Chapter 6: International Trade

International Trade

Chapter 1 + Chapter 4 → Chapter 6 ☺

How much to import or export?

What happens if the government intervenes by implementing trade policies?

International Trade

Definitions:

The **Domestic Price** represents the equilibrium price that would occur in a country if no international trade is allowed.

The **World Price** represents the equilibrium price on the international market.

International Trade

Definitions:

A **Small Open Economy** is an economy that participates in international markets, but its production (or consumption) is small enough compared to the rest of the world that its supply (or demand) does not affect the world price.

A **Closed Economy** is an economy that does not engage in international trade. Also known as **autarky**.

International Trade

Meet a small open economy ☺

→ Has a certain P_d (domestic price), and

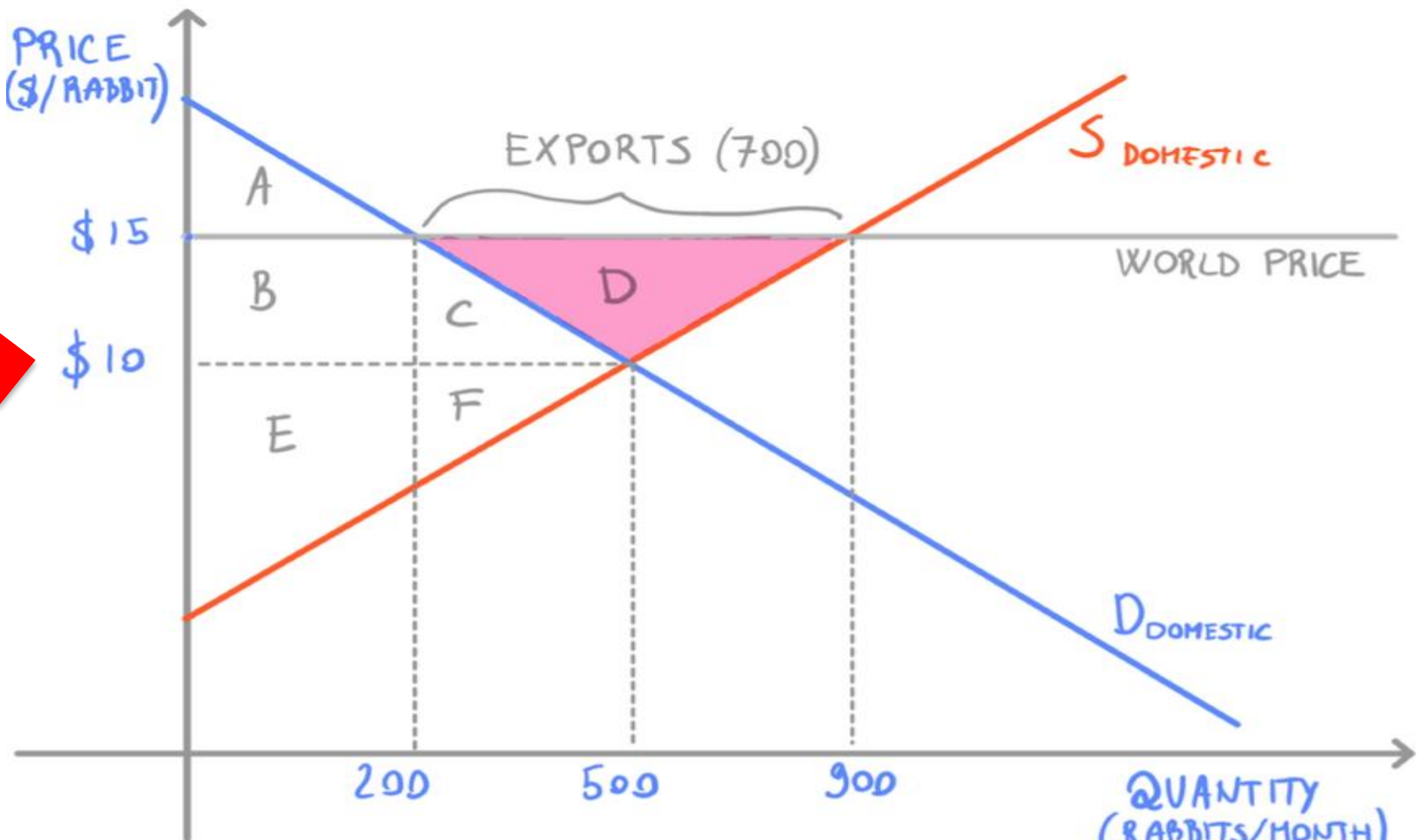
→ takes P_w (world price) as given

→ no seller will accept less than P_w as he can always sell overseas at P_w;

→ no buyer will pay more than P_w as she can always buy from overseas at P_w.

