

factors of production—often appear extremely unrealistic, it is important to concentrate on the insights provided by the results generated by trade theories.

The insights deriving from international trade theory are important because, in spite of the restrictive assumptions of the models, they have weathered the test of critical intellectual scrutiny over a very long period and, hence, have come to be generally accepted by political decision makers. As a result, these propositions represent the underlying basis for trade policy, particularly in the major developed economies. Thus, unless one has a basic understanding of trade theory, it is not possible to comprehend the dynamics of nations' international commercial relations.

### *The Determinants of International Competitiveness*

Since the earliest investigations of economic activity, it has been recognized that firms in different countries initiate transactions with firms in other countries because it will bring them some advantage. This is one of the cornerstones of *The Wealth of Nations*, written by the Scottish economist Adam Smith in 1776. The reasons for exchanges between firms in different countries are no different than those that underlie exchanges between firms in the same country. To understand this fundamental point is extremely important. This is because concerns are often expressed regarding transactions taking place internationally that would not illicit any comment if undertaken by two firms in the same country. This suggests that the source of concerns regarding international transactions must be based on a perception that what may be good for an individual firm may not necessarily be good for the nation. It is also important to realize that nations themselves do not trade, only firms.<sup>1</sup> Why then, are international trade issues often so politically charged and trade debates so heated?

The reason lies in the concept of competitiveness. The bundle of goods and services traded and their volumes are determined by the relative competitiveness of the firms in a nation. The types of goods a nation exports or imports are important indicators of that nation's degree of economic development. While the perception of

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<sup>1</sup> Of course, in some countries the government or its agents may actually undertake all or part of a nation's international commerce. If this is the case, different types of advantages may be perceived as arising from trade than those associated with the strict commercial interest of private firms. Transactions must, however, still be organized, and a nation's trade is only the sum of these transactions.