LECTURE NINE - PART FIVE

A Cautionary Note

Key Point
There are severe real-world limitations of the simplified Ricardian free trade model.

The Ricardian Free Trade Model

- Two countries engage in unrestricted free trade.
- Both countries follow the principles of comparative advantage.
- Both countries gain from free trade.
- It's a "win-win".

Why Free Trade Is Like A Marriage

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- If one partner cheats on the other, the relationship will fail.

When Free Trade Fails

- A cheating country uses unfair trade practices to illegally subsidize exports.
- The cheater also uses trade barriers to protect its own markets.
- Under these conditions, free trade becomes a "zero sum" game.

The Result
Jobs and growth shift to the cheater at the expense of the country being cheated upon.

The Mercantilist Case of China

- China joined the World Trade Organization in 2001.
- China promised to obey free trade rules.
- China instead engaged in unfair trade practices.
- Practices included currency manipulation, illegal export subsidies, piracy, & forced technology transfer.

China Causes A Major Structural Shift In The World Economy

- China captures more and more of the world's manufacturing base using unfair trade practices combined with cheap labor.
- Countries around the world suffer from slower growth and less job creation.
- This was not how David Ricardo envisioned free trade!

In The Next Lecture

- Introduce a companion theory to Ricardian comparative advantage.
- The exchange rate model predicts trade imbalances smoothly adjust through market forces and ALL countries gain through trade.
- These theoretically smooth adjustments haven't always taken place in the real world!

Bottom Line
The textbook model of free trade provides important insights but isn't always mirrored in the real world!

THE POWER OF MACROECONOMICS

Professor Peter Navarro
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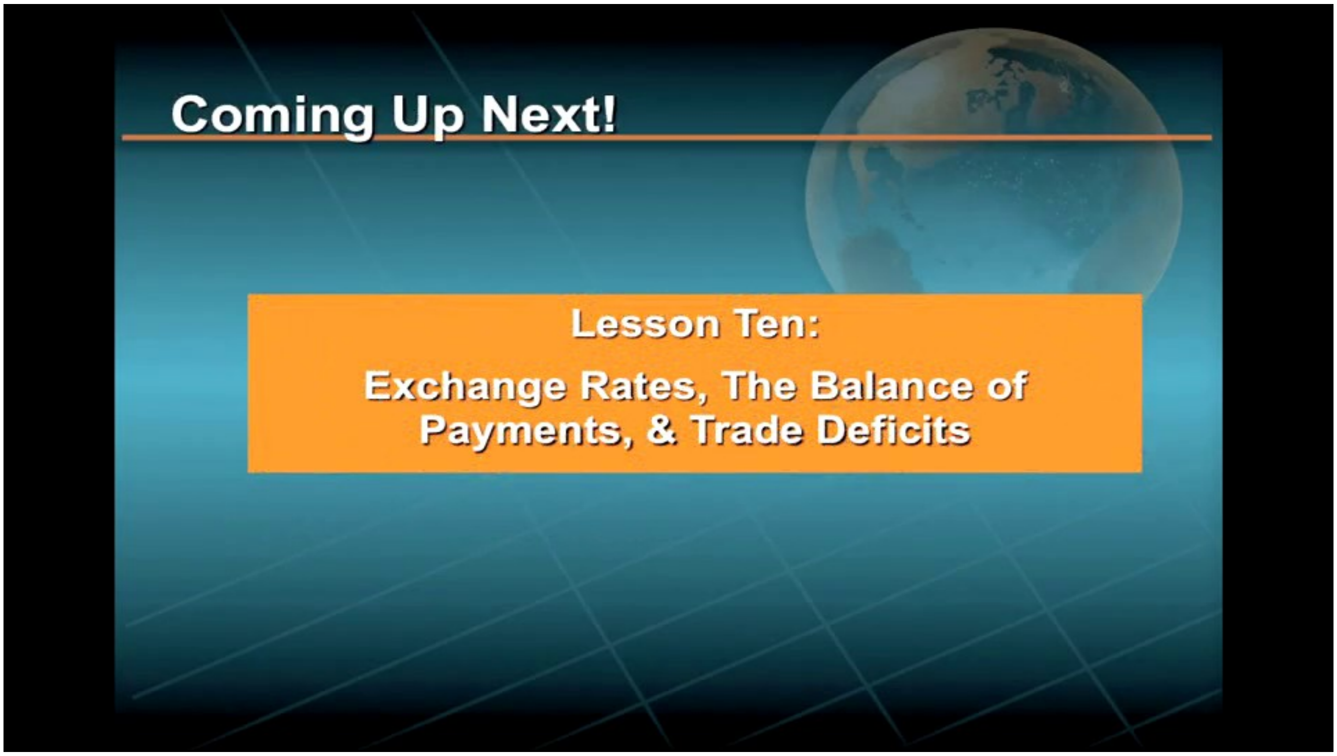
END OF LESSON NINE


Coming Up Next!
Lesson Ten:
Exchange Rates, The Balance of Payments, & Trade Deficits