Public Affairs 856
Trade, Competition, and Governance in a Global Economy

Lecture 1

1/18/2017

Instructor: Prof. Menzie Chinn
UW Madison

Spring 2017

Administrative Issues

- Course website: http://www.ssc.wisc.edu/~mchinn/web856_s17.html
- OH: MW 1-2, 7418 Soc Sci
- Textbook: Feenstra/Taylor, *International Trade*
- Additional Readings: from CRS, CBO, web, Econbrowser
- *NYT*, *FT*, *WSJ*, *Economist*

Administrative Issues

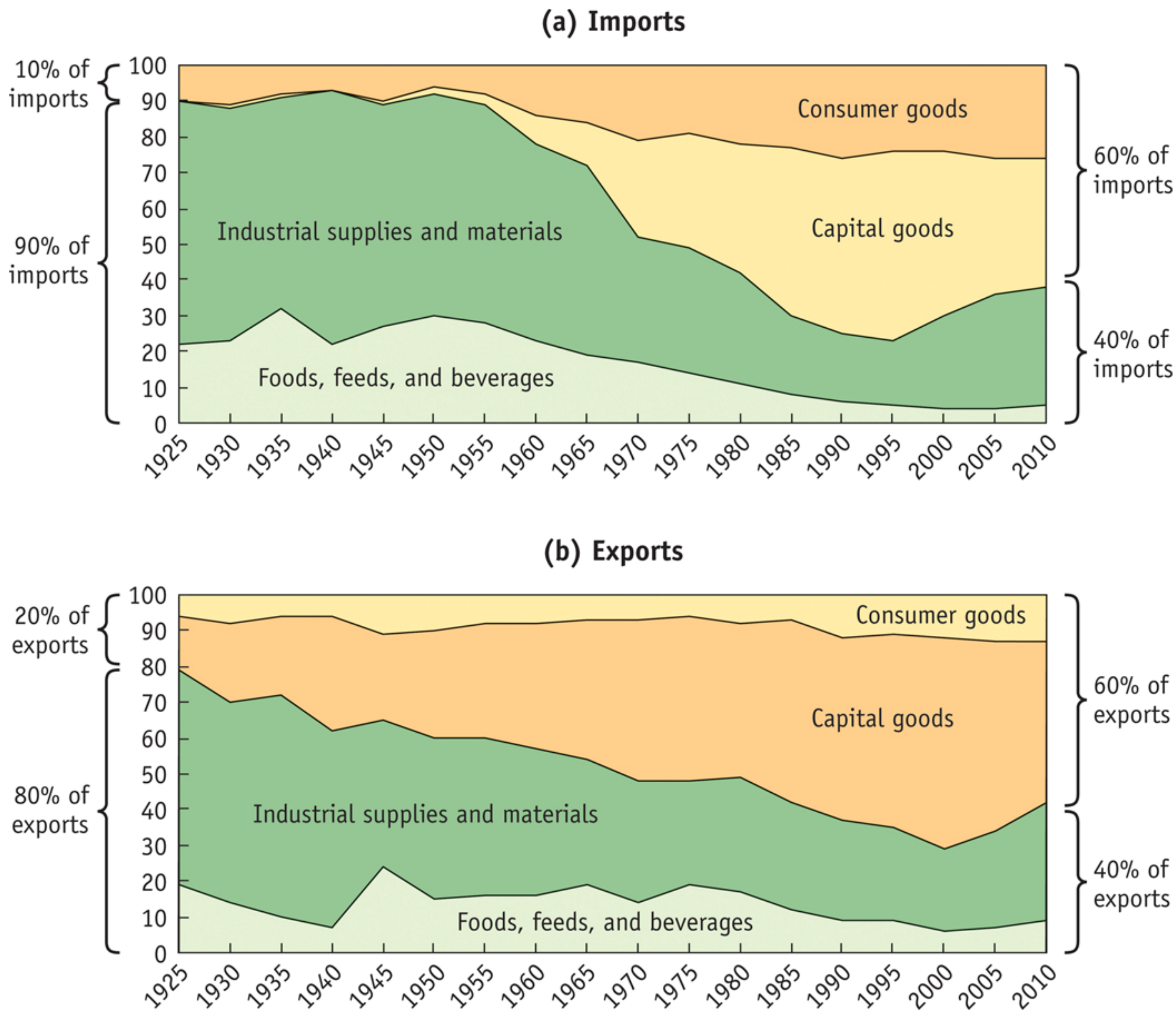
- Grading: 10% PS, 50% 2 × MT, 40% paper
- Dates:

