

Trading Internationally

Chapter 5



Quick Diversion....ethnocentrism

How the average American sees the World A Stereotype Map



Quick Diversion....cultural intelligence



Quick Diversion....cultural intelligence

CQ-DriveCQ

Drive is a person's interest and confidence in functioning effectively in culturally diverse settings. It includes:

Intrinsic interest – deriving enjoyment from culturally diverse experiences

Extrinsic interest – gaining benefits from culturally diverse experiences

Self-efficacy – having the confidence to be effective in culturally diverse situations

Quick Diversion....cultural intelligence

CQ-KnowledgeCQ

Knowledge is a person's knowledge about how cultures are similar and how cultures are different. It includes:

Business – knowledge about economic and legal systems

Interpersonal – knowledge about values, social interaction norms, and religious beliefs

Socio-linguistics – knowledge about rules of languages and rules for expressing non-verbal behaviors

Quick Diversion....cultural intelligence

CQ-StrategyCQ

Strategy is how a person makes sense of culturally diverse experiences. It occurs when people make judgments about their own thought processes and those of others. It includes:

Awareness – knowing about one's existing cultural knowledge;

Planning – strategizing before a culturally diverse encounter;

Checking – checking assumptions and adjusting mental maps when actual experiences differ from expectations.

Quick Diversion....cultural intelligence

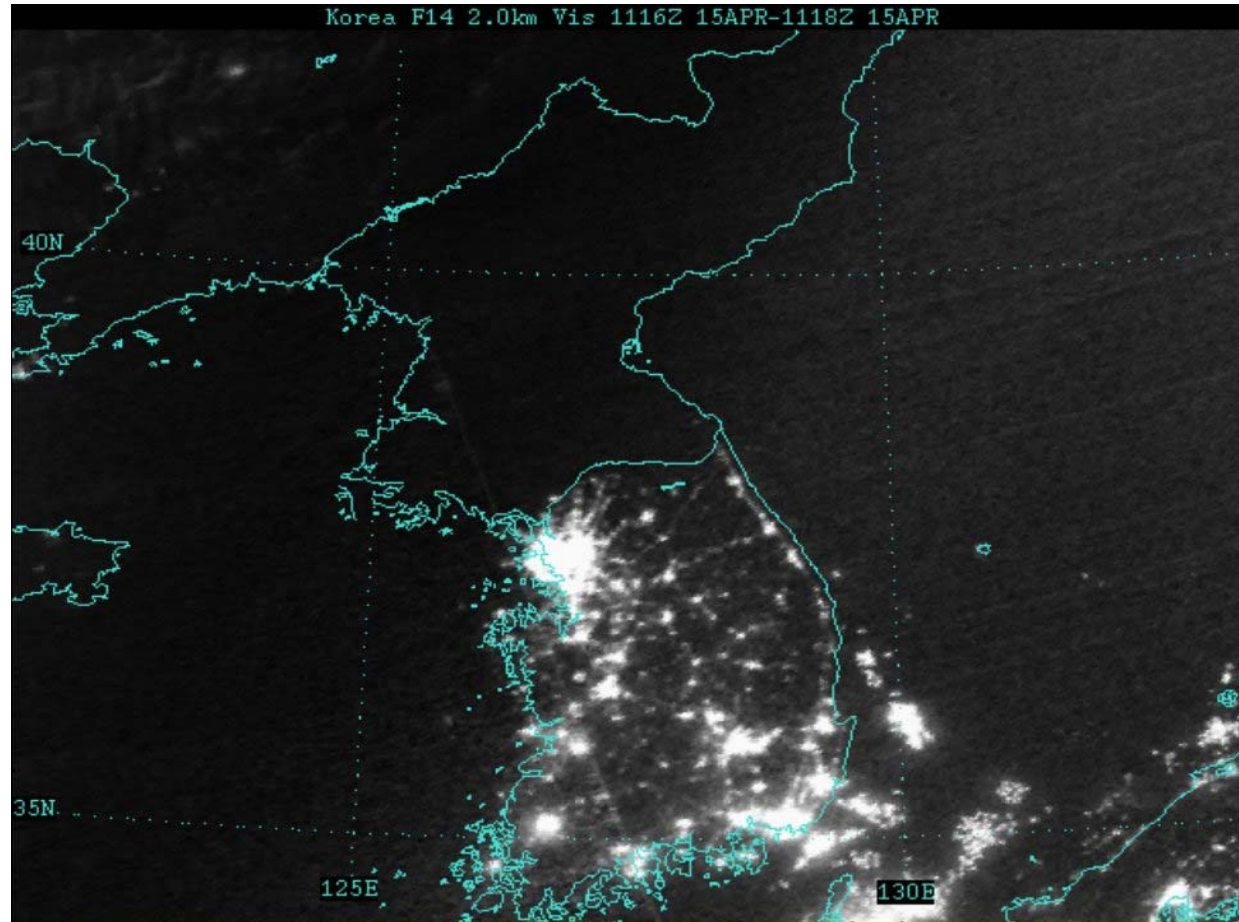
CQ-ActionCQ

Action is a person's capability to adapt verbal and nonverbal behavior to make it appropriate to diverse cultures. It involves having a flexible repertoire of behavioral responses that suit a variety of situations. It includes:

Non-verbal – modifying non-verbal behaviors (e.g., gestures, facial expressions)

Verbal – modifying verbal behaviors (e.g., accent, tone)

North Korea V. South Korea



Source: Globalsecurity.org

Objectives

Explain why countries trade

- Actually firms...

Understand history of trade theory

Political realities of trade

Factors to be considered for trade decisions

Why Nations Trade

Remember elementary school --- Chips for Dessert

- Both parties gain from trade

Not usually nations trading

- Firms trade with each other
- Patterns in firms, easier to say/think nations

Firms selling their products abroad are exporting

Consumers or firms purchasing goods produced abroad are importing

Balance of Trade

Balance of Trade – country level of trade, surplus or deficit

Bilateral trade deficits are poor statistics

- Trade deficit with grocery store...

Trade Surplus – when a nation exports more than it imports

Trade Deficit – when a nation imports more than it exports

Is the US in a deficit or surplus?

Where do gains come from?

