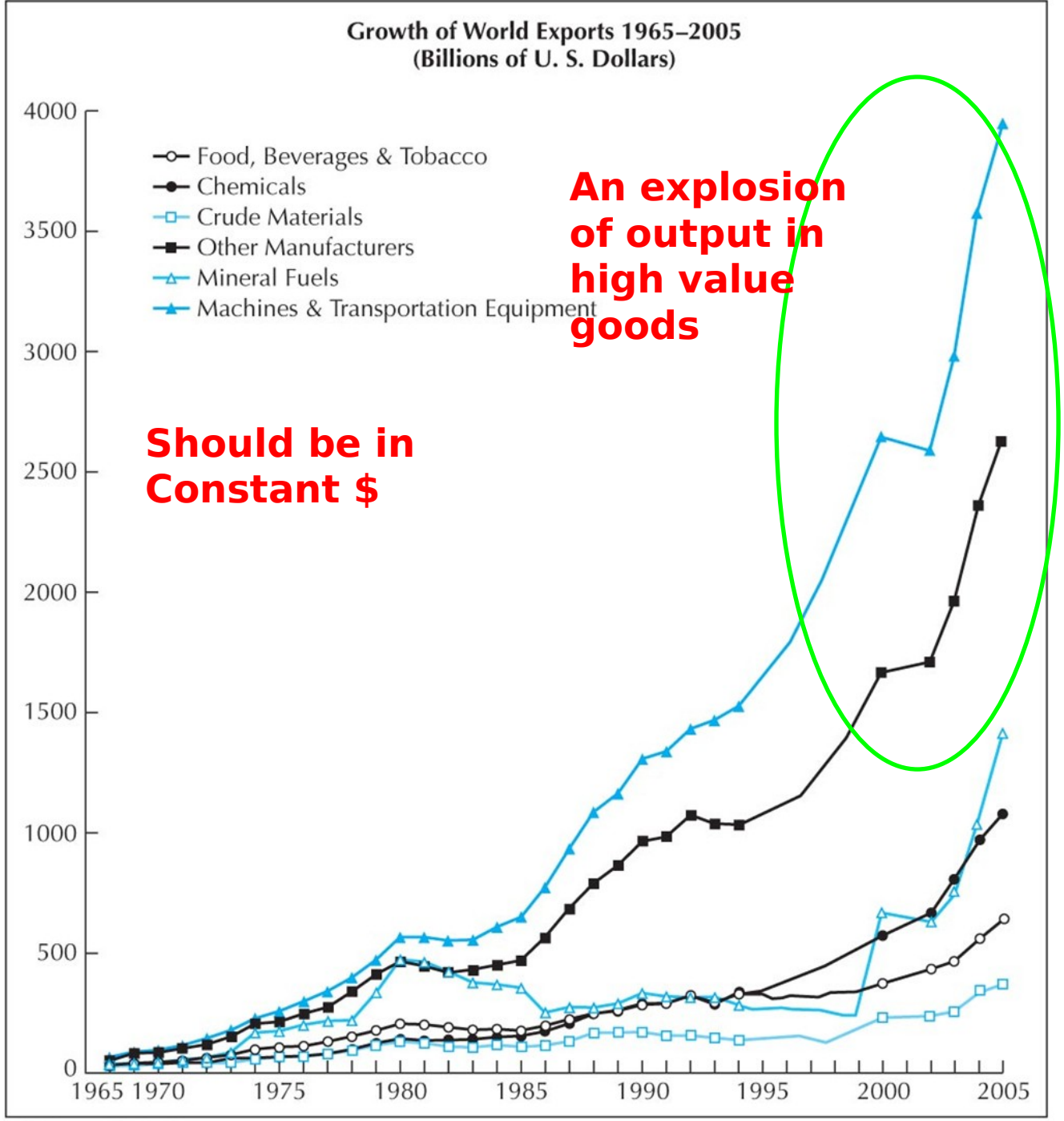
Chapter 12
International Trade and Investment

- Explaining the theoretical basis for international trade and factor flows, including comparative and competitive advantage
- Understanding trade barriers (tariffs)
- Examining the dynamics of FDI
- Understanding the financing of international trade
- To appreciate trade organizations such as GATT and WTO

International Trade in Goods



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Huge differences in factor endowments among countries.

Long-run shift from barter to money trade

The Principle of Comparative Advantage: Ricardo

Before Specialization (labor hours / unit)				
	Timber	Wheat	Total	
Western WA	25	40	65	
Eastern WA	30	25	55	
(units)	2	2	120	
After Specialization (labor hours / unit)			Total	Savings
Western WA	50	0	50	15
Eastern WA	0	50	50	5
(units)	2	2	100	20

sequences:

rade powerfully shapes local production systems

pecialization lowers total production costs

nd large markets allow exploitation of scale economies: "the division o

abor is governed by the size of the market" – Adam Smith 1776

But, Transport Costs are Crucial in Determining if Trade will Occur

Trade Feasible in this Case

Before Specialization (labor hours / unit)				
	Timber	**Wheat**	**Total**	
Western WA	**25**	**40**	**65**	
Eastern WA	**30**	**25**	**55**	
(units)	**2**	**2**	**120**	
After Specialization (labor hours / unit) + Transport Costs			**Total**	**Savings**
Western WA	**55**	**0**	**55**	**10**
Eastern WA	**0**	**53**	**53**	**2**
(units)	**2**	**2**	**108**	**12**

But, Transport Costs are Crucial in Determining if Trade will Occur

Trade Not Feasible in this Case

Before Specialization (labor hours / unit)

	Timber	Wheat	Total
Western WA	25	40	65
Eastern WA	30	25	55
(units)	2	2	120

After Specialization (labor hours / unit) + Transport Costs			Total	Savings
Western WA	65	0	65	0
Eastern WA	0	55	55	0
(units)	2	2	120	0

? Not sure if Figure 12.3 conveys this point…..

Long-run reduction in transport costs has promoted more trade

Heckscher-Ohlin Trade Theory

- An extended version of Ricardo's model
- Controversial, as one of its basic tenants (factor price equalization) has not played out (globally)

"If a country specializes in a labor intensive good, its abundance of labor diminishes, the marginal productivity of labor rises, and wages increase. Conversely, if a different country specializes in capital-intensive goods, labor becomes less scarce, the marginal productivity of labor falls, and wages also fall." p. 317

Arguments over Trade Theories

- Traditional theories are based on restrictive assumptions
- “New trade theory” (Krugman): (a) based on increasing returns to scale, (b) creates benefits to host countries able to produce these products, (c) but competition reduces excess profit, (d) global gains come from specialization
- Power relations in trade: unequal exchange issues (who determines prices?)
- Worsening terms of trade in cases where countries are very dependent on single commodities (Table 12.2) AND are caught in structurally rigid markets (Figure 12.4)

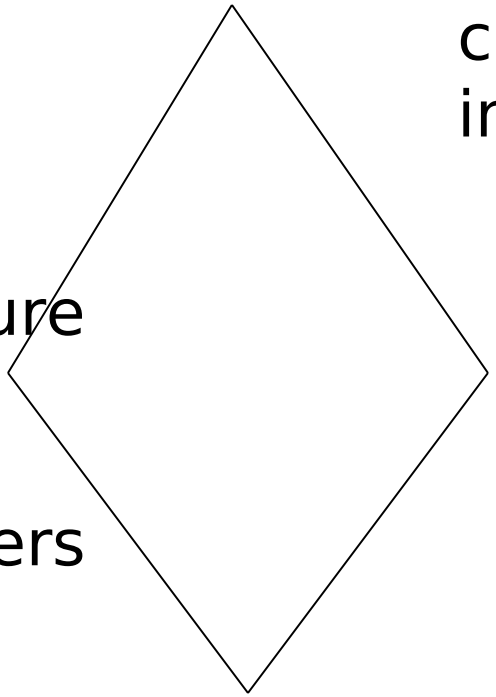
Enter Michael Porter, Harvard Business School Guru

- The notion of competitive advantage
- It is constructed by firms in regions/nations
- It is based on a dynamic view of industrial systems
- It is NOT based on production systems built around cheap labor or low cost natural resources
- It IS built around a vision of productivity growth driven by skilled labor, available capital, government policy and infrastructure, and opportunities for scale economies (in industries: “clusters”) – e.g. agglomerations
- Based on careful case studies, now seized upon (and promoted by Porter) in regions ranging from Nations to inner cities

Porter’s “Diamond”

Factor Conditions – human, physical, capital, knowledge-based infrastructure

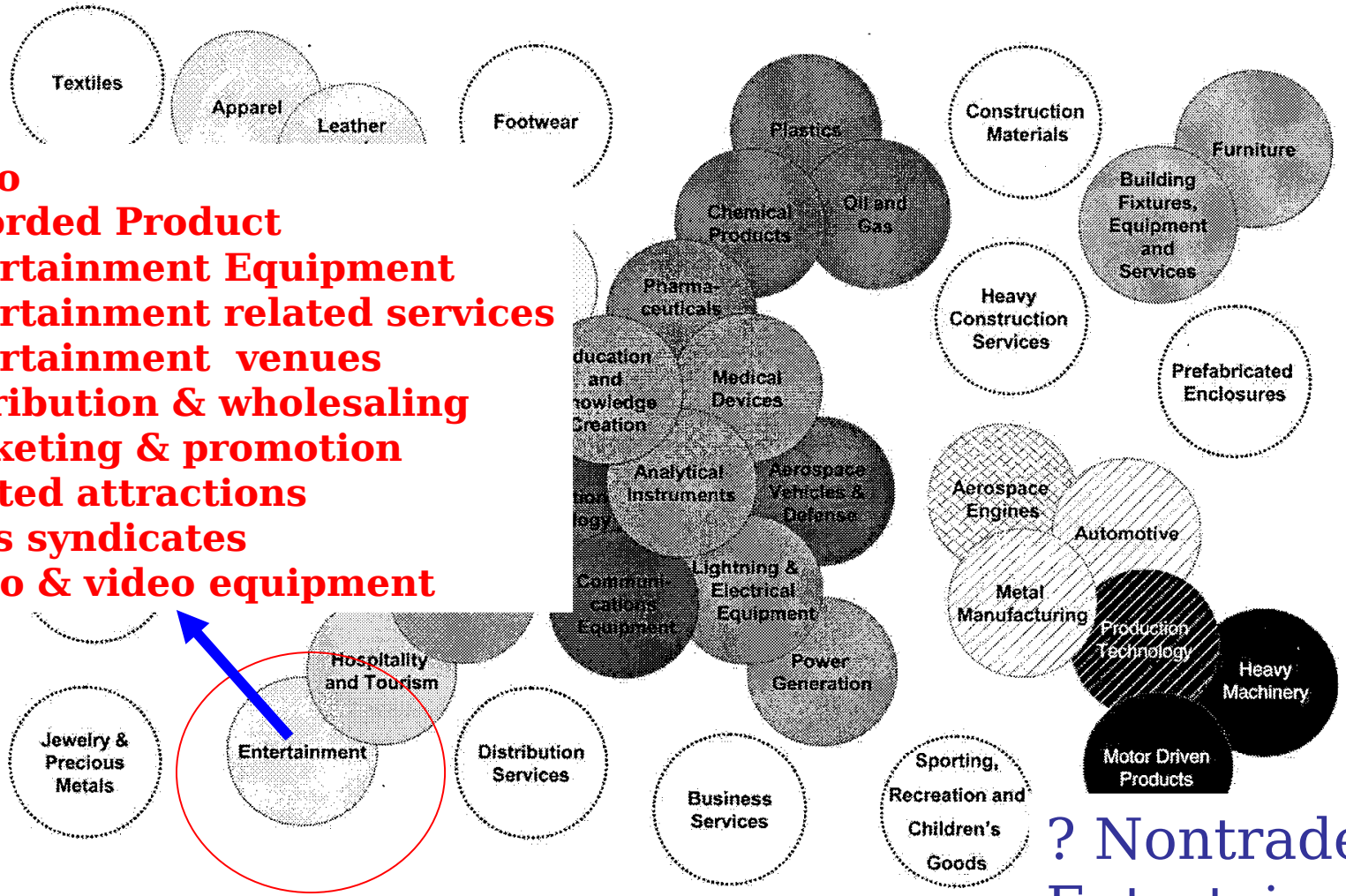
Firm Strategy, Structure And Competition – The importance of Agglomerations/clusters



Supporting Industries

Demand Conditions

Porter's Traded Clusters



Video
Recorded Product
Entertainment Equipment
Entertainment related services
Entertainment venues
Distribution & wholesaling
Marketing & promotion
Related attractions
News syndicates
Audio & video equipment

? Nontraded Entertainment?

