OCR Economics A-level

Macroeconomics

Topic 4: The Global Context

4.1 International Trade

Notes

International trade

This is the exchange of goods and services across international borders.

How the pattern of global trade has changed over time

Since WW2, global trade has increased significantly. The increasing number of trading blocs, the rise of emerging markets such as China and India and greater participation from previously communist nations has led to a change in the pattern of trade.

Trading blocs have led to trade creation between members, since there is free trade within the bloc. However, trade has been diverted from outside the bloc, since protectionist barriers are often imposed on countries who are not members.

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.

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.

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

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.

Evaluate comparative advantage as an explanation of global trade patterns

The theory of comparative advantages assumes a perfectly competitive market. In reality, this is likely to be different, which results in the full benefit of specialisation not happening. Specialising fully could also lead to structural unemployment, since workers might not gain the transferable skills they need to change between sectors, or they are simply unable to change.

Comparative advantage does not consider the exchange rate when considering the cost of production for both countries. Therefore, if the price of one good increase, it is more worthwhile producing that good, even if the country has a comparative advantage in the other good.

Countries can develop an advantage in the production of a good, such as Vietnam in the production of coffee. It is the largest coffee supplier to the UK and, over the last 30 years, it has become one of the world's largest coffee producers. During this period, Vietnam's market share increased from 1% to 20%.

Moreover, comparative advantage is derived from a simple model with two countries; the global trade market is significantly more complex than this.

It can be argued that comparative advantage is no longer a relevant concept. Countries do not only produce a handful of goods and services, like the theory suggests. Rather, a wide variety of goods and services are produced, and there is very little specialisation. This is helped by the advancement of technology. However, comparative advantage has helped construct the pattern of world trade, even if it has evolved over time.

Advantages and disadvantages of international trade and aid

Trade

Advantages:

- Greater world output, so there is a gain in economic welfare.
- There could potentially be higher quality, since production focusses on what people and businesses are best at.
- A greater variety of goods and services could be produced.
- Lower average costs, since the market becomes more competitive.
- There is an increased supply of goods to choose from.
- There is an outward shift in the PPF curve.
- More opportunities for economies of scale

Disadvantages:

- Less developed countries might use up their non-renewable resources too quickly, so they might run out.
- Countries could become over-dependent on the export of one commodity, such as wheat. If there are poor weather conditions, or the price falls, then the economy would suffer.
- There could be more structural unemployment, since production moves abroad.
- Some countries might become stuck in the production of one good or service, so they cannot develop further.