

Research on Trading Relationship between China and Latin America based on Terms of Trade Analysis

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Abstract: China has made great achievements in foreign trade growth, but in recent years, Latin America lay the basis for market development to hedge the risk of trade in Europe and America and other countries. Latin American countries' resources curse is not a simple problem of resource endowment advantage in the essence, but in-depth resource use efficiency problem, which relates to technological innovation and trade, product optimization, in terms of trade framework, it reflects terms of trade trends in service. In recent years, the state support industrial upgrading, this reflects the mind of improving efficiency of resource usage.

Keywords: terms of trade; trading relationship; Latin America

1. Introduction

Since China's reform and opening, foreign trade has made great achievements, substantial growth in foreign trade, and optimized the trade structure. Total imports and exports of Chinese goods were increased of 107 times. But China faces a series of challenges due to increasing in trade friction and competition in the market, and imperfections of supporting policies. The subprime mortgage crisis in U.S. has made China's export growth declined, and the debt crisis in Europe has affected the demand for exports. Weakness of exporting in Europe and other countries will directly affect the domestic economic balance. At the same time, China's economic cooperation with Latin American countries show a steady increase trend in recent years, according to data from National Bureau of Statistics, the turnover of foreign economic cooperation from 2007 to 2009, were \$2,923,730,000, \$3,047,520,000 and \$3,681,720,000. Therefore it is necessary to study the terms of trade in China to explore the response to this global economic volatility trading strategies. Generally speaking, many literature use terms of trade as an important indicator to reflect the status of a country's export situation. This paper considers that for a very long period of time, Latin America and other emerging trade body lay the basis for the development of the market to hedge the risk of trade in Europe and America and other countries, this article attempts to conduct a comparative study through the terms of trade index for China and major countries in Latin America.

2. Literature Review

Research on the terms of trade, foreign research can be traced back to 1776, Smith wrote "Wealth of Nations" and proposed a theory of international division of labor, international trade has laid a theoretical foundation for the terms of trade study provides an analysis of ideas^[1]. Muller then raised the British classical economists' doctrine of mutual needs, considered that the equilibrium price in terms of trade depends on the strength of demand for trade goods situation between two countries. Marshall expressed the shape of the curve depends on the two trading countries, import demand elasticity, the intersection of the curve indicates the equilibrium in terms of trade^[2]. In 1949, Argentine economist Raul Prebisch raised point of view of "deteriorating terms of trade theory" in his "Latin American economic development and its key issues", he believed that developing countries export primary products, while developed countries export finished industrial products, in this pattern of trade, the terms of trade in developing countries will be in long-term deterioration, which attracts the attention of academic in the perspective of the importance of terms of trade. In 1931, Professor He Lian in Nankai University, who conducted a China's import and export price index from 1894 to 1928, and calculated the terms of trade of China's exports. Shi Shuo(2007) and Huang Manying (2008) conducted a more systematic study from two different angles in perspectives of volatility and commodity for the terms of trade respectively[3]. Li Qiang (2010) explored the terms of trade in the economic transition using evolutionary economics analysis tools, considered the government should enhance the integration from two aspects, namely technical and institutional innovations, in order to truly improve the terms of trade of China's export prices.

Domestic studies on terms of trade relatively later than scholars in the west, foreign trade growth related research has become a hot concerned by economists after joining the WTO[3]. Li Qiang (2010) proposed international trade growth is the “engine” for economic development, but in recent years, the overall terms of trade worsening, Latin American countries faced with similar “poverty growth” risk, which is common point of view of many mainstream scholars^[3,4].

The terms of trade is one of recognized indicators to reflect a country's trade accepted by mainstream scholars, and during operation it is still needed to be integrated with national conditions into account. If relying solely on the terms of trade index, it is more prone to be protectionist tendencies, which contrary to the principle of comparative advantage in international trading. Therefore, it is need to fully consider the comparative advantages of the trade to achieve sustainable development, especially for upgrade and optimize the terms of trade in developing countries.

3. Comparative Study of Terms of Trade

Research on the terms of trade between countries are mainly around what exactly the ratio of goods exchange, which reflects a country or a particular industry or class of products' competitive position of international market, the economic meaning is the number of each unit exports to exchange for imported goods. If units of export goods can be exchanged for more imported goods in a certain period which improves the terms of trade improve, otherwise deteriorate. In general, improved terms of trade means a increase of country's trade interests or economic welfare, while its trading partners means the opposite situation. Therefore, the terms of trade are also an important indicator to measure a country's export profitability relative to imports. There are three kinds of terms of trade, namely price terms of trade, income terms of trade and factor terms of trade, and the first one is easy to attain data and more widely used in academics.

Firstly, it analyzes in perspective of trade in goods.

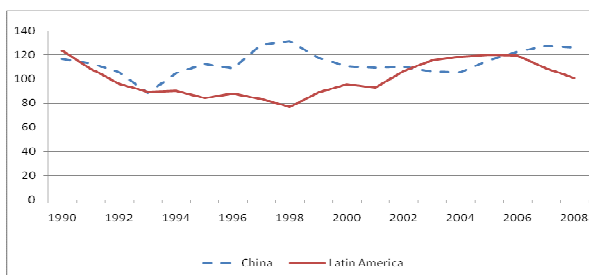


Figure 1. Trend of Terms of Trade in Gross Import and Export (unit: million)(Source: World Trade Organization Database)

