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***Introduction***

Nations are commonly grouped into two based on their real income. The two groups are classified as to either Advanced/Rich countries or Poor/Developing Nations. Examples of Rich/Advanced countries include; North America, and Western Europe, Australia, New Zealand and Japan, while Poor/developing nations include; Africa, Asia, Latin America and Middle East countries.

Advanced nations are those with high GDP per capita, longer life expectancies, and higher levels of literacy. Generally, developing nations see international trade that is based on comparative Advantage as a method that economist of the advanced nations propounded to cheat them and prevent economic growth of their nations there by raised skepticism reasons which we shall discuss and evaluate on who does the trade benefits actually ? And whether economists should research more on how to balance the situation currently being practiced for fairness.

**TRADE POLICIES FOR THE DEVELOPING NATIONS**

***1. Reasons for the skepticisms of many developing nations regarding the comparative advantage principle and free trade***

The theory of Comparative advantage means that in order to enjoy maximum benefits of free trade a country should specialized on the production of goods and services that they have comparative advantage over others and make exchange with some other goods that they are disadvantaged and are being produced by other nations. If that happens, interests of all nations are best served by pragmatic, incremental changes in the existing system. Advanced nations maintain that to achieve trading success, they must administer their own domestic and international economic policies.

It is on this ground that developing countries raised the following reasons about comparative advantage and free trade.

*Unstable Export Markets-*

The developing countries generally are not yet into high technological development, therefore they engage mostly on the production of primary commodity products. This makes them to concentrate on the production of single primary commodity products. With bad production season, it placed them at disadvantage position as a poor harvest or decrease in market demand can lead to significantly low export and disruption in domestic income likewise low employment levels. Although from economists’ point of view, the instability of primary products and low revenue is due to low price elasticity of demand and supply of products.

*Worsening Terms of Trade-*

Another reason the developing nations gave is that of worsening terms of trade. That the gains from international trade are distributed among trading partners controversially targeting the developing nations whose exports are concentrated in primary products with a negative motives. They believe that the benefits of international trade accrue disproportionately to the advanced nations.

According to them, the commodities they traded has deteriorated in the past century or so, suggesting that the prices of their exports relative to their imports have dropped. These worsening terms of trade has been used to justify refusal of these developing nations to participate in trade – liberalization negotiations. It has also underlain developing nations’ demand for preferential treatment in trade relations with advanced nations. This reason was supported by the UN study in 1949.

Similarly, Economists in 2004 found out that between 1961 to 2001 the average price of Agricultural commodities sold by developing nations fell by 70% relative to price of manufactured goods purchased from developed nations. Such terms of trade are harmful to developing nations of sub-Saharan African Countries.

*Limited Market Access-*

Average tariff placed on price of primary commodities that is mainly produced by developing countries are placed high for developing countries by the developed nations there by limiting market access of those commodities being traded by the developing nations. Developing nations are also plagued by tariff escalation.

 *Agricultural subsidies of Advanced Nations –* Global protectionism of agriculture are another problem for developing Nations. According to them Farmers in Europe are given subsidies to encourage them in the production of agricultural commodities, subsidies discourage imports as European farmers are likely to engage in large scale production of the same products there by discouraging import or reducing the price of those commodities like rice, cocoa and tea.

***2. Major Methods used to achieve price stabilization***

Due to the high volatile nature of the price of primary commodity products, exports by the developing nations, they formed international commodities agreements (ICAs) this is aimed at stabilizing export prices and revenue of primary commodities to the member countries.

These agreements are between leading producing and consuming nations of commodities like coffee, rubber, cocoa etc. the terms of reference are,; stabilizing prices, assuring adequate supplies to consumers and promoting the economic development of producers.

To actualize the agreements, ICAs have relied on production of Buffer stock, Multilateral Contracts and export controls as major methods of stabilizing prices.

*Production and Export Control-* This is a method that is based on the premise that if the ICA members have large share of total world output of primary commodities, its members may agree on production and export controls to stabilize export revenues. Production and export controls affect the price of commodities by influencing the world supply of the commodity.

*Buffer stock* - This is a method used to limiting commodity price to swings in which producers’ association ( or international Agency) is prepared to buy and sell a commodity in large amount. The buffer stock manager buys from the market when are abundant and prices are falling below acceptable levels, and sell from the buffer stock when supplies are tight and prices are high. Proponents are of the view that the scheme offers the primary producing nations several advantages.

