mexico
Smith & Wesson (guns)	U.K.
RCA (televisions)	France/China
Chef America ("Hot Pockets" and other foods)	Switzerland
Huffy Corp. (bicycles)	China
Swift & Company (meatpacking)	Brazil
Barneys New York (retailer)	Dubai
Columbia Pictures (movies)	Japan
T-Mobile	Germany
Budweiser	Belgium
Frigidaire	Sweden
Church's Chicken	Bahrain
Genentech	Switzerland

in the United States. Investments go the other way as well. Ford bought and sold Volvo; PacifiCorp acquired Energy Group, the United Kingdom's largest electricity supplier and second-largest gas distributor; and Wisconsin Central Transportation, a medium-sized U.S. railroad, controls all U.K. rail freight business and runs the Queen's private train via its English, Welsh & Scottish Railway unit. It has also acquired the company that runs rail shuttles through the Channel Tunnel. Investments by U.S. multinationals abroad are nothing new. Multinationals have been roaming the world en masse since the end of World War II, buying companies and investing in manufacturing plants. What is relatively new for U.S. companies is having their global competitors competing with them in "their" market, the United States. One of the more interesting new entrants is Chivas USA, a Mexican-owned soccer team that will play its matches in southern California.

Once the private domain of domestic businesses, the vast U.S. market that provided an opportunity for continued growth must now be shared with a variety of foreign companies

Along with NAFTA have come two of Mexico's most prominent brand names. Gigante, one of Mexico's largest supermarket chains, now has several stores in southern California, including this one in Anaheim. On store shelves are a variety of Bimbo bakery products. Grupo Bimbo, a growing Mexican multinational, has recently purchased American brand-named firms such as Oroweat, Webers, and Mrs. Baird's Bread.

CROSSING BORDERS 1.2 Blanca Nieves, La Cenicienta, y Bimbo (Snow White, Cinderella, and Bimbo)

Bimbo is a wonderful brand name. It so well demonstrates the difficulties of marketing across borders. In Webster's Dictionary "bimbo" is defined as ". . . a term of disparagement, an attractive, but empty-headed person, a tramp."

Meanwhile, in Spain, Mexico, and other Spanish-speaking countries, the word "bimbo" has no pejorative meaning. Indeed, it is often simply associated with the little white bear logo of Bimbo brand bread. Bimbo is the most popular brand of bread in Mexico and, with the North American Free Trade Agreement (NAFTA), is stretching its corporate arms north and south. For example, the Mexican firm most recently acquired Bestfoods American brands, Mrs. Baird's Bread, the most popular local brand in Dallas, Texas, and Fargo, the most popular bread brand in Argentina. And you can now see 18-wheelers pulling truckloads of Bimbo products north on Interstate 5 toward Latino neighborhoods in Southern California and beyond.

Perhaps Bimbo is the reason the city leaders in Anaheim so feared Gigante's entrance into their city. Gigante, the Mexican-owned supermarket chain, features Bimbo buns, tomatillos, cactus pears, and other Latino favorites. Gigante already had three stores in Los Angeles County. But it was denied the city's permission to open a new market near the "Happiest Place on Earth." One has to wonder if Disneyland, Anaheim's biggest employer, may have been fretting over the juxtaposition of the Bimbo brand and its key characters, blonde, little, all-American Alice and her cinema sisters. Actually, a better case can be made that the Gigante–Anaheim imbroglio was more a matter of a mix of nationalism, xenophobia, and even racism. The city council eventually was forced to allow Gigante to open.

American firms have often run into similar problems as they have expanded around the world. Consider French nationalism. French farmers are famous for their protests—throwing lamb chops at their trade ministers and such. Or better yet, Culture Minister Jack Lang's comments about the U.S. Cartoon Network: "We must fight back against this American aggression. It is intolerable that certain North American audiovisual groups shamelessly colonize our countries."

Consider our own fear and loathing of "Japanese colonization" in both the 1920s and the 1980s. This apparent xenophobia turned to racism when Americans stoned Toyotas and Hondas but not Volkswagens and BMWs or when we decried Japanese takeovers of American firms and ignored Germany's gorging on the likes of Bankers Trust, Random House, and Chrysler.

PEMEX's current ban on American investments in the oil and gas industry in Mexico is a good example of nationalism. However, when British Petroleum buying ARCO is no problem, but Mexican cement giant CEMEX buying Houston's Southdown is, that's racism at work.

A cruel irony regarding Gigante's problems in Anaheim is well revealed by a quick drive around Tijuana. During the last decade, the change in Tijuana's retail facade has been remarkable. In this border town, after NAFTA, McDonalds, Costco, Smart & Final, and other American brands now dominate the signage.

Sources: John L. Graham, "Blanca Nieves, La Cenicienta, y Bimbo," La Opinion, February 22, 2002, p. C1 (translated from the Spanish); Clifford Kraus, "New Accents in the U.S. Economy," The New York Times, May 2, 2007, pp. C1, C14; "Grupo Bimbo," American Lawyer, April 2009, pp. 38–40.

and products. Companies with only domestic markets have found increasing difficulty in sustaining their customary rates of growth, and many are seeking foreign markets in which to expand. Companies with foreign operations find that foreign earnings are making an important overall contribution to total corporate profits. A four-year Conference Board study of 1,250 U.S. manufacturing companies found that multinationals of all sizes and in all industries outperformed their strictly domestic U.S. counterparts. They grew twice as fast in sales and earned significantly higher returns on equity and assets. Furthermore, U.S. multinationals reduced their manufacturing employment, both at home and abroad, more than domestic companies. Another study indicates that despite the various difficulties associated with internationalization, on average, firm value is increased by global diversification.[15] Indeed, at least periodically, profit levels from international ventures exceed those from domestic operations for many multinational firms.[16]

[15] John A. Doukas and Ozgur B. Kan, "Does Global Diversification Destroy Firm Value?" *Journal of International Business Studies* 37 (2006), pp. 352–71.

[16] Justin Lahart, "Behind Stocks' Run at Record," *The Wall Street Journal*, April 25, 2007, pp. C1–2.

Exhibit 1.2
Selected U.S. Companies and Their International Sales

Source: Compiled from annual reports of listed firms, 2010.

Company	Global Revenues (billions)	Percent Revenues from Outside the U.S.
Walmart	$401.2	24.6%
Ford Motor	146.3	51.9
General Electric	182.5	53.7
CitiGroup	52.8	74.8
Hewlett-Packard	118.4	68.2
Boeing	60.9	38.9
Intel	37.6	85.4
Coca-Cola	31.9	77.0
Apple	36.5	46.0
Starbucks	10.4	20.8

Exhibit 1.2 illustrates how important revenues generated on investments abroad are to U.S. companies. In many cases, foreign sales were greater than U.S. sales, demonstrating the global reach of these American brands. Apple's performance has been most impressive, with total revenues exploding from just $6 billion in 2003 to $24 billion in 2007. Meanwhile, the company maintained its traditional level of more than 40 percent revenues from outside the United States.

Companies that never ventured abroad until recently are now seeking foreign markets. Companies with existing foreign operations realize they must be more competitive to succeed against foreign multinationals. They have found it necessary to spend more money and time improving their marketing positions abroad because competition for these growing markets is intensifying. For firms venturing into international marketing for the first time and for those already experienced, the requirement is generally the same: a thorough and complete commitment to foreign markets and, for many, new ways of operating.

International Marketing Defined

International marketing is the performance of business activities designed to plan, price, promote, and direct the flow of a company's goods and services to consumers or users in more than one nation for a profit. The only difference between the definitions of domestic marketing and international marketing is that in the latter case, marketing activities take place in more than one country. This apparently minor difference, "in more than one country," accounts for the complexity and diversity found in international marketing operations. Marketing concepts, processes, and principles are universally applicable, and the marketer's task is the same, whether doing business in Dimebox, Texas, or Dar es Salaam, Tanzania. Business's goal is to make a profit by promoting, pricing, and distributing products for which there is a market. If this is the case, what is the difference between domestic and international marketing?

A Citibank branch in the heart of Brazil on a rainy day in 2008. The address on the Avenida Paulista is 1776—how American! One of the world's great multinational corporations barely survived the financial debacle of October 2008. Perhaps its red, white, and blue umbrella logo protected it from "adverse weather" on Wall Street? Indeed, during the past two years, its international operations have performed much better than its domestic ones. In particular, emerging markets such as China, India, and Brazil proved relatively resilient during the global financial crisis that began in 2008.

The answer lies not with different concepts of marketing but with the environment within which marketing plans must be implemented. The uniqueness of foreign marketing comes from the range of unfamiliar problems and the variety of strategies necessary to cope with different levels of uncertainty encountered in foreign markets.

Competition, legal restraints, government controls, weather, fickle consumers, and any number of other uncontrollable elements can, and frequently do, affect the profitable outcome of good, sound marketing plans. Generally speaking, the marketer cannot control or influence these uncontrollable elements but instead must adjust or adapt to them in a manner consistent with a successful outcome. What makes marketing interesting is the challenge of molding the controllable elements of marketing decisions (product, price, promotion, distribution, and research) within the framework of the uncontrollable elements of the marketplace (competition, politics, laws, consumer behavior, level of technology, and so forth) in such a way that marketing objectives are achieved. Even though marketing principles and concepts are universally applicable, the environment within which the marketer must implement marketing plans can change dramatically from country to country or region to region. The difficulties created by different environments are the international marketer's primary concern.

The International Marketing Task

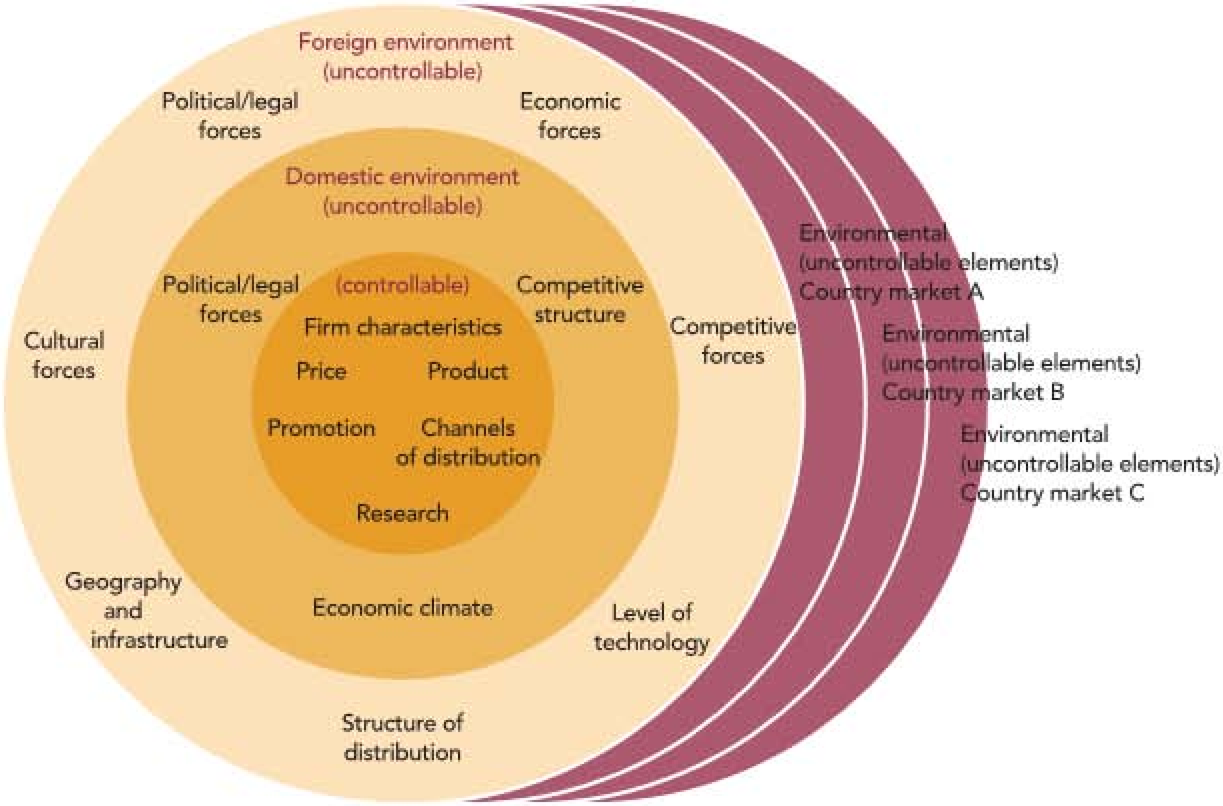
LO3

The scope of the international marketing task

The international marketer's task is more complicated than that of the domestic marketer because the international marketer must deal with at least two levels of uncontrollable uncertainty instead of one. Uncertainty is created by the uncontrollable elements of all business environments, but each foreign country in which a company operates adds its own unique set of uncontrollable factors.

Exhibit 1.3 illustrates the total environment of an international marketer. The inner circle depicts the controllable elements that constitute a marketer's decision area, the

Exhibit 1.3
The International Marketing Task



second circle encompasses those environmental elements at home that have some effect on foreign-operation decisions, and the outer circles represent the elements of the foreign environment for each foreign market within which the marketer operates. As the outer circles illustrate, each foreign market in which the company does business can (and usually does) present separate problems involving some or all of the uncontrollable elements. Thus, the more foreign markets in which a company operates, the greater is the possible variety of foreign environmental factors with which to contend. Frequently, a solution to a problem in country market A is not applicable to a problem in country market B.

Marketing Decision Factors

The successful manager constructs a marketing program designed for optimal adjustment to the uncertainty of the business climate. The inner circle in Exhibit 1.3 represents the area under the control of the marketing manager. Assuming the necessary overall corporate resources, structures, and competencies that can limit or promote strategic choice, the marketing manager blends price, product, promotion, channels-of-distribution, and research activities to capitalize on anticipated demand. The **controllable elements** can be altered in the long run and, usually, in the short run to adjust to changing market conditions, consumer tastes, or corporate objectives.

The outer circles surrounding the marketing decision factors represent the levels of uncertainty created by the domestic and foreign environments. Although the marketer can blend a marketing mix from the controllable elements, the **uncontrollable elements** are precisely that; the marketer must actively evaluate and, if needed, adapt. That effort—the adaptation of the marketing mix to these environmental factors—determines the outcome of the marketing enterprise.

Aspects of the Domestic Environment

The second circle in Exhibit 1.3 represents the aspects of the **domestic environment uncontrollables**. These include home-country elements that can have a direct effect on the success of a foreign venture: political and legal forces, economic climate, and competition.

A political decision involving domestic foreign policy can have a direct effect on a firm's international marketing success. For example, the U.S. government placed a total ban on trade with Libya to condemn Libyan support for terrorist attacks, imposed restrictions on trade with South Africa to protest apartheid, and placed a total ban on trade with Iraq, whose actions were believed to constitute a threat to the national security of the United States and its allies. In each case, the international marketing programs of U.S. companies, whether IBM, Exxon, or Hawg Heaven Bait Company, were restricted by these political decisions. The U.S. government has the constitutional right to restrict foreign trade when such trade adversely affects the security or economy of the country or when such trade is in conflict with U.S. foreign policy.

Conversely, positive effects occur when changes in foreign policy offer countries favored treatment. Such were the cases when South Africa abolished apartheid and the embargo was lifted and when the U.S. government decided to uncouple human rights issues from foreign trade policy and grant permanently normalized trade relations (PNTR) status to China, paving the way for its entry into the World Trade Organization (WTO). In both cases, opportunities were created for U.S. companies. Finally, note that on occasion, companies can exercise a controversially high degree of influence over such legislation in the United States. Recall that it is Congress's responsibility to regulate business, not vice versa. Indeed, in the case of PNTR for China, companies with substantial interests there, such as Boeing and Motorola, lobbied hard for the easing of trade restrictions.

