

Good example of economics concepts essay

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Factor-Endowment Theory

This theory is also known as “ Heckscher-Ohlin Theory. It is a theory of international trade. This theory is projection of the classical view. The main point of focus of this theory is the comparative advantage and its different patterns. This theory proposes that the comparative advantage is due to the differences in the factor endowment. This theory has gained much familiarity from the mid of the twentieth century to the end of the century. It is still center of the attention but faces a lot of criticism as well (Rich, 1992)

The amount of labor, capital, land, entrepreneurship and other valuable sources possessed by a country used for the purpose of manufacturing are known as the factor endowment. This concept of economics states that the prosperity of the country is dependent on its factor endowment. Those countries with large resources and in turn large factor endowment are more developed as compared to the countries having small factor endowment if all other things hold the same. The social equality, justice, rule of law and institutional framework is, however, important for any country to fully exploit its factor endowment(Krugman, 2008).

It is a stated fact that the emerging world economies have been blessed with an attractive endowment in the form of weather conditions, geographical conditions, sparse populations, suitable size and the fertile soils. The European economies, US and the other developed countries have taken the control over their endowment and mobilized the resources in the right direction for an immense prosperity (Bento, 2009).

The countries having large factors endowment tend to be more self-sustaining. Such countries have more domestic productions and rely on their

own resources for their needs. These countries have more exports than the imports. The factor endowment directly relates to the production capacity of the country, and the countries with the large endowment factors are the world producers. However, the factor endowment alone is not responsible for the perfect production and trade conditions. Many externalities like political situations, justice system, governmental policies, cultural and environmental factors also contribute to the exploitation of resources at their fullest (Berj, 2007).

Product Cycle Theory

This theory was given by Vernon and explained the concepts left vague by the factor endowment theory. This theory got familiarity when factor endowment theory failed to explain certain concepts. This theory suggests that the labor, expertise and the necessary resources come from the country producing or inventing it in the early phase of the product lifecycle. With the passage of time as the product reaches the growth or maturity phase the production facility moves away from the origin point. The purpose of this act is to gain competitive advantage and economies of scale. In some cases, the inventing countries start to import their own product (Salvatore, 2014)

A product has distinct stages of its life cycle. These stages are introduction, growth, maturity and decline. At the growth stage, the country with the innovation sets the production site within the country. The reason is the advanced technology, labor and the necessary expertise. The purpose is to create and meet the domestic demand. However, as the product gets adopted and reaches growth phase, the surplus is exported. It creates a demand of the product outside the innovating country. Therefore, with time

the production facilities are moved out to the developing countries having low labor costs. In this way, the local demand of those countries is also met, and the products are exported to more new markets. In some cases, the costs in the developing countries are so low that the innovating countries cease their production and rely purely on import of their innovation. The production is outsourced to gain economies of scale and exploit the factor endowment of other countries. It takes place as the standardization in a product increases (Westra, 2009).

The development of the personal computers (PC) is a perfect example of this phenomenon. The personal computers were an innovation of US. Initially, the production was carried out locally. Now with the time, most companies have their production facilities to remote areas, and the US is now importing the PCs. Similar is the case with Apple, a renowned tech giant. The company is based in California, USA. They have moved their production facilities to China, and most production is carried outside the US (Eckes, 2011)

Purchasing Power Parity Theory

The theory of purchasing power parity (PPP) suggests that the exchange rate between one currency and the other stays in an equilibrium provided the purchasing powers (domestic) are also equivalent with the rate of the exchange. In simple words, same cost will be incurred to purchase the same good in any country. The Big Mac concept also explains the concept of PPP. According to this model, the cost of a Big Mac of McDonalds is same worldwide irrespective of the exchange rates (Bisely, 2007).

According to this theory, in the long run the price differences are not sustainable. The market demands and supplies along with the exchange

rates will shift eventually. The example of individuals might be unrealistic, but the large firms do exploit such opportunities. The market forces of demand and supply shift to establish new equilibriums in such situations. The exchange rate variations are also caused due to the trading. Therefore, in the long run the overall cost remains the same (Krugman, 2008).

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