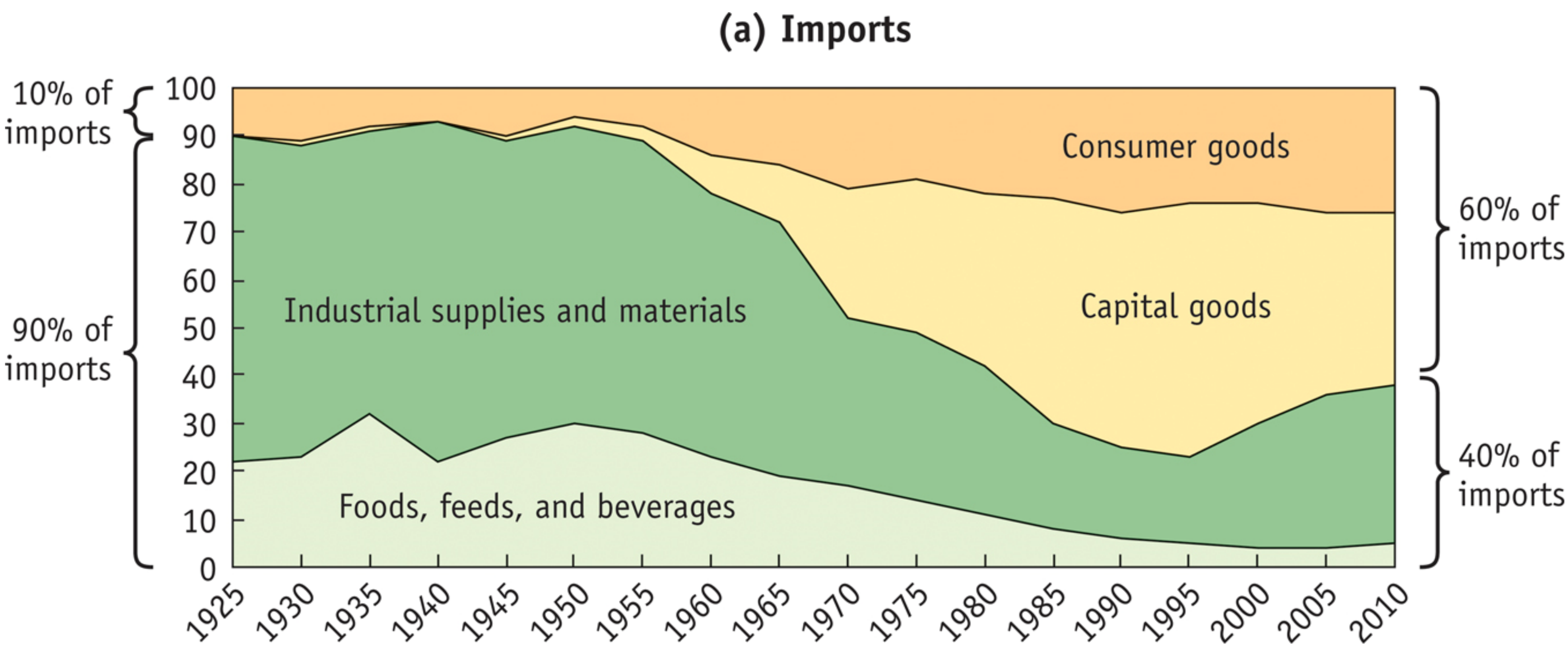
  - MT on 3/1, 4/19

  - **Paper due on Thu, 5/4**
- Make-ups: **None**. Points are re-allocated *if* you have a legitimate excuse. **No** late assignments accepted (must be handed in during lecture)