A. Exporting

Say P_d = \$10 and P_w = \$15



Without Trade:
$P^* = P_d = \$10$

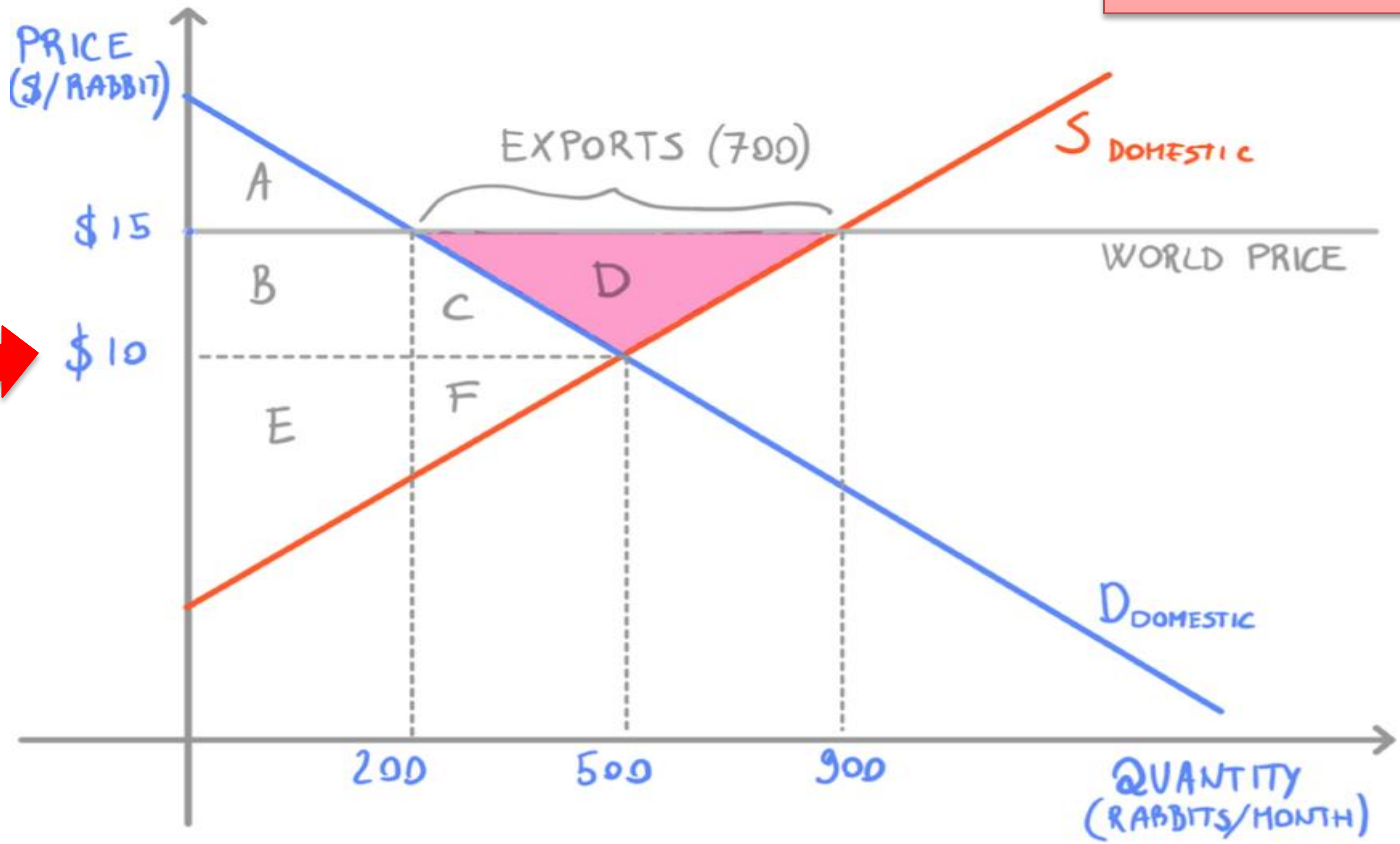
With Trade:
$P^* = P_w = \$15$

A. Exporting

If $P_d < P_w$

→ Exporter!!!

Say P_d = \$10 and P_w = \$15



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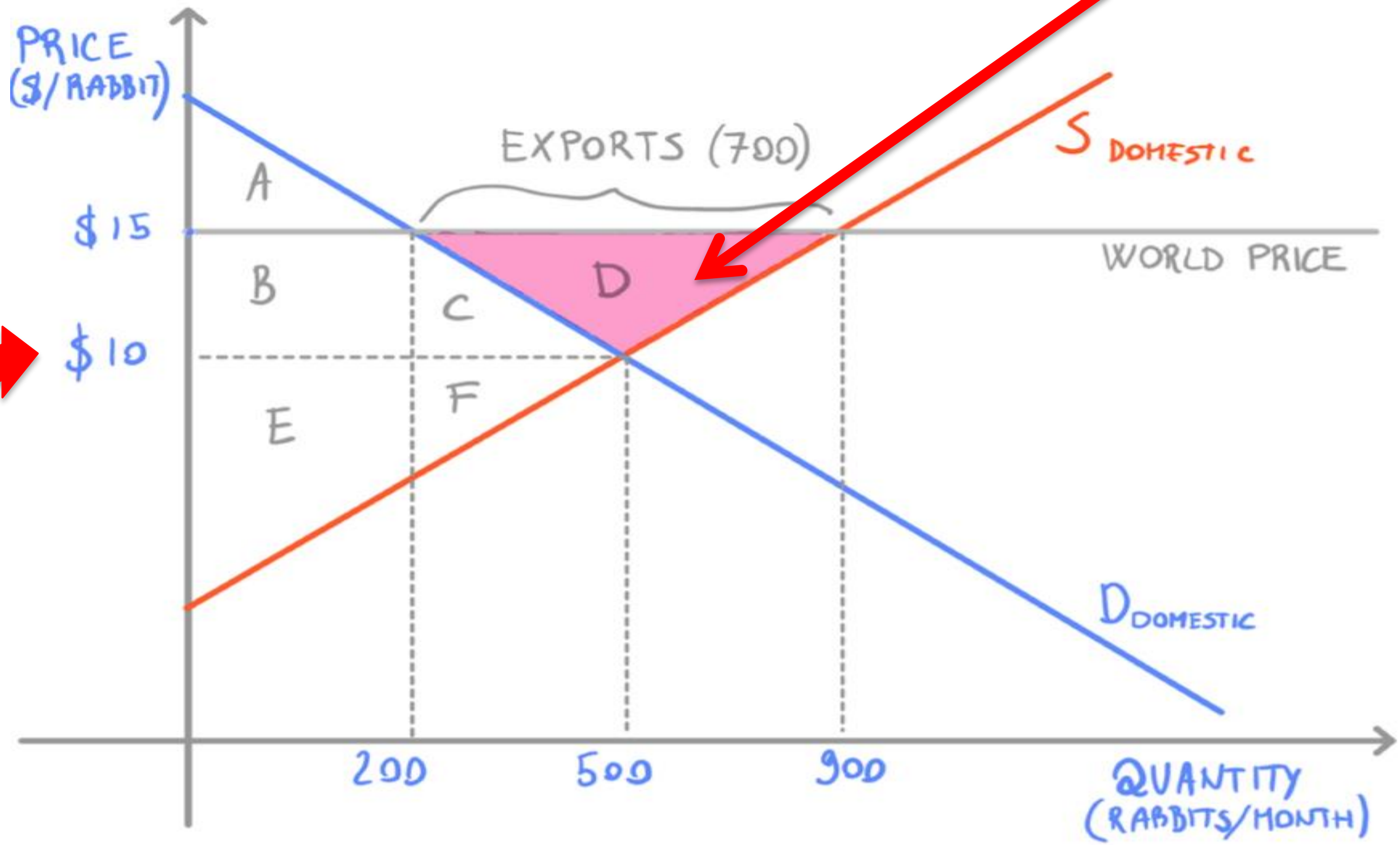
A. Exporting

