International Business and Finance Seminar 10

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Trade and Globalisation

- In previous seminars, we have discussed a lot on the role of multi national enterprises
- To better connect the dots, a hidden layer for why multi national enterprises succeed is trade

Globalisation: Trend toward greater economic, cultural, political, and technological interdependence among national institutions and economies.

Globalisation is characterised by **denationalisation** (national boundaries becoming less relevant)

Globalisation is different from **internationalisation** (entities cooperating across national boundaries)

Globalisation

- **Market Globalisation:** the convergence in buyer preferences in markets around the world
- **Production Globalisation:** the dispersal of production activities to locations that help a company achieve its cost-minimization or quality-maximization objectives for a good or service. This includes the sourcing of key production inputs (such as raw materials or products for assembly) as well as the international outsourcing of services.

Why People Are for and Against Globalisation

For Globalisation

- Increases wealth and efficiency in all nations
- Generates labour market flexibility in developed nations
- Advances the economies & technology of developing nations
- Allows poor countries to profit from their differing circumstances and skills
- It creates some institutions in developing economies that promote democratic values
- It creates tax income for the governments in poor countries

Why People Are for and Against Globalisation

Against Globalisation

- Eliminates jobs and lowers wages in developed nations
- Exploits workers in developing nations
- Creates a wage gap between white-collar and blue-collar occupations in developed nations
- Homogenises our world and destroys our rich diversity of cultures
- Empowers supranational institutions at the expense of national governments
- It increases the environmental damage/pollution in countries without strong protection laws or strong monitoring institutions

Why People Are for and Against Globalisation

We analyze the effect of rising Chinese import competition between 1990 and 2007 on US local labor markets, exploiting cross-market variation in import exposure stemming from initial differences in industry specialization and instrumenting for US imports using changes in Chinese imports by other high-income countries. Rising imports cause higher unemployment, lower labor force participation, and reduced wages in local labor markets that house import competing manufacturing industries. In our main specification, import competition explains one-quarter of the contemporaneous aggregate decline in US manufacturing employment. Transfer benefits payments for unemployment, disability, retirement, and healthcare also rise sharply in more trade-exposed labor markets.