The domestic economic climate is another important home-based uncontrollable variable with far-reaching effects on a company's competitive position in foreign markets. The capacity to invest in plants and facilities, either in domestic or foreign markets, is to a large extent a function of domestic economic vitality. It is generally true that capital tends to flow toward optimum use; however, capital must be generated before it can have mobility. Furthermore, if internal economic conditions deteriorate, restrictions against foreign investment and purchasing may be imposed to strengthen the domestic economy.

Competition within the home country can also have a profound effect on the international marketer's task. For more than a century, Eastman Kodak dominated the U.S. film market and could depend on achieving profit goals that provided capital to invest in foreign markets. Without having to worry about the company's lucrative base, management had the time and resources to devise aggressive international marketing programs. However, the competitive structure changed when Fuji Photo Film became a formidable competitor by lowering film prices in the United States, opening a $300 million plant, and soon gaining 12 percent of the U.S. market. Since then, the acceptance of digital photography, with Canon, from Japan, leading the market, has further disrupted Kodak's domestic business. As a result, Kodak has had to direct energy and resources back to the United States. Competition within its home country affects a company's domestic as well as international plans. Inextricably entwined with the effects of the domestic environment are the constraints imposed by the environment of each foreign country.

Aspects of the Foreign Environment

In addition to uncontrollable domestic elements, a significant source of uncertainty is **foreign environment uncontrollables**. (depicted in Exhibit 1.3 by the outer circles). A business operating in its home country undoubtedly feels comfortable in forecasting the business climate and adjusting business decisions to these elements. The process of evaluating the uncontrollable elements in an international marketing program, however, often involves substantial doses of cultural, political, and economic shock.

A business operating in a number of foreign countries might find polar extremes in political stability, class structure, and economic climate—critical elements in business decisions. The dynamic upheavals in some countries further illustrate the problems of dramatic change in cultural, political, and economic climates over relatively short periods of time. A case in point is China, which has moved from a communist legal system in which all business was done with the state to a transitional period while a commercial legal system develops. In this transitional phase, new laws are passed but left to be interpreted by local authorities, and confusion often prevails about which rules are still in force and which rules are no longer applicable.

For example, commercial contracts can be entered into with a Chinese company or individual only if that company or person is considered a "legal person." To be a legal person in China, the company or person must have registered as such with the Chinese government. To complicate matters further, binding negotiations may take place only with "legal representatives" of the "legal person." So if your company enters into negotiations with a Chinese company or person, you must ask for signed legal documents establishing the right to do business. The formalities of the signature must also be considered. Will a signature on a contract be binding, or is it necessary to place a traditional Chinese seal on the document? Even when all is done properly, the government still might change its mind. Coca-Cola had won approval for its plan to build a new facility to produce product for its increasing Chinese market share. But before construction began, the Chinese parliament objected that Coca-Cola appeared to be too successful in China, so negotiations continued delaying the project. Such are the uncertainties of the uncontrollable political and legal factors of international business.

The more significant elements in the uncontrollable international environment, shown in the outer circles of Exhibit 1.3, include political/legal forces, economic forces, competitive forces, level of technology,[17] structure of distribution, geography and infrastructure, and cultural forces.[18] These forces constitute the principal elements of uncertainty an international marketer must cope with in designing a marketing program. Although each will be discussed in depth in subsequent chapters, consider the level of technology and political/legal forces as illustrations of the uncontrollable nature of the foreign environment.

The level of technology is an uncontrollable element that can often be misread because of the vast differences that may exist between developed and developing countries.

[17] Shih-Fen S. Chen, "Extending Internationalization Theory: A New Perspective on International Technology Transfer and Its Generalization," *Journal of International Business Studies* 36 (2005), pp. 231–45.

[18] Laszlo Tihany, David A. Griffith, and Craig J. Russell, "The Effect of Cultural Distance on Entry Mode Choice, International Diversification, and MNE Performance: A Meta-Analysis," *Journal of International Business Studies* 36, no. 3 (2005), pp. 270–83.

CROSSING BORDERS 1.3 Mobile Phones, Economic Development, and Shrinking the Digital Divide

Wedged between stalls of dried fish and mounds of plastic goods, a red shipping container is loaded with Coca-Cola bottles. The local distributor for Soweto market, located in a tatty corner of Zambia's capital city, Lusaka, sells all its stock every few days. A full load costs 10m kwacha (about $2,000). In cash, this amount can be hard to get hold of, takes ages to count, and—being 10 times the average annual wage—is tempting to thieves. So Coca-Cola now tells its 300 Zambian distributors to pay for deliveries not in cash but by sending text messages from their mobile phones. The process takes about 30 seconds, and the driver issues a receipt. Far away computers record the movement of money and stock. Coca-Cola is not alone. Around the corner from the market, a small dry-cleaning firm lets customers pay for laundry using their phones. So do Zambian petrol stations and dozens of bigger shops and restaurants.

This is just one example of the many innovative ways in which mobile phones are being used in the poorest parts of the world. Anecdotal evidence of mobile phones' ability to boost economic activity is abundant: They enable fishermen or farmers to check prices at different markets before selling produce and make it easier for people to look for jobs and prevent wasted journeys. Mobile phones reduce transaction costs, broaden trade networks, and substitute for costly physical transport. They are of particular value when other means of communication (such as roads, post, or fixed-line phones) are poor or nonexistent.

This importance can be hard for people in affluent countries to understand, because the ways in which mobile phones are used in low-income countries are so different. In particular, phones are widely shared. One person in a village buys a mobile phone, perhaps using a microcredit loan. Others then rent it out by the minute; the small profit margin enables its owner to pay back the loan and make a living. When the phone rings, its owner carries it to the home of the person being called, who then takes the call. Other entrepreneurs set up as "text message interpreters," sending and receiving text messages (which are generally cheaper than voice calls) on behalf of their customers, who may be illiterate. So though the number of phones per 100 people is low by affluent-world standards, they still make a big difference.

Yet mobile phone technologies also can be controversial. Chinese authorities imposed a blackout on communications (Internet access, international phone service, and text messaging) in the northwest region of Xinjiang province in the wake of ethnic violence in the area in July 2009. The government there said it severed communications to ease tensions that it claims were inflamed by social networking sites and text messages.

Sources: The Economist, "Economics Focus, Calling across the Divide," March 12, 2005, p. 74; Bruce Meyerson, "Skype Takes Its Show on the Road," BusinessWeek, October 29, 2007, p. 38; Andrew Jacobs, "China Restores Text Messaging in Xinjiang," The New York Times, January 18, 2010, p. A9.

A marketer cannot assume that understanding of the concept of preventive maintenance for machinery is the same in other countries as in the United States. Technical expertise may not be available at a level necessary for product support, and the general population may not have an adequate level of technical knowledge to maintain equipment properly. In such situations, a marketer will have to take extra steps to make sure that the importance of routine maintenance is understood and carried out. Furthermore, if technical support is not readily available, local people will have to be specially trained, or the company will have to provide support.

Political and legal issues face a business, whether it operates at home or in a foreign country. However, the issues abroad are often amplified by the "alien status" of the company, which increases the difficulty of properly assessing and forecasting the dynamic international business climate. The alien status of a foreign business has two dimensions: It is alien in that foreigners control the business and in that the culture of the host country is alien to management. The alien status of a business means that, when viewed as an outsider, it can be seen as an exploiter and receive prejudiced or unfair treatment at the hands of politicians, legal authorities, or both. Political activists can rally support by advocating the expulsion of the "foreign exploiters," often with the open or tacit approval of authorities. The Indian government, for example, gave Coca-Cola the choice of either revealing its secret formula or leaving the country. The company chose to leave. When it was welcomed

Masai tribesmen in Tanzania with their cell phones. Competition is fierce among carriers in burgeoning markets like Tanzania. Both Celtel and Vodacom provide paint for local stores and houses. Here you see the bright Celtel yellow and red, which goes nicely with the colorful garb of local customers. Vodacom blue is at a disadvantage there. We imagine the ear lobe "carrying case" makes it easy to hear the ring but hard to dial!

back several years later, it faced harassment and constant interference in its operations from political activists, often inspired by competing soft drink companies.

Furthermore, in a domestic situation, political details and the ramifications of political and legal events are often more transparent than they are in some foreign countries. For instance, whereas in the United States, each party in a dispute has access to established legal procedures and due process, legal systems in many other countries are still evolving. In many foreign countries, corruption may prevail, foreigners may receive unfair treatment, or the laws may be so different from those in the home country that they are misinterpreted. The point is that a foreign company is foreign and thus always subject to the political whims of the local government to a greater degree than a domestic firm. Google's conflicts with the Chinese government regarding censorship and confidentiality are pertinent here.[19]

Political/legal forces and the level of technology are only two of the uncontrollable aspects of the foreign environment that are discussed in subsequent chapters. The uncertainty of different foreign business environments creates the need for a close study of the uncontrollable elements within each new country. Thus, a strategy successful in one country can be rendered ineffective in another by differences in political climate, stages of economic development, level of technology, or other cultural variations.

Environmental Adaptation Needed

To adjust and adapt a marketing program to foreign markets, marketers must be able to interpret effectively the influence and impact of each of the uncontrollable environmental elements on the marketing plan for each foreign market in which they hope to do business. In a broad sense, the uncontrollable elements constitute the culture; the difficulty facing the marketer in adjusting to the culture lies in recognizing its impact. In a domestic market, the reaction to much of the environment's (cultural) impact on the marketer's activities is automatic; the various cultural influences that fill our lives are simply a part of our socialization, and we react in a manner acceptable to our society without consciously thinking about it.

The task of cultural adjustment, however, is the most challenging and important one confronting international marketers; they must adjust their marketing efforts to cultures to which they are not attuned. In dealing with unfamiliar markets, marketers must be aware of the frames of reference they are using in making their decisions or evaluating the potential of a market, because judgments are derived from experience that is the result of

[19] Sharon LaFraniere, "China at Odds with Future in Internet Fight," *The New York Times*, January 17, 2010, p. 6.

acculturation in the home country. Once a frame of reference is established, it becomes an important factor in determining or modifying a marketer's reaction to situations—social and even nonsocial.

For example, time-conscious Americans are not culturally prepared to understand the culturally nuanced meaning of time to Latin Americans. Such a difference must be learned to avoid misunderstandings that can lead to marketing failures. Such a failure occurs every time sales are lost when a "long waiting period" in the outer office of a Latin American customer is misinterpreted by an American sales executive. Cross-cultural misunderstandings can also occur when a simple hand gesture has a number of different meanings in different parts of the world. When wanting to signify something is fine, many people in the United States raise a hand and make a circle with the thumb and forefinger. However, this same hand gesture means "zero" or "worthless" to the French, "money" to the Japanese, and a general sexual insult in Sardinia and Greece. A U.S. president sent an unintentional message to some Australian protesters when he held up his first two fingers with the back of his hand to the protesters. Meaning to give the "victory" sign, he was unaware that in Australia, the same hand gesture is equivalent to holding up the middle finger in the United States.

Cultural conditioning is like an iceberg—we are not aware of nine-tenths of it. In any study of the market systems of different peoples, their political and economic structures, religions, and other elements of culture, foreign marketers must constantly guard against measuring and assessing the markets against the fixed values and assumptions of their own cultures. They must take specific steps to make themselves aware of the home cultural reference in their analyses and decision making.[20]

The Self-Reference Criterion and Ethnocentrism: Major Obstacles

LO4

The importance of the self-reference criterion (SRC) in international marketing

The key to successful international marketing is adaptation to environmental differences from one market to another. Adaptation is a conscious effort on the part of the international marketer to anticipate the influences of both the foreign and domestic uncontrollable factors on a marketing mix and then to adjust the marketing mix to minimize the effects.

The primary obstacles to success in international marketing are a person's **self-reference criterion (SRC)** and an associated ethnocentrism. The SRC is an unconscious reference to one's own cultural values, experiences, and knowledge as a basis for decisions. Closely connected is ethnocentrism, that is, the notion that people in one's own company, culture, or country know best how to do things. Ethnocentrism was particularly a problem for American managers at the beginning of the 21st century because of America's dominance in the world economy during the late 1990s. Ethnocentrism is generally a problem when managers from affluent countries work with managers and markets in less affluent countries. Both the SRC and ethnocentrism impede the ability to assess a foreign market in its true light.

When confronted with a set of facts, we react spontaneously on the basis of knowledge assimilated over a lifetime—knowledge that is a product of the history of our culture. We seldom stop to think about a reaction; we simply react. Thus, when faced with a problem in another culture, our tendency is to react instinctively and refer to our SRC for a solution. Our reaction, however, is based on meanings, values, symbols, and behavior relevant to our own culture and usually different from those of the foreign culture. Such decisions are often not good ones.

To illustrate the impact of the SRC, consider misunderstandings that can occur about personal space between people of different cultures. In the United States, unrelated individuals keep a certain physical distance between themselves and others when talking or in groups. We do not consciously think about that distance; we just know what feels right without thinking. When someone is too close or too far away, we feel uncomfortable and either move farther away or get closer to correct the distance. In doing so, we are relying on our SRC. In some cultures, the acceptable distance between individuals is substantially

[20]Emily Maltby, "Expanding Abroad? Avoid Cultural Gaffes," *The Wall Street Journal*, January 19, 2010, p. B5.

less than that which is comfortable for Americans. When someone from another culture approaches an American too closely, the American, unaware of that culture's acceptable distance, unconsciously reacts by backing away to restore the proper distance (i.e., proper by American standards), and confusion results for both parties. Americans assume foreigners are pushy, while foreigners assume Americans are unfriendly and literally "standoffish." Both react according to the values of their own SRCs, making both victims of a cultural misunderstanding.

Your self-reference criterion can prevent you from being aware of cultural differences or from recognizing the importance of those differences. Thus, you might fail to recognize the need to take action, you might discount the cultural differences that exist among countries, or you might react to a situation in a way offensive to your hosts. A common mistake made by Americans is to refuse food or drink when offered. In the United States, a polite refusal is certainly acceptable, but in Asia or the Middle East, a host is offended if you refuse hospitality. Although you do not have to eat or drink much, you do have to accept the offering of hospitality. Understanding and dealing with the SRC are two of the more important facets of international marketing.

Ethnocentrism and the SRC can influence an evaluation of the appropriateness of a domestically designed marketing mix for a foreign market. If U.S. marketers are not aware, they might evaluate a marketing mix based on U.S. experiences (i.e., their SRC) without fully appreciating the cultural differences that require adaptation. Esso, the brand name of a gasoline, was a successful name in the United States and would seem harmless enough for foreign countries; however, in Japan, the name phonetically means "stalled car," an undesirable image for gasoline. Another example is the "Pet" in Pet Milk. The name has been used for decades, yet in France, the word *pet* means, among other things, "flatulence"—again, not the desired image for canned milk. Both of these examples were real mistakes made by major companies stemming from their reliance on their SRC in making a decision.

When marketers take the time to look beyond their own self-reference criteria, the results are more positive. A British manufacturer of chocolate biscuits (cookies, in American English), ignoring its SRC, knew that it must package its biscuits differently to accommodate the Japanese market. Thus, in Japan, McVitie's chocolate biscuits are wrapped individually, packed in presentation cardboard boxes, and priced about three times higher than in the United Kingdom—the cookies are used as gifts in Japan and thus must look and be perceived as special. Unilever, appreciating the uniqueness of its markets, repackaged and reformulated its detergent for Brazil. One reason was that the lack of washing machines among poorer Brazilians made a simpler soap formula necessary. Also, because many people wash their clothes in rivers, the powder was packaged in plastic rather than paper so it would not get soggy. Finally, because the Brazilian poor are price conscious and buy in small quantities, the soap was packaged in small, low-priced packages. Even McDonald's modifies its traditional Big Mac in India, where it is known as the Maharaja Mac. This burger features two mutton patties, because most Indians consider cows sacred and don't eat beef. In each of these examples, had the marketers' own self-reference criteria been the basis for decisions, none of the necessary changes would have been readily apparent based on their home-market experience.

