

## Ch.20: Trading with the World

### Trends in the Volume of Trade

- In 1960, United States
  - exported 3.5 percent of GDP total output
  - imported 4 percent of GDP
- In 2003, United States
  - exported 10 percent of GDP.
  - imported 15 percent of GDP.

## Patterns and Trends in International Trade

### Trade in Goods

Manufactured goods represent 55 percent of U.S. imports and 68 percent of exports.

Raw materials and semi-manufactured materials represent 14 percent of U.S. exports and 15 percent of imports.

The largest export item from the United States is capital goods and the largest import item is automobiles.

## Patterns and Trends in International Trade

### Trade in Services

International trade in services such as travel, transportation, and insurance is large and growing.

### Geographic Patterns of International Trade

The biggest trading partner with the U.S. is Canada with 20 percent of U.S. exports and 17 percent of U.S. imports.

Japan is our second largest trading partner with 8 percent of our exports and 9 percent of our imports.

## Patterns and Trends in International Trade

### Net Exports and International Borrowing

The value of exports minus imports is called **net exports**.

- In 2003,
  - U.S. net exports = -\$500 billion
  - U.S. had a trade deficit.
- Trade deficit → country borrows from foreign countries or sell some of its assets (net borrower).
- Trade surplus → country makes loans to foreign countries or buys some of their assets (net lender).

## The Gains from International Trade

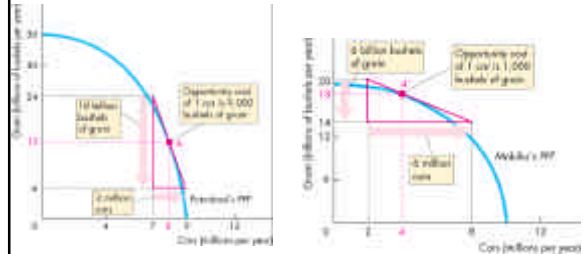
The Law of Comparative Advantage:

Nations can increase the consumption of goods and services when they

- allocate resources to the production of those goods and services for which they have a comparative advantage
- Trade for the goods they do not have comparative advantage in.

If without trade, Farmland produces at point A and Mobilia produces at point A':

- who has comparative advantage in cars?
- who has comparative advantage in grain?



## The Gains from International Trade

### The Gains from Trade: Cheaper to Buy Than to Produce

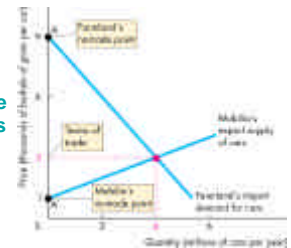
If Mobilia buys grain for the price that Farmland produces it, Mobilia could buy 9,000 bushels of grain for 1 car (instead of 1,000 bushels per car domestically)

If Farmland bought cars for what Mobilia pays for them, Farmland could buy 1 car for 1,000 bushels of grain (instead of 9,000 bushels per car domestically).

## The Gains from International Trade

### The Terms of Trade

- why won't Mobilia trade at less than 1,000 bushels per car?
- Why won't Farmland trade at more than 9,000 bushels per car?



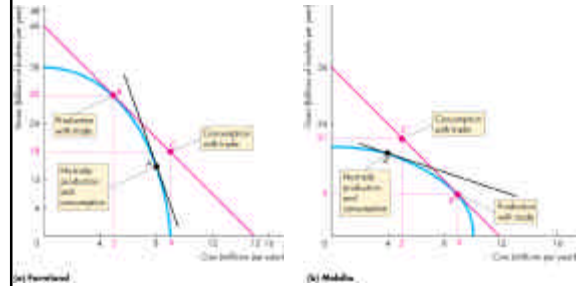
## The Gains from International Trade

### The Gains from Trade.

- Farmland buys cars at a lower price than it would pay if it made them itself, and sells its grain at a higher price.
- Mobilia buys grain at a lower price than it would pay if it grew the grain itself, and sells its cars at a higher price. Everyone gains from trade.

## The Gains from International Trade

The slope of the line consumption possibilities curve (CPC) is determined by the terms of trade.



## The Gains from International Trade

### Calculating the Gains from Trade

Farmland increases its consumption of both cars and grain by decreasing car production and increasing grain production until PPC is tangent to CPC.

