International Trade

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International Trade

- The impetus for the existence and expansion of international trade is the same as that for any commercial transaction: **value creation**. International trade creates value for both producers and consumers

International Trade

- increases **demand** for exportable products → raising **prices** and **volumes**
- increases the **supply** for importable products → reducing **prices** and increasing **availability** and **variety** for consumers
- increases the **efficiency of resource allocation** worldwide → reduces **production costs** and lowers **input costs**

Economies of Scale

International Trade

- International trade leads to increased exposure for both firms and countries to the forces in the international economy, and disruption and restructing.

Increased openness to the international economic environment ➡

- Changes in prices and demand in export markets
- Changes in prices and supply in imported products
- Changes in exchange rates

➡

- increase the risks of a firm's operations
- reduce the stability of a country's economy

Less expensive or higher-quality imported products ➡ Increased competition for domestic firms ➡ Disruption and restructing

International Trade

- International trade is inextricably linked with **FDI**, **international technology transfer** and **international finance**.

International Trade

- **FDI**: change trade flows and patterns
- **International financial flows**: foreign exchange availability and exchange rate movements impact on trade
- **International technology transfer** (capital goods): leads to trade in materials and semi-finished and financial products

Impediments to Trade

The third block of analysis: impediments to trade:

- Government policies to restrict and to promote trade can have a decisive influence on:
  - Trade flows
  - The competitive position of firms in export markets
  - The availability and price of imports
  - The ability of firms to compete with imports
- Governments can also facilitate exports directly by:
  - Concessional export financing
  - Export subsidies
  - Differential taxation of export earnings
  - Financing for export market development

Trade Intermediaries

If the last three factors are settled:

- Trade Intermediaries analyze the linkages of producers on one country to buyers in the export market.

  The product must be:

  Transported from the factory to the point of shipment (port or airport)