The most effective way to control the influence of ethnocentrism and the SRC is to recognize their effects on our behavior. Although learning every culture in depth and being aware of every important difference is almost humanly impossible, an awareness of the need to be sensitive to differences and to ask questions when doing business in another culture can help you avoid many of the mistakes possible in international marketing. Asking the appropriate question helped the Vicks Company avoid making a mistake in Germany. It discovered that in German, "Vicks" sounds like the crudest slang equivalent of "intercourse," so it changed the name to "Wicks" before introducing the product.

Be aware, also, that not every activity within a marketing program is different from one country to another; indeed, there probably are more similarities than differences. For example, the McVitie's chocolate biscuits mentioned earlier are sold in the United States in the same package as in the United Kingdom. Such similarities, however, may lull the marketer into a false sense of apparent sameness. This apparent sameness, coupled with the self-reference criterion, is often the cause of international marketing problems. Undetected similarities do not cause problems; however, the one difference that goes undetected can create a marketing failure.

To avoid errors in business decisions, the knowledgeable marketer will conduct a cross-cultural analysis that isolates the SRC influences and maintain vigilance regarding ethnocentrism. The following steps are suggested as a framework for such an analysis.

1. Define the business problem or goal in home-country cultural traits, habits, or norms.
2. Define the business problem or goal in foreign-country cultural traits, habits, or norms through consultation with natives of the target country. Make no value judgments.
3. Isolate the SRC influence in the problem and examine it carefully to see how it complicates the problem.
4. Redefine the problem without the SRC influence and solve for the optimum business goal situation.

An American sales manager newly posted to Japan decided that his Japanese sales representatives did not need to come into the office every day for an early morning meeting before beginning calls to clients in Tokyo. After all, that was how things were done in the United States. However, the new policy, based on both the American's SRC and a modicum of ethnocentrism, produced a precipitous decline in sales performance. In his subsequent discussions with his Japanese staff, he determined that Japanese sales representatives are motivated mostly by peer pressure. Fortunately, he was able to recognize that his SRC and his American "business acumen" did not apply in this case in Tokyo. A return to the proven system of daily meetings brought sales performance back to previous levels.

The cross-cultural analysis approach requires an understanding of the culture of the foreign market as well as one's own culture. Surprisingly, understanding one's own culture may require additional study, because much of the cultural influence on market behavior remains at a subconscious level and is not clearly defined.

Developing a Global Awareness

LO5

The increasing importance of global awareness

Opportunities in global business abound for those who are prepared to confront myriad obstacles with optimism and a willingness to continue learning new ways. The successful businessperson in the 21st century will have global awareness and a frame of reference that goes beyond a region or even a country and encompasses the world.[21] To be globally aware is to have (1) tolerance of cultural differences and (2) knowledge of cultures, history, world market potential, and global economic, social, and political trends.

Tolerance for cultural differences is crucial in international marketing. Tolerance is understanding cultural differences and accepting and working with others whose behaviors may be different from yours. You do not have to accept as your own the cultural ways of another, but you must allow others to be different and equal. For example, the fact that punctuality is less important in some cultures does not make them less productive, only different. The tolerant person understands the differences that may exist between cultures and uses that knowledge to relate effectively.

A globally aware person is knowledgeable about cultures and history. Knowledge of cultures is important in understanding behavior in the marketplace or in the boardroom. Knowledge of history is important because the way people think and act is influenced by their history. Some Latin Americans' reluctance toward foreign investment or Chinese reluctance to open completely to outsiders can be understood better if you have a historical perspective.

Global awareness also involves knowledge of world market potentials and global economic, social, and political trends. Over the next few decades, enormous changes will take place in the market potentials in almost every region of the world, all of which a globally

[21] Gary A. Knight and Daekwan Kim, "International Business Competence and the Contemporary Firm," *Journal of International Business Studies* 40, no. 2 (2009), pp. 255–73.

aware person must continuously monitor. Finally, a globally aware person will keep abreast of global economic, social, and political trends, because a country's prospects can change as these trends shift direction or accelerate. The former republics of the Soviet Union, along with Russia, eastern Europe, China, India, Africa, and Latin America, are undergoing economic, social, and political changes that have already altered the course of trade and defined new economic powers. The knowledgeable marketer will identify opportunities long before they become evident to others. It is the authors' goal in this text to guide the reader toward acquiring global awareness.

Global awareness can and should be built into organizations using several approaches. The obvious strategy is to select individual managers specifically for their demonstrated global awareness. Global awareness can also be obtained through personal relationships in other countries. Indeed, market entry is very often facilitated through previously established social ties. Certainly, successful long-term business relationships with foreign customers often result in an organizational global awareness based on the series of interactions required by commerce. Foreign agents and partners can help directly in this regard. But perhaps the most effective approach is to have a culturally diverse senior executive staff or board of directors. Unfortunately, American managers seem to see relatively less value in this last approach than managers in most other countries.

Stages of International Marketing Involvement

LO6

The progression of becoming a global marketer

Once a company has decided to go international, it has to decide the degree of marketing involvement and commitment it is prepared to make. These decisions should reflect considerable study and analysis of market potential and company capabilities—a process not always followed.[22] Research has revealed a number of factors favoring faster internationalization: (1) Companies with either high-technology and/or marketing-based resources appear to be better equipped to internationalize than more traditional manufacturing kinds of companies;[23] (2) smaller home markets and larger production capacities appear to favor internationalization;[24] and (3) firms with key managers well networked internationally are able to accelerate the internationalization process.[25] Many companies begin tentatively in international marketing, growing as they gain experience and gradually changing strategy and tactics as they become more committed.[26] Others enter international marketing after much research and with fully developed long-range plans, prepared to make investments to acquire a market position and often evincing bursts of international activities.[27] One study suggests that striking a balance between the two approaches may actually work best,[28] with a variety of conditions and firm characteristics to be evaluated.

Regardless of the means employed to gain entry into a foreign market, a company may make little or no actual market investment—that is, its marketing involvement may be limited to selling a product with little or no thought given to the development of market control. Alternatively, a company may become totally involved and invest large sums of

[22]Protiti Dastidar, "International Corporate Diversification and Performance: Does Firm Self-Selection Matter?" *Journal of International Business Studies* 40, no. 1 (2009), pp. 71–85.

[23]Chiung-Hui Tseng, Patriya Tansuhaj, William Hallagan, and James McCullough, "Effects of Firm Resources on Growth in Multinationality," *Journal of International Business Studies* 38 (2007), pp. 961–74.

[24]Terence Fan and Phillip Phan, "International New Ventures: Revisiting the Influences behind the 'Born-Global' Firm," *Journal of International Business Studies* 38 (2007), pp. 1113–31.

[25]Susan Freeman and S. Tamer Cavusgil, "Toward a Typology of Commitment States among Managers of Born-Global Firms: A Study of Accelerated Internationalization," *Journal of International Marketing* 15 (2007), pp. 1–40.

[26]Marian V. Jones and Nicole E. Coviello, "Internationalisation: Conceptualising an Entrepreneurial Process of Behaviour in Time," *Journal of International Business Studies* 36, no. 3 (2005), pp. 284–303.

[27]Elizabeth Maitland, Elizabeth L. Rose, and Stephen Nicholas, "How Firms Grow: Clustering as a Dynamic Model of Internationalization," *Journal of International Business Studies* 36 (2005), pp. 435–51.

[28]Harry G. Barkema and Rian Drogendijk, "Internationalizing in Small, Incremental or Larger Steps?" *Journal of International Business Studies* 38 (2007), pp. 1132–48.

money and effort to capture and maintain a permanent, specific position in the market. In general, one of five (sometimes overlapping) stages can describe the international marketing involvement of a company. Although the stages of international marketing involvement are presented here in a linear order, the reader should not infer that a firm progresses from one stage to another; quite to the contrary, a firm may begin its international involvement at any one stage or be in more than one stage simultaneously. For example, because of a short product life cycle and a thin but widespread market for many technology products, many high-tech companies, large and small, see the entire world, including their home market, as a single market and strive to reach all possible customers as rapidly as possible.

No Direct Foreign Marketing

A company in this stage does not actively cultivate customers outside national boundaries; however, this company's products may reach foreign markets. Sales may be made to trading companies as well as foreign customers who directly contact the firm. Or products may reach foreign markets via domestic wholesalers or distributors who sell abroad without the explicit encouragement or even knowledge of the producer. As companies develop Web sites on the Internet, many receive orders from international Internet users. Often an unsolicited order from a foreign buyer is what piques the interest of a company to seek additional international sales.

Infrequent Foreign Marketing

Temporary surpluses caused by variations in production levels or demand may result in infrequent marketing overseas. The surpluses are characterized by their temporary nature; therefore, sales to foreign markets are made as goods become available, with little or no intention of maintaining continuous market representation. As domestic demand increases and absorbs surpluses, foreign sales activity is reduced or even withdrawn. In this stage, little or no change is seen in the company organization or product lines. However, few companies fit this model today, because customers around the world increasingly seek long-term commercial relationships. Furthermore, evidence suggests that financial returns from such short-term international expansions are limited.

The first two stages of international marketing involvement are more reactive in nature and most often do not represent careful strategic thinking about international expansion. Indeed, putting strategic thinking on the back burner has resulted in marketing failures for even the largest companies.

The consensus of researchers and authors[29] in this area suggests three relatively distinct approaches to strategic decisions in firms involved in international markets:[30]

1. Regular foreign marketing
2. Multidomestic or international marketing
3. Global marketing

Next we discuss each of the three stages (and their associated strategic orientations) in turn.

Regular Foreign Marketing

At this level, the firm has permanent productive capacity devoted to the production of goods and services to be marketed in foreign markets. A firm may employ foreign or domestic overseas intermediaries, or it may have its own sales force or sales subsidiaries in important foreign markets. The primary focus of operations and production is to service domestic market needs. However, as overseas demand grows, production is allocated for foreign markets, and products may be adapted to meet the needs of individual foreign markets. Profit expectations from foreign markets move from being seen as a bonus in addition to regular domestic profits to a position in which the company becomes dependent on foreign sales and profits to meet its goals.

[29]A seminal paper in this genre is by Yorum Wind, Susan P. Douglas, and Howard V. Perlmutter, "Guidelines for Developing International Marketing Strategy," *Journal of Marketing*, April 1973, pp. 14–23.

[30]Christian Geisler Asmussen, "Local, Regional, or Global? Quantifying MNE Geographic Scope," *Journal of International Business Studies* 40, no. 7 (2009), pp. 1192–205.

Meter-Man, a small company (25 employees) in southern Minnesota that manufactures agricultural measuring devices, is a good example of a company in this stage.[31] In 1989, the 35-year-old company began exploring the idea of exporting; by 1992 the company was shipping product to Europe. Today, one-third of Meter-Man's sales are in 35 countries, and soon the company expects international sales to account for about half of its business. "When you start exporting, you say to yourself, this will be icing on the cake," says the director of sales and marketing. "But now I say going international has become critical to our existence." Recently Meter-Man was purchased by Komelon, Inc., a larger, more diversified international company with operations in Washington state, South Korea, China, and Europe.

International Marketing

Companies in this stage are fully committed to and involved in international marketing activities. Such companies seek markets all over the world and sell products that are a result of planned production for markets in various countries. This planning generally entails not only the marketing but also the production of goods outside the home market. At this point, a company becomes an international or multinational marketing firm.

The experience of Fedders, a manufacturer of room air conditioners, typifies that of a company that begins its international business at this stage.[32] Even though it is the largest manufacturer of air conditioners in the United States, the firm faced constraints in its domestic market. Its sales were growing steadily, but sales of air conditioners (the company's only product) are seasonal, and thus, domestic sales at times do not even cover fixed costs. Furthermore, the U.S. market is mature, with most customers buying only replacement units. Any growth would have to come from a rival's market share, and the rivals, Whirlpool and Matsushita, are formidable. Fedders decided that the only way to grow was to venture abroad.

Fedders decided that Asia, with its often steamy climate and expanding middle class, offered the best opportunity. China, India, and Indonesia were seen as the best prospects. China was selected because sales of room air conditioners had grown from 500,000 units to more than 4 million in five years, which still accounted for only 12 percent of the homes in cities like Beijing, Shanghai, and Guangzhou. The company saw China as a market with terrific growth potential. After careful study, Fedders entered a joint venture with a small Chinese air conditioner company that was looking for a partner; a new company, Fedders Xinle, formed. The company immediately found that it needed to redesign its product for this market. In China, air conditioners are a major purchase, seen as a status symbol, not as a box to keep a room cool, as in the United States. The Chinese also prefer a split-type air conditioner, with the unit containing the fan inside the room and the heat exchanger mounted on a wall outside. Because Fedders did not manufacture split models, it designed a new product that is lightweight, energy efficient, and packed with features, such as a remote control and an automatic air-sweeping mechanism.

The joint venture appears to be successful, and the company is exploring the possibility of marketing to other Asian markets and maybe even back to the United States with the new product that it developed for the Chinese market. As Fedders expands into other markets and makes other commitments internationally, it continued to evolve as an international or multinational company. Finally, Fedders's successes internationally made it an attractive acquisition candidate, and in 2008 it was purchased by a French firm, Airwell, that has distributors in over 80 countries around the world.

Global Marketing

At the global marketing level, the most profound change is the orientation of the company toward markets and associated planning activities. At this stage, companies treat the world, including their home market, as one market. Market segmentation decisions are no longer focused on national borders. Instead, market segments are defined by income levels, usage patterns, or other factors that frequently span countries and regions. Often this transition from international marketing to global marketing is catalyzed by a company's crossing the threshold at which more than half its sales revenues comes from abroad. The best people in the company begin to seek international assignments, and the entire

[31] See http://www.komelon.com for its Meter-Man product line and other details.

[32] See http://www.airwell-fedders.com for details about the company.

CROSSING BORDERS 1.4 Orange County, CA, Travels East and West

For $500,000 you can now buy a four-bedroom house in Orange County—in China!

The homes are designed by Southern California architects and built with American features but are located in a new development an hour's drive north of Beijing. The country road can be icy and is lined by fields and populated by trucks and sheep. The landscape is a far cry from palm-ringed golf courses and "Surfin' USA." A bit after Sun City, another half-built gated community, the tidy homes of Orange County come into view. Finally, you drive through a stone portal, past advertisements showing men fly-fishing in cowboy hats and such, and pull up before the impressive mansions of Watermark-Longbeach, the epicenter of faux L.A. in China. Says homeowner Nasha Wei, a former army doctor turned businesswoman, "I liked it immediately—it is just like a house in California." By the way, in other neighborhoods around Beijing, you can also buy a large home in a development of French villas called "Palais de Fortune" or an eco-friendly Toronto-designed home in "Maple Town."

Apparently, in France, the waves can actually be better than in California. Check out the 60-footers at Belharra Reef off St. Jean de Luz. Or hang ten along the surfwear shops nearby in the hamlet of Hossegor in southwest France. They're all there: Roxy, Rip Curl Girl, Billabong, and Quicksilver Boardriders Club. And the kids in the neighborhoods and sidewalk cafés are decked out in Volcom sweatshirts, Vans sneakers, and jeans.

The $5-billion plus surfwear industry, rooted in Orange County, California, has established a beachhead in Europe. So many U.S. surfwear companies have international headquarters, subsidiaries, and stores in Pays Basque that it has a new nickname: la petite Californie. "This is the best place to observe the market," says Petra Holtschneider, who recently organized the first Action Sports Retailer trade show in the area. "So if you're not here, you're not getting it."

Finally, perhaps the scariest OC exports are the television programs about the place. First it was Fox's The OC, then MTV's Laguna Beach: The Real Orange County, which has now morphed into Newport Harbor: The Real Orange County. The latter is now showing an entirely new generation of Europeans the latest kinds of misbehavior going on in "paradise" while influencing teen fashions globally. And there's a British spin-off in the works, Alderley Edge, Cheshire. Perhaps it will make its way back to the United States in the form of "educational TV"— those British accents make them sound so smart!

