International Trade

Chapter 2:

INTERNATIONAL TRADE: AN OVERVIEW

MA. Nguyen Thi Minh Phuong
University of Economics and Busniess, VNU

MAIN CONTENTS

- Who trade with whom?: The Gravity model
- International trade situation

1 WHO TRADE WITH WHOM? THE GRAVITY MODEL

Who trade with whom?: The Gravity Model

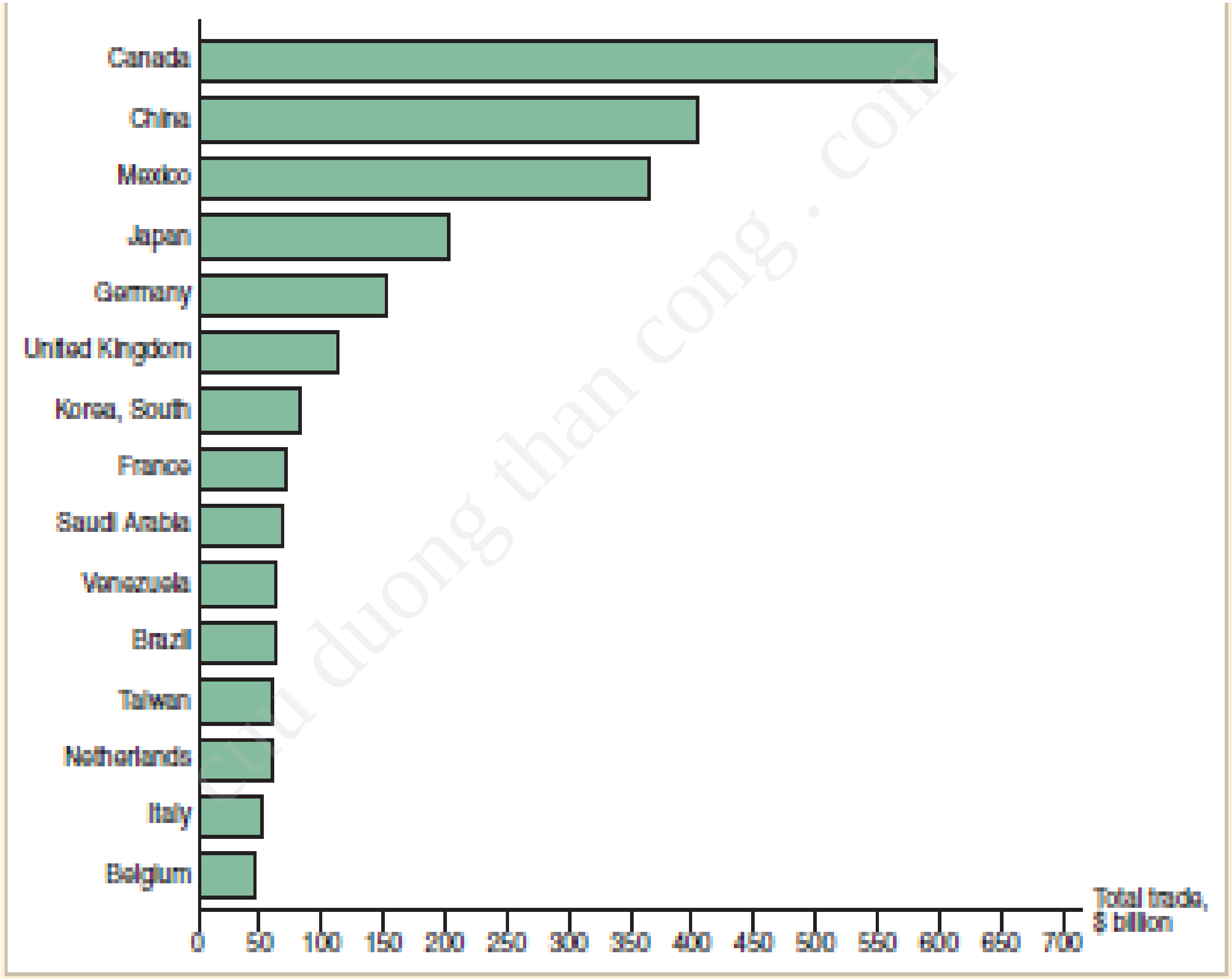


Figure 2.1. Total U.S. Trade with Major Partners, 2008

Source: U.S. Department of Commerce

Who trade with whom?: The Gravity Model

- 3 of the top 15 trading partners with the U.S were the three largest European economies (with highest GDPs): Germany, United Kingdom and France
- 3 of the top 15 trading partners with the U.S were also the three largest Asian economies: China, Japan, South Korea
- Many of the top 15 trading partners with the U.S were the U.S neighboring countries: Canada, Mexico, Brazil, Venezula

Why does the U.S. trade most with these countries and not other countries?

