



Chapter 2

International Flow of Goods, Services and Investments

Lecture Outline

Balance of Payments

- Current Account
- Capital Account
- Financial Account
- Understanding the balance
- The Relation between the Current and Financial Account
 - Current Account in Surplus, Financial Account in Deficit
 - Current Account in Deficit, Financial Account in Surplus
 - Current Account and Financial Account in Balance

International Trade Flows

- Distribution of Exports and Imports for Major Countries
- Balance of Trade Trends

Updated Trade and Investment Conditions

- Trade Agreements
- Trade Disagreements

Factors Affecting International Trade Flows

- Impact of Inflation
- Impact of National Income
- Impact of Government Restrictions
- Impact of Exchange Rates
- The Marshall Lerner Conditions
- Interaction of Factors

Correcting a Balance of Trade Deficit

- Why a Weak Home Currency is not a Perfect Solution?

International Capital Flows

- Factors Affecting Foreign Direct Investment
- Factors Affecting International Portfolio Investment

Agencies that Facilitate International Flows

- International Monetary Fund
- World Bank
- World Trade Organization
- International Financial Corporation
- International Development Association
- Bank for International Settlements
- Regional Development Agencies
- BRICS



Chapter Theme

This chapter provides an overview of the international environment surrounding MNCs. The chapter discusses the structure of international organisations, the recording and implications of international trade and investment and their effect on the wealth of nations. MNCs need to be aware of the international environment and the arguments for and against international transactions that are essential to the MNC.

Topics to Stimulate Class Discussion

1. Is a current account deficit something to worry about?
2. If a government wants to correct a current account deficit, why can't it simply enforce restrictions on imports?
3. Why don't exchange rates always adjust to correct current account deficits?

Critical debate

Trade and human rights

Proposition. Some countries do not protect human rights in the same manner as European countries. At times, European countries should threaten to restrict EU imports from, or investment to, a particular country if it does not correct human rights violations. The EU should use its large international trade and investment as leverage to ensure that human rights violations do not occur. Other countries with a history of human rights violations are more likely to honour human rights if their economic conditions are threatened.

Opposing view No. International trade and human rights are two separate issues. International trade should not be used as the weapon to enforce human rights. Firms engaged in international trade should not be penalized for the human rights violations of a government. If the EU imposes trade restrictions to enforce human rights, the country will retaliate. Thus, the EU firms that export to that foreign country will be adversely affected. By imposing trade sanctions, the EU is indirectly penalizing the MNCs that are attempting to conduct business in specific foreign countries. Trade sanctions cannot solve every difference in beliefs or morals between the more developed countries and the developing countries. By restricting trade, the EU will slow down the economic progress of developing countries.

Who has the better argument and why? Search under 'UN Norms on the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights '.

ANSWER: It is not just a matter of protecting human rights in the foreign country but also in the home country. Part of the 'race to the bottom ' argument. Importing goods without full social costs etc threatens domestic rights. The other argument is whether improvement in foreign countries will ever come about through banning. Development is surely through wealth, or does wealth merely prop up dictatorial regimes and prevents the development of rights?



The UN charter is as follows from

<http://www.unhchr.ch/Huridocda/Huridoca.nsf/0/64155e7e8141b38cc1256d63002c55e8?>

Open document:

A. General obligations

1. States have the primary responsibility to promote, secure the fulfilment of, respect, ensure respect of and protect human rights recognized in international as well as national law, including ensuring that transnational corporations and other business enterprises respect human rights. Within their respective spheres of activity and influence, transnational corporations and other business enterprises have the obligation to promote, secure the fulfilment of, respect, ensure respect of and protect human rights recognized in international as well as national law, including the rights and interests of indigenous peoples and other vulnerable groups.

B. Right to equal opportunity and non-discriminatory treatment

2. Transnational corporations and other business enterprises shall ensure equality of opportunity and treatment, as provided in the relevant international instruments and national legislation as well as international human rights law, for the purpose of eliminating discrimination based on race, colour, sex, language, religion, political opinion, national or social origin, social status, indigenous status, disability, age - except for children, who may be given greater protection - or other status of the individual unrelated to the inherent requirements to perform the job, or of complying with special measures designed to overcome past discrimination against certain groups.

