



Rotman Commerce UNIVERSITY OF TORONTO

RSM 480H1 F

Business in the Global Economy

Autumn 2014

Class Meets : Wednesday 2:00 – 4:00 p.m. / WW 126

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Pre-requisites: ECO208Y/ECO209Y, RSM333H

Objectives and Structure of the Course

RSM 480 is organized along three themes:

International Trade
International Finance
International Investment

International Trade

The course introduces (or reviews, depending on the student's experience) the fundamental economic principles of international trade including comparative advantage, gains from trade and the determinants of industrial specialization.

Countries unequivocally gain from trade. On the other hand, individual companies and industries may or may not gain from trade liberalization. Companies that do not gain from trade liberalization tend to be those that have enjoyed the narrow benefits of trade protection. Those that gain are typically those that come to enjoy easier access to expanded markets. The general point is that production efficiency can be expected to be enhanced in all industry as a result of the trade liberalization. From the perspective a particular industry or firm, it is our objective in RSM 480 to understand the extent to which international influences in general, along with impediments to trade and investment in particular, shape opportunities for business.

The vast bulk of international trade is carried on within firms, so-called *intra-firm trade* by transnational enterprise. More than 75 percent of trade in manufactured and processed goods is intra-firm trade. In light of the overwhelming importance of intra-firm trade, and also in view of the relevance for transnational corporate strategy and management, in RSM 480 we extend and adapt the traditional trade model to better understand the

connections between cross-border investment and international trade including how these connections reflect multinational corporate strategy.

Current issues in international trade addressed in the course include the multilateral negotiations at The World Trade Organization and the increasingly regional focus of trade liberalization – NAFTA, European Union, ASEAN and the FTAA. We also examine a number of specific current issues in international business including trade dispute mechanisms, trade in services (with special emphasis on financial services), international aspects of competition policy and the so-called “new protectionism”.

International Finance

RSM 480 includes a selective introduction to international finance. This section of the course includes a critical examination of the parity conditions in international finance. The parity conditions underlie modern explanations of the determinants of exchange rates as well as most models of international interest arbitrage, the cost of capital of multinational enterprise, and foreign exchange hedging techniques. Managerial aspects of international finance dealt with in the course include managing foreign exchange risk and the cost of capital for multinational enterprise.

International Investment

The vehicle for international corporate investment is multinational enterprise. Multinationals engage in *foreign direct investment* – the international transfer and management of capital, technology and production. RSM 480 examines the economic motives for foreign direct investment with a focus on the opportunities and risks involved. Special attention is directed to restrictions, regulations and policies that sovereign countries impose on foreign direct investment.

Complementarity to Other Courses

RSM 480 is complementary to:

RSM 490: *International Business*

RSM 437: *International Finance*

RSM 413: *Globalization and Capital Markets: Political Economy and Investment Strategy*

A Helpful Text: Thomas A. Pugel, *International Economics*, 15th
Toronto: McGraw-Hill Irwin

This is an excellent text, but it is not required. However, those students who do not have a confident grasp of the basics of international trade are strongly advised to refer to Pugel, especially in the first few sections of the course.

Required readings and supplementary material will be posted on BlackBoard.

Evaluation

Mid-term	October 22	30
Essay / Presentation	Due November 13	25
December	Final Examination	45

The Term Paper and In-Class Presentations

Students are required to prepare a paper that addresses an issue in international economics with relevance to international business. The theme must primarily involve some aspect of the international economic environment of business - markets and structure, institutions, national and multilateral policies *et cetera*. It is entirely appropriate, and indeed it is preferred, if the project deals with an international economic issue from the perspective of one industry or even one company. A particularly useful sort of paper is one that examines the success or failure of a particular firm's international strategy and/or operations.

Topics successfully explored in recent years include ...

