



ECON 202 - MACROECONOMIC PRINCIPLES

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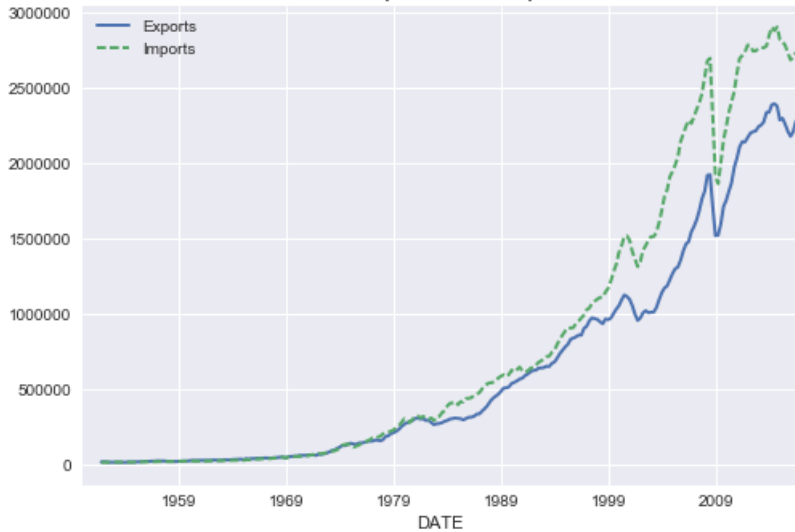
Chapter 18 - International Trade and Public Policy

International Trade and Public Policy - Topics

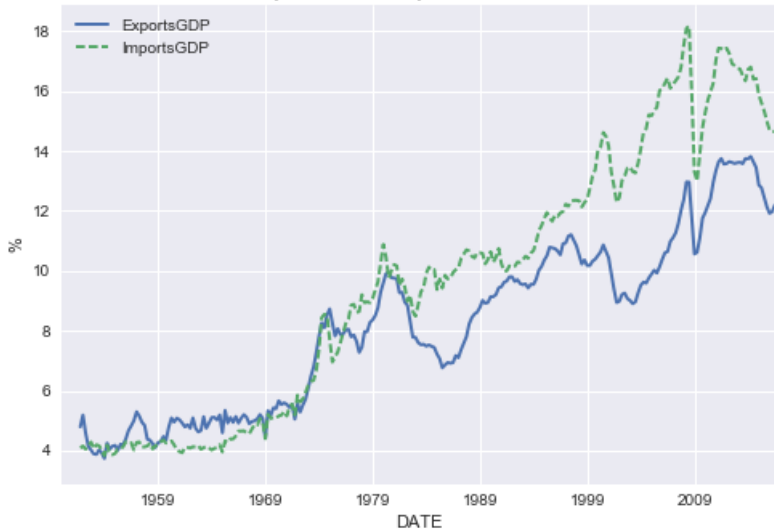
- U.S. Trade Data
- Comparative advantage and terms of trade
- Common protectionist policies
- Rationales for protectionist policies
- History of international trade agreements
- Recent controversy in trade policy

