International Trade ECO3111

Chapter 1

Introduction

Some facts and questions about trade

How are trade patterns determined ?

- Why does China export iPods to the USA?
- Why does Canada export wheat to Europe?
- Why does Canada export aircrafts and Blackberries?
- Why are there so much trade flows between apparently similar rich countries and so little between rich and poor countries?
- An **export** is a product sold from one country to another.
- An **import** is a product bought by one country from another.

Trade patterns

- A lot of world trade takes place between rich countries.

What are the effects of trade policies?

- **Import tariffs:** Taxes on imported goods.
- Trade between EU countries is large in part because of very low import tariffs.
- Also because of proximity, ie low transport costs.
- **Trade barriers:** All factors that reduce the amount of goods and services shipped across international borders.
- Trade between industrialized countries is large in part because they are rich.

Why do some countries rely more on trade than others?

- Define amount of trade in goods and services for a country as follows, expressed in ($) value terms:

$$\frac{Imports + Exports}{2}$$

- Express in % of GDP as a measure of the relative importance of trade among countries.

Country	Trade/GDP (%)	GDP ($ billion)
Hong Kong, China	201	215
Malaysia	116	222
Hungary	81	155
Thailand	71	272
Switzerland	66	488
Austria	56	414
Denmark	51	341
Sweden	50	479
Germany	44	3,649
Norway	38	452
South Africa	37	276
Canada	33	1,501
China	33	4,327
United Kingdom	30	2,674
Indonesia	28	511
Italy	28	2,303
Mexico	28	1,088
Spain	29	1,604
Greece	[illegible]	356
France	28	2,857
Turkey	[illegible]	735
Russian Federation	26	1,679
Venezuela	25	314
India	[illegible]	1,159
Argentina	23	328
Pakistan	18	165
Japan	16	4,921
United States	15	14,093
Brazil	14	1,575

Is trade good?

- Should Africa be exporting more to Europe?
- Why are there people opposed to trade?
- How should we measure the benefits from trade?
- Is one country's gain the other's loss? (A zero-sum game?)
- What about inside the country? Are there groups that gain while others lose from trade?

Is a trade deficit bad?

- **Trade balance**: Difference between total value of exports and total value of imports in goods and services.
- **Trade surplus**: When exports exceed imports in value terms. (China, Germany)
- **Trade deficit**: … (USA)
- What about Canada?

Is bilateral trade balance a useful statistic?

- **Bilateral trade balance:** Difference of exports and imports between two countries only.
- A politically sensitive issue between the USA and China these days.
- Does it make sense to concentrate on that number?

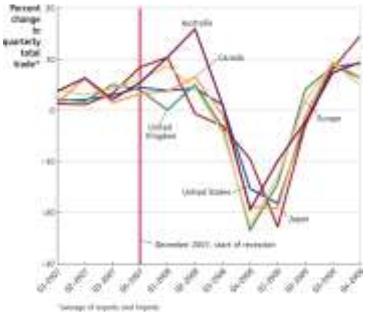
The iPod case

- $300 = Sales price in the USA
- $150 = “Value” when leaving docks from China (in terms of production costs?). Breakdown of those costs:
  - $73 for imported hard drive
  - $20 for imported display module
  - $13 for various chips
  - $4 for Chinese labor input during assembly
  - … = $146 of imported material into China.
- Only $4 remains in China.
- **Value added:** The difference between the “value” of the iPod when it leaves China and the cost of parts and materials imported by Chinese in order to produce the iPod.
- Some of the above parts and materials may come from countries with which the USA has a trade surplus.

The iPod case (cont'd)

- The fact that the production of a good requires movements of inputs between a large number of countries, sometimes back and forth, is a relatively recent phenomenon.
- This is often referred to as **offshoring**.
- Question: If the USA pays $150 to China for one ipod but sells for $300, where does the difference go?
- Apple receives $80 per unit sold. That is by far the largest single share of value added. Who gets to keep that share?

Why did the 2007-2009 recession affect trade so much?



What determines migrations and what are their effects?

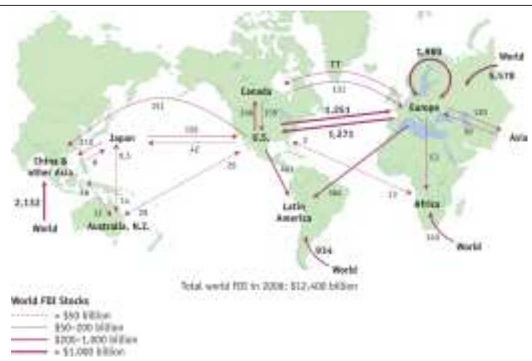
Migrations

- In 2005 there were 62 million foreign-born people living in the OECD countries. That is less than one-third of the total number of foreign-born people worldwide.
- Unlike trade, the majority of immigration occurs outside the OECD between countries that are less wealthy.
- Generally, the flow of people is much less free than the flow of goods and services, ie there are barriers to immigration.Why?
- Even if imperfect, the possibility of exporting acts as a substitute for labor and capital movements.

