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**The Flawed Logics of Current Trade Reform Efforts**

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## Abstract

Major flaws lie at the heart of current thinking promoting agricultural deregulation and trade liberalisation. Welfare effects associated with market stabilisation go unappreciated. There is failure to meet Walras' necessary conditions for general equilibrium. Perverse effects from tariffs and other changes occur in the presence of multinationals and institutions. Compounding things, in the case of Australia at least, is a failure to appreciate market sizes, relativities and interrelations. Any one of these alone would be a serious challenge to the deregulation and liberalisation orthodoxy. Taken together they appear catastrophic for it, and for the world to which policies so based would be applied. Breakdowns in talks at Seattle, Cancun and elsewhere and the asymmetric realities of bilateral proposals (such as the USAA FTA) add urgency to the need for renewed understanding of production and trade aspects of agriculture, of foundational economic thought and of the various implications. Perhaps a new orthodoxy is needed, one more in keeping with the stated intent of both the GATT and WTO agreements? Such are the issues raised for discussion in this paper.

Keywords : Free Trade, Reform, Australia, Agriculture.

## Introduction

International trade reform is currently much in the news. Agricultural trade liberalisation and the Doha Round both currently appear to be at risk. Bilateral deals such as the free trade agreement between the USA and Australia attract wide and critical commentary, along with much passion. Results from the Uruguay Round continue to be disappointing leading to an apparent practical concern that trade is failing to deliver on its promises. More broadly it also appears that international relations are being reshaped in uncertain ways during these less certain times.

The intent in this paper is to raise a number of issues associated with international trade liberalisation for discussion and critical examination. The current international trade reform efforts have been ongoing for sixty years now. Much has changed in the world since the initial Bretton Woods discussions. Indeed much has been achieved for the good from past rounds of trade reforms. However, an obvious question now, given the age of the reform agenda, is whether diminishing returns have set in for trade reform initiatives.

It is a second question, however, that is of interest in this paper: is the very logic guiding trade reform thinking itself now flawed? That this is so in a number of areas will be explored in the four main parts of this paper. Though many areas can only be lightly touched upon, it will be seen that:

1. Inconsistent goals, and means, exist in international trade reform proposals.
2. The economist's intellectualisation of trade and markets has been debased and misused.

3. Policy analysts appear reluctant to incorporate relevant influences such as those from multinational enterprises and national institutions, despite the development of relevant literature in this area.
4. Issues of market positioning, adjustment and stabilisation appear underappreciated by at least some advocating reform, with the USAA FTA debate providing a demonstration. The relativities of markets is seriously misunderstood as is the Australian international position.

There are then at least four areas of logical inconsistency or error. Rectification of such problems would seem to be a sensible priority.

## The Goals of International Trade Reform

The preamble to both the GATT and subsequent WTO agreements reads:

*The Governments of...*

*Recognising that their relations in the field of trade and economic endeavour should be conducted with a view to raising standards of living, ensuring full employment and a large and steadily growing volume of real income and effective demand, developing the full use of resources of the world and expanding the production and exchange of goods,*

*Being desirous of contributing to these objectives by entering into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international commerce, Have through their Representatives agreed as follows, ...*

The stated goal is to raise standards of living. Full employment, rising incomes and rising effective demand are stated targets. Full use of resources and expanded production and exchange are the developmental aspirations. "Reciprocal and mutually advantageous arrangements" are the means.

Procedurally such things are to be advanced in three ways:

1. Substantial reduction in tariffs
2. Substantial reduction in other barriers to trade
3. Elimination of discriminatory treatment in international commerce

Notice that tariff elimination is not a stated goal, nor is the removal of barriers to trade. Rather these are to be substantially reduced, the meaning of "substantial" being a moot point. However, discriminatory treatment is to be eliminated, something that might be pondered by those advocating preferential trade agreements which often contain explicit country of origin and other discrimination.

The rest is detail. Though extensive and important, and often containing a "devil" or three as well as agreed accommodations, the agreed specifics remain details. Details need to be judged against the stated goals, targets, aspirations and means, as do current arrangements and orthodoxy.