Who trade with whom?: The Gravity Model

Size and distance matter:

• 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.

• ***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.

Who trade with whom?: The Gravity Model

- The gravity model of world trade postulates that the value of trade between two countries is proportional, other things equal, to the economic size of the two countries (e.g. Their GDPs), and diminshes with the distance between the two countries.

- 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*

Who trade with whom?: The gravity model

- Perhaps surprisingly, the gravity model works fairly well in predicting actual trade flows, as the figure above representing US–EU trade flows suggested.

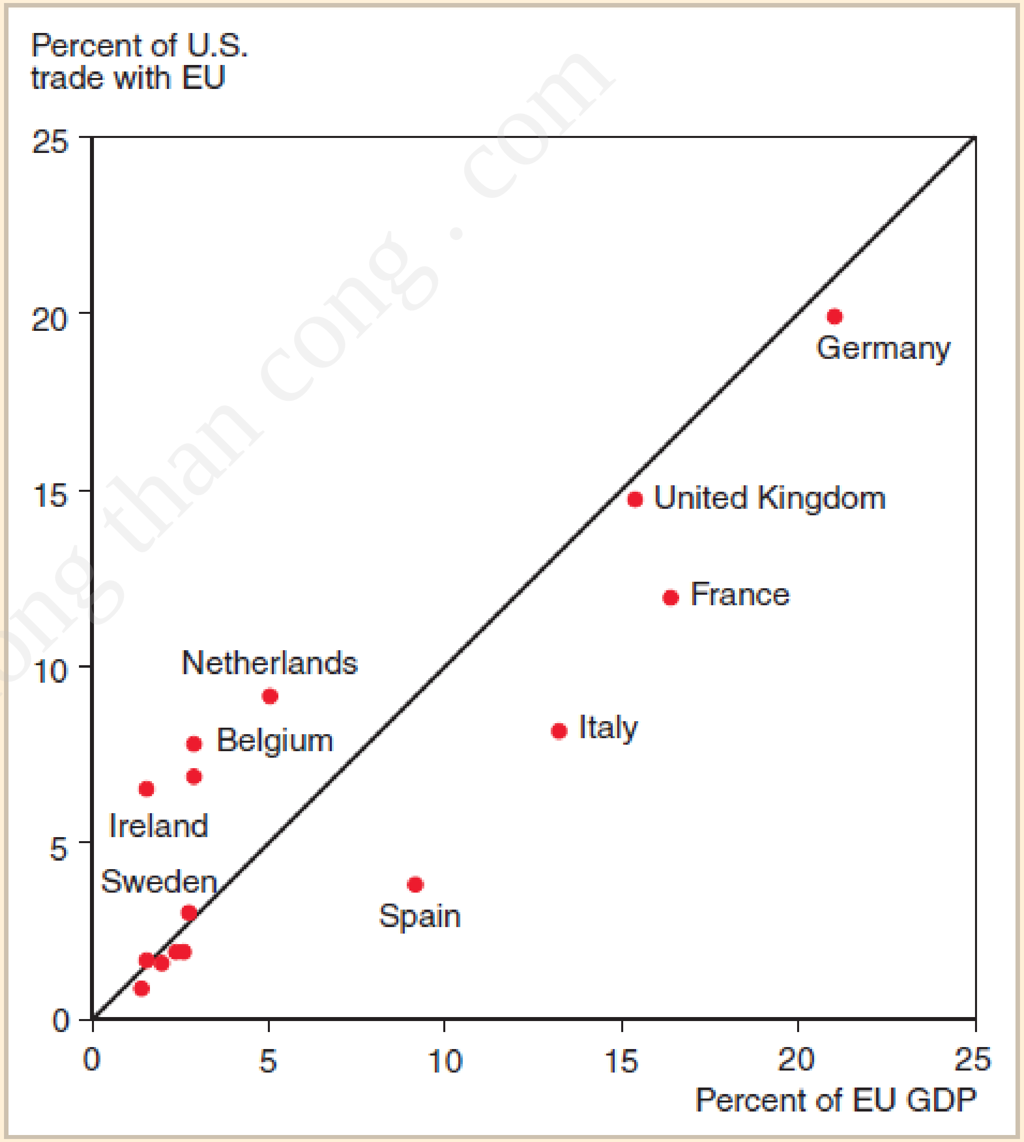
- Estimates of the effect of distance from the gravity model predict that a 1% increase in the distance between countries is associated with a decrease in the volume of trade of 0.7% to 1%.

