

The Power of Macroeconomics

Lecture Nine: International Trade and Protectionism



Presented By:
Professor Peter Navarro
University of California-Irvine

Introduction

- Alphabet Soup: NAFTA, GATT, the Euro.
- **The Language of Trade:**
 - Tariffs, quotas, trade deficits.
 - Dumping, non-tariff barriers, protectionism.
- A language we must come to master!



In This Lecture

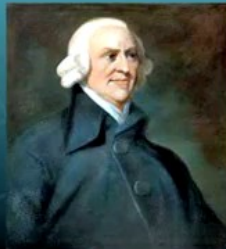
- Examine economic principles governing trade.
- **Ask:** Why do nations trade?
- **Ask:** How do nations decide what to import and export?

Key Concept

Absolute advantage versus comparative advantage.

Absolute Advantage As A Basis For Trade

- A country that can produce a good at a lower cost than another country has an **absolute advantage** in the production of that good.



An Absolute Advantage Example

- **Saudi Arabia:** Cheap oil, expensive food.
- **America:** Cheap food, expensive oil





An Absolute Advantage

- Saudi Arabia has an absolute advantage over the U.S. in producing oil.
- The U.S. has an absolute advantage over Saudi Arabia in producing food.

Prediction?
The theory of absolute advantage says
America will sell food to Saudi Arabia
and buy oil from it.

Let's Think Again!

- The principal of absolute advantage appears to make eminent sense.
- The theory is, however, badly flawed.

% of Resources Devoted to Autos				% of Resources Devoted to Autos			
	Autos Produced	Food Produced	Row		Autos Produced	Food Produced	Row
100%	100	0	A	100%	20	0	A
80	80	40	B	80	16	1	B
60	60	80	C	60	12	2	C
40	40	120	D	40	8	3	D
20	20	160	E	20	4	4	E
0	0	200	F	0	0	5	F
Germany 				Algeria 			

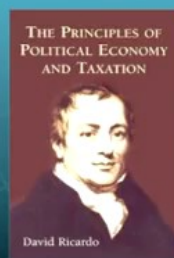
- ♦ The theory of absolute advantage predicts Germany has **nothing** to gain from trading with Algeria.

Will Comparative Advantage Trump Absolute Advantage As A Theory?

- A more subtle understanding of trade patterns is embodied in the theory of comparative advantage.

The Theory Of Comparative Advantage

- Set forth by David Ricardo.
- The historical context for the development of Ricardo's theory is VERY interesting.



An European-American Trade War?

- Should Europe protect its markets from American imports using tariffs or quotas?
- **Europe's Concern:** America would have an absolute advantage producing many goods because of cheap labor and land.
- America therefore might therefore not import from Europe – just export its cheaper goods.
- **Jobs would be destroyed in Europe!**

The Principle of Comparative Advantage

The Key Concepts

1. Each country will benefit if it specializes in the **export** of those goods that it can produce at relatively **low** cost.
2. Conversely, each country will benefit if it **imports** those goods that it produces at relatively **high** cost.