CHAPTER 2

Motives for World Trade and Foreign Investment

Opening Case 2: The Effect of Foreign Investment on Exports

In 1989, Mexico significantly liberalized its foreign investment regulations to allow 100 percent foreign ownership. The North American Free Trade Agreement of 1994 extends the areas of permissible foreign direct investment (FDI) and protects foreign investors with a dispute settlement mechanism. In addition, Mexico has recently taken a series of additional actions to increase FDI in Mexico. As a consequence, the US FDI in Mexico has increased more rapidly in recent years than ever before. Mexico is now the third-largest host country for US FDI after the United Kingdom and Canada.

Because FDI is generally used to set up foreign production, US exports to Mexico should have dropped as a result of increased US FDI in Mexico. Right? Apparently not, according to a 1999 study by Wilamoski and Tinkler. The study found that US FDI in Mexico raises total US exports to Mexico and has a positive effect on the US trade balance with Mexico. The removal of barriers to investment has allowed US firms to establish a presence in Mexico. This has required the Mexican subsidiary to import inputs from the US parent firms and capital goods from unaffiliated US firms.

International investment flows can boost efficiency and the flow of information across borders. In addition, FDI is closely linked to export expansion. For example, FDI by US companies can open the way for US exports, both as inputs to foreign production and as consumer goods to supply foreign demand. It also offers US companies a toehold in foreign markets, from which they can further expand sales. In many cases, investment in distribution and other essential services increases a supplier's ability to export into a market. Trade between firms and their foreign affiliates (intrafirm trade) can be an efficient means of international trade, particularly when problems of imperfect information exist. Over a third of US exports and two-fifths of

US imports are estimated to be intrafirm. Worldwide, about a third of trade is intrafirm trade. In fact, many recent studies have confirmed that FDI is closely linked to export expansion.

Source: Peter Wilamoski and Sarah Tinkler, "The Trade Balance Effect of US Foreign Direct Investment in Mexico," *Atlantic Economic Journal*, Mar. 1999, pp. 24–37.

This book deals with both foreign trade and foreign investment. Because these two types of international transactions are extremely interdependent, this chapter examines motives for foreign trade and foreign investment. The knowledge and understanding of these motives are essential if we are to appreciate the economic dynamics and policy issues of trade and investment flows among nations. Thus, in this important overview, we will discuss key trade and investment theories before we consider them separately in the coming chapters. This chapter also describes global and regional market agreements designed to eliminate trade barriers.

2.1 Motives for Foreign Trade

Human desires for goods and services are unlimited, yet our resources are limited. Thus, one of our most important tasks is to seek new knowledge necessary to bridge the gap between desires and resources. The traditional concept of economic man assumed that man allocates his scarce resources between competing uses in the most economical manner. In Robinson Crusoe's world, for example, he would allocate his time for labor between different alternatives. He would use one level site on the uncharted island as either the location for a hut (shelter) or as a vegetable garden (food). Of course, the real world consists of many persons and nations that are interdependent for sociological and economic reasons. Most societies face problems similar to those faced by Robinson Crusoe, but in more complex forms.

The advantages of economic interdependence between persons and nations center mainly on the efficiency of specialization. Specialization of function or division of labor allows each person or nation to utilize any peculiar differences in skills and resources in the most economical manner. There are a number of reasons why specialization produces a greater amount of goods and services:

1 Natural talents among people are different. If intelligent people specialized only in mental tasks while physically strong people specialized only in physical tasks, the total amount of their output would be greater than if each person tried to do both for him- or herself.
2 Even if the natural abilities of two persons are identical, specialization is advantageous because it creates the opportunity for improved skills and techniques through repetition of tasks.
3 The simplification of function through specialization leads to mechanization and the use of large-scale machinery.
4 Personal specialization saves time, because one person does not have to shift from one task to another.

The theories of comparative advantage, factor endowments, and product life cycle have been suggested as three major motives for foreign trade.

2.1.1 The theory of comparative advantage

The classical economic theory of comparative advantage explains why countries exchange their goods and services with each other. Here, the underlying assumption is that some countries can produce some types of goods more efficiently than other countries. Hence, the **theory of comparative advantage** assumes that all countries are better off if each specializes in the production of those goods that it can produce more efficiently and buys those goods that other countries produce more efficiently.

WHY COMPARATIVE ADVANTAGE OCCURS The theory of comparative advantage depends on two elements:

1 Factors of production, such as land, labor, capital, and technology, are unequally distributed among nations.
2 Efficient production of various goods and services requires combinations of different economic resources and different technologies.

For instance, Canada has vast amounts of fertile land resources and relatively few people. In contrast, Japan has little land and abundant skilled labor. Thus, Canada may produce such land-intensive goods as wheat more economically than Japan, while Japan may produce such labor-intensive goods as cameras more economically than Canada.

However, it is important to recognize that the distribution of economic resources and technology can change over time. This change may alter the relative efficiency of production. In the past 10–20 years, some developing countries have considerably upgraded the quality of their labor forces and have substantially expanded their stock of capital. Therefore, they now produce capital-intensive products such as steel, machinery, and automobiles. Moreover, some newly developed countries, such as Korea, Taiwan, and Brazil, now produce high-technology products, such as computers and computer software.

Example 2.1

Suppose, for the time being, that the world has two nations (Canada and Japan) and two commodities (wheat and cameras). For a fixed amount of $1,000 in land, labor, capital, and technology, Canada and Japan can produce either of the two commodities listed in table 2.1. In other words, if each country were to make one or the other, Canada could produce 180 bushels of wheat or six cameras, while Japan could produce 80 bushels of wheat or eight cameras. If there is no trade, then Canada can produce 90 bushels of wheat and three cameras, while Japan can produce 50 bushels of wheat and three cameras.

It is clear from table 2.1 that under full employment conditions, Canada's exchange ratio for the two products is one camera (C) for 30 bushels of wheat (W), or 1C = 30W. Japan's

Table 2.1 Production alternatives of wheat and cameras

Country	*Wheat*	*Cameras*
Canada	180	6
Japan	80	8

Table 2.2 Gains to both nations from specialization and trade

Country	*Before specialization*	*After specialization*	*Exports (–) and imports (+)*	*After trade*	*Gains from trade*
Canada	90W	180W	–80W	100W	10W
	3C	0C	+4C	4C	1C
Japan	50W	0W	+80W	80W	30W
	3C	8C	–4C	4C	1C

exchange ratio for the two products is one camera for 10 bushels of wheat, or 1C = 10W. Thus, Canada has a greater advantage in the production of wheat, whereas Japan has a better advantage in the production of cameras. In other words, these two countries produce both products but at different levels of economic efficiency. If they specialize according to their comparative advantage, Canada must produce only wheat while Japan must produce only cameras. If they trade with each other, larger outputs of both wheat and cameras would be available to both nations, because specialization allocates world resources more efficiently.

The exchange ratios for the two products differ in the two countries. This difference becomes the basis for mutually beneficial specialization and trade. Trade requires a new exchange ratio between the two products, so that Canada may obtain one camera for less than 30 bushels of wheat and Japan may obtain more than 10 bushels of wheat for one camera. Thus, the terms of trade lie somewhere between 1C = 30W and 1C = 10W, or 30W > 1C > 10W. The actual exchange ratio will depend on world conditions of supply and demand. However, assume that the international exchange ratio for the two products is 1C = 20W. The quantities of the two products available to both countries after specialization and trade would be greater than the optimum product mixes before specialization and trade.

