International Trade

Chapter Preview

• Discuss the volume and patterns of world trade
• Identify the inherent flaws of mercantilism
• Explain the absolute and comparative advantage theories
• Describe the factor proportions and international product life cycle theories
• Explain the new trade and national competitive advantage theories
International Trade

Purchase, sale, or exchange of goods and services across national borders

- People have larger selection of products
- Important engine for job creation

Trade and World Output

- World trade
  - 80% merchandise
  - 20% services

- World output impacts trade
  - Growing output = growing trade
  - Sluggish output = sluggish trade

- World trade grows faster than world output
World’s Top Exporters

<table>
<thead>
<tr>
<th>Rank</th>
<th>Exporter</th>
<th>Value (U.S. $ billion)</th>
<th>Share of World Total (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Korea</td>
<td>1,112.0</td>
<td>9.2</td>
</tr>
<tr>
<td>2</td>
<td>United States</td>
<td>1,088.3</td>
<td>8.6</td>
</tr>
<tr>
<td>3</td>
<td>China</td>
<td>988.9</td>
<td>8.0</td>
</tr>
<tr>
<td>4</td>
<td>Japan</td>
<td>641.9</td>
<td>5.4</td>
</tr>
<tr>
<td>5</td>
<td>France</td>
<td>495.6</td>
<td>4.1</td>
</tr>
<tr>
<td>6</td>
<td>Netherlands</td>
<td>462.4</td>
<td>3.8</td>
</tr>
<tr>
<td>7</td>
<td>United Kingdom</td>
<td>445.3</td>
<td>3.7</td>
</tr>
<tr>
<td>8</td>
<td>Italy</td>
<td>410.6</td>
<td>3.4</td>
</tr>
<tr>
<td>9</td>
<td>Canada</td>
<td>385.5</td>
<td>3.2</td>
</tr>
<tr>
<td>10</td>
<td>Belgium</td>
<td>362.2</td>
<td>3.1</td>
</tr>
</tbody>
</table>

World’s Top Service Exporters

<table>
<thead>
<tr>
<th>Rank</th>
<th>Exporter</th>
<th>Value (U.S. $ billion)</th>
<th>Share of World Total (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>United States</td>
<td>288.8</td>
<td>16.3</td>
</tr>
<tr>
<td>2</td>
<td>United Kingdom</td>
<td>227.5</td>
<td>8.3</td>
</tr>
<tr>
<td>3</td>
<td>Germany</td>
<td>168.8</td>
<td>6.1</td>
</tr>
<tr>
<td>4</td>
<td>Japan</td>
<td>122.5</td>
<td>4.4</td>
</tr>
<tr>
<td>5</td>
<td>France</td>
<td>114.5</td>
<td>4.2</td>
</tr>
<tr>
<td>6</td>
<td>Spain</td>
<td>105.5</td>
<td>3.8</td>
</tr>
<tr>
<td>7</td>
<td>Italy</td>
<td>97.5</td>
<td>3.5</td>
</tr>
<tr>
<td>8</td>
<td>China</td>
<td>91.4</td>
<td>3.3</td>
</tr>
<tr>
<td>9</td>
<td>Netherlands</td>
<td>82.5</td>
<td>3.0</td>
</tr>
<tr>
<td>10</td>
<td>India</td>
<td>73.6</td>
<td>2.7</td>
</tr>
</tbody>
</table>


Trade Patterns

Merchandise trade among: Low- and middle-income nations, High-income nations, High-income and low- and middle-income nations

Western European trade is mostly intra-regional trade

North America imports twice as much from Asia as it exports to Asia
Who Trades with Whom?

### Total Dependence

<table>
<thead>
<tr>
<th>Origin</th>
<th>North America</th>
<th>South and Central America</th>
<th>Commonwealth of Independent States</th>
<th>Africa</th>
<th>Middle East</th>
<th>Asia</th>
<th>World</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>195</td>
<td>107</td>
<td>270</td>
<td>8</td>
<td>22</td>
<td>42</td>
<td>314</td>
</tr>
<tr>
<td>South and Central America</td>
<td>115</td>
<td>112</td>
<td>88</td>
<td>6</td>
<td>11</td>
<td>8</td>
<td>62</td>
</tr>
<tr>
<td>Europe</td>
<td>1310</td>
<td>67</td>
<td>362</td>
<td>142</td>
<td>120</td>
<td>129</td>
<td>366</td>
</tr>
<tr>
<td>Commonwealth of Independent States</td>
<td>34</td>
<td>8</td>
<td>247</td>
<td>10</td>
<td>6</td>
<td>13</td>
<td>46</td>
</tr>
<tr>
<td>Aten</td>
<td>80</td>
<td>11</td>
<td>148</td>
<td>1</td>
<td>33</td>
<td>6</td>
<td>73</td>
</tr>
<tr>
<td>Middle East</td>
<td>72</td>
<td>4</td>
<td>110</td>
<td>3</td>
<td>21</td>
<td>72</td>
<td>340</td>
</tr>
<tr>
<td>Asia</td>
<td>798</td>
<td>70</td>
<td>604</td>
<td>50</td>
<td>70</td>
<td>111</td>
<td>1089</td>
</tr>
<tr>
<td>World</td>
<td>2755</td>
<td>378</td>
<td>1116</td>
<td>290</td>
<td>283</td>
<td>381</td>
<td>2839</td>
</tr>
</tbody>
</table>

Note: Regional figures do not equal world totals because of rounding and World Trade Organization data collection methods.


