Trade & Globalisation

AQA A-Level Economics

Comparative Advantage · Free Trade · Protectionism · Trading Blocs · Globalisation

Comparative Advantage

The theory of comparative advantage (Ricardo, 1817):

A country has a comparative advantage in producing a good if it can produce it at a lower opportunity cost than another country — even if it is absolutely less efficient at producing everything.

Absolute advantage vs Comparative advantage:

Absolute advantage: producing more output per unit of input than another country. A country can have an absolute advantage in all goods.
Comparative advantage: producing at lower opportunity cost. Every country has a comparative advantage in something — this is what drives mutually beneficial trade.

The key insight:

If each country specialises in the good where it has comparative advantage and trades, both countries can consume beyond their own production possibility frontier. Total world output rises.

Limitations of comparative advantage:

Assumes perfect factor mobility, no transport costs, constant returns to scale. Ignores dynamic advantages (infant industries). In practice, comparative advantage changes over time as technology and factor endowments change.

Comparative Advantage: Worked Example

Country	Wheat (hrs per unit)	Cloth (hrs per unit)
UK	**10 hours**	5 hours
Portugal	8 hours	**4 hours**
Opp. cost of wheat	UK: 2 cloth ← LOWER	Portugal: 2 cloth (same)
Opp. cost of cloth	UK: 0.5 wheat	Portugal: 0.5 wheat ← LOWER

Portugal has absolute advantage in BOTH goods

BUT: UK has comparative advantage in wheat; Portugal in cloth → both gain from specialising and trading

Note: opp. cost = hrs in one good ÷ hrs in the other

Real-World Example

UK comparative advantage today: services (finance, law, education, creative industries) where UK has a genuine productivity edge. UK should import manufactured goods from lower-cost producers — consistent with Ricardo. UK runs a services surplus but goods deficit, reflecting this specialisation.

Benefits and Costs of Free Trade

Free trade — the absence of barriers to international trade — generates large gains but also creates losers who may demand protection:

Benefits of Free Trade

Lower consumer prices: competition from imports drives down prices. Consumers benefit from lower costs — especially for goods produced more cheaply abroad.

Greater variety and quality: access to a wider range of goods and services than could be produced domestically. Innovation and quality competition improves all producers.

Economies of scale: specialisation for world markets allows production at far greater scale — lower average costs than serving the domestic market alone.

Dynamic efficiency: exposure to global competition forces firms to innovate, adopt best practices, and raise productivity — improving long-run LRAS.

e.g. UK car consumers: post-1992 single market, car prices fell significantly as European competition intensified. Japanese car imports drove quality improvements across the industry.

Costs and Concerns

Structural unemployment: import competition destroys jobs in uncompetitive industries. Workers in declining sectors face structural unemployment — skills mismatch and geographical immobility make adjustment painful.

Deindustrialisation: loss of manufacturing base as production moves to lower-cost countries. UK textile, steel, and electronics industries largely lost to imports since the 1970s.

Current account deficits: if a country's industries are not competitive, free trade can generate large, persistent trade deficits — requiring net borrowing from abroad.

Distributional effects: gains from trade may go mainly to consumers and shareholders; costs fall on workers in competing industries. Rising inequality can result.

e.g. UK steel industry: import competition from subsidised Chinese steel decimated UK production — Tata Steel's closure threats in 2016 highlighted the human cost of free trade.

Protectionism: Types of Barrier (1/2)

Definition:
Protectionism refers to government policies that restrict imports or subsidise domestic producers to shield them from foreign competition. It is the opposite of free trade.

Tariffs

Taxes on imported goods. Raise the price of imports for domestic consumers, reducing import volumes and domestic demand for them. Generate revenue for government. Most transparent form of protection.

e.g. US 25% tariff on Chinese steel (2018 Trump administration). UK post-Brexit tariffs on EU goods — previously zero under single market.

Quotas

Quantitative limits on the volume of imports allowed. Ensure the import volume is capped even if foreign prices fall further. Domestic producers are protected from further competition beyond the quota.

e.g. EU banana quota: historically restricted imports from Latin America to protect Caribbean banana producers. WTO eventually ruled this illegal after years of trade disputes.

Subsidies to Domestic Producers

Government payments to domestic firms lower their costs — making them more competitive against imports without raising prices for consumers. Can be hidden and harder to challenge at WTO.

e.g. EU Common Agricultural Policy (CAP): €50bn+ per year in farm subsidies. Keeps European farmers viable against lower-cost global competitors. Criticised for distorting world food markets.