Table 2.2 shows the gains of the two nations from specialization and trade. If Canada were to export 80 bushels of wheat (out of 180 bushels) for four cameras, it would enjoy 100 bushels of wheat and four cameras. Hence, Canada would have 10 more bushels of wheat and one more camera than the optimum product mix that existed before specialization and trade. If Japan were to trade four cameras (out of eight cameras) for 80 bushels of wheat, Japan would enjoy four cameras and 80 bushels of wheat. Thus, Japan would enjoy one more camera and 30 more bushels of wheat than its optimum product mix without specialization and trade.

Specialization and trade permit the two countries in our model to obtain a total of 180 bushels of wheat and a total of eight cameras. It is important to note that the two countries had a total of 140 bushels of wheat and a total of six cameras before specialization and trade. Thus, larger outputs of both wheat and cameras are available to the two countries from specialization and trade.

2.1.2 *The theory of factor endowments*

Countries are endowed differently in their economic resources. Thus, Colombia is more efficient in the production of coffee and the United States is more efficient in the production of computers. Colombia has the soil, weather, and abundant supply of unskilled labor necessary to produce coffee more economically than the USA. The USA possesses the facilities, key parts, and ample supply of skilled labor necessary to produce computers more efficiently than Colombia.

Differences in these national factor endowments explain differences in comparative factor costs between the two countries. Capital costs are lower in the USA than in China because the USA has more capital than China. Labor costs are lower in China than in the USA because China has more labor than the USA. Simply stated, the more abundant the supply of any factor, the lower is the cost of that factor.

The **theory of factor endowments** says that countries are mutually benefited if they specialize in the production of those goods that use a large amount of abundant factors and trade those goods among them. This means that a country must specialize in the production and export of any good that uses large amounts of abundant factors. It must import those commodities that use large amounts of production factors that are scarce at home. On the one hand, most developing countries have a comparative cost advantage in the production of labor-intensive commodities. On the other hand, most industrialized countries enjoy a comparative cost advantage in the production of capital-intensive commodities. Thus, specialization and trade can be mutually beneficial if industrialized countries specialize in the production and export of capital-intensive goods, and if developing countries specialize in the production and export of labor-intensive commodities.

2.1.3 *The product life cycle theory*

All products have a certain length of life. During this lifetime, they go through certain stages. A product's life begins with its market introduction; its market grows rather rapidly; its demand reaches maturity; its market declines; and finally, its life ends.

This **product life cycle theory** attempts to explain both world trade and foreign investment patterns on the basis of stages in a product's life. In the context of international trade, the theory assumes that certain products go through four stages:

1 A large company introduces a new product in response to some change in the home-country market. After a time lag, this home country establishes itself as an exporter with a monopoly position.

2 Increasing transportation and tariff costs make it less attractive to export the product. Thus, the firm begins to produce its product in some foreign countries. This international production replaces home-country exports in certain foreign markets.
3 Some foreign companies begin to compete in third-country markets. This competition leads to a further reduction in home-country exports.
4 Some foreign companies export the product back to the home country. Many factors, such as low labor costs, economies of scale, and government subsidies, make it possible for foreign companies to invade the home-country market.

2.1.4 Other motives for world trade

ECONOMIES OF SCALE A synergistic effect is said to exist when the whole is worth more than the mere sum of its parts. It is this effect, which has frequently been defined as "2 + 2 = 5," that leads to **economies of scale**. Hence another important cause of international trade is that costs may fall as outputs expand. Economies of mass production can be realized if each country specializes in a limited number of products in which it has a comparative advantage. Mass production and mass marketing improve skills and technologies. Opportunities to eliminate duplicate facilities occur. There are also opportunities to consolidate the functions of production, marketing, and purchasing. These types of operating economies and improved skills can lead to larger outputs of goods and services even if no differences existed in comparative costs among countries.

DIFFERENCES IN TASTES Even if differences in comparative costs among countries and economies of scale were absent, world trade might take place due to differences in tastes. Suppose that both Canada and Japan produce the same amount of fish and meat. If Canadians prefer meat and Japanese prefer fish, then a mutually beneficial export of meat from Japan to Canada and fish from Canada to Japan would take place. Both countries would gain from this trade, because the sum total of satisfaction derived from the trade would be greater than would be possible under isolated self-sufficiency without trade.

2.1.5 Benefits of open trade

Open, competitive trade promotes the economic welfare of all countries that engage in it, and does so in four ways. Open trade secures the benefits of national comparative advantage; increases domestic competitive pressures; accelerates the flow of technology and ideas; and broadens the variety of goods and services available to both producers and consumers.

ALLOCATION EFFICIENCY FROM COMPARATIVE ADVANTAGE A more traditional approach depicts a world in which markets are competitive and economies of scale do not exist. In these situations, gains stem from comparative advantage. Under the concept of comparative advantage, each country imports those goods produced more efficiently abroad and exports those goods produced more cheaply at home. Such types of trade allow each trading country to devote more of its resources to producing those goods and services that it can produce more efficiently. Because

free trade leads to the most efficient use of scarce resources, all countries that engage in free trade would obtain economic gains.

INCREASED COMPETITION Foreign trade strengthens competitive pressures in the domestic economy, stimulating efficiency and growth. An open trade regime effectively increases the number of both actual and potential competitors in the domestic market by including those located beyond a nation's borders. This encourages domestic producers to innovate and become more competitive. Consumers, both at home and abroad, reap the benefits.

INCREASED PRODUCTIVITY FROM PRODUCTION EFFICIENCY Access to international markets through foreign trade stimulates the flow of information across borders. Domestic companies engaged in international competition assimilate new ideas about production methods, product design, organizational structure, and marketing strategy. These new ideas allow domestic companies to employ their resources more efficiently. Thus, open competition through free trade increases productivity.

Open trade also creates opportunities for economies of scale or synergistic effects. The reduction of barriers automatically increases total demand. As economic resources shift to the more efficient producers due to increased competition, companies can expand production to take advantage of the larger market. This dynamic change in market size allows companies to spread fixed costs over more and more units of production.

AN EXPANDED MENU OF GOODS Foreign trade expands the menu of goods and services available to both producers and consumers. Companies gain access to a wider variety of inputs. Consumers get to choose from a broader assortment of goods and services. By expanding the choices, foreign trade boosts efficiency and improves living standards.

Global Finance in Action 2.1
Economic Freedom and Consumption

People who live in free countries enjoy substantially higher living standards than those living in repressive countries. The World Bank collects data on per capita consumption by country. Two independent research groups – the Heritage Foundation in Washington, DC, and the Fraser Institute in Canada – measure economic freedom across the world using a broad variety of criteria based on key components of free enterprise, including trade policies and openness to foreign investment. Relating the consumption to freedom data sets, one finds that per capita consumption in the economically freest fifth of countries is eight to nine times that of the least free fifth (see figure 2.1).

Source: Robert D. McTeer, Jr, *The Fruits of Free Trade: 2002 Annual Report*, Federal Reserve Bank of Dallas, 2002, p. 13.