  Transported to export market

  Be received in the export market

  Clear customs

  Move through distribution channels to the point of sale

  Sold to the customer

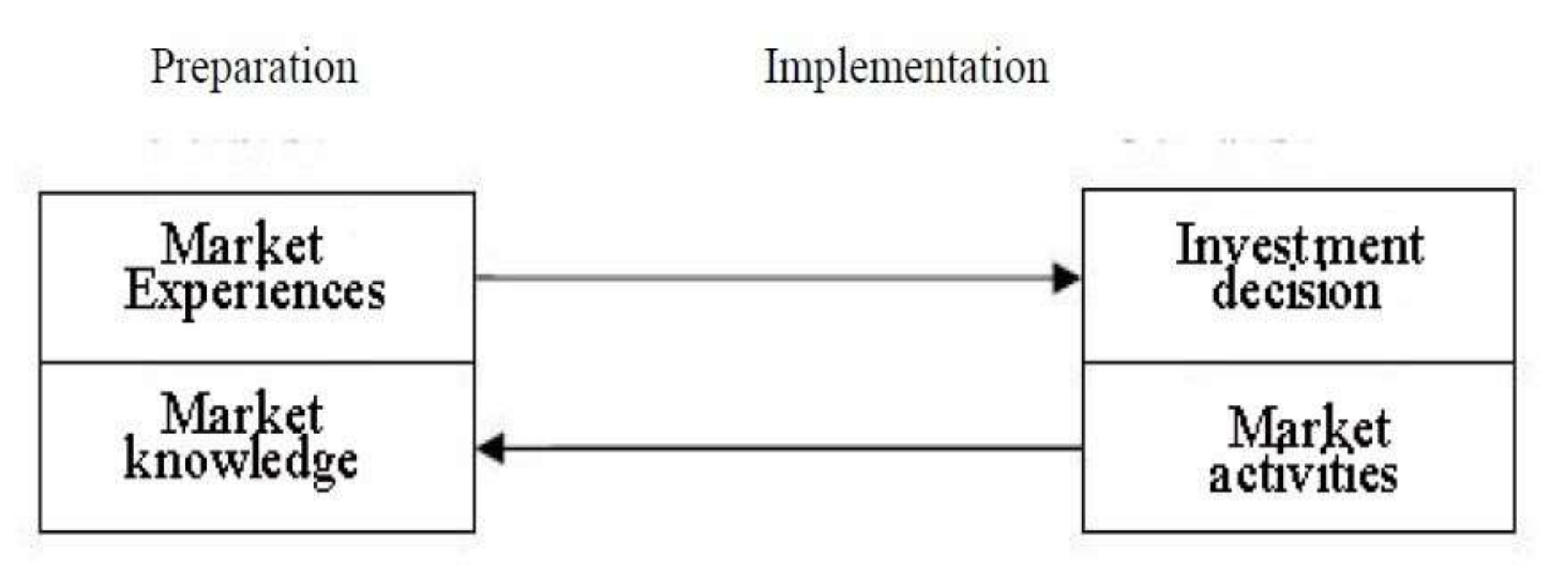
  Be serviced after sale

- International channels of distribution are often long, multilayered, complex, difficult to analyze and understand, and expensive to access or to develop. Channel costs may represent three times the production cost of a product.

The Internationalization Process

Internationalization is the process by which firms increase their awareness of the influence of international activities on their future, and establish and conduct transactions with firms from other countries.

Internationalization Process



Johanson, J. and Vahlne, J. E. (1998). “The Mechanism of Internationalization”, International Marketing Review, 7(4), pp.11-24,1990.

Dimensions

- Internationalization has *outward-looking* and *inward-looking* dimensions:

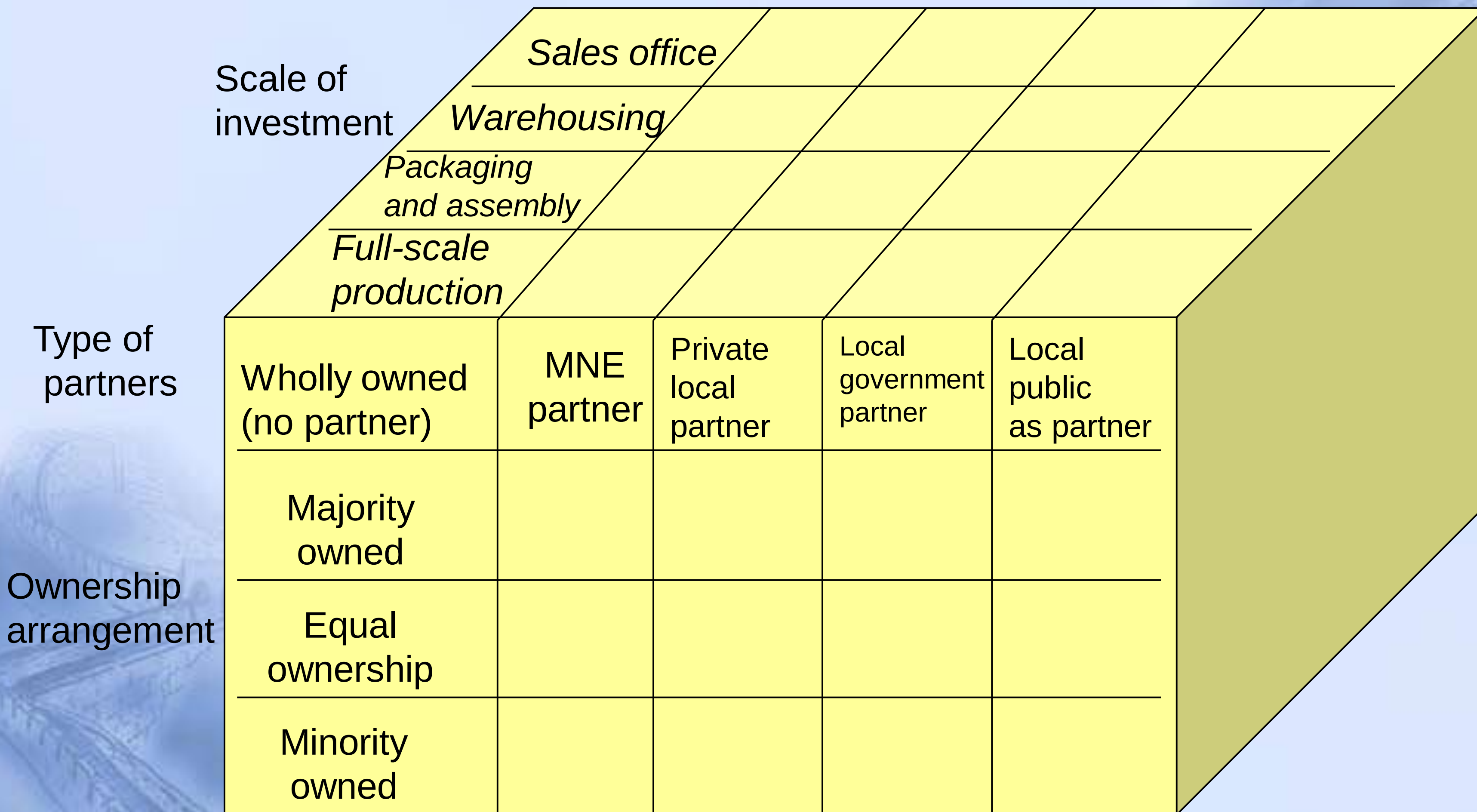
1) Outward-looking perspective:

