

UWTSD MBA (Nov 2019 intake)
BMMB7006 Global Business Challenges
(3-1)

International Trade and Market Protection

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19 January 2020; 10:00 am to 1:00 pm

Lecture Agenda:

- Trading Patterns
- International Trade Theories: Rationale behind International Trade
- Trade Restriction
- Entry strategies in emerging economies



International trade refers to trade between countries, it includes import and export of goods and services.

International trade has been growing as a proportion of countries' national income for many years, and the global trade volume has been growing much rapidly than GDP.



What are the benefits to countries and firms of international trade?

Which goods should a country export and which should it import?

Why do countries sometimes try to restrict trade and protect their domestic industries?

Trading patterns

主要國家的貿易額 Trade value of major countries

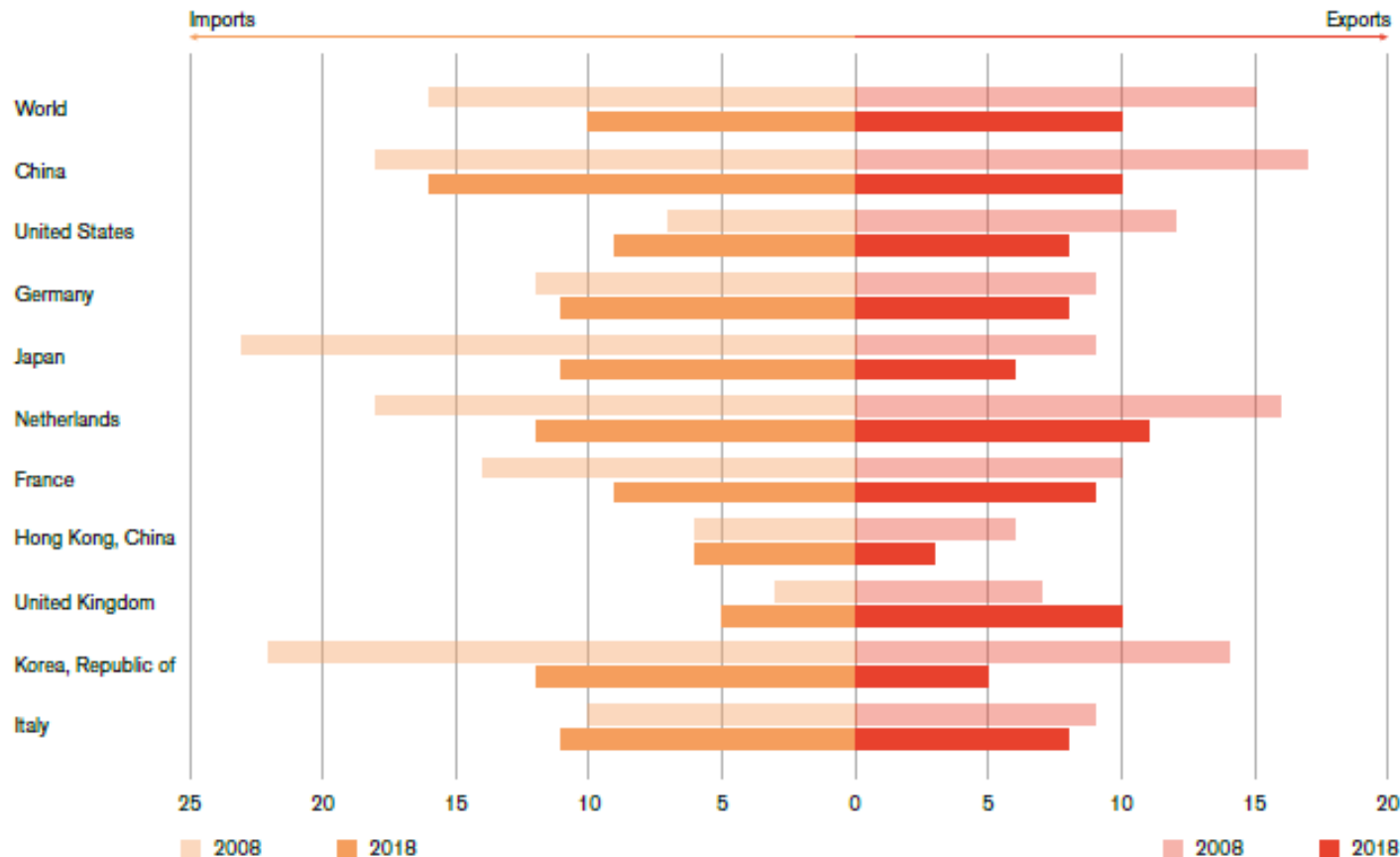
(100 million USD)

Country or Region	2008		2018	
	Exports	Imports	Exports	Imports
World	161,271 (100%)	164,150 (100%)	194,754 (100%)	198,665 (100%)
China	14,285 (8.9%)	11,330 (6.9%)	24,870 (12.8%)	21,359 (10.8%)
USA	13,005 (8.1%)	21,660 (13.2%)	16,641 (8.5%)	26,143 (13.2%)
Japan	7,823 (4.9%)	7,626 (4.6%)	7,384 (3.8%)	7,487 (3.8%)
UK	4,580 (2.8%)	6,319 (3.8%)	4,857 (2.5%)	6,735 (3.4%)
India	1,791 (1.1%)	2,916 (1.8%)	3,256 (1.7%)	5,107 (2.5%)

Note: Figures in parentheses are percent to total

Sources: China Statistical Yearbook 1997 and 2019

Leading merchandise traders, 2008 and 2018 (Annual percentage change in trade growth)



9/10

Trade growth for nine out of the top ten traders is below their 2008 pre-crisis levels.

Source: WTO-UNCTAD estimates.

Note: The traders are shown in the order of their world ranking in 2018. Ranking is based on total trade, calculated as the sum of exports and imports.

