Edexcel

A Level

Business studies

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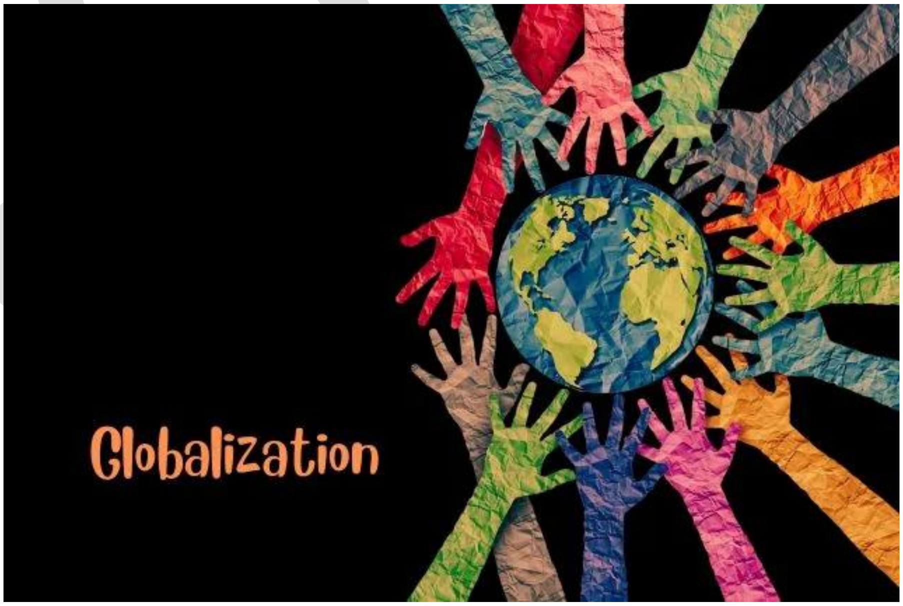
Unit 04-Section 07

Globalization



Chapter 22 Growing Economics

CHARACTERISTICS OF ECONOMIES AT DIFFERENT STAGES OF DEVELOPMENT

There is a vast difference between the welfare and prosperity (i.e. success in making money) of people around the world. People experience a comfortable existence in only a minority of countries. They have access to good healthcare, education, housing and high- quality food. They may also have spare income to spend on non-essential items such as holidays, entertainment and leisure activities.

Economies where these different groups of people live are defined as follows.

Developed economies: In many European countries, the USA, Canada, Japan and Australia most people experience a good standard of living. They live in developed economies, which have the following characteristics.

- High income levels. In developed economies, the average income level is relatively high. According to the World Bank, in 2016, high-income economies were those with an income per capita of $12 476 or more.

- High literacy rate. The majority of people in developed countries can read and write. For example, literacy rates in Germany, the USA and Canada are close to 100 per cent.

- High life expectancy. People in developed countries expect to live for over 60 years. For example, the life expectancy is 85.3 years in Japan, 80 years in the USA and 82.3 years in Italy.

- Good infrastructure. The majority of people in developed countries have access to schools, colleges, healthcare and varying degrees of welfare support (e.g. monetary payments, housing assistance, etc.). There are railway networks, motorways, sewerage systems, electricity grids and telecommunication systems.

- Highly industrialised. Developed economies tend not to rely on the primary sector and to rely more heavily on the tertiary sector.

- Low levels of unemployment. Most people in developed economies can find work. There are laws to protect employees from being exploited and working conditions are generally safe and clean. However, in a minority of developed countries, unemployment has been a problem.

Developing economies: There are more than 200 developing or less-developed countries in the world. Although most of them are in the southern hemisphere, they are not all the same. However, they do share some common characteristics.

- Low income levels. Income levels in developing countries are low or lower middle. According to the World Bank, low-income economies are defined as those with an income per capita of $1025 or less in 2015.

- Low literacy rate. In some developing countries there are not enough resources to educate the entire population. This means it is possible that only a small proportion of the population are able to read and write effectively.

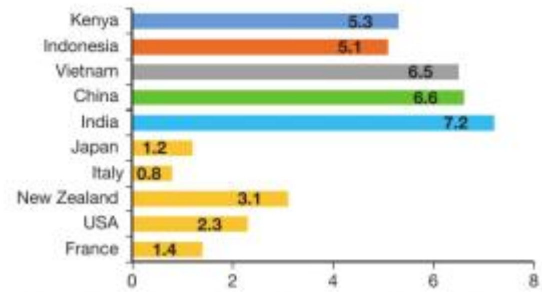
- Low life expectancy. People in developing countries are not expected to live as long as those in the developed world.

- Poor infrastructure. Developing countries have a lack of roads, railway networks, schools, hospitals and production facilities, such as factories.

- Reliance on the primary sector. Many developing countries rely on the primary sector for employment, exports and income.

- High population growth. Many developing nations have high rates of population growth.

Emerging economies: An **emerging economy** could be defined as one with rapid **economic growth** (the increase in a country's productive capacity - usually measured using Gross Domestic Product (GDP]). Some of the important indicators used to reflect levels of economic growth are discussed later in this chapter.



