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International Trade: Theories and Significance

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ABSTRACT:

Theories of international trade have long been a subject of study and debate among economists, seeking to understand the patterns and determinants of trade between nations. This chapter provides a concise overview of the key theories of international trade. It examines the classical theories, such as the theory of absolute advantage and comparative advantage, which explain trade based on differences in productivity and factor endowments. It also explores more modern theories, including the Heckscher-Ohlin theory, the new trade theory, and the gravity model, which consider factors such as factor proportions, economies of scale, and transportation costs. By understanding these theories, policymakers and economists can gain insights into the forces that shape international trade patterns and make informed decisions to promote trade and economic growth.

KEYWORDS:

Absolute Advantage, Balance Payments, Comparative Advantage, Dumping, Factor Endowments, Foreign Exchange.

I. INTRODUCTION

Thomas Mu put out the following thesis in 1630: To increase our wealth, sell more to strangers each year than we consume of theirs in value. The fundamental tenet of absolute advantage is that a party has the power to create more of an item, product, or service than rivals while utilizing the same number of resources. Trade occurs between two nations. There are only two commodities exchanged. There is free trade between the nations. Labour is the sole component of the cost of production. The concept of absolute advantage was initially introduced in 1776 by Adam Smith in the context of international commerce, using labour as the sole input. According to his theory, a nation has a certain advantage in the production of a good if it is more productive than any other nation [1], [2]. According to theory, two nations will have more of both things accessible for consumption if they trade with one another and specialize in producing various goods [3], [4]. Smith also contended that practising mercantilism was ineffective because the export of one nation is the import of another, and that instead, all nations would benefit simultaneously from free trade and specialisation in accordance with their absolute advantages.

Criticism

1. There are no clear benefits for many nations.
2. The size of a nation fluctuates.
3. Different specialisations across nations
4. Only addresses labour and ignores other variables
5. Ignored Transportation costs

Comparative Benefit

The classical theory of comparative advantage was created by David Ricardo in 1817 to explain why nations participate in international commerce even when their employees are more effective at producing each and every product than those in other nations [5], [6]. A party having a comparative advantage over another is able to produce a certain item or service at a lower marginal cost and opportunity cost. As long as they have differing relative efficiencies, both nations will benefit from trade with one another even if one is more efficient than the other at producing all items.

Confidence in Comparative Advantage

1. There are only two commodities and two countries.
2. No trade restrictions exist. Trade between the two nations is not subject to any restrictions.

3. The sole component of production is labour. In other words, the amount of labour required to produce a commodity determines its cost of production.
4. There are no transportation expenses.
5. While labour is completely movable inside a nation, it is completely static across nations. The upshot of this assumption is that although labour is perfectly mobile inside a country, salaries across countries may vary since people from one country cannot relocate to another.
6. Constant production costs: The cost conditions are the same regardless of the degree of output since there are constant returns to scale in manufacturing.
7. Labour is fully employed, meaning that in order to create more of one good, labour must be taken away from the production of another good. The overall labour is also consistent.
8. Technology does not alter.

II. DISCUSSION

Consider the straightforward two nations, two products comparative advantage model. Both of these undifferentiated products apples grown in Europe and oranges grown in South Africa—are created using production units that combine land, labour, and capital. South Africa can produce 100 apples but no oranges using the same production equipment, while Europe can produce 80 apples but no oranges. South Africa can only produce 50 oranges and no apples, whereas Europe can only generate 30 oranges and no apples. South Africa should thus focus on producing oranges since this is where it has the largest competitive advantage. Unfortunately, the hypothesis relies on relatively constant manufacturing costs. But it is a well-known fact that higher volumes often translate into reduced expenses. In fact, the so-called experience curve impact notion was the basis for the Boston Consulting Group's observation of this phenomena. Additionally, it is not just production related but also all experience connected, which includes marketing. According to the Boston Consulting group, cost reduction increases as an organisation obtains more manufacturing and marketing expertise. The notion of comparative advantage similarly disregards the distinction between products and programmers. Consumers don't always choose items based on those with the lowest manufacturing costs [7], [8]. Image, quality, delivery dependability, and other physical and intangible elements are taken into consideration.

Ricardo's Law of Comparative Advantage: Criticism

The most serious critique of Ricardo's theory was that it was predicated on the labour theory of value. According to this presumption, a commodity's price only relies on the volume of labour required to produce it [9], [10]. This presumption has the following implications:

1. The sole production factor is labour.
2. All goods are produced using labour in the same set ratio.
3. Labour is uniform.

