

Chapter 35

Some Key Facts
The Economic Basis for Trade
Supply and Demand
Analysis of Exports and Imports
Trade Barrier
Trade Adjustment Assistance
Last Word

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International Trade

Key Terms



End Show



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Chapter Objectives

- **The Graphical Model of Comparative Advantage, Specialization, and the Gains From Trade**
- **How Differences Between World Prices and Domestic Prices Prompt Exports and Imports**
- **How Economists Analyze the Economic Effects of Tariffs and Quotas**
- **The Rebuttals to the Most Frequently Presented Arguments for Protectionism**
- **About the Assistance Provided Workers Under the Trade Adjustment Act of 2002**
- **How the Offshoring of U.S. Jobs Relates to the Growing International Trade in Services**

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Some Key Facts

- **U.S. Trade Deficit \$782 Billion in Goods in 2005**
- **U.S. Trade Surplus \$58 Billion in Services in 2005**
- **U.S. Exports Chemicals, Consumer Durables, Agricultural Products, Semiconductors**
- **U.S. Imports Petroleum, Automobiles, Appliances, Computers**
- **Some of Same Categories are Exported and Imported**
- **Canada Largest U.S. Partner Quantitatively**

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Some Key Facts

- **U.S. Sizable Trade Deficit with China**
- **U.S. Dependence on Oil is Reflected**
- **U.S. has World's Highest Trading Volume**
- **Exports are 11% of U.S. Output**
- **China a Major Trade Force**
- **International Trade Links World Economies**
- **International Trade is the Center of Policy Debates**

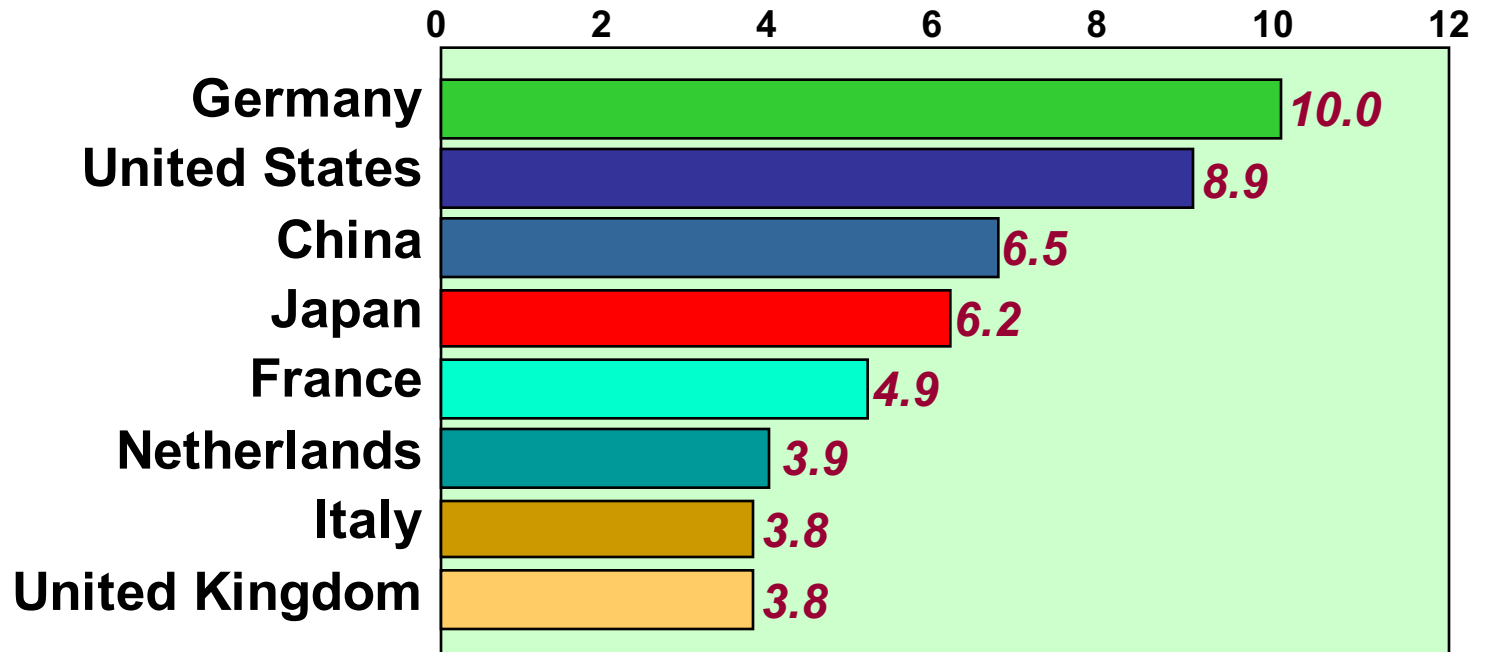
Some Key Facts

Shares of World Exports, Selected Nations



GLOBAL PERSPECTIVE

Percentage Share of World Exports, 2004



Source: World Trade Organization

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The Economic Basis for Trade