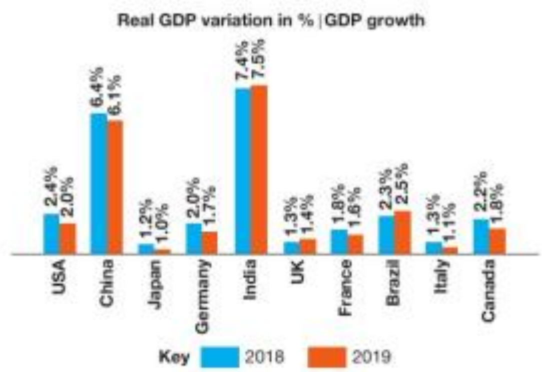
▲ Figure 1 A comparison of growth rates between emerging economies and developed economies (2017)

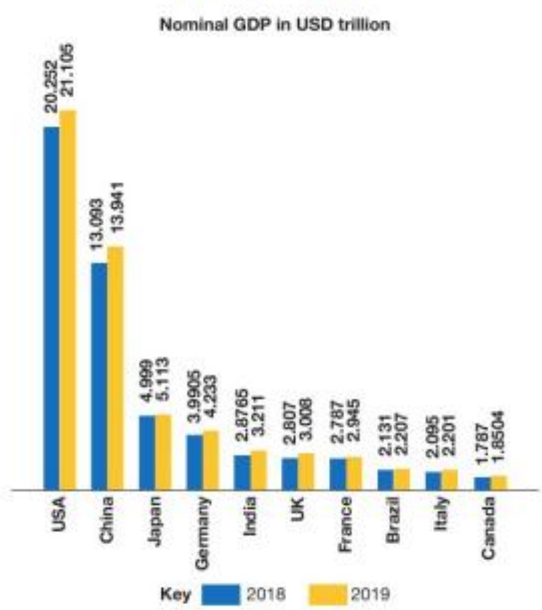
GROWING ECONOMIC POWER OF ASIA, AFRICA AND OTHER PARTS OF THE WORLD

Most of the BRICS and MINT countries have experienced strong growth over the past few years. This growth is increasing the overall economic power of many of the countries in Asia, Africa and other parts of the world.

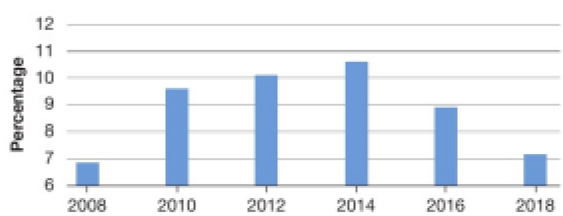
IMPLICATIONS OF ECONOMIC GROWTH FOR INDIVIDUALS AND BUSINESSES

Economic growth in emerging markets may attract new businesses, create trade opportunities, and alter employment patterns. As disposable income rises, demand for goods and services increases, creating income elastic demand. Western businesses like KFC, McDonald's, Pizza Hut, Costa Coffee, and Starbucks are now marketing their products and services in countries like China, India, and Vietnam, thereby creating numerous trade opportunities.





▲ Figure 3 The world's biggest economies for 2018 and 2019



▲ Figure 4 EU unemployment levels 2008–18

Employment patterns: Employment patterns are crucial indicators of an economy's health, affecting growth rates, unemployment rates, labor costs, productivity, and educational qualifications. Unemployment rates reveal job gains or losses, and high unemployment levels may affect consumer spending and export prospects. Developed countries have lower unemployment rates, while developing countries experience higher levels. Emerging economies are experiencing a decline in unemployment rates due to rapid job creation. However, unemployment rates have been a problem since the 2008 financial crisis, with the EU experiencing a rise in unemployment between 2008 and 2013. Future employment trends, such as new technology, also impact manufacturing.

INDICATORS OF GROWTH

A business needs to be able to recognise where an economy is likely to grow to find trade opportunities or investments. There are many indicators of economic growth, including GDP per capita and the Human Development Index (HDI).

Gross Domestic Product (GDP) per capita: GDP per capita measures economic activity by dividing goods and services produced by the number of people in a country. Business interests are influenced by GDP trends. China's 2018 growth rate was high, but down from 2010 and 2011. Government departments and international organizations collect data, but data may not always be consistent or easily verified.

Human Development Index: The Human Development Index (HDI) ranks countries based on life expectancy, education, and income, assessing a country's people and skills, rather than just economic conditions.

- Life expectancy. Life expectancy, the average life duration, is a crucial indicator of a nation's health and healthcare quality. Countries with high life expectancies include Japan, Italy, and Hong Kong, while low-life expectancies include Swaziland and Sierra Leone.
- Mean years of schooling. The average education of a 25-year-old is assessed, but does not consider the quality. Countries with high scores include USA, Australia, Germany, Israel, and Lithuania, while low scores include Burkina Faso, Niger, and Chad.
- Gross National Income per capita (GNI). This calculation illustrates the relative wealth of the population (as measured in PPP$). Countries with a wealthy population in 2016 include Singapore (85020), UAE (72830) and Luxembourg (69 640). In contrast, the poorest populations in 2016 included the Central African Republic (700), Burundi (770) and the Democratic Republic of Congo (780).

SUBJECT VOCABULARY

disposable income the amount of money a household has available to spend and save after paying taxes
economic growth an increase in a country's productive capacity
emerging economies the economies of developing countries where there is rapid growth, but also significant risk
employment people in paid work
Human Development Index (HDI) a collection of statistics that are combined into an index, ranking countries according to their human development
income elastic the percentage change in demand for a product is proportionately greater than the percentage change in income
literacy rate the percentage of adults (over 15) who can read and write
per capita for each person; in relation to people taken individually
PPP$ are the rates of currency conversion that adjust the purchasing power of different currencies by excluding the differences in price levels between countries
primary sector the area of production involving the extraction of raw materials from the earth
tertiary sector the production of services in the economy
unemployment the number of people who are not in work but are actively seeking a job

23. International trade and business growth

WHAT IS INTERNATIONAL TRADE?

