dynamics of the world economy: international trade
dynamics of international trade: introduction

“trade across borders inflames passions and creates controversies that are absent in discussions of trade within countries”

- this tells us that international trade, as opposed to trade in general, requires special attention

- to understand international trade, then, requires that we examine it analytically, that is, as students of ipe/gpe and not as proponents or opponents
international trade is obviously important: not only is it an integral part of all our lives, but the process of international trade has a materially profound effect on our lives and the lives of others.

- no doubt all of you rely on imported products; in fact, it’s likely that much of what we own is the product of trade: our clothes, cell phones, computers, cars, tvs, mp3 players, entertainment systems, appliances, and so on. and, don’t forget about oil (and strategic metals/minerals, such as manganese, chromium and platinum).
dynamics of the world economy

international trade

dynamics of international trade: introduction

- international trade--and specifically free trade--can therefore easily be seen as primarily beneficial: after all, we’re all benefiting right now from imported products, both directly and indirectly

but is this necessarily the case?

- that is, by buying so many foreign products, aren’t there fewer jobs for americans? by buying so many imported products, aren’t we indirectly reducing our own wages? by relying of foreign technology or resources, is the country becoming more dependent on others?
International trade: some basic definitions

- **Trade**: the exchange of one commodity for another
- **International trade**: exchange conducted across national borders

In international trade, the existence of national borders have added significance in so far as different national authorities may attempt to control the activities of their citizens in making transactions across borders: such control is typically exercised through a variety of means collectively labeled **protectionism** (more on next slide).
international trade: some basic definitions

- protectionism: refers to (government) policies designed to restrict the import of goods and services or otherwise make imported goods “less competitive” relative to domestically manufactured goods; the basic intent, of course, is to protect domestic manufacturers (or the domestic market) from foreign goods.

- protectionism relies on a number of easily identifiable policies and strategies, the most salient of which are listed on following slide …
international trade: some basic definitions

common protectionist policies

- tariffs
- import quotas
- anti-dumping legislation
- subsidies (below market loans, tax breaks, fiscal incentives)
- currency controls and exchange rate manipulation
- administrative regulations (non-tariff barriers)
- “voluntary” export restraints (vers)
international trade: introduction

some questions

- is trade beneficial or harmful? more specifically, is free trade beneficial or harmful?
- are restrictions on trade ever justified? if so, when and under what conditions?
- is the only choice between free trade and “un-free” trade?

try to answer as a student of international political economy. try to answer from the perspective of three major approaches
international trade: the debate

the liberal perspective on international trade?

**basic answer.** Free trade is a *positive-sum* activity. By engaging in trade, everyone benefits because trade increases *efficiency* and raises *productivity*.

- We already know that this is based largely on the concept of __comparative advantage__.

- But another important concept comes from two economists, Heckscher and Ohlin: __factor endowment__ theory.
international trade: the debate

factor endowment theory

quick explanation. relative endowments of the factors of production (land, labor, and capital) determine a country’s comparative advantage. countries have comparative advantages in those goods for which the required factors of production are relatively abundant locally. this is because the prices of goods are ultimately determined by the prices of their inputs. goods that require inputs that are locally abundant will be cheaper to produce than those goods that require inputs that are locally scarce. (source: wikipedia)
international trade: the debate

factor endowment theory

example. a country where capital and land are abundant but labor is scarce will have comparative advantage in goods that require lots of capital and land, but little labor—grains, for instance. if capital and land are abundant, their prices will be low. as they are the main factors used in the production of grain, the price of grain will also be low—and thus attractive for both local consumption and export. labor intensive goods on the other hand will be very expensive to produce since labor is scarce and its price is high. therefore, the country is better off importing those goods (source: wikipedia)

key point: despite modifications and refinements, liberal economic theory shows, time and time again, that free trade is beneficial to everyone!
international trade: the debate

international trade: **static** and **dynamic** benefits

- in the liberal view, it’s important to understand that trade has both static and dynamic benefits

  - the **static benefit** is the “one-time” benefit from an exchange of goods/services itself: both parties get something they want, and at lower prices than if they produced everything themselves
  
