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GEOGRAPHY AND TRADE.

Chris Giles

When you can download software from the US or your favourite song from Australia, it is not surprising that both the tech-savvy and those wanting Britain to leave the EU assert that geographical proximity has never mattered less. This is a favourite phrase of Daniel Hannan, a Brexit-supporting Conservative member of the European Parliament. It also happens to be a myth.

Take two countries, one with historic ties to Britain and which shares the same language, the other merely in the middle of the European continent. New Zealand and the Czech Republic were both $200bn economies in 2014, measured at prevailing exchange rates, and Britain trades significantly more with one than the other. Imports and exports of goods and services in 2014 were 3.9 times higher with our European not-

This is not cherry-picking countries. Britain might not play a lot of cricket with Spain but it trades 3.3 times more with its former enemy than it does with Australia. Both Spain and Australia are $1.4tn economies, but British people are more willing to travel short haul for sunshine and sangria than for the lifestyle of *Neighbours*, the long-running Australian television soap opera.

Geography still matters in trade, but distance is not the only determinant. Size of market is also important. As China's weight in the world economy has grown rapidly, so naturally has the amount of trade with Beijing.

China is a growing share of Britain's trade, for sure, but we should not exaggerate its importance. Chinese gross domestic product was $10.4tn in 2014 but trade with Britain accounted for 0.9 per cent of it, much smaller than the EU's trade with the UK, which accounted for 5.5 per cent of the EU economy in 2014.

Not only is Britain's trade with the EU much larger relative to the size of the market, geography also appears to be becoming more, not less, important. Ten years earlier, in 2004, Beijing's trade with the UK accounted for 1.4 per cent of China's economy, a larger slice, but the trade intensity with the EU has remained essentially the same.

So-called gravity models, which are economic analyses that try to explain trade patterns by geography and size of markets, find that Britain trades more than might be expected with Europe largely because that market is much more integrated than a free-trade zone.

Although the economic theory of trade started with David Ricardo's stories about exchanging Portuguese wine for British cloth, most modern trade occurs among similar

goods and services in similar markets. It brings benefits from increased forces of competition, raising productivity through improved processes and management and eliminating inefficient producers.

Reducing tariffs and removing quotas boost trade and bring gains but deeper integration, harmonisation of regulation, recognition of other countries standards, prohibition of artificial state aid and eliminating non-tariff barriers are more powerful. For Britain, the only big and close market in which it can achieve these benefits is the European single market. All other large markets are too far away.

In trade, geography matters more than you think

Countries and companies often find deep integration uncomfortable because the weak go to the wall complaining bitterly. But that is as it should be. Complete in goods, the single market still needs to develop further in services.