Firms in the Global Economy: Export Decisions, Outsourcing, and Multinational Enterprises

1. The Theory of Imperfect Competition:

Introduction to Imperfect Competition

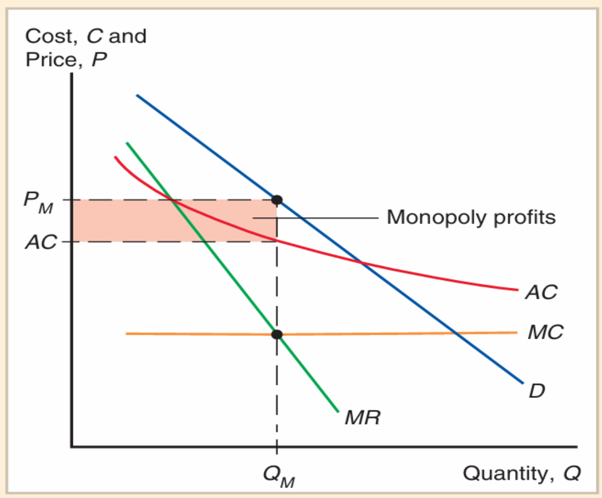
This section begins by explaining how economies of scale lead to market structures where perfect competition does not exist. In these markets, firms can lower their average costs by increasing production, which gives them pricing power and the ability to influence the market.

Monopoly: A Brief Review: Here, the text reviews the concept of monopoly, where a single firm dominates the market, setting prices and output levels without competition. The monopoly firm faces a downward-sloping demand curve, which means it can influence the market price by adjusting its output.

Figure 8-1

Monopolistic Pricing and Production Decisions

A monopolistic firm chooses an output at which marginal revenue, the increase in revenue from selling an additional unit, equals marginal cost, the cost of producing an additional unit. This profit-maximizing output is shown as Q_M; the price at which this output is demanded is P_M. The marginal revenue curve *MR* lies below the demand curve *D* because, for a monopoly, marginal revenue is always less than the price. The monopoly's profits are equal to the area of the shaded rectangle, the difference between price and average cost times the amount of output sold.



Monopolistic Competition: This part describes markets where many firms sell differentiated products. Each firm has some market power because of product differentiation, which allows them to set prices above marginal cost. Unlike monopolies, firms in monopolistic competition face competition from other firms, but still retain some pricing power due to brand loyalty or unique features of their products.