*Multilateral Contracts* – This is a method of stabilizing commodities prices by stipulating a minimum price at which importers will purchase guaranteed quantities from the product from the producing nations and a maximum price at which producing nations will sell guaranteed amounts to the importers. Such purchases and sales are designed to hold prices within target range. The advantage of multilateral contract over buffer stock is the results in less distribution of the market mechanism and the allocation of resources. The result is because the typical multilateral contract does not involve output restraints and thus does not check the development of more efficient low cost producers.

***3. Examples of international commodity agreement and why many of them have broken down***

The examples of international commodity agreement include: The international Cocoa Agreement (ICCAs), the International Coffee Agreement (ICOAs), the International Natural Rubber Agreements (INRAs), the International Sugar Agreements (ISAs), the International Tin Agreements (ITAs) and the International Wheat Agreement (IWAs). These are all agreements formed to control excess production of the primary products to avoid low prices. The ISA and ITA focuses on supply management, but the ITA utilized Buffer stock, the purpose of which is to the price over the period in which export restrictions took effect.

Coffee use to be predominantly Latin American commodity – Brazil and Colombia were the largest exporters. Then the ICOA was modeled as a pure export control agreement and looks as the most successful of all the international agreements. The member countries use the buffer stock.

Almost all the agreements hard one problem or the other. The ISAs for example had never managed to overcome the problems caused by the USA’s 1962 decision to deny access to Cuba, then the largest sugar exporting country in the European Union. The fourth ISA terminated in 1984 and was replaced with an agreement which did not contain market intervention clauses (Gilbert, 1987)

The ICCAs never had the finance to the country coverage to be able to have more than a small effect of the cocoa market (Gilbert, 1987, 1996).

The ITA broke down spectacularly in October 1985 as the result of attempting to defend an unrealistic floor price with insufficient finance (Anderson and Gilbert, 1988).

The ICOA effectively abandoned supply management ambitions in July 1989 and the INRA staggered on until 1999 when the major producing countries gave notice of withdrawal from the agreement.

From the analysis of the formation of these international commodity agreements to their termination, there is no single reason for the breakdown or the lapse of the commodity agreements. The cocoa and sugar agreement terminated because they were ineffective. The Tin agreement collapsed because it was attempting to hold the price at too high a level with too little finance to cover it. It was only the ITA that managed to exist for twenty years. The Coffee and Rubber agreement lapsed rather than collapsed. This was because producing countries government saw little benefit from continued price smoothing, while in the case of coffee, the agreement lost support from consumers and to some extent also producers (Gilbert,1964).

***4. Why the developing nations are concerned with commodity price stabilization***

The developing nations are concerned with price stabilization because small changes in supply or demand often result in small swings in commodity prices and export earnings. Small changes in supply or demand often results in large swings in commodity prices and export earnings. Improving terms of trade threaten the growth of importing nations. Developing economics are often highly dependent on the export of just one or few commodities.

A good example was the case of OPEC, when oil was abundant in the 1970s globally; it limited OPEC ability to raise oil prices. By the 1960s oil was perceived to be short in supply and OPEC realized that market conditions would support substantial increase in the price of oil (www.chegg.com).

***5. How import –substitution and Export Promotion policies used to aid in the industrialization of developing nations.***

Developing nations perceived import substitution and export promotion as a policy that could help in industrializing them. The rationale for import substitution arises from the developing nation’s perspective on trade. Many developing nations feel that they cannot export manufactured goods because they cannot produce better product that can compete with the developed nation especially in the view of the high trade barriers maintained by these nations.

The thirst for economic growth and development has made the developing nations to manufacture for themselves some goods they now import. This will saved the tariffs and quota restrictions on imports and domestic market is reserved for domestic manufacturers.

The import substitution logic is that if a good is demanded and imported, why not produce it domestically? Economist however said that it will be more costly to produce it at home and cheaper to import it; comparative advantage should be decided which goods are imported and which are exported.

The advantages gained in import substitution are:

The risk of establishing a home industry to replace imports is low because the home market for the manufactured good already exists.

It is easier for a developing nation to protect its manufacturers against foreign competitors than to force advanced nations to reduce their trade restrictions on products exported by developing nations.

 To avoid the import tariff walls of the developing nations, foreigners have an incentive to locate manufacturing plants in the nation, thus providing jobs for local workers.

 The export led growth or export policies strategy linked the domestic economy to the world economy. Here the policy said instead of pursuing growth through the protection of domestic industries suffering comparative disadvantage to export resulting from import barriers are counterbalanced by export subsidies. Industrialization is viewed as a natural outcome of development instead of being an objective pursed at the expense of the economy’s efficiency. The export oriented policies has three advantages;

They encourage industries in which developing nations are likely to have a comparative advantage, such as labor intensive manufactured goods.