  - the **dynamic benefit** is perhaps even more important: trade generates faster, more productive economic growth and development **over time**
international trade: the debate

international trade: **dynamic benefits**

liberal economists tell us that trade is a basic "engine of growth": it generates a number of dynamic, educative effects, which include, most importantly the **diffusion of knowledge** of production and organizational techniques, which make national economies much stronger over time.
international trade: the debate

questions for discussion

- is the liberal argument for “international trade” utterly persuasive?
- are there any holes or flaws in the argument? or should we all just embrace the liberal idea?
- does the answer change when we adjust the parameters and consider issues of power and its uneven distribution throughout the world?
international trade: the debate

- we must begin with an understanding that the IPE is shaped by power, and even more by an unequal distribution of power
- states, by their very nature, use power to enhance and promote their own interests first and foremost
- one implication: even the most "liberal" states—including the u.s. today—are protectionist when it serves their interests

what is the mercantilist perspective on trade?
international trade: the debate

in the mercantilist view, here’s the basic problem …

“liberals can’t handle the truth!”
international trade: the debate

recognizing the truth

- liberal theory is well and fine if the “truth” of unequal power is ignored: but, since the struggle for power is an essential, unchanging part of the world we live in, states must …

- put national security needs above the principles of free trade, which means ensuring a manufacturing base, maintaining access to critical resources (including food, minerals, and oil), ensuring control of technology and technological knowledge, and so on
international trade: the debate

recognizing the truth: infant industry protection

mercantilists tell us that free trade must wait until a country develops a competitive, independent manufacturing base. here are the basic reasons:

- countries that don’t have a **manufacturing base**, that don’t have the capacity to produce in cutting-edge industries, will be weak and subservient (economically and militarily)
- countries that don’t have **competitive industries** will never achieve strong, independent economic growth
- countries that don’t protect and nurture **vital industries** will always be second- or third-rate powers; they will always be dependent on others and on the ebbs and flows of larger economic forces
international trade: the debate

national security: the ultimate truth

in a war, would your rather have steel or coffee, advanced avionics or call centers? would you rather have “ownership” of a vital resource, such as oil, or would rather have the independent manufacturing, technological, and military capacity to take what you need, when you need it?

economic power (e.g., manufacturing capacity, control of resources, capital, technology) is, in short, the most powerful weapon
international trade: **the debate**

**national security:** the ultimate truth

**consider this:** saudi arabia is controls a vital resource, but it has a very small, underdeveloped manufacturing base. petroleum accounts for 45% of GDP and 90% of exports. the country’s comparative advantage is clear, but what will happen to saudi arabia if is no longer able to buy military equipment from abroad? what happens if saudi arabia’s close ties with the united states change? (since 1990, the u.s. has sold about $40 billion in arms to saudi arabia)
international trade: **the debate**

- as we already know, marxists share many of the same general criticisms as mercantilists, albeit for different reasons

- one shared concern is with power: marxists are skeptical of free trade because it reflects the **interests of the capitalist class**, and specifically, of the most dominant players, namely, **transnational corporations** (TNCs)
international trade: the debate

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the marxist perspective: basic points

- TNCs benefit disproportionately from free trade, and since the leading TNCs are based or have significant operations in Western states, workers in those countries generally do well, too (but not always or necessarily).

- More generally, richer countries dominate the international trading system: they write the rules and control the framework within which all trade is conducted; with this control, they are able to bias the system in their favor.
international trade: the debate

dynamics of the world economy

international trade: the debate

the marxist perspective: basic points

when it suits their interests, tncs and their states ignore the rules of free trade

**case in point**: income support for American dairy farmers. In 2002, Congress added an income support program for dairy farmers, which distributes cash payments whenever prices fall below target levels. To enforce artificially high prices, the government imposes import barriers on milk, butter, cheese, and other products. Without those barriers, consumers could simply purchase lower-priced foreign goods. Imports of cheese, butter, and dried milk are limited to about 5 percent or less of U.S. consumption.
the marxist perspective

to marxists, the logic of comparative advantage not only locks poorer countries into permanently subservient positions, but can be extraordinarily perverse

consider the following example, a memo written by lawrence summers, former chief economist for the world bank (and current treasury secretary in the obama administration) …

Memorandum (Confidential)
From: Lawrence Summers
Chief Economist, World Bank

Health-impairing pollution should be done in the country with the lowest cost, which will be the countries with the lowest wages

Just between you and me, shouldn’t the World Bank be encouraging more migration of the dirty industries to the [Third World]?

