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TRADE, BILATERAL

Trade is the exchange of goods or services within market conditions. A synonymous term is *commerce*, which involves individuals, companies, or even governments and countries when they seek to buy or sell goods and services mainly for profit. Bilateral trade is a form of trade that takes place between two traders or two countries, or two trading blocks, or a trading block and a country.

Initially, people used a bilateral barter system of trade, that is, exchanging goods and services for other goods and services. Money was introduced as a means of exchange as trade developed over time. The development of trade was facilitated and promoted by money, which first took the form of coins and later banknotes, then checks, or bills of exchange, and finally "plastic money" (credit cards). There are many reasons why bilateral trade further expands. As time passes, labor is specialized and divided into discrete activities as people decide to concentrate on the production of a specific good or even a part of a good, and then sell it to purchase other goods. As well, countries differ in comparative advantage for the production and supply of goods or services. On the basis of the theory of comparative advantage proposed by David Ricardo (1817), international free trade is lucrative for all countries. Comparative advantage (relative cost advantage) as a basis for bilateral trade contrasts with Adam Smith's absolute advantage (absolute cost advantage), or the proximity effects associated with the gravity model. (The gravity model may predict bilateral trade flows based on distance, economic size, diplomatic relationships, income level, and trade policies between two countries, although the model could be subsumed under relative transportation costs.)

Bilateral trade has evolved through human history. As the most valuable of commodities, metals were a great incentive to trade. The extensive deposits of copper on Cyprus brought the island much wealth from about 3000 BCE. The first extensive trade routes were initially the long rivers (e.g., the Nile, the Tigris), which became the foundation of early civilizations. From the third millennium BCE there is evidence that long-range trade routes existed. The eastern Mediterranean was the first region to develop extensive maritime trade. The presence of Greeks in Mesopotamia and the eastern Mediterranean encouraged a new trade route. Goods were put on board ships after arriving in caravans from Mesopotamia. An ancient trade route existed between China and the Mediterranean Sea linking China with the Roman Empire—the Silk Road, which was not a trade route that existed solely for the purpose of trading in silk; many other commodities were also traded, from gold and ivory to exotic animals and plants. During the Dark Ages (500–1000 CE) trade almost collapsed. The Portuguese expeditions of the fifteenth century brought European ships for the first time into regular contact with sub-Saharan Africa. The Netherlands promoted the free movement of goods, and became the center of free trade in the sixteenth to eighteenth centuries, together with Spain and England. In 1776, the famous economist Adam Smith contributed to trade theory by arguing against mercantilism (that government should protect the economy from international trade through the use of tariffs to achieve a positive trade balance) by pointing out that economic specialization is as advantageous to nations as it is for firms. In 1799, the Dutch East India Company, the world's largest company at that time, became bankrupt, mainly due to increased competition in free international trade. By the nineteenth century the adoption of free trade was based on absolute advantage until David Ricardo in 1817 demonstrated that all countries can benefit from international trade based on the theory of comparative advantage. In the twentieth century, the Great Depression brought a considerable decrease in trade. The Bretton Woods Agreement, which was signed in 1944 by forty-four countries, aimed at the removal of national trade barriers. In 1947 twenty-three countries made an agreement, the General Agreement on Tariffs and Trade (GATT), to advance free trade. The World Trade Organization (WTO) was formed through the GATT Marrakech Agreement in 1994.

Bilateral trade is a part of each country's gross domestic product (GDP). A country's *balance of trade* is the amount of goods and services that the country exports minus the amount of goods and services that the country imports. The term *bilateral trade agreement* denotes an agreement on trade issues between two countries or two trading blocks (e.g., the European Union and Mercosur) or a trading block and a country (e.g., the EU and China). The main aim of a bilateral trade agreement is the elimination of barriers in trade and the facilitation of the movement of goods and services across the national or regional

borders to encourage expansion and diversification of trade. Other decisive goals of bilateral trade agreements can be the promotion of fair competition conditions; the substantial increase of investment opportunities; the provision of protective measures concerning intellectual property rights; and the creation of procedures that will secure the implementation and application of the bilateral agreement. All the abovementioned goals are achieved by the bilateral jointed administration of the agreement and the removal of disagreements, together with the establishment of a framework that will further trilateral, regional, and multilateral cooperation in order to promote the advantages of the bilateral trade agreement.

Throughout history bilateral trade has been standard practice. However, the importance it carries economically, socially, and politically has increased substantially recently. This is due to industrialization, advanced transportation, globalization, multinational corporations, and outsourcing (Bitzenis 2004). High tariffs, governmental quotas, and restrictions are usually used to regulate bilateral international trade. Although tariffs are usually imposed on imports, it is not unusual for a country with a protectionist policy to impose export tariffs or provide subsidies. Such restrictions are known as *trade barriers*; free trade exists in a situation where a government does not impose any trade barriers. Countries are sometimes punished economically by other nations through the implementation of trade sanctions against it. The term *embargo*—that is, externally imposed isolation that is severe—refers to the total absence of trade between the two countries. An example is the United States's trade embargo on Cuba, which has lasted for more than forty years.

A preferential trade agreement (PTA) may exist between two trading partners in a bilateral trade agreement, creating a preferential trading area. In this case, the two trading partners (the two countries or the two trading blocks, or one trading block and a country) reduce tariffs between each other, but do not necessarily abolish them completely; this is the weakest form of economic integration. States that are not party to the PTA do not usually benefit from such reductions. PTAs may have adverse effects on multilateral trade liberalization. Since the creation of the GATT and its successor, the WTO, 362 regional trade agreements have been reported to the WTO; of these, 211 were in force in mid-2006 (Lamy 2006). Agreements with services provisions are more and more common. Trade provisions in sectors not controlled multilaterally are a part of an increasing number of bilateral agreements. According to a World Bank study, Global Economic Prospects 2006: Economic Implications of Remittances and Migration (2005), the percentage of trade that takes place under preference treatment varies from 15 to 40 percent (Lamy 2006). The situation of trade under preference treatment undermines substantially the principle of the "most-favored nation," which is one of the cornerstones of the WTO.

SEE ALSO *Absolute and Comparative Advantage; Barriers to Trade; Free Trade; Liberalization, Trade; North American Free Trade Agreement; Quotas, Trade; Tariffs; Trade*

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TRADE, SLAVE

SEE *Slave Trade.*

TRADE CREATION

SEE *Customs Union.*

TRADE DEFICIT

A trade deficit—that, is, a deficit on flows of goods and services in a country's international balance of payments—occurs when a country imports more than it exports. Because the concept of the trade deficit depends intimately on its two component flows of exports and imports, what motivates these cross-border, that is, international, transactions? If a country buys more than it sells, how does it pay for the excess purchases? Does the concept of the trade deficit give a complete picture of a country's international relationships and flows?

People and firms trade because they want different things, have different skills and technologies, and earn different amounts of money. People and firms value goods and services differently, depending on their income, tastes, and needs. Countries are the aggregation of individual actions by firms and individuals. So, countries differ from