Heckscher-Ohlin Principle

Eli Heckscher and Bertil Ohlin, who opposed Ricardo's theory that emphasizes productivity, suggested in 1919 and 1933, respectively, that comparative advantage results from variations in national factor endowments, such as land, labour, or capital. Wassily Leontief later created The Leontief Paradox in 1953, which proposed that since the United States has an abundance of capital relative to other countries, it would export capital-intensive products and import labor-intensive ones. Data, however, refuted the notion. As a result, Ricardo's thesis seemed to be more foretelling.

The Theory of the Product Life Cycle

This idea was put out by Raymond Vernon in the 1960s and aims to explain trends in international commerce. The United States first introduces new items. Then, when demand increases in the United States, it also spreads to other wealthy countries that the United States sells to. Then, when other developed countries start to manufacture the good as well, U.S. businesses are forced to establish production there as well, hence reducing exports from the U.S. Then, everything repeats again, except this time, manufacturing starts in advanced countries. In the end, the product that was first distributed inside American boundaries is imported into the country. According to the international product trade cycle model, many items go through a cycle in which high-income, nations with large populations who first export the product lose their markets and eventually start importing it. Other nations, primarily those that are less developed but not entirely, go from being importers to exporters at the same period. From the perspective of a high income nation:

Phase 1 includes exporting, depending on the strength and excess of domestic products.

Phase 2, the start of international manufacturing.

Phase 3 marks the point at which foreign production may compete, while Phase 4 marks the start of import competition.

According to the underlying premise of this cycle, new items are first introduced in high-income areas because there is the most potential and Because a product can be tested domestically most effectively close to its place of manufacture, new products often originate from high-income nations. Over time, however, orders start to flow in from lower-income nations, and a robust export market emerges. Entrepreneurs in high-income countries rapidly realise that the markets they are targeting often have cheaper manufacturing costs, therefore production of the new items is started overseas, kicking off the second stage. The output from high-income and foreign countries starts to serve the same export market in the second stage of the cycle. The high-income export production source is replaced by foreign competitors as they grow and develop more expertise. High-income nations often prefer to invest abroad at this juncture to preserve their market share. As foreign manufacturers develop, their rising economies of scale enable them to compete with high-income exporters for third-country markets. The last phase of the cycle is when the foreign producer reaches a size and level of expertise that enables it to begin exporting to the original high income producer at a production cost that is lower than its original high income producer. Formerly having a monopoly in their own market, high income manufacturers now confront competition at home. The cycle continues as the product's manufacturing capacity expands from other advanced nations to less developed ones domestically, followed by international commerce and subsequently home markets in other advanced countries.

Case of UK Textiles

The international product trade cycle is evident in several instances. Not any more than the cotton and textile industries. The UK was a significant manufacturer of cotton textile materials in the early and middle twenties, mostly due to its availability to cheap raw materials from its Commonwealth nations and its comparably inexpensive workforce. However, its former colonies, like India, Pakistan, and several African nations, who were cotton producers in and of themselves, discovered they had the workforce and resources on hand to support domestic production. They started to do it. They were so successful in servicing their own sizable markets that developing economies of scale caused a sharp decline in their manufacturing costs. The UK, which at this point had seen increased manufacturing costs because to rising labour costs and declining market share, was soon able to support cloth and completed goods back to the country. Currently, the UK produces little cotton material and is supported by many nations throughout the globe, including its former colonies and Commonwealth nations.

Objections to the Hypothesis

New items are not always produced in the US. New cellular phones from Europe and Japan, for example, and video gaming systems from foreign nations are just a few examples. Products are concurrently launched in a number of wealthy nations. As a result, the theory cannot account for current trade trends.

Modern Trade Theory

This hypothesis was put out in the 1970s and claimed that through achieving economies of scale via trade, customers would have access to a wider range of products at lower average prices. Furthermore, a crucial first-mover advantage is the capacity to initially realise economies of scale. Even when countries have the same technological and resource endowments, trade may still be advantageous to both parties. Trade can enable each nation to concentrate on one product, enabling the achievement of economies of scale that will increase the variety of products in both countries at low enough prices, for instance, if two nations both desire sports cars and minivans but neither can produce them at a low enough price within their own national markets. Since first mover advantage is seen as a significant source of comparative advantage by new trade theory, it is not in conflict with comparative advantage.

Porter's Diamond: National Competitive Advantage

Michael Porter set out to find the reason why a country succeeds internationally in a specific sector in 1990. He suggested basing it on the following four qualities:

Endowed Factors

Natural resources, climate, location, and demographics are considered basic factors. Advanced factors include communication infrastructure, sophisticated and skilled labour, research facilities, and technological know-how. According to Porter, advanced factors are the most important for gaining a competitive advantage. Demand circumstances. Businesses will need to generate creative, high-quality items early if domestic consumers are smart and demanding, which creates a competitive advantage. Related and supporting industries. If there are suppliers or related industries in the place of origin that are also globally competitive, this might provide the new sector a competitive edge.