Fig. 18. *Schematic diagram of cluster overlap in the US economy*

Note: Clusters with overlapping borders or identical shading have at least 20% overlap (by number of industries) in both directions.

Typical Cluster Representation

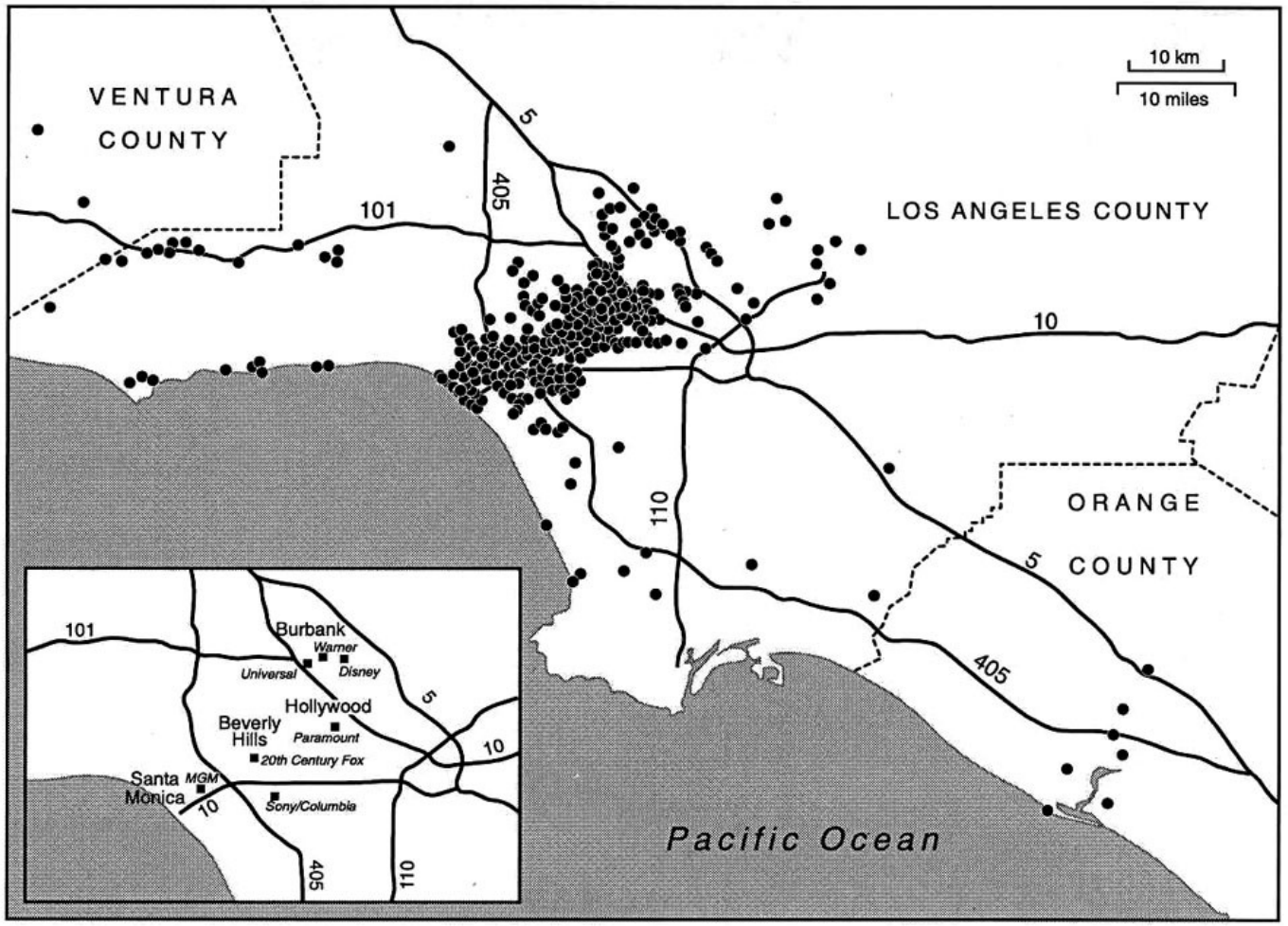


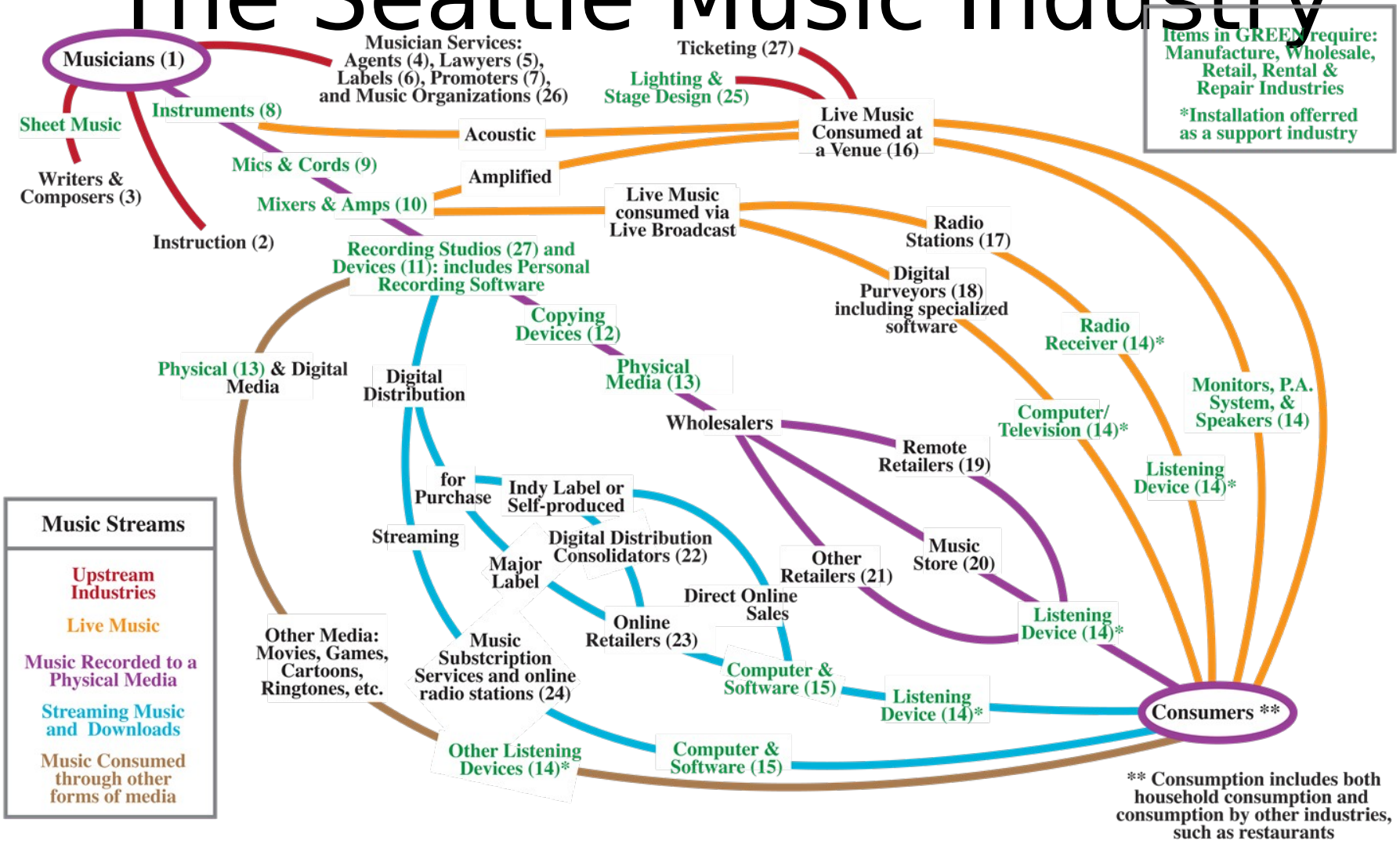
Fig. 4. Motion-picture production companies in Southern California

Note: The inset shows locations of the majors and selected place-names.

Sources: Blu-Book, 2001 (Los Angeles: Hollywood Reporter), and *Producers* (Los Angeles: Ifilm).

Source: A.J. Scott, Regional Studies, Vol. 36, no. 9, p. 966

Typical Cluster Flow Chart – The Seattle Music Industry



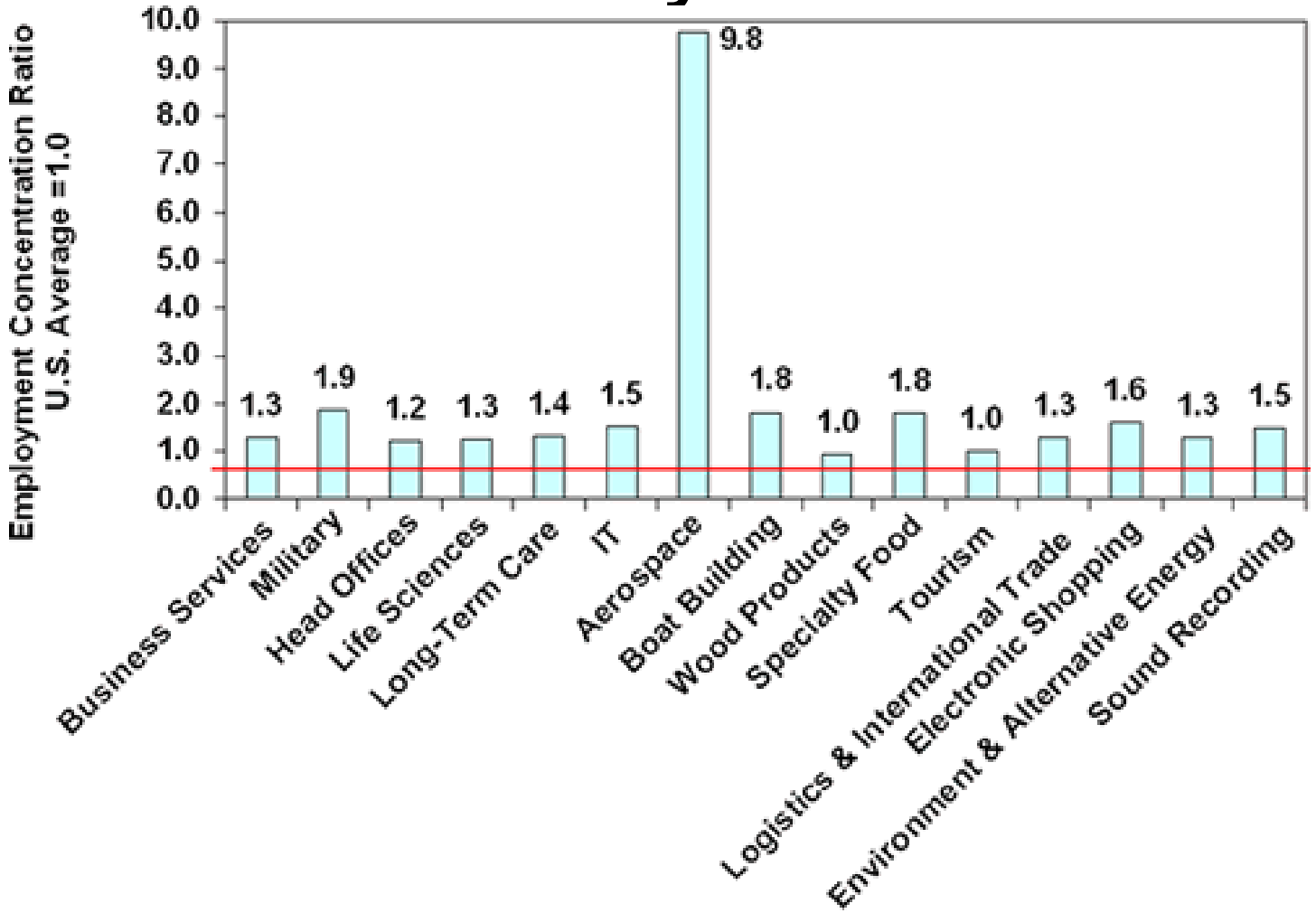
From Beyers, Fowler & Andreoli Seattle Music Industry Study, 2008