World merchandise trade volume and real GDP growth, 2011-2018 (Annual percentage change)

Chart 3.1

World merchandise trade volume and real GDP growth, 2011-2018

(Annual percentage change)



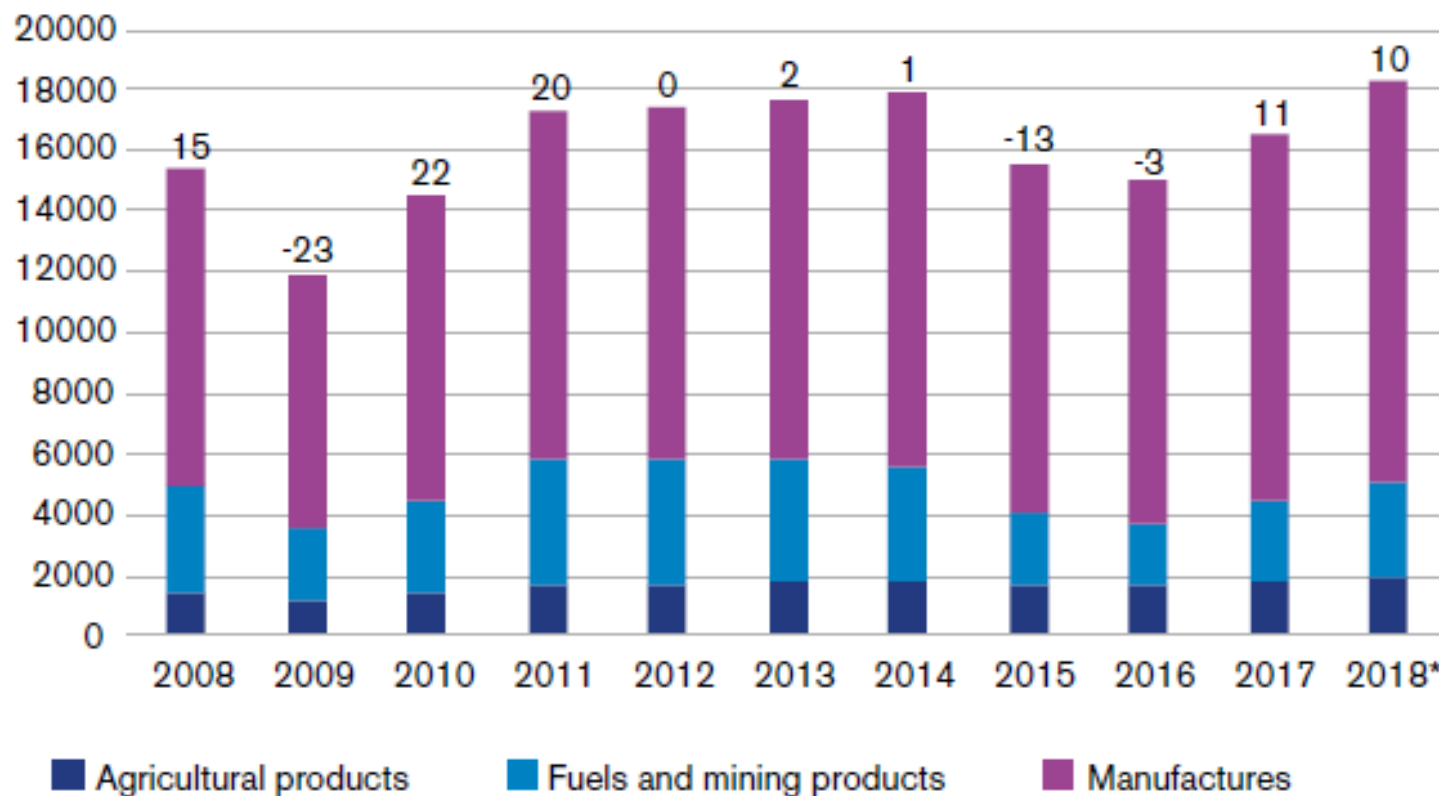
Note: GDP growth is calculated with market exchange rate weights.
Source: WTO Secretariat for trade, consensus estimates for GDP.

Sources: World Trade Statistical Review 2019

Chapter III World trade developments, 2018-2019

https://www.wto.org/english/res_e/statis_e/wts2019_e/wts2019chapter03_e.pdf

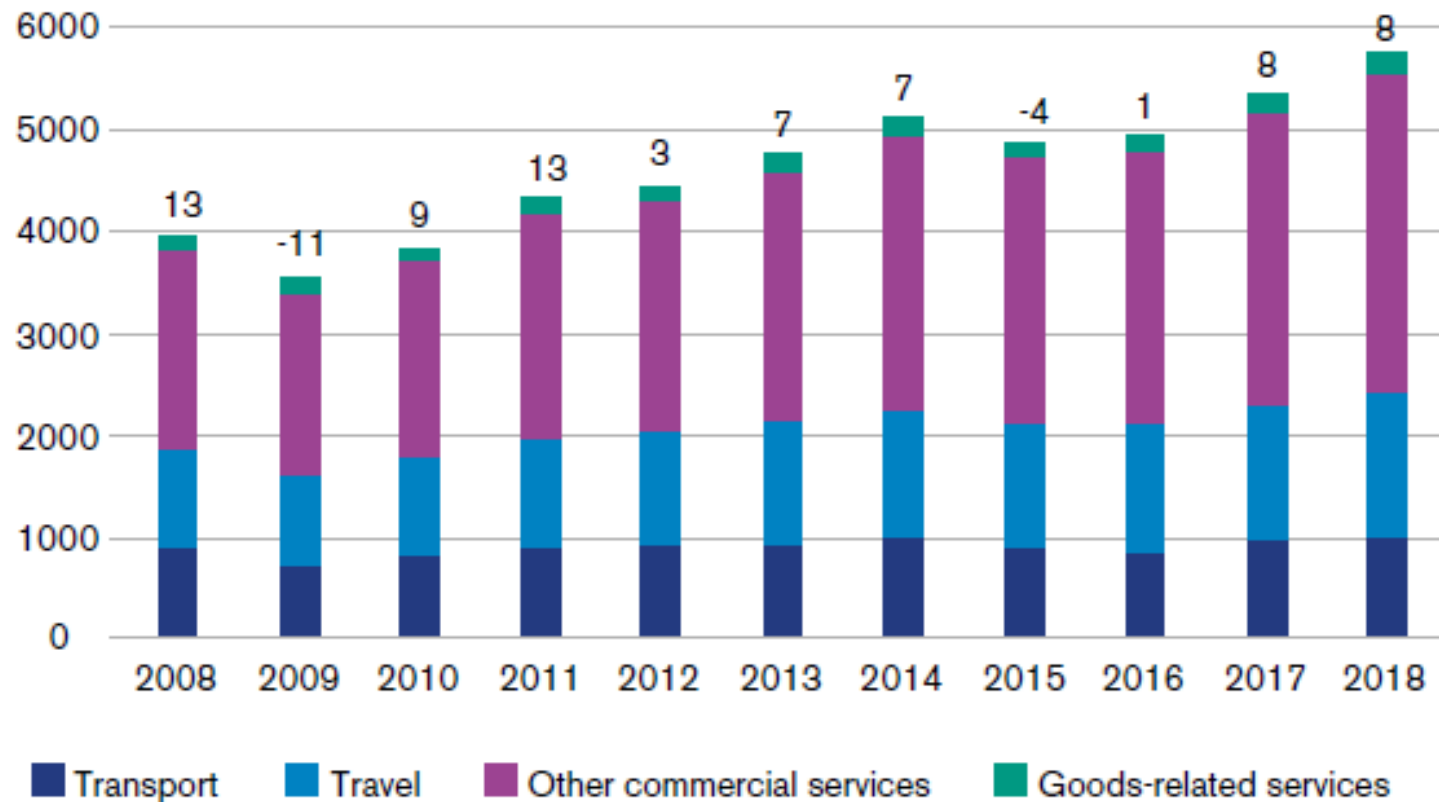
World merchandise exports by product group and annual growth, 2008-2018 (US\$ billion and average annual percentage change)