Considerable successes have been achieved under the GATT and WTO. This is a credit to the thinking, agreements and actions of those involved, and to those taking appropriate practical advantage of opportunities that arose. The early emphasis in international negotiations on manufacturing has now been largely replaced by an emphasis on services and agriculture. This extension appears to have occurred with little explicit addressing of the central question of whether gains were actually there to be had from these sectors. This appears notably so in the incorporation of agriculture. Compounding things are the different agenda item preferences as outlined in Table 1.

**Table 1: Doha Proposals Offered in Phase 1**

	USA	EU	Cairns Group
<b>Export competition</b>		*	*
- Export restrictions, taxes			*
<b>Domestic support</b>	*	*	*
- Blue box		*	
<b>Market access</b>	*	*	*
- Food quality		*	
- Tariff-rate quotas	*		
<b>S&amp;D access</b>	*	*	*
<b>Non-trade concerns</b>		*	
- Animal welfare		*	

Source: McGovern and Pace (2004)

Given disagreement still about exactly where reform efforts should be advanced, let alone how they might be agreed, it is little wonder that there is talk of alternative trade arrangements. Australia finds itself in the middle of a confused situation. Debate includes the ongoing proper role for APEC (Uren 2004). Will agricultural trade reform remain the “elusive goal” described by Anderson and Morris (2000)?

## The Intellectual Path

Economics has generated a coherent intellectual view of the world which has gained wide acceptance. Despite the protestations of Harrod and other original thinkers of renown that there is no single “golden path” for growth or to development, the conventional consensus is that liberalised markets domestically and internationally do provide such a singular golden road.

## Reviewing the Road Most Travelled

The neoclassical synthesis (NCS) brilliantly blends such things as goals, aspirations, targets and means into one. Under the coordination of competition in the market and given producer and consumer preferences, all can be rendered to an optimal outcome. Such a synthesis is however a fragile thing, one conceptually achieved only under special conditions, simplifications and restrictive assumptions. It does show a possibility but it does not detail a practicality.

Complementing this is the general equilibrium (GE) approach. Considering the economic world as a series of interlinked markets, the possibility of equilibrium across each and all markets is investigated. Additionally, if some change in settings were to occur, the potential disruptions to existing market states (typically assumed to be equilibria) may be investigated.

The neoclassical synthesis with its blending of the interests of producers and consumers via the market along with the General Equilibrium blending of all markets is a brilliant construction and a major intellectual achievement. Advances in understanding many facets of the market economy may be gained with their judicious and careful use. However they remain intellectualisations and abstractions whose adequacy should, I would argue, be kept under constant review.

Three points of such a review are:

- The adequacy of the intellectualisation as formulated, irrespective of any particular applications.
- The sensitivity of the whole to changes in constituent abstractions.
- The relevance of any particular application given situations as variously observed and observable.

These issues of intellectualisation adequacy, constituency and application relevance provide points from which critical examination and review can be mounted. While much has been argued around the relevance issue, issues of sensitivity and the soundness of the intellectualisation are relatively little addressed.

This is notably so when deregulation and trade liberalisation of agriculture and its products are considered. Serious flaws can be seen from all three points of review. This is perhaps somewhat surprising given the comfortable way in which many in the world, including essentially all signing off on the Uruguay Round, seem to have accepted that deregulation and trade liberalisation in agriculture and more broadly are a good thing. Alternative explanations, that such agreements were made under duress or as political accommodations for example, are not investigated here.

## Features of the Intellectualisation

Intellectualisation has as its heart an emphasis on use of the mind to know, understand or reason. Intellectualism adds the belief that reason is the ultimate principle of reality. It is a further step to assume that actions should then be so guided. Arguably, and as can be considered elsewhere, all three aspects are conflated in what we might term the current NCS-GE convention.

It is the intellectualisation itself that is of concern here, however. Explicitly what do the NCS and GE approaches involve when taken together and how adequate are they when viewed as intellectual works? Ideally, the melding of interests via NCS is accompanied by a full expression of these at GE. Fully developed, NCS-GE is indeed a magnificent structure, a stunning and intricate creation of many like minds. Tragically, however, many today seem

unaware of the full development, key structural features or important intricacies upon which it depends.