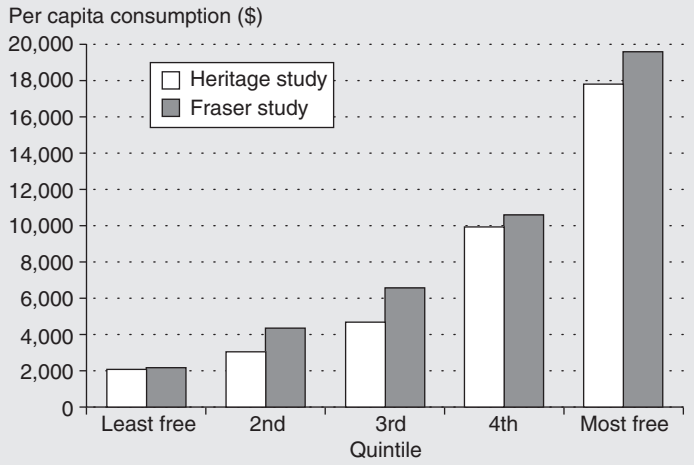

Figure 2.1 Economic freedom and consumption

2.1.6 *Free trade versus protectionism*

The possibility of a foreign embargo on sales of certain products and the needs of national defense may cause some countries to seek self-sufficiency in some strategic commodities. Political and military questions constantly affect international trade and other international business operations. Conflicts have historically taken place between multinational companies (typically exporters) and host countries (typically importers) over political ideology, national sovereignty, control of key industries, balance of payments, and control of export markets.

REASONS FOR PROTECTIONISM There are a variety of arguments for protectionism: (1) national security, (2) unfair competition, (3) the infant-industry argument, (4) domestic employment, and (5) diversification.

First, if a country wishes to be a world power, it must maintain key sectors, such as steel, for national security. By maintaining strategic commodities, it is assured of supplies in the event of global conflicts and boycotts.

Second, labor-intensive industries in developed countries argue that low wages in foreign countries constitute unfair competition. In addition to low wages, countries with industrial policies enjoy unfair competitive advantage because of their public policies, such as special tax incentives, subsidies, and selective protection to overcome the competition.

Third, the logic of the infant-industry argument is that protective measures are essential for newly begun domestic industries to establish themselves. They need time and thus protection to realize the economies of mass production.

Fourth, protection maintains domestic employment and living standards. The costs from unemployment may be higher than the costs of inefficient domestic production for certain products.

Fifth, highly specialized economies, such as Kuwait's oil economy, depend on international markets for incomes. If they are to reduce their dependence upon world markets for one or two products, these countries need some protection to diversify the economy.

FORMS OF TRADE CONTROL Tariffs, import quotas, and other trade barriers are three primary means of protectionism.

Tariffs are duties or taxes imposed on imported commodities. Tariffs on imported commodities may be imposed for purposes of revenues or protection. Tariffs are usually modest when they are used to increase revenues. However, tariffs are typically high when they are imposed to protect domestic companies from foreign competition. Although protective tariffs do not eliminate the importation of foreign products completely, they clearly put foreign sellers at a comparative disadvantage. Here, consumers must pay more for foreign goods, thereby reducing their consumption of imported commodities.

Import quotas specify maximum amounts of certain products to be imported during a given period of time, usually 1 year. Import quotas may also be used to shield domestic producers from foreign competition. They are sometimes more effective than tariffs in reducing the importation of certain products. Even if tariffs are high, certain commodities may still be imported in relatively large quantities. In contrast, low import quotas totally prohibit imports beyond a quota. Hence, it is no wonder why many countries have recently imposed quotas on the importation of certain goods.

There are **other trade barriers**. The general trend around the world since World War II has been to reduce such obvious trade barriers as quotas and tariffs. This trend has compelled governments to replace them with less obvious forms of protection which, according to a survey by Ball and McCulloch (1999), number over 800. Three major classes of such other trade barriers are:

1 Direct government participation in trade.
2 Customs and other administrative procedures.
3 Technical and health regulations or standards.

First, a government's participation in trade covers export subsidies, countervailing duties, and antidumping duties; when engaged in these activities, the government prefers national over foreign bidders. **Countervailing duties** are additional import duties imposed to offset an export subsidy by another country. **Antidumping duties** are customs duties imposed on an imported product whose price is lower than that of the same product in the home market.

Second, customs and other administrative procedures include customs classification, valuation, and procedures. Import duties imposed on certain products often depend on how they are classified into the tariff schedule and how they are valued by customs authorities. In addition, customs inspectors can discriminate against a good or a country by delaying the importation process.

Finally, technical and health regulations make up the standards that can hinder imports. Governments apply many safety rules and regulations on imports, in the form of marking, labeling, packaging, and technical standards. These standards tend to discriminate against imports by imposing greater hardship on foreign than domestic companies.

Other trade barriers can have a significant impact on international trade. For example, Japan is criticized by some countries for its nontariff barriers, such as extremely stringent product standards on imported products. Some economists argue that these barriers are major causes of the lingering US trade deficit with Japan. Others, however, attribute the deficit to Japan's superior quality and production efficiencies based on teamwork, quality education, and work ethic.

Global Finance in Action 2.2

The High Cost of Protectionism

How much does it cost to protect a job? An average of $231,289, figured across just 20 of the many protected industries (see table 2.3). Costs range from $132,870 per job saved in the costume jewelry business to $1,376,435 in the benzenoid chemical industry. Protectionism costs US consumers nearly $100 billion annually. It increases not just the cost of the protected items but downstream products as well. Protecting sugar raises candy and soft drink prices; protecting lumber raises home-building costs; protecting steel makes car prices higher; and so forth. Then there are the job losses in downstream industries. Workers in steel-using industries outnumber those in steel-producing industries by 57 to 1. In addition, the protection does not even work. Subsidies to steel-producing industries since 1975 have exceeded $23 billion; yet industry employment has declined by nearly two-thirds.

Table 2.3 The cost of protectionism

	Protected industry	*Jobs saved*	*Total cost (in millions)*	*Annual cost per job saved*
1	Benzenoid chemicals	216	$297	$1,376,435
2	Luggage	226	290	1,285,078
3	Softwood lumber	605	632	1,044,271
4	Sugar	2,261	1,868	826,104
5	Polyethylene resins	298	242	812,928
6	Dairy products	2,378	1,630	685,323
7	Frozen concentrated orange juice	609	387	635,103
8	Ball bearings	146	88	603,368
9	Maritime services	4,411	2,522	571,668
10	Ceramic tiles	347	191	551,367
11	Machine tools	1,556	746	479,452
12	Ceramic articles	418	140	335,876
13	Women's handbags	773	204	263,535
14	Canned tuna	390	100	257,640
15	Glassware	1,477	366	247,889
16	Apparel and textiles	168,786	33,629	199,241
17	Peanuts	397	74	187,223
18	Rubber footwear	1,701	286	168,312
19	Women's nonathletic footwear	3,702	518	139,800
20	Costume jewelry	1,067	142	132,870

Source: Robert D. McTeer, Jr, *The Fruits of Free Trade: 2002 Annual Report*, Federal Reserve Bank of Dallas, 2002, p. 13.

2.2 Economic Integration

World leaders have recognized that the reduction or elimination of artificial barriers to trade is necessary for expanding world trade. The worldwide postwar efforts to expand foreign trade included the elimination of tariff barriers through the World Trade Organization and the stabilization of currencies through the International Monetary Fund. At the same time as these efforts went forward on the international level, many countries around the world also pursued economic cooperation at the regional level. Regional economic cooperation is based on the premise that countries in a region connected by historical, geographical, cultural, economic, and political similarities may be able to strike more intensive cooperative agreements for mutually beneficial economic advantages.

2.2.1 From GATT to WTO

In 1947, 23 countries signed the General Agreement on Tariffs and Trade (GATT) in Geneva. To join GATT, countries must adhere to the **most favored nation (MFN)** clause, which requires that if a country grants a tariff reduction to one country, it must grant the same concession to all other countries. For example, if the USA cuts its tariff from 20 percent to 10 percent on wool sweaters from Australia, it must grant the same concession on wool sweaters from all other countries. The MFN clause also applies to quotas and licenses.