C. Right to security of persons

3. Transnational corporations and other business enterprises shall not engage in nor benefit from war crimes, crimes against humanity, genocide, torture, forced disappearance, forced or compulsory labour, hostage-taking, extrajudicial, summary or arbitrary executions, other violations of humanitarian law and other international crimes against the human person as defined by international law, in particular human rights and humanitarian law.

4. Security arrangements for transnational corporations and other business enterprises shall observe international human rights norms as well as the laws and professional standards of the country or countries in which they operate.

D. Rights of workers

5. Transnational corporations and other business enterprises shall not use forced or compulsory labour as forbidden by the relevant international instruments and national legislation as well as international human rights and humanitarian law.

6. Transnational corporations and other business enterprises shall respect the rights of children to be protected from economic exploitation as forbidden by the relevant international instruments and national legislation as well as international human rights and humanitarian law.

7. Transnational corporations and other business enterprises shall provide a safe and healthy working environment as set forth in relevant international instruments and national legislation as well as international human rights and humanitarian law.



8. Transnational corporations and other business enterprises shall provide workers with remuneration that ensures an adequate standard of living for them and their families. Such remuneration shall take due account of their needs for adequate living conditions with a view towards progressive improvement.

9. Transnational corporations and other business enterprises shall ensure freedom of association and effective recognition of the right to collective bargaining by protecting the right to establish and, subject only to the rules of the organization concerned, to join organizations of their own choosing without distinction, previous authorization, or interference, for the protection of their employment interests and for other collective bargaining purposes as provided in national legislation and the relevant conventions of the International Labour Organization.

E. Respect for national sovereignty and human rights

10. Transnational corporations and other business enterprises shall recognize and respect applicable norms of international law, national laws and regulations, as well as administrative practices, the rule of law, the public interest, development objectives, social, economic and cultural policies including transparency, accountability and prohibition of corruption, and authority of the countries in which the enterprises operate.

11. Transnational corporations and other business enterprises shall not offer, promise, give, accept, condone, knowingly benefit from, or demand a bribe or other improper advantage, nor shall they be solicited or expected to give a bribe or other improper advantage to any Government, public official, candidate for elective post, any member of the armed forces or security forces, or any other individual or organization. Transnational corporations and other business enterprises shall refrain from any activity which supports, solicits, or encourages States or any other entities to abuse human rights. They shall further seek to ensure that the goods and services they provide will not be used to abuse human rights.

12. Transnational corporations and other business enterprises shall respect economic, social and cultural rights as well as civil and political rights and contribute to their realization, in particular the rights to development, adequate food and drinking water, the highest attainable standard of physical and mental health, adequate housing, privacy, education, freedom of thought, conscience, and religion and freedom of opinion and expression, and shall refrain from actions which obstruct or impede the realization of those rights.

F. Obligations with regard to consumer protection

13. Transnational corporations and other business enterprises shall act in accordance with fair business, marketing and advertising practices and shall take all necessary steps to ensure the safety and quality of the goods and services they provide, including observance of the precautionary principle. Nor shall they produce, distribute, market, or advertise harmful or potentially harmful products for use by consumers.

G. Obligations with regard to environmental protection

14. Transnational corporations and other business enterprises shall carry out their activities in



accordance with national laws, regulations, administrative practices and policies relating to the preservation of the environment of the countries in which they operate, as well as in accordance with relevant international agreements, principles, objectives, responsibilities and standards with regard to the environment as well as human rights, public health and safety, bioethics and the precautionary principle, and shall generally conduct their activities in a manner contributing to the wider goal of sustainable development.

H. General provisions of implementation

15. As an initial step towards implementing these Norms, each transnational corporation or other business enterprise shall adopt, disseminate and implement internal rules of operation in compliance with the Norms. Further, they shall periodically report on and take other measures fully to implement the Norms and to provide at least for the prompt implementation of the protections set forth in the Norms. Each transnational corporation or other business enterprise shall apply and incorporate these Norms in their contracts or other arrangements and dealings with contractors, subcontractors, suppliers, licensees, distributors, or natural or other legal persons that enter into any agreement with the transnational corporation or business enterprise in order to ensure respect for and implementation of the Norms.

16. Transnational corporations and other business enterprises shall be subject to periodic monitoring and verification by United Nations, other international and national mechanisms already in existence or yet to be created, regarding application of the Norms. This monitoring shall be transparent and independent and consider input from stakeholders (including non-governmental organizations) and as a result of complaints of violations of these Norms. Further, transnational corporations and other business enterprises shall conduct periodic evaluations concerning the impact of their own activities on human rights under these Norms.

