Edexcel (A) Economics A-level

Theme 4: A Global Perspective

4.1 International Economics

4.1.3 Pattern of trade

Notes

Factors influencing the pattern of trade and changes in trade flows between countries:

Comparative advantage

There has been a recent growth in the exports of manufactured goods from developing countries to developed countries. This is because developing countries have gained an advantage in the production of manufactured goods, due to their lower labour costs, so production shifted abroad.

The deindustrialisation of countries such as the UK has meant the manufacturing sector has declined. This means that production of manufactured goods has shifted to other countries, such as China, whilst the UK now focuses more on services, such as finance.

This has led to the industrialisation of China and India. Their share of world trade has and the volume of manufactured goods that they export has increased.

However, since China's population is now ageing, their wage competitiveness has fallen. This is also due to the rise of the middle class in China, who demand higher wages and consume more.

Impact of emerging economies

The collapse of communism has meant that more countries, especially developing countries, are participating in world trade.

International trade is arguably more important for developing countries than developed countries. It contributes towards 20% of LDC economies compared to 8% of the US economy.

Between 1995 and 2005, India's share of textiles and clothing fell from 35% in 1995 to 16% in 2005. Instead, India's manufacturing sector seems to produce more engineered goods than clothing and textiles. This has resulted in UK manufacturers selling fewer manufactured goods abroad.

China and India are important for African infrastructure. They have invested in their infrastructure in exchange for natural resources.

Both China's and India's share in agriculture, mining and fuel has declined. Both countries are important in the Euro area, with trade and financial relations. China is a main import source, whilst both are important for capital.

- **Growth of trading blocs and bilateral trading agreements**

With more trading blocs, trade has been created between members, but diverted from elsewhere. Trade creation occurs when a country consumes more imports from a low cost producer, and fewer from a high cost producer. Trade diversion occurs when trade shifts to a less efficient producer. Usually, a country might stop importing from a cheaper producer outside a trading bloc to a more expensive one inside the trading bloc. Moreover, protectionist barriers are often imposed on countries who are not members, so trade is diverted from producers outside the bloc to producers within the trading bloc.

The policies of developed countries have limited the ability of developing countries to export primary commodities. For example, the EU Common Agricultural Policy (CAP) means domestic farmers receive subsidies to encourage production and lower costs. This increases the incomes of domestic farmers and protects the industry, but farmers in other countries find it hard to compete with them. Therefore, they are not able to access the market in developed countries, which limits their participation in trade.

- **Changes in relative exchange rates**

For a long time, China has been running a trade surplus with the US. Since 2006, the US trade deficit has narrowed with China, and China has reduced their trade surplus, too. China has planned this change from export-led growth to growth fuelled by domestic consumption. When running the trade surplus, China had kept their currency's value, the Renminbi, low, in order to make their exports relatively cheap.

It could be argued that one of the reasons for the UK's current account deficit is the strength of the pound compared to the Euro. In 2015, it reached a seven year high against the Euro (more information: http://www.bbc.co.uk/news/business-31811791).