Sources: Elisabeth Rosenthal, "North of Beijing, California Dreams Come True," The New York Times, February 3, 2003, p. A3; Leslie Earnest, "Riding a French New Wave," Los Angeles Times, May 11, 2003, p. C1; Cristina Kinon, "The Laguna Effect: MTV's Sexy Soaps Are Changing the Face of Fashion, Mags, and the Way Teens Speak," New York Daily News, August 13, 2007, p. 33; Alyssa Abkowitz, "The Surfin' CEO," Fortune International (Europe), July 20, 2009, p. 17.

operation—organizational structure, sources of finance, production, marketing, and so forth—begins to take on a global perspective.

The example of Coca-Cola's transition from international to global is instructive. Coca-Cola had actually been a global company for years; the mid-1990s organizational redesign was the last step in recognizing the changes that had already occurred. Initially, all international divisions reported to an executive vice president in charge of international operations, who, along with the vice president of U.S. operations, reported to the president. The new organization consists of six international divisions. The U.S. business unit accounts for about 20 percent of profits and has been downgraded to just part of one of the six international business units in the company's global geographic regions. The new structure does not reduce the importance of the company's North American business; it just puts other areas on an equal footing. It represents the recognition, however, that future growth is going to come from emerging markets outside the United States.

International operations of businesses in global marketing reflect the heightened competitiveness brought about by the globalization of markets, interdependence of the world's economies, and the growing number of competing firms from developed and developing countries vying for the world's markets. *Global companies* and *global marketing* are terms frequently used to describe the scope of operations and marketing management orientation of companies in this stage.

As the competitive environment facing U.S. businesses becomes more internationalized—and it surely will—the most effective orientation for many firms engaged in marketing in another

North of Beijing, China, a new development is being marketed as Orange County, China. The gardens and stucco and tile exteriors are all intended to replicate the Mediterranean look and feel of homes in Newport Beach, California.

country will be a global orientation.[33] This orientation means operating as if all the country markets in a company's scope of operations (including the domestic market) were approachable as a single global market and standardizing the marketing mix where culturally feasible and cost effective. It does not, however, mean a slavish adherence to one strategic orientation. Depending on the product and market, other orientations may make more marketing sense. For example, Procter & Gamble may pursue a global strategy for disposable diapers but a multidomestic strategy in Asian markets for detergents.

The Orientation of International Marketing

Most problems encountered by the foreign marketer result from the strangeness of the environment within which marketing programs must be implemented. Success hinges, in part, on the ability to assess and adjust properly to the impact of a strange environment. The successful international marketer possesses the best qualities of the anthropologist, sociologist, psychologist, diplomat, lawyer, prophet, and businessperson.

In light of all the variables involved, with what should a textbook in foreign marketing be concerned? It is the opinion of the authors that a study of foreign marketing environments, people, and cultures[34] and their influences on the total marketing process is of primary concern and is the most effective approach to a meaningful presentation. Our views are supported by the most recent ranking of countries on their extent of globalization—see Exhibit 1.4.[35] Yes, the United States is near the top of the list, and most of the "Global Top 20" are small countries. However, the key conclusion to be drawn from the graph is the dominance of "technological connectivity" for

[33] Amar Gande, Christoph Schenzler, and Lemma W. Senbet, "Valuation of Global Diversification," *Journal of International Business Studies* 40, no. 9 (2009), pp. 1515–32.

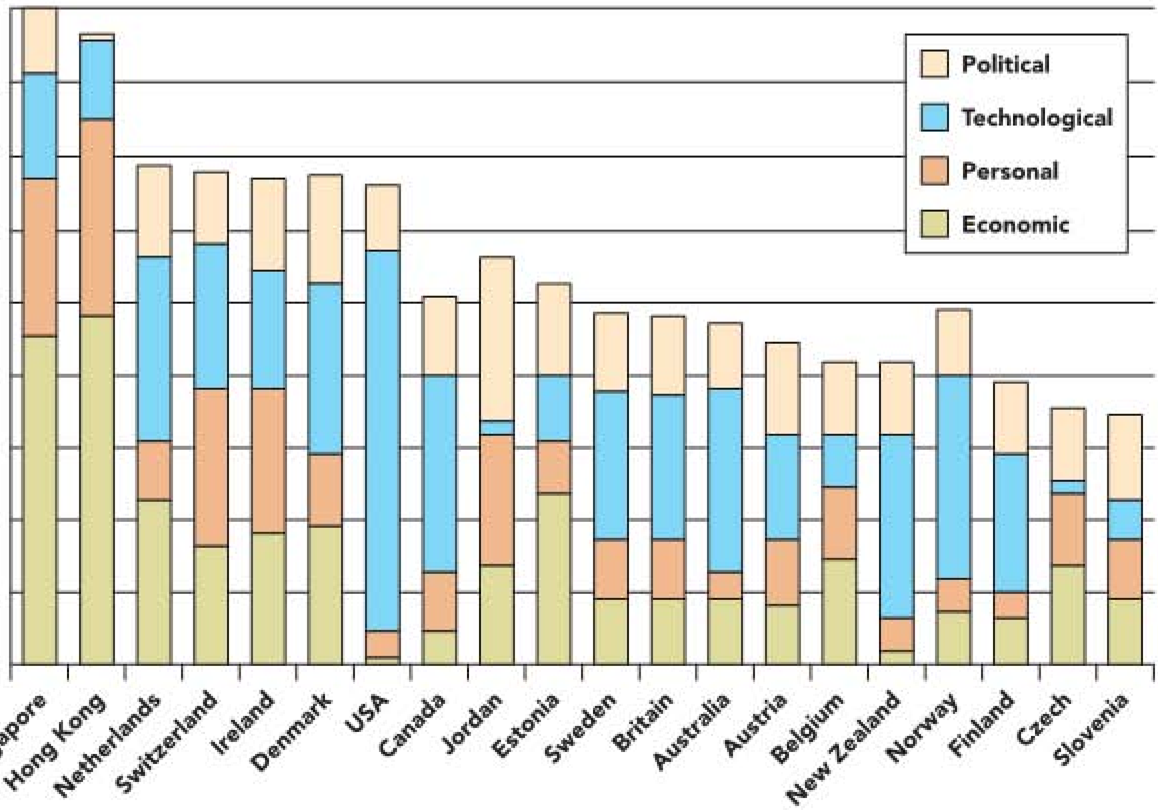
[34] Tricia Bisoux, "Trade Secrets: An Interview with Caterpillar CEO, Jim Owens," *BizEd*, September/October 2009, pp. 20–27; Udo Zander and Lena Zander, "Opening the Grey Box: Social Communities, Knowledge and Culture in Acquisitions," *Journal of International Business Studies* 41, no. 1 (2010), pp. 27–37.

[35] "Measuring Globalization," *Foreign Policy*, November/December 2007, pp. 68–77.

Orange County has also come to France in the form of the southern California surfing culture and clothiers. The OC's Quiksilver opened its European headquarters in southwest France in 1984. Last year, European sales amounted to over $1 billion. Part of the firm's success in Europe can be attributed to hiring local nationals in key marketing positions. Maritxu Darrigrand, former French women's surfing champion, is now Quiksilver's marketing director for Europe. The OC has also come to the U.K. as Laguna Beach: The Real Orange County. The MTV program brings California beach culture—clothes, music, and misbehavior—to Europe.

Exhibit 1.4
Foreign Policy's Global Top 20

The countries that top the charts in trade, travel, technology, and links to the rest of the world



ECONOMIC INTEGRATION:
Trade and foreign direct investment

TECHNOLOGICAL CONNECTIVITY:
Internet users, Internet hosts, and secure servers

PERSONAL CONTACT:
International travel and tourism, international telephone traffic, and remittances and personal transfers (including worker remittances, compensation to employees, and other person-to-person and non-governmental transfers)

POLITICAL ENGAGEMENT:
Membership in international organizations, personnel and financial contributions to U.N. peacekeeping missions, international treaties ratified, and governmental transfers

Source: Foreign Policy, November/December 2007, pp. 68–77. Copyright 2007 by Foreign Policy. Reproduced with permission of Foreign Policy via Copyright Clearance Center.

America. In particular, notice that as a country, the United States is weakest on the "personal contact" dimension. Compared with folks in other countries, Americans generally do not experience foreign environments. This lack is the gap our book focuses on.

Consequently, the orientation of this text can best be described as an environmental/cultural approach to international strategic marketing. By no means is it intended to present principles of marketing; rather, it is intended to demonstrate the unique problems of international marketing. It attempts to relate the foreign environment to the marketing process and to illustrate the many ways in which culture can influence the marketing task. Although marketing principles are universally applicable, the cultural environment within which the marketer must implement marketing plans can change dramatically from country to country. It is with the difficulties created by different environments that this text is primarily concerned.

The text addresses issues relevant to any company marketing in or into any other country or groups of countries, however slight the involvement or the method of involvement. Hence this discussion of international marketing ranges from the marketing and business practices of small exporters, such as a Colorado-based company that generates more than

50 percent of its $40,000 annual sales of fish-egg sorters in Canada, Germany, and Australia, to the practices of global companies such as Motorola, Avon, and Johnson & Johnson, all of which generate more than 50 percent of their annual profits from the sales of multiple products to multiple country-market segments all over the world.

The first section of *International Marketing* offers an overview of international marketing, including a discussion of the global business environment confronting the marketer. The next section deals exclusively with the uncontrollable elements of the environment and their assessment, followed by chapters on assessing global market opportunities. Then, management issues in developing global marketing strategies are discussed. In each chapter, the impact of the environment on the marketing process is illustrated.

Space prohibits an encyclopedic approach to all the issues of international marketing; nevertheless, the authors have tried to present sufficient detail so that readers will appreciate the real need to do a thorough analysis whenever the challenge arises. The text provides a framework for this task.

Summary

The internationalization of American business is accelerating. The globalization of markets and competition necessitates that all managers pay attention to the global environment. International marketing is defined as the performance of business activities, including pricing, promotion, product, and distribution decisions, across national borders. The international marketing task is made more daunting because environmental factors such as laws, customs, and cultures vary from country to country. These environmental differences must be taken into account if firms are to market products and services at a profit in other countries.

Key obstacles facing international marketers are not limited to environmental issues. Just as important are difficulties associated with the marketer's own self-reference criteria and ethnocentrism. Both limit the international marketer's abilities to understand and adapt to differences prevalent in foreign markets. A global awareness and sensitivity are the best solutions to these problems, and they should be nurtured in international marketing organizations.

Three different strategic orientations are found among managers of international marketing operations. Some see international marketing as ancillary to the domestic operations. A second kind of company sees international marketing as a crucial aspect of sales revenue generation but treats each market as a separate entity. Finally, a global orientation views the globe as the marketplace, and market segments are no longer based solely on national borders—common consumer characteristics and behaviors come into play as key segmentation variables applied across countries.

Key Terms

International marketing
Controllable elements
Uncontrollable elements
Domestic environment uncontrollables
Foreign environment uncontrollables
Self-reference criterion (SRC)
Global awareness

Questions

1. Define the key terms listed above.
2. "The marketer's task is the same whether applied in Dimebox, Texas, or Dar es Salaam, Tanzania." Discuss.
3. How can the increased interest in international marketing on the part of U.S. firms be explained?
4. Discuss the four phases of international marketing involvement.
5. Discuss the conditions that have led to the development of global markets.
6. Differentiate between a global company and a multinational company.
7. Differentiate among the three international marketing concepts.
8. Prepare your lifelong plan to be globally aware.
9. Discuss the three factors necessary to achieve global awareness.
10. Define and discuss the idea of global orientation.
11. Visit the Bureau of Economic Analysis homepage (http://www.bea.doc.gov). Select the section "International articles" and find the most recent information on foreign direct investments in the United States. Which country has the highest dollar amount of investment in the United States? Second highest?

Chapter 2

The Dynamic Environment of International Trade

CHAPTER OUTLINE

CHAPTER LEARNING OBJECTIVES

What you should learn from Chapter 2:

LO1 The basis for the reestablishment of world trade following World War II

LO2 The importance of balance-of-payment figures to a country's economy

LO3 The effects of protectionism on world trade

LO4 The several types of trade barriers

LO5 The provisions of the Omnibus Trade and Competitiveness Act

LO6 The importance of GATT and the World Trade Organization

LO7 The emergence of the International Monetary Fund and the World Bank Group

Global Perspective

TRADE BARRIERS—AN INTERNATIONAL MARKETER'S MINEFIELD

We all know the story about U.S. trade disputes with Japan. Japan has so many trade barriers and high tariffs that U.S. manufacturers are unable to sell in Japan as much as Japanese companies sell in the United States. The Japanese claim that "unique" Japanese snow requires skis made in Japan, and U.S. baseballs are not good enough for Japanese baseball. Even when Japan opened its rice market, popular California rice had to be mixed and sold with inferior grades of Japanese rice. And, at this writing, the Japanese government continues to exclude American beef from the Japanese diet based on disputes about mad cow disease.[1]

However, the Japanese are not alone; every country seems to take advantage of the open U.S. market while putting barriers in the way of U.S. exports. The French, for example, protect their film and broadcast industry from foreign competition by limiting the number of American shows that can appear on television, the percentage of American songs broadcast on radio, and the proportion of U.S. movies that can be shown in French theaters. Most recently, France launched its own "French" version of CNN with strong government financial support. Not only do these barriers and high tariffs limit how much U.S. companies can sell, they also raise prices for imported products much higher than they sell for in the United States.

Another trade protection tactic even involved Britain's Supreme Court of Judicature, which has finally answered a question that has long puzzled late-night dorm-room snackers: What, exactly, is a Pringle? With citations ranging from Baroness Hale of Richmond to Oliver Wendell Holmes, Lord Justice Robin Jacob concluded that legally it is a potato chip. The decision is bad news for Procter & Gamble U.K., which now owes $160 million in value-added taxes to the state. It is thus good news for Her Majesty's Revenue and Customs—and for fans of no-nonsense legal opinions. It is also a reminder, as conservatives in the United States attack Justice Sonia Sotomayor for not being a "strict constructionist," of the pointlessness of such labels. In Britain, most foods are exempt from the value-added tax (VAT), but potato chips (known there as crisps) and "similar products made from the potato, or from potato flour" are taxable. Procter & Gamble, in what could be considered a strict constructionist plea, argued that Pringles are about 40 percent potato flour but also contain corn, rice, and wheat and therefore should not be considered potato chips or "similar products." Rather, they are "savory snacks."

The VAT and Duties Tribunal disagreed, ruling that Pringles, marketed in the United States as "potato chips," are taxable. "There are other ingredients," the Tribunal agreed, but a Pringle is "made from potato flour in the sense that one cannot say that it is not made from potato flour, and the proportion of potato flour is significant being over 40 percent."

Barriers to trade, whatever form they take, both tariff and nontariff, are one of the major issues confronting international marketers. Nations continue to use trade barriers for a variety of reasons: some rational, some not so rational. Fortunately, tariffs generally have been reduced to record lows, and substantial progress has been made on eliminating nontariff barriers. And work continues around the world to further reduce these pesky hurdles to peace and prosperity.

Sources: Adapted from Todd G. Buchholz, "Free Trade Keeps Prices Down," *Consumers' Research Magazine*, October 1995, p. 22; Tomas Kellner, "What Gaul!" *Forbes*, April 28, 2003, p. 52; Jonathan Lynn, "WTO Negotiators to Tackle Obstacles to Farm Deal," *Reuters News*, January 3, 2008; Adam Cohen, "The Lord Justice Hath Ruled: Pringles Are Potato Chips," *The New York Times*, June 1, 2009.

[1]See James Day Hodgson, Yoshihiro Sano, and John L. Graham, *Doing Business in the New Japan, Succeeding in America's Richest Foreign Market* (Boulder, CO: Rowman & Littlefield, 2008) for the complete story.

Exhibit 2.1
Top Ten 2009 U.S. Trading Partners ($ billions, merchandise trade)

Source: http://www.census.gov/foreign-trade/top, 2010.