Who trade with whom?: The Gravity Model

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.



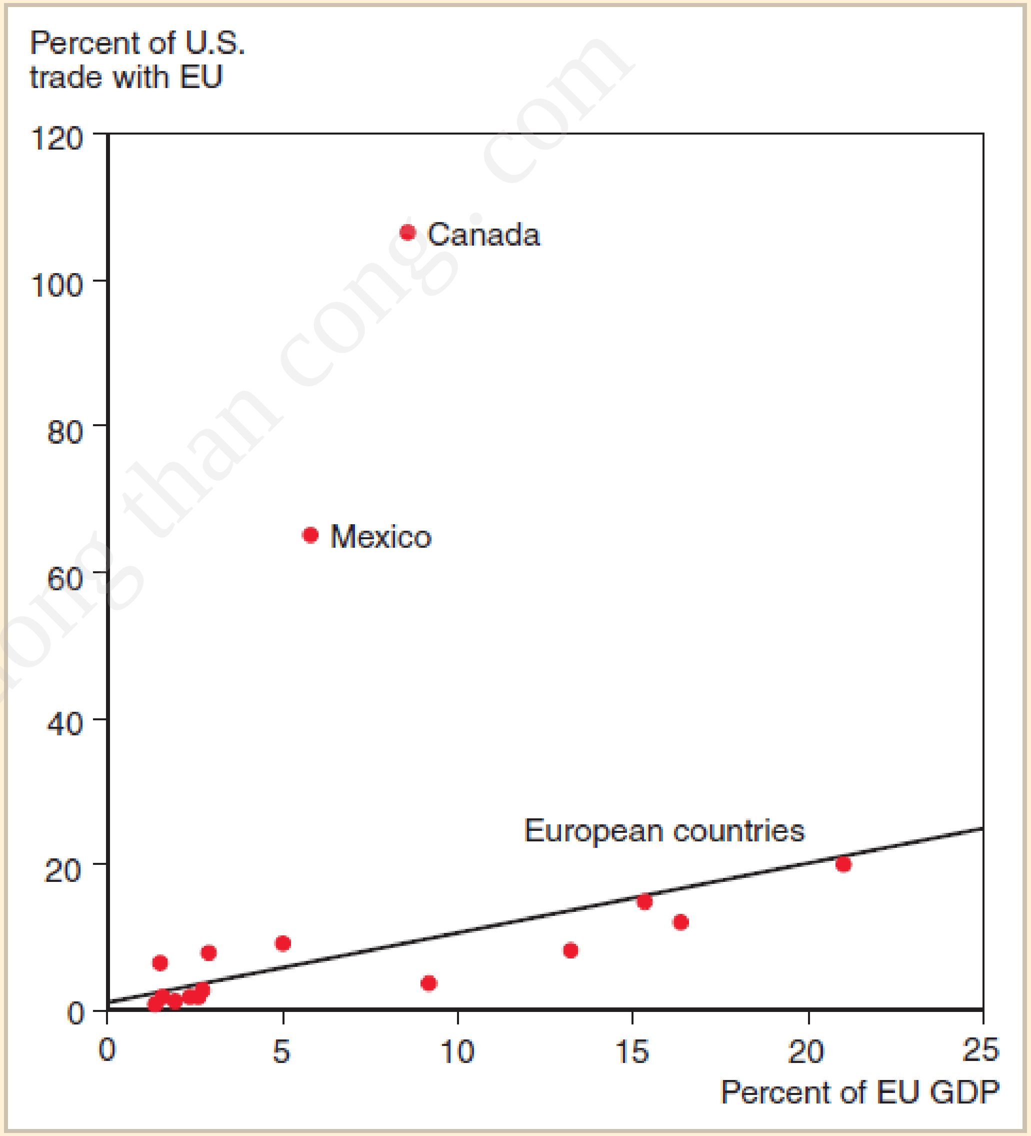
Who trade with whom?: The Gravity Model

Figure 2-3

Economic Size and Trade with the United States

The United States does markedly more trade with its neighbors than it does with European economies of the same size.