A Detour into a current regional effort rooted in Porter's model at PSRC

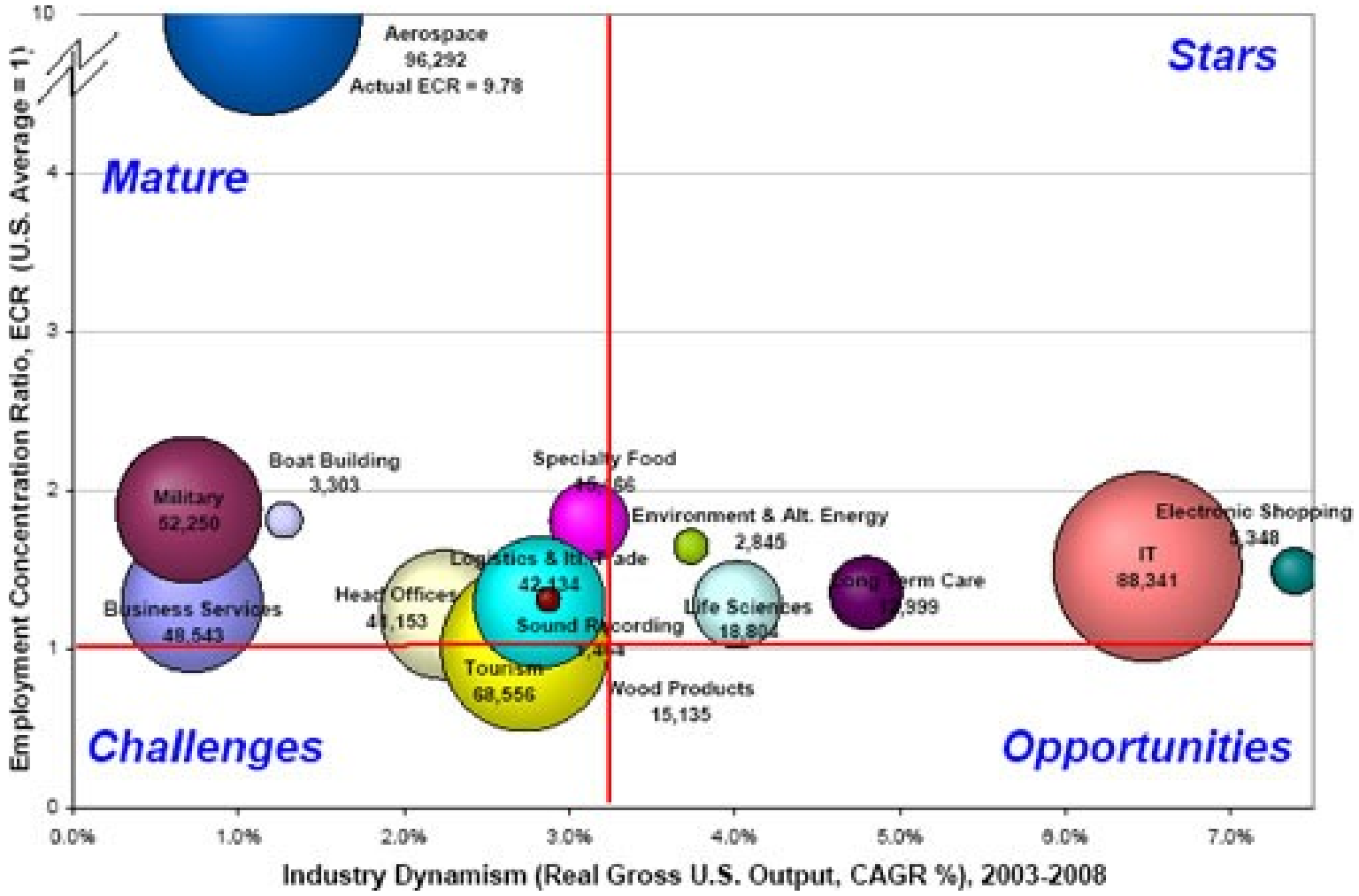


From: http://www.psrc.org

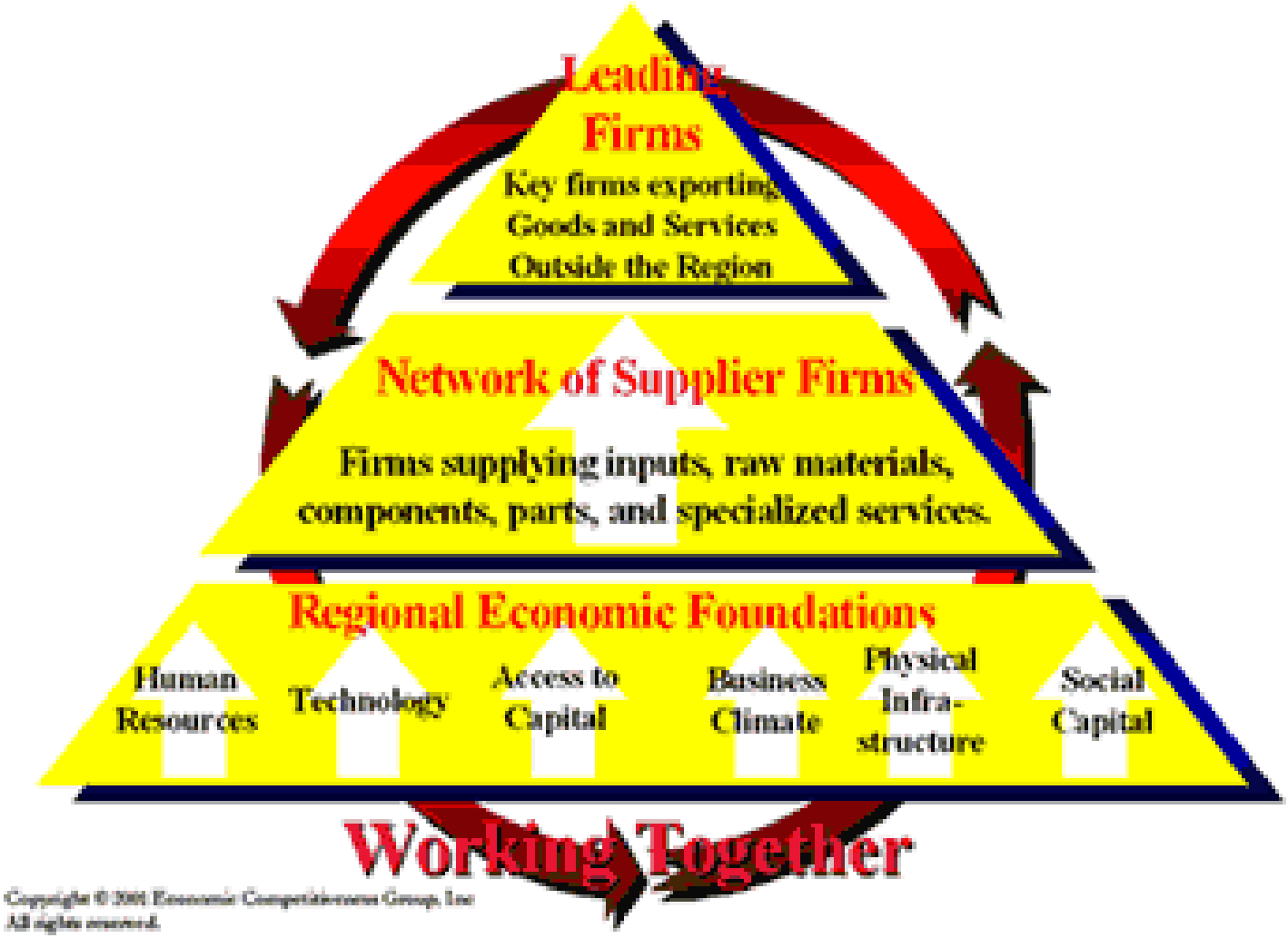
PSRC Consultant's Cluster Analysis



PSRC Consultant's Cluster Analysis



PSRC Cluster Framework



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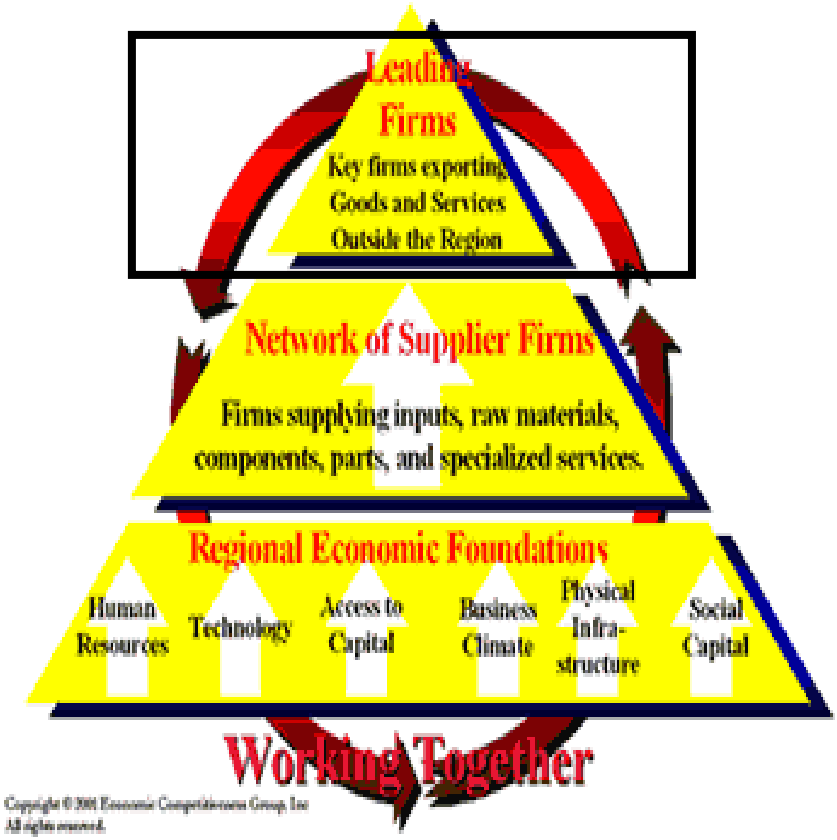
PSRC Cluster Organization and Geography