International trade benefits the world. It creates opportunities for business growth, increases competition and provides more consumer choice. In more detail, international trade:

- allows countries to obtain goods that cannot be produced domestically
- allows countries to obtain goods that can be bought more cheaply from overseas
- helps to improve consumer choice
- provides opportunities for countries to sell off surplus commodities.

There is a clear difference between visible trade and invisible trade.

- Visible trade involves trade in physical goods.
- Invisible trade involves trade in services.

EXPORTS AND IMPORTS

Businesses that trade internationally export and import goods and services. Exports and imports generate revenue for businesses in different countries. This contributes to business growth.

Exports: The easiest mode of entry into the international market is through exporting. A firm continues to produce in its home market but exports some of what it makes to a foreign market.

Imports: are goods and services brought into one country from another, often regulated by trade barriers such as tariffs. Trade liberalization has reduced the use of tariffs, but non-tariff barriers (NTBs) are becoming more difficult to manage. Firms can export or import directly or indirectly, depending on their needs and demand. Exporting is the easiest way for a firm to enter the international market and is the least risky.

IMPLICATIONS OF INCREASING SPECIALISATION BY COUNTRIES AND BUSINESSES

At the core of the modern exchange economy (and international trade) is the concept of the **division of labour**.

Many more products could be produced than if each worker made the entire product alone. **Specialization** increases the speed and skill with which a task can be done. This saves time, and so improves efficiency. As the market becomes larger, opportunities for specialisation increase.

Specialisation by countries: It is not unusual for countries to specialise in the production of certain goods or services. Countries are likely to specialise if they have developed more efficient production methods than those of their rivals. A country may be more efficient because it has access to cheaper resources such as labour, for example.

Specialisation by businesses: The principle of specialisation can be applied to businesses. Generally, businesses will gain a competitive advantage if they specialise in the production of those products in which they are most efficient. Businesses may enjoy such a competitive advantage for a number of reasons. For example:

- A business may have particular resources that it can use wherever it goes, such as a business model, highly trained and specialised staff, or intellectual property.
- It may have acquired access to local markets, local resources and materials.

- It may be able to better organise and replace separate, cross-border trading enterprises (exporting and importing) with one firm that does it all-organises, manages and controls all trading activities.

Specialisation in production results in greater efficiency. This allows for goods and services to be produced at a lower cost per unit. This enables businesses to reduce prices or to increase profit margins, both of which can lead to business growth.

FOREIGN DIRECT INVESTMENT (FDI) AND LINK TO BUSINESS GROWTH

Businesses often expand into new markets, leveraging competitive advantages like resource ownership, locations, and internal organization to become multinational companies (MNCs) and invest directly in other countries.

Firms may choose to invest directly because the business:

- has a high potential for making a profit if it invests in a new location
- needs to maintain control over its subsidiaries in the new market
- is trying to acquire direct knowledge of the local market
- is attempting to avoid barriers to the market.

Foreign direct investment (FDI) Foreign direct investment (FDI) involves a firm taking over 10% equity stake in a foreign enterprise, unlike foreign portfolio investments which involve holding stocks or bonds but not tangible assets. FDI's main characteristic is control.

So, a firm might prefer FDI over exporting or licensing for many reasons, including the following.

• Managers want to keep tight control over operations in the other country or countries. The businesses may need to share a common culture or communications systems, or they may want to ensure that agreements are enforced.

• A firm wants to protect its intellectual property (such as patents, copyrights, trademarks and management know-how).

• It needs to be close to its customers.

• Its products have high transportation and logistics costs.

• It faces trade barriers or political opposition.

Different forms of FDI: FDI can take many forms, which involve either buying, building or collaborating (i.e. working together).

• A joint venture. This is a collaborative agreement between two parties to invest in a business and share ownership and control (see Chapter 30).

• Strategic alliances. These are collaborations created when firms contract to share resources (often intellectual property in the form of patents or copyrights) or certain skills (such as cultural understanding or managerial expertise).

• Buying through cross-border mergers and acquisitions (M&A). This is the main way that businesses carry out FDI. Most M&As are actually acquisitions, with over 90 per cent of cross-border ventures involving the purchase of the entire target business. There are many reasons for buying other firms, several of which are explored in Chapter 30.

• A firm may build 'greenfield' facilities (i.e. on a site where business activity has not existed before, often in a rural location) if they cannot collaborate, find another firm to buy, or if it is too expensive for one reason or another. Also, many local governments may prevent certain acquisitions in order to protect competition.

Horizontal or vertical FDI: FDI can be horizontal or vertical.

- Horizontal FDI. Horizontal FDI refers to producing the same products or services as is done at home.

- Vertical FDI. This is where one firm wants to acquire materials or support for its own products or services. Basically, the firm is moving into another part of the value chain.

Firms engaged in FDI used to come mainly from developed countries, however, the number and size of multinational corporations coming from emerging market countries, such as China, Brazil, Mexico and South Africa, is increasing.

SUBJECT VOCABULARY

division of labour different workers specialising in different productive activities
exports goods or services that a firm produces in its home market but sells in a foreign market
foreign direct investment (FDI) investing by setting up operations or buying assets in businesses in another country
imports goods and services that are bought into one country from another
international trade exporting (selling abroad) and importing (buying from abroad)
invisible trade trade in services rather than physical products
specialisation a production strategy where a business or country focuses on a limited number of products or services This results in greater efficiency, allowing for goods and services to be produced at a lower cost per unit
tariffs taxes that are imposed on imports
visible trade trade in physical goods

24. Factors contributing to increased globalization

WHAT IS GLOBALISATION?