Country	Total Trade	Exports	Imports	Balance
Canada	$429.6	$204.7	$224.9	$−20.2
China	366.0	69.6	296.4	−226.5
Mexico	305.5	129.0	176.5	−47.5
Japan	147.1	51.2	95.9	−44.7
Germany	114.6	43.3	71.3	−28.0
United Kingdom	93.2	45.7	47.5	−1.8
South Korea	67.9	28.6	39.2	−10.6
France	60.6	26.5	34.0	−7.5
Netherlands	48.4	32.3	16.1	+16.2
Taiwan	46.8	18.4	28.4	−10.0

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

Bound together by burgeoning international communications media and global companies, consumers in every corner of the world are demanding an ever-expanding variety of goods and services. As Exhibit 2.1 illustrates, world trade is an important economic activity. Because of this importance, the inclination is for countries to attempt to control international trade to their own advantage. As competition intensifies, the tendency toward protectionism gains momentum. If the benefits of the social, political, and economic changes now taking place are to be fully realized, free trade must prevail throughout the global marketplace. The creation of the World Trade Organization (WTO) is one of the biggest victories for free trade in decades.

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

The Twentieth to the Twenty-First Century

At no time in modern economic history have countries been more economically interdependent, have greater opportunities for international trade existed, or has the potential for increased demand existed than now, at the opening of the 21st century. This statement remains true even with due regard to the global financial crisis that began in 2008. In contrast, in the preceding 100 years, world economic development was erratic.

The first half of the 20th century was marred by a major worldwide economic depression that occurred between two world wars that all but destroyed most of the industrialized world. The last half of the century, while free of a world war, was marred by struggles between countries espousing the socialist Marxist approach and those following a democratic capitalist approach to economic development. As a result of this ideological split, traditional trade patterns were disrupted.

LO1
The basis for the reestablishment of world trade following World War II

After World War II, as a means to dampen the spread of communism, the United States set out to infuse the ideal of capitalism throughout as much of the world as possible. The Marshall Plan to assist in rebuilding Europe, financial and industrial development assistance to rebuild Japan, and funds channeled through the Agency for International Development and other groups designed to foster economic growth in the underdeveloped world


Even though the John Deere tractors lined up for shipment from its Waterloo, Iowa, plant appear impressive, the Hyundai cars stacked up by the water in Ulsan, South Korea, headed for the United States dwarf their numbers. The juxtaposition of the two pictures aptly reflects the persistence of America's broader merchandise trade deficit.

were used to help create a strong world economy. The dissolution of colonial powers created scores of new countries in Asia and Africa. With the striving of these countries to gain economic independence and the financial assistance offered by the United States, most of the noncommunist world's economies grew, and new markets were created.

The benefits of the foreign economic assistance given by the United States flowed both ways. For every dollar the United States invested in the economic development and rebuilding of other countries after World War II, hundreds of dollars more returned in the form of purchases of U.S. agricultural products, manufactured goods, and services. This overseas demand created by the Marshall Plan and other programs[2] was important to the U.S. economy because the vast manufacturing base built to supply World War II and the swelling labor supply of returning military created a production capacity well beyond domestic needs. The major economic boom and increased standard of living the United States experienced after World War II were fueled by fulfilling pent-up demand in the United States and the demand created by the rebuilding of war-torn countries of Europe and Asia. In short, the United States helped make the world's economies stronger, which enabled them to buy more from us.

In addition to U.S. economic assistance, a move toward international cooperation among trading nations was manifest in the negotiation (1986–1994) of the General Agreement on Tariffs and Trade (GATT). International trade had ground to a halt following World War I when nations followed the example set by the U.S. passage of the Smoot-Hawley Act (1930), which raised average U.S. tariffs on more than 20,000 imported goods to levels in excess of 60 percent. In retaliation, 60 countries erected high tariff walls, and international trade stalled, along with most economies. A major worldwide recession catapulted the world's economies into the Great Depression when trade all but dried up.[3]

Determined not to repeat the economic disaster that followed World War I, world leaders created **GATT**, a forum for member countries to negotiate a reduction of tariffs and other barriers to trade. The forum proved successful in reaching those objectives. With the ratification of the Uruguay Round agreements, the GATT became part of the World Trade Organization (WTO) in 1995, and its 117 original members moved into a new era of free trade.

[2]The Organization for Economic Cooperation and Development (OECD) was a direct result of the Marshall Plan.

[3]David M. Kennedy, Lizabeth Cohen, and Thomas A. Bailey, *The American Pageant*, 13th ed. (Boston: Houghton Mifflin, 2006).

World Trade and U.S. Multinationals

The rapid growth of war-torn economies and previously underdeveloped countries, coupled with large-scale economic cooperation and assistance, led to new global marketing opportunities. Rising standards of living and broad-based consumer and industrial markets abroad created opportunities for American companies to expand exports and investment worldwide. During the 1950s, many U.S. companies that had never before marketed outside the United States began to export, and others made significant investments in marketing and production facilities overseas.

At the close of the 1960s, U.S. multinational corporations (MNCs) were facing major challenges on two fronts: resistance to direct investment and increasing competition in export markets. Large investments by U.S. businesses in Europe and Latin America heightened the concern of these countries about the growing domination of U.S. multinationals. The reaction in Latin American countries was to expropriate direct U.S. investments or to force companies to sell controlling interests to nationals. In Europe, apprehension manifested itself in strong public demand to limit foreign investment. Concerns, even in Britain, that they might become a satellite with manufacturing but no determination of policy led to specific guidelines for joint ventures between British and U.S. companies. In the European Community, U.S. multinationals were rebuffed in ways ranging from tight control over proposed joint ventures and regulations covering U.S. acquisitions of European firms to strong protectionism laws.

The threat felt by Europeans was best expressed in the popular book *The American Challenge*, published in 1968, in which the French author J. J. Servan-Schreiber wrote:

> Fifteen years from now it is quite possible that the world's third greatest industrial power, just after the United States and Russia, will not be Europe but American Industry in Europe. Already, in the ninth year of the Common Market, this European market is basically American in organization.[4]

Servan-Schreiber's prediction did not come true for many reasons, but one of the more important was that American MNCs confronted a resurgence of competition from all over the world. The worldwide economic growth and rebuilding after World War II was beginning to surface in competition that challenged the supremacy of American industry. Competition arose on all fronts; Japan, Germany, most of the industrialized world, and many developing countries were competing for demand in their own countries and looking for world markets as well. Countries once classified as less developed were reclassified as newly industrialized countries (NICs). Various NICs such as Brazil, Mexico, South Korea, Taiwan, Singapore, and Hong Kong experienced rapid industrialization in select industries and became aggressive world competitors in steel, shipbuilding, consumer electronics, automobiles, light aircraft, shoes, textiles, apparel, and so forth. In addition to the NICs, developing countries such as Venezuela, Chile, and Bangladesh established state-owned enterprises (SOEs) that operated in other countries. One state-owned Venezuelan company has a subsidiary in Puerto Rico that produces canvas, cosmetics, chairs, and zippers; there are also Chilean and Colombian companies in Puerto Rico; in the U.S. state of Georgia, a Venezuelan company engages in agribusiness; and Bangladesh, the sixth largest exporter of garments to the United States, also owns a mattress company in Georgia.

In short, economic power and potential became more evenly distributed among countries than was the case when Servan-Schreiber warned Europe about U.S. multinational domination. Instead, the U.S. position in world trade is now shared with other countries. For example, in 1950, the United States represented 39 percent of world gross national product (GNP), but by 2010, it represented less than 25 percent. In the meantime, however, the global GNP grew much larger, as did the world's manufacturing output—all countries shared in a much larger economic pie. This change was reflected in the fluctuations in the growth of MNCs from other countries as well. Exhibit 2.2 reflects the dramatic changes between 1963 and 2009. In 1963, the United States had 67 of the world's largest industrial corporations. By 1996, that number had dropped to a low of 24, while Japan moved from having 3 of the largest to 29 and South Korea from 0 to 4. And following the great economic boom in the late 1990s in the United States, 36 of the largest companies were American, only 22 Japanese, and none were Korean. Most recently, GAZPROM, the Russian natural

[4] J. J. Servan-Schreiber, *The American Challenge* (New York: Atheneum Publishers, 1968), p. 3.

Exhibit 2.2
The Nationality of the World's 100 Largest Industrial Corporations (size measured by annual revenues)

Source: "2009 Global 500," Fortune, http://www.fortune.com, 2010.

	1963	1979	1984	1990	1996	2000	2005	2009
United States	67	47	47	33	24	36	33	30
Germany	13	13	8	12	13	12	15	14
Britain	7	7	5	6	2	5	10	6
France	4	11	5	10	13	11	10	10
Japan	3	7	12	18	29	22	12	10
Italy	2	3	3	4	4	3	3	5
Netherlands–United Kingdom	2	2	2	2	2	2	1	1
Netherlands	1	3	1	1	2	5	2	1
Switzerland	1	1	2	3	5	3	4	1
Luxembourg								1
Belgium		1	1	1		1		1
Norway							1	1
Finland								1
Brazil		1		1				1
Canada		2	3					
India			1					
Kuwait			1					
Mexico		1	1	1	1		1	1
Venezuela		1	1	1	1			
South Korea			4	2	4		1	4
Sweden			1	2				
South Africa			1	1				
Spain				2			1	3
Russia								2
China						2	1	5
Malaysia								1

gas giant, was the first eastern European entrant into the top 100 global firms, ranking number 52 in the most recent *Fortune* list.[5] The decline in Japanese and increase in Chinese companies' rankings are prominent as well.

Another dimension of world economic power, the balance of merchandise trade, also reflected the changing role of the United States in world trade. Between 1888 and 1971, the United States sold more to other countries than it bought from them; that is, the United States had a favorable balance of trade. By 1971, however, the United States had a trade deficit of $2 billion that grew steadily until it peaked at $160 billion in 1987. After that, the deficit in merchandise trade declined to $74 billion in 1991 but began increasing again and by 2007 had surpassed $700 billion. With the continued weakness in the U.S. dollar, the trade deficit began to abate some in the fall of 2007.[6] The positive consequence of the global financial crisis that began in 2008 in the United States was the halving of the U.S. trade deficit during 2009 from its high in 2007.

The heightened competition for U.S. businesses during the 1980s and early 1990s raised questions similar to those heard in Europe two decades earlier: how to maintain the competitive strength of American business, to avoid the domination of U.S. markets by foreign MNCs, and to forestall the "buying of America." In the 1980s, the United States saw its competitive position in capital goods such as computers and machinery erode sharply. From 1983 to 1987, almost 70 percent of the growth of the merchandise trade deficit was in capital goods and automobiles. At the time, those were America's high-wage, high-skill industries. But U.S. industry got a wake-up call and responded by restructuring its industries, in essence, "getting lean and mean." By the late 1990s, the United States was once again holding its own in capital goods, particularly with trade surpluses in the high-tech category.

[5]"GASPROM Eyes 10% of French Gas Market in 4–5 Years," *Dow Jones International News*, January 3, 2008.

[6]Elizabeth Price and Brian Blackstone, "U.S. Trade Deficit Shrinks—Rising Prices Dampen Demand for Imports, Could Fuel Inflation," *The Wall Street Journal Asia*, November 12, 2007, p. 9.

Among the more important questions raised in the 1980s were those concerning the ability of U.S. firms to compete in foreign markets and the fairness of international trade policies of some countries. Trade friction revolved around Japan's sales of autos and electronics in the United States and Japan's restrictive trade practices. The United States, a strong advocate of free trade, was confronted with the dilemma of how to encourage trading partners to reciprocate with open access to their markets without provoking increased protectionism. In addition to successfully pressuring Japan to open its markets for some types of trade and investment, the United States was a driving force behind the establishment of the WTO.

By the last decade of the 20th century, profound changes in the way the world would trade were already under way. The continuing integration of the countries of the European Union, the creation of NAFTA[7] and the American Free Trade Area (AFTA), and the rapid evolution of the Asia-Pacific Economic Cooperation Conference (APEC) are the beginnings of global trading blocks that many experts expect to dominate trade patterns in the future. With the return of Hong Kong in 1997 and Macao in 2000 to China, all of Asia is now controlled and managed by Asians for the first time in 400 years. During the decades since World War II, the West set the patterns for trade, but increasingly, Asia will be a major force, if not the leading force.

Beyond the First Decade of the Twenty-First Century

The unprecedented and precipitous growth of the U.S. economy in the late 1990s slowed dramatically in the last few years, and of course dramatically so in 2009. Growth in most of the rest of the world has followed suit, with the exception of China. The Organization for Economic Cooperation and Development (OECD) estimates that the economies of member countries will expand an average of 3 percent annually for the next 25 years, the same rate as in the past 25 years. Conversely, the economies of the developing world will grow at faster rates—from an annual rate of 4 percent in the past quarter century to a rate of 6 percent for the next 25 years. Their share of world output will rise from about one-sixth to nearly one-third over the same period. The World Bank estimates that five countries—Brazil, China,[8] India, Indonesia, and Russia—whose share of world trade is barely one-third that of the European Union will, by 2020, have a 50 percent higher share than that of the European Union. As a consequence, economic power and influence will move away from industrialized countries—Japan, the United States, and the European Union—to countries in Latin America, eastern Europe, Asia, and Africa.

This shift does not mean that markets in Europe, Japan, and the United States will cease to be important; those economies will continue to produce large, lucrative markets, and the companies established in those markets will benefit. It does mean that if a company is to be a major player in the 21st century, now is the time to begin laying the groundwork. How will these changes that are taking place in the global marketplace impact international business? For one thing, the level and intensity of competition will change as companies focus on gaining entry into or maintaining their position in emerging markets, regional trade areas, and the established markets in Europe, Japan, and the United States.

Companies are looking for ways to become more efficient, improve productivity, and expand their global reach while maintaining an ability to respond quickly and deliver products that the markets demand. For example, large Chinese state-owned companies are investing heavily in developing economies. Nestlé is consolidating its dominance in global consumer markets by acquiring and vigorously marketing local-country major brands. Samsung of South Korea has invested $500 million in Mexico to secure access to markets in the North American Free Trade Area. Whirlpool, the U.S. appliance manufacturer, which secured first place in the global appliance business by acquiring the European division of the appliance maker N. V. Philips, immediately began restructuring itself into its version of a global company. These are a few examples of changes that are sweeping multinational companies as they gear up for the rest of the 21st century.

[7] Jenalia Moreno, "Trade Tariffs End, Making NAFTA a Milestone," *Houston Chronicle*, January 2, 2008.

[8] "Fear of the Dragon," *The Economist*, January 9, 2010, pp. 73–74.

Global companies are not the only ones aggressively seeking new market opportunities. Smaller companies are using novel approaches to marketing and seeking ways to apply their technological expertise to exporting goods and services not previously sold abroad. A small midwestern company that manufactures and freezes bagel dough for supermarkets to bake and sell as their own saw opportunities abroad and began to export to Japan. International sales, though small initially, showed such potential that the company sold its U.S. business to concentrate on international operations. Other examples of smaller companies include Nochar Inc., which makes a fire retardant it developed a decade ago for the Indianapolis 500. The company now gets 32 percent of its sales overseas, in 29 countries. The owner of Buztronics Inc., a maker of promotional lapel buttons, heard from a friend that his buttons, with their red blinking lights, would "do great" in Japan. He made his first entry in exporting to Japan, and after only a year, 10 percent of Buztronics sales came from overseas. While 50 of the largest exporters account for 30 percent of U.S. merchandise exports, the rest come from middle- and small-sized firms like those just mentioned. The business world is weathering a flurry of activity as companies large and small adjust to the internationalization of the marketplace at home and abroad.

Balance of Payments

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

LO2

The importance of balance-of-payment figures to a country's economy

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

A nation's balance-of-payments statement presents an overall view of its international economic position and is an important economic measure used by treasuries, central banks, and other government agencies whose responsibility is to maintain external and internal economic stability. A balance of payments represents the difference between receipts from foreign countries on one side and payments to them on the other. On the plus side of the U.S. balance of payments are merchandise export sales; money spent by foreign tourists; payments to the United States for insurance, transportation, and similar services; payments of dividends and interest on investments abroad; return on capital invested abroad; new foreign investments in the United States; and foreign government payments to the United States.

