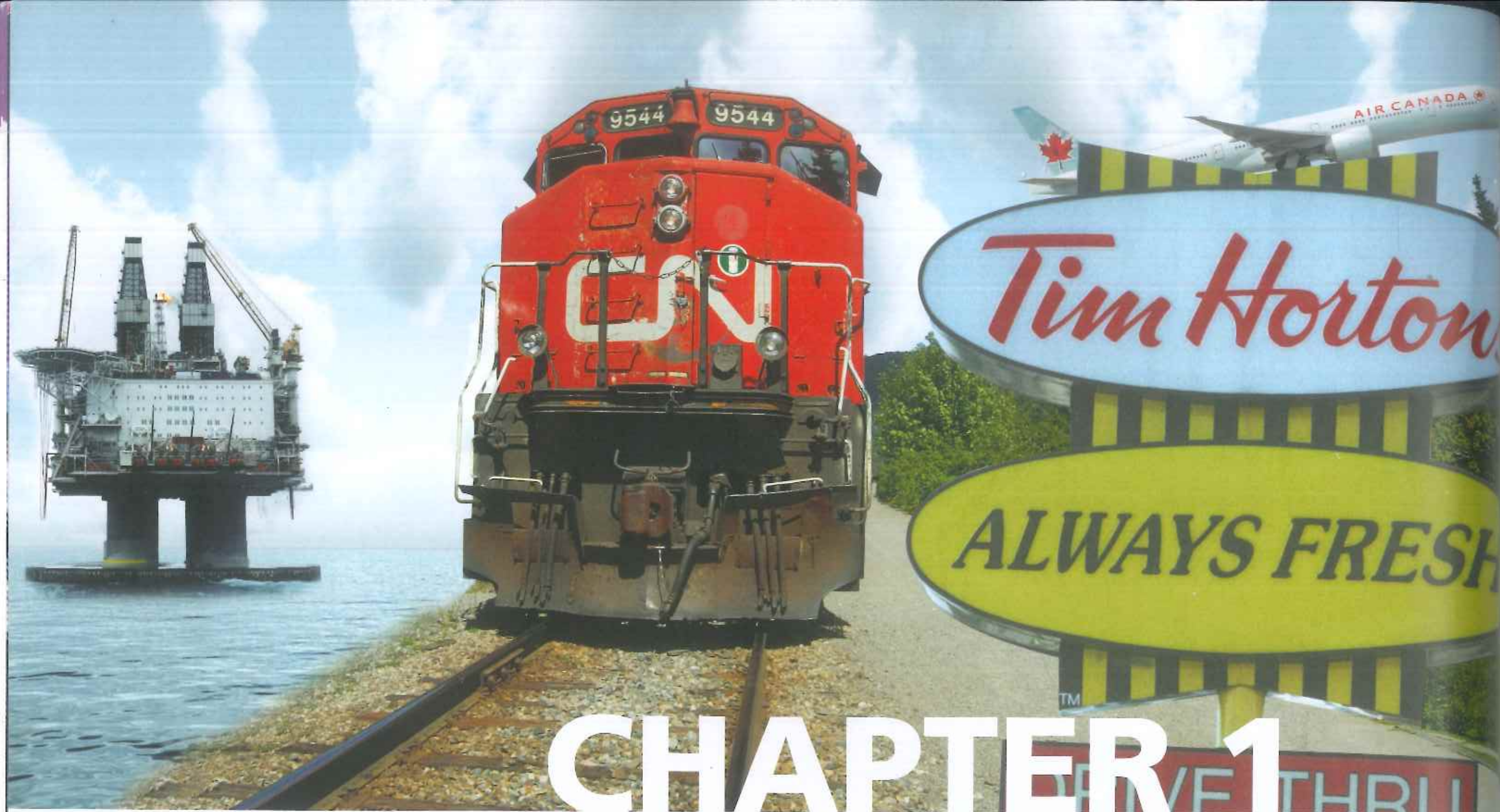


CHAPTER 1

WHAT IS TRADE?

By the time you finish this chapter you should be able to:

- Describe key concepts related to international business
- Explain how and why Canada's major international business relationships have evolved over time
- Demonstrate an understanding of how globalization has affected international business
- Describe ways in which international business activity develops interdependence among nations
- Evaluate the benefits and drawbacks of international trade for Canada
- Explain how the global market has affected consumer demand

Key Terms

- business
- transactions
- domestic business
- international business
- domestic market
- foreign market
- trade
- foreign or international trade
- trading partner
- duty or tariff
- globalization
- interdependence
- primary industries
- secondary industries
- branch plant
- tertiary industries
- service sector
- foreign direct investment
- portfolio investment
- culture industry

International Business Defined

Business is defined as the manufacturing and/or sale of goods and/or services to satisfy the wants and needs of consumers to make a profit. Consider the lemonade stand that you set up when you were nine years old. You manufactured the lemonade out of lemons and sugar (or used frozen concentrated lemonade) and sold it to consumers in the summertime to satisfy their need for something cold to drink. You sold the lemonade for 50¢ a cup, and it cost you 10¢ a cup to make, so you made a profit of 40¢ on each cup you sold. Your lemonade stand was a business.

To conduct business, a company completes various **transactions**. A transaction is an exchange of things of value. For example, selling a used video game to a friend for $10 is a transaction because one thing of value (the video game) has been exchanged for another (money). Your lemonade business consisted of a series of transactions as well. You exchanged money to purchase the ingredients and supplies to make your product, and then exchanged your product for money. Each time you bought a lemon or sold a cup of lemonade, you were participating in a business transaction.

If you bought all of your supplies and ingredients directly from Canadian businesses and sold the lemonade to only Canadian customers, then you were running a **domestic business.** A domestic business is a business that makes most of its transactions within the borders of the country in which it is based. A domestic business in Canada is owned by Canadians, relies primarily on products and services made in Canada, and sells the products it makes and services it provides to people who live in Canada.

Today, it is difficult to be a totally domestic business. Canada relies heavily on imports for much of its machinery and products, so Canadian companies that might appear to be purely domestic businesses, could, on careful examination, make non-domestic transactions. Think about the logging industry for a moment. A logging company cuts trees in a Northern Ontario forest and sells the trees to a pulp and paper mill in Thunder Bay. This seems to be a domestic business, doesn't it? But what if the company buys its logging equipment from China? Or it is owned by an American firm? Or the logging trucks were purchased from a German company? If any (or all) of these things are true, the business is not domestic—it is international. **International business** is the economic system of transactions conducted between businesses located in different countries. This term is also used to refer to a specific company or corporation that conducts business between countries.

International Business

If your lemonade business is large enough, you might negotiate with a supplier to bring truckloads of lemons from Florida or California to you. If you buy your lemons from a supplier in the United States, your business is an international business. Any business that conducts financial transactions outside of its native country is an international business.

