

Analyzing the Comparative Advantage Theory and the Stages of Globalization in the 21st Century

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Abstract

In the fast-changing world, globalization is becoming a prevalent issue for many companies in the 21st century. Whether the comparative advantage theory is suitable for the current situation and how can the corporation achieve globalization within two stages, this paper may provide a reference in certain extent.

Keywords: Globalization stages • Comparative advantage theory • Fast-changing world

Introduction

These days, many countries are facing the international and multinational development with the quickening pace of modern life and ever-increasing technology and economy. Opinions vary when it comes to whether the theory of comparative advantage is still useful for modern economy in 21st. Besides, the globalisation is now quite prevailing for many companies to acquire more physical and human capital and make great achievement in economy. Consequently, this report is devoted to examine the application of the comparative advantages in 21st and analyze the advantages of disadvantages of the two globalization phases. This paper is mainly divided into two parts, the significance and application of comparative theory and the globalization evolution [1].

Literature Review

The theory of comparative advantage theory

The meaning and schools of theory: The theory of comparative advantage is used to explain and justify international trade through a model, which assumes that there are trading freely, competing perfectly, no uncertainty, costless information and government interference [2].

There are two schools of comparative advantage theory in the subsequent evolution, namely the traditional exogenous static comparative advantage theory and the new endogenous dynamic theory. Both theories have shortcomings, however, the theory based on exogenous comparative advantage worse than the endogenous one [3]. The economic policy based on this theory will have

advantages in the short term, but have disadvantages in the long run. Due to the inherent destruction mechanism of this theory, it will lead to the deterioration of natural environment and human environment, such as social, political and economic environment.

The application of the new theory in the 21st century

Since the mid-1980's, a large number of studies on trade in services have emerged, which are influenced by WTO and regional trade agreements. More and more evidence shows that service liberalization is a major potential source of improving economic efficiency, such as the productivity of manufacture industry and the collaboration within enterprises. The performance and service police of the service sector play an extremely indispensable role in determining the trade turnover, trade distribution and the economic growth and development [4].

While promoting this process, the latest advances in information and communication technology are inclined to permit cross-border "de materialized" trade in services. In an open economy, manufacturing enterprises enjoy priority in the availability of low cost and high quality productive services, telecommunications, transportations and distribution services and so on. Particularly, the feasibility related to outsourcing processes which also nominated as decentralization, production sharing and offshoring is affected by the opportunity and cost of obtaining these services. In addition, compared with product trade, more and more international exchanges are taking the forms of service trade. This is due to the production process are divided into different parts and executed a various locations.

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Generally speaking, service provision usually has the element of "union in production", that is, the effective trade of services can be realized only by supplementary input including other services. In the process of modern economic development, the service industry plays a coordinating role. It promotes the further subdivision of tasks and the large-scale adjustment of production structure, resulting in economies of scale [5].

Meyer and Peng report that a large number of data indicates that service exporters are larger and more productive. They are also more likely to become part of multinational or foreign enterprises. There is no evidence that service outsourcing has a negative impact. In fact, they found that companies engaged in offshoring are growing faster than others. For example, India, due to its advanced and competitive cost in software industry, has a comparative advantage in the developed network system in today's economic globalization.

The theory of comparative advantage is not only applied in the field of global outsourcing, but also has reference significance for developing countries to adapt to the global business model. Firstly, on the basis of a clearer understanding of the product structure layout with potential comparative advantages, China and other developing countries can selectively strengthen the development of high value products through appropriate policy measures. It is positive for these countries to transform the potential comparative advantage into practical advantage, so as to improve the domestic industrial structure.

Secondly, it stimulates developing countries to increase investment in key industries. In order to develop high technology industry, developing countries will stress on introducing human capital. Through this measure, developing countries take the initiative and successfully transform their leading industries which based on resources to technology intensive industries in the process of international competition [6].

Last but not least, developing countries will attach great importance on the evolution of product technology complexity density distribution and path distribution. Through macro policy support and micro guidance, a country can gradually maximize the density and path distribution of technical complexity, improve the added value of high complexity products, so as to improve the overall export technology complexity and further strengthen the national core competitiveness.

Discussion

The globalization stages

According to Eiteman et al., the globalization of the companies has two stages. The first stage is from domestic to international trade. The second stage is from international to multinational trade.