If toxic waste or pollutants cause cancer in later life, why not send that material to countries where people don’t live so long?

The economic logic behind dumping a load of toxic waste in the lowest-wage country is impeccable and we should face up to that.

Cheers,
Larry
international trade: the debate

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the marxist perspective

this video on the WTO reflects some of the key criticisms marxists have toward free trade. Pay particular attention to whom the video identifies as the power behind the WTO. (hint: it’s not governments)
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debating international trade

summing up

- despite what liberals say, the debate about free trade is far from settled: to a certain extent, both mercantilists and marxists make powerful counter-arguments; at the same time, liberal views cannot be easily discarded.

- the real question, however, may not be whether free trade is good or bad; instead, the question may be: are there viable alternatives? that is, is “free trade” the only game in town or are there other types of trade that may ultimately produce “better” results?
international trade: alternatives?

one alternative to free trade is **fair trade**, which is based on the idea that international trade, while market based, should also pay careful attention to questions of **equity**

- fair trade aims to provide higher wages than typically paid to producers in typical trading relationships, with the hope of allowing them to achieve greater financial stability, improve their general well-being and allow future investments

- fair trade is, fundamentally, a response to the failure of conventional trade to deliver sustainable livelihoods and development opportunities to people in the poorest countries of the world.
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international trade

international trade: alternatives?

discussion question

- is fair trade a viable alternative to free trade?

is answering this question, it is important to keep in mind a often overlooked aspect of the current (and past) international trading system, which is …

it has never been premised on free trade or laissez faire; instead, international trade has always been “managed trade”
international trade: **managed trade**

The system of managed trade is based on four key principles:

- **non-discrimination**
- **reciprocity**
- **transparency**
- **multilateralism**

Taken together, the 4 principles tell us that international trade takes place within an **agreed** upon framework, or **regime**, that requires cooperation, rule-making, and (implicitly) coercion.
international trade: managed trade

dynamics of the world economy
international trade

non-discrimination

- non-discrimination is enshrined in the most favored nation (MFN) clause, which is based on the principle that any concession granted to one member must be extended to all other members (originally, this meant membership in GATT but now is premised on membership in the WTO)

in the United States, the granting or renewing of MFN status has often been controversial, especially with regard to countries such as China
international trade: **managed trade**

- **reciprocity** is based on the principle that the granting of trade concessions (lower tariffs, quotas, etc.) is neither intended nor expected to be **generalized** to other countries; it is meant only for the parties that make a specific agreement with each other or within the context of a multilateral agreement.

- Reciprocity treaties have **lost importance** in the current trade era, which is governed by broader based trade regimes, in particular, the world trade organization.
international trade: managed trade

**transparency** and **multilateralism**

- **transparency** refers to the fact that any discrimination, when it occurs, must be **visible**; in other words, hidden trade discrimination (most typically, in the form of NTBs) is not permissible (current international trade norms allow for the use of tariffs)

- **multilateralism** implies and reflects a commitment to the creation of a multilateral **trade regime** and multilateral **cooperation** in maintaining a rule-based system
international trade: managed trade

**key points**

- international trade has always been **governed** by negotiations, rule-making, reciprocity, and agreed frameworks; international trade has always been and continues to be **highly managed**

- concepts such as fair trade, in this view, are nothing new, but they do reflect an effort by generally disadvantaged (or developing) countries to **exert more power** in international trade negotiations: indeed, this is one of the most **important trends** in contemporary multilateral negotiations

**consider the emergence** the Like-Minded Group (LMG), the G-4, the G-20 (also G-21, G-22 and G-23), the G-24, the G-33, the G-77, the G-90, the Cairns Group, APEC, and so on
dynamics of the world economy

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international trade: managed trade

key points

- the rules governing international trade used to written only by the most powerful countries, but this role is now being challenged: this is a major reason ongoing negotiations in the WTO have faltered

- consider negotiations on MFA (multi-fibre agreement), TRIPS (trade-related intellectual property rights), TRIMS (trade-related investment measures), MAI (multilateral agreement on investment), and GATS (general agreement on trade-in-services): disagreements have led to a stalemate in latest round of WTO negotiations, which began in Doha in 2001 (followed by negotiations in Cancun, 2003; Geneva, 2004; Paris, 2005; Hong Kong, 2005; Postam, 2007; and Geneva, 2008)