On the minus side are the costs of goods imported, spending by American tourists overseas, new overseas investments, and the cost of foreign military and economic aid. A deficit results when international payments are greater than receipts. It can be reduced or eliminated by increasing a country's international receipts (i.e., gain more exports to other countries or more tourists from other countries) and/or reducing expenditures in other countries. A balance-of-payments statement includes three accounts: the **current account**, a record of all merchandise exports, imports, and services plus unilateral transfers of funds; the *capital account*, a record of direct investment, portfolio investment, and short-term capital movements to and from countries; and the official *reserves account*, a record of exports and imports of gold, increases or decreases in foreign exchange, and increases or decreases in liabilities to foreign central banks. Of the three, the current account is of primary interest to international business.

The *current account* is important because it includes all international merchandise trade and service accounts, that is, accounts for the value of all merchandise and services

Exhibit 2.3
U.S. Current Account by Major Components, 2009 ($ billions)

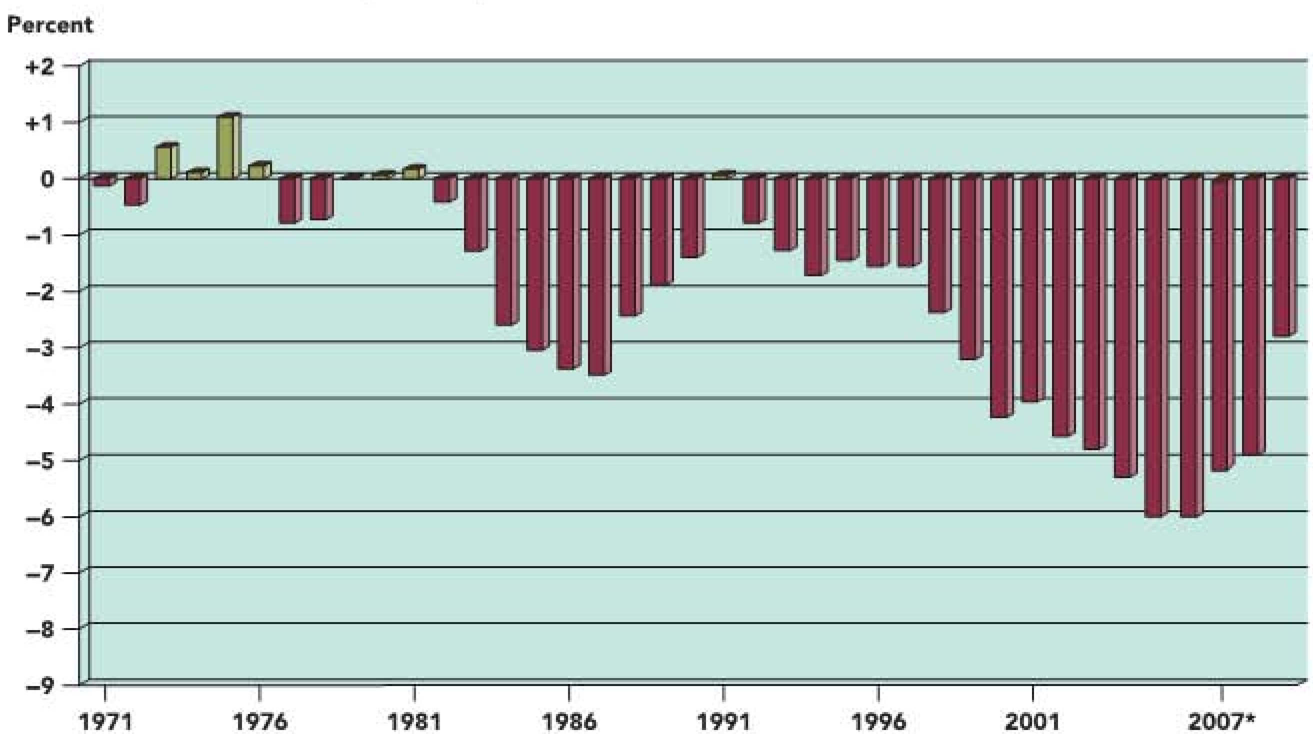
Exports	
Goods	$ 1046
Services	509
Income receipts	561
Imports	
Goods	−1563
Services	−371
Income payments	−472
Unilateral current transfers, net	−130
Current account balance	−420

imported and exported and all receipts and payments from investments and overseas employment.[9] Exhibit 2.3 gives the current account calculations for the United States in 2009.

Since 1971, the United States has had a favorable current account balance (as a percentage of GDP) in only a few years—see Exhibit 2.4. The imbalances resulted primarily from U.S. demand for oil,[10] petroleum products, cars, consumer durables, and other merchandise. Indeed, the merchandise trade deficit for 2009 was $517 billion, a mega improvement over the two previous years.[11] Still, such imbalances have drastic effects on the balance of payments and therefore the value of U.S. currency in the world marketplace. Factors such as these eventually require an adjustment through a change in exchange rates, prices, and/or incomes. In short, once the wealth of a country whose expenditures exceed its income has been exhausted, that country, like an individual, must reduce its standard of living. If its residents do not do so voluntarily, the rates of exchange of its money for foreign monies decline, and through the medium of the foreign exchange market, the purchasing power of

[9] "Financial Globalization and U.S. Current Account Deficit," *US Fed News*, January 3, 2008.
[10] Terence Poon, "China to Steady Prices Amid Inflation Worries," *The Wall Street Journal*, January 10, 2008.
[11] www.bea.gov.

Exhibit 2.4
U.S. Current Account Balance (% of GDP)



Source: World Bank.

Exhibit 2.5
What Would One U.S. Dollar Buy?

Source: The Wall Street Journal, 2010.

	1985	1988	1992	1995	1999	2000	2005	2010
British pound	0.86	0.54	0.56	0.63	0.62	0.68	0.57	0.63
French franc	9.6	5.4	5.29	4.95	6.49	7.28		
Japanese yen	250.23	123.7	126.7	93.96	102.58	112.21	112.3	89.9
Swiss franc	2.25	1.29	1.41	1.18	1.58	1.68	1.31	0.96
Euro			1.01	0.90	0.92	1.08	0.79	0.71
Mexico peso	0.37	2.28	3.12	6.45	9.43	9.47	10.8	13.0

foreign goods is transferred from that country to another. As can be seen in Exhibit 2.5, the U.S. dollar strengthened against most of the other major currencies during the 1990s but has weakened during the last decade.

As the U.S. trade deficit has grown, pressures have begun to push the value of the dollar to lower levels. And when foreign currencies can be traded for more dollars, U.S. products (and companies) are less expensive for the foreign customer and exports increase, and foreign products are more expensive for the U.S. customer and the demand for imported goods is dampened. Likewise, investments in dollar-denominated equities and such investment goods become less attractive. Indeed, the dollar itself becomes less useful as a global currency.[12]

Protectionism

LO3

The effects of protectionism on world trade

International business executives understand the reality that this is a world of tariffs, quotas, and nontariff barriers designed to protect a country's markets from intrusion by foreign companies.[13] Although the World Trade Organization has been effective in reducing tariffs, countries still resort to measures of **protectionism**.[14] Nations utilize legal barriers, exchange barriers, and psychological barriers to restrain the entry of unwanted goods. Businesses work together to establish private market barriers, while the market structure itself may provide formidable barriers to imported goods. The complex distribution system in Japan, as will be detailed in Chapter 15, is a good example of a market structure creating a barrier to trade. However, as effective as it is in keeping some products out of the market, in a legal sense, it cannot be viewed as a trade barrier.

Protection Logic and Illogic

Countless reasons to maintain government restrictions on trade are espoused by protectionists, but essentially all arguments can be classified as follows: (1) protection of an infant industry, (2) protection of the home market,[15] (3) need to keep money at home, (4) encouragement of capital accumulation, (5) maintenance of the standard of living and real wages, (6) conservation of natural resources, (7) industrialization of a low-wage nation, (8) maintenance of employment and reduction of unemployment, (9) national defense, (10) increase of business size, and (11) retaliation and bargaining. Economists in general recognize as valid only the arguments regarding infant industry, national defense, and industrialization of underdeveloped countries. The resource conservation argument becomes increasingly valid in an era of environmental consciousness[16] and worldwide shortages of raw materials and agricultural commodities. A case might be made for temporary protection of markets with excess productive capacity or excess labor when such protection could facilitate an orderly transition. Unfortunately such protection often becomes long term and contributes to industrial inefficiency while detracting from a nation's realistic adjustment to its world situation.

[12]Mark Whitehouse, "Foreign Investors View Dollar as 'Refuge Currency' Despite Recent Tumult," *The Wall Street Journal*, August 20, 2007, p. A2.

[13]Tor Korneliussen and Jorg Blasius, "The Effects of Cultural Distance, Free Trade Agreements, and Protectionism on Perceived Export Barriers," *Journal of Global Marketing* 21, no. 3 (2008), pp. 217–30.

[14]"The Nuts and Bolts Come Apart," *The Economist*, March 28, 2009, pp. 79–80.

[15]Alistair MacDonald and Cecilie Rohwedder, "U.K. Officials, Workers Troubled by Foreign Takeovers," *The Wall Street Journal*, January 20, 2010, p. B6.

[16]John Carey, "Global Warming, Suddenly the Climate in Washington Is Changing," *BusinessWeek*, June 27, 2005, p. 91.

CROSSING BORDERS 2.1 Trade Barriers, Hypocrisy, and the United States

The United States thinks of itself as the leader in free trade and frequently brings actions against nations as unfair trade partners. Section 301* of the Omnibus Trade and Competitiveness Act authorizes the U.S. government to investigate and retaliate against specific foreign trade barriers judged to be unfair and to impose up to 100 percent tariffs on exports to the United States from guilty nations unless they satisfy U.S. domestic demands. But critics in many countries say the United States is hypocritical in some of the stances taken, since it is just as guilty of protecting its markets with trade barriers. A Japanese government study alleges that the United States engages in unfair trade practices in 10 of 12 policy areas reviewed in the study. Notably, the United States imposes quotas on imports, has high tariffs, and abuses antidumping measures. Are the critics correct? Is the United States being hypocritical when it comes to free trade? You be the judge.

The United States launched a Section 301 investigation of Japanese citrus quotas. "The removal of Japan's unfair barriers could cut the price of oranges for Japanese consumers by one-third," said the U.S. trade representative. Coincidentally, the United States had a 40 percent tariff on Brazilian orange juice imports when the investigation was initiated.

The United States brought a 301 case against Korea for its beef import quotas even though the United States has beef import quotas that are estimated to cost U.S. consumers $873 million annually in higher prices. Another 301 case was brought against Brazil, Korea, and Taiwan for trade barriers on footwear even though the United States maintains tariffs as high as 67 percent on footwear imports.

Can you believe that we have two phone book–sized volumes of the U.S. customs code that include restrictions on such innocuous items as scissors, sweaters, leather, costume jewelry, tampons, pizzas, cotton swabs, ice cream, and even products we do not produce, such as vitamin B12? We also have restrictions on more sensitive products such as cars, supercomputers, lumber, and every type of clothing imaginable. Would-be Latin American exporters find hundreds of their most promising export products, such as grapes, tomatoes, onions, steel, cement, asparagus, and shoes, on the customs list. Visit www.usitc.gov/tata/index.htm and select the Interactive Tariff Database to see some other examples.

So, is the U.S. as guilty as the rest or not?

*Section 301, a provision of U.S. trade law, enables the U.S. government to take action against countries deemed to have engaged in "unreasonable, unjustifiable, or discriminatory" practices that restrict U.S. commerce.

Sources: Abstracted from James Bovard, "A U.S. History of Trade Hypocrisy," The Wall Street Journal, March 8, 1994, p. A10; Brian Hindley and Fredrik Erixon, "Dumping Protectionism," The Wall Street Journal, November 1, 2007, p. 12; "Chinese Dumping Duties," Steel Times International, October 2009, p. 4.

To give you some idea of the cost to the consumer, consider the results of a recent study of 21 protected industries. The research showed that U.S. consumers pay about $70 billion per year in higher prices because of tariffs and other protective restrictions. On average, the cost to consumers for saving one job in these protected industries was $170,000 per year, or many times the average pay (wages and benefits) for manufacturing workers. Unfortunately, protectionism is politically popular, particularly during times of declining wages[17] and/or high unemployment, but it rarely leads to renewed growth in a declining industry. And the jobs that are saved are saved at a very high cost, which constitutes a tax that consumers unknowingly pay.

Trade Barriers

LO4

The several types of trade barriers

To encourage development of domestic industry and protect existing industry, governments may establish such barriers to trade as tariffs and a variety of **nontariff barriers** including, quotas, boycotts, monetary barriers, and market barriers. Barriers are imposed against imports and against foreign businesses. While the inspiration for such barriers may be economic or political, they are encouraged by local industry. Whether or not the barriers are economically logical, the fact is that they exist.

Tariffs. A **tariff**, simply defined, is a tax imposed by a government on goods entering at its borders. Tariffs may be used as revenue-generating taxes or to discourage the importation of goods, or for both reasons. Tariff rates are based on value or quantity or a

[17] Jane Sasseen, "Economists Rethink Free Trade," *BusinessWeek*, February 11, 2008, pp. 32–33.

CROSSING BORDERS 2.2

Underwear, Outerwear, Sony Playstations, and Pointed Ears—What Do They Have in Common?

What do underwear, outerwear, Sony Playstations, and pointed ears have in common? Quotas, that's what!

Call the first one the Madonna Effect. Madonna, the pop star, affected the interpretation of outerwear/underwear when the ever-vigilant U.S. Customs Service stopped a shipment of 880 bustiers at the U.S. border. The problem was quota and tariff violations. The shipper classified them as underwear, which comes into the United States without quota and tariff. Outerwear imports, however, have a quota, and the Customs official classified the fashion item inspired by Madonna as "outerwear" and demanded the appropriate quota certificates.

"It was definitely outerwear. I've seen it; and I've seen the girls wearing it, and they're wearing it as outerwear." It took the importer three weeks to obtain sufficient outerwear quota allowances to cover the shipment; by that time, several retailers had canceled their orders.

Call the second the Video/Computer Effect. EU officials originally classified Sony's Playstation a video game and thus subject to a higher tariff than it would be if it were classified as a computer, which was Sony's desired classification. The Court of First Instance ruled that "it is intended mainly to be used to run video games," thus subject to millions of euros in customs duties as a video game. The appeals court sided with Sony on a technical error and reversed the decision. It really did not make much difference, because EU customs classifications were set to change six months later to allow computers and games consoles into the European Union with zero tariff.

Call the third the Vulcan Effect. EU officials applied the Vulcan death grip to Star Trek hero Spock. Likenesses of the pointy-eared Spock and other "nonhuman creatures" have fallen victim to an EU quota on dolls made in China. The EU Council of Ministers slapped a quota equivalent to $81.7 million on nonhuman dolls from China—but it left human dolls alone.

British Customs officials are in the unusual position of debating each doll's humanity. They have blacklisted teddy bears but cleared Batman and Robin. And though they turned away Spock because of his Vulcan origins, they have admitted Star Trek's Captain Kirk. The Official Fan Club for Star Trek said the Customs officials "ought to cut Spock some slack" because his mother, Amanda, was human. But Britain's Customs office said, "We see no reason to change our interpretation. You don't find a human with ears that size."

Sources: Rosalind Resnick, "Busting Out of Tariff Quotas," North American International Business (now published as International Business), February 1991, p. 10; Dana Milbank, "British Customs Officials Consider Mr. Spock Dolls to Be Illegal Aliens," The Wall Street Journal, August 2, 1994, p. B1; "EU Rejects Sony Customs Claim," (Salt Lake City) Deseret News, October 6, 2003.

combination of both. In the United States, for example, the types of customs duties used are classified as follows: (1) ad valorem duties, which are based on a percentage of the determined value of the imported goods; (2) specific duties, a stipulated amount per unit weight or some other measure of quantity; and (3) a compound duty, which combines both specific and ad valorem taxes on a particular item, that is, a tax per pound plus a percentage of value. Because tariffs frequently change, published tariff schedules for every country are available to the exporter on a current basis.[18] In general, tariffs:

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

In addition, tariffs are arbitrary, are discriminatory, and require constant administration and supervision. They often are used as reprisals against protectionist moves of trading partners.