Resource based view – firms in one country produce products that are valuable, unique, and hard to imitate

- Firms from other nations find it beneficial to import

Institution based view – rules governing trade facilitate or deter trade

Theories of Trade

Mercantilism – trade is zero sum game

- 18th century but still not dead...
- Fixed amount of wealth (not true, problem)
- Export more than import to accumulate gold/wealth

**US Pursuing
Open Trade
Policy**

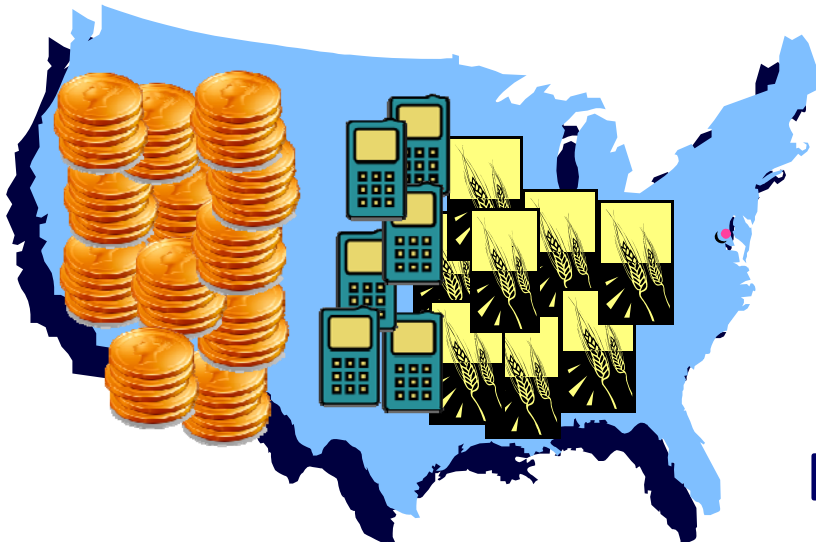
**China Pursuing
Mercantilist
Policy**

2. Goods

1. Goods

$$M \times V = P \times Y$$

$$M \times V = R \times Y$$



**Eventually
Reach
Balance
1. Gold**

2. Gold

MS dec. -> Price

**Reduced MS in US,
MS inc. > Prices inc.
Prices fall**

**Inc. MS in China,
Prices rise**

Theories of Trade

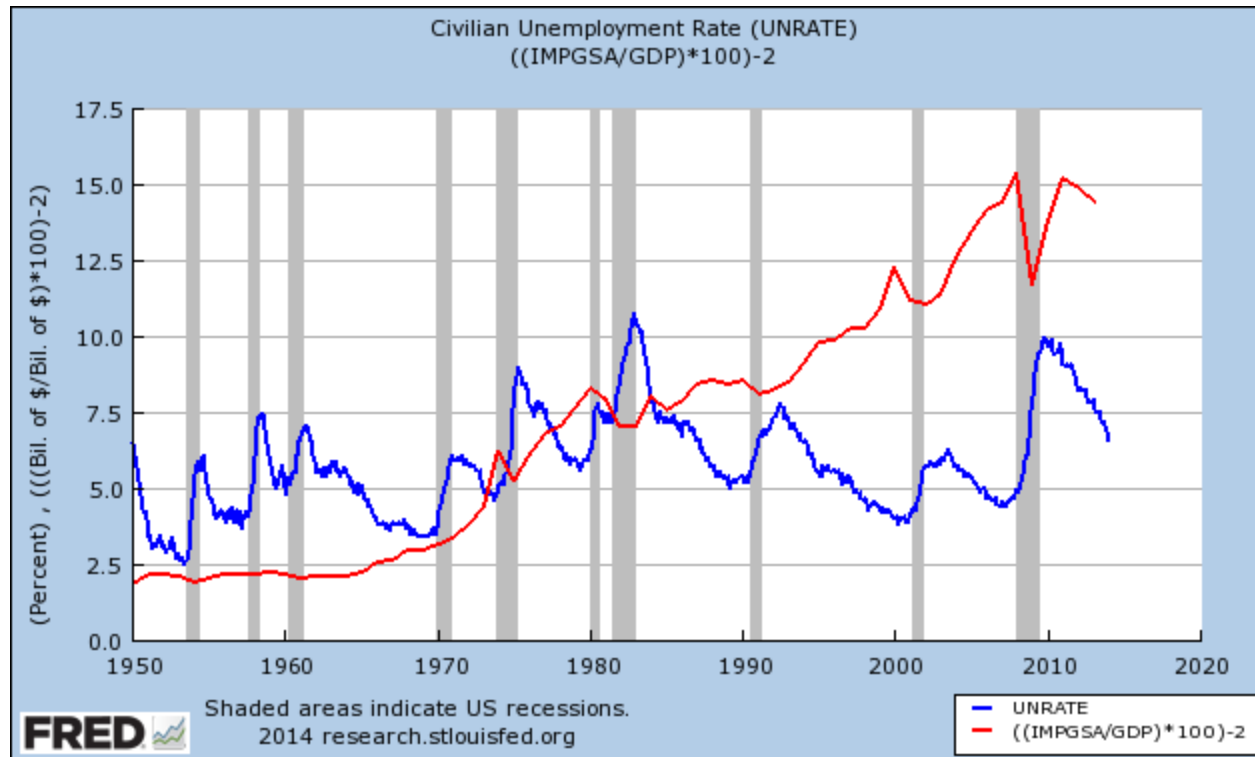
Mercantilism – trade is zero sum game

- Fixed amount of wealth (not true, first problem)
- Export more than import to accumulate gold/wealth
- Second problem
 - Not sustainable
 - Gold in – prices increase, gold out prices decrease
 - Eventually imbalances reverse direction of trade

Protectionism – active protection of domestic industries by government

- Similar mindset to Mercantilism

Does Trade Destroy Jobs?



- Imports are not reducing number of jobs
- Protectionism based on flawed theory

Example



Absolute Advantage – Adam Smith

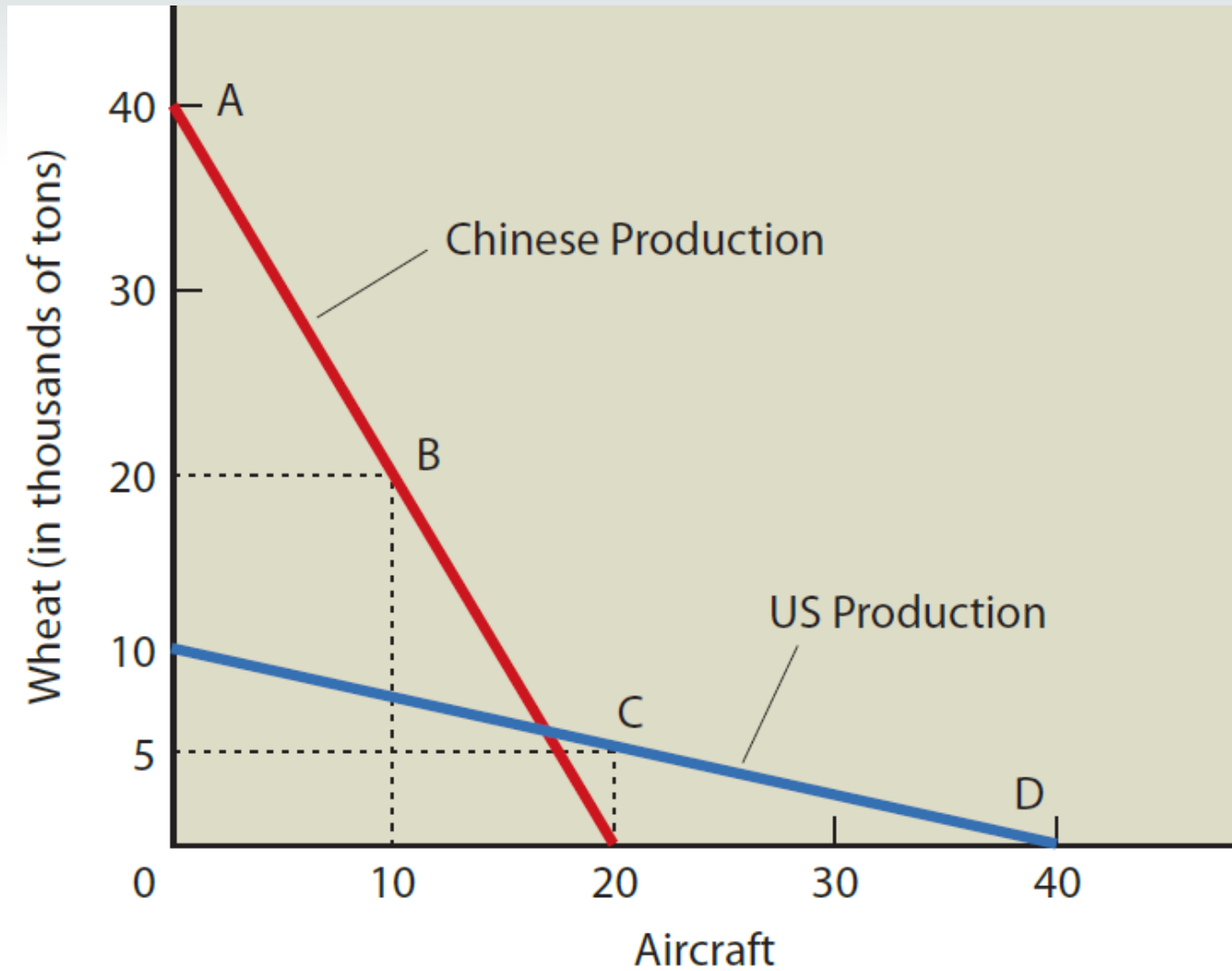
Advocate of Free Trade – market forces determine the buying and selling of goods and services