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



Who trade with whom?: The Gravity Model

Other things (besides size and distance) that matter for trade:

1. *Cultural affinity*: if two countries have cultural ties, it is likely that they also have strong economic ties.
2. *Geography*: ocean harbors and a lack of mountain barriers make transportation and trade easier.
3. *Trade agreements* between countries are intended to reduce the formalities and tariffs needed to cross borders, and therefore to increase trade.
4. *Political factors,* such as wars can damage international trade a lot.

2 INTERNATIONAL TRADE SITUATION

World trade's growth rate is higher than world GDP's growth rate before 2009

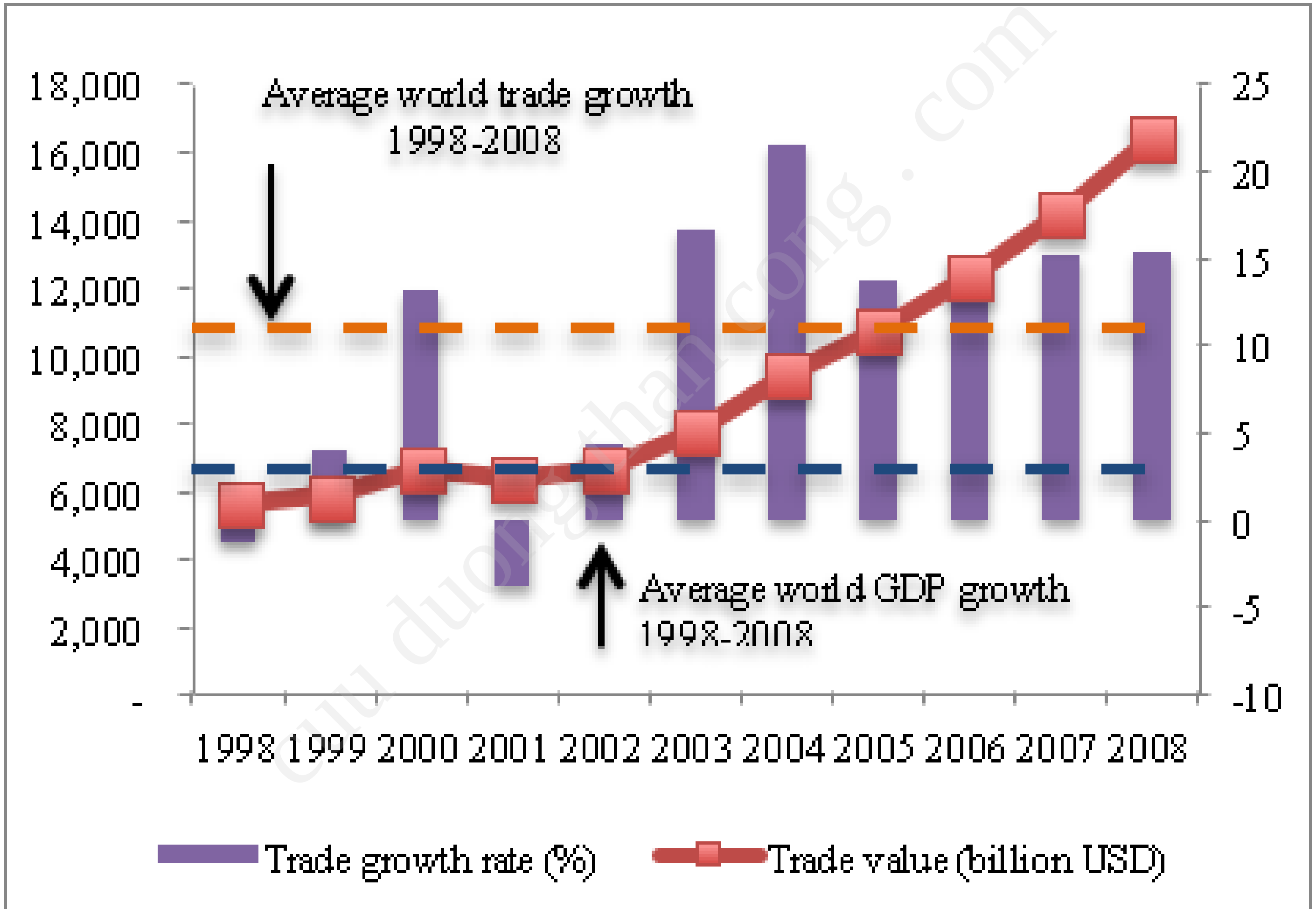


Figure 1: World trade and GDP, 1998-2008

Source: WTO (2017), IMF (2017)