[18]The entire Harmonized Tariff Schedule of the United States can be downloaded or accessed via an interactive tariff database at http://www.usitc.gov; select the Harmonized Tariff Schedule.

Exhibit 2.6
Types of Nontariff Barriers

Specific Limitations on Trade Quotas Import licensing requirements Proportional restrictions of foreign to domestic goods (local-content requirements) Minimum import price limits Embargoes **Customs and Administrative Entry Procedures** Valuation systems Antidumping practices Tariff classifications Documentation requirements Fees **Standards** Standards disparities Intergovernmental acceptances of testing methods and standards Packaging, labeling, marking standards	**Governmental Participation in Trade** Government procurement policies Export subsidies Countervailing duties Domestic assistance programs **Charges on Imports** Prior import deposit requirements Administrative fees Special supplementary duties Import credit discriminations Variable levies Border taxes **Others** Voluntary export restraints Orderly marketing agreements

Source: Reprinted from A. D. Cao, "Nontariff Barriers to U.S. Manufactured Exports," Journal of World Business, Vol. 15, p. 94. Copyright © 1980, with permission from Elsevier.

In a dispute with the European Union over pasta export subsidies, the United States ordered a 40 percent increase in tariffs on European spaghetti and fancy pasta. The European Union retaliated against U.S. walnuts and lemons. The pasta war raged on as Europe increased tariffs on U.S. fertilizer, paper products, and beef tallow, and the United States responded in kind. The war ended when the Europeans finally dropped pasta export subsidies. Less developed countries are increasingly voicing complaints about American and European tariffs on agricultural products.[19]

Quotas and Import Licenses. A quota is a specific unit or dollar limit applied to a particular type of good. Great Britain limits imported television sets; Germany has established quotas on Japanese ball bearings; Italy restricts Japanese motorcycles; and the United States has quotas on sugar, textiles, and, of all things, peanuts. Quotas put an absolute restriction on the quantity of a specific item that can be imported. When the Japanese first let foreign rice into their country, it was on a quota basis, but since 2000 the quotas have been replaced by tariffs.[20] Even more complicated, the banana war between the United States and the European Union resulted in a mixed system wherein a quota of bananas is allowed into the European Union with a tariff, then a second quota comes in tariff-free. In early 2010, as *Avatar* dominated cinema around the world, China ordered its movie houses to limit showings to the 3D version only.[21] Like tariffs, quotas tend to increase prices.[22] The U.S. quotas on textiles are estimated to add 50 percent to the wholesale price of clothing.

As a means of regulating the flow of exchange and the quantity of a particular imported commodity, countries often require import licenses. The fundamental difference between quotas and import licenses as a means of controlling imports is the greater flexibility of import licenses over quotas. Quotas permit importing until the quota is filled; licensing limits quantities on a case-by-case basis.

[19] Allan Odhiambo, "EAC States in Row over Wheat Import Tariffs," *All Africa*, August 30, 2007.

[20] See the USA Rice Federation's Web site for details, http://www.usarice.com; also see Hodgson et al., *Doing Business in the New Japan*.

[21] Ian Johnson, "China's Homegrown Movies Flourish," *The Wall Street Journal*, January 20, 2010, pp. B1, B4.

[22] Peter T. Leach, "Is China Losing Its Edge?" *Journal of Commerce*, December 3, 2007.

CROSSING BORDERS 2.3 Crossing Borders with Monkeys in His Pants

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

Similarly, Wang Hong, a Chinese exporter, pleaded guilty to smuggling sea turtles into the United States. He didn't have them in his pants; instead, the sea turtle "parts" came in the form of shells and violin bows, among other things.

Smuggling isn't just a game played by sneaking individuals. Multinational companies can also get into the act. During the last year alone, convictions have come down for smuggling cell phones into Vietnam, cigarettes into Iraq and Canada, and platinum into China. In perhaps the biggest ever corporate case, after a nine-year lawsuit, Amway Corporation agreed to pay the Canadian government $38.1 million to settle charges it had avoided customs duties by undervaluing merchandise it exported from the United States to Canadian distributors over a six-year period. As long as there have been trade barriers, smuggling has been a common response. Indeed, Rudyard Kipling wrote some 100 years ago:

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

Sources: "Amway Pays $38 Million to Canada," Los Angeles Times, September 22, 1989, p. 3; Patricia Ward Biederman, "Smuggler to Pay for Pocketing Monkeys," Los Angeles Times, December 19, 2002, p. B1; "Chinese National Pleads Guilty of Smuggling Protected Sea Turtles," Associated Press, January 3, 2008; Raymond Fisman, "Measuring Tariff Evasion and Smuggling," NBER Reporter, No. 3, 2009, pp. 8–10.

Voluntary Export Restraints. Similar to quotas are the **voluntary export restraints (VERs)** or *orderly market agreements* (OMAs). Common in textiles, clothing, steel, agriculture, and automobiles, the VER is an agreement between the importing country and the exporting country for a restriction on the volume of exports. For many years Japan had a VER on automobiles to the United States; that is, Japan agreed to export a fixed number of automobiles annually. When televisions were still manufactured in the United States, Japan signed an OMA limiting Japanese color television exports to the United States to 1.56 million units per year. However, Japanese companies began to adjust their strategies by investing in television manufacturing in the United States and Mexico, and as a result, they regained the entire market share that had been lost through the OMA, eventually dominating the entire market. A VER is called voluntary because the exporting country sets the limits; however, it is generally imposed under the threat of stiffer quotas and tariffs being set by the importing country if a VER is not established.

Boycotts and Embargoes. A government boycott is an absolute restriction against the purchase and importation of certain goods and/or services from other countries. This restriction can even include travel bans, like the one currently in place for Chinese tourists; the Beijing government refuses to designate Canada as an approved tourism destination. Officials in Beijing have not been forthcoming with explanations, even after three years of complaints by and negotiations with their Canadian counterparts, but most believe it has to do with Canada's unrelenting criticism of Chinese human rights policies.[23] An embargo is a refusal to sell to a specific country. A public boycott can be either formal or

[23]"Canada Threatens China with WTO Action over Tourism Ban," *Agence France-Presse*, January 8, 2008.

NYK Line (Nippon Yusen Kaisha) brings automobiles from Japan to Aqaba, Jordan, on the Red Sea for delivery to other countries in the area, but not for neighboring Israel. Because of the Arab boycott of Israel, separate shipments of cars are made to the adjacent port of Eilat.

informal and may be government sponsored or sponsored by an industry. The United States uses boycotts and embargoes against countries with which it has a dispute. For example, Cuba[24] and Iran still have sanctions imposed by the United States. Among U.S. policymakers, there is rising concern, however, that government-sponsored sanctions cause unnecessary harm for both the United States and the country being boycotted without reaching the desired results. It is not unusual for the citizens of a country to boycott goods of other countries at the urging of their government or civic groups. Nestlé products were boycotted by a citizens group that considered the way Nestlé promoted baby formula in less developed countries misleading to mothers and harmful to their babies.

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

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

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

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

Standards. Nontariff barriers of this category include standards to protect health, safety, and product quality. The standards are sometimes used in an unduly stringent or discriminating way to restrict trade, but the sheer volume of regulations in this category is a problem in itself. A fruit content regulation for jam varies so much from country to country that one agricultural specialist says, "A jam exporter needs a computer to avoid one or another country's regulations." Different standards are one of the major disagreements between the United States and Japan. The size of knotholes in plywood shipped to Japan can determine whether or not the shipment is accepted; if a knothole is too large, the shipment is rejected because quality standards are not met. Other examples include the following: In the Netherlands, all imported hen and duck eggs must be marked in indelible ink with the country of origin; in Spain, imported condensed milk must be labeled to show fat content if it is less than 8 percent fat; and in the European Union, strict import controls have been placed on beef and beef products imported from the United Kingdom because of mad cow disease. Add to this list all genetically modified foods,

[24]Cornelia Dean, "Cuba After the Embargo," *The New York Times News Service, Edmonton Journal*, January 6, 2008, p. E8.

Cracker Jack invented the toy-with-candy promotion back in 1912. However, the Italian chocolatier Ferrero took things much further. Its milk chocolate Kinder eggs contain "sopresas" that kids enjoy in 37 countries around the world. The product is unavailable in the United States because of concerns about choking hazards. The product pictured is produced in Argentina for sale in Mexico, and it includes a warning label regarding kids under three years of age. Cracker Jack has had to eliminate many of the cool little toys it put in the packages for the same reason. Nestlé introduced a product similar to Kinder eggs in the U.S. market in the late 1990s but had to withdraw it for safety reasons. Wonderball is the latest version, but it has edible chocolate figures inside. See www.ferrero.com.ar and www.crackerjack.com for more details. Toys must be larger than the diameter of the plastic tube pictured on the right to meet the U.S. safety standard.

which are meeting stiff opposition from the European Union as well as activists around the world.

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

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

Recent years have seen a staggering increase in antidumping cases in the United States. In one year, 12 U.S. steel manufacturers launched antidumping cases against 82 foreign steelmakers in 30 countries. In September 2009, the U.S. imposed antidumping duties of 35 percent on tires imported from China, despite President Barack Obama's agreement with other G20 leaders "to avoid protectionist measures at a time of great economic peril" in April of that year.[25] Many economists felt that these antidumping charges were unnecessary because of the number of companies and countries involved; supply and demand could have been left to sort out the best producers and prices. And of course, targeted countries have complained as well. Nevertheless, antidumping cases are becoming de facto trade barriers. The investigations are very costly, they take a long time to resolve, and until they are resolved, they effectively limit trade. Furthermore,

[25] "Economic Vandalism," *The Economist*, September 19, 2009, p. 13.

the threat of being hit by an antidumping charge is enough to keep some companies out of the market.

Domestic Subsidies and Economic Stimuli. Agricultural subsidies in the United States and Europe have long been the subject of trade complaints in developing countries. However, the economic doldrums beginning in 2008 triggered new, huge, domestic bailout packages in the larger economies for banks and auto makers, to name just a couple. Developing countries complained that such subsidies of domestic industries gave companies in those countries unfair advantages in the global marketplace. Smaller countries defended themselves with a variety of tactics; for example, Malaysia limited the number of ports that could accept inbound goods, Ecuador increased tariffs on 600 types of goods, and Argentina and 15 other countries asked the WTO to examine whether stimuli and bailouts were "industrial subsidies," in which case, under WTO rules, trading partners have the right to retaliate.[26] Similarly, the U.S government complained about Chinese policies, including continuing currency controls, tax breaks on exports, and requirements that force government entities to buy Chinese products.[27]

Easing Trade Restrictions

Lowering the trade deficit has been a priority of the U.S. government for a number of years. Of the many proposals brought forward, most deal with fairness of trade with some of our trading partners instead of reducing imports or adjusting other trade policies. Many believe that too many countries are allowed to trade freely in the United States without granting equal access to U.S. products in their countries. Japan was for two decades the trading partner with which we had the largest deficit and which elicited the most concern about fairness. The Omnibus Trade and Competitiveness Act of 1988 addressed the trade fairness issue and focused on ways to improve U.S. competitiveness. At the turn of the century, China took over from Japan as America's number one "trade problem," as can be seen in Exhibit 2.1.

The Omnibus Trade and Competitiveness Act

LO5

The provisions of the Omnibus Trade and Competitiveness Act

The *Omnibus Trade and Competitiveness Act of 1988* is many faceted, focusing on assisting businesses to be more competitive in world markets as well as on correcting perceived injustice in trade practices.[28] The trade act was designed to deal with trade deficits, protectionism, and the overall fairness of our trading partners. Congressional concern centered on the issue that U.S. markets were open to most of the world but markets in Japan, western Europe, and many Asian countries were relatively closed. The act reflected the realization that we must deal with our trading partners based on how they actually operate, not on how we want them to behave. Some see the act as a protectionist measure, but the government sees it as a means of providing stronger tools to open foreign markets and to help U.S. exporters be more competitive. The bill covers three areas considered critical in improving U.S. trade: market access, export expansion, and import relief.

The issue of the openness of markets for U.S. goods is addressed as *market access*. Many barriers restrict or prohibit goods from entering a foreign market. Unnecessarily restrictive technical standards, compulsory distribution systems, customs barriers, tariffs, quotas, and restrictive licensing requirements are just a few. The act gives the U.S. president authority to restrict sales of a country's products in the U.S. market if that country imposes unfair restrictions on U.S. products. Furthermore, if a foreign government's procurement rules discriminate against U.S. firms, the U.S. president has the authority to impose a similar ban on U.S. government procurement of goods and services from the offending nation.

[26]Carol Matlack, "The New Protectionsim," *BusinessWeek*, June 22, 2009, pp. 22–23.

[27]Pete Engardio, "Beijing Bolsters the Barriers," *BusinessWeek*, July 6, 2009, p. 26.

[28]Caroline Baum, "China Isn't a Currency Manipulator," *Today* (Singapore), June 20, 2007, p. 35.

The billboard overlooking a busy shopping district in Beijing proclaims the importance of China's space technology to all passersby. Meanwhile, Boeing and Hughes have had to pay $32 million in a settlement with the U.S. government for allegedly giving the Chinese sensitive space technology in the middle 1990s. The restrictions on technology sales have rendered American high-tech firms less competitive in international markets even beyond China, such as Canada.

Besides emphasizing market access, the act recognizes that some problems with U.S. export competitiveness stem from impediments on trade imposed by U.S. regulations and export disincentives. Export controls, the Foreign Corrupt Practices Act (FCPA), and export promotion were specifically addressed in the *export expansion* section of the act. Export licenses could be obtained more easily and more quickly for products on the export control list. In addition, the act reaffirmed the government's role in being more responsive to the needs of the exporter. Two major contributions facilitating export trade were computer-based procedures to file for and track export license requests and the creation of the National Trade Data Bank (NTDB) to improve access to trade data.

Export trade is a two-way street: We must be prepared to compete with imports in the home market if we force foreign markets to open to U.S. trade. Recognizing that foreign penetration of U.S. markets can cause serious competitive pressure, loss of market share, and, occasionally, severe financial harm, the *import relief* section of the Omnibus Trade and Competitiveness Act provides a menu of remedies for U.S. businesses adversely affected by imports. Companies seriously injured by fairly traded imports can petition the government for temporary relief while they adjust to import competition and regain their competitive edge.

The act has resulted in a much more flexible process for obtaining export licenses, in fewer products on the export control list, and in greater access to information and has established a basis for negotiations with India, Japan, and other countries to remove or lower barriers to trade. However, since a 1999 congressional report (accusing China of espionage regarding defense technology), restrictions on exports of many high-tech products have again been tightened for national security reasons.[29]

As the global marketplace evolves, trading countries have focused attention on ways of eliminating tariffs, quotas, and other barriers to trade. Four ongoing activities to support the growth of international trade are GATT, the associated WTO, the International Monetary Fund (IMF), and the World Bank Group.

General Agreement on Tariffs and Trade

LO6

The importance of GATT and the World Trade Organization

Historically, trade treaties were negotiated on a bilateral (between two nations) basis, with little attention given to relationships with other countries. Furthermore, they tended to raise barriers rather than extend markets and restore world trade. The United States and 22 other countries signed the *General Agreement on Tariffs and Trade (GATT)* shortly after World War II.[30] Although not all countries participated, this agreement paved the way for the first effective worldwide tariff agreement. The original agreement provided a process to reduce tariffs and created an agency to serve as watchdog over world trade. The GATT's agency director and staff offer nations a forum for negotiating trade and related issues. Member nations seek to resolve their trade disputes bilaterally; if that fails, special GATT panels are set up to recommend action. The panels are only advisory and have no enforcement powers.

