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Notes – Topic 13

Topic 13: International Trade

I. Introduction
  a. Used to spend about 95% of semester looking at closed economy. Now significant portion of class spent on international economics.
  b. Nations becoming more and more economically connected.
  c. US in 70s had about 10% of GDP in imports/exports. Now about 30% of GDP.
    i. Total Exports + Total Imports. NOT the same as Net Exports, in which the two are *subtracted*.
    ii. US one of the less open nations. Canada has closer to 90% of GDP.
  d. All economists agree that trade benefits all participating nations.

II. Absolute Advantage
  a. Deals with who can produce a good/service at the lowest cost.
  b. One Widget
    i. 2 labor-hours in Japan.
    ii. 3 labor-hours in Korea.
    iii. Japan has an absolute advantage.
  c. Nations should specialize in what they have an absolute advantage in and then trade amongst themselves to determine the final distribution of goods.
  d. US has an absolute advantage in wheat production, Saudi Arabia has an absolute advantage in oil production.

III. Comparative Advantage
  a. Comparative advantage is an extension of Gains from Trade
  b. Mankiw Chapter 3 is a good source.
  c. *Not* the same as absolute advantage.
  d. Does it make sense to trade with a nation that has no absolute advantage in anything? Yes.
  e. Nation should specialize in the good/service it has the best comparative advantage in.
  f. Which nation can produce a good at the lowest cost of other outputs.
  g. "Relatively Less Inefficient"
  h. One Weedget:
    i. 1 labor-hour in Japan.
    ii. 3 labor-hours in Korea.
    iii. Only two nations trading, only two goods produced (widgets, weedgets)
    iv. Korea relatively less efficient in widget production.
  i. Every nation must have a comparative advantage in producing *something* (by definition).
  j. Total global efficiency will be highest if nations produce what they have a comparative advantage in.
  k. Autarky → Nation produces everything it consumes.
  l. Example
    i. Suppose US has an absolute advantage over Mexico in producing both computers and clothing.
    ii. Suppose US is more efficient, relatively, at producing computers.
    iii. If Mexico produces more clothing, US can spend more of its resources on computers, which it's better at anyway.

IV. Real-World Implications
  a. Unassailable in theory.
  b. Other factors come into play realistically.
  c. Costs of Adjustment.
    i. For US to produce less clothing and more computers, US clothing workers will lose out.

        ii. The whole *point* is to free workers from the clothing industry, but the workers won't be too happy.
        iii. Short-term losers tend to be low-skill workers.
        iv. The people who immediately gain tend to be the ones who were already best off beforehand.
    d. Comparative advantages shift
        i. The same industries don't perpetually have a comparative advantage.
        ii. Some industries aren't very good to have a comparative advantage in.
            1. Low Value-Added industries.
            2. Coffee, rubber, timber, unprocessed commodities.
            3. Better to have a comparative advantage in software, aircraft, entertainment, etc.
        iii. Japan
            1. Used to have a comparative advantage in "Cheap Stuff": cheap toys, silk ties, etc.
            2. Decided against sticking with its advantages and focusing instead on high value-added industries.
            3. Strategy obviously worked and its comparative advantage did eventually shift to that area.
        iv. Japan's strategy doesn't always work.
            1. Infamous Brazillian Computer Industry.
            2. Brazil decided it didn't want to produce timber and coffee, it decided to produce computers instead.
            3. Ultimately it just wasted labor-hours on an industry it wasn't good at instead of sticking with the industry it really did have a comparative advantage in.

V. Arguments For Trade
    a. Economies of Scale
        i. Lower production costs as they produce more.
        ii. If the world's markets are open, it's easier to sell enough to reap the benefits of economies of scale.
        iii. Probably more important than comparative advantage.
    b. Increased Product Differentiation
        i. A lot of trade is "Inter-Industry Trade"
            1. Nations both import and export in the same industry.
            2. Makes no sense from the perspective of comparative advantage or economies of scale.
        ii. Minor differences in products' characteristics matter to consumers.
        iii. Bigger range of choice.
        iv. Can't *measure* the benefits, but they obviously exist.

VI. Arguments Against Trade
    a. "Cheap Labor"
        i. Argument
            1. Since wages are lower in other countries, US workers will lose out big time if they're in competition.
            2. US wages may be forced down to the same level.
            3. US jobs will simply be lost as firms move their operations or shut down completely.
        ii. Truth
            1. Low wages reflect lower productivity.
            2. US worker get paid more because they produce more.
            3. Examples
                a. Indonesian workers paid $2/hour produce 1 widget per labor-hour
                b. US workers paid $10/hour produce 5 widgets per labor-hour.
                c. Unit labor cost is the same and it's what's important.

