Trade Theories

Manajemen International Bisnis
Semester Genap 2016
Universitas Pembangunan Jaya

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Introduction

- Exchange programs allow a university to trade without imposing significant risks and to avoid uncertainty

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International Trade and the World Economy

Trade is the voluntary exchange of goods, services, assets, or money between one person or organization and another.

International trade is trade between residents of two countries.

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Figure 6.1 Growth of World Merchandise Exports since 1950

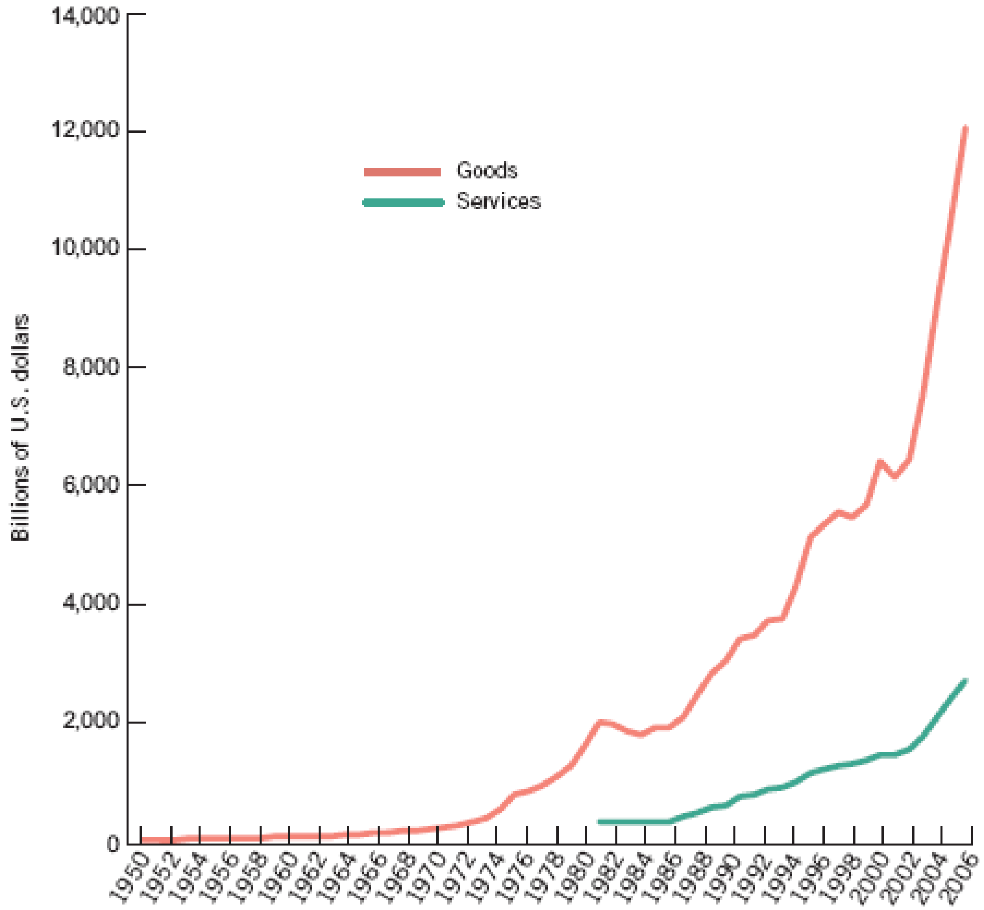

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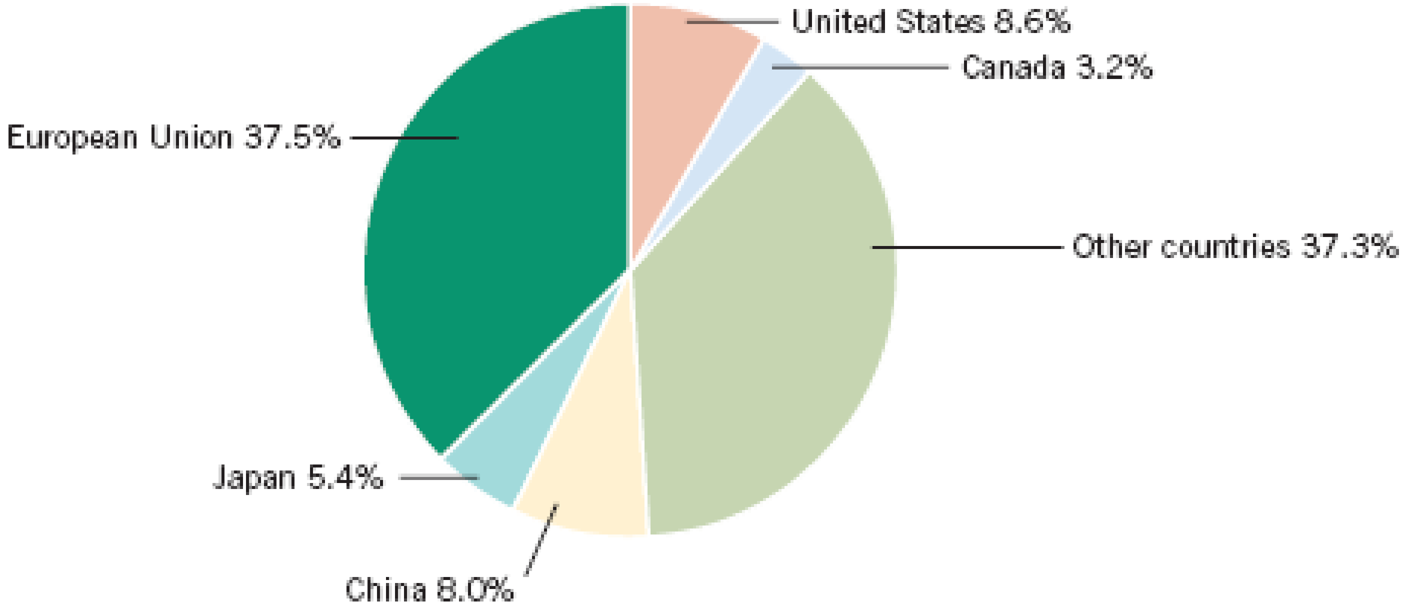
Figure 6.2 Sources of World's Merchandise Exports, 2006



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- **The first theories of international trade developed with the rise of the great European nation-states during the sixteenth century.**
- **These early theories focused on the individual country in examining patterns of exports and imports.**
- **The country-based theories are particularly useful for describing trade in commodities—standardized, undifferentiated goods such as oil, sugar, or lumber that are typically bought on the basis of price rather than brand name.**

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Classical Country-Based Trade Theories

Political and economic policy in the 17th and early 18th centuries aimed at increasing a nation's wealth and power by encouraging the export of goods in return for gold

Absolute Advantage

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Classical Trade Theory

- Trying to Explain:
  - Why countries trade, and
  - Why some countries grow faster and wealthier than others through trade?

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Classical Country-Based Trade Theories

- Mercantilism
- Absolute Advantage
- Comparative Advantage
- Comparative Advantage with Money
- Relative Factor Endowments

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Mercantilism

- A country's wealth is measured by its holdings of gold and silver
- A country's goal should be to enlarge holdings of gold and silver by:
  - Promoting exports
  - Discouraging imports

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Disadvantages of Mercantilism

- Confuses the acquisition of treasure with the acquisition of wealth
- Weakens the country because it robs individuals of the ability to:
  - Trade freely
  - Benefit from voluntary exchanges
- Forces countries to produce products it would otherwise not in order to minimize imports

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Protectionism

- Modern mercantilism (neomercantilists)
  - American Federation of Labor -Congress of Industrial Organizations
  - Textile manufacturers
  - Steel companies
  - Sugar growers
  - Peanut farmers

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Absolute Advantage

- Export those goods and services for which a country is more productive than other countries
- Import those goods and services for which other countries are more productive than it is

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Comparative Advantage

- Produce and export those goods and services for which it is *relatively* more productive than other countries
- Import those goods and services for which other countries are *relatively* more productive than it is