Why we generally want countries to open up to trade?

A. Exporting

Say P_d = \$10 and P_w = \$15

Gains from Trade!



Without Trade:
$P^* = P_d =$ \$10

With Trade:
$P^* = P_w =$ \$15

A. Exporting

<u>Definition:</u>

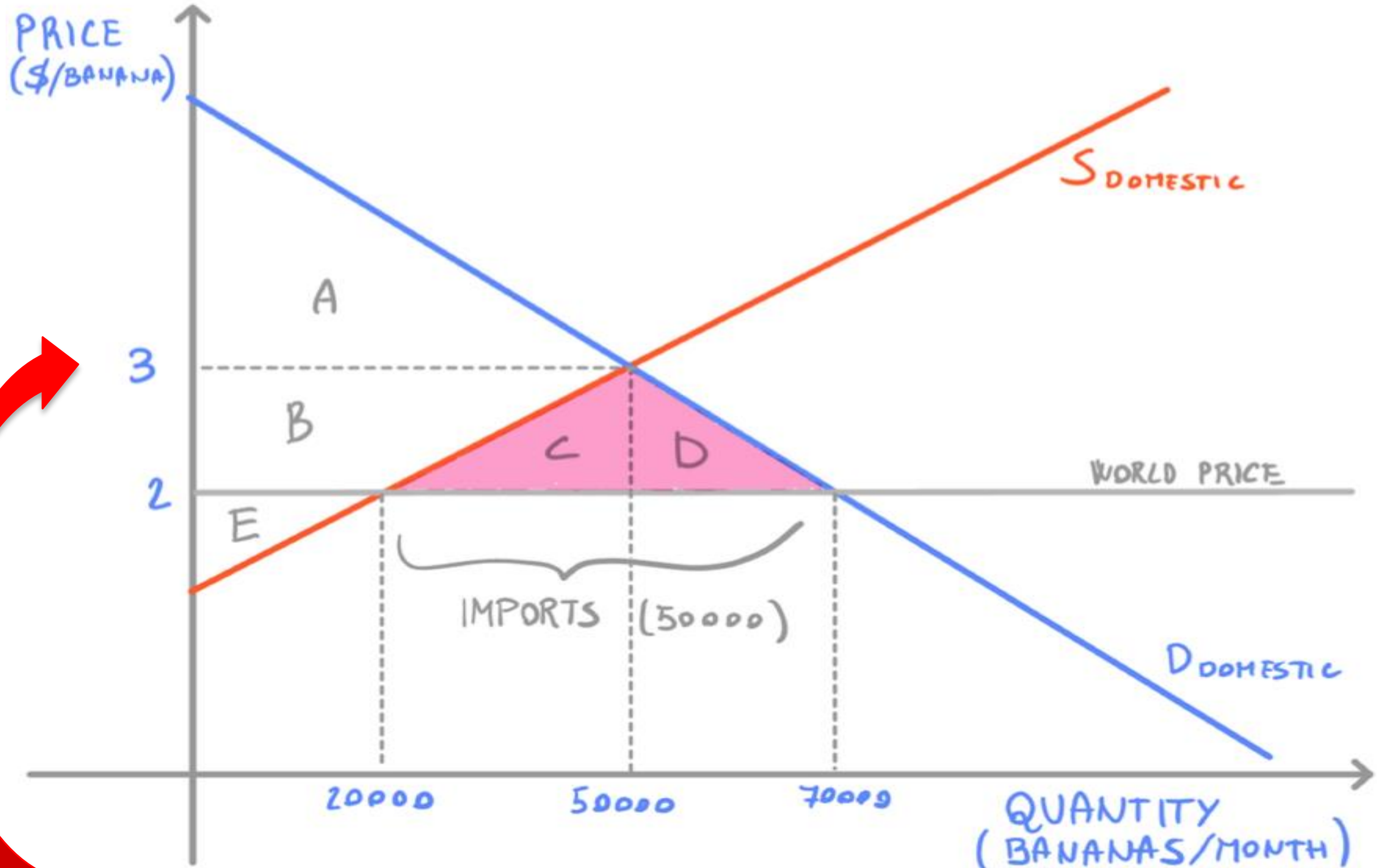
The **Gains from Trade** capture the extra surplus available in an open economy compared to a closed economy.

A. Exporting

The **Gains from Trade** come from international consumers (at the expense of domestic consumers surplus)!