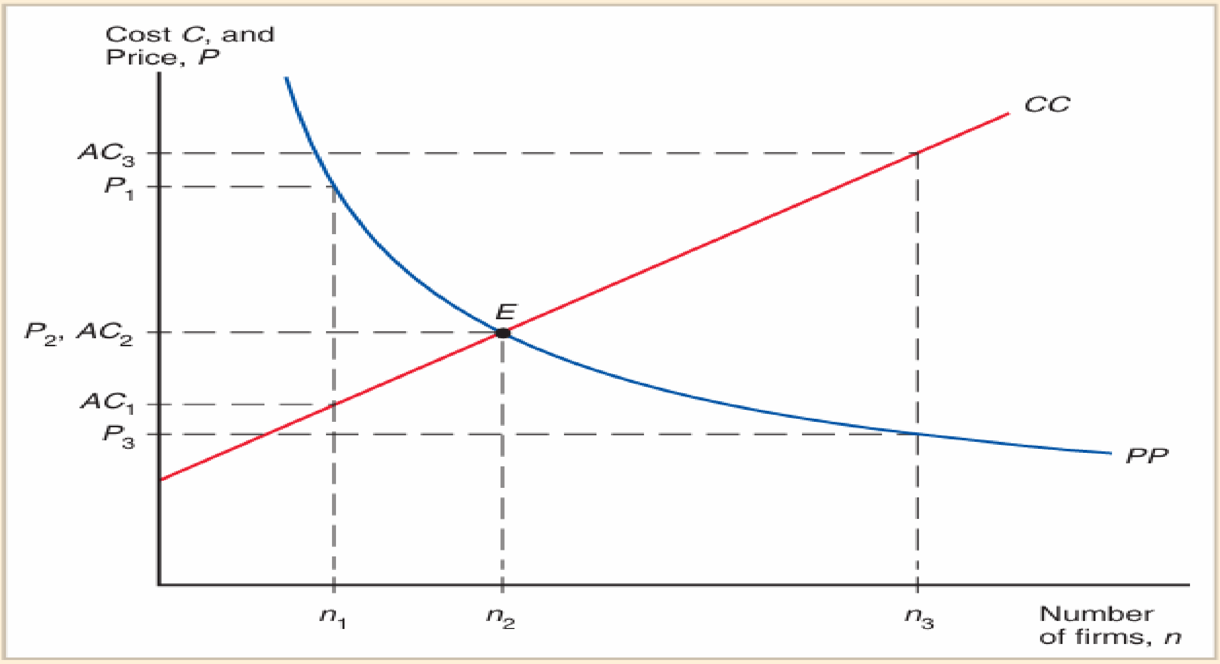


Figure 8-3

Equilibrium in a Monopolistically Competitive Market

The number of firms in a monopolistically competitive market, and the prices they charge, are determined by two relationships. On one side, the more firms there are, the more intensely they compete, and hence the lower is the industry price. This relationship is represented by *PP*. On the other side, the more firms there are, the less each firm sells and therefore the higher is the industry's average cost. This relationship is represented by *CC*. If price exceeds average cost (that is, if the *PP* curve is above the *CC* curve), the industry will be making profits and additional firms will enter the industry; if price is less than average cost, the industry will be incurring losses and firms will leave the industry. The equilibrium price and number of firms occurs when price equals average cost, at the intersection of *PP* and *CC*.

2. Monopolistic Competition and Trade:

Monopolistic Competition and Trade: This section discusses how international trade can occur even without comparative advantage due to economies of scale and product differentiation. Firms in different countries produce similar but differentiated products, leading to trade based on consumers' preference for variety.

The Effects of Increased Market Size: Here, the text explains how increasing the size of the market through trade allows firms to produce at a larger scale, reducing average costs and offering more variety to consumers. This results in lower prices and greater consumer satisfaction.

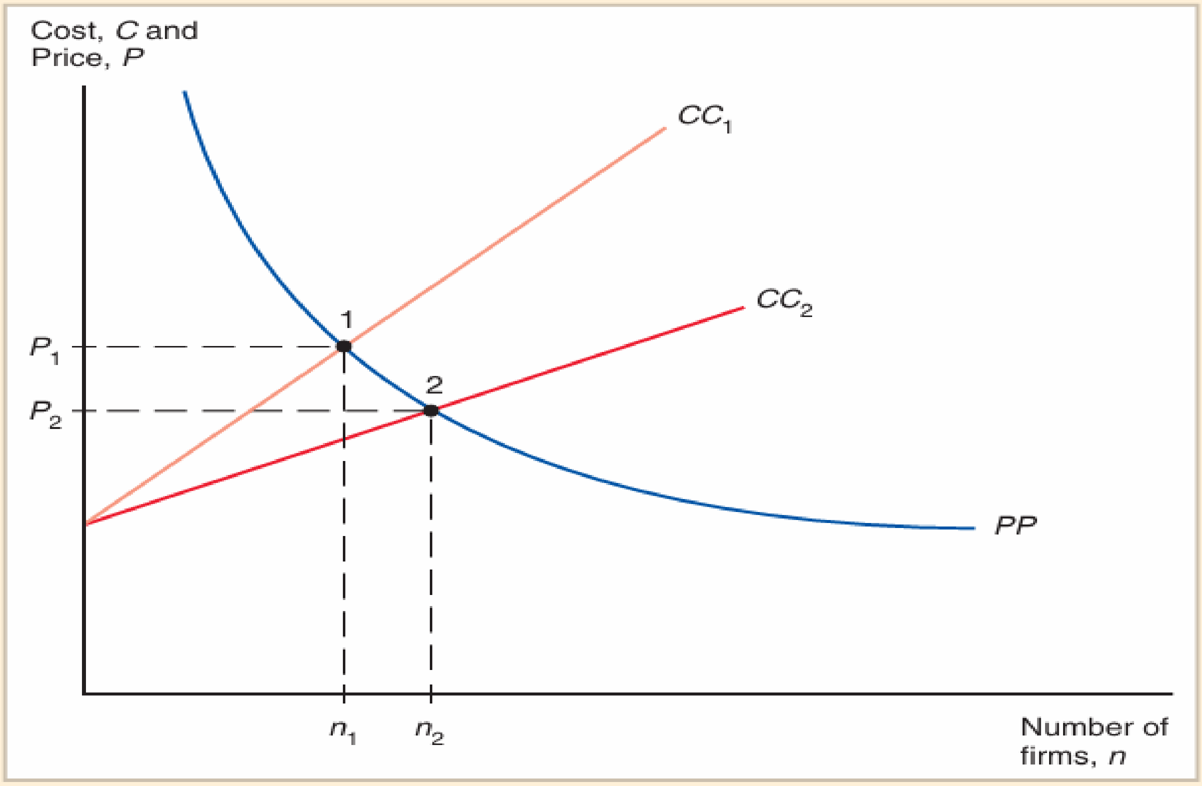


Figure 8-4

Effects of a Larger Market

An increase in the size of the market allows each firm, other things equal, to produce more and thus have lower average cost. This is represented by a downward shift from CC_1 to CC_2. The result is a simultaneous increase in the number of firms (and hence in the variety of goods available) and a fall in the price of each.