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TABLE 5.1

Absolute Advantage and Comparative Advantage*

Country	Wheat	Cloth
England	2	4
France	4	2

- England has absolute advantage in the production of wheat. It requires fewer labor-hours (2 being less than 4) for England to produce one unit of wheat.
- France has absolute advantage in the production of cloth. It requires fewer labor-hours (2 being less than 4) for France to produce one unit of cloth.
- England has comparative advantage in the production of wheat. If England produces one unit of wheat, it is forgoing the production of 2/4 (0.50) of a unit of cloth. If France produces one unit of wheat, it is forgoing the production of 4/2 (2.00) of a unit of cloth. England therefore has the lower opportunity cost of producing wheat.
- France has comparative advantage in the production of cloth. If England produces one unit of cloth, it is forgoing the production of 4/2 (2.00) of a unit of wheat. If France produces one unit of cloth, it is forgoing the production of 2/4 (0.50) of a unit of wheat. France therefore has the lower opportunity cost of producing cloth.

*Labor-hours per unit of output.

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Differences between Comparative and Absolute Advantage

- Absolute versus relative productivity differences
- Comparative advantage incorporates the concept of opportunity cost
  - Value of what is given up to get the good

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Comparative Advantage with Money

- One is better off specializing in what one does relatively best
- Produce and export those goods and services one is relatively best able to produce
- Buy other goods and services from people who are better at producing them

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Relative Factor Endowments

- Heckscher-Ohlin Theory
- What determines the products for which a country will have a comparative advantage?
  - Factor endowments vary among countries
  - Goods differ according to the types of factors that are used to produce them

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Heckscher-Ohlin Theory

A country will have a comparative advantage in producing products that intensively use resources (factors in production) it has in abundance.

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Modern Firm-Based Trade Theories

- Growing importance of MNCs
- Inability of the country-based theories to explain and predict the existence and growth of intraindustry trade
- Failure of Leontief and others to empirically validate country-based Heckscher-Ohlin theory

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Firm-Based Trade Theories

- Country Similarity Theory
- Product Life-Cycle Theory
- Global Strategic Rivalry Theory
- Porter's National Competitive Advantage

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Country Similarity Theory

- Explains the phenomenon of intraindustry trade (as opposed to interindustry trade)
  - Trade between two countries of goods produced by the same industry
    - Japan exports Toyotas to Germany
    - Germany exports BMWs to Japan

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Product Life-Cycle Theory

- Describes the evolution of marketing strategies
- Stages
  - – New product
  - – Maturing product
  - – Standardized product

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Stages in the Product Life Cycle

New Product Stage

↓

Maturing Product Stage

↓

Standardized Product Stage

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Figure 6.4a The International Product Life Cycle: Innovating Firm's Country