From 2009 up to now, world trade's growth rate is much lower than world GDP's growth rate

After 2008: a dramatic slowdown in global trade growth

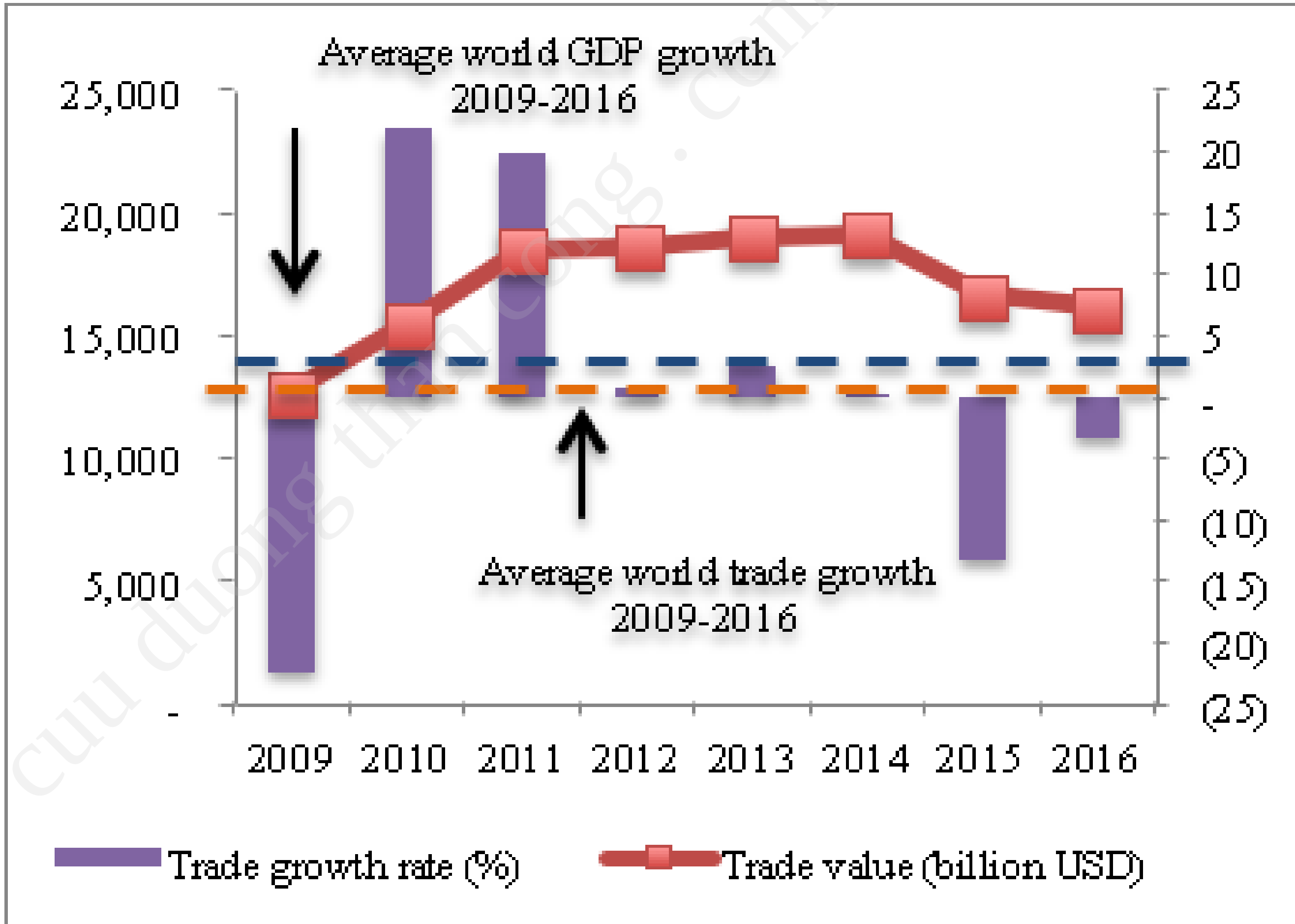


Figure 2: World trade and GDP, 2009-2016*

Source: Vu Thanh Huong (2017)