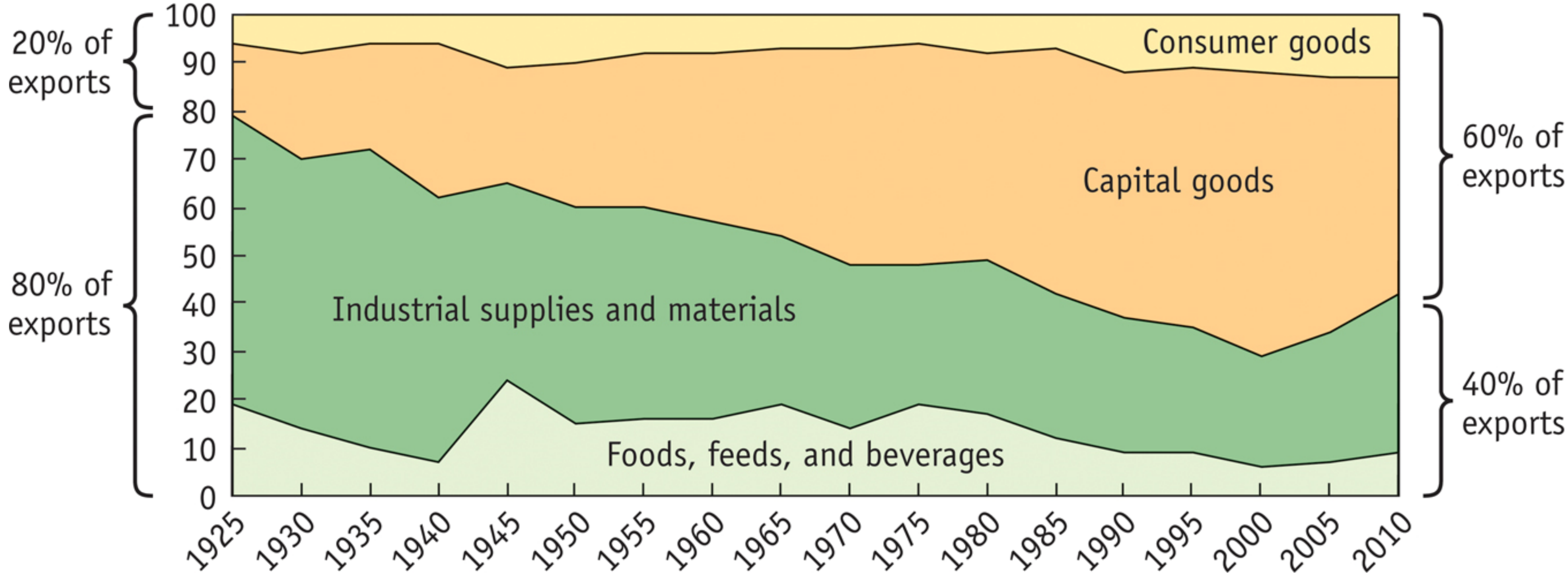
Issues

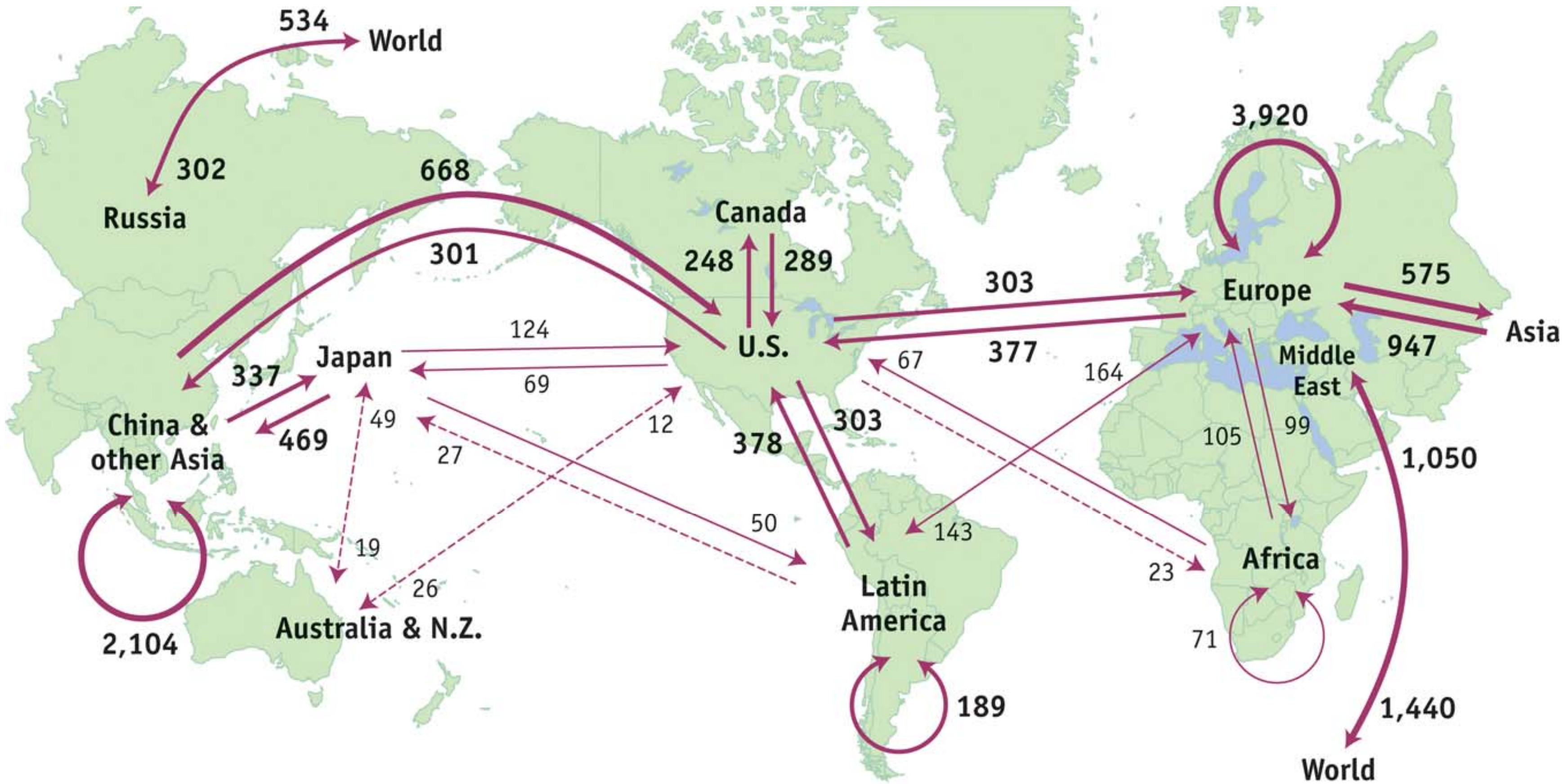
- The theory remains the same, but the context differs
- The post-war consensus for continued liberalization is gone
- Instead, liberalization is in reverse: Brexit and Trump (Nafta/TPP/China)
- Empirics have changed as well: impact of China on US manufacturing