- Boeing vs Airbus – The Structure of an International Duopoly
- Barrick's Foreign Exchange Risk
- TD Bank's Great American Adventure
- The Korean-US DRAM Trade Dispute
- The Relation Between the Exchange Rate and US Action on Softwood Lumber
- The Ultimate Branding Campaign: Debeers Diamonds
- Effect of Kyoto on the U.S Steel Industry
- Remittance Corridor Canada-Mexico: Opportunities and Obstacles Facing Mexican Casas de Cambio
- Siemens and Power Machines in Russia
- The Development of a "Branded" Boutique Coffee Export from Colombia
- Vietnam and the Global Coffee Industry
- The Global Uranium Industry: Canadian Perspectives
- The Rise and Fall of Nokia
- Nike's Outsourcing
- The Story of Maersk
- The International Story of Red Bull

A proposal (not to exceed 2-3 pages) for the term project must be submitted on or before 8 October. The proposal ought to identify the focus of the project, the proposed structure of the report, the strategic challenges of the company or industry under investigation as well as potential sources of data, information and/or key references. Students may work in groups of **two** if they prefer.

The project report is due 19 November at the beginning of class. Please, no requests for extensions beyond that date. The main points of students' papers will be presented in class on 3 December. Some students will be asked to present a summary of their paper. Other papers will be summarized by the professor. Papers chosen for in-class presentation will be selected in light of relevance to the themes of the course as well as diversity in the set of presentations.

Key points, perspectives and arguments developed in the in-class presentations are “testable” on the final examination.

Lecture Schedule and Readings

<u>Date</u>	<u>Topic and Readings</u>
10/9	<u>Introduction: Course organization. Evaluation</u> The Global Economy and the Firm The major international economic and business issues of 2014
17/9	<u>The Fundamentals of International Economics</u> Canada’s Current Account and Capital & Financial Account Basic Theory of Trade / No Factor Movements Comparative Advantage Gains from Trade, Terms of Trade, The Trade Triangle Factor Intensities & The Composition of Trade Factor Movements / Convergence Engineering Competitive Advantage (The McCain Food Story) Simple Analytics of Tariff Protection <ol style="list-style-type: none">1. Teaching Note on The Simple Analytics of Trade2. “The Elusive Link Between Trade and Wage Inequality”, Paul Krugman, <i>Economist</i>, April 20093. “Gains from Trade when Firms Matter”, Marc Melitz and Daniel Trefler, <i>Journal of Economic Perspectives</i>, Vol 26, No 2, pp 91-118 http://www.aeaweb.org/articles.php?doi=10.1257/jep.26.2.91

Hints for Studying:

As with all introductory treatments of trade, we develop the naïve and crude comparison of 2 countries that at first do not trade and then – wham! – they trade. Beyond the international flow of goods itself, trade effects are observed in product price ratios (changing from national price ratios to an international price ratio) and re-allocation of production in line with *comparative advantage*. The value of all production increases, which represents *gains from trade*. This Ricardian analysis is referred to as the 2x2x2 Model – 2 countries, 2 tradable goods, 2 factors of production. And, incidentally, 1 technology. While simple, stylized and not at all representative of the real world, the 2x2x2 Model is nevertheless a remarkably useful framework for understanding the economic consequences of trade.

We are also interested in the *distributional effects* of trade. Try to think of this in the context of *specific industries*. In the basic model, a country’s factor endowments determine its relative cost structure and hence determines its comparative advantage. This is a highly regarded contribution, but does it still hold today? Note that the traditional

trade analysis proceeds as if factors – capital and labour – are homogeneous, as if there is no economic difference between a shovel and a computer or between a peasant and a rocket scientist. We must go beyond that.

The insights in the paper by Melitz & Trefler are especially important. It focuses on intra-industry while exploring the implications of the fact that world trade is dominated by “huge, innovative and extraordinarily productive firms”. Melitz & Trefler apply clever empirical techniques to demonstrate that trade liberalization enhances innovation and productivity. Much of their attention is on the effects of Canadian trade liberalization via the US-Canada Free Trade Agreement (1989) and the NAFTA (1992).