When Leon Walras first proposed the general equilibrium approach he saw that:

*“The world can be regarded as a vast general market made up of different special markets ... to discover the laws ... we suppose always a perfectly organised competitive market” Elements: 7(Walras 1874)*

His comprehensive analysis of GE was such an exploration. Tatonnement and like intricacies built into his idealisation are the simplifications needed to make the pure approach tractable, closable and coherent.

Walras was also a rationalist reformer holding, amongst other things, that:

*“freedom secures within certain limits the maximum of utility ... The disturbing causes which hinder the reaching of this maximum, of whatever kind, must be removed as far as possible”(Walras 1874)*

His was a particular view of optimisation and of the means to achieve it.

Notably, however, in his applied economics Walras saw the State as crucially involved in the endeavour as is discussed by Hutchinson (1953). Effective free competition involves an interventionist State in five roles:

- responsible for monetary policy and related institutions
- for right estimation of utility by consumers
  - controls on advertising
  - provision of communal services of education, justice, security etc
- free mobility of entrepreneurs with State control of natural monopolies, utilities, and increasing return industries
- restrictions on speculators in stock exchanges and the like
- as free competition would see undesirably lengthy hours of work, States need to restrict competition locally and agree internationally.

In what seems a fascinating twist, this list has been almost exactly reversed in recent years with

- States taking limited responsibility for monetary policy and institutions. Market force and “independent” institutions are proposed instead.
- Controls on advertising (and the media more generally) have been loosened. Private provision of education, justice, security and the like has been promoted, including through so-called public private partnerships (PPPs).
- Entrepreneurs have been promoted on one hand but have been relatively restricted by competition and like policies with asymmetric impacts, quality assurance and other expenses. Utilities have been privatised. Increasing return industries have been allowed to grow largely unchecked, the threat of competition alone being sufficient for

followers of contestability. Natural monopolies have been moved towards market disciplines and away from government controls.

- Restrictions on speculators have been relaxed in many areas. Indeed some speculative activity has grown almost unchecked to very high levels.
- Deregulation of labour markets has been fostered, and has often occurred, domestically and internationally.

Such is the faint regard and apparent lack of understanding of the followers of Walras for the conditions he regarded as necessary for any proper application of his intellectualisation.

Compounding things on the NCS side are the marked simplifications successively introduced. Commenting on the use of his seminal ideas which helped secure the synthesis, John Hicks reportedly said, sadly, "I wrote a book and they took a footnote" (Holland *pers comm*). It was the tool not the wider contribution that was retained.

Reductive processes such as these made for mathematical virtuosity and a technical synthesis. Models became tractable. Whether the economy became any better understood is a further moot point.

Accepting for now the synthesis at face value a variety of pertinent comments remain. Samuelson in his *Foundations* (1947), for example, noted that a mathematical equilibrium solution need not be a societally desirable one. Indeed Samuelson indicated such a lack of normative significance instanced that equilibrium could occur at 50 per cent unemployment

The classical and neoclassical schools relied upon the market to bring about full employment "equilibrium", essentially a convergence of values, "in the long run". They differed on how they addressed value. The classical proponents largely acknowledged different valuations and relied upon political economy to bring about a resolution; the neoclassical proponents focused on marginal choice given some abstracted situation (and so embedded a selective use of value) to which formal analysis was applied in search of a "scientific solution". The neoclassical synthesis demonstrated via static analysis how an internally consistent model could be developed wherein firms were able to adjust to the market and consumer choices. This has been further developed through General Equilibrium analysis, the equilibrium being a state of simultaneous equation solution that has no particular normative significance.

## **MNEs, Institutions and Other Influences**

Walras clearly saw a role for the appropriately interventionist State. It was not a residual role but rather one that conditioned the market and those in it so that general equilibrium might be achieved in a societally satisfactory way. He was not alone. The whole area of welfare economics rests on the perception that markets can fail, specifically in terms of achieving attainable optimality. Walras and Samuelson, amongst others, explicitly discussed the need for market solutions to be critically appraised with appropriate influences exerted.