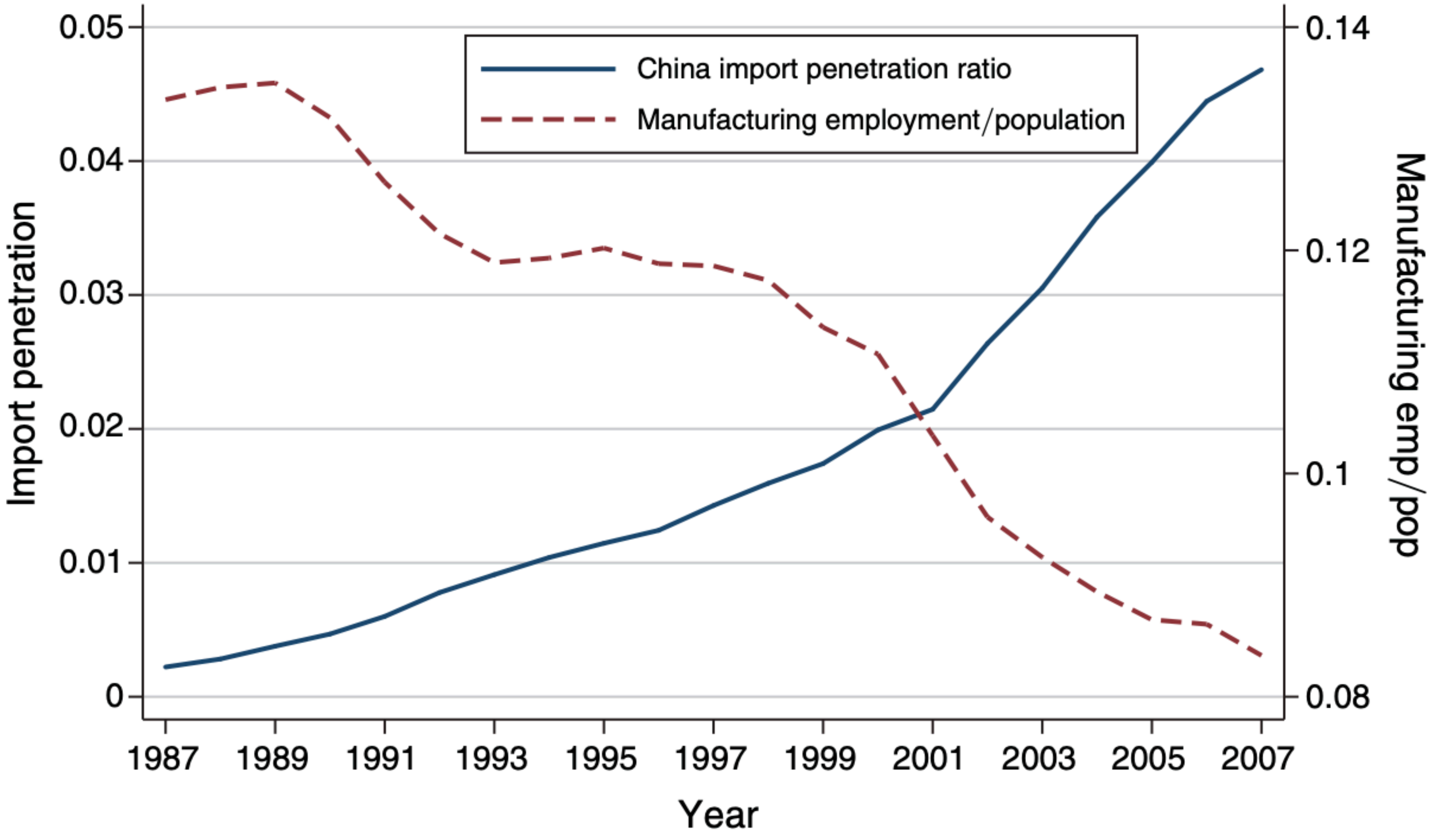

Figure 1. Import Penetration Ratio for US Imports from China (*left scale*), and Share of US Working-Age Population Employed in Manufacturing (*right scale*)

Autor, David H., David Dorn, and Gordon H. Hanson. 2013. "The China Syndrome: Local Labor Market Effects of Import Competition in the United States." *American Economic Review*, 103 (6): 2121-68.

Why People Are for and Against Globalisation

Has rising import competition contributed to the polarization of US politics? Analyzing multiple measures of political expression and results of congressional and presidential elections spanning the period 2000 through 2016, we find strong though not definitive evidence of an ideological realignment in trade-exposed local labor markets that commences prior to the divisive 2016 US presidential election. Exploiting the exogenous component of rising import competition by China, we find that trade exposed electoral districts simultaneously exhibit growing ideological polarization in some domains, meaning expanding support for both strong-left and strong-right views, and pure rightward shifts in others. Specifically, trade-impacted commuting zones or districts saw an increasing market share for the Fox News channel (a rightward shift), stronger ideological polarization in campaign contributions (a polarized shift), and a relative rise in the likelihood of electing a Republican to Congress (a rightward shift). Trade-exposed counties with an initial majority White population became more likely to elect a GOP conservative, while trade-exposed counties with an initial majority-minority population became more likely to elect a liberal Democrat, where in both sets of counties, these gains came at the expense of moderate Democrats (a polarized shift). In presidential elections, counties with greater trade exposure shifted toward the Republican candidate (a rightward shift). These results broadly support an emerging political economy literature that connects adverse economic shocks to sharp ideological realignments that cleave along racial and ethnic lines and induce discrete shifts in political preferences and economic policy.

Autor, David, David Dorn, Gordon Hanson, and Kaveh Majlesi. 2020. "Importing Political Polarization? The Electoral Consequences of Rising Trade Exposure." *American Economic Review*, 110 (10): 3139-83.

Why People Are for and Against Globalisation

Table 2—Exposure to Chinese Import Competition and Cable TV News Viewership, November 2004–November 2012