By providing a larger market in which to sell, they allow domestic manufacturers greater scope for exploiting economies of large scale.

By maintaining low restrictions on imported goods, they impose a competitive discipline on domestic firms that forces them to increase efficiency.

Export led growth policies introduced international competition to domestic markets, which encourages efficient firms and discourages inefficient ones. Y creating a more competitive environment, they also promote higher productivity and hence faster economic growth. Consequently, import substitution policies relying on trade protection switch demand to products produced domestically. Exporting is then discouraged by both the increased cost of imported inputs and the increased cost of domestic inputs relative to the price by exporters.

***6. The strategy that east –Asia used from 1970s to the 1990s to achieve high rates of economic growth. Can the Asian miracle continue in the millennium?***

Among the developing nations of the East Asia, there has been some few number that has recorded economic growth and development between 1970s to 1990s. Notably among them include: Hong Kong, South Korea, Singapore, and Taiwan. Their success story is attributed to high rate of investment, and high and increasing endowments of human capital due to universal primary and secondary education.

To open way for growth and developments these nations invested in their people and provided a favorable competitive climate for private enterprise to flourish. They sought foreign technology such as Licenses, capital good import, and foreign training. They also discourage trade union and thereby blocking legislation making labor wage to be cheap.

Also, Export push strategies were enacted in the eastern Asian economies by the late 1950s and 1960s. Singapore and Hong Kong set up trade regimes that were close to free trade. Japan, South Korea and Taiwan initiated policies to promote exports while protecting domestic producers from import competition. These measures contribute to an increase in the East Asian economies share of the world exports, with manufactured exports accounting for most of this growth.

The East Asian economies have followed a flying – gees pattern of economic growth. Starting gradually and moving to highly technological development by following the nations that are ahead of them climbing the ladder step by step. The flying geese pattern is as a result of market forces. If they continue to pursue new technologies, definitely a total development turn around will continue to happen. This should be a lesson to African leaders to learn from.

***7. How China achieved the status of high performing Asian economy and why China’s normal – trade –relation status has been a source of controversy in the United States and the likely effects of china’s entry into the WTO.***

China is one of the most powerful Asian nations to watch in economic and development success recently. Before 2005, china was not a big nation to reckon with but by 2005 china had grown to be the world’s second largest economy with a national output over half that of United States and 60% larger than Japan’s . China’s giant stride began when they dumped the soviet model and shifted from large scale, capital – intensive industry to small –scale, labor Intensive industry scattered across the country side in the late 1950, but their Agricultural output was not enough to carter for the population and so they became a heavy importer of grains. As a result professional workers were sent out to the field to work.

By 1970, Looking at the prosperity of their neighbors like; Japan, South Korea, Hong Kong and Taiwan, China began to Marketize its economy through small step by step changes to minimize economic disruption and political opposition.

Reforms were made in agriculture and industry to increase the role of producing unit, to increase individual incentives and to reduce the role of state planners. Most goods prices were determined by market forces not government. Greater competition was allowed both between new firms and between new firms and state firms, by 2000, non-state firms manufactured about 75% of china’s industrial output. China also opens its economy to foreign investments and joint ventures. China in summary has parted with import substitution.

China opens its arms to international trade, and imports play a very large role in the Chinese economy. By the first decade of 2000s china had made all of the easy economic adjustment in its transition towards capitalism: letting farmers sell their own produce and opening its doors to foreign investors and sales people. On international trade china had follow the pattern of comparative advantage as explained by endowment theory of Eli Heckscher and Berlin Ohlin. Most of China’s economic expansion since 1970 has been driven by rapid growth in exports and investment spending.

After 15 years of negotiations, China was admitted into the WTO in 2001. It struggle to be a member because it would represent international recognition of its growing economic power, reduce threats of restrictions on the exports and induce the United States to grant china permanent normal trade relations.

China’s growth success is a testament that its economy has become open to international trade and investment.

***8. What led to India in the 1990s to abandon its system of import substitution and what growth strategy did India adopt.***

India is another economy that has recorded success in economic performance following the adoption of freer trade policies. India has a diverse economy from agriculture, handicraft, manufacturing, and a multitude of services. Although, two thirds of Indian is still relying on agriculture, many of the Indians are highly educated and are outsourcing customer services and technical support in this digital era. They are also into consultancy services of data processing. Unlike China India had a better change in exporting services as we have seen above being educated they export the highly skilled man power available. India’s development therefore is more of services than industries.