If you buy your lemons from a Canadian fruit distributor, this would be a domestic transaction. The type of transaction depends upon the

Chapman's is a domestic business, buying ingredients solely from Canadian companies and selling only to Canadian consumers.

Frank and Ernest

businesses involved, not the product. Domestic transactions are made between two Canadian companies. An international transaction involves a Canadian business and a non-Canadian one.

Consider the sugar you use to make your lemonade. You could buy sugar from a Canadian supplier. Lantic Sugar is a Canadian sugar refinery that buys unprocessed cane sugar from a country such as Cuba and turns it into the white sugar that we use in lemonade. Lantic Sugar also purchases sugar beets from Canadian farmers. Canada has a large sugar beet industry, and refineries use them to provide high-quality sugar to Canadian businesses. If you buy your sugar from Lantic, you are involved in a domestic transaction. If you buy refined sugar directly from Cuba, you are involved in an international transaction.

The customers of your lemonade business are passersby, friends, and neighbours. You have a **domestic market** for your lemonade. A domestic market means that all of your customers live in the country where your business operates. If your business becomes very large and you bottle your lemonade and sell it to businesses in Mexico, then you have a **foreign market**. A foreign market consists of all the customers in a country other than your own. International businesses operate in foreign markets.

International businesses can be companies, government organizations, or even non-profits that mix both domestic and international transactions. There are five main ways for a business to be considered an international business. A business could:

- **Own a retail or distribution outlet in another country.** Tim Hortons is an international business because the company has opened Tim Hortons outlets in the United States.
- **Own a manufacturing plant in another country.** Bombardier, a world leader in transportation products, is an international business because the company has manufacturing plants all over the world.
- **Export to businesses in another country.** Lee Valley Tools is an international business because the company sells its Canadian-made products to retail outlets and dealers in North America, Europe, Australia, Asia, and Africa.

Where Do We Get

Lemons

The Arab world first cultivated lemons, using them in cooking, as an antiseptic medicine, and as a decoration in Islamic gardens. Lemons became a trading commodity throughout the Middle East and the Mediterranean countries between AD 1000 and AD 1150; however, the fruit was not widely grown in Europe until the fifteenth century. Farmers in Genoa, Italy, were responsible for the first real lemon cultivation. A famous citizen of Genoa, Christopher Columbus, introduced lemons to South and Central America in AD 1493. From there, lemon seeds were brought to California and Florida. Most of the lemons available in Canada today come from one of those two states.

Most lemons available in Canada today are imported from the United States, the major supplier of many fruits sold here, including oranges and strawberries.

The equipment found in sporting goods stores in Canada is often made overseas. Running shoes are imported because there is no major Canadian manufacturer of athletic footwear.

- **Import from businesses in another country.** Canadian sporting goods stores are international businesses because they sell running shoes made by companies in other countries (for example, Nike, Puma, Brooks, and Reebok).
- **Invest in businesses in another country.** Etruscan Resources of Nova Scotia is an international business because the company invested in Haber Mining Inc. in the United States, which has developed and owns environmentally friendly technology for processing gold-bearing ores.

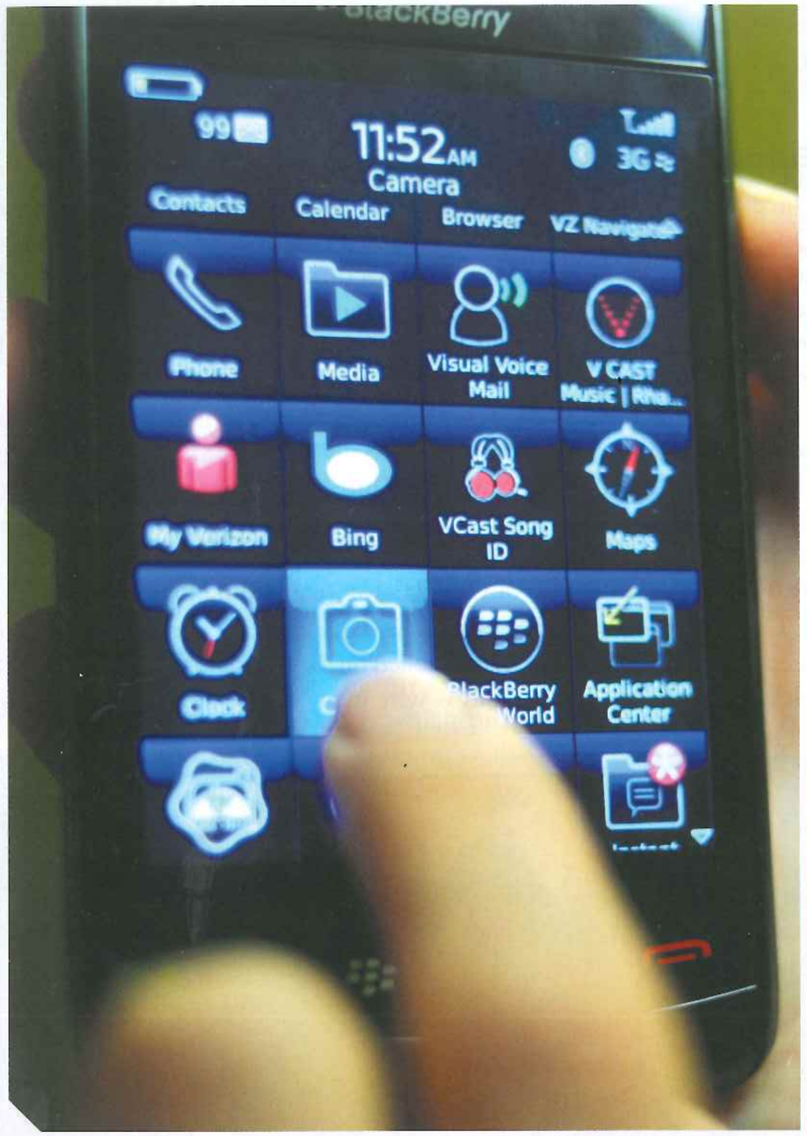
The term **trade** is often used interchangeably with the term business. **Foreign trade** or **international trade** means the same thing as international business. When a business in Canada develops a relationship with a business in another country, that country is then considered a **trading partner** with Canada. It is important to note that international trade occurs between businesses, not countries. Businesses in Ireland (for example, Chivers Jam, Guinness Stout, and Lyon's Tea) sell products to businesses in Canada. Canadian businesses (for example, Weston's Bakery under the Brown Thomas brand, AGF Investments, and Bombardier) sell products and services to businesses in Ireland. Ireland is, therefore, a trading partner of Canada.