GATT members have held many talks since 1947 to expand and promote world trade. First, GATT members held periodic meetings from 1947 to 1952 to cut specific tariffs. Second, the Kennedy Round (1964–7) covered across-the-board tariff reductions on industrial products. Perhaps the most important part of the Kennedy Round was to reduce trade barriers between the USA and the European Economic Community. Third, the Tokyo Round (1973–9) of multilateral trade negotiations discussed the reduction of nontariff barriers. The most important part of these agreements is a series of detailed codes spelling out permissible and nonpermissible "good" behavior by governments in almost all nontariff measures. Fourth, the Uruguay Round (1986–93) discussed the expansion of trade liberalization to include services, intellectual property rights, and agricultural products.

The new organization, known as the World Trade Organization (WTO), has replaced the GATT since the Uruguay Round accord became effective on January 1, 1995. Today, the WTO's 144 members account for more than 97 percent of world trade. The WTO has five major functions: (1) administrating its trade agreements; (2) acting as a forum for trade negotiations; (3) monitoring national trade policies; (4) offering technical assistance and training for developing countries; and (5) cooperating with other international organizations. China joined the WTO in 2001. China's WTO membership has further legitimized the idea of free trade.

The WTO has more power to enforce the rules of international trade than the GATT. Under the WTO there is a powerful dispute-resolution system, with three-person arbitration panels. Countries may bring charges against their trading partners to a WTO panel. WTO members cannot veto the panel's rulings, as was the case under GATT. If an offending country fails to comply with panel recommendations, its trading partners are guaranteed the right to compensation. As a final resort, the trading partners are given the right to impose countervailing sanctions against the offending country.

In November 2001, WTO members began to explore a new round of talks with the aim of further liberalizing global commerce. Major issues include a moratorium on tariffs for electronic commerce, easier access to foreign markets for high-tech, banking, and insurance exports, elimination of agricultural subsidies, tougher labor standards around the world, revision of US antidumping laws, and more time for developing countries to liberalize trade.

2.2.2 *Trading blocs: types of economic cooperation*

A **trading bloc** is a preferential economic arrangement between a group of countries that reduces intraregional barriers to trade in goods, services, investment, and capital. There are more than 50 such arrangements at the present time. There are five major forms of economic cooperation among countries: the free trade area, the customs union, the common market, the economic union, and the political union.

The **free trade area** type of cooperation requires member countries to remove all tariffs among themselves. However, the member nations are allowed to have their own tariff arrangements with nonmember countries. The North American Free Trade Agreement among the USA, Canada, and Mexico illustrates the free trade area type of agreement.

Under the **customs union** arrangement, member nations not only abolish internal tariffs among themselves but also establish common external tariffs. The trading bloc called Mercosur in Spanish constitutes a customs union. The four members of Mercosur – Argentina, Brazil, Paraguay, and Uruguay (see figure 2.2) – account for 70 percent of South America's total output. The aims of this customs union are designed to establish free trade among member countries and to impose a common tariff of 5–20 percent on products imported from the outside. Furthermore, the leaders of these four countries wish to develop a unified strategy for trade negotiations with the USA over the proposed Free Trade Area of the Americas.

In a **common market** type of agreement, member countries abolish internal tariffs among themselves and levy common external tariffs. Moreover, they allow the free flow of all factors of production, such as capital, labor, and technology. The Central American Common Market exemplifies a common market type of agreement among Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua. This common market wishes to permit the free flow of production factors among its member countries, but its goal is hampered by the nonuniformity of economic conditions among them.

The **economic union** combines common market characteristics with harmonization of economic policy. Member nations are required to pursue common monetary and fiscal policies. This means that economic union members have to synchronize taxes, money supply, interest rates, and regulation of capital markets. The current version of the European Union (EU) represents an economic union. The name of the European Economic Community (EEC) was officially changed to the EU on November 1, 1993, when the Maastricht Treaty of the EEC came into effect.

The **political union** combines economic union characteristics with political harmony among the member countries. Essentially, countries merge with each other to create a new nation. Thus, it is the ultimate market agreement among nations. In the 1950s, Egypt, Syria, and Yemen formed a political union, but it did not last long. Thus, in its pure form, an example of the political union does not exist. However, the recently created commonwealth of 11 former Soviet republics could be considered a political union.

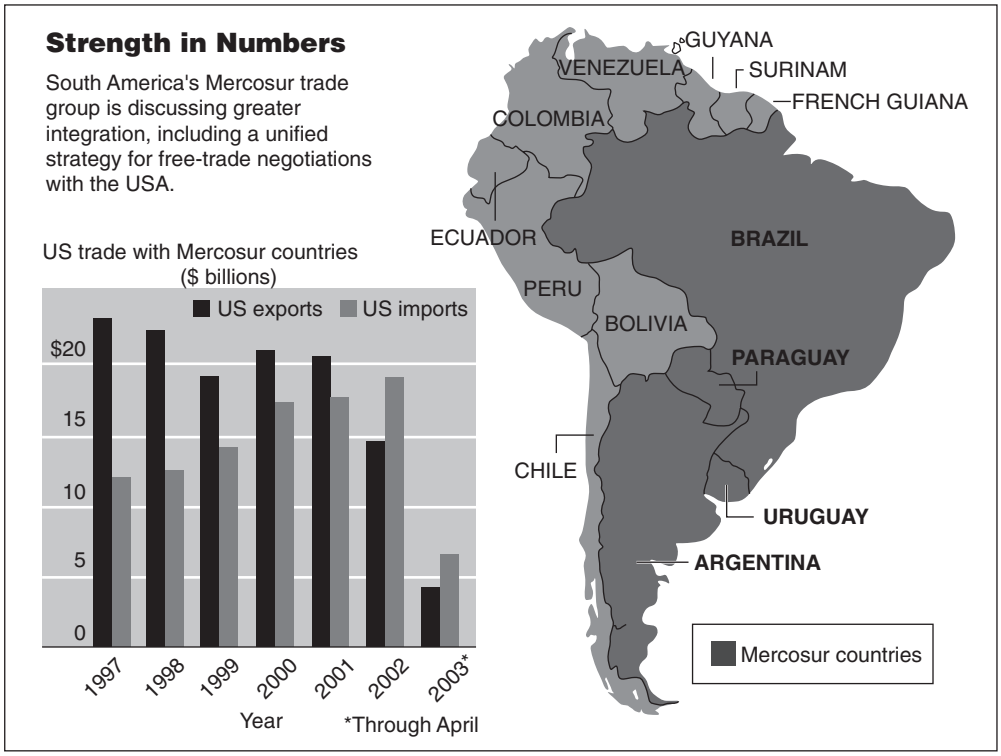

Figure 2.2 The Mercosur trade group
Source: *The Wall Street Journal*, June 16, 2003, p. A13.

2.2.3 *Regional economic agreements*

The world has been swiftly moving toward trading blocs in recent years. Economists divide trading nations into three groups based on the euro, the dollar, and the yen. The world's future economic landscape will see that companies will compete within the boundaries of trading blocs – whether in Europe, North America, or Asia. Each of these trading blocs is expected to pose its own challenges. If countries continue to compete with one another as single nations, they could lose their competitiveness in the world marketplace. Many world leaders loudly assail regional trading blocs that serve as protectionist trade umbrellas. However, they also concede that trading blocs may be an unfortunate but emerging trend.