By 1991, Indian government noted that their system of state controls and import substitution was strangling the economy and that reforms were needed. The requirement that government most approve investment expenditure was terminated, quotas on imports were abolished, export subsidies were eliminated and import tariffs were slashed from an average of 87% in 1990 to 33% in 1994. Also Indian companies were allowed to borrow on international markets and the rupes was devalued. This reform changed India from agrarian, underdeveloped and closed economy into a more open and progressive one that encourages foreign investment and draws more wealth from industry and services. The result has been a dramatic increase in economic growth and falling poverty rates. India’s outsourcing business and auto industry is another two major areas of development recorded that has contributed to the rapid transformation of the incredible India.



**REGIONAL TRADING ARRANGEMENT**

**Introduction**

Since World War II, Under the General Agreement on Tariffs and Trade (GATT) and its successor, the World Trade Organization (WTO). Member nations acknowledged to reduce tariffs and this approached led to reduction on Tariffs throughout the world.

A second Approached was forming regional trading arrangement like the West African Free Trade Zone. Under which member nations are allowed to lower barriers to trade within the Zone or among member nations.

Such regional trading arrangements have been an exception to the principle of nondiscrimination embodied in the world Trade organization. We shall therefore try to discuss how generally the operations of this regional is trading arrangement, the benefits and who it favors and it does not favor.

***1. How trade liberalization exist on a non- discriminatory basis versus a discriminatory basis? And what are some actual examples of each.***

The main purpose WTO exists is to promote trade liberalization through worldwide agreements. And by the year 2000 as WTO was struggling to integrate countries of the world to have worldwide trading arrangement, countries were looking for more narrow way of alternative of regional trading arrangement that may be more beneficial to them. Regional Trade liberalization is different from trading under multinational arrangements. Under regional arrangements, countries open their boarders with no or little barriers to small group rather than all, thus creating a discriminatory against the rest of the world while under WTO trade liberalization is open to all countries of the world without discrimination.

This regional trading arrangement is by their nature discriminatory and is a departure from the principle of normal trading relations, a cornerstone of the WTO system.

This regional trading arrangement makes members not to take interest in the worldwide liberalization because members may not realize additional economies of scale from global trade liberalization, may allow domestic firms’ sufficient production runs to exhaust scale economics. Secondly trade bloc members may want to invest their time and energy in establishing strong regional linkages rather than investing them in global negotiations. But when structured according to principles of openness, and inclusiveness, regional blocs can be building blocks rather than stumbling blocks to global free trade and investment.

Regional blocs can foster global market openings in several ways

First, it may achieve deeper economic interdependence among member states than do multilateral accords because of the greater commonality of interest and the simpler negotiating processes.

Secondly, a Self-reinforcing process is set in place by the establishment of regional free trade areas; as the market encompassed by free trade enlarges, it becomes increasingly attractive for nonmembers to join to receive the same trade preferences as members.

Thirdly, it encourages partial adjustment of workers out of import competing industries in which the nation’s comparative advantage is strong.

The following are examples of Regional Trading arrangements formed: The North American Free trade Agreement (NAFTA) which consists of Canada, Mexico, and the United States as members. The Custom Union agreement called Benelux which comprises of Belgium, the Netherlands and Luxembourg. The common market like the European Union and the West African free trade zone as mentioned earlier.

***2. Economic Integration and the various stages that economic integration can take.***

Economic Integration is the unification of economies policies between different states through the partial or full abolition of tariff and non-tariff (Wikipedia). According to corporate finance institute, economic integration involves agreements between countries that usually include the elimination of trade and aligning monetary and fiscal policies. Economic integration has been one of the main economic developments affecting international trade in the last years. Countries have wanted to engage in economic cooperation to use their respective resources more effectively and to provide large markets for member countries of the resulting integrated areas. Economic integration is sometimes referred to as regional integration as it often occurs among neighboring nations.

When regional economies agree on integration, trade barriers fall and economic and political coordination increases. Specialist in these area said there are mainly seven stages of economic integration: **A preferential trading area, a free trade area, a custom union, a common market, an economic union and economic and monetary union and the complete economic integration** (www.investopedia.com)