Working within the general equilibrium framework itself, several commentators have conceptually investigated how general equilibrium would be altered when multinational enterprises and institutions are incorporated. Batra and Ramachandran (1980) comment that :

*“the conventional general equilibrium models of international trade and investment ... [are] ill-equipped to tackle the specificity of some factors and technologies which we consider to be one of the main characteristics of international investment by multinational firms.” (p 278)*

Using a specific factor model of international trade, they consider international investment decisions. One of their findings is that

*“3. One country’s tariff stimulates the output of import-competing industries of not only that country but also of the other country. The real wage rises if the tariff is imposed on goods produced by the multinational firms but declines if the local firms are the beneficiaries of protection. The opposite occurs in the other country.” (p 289)*

Such possibilities underline the need for careful consideration of bilateral trade deals which involve asymmetric trade liberalisation, as is present in the USAA FTA. Helpman (1984) develops “a simple general equilibrium model of international trade in which the location of plants in a differentiated product industry is a decision variable” (p 451). He finds a range of possible outcomes and varied trade patterns accompany the explicit incorporation of intersectoral, intra-industry and intrafirm trade. Drivers for international investment by MNEs in the presence of trade barriers are also discussed. He expounds on these issues further in Helpman and Krugman 1985, 1989).

Another interesting consideration is the essential incompatibility between the comparative advantage and competitive advantage views on trade. Porter (1990) states his desire for a new paradigm and seeks to deliver this in terms of the competitiveness of a nation. It is a single-nation view, one that focuses on a single diamond and on developing competitive trade from a singular perspective. Comparative advantage on the other hand pointed to the possibility of mutual gains from trade, but not to any necessary eventuality of such gains. Reconciling two-party trade approaches with one-party ones is difficult enough. Allowing three or more nations brings in all sorts of possibilities as to discrimination and loss from trade.

Despite claims along the lines that “all trade is good” (Cole pers comm) or that unilateral liberalisation is advantageous, this is clearly not necessarily so. A much more adequate review of the conceptualisation of trade possibilities than can be attempted here is clearly needed. There are also wider opportunities. The dynamic forces influencing growth and the ‘deficiencies of the Walrasian general equilibrium theory for understanding the process of change in dynamic capitalist economies’ have been expounded by Kaldor (1996). Considerations of trade under monopolistic competition and oligopoly



can benefit from the contributions of authors such as Lancaster (1996). There are also whole other lines of thinking, such as that about firms and transactions arising from the works of Coase, Williamson, North and so on. Recognising that the “interface between national states and MNEs...[involves] a negotiated solution rather than perfect market equilibrium” (Agmon 2003) is a significant step forward.

The partial nature of the currently popular interpretation of international trade is clearly evident as is a wider view. Alternative conceptualisations are there for the taking. As Casson (pers comm) once commented, use of naïve general equilibrium thought or models might be humorous were it not so serious. Also evidently neglected are important differences in economic and societal mechanisms. Simply assuming these away will not change the realities of international trade. Indeed such actions are likely to imperil their potential success.

## Australian Confusions

A number of other confusions currently apparent in Australia are now briefly touched upon. Issues involve estimates of the proportion of agricultural exports, the performance of the Australian economy. Present in each area factual or logical errors, and sometimes both.

While the situation varies markedly from sub-sector to sub-sector, Australian agriculture as a whole has been found to export around a quarter of its production McGovern (1999, 2001). Reviewing this and the competing claims of around 70 percent from ABARE (2000) and others, West (2002) finds similarly with documented exports accounting for 21.5 and 25.4 percent of Agriculture output in 1994-94 and 1996-97 respectively (p 157). Direct and indirect exports (using a value added valuation) account for 26.5 and 27.6 percent. Using an output valuation basis they would be 35.9 and 37.9 percent, but this method yields 148 percent of total exports if applied across the economy indicating the overstatement inherent in the method. As West comments the ABARE figures “are clearly not consistent with the national accounts data.” (p 143)