U.S. Trade Data

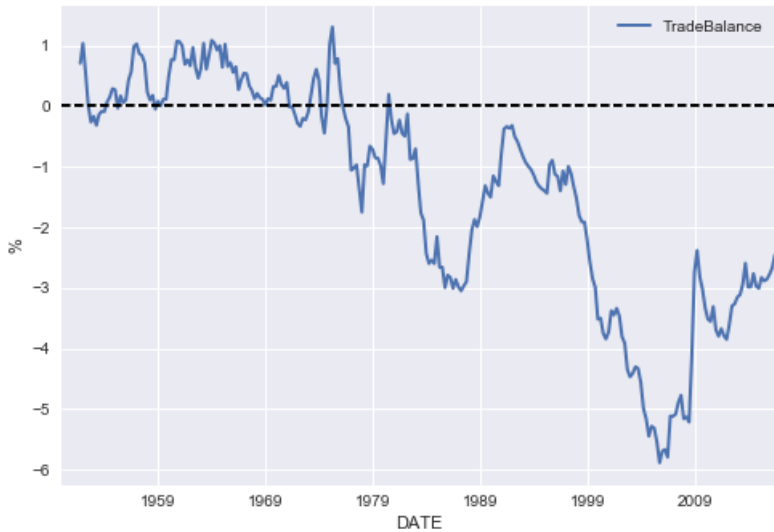
U.S. Exports and Imports



U.S. Exports and Imports Shares of GDP



U.S. Trade Balance Share of GDP



How Globalized are we?

- What percent of purchased output of goods/services is from Mexico?
- What percent of purchased output of goods/services is from China?
- What percent of purchased output of goods/services is from Canada?
- What percent of purchased output of goods/services is from India?

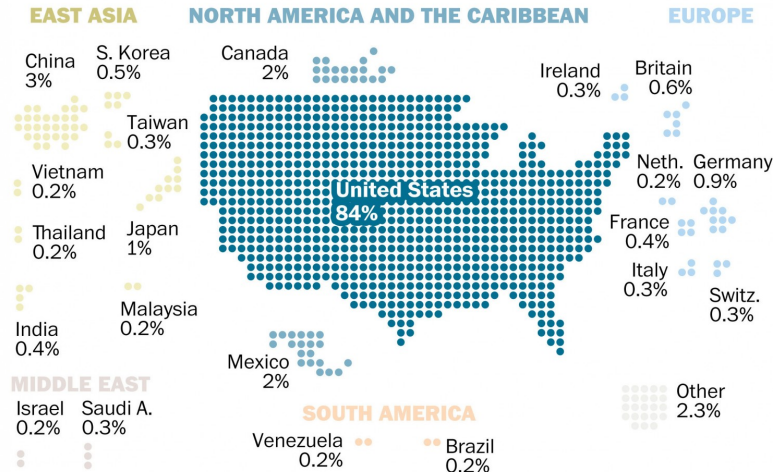
How Globalized are we?

- What is the percentage of (first generation) immigrants from Mexico in the US?
- What is the percentage of (first generation) immigrants from China?
- What is the percentage of (first generation) immigrants from Canada?
- What is the percentage of (first generation) immigrants from India?

Where does output purchased in the U.S. come from?

Origin of goods and services in 2014

• 0.1%

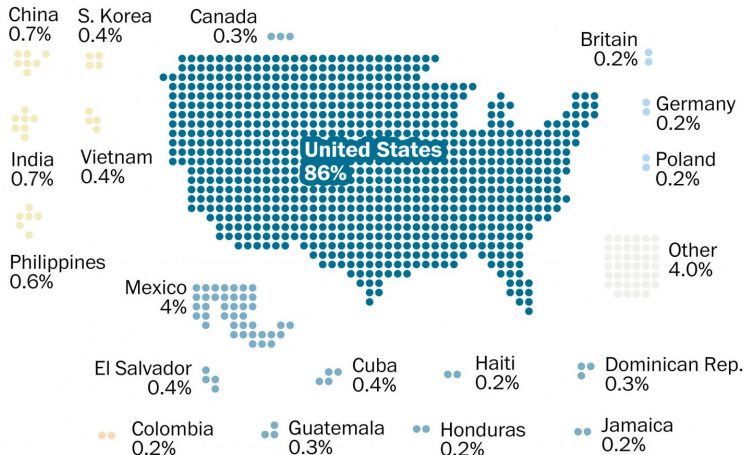


How Globalized are we?

- What percent of purchased output of goods/services is from Mexico?
 - ▶ 2%
- What percent of purchased output of goods/services is from China?
 - ▶ 3%
- What percent of purchased output of goods/services is from Canada?
 - ▶ 2%
- What percent of purchased output of goods/services is from India?
 - ▶ 0.4%

Where do people living in the U.S. come from?

