



# Trade theory and regional integration

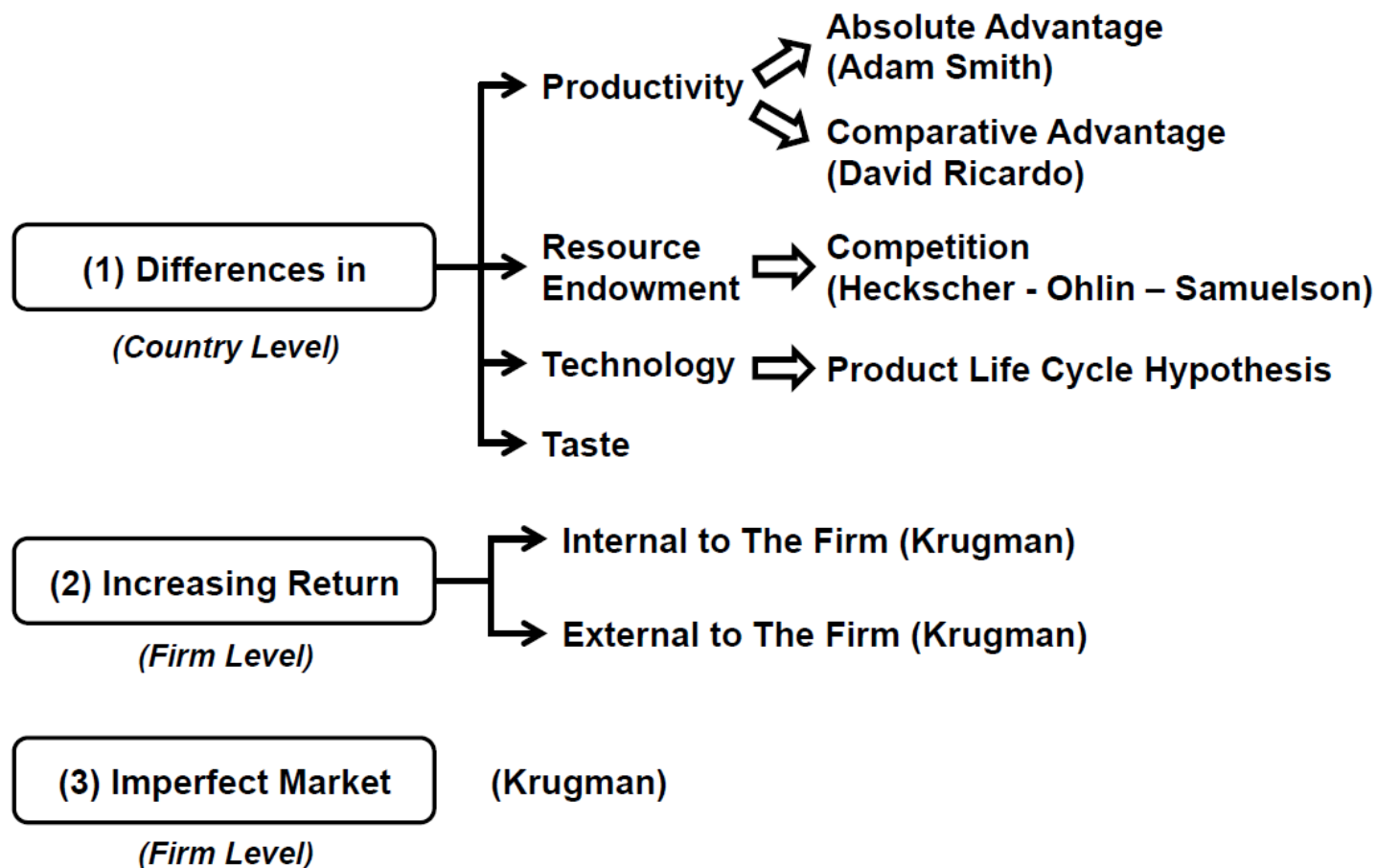
Dr. Mia Mikic  
[mia.mikic@un.org](mailto:mia.mikic@un.org)

*Myanmar Capacity Building Programme  
Training Workshop on Regional Cooperation and Integration  
9 - 11 May 2016, Yangon*