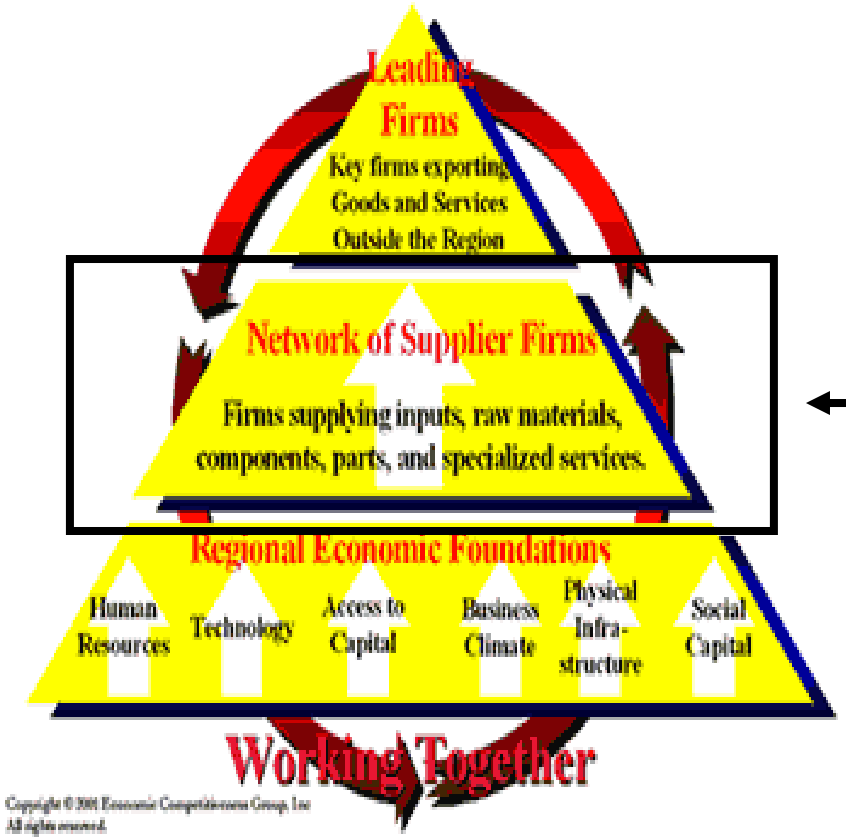
Each cluster has a different spatial and economic organization

-**Aerospace** – one dominant firm that organizes production on a global scale (and has a few local subcontractors)

-Information Technology – Microsoft is huge and global, but there are several thousand small companies plus a few medium sized one (plus IT divisions in companies in other industries); IT-manufacturing not very significant locally

-Logistics and trade as defined ignores several components of a highly integrated maritime cluster (fishing, seafood processing, ship building, marine construction plus linked service firms); global players are not headquartered locally; strong local-based players are regionally focused; ports are key institutions

PSRC - Specialized Suppliers?



I/O analysis suggests a strong generic supplier list -- specializations may exist at a finer level of detail, e.g., marine lawyers

From Washington I/O Table – Forward / Backward Linkages – Parts of PSRC Clusters

Linkages to Labor are stronger than other regional linkages in all sectors

Washington I/O Model Sector	% Intermediate Sales	% IntraIndustry	% Intermediate Purchases	% Regional Final Demand	% Exports & Federal Sales	% Labor Purchases	% Imports U.S. & Foreign
21 Computer and electronic product	12%	1%	20%	3%	85%	32%	42%
31 Information	22%	2%	15%	19%	59%	43%	13%
23 Aircraft and parts	2%	2%	8%	2%	96%	24%	71%
28 Wholesale trade	23%	1%	23%	22%	55%	34%	8%
30 Transportation and warehousing	24%	5%	27%	18%	57%	32%	23%

Washington industry markets are modest

Cluster center: linkages are uniformly weak

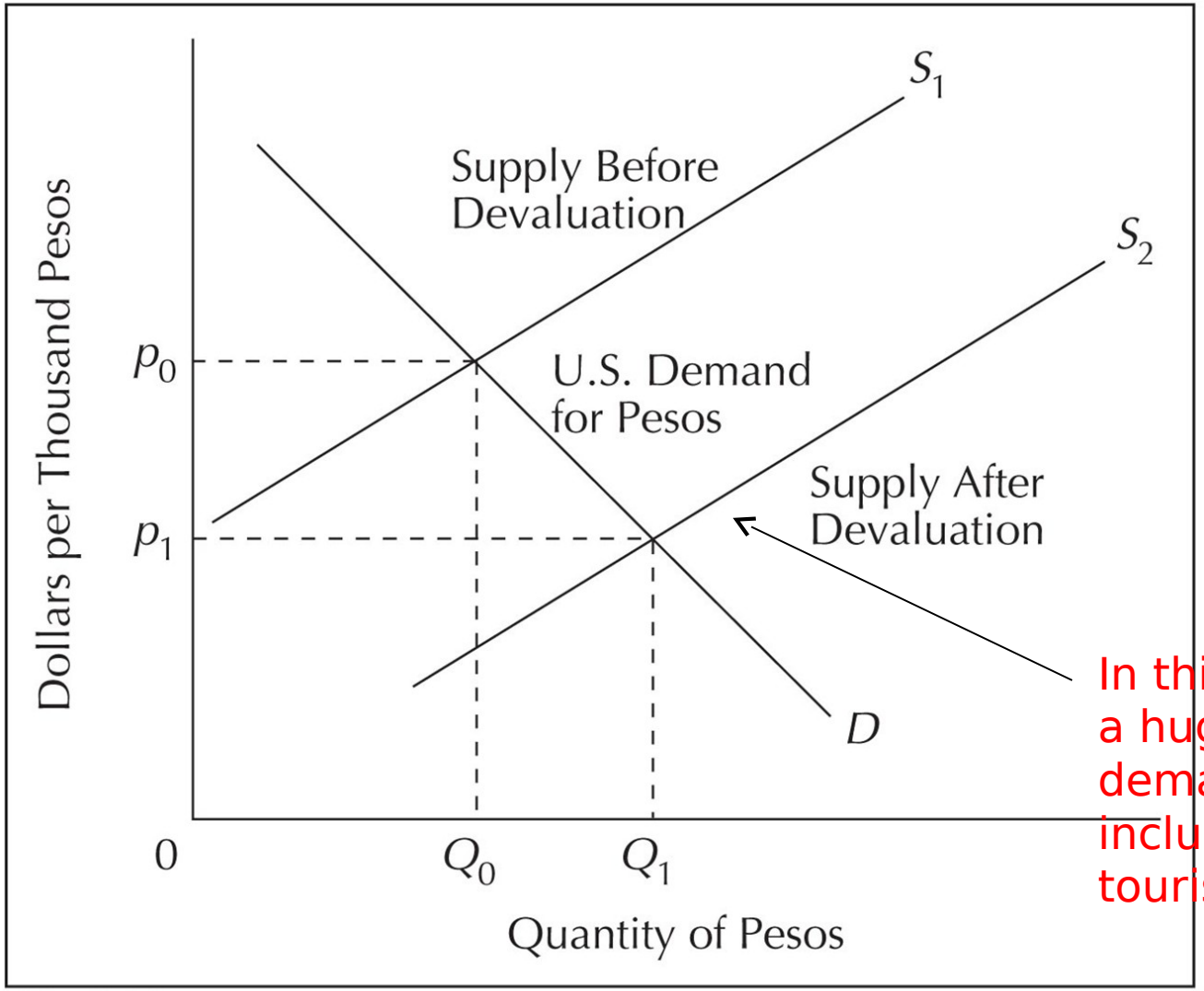
Regional purchases are dominated by services inputs

Exports strong in all sectors, imports vary in significance

International Money and Capital Markets

- Beyond the “facts” related to trade are institutions facilitating it—key types of markets: currency, banking, and capital
- Public and corporate capital markets, including direct investment markets
- Banks – all breeds
- Regional currency markets – Euromarkets – in “onshore” and “offshore locations

Financing International Trade
– the role of currency value changes



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In this example a huge surge in demand for pesos including for tourism

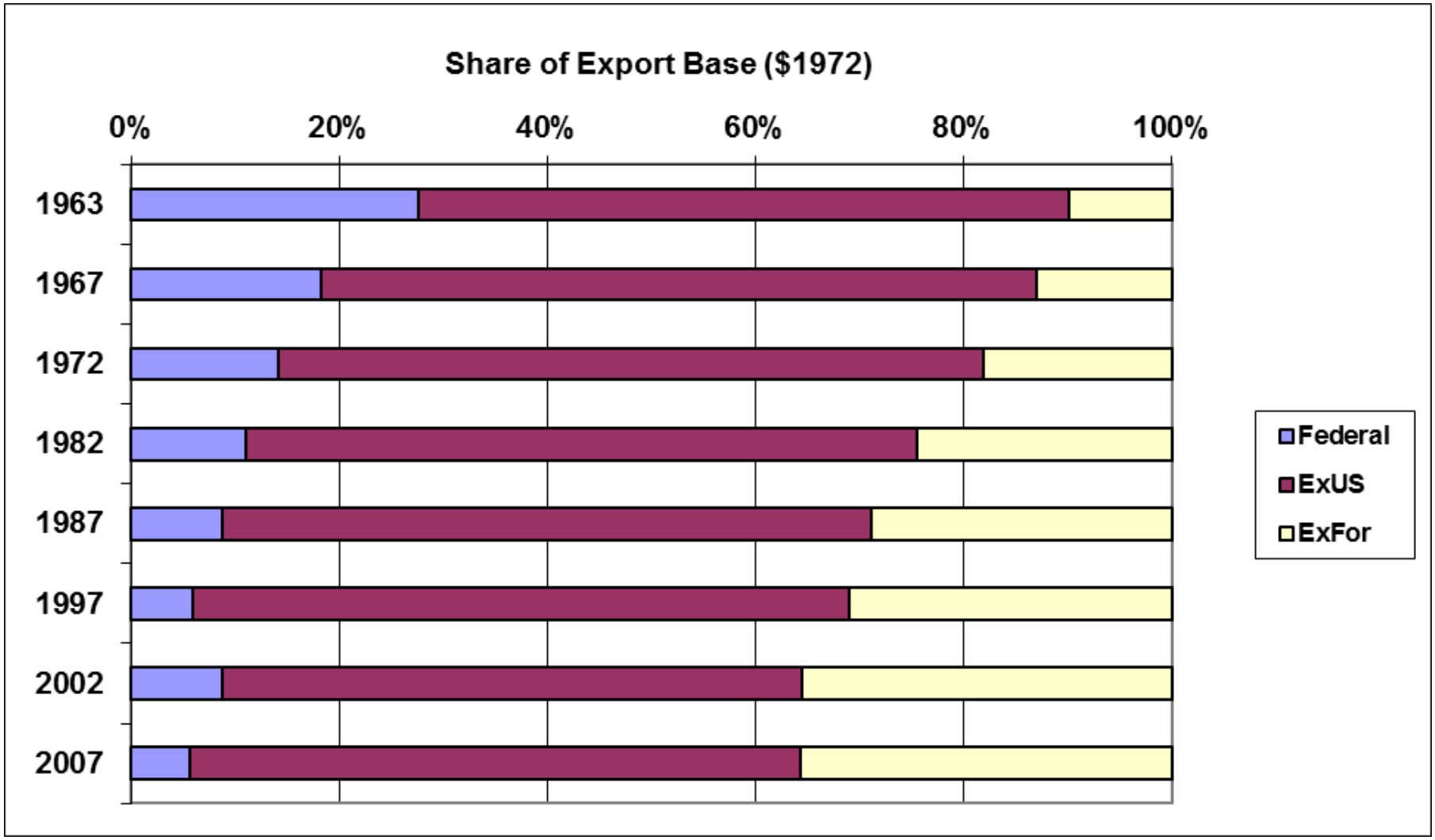
Key factors influencing exchange rates (Not just $!!)