THE EUROPEAN ECONOMIC AREA Six European countries – Belgium, France, West Germany, Italy, Luxembourg, and the Netherlands – established the EEC through the Treaty of Rome in March 1957, to remove trade barriers among the member countries. Since then, the EEC has added Denmark, Greece, Ireland, Portugal, Spain, and the United Kingdom.

According to the 1957 Treaty of Rome, EEC member countries agreed to: (1) abolish tariffs, quotas, and other trade restrictions among member countries; (2) impose a uniform tariff on

imports from nonmember countries; (3) remove restrictions on movements of capital and labor within the six-nation group; (4) establish a common policy on transportation, agriculture, competition, and business conduct; (5) coordinate and synchronize member countries' monetary and fiscal policies; and (6) set up a "social fund" to compensate workers who might experience economic injury due to the integration process.

The 12 member countries created a single market on January 1, 1993, through the Single European Act of 1987. The EU identified three general barriers for complete removal: (1) physical barriers, such as customs controls and border formalities; (2) technical barriers, such as different health and safety standards; and (3) fiscal barriers, such as differences in value-added tax rates and excise duties. These goals are identical with those established under the 1957 Treaty of Rome. The EU made 280 regulatory changes to create a genuine single market in Europe.

In December 1993, the EU ratified a treaty to create the European Economic Area (EEA). The treaty took effect on January 1, 1994. It extends most of the then 12-country EU's single-market legislation to Austria, Finland, and Sweden, which are members of the European Free Trade Association (EFTA). On January 1, 1999, the European Central Bank began to conduct monetary policy for 11 of the 15 EU nations with a single currency known as the euro (Greece joined in 2001). The existing 12 central banks expect to become regional banks in the next few years, much like the 12 Federal Reserve Banks in the US Federal Reserve System. The EU accepted 10 new members on May 1, 2004. Several EU member countries are expected to join the eurozone in the next few years.

THE NORTH AMERICAN FREE TRADE AGREEMENT On January 2, 1988, President Reagan and Canadian Prime Minister Mulroney signed the US–Canada Free Trade Agreement (FTA), which came into effect on January 1, 1989. The USA and Canada are each other's most important trading partners. The FTA liberalizes the largest trading relationship in the world. Throughout the 1990s, the FTA phased out tariffs, liberalized investment laws, and granted "national treatment" to companies on both sides of the border.

In August 1992, representatives of Canada, Mexico, and the USA concluded their negotiations of the North American Free Trade Agreement (NAFTA), which became effective on January 1, 1994. As of January 1, 1994, NAFTA created the world's largest trading bloc, with 365 million people and $7 trillion in purchasing power. NAFTA eliminates tariffs among the three countries over a period of 15 years, it substantially reduces nontariff barriers over the same period, and it immediately ensures the free flow of capital throughout its region. Business leaders, government officials, and scholars view the NAFTA as a natural trading bloc because of American technology, Canadian resources, and Mexican labor. In 2001, the USA and 33 other countries initiated trade negotiations for a free trade area of the Americas, which would include all North–South American countries and some countries in the Caribbean Sea. Chile has become the first Latin American country to forge a free trade agreement with the USA in 2003, one step toward what the Bush Administration foresees as a new era of open markets around the Americas.

ASIAN INTEGRATION EFFORTS Asia represents the third major region of the world economy, although it is difficult to clearly delineate its boundaries. Hence, the development in Asia has been quite different from that in Europe and in the Americas. While European and North American agreements have been driven by political will, market forces may force more formal integration on the politicians in Asia. If Asian countries continue to compete in the world

marketplace as single nations, they could lose their competitiveness in the world marketplace. While Japan is the dominant force in the area to take leadership in such an endeavor, neither the Japanese themselves nor the other nations wanted Japan to do it.

As a result, Asia does not have a strong trading bloc such as NAFTA or EU, but it has two loose affiliations: the Association of South East Asian Nations (ASEAN) and the Asian Pacific Economic Cooperation (APEC). Created in 1967, ASEAN consists of Brunei, Burma (currently Myanmar), Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Vietnam; since then, ASEAN has added Cambodia and Laos. In November 2001, China and 10 ASEAN countries agreed to create a free trade area within 10 years. Trade liberalization already under way in the region, through the ASEAN Free Trade Area, which began in 2002, will cut tariffs on all foreign trade to a maximum of 5 percent by January 1, 2008.

APEC was formed in 1989 to promote multilateral economic cooperation on issues of trade and investment. APEC consists of 18 countries that account for half of world output and it includes the world's three largest economies: the USA, Japan, and China. In 1994, APEC leaders agreed to achieve free and open trade in the region by 2010 for the industrial nations and 2020 for the rest of the members.

Japan has sought to cut the best trade deals for itself by negotiating through the multilateral World Trade Organization instead of making bilateral or regional pacts. This continued in recent years even as many countries around the world formed regional trading blocs, such as the NAFTA and the EU. However, Japanese officials and business executives have grown alarmed as regional blocs have continued to put Japanese exporters at a disadvantage. Thus, Japan and Singapore recently signed a bilateral free trade agreement, in a move that eventually could change the way in which Japan conducts its long-troubled trade relations. There has already been talk of Japan forging trade zones with such Pacific Rim countries as Korea, Mexico, and the USA. Other Asian countries have recently stepped up to cut their own trade deals with their fellow Asian countries and countries from other regions. For example, South Korea and Chile formed a free trade agreement in 2003, and the USA signed a free trade agreement with Singapore in 2004.

2.2.4 Corporate response to trading blocs

Corporations' investments are an important consideration in the proliferation of trading blocs. On the one hand, investments are made in various blocs to ensure continued access to the markets should protectionist barriers be erected. In a sense, this necessity may foster inefficiency, because investments would not be made with the objective of optimization in mind. However, if trading blocs attract nations with similar consumer profiles, these investments do make sense from an overall business-development and customer-service point of view. Regional strategies may, in turn, accelerate the concentration of the different markets that comprise the trading blocs.

Many companies may not have the resources or the time to invest in all of the emerging trading blocs. To ensure future competitive capability, many strategic alliances have been forged across national and regional borders in recent years. These alliances involve arrangements ranging from contract manufacturing to joint research and development. Corporate mergers have occurred across regional borders to guarantee access to blocs as local entities.

What impact will these corporate investments and alliances have on blocs and the argument that they are indeed basically protectionist? The "stateless" corporation may be able to move production and investment wherever it gets its best return without concern for a particular country or a region. Technology has made such transfer relatively swift and quite painless.

First, corporations and their assets can no longer be held hostage by a dismayed government or even a supranational organization. Second, it is becoming increasingly difficult to establish a product's national/regional origin, which makes protectionist moves correspondingly difficult. Finally, the interdependence that is being formed by companies may also spill over in a major way to the national and regional levels as well. As has been shown recently, tariff barriers erected against Japanese and European imports into the USA have ended up hurting US businesses as well. In 1991, IBM urged the US government to remove an antidumping duty that it had imposed on certain computer display screens imported from Japan. The effect of this duty was that American-built computers using this component became uncompetitive against models built completely in Japan.

2.3 Motives for Foreign Investment

In recent years, many companies have been induced to enter into new and profitable markets abroad. Economic and political forces in the host countries, along with their desire to sell more abroad, are largely responsible for the expansion of direct foreign investment. Companies find it increasingly easier to reach foreign markets through direct investment. The product life cycle theory, the portfolio theory, and the oligopoly model have been suggested as bases for explaining and justifying foreign investment.

2.3.1 The product life cycle theory

The theory of product life cycles explains changes in the location of production. When new products are introduced in home-country markets, their sales and profits tend to increase sharply until they reach maturity. Competition increases rapidly as these products approach their maturity point; this competition narrows profit margins. At this stage, companies may utilize foreign manufacturing locations to lower production costs and sustain profit margins.

