Day 1 Hour 1

Differences between Domestic Trade and International Trade

I. What makes domestic and international trade different?

Most of us understand domestic trade in goods and services. After all, this is what we do each day; we produce and then buy and sell goods and services *within our own country*., Similarly, most of us would probably think that international trade involves enormous differences from domestic trade. However, the basic principles governing domestic and international trade are much the same. These basic principles involve supply and demand. Think for a moment about trade between Kaohsiung and Taipei. This is certainly domestic trade, but it nevertheless looks in many ways like international trade – trade between one region with another. Taipei produces things and sells to Kaohsiung. Kaohsiung similarly produces things and sells to Taipei. You might even say Taipei exports goods and services (including tourism) to Kaohsiung and *vice versa*. So what are the differences between domestic trade and international trade?

First, Taipei and Kaohsiung follow the same laws, at least with regard to the central government. This is certainly not true if we compare Taiwan and Japan. The harmonization of laws between Taipei and Kaohsiung makes trade between the two regions easier and less costly. It facilitates trade. If Japanese business law, consumer law, environmental law, labor law, etc. were the same as Taiwan's laws, trade between the two countries would similarly be a lot easier. Differences in the laws between countries are a type of **man-made barrier to trade**.

Second, Taipei and Kaohsiung are not separated by a vast ocean. They are connected on the same island where trains, planes, and trucks can easily run with low cost and low risk. By contrast, Taiwan and Japan are separated by over a thousand miles of water and there are very real risks and sizeable costs of transporting goods to Japan. This is a type of **natural barrier to trade**.

These examples above give us some idea of how international and domestic trade differ. International trade involves *additional* man-made and natural barriers to trade that do not significantly matter in domestic trade. Here is a list of some other barriers to international trade. Try thinking of examples of each of these and explain how we have found solutions to these differences that help lower barriers and increase international trade.

Table 1 Barriers to Trade

(i) different languages	(vi) natural obstructions to trade
(ii) different monies	(vii) different types of goods and services
(iii) different tastes and preferences	(viii) different demographics
(iv) different cultures and histories	(ix) different religions
(v) different taxes	(x) different regulations and legal systems

This is a short list, but it nevertheless covers the important reasons why international trade is different from domestic trade. That is, if you could eliminate (i) – (x) above for Japan and Taiwan, there would no doubt be an enormous increase in trade between Japan and Taiwan. Japan's economy and Taiwan's economy would be larger (if combined) than they would if they remained separate. The whole is larger than the sum of its parts because of increased scale economies. This is why that domestic trade is usually several times larger than international trade. Free trade is an ideal where the above barriers to trade are eliminated.

II. Overcoming our barriers to trade

The list of barriers in Table 1 are formidable. Even with our commitment to freer trade and with the power of technology, we find it difficult to overcome these barriers. Let's take a moment to reflect on how we have tried over the years to reduce some of these barriers.

Barrier (i) is easy to understand. By some estimates there are over 6000 spoken languages in the world, with 2,000 of these languages having fewer than 1,000 speakers. The most popular language in the world is Mandarin Chinese. There are 1.2 billion people in the world that speak Mandarin. Can you imagine producing a product and then including a user's manual in 6000 languages. Okay, so that's not going to work. Producers must choose their markets and then choose a few languages relevant for that regional market. One writer for American Express has claimed that the top five languages for business are as follows:

Table 2 Five Important Business Languages

Spanish - The U.S. has over 35 million Spanish speakers, and there are 425 million Spanish-speaking people worldwide.
Portuguese. With Brazil becoming one of the most significant superpowers, not only in the Americas, but the entire globe, Portuguese is the language to know.
Russian. Russia's capital, Moscow, has the highest billionaire population of any city in the world.
Chinese (Mandarin). China's dominance in the world economy makes it an obvious source of business opportunities for decades to come.
English. English remains the number-one language for business. With economic powerhouses like the U.S., England, Australia, and large parts of India, English continues to be a critical language.

See Essential Languages for Business

In addition, Hindi, French, and Arabic are mentioned by this author as important. Certainly, there are many other languages we could point to as having a profitable future. But, we see that there is no real agreement over which language will be essential for business in the future. Thus far, English remains the dominant language of business and 2 billion people speak English in the world.

Barrier (vi) has traditionally been a formidable wall to increased international trade. Technology has improved over the years and this has led to increased globalization of many economies. The creation of the world wide web has allowed increased flow of services and thus services have grown in trade. They are still not large compared to domestic services, but they are growing at a faster pace than merchandise trade. In the OECD, exports and imports of services grew almost 10% per year between 2000 and 2005. Economists at the IMF have written in 2017

> "Using a newly constructed dataset on trade in services for 192 countries from 1970 to 2014, this paper shows that services currently constitute one-fourth of world trade and an increasingly important component of global production. A detailed analysis of patterns and stylized facts reveals that exports of services are not only gaining strong momentum and catching up with exports of goods in many countries, but they could also trigger a new wave of trade globalization."

Companies like Alibaba and Amazon have made it much easier to shop online and then have goods shipped directly to your door, even internationally. Online shopping has grown significantly in domestic trade, but online shopping is also becoming popular in international trade.