Many markets today are global. This means that some firms expect to sell their products anywhere in the world. A firm could have a head office in London, borrow money from a bank in Japan, manufacture products in China, deal with customers from a call centre in India and sell goods to countries all over the world.

Some of the key features of globalisation are outlined below.

• Goods and services are traded throughout the world. This means that firms like Toyota, the Japanese car giant, can sell their products as easily in Australia as in India.

• Many people are able to live and work in a country of their choice. This has resulted in more multicultural societies. People from many different nations live and work together, for example in the same city.

• There is a high level of interdependence between countries. This means that events in one economy are likely to affect other economies. For example, the financial crisis in the USA in 2008 had an impact on many economies all over the world.

- Capital flows freely between different countries.

• The sharing of technology and intellectual property (i.e. intangible assets, such as patents, brand names and copyright resulting from creativity) across borders.

TRADE LIBERALISATION, THE REDUCTION OF TRADE BARRIERS AND THE ROLE OF THE WORLD TRADE ORGANIZATION

Trade liberalisation refers to the increased openness of economies and the absence of barriers to trade between nations, thereby promoting globalisation. However, some governments, like the USA and China, have resisted involvement due to potential business exploitation. Recent trade agreements, such as Mexico and the EU's 2018 deal, demonstrate this liberalisation, simplifying customs processes and improving labor, safety, and environmental standards.

Evidence of increasing trade liberalisation is provided by recent trade agreements. Some examples of which are outlined below.

- In 2018, Mexico and the EU agreed on a wide- reaching deal to simplify the customs process. They eliminated tariffs for 'practically all' goods traded between EU member nations and Mexico. It was reported that the agreement allows companies in the EU or Mexico to bid for government contracts abroad. It also makes labour, safety and environmental safety standards clearer.
- In 2018, the USA and South Korea signed a trade deal, limiting steel exports to the US and opening markets to US-made cars and trucks. This change altered the 2012 bilateral agreement, allowing free trade and reducing steel import tariffs.

The World Trade Organization (WTO), established in 1995, plays a crucial role in promoting trade liberalization by promoting free trade and abolishing trade barriers, making it the only international agency overseeing international trade rules.

Trade negotiations: The WTO promotes trade liberalization by encouraging countries to negotiate agreements on anti-dumping, subsidies, and product standards. It establishes procedures for settling disputes, allowing for changes over time due to the constantly evolving nature of businesses.

Implementation and monitoring: The WTO employs various councils and committees. They manage and monitor the application of the WTO's rules for trade in goods, services and intellectual property rights. For example, the WTO may examine trade policies to ensure that trade agreements are clear and well documented. All WTO members must carry out regular reviews of their trade policies and practices.

Settling trade disputes: Trade disputes between members are not unusual. The WTO's procedure for resolving trade disputes is vital for enforcing the rules and making sure that trade flows smoothly. Countries bring disputes to the WTO if they think their rights under their agreements have been broken. The WTO appoints independent experts to make judgements about disputes after the arguments from both sides have been presented.

Building membership: There are around 20 countries which are yet to join. The WTO encourages new members to sign up.

POLITICAL CHANGE

Some radical changes in the political regimes (i.e. a system of government, usually not elected in a fair way) of certain nations have helped to increase globalisation. Some examples of these are outlined below.

• After the end of Communist rule in 1991, old Soviet bloc countries like Latvia, Georgia, Lithuania, Belarus, Estonia, and Moldova gained independence, leading to increased economic growth, trade agreements, EU membership, and liberalization of trade.

• A number of other countries in Eastern Europe wanted political and economic reform as their relationships with the old Soviet bloc were gone. For example, the Berlin Wall was removed which brought together West Germany and East Germany as a single nation. In Romania, Communist leader Nicolae Ceausescu was removed from power in 1989.

• China's economic changes began in the 1970s with agricultural reforms and a large-scale privatization program. Trade opened, China became a WTO member, and now has a successful manufacturing sector. Heavy state expenditure on infrastructure and rising middle class prosperity are seen as signs of advanced economic development.

REDUCED COST OF TRANSPORT AND COMMUNICATION

International transport networks have improved in recent years. The cost of flying has fallen, and the number of flights and destinations has increased. This means that people can travel to business meetings more easily and goods can be transported more cheaply.

contribution to globalisation. Containers are identical metal boxes that can be loaded and unloaded easily from ships, lorries and trains. They provide a flexible means of transporting goods, but most importantly their use has reduced the cost of transportation significantly.

• Before the use of containers it cost $5.83 per tonne to load a ship manually. The use of containers has reduced this to just $0.16 per tonne.

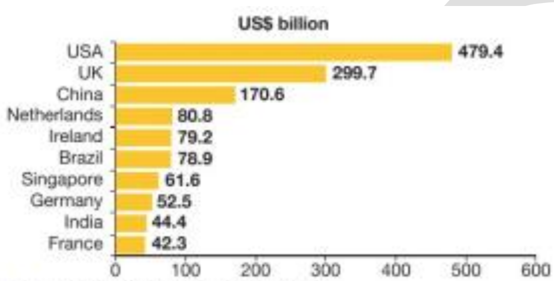
• There has been a 50 per cent reduction in the amount of capital tied up in a tonne of stock in a journey from Hamburg to Sydney.