B. Importing

Say P_d = \$3 and P_w = \$2



Without Trade:

$P^* = P_d = \$3$

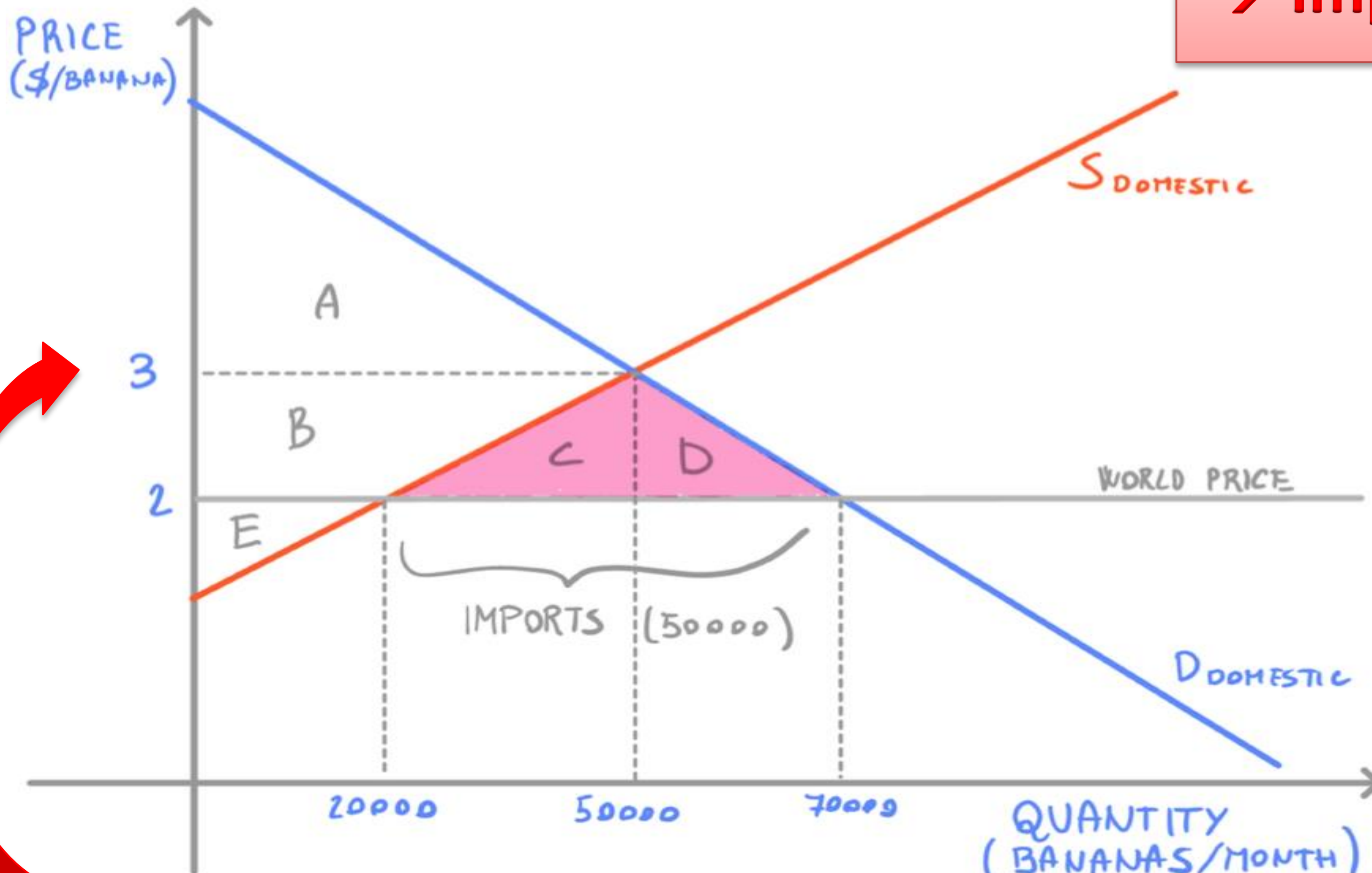
With Trade:

$P^* = P_w = \$2$

B. Importing

Say P_d = \$3 and P_w = \$2

If $P_d > P_w$ → Importer!!!



Without Trade:

$P^* = P_d$ = \$3

With Trade:

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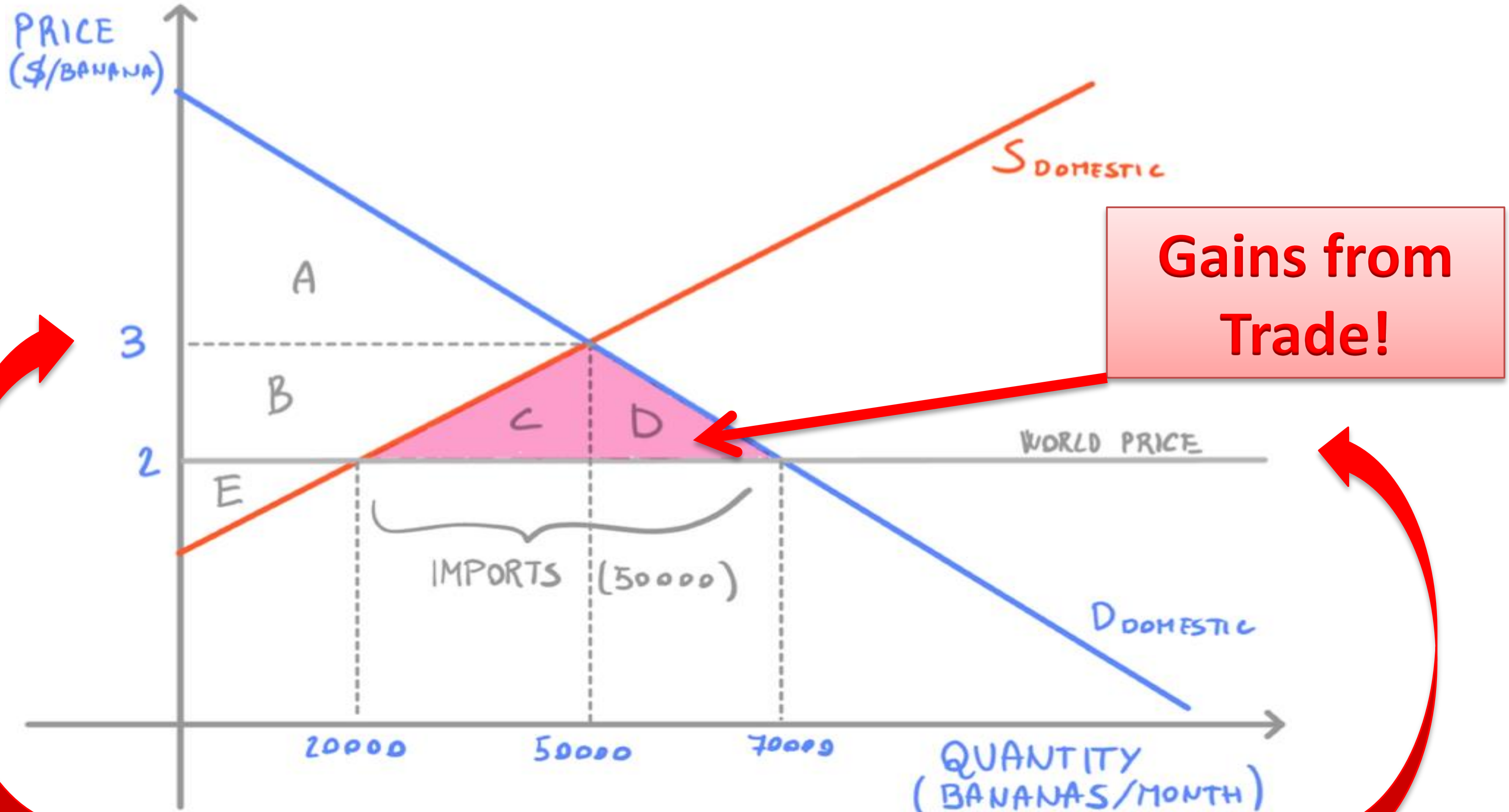
B. Importing