1. Preferential trading area - it is a trading bloc that gives preferential access to certain products from the participating countries. This requires the lowest level of commitment to reducing trade barriers. They typically reduce the quantity of goods and services that can be imported. Example of Preferential trading area includes the North American Trade Agreement and the ASEAN free trade area.
2. A free trade area - This is the least restrictive and loosest form of economic integration among nations. In a free trade area all barriers to trade among members are removed.
3. Custom Union – This is one step further in the economic integration processes. As in free trade, goods and services are freely traded among members. In addition, the customs union establishes a common trade policy with respect to non –members. This takes form of a common external tariff whereby imports from non –member states are subject to the same tariff of a common external tariff when sold to any member country.
4. Common Market – it has same features as the custom union but in addition, factors of production are mobile among members. Restriction on immigration and cross boarder investment is abolished.
5. Economic Union – In addition to free movement of goods, services and production factors, it also requires integration of economic policies, taxation and government spending. In addition, a common currency is used by member states and this could involve a system of fixed exchange rate.
6. Economic Monetary Union – This is a type of trade blocs that features a combination of a common market, customs union and monetary union.
7. Complete economic integration – This involves a single economic market , a common trade policy , a single currency , a common monetary policy, together with a single fiscal policy including common tax and benefit rates. In short a complete harmonization of all policies, rates, and economic trade rules.

***3. How do static welfare effects of trade creation and trade diversion relate to a nation’s decision to form a custom Union? And of what importance to this decision is the dynamic welfare effect.***

 Trade creation happens when some domestic production of one customs union member is replaced by another member’s imports with lower costs. This increases welfare in the domestic economy because it is able to have access to lower cost of goods and the resulting gain in consumer surplus exceeds the loss in producer surplus. Trade diversion occurs when the opposite happens: a customs Union member is replaced by another member’s imports with higher costs. This results in decrease in welfare in the domestic economy because the loss in consumer surplus exceeds the gains in producer surplus. Together, these static welfare effects affects a nation’s decision to form a customs Union because when the nation sees that the trade creation effect is greater than the trade diversion effect, it will choose to from a customs union in order to increase its welfare. Conversely when the trade diversion effect is greater than the trade creation effect, the nation will choose to form a customs union in order to avoid the decrease in welfare.

The importance of this dynamic welfare effect includes the following: Regional integration may lead to increase in income due to the static efficiency and also sustained increase in the rate of growth of income. It is likely to improve the investment climate and the economies of scale and spillover effects may provide a rational for regional trading arrangements based on temporarily high external barriers. Significant dynamic gain may also stem from increased competition spurred by regional liberalization.

***4. Why has the so called common agricultural policy been a controversial issue for the Union as determined by empirical studies?***

This was a policy were the European Union called common agricultural policy. Under this policy, subsidies are given to their own farmers. These subsidies lower the price of some crops leading to market distortions. This is the reason why the European Union common agricultural policy has come under a severe criticism several times. It is a policy that is criticized by the developing countries of Africa. It has also been criticized by the small farmers within European Union. It is considered to be one of the most regressive and ill formed policies.

***5. How import – substitution and Export promotion policies used to aid in the industrialization of developing nations***

The theory of Import substitution refers to the development policies of the 20th century, although the theory itself has been advocated since the 18th century and was supported by great economist such as Alexander Hamilton and Friedrich List (Investopedia).

Import substitution is a theory adhered by the developing nations or the emerging economies that seek to decrease in their dependence on developed countries. This idea of Import-substitution for economic development involves utilizing a variety of policy instruments (Tariffs, quotas, and subsidies) to protect the domestic market for many types of manufactured goods. In this regards, efforts are to give incentives or subsidized government loans to the manufacturing sector to produce for the domestic market.

Export promotion on the other hand, refers to those public policy measures which actually or potentially enhance exporting activity at the company, industry, or national level. Although many forces determine the international flow of goods and services, export promotion is one of the principal opportunities that governments have to influence the volume and type of goods and services exported from their areas of jurisdiction abroad. This is good for trade balance and for the overall economy. Export promotion can also have incentive programs designed to draw more companies into exporting. Governments do this by providing assistance in the marketing and post – shipment financing, trade visits, training, trade fairs, and foreign representation. (www.allianceexperts.com).

The two policy strategies often been debated with different view point, but in reality, if properly implemented they could serve as alternative ways for stimulating the growth in the size of markets for manufactured goods and overall economic development of the nations in the following ways:

A country’s importing and exporting activity can influence its GDP, its exchange rates, and its level of inflation and interest rates.

GDP -- A trade surplus contributes to economic growth in a country. When there are more exports, it means that there is a high level of output from a country’s factories and industrial facilities, as well as a greater number of people that are being employed in order to keep these factories in operation.

When a company is exporting a high level of goods, this also equates to a flow of funds into the country which stimulates consumer spending and contributes to economic growth.

Also a high level of import indicates robust domestic demand and a growing economy. If these imports are mainly productive assets like machines, raw materials for processing it is even more value adding for a country since productive assets will improve the economy’s productivity over the long run.

 A growth in imports and exports of a country shows that the country has a healthy economy and consequently a high GDP.