Firm Strategy, Organisation, and Competition

Different management beliefs distinguish different countries, which may either assist or hinder them in gaining a competitive edge. Strong local competition contributes to increased efficiency, which makes such businesses stronger global rivals. Porter's theory's implications for managers. Work should be done where it will be most productive and efficient. First-mover implications. The goal is to establish a long-term sustainable competitive advantage by anticipating the available demand, gaining volume-related cost advantages, and building an enduring brand ahead of later competitors. Lobbying for or against free trade or governmental limitations is a policyimplication. Investment in modernising advanced production aspects, such as bettering personnel training and increasing R&D spending, is in a company's best interest. Businesses should advocate for funding for education, infrastructure, fundamental science, and any legislation fostering fierce domestic competition.

Participation in International Marketing

Despite the idea of worldwide marketing involvement's expansion and its generally acknowledged significance, surprisingly little attention has been paid to a comprehensive investigation of its meaning and measurement. Since 1990, most global corporations have engaged in cross-border competition. As a result, there has been a lot of interest among marketing academics, professionals, and decision-makers in comprehending the many facets of a company's global engagement in marketing programmes. Apparently, Terry L. International marketing involvement (IMI) is the cross-national movement of resources to assist marketing efforts in a host country, according to et al., 1995. IMI is the cross-national transfer of resources to service one or more overseas markets. IMI should be conceptualised as a continuous behavioural construct along a high-low engagement continuum and implies that the focus on cross-national performance of marketing efforts. The product, price, distribution, and marketing activities of a Product Market Unit in a certain host nation must be taken into consideration while evaluating IMI. IMI is another intricate, chapter concept that, until dissected into its constituent elements, is intrinsically unclear. Therefore, identifying the components is necessary for the correct operationalization of the construct.

Strategic Attitudes

The aforementioned phases of international marketing engagement do not always align with the managers' perspectives and inclinations. Three main methods tend to dominate strategic thinking in businesses that operate in foreign markets, according to research in the field of international marketing. These strategic orientations are a reflection of the philosophical outlook that must be connected to the various phases of the development of global operations.

Orientation towards Domestic Market Extension

1. The local company wants to expand its domestic product line into international markets.
2. Foreign markets are seen as secondary.
3. The primary goal is to export surplus domestic goods.
4. The focus of the company is domestic, and nothing is done to modify the marketing mix for it.
5. Multiple Domestic Market Focus.
6. Here, the business is aware of the distinctions between home and international markets.
7. Recognise that various nations need different goods.
8. Create and put into action unique marketing plans for each nation.
9. Operating independently from one another, subsidiaries.
10. Advertising is localised, and products are modified.
11. Products may not be standardised, instead emphasising market adaptability.

International Focus

Truly global. The whole market is global, and the entire world is regarded as one market. Companies put a strong emphasis on product and process standardisation. When it is cost- or culture-effective, businesses standardise market mix across borders in an effort to achieve economies of scale. These strategic-minded businesses seek a worldwide strategy. A multi-domestic approach for large brands or other companies. It is clear that globalisation has played a significant role in the economic integration of all global marketplaces. Unprecedented cross-border marketing possibilities have emerged as a consequence of decreased trade barriers and unprecedented connectivity in telecommunications, transport, travel, and technology. Along with potential, there are a number of difficulties that businesses must carefully navigate before accessing global markets. Understanding the theories of international commerce lays the groundwork for practising marketing managers to make the best choices when implementing strategies to take advantage of new marketing possibilities and appropriate responses to challenges from global marketplaces.

Major Terms

Subcontracting: Subcontracting is the practise of delegating to a different party, known as a subcontractor, a portion of the duties and responsibilities under a contract. Subcontracting is particularly common in industries like construction and information technology where complicated projects are the norm.

Subsidiaries: A firm, corporation, or limited liability company is a subsidiary. It may sometimes be a government- or state-owned company.

When faced with a homogenous global village, Levitt advised organisations to create standardised, high-quality global products and market them globally using standardised advertising, pricing, and distribution. His recommendations were questioned after several well-publicized failures by Parker Pen and other businesses that tried to heed his counsel. Industry experts who disagreed with Levitt's assertions were regularly mentioned in the business press. For instance, Carl Spielvogel, chairman and CEO of Backer Vogel Bates Worldwide, told The Wall Street Journal that Theodore Levitt's assertion that the globe was homogenising was untrue. One of the two items that naturally lend themselves to global marketing is Coca-Cola. In fact, Coke's success throughout the globe was a result of global marketing. That accomplishment, however, was not the result of a complete standardisation of marketing mix components. Kenichi Ohmae argues in his book The Borderless World that Coke's success in Japan could only have been attained by investing a significant amount of time and money in becoming an insider. In other words, the company's sales team and vending machine operations helped to create a fully functional local infrastructure. According to Ohmae, Coke's success in Japan was a consequence of its ability to accomplish global localisation, or the capacity to be as much of an insider as a local firm insider while yet receiving the advantages from global operations.

