

CHAPTER

2

THEORIES OF INTERNATIONAL TRADE

Chapter Outline

- (A) Introduction;
- (B) Mercantilism;
- (C) Theory of Absolute Cost Advantage;
- (D) Comparative Cost Advantage Theory;
- (E) Comparative Cost Advantage with Money;
- (F) Relative Factor Endowments Theory;
- (G) Country Similarity Theory;
- (H) Product Life Cycle Theory;
- (I) Global Strategic Rivalry Theory;
- (J) Porter's National Competitive Advantage.

Learning Objectives

After studying this chapter, you should be able to –

- Know the origin of international trade theories;
- Analyse the international trade theories from the point of view of labour cost; factor endowments;
- Understand the international trade theories based on various factors of production/ factor endowments;
- Distinguish country-based theories from industry-based theories and company-based theories;
- Appreciate Porter's national competitive advantage;
- Draw a comprehensive basis for international trade.

theory of international trade.

(B)

MERCANTILISM

Mercantilism is the oldest international trade theory that formed the foundation of economic thought during about 1500 to 1800.² According to this theory the holdings of a country's treasure primarily in the form of gold constituted its wealth. This theory specifies that countries should export more than they import and receive the value of trade surplus in the form of gold from those countries which experience trade deficits.

BOX 2.1 : PROTECTIONISM VS. FREE TRADE : CASE OF FRENCH CANDLE MAKERS

French economist Fredric Bastiat's "The Protectionism of French Candle Makers", (1873) is used to illustrate what protection of a domestic industry from foreign competition implies.

We are subjected to the intolerable competition of a foreign rival whose superior facilities for making light enable him to flood the French market at so low a price as to take away all our markets. The moment he appears, suddenly an important branch of French industry disappears. This rival is the sun.

He asks a law to shut up all windows, dormers, openings, holes, chinks, and fissures through which sunlight penetrates. Our industry manufactures such valuable manufactures that our

answered the objection. When told that the consumer is interested in free importation of iron, coal, corn, wheat, cloth, etc., you have answered that the producer is interested in their exclusion. You have always acted to encourage labour, to increase the demand for labour.

Will you say the sunlight is a free gift, and that to repulse free gifts is to repulse riches under pretense of encouraging the means of obtaining them? Take care you deal a death blow to your own policy. Remember: hitherto you have always repulsed foreign produce because it was an approach to a free gift and closer this approach, the more you have repulsed the good. When we buy a Portuguese...

Governments imposed restrictions on imports and encouraged exports in order to prevent trade deficit and experience trade surplus (See Box 2.1). Colonial powers like the British used to trade with their colonies like India, Sri Lanka, etc., by importing the raw materials from and exporting the finished goods to colonies. The colonies had to export less valued goods and import more valued goods. Thus, colonies were prevented from manufacturing. This practice allowed the colonial powers to enjoy trade surplus and forced the colonies to experience trade deficits. The theory benefited the colonial powers and caused much discontent in the colonies. In fact, this was the background situation for the American Revolution.

Benefited
colonial powers
and caused
discontent in the
colonies.

The Mercantilism theory suggests for maintaining favourable balance of trade in the form of import of gold for export of goods and services. But the decay of gold standard reduced the validity of this theory. Consequently this theory was modified in Neo-mercantilism.

Decay of gold
standard reduced
the validity of
this theory.

Neo-mercantilism proposes that countries attempt to produce more than the demand in the domestic country in order to achieve a social objective like full employment in the domestic country or a political objective like assisting a friendly country.

This theory was attacked on the ground that the wealth of a nation is based on its available goods and services rather than on gold. Adam Smith developed the theory of absolute cost advantage which says that different countries can get the advantage of international trade by producing certain goods more efficiently than others. Now we shall discuss this theory.

(C) THEORY OF ABSOLUTE COST ADVANTAGE

Adam Smith, the Scottish economist viewed that mercantilism weakens a country. He advocated free trade among countries to increase a country's wealth. Free trade enables a country to provide a variety of goods and services to its people by specialising in the production of some goods and services and importing others. Which goods should a country produce and which goods it should import? Adam Smith proposed a theory to answer this question.

According to
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services.

Adam Smith proposed Absolute Cost Advantage Theory of International Trade (1776) based on the principle of division of labour. According to him application of this principle to international scenario helps the countries to specialise in the production of those goods in which they have cost advantage over other countries.