(a) Imports
10% of imports
90% of imports
Consumer goods
Capital goods
Industrial supplies and materials
Foods, feeds, and beverages
60% of imports
40% of imports
100
90
80
70
60
50
40
30
20
10
0
1925
1930
1935
1940
1945
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010
(b) Exports
20% of exports
80% of exports
Consumer goods
Capital goods
Industrial supplies and materials
Foods, feeds, and beverages
60% of exports
40% of exports
100
90
80
70
60
50
40
30
20
10
0
1925
1930
1935
1940
1945
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010


(a) Imports
10% of imports
90% of imports
60% of imports
40% of imports
Consumer goods
Capital goods
Industrial supplies and materials
Foods, feeds, and beverages
100
90
80
70
60
50
40
30
20
10
0
1925
1930
1935
1940
1945
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010

(b) Exports


20% of exports
80% of exports
60% of exports
40% of exports
Consumer goods
Capital goods
Industrial supplies and materials
Foods, feeds, and beverages
100
90
80
70
60
50
40
30
20
10
0
1925
1930
1935
1940
1945
1950
1955
1960
1965
1970
1975
1980
1985
1990
1995
2000
2005
2010



Total world trade flows in 2010: $16,800 billion

World Trade in Goods

< $50 billion
$50–150 billion
$150–500 billion
> $500 billion

	Share of World Trade (%)		Share of World Trade (%)
Europe (internal trade)	23	Asia (exports)	34
Europe (internal) plus trade with the U.S.	27	Middle East and Russia (exports)	12
Americas (internal trade)	8	Africa (exports)	2
Europe and the Americas (exports)	51	Australia and New Zealand (exports)	1.6

Country	Trade/GDP (%)	GDP ($ billion)
Hong Kong (China)	216	229
Singapore	193	213
Malaysia	85	247
Hungary	83	129
Thailand	68	319
Austria	52	377
Denmark	48	313
Sweden	46	463
Switzerland	46	552
Germany	44	3,284
Norway	35	418
United Kingdom	32	2,256
Mexico	31	1,035
Canada	30	1,577
China	29	5,931
Spain	28	1,380
Italy	28	2,044
South Africa	27	364
Greece	27	292
France	27	2,549
Russian Federation	26	1,488
India	25	1,684
Turkey	24	731
Indonesia	24	708
Venezuela	23	394
Argentina	20	369
Pakistan	17	176
Japan	15	5,488
United States	15	14,419
Brazil	11	2,143

Barriers to Trade

- **Trade barriers** refer to all factors that influence the amount of goods and services shipped across international borders.
- Barriers to trade change over time as policies, technology, etc. change.
- Figure 1.3 shows the ratio of trade in goods and services to GDP for a selection of countries over time.
- We can look at important events that have affected trade.

Barriers to Trade

- The First "Golden Age" of Trade
  - 1890–1913
  - Ended with the beginning of WWI
  - Significant improvements in transportation
    - Steamship and railroad
  - U.K. had highest ratio of trade to GDP at 30%

Barriers to Trade

- Inter-War Period
  - 1913–1920 showed decreases in trade for Europe and Australia due to WWI and aftermath.
  - After 1920 the ratio fell in all other countries and was made worse by the Great Depression which began in 1929.
  - U.S. adopted high tariffs—Smoot-Hawley tariffs—in June 1930, some as high as 60%.