- **Labor-Intensive Goods**– goods that require a large or well-educated labor force (usually implies abundant, inexpensive labor) EX – Japan & technological goods, electronics.
- **Land-Intensive Goods**– goods that require large amounts of land to produce. EX- U.S. & agricultural products.
- **Capital-Intensive Goods**– goods that require large amounts of capital (machinery, tools, equipment,\$) to produce. EX – airplanes, cars, industrial machinery. Usually found in industrially advanced nations.



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The Economic Basis for Trade

Comparative Advantage – the ability to produce goods or services at a lower opportunity cost (every nation has comparative advantage in something!)

- Graphical Analysis – analyze the PPFs of each nation (always compare 2 nations)
- Opportunity Cost Ratio – domestic exchange ratio (production of one good compared to production of another good)



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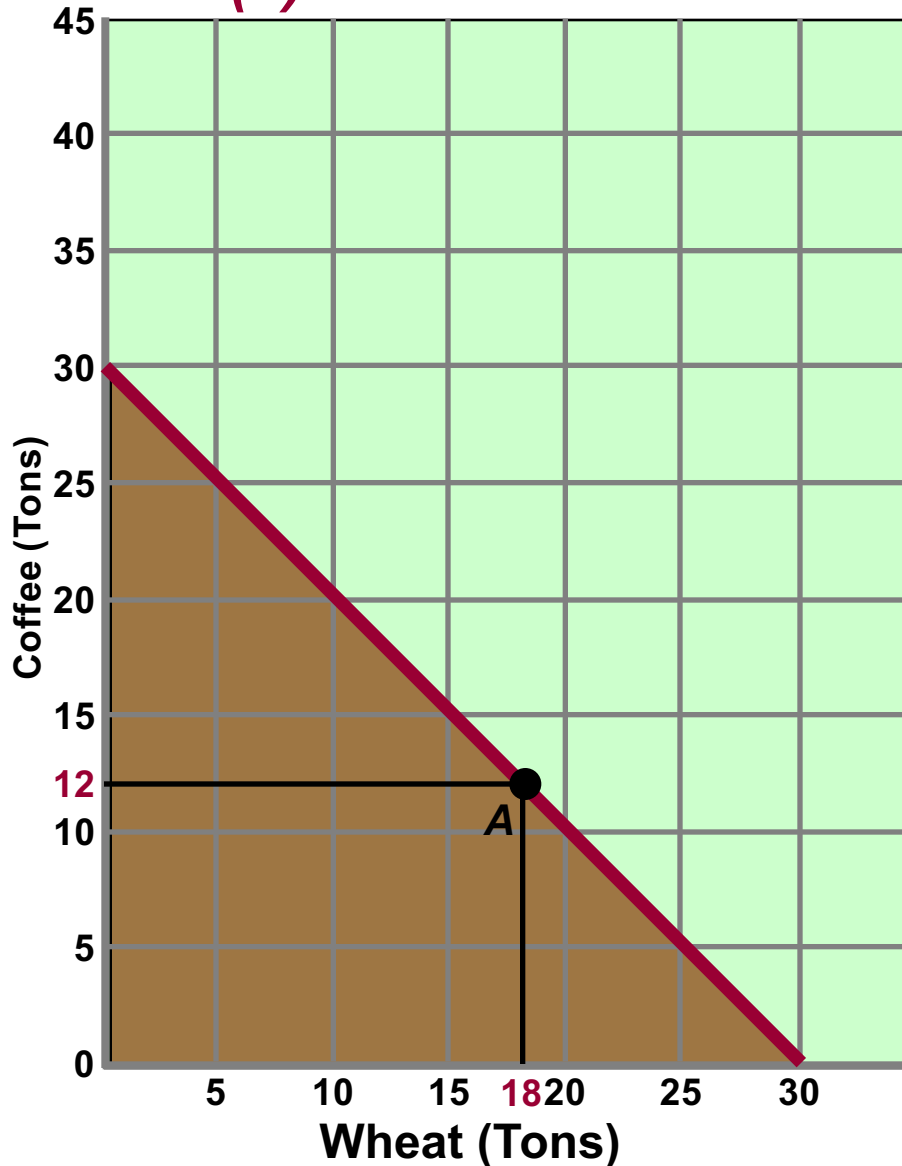


Graphically...

