Theories of International Business

Classical Theories of Trade & Investment

-Mercantilism:

-Maximising Reserves of Bullion; Gold & Silver.

-Produce Domestically & Export at Large Scale (Minimal Imports).

-High Scale Government Intervention.

-Conflate Political & Economic Power; Associated With Trade Surplus.

-Example: China → Deliberately Keeping Currency Low Against the US Dollar.

-Disadvantage: Balance of Payments at a Surplus of Greater Exports → Results in Domestic Inflation.

-Example, France (Low Exports, High Imports), England (High Exports, Low Imports).

-England: Import More French Goods, Less Expensive.

-France: Import Fewer English Goods, More Expensive.

-Deterioration in the Balance of Trade (England), Improvement in Balance of Trade (France).

-Continues Until the Surplus of Trade is Eliminated; Domestic Economic Pressure to Import (England), and to Reduce Imports (France)

→ Reducing English Exports, Increasing French Exports.

-Absolute Advantage (A. Smith): A Country is the Most Efficient Producer of a Given Good (Uses Fewer Resources)

-More & Better Quality Goods Given the Same Input of All Countries.

-Beneficial to Buy Goods Made by the Most Efficient Producer (as Opposed to Domestic Production) → Make More of the Product For Less, Cheaper to Import.

-Devote Production to Goods in Which the Country Has an Absolute Advantage of Output When Producing.

-Comparative Advantage (D. Ricardo): Specialise in Production of Goods Most Efficient at, Import Goods They Produce Less Efficiently.

-Ability to Produce the Good at a Lower Opportunity Cost.

-Example: South Africa & Japan.

-Japan: Opportunity Cost to Produce 1 DVD is 2 Bags of Wheat.

-South Africa: Opportunity Cost to Produce 1 DVD is 5 Bags of Wheat.

-Japan Has the Comparative Advantage to Produce DVD's at LESS Expense.

-Revealed Comparative Advantage:

Percentage of Exports of a Product (for a Given Country) / Average Percentage of Exports of a Product (Worldwide)

-Greater Than One → Export Strength Relatively Higher Than Average (RCA)

Problems with Ricardian Model

-Simple World with 2 Countries & 2 Goods.

-Transportation Costs.

-Differences in the Price of Resources.

-Free Movement of Goods Between Countries?

Problems with Classical Trade Theories

-Does Not Account For:

-Immobile Resources: Immediately Sacrificing Production of One Thing For Another, Improbable to Achieve.

-Diminishing Returns: When More Effective at Producing Things → Overall Cost Decreases.

-Dynamic Effects: Significant Levels of Capital or Stock Available Due to Trade → Changes Production Capabilities.

-Economic Growth: Causes Growth at Different Rates Across Countries.

Modern Theories of Trade & Investment

-Heckscher-Ohlin Theory: Comparative Advantage Arises From Differences in National Factor Endowments.

-Naturally Occuring; Labour, Land & Resources → Comparative Advantage.

-Exports Goods That They are Abundant in.

-Leontief Paradox:

-USA → Abundance of Capital (Assumed to be Imports From Labour Intensive Industries).

-Abundance of Capital → Largely From Goods Produced Domestically (Not Necessarily Imports).

-Product Life Cycle Theory (R. Vernon):

(1) Introduction: of Good Produced.

(2) Growth: of Product Consumption.

(3) Maturity: Expansion into International Market.

(4) Decline: Increasing Competition & Natural Occurrence.

-New Trade Theory: Diminishing of Marginal Costs for Greater Levels of Profit.

-Greater Efficiency & Effectiveness → Increased Economies of Scale (Saving in Costs Due to Increased Production).