Population origin in 2015



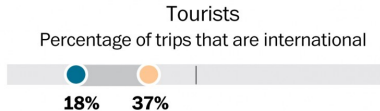
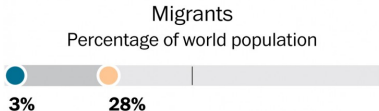
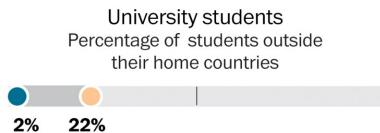
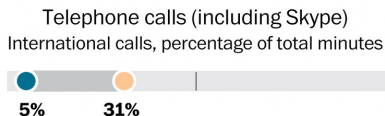
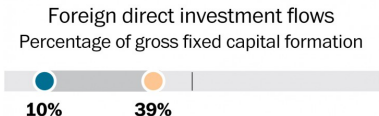
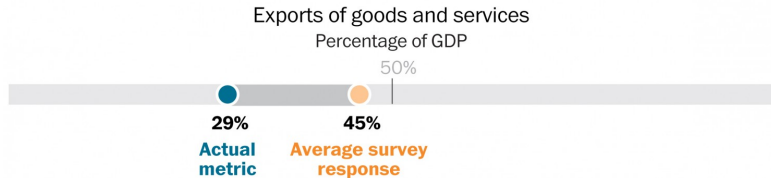
Totals may not add up to 100 percent because of rounding.

Sources: International Monetary Fund, U.N. Department of Economic and Social Affairs
THE WASHINGTON POST

How Globalized are we?

- What is the percentage of (first generation) immigrants from Mexico in the US?
 - ▶ 4%
- What is the percentage of (first generation) immigrants from China?
 - ▶ 0.7%
- What is the percentage of (first generation) immigrants from Canada?
 - ▶ 0.3%
- What is the percentage of (first generation) immigrants from India?
 - ▶ 0.7%

How globalized do Americans think the world is in terms of ...



Source: Pankaj Ghemawat and Steven A. Altman, "DHI Global Connectedness Index 2016"

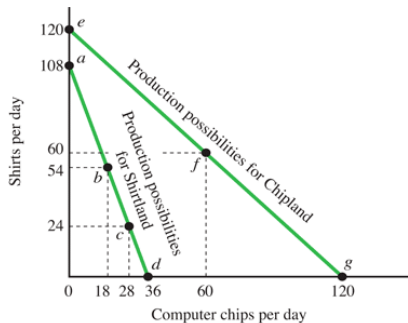
Ricardian Trade Model of Comparative Advantage

Benefits from Specialization

TABLE 18.1 Output and Opportunity Cost

	Quantity Produced Per Day	Opportunity Cost of Shirts	Opportunity Cost of Chips
Shirtland	108 shirts 36 chips	1/3 chip	3 shirts
Chipland	120 shirts 120 chip	1 chip	1 shirt

Benefits from Specialization (cont.)



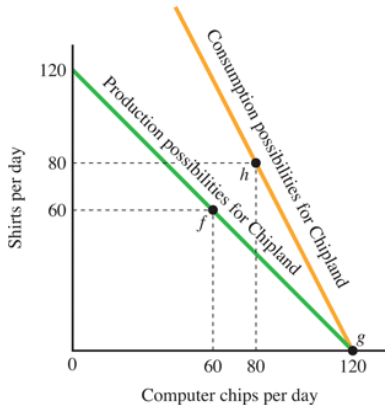
Shirtland Possibilities

Point	Shirts	Chips
<i>a</i>	108	0
<i>b</i>	54	18
<i>c</i>	24	28
<i>d</i>	0	36

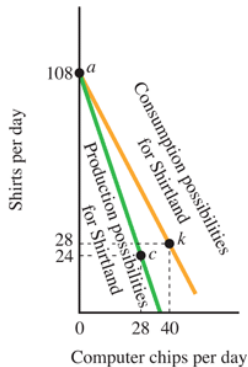
Chipland Possibilities

Point	Shirts	Chips
<i>e</i>	120	0
<i>f</i>	60	60
<i>g</i>	0	120

Benefits from Specialization (cont.)