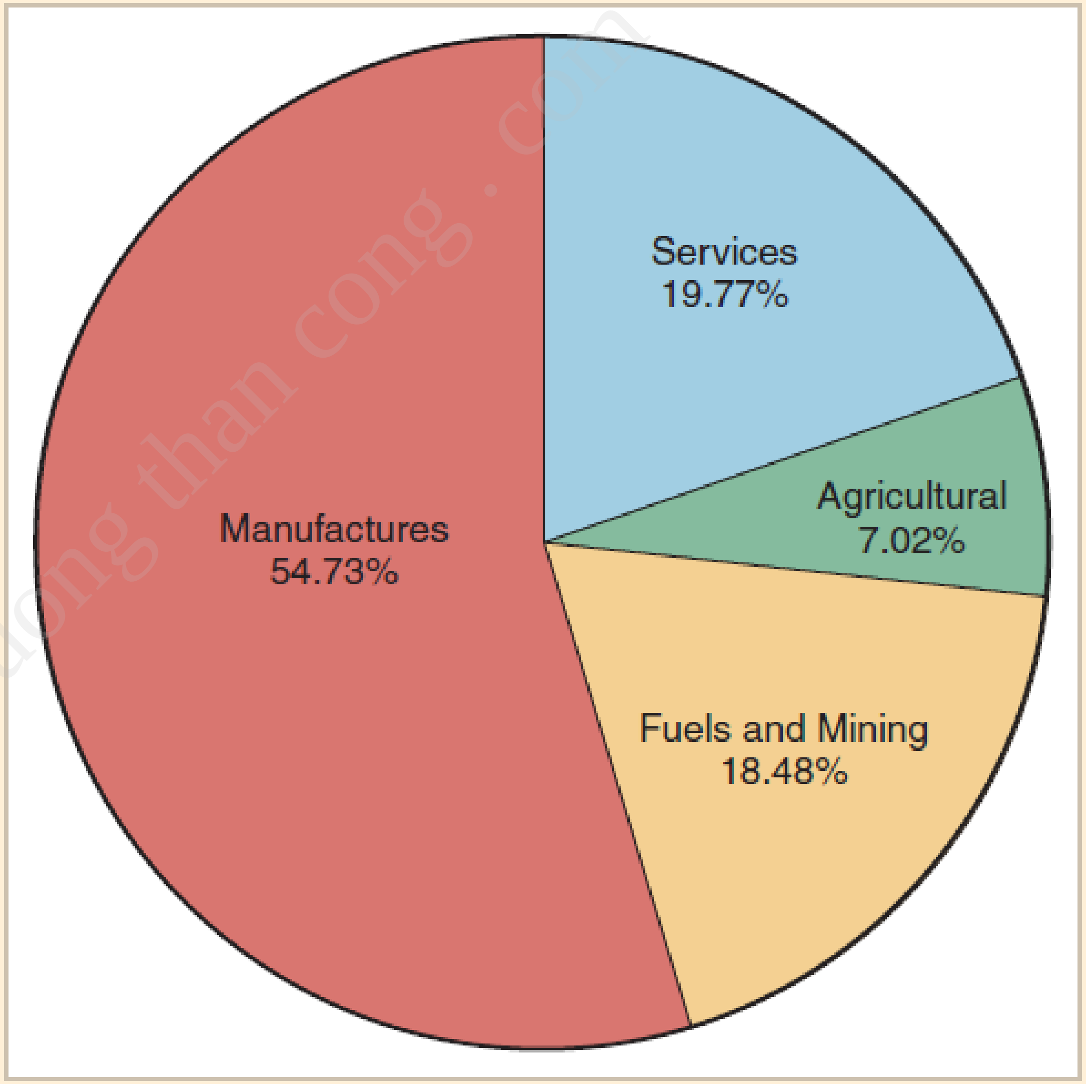
The changing pattern of world trade

Figure 2-5

The Composition of World Trade, 2008

Most world trade is in manufactured goods, but minerals—mainly oil—remain important.

Source: World Trade Organization.