Exchange rates – The relationship between a nation’s export and imports and its exchange rates is somehow complicated because there is a constant feedback loop between international trade and the way a country’s currency is valued. The exchange rate has an effect on the trade surplus or deficit, which in turn affects the exchange rate and so on. For example, a weaker domestic currency stimulates exports and makes imports more expensive; conversely, a strong domestic currency hampers exports and makes imports cheaper. We can see here that one will always complement other if properly watched and utilized.

Inflation and Interest Rates - Inflation and exchange rates affects imports and exports primarily through their influence on the exchange rate. Higher inflation typically leads to higher interest rates.

 So from the above, a stronger domestic currency can have an adverse effect on exports and on the trade balance. Higher inflation can also impact on having a direct impact on input costs such as materials and labor; these higher costs can have a substantial impact on the competitiveness of export in the international trade environment

According to economist, a nation’s merchandise trade balance report is the best source of information to tract its imports and exports and work with it for the benefit of development of country.

**6. SUPPLY AND DEMAND FOR GLOVES: PORTUGAL**

|  |  |  |
| --- | --- | --- |
| Price | quantity supplied | quantity demand |
| 0 | 0 | 18 |
| 1 | 2 | 16 |
| 2 | 4 | 14 |
| 3 | 6 | 12 |
| 4 | 8 | 10 |
| 5 | 10 | 8 |
| 6 | 12 | 6 |
| 7 | 14 | 4 |
| 8 | 16 | 2 |
| 9 | 18 | 0 |

 Price

6a.From the above graph of demand and supply for gloves of Portugal, if Germany supply gloves to Portugal at the price of $2 per gloves Portugal will demand 16 gloves, and could produce only 2 gloves, there for there is a short of 12 glove. With free trade Germany should export 12 gloves to Portugal because it will be cheaper to buy from them than France who cannot.

6b. If Portugal levies a 100% nondiscriminatory tariff on its gloves imports, Germany will export at $4 per glove and France $6 per glove. At $4 Portugal could produce only 6 gloves and the demand is 12 gloves so Germany will export to Portugal 6 gloves to complement the shortage in demand. At $6 Portugal could produce 10 gloves and demand is 6, productions exceed demand. At $6 Portugal does not need imports. So Portugal could import 6 gloves from Germany at $4 to complement the shortage in demand.

6c. suppose Portugal forms a Custom Union with France, and Portugal buy from Germany at $4 and sell to France it will crease trade creation effect of the custom Union. And to France it will be trade diversion.

6d. Suppose Portugal forms custom Union with Germany and Germany sell to France who is more efficient than Portugal it will be trade diversion since France produces more efficient than Portugal.



**INTERNATIONAL FACTOR MOVEMENTS AND MULTINATIONAL ENTERPRISE**

***1. Diversification approaches of Multinational enterprises along Vertical, Horizontal and conglomerate lines.***

Multinational enterprise may diversify their operations along vertical, horizontal and conglomerate lines within the host or source countries.

Vertical diversification - occurs when the parent multinational enterprise decides to establish foreign subsidiaries to produce intermediate goods or inputs that go into production of finished good.

Horizontal diversification – Occurs when a parent company producing a commodity in the source country sets up a subsidiary to produce an identical product in the host country. These subsidiaries are independent unit in productive capacity and are established to produce and market the parent company’s product in overseas markets.

Conglomerate Diversification - This is a development strategy that incorporates new products or services that are diverse from the organization’s current products. That is when the company decides to diversify into areas that are unrelated to its current line of business. The essence is to expand their business operations.

***2 The Major foreign industries in which U.S. businesses have chosen to place direct investments and the Major industries in the United States in which foreigners place direct investments.***

***U.S direct foreign investment abroad –*** U. S. invest in nearly every country through direct foreign investment, but their Major direct investment are in five countries accounted for more than half the total position at the end of 2018. The US directs invest abroad position remained the largest in the Netherlands, at $883.2 billion, followed by the United Kingdom ($757.8 Billion), Luxembourg ($442.2 Billion) and Canada ($401.9Billion).

By industry of the directly –owned foreign affiliates, investment was highly concentrated in holding companies, which accounted for nearly half of the overall position in 2017. Most holding company affiliates, which are owned by U. S, parents from a variety of industries, own other foreign affiliates that operate in a variety of industries. By industry of the U.S. parent, investment by manufacturing MNEs accounted for 54.0% of the position followed by MNEs in finance and insurance (12.1%).