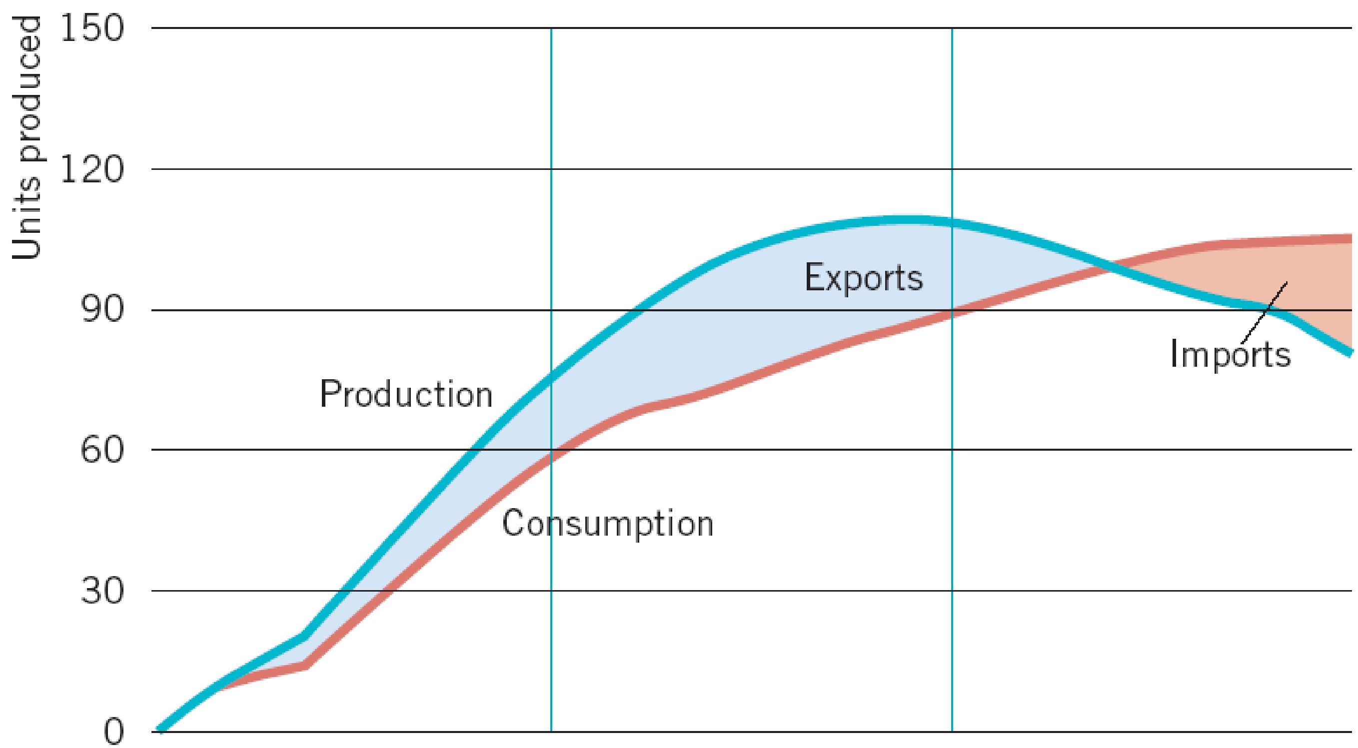

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Figure 6.4b The International Product Life Cycle: Other Industrialized Countries