• The loss to theft has fallen because containers are locked. This has reduced insurance costs.

• Containerisation has significantly increased loading speed, cutting costs and reducing port time. It has also reduced the number of loading ports in Europe from 11 to just three, allowing for larger ships and more efficient transportation.

INCREASED INVESTMENT FLOWS

Foreign direct investment (FDI) involves companies investing in foreign countries, such as construction, mining, or tea plantations. The USA, the UK, and China are the top destinations for FDI. Global FDI flows were predicted to decline in 2017, but inflows to developing economies were expected to stabilize, reaching $653 billion, an increase of 2% over 2016.



▲ Figure 3 Flows of inward investment – 2016

Some specific examples of FDI around the world are outlined below.

• During a tour of Asia in 2018, the King of Saudi Arabia promised to invest around $10 billion in the Maldives tourism industry and $7 billion in the oil sector in Malaysia.

• Spain attracted 385 greenfield FDI projects in 2017, 61 more than the year before and 133 more than in 2015. Greenfield capital investment hit US$13.9 billion in 2017.

• In 2017, UAE attracted US$11 billion in FDI, accounting for 22% of the Middle East and North Africa's total. FDI promotes globalization, job creation, and wealth, and often attracts foreign businesses by offering incentives.

MIGRATION

Migration is the movement of people to live permanently or temporarily in a new location, with Canada planning to welcome 980000 new residents between 2018 and 2021. Migrants contribute to globalisation by importing their cultures and goods from their home countries, such as Eastern European produce in the UK.

• Migrants often provide a supply of low-cost labour to a nation. As a result, businesses can lower their costs and gain a competitive advantage in overseas markets. This helps them to sell more overseas.

• A significant proportion of the money earned by migrants is sent back to their place of birth. This money is usually spent by families and helps to generate demand in these countries. Transnationals are likely to benefit from this increase in demand. So, economic activity is spread around the world by the migrants.

• Some migrants, such as lawyers, doctors, teachers, musicians, writers, academics and Premier League footballers, are highly skilled people. They can help to fill 'skills gaps. Therefore, they make big contributions to businesses and national income.

GROWTH OF THE GLOBAL LABOUR FORCE

The global labour force has grown substantially.

This growth in the size of the global labour market has contributed to globalisation for the following reasons.

• A bigger global labour market helps to influence global demand. This is because people in employment earn money which can be spent on goods and services. Some of this extra demand will be directed at imports sold by MNCs and other exporters.

• The increasing number of people making themselves available for work has negatively affected labour costs, especially in developed countries. This is because the rising supply of labour forces wages down. This has helped to keep costs down and encouraged businesses to expand their activities more widely.

• Some people moving into the labour market will set up their own businesses once they have gained work experience. This will boost the number of businesses globally. Some of the businesses might grow and develop their activities around the world adding another lift to globalisation.

STRUCTURAL CHANGE

The structure of economies is likely to change over time, with primary and secondary sectors contributing less to national income in Western economies. The growth in services provides most income, employment, and wealth. This shift allows businesses and economies to thrive, as higher returns on capital in service industries are often higher.

IMPACT ON BUSINESSES OF GLOBALISATION

Many would argue that the main winners from globalisation are the global companies that develop business interests overseas. Some specific benefits include the following.

• Access to huge markets. Global markets are much bigger than domestic markets. For example, if businesses have access to several billion customers rather than 40 million, this provides huge opportunities to increase sales. This should result in higher sales revenue and increased profit for businesses.

• Lower costs. If businesses are able to grow by selling more output to larger markets, they may be able to lower their costs. This is because as firms grow they can exploit economies of scale.

• Access to labour. Globalisation allows for the free movement of labour, enabling businesses to access a larger pool of workers. This boosts the labour supply, potentially preventing wage increases in markets where unskilled labour is needed. This, in turn, helps businesses lower their costs and maintain a competitive edge.

• Reduced taxation. Global businesses can reduce the amount of tax they pay. They can do this by locating their head offices in countries where business taxes are low. However, some businesses may be threatened by globalisation. There may be a number of reasons for this.

• Competition. Many businesses may face strong competition from overseas companies attempting to enter their markets.

• The power of MNCs Globalisation. allows large MNCs to become very powerful. They can produce very cheaply and start to dominate global markets. This will make it difficult for firms in some markets to survive. MNCs also have huge resources which often allow them to manipulate markets and governments.

• Interdependence. Growing globalisation results in economies becoming more interdependent. This means that an event in one country could have an impact on businesses based in another country.

• Exploitation. Growing globalisation often results in businesses moving operations to countries where the legal system is under-developed.

SUBJECT VOCABULARY

brain drain when highly educated and talented people find jobs overseas
Economic Globalisation Index first measures the economic flows between a country and the rest of the world in terms of international trade and international investment. This shows whether a country exchanges a lot of goods, services and investments with other countries. Second, it measures the restrictions to trade and investment, such as tariffs and capital controls on international investment. Each dimension is based on several variables that are combined in one overall index that ranges from 0 to 100
free trade trade between nations without restrictions from barriers
globalisation the growing integration of the world's economies
multinational companies (MNCs) companies that own or control production or service facilities outside the country in which they are based
remittances the money sent back to their country of origin by overseas workers
trade liberalisation the removal of rules and regulations that restrict free trade
World Trade Organization (WTO) an international organisation that promotes free trade by persuading countries to abolish tariffs and other barriers. It polices free trade agreements, settles trade disputes between governments and organises trade negotiations

25 Protectionism

WHAT IS PROTECTIONISM?