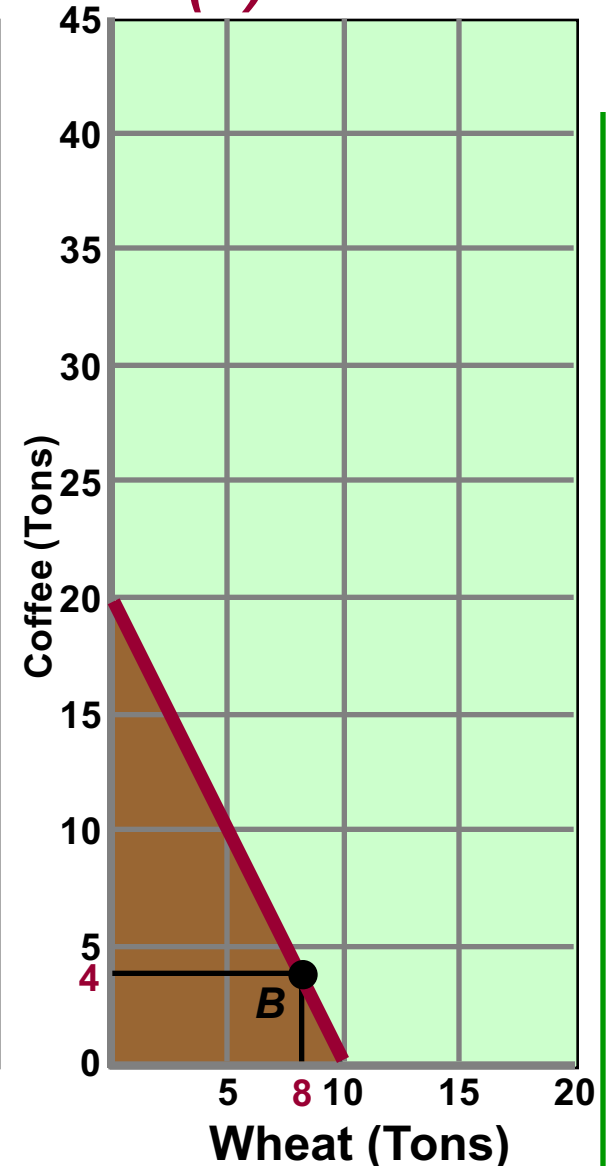
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The Economic Basis for Trade

(a) United States



(b) Brazil



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The Economic Basis for Trade

- Specializing Based on Comparative Advantage (must use comparative advantage to determine what each country should produce)
 - Principle of Comparative Advantage- total output will be highest when each good is produced by the nation with the lowest opportunity cost



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The Economic Basis for Trade

- Terms of Trade (exchange ratio between the two nations)
 - $1W \equiv 1C$ in the U.S. (so U.S. wants *more* than 1 Coffee for each Wheat)
 - $1W \equiv 2C$ in Brazil (so Brazil wants to give *less* than 2 coffee for each wheat) (1.5 C for each 1W)...
- Gains from Trade
- Trading Possibility Line
 - Improved Options
 - Added Output