- Relative demands for foreign commodities and services (due to real changes in wealth) translates into shifting quantities of demand for particular currencies
- Relative inflation rates
- Shifts in domestic demand – driven by shifting product offerings
- Differentials in interest rates
- Impacts of currency speculation: herding and fleeing

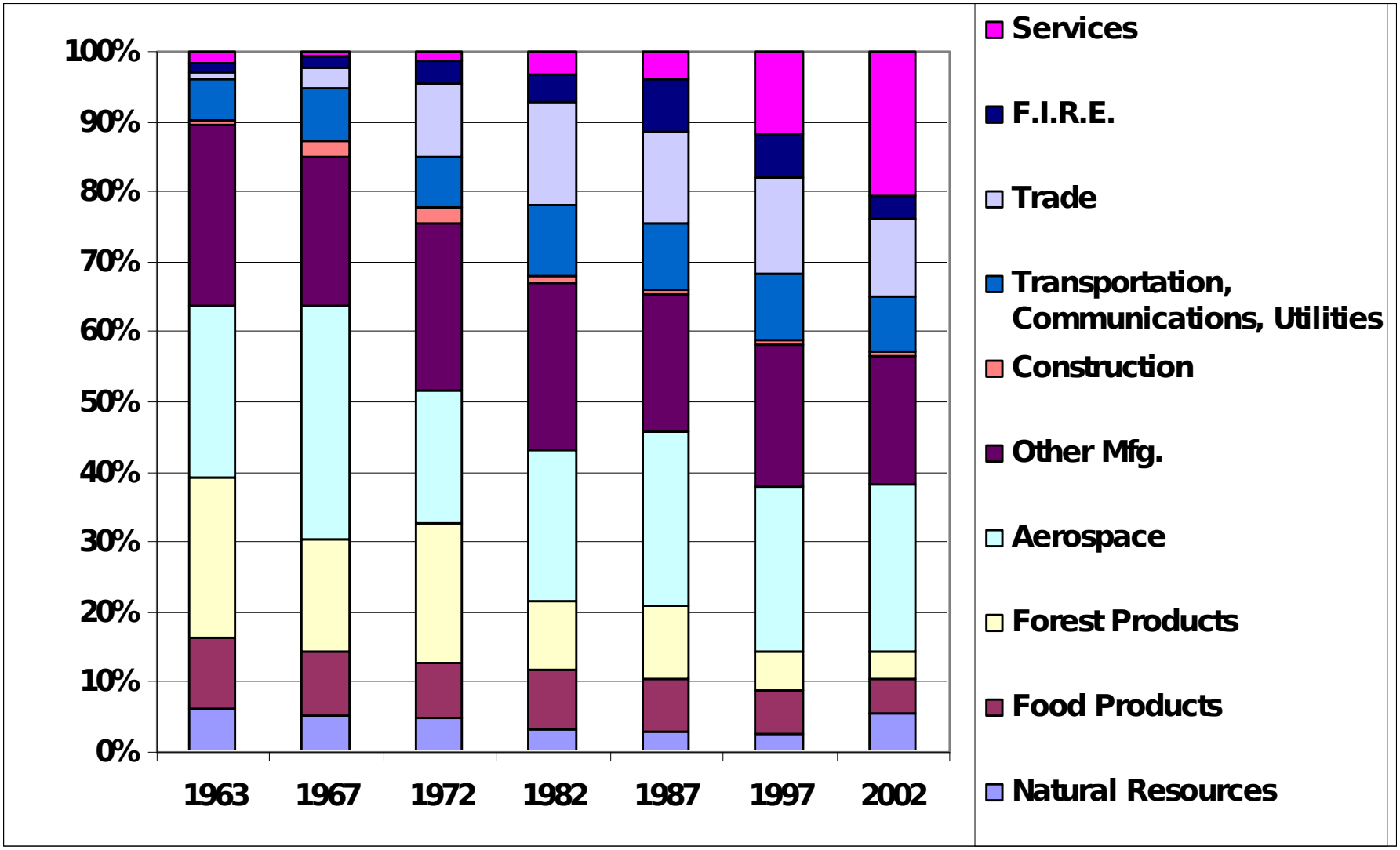
U.S. Trade Deficits

- Figure 12.7 – clearly shows the ramp-up in the level of exports & imports, and the ballooning of trade deficits since the late 1990's.
- Probably needs to be re-expressed in constant $ and as a share of GDP
- Table 12.3 shows rise in trade as a share of GDP – same as my figure in Ch. 11
- Fueled by (a) a highly valued $, (b) relatively rapid U.S. economic growth, and (c) diminished U.S. exports to less developed countries due to their relative poverty. Current account deterioration is clear in Figure 12.7

Share of Washington State Export Base

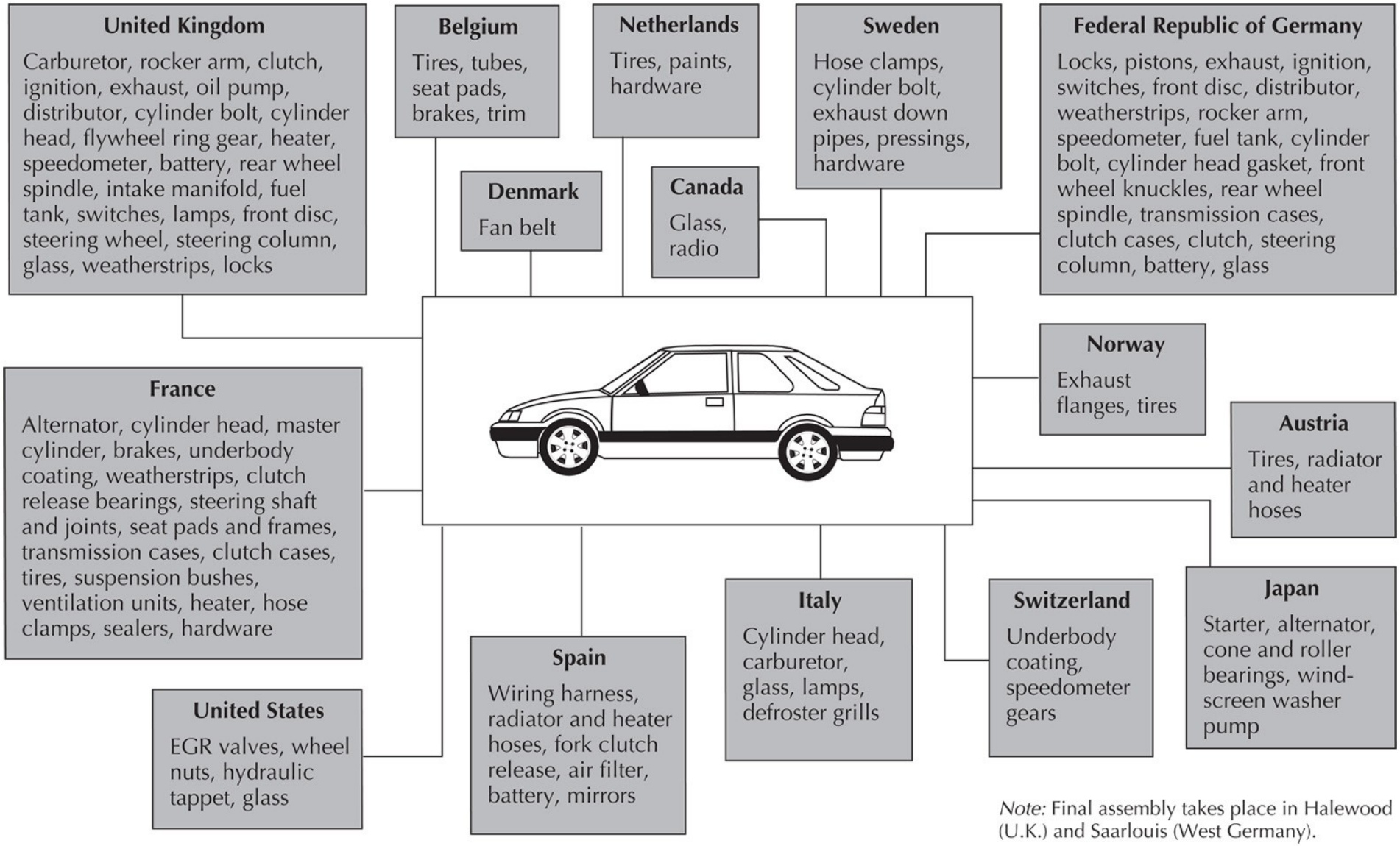


Sectoral Composition of Washington State Exports



Capital Flows and Foreign Direct Investment

- The rise of FDI is basically driven by the profit motive
- There are constraints, such as uncertainties as to how consumers will respond to offerings by foreign firms
- The trend is clear: a long-run rise in FDI, fueled by giant conglomerates, well illustrated by Ford (Figure 12.8), but also recall the Boeing 787 supplier chain touched on earlier in the quarter



Note: Final assembly takes place in Halewood (U.K.) and Saarlouis (West Germany).

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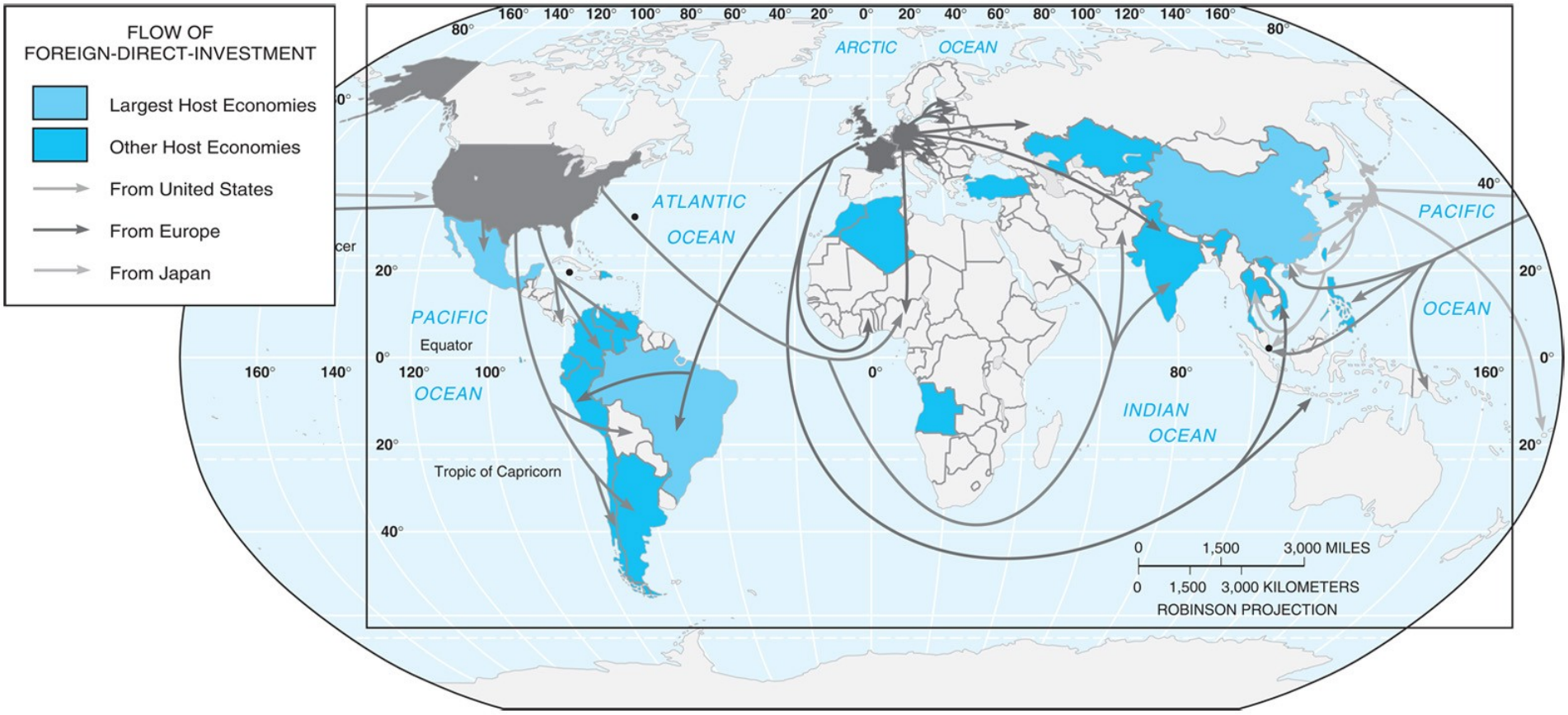
FDI Flows from 3 hearths: Others?