***Foreign direct investment in the United States –*** By country of the foreign parent, five countries accounted for more than half of the total position at the end of 2018. The United Kingdom remained the top investing country with a position of $5609 Billion. Canada ($511.2Billion) moves up as second position, followed by Japan ($484.4 Billion) third position then Netherlands ($479.0 Billion) and Luxembourg ($356.0Billion).Foreign direct foreign investment in U.S. as at 2018. (US Bureau of Economic Analysis, July, 2019)

***3. Why the rate of return on US direct investments in the developing nations often exceeds the rate of returns on its investments in industrial nations.***

Rate of returns are the amounts of gains or net proceeds from investments. Rate of returns is very useful tool to analyses how much the investor tends to gain or lose from investments over a period of time. It measures the percentage change in value of investment over time.

U.S. rate of return on direct invests in the developing countries more than in industrial nations because, investing in developing countries is more profitable due to low prices and lenient regulations.

Also, U.S. foreign direct investment turns developing countries to supply depot through foreign direct investment.

Most of the foreign direct investments U.S. get from developing countries are natural resources extraction and that makes the developing nations dependent on developed nation for proceeds from the natural resources.

The subsidiary expropriation risk is usually higher in developing countries compared to the industrial nations.

***4 The most important motives behind an enterprise’s decision to undertake foreign direct investment***

The most important motives behind an enterprise to undertake foreign direct investment include: Its anticipation of future profits after allowing for risk, the market demand conditions in the area of investment, the cost of labor and transportation, trade restriction and investment regulations. These factors are taken into account before firms decide to undertake foreign direct investments and they affect the level of profit investing enterprises receive.

***5. What is the term multinational enterprise means?***

A multinational Enterprise abbreviated as MNE and sometimes also called Multinational Corporation (MMC) is an enterprise producing goods and services in more than one country. A Multinational enterprise has its national Headquarters in one (or rarely more than one) country, the home country, while also operating in other countries (Eurostat).

***6. Conditions to meet for business who wish to enter foreign markets by exchanging licenses or franchises to local businesses to produce its goods***

Licensing involves granting a foreign firm the right to create a company’s product within a foreign country in exchange for free. These relationship often center on patented technology. A firm that grants a license avoids absorbing a lot of startup costs, but typically losses some control over how its technology is used, including quality control. Profits are limited to the fees collected from the local firm and firms must be aware of the degree of risk to intellectual property loss.

Franchising is an attractive way to enter foreign markets because it requires little financial investment by the franchisor. Local franchise are responsible for the expenses associated with getting their business up and running, that means the franchise get to enjoy only a small portion of the profits made under its brand name. Also local franchise may have different business culture from the parent company without approval.(www.opentextbc,ca/strategicmanagement/)

Once a firm decides to choose foreign production as a method of supplying goods abroad, it must decides whether it is more efficient to establish a foreign production or license the technology to a foreign firm to produce its goods.

International business however are influenced by such factors as production costs, fixed costs of locating overseas, the relative importance of labor and capital in the production process, and the size of foreign market. Another factor is the element of risk and uncertainty. In deciding where to locate the business, management is concerned with possibilities such as currency fluctuations and subsidiary expropriations.

***7. Major issues involving multinational enterprise as a source of conflict for source and host countries***

Although, MNE points out benefits to both the host country where they operate and the source nation investing in the form of additional levels of investments ad capital, creation of new jobs, and development of technologies and production processes.

Critics are of the view that MNEs often create trade restraints, cause conflict with national economic and political objectives and have adverse effects on a nation’s balance of payments. The following are examples of the conflict;

Employment - On employment, it was debated that MNE provide job opportunities for recipient country, critics are of the view that MNE effect on Job creation varies from business to business. For example, where the MNEs buy a local business, instead of creating more Jobs, new technologies will be introduced and even the existing labor force will be down sized. In this case the investment spending may not result in additional production capacity and may not have any effect on job creation.

The source country labor organization may feel the MNE is running away to look for cheap labor in the host country or running to escape collective bargaining of the domestic unions.

Technology Transfer – Donor nations contend that the establishment of production operations abroad by multinational enterprise decreases their export potential and leads to job losses for their workers. By sharing technical skills to foreign nations, workers in the source nation losses job.

National Sovereignty - These are in the area of politics, MNEs effect on economic and political affairs on the host nation, the presence of MNE in a given country results in a loss of a nation’s sovereignty. MNE may resist government attempt to redistribute national income through taxation. By accounting techniques, that shift profits overseas an MNE may be able to evade the taxes of a host nation. This could happen by raising prices of goods of its subsidiary in nations that has modest tax rate to reduce profits on its operations in a high tax nation where most of its business actually takes place.