(A)



(B)

Empirical Evidence on the Ricardian Model

■ Yes

- ▶ The ratio of U.S. to British exports in 1951 compared to the ratio of U.S. to British labor productivity in 26 manufacturing industries suggests yes.
- ▶ At this time the U.S. had an **absolute advantage** in all 26 industries, yet the ratio of exports was low in the least productive sectors of the U.S.

■ But the limitation of the Model are:

- ▶ Model predicts extreme degree of specialization → don't see this in data
- ▶ Assumes away effects of trade on distribution of income within the country → trade is always good
- ▶ No role for differences in resources among countries as cause of trade (everything is in relative labor productivity)
- ▶ Neglects economies of scale as reasons for trade between countries with similar productivities

The Employment Effects of Free Trade

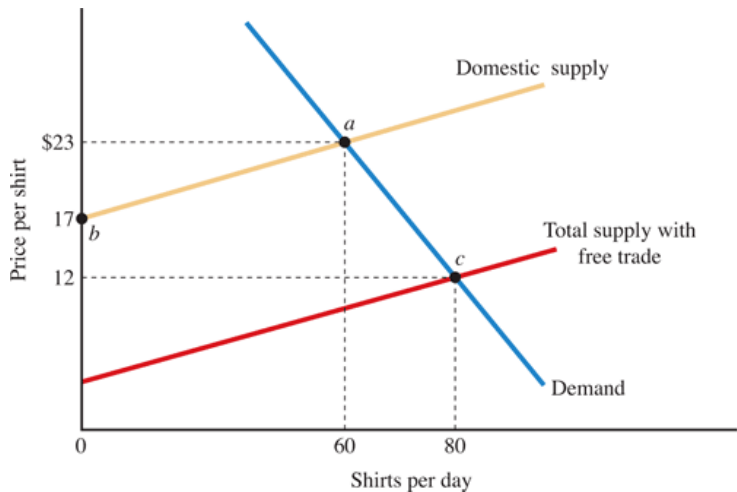
- In our example, some people in both nations will be harmed by free trade
- In Chiiland, for example, people in the shirt industry will lose their jobs when the shirt industry disappears
- Some workers can “easily” move into the expanding computer-chip industry, but others will be unable to make the move and will be forced to accept lower-paying jobs or face unemployment
- In the U.S. higher skilled workers are more mobile and able to switch to a new industry

Protectionist Policies

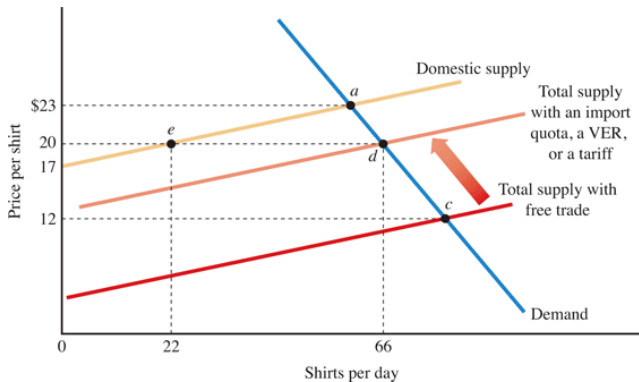
Protectionist Policies

- 1 Ban on imports
- 2 Voluntary export restraint (VER)
- 3 Import quota
- 4 Import licenses
- 5 Tariff/Tax

Import Ban



Quotas and Voluntary Export Restraints



Do Tariffs Hurt the Poor Disproportionately?