Why we generally want countries to open up to trade?

B. Importing

Say P_d = $3 and P_w = $2



Without Trade:

$P^* = P_d = \$3$

With Trade:

$P^* = P_w = \$2$

B. Importing

The **Gains from Trade** come from <u>larger surplus for domestic consumers</u> (who now buy at lower prices)!

Additional Benefits from Trade

- **Consumers** have access to a wider variety of goods (Italian soft drinks, Indian movies),
- **Producers** may be able to take advantage of economies of scale by selling to a larger market (bauxite, copper),
- **Domestic monopolies** or oligopolies might face international competition, reducing their market power (bookstores),
- **Flow of ideas and technology** is faster and easier. ☺

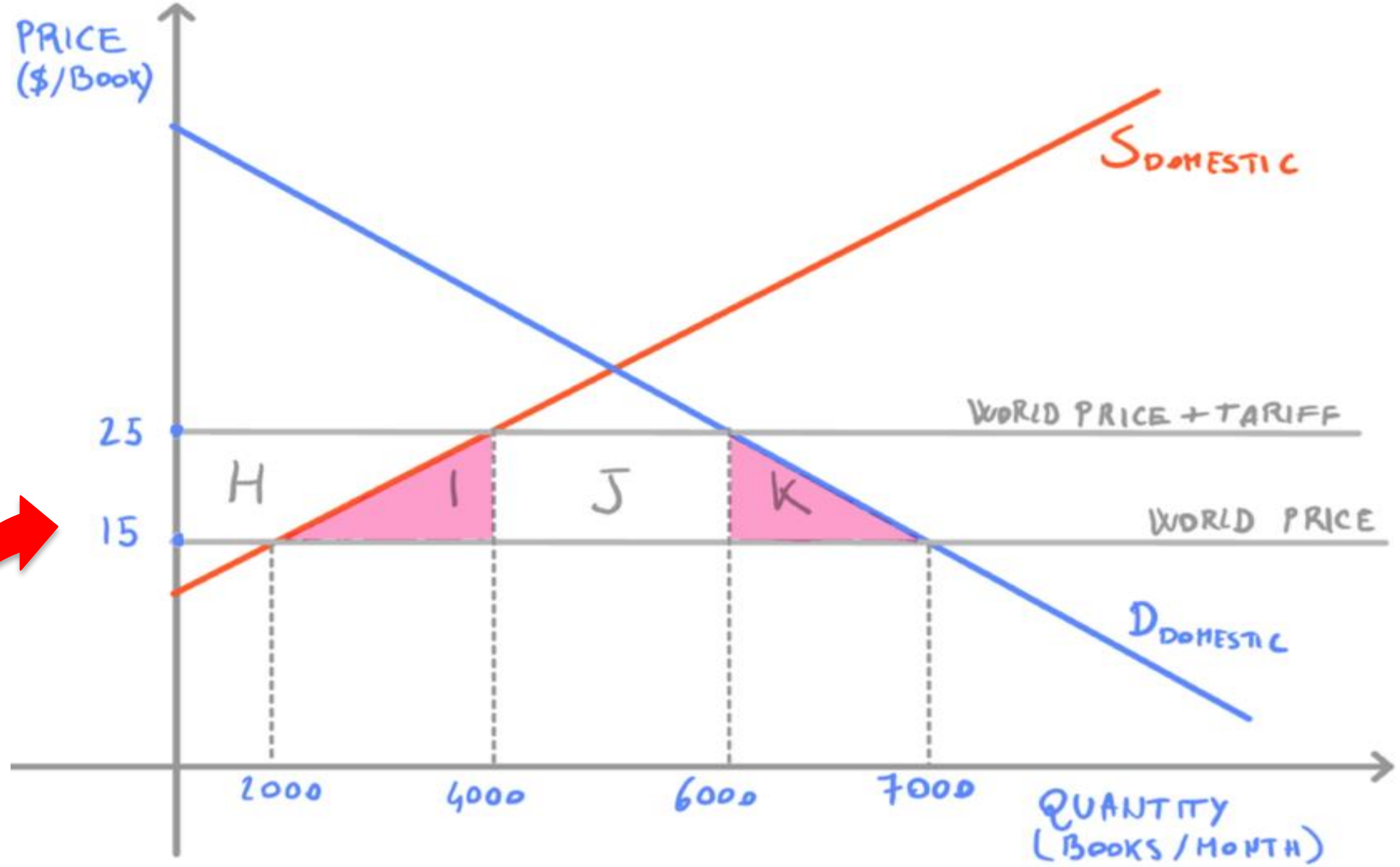
C. Trade Restrictions: Tariffs

Definition:

An **Import Tariff** represents a tax on imported goods or services.