Canadians Make

The BlackBerry

Research In Motion (RIM), a company based in Waterloo, Ontario, is responsible for inventing and marketing what is possibly the most popular hand-held device in the world—the BlackBerry. The device can transmit both voice and data and connect to the Internet, and is loaded with features that make it an indispensable part of a typical business executive's day. BlackBerrys are so indispensable, in fact, that they are often called CrackBerrys because they are almost addictive.

Founded in 1984 by Mike Lazaridis and Douglas Fregin, RIM has a large research and development department that continually works to upgrade the designs and features of RIM products. Research In Motion is an international business, with offices in the United States, Europe, and Asia.



The foreign market for the BlackBerry (produced by Canadian-owned RIM) includes customers in countries such as Turkey, India, and Korea.

Think About It!

1.1. Define business.
1.2. What is a transaction? Give an example.
1.3. What is a domestic business?
1.4. Why is it difficult to be a totally domestic business?
1.5. What are the two main sources of sugar for Lantic Sugar?
1.6. What makes up a domestic market?
1.7. What makes up a foreign market?
1.8. List the five main ways for companies to participate in international business.
1.9. What is another word for business?
1.10. When is a country considered to be a trading partner with Canada?

History of Canadian Trade

The Canada we know today exists because of trade. After Columbus's success in exploring the New World and exploiting its riches, other explorers set out to find what lay across the ocean. In the 1600s, ships from France and England landed in what is now Canada, sailing up the St. Lawrence River to Quebec. There they traded with First Nations peoples for fur and food, and sent their treasures back to their home country. This international business was so prosperous that settlers from France and England soon moved to Canada to establish colonies and trading outposts (notably the Hudson's Bay Company and the North West Company).

Many First Nations, notably the Ojibwa and the Cree, traded with the Europeans. Representatives from these nations would often bring the furs (mainly beaver pelts) that they had trapped to European trading posts and exchange them for rifles, blankets, and other goods they needed. First Nations also acted as middlemen, trading furs for prized European manufactured items, and then trading these items for more furs from nations much farther west. The traders would bring the newly acquired furs to the trading posts and strike new deals.

European Trade

Once permanent settlements were established in Halifax, Montreal, Quebec, Ottawa, Kingston, and Toronto during the 1700s, trade grew very quickly. There was little manufacturing taking place in Canada at this time, so finished goods came from British or French businesses overseas. In turn, the demand in Europe for raw materials from Canada (especially beaver pelts, fish, and lumber) grew rapidly.

During this time, France and England were fighting the Seven Years War in both Europe and Canada, especially in Nova Scotia (Louisbourg) and Quebec (Quebec City and the Plains of Abraham, 1759). The defeat of the French led to a greater reliance on trade from England and less on trade from France. Canada's historical connection to Britain remains strong; it is currently one of Canada's top five trading partners.

Canada's geography was shaped in large part by early trade. Traders needed to settle near water, as they relied on ships to send their raw products back to Britain or France. This is why many major Canadian cities have

Many First Nations, including the Cree (shown here at a Hudson's Bay Company trading post in Fort Pitt, Saskatchewan, in 1885), traded with the Europeans for fur and food.

A map of the major fur trade routes used to travel between Canada and Europe.

ports. All of the goods required for settlement came from Europe by ship. The same was true for the United States, as their cities, too, developed near the Atlantic seacoast and inland waterways, such as the Great Lakes. The United States was building its trade economy at the same time that Canada was, and because of the proximity of their cities to our cities, it was only a matter of time before the two countries became trading partners.

Trade with the United States

The United States declared its independence from Britain (and fought for that independence in the American Revolutionary War) in the late 1700s. As a result of the sudden decrease of trade with Britain, the United States had to become self-reliant. This need for independent sources of manufactured goods coincided almost perfectly with the Industrial Revolution.

In 1775, one year before the Americans won independence, James Watt invented the steam engine, which provided cheap power to run machines. American Eli Whitney invented the cotton gin in 1794. The cotton gin was an automated device that separated cottonseed from raw cotton fibres—a job that was exceptionally labour intensive. Whitney's invention increased production of clean, raw cotton dramatically, and revolutionized the cotton industry in the United States, making the cotton industry the profitable backbone of the Southern States.

Other inventions and developments quickly followed, which led to the rapid growth of American industry. Canada, meanwhile, was still dependent upon Britain, which had no interest in developing a manufacturing base so far away from the home country. Instead, Britain used Canada's wealth of natural resources to feed the factories that were springing up in England. Canada also became a supplier of raw materials (notably wheat and timber) to manufacturers in the United States.

The U.S. became a major supplier of cotton in the 1800s, after the invention of the cotton gin.

Impact: Society

Are cheap Chinese imports good for Canada?

Yes: Inexpensive Chinese goods provide a big economic break to Canadian consumers.

No: Importing Chinese goods eliminates manufacturing jobs in Canada.

The early manufacturing lead that America took over Canada is still obvious today. The industrial jobs created by the growth of manufacturing in the United States were labour intensive and required more workers. As immigrants moved to the United States to work, the country experienced huge population growth, and expansion westward. The U.S. grew much faster than Canada, and its plants and factories expanded rapidly as well. During this time, Canadian businesses were mainly resource-based, producing coal, lumber, oil, and agricultural products. Our economy was dependent upon trade with Britain and America for most of the manufactured goods we needed.

The U.S. continues to be our largest trading partner, and American brands can be found everywhere in Canada. The United States still relies upon Canada's raw materials, notably oil and water. Canada's exports to the U.S. in 2008 amounted to $375 billion, and our imports from the U.S. were $227 billion.

Manufacturing jobs are decreasing in both Canada and the United States as cheaper labour and improved technology make it more economical to send manufacturing jobs to Asia.

Table 1.1: Canada's Trade with the U.S. by the Numbers, 2007

■ 21.37	Percentage of U.S. exports that went to Canada, more than any other country
■ 16.03	Percentage of U.S. imports that came from Canada; the only country that imported more was China
■ 331,901	Value (in millions of U.S. dollars) of Canada's exports to the U.S.
■ 220,363	Value (in millions of U.S. dollars) of Canada's imports from the U.S.

Top Ten Domestic Exports to the U.S.

Product	Value (millions of CAD)
Crude petroleum oils	41,539
Motor vehicles (capacity > 3000 cc)	32,201
Natural gas	27,151
Trucks	8,019
Motor vehicles (capacity: 1500–3000 cc)	6,892
Heavy petroleum oil preparations	6,629
Lumber	5,536
Light petroleum oil preparations	5,288
Medications—in dosage	3,680
Parts and accessories of motor vehicle bodies	3,648
TOTAL (all domestic exports)	331,901

Top Ten Imports from the U.S.

