Chapter 19: Trading with the World.

I. Facts on Trade.

A. the % of GDP exported in the U.S. has grown over time.
   1. 2001
      i. U.S. imports 15% of GDP
      ii. U.S. exports 13% of GDP
   2. in 1960
      i. U.S. imports 4% of GDP
      ii. U.S. exports 5% of GDP

B. the U.S. has incurred a “trade deficit” in recent years.
   1. 2001: net exports = -$348 billion (deficit)
   2. U.S. has run a balance of trade deficit every year since 1978.
   3. between 1960 and 1978, had more years of surplus than deficit.
   4. When U.S. runs a trade deficit, they must "borrow" from the rest of the world to
      finance the deficit.

II. Gains from Trade and Comparative Advantage.

A. A country has the comparative advantage in a product when it can produce
   the good at a lower opportunity cost than other countries.

B. Sources of comparative advantage:
   1. climate
   2. educational attainment of work force
   3. raw materials
   4. infrastructure
   5. tax and institutional arrangements.

C. Similar to examples given earlier in the year for trade within an economy.

D. By specializing and trading, can expand consumption possibilities for a
   country beyond its production possibilities.

E. example: 2 countries produce cars and computers.
1. U.S.: 900 hours per car; 150 hours per computer.
2. Japan: 1200 hours per car, 120 hours per computer.
3. opportunity cost of a car:
   i. U.S.: 6 computers; Japan: 10 computers
4. opportunity cost of a computer:
   i. U.S. 1/6 car; Japan: 1/10 car.
5. U.S. has CA in cars; Japan has CA in computers

F. U.S. production and consumption possibilities (assuming 180 million hours per day)

G. Japan (assuming 180 million hours per day)

1. Exchange rate determines terms of trade between countries.
2. For trade to be "bi-directional", exchange rate must generate between 6 and 10 computers per car.
III. Winners and Losers from trade: supply-demand analysis.

A. U.S.
1. before trade: P=12, Q=20
2. after trade: P=10, Q_d=14, Q_s=28; iimports=14
   i. increase in consumers surplus=48m
   ii. decrease in producers surplus=34m
   iii. net improvement=14m

B. Mexico
1. before trade: P=7, Q=15
2. after trade: P=10, Q_d=12; Q_s=26; exports=14
   i. increase in producers surplus=$61.5m
   ii. decrease in consumers surplus=$40.5 m.
   iii. net improvement=$21m.

C. Results:
1. consumers in the importing country win.
2. producers in the importing country lose.
3. consumers in the exporting country lose.
4. producers in the exporting country win.
5. on net, gains exceed losses in both countries.
IV. PROTECTIONISM.

A. Major types:

1. tariffs (tax on imports)

2. examples of U.S. tariffs.
   i. 67% on some shoe imports
   ii. 40% on orange juice
   iii. 25% on flashlights
   iv. 42% on brooms
   v. 151% on low-priced watch parts.

3. quotas (limit on imports)
   i. about 1 teaspoon of ice cream per person
   ii. about 7 peanuts per person
   iii. about 1 lb of cheese per person
   iv. quotas on sugar are estimated to double the price of sugar
   v. “voluntary export restraints”
      a. Japan and cars
      b. Korea and textiles

4. anti-dumping laws (minimum price on imports)
   i. U.S. steel industry pushing for restraints on Japan and Russia now.
B. Effect of tariffs.

$1 is world price of peanuts.

Effect of a $.20 tariff on peanuts.

1. Producers gain A
2. Consumers lose A+B+C+D
3. tax revenue=C
4. on net, loss=B+D

C. Quota: similar result except no tax revenue. Effect on foreign producers depends on how quota is implemented (Do importers have rights to quota, or do exporters have rights?)

D. Arguments for protectionism.

1. trade restrictions save jobs.
   i. save jobs in protected industry
   ii. cost jobs in others
      a. less income for U.S. consumer to spend elsewhere;
      b. less income for foreign producers to buy from U.S.
      c. foreign countries may retaliate against our export industries.
2. infant industries argument
   i. can't compete initially, but will eventually
3. national defense