Every country
should specialize
in producing
those products at
the cost less than
that of other
countries.

According to Adam Smith, every country should specialise in producing those products which it can produce at less cost than that of other countries and exchange these products with other products produced cheaply by other countries. Trade between two countries takes place when one country produces one product at less cost than that of another country and the other country has an absolute cost advantage over the first country in producing in any other product.

Skilled Labour and Specialisation Advantage

Countries have absolute cost advantage due to the following reasons:

- Suitability of the skill of the labour of the country in producing certain products.
- Specialisation of labour in producing certain products leads to higher productivity and less labour cost per unit of output.
- Economies of scale would reduce the labour cost per unit of output.

Natural
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to climatic
conditions,
natural
resources, etc.

Natural Advantage: In addition to the skilled labour and specialisation advantage, countries do also have natural advantage in producing certain products due to climatic conditions, access to certain natural resources, etc. *For example*, Indian climate suits the production of sweet mangoes, coconuts, cotton and cashew nuts. Sri Lankan climate suits the production of tea,

BOX 2.2 : NATURAL ADVANTAGES FOR CASHEW EXPORTS

Indian soil and tropical climate in Southern India are suitable for growing cashew nuts in India. As such, India's cashew nuts exports accounted for 65 per cent (US \$ 208 million) of the global cashew exports. The skill of Indian labour helped the country to process the cashew skilfully and produce higher grade cashew and compete with Mozambique, Indonesia and South East Asian countries. Indian farmers use less fertilisers than those of Brazil, which gives Indian nuts a better flavour and consequently better price in the global

market. But the cashew yield in Brazil is nearly three times higher than that of India.

Vietnam has been growing as a close competitor to India by processing the nuts of its own and also from the neighbouring countries. Now, the cashew fruit is used in producing candy, jams, juice, wine, etc., in India. The unfavourable climate conditions in other countries have also been helping India to remain as the leading exporter of cashew.

Source: Adapted from John D. Daniels *et. al.*, "International Business", Pearson, Singapore.

Acquired advantage is due to technology and skill development.

Acquired Advantage: In addition to the skilled labour and natural advantages, countries also acquire advantages through technology and skill development. Japan acquired advantage in steel production through the imports of both iron and coal. The reason for this success is that Japan acquired labour saving and material saving technology. Denmark exports silver tableware due to the ability of Danish companies in developing distinctive products.

Technologically advanced countries acquired abilities to develop substitute products for a number of natural products.

Thus, countries have absolute advantage in producing certain products as discussed above. *For example*, England had the absolute advantage in producing textiles, whereas France had the absolute advantage in producing wine. *Similarly*, India has the absolute advantage in producing pens and Japan has the absolute advantage in producing audio tape recorders.

Assumptions of the Theory: Adam Smith proposed the absolute cost advantage theory based on the following assumptions:

- Trade is between two countries.
- Only two commodities are traded.
- Free trade exists between the countries.
- The only element of cost of production is labour.

Now, we discuss the absolute cost advantage through a numerical example. We explain the absolute advantage using two countries and two products. In this example, the countries are India and Japan and the commodities are pens and audio tape recorders. We treat the cost of production in terms of labour input.

Table 2.1 shows the output of two goods per one day of labour for the two countries.

TABLE 2.1

THE THEORY OF ABSOLUTE COST ADVANTAGE: AN EXAMPLE

	<i>Output per one day of Labour</i>	
	<i>Japan</i>	<i>India</i>
Pens	20	60
Audio tape recorders	6	2

Ability of labour to produce different goods/services in a day is known as production possibilities. In Japan one day of labour can produce either 20 pens or six audio tape recorders. In India one day of labour can produce either 60 pens or two audio tape recorders. Japan has an absolute advantage in the production of audio tape recorders and India has an absolute advantage in the production of pens. One day of labour in India produces 60 pens, whereas only 20 pens in Japan. It is clear that Japan has absolute advantage in producing audio tape recorders and India in producing pens.

Assume that India and Japan are able to trade with one another, then both will get the advantage. Suppose Japan agrees to exchange four audio tape recorders for 40 pens. Two days of Japanese labour is needed to produce 40 pens and only 0.67 day of Japanese labour is enough to produce four audio tape recorders. Thus, Japan can save 1.33 ($2 - 0.67 = 1.33$) days of labour, if it exports audio tape recorders to India and imports pens from India.