Mobilia increases its consumption of both cars and grain by increasing car production and decreasing grain production until PPC is tangent to CPC.

## International Trade Restrictions

Governments restrict international trade to protect domestic producers from competition by using two main tools

A **tariff** is a tax that is imposed by the importing country when an imported good crosses its international boundary.

A **nontariff barrier** is any action other than a tariff that restricts international trade.

## International Trade Restrictions

### The History of Tariffs

The average tariff rate has generally fallen over the last 70 years.

Average tariffs reached their peak of 20 percent in 1933.



## International Trade Restrictions

The **General Agreement on Tariffs and Trade** (GATT) is an agreement between nations to have a series of trade negotiations, or "rounds," to reduce tariffs on international trade.

The United States joined GATT in 1947.

Subsequent rounds of the GATT occurred in the 1960s, late 1970s and 1980s, resulting in gradual decline in the average tariff rate in the United States

## International Trade Restrictions

The Uruguay round was the most ambitious and led to the creation of the **World Trade Organization** (WTO).

The United States became a WTO member in 1994.

WTO membership brings greater obligations to follow the GATT rules governing trade.

## International Trade Restrictions

In 1994, the United States became party to the **North American Free Trade Agreement** (NAFTA), under which trade barriers between Canada, Mexico and the United States are being lowered.

The **European Union** (EU) is an organization of European countries that have agreed to eliminate trade barriers among them.

The **Asia-Pacific Economic group** (APEC) is another agreement to reduce trade barriers among East Asian countries, including China.

## International Trade Restrictions

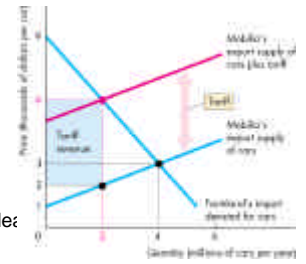
### Barriers to trade

- **Tariff**
- **Quota**
- **Voluntary export restraint (VER)**

## International Trade Restrictions

Effect of tariff on cars on

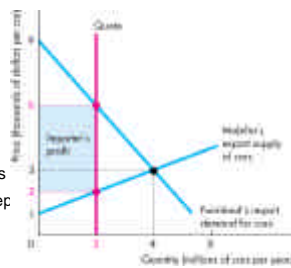
- a. Price, output
- b. Producer.
- c. Consumer
- d. Tariff revenue.
- e. Excess burden of tax (de



## International Trade Restrictions

Effect of quota:

- price, quantity.
- Consumer
- Producer
- Importer
- Deadweight loss
- A quota vs. tariff: importer profits
- A VER is similar to a quota except economic profit.



## Arguments for protection

- Protect national security
- Protect infant industries
  - How long?
  - How defined?
- Punish "dumping"
  - How defined?
  - Beneficiaries of dumping?
- Saves jobs
- Costs other jobs

### Arguments for protection

- Brings diversity and stability to our economy
  - At a cost
  - Other ways to stabilize.
- Penalizes nations with lax environmental standards or poor human rights records
  - Our choice or theirs?
- Prevents rich nations from exploiting poor ones
  - What is "exploitation"?

### Why Is International Trade Restricted?

The two key reasons why international trade is restricted are

- Tariff revenue
- Rent seeking

### Why Is International Trade Restricted?

#### Tariff Revenue

It is costly for governments to collect taxes on income and domestic sales.

It is cheaper for governments to collect taxes on international transactions because international trade is carefully monitored.

This source of revenue is especially attractive to governments in developing nations.

### Why Is International Trade Restricted?

#### Rent Seeking

Rent seeking is lobbying and other political activities that seek to capture the gains from trade.

Despite the fact that protection is inefficient, governments respond to the demands of those who gain from protection and ignore the demands of those who gain from free trade because protection brings concentrated gains and diffused losses.

## Why Is International Trade Restricted?

### Compensating Losers

The gains from free trade exceed the losses, and sometimes free trade agreements address the issue of the distribution of gains from trade by compensating those who lose from free trade.

Under NAFTA, a \$56 million fund was created to support and retrain workers who lost their jobs from foreign competition resulting from the agreement.