

### Theory of absolute advantage

Countries can produce some goods more effectively and efficiently than others.

### Theory of comparative advantage

Free trade can increase global output even if one country has an absolute advantage in the production of all products

### Trade pattern theories

| Theory of country size | Large depend on export less than small. Large = varied climates and more resources, so more self sufficient. | Russia, USA, Brazil, India, China are large |
|------------------------|--------------------------------------------------------------------------------------------------------------|---------------------------------------------|
|------------------------|--------------------------------------------------------------------------------------------------------------|---------------------------------------------|

Size of economy: Developed countries more likely to trade. Top 10 export/importers developed countries. Developed economies produce more so have more to trade, incomes are high so people buy more.

### With whom trade theories

Country-Similarity theory: Developed trade mostly with each other because they - produce and consume more, create new products to compete, produce differentiated products and services

Specialisation and acquired advantage: Provide other countries an advantage over domestic producers. Specialise to grain advantage, eg Germany = machinery & equip

### Product differentiation

Cultural similarity: Importers and exporters find it easier to trade with countries they are similar to in language and or culture

Political relationships / economic agreements: May discourage or encourage trade

Overcoming distance: Transport costs

### Specialisation assumptions (valid?)

Full employment: Everyone who wants a job has one

Economic efficiency: Minimisation of real and opportunity costs of production by exploiting comparative advantages rather than necessarily absolute advantages

Division of gains: Ops for gains: resource owners benefit by sale of one output for other, more highly valued goods.

Two countries, two commodities: Simplified version of reality

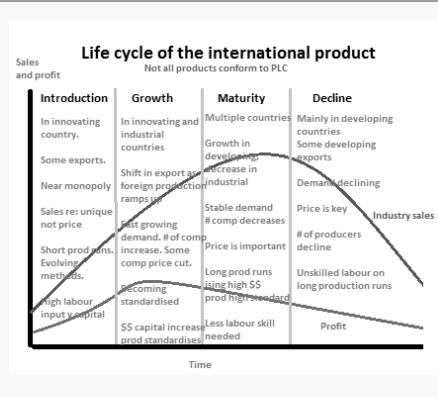
Transport costs: Reduce the benefits of specialization

Statics and dynamics: Relative conditions in a country change

Production networks: bits of products made in different countries

Mobility: Assume resources can move domestically to where they are needed. Not always valid.

### International PLC Theory



### Free trade results in

Specialisation - natural advantage: Soil, natural resources, fish in seas, minerals, wildlife, rainforests

Specialisation - acquired advantage: Product or process technology



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Page 1 of 2.

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### Free trade results in (cont)

Increased efficiency  
Increased global output

### What type of products are traded

|                                         |                                                                                                        |
|-----------------------------------------|--------------------------------------------------------------------------------------------------------|
| People and land                         | Countries with high people to land ratio trade labor with wheat and wool for example                   |
| Manufacturing locations                 | Places which need lots of room manufacture in places where there is a lot of room.                     |
| Capital, labor rates and specialisation | Production factors are not homogenous, vary within and among countries coz of training/edu differences |
| Process tech (FP theory results varied) | Companies may substitute capital for labour, depending on the cost of each.                            |
| Product tech                            | New products req \$\$\$ in R & D so most come from developed countries                                 |

According to the factor proportions (FP) theory - factors in abundance are cheaper than factors in scarcity. Assumes homogeneity in countries.

### Production possibilities curve

Graphical representation of all combinations of goods and services an economy can produce.

An economy's factors of production are scarce; they cannot produce an unlimited quantity of goods and services.

### Importing and exporting probs

|                     |                                                                                                                                                                        |
|---------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Financial risks     | Most SMEs cite 'shortage of working capital to finance export' as big barrier. Offers low profitability in light of unexpected costs and unknown financial constraints |
| Customer management | With high speed connections customers want immediate answers.                                                                                                          |
| Scant IB expertise  | Difficulties of understanding foreign business practices. Limited knowledge of competitors, unfamiliarity with local customs etc                                       |
| Marketing barriers  | High shipping costs / logistic demands, difficulty price matching & promoting. Discouraging for exporters.                                                             |

### Importing and exporting probs (cont)

|                           |                                                                                                                                                                                                                                  |
|---------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Top management commitment | International outlook and risk orientation. Most focus on domestic rather than foreign. Exporting and importing places tough demands on mgmt. Firms with aggressiveness and surplus resources to trade internationally are rare. |
| Trade regulation          | Inefficiencies due to delays, documents and admin fees. Regulations differ from one country to the next. Homeland security also can be a problem.                                                                                |
| Trade documentation       | Lots of it. Including: duty rates, customs clearance and entry processes. Values declarations, duty management, Mistakes spawn costs and it can get \$\$\$ to manage                                                             |

### Why import?

Specialisation of labour  
Global rivalry  
Local unavailability  
Diversification  
Top management's outlook



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Page 2 of 2.

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