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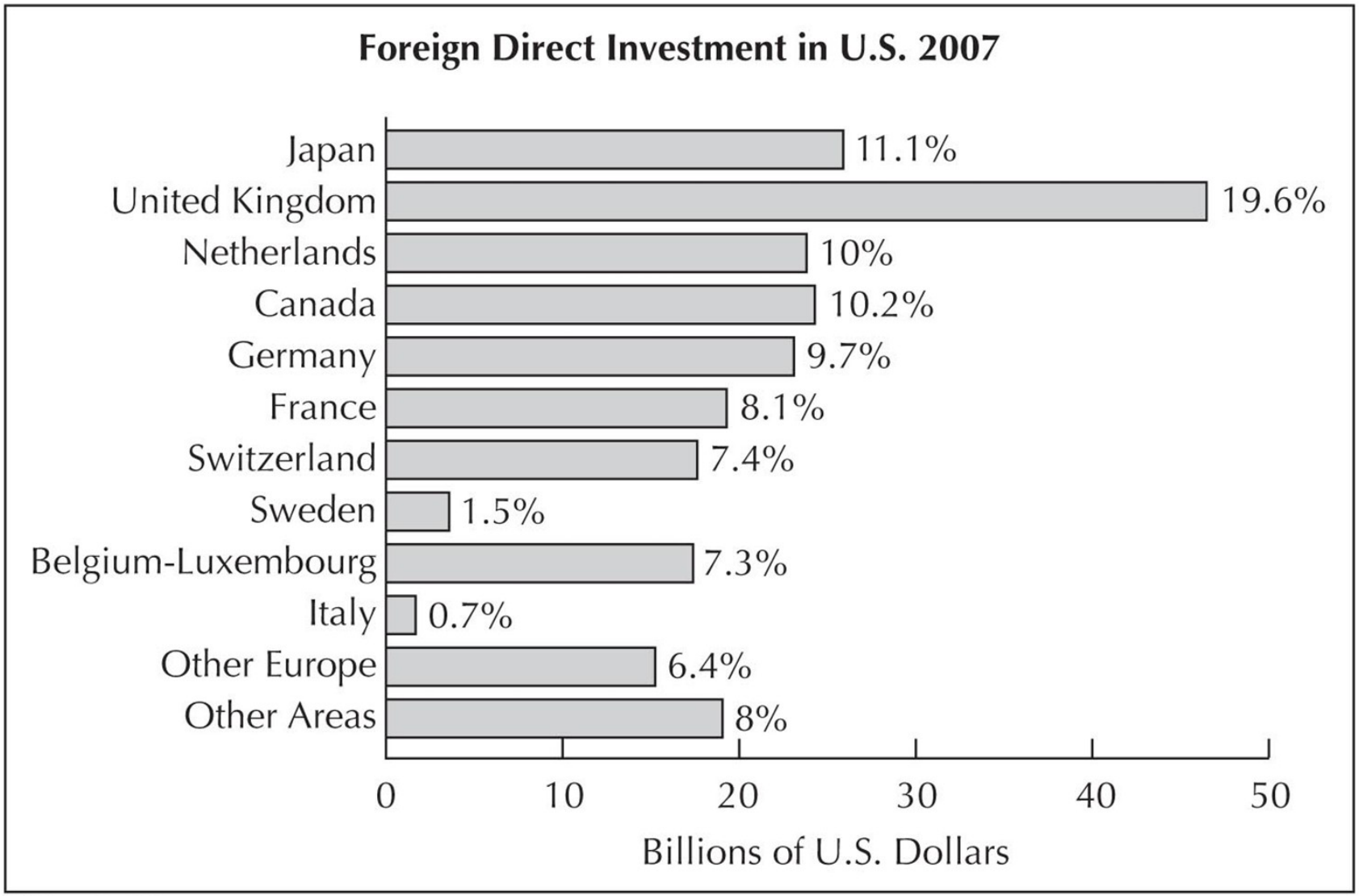
U.S. FDI – Spatial Diversification, See Figure 12.15

Inward FDI in the U.S.

Clearly dominated by $ from other high-income countries



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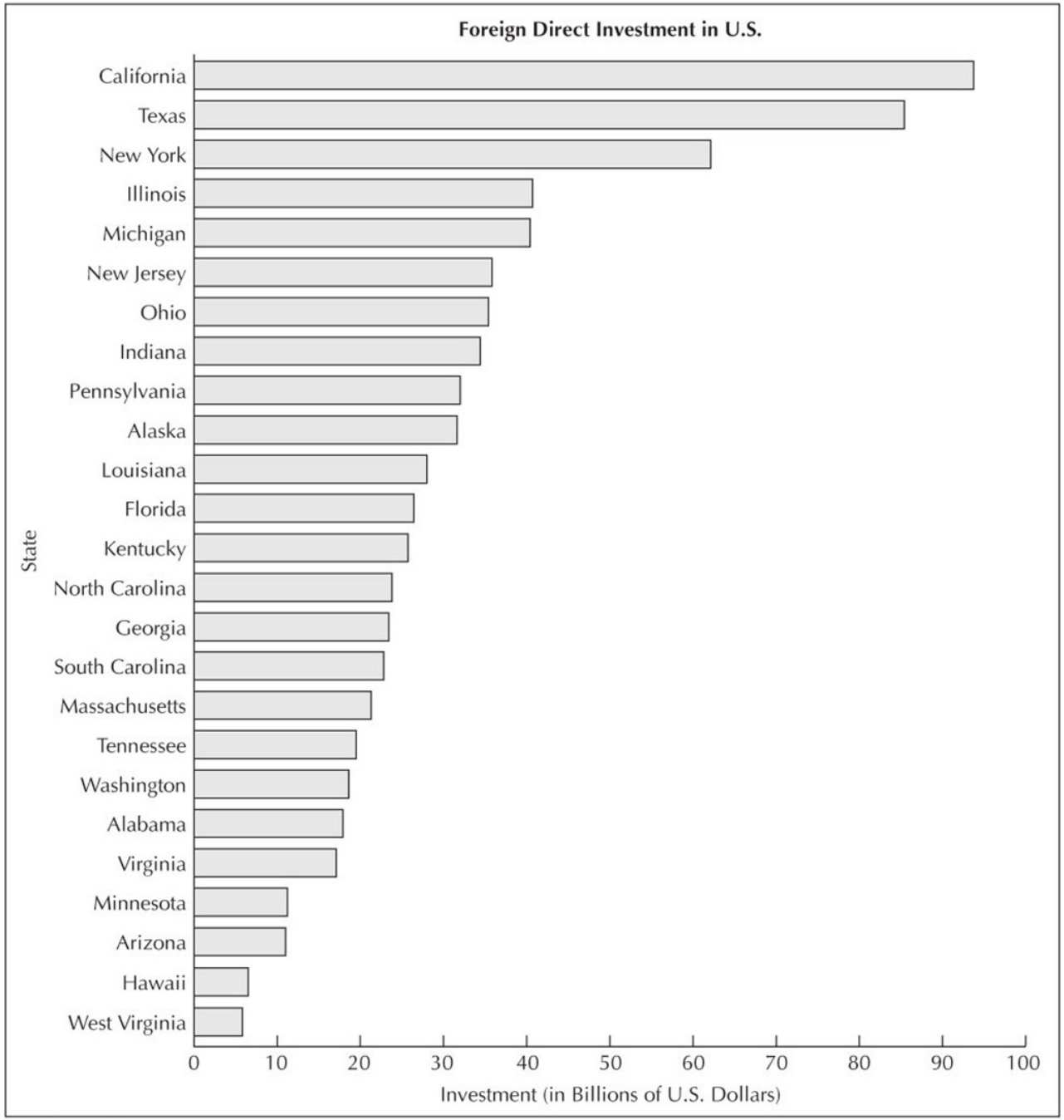

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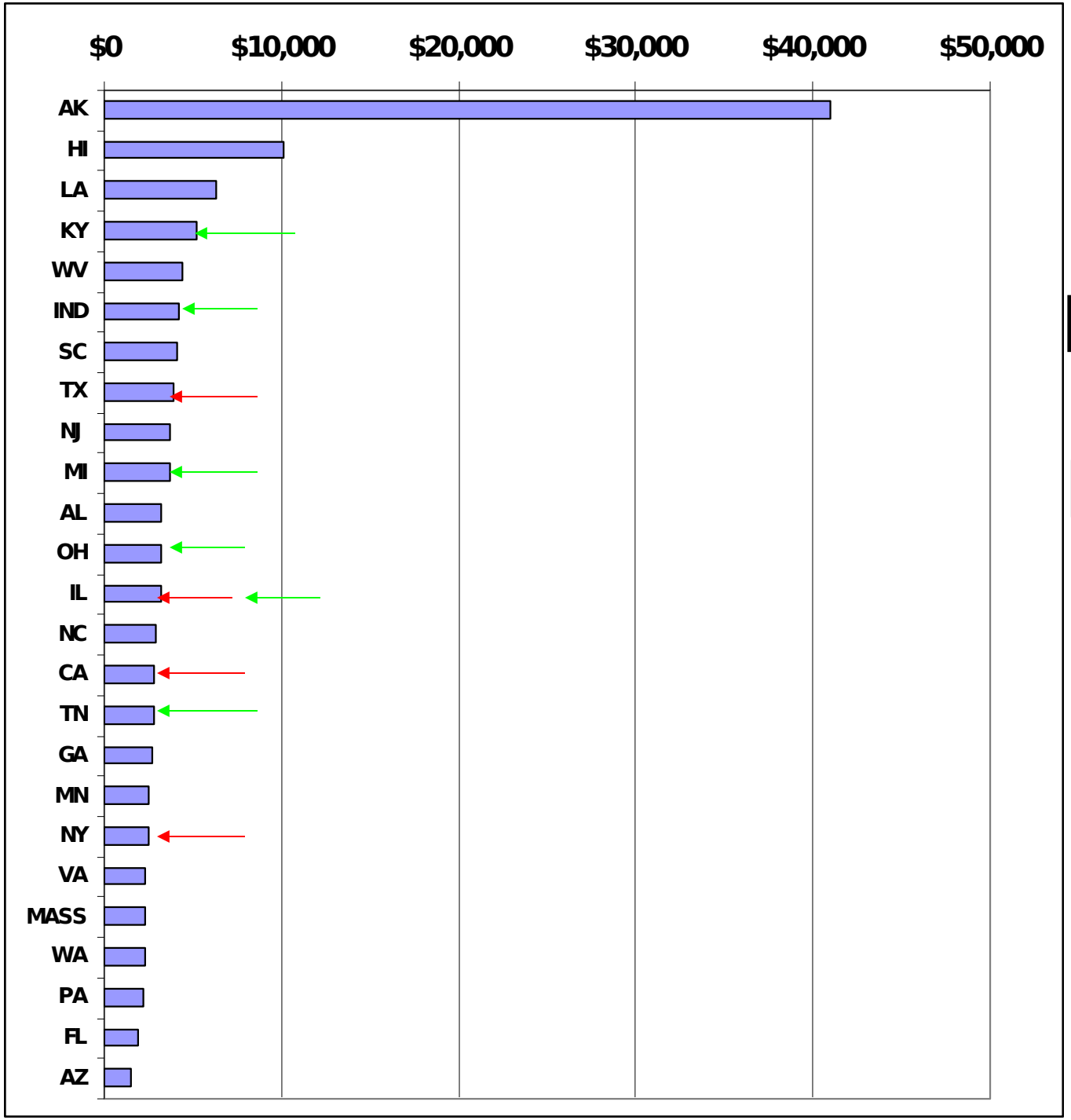
FDI by state - absolute $ strongly correlated with size of state economies



capita 2000 data w/2007 population s has a very different pattern than the totals