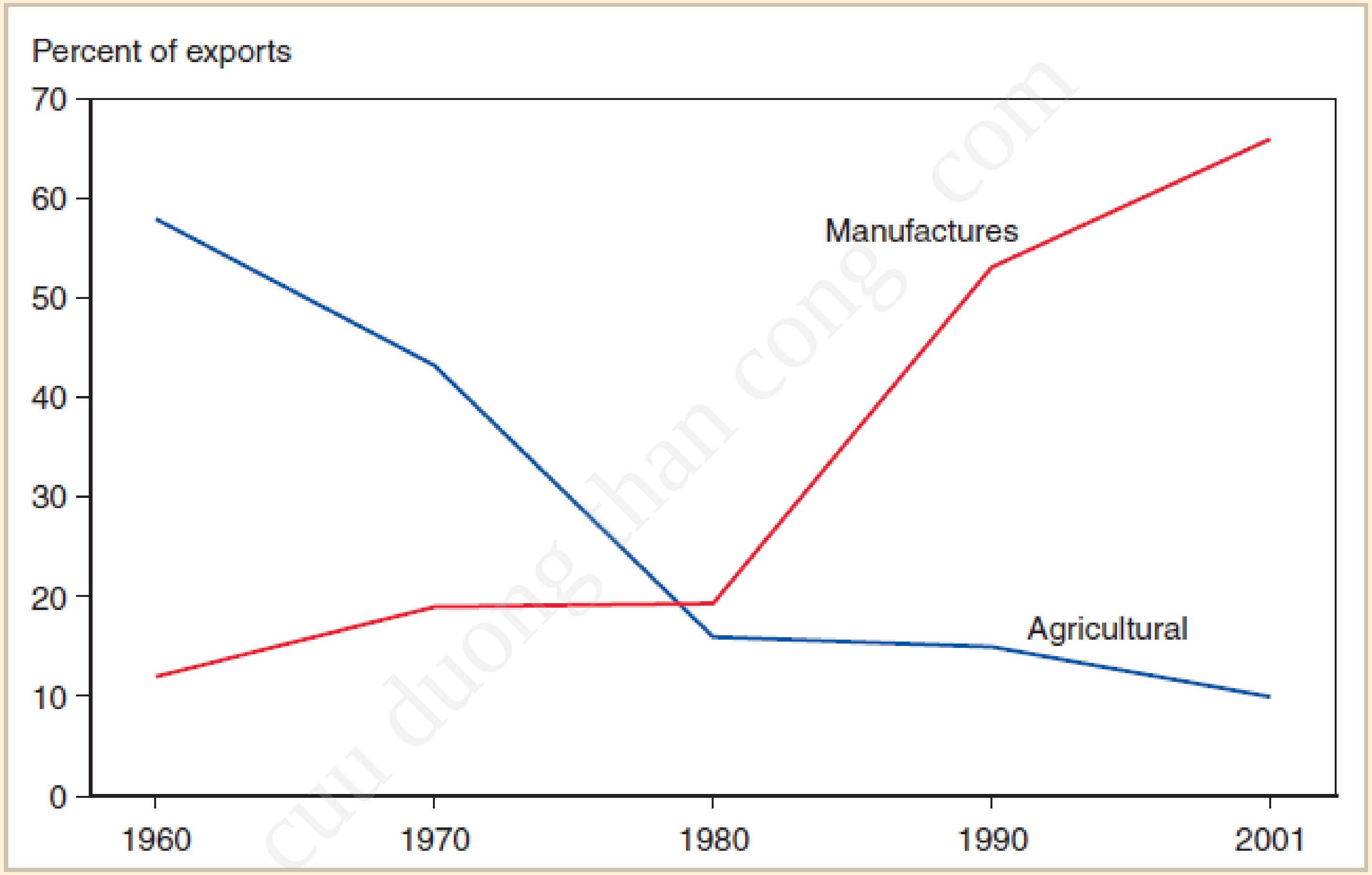


Figure 2-6

The Changing Composition of Developing-Country Exports

Over the past 50 years, the exports of developing countries have shifted toward manufactures.