24/9

Economic Growth, Industrial Productivity and Innovation

International Industry, Imperfect Competition, The Productivity Issue

Major Initiatives in Economic Liberalization

NAFTA, European Union, World Trade Organization

The Story of McCain Foods

1. Gordon Hanson, “The Rise of Middle Kingdoms: Emerging Economies in Global Trade”, *Journal of Economic Perspectives*, Vol 26, No 2, pp 41-64
<http://www.aeaweb.org/articles.php?doi=10.1257/jep.26.2.41>
2. Daniel Schwanen “Trading Up: The Impact of Continental Integration on Trade, Investment and Jobs in Canada”, C.D.Howe Institute, Toronto <http://www.cdhowe.org/pdf/Sch-01.pdf>
3. Antweiler, Werner and Daniel Trefler (2002). “Increasing Returns and All That: A View From Trade”, *American Economic Review*, Vol 92, No 1, March, pp 93-119

Hints for Studying:

What we want to achieve in today’s class is a clear understanding of the economic and industrial effects of interventions in trade – old-fashioned interventions such as tariffs as well as newer forms of intervention including export subsidies. We develop a framework that despite its simplicity has substantial explanatory power. The fundamental idea is that interventions in trade distort prices of traded goods – producers adjust to the distorted prices and consumers in different places pay different prices for similar products and services. We will address these issues through numerous examples in reference, for instance, to steel, agriculture, aircraft, softwood lumber, textiles & shoes and financial services.

One of the more important issues that we explore in these classes is that the underlying economics of production – economies of scale in particular but also the incentives for non-competitive, collusive behaviour – have significant effects on the composition,

volume and directions of trade. This anticipates our discussion of competition policy later in the course.

By the end of these classes, you will have a solid understanding of why nations intervene in trade, the consequences of such interventions and why nations work together to find ways of reaching mutual, enforceable agreements to dismantle barriers to trade and international investment.

1/10 Canada's Trade – Composition and Evolutionary Patterns

1. Macdonald, Ryan, "Not Dutch Disease, It's China Syndrome", Statistics Canada: Micro-economic Analysis Division, 2007
2. Trefler, Daniel (2000). "The Long and the Short of The Canada-U.S. Free Trade Agreement", Industry Canada Research Program – Perspectives on North American Free Trade, Paper Number 6
Summary ...
[http://strategis.ic.gc.ca/epic/internet/ineas-aes.nsf/vwapj/micro200102e.pdf/\\$FILE/micro200102e.pdf](http://strategis.ic.gc.ca/epic/internet/ineas-aes.nsf/vwapj/micro200102e.pdf/$FILE/micro200102e.pdf)

8/10 Conflict in Trade: WTO Decision on Bombardier & Embraer

The history of the case
Why the WTO found Canadian policy unacceptable
Why the WTO found Brazilian policy unacceptable
The structure of the WTO decision
The implications for Bombardier, for Embraer

In addition to the facts of the Bombardier / Embraer case, the objective is to have you come away with an understanding of the WTO process of dispute resolution and the structure of remedies. Following this class you will have a clear understanding of the extent to which export promotion via subsidized finance is permitted within the rules of the WTO as well as the criteria for identifying violation of those rules.

