

“New Trade Theory”

Additional models of why countries trade

Challenges to H-O model

- By World War II, H-O model brought into question
- “Leontief paradox” – empirical test of H-O model
 - While the US is K-abundant, we were not exporting K-intensive products
 - H-O model hold?

How can we change the H-O model to address this issue?

- More analysis into different subdivisions of K,L
 - Not all K, L identical

Types of Capital – Land, Labor, Human Capital

Types of Labor – Skilled, Unskilled, Semi-Skilled

In this way, we can focus on different types of K,L endowments across countries and different K,L intensities in production

What types of K,L does the US have an abundance of?

Intra-Industry Trade

- All of the previous models of trade (Comp. Adv., H-O) focus on “supply side” reasons for trade – no real focus on demand side

• What global trade data suggests is that much of the trade occurring between industrialized countries is in the same industry

Ex. – Auto parts Automobiles

Food (e.g. French wine for Italian wine)

At the macroeconomic level, our theories suggest that this shouldn't happen -we should see inter-industry trade, not intra-industry trade.

Intra-Industry Trade

- **Definition** Intra-industry trade (IIT) is two-way trade (exports and imports) of the same or very similar goods.

-This means we are trading goods with nearly identical factor requirements

-This trade often occurs between countries with very similar factor endowments

In general, IIT accounts for over 50% of trade in all non-food manufacturing sectors.

Why Does IIT occur?

Why does IIT occur?

Lets split goods to be either homogeneous or heterogeneous (differentiated) products.

Why does trade occur in homogeneous products?

- 1)Transport costs
- 2) Seasonality

Why does trade occur in differentiated products?

- 1) Increases range of choices – “love of variety”
- 2) Overlapping demand segments/similar markets

Product Life Cycle Hypothesis

- Additional trade theory
- Begins with the idea of the “imitation lag”

Consider two countries – US and Honduras

New products appear in the US due to new R&D processes
These goods won't immediately be produced in Honduras – WHY?

- 1) “Imitation Lag” – Learning period to acquire tech., know-how, purchase inputs, install equipment, etc.
- 2) “Demand Lag” – length of time between produced in US and acceptance in Honduras – affected by consumer loyalty to old Products, delays in information, etc.

PLC

- Looks at the “cycle” of new product development/production location.
- 3 stages of PLC
 - 1) New Product Stage
 - 2) Maturing Stage
 - 3) Standardized Product Stage

What can the PLC possibly tell us about our trade deficit?

PLC Stages

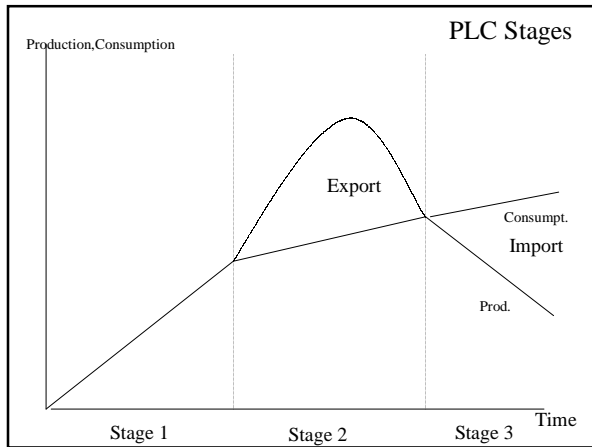
- 1) New product stage
 - produced/consumed in industrialized country only – no trade
 - production process/product “fine-tuning”
- 2) Maturing Stage
 - general production process/product standards
 - mass production/economies of scale realized
 - foreign demand grows in developed countries/ trade begins
 - some production abroad in developed countries

PLC Stages

3) Standardized production

- Product/production process well-established
- product familiar with consumers
- production shifts to developing countries

What does the consumption-export relationship look like?



PLC

- Does the PLC indicate some version of “Dynamic Comparative Advantage?”

The country of production shifts through the product’s life-cycle

For which goods might this relationship hold?