Many governments and businesses might argue that free trade could benefit the global economy. However, sometimes countries believe that it is in their interests to restrict trade. There are several reasons why some governments have opted to use trade barriers.

Preventing dumping: Governments can impose trade barriers if they believe an overseas firm is dumping goods, which is considered unfair competition for domestic producers. In 2016, the US Commerce Department reported Chinese manufacturers dumped truck and bus tyres at below market prices, resulting in 9 million tyres worth $1 billion.

Protecting employment: Trade barriers may be used if domestic industries need protection from overseas competitors to save jobs. Unemployment is undesirable (i.e. not wanted). A government may be criticised if jobs are being lost because of cheap imports.

Protecting infant industries: It is often argued that infant industries need protection. Infant industries are new industries that are not established yet. Many argue that infant industries should be protected from strong overseas rivals until they can grow, become established and exploit economies of scale. However, this approach may not be successful because governments have a poor record when identifying infant industries with potential.

To gain tariff revenue: A government can raise revenue if it imposes tariffs on imports. This money can be spent on government services to improve living standards.

Preventing the entry of harmful or undesirable goods: A government might be justified in protectionism if overseas producers are trying to sell goods that are harmful or undesirable.

Reduce current account deficits: A country might need to use trade barriers because it has a very large current account deficit on the balance of payments. A country has to pay its way in the world. If a current account deficit gets out of control, action may be needed. A government might try to reduce imports and increase exports at the same time to reduce the deficit.

Retaliation: Imposing trade barriers can be a response to retaliation against dumping, where a country imposes heavy taxes on foreign goods. This can lead to a trade war, reducing trade and negatively impacting both nations. In 2018, the USA imposed 25% tariffs on steel and 10% on aluminum imports, leading to China imposing $3 billion tariffs.

National security: Some governments have used trade barriers to protect national security. This argument recognises the threat to a nation if it becomes over-dependent on trade with other countries for its economic sustainability.

TARIFFS

Governments can restrict trade by making imports more expensive, reducing demand for imports and increasing demand for domestic goods. Special taxes on imports, known as tariffs or customs duties, can reduce imports and raise revenue for the government. However, these measures may have limited impact if demand is price inelastic.

Globalisation is accelerating, and an increasing number of countries are allowing foreign business to enter their economies. But, there are many examples of countries imposing tariffs on imports. Here is a selection.

- In 2015, Ecuador imposed tariffs of 21 per cent on imports from Colombia and 7 per cent on imports from Peru. The main purpose of these tariffs was to reduce the negative impact of a stronger US dollar. Colombian and Peruvian officials claimed that the tariffs were a protectionist move and that they were against the principles of the Andean Community (CAN), a customs union formed by Bolivia, Ecuador, Colombia and Peru.
- In 2018, the Indian government raised tariffs on almost 50 product groups, from clocks and kites to television and auto components. The measures follow new duties imposed in December 2017 on electronic goods such as mobile phones and microwave ovens. The highest tariffs were those on fruit and vegetable juices - up to 50 per cent.
- The EU imposes tariffs on imports from a number of countries. Some examples of tariffs imposed on goods from Nigeria in 2018 included those on live animals (15 per cent), meat products (26 per cent), dairy produce (31 per cent) and sugars and sugar confectionery (28 per cent).

IMPORT QUOTAS

Another way of reducing imports is to place a physical limit on the amount allowed into the country. This is called an **import quota**. By restricting the quantity of imports, domestic producers face less of a threat. They will have more of the market for themselves. However, quotas will raise prices because fewer of the cheaper imports are available. An extreme form of quota is an **embargo**.

Placing physical limits on the flow of imports means that some demand for those goods will be met by domestic producers. This improves consumer choice. Some examples of countries using import quotas are given below.

- Japan has made use of use of quotas in recent years.
- In 2018, India imposed a quota of 5 million tonnes on pulses. This was to protect the prices of pulses in India, which had fallen so low that it threatened the survival of many businesses.
- Vietnam uses quotas to control the quantity of sugar coming into the country.

GOVERNMENT LEGISLATION

Countries can reduce imports by requiring goods to meet strict regulations and specifications, or by implementing legislation to prevent entry. Some goods may face administrative barriers, such as restrictions on certain products. Legal import bans aim to protect consumers from potentially harmful goods, such as Australia's import controls for food and animal products.

DOMESTIC SUBSIDIES

Protectionism involves quotas and tariffs to reduce imports, while subsidies to domestic producers can lower prices for consumers and make it easier for domestic businesses to enter foreign markets. Government subsidies can break free trade agreements, but examples include the Japanese government's $65 million in 2012 to reduce reliance on rare-earth imports, and the UK's £528 million to support fossil-fuel projects overseas. Examples include Petrobras in Brazil and Rolls-Royce in Russia.

IMPACT OF PROTECTIONISM ON BUSINESSES

Trade barriers can benefit domestic businesses in the short term by reducing competition from overseas and increasing sales volumes, revenues, and profits. Tariffs on imports can lead to higher prices, which can be used to develop new products or improve production techniques. However, in the long term, businesses benefit more from free trade, which encourages competition, improves efficiency, and leads to increased specialization. Eliminating trade barriers will benefit countries, businesses, and consumers in the long term. However, protectionism can attract retaliation from overseas governments, as seen in the 2018 US and China trade wars. Eliminating trade barriers can lead to a more prosperous and efficient global economy.