Product	Value (millions of CAD)
Motor vehicles (capacity > 3000 cc)	7,498
Motor vehicles (capacity: 1500–3000 cc)	7,265
Trucks	6,058
Parts and accessories of motor vehicle bodies	5,446
Reciprocating piston engines	5,097
Gear boxes (transmissions) for motor vehicles	3,145
Natural gas	2,948
Heavy petroleum oil preparations	2,684
Motor vehicle parts	2,486
Aircraft	2,128
TOTAL (all imports)	220,363

Source: Industry Canada

Trade with Asia

Canada's trade with Asian countries is very modern. Canada started trading with Japan after World War II, in the late 1940s, when Japan's industries were rebuilt after being virtually destroyed by Allied bombing. Japan's economy grew rapidly. Japan's modern factories began to produce high-quality electronic products such as radios, televisions, cameras, and computers. Towards the end of the twentieth century, Japan also became known for its automobiles and high-tech equipment. Japan is now one of Canada's top five trading partners. Canadian businesses imported $15 billion worth of goods from Japan in 2008, and exported $11 billion in goods to that nation in the same year.

Within the past thirty years, China has emerged as a major economic force. A liberalization of communist economic policies has led to free enterprise being promoted in several Chinese districts. Cheap and abundant labour has encouraged businesses from the West to develop partnerships with Chinese firms. Two-thirds of China's exports are from factories that foreign investors own, either outright or in partnerships with Chinese firms. Chinese-made products are well made and inexpensive; as a result, they have become very popular with North American retailers. Walmart, for example, buys $15 billion worth of goods from China. Today, China is one of Canada's top five trading partners, accounting for over $42 billion in imports, and $10 billion in exports in 2008.

Think About It!

1.11. Who were Canada's first trading partners?

1.12. When did trade with Asia become important?

1.13. Why is Mexican trade now important to Canada?

1.14. What is a duty or tariff?

1.15. Why do countries impose duties on imported products?

Trade with Mexico

The growth of Canada's trade with Mexico is a very recent development, spurred completely by the North American Free Trade Agreement (NAFTA), which was signed in 1993. As a result of NAFTA, goods made in Mexico and the United States can enter Canada duty-free. A **duty** (or a **tariff**) is a tax most countries place on imports in order to make the price of domestic goods competitive. Duties increase the price of foreign imports. Perhaps your parents have paid duty on goods they purchased while vacationing in another country and brought back to Canada.

Mexican imports to Canada are now duty-free because of NAFTA, so Canadian businesses find Mexican goods to be a bargain. As a result, imports have greatly increased since NAFTA was signed. Imports from Mexico rose from $13 billion in 2004 to almost $18 billion in 2008. For the same reason, Canadian exports to Mexico have increased, from just over $3 billion in 2004 to just under $6 billion in 2008. Mexico has become one of Canada's top five trading partners within the last decade.

Table 1.2: Top Five Items Canada Trades with Mexico

Rank	Imports	Exports
1	Electrical machinery	Vehicles
2	Vehicles	Electrical machinery
3	Other machinery	Grain/seed/fruit
4	Mineral fuel, oil	Other machinery
5	Furniture/bedding	Iron and steel

Source: International Business Information, Industry Canada

Many Canadians buy electronics manufactured in and imported from Asia.

Dubai has grown into the real estate, tourism, and financial hub of the Middle East.

Trade with Emerging Markets

Canada's trade with emerging markets has, historically, helped shape our economy. Japan was an emerging market in the early 1950s and Mexico was in the 1980s. Today's emerging markets could become Canada's major trading partners in the years ahead.

The Middle East

Canada's trade with the Middle East centres around one commodity—oil. There are currently a number of problems in the Middle East that restrict the trade Canadian businesses do in this region.

Most of the Middle East is situated on non-arable desert, and the majority of the nations that comprise the area are not yet industrialized. As a result of the Israeli-Arab conflict in the region, along with widespread anti-American feelings, conservative religious leadership, and the recent Iraq war, the Middle East is politically unstable. Primarily, however, it is the non-sustainability of the oil market that will prevent many of the nations in the Middle East from becoming long-term economic leaders.

The world is moving away from using oil, as the world's oil resources are diminishing. Many people believe that at some point in the future, there will be none left. Countries such as Saudi Arabia, Kuwait, and Iraq, which rely primarily on oil revenue to purchase food and other necessities from other nations, will have no other established industries to replace this revenue once the oil is gone. It is unlikely that these nations will emerge as major trading partners in the future.

However, the United Arab Emirates (notably Dubai), Israel, and Egypt have established trading relationships with Canadian businesses that do not depend on oil. Dubai has become the real estate, tourism, and financial centre of the Middle East, showing phenomenal growth throughout the first decade of the twenty-first century. Over $1.4 billion worth of Canadian exports reached Dubai in 2008. Dubai's economy was hurt by the 2008 global economic crisis, as the real estate bubble burst and many people cancelled their travel plans. Dubai postponed the repayment of $26 billion in debt to foreign banks in November 2009, which caused a minor panic in financial markets around the world. This indicates just how powerful Dubai had become in a very short time.

Israel and Canada have signed a free trade agreement and Israeli businesses shipped over $1.2 billion worth of medicine, diamonds, engines, shoes, and numerous other products to Canada in 2008.

Table 1.3: Canada's Top Five Trading Partners in the Middle East

Country	Imports to Canada 2003	Imports to Canada 2008	Exports from Canada 2003	Exports from Canada 2008
Saudi Arabia	$1.2 billion	$2.1 billion	$586 million	$1 billion
Iraq	$1.1 billion	$2.2 billion	$31 million	$185 million
Israel	$691 million	$1.2 billion	$382 million	$583 million
Egypt	$198 million	$138 million	$200 million	$633 million
United Arab Emirates	$90 million	$330 million	$421 million	$1.4 billion

Source: Industry Canada

Although technically part of Africa, the world sees Egypt as more connected to the Middle East. Egypt imported over $633 million in newsprint, lumber, wheat, machinery, and other Canadian goods to help build its manufacturing base in 2008.

India

With a population of fifteen million, Calcutta is India's third-largest metropolitan area.

India's population is over one billion people, second only to China. It has become a major centre for outsourcing services and manufacturing. India's workforce is young (the average age is twenty-seven) and well educated. As an emerging market, India seems poised to take on China.

China has a highly controlled economy, as it remains a communist dictatorship. India has not managed to instigate the same infrastructure changes as China, due to government bureaucracy and far different social and political structures. Lack of major highways, telecommunication services, and reliable electrical power makes growth difficult for businesses in India. High taxes and widespread corruption are also persistent problems for companies wishing to grow their business in India.