Theory of Absolute Advantage – each nation gains by specializing in economic activities in which it is most efficient

- Can produce same amount of good using fewer inputs than other countries

Exhibit 5.2

Absolute Advantage



Better at Both?

Can countries gain if one is more efficient at producing both goods?

- David Ricardo

- **Opportunity cost** – the cost of pursuing one activity at the expense of another, a relative cost
- **Theory of Comparative Advantage** – a country should specialize in producing the good in which it has a *relative* advantage

Comparative Advantage

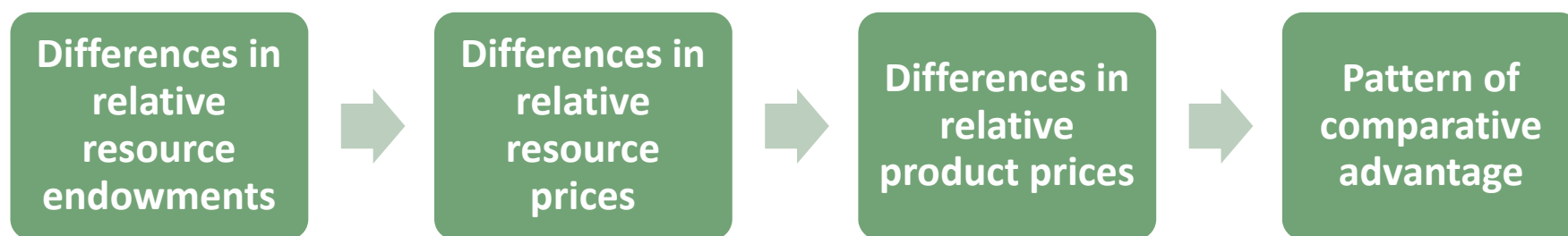
Countries specialize in comparative advantage

Where does this advantage come from?

- **Factor Endowment Model** (HO Model)
 - Countries are endowed with factors of production
 - Locally abundant factors lead to comparative advantage

Factor Endowments

Effect of resource endowments on comparative advantage



- Model explains trade between countries with different endowments
 - ~ trading natural resources for manufactured goods
 - Oil for wheat

Trade Realities

Most of trade is between industrialized/ similar nations

- Trade in manufactured goods
- Not well explained by factor endowment model

Intra-industry Trade



Intraindustry Trade

U.S. Exports to China

Electrical machinery	65,236,121
Nuclear reactors, boilers	10,693,159
Grain, seed, fruit	8,849,565
Aircraft, spacecraft	7,198,055
Plastics	3,600,940
Optic, photo, medical	3,314,019
Iron, steel	2,255,434
Wood pulp	2,053,178
Aluminum	1,819,115
Organic chemicals	2,101,193

U.S. Imports from China

Sound equipment, TVs	76,719,118
Machinery	64,025,786
Toys, sporting equipment	26,127,241
Apparel	23,965,281
Furniture	20,361,512
Footwear	14,134,828
Iron and steel products	9,764,720
Plastics	8,249,394
Leather articles	7,230,980
Vehicles	6,384,209

