CHAPTER 9

Application: International Trade

PRINCIPLES OF
Economics
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Premium PowerPoint Slides
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In this chapter, look for the answers to these questions:

- What determines how much of a good a country will import or export?
- Who benefits from trade? Who does trade harm? Do the gains outweigh the losses?
- If policymakers restrict imports, who benefits? Who is harmed? Do the gains from restricting imports outweigh the losses?
- What are some common arguments for restricting trade? Do they have merit?

Introduction

- Recall from Chapter 3:
  A country has a **comparative advantage** in a good

  Countries can gain from trade if each exports the goods in which it has a comparative advantage.
- Now we apply the tools of welfare economics to see where these gains come from and who gets them.

The World Price and Comparative Advantage

- P_W =
- P_D =
- If $P_D < P_W$,
- If $P_D > P_W$,

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The Small Economy Assumption

- A small economy
- Not always true – especially for the U.S. – but simplifies the analysis without changing its lessons.
- When a small economy engages in free trade, P_W is the only relevant price:

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A Country That Exports Soybeans

Without trade,
P_D = $4
Q = 500

P_W = $6

Under free trade,
- domestic consumers demand _____
- domestic producers supply _____
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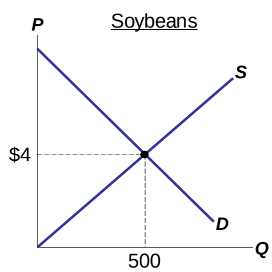

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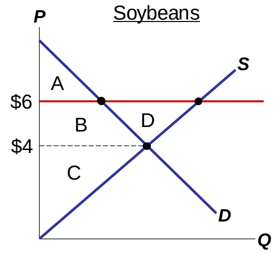
A Country That Exports Soybeans

Without trade,
CS =
PS =
Total surplus =

With trade,
CS =
PS =
Total surplus =



ACTIVE LEARNING **1**

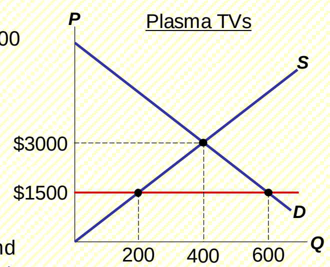
Analysis of trade

Without trade,
P_D = \$3000, Q = 400

In world markets,
P_W = \$1500

Under free trade, how many TVs will the country import or export?

Identify CS, PS, and total surplus without trade, and with trade.



Summary: The Welfare Effects of Trade

	$P_D < P_W$	$P_D > P_W$
direction of trade		
consumer surplus		
producer surplus		
total surplus		

Whether a good is imported or exported, trade creates winners and losers.

Other Benefits of International Trade

- Consumers
- Producers
- Competition from abroad may
- Trade

Then Why All the Opposition to Trade?

- Recall one of the Ten Principles from Chapter 1:
  Trade can make everyone better off.
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- Yet, such compensation rarely occurs.
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- Hence, the losers have more incentive to organize and lobby for restrictions on trade.

Tariff: An Example of a Trade Restriction

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- Example: Cotton shirts
  P_W = $20
  Tariff: T = $10/shirt
  Consumers must pay $____ for an imported shirt.
  So, domestic producers can charge $___ per shirt.
- In general, the price facing domestic buyers & sellers equals ($P_W + T$).

Analysis of a Tariff on Cotton Shirts

P_W = $20

Free trade:

buyers demand ____

sellers supply ____

imports = ____

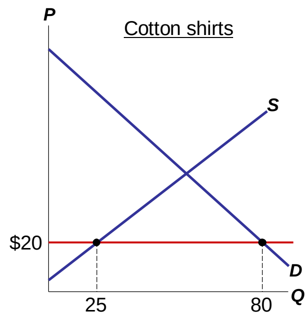
T = $10/shirt

price rises to ____

buyers demand ____

sellers supply ____

imports = ____



Analysis of a Tariff on Cotton Shirts

Free trade

CS =

PS =

Total surplus =

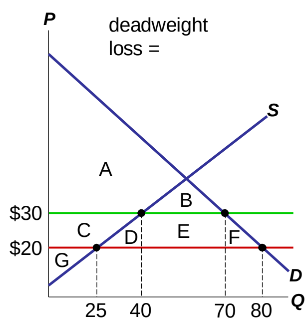
Tariff

CS =

PS =

Revenue =

Total surplus =



Import Quotas: Another Way to Restrict Trade

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- Mostly has the same effects as a tariff:
  - Raises price, reduces quantity of imports.
  - Reduces buyers' welfare.
  - Increases sellers' welfare.
- A tariff creates revenue for the govt. A quota
- Or, govt could auction licenses to import to capture this profit as revenue. Usually it does not.

Arguments for Restricting Trade

1. The jobs argument

Economists' response:

Look at the data to see whether rising imports cause rising unemployment…

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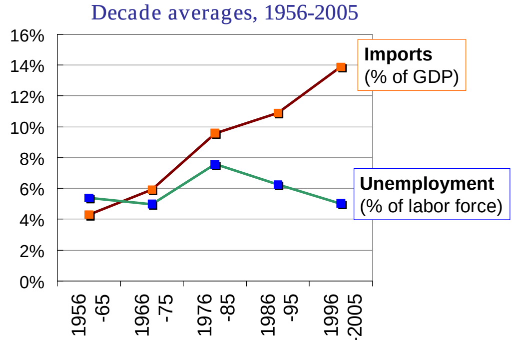
U.S. Imports & Unemployment,
Decade averages, 1956-2005



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Arguments for Restricting Trade

1. The jobs argument

Trade destroys jobs in the industries that compete against imports.

Economists' response:

Total unemployment does not rise as imports rise, because

Even if *all* goods could be produced more cheaply abroad, the country need only have a ___________________ to have a viable export industry and to gain from trade.

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Arguments for Restricting Trade

2. The national security argument

Economists' response:

Arguments for Restricting Trade

3. The infant-industry argument

Economists' response:

Besides, if a firm will be profitable in the long run, it should be willing to incur temporary losses.

Arguments for Restricting Trade

4. The unfair-competition argument

Economists' response:

Great! Then we can import extra-cheap products subsidized by the other country's taxpayers.

Arguments for Restricting Trade

5. The protection-as-bargaining-chip argument

Example:

Economists' response:

Suppose France refuses. Then the U.S. must choose between two bad options:

A) Restrict imports from France,

B) Don't restrict imports,

Trade Agreements

- A country can liberalize trade with
  - unilateral reductions in trade restrictions
  - multilateral agreements with other nations
- Examples of trade agreements:
- World Trade Organization (WTO), est. 1995,