# Outline of this presentation

- We will look into what causes international trade (“why countries trade?”) and what are the welfare outcomes of trade when it is free
- We will explore why countries are not satisfied with just implementing their own free trade policy (or other trade policy) and strive to negotiate various agreements through which they reciprocate trade (and other concessions)
- We want to understand benefits and costs of these efforts, especially for a country such as Myanmar

# Summary of the causes for trade



# Evolution of International Trade Theory

- Mercantilist (1500-1600)
- Classical (1600-1700)
- Neo-Classical or Standard Trade Theory (1900)
- New Trade Theory (1980)
- New New Trade Theory (2000s)
- ????

# Mercantilism

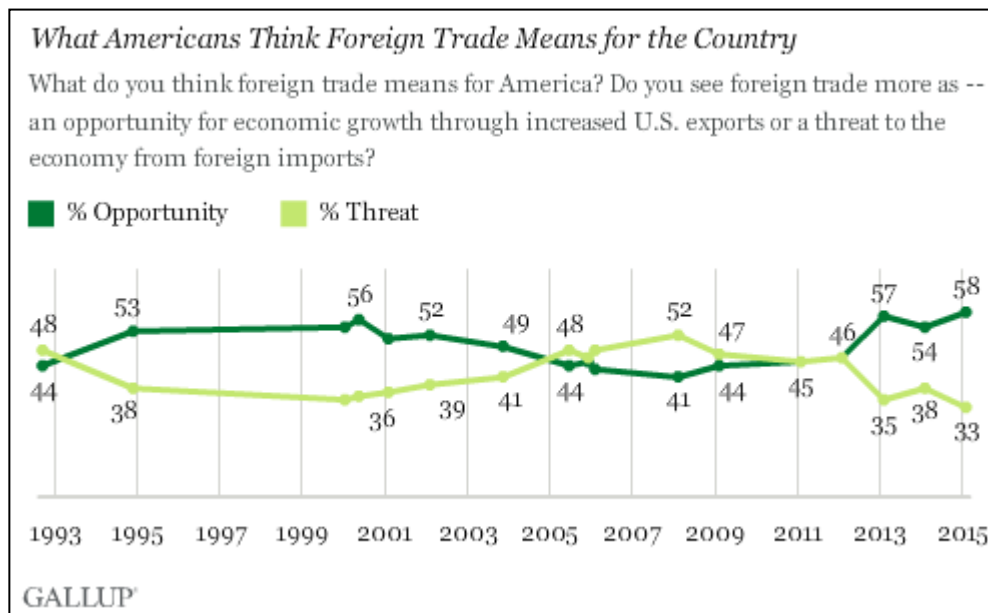
Thomas Munn  
(1571-1641)  
wrote “England  
Treasure by  
Foreign Trade”

- The nation will become rich and powerful if its exports are more than imports
- The more gold and silver a nation had, the richer and more powerful it was. Wealth of nations measured by stocks of precious metal
- The government had to do all in its power to stimulate the nation's export and discourage imports.
- One nation could gain only on the expense of other nations (known as the **zero sum game**)
- Believe in strict government control of all economic activity and preached economic nationalism
- Policy implications:
  - Protectionist tariffs on imports to ensure a country exports a lot but imports very little
  - Government intervention to gain as much surplus as possible

# Mercantilism – is it still alive?

How about  
Myanmar?