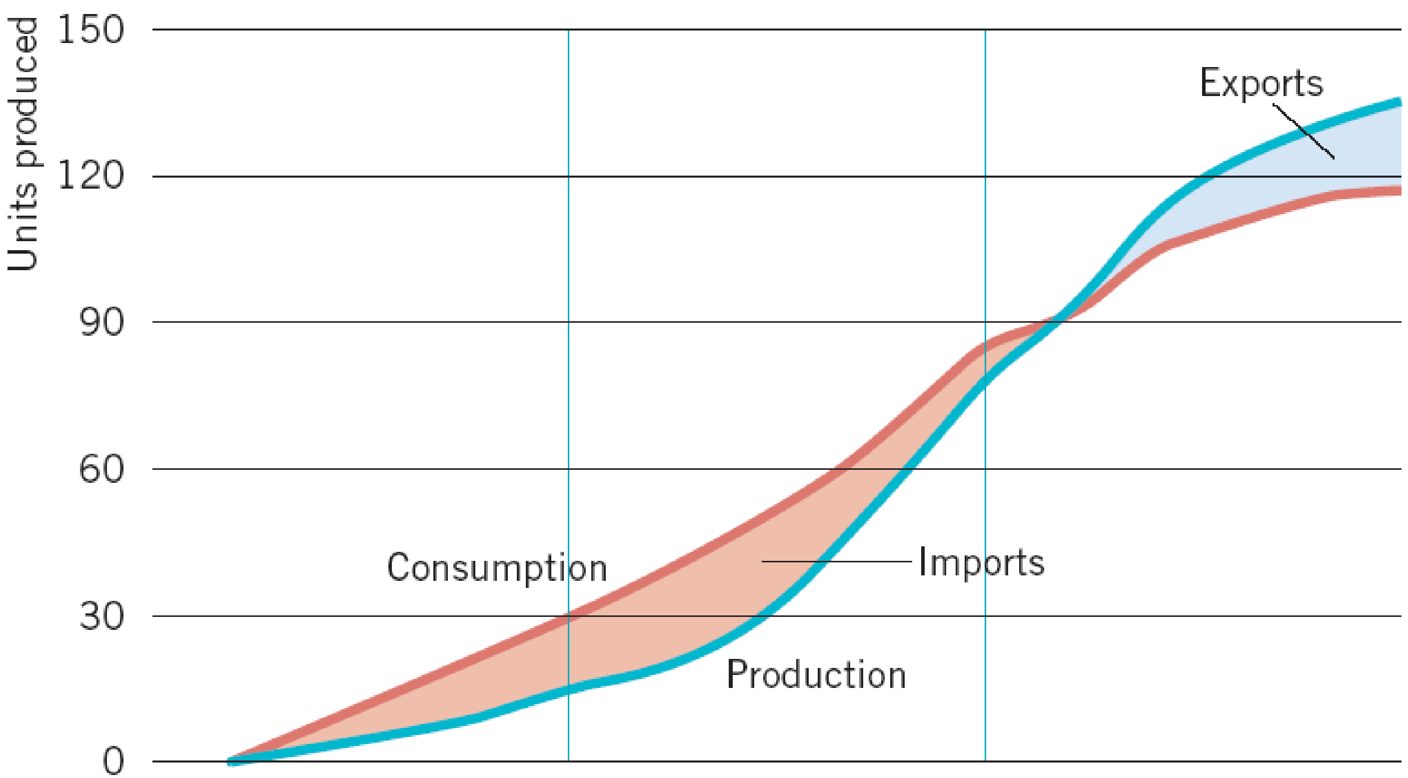

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