Thus the Commonwealth of Australia has entered international trade talks contenting that exports are seventy percent or so of the market for agriculture, an empirical fallacy. As a corollary they discount the size of the “small” domestic market little realising, it seems, that the size of Australian economy ranks 15th to 20th globally depending on the details of the estimate. Given that many of those nations of larger sized-economies are tied into the EU and that Canada is tied into NAFTA, there are few large and accessible markets available globally. Little wonder that various corporations, and some host governments, vigorously support unilateral and bilateral liberalisation by Australia. It’s not often that a large market agrees to expose itself while expecting little if anything in return.

Looking more directly at the USAA FTA, questions such as these might be considered:

- *How alike really are the Australian and US economies, and what are the implications of existing differences?* We in Australia seek to strike a deal with a major competitor yet rather than cooperate, collude or enter strategic partnerships (as businesses sensibly might) we are rearranging border and institutional conditions in unbalanced ways. We seek to “bolt onto” their economy and essentially consider only simple gains. Incompatibilities between regulatory regimes, for example, seem to be ignored, not only in areas like pharmaceuticals and copyright but also in broader business areas such as antitrust. In agriculture the central question of how unsubsidised producers are supposed to compete with the subsidised is completely ignored. Until such things were resolved, if they could be, there would be no level playing field under any FTA, no matter how good. Indeed resolution is likely to be made more difficult once any agreement were in place, otherwise why would the advantaged (notably selected US businesses) seek to reduce their positions?
- Much ado has been made about the effects of minor changes in tariffs and these will be a focal part of CGE and like models. Such things are interesting but should be of little real relative importance, including to international businesses, given the movements in the Australian currency and the growth of non tariff barriers over the last few years. Additionally, the existence and influences of international supply chains appears unacknowledged and unmodelled. Influences from along the supply chain (market imperfections to some) exist – otherwise the prices of imported vehicles, for example, would have risen and then dropped (to the order of 40 percent or so). The fact that such market adjustments do not occur has both conceptual and policy implications. *How then have economic modellers factored in such things?* If they have not then modelling results can be expected to be inaccurate and potentially misleading. There are models available that can provide insight into such things.
- *Why would Australia consider that freer trade and perhaps integration with the USA would advance its interests given a starting position that is more comparable with the poorer US states?* Such states have relatively falling behind within the USA despite the redistributive mechanisms within the US federation, such mechanisms not being available to Australia under the proposed agreement. If Victoria, for example, begins as more like a small Virginia, South Australia a West Virginia or the whole of Australia a 25% plus poorer Texas, how could we in Australia realistically expect gains, especially given the extensive subsidies already available to the US states and producers and the ongoing poor performance of the poorer ones? (At least in an EU-type integration arrangement there would be Objective 1 and other funds to help to try and overcome our significant economic disadvantage.)
- At the same time as refusing any market access for Australian sugar, the USA has offered Central American countries under CAFTA additional 99 000t quota access growing annually at 2% simple. Interestingly, the agreement may see payment of cash in lieu of actual access. Not only will subsidies then be exported but the undelivered product will further corrupt the world sugar market. *Why would*

*Australia, which is already challenging EU sugar regimes through the WTO, not only fail to gain equivalent increases in US market access comparable to those offered Central American sectors but also compromise possible future WTO challenges against the US sugar regime?*

Considerations of such common sense questions may bring some of the limitations of current thinking into sharp relief. Further, in US dollar terms the Australian economy has been showing a relative decline with Australian GDP falling behind that of the USA (McGovern 2003). This might matter little if Australia were not contemplating the current free trade agreement and closer integration with the USA (Deady pers comm). The experiences of Canada under NAFTA might provide further room for thought.

### **A Bridge Too Far, or an “Inappropriate” One?**

Has much of economics become an irrelevance to many today discussing trade reform and liberalisation in sectors such as agriculture? What can insights for international business offer, and how might these be advanced? Most importantly, how can sound understanding be expected if important details and key concepts are neglected? Such questions deserve considered answers, and it is to be hoped that discussions at this conference may advance appropriate dialogues.