Balance of payment – MNE can affect a nation’s balance of payment through buying of raw materials and parts or machines from the source nation. The processes strengthen the country’s balance of payments. This is not healthy also to the host nation especially where those raw materials can be harnessed locally.

Transfer Pricing - MNEs also faces controversy of transfer pricing, the pricing of goods within an MNE. For example if goods from the company’s production division may be sold to its foreign marketing division, or inputs obtained by a parent company can come from a foreign subsidiary. The transfer pricing may be purely arbitrary figure which means that it may be unrelated to cost incurred or to operations carried out. The choice of the transfer price may affect the division of profits.

1. ***Is the theory of multinational enterprise essentially consistent or inconsistent with the traditional model of comparative advantage?***

 The multinational enterprise rationale is fundamentally in agreement with the predictions of comparative advantage theory. Corporate managers see advantage of where they can invest with minimum cost and gain more profit and exploit the opportunity. These advantages include access to inputs, available raw materials, new technology and managerial know how.

From the theory of comparative advantage, the rationale is that commodities should be produced in a country where there is access to inputs and can be produced at the lowest cost which is the same with multinational enterprise.

However the difference between comparative cost advantage and multinational enterprise is that , comparative cost advantage theory stresses on movement of merchandise that is movement of goods and services from one country to the country whereas the MNEs is based on movement of factor inputs to host country.

Another difference is that comparative cost advantage presupposes that goods are exchanged between independent organizations on international markets at comparatively determined prices. But MNEs are generally vertically diversified companies whose subsidiaries manufacture intermediate goods as well as finished goods.

***9. Some examples of welfare gains and welfare losses that can result from the formation of international joint ventures among competing businesses***

A joint venture is a business organization established between two or more companies that agree to share and combined their skills of expertise and assets. The business may have a limited objective and can be short lived. It may also be multinational in nature. Reasons for joint ventures can be as a result of government policy, research and development, or oil exploration that needs two or more companies to come together.

The advantages gains from Joint venture include strengthening balance of payment of the host nation, Minimizing dividend transfer abroad and prevent excessive political interfering of the host country. It is also seen as a means of forestalling protectionism against import.

However, there are disadvantages attached to forming joint ventures which include: being a cumbersome organization compare to a single owner company, Control is divided creating the problem of two masters. Success or failure depends on how well companies can work together despite having different objectives, corporate cultures, and ways of doing things. When joint venture ownership is equal, there used to be long board meetings because it created deadlocks.

The welfare gains of a joint venture to the domestic economy includes: The newly established business adds to pre-existing production capacity and foster additional competition.

The joint venture is able to enter new market that their parent company could not have entered individually

The business yields cost reductions that would have been unavailable if each parent performed the same function separately.

There are also welfare losses attaché to joint venture business:

It may give rise to increased market power, suggesting that greater ability to influence market output and price. Such activities may limits competition, reinforce upward pressure on prices and lowers the level of domestic welfare.

***10. What effects does labor migration have on the country of immigration? The country of emigration? The world as a whole?***

Migration increases labor mobility which in turn increases output of production and consequently as workers are used more productivity world output expands in the country where immigrant is recorded.AN example is the U.S. which has an influx of immigrants.

Migration also affects the distribution of income. The gains from in world income resulting from labor mobility are not distributed equally among all nations and factors of production. The country that recorded high immigrants as results of labor mobility is likely to record high income and the ones that lose labor due to emigration will have a contrast of income. The e

Effects of migration however to country of emigration decrease in income and higher wages.

To the world as whole, the effect of labor mobility is to increased income and redistributes income from labor capital. Because emigrants usually move to country that has higher wages.

***Conclusion***

In this study, we have seen that developing nations could not match the advanced nations in the current international trade system. This is due to the types of commodities that they engage in which are primarily agricultural commodities. Their inabilities to key into modern technology and manufacturing sector have placed them at disadvantage position, thereby recodes low development. Among the alleged problems facing them are unstable export market, worsening terms of trade and limited market access. However, some economies of the Eastern Asia who have utilized the Import – substitution and Export promotion and key into modern technology and information and communication have recorded growth in industrialization. Notable among them are China, India and Malaysia.

Furthermore, the formation of various organizations like the WTO, EU, NAFTA, brought in trade liberalization which is aimed at making countries easy to gain access to the international market.

Finally, with the world economy becoming global, movement of factor inputs are being easier for nations that open up the economies for development through the multinational enterprise or foreign direct investment. International labor migrations also has help in increasing output and decreases wages in the countries of migration and for the world as a whole, migration has led to net increase in output.

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