STUDY GUIDE

Chapter 5

TRADING INTERNATIONALLY

Learning Objectives

After studying this chapter, you should be able to:

1. Use the resource-based and institution-based views to answer why nations trade.
2. Understand classical and modern theories of international trade.
3. Realize the importance of political realities governing international trade.
4. Participate in two leading debates concerning international trade.
5. Draw implications for action.

Chapter Outline: Key Concepts and Terms

I. WHY DO NATIONS TRADE?

1. Key Concept

The resource-based view suggests that nations trade because some firms in one nation generate valuable, unique, and hard-to-imitate exports that firms in other nations find it beneficial to import. The institution-based view argues that as "rules of the game," different laws and regulations governing international trade aim to share gains from trade.

2. Key Terms

Balance of trade: the aggregation of buying (importing) and selling (exporting) by both sides leads to the country-level trade surplus or deficit.

Export: selling abroad.

Importing: buying from abroad.

Merchandise: transactions involving tangible goods.

Service: transactions involving intangibles.

Trade deficit: an economic condition in which a nation imports more than it exports.

Trade surplus: an economic condition in which a nation exports more than it imports.

II. THEORIES OF INTERNATIONAL TRADE

1. Key Concepts

Classical theories include (1) mercantilism, (2) absolute advantage, and (3) comparative advantage. Modern theories include (1) product life cycles, (2) strategic trade, and (3) "diamond."

2. Key Terms

Absolute advantage involves being more efficient than anyone else in the production of any good or service.

Classical trade theories: the major theories typically studied consist of mercantilism, absolute advantage, and comparative advantage.

Comparative advantage is the relative (not absolute) advantage in one economic activity that one nation enjoys in comparison with other nations.

Factor endowments: the extent to which different countries possess various factors such as labor, land, and technology.

Factor endowment theory (or Heckscher-Ohlin theory) is the proposition that nations will develop comparative advantage based on their locally abundant factors.

First-mover advantages: advantages that first entrants enjoy and do not share with late entrants.

Free trade: the idea that free market forces should determine how much to trade with little (or no) government intervention.

Mercantilism: Classical trade theory that viewed international trade as a zero-sum game.

Modern trade theories: the major theories typically studied consist of product life cycle, strategic trade, and national competitive advantage.

Opportunity cost: given the alternatives, the cost of pursuing one activity at the expense of another activity.

Product life cycle theory: an economic theory that accounts for changes in the patterns of trade over time.

Protectionism: the idea that governments should actively protect domestic industries from imports and vigorously promote exports.

Resource mobility: the assumption that a resource removed from one industry can be moved to another.

Strategic trade policy: economic policies that provide companies a strategic advantage through government subsidies.

Strategic trade theory: a theory that suggests that strategic intervention by governments in certain industries can enhance their odds for international success.

Subsidy: Government payments to domestic firms.

Theory of absolute advantage: the economic advantage one nation enjoys that is absolutely superior to other nations.

Theory of comparative advantage: the relative (not absolute) advantage in one economic activity that one nation enjoys in comparison with other nations.

Theory of Mercantilism: the belief that held that the wealth of the world (measured in gold and silver) was fixed and that a nation that exported more and imported less would enjoy the net inflows of gold and silver and thus become richer.

Theory of national competitive advantage of industries (or diamond theory). The theory that the competitive advantage of certain industries in different nations depends on four aspects that form a "diamond."

III. REALITIES OF INTERNATIONAL TRADE

1. Key Concepts

The net impact of various tariffs and NTBs is that the whole nation is worse off while certain special interest groups (such as certain industries, firms, and regions) benefit. Economic arguments against free trade center on (1) protectionism and (2) infant industries. Political arguments against free trade focus on (1) national security, (2) consumer protection, (3) foreign policy, and (4) environmental and social responsibility.

2. Key Terms

Administrative policy: bureaucratic rules that make it harder to import foreign goods.

Antidumping duty: costs levied on imports that have been "dumped" (selling below costs to "unfairly" drive domestic firms out of business).

Deadweight cost: net losses that occur in an economy as the result of tariffs.

Import quota: restrictions on the quantity of imports for specific period of time.

Import tariff: a tax imposed on imports.

Infant industry argument: the belief that if domestic firms are as young as "infants," in the absence of government intervention, they stand no chance of surviving and will be crushed by mature foreign rivals.

Local content requirements: a requirement that a certain proportion of the value of the goods made in one country originates from that country.

Nontariff barrier (NTB): laws, selective enforcement of laws, government purchasing policies and other means used intended to place products and investments of companies based in other countries at a competitive disadvantage compared to local companies.

Resource mobility: assumption that a resource used in producing a product for one industry can be shifted and put to use in another industry.

Subsidy: government payment to domestic firms to produce a competitive advantage.

Tariff barrier: taxes intended to result in products produced overseas to be priced higher than products produced locally.

Trade embargo: politically motivated trade sanctions against foreign countries to signal displeasure.

Voluntary export restraint: a superficial policy to show that exporting countries voluntarily agree to restrict their exports.

IV. DEBATES AND EXTENSIONS

1. Key Concepts

The first debate deals with whether persistent trade deficit is of grave concern or not. The second deals with whether service trade will benefit or hurt rich countries.

V. MANAGEMENT SAVVY

1. Key Concepts

Managers should discover and leverage the comparative advantage of world-class locations. Monitor and nurture current comparative advantage of certain locations and take advantage of new locations. Be politically active to demonstrate, safeguard, and advance the gains from international trade.