Protectionism: Types of Barrier (2/2)

Further protectionist measures:

Non-Tariff Barriers (NTBs)

Regulatory barriers, product standards, health and safety rules, and bureaucratic customs procedures that effectively restrict imports without explicit tariffs. Often harder to identify and challenge.

e.g. Post-Brexit UK-EU trade: new customs checks, rules of origin requirements, and SPS (sanitary/phytosanitary) controls created significant NTBs even with zero tariffs under the Trade and Cooperation Agreement.

Exchange Rate Manipulation

Deliberate depreciation of the currency (via central bank intervention) to make exports cheaper and imports dearer. A form of 'competitive devaluation' or 'beggar-thy-neighbour' policy.

e.g. China historically: People's Bank of China kept yuan undervalued to support export-led growth — US Treasury repeatedly accused China of currency manipulation.

Voluntary Export Restraints (VERs)

Agreements where exporting countries voluntarily limit exports to a partner country, often under threat of harder restrictions. Technically not imposed by the importing country.

e.g. 1980s Japan-USA car VERs: Japan agreed to limit car exports to the USA — helping Detroit auto industry but at cost to US consumers who paid higher prices for both Japanese and domestic cars.

Arguments For Protectionism

The free trade vs protectionism debate is central to international economics — AQA requires balanced evaluation:

Infant Industry Argument

New industries need protection from established foreign competitors until they achieve economies of scale and become internationally competitive. Once established, protection can be removed.

Counter: Difficult to know which industries will become viable. Protection may become permanent and inefficient. Better to use subsidies (more transparent) than tariffs.

Strategic Trade Policy

In industries with economies of scale or learning-by-doing, a government subsidy can help domestic firms gain market share and push foreign rivals out — generating long-run gains.

Counter: Works only if foreign governments don't retaliate. In practice, subsidy wars escalate. Requires government to pick winners — often gets it wrong.

Protect Employment

Import competition destroys domestic jobs — especially in communities with few alternatives. Short-run protection can reduce adjustment pain while workers retrain and industries adapt.

Counter: Protected industries become inefficient. Jobs saved are expensive — far cheaper to retrain workers directly. Consumers pay higher prices for protected goods.

Arguments Against Protectionism

The case against — and why most economists favour free trade:

✗ Retaliation Risk

Protectionism invites counter-tariffs from trading partners. A trade war raises costs for all parties, reduces trade volumes, and may cancel out any gains from protection — everyone loses.

Counter: e.g. USA-China trade war 2018–present: both sides imposed tariffs. US firms faced higher input costs; Chinese exporters lost market share. Global supply chains disrupted.

✗ Efficiency Losses

Tariffs and quotas prevent specialisation according to comparative advantage — world output is lower than under free trade. Consumers pay higher prices; resources are misallocated.

Counter: Deadweight welfare loss from tariffs is a pure economic cost — production and consumption are distorted. The gains to protected producers are smaller than the losses to consumers.

✗ Corruption and Capture

Protected industries lobby governments for continued protection — creating 'regulatory capture'. Politicians face incentives to protect visible industries (jobs) at invisible cost to consumers (higher prices).

Counter: Political economy of protection is biased toward producers (concentrated, organised) and against consumers (dispersed, unaware of price effects). WTO rules aim to counteract this.

Trading Blocs (1/2)

What is a trading bloc?

A group of countries that have agreed to reduce or eliminate trade barriers between themselves. Trading blocs represent a middle ground between free trade and full protectionism — free trade within the bloc, but restrictions against non-members.

Free Trade Area (FTA)

Zero tariffs and quotas between members. Each member keeps its own external tariffs against non-members. Rules of origin prevent goods entering via the lowest-tariff member.

e.g. NAFTA/USMCA (USA, Canada, Mexico). UK-EU Trade and Cooperation Agreement. ASEAN. Each member can negotiate separate trade deals with third countries.

Customs Union

Free trade between members PLUS a common external tariff (CET) against non-members. Members cannot set their own external trade policy — must apply the agreed common tariff.

e.g. EU Customs Union. Turkey is in the EU customs union but not the EU itself. UK left the customs union via Brexit — enabling independent trade deals (e.g. UK-Australia FTA).

Trading Blocs (2/2)

Deeper forms of economic integration:

Common Market (Single Market)

Customs union PLUS free movement of the four factors of production — goods, services, capital, and labour. Regulatory harmonisation eliminates non-tariff barriers. Deepest form of economic integration short of monetary union.

e.g. EU Single Market: ~450m people, 30 countries (EEA). UK left single market via Brexit — losing passporting rights for financial services and facing new regulatory divergence.