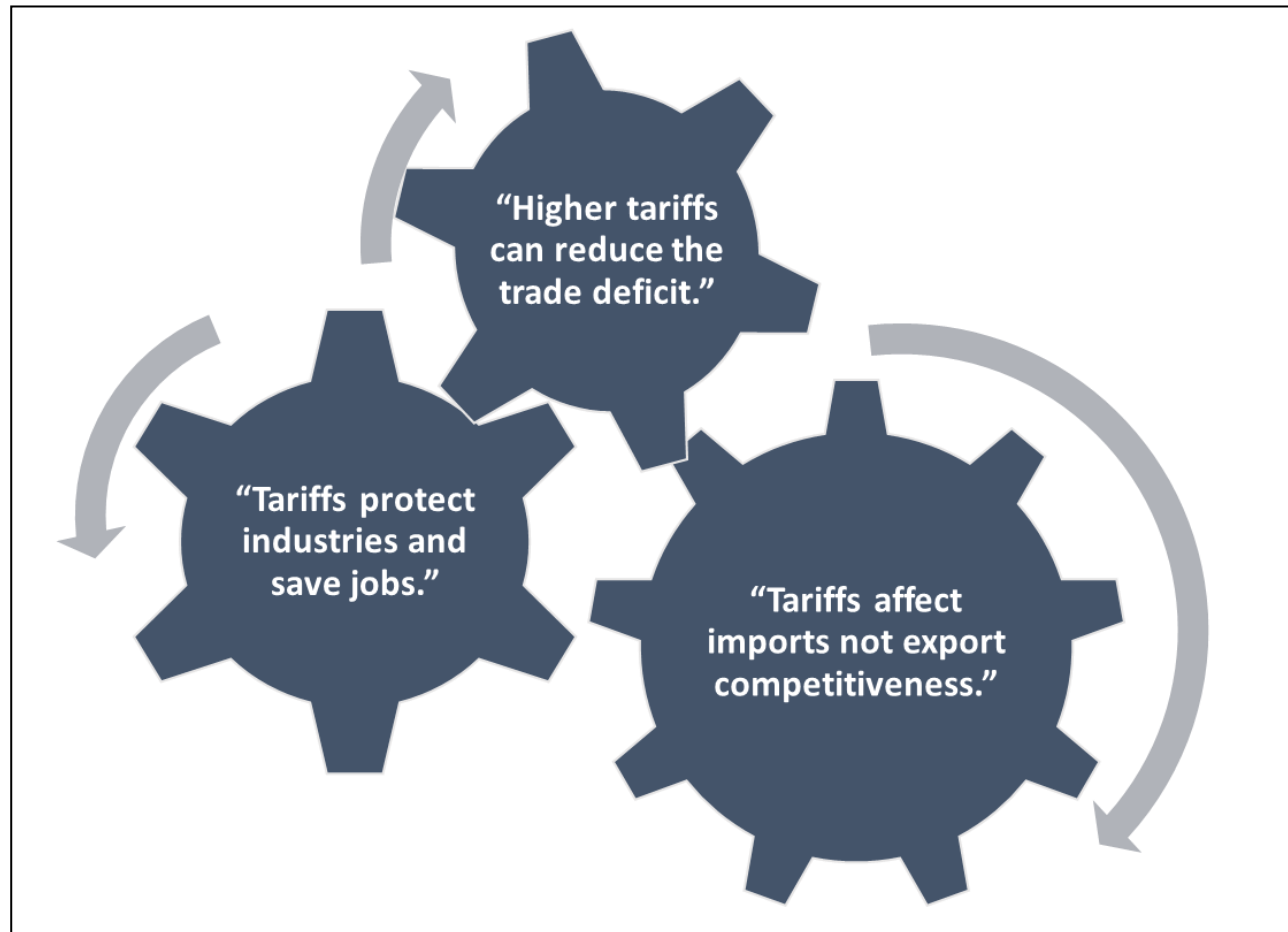
- Developed countries – US , EU, Japan, etc.?



- Do we get a different picture from the US in 2016 (election campaign?)
- What about EU and other countries?
- Developing countries (remember average protection is higher in developing countries)

# Do you support these claims? Why or why not?

Replace tariffs  
with quotas,  
antidumping,  
etc...



# Classical trade theory

Adam Smith  
(1723-1790)

David Ricardo  
(1772-1823)

- Theory of absolute advantage
- Theory of comparative advantage
- **Both explanations result in the same policy prescription: free trade**
- Why:
  - Efficient allocation of resources
  - Maximum output
  - Maximum welfare
- Important assumptions: perfect competition, no externalities or distortions, perfect information, timeless and costless restructuring



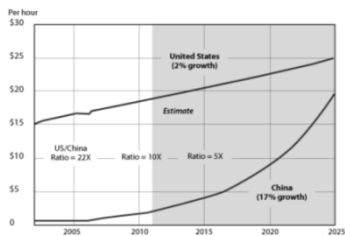
# Neoclassical trade theory

Eli Heckscher  
Bertil Ohlin  
Paul Samuelson

- Trade still based on comparative advantage
- Only here the source of comparative advantage is found in the relative factor endowments and, because of that (and fixed amounts of these factors), there are increasing marginal costs preventing full specialization
- Policy prescription: free trade
- Important assumption: countries share the same technology (PLUS other assumptions we had on market structure)
- Important result: changes in relative factor prices