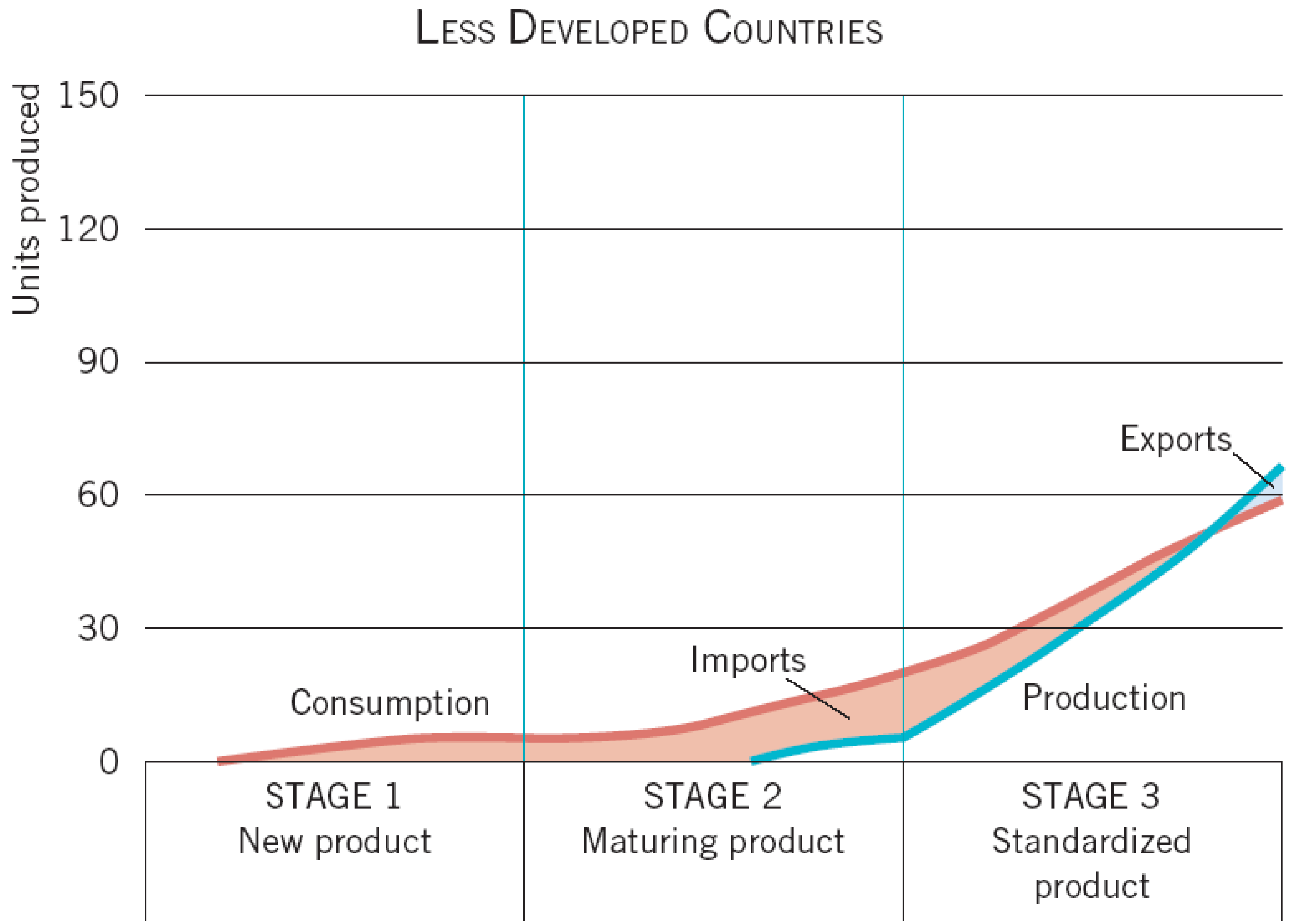
Figure 6.4c The International Product Life Cycle: Less Developed Countries