Gains from an Integrated Market: A Numerical Example: This part provides a numerical example to illustrate how integrating markets can lead to gains in welfare. By combining markets, firms can achieve economies of scale, reduce prices, and increase the variety of products available to consumers.

The Significance of Intra-Industry Trade: This section highlights the importance of trade within the same industry, known as intra-industry trade. It explains that countries often export and import similar products, benefiting from the increased competition and variety that trade brings.

3. Firm Responses to Trade: Winners, Losers, and Industry Performance:

Firm Responses to Trade: This section analyzes how firms respond to international trade. It discusses that some firms benefit from trade by expanding their markets and increasing their efficiency, while others may struggle to compete with foreign firms.

Winners and Losers: Here, the text identifies which firms benefit from trade and which do not. Firms that are more efficient and can achieve economies of scale tend to be the winners, while less efficient firms may lose market share or be forced to exit the market.

Industry Performance: This part discusses how trade can improve overall industry performance. By allowing more efficient firms to expand and less efficient firms to contract, trade leads to a more efficient allocation of resources within industries, promoting innovation and productivity.\

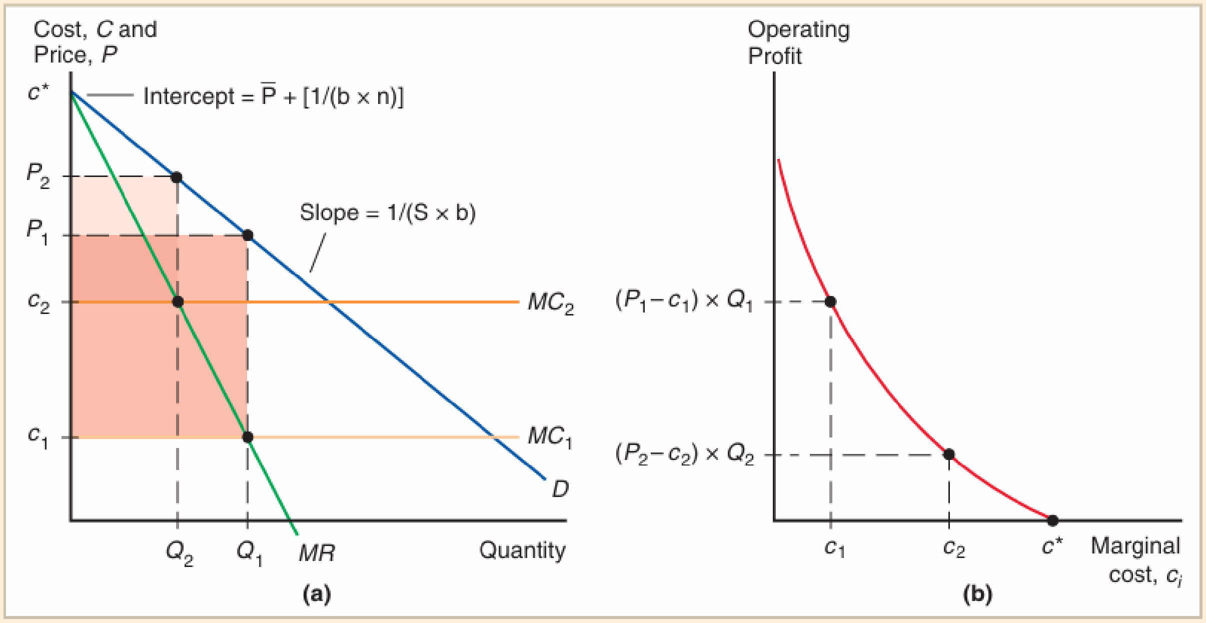


Figure 8-6

Performance Differences Across Firms

(a) Demand and cost curves for firms 1 and 2. Firm 1 has a lower marginal cost than firm 2: $c_1 < c_2$. Both firms face the same demand curve and marginal revenue curve. Relative to firm 2, firm 1 sets a lower price and produces more output. The shaded areas represent operating profits for both firms (before the fixed cost is deducted). Firm 1 earns higher operating profits than firm 2. (b) Operating profits as a function of a firm's marginal cost c_i. Operating profits decrease as the marginal cost increases. Any firm with marginal cost above c^* cannot operate profitably and shuts down.