Top 4 States

Warf's Rust Belt States

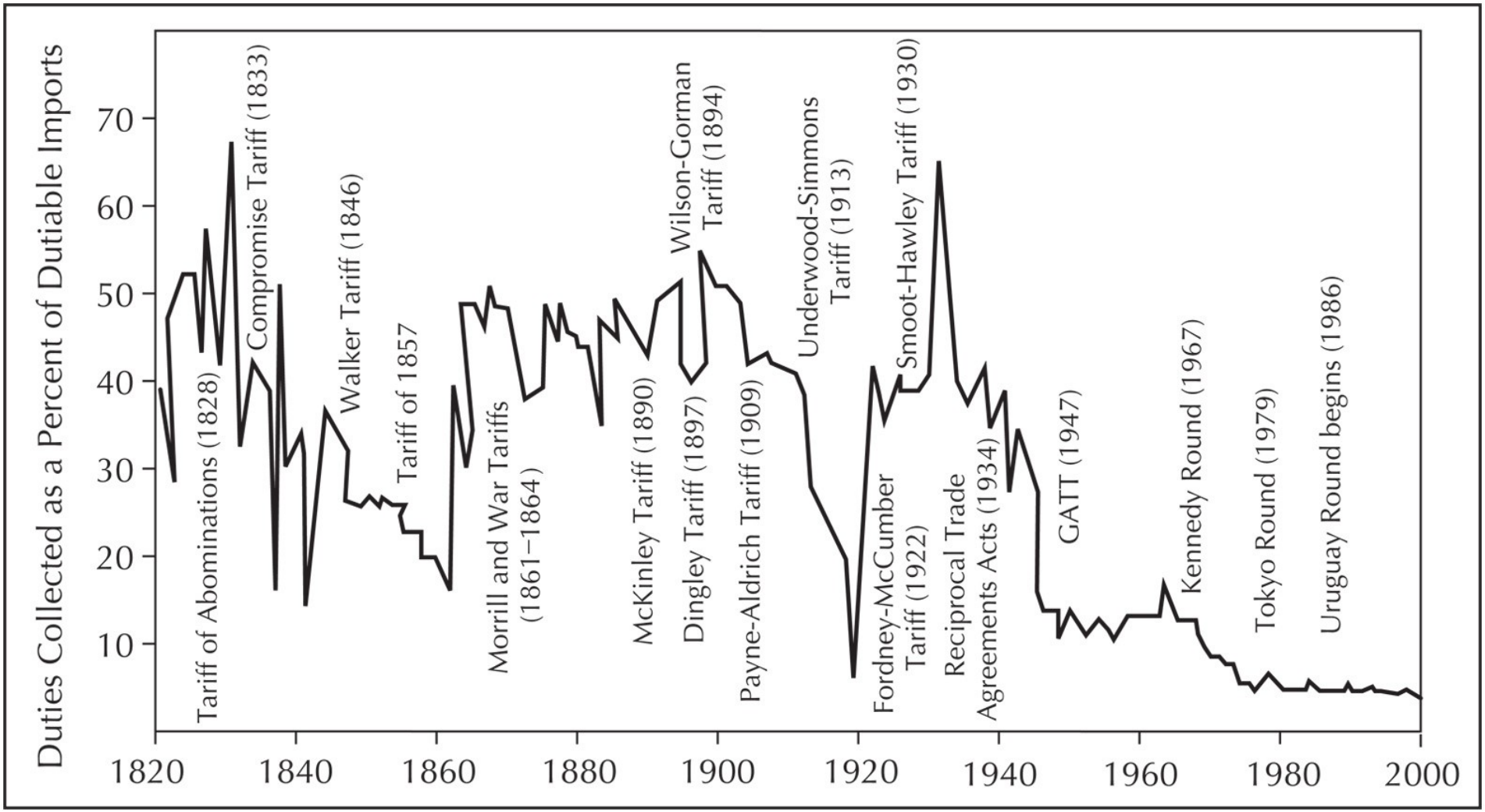
Effects of FDI on nations/regions

- The “right” – free marketeers
- The “left” – those critical of the “free-market”
- Is there really this polarity?
- The clear impact of the list on page 327-328
- The also powerful arguments regarding *dependency*
- *A practical view: unless global capitalism is somehow reigned in by forces that we do not currently recognize, these trends will continue*

Barriers to International Trade and Investment

- Trade offsets differences in factor endowments, and factor movements reduce these differences
- However, barriers exist:
  - Management (limited ambition, ignorance of opportunities, lack of skills, fear, inertia)
  - Distance (transport costs, and various fees, resulting in transfer costs/transfer pricing
  - Government (tariffs, nontariff barriers, protectionism / infant-industry arguments

The Long-Run Decline in Tariffs



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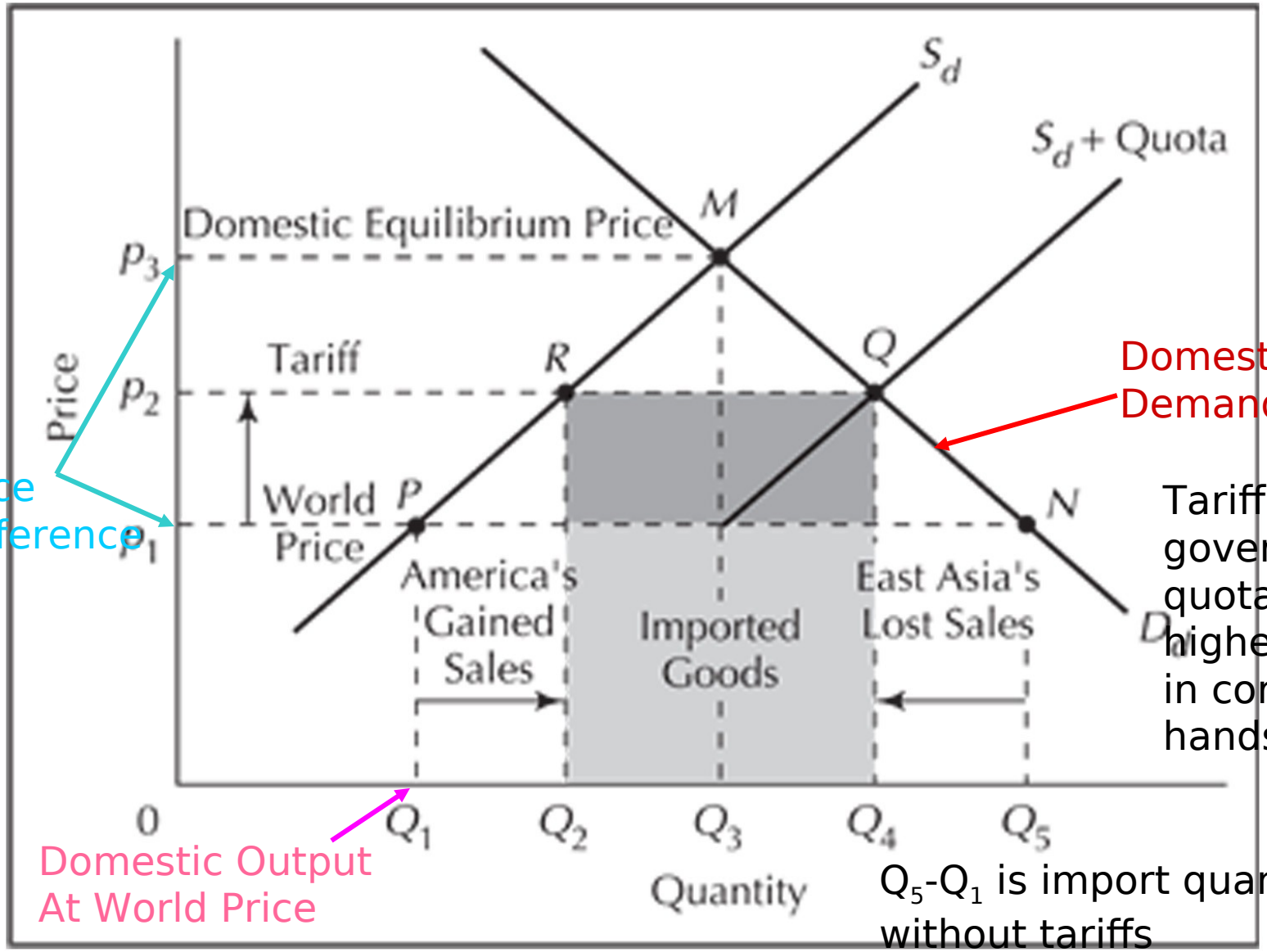
Tariffs, Quotas, and Nontariff Barriers

- Tariffs imposed on exports, imports, or in transit
- The rise of quotas – especially the use of export quotas
- Consequences of tariffs and quotas: protection of inefficient industry (Figure 12.19 – we will pick it apart)
- Government assistance to promote trade

The economic impact of tariffs and quotas



Price Difference

Domestic Demand

Tariff goes to government; quotas put higher spending in corporate hands

Domestic Output At World Price

Q_5-Q_1 is import quantity without tariffs

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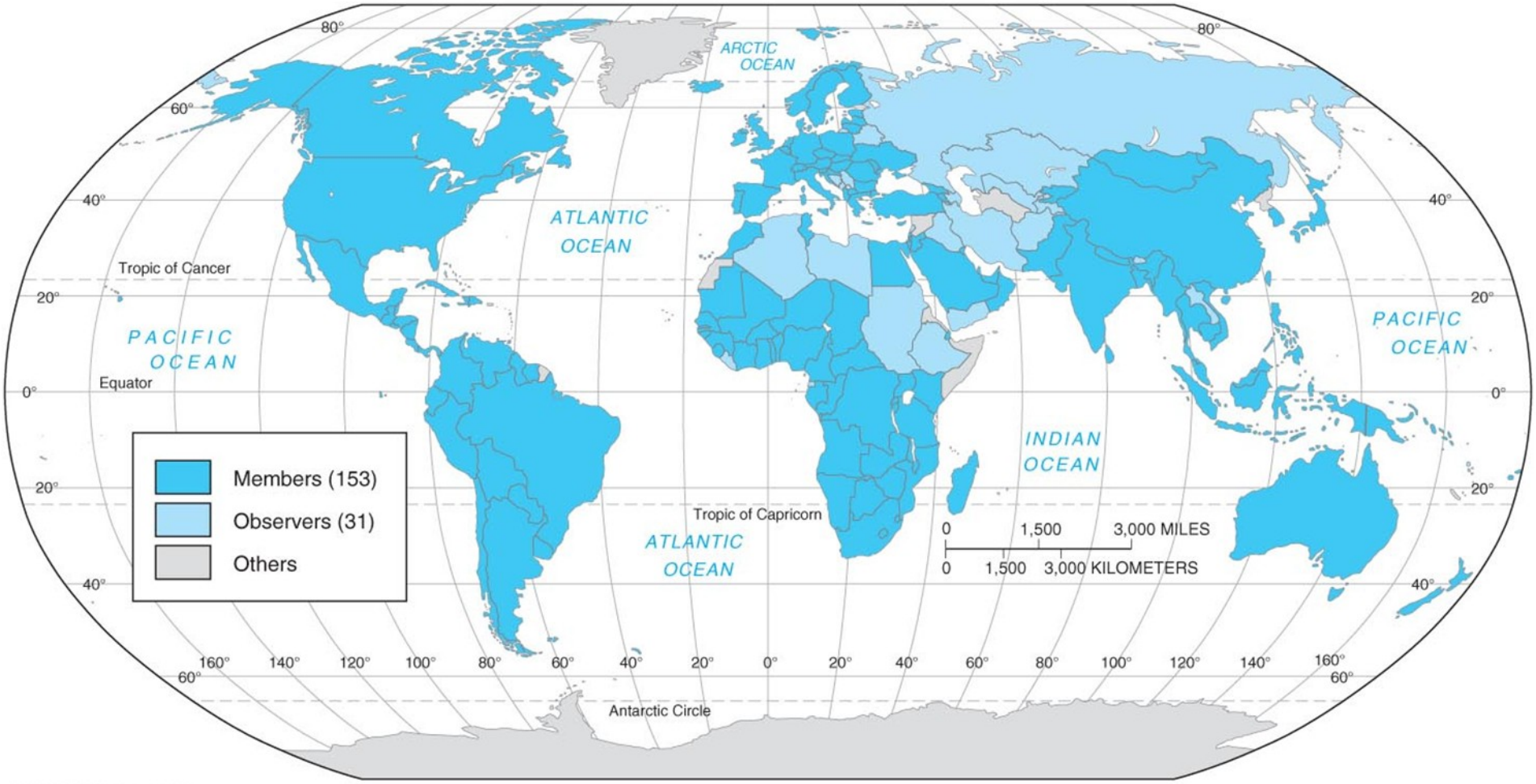
Reductions of Trade Barriers