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Global Strategic Rivalry Theory

- Firms struggle to develop sustainable competitive advantage
- Advantage provides ability to dominate global marketplace
- Focus: strategic decisions firms use to compete internationally

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Global Strategic Rivalry Theory Sustaining Competitive Advantage

- Owning intellectual property rights
- Investing in research and development
- Achieving economies of scale or scope
- Exploiting the experience curve

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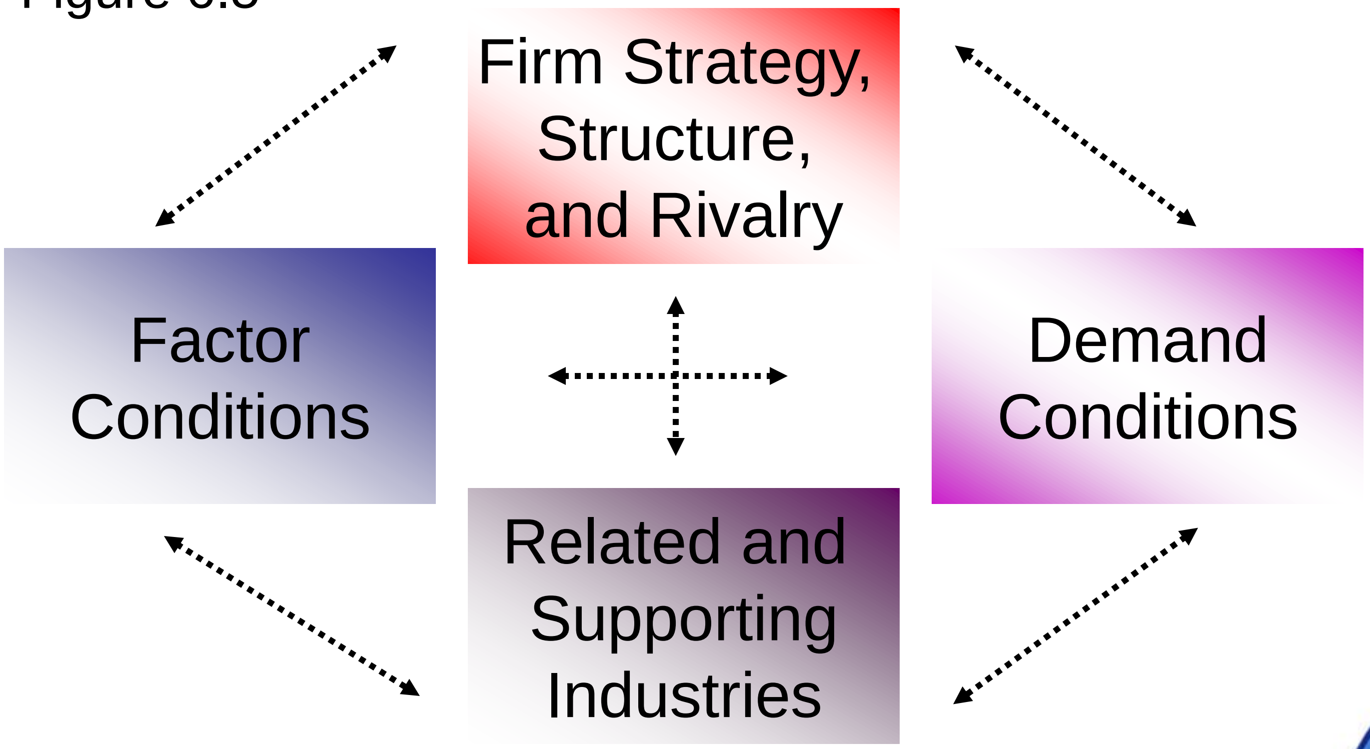
Porter's Diamond of National Competitive Advantage