* Provisional estimate.

Source: WTO estimates.

World exports in commercial services by sector and annual growth, 2008-2018 (US\$ billion and average annual percentage change)



Source: WTO-UNCTAD-ITC estimates.

WTO



- General Agreement on Tariffs and Trade (GATT)
 - It was first signed in 1947
 - It covers international trade in goods.
- WTO
 - Location: Geneva, Switzerland
 - Established: 1 January 1995
 - Created by: Uruguay Round
 - Covers broad areas, including services and IP

WTO has 160 members since 26 June 2014

European Communities 1 January 1995

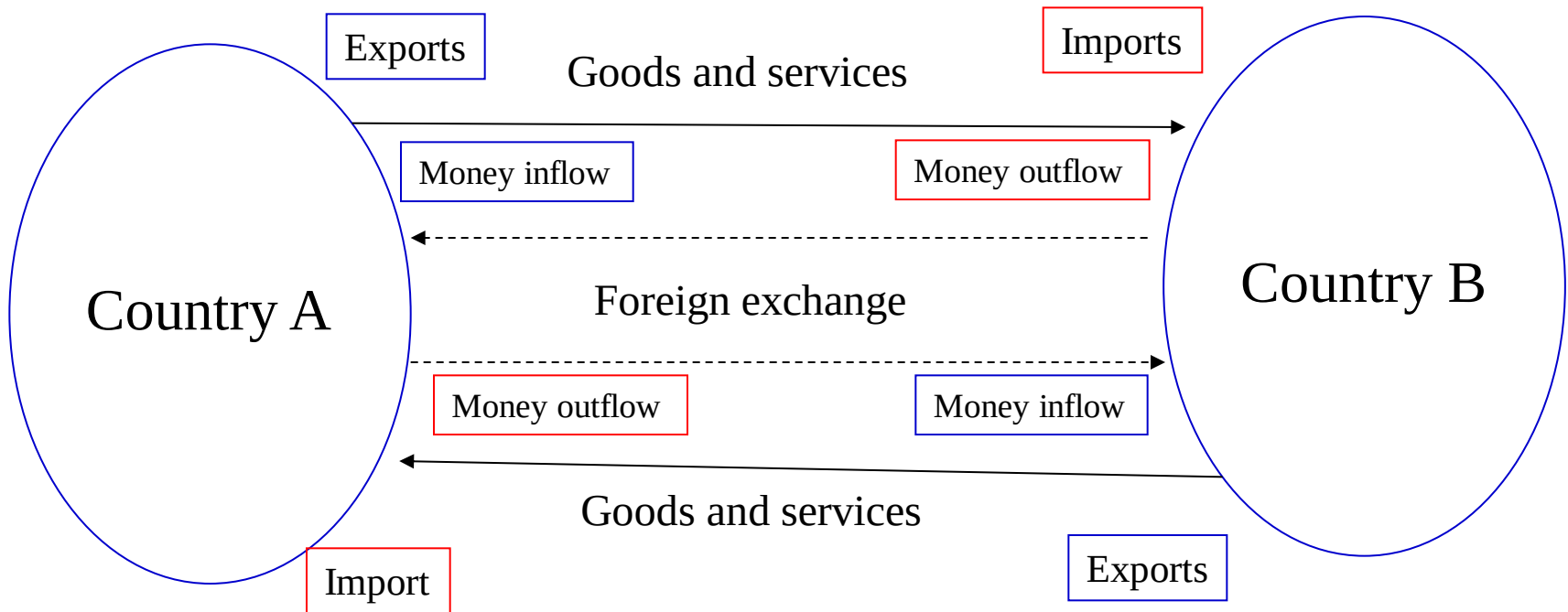
Hong Kong, China 1 January 1995

Macao, China 1 January 1995

China 11 December 2001

Chinese Taipei 1 January 2002

International Trade Theories: Rationale behind International Trade



————→ Physical flow (The scope of international trade)

-----→ Money flow (The scope of international finance)

International Trade Theories

Theory of Absolute Advantage

- Adam Smith: *Wealth of Nations* (1776).
- Assumptions:
 - A two-country and two-commodity model
 - Labor is the only factor of production
 - Labor is perfectly mobile within a country but completely immobile internationally
 - There is no transactions cost
 - The economy is operating under perfect competition
- Trade will occur and will be beneficial whenever there are international differences in cost of production.
- If country A is more efficient in producing commodity X and country B is more efficient in producing commodity Y, they will both profit if each produces what it is more efficient in producing and then exchange.

