industrial clusters emerge. But, once again, the differences in transportation costs and the relative importance of being close to suppliers and to customers, also known as agglomeration effects, are characteristics associated with the industry.

If classical theory focuses on differences in characteristics between locations, and new trade theory focuses on the characteristics of individual industries, more recently, heterogeneous firm theory, which is often called new new trade theory, focuses on the characteristics of individual firms. New new trade theory recognizes that within a given industry and in a given location there can be a great degree of variation between firms. There will be many firms that do not engage in international trade, those that do tend to be more productive and the subset of those that both trade and invest abroad tend to be even more productive.

Within new new trade theory, opening to international trade allows for the best firms to expand and replace weaker firms resulting in increased productivity, higher wages and improved standards of living. Under both classical and new trade theory, much of the gains from trade occur as a result of the movement of resources between industries[12], under new new trade theory much of the benefits from trade occur as a result of the shifts within industries. Additionally, under new new trade theory, trade takes place as a result of the differences between individual firms that possess a technology (i.e. process, product, or management) or intellectual property (IP) that makes them better able to compete internationally. This produces a second source of benefit from exchange in that as individual firms expand, they can spread fixed costs of innovation across a larger customer base, increasing the incentives to innovate. As a dynamic benefit that accumulates over time, much like compound interest, this potentially is a critical gain from trade.

Just as trade theory has developed to identify a number of drivers at various levels of disaggregation (i.e. country, industry and firm), the theory of FDI is also focused through multiple lenses. The most commonly used theory of FDI is known as the "Eclectic Theory of FDI" precisely because of its multiple drivers, indeed it is often simply referred to as the "OLI" theory because it is a mix of three theories; Ownership advantage, Location advantage, and Internalization advantage. *Ownership advantage* is, in a sense, similar to heterogeneous firm trade theory in that it focuses on specific firm-level advantages such as technology or management practices. A multinational can expand internationally and enter new markets because it is employing better technology, superior management practices or similar firm-specific advantages compared to rivals. Economies of scale, as described in new trade theory may also be though of as belonging in this category as they are realized at the firm level. However, while new new trade theory explains why some firms might export and others do not, ownership advantage explains why a foreign multinational will invest in a foreign location and succeed against domestic firms which would otherwise be expected to have an advantage in their own market. *Location advantage*, on the other hand, relies on the firm having an advantage that derives from the home location of the firm. Location advantage also impacts on where the firm will locate activities. In this sense, the location advantage theory is comparable to classical theories of trade with comparative advantage. *Internalization* relies on a transaction cost model of the firm extended to the multinational by McManus (1972). Essentially, a multinational must decide whether to serve a local market through an arrangement such as licensing or franchising (i.e. outside of the ownership structure of the firm) or to serve the

[12] Gains from trade in these models can be a result of reduced costs from economies of scale or more efficient use of resources as well as from reducing distortions as one moves closer to perfect competition and from increased product variety.