17. States should establish and reinforce the necessary legal and administrative framework for ensuring that the Norms and other relevant national and international laws are implemented by transnational corporations and other business enterprises.

18. Transnational corporations and other business enterprises shall provide prompt, effective and adequate reparation to those persons, entities and communities that have been adversely affected by failures to comply with these Norms through, inter alia, reparations, restitution, compensation and rehabilitation for any damage done or property taken. In connection with determining damages, in regard to criminal sanctions, and in all other respects, these Norms shall be applied by national courts and/or international tribunals, pursuant to national and international law.

19. Nothing in these Norms shall be construed as diminishing, restricting, or adversely affecting the human rights obligations of States under national and international law, nor shall they be construed as diminishing, restricting, or adversely affecting more protective human rights norms, nor shall they be construed as diminishing, restricting, or adversely affecting other obligations or responsibilities of transnational corporations and other business enterprises in fields other than human rights.

International finance and accountability

Proposition. The sheer size of the foreign currency markets makes MNCs and their free market philosophy intimidating even for developed countries. Countries can in effect no longer regulate



their financial institutions or their currencies. Only the IMF and the G8 have any influence and neither of those are democratic bodies. The UN has tried, but frankly, its statement of norms for Transnational Corporations is not very strong. Although MNCs do not want to give the impression that they are above the law, it is difficult to see what law they are obeying.

Opposing view. Nonsense. Companies are registered in their home country and their subsidiaries are registered in their country of operation, they obey all the laws of those countries and more – transgressions by MNCs, if you look on the web, are remarkably few. MNCs in their Annual Reports demonstrate that not only do they comply with all local laws, but also, they have overriding concerns about the environment and working conditions. If countries wanted to stop trading in foreign assets, they could pass laws and ban the practice. But all countries know that MNCs are a source of wealth and prosperity and that their standards are higher than the local equivalent.

With whom do you agree? You may Google 'MNCs', 'accountability', '+OECD' and '+pdf' as one search and 'UN global Compact', 'OECD Guidelines for Multinational Enterprises' and finally 'FTSE4Good' but be aware that there is a bias towards the proposer's viewpoint.

ANSWER: The charter is given above. Here the issue is the size of the foreign markets. Speculation might include what happens if a country pursues policies that are not favoured by international markets. The role of the IMF and G8 is also an issue; the organizations are driven by whom, the MNCs, governments? Hopefully the class will come along with evidence from the sources suggested and discuss what they have found.

Answers to End of Chapter Questions

1. Balance of payments.

a. What is the current account generally composed of?

ANSWER: The current account balance is composed of (1) the balance of trade, (2) the net amount of payments of interest to foreign investors and from foreign investment, (3) payments from international tourism, and (4) private gifts and grants.

b. What is the financial account generally composed of?

ANSWER: The financial account is composed of all investments made between countries. The main classifications are portfolio investment and direct investment. Portfolio investments include the purchase of bonds and shares in companies. The characteristic of portfolio investment is that there is no ownership interest. In the case of shares the normal rule is that ownership amounts to less than 10 per cent, if more than that then it is classified as direct investment. Ownership is the key feature of direct investment. The cross-border purchase of shares and payments generally that are related to direct economic activity between entities as well as payments to governments are treated as direct investments. Typically, the setting up of a subsidiary company in a foreign country and naming it as <Company name> US Ltd or France Ltd denotes a foreign subsidiary and will be a direct investment. Generally, portfolio investment is more volatile than direct investment as selling shares etc. is quicker and easier than closing down a factory!

Formerly, what is now termed the financial account was called the capital account. The IMF now classifies the capital account for what it terms as non-produced non-financial assets, being grants



and transactions with the IMF and formerly with EU and other international bodies as well as sundry items such as debt forgiveness. The new capital account is now a minor item in the balance of payments.

2. Inflation effect on trade.

- a. How would a relatively high home inflation rate affect the home country's current account, other things being equal?

ANSWER: A high inflation rate tends to increase imports and decrease exports, thereby increasing the current account deficit, other things equal.

- b. Is a negative current account harmful to a country? Discuss.

ANSWER: This question is intended to encourage opinions and does not have a perfect solution. A negative current account is thought to reflect lost jobs in a country, which is unfavorable. Yet, the foreign importing reflects strong competition from foreign producers, which may keep prices (inflation) low.