1. Notes to be distributed

15/10 Introduction to International Finance

Markets for Foreign Exchange
International Parity Conditions

Readings:

Brean, Eun & Resnick, International Financial Management, 3rd ed,
Chapter 5

Bailliu, Jeannine and Michael R. King, "What Drives Movements in Exchange Rates?", Bank of Canada Review, Autumn 2005

22/10 **Mid-term Examination**

29/10 Foreign Exchange Risk and Exposure

Defining & Measuring Foreign Exchange Risk
Managing Foreign Exchange Risk

1. Bodnar, Gordon, “Exchange Rate Exposure and Market Value”, in *Mastering Risk: The Complete Finance Companion*, London: Pitmen Press for The Financial Times, 1998, pp.331-319
2. “Management of Transaction Exposure”, Brean, Eun & Resnick: International Financial Management: Chapter 13

Case: Western Mining

5/11 Foreign Direct Investment / Integrative Trade

Strategic Industrial Policy

Applications of Game Theory

Special Topic: The US:EU conflict concerning subsidies to aircraft manufacturers (Airbus : Boeing)

1. Pugel, Chapter 15
2. Hejazi, Walid and A.E. Safarian (2000). “Modeling Links Between Canadian Trade and Foreign Direct Investment”, Industry Canada Research Program – Perspectives on North American Free Trade, Paper Number 6
3. Rajan, Raghuran “Foreign Capital and Economic Growth”
<http://www.imf.org/external/np/speeches/2006/082506.htm>
4. Conference Board of Canada:
How Canada Performs: A Report Card on Canada
Executive Summary, especially pages 4 - 9

12/11 International Taxation

1. D.J.S. Brean, “The Deductibility of Financing Costs to Finance Investments in Foreign Enterprises”, Corporate Finance, Volume V, No.4, 1997
2. Department of Finance (Canada): Report of the Technical Committee on Business Taxation, Chap 6
3. International Tax Arbitrage: The Shell Case
4. Harmful Tax Competition: OECD
5. The WTO decision on the US FISC

19/11

Competition Policy: An International Overview

A useful introduction is ...

<http://www.policyalternatives.ca/publications/competition-policy.pdf>

An excellent source of interesting, current and authoritative commentary of competition policy – frequently with international dimensions – is the EC Competition Policy Newsletter ...

<http://ec.europa.eu/comm/competition/publications/cpn/>

1. The Thomson / Reuters Merger Investigation: a search for the relevant markets in the world of financial data, EC Competition Policy Newsletter 2008, No.2, pp. 61 - 67
2. Mergers: Danone/Numico and Kraft/Danone, EC Competition Policy Newsletter 2008, No.1 at, pages 55 - 58
3. Microsoft, EC Competition Policy Newsletter 2007, No.3, pp. 39 – 44

We will discuss two cases that focus on important market structural issues underlying the analysis of potential market power created through international mergers and/or acquisitions... the proposed and denied GE-Honeywell merger and the proposed and withdrawn Alcan-Alusuisse-Pechiney merger.

Background Reading: Trebilcock, Michael, R. Winter, P. Collins and E. Iacobucci, “Competition Policy and Trade Policy”, in The Law and Economics of Canadian Competition Policy, Toronto: University of Toronto Press (2000)

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Student Presentations

- /12

Final Examination – 2 hours

Summary of Topics, Day by Day

10/9	Introduction: Course organization & evaluation Major International Economic Issues of the Day Canada's National Accounts: International Perspectives
17/9	Fundamentals of International Economics – Industry Perspectives
24/9	Economic Growth, Industrial Productivity and Innovation
1/10	Canada's Trade – Composition and Evolutionary Patterns
8/10	Conflict in Trade: WTO Decisions on Bombardier & Embraer Project Proposal Due
15/10	Introduction to International Finance
22/10	Mid-term Examination
29/10	Foreign Exchange Risk and Exposure
5/11	No Class
12/11	Foreign Direct Investment / Integrative Trade
19/11	International Taxation Term Project Due
26/11	Competition Policy: An International Overview
3/12	Student Presentations
- /12	Final Examination – 2 hours

Missed Tests and Assignments (including midterm examinations)

Students who miss a test or assignment for reasons entirely beyond their control (e.g. illness) may submit a request for special consideration. Provided that notification and documentation are provided in a timely manner, and that the request is subsequently approved, no academic penalty will be applied.