a. Exporting
b. Acting as licensor to a foreign company
c. Establishing joint ventures outside the home country with foreign companies
d. Establishing or acquiring wholly owned businesses outside the home country

Stages model of international expansion:

a. indirect/ad hoc exporting
b. active exporting and/or licensing
c. active exporting, licensing, and joint equity investment in foreign manufacture
d. full-scale multinational marketing and production

The Foreign Direct Investment of MNEs



Forms of Foreign Investment

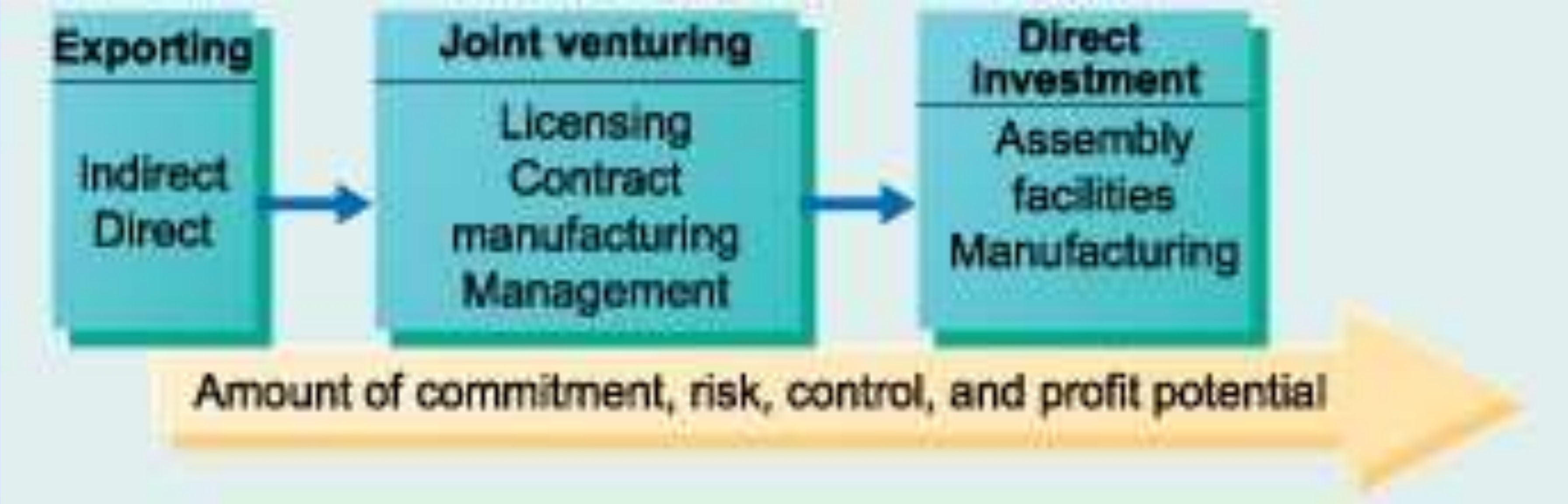
	Partially Owned	**Wholly Owned**
Existing Business	Capital Participation	Acquisition
New Business	Joint Venture	Greenfield

Types of International New Ventures

Coordination of Value Chain Activities	Few	Many
Few Activities Coordinated across Countries (Primate Logistics)	New International Market Makers Exporting/Import Start-up	Multinational Trader
Many Activities Coordinated across Countries	Geographically Focused Start-up	Global Start-up

Number of Countries Involved

Deciding How to Enter the Market



Market Entry Strategies

Exporting: Entering a foreign market by selling goods produced in the company's home country, often with little modification.

