

INTERNATIONAL TRADE AND THE WORLD ECONOMY

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Answers to * exercises in chapter 15 of the Study Guide

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The * exercises in chapter 15 are: 15.2.

Question 15.2

15.2A.

According to Dunning, three conditions need to be satisfied in order for a firm to establish or purchase a foreign production plant. This is the so-called OLI-approach.

The conditions are:

- Ownership advantages. The firm needs to have a product or production process that is not accessible for other firms. This can be in the form of a patent or trade secret but also reputation can be a factor.
- Location advantages. It must be attractive for the firm to establish a production plant in another country instead of exporting the product. Location advantages can include low factor costs in the foreign country or high import tariffs.
- Internalisation advantages. It should also be more profitable for the firm to own a foreign production plant itself instead of licensing its unique product or production process to a foreign production firm. Especially the fear that the foreign licensee may copy the product or production process and become a direct competitor of the firm is a strong internalisation advantage.

15.2B.

All three conditions need to be satisfied before a firm will establish a production plant in another country. When there is no ownership advantage the firm does not have an obvious product to sell on the foreign market. When there is no location advantage the firm can better produce its product in its domestic plant. When there is no internalisation advantage the firm can better license the product instead of producing it itself. So all three conditions need to be satisfied simultaneously in order for foreign production to occur.