Key Terms



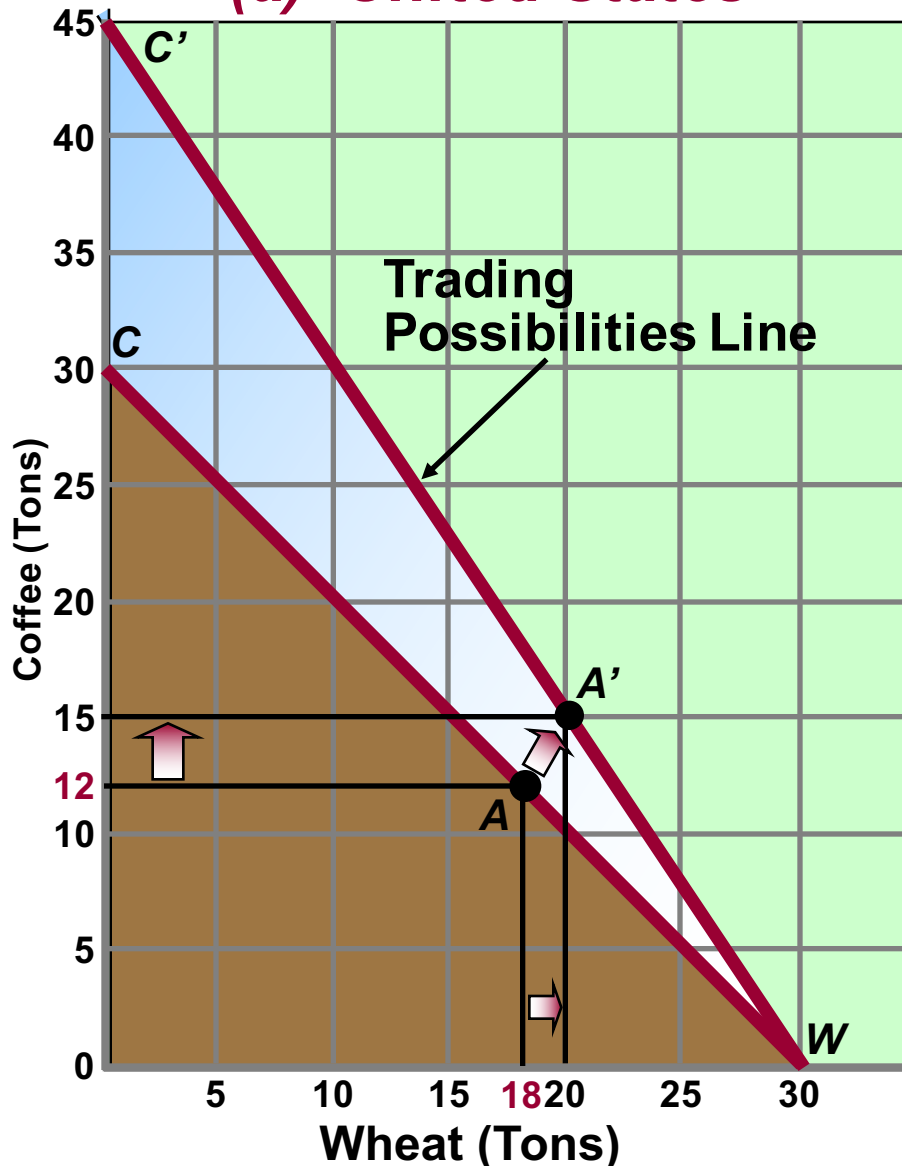
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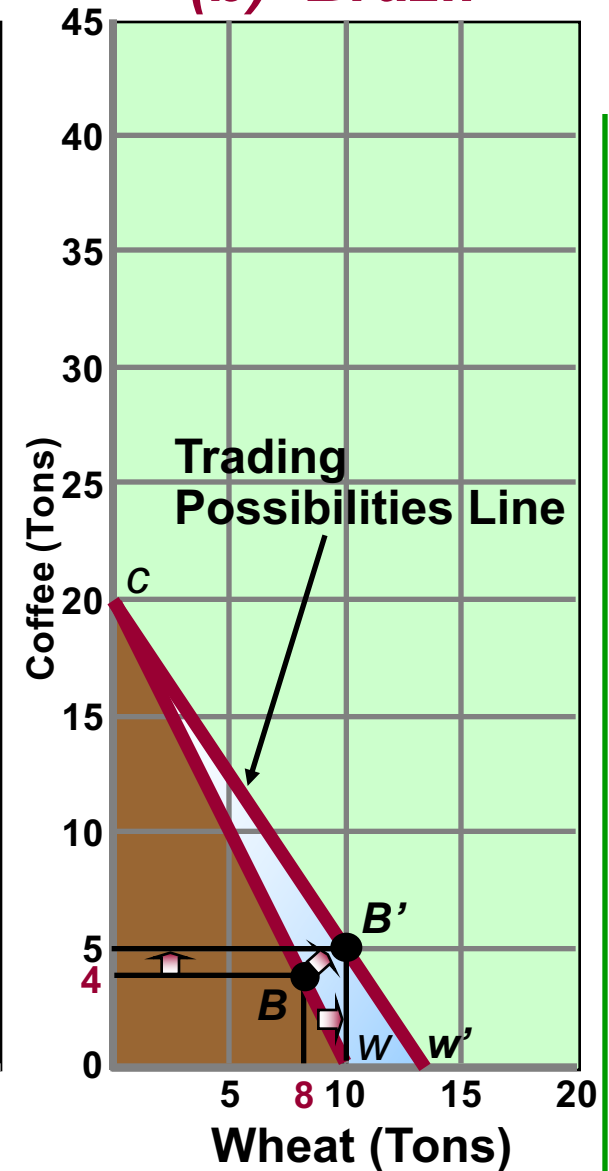
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The Economic Basis for Trade