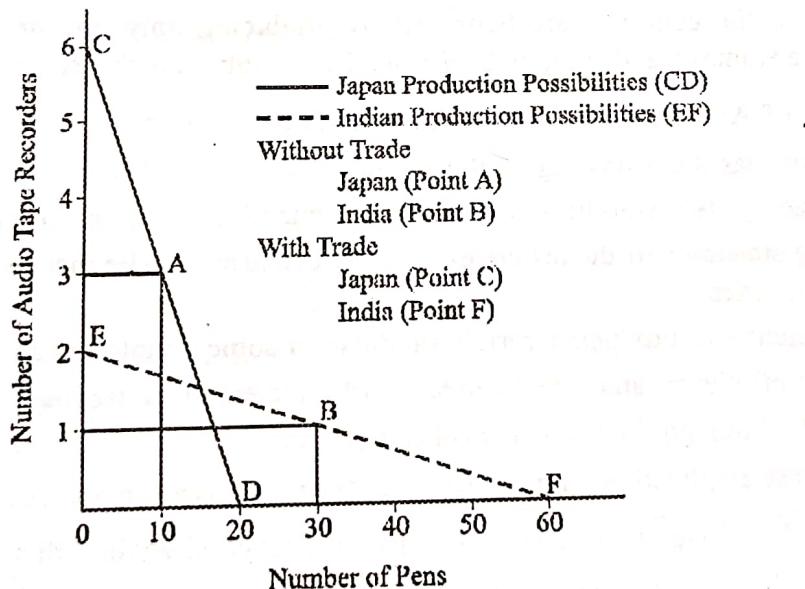
India needs two days of labour to produce 4 audio tape recorders and 0.67 day of labour is enough to produce 40 pens. India can also save 1.33 ($2 - 0.67 = 1.33$) days of labour by exporting pens to Japan and importing audio tape recorders from Japan.

Thus, two countries save labour by trading with each other rather than by producing both the products. The saved labour can be used for the production of more audio tape recorders by Japan and for the production of more pens by India (See Fig. 2.1). Japan can consume more pens by allocating its labour to produce audio tape recorders and by trading with India. And the *vice versa* is true in case of India.

Trading countries save labour and thereby cost per unit.

FIGURE 2.1 :

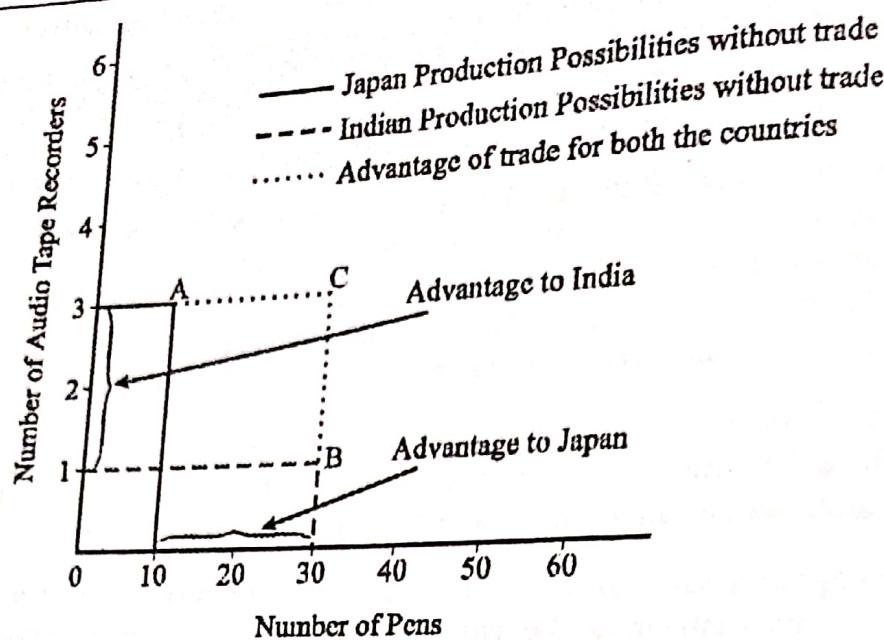
Production Possibilities with Absolute Cost Advantage