	(1)	(2)	(3)	(4)	(5)	(6)
Panel A. Combined Nielsen rating of TV news networks						
ΔCZ import penetration × [$t = 2012$]	−0.18	−0.10	0.67	0.54	0.16	0.03
	(0.09)	(0.17)	(0.37)	(0.37)	(0.40)	(0.41)
Panel B. Market share Fox News						
ΔCZ import penetration × [$t = 2012$]	2.86	5.87	5.09	7.31	8.32	10.48
	(1.49)	(2.77)	(5.03)	(4.81)	(5.21)	(5.30)
Panel C. Market share CNN						
ΔCZ import penetration × [$t = 2012$]	−0.51	−1.28	−6.51	−5.37	−4.34	−4.20
	(1.25)	(2.03)	(3.73)	(3.44)	(3.47)	(3.36)
Panel D. Market share MSNBC						
ΔCZ import penetration × [$t = 2012$]	−2.34	−4.58	1.42	−1.95	−3.98	−6.28
	(1.47)	(1.96)	(3.94)	(3.14)	(3.46)	(3.72)
Estimation method	OLS	2SLS	2SLS	2SLS	2SLS	2SLS
F-statistic first stage		45.4	40.6	38.3	27.7	27.7
CZ fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Age-race group fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
CZ industry/occ × [$t = 2012$]			Yes	Yes	Yes	Yes
Presidential election controls × [$t = 2012$]				Yes	Yes	Yes
Census divisions × [$t = 2012$]					Yes	Yes
Age-race group fixed effects × [$t = 2012$]						Yes

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Trade

- Mercantilism: An economic doctrine in which permanent economic growth can be achieved by the accumulation of financial wealth, usually in the form of gold/silver, by maintaining a trade surplus strategy (i.e., encouraging exports and discouraging imports).
- Absolute advantage: When an entity (business or country) can produce a good/goods more efficiently using one unit of resources
- Comparative advantage: When an entity (business or country) is less efficient in the production of all goods, but it is less inefficient in the production of one good.

Trade

Labor hours (for producing 1 unit)	Cars	Bikes
Country A	10	5
Country B	8	2

Opportunity Costs (for producing 1 unit)	Cars	Bikes
Country A	2 bikes	0.5 cars
Country B	4 bikes	0.25 cars

assume that both countries have 2000 labor hours available & both decided to allocate half of those resources to each product

Total outputs (without specialization)	Cars	Bikes
Country A	100	200
Country B	125	500
Total	225	700

Total outputs (with specialization)	Cars	Bikes
Country A	200	0
Country B	25	900
Total	225	900

Foreign Exchange Rate

	iPhone X	iPhone Xs	iPhone 11 Pro	iPhone 12 Pro	iPhone 13 Pro	iPhone 14 Pro
US pre-tax price	$999	$999	$999	$999	$999	$999
US price with tax (NY, 8.875%)	$1088	$1088	$1088	$1088	$1088	$1088
UK actual price in £ (20% VAT)	£999	£999	£1049	£999	£949	£1099
UK pre-tax price in £	£832.5	£832.5	£874.2	£832.5	£790.8	£915.83
UK pre-tax price in $	$1115	$1082	$1075	$1065	$1083	$1025.7
Exchange rate at launch	1:1.34	1:1.30	1:1.23	1:1.28	1:1.37	1:1.12

Foreign Exchange Rate

Risk of Exchange Rate Fluctuations:

Fluctuating exchanges rates cause a problem known as the importer-exporter dilemma:

US importer: $\$ \downarrow \Longrightarrow$ more expensive to import

Foreign exporter to the US market: $\$ \downarrow \Longrightarrow$ Assuming no change in the sale, they can get less due to the exchange rate

Question: You have ordered a new machine from Germany that costs €1 million. On the day of the order, the \$/€ exchange rate was \$1.13/€. The machine will ship in six months, and you expect the exchange rate to change to \$1.23/€. What is the cost of the machine if you pay for it on the day of the order? What is the cost of the machine if you pay for it in six months?

Answer: If you pay for the machine on the day it is ordered, the cost is

$$€1\ million \times 1.13/€ = \$1{,}130{,}000$$

If you pay for the machine in six months when it ships, the cost is

$$€1\ million \times 1.23/€ = \$1{,}230{,}000$$

Because of the change in exchange rates, the cost of the machine rises \$100,000 or about 8.8% higher.

Foreign Exchange Rate

Using a Forward Contract to Lock In an Exchange Rate

Problem

In December 2002, banks were offering one-year currency forward contracts with a forward exchange rate of $0.987/€. Suppose that at that time, Manzini placed the order with Campagnolo with a price of 500,000 euros and simultaneously entered into a forward contract to purchase 500,000 euros at a forward exchange rate of $0.987/€ in December 2003. What payment would Manzini be required to make in December 2003?