Four lines of investigation of the role of intellectual endeavours would suggest themselves: how might

1. academia rediscipline or redefine itself? That is, how might the body of intellectual thought be more adequately structured, explicated and developed so that the strengths and limitations of a discipline or various schools of thought are properly appreciated.
2. such thoughts better guide dialogues? Economics is important but it is not the only source of insights. What might IB usefully contribute? Combining or contrasting relevant insights would need some interdisciplinary endeavours.
3. informed understanding of the possibilities that attend economic development, trade and such things be properly progressed? Domination of the market for developmental thought and policy advice carries substantial risks, including for those being advised. A suitably open and competitive market for policy advice is needed.
4. economics and any other disciplined area suitably distance itself when it has no particular insights or where cited insights do not reflect mature economic thinking? “Everyone” understands economics and, since the claim of Engels and Marx of economics being at the core of society is rarely disputed nowadays, it is convenient for many that they claim support from economics.

The first set of issues is essentially an intellectual challenge, the second more a professional one. The third and fourth involve societal responsibilities. These need intellectually strong and professional contributions.

The NCS-GE combination intellectually bridged diverse interested and showed them potentially reconciled within a liberal world. The GATT-WTO initiatives have sought to build practical trade bridges between the nations of the world. With informed understanding, mutual regard and good will much has been achieved. Much more could be achieved if economists, international business scholars and other professionals were to rejuvenate understanding, act with mutual regard to other view points and seek a better world with appropriate good will.

A renewed concern with the issues raised in this paper would seem an appropriate step forward. An immediate and important application could be in the area of agriculture. We might also consider more fully the issues raised by authors such as Stiglitz (2002) and comments such as these by Gray (1998)

*“The Utopia of a global free market has not incurred a human cost in the way that communism did. Yet over time it has come to rival it in the suffering that it inflicts...”*

*[Such Utopias] In their cult of reason and efficiency, their ignorance of history and their contempt for the ways of life they consign to poverty or extinction, they embody the same rationalist hubris and cultural imperialism that have made the central traditions of Enlightenment thinking throughout its history.*

*A global free market presupposes that economic modernisation means the same thing everywhere. It interprets the globalisation of the economy – the spread of industrial” [and now agricultural and services] “production into interconnected market economies throughout the world – as the inexorable advance of a particular type of western capitalism: the American free market.*

*The real history of our time is nearer the opposite... (Gray 1998, p 3)*

What then are the particular challenges for international business, scholars, and the community? Buckley (2004) comments that “the academic community of international business scholars is taking stock” (p 1) and argues with Gahuri that “a new research agenda needs to address the dark side of globalisation” (ibid). What will be the intellectual basis of such an agenda, and how well predisposed is international business with its emphasis on flows of foreign direct investment, MNEs and “understanding and predicting the development of the internationalisation of firms and the new developments of globalisation” (Buckley 2004, p 7). How well predisposed are international businesses themselves to engaging in relevant policy debate, especially where there is a driving focus on short term competition – and for a real firm can there ever be anything else? Communities around the world seek answers to problems they associate with such business. How might IB scholars inform and perhaps enlighten business and community, and how might they encourage precedence being given to more adequate theoretical bases for thinking, particularly by governments and those advisers caught in the thrall of ideal but inadequate models?

Clearly the need for a new research agenda is supported by the arguments and items in this paper. A real challenge, I would argue, is for international business scholars to assist in building better dialogues. A colleague commenting on her experiences in Sri Lanka (Smith *pers. comm.*) noted that the warring parties had not thought about an alternative system of government to the strongly centralist one. Not only were their dialogues inadequately framed, their problems were compounded by logics limited in unappreciated ways. Introducing more adequate insights appeared to have progressed their situations. Is this also true of international business? I would argue that in the affirmative, with a particular need to develop “more adequate” insights. There appear to be valuable and exciting research opportunities in understanding international trade reform and its impacts. It is hoped that this paper may stimulate some debate in this, an important area for businesses and communities internationally.

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