In such cases, students must notify Rotman Commerce on the date of the missed test (or due date in the case of course work) and submit supporting documentation (e.g. [Verification of Student Illness or Injury form](#)) to the Rotman Commerce Program Office within **48 hours** of the originally scheduled test or due date. Students who do not provide Rotman Commerce or the instructor with appropriate or sufficient supporting documentation will be given a grade of 0 (zero) for the missed test or course deliverable.

Note that the physician's report must establish that the patient was examined and diagnosed at the time of illness, not after the fact. Rotman Commerce will not accept a statement that merely confirms a report of illness made by the student and documented by the physician.

INSERT detailed instructions on how student's marks will be handled, for example, a make-up test or re-weighting of another deliverable/text/exam (note that no single essay, test, examination, etc., should have a value of more than 80% of the grade).

Accessibility Needs - The University of Toronto is committed to accessibility. If you require accommodations for a disability, or have any accessibility concerns about the course, the classroom or course materials, please contact Accessibility Services as soon as possible: disability.services@utoronto.ca or <http://www.accessibility.utoronto.ca/>.

Academic Integrity

Academic Integrity is a fundamental value essential to the pursuit of learning and scholarships at the University of Toronto. Participating honestly, respectfully, responsibly, and fairly in this academic community ensures that the UofT degree that you earn will continue to be valued and respected as a true signifier of a student's individual work and academic achievement. As a result, the University treats cases of academic misconduct very seriously.

The University of Toronto's Code of Behaviour on Academic Matters

<http://www.governingcouncil.utoronto.ca/policies/behaveac.htm> outlines the behaviours that constitute academic misconduct, the process for addressing academic offences, and the penalties that may be imposed. You are expected to be familiar with the contents of this document. Potential offences include, but are not limited to:

In papers and assignments:

- Using someone else's ideas or words without appropriate acknowledgement.
- Submitting your own work in more than one course without the permission of the instructor.
- Making up sources or facts.
- Obtaining or providing unauthorized assistance on any assignment (this includes collaborating with others on assignments that are supposed to be completed individually).

On test and exams:

- Using or possessing any unauthorized aid, including a cell phone.
- Looking at someone else's answers
- Misrepresenting your identity.
- Submitting an altered test for re-grading.

Misrepresentation:

- Falsifying institutional documents or grades.
- Falsifying or altering any documentation required by the University, including (but not limited to), medical notes.

All suspected cases of academic dishonesty will be investigated by the following procedures outlined in the *Code of Behaviour on Academic Matters*. If you have any question about what is or is not permitted in the course, please do not hesitate to contact the course instructor. If you have any questions about appropriate research and citation methods, you are expected to seek out additional information from the instructor or other UofT resources such as College Writing Centres or the Academic Success Centre.

Email

At times, the course instructor may decide to communicate important course information by email. As such, all UofT students are required to have a valid UTmail+ email address. You are responsible for ensuring that your UTmail+ email address is set up AND properly entered on the ROSI system. For more information please visit <http://help.ic.utoronto.ca/category/3/utmail.html>

Forwarding your utoronto.ca email to a Hotmail, Gmail, Yahoo or other type of email account is not advisable. In some cases, messages from utoronto.ca addresses sent to Hotmail, Gmail or Yahoo accounts are filtered as junk mail, which means that important messages from your course instructor may end up in your spam or junk mail folder.

Blackboard and the Course Page

The online course page for this course is accessed through Blackboard. To access the course page, go to the UofT Portal login at <https://portal.utoronto.ca/> and log in using your UTORid and password. Once you have logged in, look for the My Courses module where you'll find the link to all your course websites. If you don't see the course listed here but you are properly registered for the course in ROSI, wait 48 hours. If the course does not appear, go to the Information Commons Help Desk in Robarts Library, 1st floor, for help, or explore the Portal Information and Help at www.portalinfo.utoronto.ca/students and review the Frequently Asked Questions.

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