Theory of Comparative Advantage

- David Ricardo: *Principles of Political Economy* (1817)
- Efficiency of resource utilization leads to more productivity.
- When a country has an absolute disadvantage in the production of both commodities with respect to the other , mutually advantageous trade still take place.
- The less efficient country should specialize in the production of and export the commodity in which its absolute disadvantage is less.

Heckscher-Ohlin Factor Endowments Theory

- Eli Filip Heckscher: *The effect of foreign trade on the distribution of income* (1919).
- Bertil Ohlin: *Interregional and international trade* (1933)
- The theory postulates that comparative advantage of a country depends on it's endowments of inputs (factors of production) to produce goods
- A nation will export goods which it produces with resources that are relatively abundant.
- A nation will import goods which it produces with resources that are relatively scarce.

Factor Endowment - Example

Resource	Country A	Country B
Capital	100 machines	20 machines
labour	200 workers	1000 workers

- Country A: capital/labor ratio = 0.5 (100/200)
- Country B: capital/labor ratio = 0.02 (20/1,000)
- Since Country A has relatively more abundant capital $\frac{K_A}{L_A} > \frac{K_B}{L_B}$, it will produce capital-intensive goods with Country B producing goods that are more labor-intensive $\frac{K_A}{L_A} < \frac{K_B}{L_B}$.

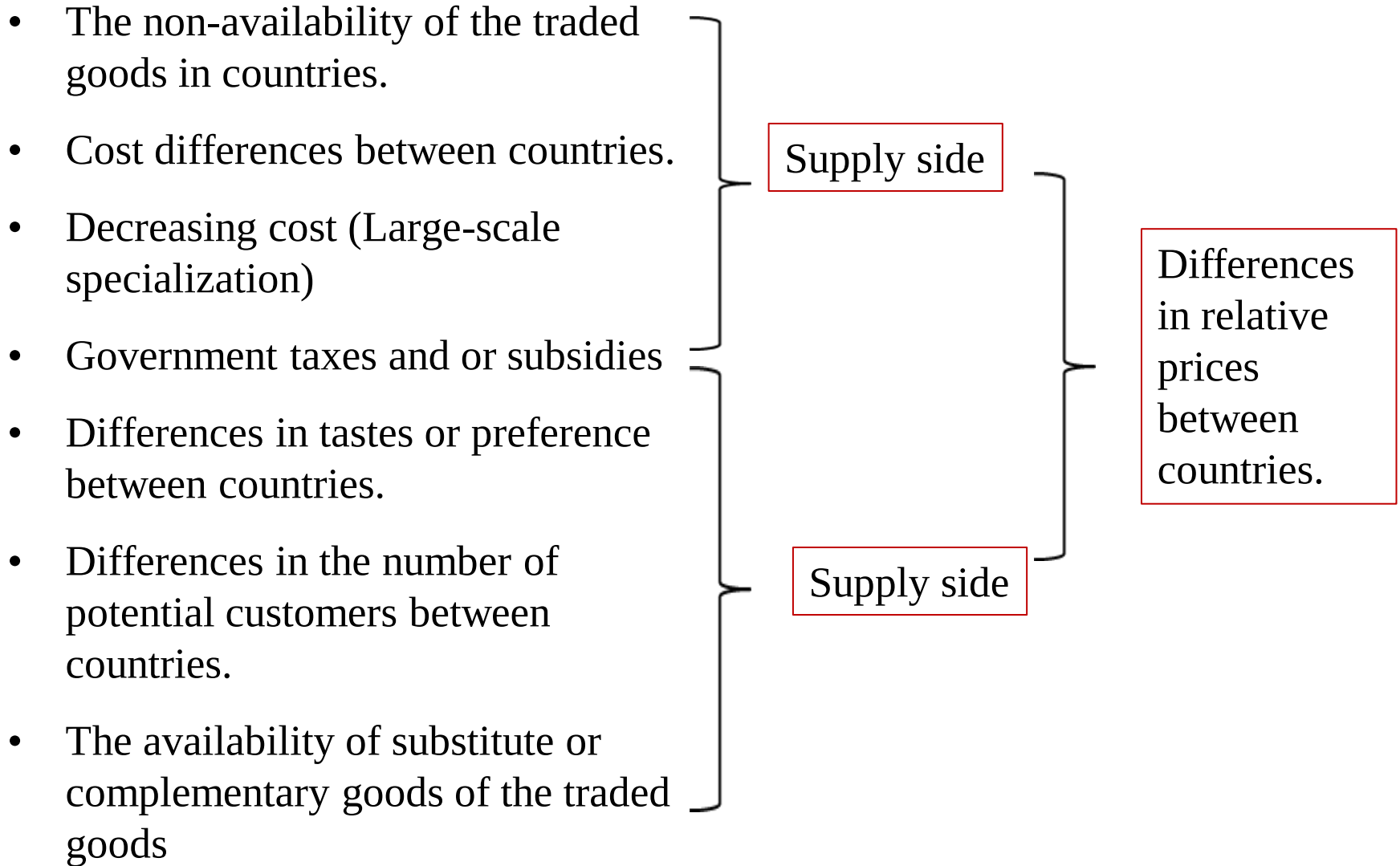
Assumptions of the Heckscher-Ohlin Model

- There are two countries and two goods model
- Production and consumption conducted under
- No transportation costs, taxes, or other obstructions to trade
- International trade does not cause complete specialization
- Consumers in both countries have equal tastes and preferences
- Both countries are endowed with homogeneous factors of production, capital (K) and labor (L), and both are used in production
- Technology for production is the same in both countries and produced under constant returns to scale
- Capital and labor are mobile domestically
- Labor and capital cannot move between countries