- Trade with Increasing Costs – we never see complete specialization due to increasing opportunity costs
- The Case for Free Trade
 - 1. the world economy can achieve more efficient allocation of resources, higher standard of living
 - 2. promotes competition (efficiency)
 - 3. promotes positive relationships

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Supply and Demand Analysis of Exports and Imports

- World Price – equilibrium price determined by supply and demand on the world market
- Domestic Price – equilibrium price determined by supply and demand in a closed economy
- Export Supply Curve – upward sloping, shows amount exported at each world price above the domestic price
- Import Demand Curve – downward sloping, shows amount imported at each world price below the domestic price

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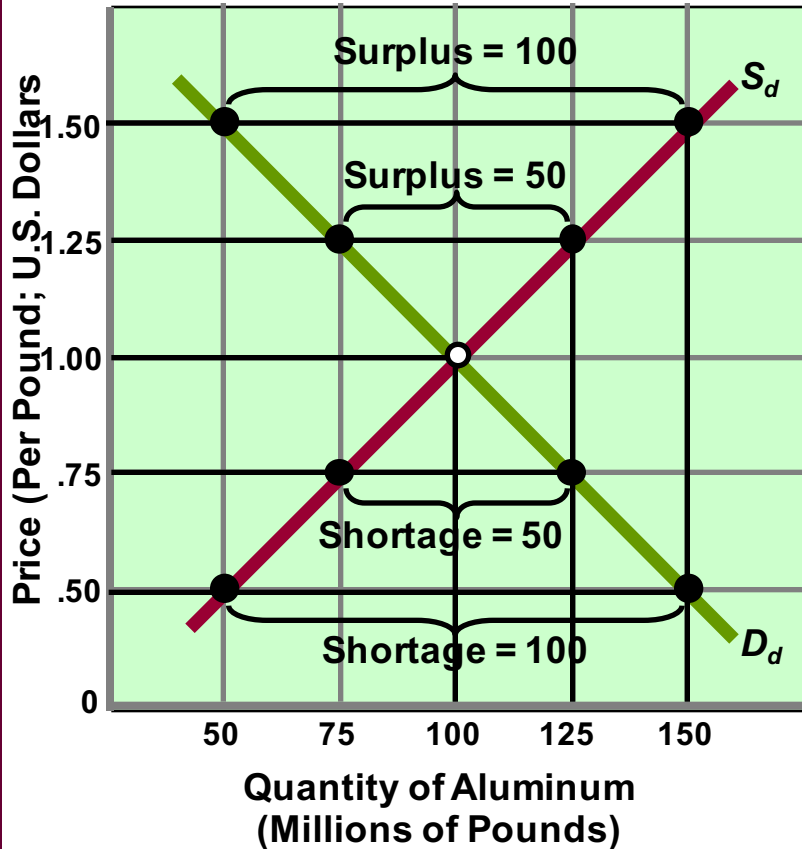


Supply and Demand Analysis of Exports and Imports

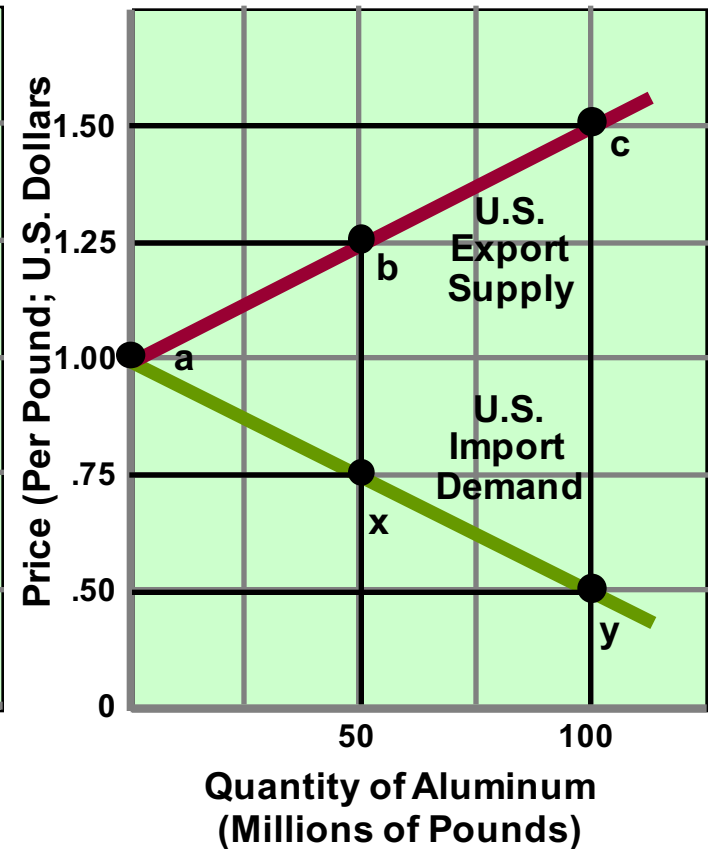
U.S. Aluminum Market

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(a) U.S. Domestic Aluminum Market