This theory assumes that larger companies in highly advanced countries have a comparative advantage in new products over the companies in developing nations. Companies in developing countries, however, have a comparative advantage in fabricating mature products. Highly advanced technologies, highly educated labor resources, and abundant capital are essential to develop new products. They are readily available to larger firms in advanced countries. Larger markets and necessary alteration requirements in early production stages are additional reasons why larger companies in the developed areas of the world first introduce new products in the home-country markets.

As products become mature, product defects and technological imperfections inherent in new products are ironed out, so that the method of production becomes standardized. Competition begins to appear during the stage of market growth and becomes highly intensive during the stage of market maturity. At this point, some companies will shift their standardized manufacturing methods to developing countries for a number of good reasons:

1 Standard production methods require many unskilled workers.
2 Most developing countries have an abundant supply of unskilled labor.
3 Labor costs are lower in developing countries than in advanced countries.

2.3.2 The portfolio theory

The **portfolio theory** indicates that a company is often able to improve its risk–return performance by holding a diversified portfolio of assets. This theory represents another rationale for foreign investment. This theory rests on two variables: risk and return. Risk is the variability of returns associated with an investment project. Two projects may have the same long-term average rate of return. But one project may fluctuate widely in annual return while the other may have a stable return. A project whose returns fluctuate widely is said to be more risky than the other whose returns are stable.

Typically, only a few financial variables are known in advance. Business executives and investors are, basically, risk averse. Thus, they desire to minimize the overall degree of risk for their investment projects. Fortunately, there are many business situations in which the risks of individual projects tend to offset each other. As a consequence, successful diversification makes it possible for investors to have a portfolio with risk less than the sum of the risks of the individual projects in the portfolio.

A study by Levy and Sarnat (1970) indicated that a company is often able to improve its risk–return performance by holding an internationally diversified portfolio. The key element in the portfolio theory is the correlation coefficient between projects in the portfolio. When projects with low degrees of correlation are combined with each other, a company is able to reduce its risk of expected return. The Levy–Sarnat model assumes that foreign investment projects tend to be less correlated with each other than domestic investment projects. The economic cycles of different countries – the USA and Saudi Arabia, for example – do not tend to be totally synchronized. On the other hand, most domestic projects tend to be highly correlated with each other, because they depend on the same state of economy.

2.3.3 The oligopoly model

If you decide to buy tennis balls in the USA, you will end up with one of four brands: Wilson, Penn, Dunlop, or Spalding. These four companies make almost all of the tennis balls sold in the USA. Together, these four firms determine the quantity of tennis balls and the price at which tennis balls are sold. Analysts say that only a small number of giant multinational companies in each major industry also dominate the world market in that segment.

An oligopoly exists where there are only a few firms whose products are usually close substitutes for one another. Because a few firms dominate a market, each of these firms has a large share of the market. Thus, the policies of one firm have repercussions on the other firms.

The oligopoly model offers a way of explaining why multinational companies (MNCs) invest in foreign countries. The **oligopoly model** assumes that business firms make foreign investments to exploit their quasi-monopoly advantages. The advantages of an MNC over a local company may include technology, access to capital, differentiated products built on advertising, superior management, and organizational scale.

Horizontal investments for foreign production of the same goods as made in a home market are made to produce operational economies of scale. A horizontal investment may reduce the number of competitors, eliminate duplicate facilities, and expand a firm's operation in an existing product line. Vertical investments for foreign production of raw materials are usually made to control input sources. The control of input sources may make it possible for companies in an

oligopolistic industry to raise barriers to the entry of new competitors and to protect their oligopoly position. Some companies make defensive investments to prevent others from gaining an unanticipated advantage.

2.3.4 Other studies of motives for foreign investment

Many foreign investors are motivated by strategic decisions. Although there are numerous sorts of strategic considerations, we can group them into two categories: those from the standpoint of investors and those from the standpoint of host countries.

CONSIDERATIONS FROM THE STANDPOINT OF INVESTORS Nehrt and Hogue (1968) suggested that companies invest abroad for several purposes:

1 New markets.
2 Raw materials.
3 Production efficiency.
4 New knowledge.

First, many companies attempt to satisfy local demand or expand their markets through foreign manufacturing locations. For example, Japanese automobile manufacturers have built their assembly plants in the USA to satisfy local demand and to expand their market.

Second, oil companies, mining companies, and lumber companies find it difficult or costly to obtain raw materials at home. Hence, they invest their money abroad to obtain these raw materials.

Third, some production efficiency-oriented companies look for low costs of production, such as low labor costs. This is one of the most important reasons why MNCs choose countries in Africa, Asia, and South America for their overseas investment.

Fourth, some companies invest abroad to seek new knowledge and managerial expertise. For example, German, Japanese, and Korean companies have acquired US-located electronic firms for their technology.

CONSIDERATIONS FROM THE STANDPOINT OF HOST COUNTRIES The National Industrial Conference Board (1969) surveyed a sample of 60 nations and found that many developing countries have various incentive programs for private foreign investments. They include tax incentives, tariff exemptions, financial assistance, remittance guarantees, administrative assistance, protection against competitive investments and imports, and protection against nationalization and political risk. These and other incentive programs would undoubtedly motivate MNCs to invest in those nations offering them.

MIXED CONSIDERATIONS Aharoni (1966) studied the process for foreign investment decisions. After surveying 38 American companies that had invested in Israel, he found the following investment motives:

1 Outside proposals, such as those from foreign governments.
2 Fear of losing a market.
3 The bandwagon effect, which means that successful foreign operations reported by a company induce competitors to go abroad.
4 Strong competition from abroad in the home market.

In addition to these four motives, the survey also detected a number of auxiliary motives for foreign investment:

1 Utilization of old machinery.
2 Capitalization of know-how; spreading of research, development, and other fixed costs.
3 Creation of a market for components and other products.
4 Indirect return to a lost market through investment in a country that has commercial agreements with these lost territories.

2.4 A Synthesis of Foreign Trade and Investment Theories

Traditionally, economists concentrated on trade only at the national level, while management scholars focused almost exclusively on the behavior of MNCs. Both groups of scholars thus failed to incorporate trade and investment theories into a single theory of international involvement. This was not a serious problem when foreign trade was largely carried on by intermediaries, while producers remained at home. However, MNCs have recently crossed the confines of individual nation-states to carry on their operations throughout the world. Consequently, motives for foreign trade and investment are too closely interrelated with each other to consider them separately.

2.4.1 Eclectic theory

The **eclectic theory**, associated with Dunning (1981), attempts to explain a logical link between the international allocation of resources and the exchange of goods between countries. In other words, this theory makes the case for an integrated approach to international economic involvement based on the advantages of both a country's location and a company's ownership. Location-specific advantages, such as natural resources and low labor costs, are advantages that are available only or primarily in a single location. Ownership-specific advantages, such as capital funds and technology, are advantages that favor MNCs over local companies. The eclectic theory implies that location-specific advantages favor a host foreign country, while ownership-specific advantages favor an investing firm. Thus, the eclectic theory helps to explain cross-country differences in patterns of MNCs' international involvement.

When a company expands its operations beyond national borders for the first time, it tends to exploit a foreign country's markets through exports. A company favors investment in a foreign country only if it is most profitable for the company to internationalize its advantages in that country. Dunning argues that a company is willing to invest in overseas production facilities if the company has the following three kinds of advantages:

1 Ownership-specific advantages: this is the extent to which a company has tangible and intangible assets unavailable to other firms.

