Chapter 2

International trade situation and prospects

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Lecture overview

- Gravity model
- Trade situation in 2008 - 2009 – 2010 - 2011
- Trade prospects for 2012

Gravity model

- The gravity model postulates that, other things equal, the larger (and the more equal in size) and the closer the two countries are, the larger the volume of trade between them is expected to be.
- The volume of trade in goods increases with the size and decreases with proximity of trading partners.
- E.g:
  - Trade between Vietnam and China – Cambodia

Gravity model (cont.)

Country	Exports (billion USD)	Imports (billion USD)	Exports plus imports (billion USD)
Canada	212.2	293.3	505.5
Mexico	120.3	172.1	292.4
China	41.8	234.5	276.3
Japan	53.3	138.0	191.3
Germany	33.6	84.6	118.2
United Kingdom	376	50.5	88.1
South Korea	27.1	43.8	70.9
Taiwan	21.5	34.8	56.3
France	22.3	33.8	56.1
Italia	11.2	31.0	41.2

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Gravity model (cont.)

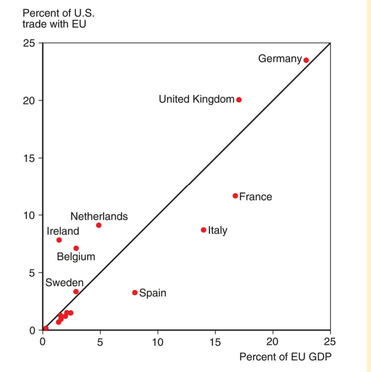
- 3 of the top 10 trading partners with the US in 2003 were also the 3 largest European economies: Germany, UK and France.
- Why does the US trade most with these European countries and not other European countries?
- These countries have the largest **gross domestic product (GDP)** in Europe.
  – GDP measures the value of goods and services produced in an economy.

Gravity model (cont.)

Figure 2-2

The Size of European Economies, and the Value of Their Trade with the United States

Source: U.S. Department of Commerce, European Commission.



Gravity model (cont.)

- In fact, the size of an economy is directly related to the volume of imports and exports.
  – Larger economies produce more goods and services, so they have more to sell in the export market.
  – Larger economies generate more income from the goods and services sold, so people are able to buy more imports.

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Gravity Model (cont.)

Other things besides size matter for trade:

1. *Distance* between markets influences transportation costs and therefore the cost of imports and exports.
   – Distance may also influence personal contact and communication, which may influence trade.
2. *Cultural affinity*: if two countries have cultural ties, it is likely that they also have strong economic ties.
3. *Geography*: ocean harbors and a lack of mountain barriers make transportation and trade easier.

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Gravity Model (cont.)

- In its basic form, the gravity model assumes that only size and distance are important for trade in the following way:

$$T_{ij} = A \times Y_i \times Y_j / D_{ij}$$

- where
  - T_{ij} is the value of trade between country *i* and country *j*
  - A is a constant
  - Y_i the GDP of country *i*
  - Y_j is the GDP of country *j*
  - D_{ij} is the distance between country *i* and country *j*

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Gravity Model (cont.)

- Perhaps surprisingly, the gravity model works fairly well in predicting actual trade flows, as the figure above representing US–EU trade flows suggested.
- Estimates of the effect of distance from the gravity model predict that a 1% increase in the distance between countries is associated with a decrease in the volume of trade of 0.7% to 1%.

TRADE SITUATION IN 2008 -2009 -2010-2011

World trade: an overview

World merchandise trade (Unit: billion USD)

Year	Export		Import	
	Value	% change	Value	% change
2008	15,775	15	16,120	16
2009	12,147	-23	12,385	-23
2010	14,855	22	15,050	21
2011	17,779	20	18,000	19

Source: WTO (2012) in World trade report, 2012

World trade: an overview

World trade in commercial services (Unit: Billion USD)

Year	Export		Import	
	Value	% change	Value	% change
2008	3,730	12	3470	13
2009	3,310	-11	3,115	-11
2010	3,665	10	3,505	10
2011	4,150	11	3,865	10

Source: WTO (2012) in World trade report, 2012

Who trade with whom? (cont.)

The 5 largest exporters and importers in merchandise trade

Year	Exporters	Importers
2008	Germany, China, US, Japan, Netherland	US, Germany, China, Japan, France, UK
2009	China, Germany, US, Japan, Netherland	US, China, Germany, France, Japan
2010	China, US, Germany, Japan, Netherland	US, China, Germany, Japan, France
2011	China, US, Germany, Japan, Netherland	US, China, Germany, Japan, France

Who trade with whom? (cont.)