Capital intensive or resource specific

Labor intensive or resource specific

Intra-industry trade

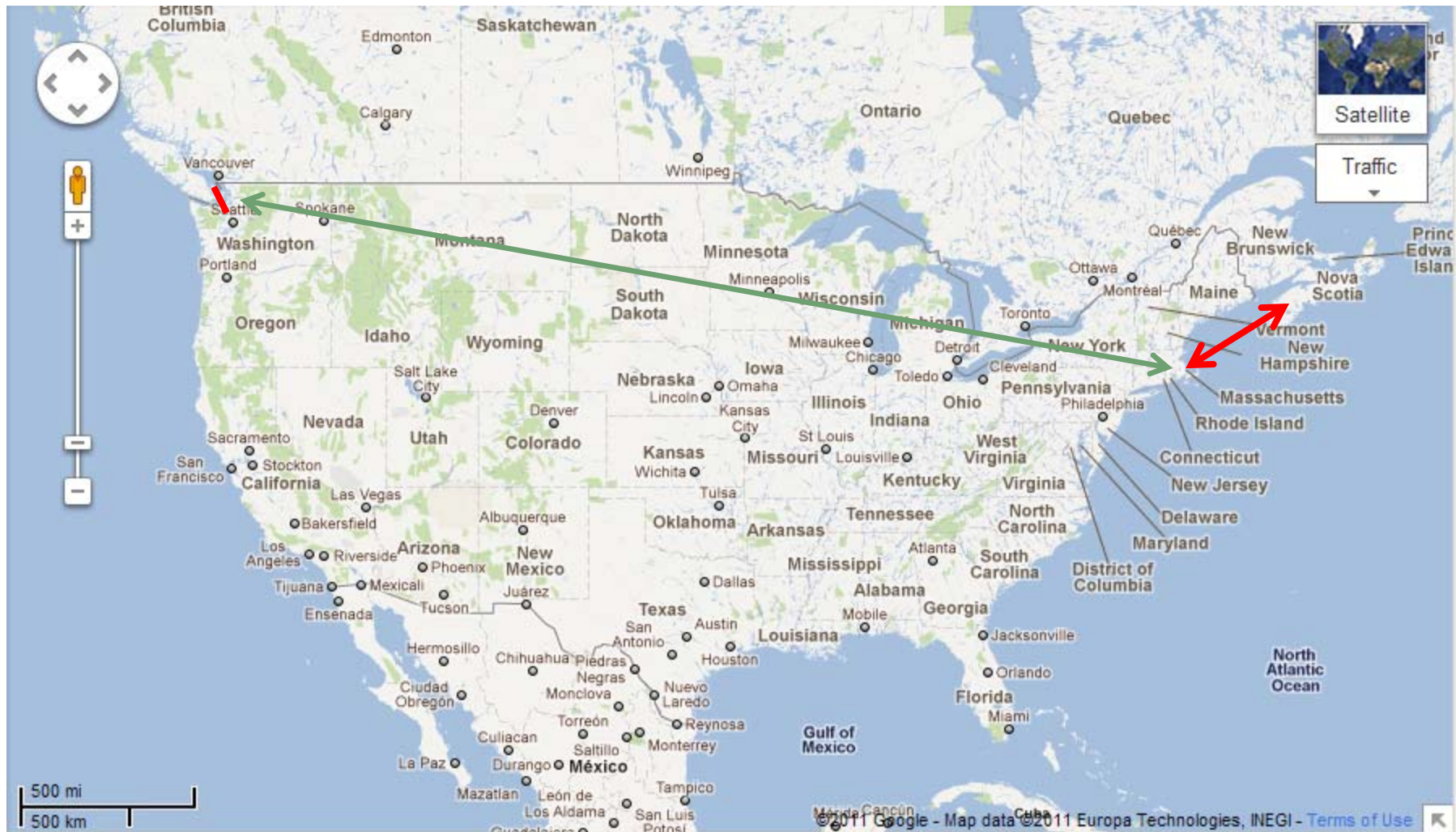
Intra-industry trade

- Product mix changes but industries may not
- Less adjustment cost than complete specialization

Explained by:

- Trade in homogeneous goods
 - Transportation costs
 - Boston buy from Nova Scotia, not Seattle

Cross Border Closer?



Intra-industry trade

Explained by:

- Trade in homogeneous goods
 - Transportation costs
 - Boston buy from Nova Scotia, not Seattle
 - Seasonal

Differentiated Products

Trade in differentiated products:

- Unmet need
 - Domestic producers produce for majority demand
 - Minority demand filled by imports
- Overlapping demand
 - preference and taste determined by income, similar incomes -> similar demands
- Economies of scale
 - Each country makes a few, trade for variety

Too Static...

Dynamic Theories



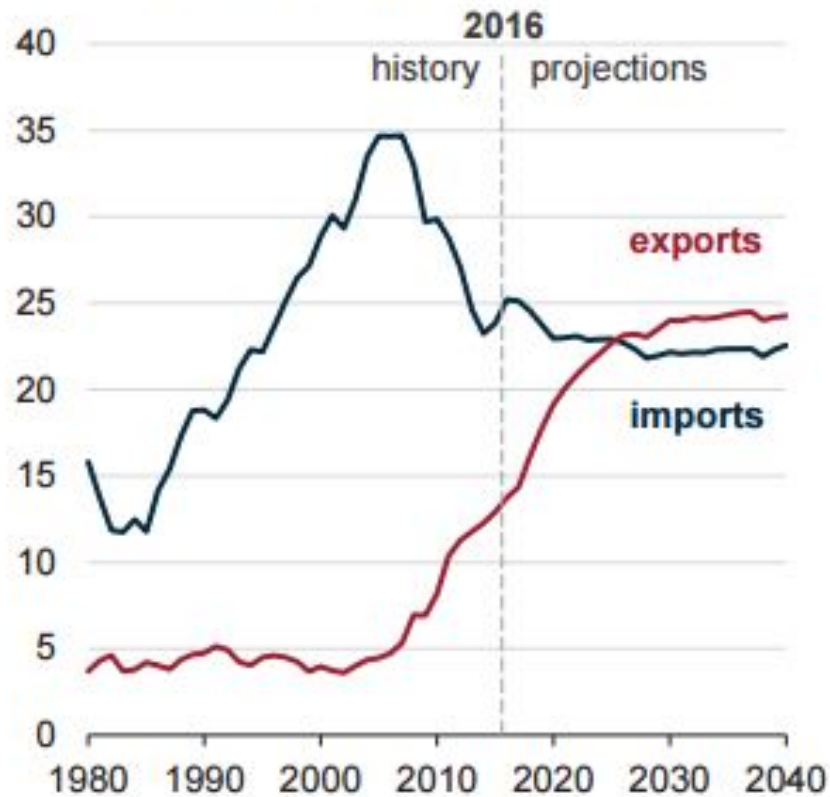
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Dynamic Theories

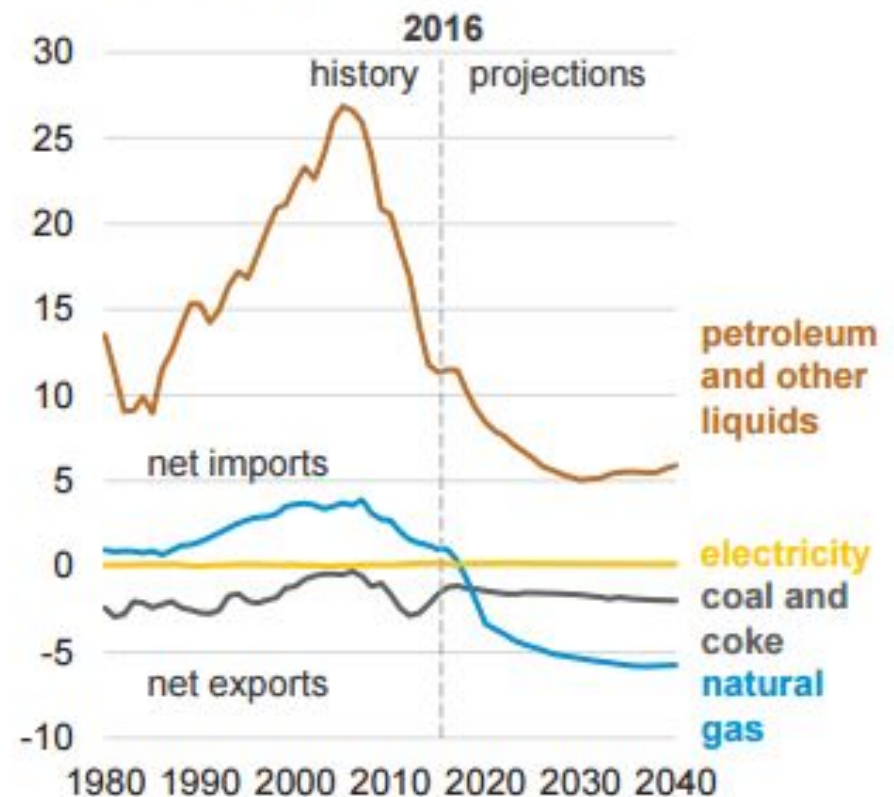
Comparative Advantage and HO model give static picture

- But many countries moving from agricultural to manufacturing, manufacturing to service...
- How? Why?
 - Resources change, i.e. education, capital,
 - Technology changes
 - Etc...