3. Government restrictions. How can government restrictions affect international payments among countries?

ANSWER: Governments can place tariffs or quotas on imports to restrict imports. They can also place taxes on income from foreign securities, thereby discouraging investors from purchasing foreign securities. If they loosen restrictions, they can encourage international payments among countries.

4. IMF.

- a. What are some of the major objectives of the IMF?

ANSWER: Major IMF objectives are to (1) promote cooperation among countries on international monetary issues, (2) promote stability in exchange rates, (3) provide temporary funds to member countries attempting to correct imbalances of international payments, (4) promote free mobility of capital funds across countries, and (5) promote free trade.

- b. How is the IMF involved in international trade?

ANSWER: The IMF is involved in international trade because it attempts to stabilize international payments, and trade represents a significant portion of the international payments.

5. Exchange rate effect on trade balance. Would the UK balance of trade deficit be larger or smaller if the pound depreciates against all currencies, versus depreciating against some currencies but appreciated against others? Explain.

ANSWER: If the pound weakens against all currencies, the UK balance of trade deficit will likely be smaller. Some UK importers would have more seriously considered purchasing their goods in the UK if most or all currencies simultaneously strengthened against the pound. Conversely, if some currencies weaken against the pound, the UK importers may have simply shifted their importing from one foreign country to another.

6. Demand for exports. A relatively small UK balance of trade deficit is commonly attributed to a strong demand for UK exports. What do you think is the underlying reason for the strong demand for UK exports?



ANSWER: The strong demand for UK exports is commonly attributed to strong foreign economies or to a weak pound.

- 7. Demand for imports.** Explain why a devaluation may result in a higher total import value. Why do we expect it to be lower?

ANSWER: Devaluation makes imports more expensive. Unless there is at least a similar percentage fall in the volume of imports, the total import bill will rise. This may or may not be offset by an increase in exports. But as regards imports it is the elasticity of imports that matters i.e. the percentage change in quantity for a 1% increase in price.

- 8. Effects of the euro.** Explain how the euro may affect UK international trade.

ANSWER: The euro allowed for a single currency among many European countries. It could encourage firms in those countries to trade among each other since there is no exchange rate risk. This would possibly cause them to trade less with the UK.

The euro can increase trade within Europe because it eliminates the need for several European countries to exchange currencies when trading with each other.

- 9. Currency effects.** When South Korea's export growth stalled, some South Korean firms suggested that South Korea's primary export problem was the weakness in the Japanese yen. How would you interpret this statement?

ANSWER: One of South Korea's primary competitors in exporting is Japan, which produces and exports many of the same types of products to the same countries. When the Japanese yen is weak, some importers switch to Japanese products in place of South Korean products. For this reason, it is often suggested that South Korea's primary export problem is weakness in the Japanese yen.

- 10. Effects of tariffs.** Assume a simple world in which the UK exports soft drinks and beer to France and imports wine from France. If the UK imposes large tariffs on the French wine, explain the likely impact on the values of the UK beverage firms, UK wine producers, the French beverage firms and the French wine producers.

ANSWER: Well, in short, the UK should not be imposing tariffs on French goods, but in this simple world we will assume that they can! The UK wine producers benefit from the UK tariffs, while the French wine producers are adversely affected. The French government would likely retaliate by imposing tariffs on the UK beverage firms, which would adversely affect their value. The French beverage firms would benefit.

Advanced Questions

- 11. Free trade.** There has been considerable momentum to reduce or remove trade barriers in an effort to achieve 'free trade'. Yet, one disgruntled executive of an exporting firm stated 'Free trade is not conceivable; we are always at the mercy of the exchange rate. Any country can use this mechanism to impose trade barriers.' What does this statement mean?

ANSWER: This statement implies that even if there were no explicit barriers, a government could attempt to manipulate exchange rates to a level that would effectively reduce foreign competition. For example, a US firm may be discouraged from attempting to export to Japan if



the value of the dollar is very high against the yen. The prices of the US goods from the Japanese perspective are too high because of the strong dollar. The reverse situation could also be possible in which a Japanese exporting firm is priced out of the US market because of a strong yen (weak dollar). [Answer is based on opinion.]

12. International investments. In recent years many UK-based MNCs have increased their investments in foreign securities, which are not as susceptible to the negative shocks of the UK market. Also, when MNCs believe that UK securities are overvalued, they can pursue non-UK securities that are driven by a different market. Moreover, in periods of low UK interest rates, UK corporations tend to seek investments in foreign securities. In general, the flow of funds into foreign countries tends to decline when UK investors anticipate a strong pound.

