EC3355 International Trade
Problem Set 1: Basic concepts and trade patterns

Consider a random economics student at Royal Holloway buying a computer for £400 at some generic computer store. The table below gives the costs associated with each step in the supply chain.

Part/process	Cost	Origin country
Hard drive	£75	Japan
Display and sound module	£50	Korea
Video chip	£20	UK
Controller chip	£10	UK
Processor	£40	Germany
Aluminium casing	£15	Germany
Assembly	£30	China
Wholesale distribution	£100	UK
Retail distribution	£60	UK

1. By how much did this purchase change the UK's trade balance with China?
   Answer: This is the sum of all components up to and including China. The computer leaves China for £240.

2. Discus whether the UK's negative balance versus China is a good measure of economic performance vis-a-vis.

   Answer: Not really, the computer leaves China for a price of £240, but only £30 of value was added in China. Which is the same value as the parts supplied by the UK.

3. HM Revenue and Customs reported that in October 2014 the value of UK exports to non-EU countries had increased from 13.9 to 14.8 billion. Imports from non-EU countries where almost stable at 17.3 billion. Calculate the terms of trade for September and October 2014.

Answer: The terms of trade are simply the ratio of exports versus imports. For September we find a ToT of 80.3, and for October 85.5.

4. How did the UK's general welfare change from September to October?

   Answer: UK's welfare with regard to non-EU trade improved by 5.2 percentage points in one month time.

5. In general, small countries have large trade to GDP ratio in comparison to larger countries. What would be an explanation for this?

   Answer: Small countries means that there is a small internal market, and therefore these countries often depend on international trade for their economic development. As mentioned during the seminar there are also other factors such as limited availability of natural resources and labour.

6. For each of the following regions describe some of the main factors that drives trade in this region and what their main exports are: Europe, Asia, and Africa.

   Answer: Africa's exports are dominated by natural resources. Factors that inhibit trade on the continent are the lack of infrastructure (ports, roads) as well as lack of well-functioning institutions. The export in Asia, specifically South-East Asia is a mix of high-labour intensive goods such as garments produce in Cambodia and Bangladesh, as well as technological goods such as computers and cars manufactured in China, Japan, and South Korea. Additionally certain countries still depend a lot on the exports of natural resources such as palm oil from Indonesia. Europe has a very large trade flow because of the common market of the European Union. Most European countries have a lot of high skilled labour and capital-intensive industries and therefore it exports goods as machinery, cars, and pharmaceuticals. Additionally, agricultural produce are an important export as well.

7. Over time the world has seen an increase in trade of manufactured goods as opposed to the decline in the value of trade in other goods such as agricultural produce. What could explain this trend?

   Answer: This is mainly due to the increase in living standards

8. Describe the two different types of foreign direct investment and find out which type is more common. Why is one type of FDI more common than the other?

Answer: The two types are horizontal and vertical FDI (definitions are given in the lecture slides). Horizontal FDI is more common indicating that access to markets is more important than cost reduction in production.

9. What are the main patterns in migration?

   Answer: The largest migration flows can be found in the developing countries.

10. What are the main differences between the flows of capital and labour across the world and what explains these differences?

    Answer: In contrast with migration, FDI flows are mainly between industrialised countries. Most immigrants move within their own continent for employment or because of conflict. The difference with FDI flow patterns is due to the fact that migration is often stricter regulated than the flow of capital.