Japan and India need both audio tape recorders and pens. Japan can produce 10 pens and three audio tape recorders with one day's of labour without trade. Similarly, India can produce 30 pens and 1 tape recorder with one day's of labour without trade. If Japan and India agree to trade with each other, then Japan can concentrate in producing audio tape recorders and India can concentrate in producing pens. Similarly, if these two countries agree to exchange 10 pens for one tape recorder, then Japan can exchange three audio tape recorders for 30 pens. In other words, India gets three audio tape recorders for 30 pens. Thus, Japan can enjoy 20 more pens ($30 - 10 = 20$) in addition to three audio tape recorders and India can enjoy two more audio tape recorders ($3 - 1 = 2$) in addition to 30 pens. Thus, two countries can get the advantage by trading with each other due to absolute cost advantage they possess. (See Fig. 2.2).

FIGURE 2.2 :

Advantage of Trading



It is clear from the Fig. 2.2 that both the countries can enjoy three audio tape recorders and 30 pens per one day of labour. It does mean that Japan can have the advantage of $(30 - 10 = 20)$ 20 pens and India can have the advantage of $(3 - 1 = 2)$ 2 audio tape recorders.

Thus, both the countries are better-off by producing only one product in which it has absolute cost advantage and trade with the another country for the second product.

Implications of Absolute Cost Advantage Theory

This theory has the following implications:

- By trading, two countries can have more quantities of both the products.
- Living standards of the people of both the countries can be increased by trading between the countries.
- Inefficiency in producing certain products in some countries can be avoided.
- Global efficiency and effectiveness can be increased by trading.
- Global labour productivity and other resources productivity can be maximised.

Despite these implications, this theory has been criticised on various grounds.

Criticism: Now, we shall discuss the criticism levelled against this theory.

- **No Absolute Advantage:** According to this theory, one country should be able to produce at least one product at a comparatively low cost. But, in reality, most of the developing countries do not have absolute advantage of producing any product at the lowest cost. Yet they participate in international trade.
- **Country Size:** Countries vary in size. This theory does not deal with country-by-country differences in specialisation.
- **Variety of Resources:** Though there are several resources like labour, technology and natural resources, this theory deals with only labour and ignores all other resources.
- **Transport Cost:** Though the cost of transportation plays a significant role in international trade, this theory ignored this aspect.
- **Scale Economies:** Large-scale economies reduce the cost of production and form a part of the absolute advantage. But, this theory ignored that aspect also.

(d) COMPARATIVE COST ADVANTAGE THEORY

As indicated earlier, Absolute Cost Advantage theory fails to explain the situation when one country has absolute cost advantage in producing many products. David Ricardo a British economist – expanded the Absolute Cost Advantage theory to clarify this situation and developed the Theory of Comparative Cost Advantage.

Assumptions of the Theory: The assumptions of the comparative cost advantage theory include:

- There exists full employment
- The only element of cost of production is labour. Production is the subject to the law of constant returns.
- There are no trade barriers.
- Trade is free from cost of production.
- Trade takes place only between two countries.
- Only two products are traded.
- There are no costs of transport, etc.

A country should produce and export those products for which it is relatively more productive than that of other countries.

Comparative cost advantage theory states that a country should produce and export those products for which it is relatively more productive than that of other countries and import those goods for which other countries are relatively more productive than it is.

The comparative cost advantage theory is based on relative productivity differences and incorporates the concept of opportunity cost. (See Table 2.2).

Now, we recall the example presented in Table 2.1. The theory of absolute cost advantage advocates that Japan should export audio tape recorders to India and India should export pens to Japan. Japan has also comparative cost advantage in audio tape recorders. It produces audio tape recorders three times more than that of India and only 0.33 times less than that of India in case of pens. Thus, Japan is comparatively more productive than India in audio tape recorders.

Similarly, India is three times more productive than Japan in producing pens – i.e., it has comparative cost advantage in pens.

Comparative cost advantage theory also advocates that Japan should export audio tape recorders to India and India should export pens to Japan. The example provided in Table 2.1 yields the same result for the theory of absolute cost advantage and for the theory comparative cost advantage.

All countries for all products may not have absolute cost advantage. We modify the figures of the example presented in Table 2.1 in order to present a different example to explain comparative cost advantage. Table 2.3 shows the different example.