However, Indian multinational companies, such as the Tata Group, have recently expanded into every major international market. Indian firms are becoming more aggressive on the world stage and India's government has begun to focus on trade. The outlook for India is very optimistic, and Canadian businesses would be well advised to consider the potential of this market.

Table 1.4: Canada's Trade with India

Canadian Imports from India, 2003	Canadian Imports from India, 2008	Canadian Exports, to India, 2003	Canadian Exports to India, 2008
$1.5 billion	$2.2 billion	$861 million	$2.4 billion
Major imports: diamonds, linen, clothing, rice			
Major exports: fertilizer, vegetables, newsprint, copper			

Source: Industry Canada

Africa

Most African nations have rural economies and poor infrastructure.

Africa is a continent of more than fifty nations, yet it accounts for only one-half of 1 percent of Canadian exports and 3 percent of imports. The import total is skewed because Algeria, Nigeria, and Angola are oil-producing nations. Without their oil, total African imports would be less than one-half of 1 percent.

Many African nations have unstable and/or corrupt governments. There are enormous social, health, and economic problems throughout the continent. Most African nations have major infrastructure problems and rural economies. Manufacturing industries in most areas are scarce. However, Africa, like Canada, produces an abundance of raw materials. The continent's exceptionally rich resources are one factor that has contributed to Africa's many problems. European colonists and other business interests exploited both the raw materials and the people of Africa. Again, like Canada, individual African nations did not have self-rule. The riches of each country were sent back to the ruling nation, and the people did not benefit nearly as much as their foreign rulers did.

Think About It!

1.16. What are the three emerging markets that Canadian businesses should know about?

1.17. What is the main product that Canada imports from Morocco?

The colonists have left Africa, been assimilated, or been driven out, and African nations are now struggling with independence and restructuring. Several countries are emerging as major trading partners, notably Morocco and South Africa. South Africa is an industrialized nation, with a stable government and major non-oil trade with Canada. Although it will take a long time, more and more African nations will follow the South African model and become major trading partners with the world.

Table 1.5: Canada's Trade with South Africa

Canadian Imports from South Africa 2003	Canadian Imports from South Africa 2008	Canadian Exports to South Africa 2003	Canadian Exports to South Africa 2008
$647 million	$845 million	$365 million	$944 million

Major imports: gold, manganese, wine, oranges, platinum
Major exports: sulfur, barley, machinery, tanks, automobile parts

Source: Industry Canada

Morocco is situated in North Africa, and although it has recently begun to export crude oil to Canada, it is known primarily for its mandarin oranges, which appear in Canadian supermarkets before Christmas.

Table 1.6: Canada's Trade with Morocco

Canadian Imports from Morocco 2003	Canadian Imports from Morocco 2008	Canadian Exports to Morocco 2003	Canadian Exports to Morocco 2008
$92 million	$146 million	$159 million	$300 million

Major imports: mandarin oranges, crude oil, olives, clothing, spices
Major exports: wheat, steel, lentils, corn, newsprint

Source: Industry Canada

Morocco, known primarily for its mandarin oranges, which arrive in Canadian supermarkets in November or December, has recently begun to export crude oil to Canada.

Globalization

Over the past century, international business transactions have grown enormously, as has the economic size, reach, and power of the major corporations that conduct business on an international scale. This is due, in large measure, to **globalization**. Globalization is a process whereby national or regional economies and cultures have become integrated through new global communication technologies, foreign direct investment, international trade, migration, new forms of transportation, and the flow of money.

It is now relatively easy for companies with sufficient resources to expand into other nations, where labour, materials, office space, and manufacturing facilities are inexpensive and plentiful. This allows companies to open up new markets and reduce production costs. The rules and regulations for setting up a business in Canada are also more restrictive than they are, for example, in India or Mexico.

Microsoft is consistently named one of the world's top brands.

Globalization has integrated sales, finance, global monetary markets, manufacturing, transportation, and communication around the world. It is important to note, however, that globalization is not synonymous with international business. Thousands of businesses that are not global in scope operate internationally.

Globalization also means that the whole world's economy may be affected by events that happen in one place. Take, for example, the global financial crisis that began in 2008. The price of oil is extremely important to the world's economy. In 2008, oil prices spiked to their highest levels. Since the price of food increases with the price of oil (because oil is used at many stages of food production, including farming and transportation), food prices rose, and global inflation increased. With the cost of living increasing, people began to find it hard to cover their costs, including their monthly mortgage payments.

In the United States, banks had been lending money at very low rates (called subprime, because they were below the prime rate offered to their best customers). Suddenly, those banks weren't being paid back, and they lost billions of dollars. In September 2008, two major banks, Bear Stearns and Lehman Brothers, lost so much money on these subprime loans that they were forced to shut down operations. Their closures, and the huge losses of many international banks, caused losses for investors around the world and had a huge impact on the world monetary markets, which, thanks to globalization, are now interdependent.

Table 1.7: Interbrand's Top Ten Global Brands in 2009

1	Coca-Cola	U.S.	6	McDonald's	U.S.
2	IBM	U.S.	7	Google	U.S.
3	Microsoft	U.S.	8	Toyota	Japan
4	General Electric	U.S.	9	Intel	U.S.
5	Nokia	Finland	10	Disney	U.S.

Note: U.S. corporations have eight of the ten top brands and over fifty of the top one hundred. Canada has two brands in the top one hundred—Thomson Reuters and BlackBerry.
*Interbrand's assessment is based on economic earnings, how the brand influences customers at the time of purchase, and the ability of the brand to secure future earnings.

History of Globalization

Modern globalization began shortly after World War II, although globalization itself can be linked historically to the many economic empires that set up colonies across the globe to exploit the goods, services, and even people of particular regions. Historians view the expansion of the Roman Empire as an early form of globalization.

Globalization, as it is defined today, began after World War II, with the establishment of the United Nations and the fostering of trade relations between countries. As the economic ties between countries strengthened, tax treaties were negotiated between countries, tariffs and capital controls were abolished, and global corporations began to develop. The pace of globalization has increased dramatically because of several changes that have taken place within the past few decades.

New Technology and Communications

Foreign deals, contracts, invoices, shipping manifests, product inquiries, financial transfers, and other business activities can now occur in real time using the Internet or cellular communication devices. The ability to process transactions in almost any country in the world as quickly as a business could process them in its own country has transformed the globe into one market, and has encouraged corporations to expand into remote parts of the world, where business costs are drastically reduced.

Socio-Political Issues

The global demand for goods and services is growing rapidly as countries such as India and China (each with populations of over a billion people) develop their economies. Multinational corporations see opportunities, and the emerging markets see the investment potential. Rich companies create jobs in poor nations, raise the standard of living there, and create new consumers (as well as increase the tax bases in these countries through property and wage taxes). Workers with incomes then demand a voice in the political system.