Energy trade (Reference case)
quadrillion British thermal units



Net energy trade (Reference case)
quadrillion British thermal units



Technology: The Product Cycle

Technological innovations

- Different nations, at different rates of speed

- Result in:
 - Innovation of new goods
 - Improvements to existing goods
 - New methods of producing existing goods

- Often transitory (tending to pass away, not persistent)

Televisions



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Radio Corporation of America



Started by GE/military following WWI

- spun off in 1930

Developed color television, electron microscope LCDs, video cassette recorders...

Company CEO said “Television will never be a medium of entertainment” 1955

Acquired Hertz, Random House, started NBC

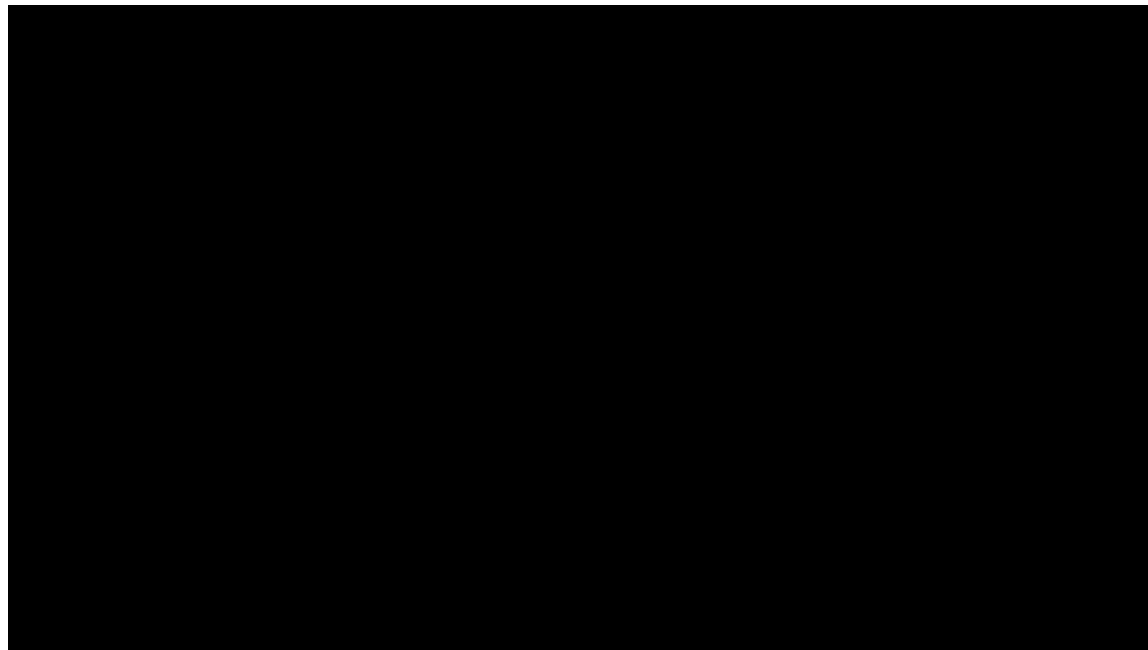
Lost profitability

Acquired by GE, (1986) broken up, RCA trademark sold to French company (irony...)

Company that innovated TV was gone!

TV production coming back to US?

Vizio claiming to American leadership in TVs



Slightly dated but follow the idea

Cycle starting again

Technology: The Product Cycle

Product life cycle theory Theory suggests patterns change over time as production shifts and product becomes standardized

- Predictable trade cycle:
 1. Manufactured good introduced to home market
 2. Domestic industry shows export strength.
 3. Foreign production begins
 4. Domestic industry loses competitive advantage
 5. Import competition begins

Always need to be innovating!