Barriers to Trade

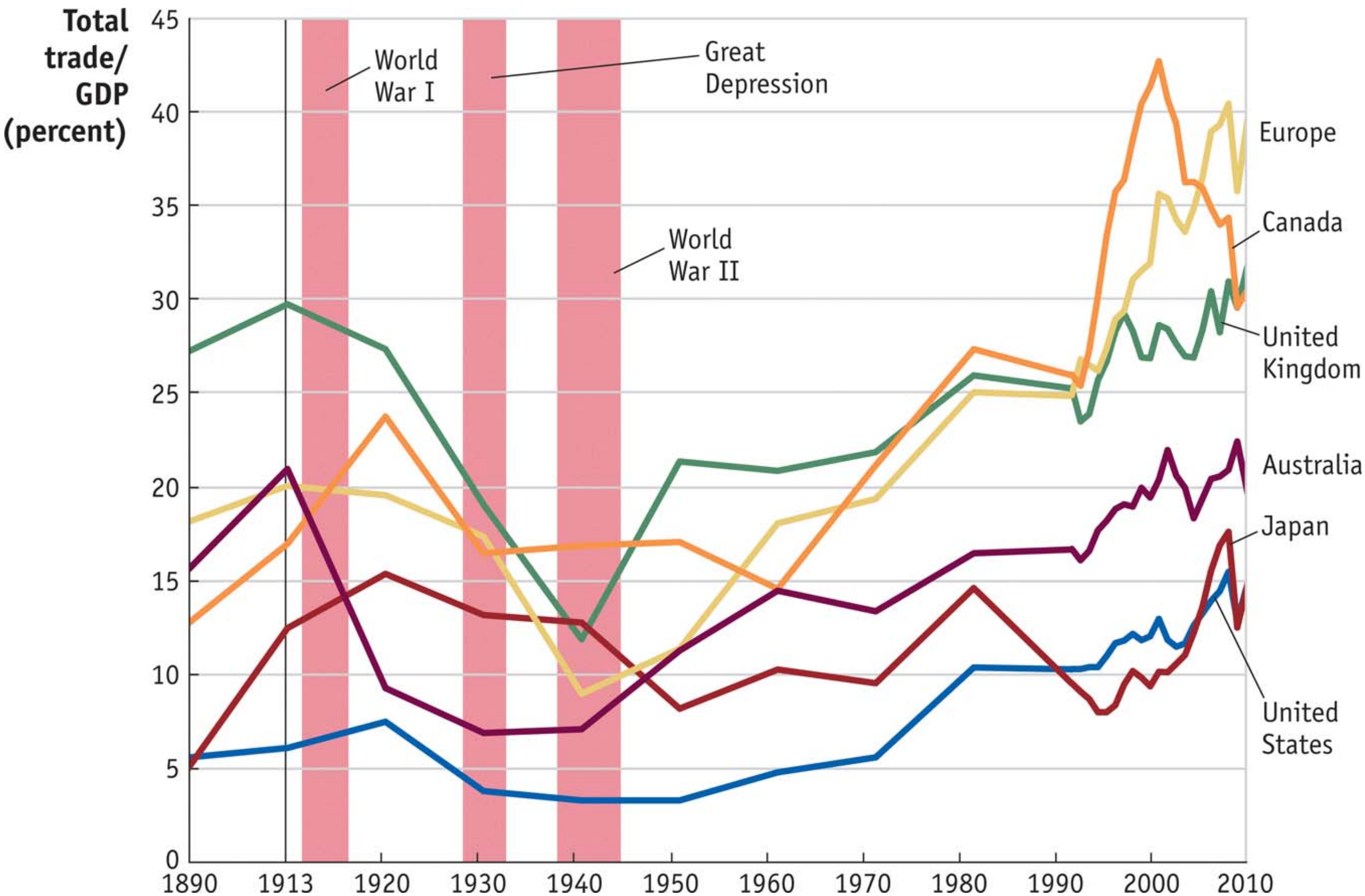
- Inter-War Period
  - Tariffs backfired as other countries retaliated—the average world-wide tariff rate rose to 25% by 1933.
  - **Import quotas**—limitations on the quantity of an imported good—were also instituted during this time.
  - High tariffs and restrictions lead to a dramatic fall in world trade with large costs to the U.S. and the world economy.