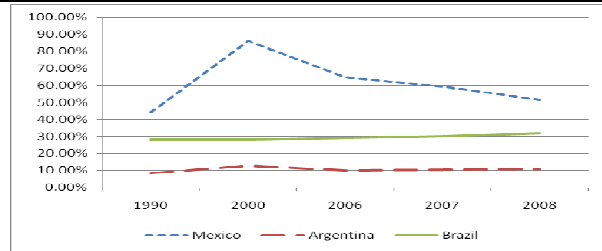


Figure 2. Major Latin American Countries Accounted for the Percentage of the Total Latin American Imports and Exports of Goods (unit: million)(Source: World Trade Organization Database)

In recent years, the trading relationship between Latin America and China grows very quickly. Take Brazil, Mexico and Argentina for example, Figure 2 shows Mexico accounted for the highest proportion of total imports and exports of goods, but recent years have gradually decreased, while the other two countries are relatively stable. According to the latest Commerce Department statistics, it analyzes these three major countries. First, the January-August 2011, the Brazilian import and export of goods amounted to 313.47 billion U.S. dollars, up 30.3% over the previous year, trade surplus of \$ 19.96 billion, and an increase of 71.3%. China is Brazil's largest export destination and second largest source of imports. Second, the January-June 2011, Mexico's import and export of goods amounted to 339.12 billion U.S. dollars, up 20.2% over the previous year, trade surplus of \$ 3.22 billion, and an increase of 1671.1%. China is Mexico's fourth largest export destination and second largest source of imports. Third, the January-July 2011, Argentina's import and export of goods amounted to 86.44 billion U.S. dollars, up 27.6 percent over the previous year, trade surplus of \$ 5.65 billion, down 28.6%. China is Argentina's second largest export market and second largest source of imports.

At present, China has replaced Japan as the most important trading partner with Latin American and Caribbean region, this article analyzes trade development with Latin America in the perspective of terms of trade. According to China's Ministry of Commerce statistics, Figure 1 presents a general complementary trade shift relationship between China and Latin America since the 90s of last century. From the characteristics of the import and export products or services, it is not difficult to see that Latin American countries rich in resources, including oil, iron ore, copper ore and other mineral resources, reserves and production in the world, while Latin American countries are major exporters of agricultural products, such as soy, sugar and vegetable oil. China's reform and opening up experienced 30 years of rapid development, socio-economic change requires a lot of energy and materials, and domestic demand greatly exceeds their supply, while the cheaper Chinese industrial products are also popular in the Latin American market. In addition, the United

States and other developed countries implement resource protection and technical trade barriers on agricultural products, improving trade costs to Latin America countries, which stimulate the complementary interaction trade in a sense.

Secondly, it analyzes in perspective of trade in services.

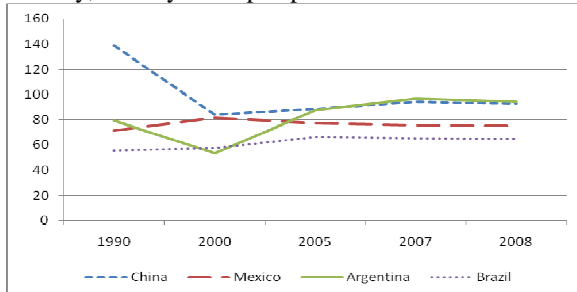


Figure 3. Trade Trends of Import and Export Terms of Trade by Total Service Calculation (Source: World Trade Organization data)

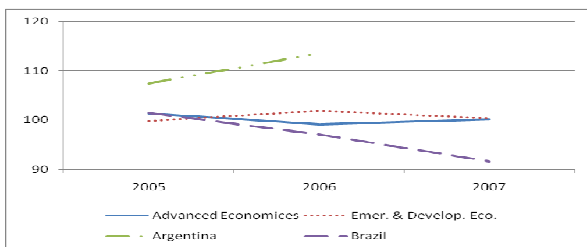


Figure 4. Terms of Trade Index Base Year 2000 = 100)(Source: International Monetary Fund database)

Compared to terms of trade calculated with the total import and export, terms of trade calculated with services imports and exports is not optimistic. From figure 3 and 4, in China, Argentina, Brazil and Mexico, trade in services tend to rely on imports, and Brazil is more significant deterioration in trade in services, which can be explained as follows to some extent, those countries rich in natural resources, however the usage does not reach that level. In 1993, Aunty in the book of "sustainable economic development in mining: resource curse" proposed the "resource curse" concept for the first time, then this proposition is becoming a new economic theory, considering that the rich natural resource endowment is not necessarily will bring the region a high degree of economic development. In general, the specific advantages relative to natural resource endowments of developing countries export mainly rely on primary products of natural resource-intensive and labor-intensive products, which gained a certain amount of trade interests for the state in the short term, but this process also negatively reinforced this relatively low level of industrial structure,

in the long run, worsening terms of trade Zhao Li-hong(2010). Goods terms of trade reflect the traditional trade status, and terms of trade in services largely reflects a country's technological development and resource utilization levels, from the perspective of sustainable development in developing countries, terms of trade in services will be analyzed and compared for policy reference.

3. Implication

Based on the above analysis, for the current world economic situation consist of some unstable factors, the stability of Latin American trade relations has laid a foundation for the economic development of domestic market, while complementary nature of trade enhanced trade relations between the two. Analysis of the terms of trade in goods vulnerable to influenced by resource prices in short-term, and the analysis of the conditions of trade in services is reflected in the level of a country's technological development, with a more stable long-term effects. It is worth mentioning that in the perspective of the domestic structure adjustment, optimize and improve the structure and content of trade in services is currently the subject of much-needed discretion. Latin American countries' resources curse is not a simple problem of resource endowment advantage in the essence, but in-depth resource use efficiency problem, which relates to technological innovation and trade, product optimization, in terms of trade framework, it reflects terms of trade trends in service. In recent years, the state support industrial upgrading, this reflects the mind of improving efficiency of resource usage.

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