4. Trade Costs and Export Decisions:

Trade Costs and Export Decisions: This section examines the various costs associated with trade, such as transportation, tariffs, and regulatory barriers, and how these costs influence firms' decisions to export. High trade costs can deter firms from entering foreign markets, while low costs encourage export activity.

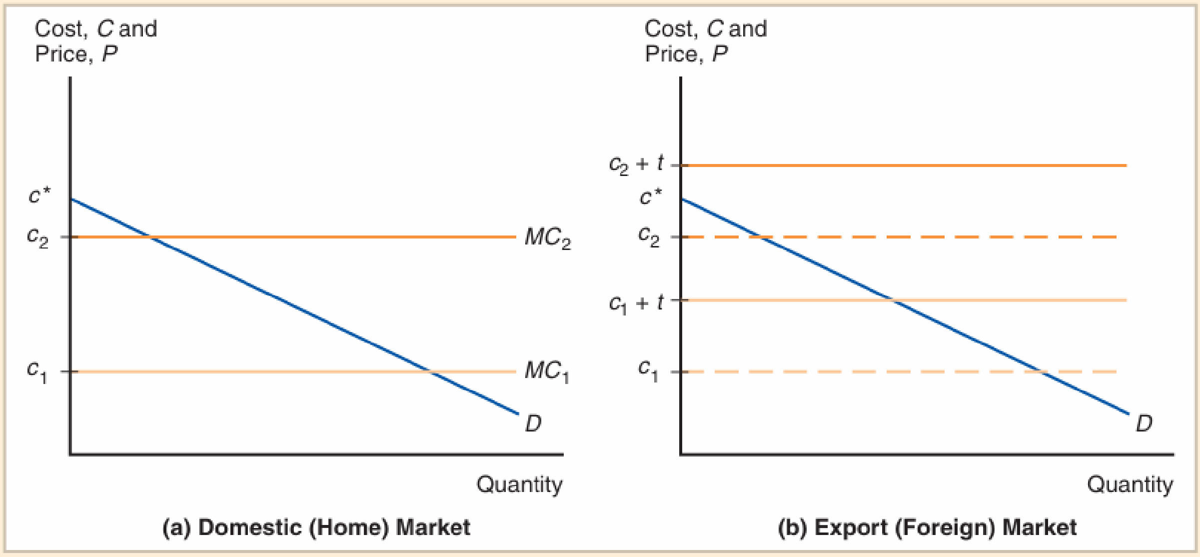


Figure 8-8

Export Decisions with Trade Costs

(a) Firms 1 and 2 both operate in their domestic (Home) market. (b) Only firm 1 chooses to export to the Foreign market. It is not profitable for firm 2 to export given the trade cost *t*.

Dumping: Here, the text explains the concept of dumping, where firms sell products in foreign markets at prices lower than in their domestic markets. Dumping can be used as a competitive strategy to gain market share abroad but may lead to trade disputes and protectionist measures.

CASE STUDY: Antidumping as Protectionism:

This case study presents an example of how antidumping measures can be used as a form of protectionism. It illustrates how countries may impose antidumping duties to protect domestic industries from foreign competition, even when the justification for such measures is weak.

5. Multinationals and Outsourcing:

Multinationals and Outsourcing: This section discusses the rise of multinational enterprises (MNEs) and their significant role in global trade. It explores how MNEs operate in multiple countries, leveraging differences in costs and markets to enhance their competitiveness.

CASE STUDY: Patterns of Foreign Direct Investment Flows Around the World:

This case study analyzes patterns of foreign direct investment (FDI) and its impact on global economic integration. It examines how FDI flows are distributed across different regions and industries, and how these investments contribute to economic development.

Consequences of Multinationals and Foreign Outsourcing: This part evaluates the economic and social consequences of MNEs and outsourcing. It discusses both the positive effects, such as increased efficiency and economic growth, and the potential negative impacts on income distribution and labor markets.

6. Summary

The summary recaps the key points discussed in the chapter. It emphasizes the role of economies of scale in shaping firm behavior and market outcomes in the global economy. It also highlights the importance of understanding how firms make decisions regarding exporting, outsourcing, and becoming multinational enterprises, and how these decisions influence global trade patterns and economic welfare.