The first stage of globalization

Nowadays, globalisation and international trade have developed rapidly with lower trade barriers, greater demand and growth from emerging markets and technological improvements. These developments are significant for the expansion of small businesses and growth in the rapidly rising global market. Many international trading companies begin with the development of their own domestic economy. When they have a sustainable competitive advantage at

home, they will choose to export to obtain more strategic opportunities. For example, ABC group, with strong market knowledge and solid business advantages, began to carry out international trade in 2004, entering Spain first and then into Alpine countries. At this stage, ABC only uses local distributors.

In this stage, compared with the previous domestic trade, although the production place of international trading companies is still in the home country, suppliers and consumers may involve multiple countries. For example, the company produces in the United States, the supplier may be in Mexico, and the consumer is in Canada.

During this stage, there are some advantages of international trade as follows. First, it is helpful for company to acquire more buyers. Second, it is more likely to increase purchasing power, experience and economies of scale. Third, it offers more natural resources and low-cost human resources which can reduce the production costs. Fourth, it is easier for company to strengthen its brand and core competencies. Five, companies can acquire more production materials. For example, BMW and Nestle decided to sell their products to Europe and joined in the markets in North America and Latin America due to the small and limited market in Europe.

However, foreign exchange risks and credit evaluations are the mainly disadvantages. Entering the international market requires a higher level of financial management, so the company is faced with higher risks. Since the breakdown of the Bretton woods system, the fluctuations of exchange rate have become a research field which has an enormous influence on the overall economy in international trade. Since the price of international trade is relatively connected with the exchange rate, the fluctuation of exchange rate will affect the income and volume of international trade. For example, under the policy targeting system for countries adopting inflation, due to the changes of exchange rate level and the volatility of exchange rate, central banks have to modify the expected inflation target frequently.

International trade is restricted by different legal systems because suppliers and consumers come from different countries, so credit evaluation is needed. The survey shows that in the field of international trade data, the form of credit crisis is usually fraud, involving huge amounts of funds, which has a huge impact on trading companies and even poses a major threat to the national budget [7].

The second stage of globalization

When international trading companies have certain competitive advantages, they will choose to further expand their economic business and become multinational companies. They will license foreign companies, set up branches abroad or subsidiaries and joint ventures to achieve the business model of production and sales in foreign countries and ultimately maximize profits [8]. For example, ABC group chooses the location according to the potential growth of the target countries in the short and medium term. ABC acquired other companies in French to strengthen production capacity and expand business propositions, such as the acquisition of Jura DSS-TEC industry.

Multinational companies set up their subsidiaries by acquiring enterprises abroad, so as to achieve win-win situation. For example, time electric and dynex have formed a good symbiotic relationship. A joint R and D center was established after the acquisition.

There are some benefits which are similar to international trade for companies to become multinational. There are mainly two benefits, acquiring location advantages and building competitive advantage through cross-border coordination. Some location advantages are illustrated as follows. Multinational companies might have extensive market, so that they will not only sell product or services to domestic market but also export to foreign countries. They could import more low cost raw materials in order to reduce the production cost. Production efficiency will be improved by coordinating with more production sectors and learning curve effects. They can acquire high-technology and talents from other foreign companies by constituting research centers in a particular nation like Silicon valley [9]. Besides, some countries have political support for foreign companies' investments. As for the cross-border coordination, multinational companies can acquire technology coordination, marketing knowledge, more workloads and small exchange rate fluctuations risks.

However, the multinational companies suffer higher risk than international trade companies. They are influenced by five factors. Different countries have different demography, culture and market situations. Therefore, international companies must consider whether the products they produce are suitable for local consumers' tastes and preferences. The international companies are required to develop strategy whether the products they produce is standard or specific. For example, BMW enlarges the size of the car in China in order to suit local needs. Production costs vary due to various geological choices. Companies' costs and profits are influenced by foreign countries' investment. Exchange rate is also an important factor which can influence the investment costs of the companies. Whether the government polices positive or not can also impact the companies operation [10]. Although foreign direct investment in the world has been liberalized over the past two decades, policies often remain restrictive on ownership. In addition, the recent trend is towards more restrictive policies on FDI.

Conclusion

All in all, based on the above research and findings, it can draw some conclusions as following. With the science and technology

development in the 21st, the new comparative advantage is still suitable for current society. Therefore, companies can combine this theory with its actual condition to improve its operation and acquire great achievement in profit. Since the increasing economy trend in the world, companies cannot avoid to achieve globalization. Globalization has two stage, companies often attain different stage due to different economy and operation situations. Both stages have advantages and disadvantages, companies can make full use of its benefits while avoiding the potential drawbacks.

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