Barriers to Trade

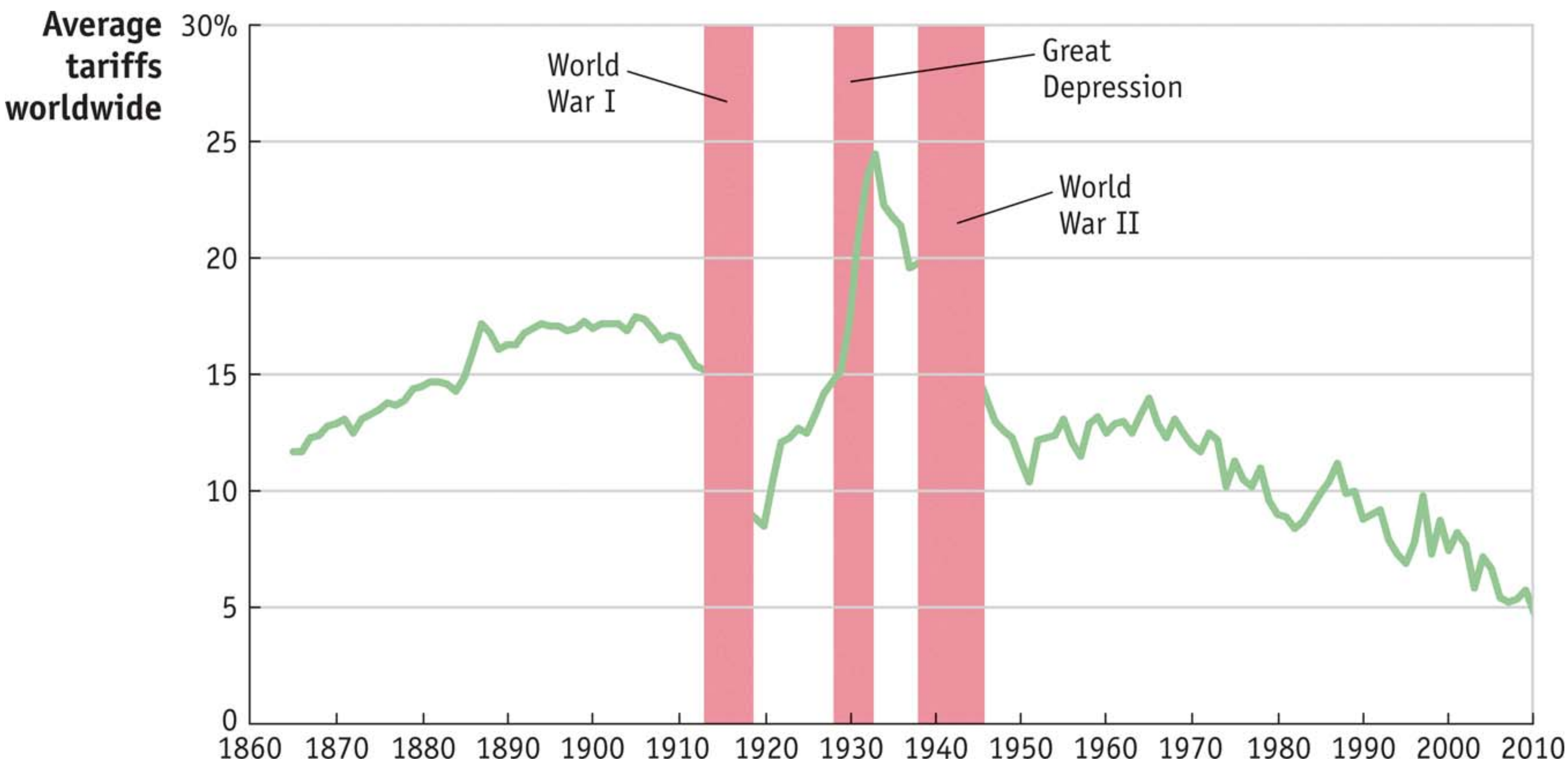
- Inter-War Period
  - This decline in the world economy lead the Allied countries to meet after WWII to develop policies to keep tariffs low.
    - General Agreement on Tariffs and Trade (GATT) which became the World Trade Organization (WTO)
  - Chapters 8–11 look at trade policies and the international institutions that govern their use.
  - Conclusion—high tariffs reduce the amount of trade and impose large costs on countries involved.

Barriers to Trade

- Second "Golden Age" of Trade
  - After WWII, some countries were able to increase trade back to WWI levels quickly.
  - The end of WWII, the reduction of tariffs from GATT, and improved transportation contributed to the increase in trade.
    - Shipping container was invented in 1956.
  - World trade grew steadily after 1950 with many countries exceeding their pre-WWI trade peak.



Robert C. Feenstra and Alan M. Taylor
International Trade, *Third Edition* / International Economics, *Third Edition*