New

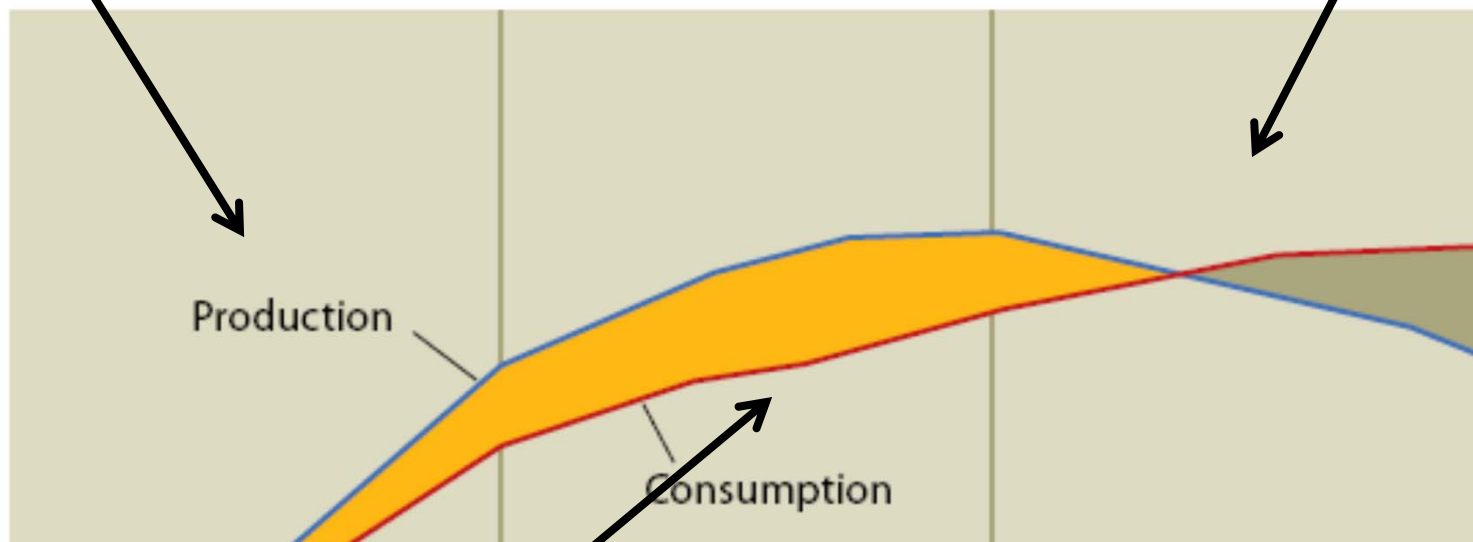
Standardized

Imports

Exports

A. United States

Trade Volume



Production

Consumption

New Product

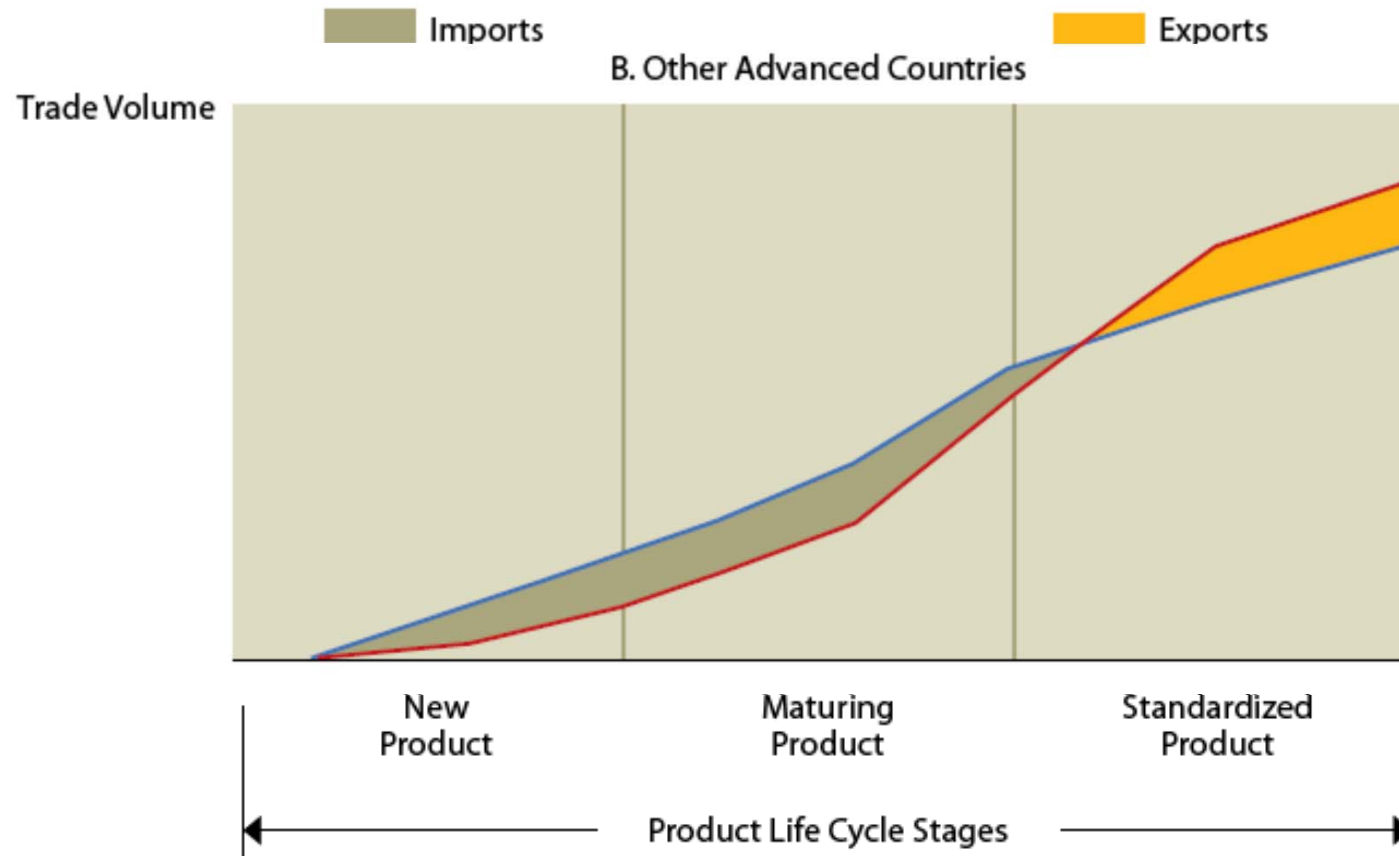
Maturing Product

Standardized Product

Product Life Cycle Stages

Maturing

Product Life Cycle



Strategic Trade



Strategic Trade

Strategic Trade Theory - gov't Intervention can enhance odds for international success

- Typically capital intensive industries
 - High barriers to entry
- First mover advantage
 - High capital industries -> first mover advantage

Strategic trade policy – policy that provides companies a strategic advantage through government subsidies

- Requires governments to pick winners (big problem!)

Solyndra



- Green energy is not cheap enough to be competitive
 - Any programs supporting it “might” be a political liability
 - May also be the future...
 - Just don’t know

National Competitive Advantage



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National Competitive Advantage

What makes one country more competitive in an industry than another?

- US and Germany: chemical industries
- Japan: automobiles and electronics

What causes industrial competitiveness?

- Natural and Human Resources?
- Domestic Demand Conditions?
- Firm strategy and competition?
- Related and supporting industries?
- All of these? Complementary assets?

Overview of Theories

Take *free trade* models for granted

Models are simplified

- 2 countries, 2 goods
- Capital and labor

Assume resource mobility between industries

Assume away transport costs and foreign exchange

Newer theories are more dynamic but based on same principles

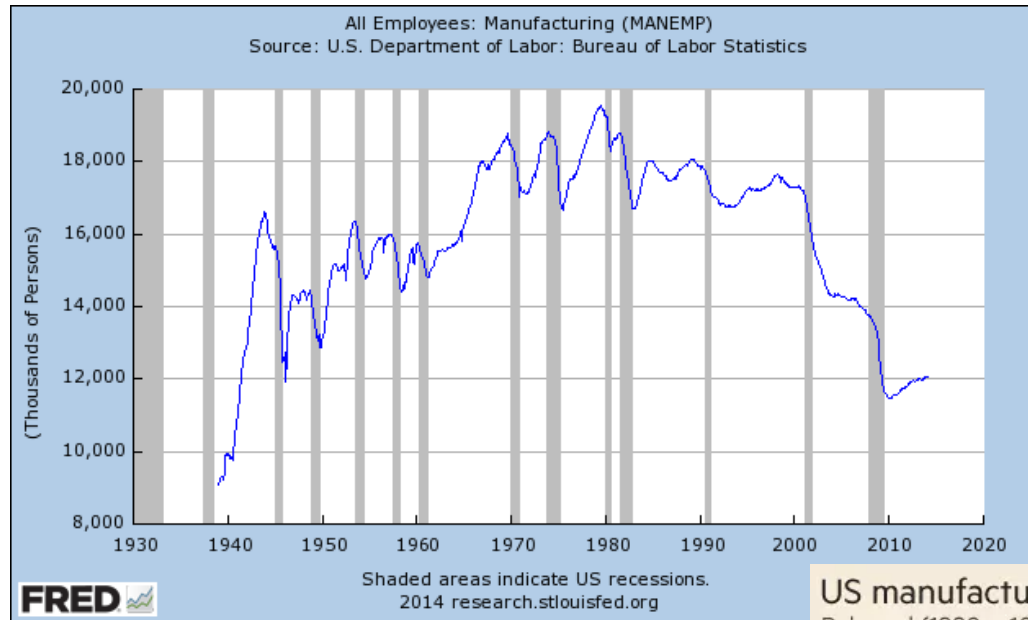
Free Trade is still good!