In the meantime, the political boundaries that once defined nations begin to blur. The European Union, for example, achieved European unity—after a thousand years of war and violence—through mutual economic interest. Canada has free trade agreements with Mexico, the United States, Jordan, Peru, Colombia, Europe, Costa Rica, Chile, and Israel, and has numerous other free trade agreements in negotiation. Globalization has increased the interdependence of all nations.

The European Parliament building is located in Strasbourg, France. Through mutual economic interest, the European Union achieved European unity after a thousand years of war and violence.

Interdependence

What did you have for breakfast this morning? A typical breakfast might include a glass of orange juice, a cup of tea, and toast with peanut butter. To enjoy this breakfast, you must rely on trade with foreign businesses—the orange juice may have come from the United States, the tea from Sri Lanka, and the peanuts from China. Without trade, you would only be eating the toast.

Other nations are equally dependent upon trade for things they need. The United States relies on Canadian energy, for example. If Canada did not send gas, oil, and hydroelectric power to the United States, Americans would be in serious trouble. Many nations rely on our wheat for their flour, our trees for their paper, and our fish for their dinner.

All nations in today's world must depend upon each other for products and services that their industries either cannot make or grow, or that industries in other nations make or grow better. The reliance of two or more nations on each other for products or services is called **interdependence**. There are three main areas of interdependence in trade: primary industries, secondary industries, and tertiary industries.

Primary Industries

Canada's export strength is still in the primary industry sector. This sector consists of the extraction and initial processing of all raw materials. There are five major **primary industries**: agriculture; fishing, hunting, and trapping; forestry and logging; energy; and mining. A sixth primary industry is often added to the list in Canada—water.

Primary industries are situated mainly in western and eastern Canada. The west produces oil and gas, metals, chemicals, and agricultural products, mainly beef and wheat. The Atlantic provinces capitalize upon their offshore oil reserves, fisheries, and mines.

Canada's export strength lies in its primary industry sector, which includes the Atlantic fisheries.

Impact: Society

Is a branch-plant economy good for Canada?

Yes: Branch plants provide products on which Canadians depend, and create jobs for Canadians.

No: Branch plants do not encourage innovation, creativity, and new product development, which are crucial for economic growth. It is difficult for Canadian businesses to compete with large foreign-owned corporations. Money spent by Canadian consumers leaves the country and goes to the owner of the branch plants, rather than staying in the country and supporting Canadian businesses.

Primary industries add value to products by extracting them from the earth or sea and beginning to process them. For example, you wouldn't want to wear a raw diamond on your finger or use it in high tech equipment. However, having a raw diamond is more valuable than having no diamond at all. Diamond mines use heavy equipment to dig out the diamond-bearing ore and separate the diamonds from the waste rock. The rock only has value because it contains diamonds; therefore, the diamond mine creates value out of the rock as it extracts the diamonds from it. All primary industries add value in this way.

The United States depends upon Canadian resources. Our greatest number of exports, both to the U.S. and other trading partners, come from businesses in the primary sectors. Canada is the largest exporter of oil and petroleum to the United States. We consistently sell more oil and petroleum to the U.S. than any other country (over two million barrels per day), including the countries of the Middle East (although Saudi Arabia occasionally surpasses us). Many countries depend upon our wheat for their food and use our minerals, chemicals, and petroleum products to make countless items in factories across the world. Only a few of our manufactured products, however, have made a global impact.

Secondary Industries

Secondary industries are made up of primary manufacturing (called processing) and secondary manufacturing. Secondary manufacturing produces both capital goods (products used by businesses such as machinery, trucks, and heavy equipment) and consumer goods (for example, clothing, packaged food, and television sets). Canada has a strong primary manufacturing sector, but a weak secondary manufacturing sector. The world knows Canada for its oil, pulp and paper, and diamonds, but not for its soft drinks, cereal, or running shoes.

Canada relies on foreign companies to invest in businesses in Canada, provide jobs for Canadians, and make the products we use. Over 50 percent of all of the processing and manufacturing businesses in Canada are owned by foreign companies, including Kellogg's, Procter and Gamble, and Kraft Foods.

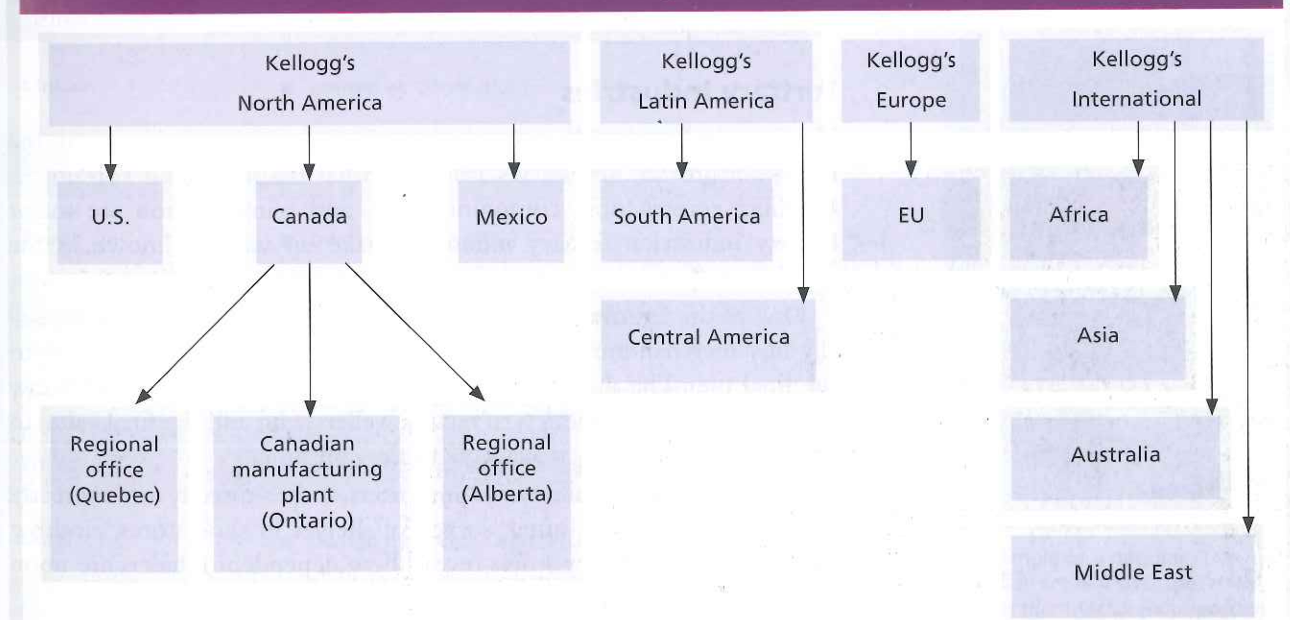
This computer manufacturer in Germany is part of the secondary industry sector.