Joint Venturing

Joint venturing: Entering foreign markets by jointing with foreign companies to produce or market a product or service.

Licensing: A method of entering a foreign market in which the company enters into an agreement with a licensee in the foreign market.

Contract manufacturing: A joint venture in which a company contracts with manufacturers in a foreign market to produce the product or provide its service.

Joint Venturing

Management contracting: A joint venture in which the domestic firm suppliers the management know-how to a foreign company that supplies the capital; the domestic firm exports management services rather than products.

Joint ownership: A joint venture in which a company joins investors in a foreign market to create a local business in which the company shares joint ownership and control.

Direct Investment

The biggest involvement in a foreign market comes through direct investment---the development of foreign-based assembly or manufacturing facilities.

Foreign direct investment is done for many reasons including to take advantage of cheaper wages in the country, special investment privileges such as tax exemptions offered by the country as an incentive for investment or to gain tariff-free access to the markets of the country or the region.

Definition of Strategic alliances

- Strategic alliances are cooperative agreements between two or more companies to work together and share resources to achieve a common business objective, Each company maintains its autonomy while gaining a new opportunity
- A global strategic alliance is an agreement among two or more independent firm to co-operate for the purpose of achieving common goal such as a competitive advantage or customer value creation while remaining independent

Franchising

- Franchising
  - A marketing system revolving around a two-party agreement, whereby the franchisee conducts business according to the terms specified by the franchisor
- Franchisee
  - An entrepreneur whose power is limited by a contractual agreement with a franchisor
- Franchisor
  - The party in the franchise contract that specifies the methods to be followed and the terms to be met by the other party

Further Reading

On the differences between economists and noneconomists on international trade, see Bryan Caplan, "Straight Talk About Economic Literacy." Online at: http://www.mercatus.org/publications/pubid.3320/pub_detail.asp.

On the history of trade theory, see Steven Suranovic, *International Trade Theory and Policy Analysis.* Online at: http://internationalecon.com/v1.0/toc.html.

On capital flows and the balance of trade, see Arnold Kling, "The Balance of Saving." Online at: http://www.techcentralstation.com/111803C.html. Reprinted in *Learning Economics.* Online at: http://arnoldkling.com/econ/book/contents.html.

For the relationship between trade and jobs, see "Remarks by Vice Chairman Roger W. Ferguson, Jr. at the Conference on Trade and the Future of American Workers, Washington, D.C." Online at: http://www.federalreserve.gov/boarddocs/speeches/2004/20041007/default.htm.

For the effects of globalization and trade on the standard of living in developed and underdeveloped countries, see the World Bank's *Assessing Globalization.* Online at: http://www1.worldbank.org/economicpolicy/globalization/documents/AssessingGlobalizationP1.pdf.

For the argument that underdevelopment reflects trade and regulatory barriers, see Stephen L. Parente and Edward C. Prescott. *Barriers to Riches.* Cambridge: MIT Press, 2000.

For more on purchasing power parity, see Ken Rogoff. "The Purchasing Power Parity Puzzle." *Journal of Economic Literature* 34 (June 1996): 647–668. Online at: http://www.economics.harvard.edu/~krogoff//JEL1996.pdf.

Footnotes

1. See http://www.independent.org/students/garvey/essay.asp?id=1381.

2. Quoted from paragraphs 7.15-7.16 in *On the Principles of Political Economy and Taxation*. Available online at: http://www.econlib.org/library/Ricardo/ricP.html.

3. See http://econ.worldbank.org/prr/globalization/.

4. See http://www1.worldbank.org/economicpolicy/globalization/documents/AssessingGlobalizationP1.pdf.