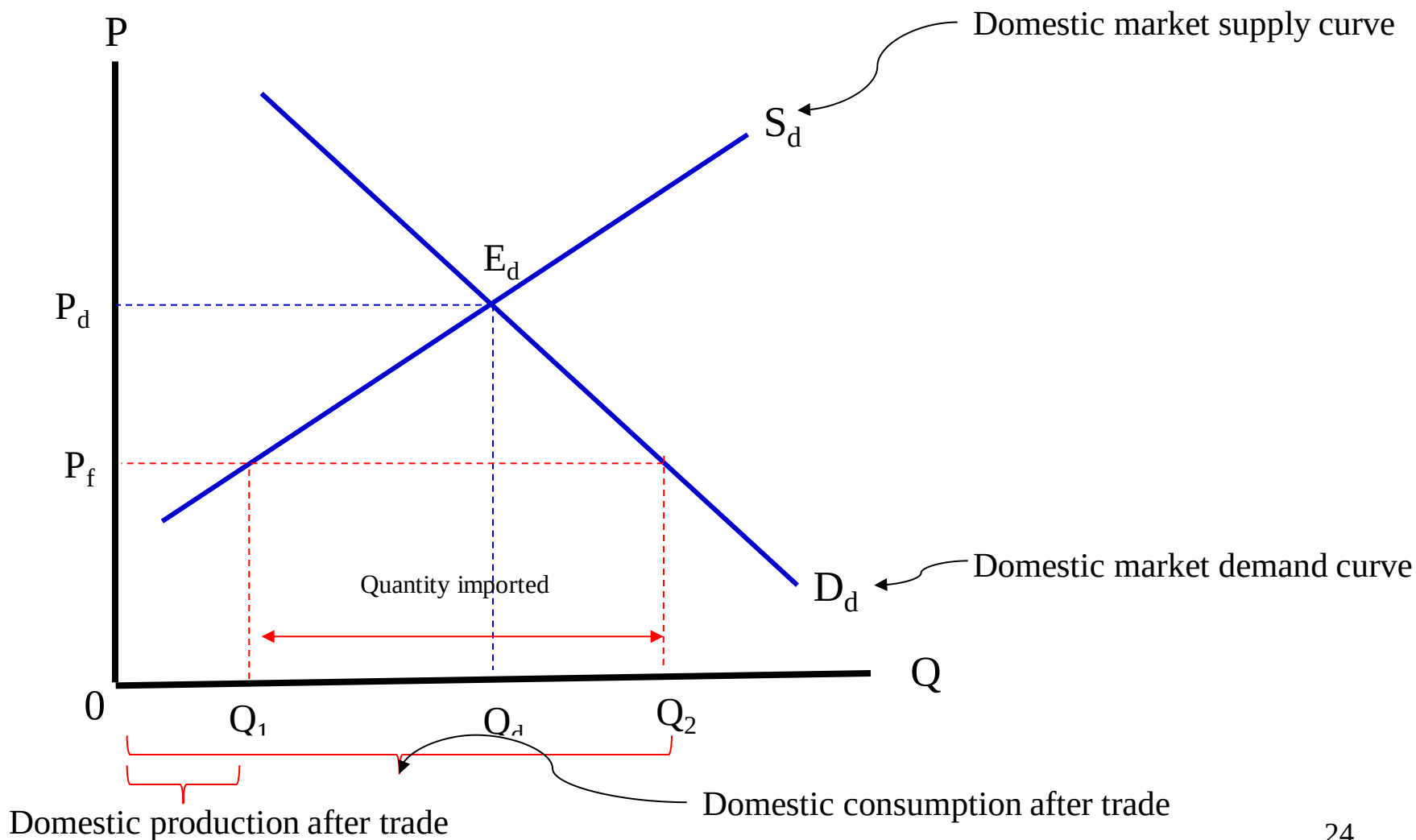
Price Difference Theory

To be removed

Causes of international trade



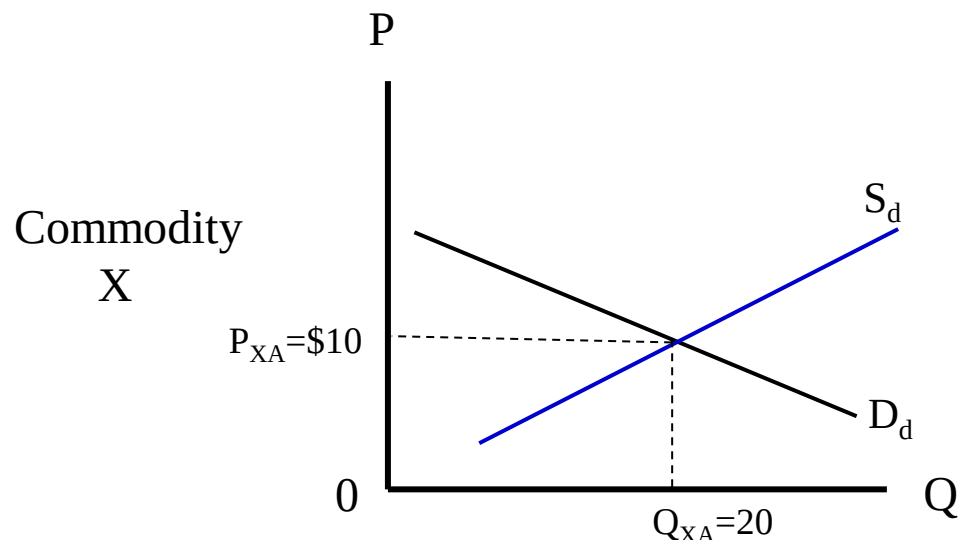
Effects of the opening of trade in the market for a single goods