2 Internalization advantages: it is in the company's best interest to use its ownership-specific advantages rather than license them to foreign owners.
3 Location-specific advantages: the company will profit by locating part of its production facilities overseas.

It is important to note that empirical tests of the eclectic theory show that the major part of foreign direct investment is made by large, research-intensive companies in oligopolistic industries. These companies find it profitable to invest overseas because they enjoy both location and ownership advantages.

SUMMARY

Several theories explain the motives for world trade and foreign investment. The theory of comparative advantage and the theory of factor endowments explain why countries exchange their goods and services with each other. The theory of comparative advantage depends on two assumptions. First, economic resources are unequally distributed among nations. Second, efficient production of various products requires combinations of different economic resources and different technologies.

Both the product life cycle theory and the portfolio theory provide a conceptual rationale for foreign investment. The product life cycle theory assumes that a country uses foreign manufacturing locations when products approach their maturity point. The portfolio theory maintains that a company invests overseas because internationally diversified portfolios of assets improve risk–return performance.

A synthesis of foreign trade and investment theories is needed to form a single theory of international economic involvement. We can integrate trade and investment theories into a model that demonstrates how these theories influence a firm's choice of entry mode best suited to a particular country. The eclectic theory postulates that specific factors of both firm and country are necessary for a firm's foreign investment. When it is most profitable for a multinational firm to internationalize its oligopolistic advantages in a given foreign country, it will invest in that country; otherwise, it will exploit the country through exports.

Questions

1 Explain the theory of comparative advantage as a motive for foreign trade. What is the logic behind this theory?
2 The theory of the product life cycle is used as a motive for foreign trade as well as a motive for foreign investment. Discuss this theory as a motive for both foreign trade and foreign investment.
3 What are economies of scale?
4 Describe reasons for trade protectionism.

5 Assume that world leaders attempt to reduce or eliminate artificial barriers to trade through many forms of economic integration. Describe the different types of economic cooperation.
6 What are the major functions of the World Trade Organization?
7 What are the major benefits of market integration?
8 Why do many companies diversify their operations internationally when there are many opportunities for domestic diversification?
9 Explain the oligopoly model as a motive for foreign direct investment.
10 Lee Nehrt and Dickerson Hogue suggested that companies invest abroad for new markets, raw materials, production efficiency, and new knowledge. Discuss each of these four motives for foreign investment.
11 What is the eclectic theory?

Problems

Assume that production possibilities data for the USA and Taiwan are as follows:

		Production alternatives		
Country	Product	A	B	C
USA	Clothing	0	30	90
	Food	30	20	0
Taiwan	Clothing	0	20	60
	Food	15	10	0

1 What is the comparative cost of clothing and food in the USA?
2 What is the comparative cost of clothing and food in Taiwan?
3 Identify the product that each country should specialize in according to comparative advantage.
4 Assume that both countries decided to specialize in a product according to the comparative advantage. With 1 food = 3½ clothing terms of trade, the USA exchanges 10 tons of its food for 35 units of Taiwanese clothing. With the assumption that B is the optimum-product mix, prepare a table such as table 2.2.
5 With a fixed investment of $10,000, the USA produces more in both clothing and food than Taiwan. Does this mean that specialization and trade do not provide any benefits for the USA?

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Case Problem 2: The Fruits of Free Trade Under the World Trade Organization

The essential difference between free trade and protection is this: Under a system of free trade excellence of the product is the only means by which it can secure a market, while under protection an inferior article can dominate the market through the aid of legislation. The necessary effect of free trade is, therefore, to encourage efficiency in production, while the necessary effect of protection is to encourage skill in corruption. Prosperity is an abundance of commodities. The merit of any policy or system can be tested by its effect on the volume of commodities available for the use of the people.

William Bourke Cockran, *In the Name of Liberty*, 1925

In 1947, in Geneva, 23 countries signed the General Agreement on Tariffs and Trade (GATT), a voluntary association of countries designed to promote free trade. GATT members have held many talks since 1947 to expand and promote world trade. As shown in figure 2.3, such talks have resulted in vast tariff reductions for industrialized countries. Many developing countries have implemented similar tariff reductions. These tariff reductions have caused world trade to increase twice as fast as world output since 1950, thereby boosting the standard of living for millions of people around the world.

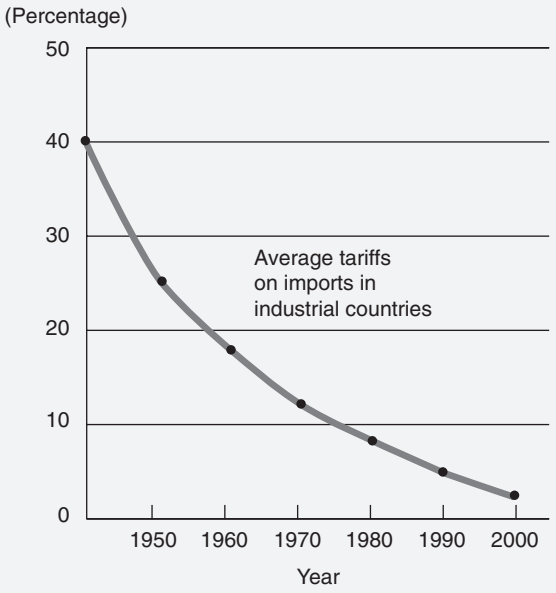

Figure 2.3 Progress on tariffs

Source: John D. Daniels and Lee H. Radebaugh, *International Business*, New York: Addison-Wesley, 2002, p. 263.

The general trend around the world since World War II has been to reduce obvious trade barriers, such as tariffs. Tariff reductions through several rounds of trade negotiations are an indication not only that countries are committed to working jointly toward freer trade but also that tariffs are the easiest trade barrier to tackle. In addition, negotiating rounds have dealt with the increasingly important and complex nontariff issues. Nevertheless, many governments have replaced obvious trade barriers with less obvious forms of protection. A growing number of nontariff barriers, such as those shown in figure 2.4 and others, threaten to undo the good work.

The biggest change to emerge from the Uruguay Round of trade negotiations (1986–93) was the agreement to replace the GATT with the World Trade Organization (WTO). Under the WTO, there is a clearly defined dispute-settlement mechanism. This dispute-settlement system allows small and developing countries to have an influence for the first time in dealing with trade practices in other countries. Further, by bringing cases to the panel, accused countries may agree to settle before a ruling is made. Consequently, the WTO's settlement body has had a much heavier caseload than existed under the old GATT system. China joined the WTO in 2001, thereby further legitimizing the idea of free trade. As of January 2003, the WTO consisted of 144 countries and 34 observer countries, all of which are in the process of applying for membership. Based in Geneva, Switzerland, the WTO has a staff of 550 individuals

Reduced tariff rates lowered trade barriers and helped stimulate economic growth in recent decades. A growing number of nontariff barriers, however, threaten to undo the good. Voluntary export restraints; antidumping laws; government subsidies; licensing, labeling and packaging restrictions; domestic-content laws and others have emerged as the new enemies of free trade.