Economic and Monetary Union

Common market PLUS a single currency and common monetary policy. Eliminates exchange rate risk between members but removes monetary policy independence for individual countries.

e.g. Eurozone: 20 EU member states. Members cannot devalue to restore competitiveness — rely on internal wage/price flexibility or fiscal transfers. Challenged by asymmetric shocks (e.g. Greece 2010–15).

Trade Creation and Trade Diversion

Joining a trading bloc has two opposing effects on economic welfare:

Trade Creation (beneficial)

Occurs when joining a bloc shifts production from a high-cost domestic producer to a lower-cost producer within the bloc. The country now imports more efficiently — consumers benefit from lower prices and higher volumes.

Resource allocation improves: production shifts to the most efficient location within the bloc, consistent with comparative advantage.

Welfare gain: consumer surplus rises (lower prices) by more than producer surplus falls (domestic producers lose).

e.g. UK joining EEC (1973): UK started importing German and French cars more cheaply than it could produce them domestically — trade creation boosted consumer welfare.

Trade Diversion (harmful)

Occurs when joining a bloc shifts imports away from a low-cost non-member to a higher-cost bloc member — purely because the bloc member faces no tariff while the cheaper non-member does.

Resource allocation worsens: production moves to a less efficient location within the bloc simply due to the preferential tariff regime — not comparative advantage.

Welfare loss: consumers pay more than necessary; efficient non-member producers lose market access. A net welfare cost if large enough.

e.g. UK in EU: EU common external tariff meant UK imported expensive EU food instead of cheaper global food (e.g. New Zealand butter, Caribbean sugar) — trade diversion away from more efficient producers.

Globalisation

Definition:

Globalisation is the increasing integration and interdependence of the world's economies — through the growth of international trade, capital flows, migration, and the spread of technology and culture across borders.

Drivers of globalisation:

Trade liberalisation (GATT/WTO): successive rounds of trade negotiations reduced tariffs from ~40% average (1947) to ~4% today. Created the framework for global trade expansion.

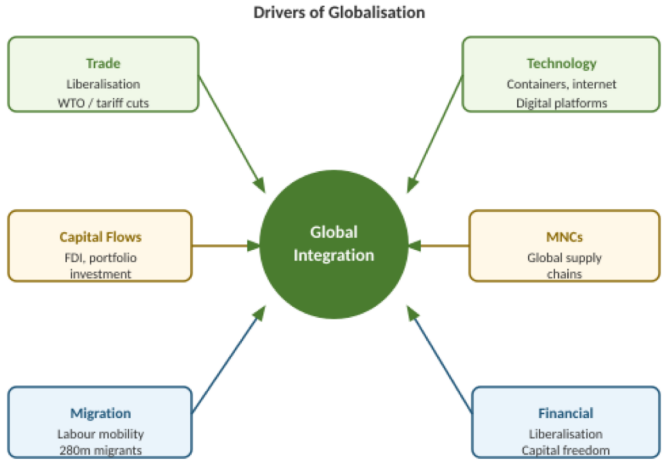
Technological change: container shipping (1956) slashed transport costs; the internet enabled global services trade; digital platforms created global markets for everything.

Financial liberalisation: removal of capital controls enabled money to flow freely across borders — fuelling FDI and portfolio investment flows.

Multinational corporations (MNCs): firms operate globally — sourcing inputs, producing, and selling across multiple countries. Global supply chains connect economies tightly.

Scale of globalisation:

World trade as % of GDP: ~50% today vs ~25% in 1970. FDI stocks: ~40% of world GDP. Daily forex turnover: ~$7.5 trillion. International migration: ~280m people live outside country of birth.



Real-World Example

Apple iPhone supply chain: designed in California, chips from Taiwan (TSMC), screens from South Korea (Samsung), assembly in China (Foxconn), software updates from Ireland, sold worldwide. One product — dozens of countries. The epitome of globalised production.

Benefits of Globalisation

Globalisation has generated enormous gains but also significant distributional and structural challenges:

Poverty Reduction

Export-led growth has lifted hundreds of millions out of poverty — especially in East Asia. World Bank: extreme poverty rate fell from 36% (1990) to 10% (2015). Globalisation's greatest achievement.

e.g. China: export-led growth averaging 9%/year (1980–2010) lifted ~800 million out of poverty. South Korea, Taiwan, Singapore all industrialised through export orientation.

Efficiency and Innovation

Global competition forces firms to innovate, adopt best practices, and improve efficiency. Technology diffuses faster across borders — raising productivity globally, not just in rich countries.

e.g. Mobile banking in Kenya (M-Pesa): technology developed globally and adapted locally transformed financial inclusion — 96% of Kenyan households use it. Global tech with local application.