TABLE 2.2

CHANGES IN COMPARATIVE ADVANTAGE OVER TIME : SOUTH KOREA

Economic value	Year	South Korea Value (in US\$)	India Value (in US\$)
GDP Per Capita	1953	796	641
	1962	921	760
	1972	1841	786
	1982	3395	936
	1991	7235	1251
	2007	24,500	3,800
Capital per Worker	1965	02093 (100%)	0786 (100%)
	1975	6533	1259
	1985	12036	1712
	1992	17995	1997
	2007	32,431	3,416
Degree of Openness	1953	11.8%	10.4%
	1962	22.1%	11.2%
	1972	44.5%	8.8%
	1982	71.5%	14.5%
	1990	62.5%	21.4%
	2007	63.3%	36.5%

Source: Adapted from : www.pwt.econ.upenn.edu

TABLE 2.3

THE THEORY OF COMPARATIVE COST ADVANTAGE : AN EXAMPLE

	Output per one day of Labour	
	Japan	India
Pens	60	50
Audio tape recorders	6	2

Japan now produces 60 pens or six audio tape recorders per day of labour. Japan now has an absolute cost advantage in both pens and audio tape recorders. For one day of labour, Japan can produce 10 more pens ($60 - 50 = 10$) or four more audio tape recorders ($6 - 2 = 4$) than India. Japan is more productive than India in both the products. As such no trade should take place between Japan and India based on absolute cost advantage theory.

Japan is three times better than India in audio tape recorder production and 1.2 times better in pen production. Alternatively, India is only 0.33 as good as Japan in audio tape recorder production but 0.83 as good in pen production. Thus, comparatively Japan is better in audio tape recorder production and India is better in pens production (See Fig. 2.3).

In the absence of trade between two countries the labour of Japan can produce either 60 pens or six audio tape recorders or alternatively 30 pens (50% of labour) and three (50% of labour) audio tape recorders. Similarly, India can produce 50 pens or two audio tape recorders or alternatively 25 pens (50% of labour) and one audio tape recorder (50% of labour). Now, we

consider the concept of opportunity cost. By not trading, these two countries, i.e., Japan and India can produce pens and audio tape recorders as indicated earlier. In other words what both the countries have foregone is the benefit of trading.

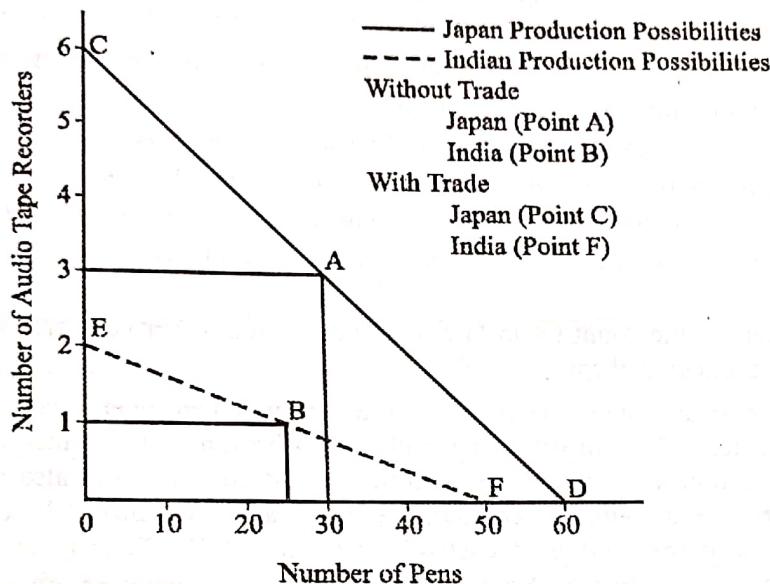


FIGURE 2.3 :
Production Possibilities with Comparative Cost Advantage

If, Japan produces only audio tape recorders and India produces only pens in which they have comparative advantage, Japan produces six audio tape recorders and India produces 50 pens. Both the countries get the advantage, by doing so and by trading with each other. India can produce either 50 pens or two tape recorders for one day of labour. It does mean that the cost of labour of two tape recorders is equal to that of 50 pens ($2 = 50$ or $1 = 25$). Thus, the cost of one tape recorder is 25 pens in India. Similarly, Japan can produce either 60 pens or six tape recorders for one day of labour. Therefore, the cost of one tape recorder in Japan is ($6 = 60$ or $1 = 10$) 10 pens.