(b) U.S. Export Supply and Import Demand



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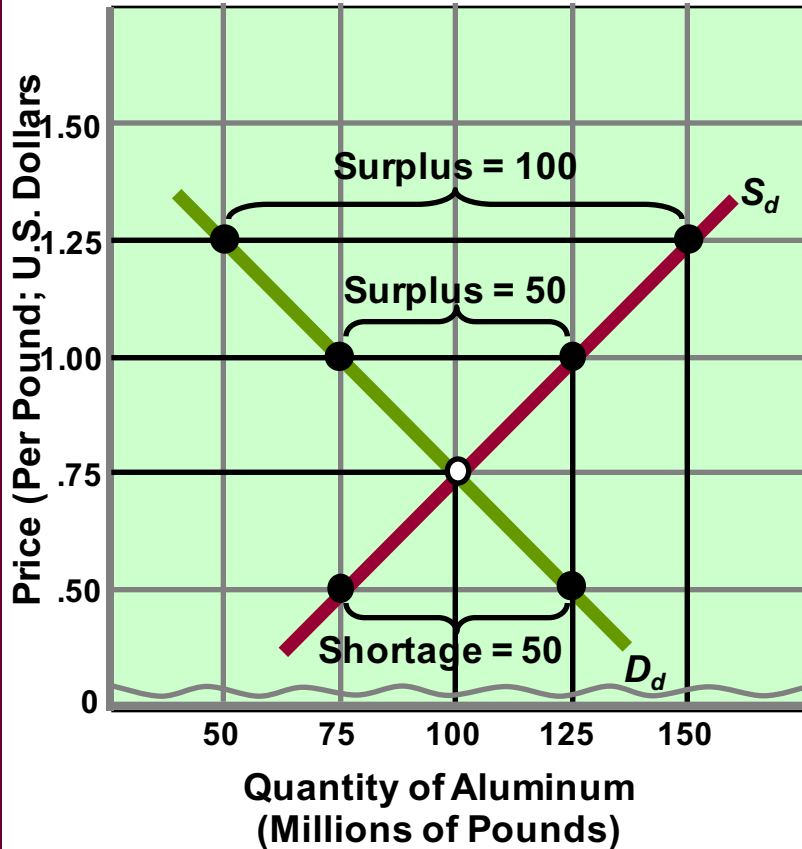


Supply and Demand Analysis of Exports and Imports

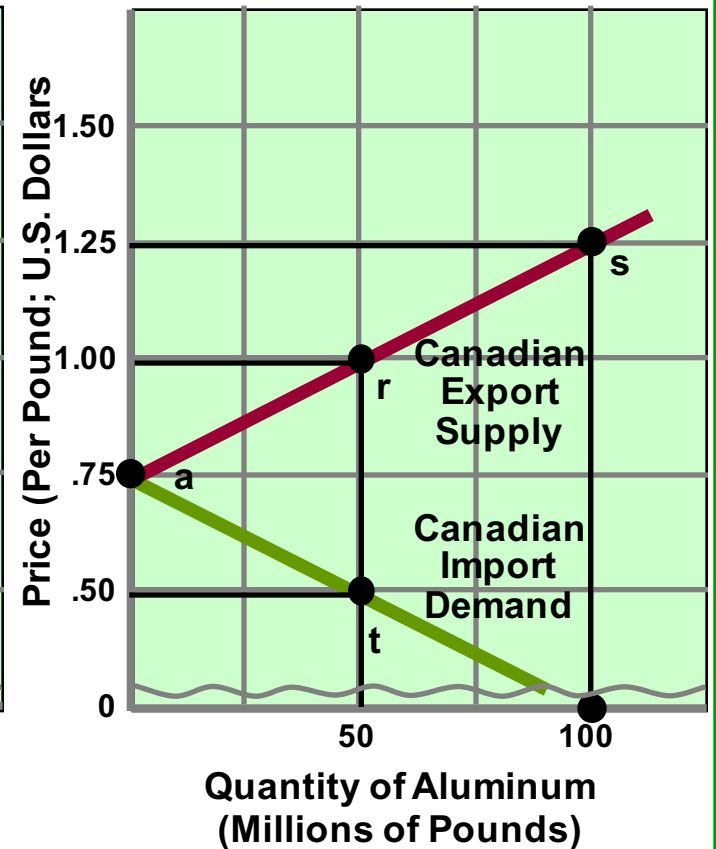
Canadian Aluminum Market

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(a) Canada's Domestic Aluminum Market