SUBJECT VOCABULARY

administrative barriers rules and regulations (such as trading standards and strict specifications) that make it difficult for importers to enter an overseas market
dumping where an overseas firm sells large quantities of a product below cost in the domestic market
embargo a complete ban on international trade – usually for political reasons
import quota a physical limit on the quantity of imports allowed into a country
infant industries new industries that are not established yet
protectionism an approach used by a government to protect domestic producers
subsidy financial support given to a domestic producer to help compete with overseas firms
tax break a tax advantage designed to help businesses
trade barriers measures designed to restrict trade
trade war where two or more countries try to damage each other's international trade by imposing trade barriers

26 Trading blocs

THE EXPANSION OF TRADING BLOCS

RTAS create **trading blocs**. A trading bloc is a group of countries that have signed a regional trade agreement to reduce or eliminate tariffs, quotas and other protectionist barriers between themselves. These countries play a very big role in shaping the patterns of business expansion. Trading blocs can take a number of different forms.

Free trade areas: A free trade area (FTA) removes trade barriers between member states, but maintains different barriers against non-member states. Taxes and excise duties may vary within FTAs.

Customs unions: A customs union is similar to a free trade area, except that the members adopt a common set of barriers against non-members. This means only one set of rules regarding customs duties and rules of origin will apply when a product is shipped from outside the union to any of the member states. Moreover, the product can then be moved freely throughout the countries within the union.

Common markets: A common market is much more integrated than free trade arrangements or customs unions. This is because goods, labour and capital can move freely across the member states. Tariffs are usually removed, and non-tariff barriers eliminated, or at least reduced. Workers can relocate from one country to another without being stopped. All of this integration means that the members of a common market must work together on economic and political policies that affect the market.

Single market: A common market is considered to be the starting point for the creation of a single market.

Borders, standards and taxes are made to be used together if possible, so as not to interfere with the commerce between members. The EU is a single market, but it is also an **economic and monetary union (**see below).

Economic unions: An economic union is a trade bloc with a customs union and common market, aiming for closer economic, political, and cultural ties between member states. The EU is one of the few fully operating economic and monetary unions, while Mercosur and ECOWAS are ongoing.

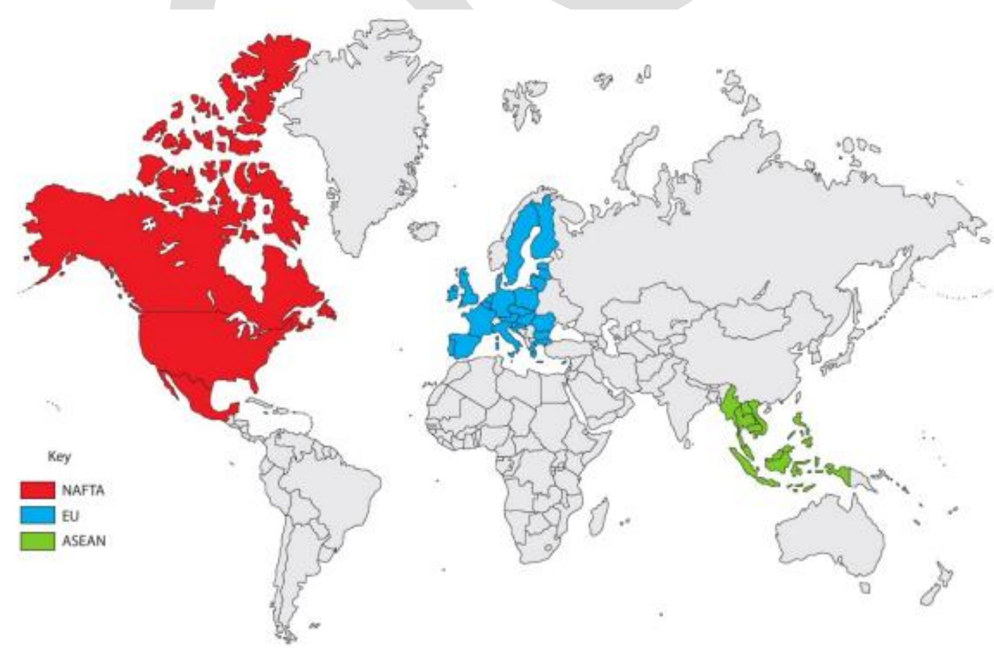
Integration	Common external tariff	No internal trade barriers	Free movement of goods, labour and capital	Common currency
Free trade area		✓		
Customs union	✓	✓		
Common or single market	✓	✓	✓	
Economic and monetary union	✓	✓	✓	✓

▲ Table 1 Integration and trading blocs

Region	Group	Member countries	Date of formation	Type of agreement
Europe	EU	Austria, Belgium, Bulgaria, Croatia, Denmark, France, Finland, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, the UK, the Czech Republic, Poland, Romania, Hungary, Slovenia, Slovakia, Estonia, Lithuania, Latvia, Cyprus, Malta	1993	Economic union
South East Asia	ASEAN	Indonesia, Malaysia, the Philippines, Singapore, Thailand, Brunei, Cambodia, Laos, Myanmar, Vietnam	1967	Free trade area
North and Central America	NAFTA	Canada, Mexico, USA	1994	Free trade area

▲ Table 2 Trading bloc data for the EU, ASEAN and NAFTA, 2015*

*Students are not required to memorise all of the member countries



▲ Figure 1 A map showing the EU, NAFTA and ASEAN trading blocs

THE EUROPEAN UNION AND THE SINGLE MARKET

The European Union, founded in 1993, is the world's most powerful trading bloc. It expanded from six founding members to 28 countries in 2018, overcoming barriers to cross-border trade and transforming from the European Economic Community to the EU.