## The Wage Gap is Shrinking

Manufacturing wages U.S. vs. China 2002 to 2025



Source: BIS

WWW.AGORAFINANCIAL.COM

# Trade and development

Stages of  
Comparative  
advantage

Manufacturing Development Path						70
	Japan	S. Korea	Taiwan	Thailand	China	
1960's	T & C ↓	-	-	-	-	
1970's	Shipbuilding +			-	-	
1980's	Machineries ↓	T & C & F ↓	T & C & F ↓	-	-	
1990's	Vehicle ↓	Shipbuilding +	Electrical	T & C ↓	T & C & L-Intensive	
2000's	Electronics ↓	Machineries ↓	Appliances	Vehicle? (Pick-up- Truck)	↓ Shipbuilding	
2010's	Product	Vehicle	-			
		Labour Intensive Industry			Heavy Industry	Light Industry

# Basic gains from trade

- Efficient structural adjustment: the country uses its resources in the most productive way when it specializes in the areas in which it has comparative advantages
  - Firms are able to source the most cost-effective inputs
  - Consumers are able to purchase imports at the lowest price
- Note that “free trade” and “free trade area” are not the same thing

# New trade theory and New New trade theory

Avanish Dixit  
Paul Krugman  
Marc Melitz  
???

- Role of imperfect competition and economies of scale
- Firms matter
- Policy prescription: free trade but not always
- Important assumption: existence of distortions, externalities and rents
- Important result: protection may increase welfare

