

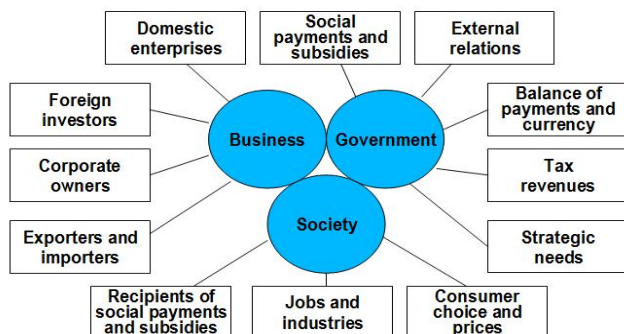
# International Trade and Regional Integration

## Learning Objectives

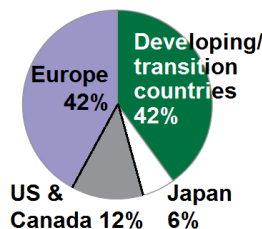
- To appreciate the role of trade in the competitive environment for national economies, societies and firms
- To understand and apply key theories of international trade to a variety of contexts
- To identify the tools of government trade policy, and their rationale in terms of wider policy goals
- To assess the progress of trade agreements among countries at multilateral, bilateral and regional levels, together with their impacts on business strategy

## Trade in the global economy

Trade impacts on business, government and society, as this sketch clearly shows. Exports create wealth and generate jobs within the economy and community benefits from an array of imported goods and services.

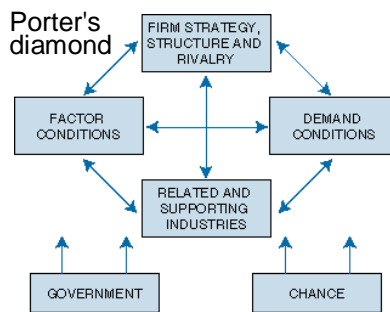
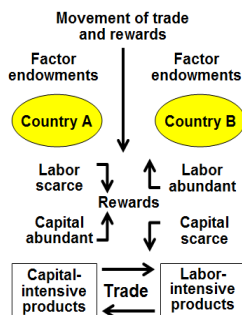


World trade until recently was dominated by the triad of US, Europe and Japan. But, as these 2007 world merchandise export data show, developing countries and transition economies have become increasingly important.



## International trade theories

- The compelling argument that all countries benefit from trade, was first formalized by Adam Smith. In **theory of absolute advantage**, he argued for a country to specialize in producing those goods in which enjoyed an absolute advantage (i.e., most production for least inputs). David Ricardo's **theory of comparative advantage**, on the other hand, favored a country to focus on producing those goods in which it has comparative advantage. This was extended in the Heckscher-Ohlin-Samuelson **factor-endowment theory** which holds that, with trade, an abundant factor of production will rise in value while a scarce factor of production will fall in value. Vernon's **Product-Life-Cycle theory** focused on the individual products, on the other hand, to argue that every product has a lifespan when it becomes standardized and its manufacturing shifts to the low-cost locations that now hold a comparative advantage.
- The newer trade theories recognize the roles of product differential, economies of scale, intra-industry trade, the first-mover advantage, oligopolistic and monopolistic competition etc. The most notable of these is Porter's diamond model of national competitive advantage. It holds that a nation can create new advanced factor endowments such as skilled



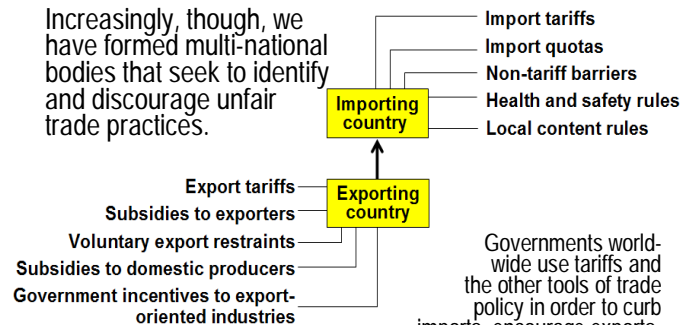
labor, a strong technology and knowledge base, government support and culture. Demand conditions here imply sophisticated customers in the home market whereas factor conditions comprise inputs like labor, land, natural resources, capital and

infrastructure. The last two of these, together with skilled labor and knowledge base are not the traditional inherited factors of production but need to be created.

## National interests shape trade policies

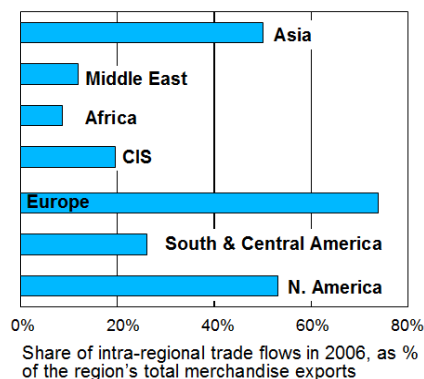
Five areas of national interest impact on trade policies: national security, strategic needs, domestic employment, culture and consumer protection. While most governments support free trade, in theory, in these sensitive areas the governments often feel justified in intervening in trade on grounds of public interest.

Increasingly, though, we have formed multi-national bodies that seek to identify and discourage unfair trade practices.



Governments worldwide use tariffs and the other tools of trade policy in order to curb imports, encourage exports, and stimulate domestic production. Take Apple's I-phone, for instance. The fact that it is made in China, does not make it cheaper to own there, however. Instead, it is first shipped out to Hong Kong from China, even though Hong Kong is a part of China (since 1997), and then returns back with a 20% duty!

## Bilateral agreements, trading blocks and WTO



Excepting Middle East, Africa and South America, world-trade is increasingly intra-regional, rather than inter-regional. Hence the rise of the trading blocks (or RTAs: regional trade agreements) like EU, NAFTA, ASEAN, SAARC, ECOWAS, MERCASUR etc. and now the WTO (or

World Trade Organization), a body of 150-plus member nations. Freer trade has been the objective of the WTO, taking up the principles of multilateral liberalization introduced by GATT. Also, while much progress has been made in reducing tariff barriers, some 'hard cases' remain, notably agricultural products, as the disappointments of the Doha Round testify. Rather than spelling the end of multilateralism, though, they do indicate how difficult it is for a body of 150 sovereign member-states to agree on trading issues crucial to their own national economies.