- a. Explain how expectations of a strong pound can affect the tendency of UK investors to invest abroad.
- b. Explain how low UK interest rates can affect the tendency of UK-based MNCs to invest abroad.
- c. In general terms, what is the attraction of foreign investments to UK investors?

ANSWER: The main attraction is potentially higher returns. The international stocks can outperform UK stocks, and international bonds can outperform UK bonds. However, there is no guarantee that the returns on international investments will be so favorable. Some investors may also pursue international investments to diversify their investment portfolio, which can possibly reduce risk.

13. Exchange rate effects on trade.

- a. Explain why a stronger dollar could enlarge the UK balance of trade deficit. Explain why a weaker dollar could affect the UK balance of trade deficit.
- b. It is sometimes suggested that a floating exchange rate will adjust to reduce or eliminate any current account deficit. Explain why this adjustment would occur.
- c. Why does the exchange rate not always adjust to a current account deficit?

ANSWER:

- a. A stronger dollar makes US exports more expensive to importers and may reduce imports. A weaker home currency increases the prices of imports purchased by the home country and reduces the prices paid by foreign businesses for the home country's exports. This should cause a decrease in the home country's demand for imports and an increase in the foreign demand for the home country's exports and will improve the current account balance.
- b. A current account deficit reflects a net sale of the home currency in exchange for other currencies. This places downward pressure on that home currency's value. If the currency weakens, it will reduce the home demand for foreign goods (since goods will now be more expensive) and will increase the home export volume (since exports will appear cheaper to foreign countries).



- c. In some cases, the home currency will remain strong even though a current account deficit exists, since other factors (such as international capital flows) can offset the forces placed on the currency by the current account.



Blades plc Case Study

Ben Holt, the finance director of Blades plc, has decided to counteract the decreasing demand for 'Speedos' roller blades by exporting this product to Thailand. Furthermore, due to the low cost of rubber and plastic in Southeast Asia, Holt has decided to import some of the components needed to manufacture 'Speedos' from Thailand. Holt feels that importing rubber and plastic components from Thailand will provide Blades with a cost advantage (the components imported from Thailand are about 20 per cent cheaper than similar components in the United Kingdom). Currently, approximately \$15 million, or 10 per cent, of Blades' sales are contributed by its sales in Thailand. Only about 4 percent of Blades' cost of goods sold is attributable to rubber and plastic imported from Thailand.

Blades faces little competition in Thailand from other UK roller blades manufacturers. Those competitors that export roller blades to Thailand invoice their exports in British pounds. Currently, Blades follows a policy of invoicing in Thai baht (Thailand's currency). Ben Holt felt that this strategy would give Blades a competitive advantage, since Thai importers can plan more easily when they do not have to worry about paying differing amounts due to currency fluctuations. Furthermore, Blades' primary customer in Thailand (a retail store) has committed itself to purchasing a certain number of 'Speedos' annually if Blades will invoice in baht for a period of three years. Blades' purchases of components from Thai exporters are currently invoiced in Thai baht.

Ben Holt is rather content with current arrangements and believes the lack of competitors in Thailand, the quality of Blades' products, and its approach to pricing will ensure Blades' position in the Thai roller blade market in the future. Holt also feels that Thai importers will prefer Blades over its competitors because Blades invoices in Thai baht.

As Blades' financial analyst, you have doubts as to Blades' 'guaranteed' future success. Although you believe Blades' strategy for its Thai sales and imports is sound, you are concerned about current expectations for the Thai economy. Current forecasts indicate a high level of anticipated inflation, a decreasing level of national income, and a continued depreciation of the Thai baht. In your opinion, all of these future developments could affect Blades financially given the company's current arrangements with its suppliers and with the Thai importers. Both Thai consumers and firms might adjust their spending habits should certain developments occur.

In the past, you have had difficulty convincing Ben Holt that problems could arise in Thailand. Consequently, you have developed a list of questions for yourself, which you plan to present to the company's CFO after you have answered them. Your questions are listed here:

1. How could a higher level of inflation in Thailand affect Blades (assume UK inflation remains constant)?
2. How could competition from firms in Thailand and from UK and European firms conducting business in Thailand affect Blades?
3. How could a decreasing level of national income in Thailand affect Blades?
4. How could a continued depreciation of the Thai baht affect Blades? How would it affect Blades relative to UK exporters invoicing their roller blades in British pounds?
5. If Blades increases its business in Thailand and experiences serious financial problems, are there any international agencies that the company could approach for loans or other financial assistance?