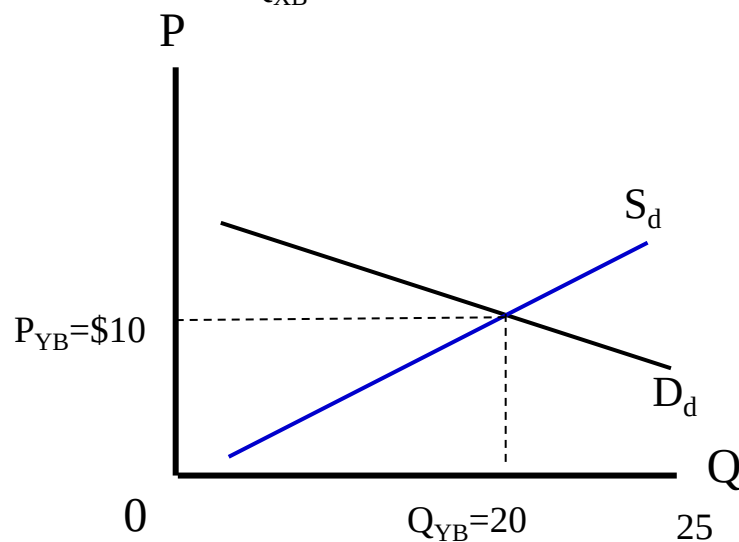
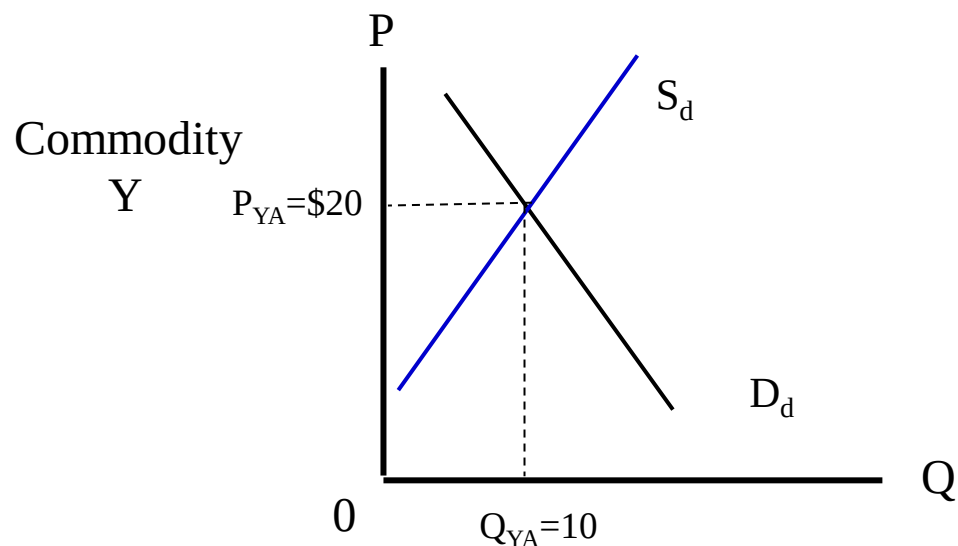
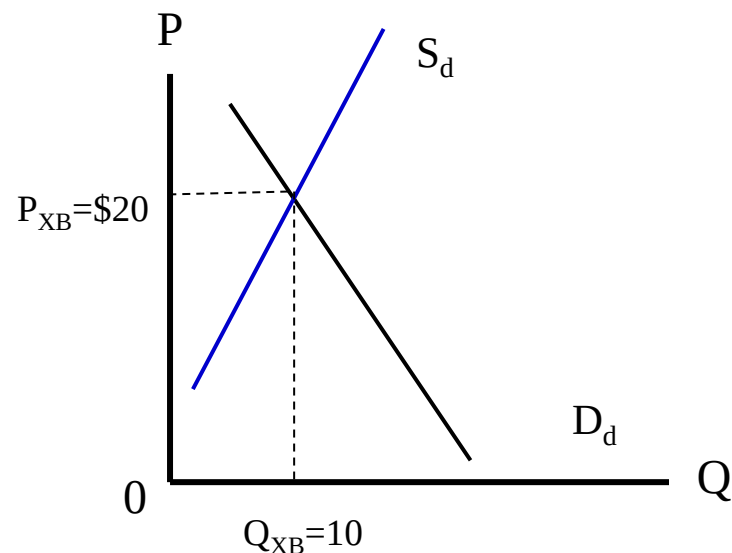
Before trade

Total world revenue = Total world expenditure = \$800;
Total world output = $30X + 30Y$