A number of foreign automotive manufacturers have established Canadian branch plants, making the automotive industry a significant secondary industry here.

An economy such as Canada's, based on businesses owned by foreign interests, is called a branch-plant economy. A **branch plant** is a factory operated from a country outside of a host country. An example is Kellogg's, which is based in Battle Creek, Michigan. Its Canadian head office is in Mississauga and its main Canadian manufacturing plant (or branch plant) is in London, Ontario.

The Canadian government initiated this situation in 1879 through the National Policy, which stated that businesses wanting to reach Canadian markets needed to build factories in Canada. The new law certainly brought direct investment to Canada (primarily from the United States), but also resulted in the branch-plant economy Canada has today.

Figure 1.1: W. K. Kellogg Institute for Food and Nutrition Research Battle Creek, Michigan, Head Office



Global Gaffes

In December 2000, Roly Morris bought the rights to franchise Krispy Kreme Doughnuts in Canada. The U.S. parent company owned a 39 percent interest in Morris's private venture, and required his company to open forty Canadian stores in seven years.

The first international Krispy Kreme franchise opened in Mississauga in December 2001. It had record sales in its first week ($465,000) and appeared ready to take on the Canadian doughnut market. By 2003, Morris had built eighteen stores and hired approximately a thousand employees.

Then people's eating habits changed and carbohydrates landed high on the list of "don't eat" foods. Customers disappeared. In 2005, the parent company forced the Canadian venture into bankruptcy. As of 2009, only five Krispy Kreme stores, owned by the U.S. corporation, remained in Canada.

Although branch plants employ Canadian workers and pay Canadian taxes, there are some disadvantages to relying on foreign ownership of the manufacturing sector, as this list shows.

- **Business functions.** The functions of the subsidiary operations are often reduced from those functions performed at head office, notably the research and development and upper management functions.
- **Innovation.** There is very little innovation in divisional operations, as the branch plant follows the lead of the parent company and works to its specifications.
- **Use of non-Canadian materials.** Often, the satellite factories rely on imports from the country where the parent company is located to supply components and materials, and do not use Canadian materials or products.
- **Exports.** Branch plants rarely export, as they have been located in Canada specifically to service the Canadian market.

We do, however, use both foreign-owned and domestic secondary industries to add other layers of value to the raw materials extracted in the primary industries, creating processed or manufactured goods from them. The diamond mine that you read about earlier sells its raw diamonds to diamond companies that create value by cutting and polishing the raw diamonds into gemstones. Other secondary industries add even more value to the diamonds by creating jewellery that is sold to stores. Each time more value is added to a product in Canada, more jobs are created here, and Canadians become less reliant on foreign businesses.

Much secondary manufacturing, however, is done in other countries, where labour is cheaper than it is in Canada. Companies such as Roots, Mountain Equipment Co-Op, and lululemon use foreign manufacturing companies in China, India, and other cost-effective locations. around the world.

Tertiary Industries

Tertiary industries do not make anything or extract anything from the earth, but provide necessary services to other businesses and consumers. Banking, construction, communications, and transportation are major tertiary industries. Tertiary industries make up what is known as the **service sector**.

One of the largest service industries is retail sales. Retailers traditionally buy merchandise from a manufacturer or a distributor and sell it to the final user. The diamond companies that create the gems out of raw diamonds sell their products to retail jewellers who add the final value to the product by making it available to the consumer.

Canadian retailers are major importers, either directly or indirectly, of foreign products. A quick survey of shelves in shoe stores, clothing stores, and even grocery stores reveals how dependent retailers are upon imports.

Foreign retailers dominate the Canadian retail service sector. There are very few major chain stores that are not owned by corporations with head offices in another country. The reverse is not true, however. Only a few Canadian-based retailers have had success in other markets (Aritzia and Roots are two examples). Most Canadians spend their retail dollars in foreign-owned stores. Without foreign retailers, we would have few places to shop.

Table 1.8: Popular Canadian Retailers that are Foreign Owned

Walmart	Costco	Hudson's Bay Co.
Future Shop	Sears	Home Depot
H&M	IKEA	HMV
Zellers	Hollister	Old Navy
Foot Locker	Forever 21	The Body Shop

Table 1.9: Major Foreign-Owned Businesses in Canada

General Motors	Ford	Toyota
IBM	McDonald's	Imperial Oil
Shell	ING Bank	Subway

Table 1.10: Recent Foreign Takeovers of Canadian Businesses

Molson	▪ owned by Coors (U.S.)
CCM	▪ owned by Reebok (Germany)
Bauer	▪ owned by Nike (U.S.)
Dofasco Steel	▪ owned by Arcelor (Luxembourg)
Alcan Aluminum	▪ owned by Rio Tinto (United Kingdom)
Stelco	▪ owned by United States Steel (U.S.)
Corel	▪ owned by Vector Capital (U.S.)
Noranda Mines	▪ owned by Xstrata (Switzerland)

Think About It!

1.18. What is globalization?

1.19. What is a primary industry? Provide an example.

1.20. Does Canada have a strong secondary industry sector?

1.21. What is another name for tertiary industries? Provide two examples of tertiary industries.

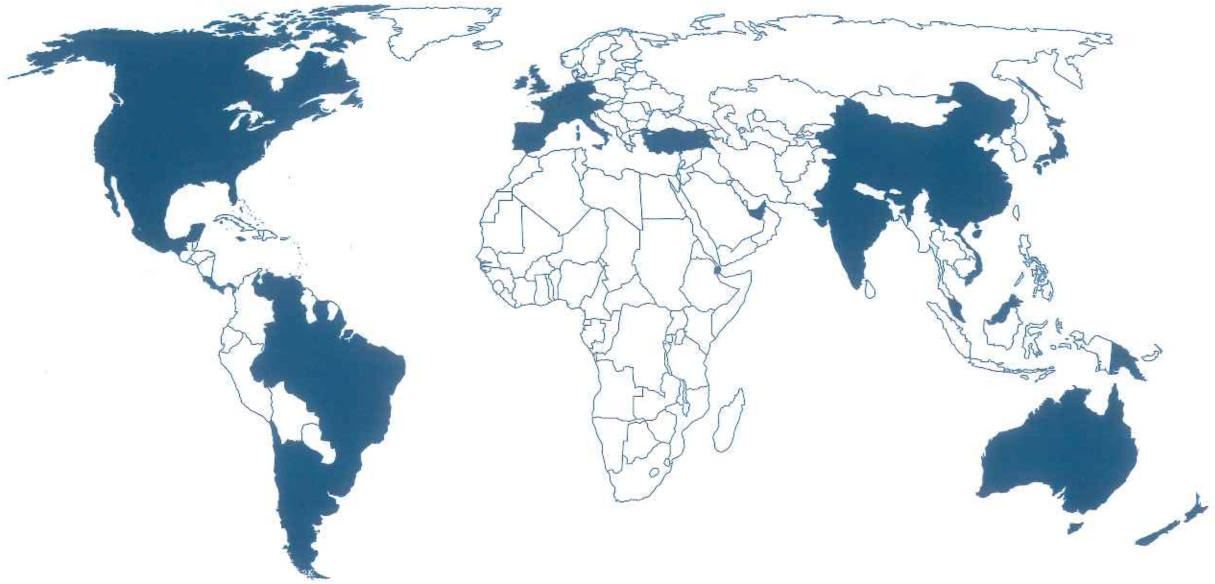
1.22. What is a branch-plant economy?