Consumer Benefits

Lower prices for traded goods, greater variety, and access to products impossible to produce domestically. Living standards have risen for consumers in rich and poor countries alike.

e.g. UK consumers: clothing, electronics, and food are far cheaper relative to wages than 40 years ago. A TV that cost 3 weeks' wages in 1980 costs less than a day's wages today.

Costs of Globalisation

But globalisation also has significant costs:

✗ Inequality Within Countries

While globalisation reduced inequality between countries, it increased inequality within rich countries — deindustrialisation destroyed middle-income manufacturing jobs, hollowing out the income distribution.

e.g. UK and USA: real wages of less-skilled workers stagnated 1980–2010 while capital incomes soared. The Gini coefficient rose in most OECD countries during peak globalisation years.

✗ Environmental Damage

Carbon-intensive global supply chains and 'carbon leakage' (industries moving to lower-regulation countries) increase global emissions. Trade volumes generate transport pollution. Race to the bottom on environmental standards.

e.g. Container shipping: responsible for ~3% of global CO2 emissions. 'Pollution havens' — firms relocating to countries with weaker environmental rules to reduce costs.

✗ Loss of Economic Sovereignty

Highly integrated economies become vulnerable to external shocks — financial contagion, supply chain disruptions, geopolitical risk. COVID-19 exposed over-dependence on single-country supply chains.

e.g. COVID-19 (2020): global supply chains for semiconductors, PPE, and pharmaceuticals collapsed. UK had minimal domestic production of critical medical supplies — a strategic vulnerability.

★ Bonus: The WTO & Trade Wars

The World Trade Organisation (WTO):

Established 1995 (successor to GATT). 164 member countries. Provides a framework of rules for international trade, negotiates trade agreements, and resolves trade disputes between members. Key principles: non-discrimination (most-favoured nation, national treatment), transparency, and reciprocity.

WTO achievements and challenges:

Dramatically reduced tariff barriers. Dispute settlement mechanism resolved hundreds of trade conflicts. Brought developing countries into rule-based trade system.

✗ Doha Development Round (2001–): stalled since 2008 — no agreement on agriculture and industrial tariffs. ✗ Cannot address new issues (digital trade, carbon borders, subsidies) fast enough. ✗ USA blocking appointments to Appellate Body — weakening dispute settlement.

USA–China Trade War

2018: Trump imposed 25% tariffs on $250bn of Chinese goods. China retaliated. US farm exports to China collapsed. US consumers faced higher prices on electronics and consumer goods. Neither side clearly won — both suffered welfare losses.

★ Bonus: Deglobalisation

Signs of deglobalisation:
Trade as % of world GDP has plateaued since 2008. USA-China trade war. Brexit. COVID-19 supply chain disruptions triggered 'nearshoring' and 'friend-shoring'. Industrial policy revival (US Inflation Reduction Act, EU Green Deal).

The 'slowbalisation' debate: is globalisation reversing or just maturing? Most economists argue deepening regional integration continues even as hyperglobalisation slows.

Brexit Trade Impact

UK-EU trade fell ~15% in the first year post-Brexit (2021) as new NTBs took effect. UK goods exports to EU hit particularly hard. Services exports (financial) fell as EU passporting rights were lost.

Real-World Example

US Inflation Reduction Act (2022): $369bn in subsidies for US-made green energy products. EU countries and UK complained of discrimination — it diverted investment away from allied countries toward the USA. A major example of industrial policy challenging WTO free-trade norms — and showing how 'strategic' protectionism is back on the policy agenda.

Summary: Key Terms & Relationships

Key Term	Meaning
Comparative advantage	Producing at lower opportunity cost than another country. Basis for all mutually beneficial trade.
Absolute advantage	Producing more output per input than another country. A country can have this in all goods.
Free trade	Absence of barriers to international trade. Maximises gains from comparative advantage.
Tariff	Tax on imports. Raises price, reduces import volumes, generates government revenue.
Quota	Quantitative limit on imports. Protects domestic producers from further price competition.
Non-tariff barrier	Regulatory or bureaucratic restrictions on trade that are harder to identify and challenge than tariffs.
Free Trade Area	Zero tariffs between members; each keeps own external tariffs. E.g. USMCA.
Customs Union	FTA + common external tariff against non-members. E.g. EU Customs Union.
Single Market	Customs union + free movement of goods, services, capital, and labour. E.g. EU Single Market.
Trade creation	Joining a bloc shifts production to a lower-cost member country — welfare gain.
Trade diversion	Joining a bloc shifts imports from efficient non-member to less efficient member — welfare loss.
Globalisation	Increasing integration of world economies through trade, capital flows, technology, and migration.