Country A



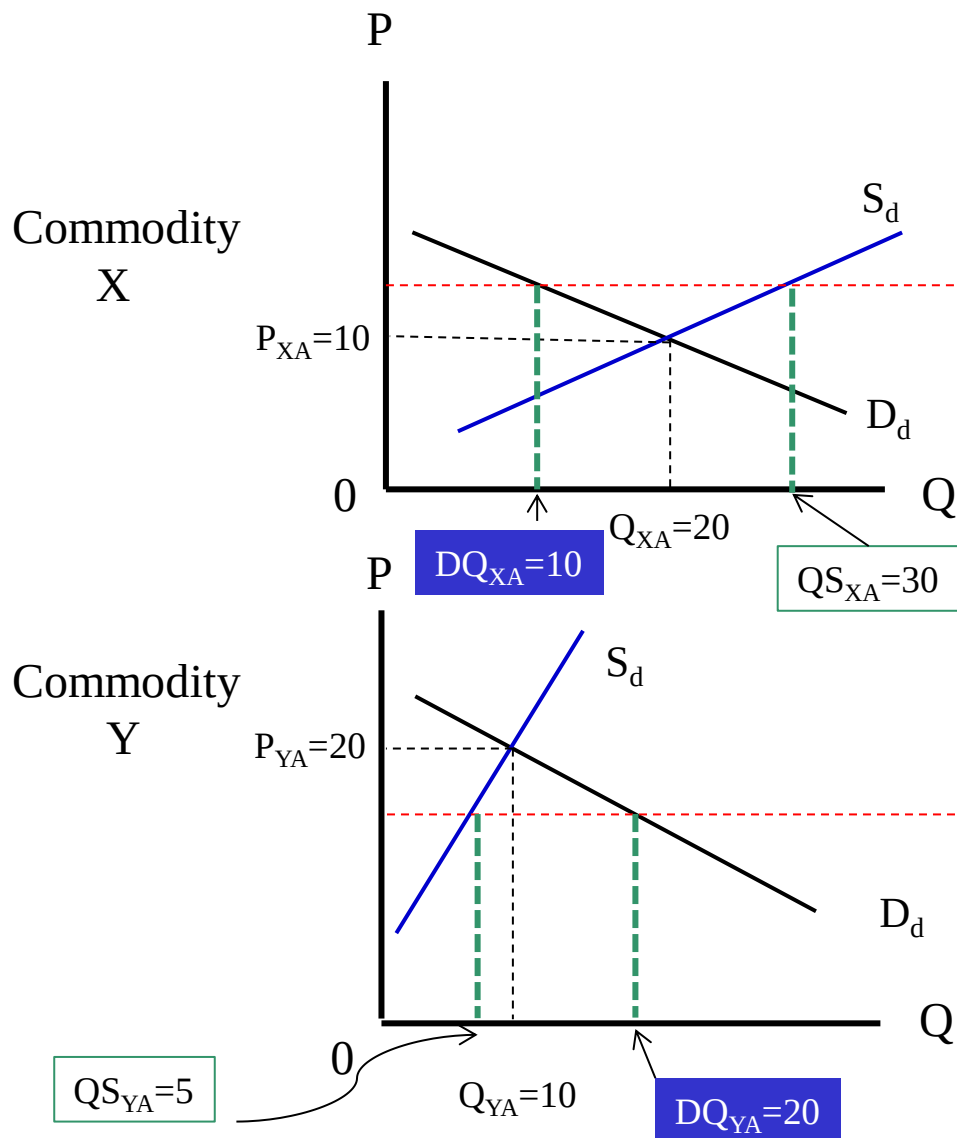
Country B



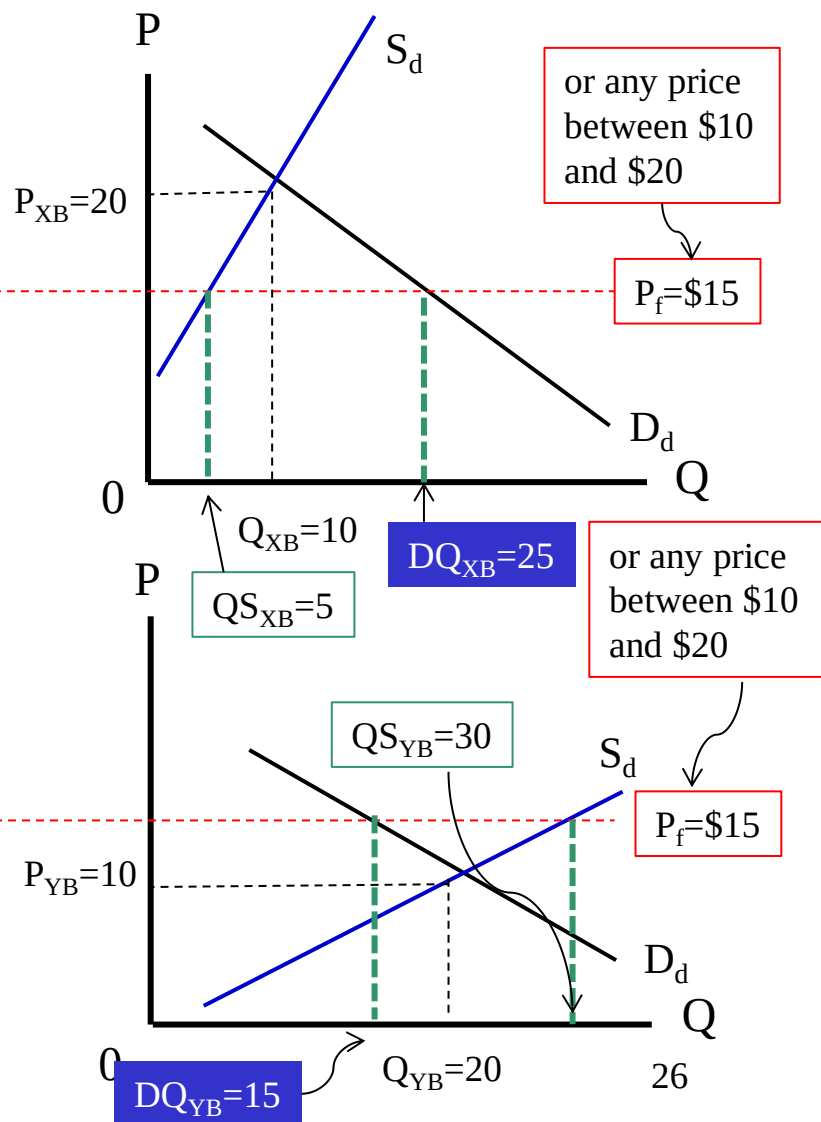
After trade

Gains from trade: Increase in world output = $5X + 5Y$
 Increase in world consumption = $5X + 5Y$

Country A



Country B



Trade restriction

The benefits of free international trade

Importing countries	Exporting countries
1. They can enjoy a wider range of goods	1. It allows a country to specialize in the manufacture and export of products that can be produced most efficiently in that country, that is, specialization and mass production are possible
2. The danger of scarcity or drastic upswings in prices are reduced	2. It enables resources to be fully employed.
3. Lower commodity prices through competition among domestic and foreign suppliers.	3. Since the price elasticity are lower in foreign markets than that in the domestic market, it allows firms to set a higher price (as relative to the price determined in the domestic market).

Free Trade occurs when a government does not impose restriction on the free international exchange of goods or services.

