

Determinants of intra- industry trade



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Intra-industry trade has been growing rapidly in the past three decades. The main characteristic for intra-industry trade is countries import and export same kind of goods but different levels of quality. Likewise, in intra-industry trade, the goods exchanged are not perfect substitutes. Many studies suggest that more specialized trade structure and more developed countries lead to higher intra-industry trade. Menon (1996) found that in Malaysia and Singapore there was more than 60 percent of the growth in the intra-ASEAN trade in the period of 1986 and 1991 was because of the intra-industry trade growth.

Based on the David Ricardo's economic theories, different countries have their comparative advantage in different manufacture production. Of which, individual regions or countries will specialize in production and thereby export goods that can be produced with comparatively cheaper price than other countries. Increasing in returns and monopolistic competition bring additional possibilities for intra-industry trade among countries.

Intra-industry trade usually will takes place in the countries that have similar social structure and economical. Meanwhile, the key factors that affecting intra-industry trade are product differentiation, human capital intensity and economies of scale (Hu & Ma, 1999). In a related study, Krugman (1979) developed new theoretical framework which vary from the traditional Heckscher-Ohlin theorem, they introducing models of monopolistic competition that determine increasing returns to scale and the demand of consumers for the varieties of differentiated products as key drivers of intra-industry trade. Besides, Duc (1994) also determined that economic size and capital endowment are important determinants of Intra-industry trade.

According to the Thorpe and Zhang (2005), the supply-induced effect on economies of scale ensures production in great volumes of differentiated products. It is because in order to meet consumer's demand for more variety, the manufacturers can take advantage of economies of scale in production then specializes in production of a variety product. Furthermore, the manufacturers in larger economies will have larger domestic market and more resources. Thus, there is higher possibility for investors to enjoy the economies of scale in production and increase the production of differentiated products.

Bernatonyte and Normantiene (2007) mention that intra-industry is important for the changes of economy of a country. Intra-industry trade exploits economies of scale and stimulates innovation. Besides, it changes the structure of goods and nature of international trade in the way of increasing specialization and the increases of the variety of goods throughout differentiated products. Consumers have more choices of goods and the countries can gain benefits from larger markets. Therefore, they concluded that intra-industry is more beneficial than inter-industry trade since intra-industry trade.

However, besides of economies of scale and product differentiation, there is also a lot other determinants that can influence the intra-industry trade. Thorpe and Zhang (2005) and Hirschberg, Sheldon and Dayton (1994), identified that there is a positive relationship between economy size and the intra-industry trade. They concluded that economic size of a country can influence the volume of trade.

Other than that, the difference in the economies size of trading partners outlines the ability of a country to produce differentiated products. With different sizes of economies, larger economy have the higher demand for differentiated products and they can take advantage of economies of scale to export large volumes of differentiated products and meanwhile, the smaller country are forced to import those differentiated products since they not able to benefit from economies of scale in their own production.

Moreover, Khalifah (1996) states that there is a positive relationship between the economic openness and intra-industry trade. The ASEAN countries have different level of openness. She concluded that countries with lower openness, such as Myanmar and Indonesia, are expected to have less participation in intra-industry trade in ASEAN. In contrast, the higher openness of Malaysia and Singapore are expected to contribute more in intra-industry trade.

During the period of 1986 to 1990, there was more than half of ASEAN's manufacturing trade is carried out under intra-industry type. The openness to foreign investment in Malaysia in the late 1980s had led to a rapid increase in foreign capital, which main on the manufacturing sector and results the expansion of trade in differentiated products. Apart from that, Singapore is also a very open and competitive country. It has generally lowest tariff barriers among ASEAN countries, followed by Malaysia and other countries. Singapore generated a high level of intra-industry trade since 1970s and it was traded heavily with Malaysia since then. Nonetheless, it is found that low openness country, Indonesia had very low level of intra-industry trade during the 1970s but slowly increased in the 1980s.

As mentioned by Khalifah (1996) the intra-industry trade between Malaysia, Singapore and Indonesia are more in intermediate goods compared to consumer goods. Indonesia's intra industry trade is mainly intermediate goods such as primary and processed fuels and lubricant whereas Singapore's intra-industry trade consists mainly of electronic goods, refined petroleum products, copolymerization, polymerization and natural rubber latex, which in among the top 13 import-export products. This indicates that protectionist sentiment will be minimizes with AFTA since it is under the interest of producers and consumers to maintain free trade environment.

In addition, geographical closeness will results the psychological and cultural similarities where increasing trade in differentiated products and having same consumption patterns. Thus, it is offsetting the effects of lower costs through economies of scale. Geographical distance is a natural international trade barrier. The transportation and information costs reduce the volume of intra-industry trade (Thorpe & Zhang, 2005).

Although, Malaysia, Indonesia and Singapore are located at different geography location and their residents have different preference demands. But because these three countries are just located nearby for each other in Asia, they have actually quite similar cultural and consumption pattern. Besides, the shorter distance and lower information costs allow them to trade to each other more easily.

Therefore, there were already many years of bilateral trade history among these three countries. They import goods and services from countries that offer the lowest price, and export goods and services to countries that can

receive highest price. This is good for both buyers and sellers in these three countries. The intra-industry trade is very important for all these three countries because the world having scarce resource, intra-industry trade can increase their residents' standard of living.

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