- GATT – created in 1947 as a part of the Bretton Woods agreements that also established the IMF and the World Bank
- The ITO—a precursor to today's WTO was not ratified by the U.S. Congress, but GATT served as a basis for trade barrier reduction until 1986, when the WTO was created as a successor (over the 1986-1994 time period – the "Uruguay round")
- Key recent issues: trade in services, limits on foreign investment, establishing intellectual property rights, and agricultural policies (EU)

WTO Members and Observers



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Issues surrounding the WTO

- Third-party arbitration of trade conflicts (Boeing and Airbus)
- Judgments enforced through sanctions by other member governments
- Loss of sovereignty
- Lack of environmental protection standards
- Job losses in production systems manipulated by global corporations
- The 1999 “Battle in Seattle” & subsequent protests (including World Social Forum)

Other Trade Issues

- Government Barriers (exchange controls, capital controls)
- Multinational (Economic) Organizations:

  U.N (WHO, ILO), ASEAN, Asian Development Bank, NATO, OPEC, OECD, EU, IMF (short-term) & World Bank (long-term)
- Reactions against these “neoliberal” institutions

Regional Economic Integration

	Removal of trade restrictions between member states	Common external trade policy towards non-members	Free movement of factors of production between member states	Harmonisation of economic policies under supra-national control
Free Trade Area	*			
Customs Union	*	*		
Common Market	*	*	*	
Economic Union	*	*	*	*

Types of regional economic integration

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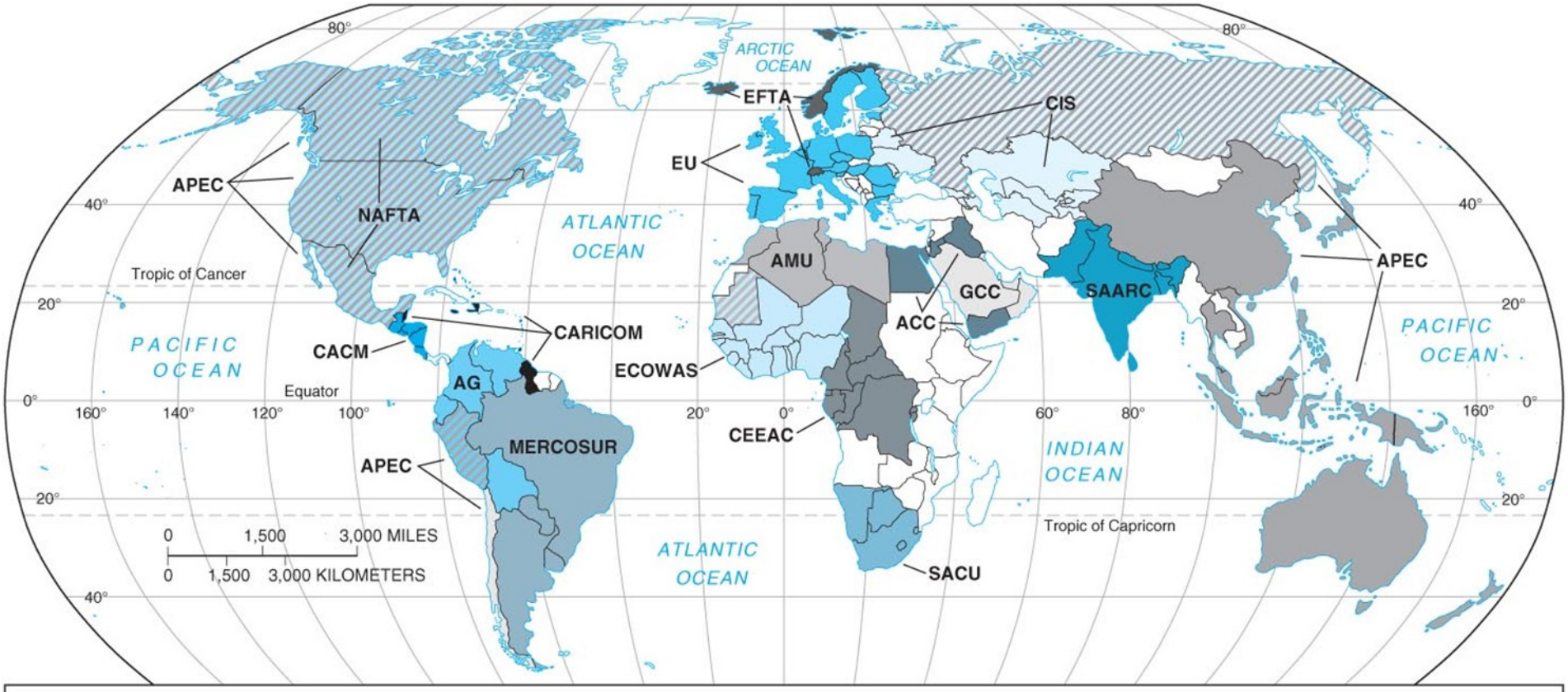

REGIONAL TRADE ORGANIZATIONS

- ACC-Arab Cooperation Council (dormant)
- AG-Andean Group
- AMU-Arab Maghreb Union
- APEC-Asia Pacific Economic Cooperation
- CACM-Central American Common Market (dormant)
- CARICOM-Caribbean Community and Common Market
- CEEAC-Economic Community of Central African States
- CIS-Commonwealth of Independent States
- EU-European Union
- ECOWAS-Economic Community of West African States
- EFTA-European Free Trade Association
- GCC-Gulf Cooperation Council
- MERCOSUR-Southern Cone Common Market
- NAFTA-North American Free Trade Agreement
- SAARC-South Asian Association for Regional Cooperation
- SACU-Southern African Customs Union

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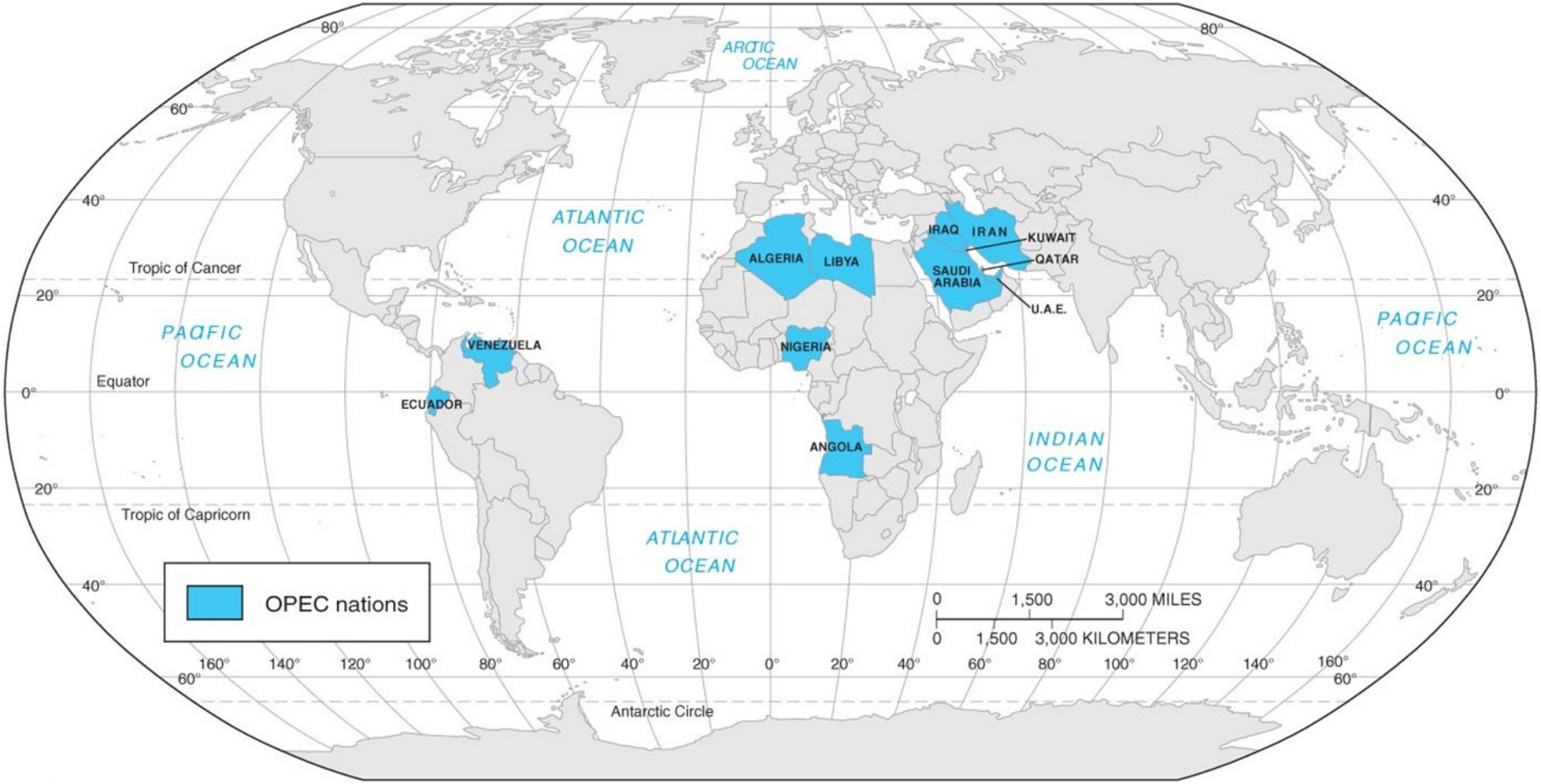
NAFTA

- Signed in 1992
- Argued to improve the comparative advantage of US, Canada and Mexico
- Impact has been negative on jobs in the U.S.; rise of the maquiladoras
- Canada has benefitted – especially its auto industry integrated with U.S. firms
- Challenges – timber from B.C. and the PNW
- The case study – paints a picture of modest impacts related to NAFTA

OPEC: The most successful cartel

Responsible for less than 50% of global crude oil production



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