C. Trade Restrictions: Tariffs

Say P_w = \$15 & t = \$10 → $P_d = P_w + t$ = \$25 (all books)



With Free Trade

$P^* = P_w$ = \$15

With Tariffs

$P^* = P_d$ = \$25

C. Trade Restrictions: Tariffs

Domestic **consumers lose** BUT domestic **producers/government gain**

→ is a tariff **good or bad**?

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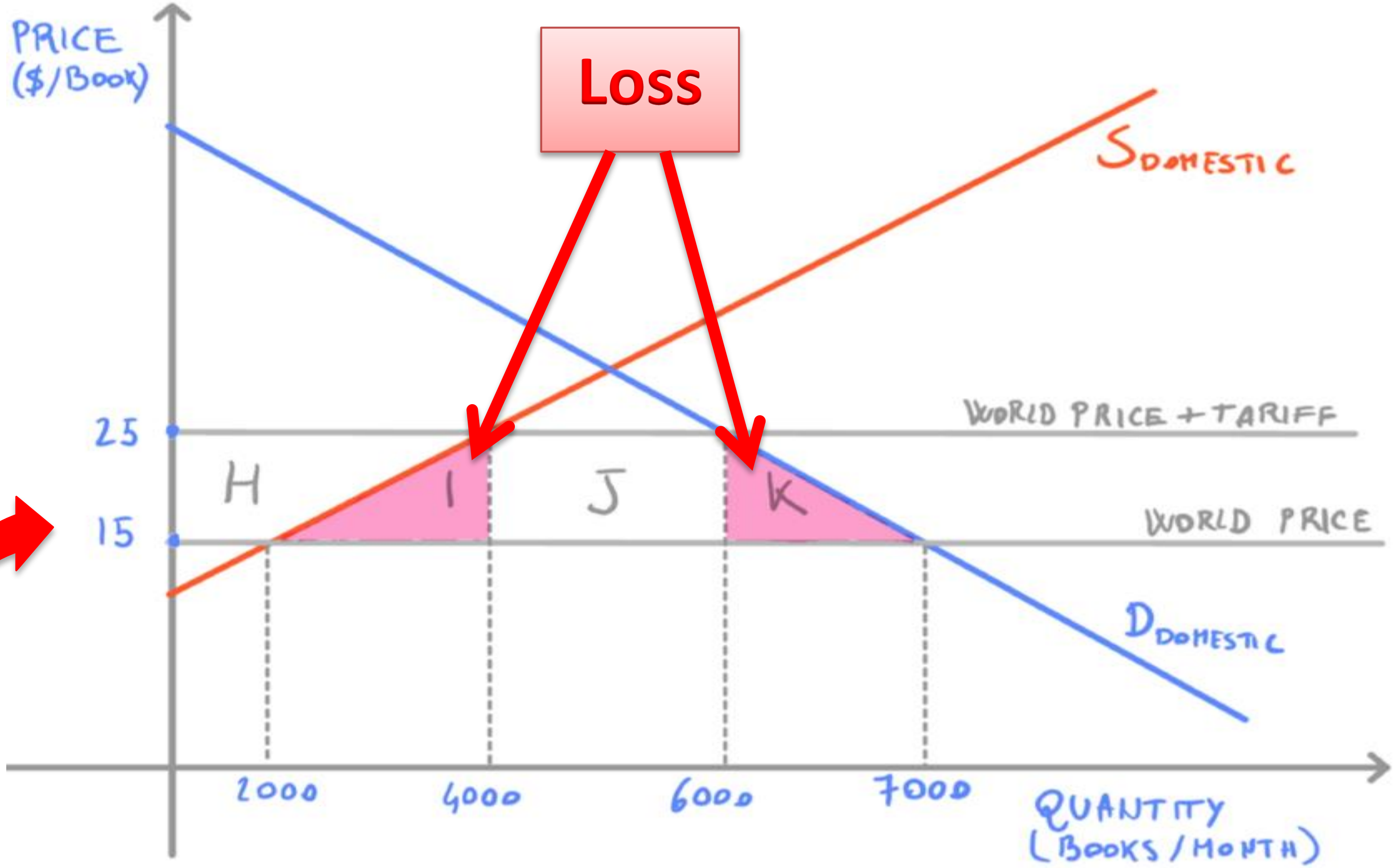


With Free Trade

$P^* = P_w = \$15$

With Tariffs

$P^* = P_d = \$25$

C. Trade Restrictions: Tariffs

Domestic **consumers lose** BUT domestic **producers/government gain**

Deadweight Loss → Tariff **is bad**!