(b) Canada's Export Supply and Import Demand



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Supply and Demand Analysis of Exports and Imports

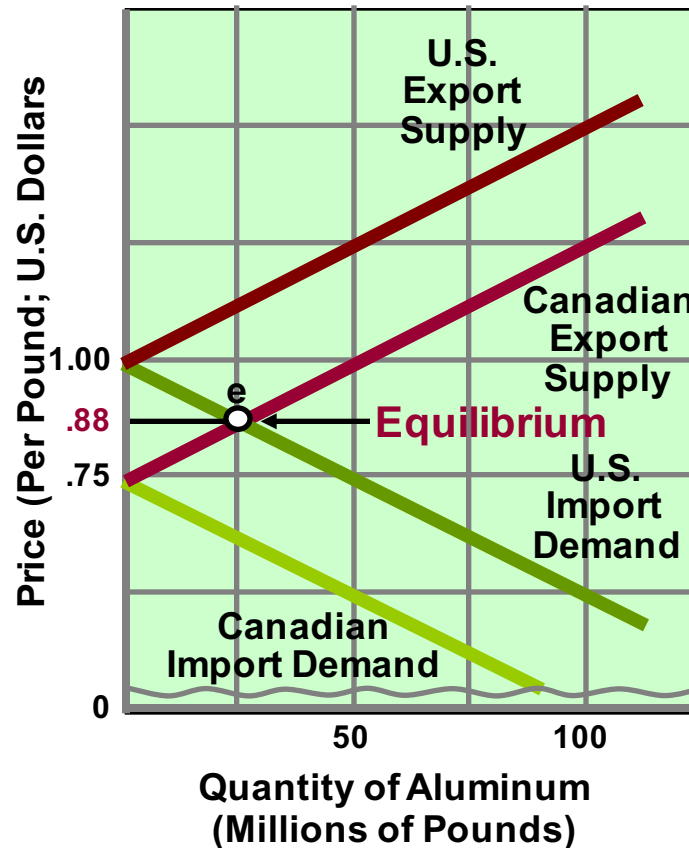
World Market for Aluminum

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Equilibrium World Price and Quantity of Exports and Imports



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Trade Barriers

- Revenue Tariff – tax on imported goods in order to provide income for the gov (typically applied to products the US does not produce)
- Protective Tariff – tax on imports meant to protect US producers from foreign competition
- Import Quota – sets a limit on the quantity of a good that can be imported
- Nontariff Barrier (NTB) – gov restriction that prevents or reduces imports EX – licensing, regulations



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Trade Barriers

- Voluntary Export Restriction (VER) – nations voluntarily limit exports in order to avoid other restrictions or maintain positive relations
- Economic Impact of Tariffs
 - Direct Effects
 - Decline in Consumption (higher price)
 - Increased Domestic Production (less imports)
 - Tariff Revenue (gov gains, consumers lose)
 - Indirect Effect
 - Other nations buy less US goods, promotes inefficient production, retaliation!