The price of audio tape recorder in India is 25 pens and it is 10 pens in Japan. Suppose, Japan offers one audio tape recorder for 17.5 pens, India would accept the offer and export 17.5 pens to Japan and get one audio tape recorder. This offer is beneficial to India as the price of one audio tape recorder is 25 pens in India. This offer is advantageous to Japan also as Japan gets 7.5 more pens for one tape recorder (Price of one audio tape recorder = 10 pens in Japan). Table 2.4 simplifies this example.

TABLE 2.4

GAINS FROM TRADE BASED ON COMPARATIVE COST ADVANTAGE

	<i>Prices without Trade</i>	<i>Prices with Trade</i>
Japan	1 audio tape recorder = 10 pens	1 audio tape recorder = 17.5 pens
India	1 audio tape recorder = 25 pens	1 audio tape recorder = 17.5 pens

Japan can get the benefit of more pens for one audio tape recorder ($17.5 - 10 = 7.5$ pens benefit). India also gets as India needs to spend only 17.5 pens to buy one tape recorder rather than 25 pens. It does mean that India saves ($25 - 17.5 = 7.5$) 7.5 pens in buying one tape recorder. India can buy 0.43 ($7.5/17.5 = 0.43$) more tape recorders with the benefit of 7.5 pens. It does mean that India can buy 1.43 (one for 17.5 pens and 0.43 for 7.5 pens) tape recorders for 25 pens. As such, Japan and India benefit from the trade. Thus, comparative cost advantage motivates the countries to trade with each other.

Implications of the Theory: The implications derived from this theory are:

- Efficient allocation of global resources.
- Maximisation of global production at the least possible cost.
- Product prices become more or less equal among world markets.
- Demand for resources and products among world nations will be optimised.
- It is better for the countries to specialise in those products which they relatively do best and export them.
- It is better for the countries to buy other goods from other countries who are relatively better at producing them.

Comparative cost advantage theory is really an improvement over Adam Smith's theory of cost absolute advantage. This theory is not only an extension to the principles of division of labour and specialisation, but applies the opportunity cost concept. It is also argued that lower labour cost need not be a source of comparative advantage. (See Box 2.3). However, Ricardo fails to consider the money value of cost of production. F.W. Taussig bridged this gap in comparative cost advantage theory. Now, we shall discuss comparative advantage theory with money.

BOX 2.3 : LOWER LABOUR COST AS A SOURCE OF COMPARATIVE ADVANTAGE

Ricardian model of international trade seems to be true. While testing Ricardian model, one should take into account the relative productivity of labour in two countries. It is established that productivity of labour and wages are highly correlated. US exports to Malaysia are relatively more productive than labour. The wage rate in Malaysia is about 15% of the US wage rate. Not surprisingly, productivity in Malaysia during 1990s is about

15% of the US labour productivity. Therefore, is Malaysia a low wage country?

The advanced countries import from low wage countries to the extent these countries have comparative advantage in a particular product and not because of the low wage rates in that country. Low wage rates are not themselves no guarantee of success in international markets as productivity differentials are adjusted.

Source: Adapted from W. Charles Saewyler and Richard L. Sprinkle, "International Economics", Prentice-Hall of India, New Delhi, p. 28.

(E)

COMPARATIVE ADVANTAGE WITH MONEY

Modern economy is money economy and almost all the transactions take place in the form of money. Therefore, absolute differences in money prices determine international trade. According to F.W. Taussig, comparative differences in labour cost of commodities can be explained by absolute differences in prices without affecting the real exchange rate. Table 2.5 introduces money into the analysis of international trade.

India for pens and

(F)

RELATIVE FACTOR ENDOWMENTS (OR) HECKSCHER-OHLIN THEORY

In view of the criticism cast against comparative advantage theory, the question pointed out by many was: How do the countries acquire comparative advantage? Eli Heckscher and Bertil Ohlin – Swedish economists – developed the theory of relative factor endowments – to answer this question. Factor endowments are land, capital, natural resources, labour, climate, etc. The observations made by these two economists include:

- Factor endowments vary among countries: *For example*, the USA is rich in capital resources, India is rich in labour, Saudi Arabia is rich in oil resources, South Africa and Papua New Guinea have gold mines, etc. Table 2.6 presents relative factor endowments of selected countries.