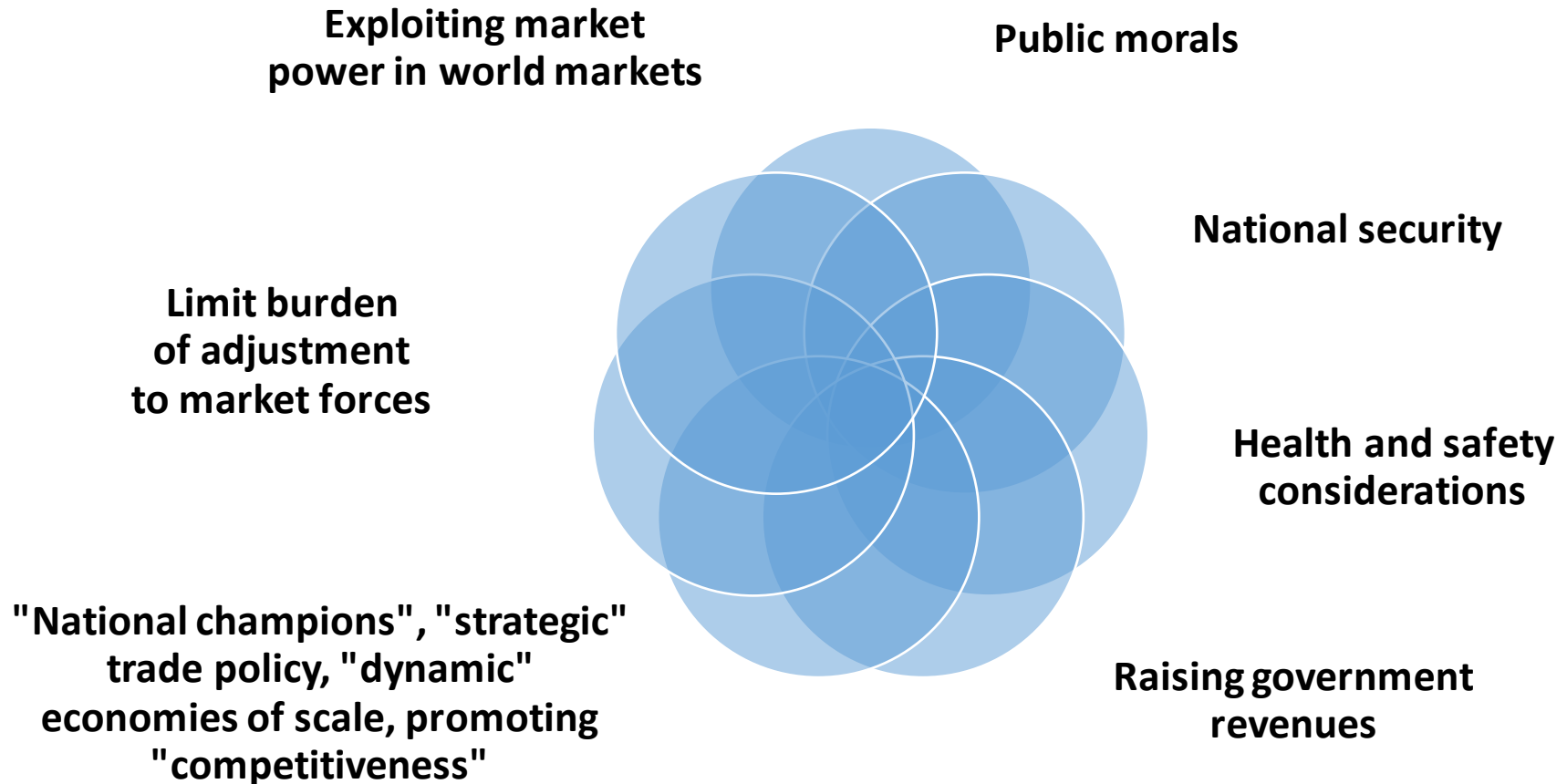
# Dynamic gains

- More important but difficult to quantify
- Economies of scale: the average cost
  - The “average” cost reduction effect
  - More competitive not only at home but also in foreign markets
- Technology transfer and FDI
  - Long-term, risk-sharing investment flows
  - MNCs provide a channel to reach the global market
  - Technology transfer from MNCs
- Stimulating competition
- Structural policy change and reform
  - Pressure to embraces “best practices”, to reform law and regulations, policy harmonization.

# Things to keep in mind

- Economic theory predicts the optimum of free trade...
- ... but there is protectionism in all markets
- Trade policy was not meant to be a tool for income redistribution
- Not every group win with the liberalization (Stolper- Samuelson, 1941)
- Losers have more incentives than winners to gather and push (lobby)