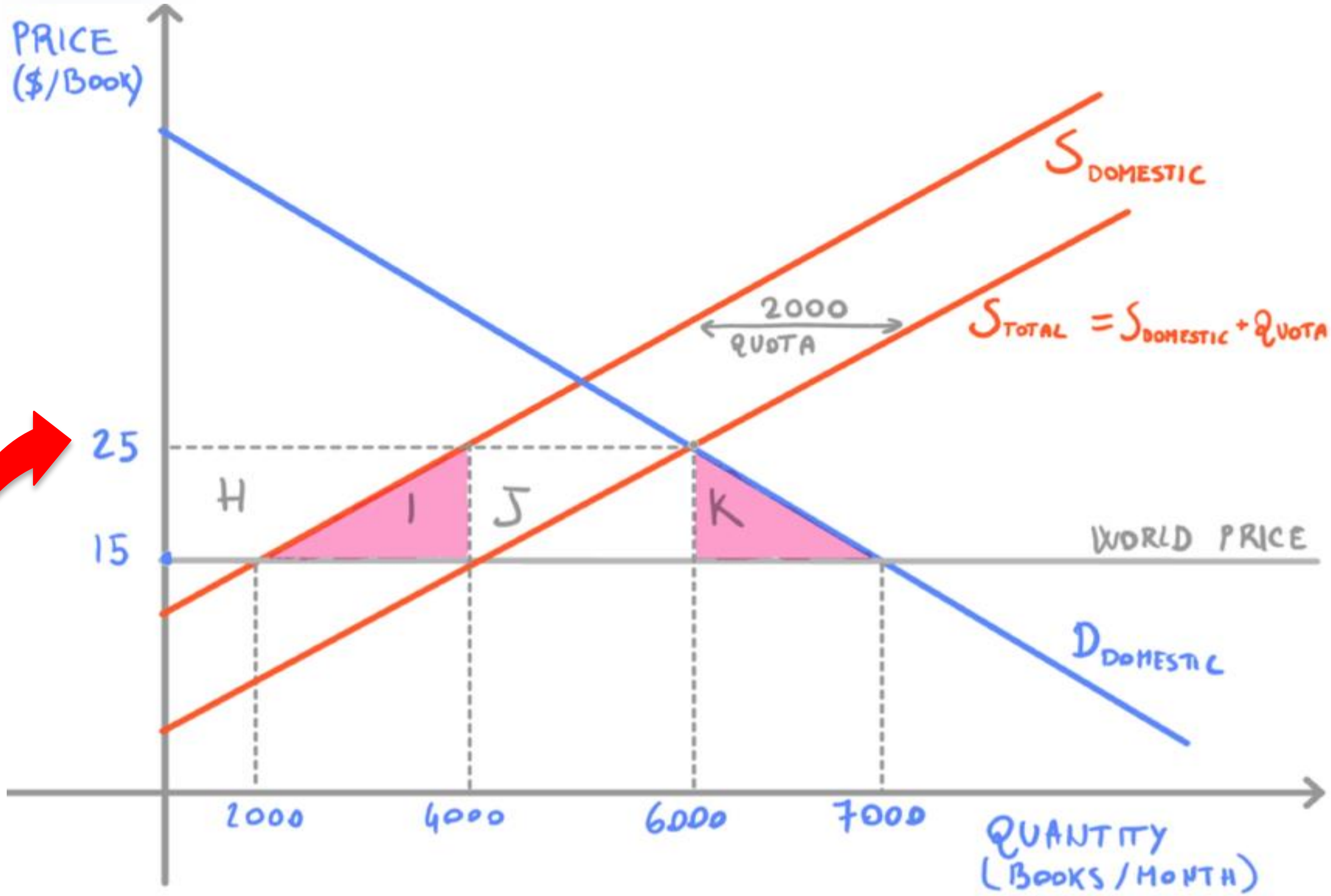
D. Trade Restrictions: Quotas

Definition:

An **Import Quota** represents a quantity limit on the amount of goods or services permitted to be imported.

D. Trade Restrictions: Quotas

Say q = 2,000 books per month



No Quotas

Q*, P*=$25

With Quotas

$Q^* = Q_d + q$, P*=$25

D. Trade Restrictions: Quotas

Domestic **consumers lose** BUT domestic **producers gain**

→ is a quota **good or bad**?

D. Trade Restrictions: Quotas

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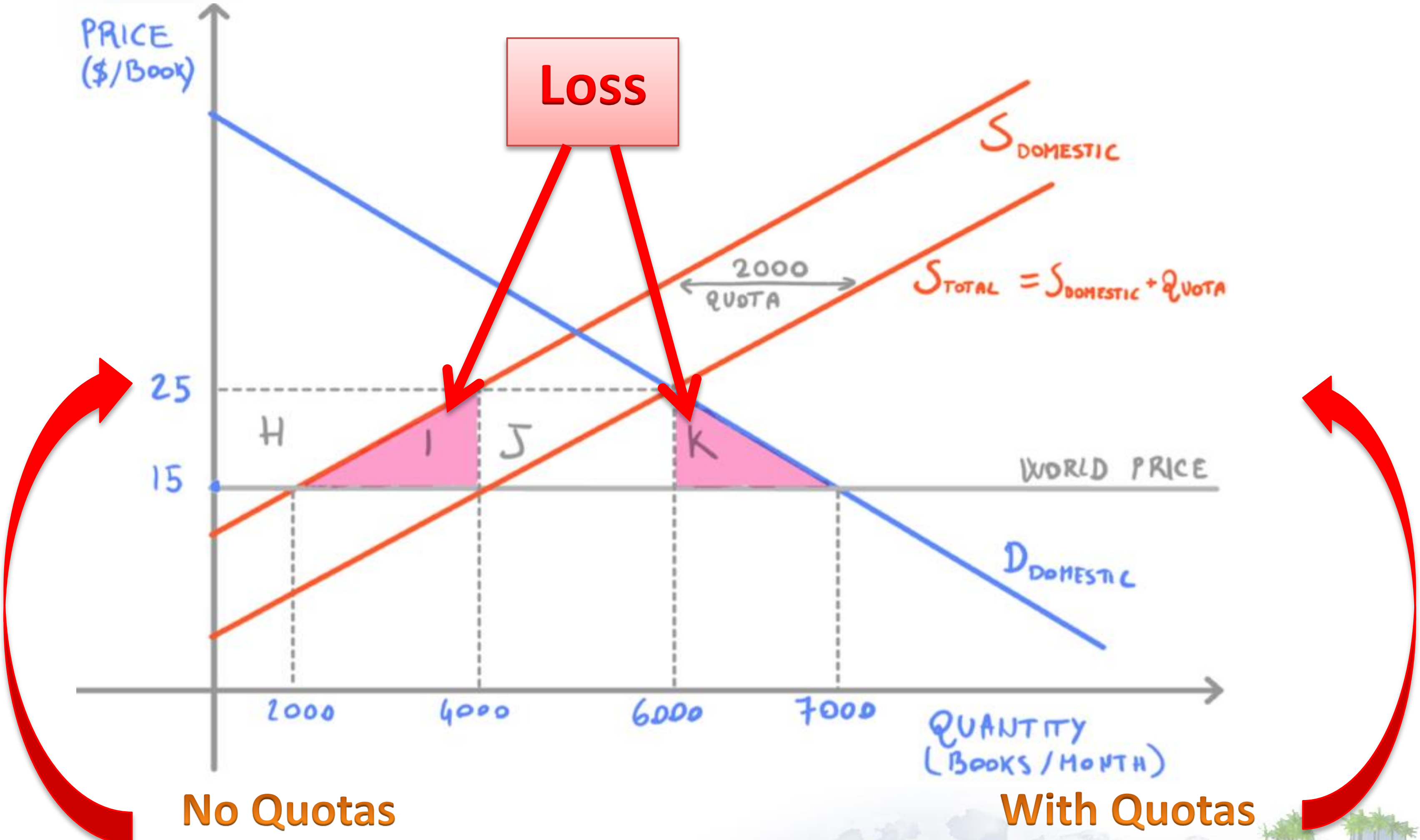