The 5 largest exporters and importers in commercial services

Year	Exporters	Importers
2008	US, UK, Germany, France, Japan	US, Germany, UK, Japan, China
2009	US, UK, Germany, France, China	US, Germany, UK, China, Japan
2010	US, Germany, UK, China, France	US, Germany, China, UK, Japan
2011	US, UK, Germany, China, France	US, Germany, China, UK, Japan

Financial crisis

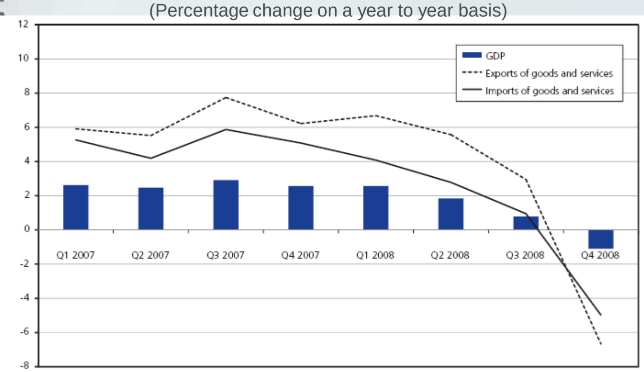
- Signs of a sharp deterioration in the global economy were evident in the second half of 2008 and the first few months of 2009
- Although the crisis began in the United States, it soon spread out.
- Financial institutions and economies throughout the developed and developing world have been severely affected.
- Disrupt the normal function of the baking systems
- Failing stock markets and housing prices
- Failing prices for oils and gas

Financial crisis

- 2008 : World trade flows sagged and production slumped, first in developed economies and then in developing countries.
- 2009: The slump in trade in 2009 was larger than most econometric models would have predicted given the size of the drop in GDP, and it was also larger than the decline predicted by the WTO in the early stages of the crisis.

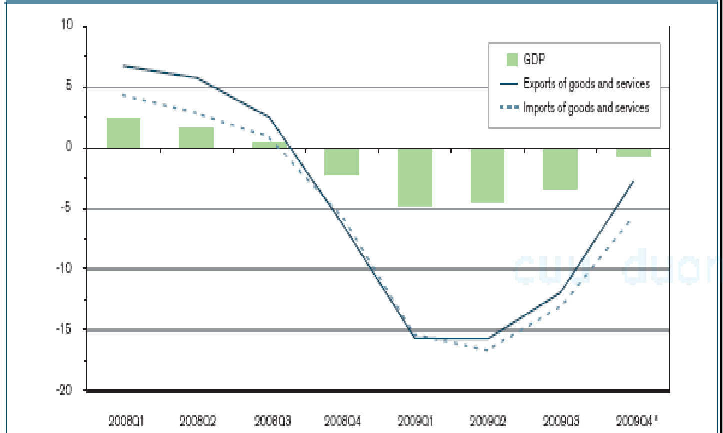
Real GDP and trade growth of OECD countries

Chart 1
Real GDP and trade growth of OECD countries, 2007-08
(Percentage change on a year to year basis)



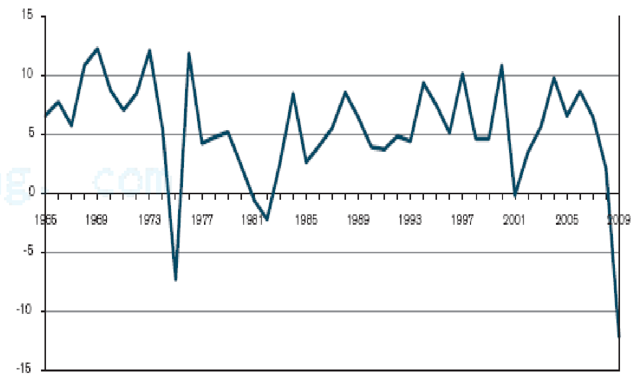
Source: WTO, 2009

Figure 4: **Real GDP and trade growth of OECD countries, 2008-09** (year-to-year percentage change)



ª Estimated based on available data.
Source: OECD Quarterly National Accounts.

Volume of world merchandise exports, 1965 - 2009



Source: WTO International Trade Statistics.

Table 1: **World trade in manufactured goods by product, 2008Q1-2009Q4**
(Year-to-year percentage change in current dollars)

	2008Q1	2008Q2	2008Q3	2008Q4	2009Q1	2009Q2	2009Q3	2009Q4	2009
Manufactures	16	18	13	-11	-28	-30	-22	0	-21
Iron and steel	15	27	43	4	-39	-56	-55	-31	-47
Chemicals	19	24	20	-7	-24	-25	-17	8	-15
Office and telecom equipment	10	13	7	-14	-29	-22	-15	8	-15
Automotive products	15	16	3	-26	-47	-46	-29	6	-32
Industrial machinery	21	22	15	-8	-29	-36	-32	-15	-29
Textiles	11	9	3	-13	-27	-27	-17	0	-19
Clothing	11	11	8	-2	-11	-15	-12	-6	-11

Source: WTO Secretariat estimates.