### Potential effects of dependence:

- Infuses needed capital
- Creates jobs and raises wages
- Imports technology and skills
- Economic problems transferred
- Political turmoil can spill over
**Trade Theory Timeline**

- **1500**: Mercantilism
- **1600**: Absolute Advantage
- **1700**: Comparative Advantage
- **1800**: Factor Proportions Theory
- **1900**: New Trade Theory
- **2000**: National Competitive Advantage

**Mercantilism**

Nations accumulate financial wealth by encouraging exports and discouraging imports

**Three pillars**
- Maintain trade surplus
- Government intervention
- Exploit colonies

**Inherent flaws**
- World trade is zero-sum game
- Constrains output and consumption
- Limits colonies’ market potential
Absolute Advantage

Ability of a nation to produce a good more efficiently than any other nation (greater output using same or fewer resources)

Riceland
1 resource unit = 1 ton rice or 1/5 ton tea

Tealand
1 resource unit = 1/6 ton rice or 1/3 ton tea

Specialization and trade allows each to produce and consume more

Trade Gains: Absolute Advantage
Comparative Advantage

Inability of a nation to produce a good more efficiently than other nations, but an ability to produce that good more efficiently than it does any other good.

Riceland

1 resource unit = 1 ton rice or 1/2 ton tea

Tealand

1 resource unit = 1/6 ton rice or 1/3 ton tea

Specialization and trade allow each to produce and consume more.

Trade Gains: Comparative Advantage
Assumptions and Limitations

1. Nations strive only to maximize production and consumption
2. Only two countries produce and consume just two goods
3. No transportation costs of trading goods
4. Labor is the only resource used to produce goods
5. Ignores efficiency and improvement gains from producing just one good

Factor Proportions Theory

Countries produce and export goods that require resources (factors) in abundance, and import goods that require resources in short supply.
Leontief Paradox

Research discovered evidence opposite the prediction of factor proportions theory
✓ U.S. exports are more labor-intensive than U.S. imports

Possible explanation
✓ Theory assumes nation's production factors to be homogeneous
✓ Theory is better predictor when expenditures on labor are considered

International Product Life Cycle

A company begins by exporting its product and later undertakes foreign direct investment as a product moves through its life cycle.
### New Trade Theory

<table>
<thead>
<tr>
<th>Fundamentals</th>
<th>First-mover advantage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gains from specialization and increasing economies of scale</td>
<td>Economic and strategic advantage of being first to enter an industry</td>
</tr>
<tr>
<td>Companies first to market create barriers to entry</td>
<td>May create a formidable barrier to market entry for potential rivals</td>
</tr>
<tr>
<td>Government may help by assisting home companies</td>
<td></td>
</tr>
</tbody>
</table>

### National Competitive Advantage

Nation’s competitiveness in an industry depends on the industry’s capacity to innovate and upgrade, which in turn depends on four main determinants (plus government and chance):

- Factor conditions
- Demand conditions
- Related and supporting industries
- Firm strategy, structure, and rivalry
### Factor Conditions

<table>
<thead>
<tr>
<th>Basic factors</th>
<th>Advanced factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nation’s resources (large workforce, natural resources, climate, and surface features)</td>
<td>Result of investing in education and innovation (skill of workforce segments, technological infrastructure)</td>
</tr>
</tbody>
</table>

Basic factors can spark initial production, but advanced factors account for sustained competitive advantage.

### Demand Conditions

Sophisticated home-market buyers drive companies to improve existing products and develop entirely new products and technologies.

This should improve the competitiveness of the entire group of companies in a market.
Related and Supporting Industries

Companies in an internationally competitive industry do not exist in isolation

Supporting industries form “clusters” of economic activity in the geographic area

Each industry reinforces the competitiveness of every other industry in the cluster

---

Mapping U.S. Clusters
Firm Strategy, Structure, and Rivalry

- Highly skilled managers are essential because strategy has lasting effects on firm competitiveness
- Domestic industry whose structure and rivalry create an intense struggle to survive, strengthens its competitiveness

Chapter Review

- Discuss the volume and patterns of world trade
- Identify the inherent flaws of mercantilism
- Explain the absolute and comparative advantage theories
- Describe the factor proportions and international product life cycle theories
- Explain the new trade and national competitive advantage theories