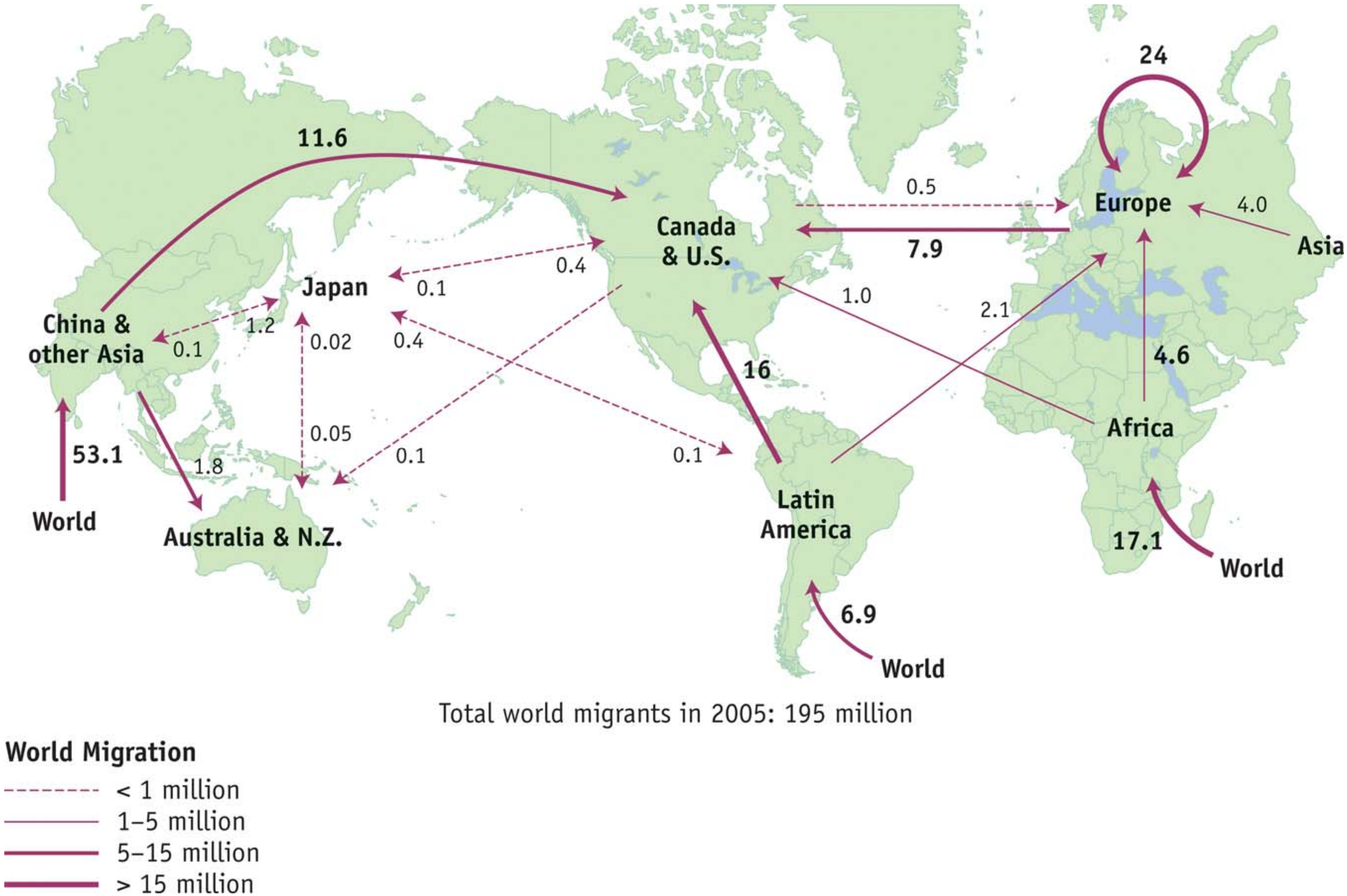

Average tariffs worldwide
30%
25
20
15
10
5
0
World War I
Great Depression
World War II
1860
1870
1880
1890
1900
1910
1920
1930
1940
1950
1960
1970
1980
1990
2000
2010

Migration and Foreign Direct Investment

- International trade, migration, and foreign direct investment (FDI) all affect the economy of a nation that opens its borders to interact with other nations.
- Now that we have introduced international trade, we need to introduce migration and FDI.

Map of Migration

- Figure 1.5 shows a map of the number of migrants around the world.
- Values shown are number of persons in 2000 who were living (legally or illegally) in a country different from where they were born.
- Two sources of data are used
- The bolder the line, the more migrants