Figure 6.5



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Theories of International Trade

Country-Based Theories

Country is unit of analysis
Emerged prior to World War II
Developed by economists
Explain interindustry trade
Include:
- Mercantilism
- Absolute advantage
- Comparative advantage
- Relative factor endowments (Heckscher-Ohlin)

Firm-Based Theories

Firm is unit of analysis
Emerged after World War II
Developed by business school professors
Explain intraindustry trade
Include:
- Country similarity theory
- Product life cycle
- Global strategic rivalry
- National competitive advantage

Figure 6.6 Theories of International Trade

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Types of International Investments

- *Does the investor seek an active management role in the firm or merely a return from a passive investment?*
  - Foreign Direct Investment
  - Portfolio Investment

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Figure 6.7 Stock of Foreign Direct Investment, by Recipient

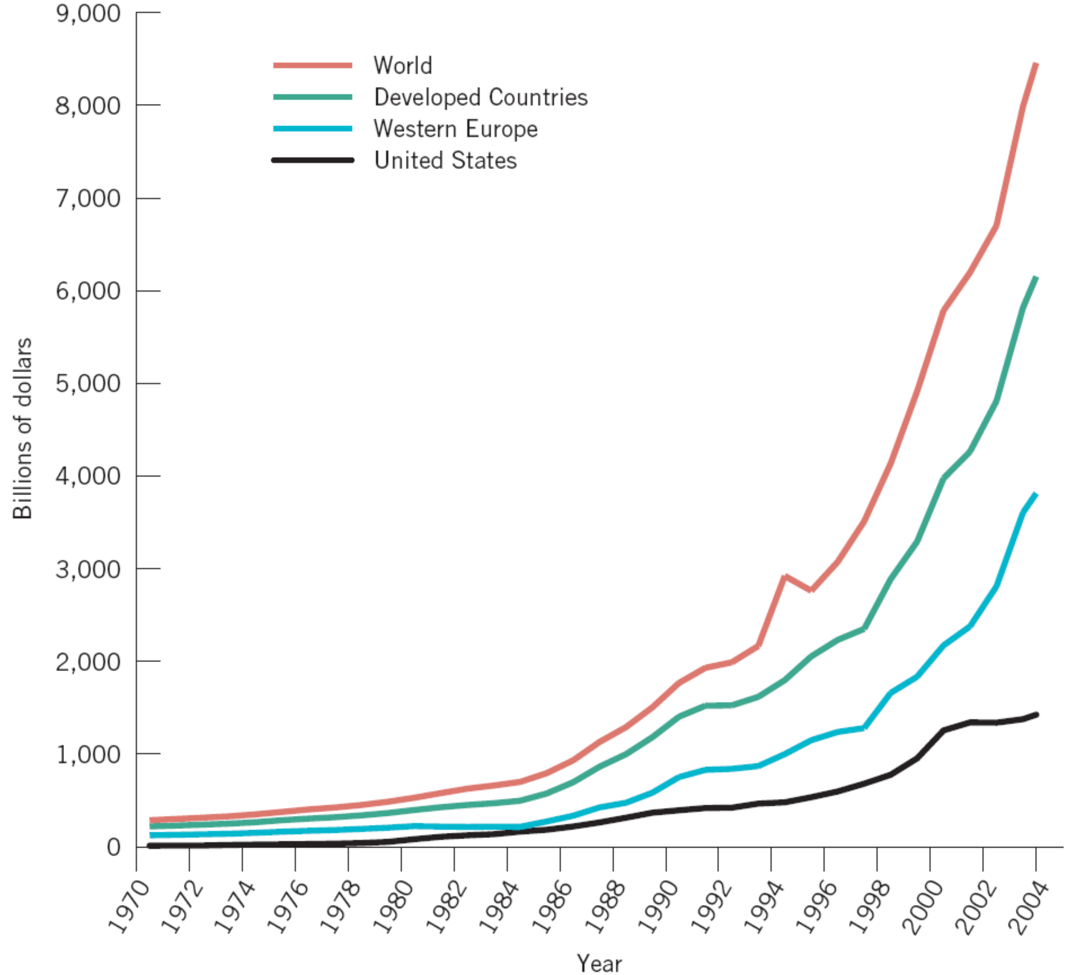

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Table 6.4a Sources of FDI in the U.S.

United Kingdom	410.8
Japan	233.1
Canada	213.2
Netherlands	209.4
Germany	202.6
France	168.6
Switzerland	155.7
Luxembourg	134.3
Australia	49.1
Bermuda, The Bahamas, and other Caribbean islands	38.7
Other European countries	201.5
All other countries	75.9
Total	2092.9

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Table 6.4b Destinations of FDI for the U.S.

United Kingdom	398.8
Netherlands	370.2
Canada	257.1
Bermuda, The Bahamas, and other Caribbean islands	243.3
Switzerland	127.7
Luxembourg	113.6
Germany	107.9
Japan	101.6
Mexico	91.7
Ireland	87.0
Other European countries	346.5
All other countries	546.5
Total	2791.9

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International Investment Theories

- Ownership Advantages
- Internalization
- Dunning's Eclectic Theory

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Ownership Advantages

- A firm owning a valuable asset that creates a competitive advantage domestically can use that advantage to penetrate foreign markets through FDI.
- *Why FDI and not other methods?*

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Internalization Theory

- FDI is more likely to occur when transaction costs with a second firm are high.
- **Transaction costs** are costs associated with negotiating, monitoring, and enforcing a contract.

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Dunning's Eclectic Theory

- FDI reflects both international business activity and business activity internal to the firm.
- Three conditions for FDI:
  - Ownership advantage
  - Location advantage
  - Internalization advantage

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Table 6.5 Factors Affecting the FDI Decision

Supply Factors	Demand Factors	Political Factors
Production costs	Customer access	Avoidance of trade barriers
Logistics	Marketing advantages	Economic development incentive
Resource availability	Exploitation of competitive advantages	
Access to technology	Customer mobility	

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Group assignments

- What are the comparative advantages of China, India and the four Asian tiger economies?-→class project for quiz 1
- Bread talk case (answer the questions)→makalah hanya menjawab pertanyaan -→2 groups

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Skema Makalah

- I. Pendahuluan
- II. Kajian Teori
- 2.1. Teori Trade *(Trade Theory)*
- *2.*1.1. Absolute Advantage
- *2.1.2. Comparative Advantage*
- *2.1.3. Comparative Advantage with money*
- *2.1.4. Competitive Advantage*
- III. Country Analysis
- !V. Analisis Comp Advantage dari masing-masing negara (jawaban dari pertanyaan)
- V. Kesimpulan

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Presentasi

- 2 PPT : Comparative advantage dan Bread Talk

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