Solution to Continuing Case Problem: Blades



1. How could a higher level of inflation in Thailand affect Blades (assume UK inflation remains constant)?

ANSWER: A high level of inflation in Thailand relative to the United States could affect Blades favorably. Generally, if a country's inflation rate increases relative to the countries with which it trades, consumers and corporations within the country will most likely purchase more goods overseas, as local goods become more expensive. Consequently, Blades' sales to Thailand may increase.

2. How could competition from firms in Thailand and from UK firms conducting business in Thailand affect Blades?

ANSWER: Blades would be favorably affected relative to Thai roller blade manufacturers and relative to other UK roller blade manufacturers with operations in Thailand. Both groups of firms will likely be forced to raise their prices if they want to maintain the same profit margin should inflation in Thailand increase. This is especially true if both groups of firms source their supplies directly from Thailand, so that the prices of these supplies are subject to the higher inflation in Thailand. Conversely, Blades' cost of goods sold incurred in Thailand is relatively small. Consequently, costs will not be subject to the higher level of inflation in Thailand to a great extent and Blades will probably not have to raise its prices to the same extent as Thai roller blade manufacturers or UK manufacturers with operations in Thailand.

3. How could a decreasing level of national income in Thailand affect Blades?

ANSWER: At first glance, it would appear that a decreasing level of national income in Thailand could hurt Blades financially, as Thai consumers will have less money to spend. Furthermore, this effect may be magnified because Blades manufactures a leisure product, which is probably one of the first products Thai consumers will stop buying. The arrangement Blades has with its primary Thai importer mitigates this effect somewhat, since the latter has committed himself to the purchase of a certain number of 'Speedos' annually. Nevertheless, the importer may not offer to renew this arrangement in excess of the original three years if the Thai economy does not improve.

4. How could a continued depreciation of the Thai baht affect Blades? How would it affect Blades' relative to UK exporters invoicing their roller blades in UK pounds?

ANSWER: A continued depreciation of the Thai baht would hurt Blades, especially because the firm invoices its roller blades in baht. A continued depreciation of the baht means that the baht-denominated revenue in Thailand will convert to fewer UK dollars. Blades also has some expenses in baht, but this amount is less than the revenue denominated in baht.

Although Blades would be hurt by a depreciating baht because its exports are denominated in baht, the demand for Blades' products may increase relative to that of its UK competitors exporting to Thailand. This is because most of the UK firms exporting roller blades to Thailand invoice their products in UK pounds. If the baht depreciates, Thai importers will have to convert more baht to pounds in order to pay for the pound-denominated exports.



5. If Blades increases its business in Thailand and experiences serious financial problems, are there any international agencies that the company could approach for loans or other financial assistance?

ANSWER: An agency extending direct loans to corporations involved in international trade is the International Financial Corporation (IFC). Besides extending loans, the IFC may also purchase stock in a corporation, thereby becoming part owner.

Small Business Dilemma

Identifying Factors That Will Affect the Foreign Demand at the Sports Exports Company

Identify the factors that affect the current account balance between Ireland and the U.K. Explain how each factor may possibly affect the British demand for the basketballs that are produced by the Sports Exports Company.

ANSWER:

1. High inflation in the UK could cause a shift in the demand for euro products instead of British products. However, at this time there is not a British producer of basketballs, so that high British inflation will not cause an increase in the demand for Irish-produced basketballs.
2. High national income in the UK could increase the amount of spending by British consumers and would therefore cause an increase in the demand for basketballs produced by the Sports Exports Company. A lower national income in the UK would have the opposite effect.
3. Government restrictions could be imposed by the British government on goods (such as the basketballs) exported by foreign firms. However, basketballs are not likely to be targeted by the British government as a product that should be subject to restrictions.
4. The exchange rate of the British pound will change over time. However, since the Sports Exports Company is willing to accept pounds when it sells basketballs to the distributor, the distributor does not have to convert the pounds into dollars. Therefore, the British demand for basketballs is not affected by changes in the value of the pound (unless this causes the Sports Exports Company to change the price it charges for the basketballs someday).