Some of the key changes brought about by this treaty included:

- economic and monetary union
- a common foreign and security policy
- more power to the European Parliament
- a system for developing co-operation between members on justice and home affairs issues
- pressure on members to become a 'citizen of the Union!

ASEAN FREE TRADE AGREEMENT

ASEAN has an agreement covering trade in goods and one relating to customs, which are part of a drive to create a common market known as the ASEAN Economic Community (AEC). As a common market, it will promote the free flow of goods and services, investment, labour and capital. Areas of co-operation include:

- macroeconomic and financial policy
- labour policies, including education and professional qualifications
- infrastructure and communications
- e-commerce
- regional sourcing (businesses buying more

In 2017, the Philippines took over the chairmanship of ASEAN and made a number of proposals. Examples of these included:

- the development of a trade facilitation index (a measure of the costs associated with overseas trading, such as checks and controls) to assess member countries' customs and clearance procedures
- establishing an e-commerce framework across the bloc
- a system for companies to self-certify (i.e. provide their own proof in writing) for their products' origin, allowing for preferential (i.e. giving an advantage) tariffs in the bloc.

NAFTA

The North American Free Trade Agreement (NAFTA) was established in 1994 and consists of Canada and resources from within the trade bloc. The AEC is an ambitious plan, with some countries ready to integrate, while others are negotiating. It covers trade, investment, labor, financial dealings, intellectual property, and environmental issues.

FACTORS TO CONSIDER IN TRADING BLOCS

There are four key factors to consider in trading blocs.

Where to produce: A company may be able to move to a neighbouring country where the costs of land, labour or capital are most favourable (i.e. give an advantage) to it. They can then ship goods and services to other members.

Where to sell: Companies may view a trading bloc as one big market for their goods and services. This can present opportunities, but also threats.

How to enter a market: The market entry strategy may be adapted according to the opportunities presented by the free trade areas or common market. It can range from new investments through to joint ventures and mergers.

Business strategy: A business may not have been able to export to a neighbouring country because of the existence of trade barriers. Once these barriers are negotiated away as part of a trade agreement, they may be able to do so. For example, once fully operating, the AEC should encourage firms from Vietnam to increase trade with Malaysia.

IMPACT OF TRADING BLOCS ON BUSINESSES

Trading blocs are likely to create both opportunities and drawbacks for businesses.

Opportunities for businesses: Businesses may be able to benefit in a number of ways. There might be certain opportunities that result from operating within a trading bloc.

• Freeing regional trade may allow individual members to specialise in the areas their country already has advantages in.

• The market for firms' goods and services should increase. Trading blocs often do more than reduce tariffs - they may also improve capital flows, make regulations more efficient and improve competition. They may actually improve the market for non-members as well, even if not by as much as for members.

• As the volume of trade increases within the region, producers are able to benefit from economies of scale. This leads to lower costs for them and usually lower prices for consumers.

• Resources may be easier to source and labour easier to recruit, while production and transport costs may continue to fall.

• As trade increases, it may result in greater competition. Therefore, there will be more efficiency in the market.

• Trading blocs may also provide a counterbalance (i.e. to have an equal but opposite effect) against globalisation, protecting industries in an area against predatory (i.e. taking advantage of weaker people or organisations) competitors from more economically powerful regions.

Therefore, for large, well-placed firms, trading blocs offer new potential markets including the prospect of higher efficiency and productivity through larger factories, lower overheads, and faster and possibly less costly logistics.

Drawbacks for businesses: On the other hand, existing businesses within a trading bloc, or those seeking to move to a country within the trading bloc, could face drawbacks and problems.

• Trading blocs may actually harm overall trade. Trade diversion occurs when countries outside a region, such as Indonesia, are excluded from the market due to their better position to specialize or develop a competitive advantage, leading to artificially low prices.

• Inefficient producers may be protected from competition. This may divert trade away from more efficient producers and potentially harm consumers.

• The overall benefits may turn out to be small if an agreement limits the goods/services that are traded.

• Locally, some of the benefits may be distributed unequally, causing political and social tensions within the region.

• Globally, the benefits accrued inside the trading bloc may lead to tensions with other regions, leading to possible retaliation. This would cause further harm to global trade.

• Members of RTAs, especially those in free trade agreements, may have different levels of economic power. This can cause long-term economic and political imbalance and potential conflict.

• For smaller organisations, opening up competition and a larger market may result in more competitors. This can put pressure on their pricing strategies, since larger producers may be able to produce at a lower cost and in a better location.

SUBJECT VOCABULARY

common market a market where goods, labour and capital can move freely across the member states; tariffs are generally removed and non-tariff barriers eliminated, or at least reduced
customs union a union where member states remove all trade barriers between themselves and members adopt a common set of barriers against non-members
economic and monetary union an economic union that uses a common currency
economic union a type of trading bloc involving both a customs union and a common market
free trade area (FTA) a region where member states remove all trade barriers between themselves, but each member state nevertheless keeps different barriers against non-member states
recession a less severe form of economic depression
single market a market where most trade barriers between members have been removed and common laws or policies aim to make the movement of goods and services, labour and capital between countries as easy as the movement within each country
trading bloc a group of countries that has signed a regional trade agreement to reduce or eliminate tariffs, quotas and other protectionist barriers between themselves