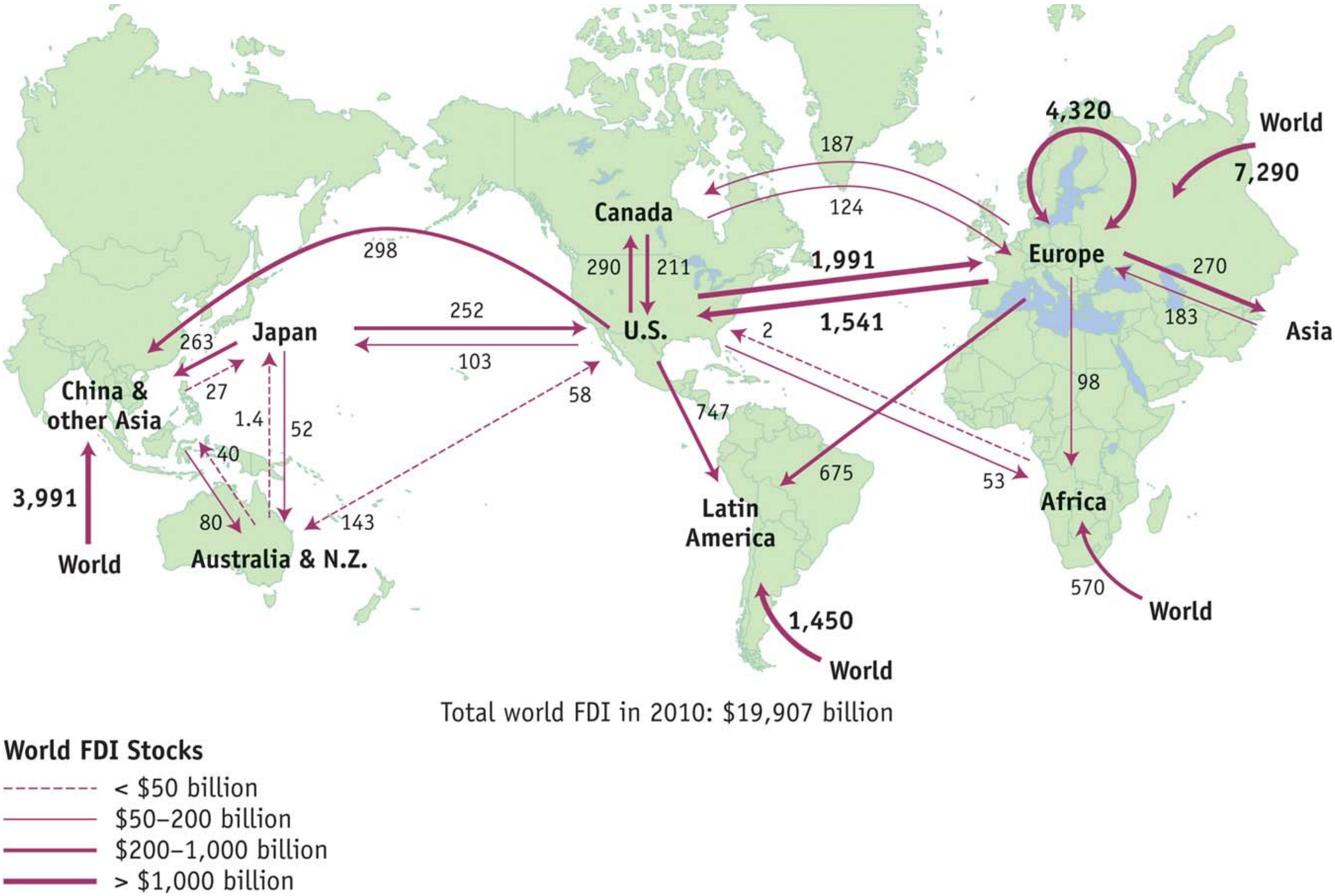

11.6
24
0.5
Europe
4.0
Canada & U.S.
7.9
Asia
0.4
Japan
0.1
1.0
2.1
China & other Asia
1.2
0.1
0.02
0.4
4.6
16
Africa
0.05
53.1
1.8
0.1
0.1
Latin America
World
Australia & N.Z.
17.1
World
6.9
World
Total world migrants in 2005: 195 million
World Migration
< 1 million
1–5 million
5–15 million
> 15 million

Map of Migration

- However, international trade can act as a substitute for movements of capital and labor across borders.
  - Trade can raise the living standard of workers in the same way that moving to a higher-wage country can.
  - As trade has increased worldwide, more workers are able to work in export industries.
    - This allows them to benefit from trade without moving to another country.

Map of Foreign Direct Investment

- FDI occurs when a firm in one country owns a company in another country.
- Figure 1.6 shows the principal flows of FDI in 2000.
  - Again, thicker lines indicate higher levels of FDI.
- In 2000 there were FDI flows of $1.3 trillion into or out of OEDC countries.
- This value is more than 90% of total world FDI.


World
4,320
7,290
187
124
Canada
Europe
298
290
211
1,991
270
252
1,541
183
Japan
U.S.
2
Asia
263
103
China &
other Asia
27
58
98
747
1.4
52
40
675
53
3,991
80
143
Africa
Latin
America
World
Australia & N.Z.
570
World
1,450
World
Total world FDI in 2010: $19,907 billion
World FDI Stocks
< $50 billion
$50–200 billion
$200–1,000 billion
> $1,000 billion

Map of Foreign Direct Investment

- Unlike migration, most FDI occurs between OECD countries.
- Two ways FDI can occur
  - Horizontal FDI occurs when a firm from one country owns a company in another industrial country.
    - Purchase of Rockefeller Center in New York by Japanese investor

Map of Foreign Direct Investment

- Reasons for Horizontal FDI
  - Having a plant abroad allows the parent firm to avoid any tariffs or quotas from exporting to a foreign market since it produces locally.
  - Having a foreign subsidiary abroad also provides improved access to that economy because the local firms will have better facilities and information for marketing products.
  - An alliance between the production divisions of firms allows technical expertise to be shared.

Map of Foreign Direct Investment

- Vertical FDI occurs when a firm from an industrial country owns a plant in a developing country.
  - This usually occurs to take advantage of lower wages in the developing country.
  - Firms have moved to China to avoid tariffs and acquire local partners to sell there.
  - China joined the WTO in 2001 and has reduced tariffs, but firms have remained, and autos are now being exported from China.