- Economists have found that tariffs in the United States fall most heavily on **lower-income consumers**
- Footwear accounts for:
 - ▶ 1.3 percent of the expenditure of lower-income households
 - ▶ 0.5 percent of the expenditure of higher-income households
- The highest tariffs fall on the cheapest products—precisely those that will be purchased by lower-income consumers
 - ▶ Low-price sneakers face a 32 percent tariff
 - ▶ Expensive track shoes face only a 20 percent tariff
- To protect U.S. industries, tariffs are highest on labor-intensive goods. But these goods tend to be lower priced
- That is why tariffs do fall disproportionately on the poor
- NOTE: This ignores labor market effects. Poor, low skilled workers have the most difficult time switching jobs once their sector disappears due to low wage competition

Responses to Protectionist Policies

- A restriction on imports is likely to lead to further restrictions on trade
- Countries may retaliate, and a trade war could escalate to the point where the two nations return to self-sufficiency
- This would force countries to scale back their consumption
- The most famous of import restrictions that sparked retaliatory policy was the Smoot-Hawley tariff of 1930 when the United States increased its average tariff on imports to 59% and its trading partners retaliated with higher tariffs on U.S. products

Rationales for Protectionist Policies

Three possible motivations to restrict trade are:

- 1 To shield workers from foreign competition
- 2 To nurture “infant” industries until they mature
- 3 To help domestic firms establish monopolies in world markets

China and Protectionist Policies

- Do imports from China really make a difference in U.S. labor markets?
- Economists David Autor David Dorn, and Gordon Hanson examined detailed data on Chinese imports into local communities.
- Some local communities are more heavily impacted by Chinese imports than others depending on the mix of products produced locally
- China joined the WTO in 2001
- The authors found that the pace of Chinese import growth was so rapid from 1990 to 2007 that it often had a strong and negative effect on local economies
 - ▶ Those communities that were more exposed to imports had larger increases in workers receiving unemployment insurance, food stamps, and disability payments.
- These findings do not mean that trade with China was ultimately beneficial

China and Protectionist Policies (cont.)

- ▶ Displaced workers can find new jobs and import competition lowers prices for all consumers
 - ▶ But it does mean that the burden of adjustment to imports varies by region
 - ▶ Some regions will have a more difficult time adjusting than others to a sudden influx of imports
- The study also does not measure the indirect benefits from trade with China
 - As the Chinese economy expanded during this period, it created more export opportunities for producers in the United States → Those benefits were not measured in this study

A Brief History of International Tariff and Trade Agreements

- The first major trade agreement following World War II was the General Agreement on Tariffs and Trade (GATT)
 - ▶ GATT is an international agreement established in 1947 that has lowered trade barriers between the United States and other nations. Over time, GATT has been expanded to include 146 nations.
 - ▶ There have been nine rounds of negotiations, resulting in progressively lower tariffs for the member nations
 - ▶ The last of which was completed in 1994: the Uruguay round.
- In 1995, the World Trade Organization (WTO) was formed to enforce GATT and other international trade agreements
 - ▶ The WTO resolves trade disputes, and holds forums for further rounds of trade negotiations. The latest GATT round, the 2001 Doha round, is concentrating on agricultural protection among other issues where developed countries are pitted against less-developed nations.

A Brief History of International Tariff and Trade Agreements (cont.)

- Other nations have formed trade associations to lower trade barriers and promote international trade:
 - ▶ The North American Free Trade Agreement (NAFTA) between Canada, Mexico, and the United States
 - ▶ The European Union (EU), which today includes close to 20 countries
 - ▶ The leaders of 18 Asian nations have formed the Asian Pacific Economic Cooperation (APEC)

Recent Policy Debates and Trade Agreements

Recent Policy Debates and Trade Agreements

We will discuss three recent policy debates in international trade:

- 1 Are foreign producers dumping their products?
- 2 Do trade laws inhibit environmental protection?
- 3 Does trade cause income inequality?
- 4 How American are American cars?
- 5 China suing U.S. at WTO

Are Foreign Producers Dumping Their Products?