E 2.6

RELATIVE FACTOR ENDOWMENTS OF SELECTED COUNTRIES

<i>Country</i>	<i>Capital/Labour (\$ per worker)</i>	<i>Capital/Land (\$ per hectare)</i>	<i>Land/Labour (Worker per hectare)</i>
USA	10,260.9	1,058.6	
UK	4359.6	5169.8	0.103
Canada	10,583.1	198.0	1.186
France	6,868.5	3,136.9	0.019
Japan	3,358.5	5,286.5	0.456
South Korea	320.4	337.3	1.574
Mexico	1684.8	122.9	1.053
			1.852

Source: Harry P. Bowen et. al., "Multi-country, Multifactor tests of the Factor Abundance Theory". American Economic Review, pp.806-807.

- According to these economists, if labour is available in abundance in relation to land and capital, in a country, the price of labour would be low and the price of land and capital would be high in that country. The *vice versa* is true in those countries where land and capital are available in abundance in relation to labour.

- These relative factor costs would lead countries to produce the products at low costs.
- Countries have comparative advantage based on the factors endowed and in turn the price of the factors. Countries acquire comparative advantage in those products for which the factors endowed by the country concerned are used as inputs. *For example*, India and China have comparative advantage in labour-intensive industry like textile and tobacco, Saudi Arabia has comparative advantage in oil. Therefore, countries export those goods in which they have comparative advantage due to factors endowed. *Table 2.7* presents principal exports of selected countries.
- Countries participate in international trade by exporting those products which they can produce at low cost consequent upon abundance of factors and import the other products which they can produce comparatively at high cost.

TABLE 2.7

PRINCIPAL EXPORTS OF SELECTED COUNTRIES

Country	Principal exports	% of Principal Exports to Total Exports
USA	Capital Goods	48.7
UK	Finished Manufactured goods	57.2
Japan	Automobiles	18.3
Canada	Automobiles and Parts	22.4
France	Capital Equipment	31.4
Germany	Motor vehicles	22.4
Malaysia	Electric and Electronic Machinery	55.6
Singapore	Machinery and Equipment	62.4
India	Manufacturer of Engineering	72.1
China	Manufacturers	30.1

Source: Adapted from The WTO

Land-labour Relationship: Countries where area of land available is less in relation to the people, go for multistorey factories and produce light-weight products.

For example, clothing production in Hong Kong. Countries with large area of land in relation to population can go for sheep, wheat and other agricultural related products. *For example*, Canada, Australia, India, etc.

Labour-capital Relationship: Countries where labour is abundant in relation to capital can be expected to export labour-intensive products, and *vice versa* is true in case of capital abundant countries. Thus, labour abundant countries acquire export competitiveness in products requiring large amounts labour compared to capital. *For example*, India has export competitiveness in textile garments while Iran has export competitiveness in hand-made carpets. Japan has export competitive advantage in products requiring large amounts of capital relative to labour like computers, televisions, refrigerators, cars, etc. However, this generalisation has an exception.

Leontief Paradox: There are certain surprising aspects to the labour-capital relationship in international trade. Wassily Leontief observed that US exports are labour-intensive compared with US imports. But, it is assumed that the USA has abundant capital relative to labour. Therefore, this surprise finding is known as the Leontief Paradox. This is because of variation in labour skills. Advanced countries have higher labour skills compared to developing countries. Therefore, advanced countries have competitive advantage in exporting products requiring higher labour skills while the developing countries have advantage in exporting products requiring less skilled labour.

(J)

PORTER'S NATIONAL COMPETITIVE ADVANTAGE THEORY

Competitive Advantages: A recent study concluded that competitive superiority is derived from four factors, viz., demand conditions, factor endowment, related and supporting industries and firm strategy, structure and rivalry. *Figure 2.4* presents the determinants of global competitive advantage. This figure is also known as the Porter Diamond.