Financial crisis (cont.)

- Reasons for plummet in the world trade in 2009:
  – Sharp decline in global demand
  – Shortage of trade finance (L/C, pre-shipping, post – shipping, export credit…)
  – Increase in protection measures

Financial crisis (cont.)

- What did governments do to address the crisis?
  – Financial bail-outs
  – Monetary and fiscal policies: reduce interest rate (e.g: US)

World trade situation in 2008 - 2009

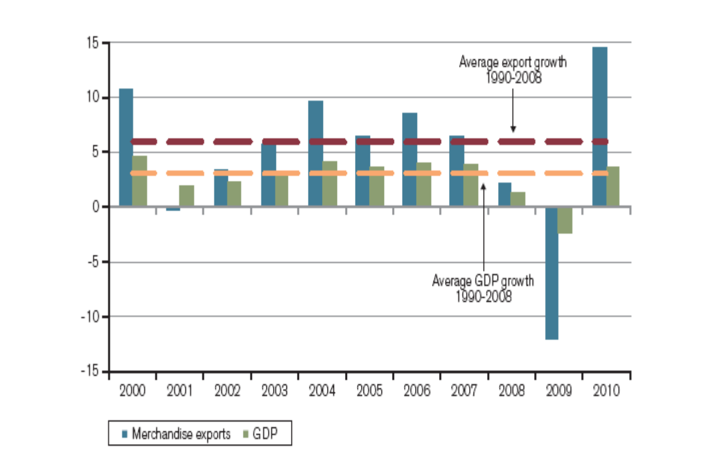
- The global financial crisis produced a global recession in 2009 that resulted in the largest decline in world trade in more than 70 years.

=> The world was experiencing a difficult time in history at the end of 2009

World trade in 2010

- Global trade flows *rebounded strongly in 2010* following their collapse in 2009.
- The *rise in the volume of goods exports in 2010 was the largest on record*, enabling world trade to return to its pre-crisis level but not its long term trend.
- *Economic conditions continued to improve* in both developed and developing economies, but the recovery of both trade and output proceeded *more slowly in developed countries*.

Figure 1: **Growth in volume of world merchandise trade and GDP, 2000-10** (Annual percentage change)



Source: WTO Secretariat.

World trade in 2010 (cont.)

- The record expansion of trade and the revival of economic activity in 2010 were certainly welcome developments, but *their importance should not be overstated.*
- Despite the rebound, the negative impact of the financial crisis and global recession *are likely to persist for some time.*
- Trade growth rates of the developing countries are higher than that of the developed nations.

World trade 2011

- The trade growth rate fluctuated:
  - The global trade value in Quarter 1 increases by 22% compared to the same Quarter in 2010
  - The global trade value in Quarter 1/2011 reached the record level since Quarter 2/2008 (before the financial crisis).
  - Beginning of Quarter 2: The global trade grows
  - Until the end of 2011: the global trade declines due to earthquake and tsunami in Japan and debt crisis in Europe.

WORLD TRADE PROSPECTS

- Some tendencies of the world development
- Impacts of those tendencies on the world trade

Some tendencies of the world development

- Cooperation for development and peace
  - The world has changed from confrontation to dialogue
  - Emergence of global issues
    - Economic issues
    - Political issues
    - Social issues
    - Environmental issues
  - Globalization
  - Even though conflicts, disputes exist
    - Terrorist, The US's policies

Some tendencies of the world development (cont.)

- Development of science and technology => Post Industrial Civilization
  - Revolution in science and technology has strongly developed
  - Agricultural civilization : 10.000 BC until the 18th century
  - Industrial civilization: the 18th century
  - ⇒ Very hard to improve productivity in the sense that high growth rate means higher exploitation of natural resources and environmental pollution.
  - Post industrial civilization with knowledge based economy.
    - New technology: informatics, telecommunication, ocean, universe…
  - Which civilization is Vietnam in?

Some tendencies of the world development (cont.)

- Development of TNCs
  - 75.000 TNCs worldwide in every fields of the world economy
  - Advantages of TNCs
    - Management skills
    - Science and Technology
    - Financial resources

Some tendencies of the world development (cont.)

- The Asia Pacific will become the new development center of the world
  - 5 big/strong economic – political forces
  - Most dynamic development

Impacts of world development trends on the world trade

- Boundaries between countries
- Global trademark
- E-commerce
- Changes in trade structure: oils, gas…
- Changes in competition: price vs non-price

Assignment

- Whole class:
  - Reading: Week 1 and Week 2 (see Syllabus)
- **Group 6: Presentation (20 - 25 minutes)**

Topic: Temporarily import for re-export in Vietnam

- **Other groups: comments and argues**

END OF CHAPTER 2