■ A firm is dumping when

- ▶ the price it charges in a foreign market is either lower than the price it charges in its home market or
- ▶ lower than its production cost
- ▶ Dumping is illegal under international trade agreements; hundreds of cases of alleged dumping are presented to WTO authorities each year
- ▶ Charging a lower price in the foreign market is a form of **price discrimination**—a process under which a firm divides consumers into two or more groups and charges a different price for each group buying the same product in order to maximize profits
- ▶ Recent Cases: Hong Kong VCRs sold in Europe, Chinese bicycles sold in the United States, and U.S. beef sold in Mexico

■ Predatory pricing:

- ▶ cutting prices in an attempt to drive rival firms out of business
- ▶ The predatory firm sets its price below its production cost, once the rival is priced out, it can increase the price (it can then act as monopolist)

Are Foreign Producers Dumping Their Products? (cont.)

- Many economists are skeptical about how frequently predatory pricing actually occurs versus price discrimination;
 - ▶ they suspect that many nations use their anti-dumping laws as protectionist policies in disguise
 - ▶ Thomas Prusa (Rutgers University) has studied anti-dumping and found that it is a potent weapon for protecting domestic industries

Do Trade Laws Inhibit Environmental Protection?

- Starting in the early 1990s, environmentalists began to question whether policies that liberalized trade could harm the environment
- Under current WTO rules, a country can adopt any environmental standard it chooses, as long as it does not discriminate against foreign producers
- The United States cannot ban imported goods produced by factories that generate air or water pollution in other countries
- Nations that use trade restrictions to pursue environmental goals will encounter resistance because WTO rules mean that a nation can pursue its environmental goals only within its borders
- In recent years, a new breed of trade disputes have erupted revolving around social problems and the role of the government in trying to solve them
- As a world trading community, we will have to decide at what point we allow national policy concerns to override principles of free trade

Does Trade Cause Inequality?

- Trade theory suggests a link between increased trade and increased wage inequality, but it is difficult to distinguish between the effects of trade and the effects of other things, such as technical progress
- If new jobs require higher skills, workers will eventually move to those jobs and earn higher wages
- But in the short run, the government could facilitate the transition by providing unskilled workers education and training
- Inequality in the United States has increased in the last several decades
 - ▶ Christian Broda and John Romalis (University of Chicago) discovered that the prices low-income groups paid for goods and services increased substantially less than for high-income groups
 - ▶ As a result, living standards have not become more unequal

Does Trade Cause Inequality? (cont.)

- ▶ The key to understanding this result is that consumption patterns of the rich and poor differ
- ▶ The poor consume a higher ratio of nondurable goods to services than the rich, while prices for nondurable goods have risen less than prices for services
- ▶ Prices for the nondurable goods purchased by the poor also increased less than the prices of nondurable goods purchased by the rich
- ▶ The moral of the story: Trade does not just affect employment patterns—it also changes prices
- ▶ We must take both factors into account to understand how living standards have changed for the rich and poor

How American are American Cars?

- There were record exports of U.S. automobiles in 2014
- American cars in the past several years have increasing amounts of foreign parts.
- Ex: Ford Fiesta parts from the U.S. have gone down from 90 percent to 55 percent in a five-year period
- Cars are now more competitively priced for consumers
- U.S. parts manufacturers have been negatively affected, however, and are facing global pressure (like many others) as a result of globalization.

China suing U.S. at WTO

- In July 2014 the World Trade Organization ruled that the U.S. had violated trade laws by imposing excessive tariffs on Chinese imports
- The U.S. agreed to the ruling but planned to impose a tariff on imported solar panels, requested by Solar World, an American subsidiary of a German company
- The company planned to move their production to other countries that would not be subject to tariffs
- WTO rulings do affect member countries, but continued trade negotiations between trading partners are still necessary

Why Do People Protest Against Free Trade?

- Trade and specialization mean that individuals and nations must surrender some of their independence and sovereignty
- By not producing precisely what we consume, we become dependent on others to trade
- By cooperating with other nations, we need to develop agreed-upon rules that, at times, limit our own actions