What exactly does the term global localisation mean? We shall see several times in this book that global marketing may contain a mix of standard and nonstandard tactics, which means a successful global marketer must be able to think globally and act locally. Global marketing demands marketers to act in a manner that is both global and local at the same time by reacting to similarities and contrasts in global marketplaces. A global product may be the same product everywhere and yet different. The capacity to think globally and act locally may be a source of competitive advantage, as the Coca-Cola Company has shown. by adjusting marketing, distribution, and customer service strategies to suit regional requirements. Coke developed such strong brand loyalty that the business claims to have a 78 percent market share for soft drinks in Japan. Coca-Cola management initially struggled to comprehend the Japanese distribution network. But after making a large time and financial commitment, they were able to create a sales force that was just as successful in Japan as it was in the US. The Japanese division has developed goods like Lactia, a lactic, no-carbonated soft drink that promotes healthy digestion and rapid refreshment specifically for the Japanese market, to complement Coke sales.

Other items include Georgia brand bottled coffee. Coke is a product that embodies both global and local marketing mix components. We don't suggest in this book that global marketing is a knee-jerk effort to enforce a completely standardised strategy to marketing globally. How to adapt the global marketing idea to match a specific product or company is a key concern in global marketing. Last but not least, it is important to realise that global marketing does not entail accessing every nation on earth. When looking for opportunity and danger, global marketing does include broadening company perspectives to include the whole planet. The choice to expand into foreign markets relies on a company's financial capabilities, management philosophy, and the nature of opportunity and danger. The Coca-Cola Company's soft drink products are sold in nearly 200 countries, according to the theme Vice, making it the most well-known and powerful brand in the world.

In addition to making the Coca-cola symbol widely recognised around the world, the company also makes more than 200 other nonalcoholic beverages to cater to regional beverage preferences. Many other businesses have effectively engaged in global marketing by developing powerful worldwide brands. For instance, Philip Morris has elevated Marlboro to the position of top cigarette brand globally. With its Mercedes brand BMM cars and motorbikes, Daimler Chrysler has become a household name in the automotive industry. Additionally, product or system design, product positioning, packaging, distribution, customer service, and sourcing concerns may all be included into global marketing strategies. A restaurant system created by Mc Donald's, for instance, may be put up almost any place in the globe. as with Coca-Cola

Additionally, McDonald's adapts their menu selections to local gastronomic practises. For instance, McDonald's is an elite dining option in Jakarta, Indonesia. In Jakarta, it is the place to be and to be seen. Local area network routers, such as those produced by Cisco Systems, enable computers to interact with one another. Cisco Systems creates innovative products that can be configured to function almost anywhere in the globe. In several international countries, Unilever utilises a teddy bear to explain the advantages of their fabric softener. The bikes made by Harley-Davidson are marketed as being uniquely American. Everywhere in the globe, Gillette employs the same packaging for their premium sensing racial. Italian clothing brand Benetton has a highly developed distribution network to swiftly provide the newest styles to its extensive global shop network. A network of dealers that supports the promise of 24-hour parts and service everywhere in the globe is the foundation of Caterpillar's international success. The original foundation of Honda and Toyota's success on the global market was the export of automobiles from Japanese auto facilities. Both businesses have now made investments in manufacturing facilities in the US and other nations from which they export. Honda achieved the distinction of being the top exporter of automobiles from the United States in 1994 by sending more than 100,000 Civics and Accords to Japan and 35 other nations. The specific global marketing strategy that a business chooses will rely on market circumstances and its source or sources of competitive advantage.

III. CONCLUSION

In conclusion, our knowledge of the motivations and trends in international commerce has advanced significantly thanks to theories of the subject. They provide economists and policymakers practical platforms for exploring and advancing global trade. However, it is crucial to take into account these ideas together with the intricacies of the actual world in order to create efficient policies and strategies that amplify the advantages of global commerce for long-term, sustainable economic growth and development. Although these ideas have shed light on critical issues, it is crucial to remember that a variety of complicated interrelated variables, such as governmental regulations, technology developments, and cultural concerns, affect global commerce. Although the theories provide a basis for comprehending trade patterns, they may not fully represent the complexity of actual trade dynamics.

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