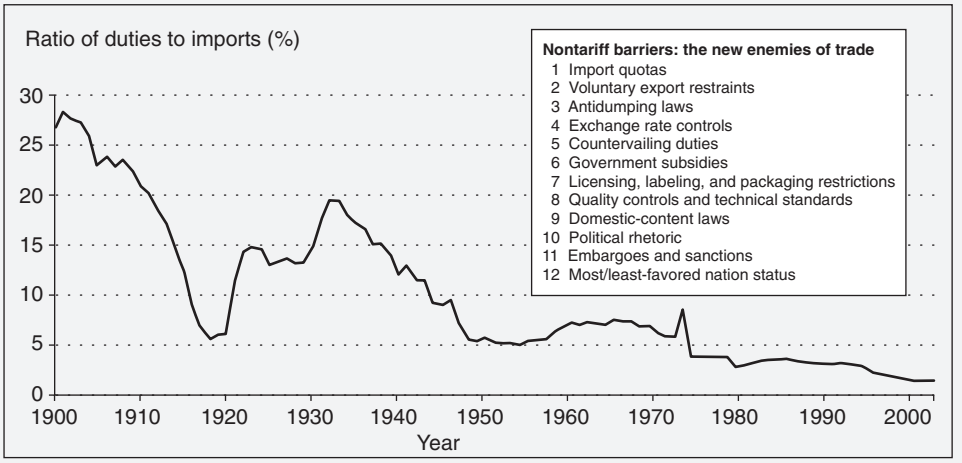

Figure 2.4 The tax on trade

from 60 different countries and a budget of 143 million Swiss francs. Today, WTO members account for 97 percent of world trade.

The WTO is a consensus-based organization: decisions are made by the entire membership. A majority vote is also possible, but it has never been used in the WTO and was extremely rare under the WTO's predecessor, GATT. The WTO's agreements have been ratified in all of the members' legislative bodies. As shown in figure 2.5, the WTO's top-level decision-making body is the Ministerial Conference, which meets at least once every two years. There have been five WTO Ministerial Conferences so far, held in Cancun, Mexico (November 2003), Doha, Qatar (November 2001), Seattle, Washington (November 1999), Geneva, Switzerland (May 1998), and Singapore (December 1996).

Below the Ministerial Conference is the General Council, which meets several times a year in the Geneva headquarters. The General Council also meets as the Trade Policy Review Body and the Dispute Settlement Body. At the next level, the Goods Council, the Services Council, and the Intellectual Property Council report to the General Council and meet frequently. At the last level, numerous specialized committees, working groups, and working parties deal with the individual agreements and other areas such as the environment, development, membership applications, and regional trade agreements.

The WTO Secretariat, with offices only in Geneva, is headed by a Director-General. Because decisions are only made by members, the Secretariat has no decision-making powers. Its main

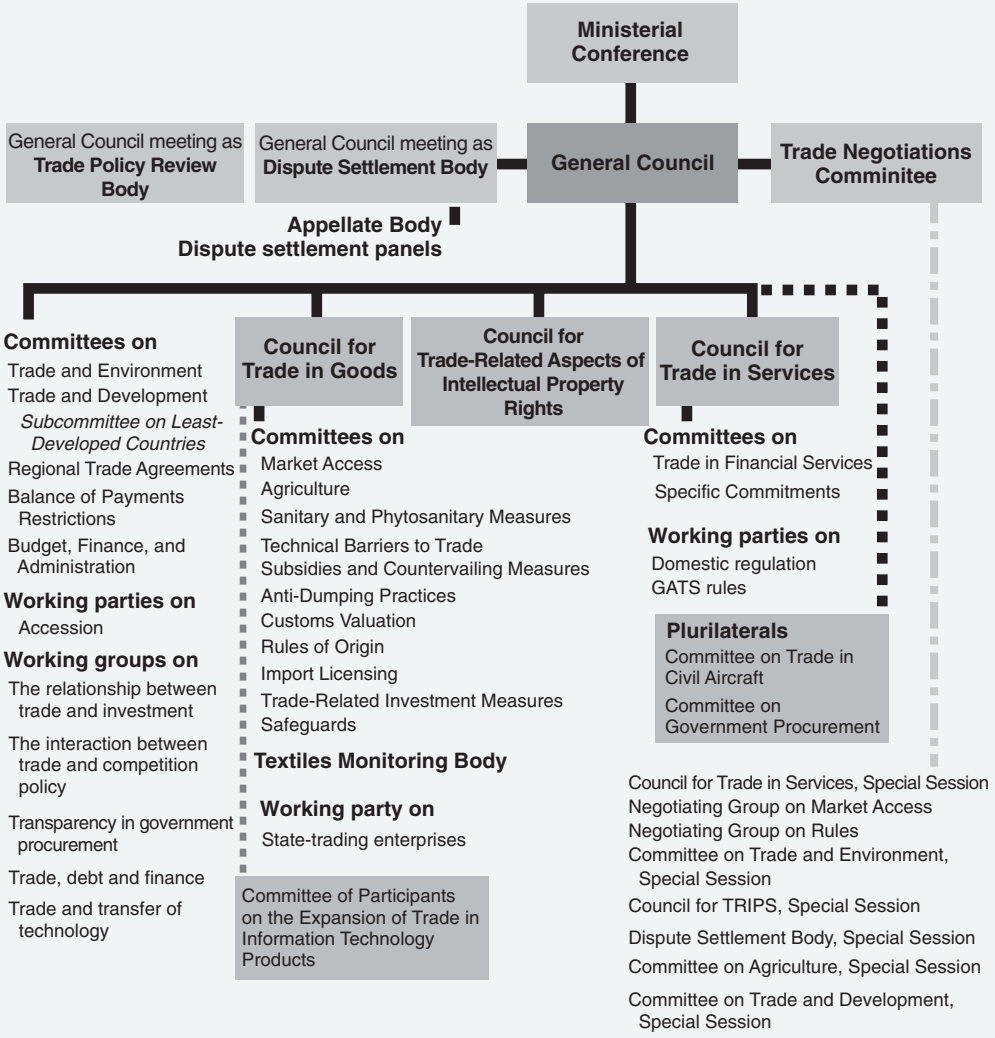

Figure 2.5 An organizational chart of the World Trade Organization

duties are to supply technical and professional support for the various councils and committees, to provide technical assistance for developing countries, to monitor and analyze developments in world trade, to provide information to the public and the media, and to organize the ministerial conferences. The Secretariat also provides some forms of legal assistance in the dispute settlement process and advises governments wishing to become Members of the WTO.

Case Questions

1 What are the main responsibilities of the WTO and what enforcement powers does it have?
2 What are the reasons for protectionism? Would the World Trade Organization consider any of them justified?
3 Many countries have begun to use less obvious trade barriers as a form of protection. What are these different approaches and how do they make the WTO's ability to monitor trade more difficult?
4 Free trade is a highly political issue. Why do you think this is? What steps can be taken to unpoliticize this issue?
5 During the past decade, the WTO has been subject to fierce criticism and attention-grabbing protests from a variety of political and social groups. Complete some independent research on these protests. What are the main criticisms of the WTO that these groups have? Do you think they are justified?
6 The website of the World Trade Organization, www.wto.org, contains a range of information about WTO activities. Use this website to find out what steps the WTO has taken to respond to the protests and criticism. Do you think that these steps are effective?

Sources: Don Ball and Wendell McCulloch, *International Business*, New York: Irwin/McGraw-Hill, 2002, ch. 3; Cletus C. Coughlin, "The Controversy Over Free Trade: The Gap Between Economists and the General Public," *Review*, Federal Reserve Bank of St. Louis, Jan./Feb. 2002, pp. 1–21; John D. Daniels, Lee H. Radebaugh, and Daniel P. Sullivan, *International Business: Environments and Operations*, New York: Addison-Wesley, 2002, ch. 6; and Robert D. McTeer, Jr, *The Fruits of Free Trade: 2002 Annual Report*, Federal Reserve Bank of Dallas, 2002.