Political Realities



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US Manufacturing Employment



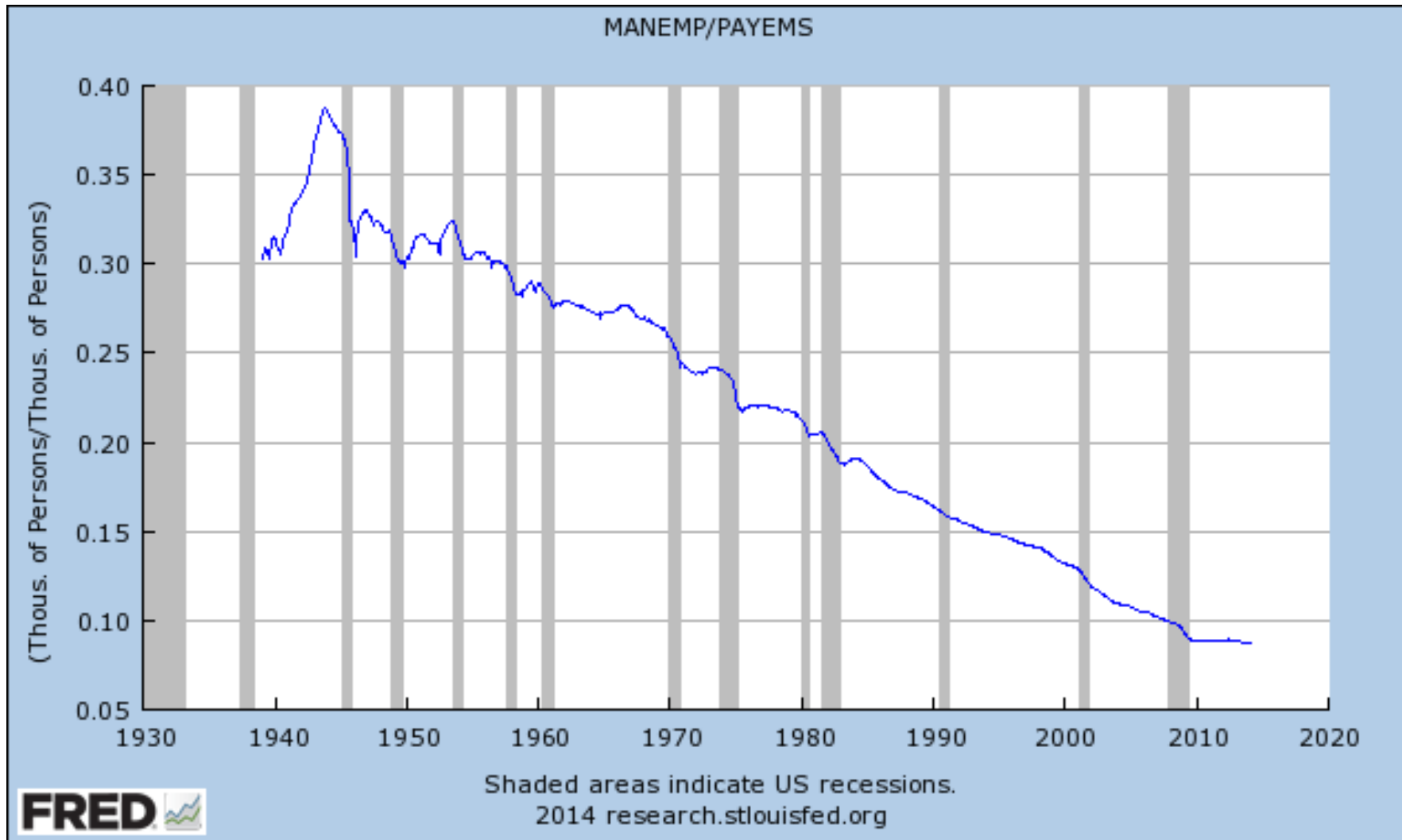
US manufacturing
Rebased (1980 = 100)



Source: Brookings, Moody's

FT

Manufacturing as % of Total Emp



Think Manufacturing is:



PHOTO: JIM R. BOUNDS/BLOOMBERG VIA GETTY IMAGES

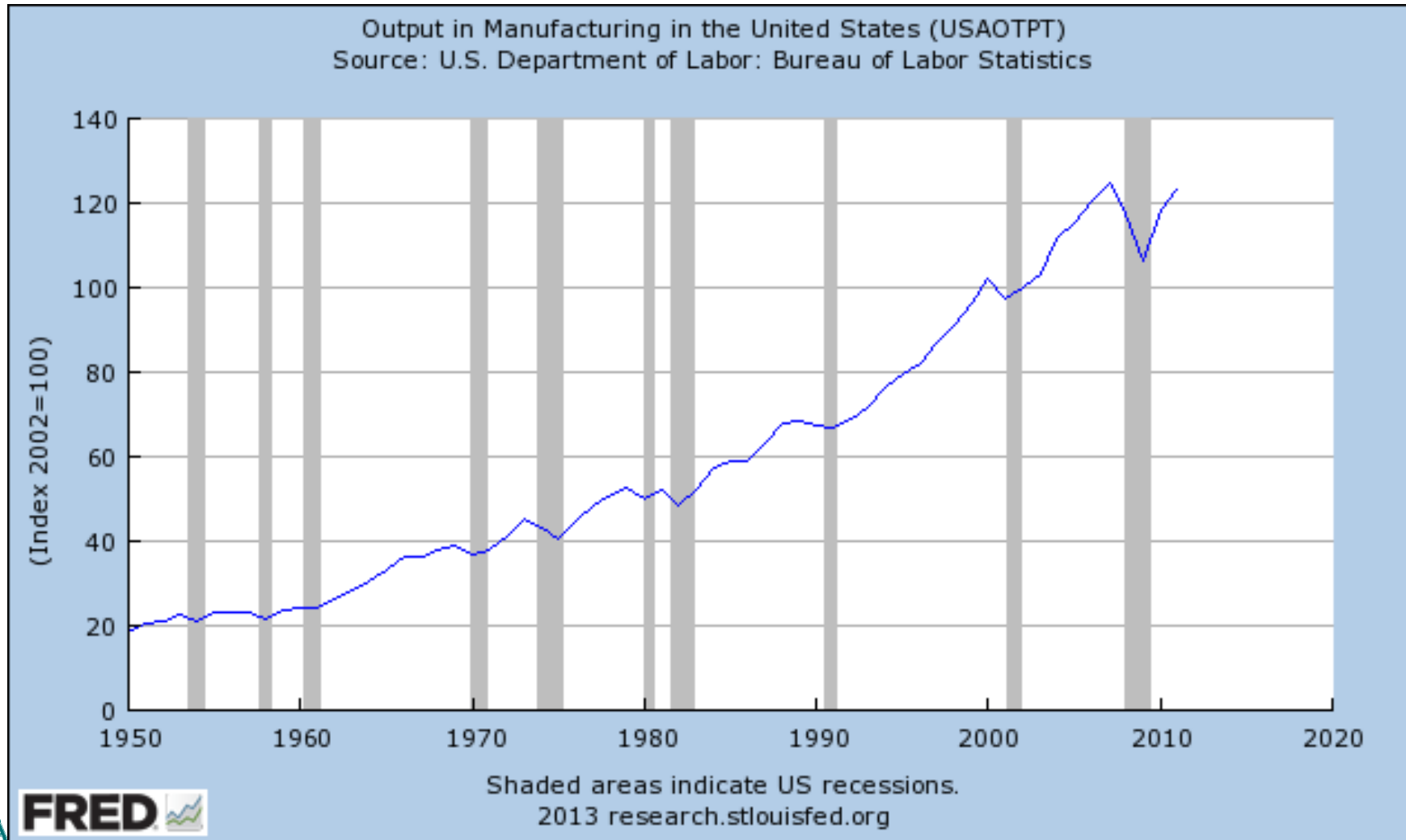
Think Manufacturing is:



Manufacturing is this...