What determines foreign direct investments and what are its effects?

- **FDI:** When a firm in one country owns (in part or in whole) a company or property (asset) in another country.
- FDI can be the result of buying an existing foreign company or building a new facility, ie creating a subsidiary.
- FDI contrasts with portfolio investment.
- **Portfolio investment:** When investors from one country buy stocks or bonds from another.
- The difference between the two is really a matter of "control".

FDI



FDI

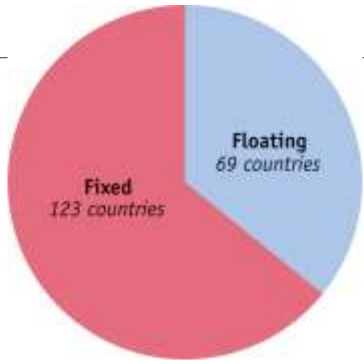
- The majority of world flows of FDI occur between industrial countries.
- In 2006 more than one-third of the world flows of FDI were within Europe or between Europe and the United States, and 90% of the world flows of FDI were into or out of the OECD countries.

FDI

- **Horizontal FDI:** When a firm from an industrial country owns a plant (company) in another industrial country.
- **Vertical FDI:** When a firm from an industrial country owns a plant (company) in a developing country.

What is the role of exchange rates?

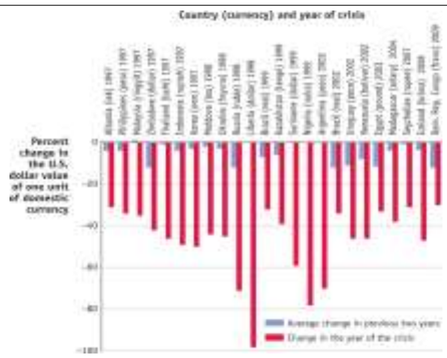
- Two regime types:
  - **Fixed (pegged) exchange rate:** "Set" to fluctuate within a narrow band.
  - **Floating (flexible) exchange rate:** Allowed to fluctuate over a much wider band.
- Where would you fit a **common currency**?
  - *A fixed exchange rate with zero bandwidth.*
- How are exchange rates determined?
- Why do some exchange rates fluctuate sharply in the short run?
- What are the long run determinants of exchange rates?



Why do exchange rates matter?

- They affect trade flows because they determine the relative prices of goods and services.
- They affect people's savings because they determine the relative price of assets.
- **Exchange rate crisis:** When there is a sudden, large drop in the value of one currency w.r.t. another.
  - Usually associated with a large fall in output, banking and debt problems, people suffering.

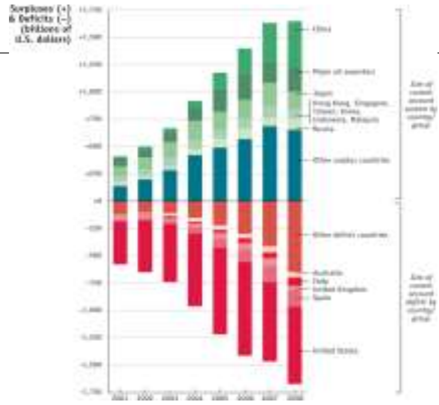
Currency crisis are not rare



How are trade and investments linked?

- A trade deficit means that imports exceed exports.
  - *This is like spending more than your income.*
- The counterpart is an increase in debt w.r.t. trading partners. It is a promise to produce goods and services for the trading partners in the future, ie a liability.
- From the trading partners' point of view, this is an increase in their foreign asset holdings.
- Defaulting on a foreign debt is equivalent to breaking a promise to produce for them.
- Conversely, a trade surplus means that the country is investing in its trading partners' assets.
- You can't have both a trade surplus and a net increase in inward foreign investment.

Trade imbalances



On foreign asset holdings (external wealth)

- What are they composed of and does it matter?
- What explains the level of a nation's external wealth and how does it change over time?
- How does it relate to the country's present and future economic welfare?

To do for this chapter

- p24, nos 1, 2 with Statistics Canada link, 3.