# Arguments made for discrimination against foreign suppliers



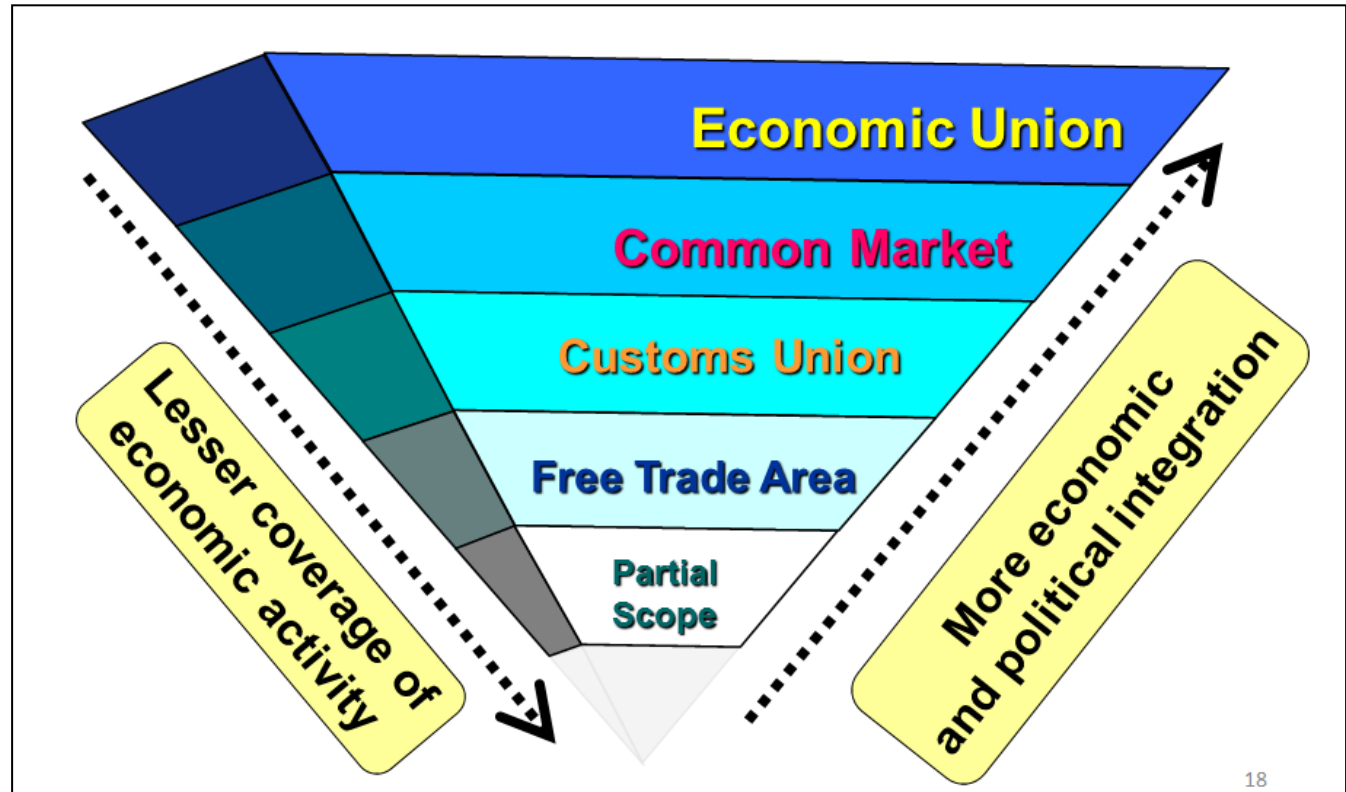
# Regional integration

- Regional integration is the process by which two or more nation-states agree to co-operate and work closely together to achieve peace, stability and wealth.
- Usually integration involves one or more written agreements that describe the areas of cooperation in detail, as well as some coordinating bodies representing the countries involved.
- This co-operation usually begins with economic integration and as it continues, comes to include political integration. This means that the integrating states would actually become a new country — in other words, total integration.
- Key levels: economic integration, single market, political integration



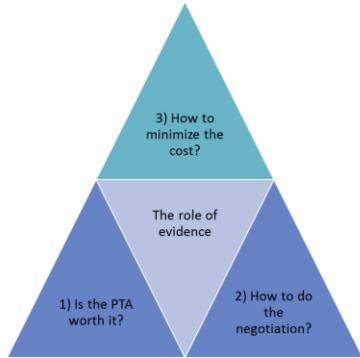
# Levels of regional integration

Often starts and ends with freeing trade



18

# Bottom line: under “regional integration” we often mean trade liberalization



- Hypothesis: PTAs are motivated as much by foreign policy objectives as by trade objectives
  - Expressing a regional (bilateral) relationship or objective
  - Political commitment helps overcome any ‘stakeholder’ resistance to liberalization
    - A factor mostly absent from multilateral negotiations
- How important are trade objectives?
  - Many have apparently small impacts relative to “baseline” trade projections
  - Most PTAs are between partners that already trade intensively, across relatively low MFN barriers
  - Preference margins erode as MFN duties fall and partners make other agreements

# Economic objectives

- The country will be better off after trade liberalization than before (that is, when it was “closed”)
- Three possible approaches to liberalization:
  - Non-reciprocity : unilateral (autonomous) liberalization
  - Reciprocity and non-discriminatory: multilateral basis (WTO) [and open regionalism]
  - Reciprocity and discriminatory: preferential basis
- Today many people think that forming an PTA is the best approach for trade liberalization.
- The benefits likely to outweigh the cost?
  - Design of a PTA

# Why reciprocal and discriminatory

## Economic motives:

- Minimizing beggar-thy-neighbor
- Gaining credibility
- Market access

## Other reasons:

- Faster results
- Increasing policy predictability
- Signaling openness to investors
- Foreign policy
- “Training ground”



# Thank you

Q&A

Dr. Mia Mikic  
[mia.mikic@un.org](mailto:mia.mikic@un.org)