The GATT treaty and subsequent meetings have produced agreements significantly reducing tariffs on a wide range of goods. Periodically, member nations meet to reevaluate trade barriers and establish international codes designed to foster trade among members.

[29]Elaine Kurtenbach, "China Says Bids Due from Three Global Nuclear Power Companies," *Associated Press*, February 25, 2005.

[30]Florence Chong, "As GATT Turns 60, Crean Pledges to Revive the Great Struggle for World Trade Liberalization," *The Australian*, January 2, 2008, p. 17.

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

In general, the agreement covers these basic elements: (1) trade shall be conducted on a nondiscriminatory basis; (2) protection shall be afforded domestic industries through customs tariffs, not through such commercial measures as import quotas; and (3) consultation shall be the primary method used to solve global trade problems.

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

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

The market access segment (tariff and nontariff measures) was initially considered to be of secondary importance in the negotiations, but the final outcome went well beyond the initial Uruguay Round goal of a one-third reduction in tariffs. Instead, virtually all tariffs in 10 vital industrial sectors with key trading partners were eliminated. This agreement resulted in deep cuts (ranging from 50 to 100 percent) in tariffs on electronic items and scientific equipment and the harmonization of tariffs in the chemical sector at very low rates (5.5 to 0 percent).

An important objective of the United States in the Uruguay Round was to reduce or eliminate barriers to international trade in services. The *General Agreement on Trade in Services (GATS)* was the first multilateral, legally enforceable agreement covering trade and investment in the services sector. It provides a legal basis for future negotiations aimed at eliminating barriers that discriminate against foreign services and deny them market access. For the first time, comprehensive multilateral disciplines and procedures covering trade and investment in services have been established. Specific market-opening concessions from a wide range of individual countries were achieved, and provision was made for continued negotiations to liberalize telecommunications and financial services further.

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

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

The Uruguay Round also includes another set of improvements in rules covering antidumping, standards, safeguards, customs valuation, rules of origin, and import licensing. In each case, rules and procedures were made more open, equitable, and predictable, thus leading to a more level playing field for trade. Perhaps the most notable achievement of the Uruguay Round was the creation of a new institution as a successor to the GATT—the World Trade Organization.

World Trade Organization[31]

At the signing of the Uruguay Round trade agreement in Marrakech, Morocco, in April 1994, U.S. representatives pushed for an enormous expansion of the definition of trade issues. The result was the creation of the **World Trade Organization (WTO)**, which encompasses the current GATT structure and extends it to new areas not adequately covered in the past. The WTO is an institution, not an agreement as was GATT. It sets many rules governing trade among its 148 members, provides a panel of experts to hear and rule on trade disputes among members, and, unlike GATT, issues binding decisions. It will require, for the first time, the full participation of all members in all aspects of the current GATT and the Uruguay Round agreements, and, through its enhanced stature and scope, provide a permanent, comprehensive forum to address the trade issues of the 21st century global market.

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

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

In the United States, ratification was challenged because of concern for the possible loss of sovereignty over its trade laws to WTO, the lack of veto power (the U.S. could have a decision imposed on it by a majority of the WTO's members), and the role the United States would assume when a conflict arises over an individual state's laws that might be challenged by a WTO member. The GATT agreement was ratified by the U.S. Congress, and soon after, the European Union, Japan, and more than 60 other countries followed. All 117 members of the former GATT supported the Uruguay agreement. Since almost immediately after its inception on January 1, 1995, the WTO's agenda has been full with issues ranging from threats of boycotts and sanctions and the membership of Iran[32] and Russia.[33] Indeed, a major event in international trade during recent years is China's

[31]See http://wto.org.

[32]Tom Wright, "WRTO to Open Talks on Iran's Membership," *International Herald Tribune*, May 27, 2005, p. 1.

[33]"Mexico Backs Russia's WTO Bid, Welcomes Russian Energy Investment," *Agence France-Presse*, June 21, 2005.

2001 entry into the WTO. Instead of waiting for various "rounds" to iron out problems, the WTO offers a framework for a continuous discussion and resolution of issues that retard trade.

The WTO has its detractors, but from most indications it is gaining acceptance by the trading community. The number of countries that have joined and those that want to become members is a good measure of its importance. Another one is its accomplishments since its inception: It has been the forum for successful negotiations to opening markets in telecommunications and in information technology equipment, something the United States had sought for the last two rounds of GATT. It also has been active in settling trade disputes, and it continues to oversee the implementation of the agreements reached in the Uruguay Round. But with its successes come other problems: namely, how to counter those countries that want all the benefits of belonging to WTO but also want to protect their markets. Indeed, the latest multilateral initiative, dubbed the "Doha Round" for the city of Qatar where the talks began in 2001, has been stalled with little progress.[34]

Skirting the Spirit of GATT and WTO

Unfortunately, as is probably true of every law or agreement, since its inception there have been those who look for loopholes and ways to get around the provisions of the WTO. For example, China was asked to become a member of the WTO, but to be accepted it had to show good faith in reducing tariffs and other restrictions on trade. To fulfill the requirements to join the WTO, China reduced tariffs on 5,000 product lines and eliminated a range of traditional nontariff barriers to trade, including quotas, licenses, and foreign exchange controls. At the same time, U.S. companies began to notice an increase in the number and scope of technical standards and inspection requirements. As a case in point, China recently applied safety and quality inspection requirements on such seemingly benign imported goods as jigsaw puzzles. It also has been insisting that a long list of electrical and mechanical imports undergo an expensive certification process that requires foreign companies but not domestic companies to pay for on-site visits by Chinese inspection officials. Under WTO rules, China now must justify the decision to impose certain standards and provide a rationale for the inspection criteria. In 2009, the WTO ruled Chinese restrictions on imports of movies, music, and books to be illegal. The ruling is subject to appeal, but if affirmed, it will create huge opportunities for companies such as Apple and its' iTunes.[35]

The previously mentioned antidumping duties are becoming a favorite way for nations to impose new duties. Indeed, following the example of the United States, the region's most prolific user of antidumping cases, Mexico and other Latin American countries have increased their use as well. The WTO continues to fight these new, creative barriers to trade.

Finally, frustrated with the slow progress of the most recent round of WTO trade negotiations, several countries are negotiating bilateral trade agreements.[36] For example, the United States has signed free-trade agreements with Peru, Colombia, Panama, and South Korea.[37] The European Union is engaged in similar activities with South American countries. Perhaps most notable, China and Taiwan have begun free trade talks.[38] South Korea and India[39] have also signed a free trade pact as have five East African countries.[40] To the

[34]John W. Miller, "Blame Goes Global at WTO," *The New York Times*, December 3, 2009.

[35]Don Lee, "A Win for U.S. Media in China," *Los Angeles Times*, August 13, 2009, pp. B1, B4.

[36]Jayant Menon, "Dealing with the Proliferation of Bilateral Free Trade Agreements," *World Economy* 32 (October 2009), pp. 1381–407.

[37]http://www.ustr.gov, 2010.

[38]Ting-I Tsai, "China, Taiwan Set Stage for a Landmark Pact on Trade," *The Wall Street Journal–Eastern Edition*, December 19, 2009, p. A19.

[39]Kanga Kong, "Trade Accord with India Will Cut or Eliminate Tariffs," *The Wall Street Journal–Eastern Edition*, August 8, 2009, p. A9.

[40]"It Really May Happen," *The Economist*, January 2, 2010, p. 36.

extent that the bilateral talks ultimately lead to multilateral concessions, such activities are not inconsistent with WTO goals and aspirations.

The International Monetary Fund and World Bank Group

LO7

The emergence of the International Monetary Fund and the World Bank Group

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

Inadequate monetary reserves and unstable currencies are particularly vexing problems in global trade. So long as these conditions exist, world markets cannot develop and function as effectively as they should. To overcome these particular market barriers that plagued international trading before World War II, the *International Monetary Fund (IMF)* was formed. Originally 29 countries signed the agreement; now 184 countries are members. Among the objectives of the IMF are the stabilization of foreign exchange rates and the establishment of freely convertible currencies to facilitate the expansion and balanced growth of international trade. Member countries have voluntarily joined to consult with one another to maintain a stable system of buying and selling their currencies so that payments in foreign money can take place between countries smoothly and without delay. The IMF also lends money to members having trouble meeting financial obligations to other members. Argentina, Turkey, and Greece have recently received such help from the IMF, but the results have been mixed.

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

Although the International Monetary Fund has some severe critics,[43] most agree that it has performed a valuable service and at least partially achieved many of its objectives. To be sure, the IMF proved its value in the financial crisis among some Asian countries in 1997. The impact of the crisis was lessened substantially as a result of actions taken by the IMF. During the financial crisis, the IMF provided loans to several countries including Thailand, Indonesia, and South Korea. Had these countries not received aid ($60 billion to Korea alone), the economic reverberations might have led to a global recession. As it was, all the major equity markets reflected substantial reductions in market prices, and the rate of economic growth in some countries was slowed.

Sometimes confused with the IMF, the *World Bank Group* is a separate institution that has as its goal the reduction of poverty and the improvement of living standards by promoting sustainable growth and investment in people. The bank provides loans, technical assistance, and policy guidance to developing country members to achieve its

[41] http://www.imf.org.

[42] http://www.worldbank.org.

[43] Krishna Guha, "Watchdog Calls on IMF to Curb Loan Conditions," *Financial Times*, January 4, 2008, p. 4.

objectives.[44] The World Bank Group has five institutions, each of which performs the following services: (1) lending money to the governments of developing countries to finance development projects in education, health, and infrastructure; (2) providing assistance to governments for developmental projects to the poorest developing countries (per capita incomes of $925 or less); (3) lending directly to the private sector to help strengthen the private sector in developing countries with long-term loans, equity investments, and other financial assistance; (4) providing investors with investment guarantees against "noncommercial risk," such as expropriation and war, to create an environment in developing countries that will attract foreign investment; and (5) promoting increased flows of international investment by providing facilities for the conciliation and arbitration of disputes between governments and foreign investors. It also provides advice, carries out research, and produces publications in the area of foreign investment law. Since their inception, these institutions have played a pivotal role in the economic development of countries throughout the world and thus contributed to the expansion of international trade since World War II.

Protests against Global Institutions

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

Three kinds of antiglobalization protests: the photo on this page and the two photos on the next. Gifford Myers showed this sculpture Object (Globalization)–2001 in Faenza, Italy, as a peaceful protest.

[44]Thomas Pearmain, "Tanzanian Power Sector Faces Difficult Year," *Global Insight*, January 2, 2008.

Starbucks may be replacing McDonald's as the American brand foreigners most love to hate. Here local police fail to stop anti–World Trade Organization rioters in Seattle from breaking windows close to home.

And, finally, protest of the deadly sort. Terrorists maim and kill those aboard the classic red London double-deck bus (you can see the pieces in the street).

domestic job losses, cultural extinction, higher oil prices, and diminished sovereignty of nations. The antiglobalization protests first caught the attention of the world press during a WTO meeting in Seattle in November 1999. Then came the World Bank and IMF meetings in April in Washington, DC, the World Economic Forum in Melbourne, Australia, in September, and IMF/World Bank meetings in Prague, also in September 2000. Some 10,000 protesters faced some 11,000 police in Prague. The protesters have established Web sites associated with each event, labeled according to the respective dates. The Web sites and the Internet have proved to be important media aiding organizational efforts. And the protests[45] and violence have continued at other meetings of world leaders regarding economic issues, such as the G20 meetings in London in 2009,[46] and in individual countries affected by the IMF. Tragically, the terrorism in London was most likely timed to coincide with the G8 meetings in Scotland in 2005.[47]

The protest groups, some of them with responsible intent, have affected policy. For example, "antisweatshop" campaigns, mostly in America and mostly student-led, have had effects beyond college campuses. A coalition of nongovernmental organizations, student groups, and UNITE (the textile workers' union) recently sued clothing importers, including Calvin Klein and The Gap, over working conditions in the American commonwealth of Saipan in the Pacific. Faced with litigation and extended public campaigns against their brands, 17 companies settled, promising better working conditions. Similarly, a World

[45]"Pakistani Farmers Stage Protests in Lahore against WTO Regime," *BBC Monitoring South Asia*, April 18, 2007.

[46]Jennifer Martinez, "Anarchists Organize to Spread Word," *The Wall Street Journal–Eastern Edition*, April 1, 2009, p. A8.

[47]Mark Rice-Osley, "Overshadowed by Terrorism, G-8 Summit Still Secures Debt Relief," *Christian Science Monitor*, July 11, 2005, p. 7.

Bank project in China, which involved moving poor ethnic Chinese into lands that were traditionally Tibetan, was abandoned after a political furor led by a relatively small group of pro-Tibetan activists.

Given the apparent previous successes associated with the generally peaceful grassroots efforts to influence policy at these global institutions, we can expect more of the same in the future. But predicting the consequences of the terrorism apparently being added to the mix of protestation is impossible.

Summary

Regardless of the theoretical approach used in defense of international trade, the benefits from an absolute or comparative advantage clearly can accrue to any nation. Heightened competitors from around the world have created increased pressure for protectionism from every region of the globe at a time when open markets are needed if world resources are to be developed and utilized in the most beneficial manner. And though market protection may be needed in light of certain circumstances and may be beneficial to national defense or the encouragement of infant industries in developing nations, the consumer seldom benefits from such protection.

Free international markets help underdeveloped countries become self-sufficient, and because open markets provide new customers, most industrialized nations have, since World War II, cooperated in working toward freer trade. Such trade will always be partially threatened by various governmental and market barriers that exist or are created for the protection of local businesses. However, the trend has been toward freer trade. The changing economic and political realities are producing unique business structures that continue to protect certain major industries. The future of open global markets lies with the controlled and equitable reduction of trade barriers.

Key Terms

GATT
Balance of payments
Current account
Protectionism
Nontariff barriers
Tariff
Voluntary export restraints (VERs)
World Trade Organization (WTO)
International Monetary Fund (IMF)

Questions

1. Define the key terms listed above.
2. Discuss the globalization of the U.S. economy.
3. Differentiate among the current account, balance of trade, and balance of payments.
4. Explain the role of price as a free market regulator.
5. "Theoretically, the market is an automatic, competitive, self-regulating mechanism which provides for the maximum consumer welfare and which best regulates the use of the factors of production." Explain.
6. Interview several local businesspeople to determine their attitudes toward world trade. Furthermore, learn if they buy or sell goods produced in foreign countries. Correlate the attitudes with their commercial experience and report on your findings.
7. What is the role of profit in international trade? Does profit replace or complement the regulatory function of pricing? Discuss.
8. Why does the balance of payments always balance, even though the balance of trade does not?
9. Enumerate the ways in which a nation can overcome an unfavorable balance of trade.
10. Support or refute each of the various arguments commonly used in support of tariffs.
11. France exports about 18 percent of its gross domestic product, while neighboring Belgium exports 46 percent. What areas of economic policy are likely to be affected by such variations in exports?
12. Does widespread unemployment change the economic logic of protectionism?
13. Review the economic effects of major trade imbalances such as those caused by petroleum imports.
14. Discuss the main provisions of the Omnibus Trade and Competitiveness Act of 1988.
15. The Tokyo Round of GATT emphasized the reduction of nontariff barriers. How does the Uruguay Round differ?
16. Discuss the impact of GATS, TRIMs, and TRIPs on global trade.

17. Discuss the evolution of world trade that led to the formation of the WTO.
18. Visit www.usitc.gov/taffairs.htm (U.S. Customs tariff schedule) and look up the import duties on leather footwear. You will find a difference in the duties on shoes of different value, material composition, and quantity. Using what you have learned in this chapter, explain the reasoning behind these differences. Do the same for frozen and/or concentrated orange juice.
19. The GATT has had a long and eventful history. Visit www.wto.org/wto/about/about.htm and write a short report on the various rounds of GATT. What were the key issues addressed in each round?