US Manufacturing Output (automation...)



Automation in Services



McDonalds in France

Changing Production Locations

The screenshot shows the top of the Wall Street Journal website. The main navigation bar includes 'Home', 'World', 'U.S.', 'New York', 'Business', 'Tech', 'Markets', 'Market Data', 'Opinion', 'Life & Culture', 'Real Estate', 'Management', and 'C-Suite'. Below this is a secondary navigation bar with regional categories like 'Asia', 'China', 'Hong Kong', 'Japan', 'India', 'SE Asia', 'Europe', 'U.K.', 'Russia', 'Middle East', 'Africa', 'Canada', 'Latin America', 'World Markets', and 'China In Transition'. The 'TOP STORIES IN WORLD' section features three articles: 'Bangladesh Sentences Islamist Figure', 'China Real-Estate Sector Posts Strong Growth', and 'Afghan Rebels Cite Mixed Messages'. The main article is titled 'China Manufacturers Survive by Moving to Asian Neighbors' by Kathy Chu, with a sub-headline 'ASIA BUSINESS | Updated May 1, 2013, 12:00 a.m. ET'. The article includes a photo of a factory and a promotional box for Charles Gasparino, author of 'The Sellout'.

Table 1. Official reported manufacturing employment in China, yearend 1978–2002

[In millions]

Year	Manufacturing employment			Manufacturing employment in urban units			Urban manufacturing staff and workers			
	Total	Rural	Derived urban ¹	Total	Men	Women	Total	State-owned units	Urban collective-owned units	Own u
1978	53.32	17.34	35.98	—	—	—	35.95	24.49	11.46	
1980	58.99	19.42	39.57	—	—	—	39.47	26.01	13.46	
1985	74.12	27.41	46.71	—	—	—	46.20	29.75	16.08	
1986	80.19	31.39	48.80	—	—	—	48.20	30.96	16.80	
1987	83.59	32.97	50.62	—	—	—	49.88	32.09	17.24	
1988	86.52	34.13	52.39	—	—	—	51.49	33.27	17.45	
1989	85.47	32.56	52.91	—	—	—	52.06	33.44	17.54	
1990	86.24	32.29	53.95	—	—	—	53.04	33.95	17.73	
1991	88.39	32.68	55.71	—	—	—	54.43	34.82	17.82	
1992	91.06	34.68	56.38	—	—	—	55.08	35.26	17.47	
1993	92.95	36.59	56.36	—	—	—	54.69	34.44	15.95	
1994	96.13	38.49	57.64	54.92	30.31	24.61	54.34	33.21	15.15	
1995	98.03	39.71	58.32	54.93	30.11	24.82	54.39	33.26	14.17	
1996	97.63	40.19	57.44	53.44	29.52	23.92	52.93	32.18	13.46	
1997	96.12	40.32	55.80	51.30	28.44	22.86	50.83	30.11	12.44	
1998	[§] 83.19	[§] 39.29	[§] 43.90	[§] 38.26	—	—	[§] 37.69	[§] 18.83	[§] 7.42	[§] 1
1999	81.09	39.53	41.56	35.54	20.12	15.42	34.96	16.48	6.22	1
2000	80.43	41.09	39.34	33.01	18.75	14.25	32.40	14.15	5.19	1
2001	80.83	42.96	37.87	30.70	17.52	13.18	30.10	11.94	4.25	1
2002	83.07	45.06	38.02	29.81	16.98	12.83	29.07	9.79	3.46	1

Changing Production Locations

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Oracle Is Moving Manufacturing Jobs to US From Mexico

Article

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Text

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By Steven D. Jones

Oracle Corp. (ORCL) is joining the growing wave of companies moving manufacturing jobs back to the U.S.

Redwood City, Calif.-based Oracle will move 130 jobs manufacturing its Exadata engineered systems to Hillsboro, Ore., from Mexico. The move comes after receiving a \$1.4 million package of incentives and loans from Oregon's business expansion program, the state's governor announced Wednesday.

After decades of outsourcing, companies such as Apple Inc. (AAPL), Caterpillar Inc. (CAT), Ford Motor Co. (F) and Whirlpool Corp. (WHR) are making more goods in the U.S. again. Cheap energy, the weak dollar, steady wages and proximity to U.S. customers and suppliers are attracting some of the business.

Larry Ellison, chairman of Oracle, said in a May 2012 interview at the All Things D technology conference that the company was "doing as much manufacturing in the U.S. as we can."

"We are actually doing a lot of high-end manufacturing in Hillsboro, Oregon," Mr. Ellison said in response to a question at the conference. "We are doing a lot of our engineered systems there, in the U.S."

Oracle has two Hillsboro manufacturing plants that the company acquired in its 2010 acquisition of Sun Microsystems.

Another factor that is leading manufacturing back to the U.S. is incentives. Oregon offered Oracle a forgivable loan of \$750,000, plus funds from its business

Political Realities

Free Trade is Good Policy!

- But maybe not good politics...

Tariff barriers discourage imports by placing a tax on imported goods (import tariff)

- Leads to **deadweight loss** – loss of total surplus from distorting policy, in this case tariffs

See supply and demand diagrams

Arguments Against Trade

Jobs argument – foreign competition has unfair advantage and destroys our jobs

- Just changes composition
 - Note: Obama politics in campaign, not policy in 2nd term

Infant Industry Argument – young firms need time to mature and become competitive

- Just how long do they need? Without competition they may never mature

Arguments Against Trade

National Security – cannot rely on foreign countries for items needed during wartime

- Interdependence increases the cost of war

Consumer protections – protect domestic consumers from dangerous foreign products

- And why not let consumers decide for themselves?



Make America Great Again US
Baseball Cap Embroidery
Cotton Men Women Hat
Velcor

\$5⁹⁹ - \$6⁹⁹

★★★★☆ ▾ 12



MAKE AMERICA GREAT
AGAIN! - Trump 2016
Adjustable Cap with Rope
Front

\$12⁹⁹ - \$29⁹⁹ Prime

★★★★☆ ▾ 313

Nontariff Barriers (NTBs)

Subsidy – government payment to domestic firm

- Improve competitiveness against imports
- Improve competitiveness of exports

Import quotas – restriction on quantity of goods brought into country

- Similar to a tariff, maybe worse

Voluntary export restraints

- Export quotas
- Allow restraining country to capture gains of quota

Local Content Requirements – rule requiring a certain proportion of value of a good must be added in domestic market

Administrative policies – just throw up rules and roadblocks

Debate: Trade Deficit

For

- Trading partners mutually benefit by developing a deeper division of labor based on comparative advantage

Against

- Trade deficits are attributed to countries with which the United States holds large deficits

Implications for Action

When managing:

- Seek out and leverage comparative advantage
- Monitor current comparative advantage
 - Always changing
 - Product cycle
- Keep an eye on politics and be active to safeguard and advance gains from international trade