Solution

Even though the exchange rate rose to $1.22/€ in December 2003, making the euro more expensive, Manzini would obtain the 500,000 euros using the forward contract at the forward exchange rate of $0.987/€. Thus, Manzini must pay

$$500{,}000 \text{ euros} \times \$0.987/€ = \$493{,}500 \text{ in December 2003}$$

Manzini would pay this amount to the bank in exchange for 500,000 euros, which are then paid to Campagnolo.

This forward contract would have been a good deal for Manzini because without the hedge, it would have had to exchange dollars for euros at the prevailing rate of $1.22/€, raising its cost to $610,000. However, the exchange rate could have moved the other way. If the exchange rate had fallen to $0.85/€, the forward contract still commits Manzini to pay $0.987/€. In other words, the forward contract locks in the exchange rate and eliminates the risk—whether the movement of the exchange rate is favorable or unfavorable.

Quiz Questions

1) Which of the following best defines international business?
A) It includes all economic flows between two or more countries.
B) It includes all private economic flows between two or more countries.
C) It includes all business transactions involving two or more countries.
D) It includes all business transactions in countries other than your home country.
Answer: C

2) Goods and services purchased abroad and brought into a country are called ________.
A) gross domestic products
B) exports
C) gross national products
D) imports
Answer: D

3) Olive oil prepared in a small Italian oil press factory and sold by large supermarkets in the United States is an example of a ________.
A) net national product
B) U.S. export
C) U.S. import
D) gross domestic product
Answer: C

Quiz Questions

4) Christopher, an accounts manager at a mid-sized health care firm, does not have any direct international responsibilities; however, Christopher would most likely benefit from studying international business issues so that he can ________.

A) conduct better job interviews
B) better understand how foreign operations affect the company's competitive position
C) supervise and evaluate subordinates who have global assignments
D) understand the legalities of importing and exporting products overseas
Answer: B

5) A business that has direct investments (in the form of marketing or manufacturing subsidiaries) abroad in several countries is called a ________.

A) dummy corporation
B) shell corporation
C) multinational corporation
D) domestic corporation
Answer: C

6) The rise of a new international entity called the ________ suggests that any company, regardless of age, experience, and resources, can engage in international business.

A) transnational corporation
B) multinational corporation
C) born global firm
D) global firm
Answer: C

Quiz Questions

7) The widening set of interdependent relationships among people from different parts of the world is known as ________.
A) globalization
B) offshoring
C) franchising
D) outsourcing
Answer: A

8) Globalization is characterized by ________.
A) the demise of democracy within a nation
B) national boundaries becoming less relevant
C) the fortification of trade barriers
D) rigid foreign relations policies
Answer: B

9) As a result of globalization, Argonia finds that its national borders are becoming less relevant. This indicates that Argonia is undergoing ________.
A) denationalization
B) standardization
C) reorganization
D) internationalization
Answer: A

Quiz Questions

19) True or False: International business includes all commercial transactions between two or more countries.
Answer: TRUE

20) Summarize each benefit a company might obtain from the globalization of markets.

Answer: The globalization of markets refers to convergence in buyer preferences in markets around the world.
The benefits of the globalization of markets for companies include:
1. Reduces marketing costs-Companies that sell global products can reduce costs by standardizing certain marketing activities. A company selling a global consumer good can make an identical product for the global market and then simply design different packaging to account for the language spoken in each market. Companies can achieve further cost savings by keeping an ad's visual component the same for all markets but dubbing TV ads and translating print ads into local languages.
2. Creates new market opportunities-A company that sells a global product can explore opportunities abroad if its home market is small or becomes saturated. Seeking sales growth abroad can be absolutely essential for an entrepreneur or small company that sells a global product but has a limited home market.
3. Levels uneven income streams-A company that sells a product with universal, but seasonal, an appeal can use international sales to level its income stream. By supplementing domestic sales with international sales, the company can reduce or eliminate wide variations in sales between seasons and steady its cash flow.
4. Local buyers' needs-The benefit of serving customers with an adapted product may outweigh the benefit of a standardized one.
5. Global sustainability-It ensures that development meets the needs of the present without compromising the ability of the future generations to meet their own needs. Most companies today operate in an environment of increased transparency and scrutiny regarding their business activities. The rise of social media is partly responsible for this trend.