Increasing importance of developing countries in world trade

Table 3: Share of selected economies in world merchandise exports in 2009 and 2016 (Unit: %)

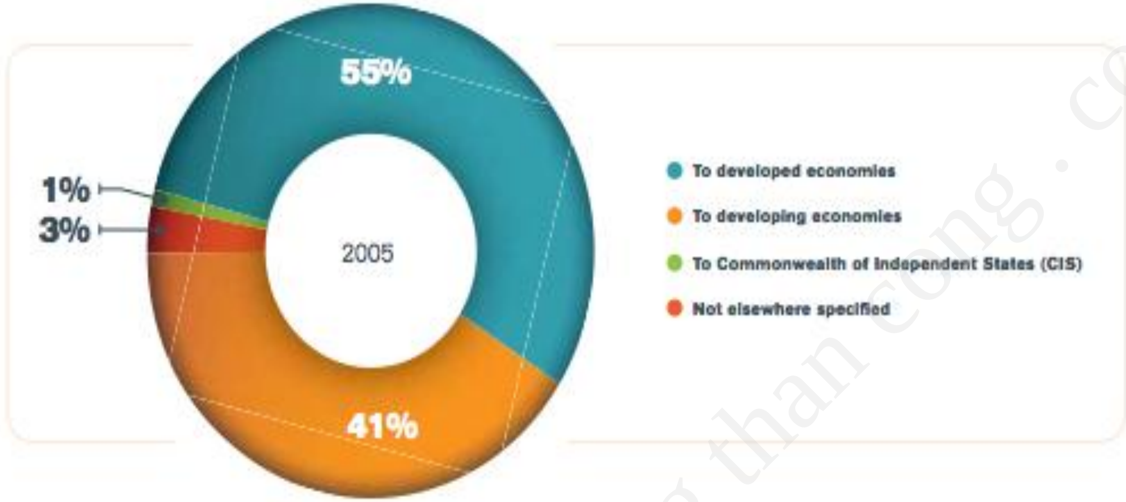
Year	2009	2016
Developed countries	**61.04**	**57.70**
EU	36.74	33.67
US	8.41	9.16
Japan	4.62	4.04
Developing and least developed countries	**38.6**	**42.3**
China	9.57	13.15

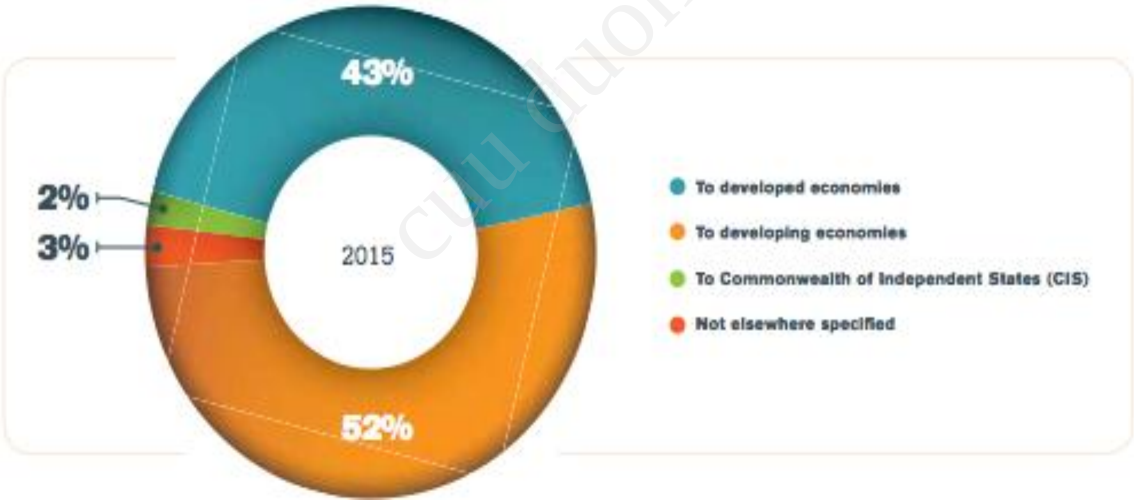
Table 4: Share of selected economies in world merchandise imports in 2009 and 2016 (Unit: %)

Year	2009	2016
Developed countries	**58.98**	**55.49**
EU	37.62	32.85
US	12.56	13.87
Japan	4.32	3.74
Developing and least developed countries	**41.02**	**44.51**
China	7.88	9.78

Source: Vu Thanh Huong (2017)

Increasing importance of developing countries in world trade





- South-South trade: increased from 41% (2005) to 52% in the last 10 years (2015)

Prospects

- Lower growth rate
- E-commerce
- Trade in services
- Increasing role of China

END OF CHAPTER 2