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With Quotas

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D. Trade Restrictions: Quotas

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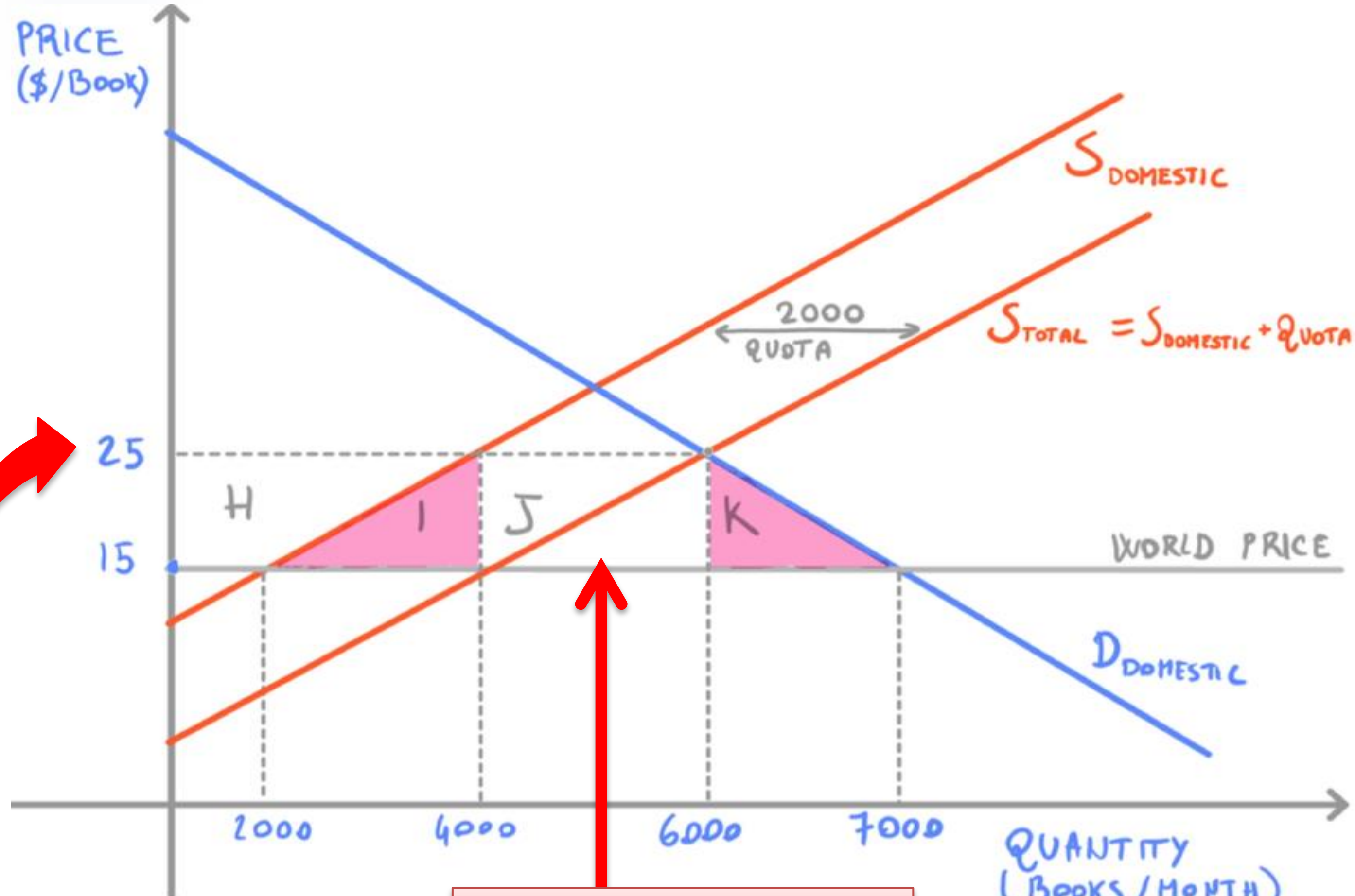

Importers Bonus!

No Quotas

Q^*, P^*=$25

With Quotas

$Q^* = Q_d + q$, P^*=$25

D. Trade Restrictions: Quotas

Domestic **consumers lose** BUT domestic **producers/government gain**

Deadweight Loss → Quota **is bad**!