1.23. Why is Canada considered to have a branch-plant economy?

1.24. How do secondary industries add value to a product?

1.25. How do tertiary industries add value to a product?

An example of a popular Canadian retailer that uses foreign manufacturers to produce the clothing it sells is lululemon.



ANTIGUA & BARBUDA
ARGENTINA
ARUBA
AUSTRALIA
AUSTRIA
BAHAMAS
BARBADOS
BELGIUM
BERMUDA
BRAZIL
BRITISH VIRGIN ISLANDS
BRUNEI
CANADA
CAYMAN ISLANDS
CHILE
CHINA
COSTA RICA
DJIBOUTI
DOMINICA
FRANCE
GERMANY
GRENADA
GUERNSEY
HONG KONG
INDIA
IRELAND
ITALY
JAMAICA
JAPAN
JERSEY
LUXEMBOURG
MALAYSIA
MEXICO
MONTSERRAT
NETHERLANDS
NETHERLANDS ANTILLES
NEW ZEALAND
PANAMA
PORTUGAL
ST. KITTS & NEVIS
ST. LUCIA
ST. VINCENT & THE GRENADINES
SINGAPORE
SPAIN
SURINAME
SWITZERLAND
TRINIDAD & TOBAGO
TURKEY
TURKS & CAICOS
UNITED ARAB EMIRATES
UNITED KINGDOM
UNITED STATES
URUGUAY
VENEZUELA
VIET NAM

Royal Bank of Canada, established in Halifax in the late nineteenth century, now has offices in more than fifty countries around the world.

Some Canadian service businesses have found success in foreign markets. Canadian banks, such as the Royal Bank, have offices all over the world.

The Importance of the Internet

Business activity across the World Wide Web is increasing rapidly, and contributing to the interdependence of nations. The Internet has become one of the primary tools that businesses and consumers use to buy and sell. The global connections that the Internet provides have transformed the world into an open marketplace. Primary industries can buy equipment online anywhere from Africa to the Arctic, or look for customers in Argentina, Australia, or anyplace in between. Manufacturing businesses use the Internet to source parts, ingredients, and other supplies from around the world, to inform importers in other countries about their product selection, and to sell online to anyone on the planet. Service industries book flights and accommodations for tourists and business travellers, arrange and track shipments, pay bills, and connect with potential customers online. In a business sense at least, the world is united.

Newsworthy: Protecting Canada's Economic Interests in the Oil Field

Who's the Banana Republic? Canada versus Venezuela

By Vincent Lauerman, Financial Post, November 5, 2009

Venezuela was once the exploited banana republic, and Canada a respected member of the G8 industrialized countries. As of now, Canada could learn an important lesson from Venezuela about protecting its economic interests.

Canada and Venezuela have the two largest commercial non-conventional oil resources in the world. According to the Alberta Energy Resources Conservation Board, the oil sands in northern Alberta had remaining proved reserves of 170 billion barrels at the end of 2008.

In Venezuela, recoverable extra-heavy crude oil, bitumen, and oil sands resources in the Orinoco belt in the central region of the country have been estimated at 235 billion barrels, with the Magna Reserve Initiative recently identifying 73 billion barrels as proved.

Despite the negative impact of the global financial crisis, the Venezuelan government is planning to increase Orinoco production capacity to about 3.6 million barrels per day (bpd) within a decade, compared to about 600,000 bpd now. In September, Venezuela signed agreements with the Chinese government and a consortium of Russian companies to each develop 450,000 bpd of Orinoco capacity within three years. In addition, the Venezuelan government has re-scheduled an auction for three projects in the Carabobo region of the Orinoco belt for January 2010, with each project to add 400,000 bpd of capacity. Almost all new Orinoco oil production is to be upgraded into lighter grades of oil or into refined products prior to export.

According to Bob Dunbar from Strategy West, if all plans for mining and in situ projects were implemented for Canada's oil sands, production capacity would eventually increase to 7.3 million bpd compared with about 1.8 million bpd today. Of course, many of these production projects are currently on hold, along with all but one Alberta-based upgrader project, the Albian Oil Sands Project, lead by Royal Dutch Shell PLC.

A recent study by the Canadian Energy Research Institute indicated a large number of oil sands production projects should move forward in the coming years, whereas there is little commitment to build upgraders in Alberta. The difference in light and heavy crude oil prices has imploded over the past year with OPEC pulling about three million bpd of heavy crude oil off the market to support prices. In addition, the cost of a coking facility to upgrade the oil sands is more than double in northern Alberta compared to the Gulf Coast region of the United States.

Wilf Gobert, a widely respected energy analyst and chairman of Calgary Economic Development, has warned the export of Canadian bitumen to the United States rather than higher quality upgraded oil "could become the greatest loss of economic value for any country in world history."

When the bitumen is upgraded outside of Alberta and Canada, it leads not only to lower levels of economic activity and employment, but lower income and corporate tax revenue for the Canada and Alberta governments, and lower royalty revenue for the Alberta government as well.

A scenario in a new study by Sheikh Zaki Yamani's Centre for Global Energy Studies and Calgary-based Geopolitics Central says that relatively strong economic growth and oil prices during the next several years and widening light-heavy price differentials as OPEC heavy crude oil returns to the market would encourage the Alberta government to follow Venezuela's example and require all new oil sands production to be upgraded within the province as of 2015.

Under this geopolitically benign scenario, the primary market for incremental volumes of oil sands supply is not the United States, which tends to be well-suited to process heavier grades of crude oil, but the relatively unsophisticated refineries of northeast Asia, especially after 2014.

❐ Questions

1. In 2008, what were the estimated oil reserves in Alberta? Venezuela?
2. Within the oil sands, which is the primary industry? Which is the secondary industry?
3. What happens when bitumen is refined outside of Canada?
4. What can Alberta do to improve this situation?