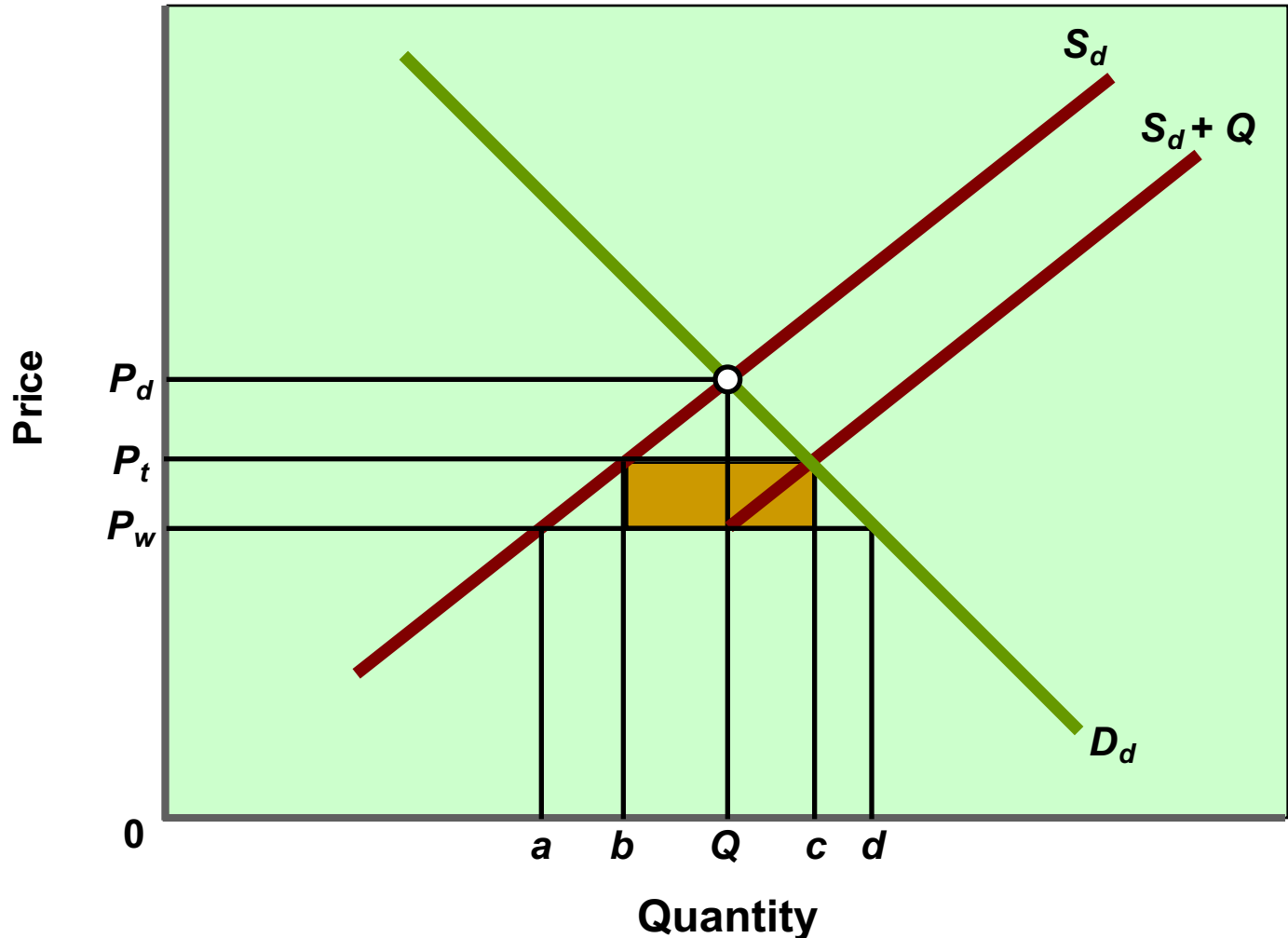


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Trade Barriers

Economic Effects of a Protective Tariff or an Import Quota

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Trade Barriers

- **The Case for Protection: A Critical Review**
 - **Military Self-Sufficiency Argument**
 - **Diversification-for-Stability Argument**
 - **Infant Industry Argument**
 - Counterarguments
 - Strategic Trade Policy
 - **Protection-Against-Dumping Argument**
 - Dumping
 - **Increased Domestic Employment Argument**
 - Smoot-Hawley Tariff Act
 - **Cheap Foreign Labor Argument**

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Trade Adjustment Assistance

- **Trade Adjustment Assistance Act of 2002**
- **Offshoring**
- **The World Trade Organization (WTO)**
–The DOHA Round

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The WTO Protests

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Various Protest Groups Angrily Target WTO

– Environmentalists, Socialists, Anarchists

- Labor Protections
- Environmental Standards
- Desire to Liberalize Trade Through Multilateral Negotiations
- International Labour Organization (ILO)

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Key Terms

- labor-intensive goods
- land-intensive goods
- capital-intensive goods
- opportunity-cost ratio
- principle of comparative advantage
- terms of trade
- trading possibilities line
- gains from trade
- world price
- domestic price
- export supply curve
- import demand curve
- equilibrium world price
- tariffs
- revenue tariff
- protective tariff
- import quota
- nontariff barrier (NTB)
- voluntary export restriction (VER)
- strategic trade policy
- dumping
- Smoot-Hawley Tariff Act
- Trade Adjustment Assistance Act
- offshoring
- World Trade Organization (WTO)
- Doha Round

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Next Chapter Preview...

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Exchange Rates, the Balance of Payments, and Trade Deficits

Chapter 36!

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