4. Why?
    a. Production Technology
    b. Capital/Labor Ratio (K/L)
    c. Human Capital (H) Education.
    d. Economic and Social Infrastructure. Political / Legal institutions, power grids, communications, transportation, etc.
5. Some short-run truth to the "Cheap Labor" argument, since firms can cut train workers and import technology, but eventually economic forces will balance it out.

b. "Infant Industry"
    i. Relates to shifting of comparative advantage
    ii. A new industry in a nation can't compete against established industries in other nations.
    iii. Example: Airbus
        1. Europeans tried producing passenger jets.
        2. Would've been crushed by Boeing if it hadn't been producted.
        3. Industry was sheltered and subsidized until it was strong enough and *then* allowed international competition.
    iv. Economists tend to accept but qualify this argument.
    v. No guarantee a sheltered industry will ever become competitive. If it doesn't, let it fail or continue to protect it forever?

c. National Security
    i. Trade may be prohibited by security concerns.
    ii. During Cold War, Western nations maintained strict controls on military related technologies.
    iii. Tends to be abused. Swamps out economic arguments.
    iv. During WWII, Angora wool was protected since it was used to make US uniforms. It's still protected, for no legitimate reason.

d. Fundamental Power Asymmetry
    i. Argument: Whenever rich and poor nations interact, the poor nations are exploited.
    ii. Truth: Most successful developing nations recently have been those open to trade.

VII. Protectionism Background

a. Protectionism → Government policies designed to shelter firms from foreign imports.
b. Purpose is to assist domestic producers.
c. Carries a cost to consumers! Foreign competition keeps domestic firms "on their toes."
d. 1900ish
    i. Very open world economy, even compared with today.
    ii. WWI abruptly ended openness.
    iii. Between WWI and WWI very little trade.
    iv. Great Depression (among other factors) led to many protectionist policies.
e. After WWII
    i. US pressured non-communists to accept more trade.
    ii. Bretton Woods Conference → US, British, and other economists worked to establish framework for more trade.
        1. System survived until 70s almost unchanged.
        2. Setup WorldBank and IMF (details later)
        3. Set path to create GATT (General Agreement on Tariffs and Trade)
f. Through end of Cold War
    i. U.S. was the champion of free trade: fewer protectionist policies than most other nations.
    ii. Politically valuable to bolster position in cold war.
    iii. Afterward, US began retreating.

g. 1996
    i. Congress refused to give President Clinton "Fast Track Authority"
        1. "Fast Track Authority" → Empowers president to negotiate trade that cannot be altered by congress
        2. Considered major blow to US position as champion of free trade.
    ii. Bush administration claims to be very pro-trade vocally but is more protectionist than Clinton was.
    iii. Bush has also failed to get Fast Track legislation passed in the senate.

VIII. Forms of Protectionism
a. Tariffs
    i. Taxes on imports.
    ii. Generally considered "less bad" than other forms of protectionism.
    iii. Transparent. Transparency → Obvious and quantitative. Nothing sneaky about it.
    iv. Source of revenue for the government imposing them (the tariffs).
    v. Still creates problems for consumers.
        1. Reduces competition from foreign firms.
        2. In long-run may even hurt domestic producers.
        3. Reduces incentive to innovate and improve quality.
        4. These disadvantages apply to *all* forms of protectionism.
b. Quotas
    i. Numerical legal limits on imports.
    ii. Deals directly with quantity. How many will be allowed?
    iii. US allows *x* tons of sugar from one country, *y* from another, etc.
    iv. 100s of millions of dollars every year in benefits to US sugar producers.
    v. Still very transparent but raises no revenues.
    vi. *Could* raise revenue by auctioning off quota rights instead of giving them away, but that's not considered good practice.
c. VERs
    i. Voluntary Export Restrictions
    ii. Quotas that are negotiated with the exporting countries.
    iii. In most cases they're not really voluntary.
    iv. Implicit understanding that importing country could just pick a number, so letting the exporting country participate in negotiations is valuable.
    v. VERs on Japanese auto imports in the 1980s. Negotiated levels with representatives from the Japanese auto industry.
    vi. Still transparent, but still don't raise revenue for any government.
    vii. Ironically tends to create windfall profits for foreign firms.
        1. Reduces supply so much that prices skyrocket.
        2. Increase can be so dramatic that it more than compensates for the reduced quantity.
        3. US auto firms didn't even take advantage of the chance to regroup – they just raised prices.
d. Non-Tariff Barriers
    i. The worst kind of protectionism
    ii. Rules and regulations and laws that have the effect of reducing imports
    iii. Often very difficult to measure or even identify.
    iv. Exceedingly non-transparent.
    v. European Union has restrictions on US beef treated with hormones and genetically altered fruits and vegetables.
    vi. Sounds reasonable but there isn't really a health risk. European Union is probably just protecting its agricultural interests.
    vii. Japan is notorious for its non-tariff barriers.
        1. On paper, Japanese economy is *very* open.
        2. Tons of regulatory obstacles restricting imports that sometimes aren't even known before shipments arrive.