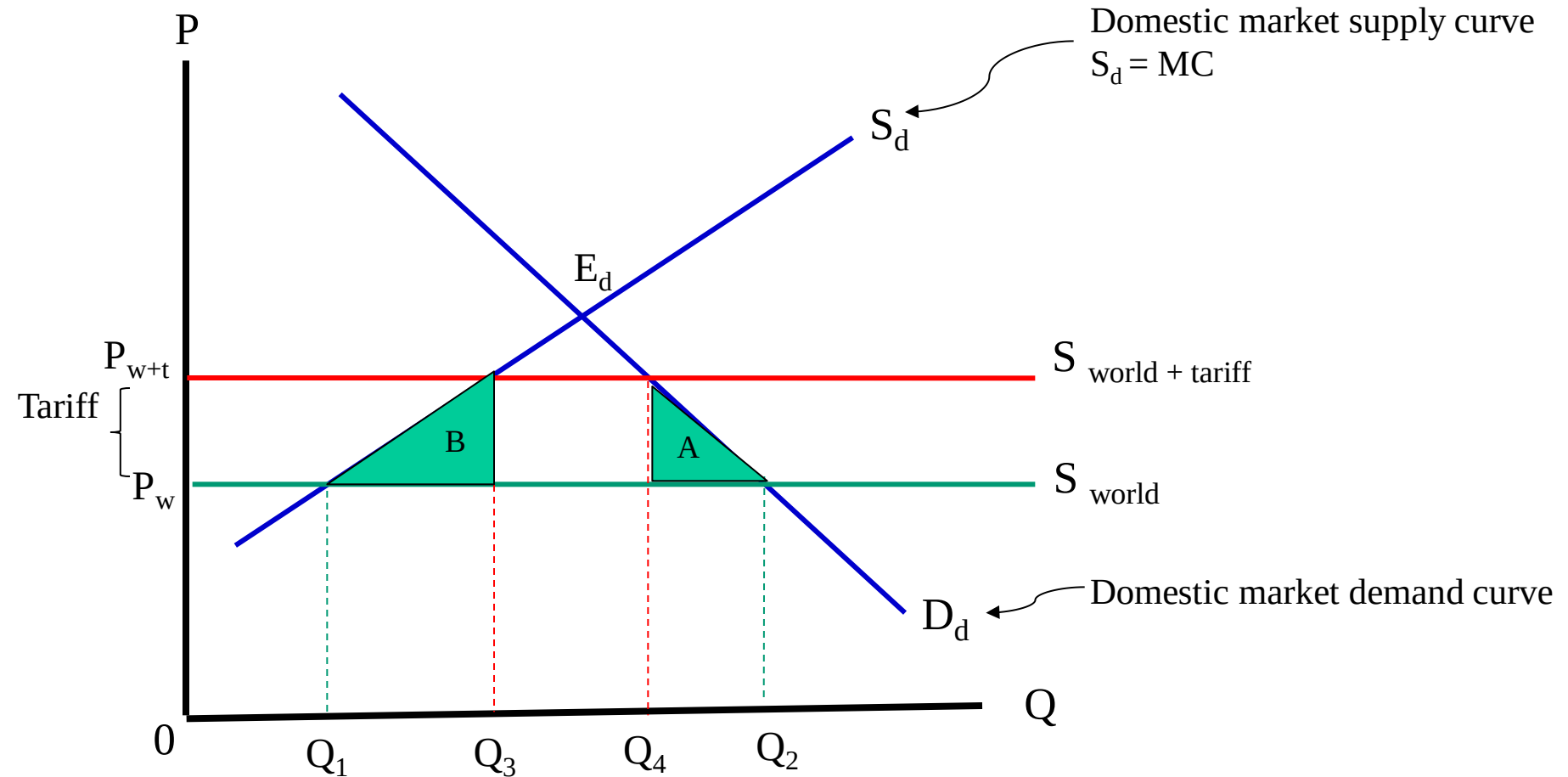
Trade restriction occurs when A government establishes some barriers on the free international exchange of goods or services.

Possible barriers to imports

- Customers duties (or tariffs) on imports
- Restrictions on the amount of certain goods that can be imported (quotas)
- Subsidies on domestic products to give them a price advantage over imports
- Administrative regulations designed to exclude imports, such as customs delays or excessive paperwork
- Government favoring domestic producers when purchasing equipment.

The cost of trade protection

The good that is partly home produced and partly imported, and the country is too small to affect world prices.



Area A represents the loss of consumer surplus by the reduction of consumption from Q_2 to Q_4 .

Area B represents the extra costs of producing $Q_3 - Q_1$ at home rather than importing it.

Arguments in favor of restricting trade

- To protect the infant industry.
- To reduce reliance on goods with little dynamic potential.
- To prevent dumping and other unfair trade practices.
- To prevent the establishment of a foreign-based monopoly.
- To prevent the spread the risk of fluctuating markets.
- To reduce the influence of trade on consumer tastes.
- To prevent the importation of harmful goods.
- To take account of externalities.

Entry Strategies in Emerging Economies

Characteristics of Emerging Economies

- The small size of the economy
- GNP/Capita much lower than in developed countries
- Strong potential for economic growth
- a high volatility of the exchange rate which implies greater risk in trading
- High birth rate
- Low education (Low adult literacy rate)
- Undeveloped infra structure
- Several languages/dialects
- Close family ties
- Less women in workforce
- Cultural issues
- Unstable government

Global Market-Entry Decision

- The need for a solid market entry decision is an integral part of a global market entry strategy.
- The target product/market
- The goals of the target markets
- The mode of entry
- The time of entry
- A marketing-mix plan
- A control system to check the performance in the entered markets

Decision Criteria for Mode of Entry

- Market Size and Growth
- Risk
- Government Regulations
- Competitive Environment
- Local Infrastructure
- Company Objectives
- Need for Control
- Internal Resources, Assets and Capabilities
- Flexibility

Entry Strategies

1. Exporting
2. Franchising
3. Contract Manufacturing
4. Joint Ventures
5. Wholly Owned Subsidiaries

1. Exporting

- Indirect Exporting
 - Export management companies
- Cooperative Exporting
 - Piggyback Exporting
- Direct Exporting
 - Firms set up their own exporting departments

2. Franchising

- Franchisor and the franchisee
- Master franchising
- Benefits:
 - Overseas expansion with a minimum investment
 - Franchisees' profits tied to their efforts
 - Availability of local franchisees' knowledge
- Drawbacks :
 - Revenues may not be adequate
 - Availability of a master franchisee
 - Limited franchising opportunities overseas
 - Lack of control over the franchisees' operations
 - Problem in performance standards
 - Cultural problems
 - Physical proximity

3. Contract Manufacturing

- Benefits:
 - Labor cost advantages
 - Savings via taxation, lower energy costs, raw materials, and overheads
 - Lower political and economic risk
 - Quicker access to markets
- Drawbacks :
 - Contract manufacturer may become a future competitor
 - Lower productivity standards
 - Backlash from the company's home-market employees regarding HR and labor issues
 - Issues of quality and production standards

4. Joint Ventures

- Cooperative joint venture
- Equity joint venture
- Benefits:
 - Higher rate of return and more control over the operations
 - Creation of synergy
 - Sharing of resources
 - Access to distribution network
 - Contact with local suppliers and government officials
- Drawbacks :
 - Lack of control
 - Lack of trust
 - Conflicts arising over matters such as strategies, resource allocation, transfer pricing, ownership of critical assets like technologies and brand names

5. Wholly Owned Subsidiaries

- Acquisitions
 - Greater control and higher profits
 - Strong commitment to the local market on the part of companies
 - Allows the investor to manage and control marketing, production, and sourcing decisions
- Acquisitions and Mergers
 - Quick access to the local market
 - Good way to get access to the local brands

Thank you for your
attention!