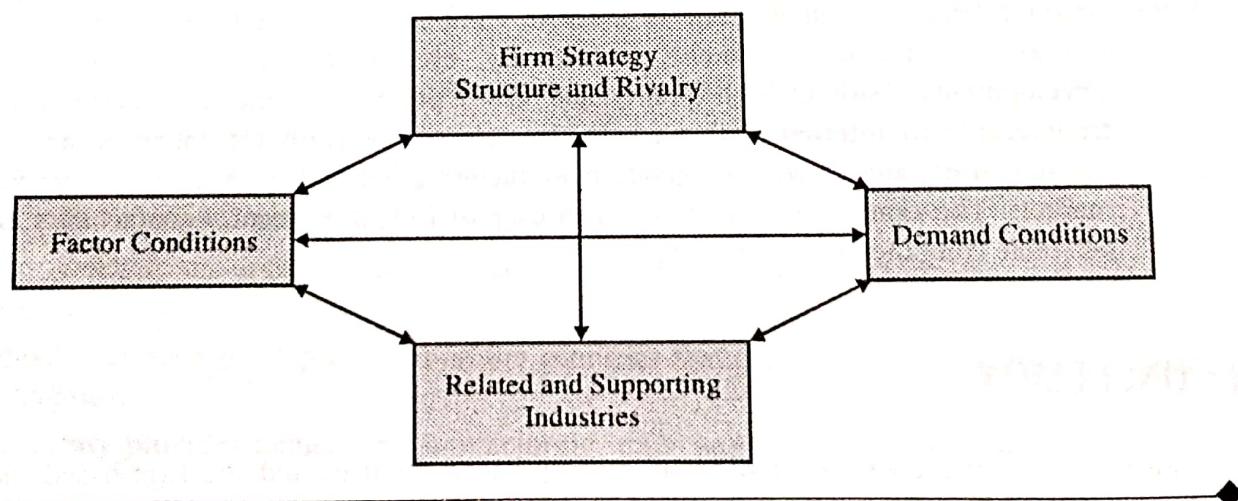
We should understand the combined effect of these factors on the development and continued existence of competitive advantages. All the four factors need not always be favourable for a company to get global supremacy. But the interactive affect of these four factors need to be favourable if an industry/company in a country is to gain a global competitive advantage.

Companies get competitive Superiority from

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

FIGURE 2

Determinants
of Global
Competitive
Advantage



Now we shall discuss the four elements of the diamond.

- **Factor Conditions:** Factor conditions include factors of production. Hecksher-Ohlin theory deals with the classical factors, viz., land, labour, capital and organisation. Porter emphasises other factors like educational level of labour and quality of the country's factor infrastructure. Country's ability to compete globally depends upon the country's factor resources, viz., research, innovation and training. The USA has rich factor endowments and enjoys top position in world trade and world economy. (See Box 2.4)

BOX 2.4 : POSITION OF THE USA IN WORLD TRADE AND WORLD ECONOMY

as unique position in the world trade and economy. Its unique positions include:
size of the country
largest GDP with approximately \$10 trillion
largest exporter and largest importer in the world's largest financial market

- Large in having MNCs (16) out of top 500 MNCs in 2006
- Lost first positions of exports of merchandise in 2006.
- It started losing its position due to rapid development of some developing and recently emerging countries including South Korea, China, Malaysia and India.

- **Demand Conditions:** The existence of a large number of sophisticated domestic consumers who are economically able and willing to consume create and improve the demand for various products in the country. Companies improve the existing products and develop new products to meet the increasing demand. In addition, domestic companies compete with each other in developing existing and new products. As such some of the processing domestic companies would be ahead of the international companies and export to other countries. *For example*, Japanese companies developed Camcorders, big screen TVs and VCRs better than the international companies and exported them to the European and North American countries after meeting the domestic demand.
- **Related and Supported Industries:** The emergence and growth of an industry provide the scope for the development of suppliers of raw material, market intermediaries, financial companies, consulting agencies, ancillary industries, etc. These supporting service agencies compete among themselves leading to high input quality and lower prices. Availability of high quality inputs at lower prices in the domestic country enhances competitive advantage of the firm internationally.
- **Firm Strategy, Structure and Rivalry:** Firms continuously improve the quality, product design, invest in R&D in order to compete domestically. Firms also invest in human resource development, technology, etc., in the domestic market. These developments result in high quality and lower prices in domestic country which are transferable to international markets. Intense competition for Japanese automobile manufacturers and electronics goods manufacturers led to their success in international markets. The same theory holds good in case of Indian garment manufacturers and US personal computer manufacturers.