Economics 2010-100 University of Colorado
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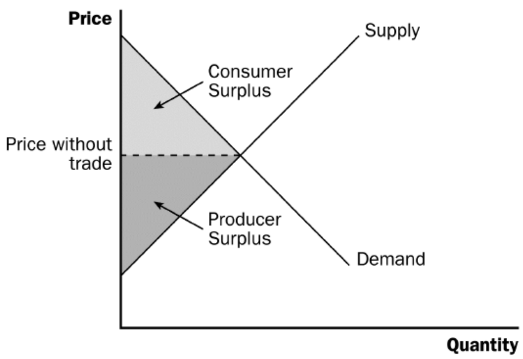
Chapter 9: Application: International Trade

- What determines how much of a good a country will import or export?
- Who benefits from trade? Who does trade harm? Do the gains outweigh the losses?
- If policymakers restrict imports, who benefits? Who is harmed? Do the gains from restricting imports outweigh the losses?

<u>The Determinants of Trade</u>

The Equilibrium without Trade

If there is no trade, the domestic price in the market will balance supply and demand.

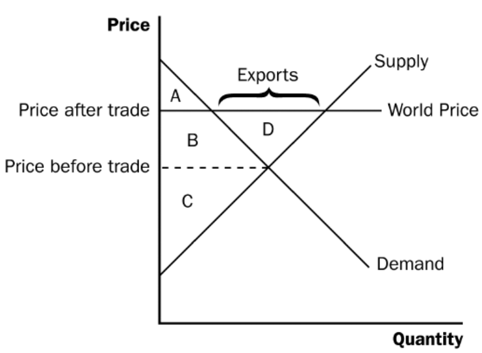


- **Import or Export?**
    - Depends on world price

<u>World Price Pw</u>: The price at which a good can be sold or bought at the world market
<u>Pd</u>: domestic price without trade

- If Pw>Pd, export
- If Pw<Pd, import

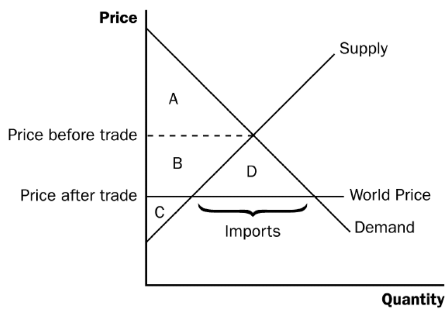
- **The small economy assumption**
    - A small economy is a price taker in world markets
- **Winners or Losers from Trade?**
    - Assume Peru is small economy, so that trade policy will not affect the world price.
    - **Case 1: Pw=$6>Pd=$4 (export), Q=500**

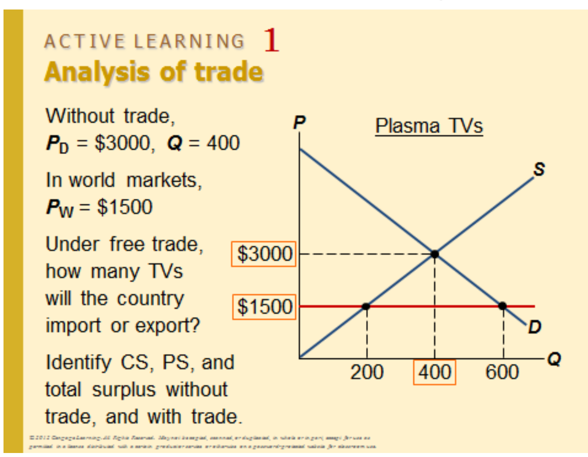


Without trade, CS =
PS =
TS =
With trade, CS =
PS =
TS =

- Producers gain, consumers lose.
- Overall welfare increases, so economy as a whole is better off. This is the gains from trade.

- **Case 2: Pw<Pd**
    - Again, trade starts, domestic price will fall to world price. Qd>Qs domestically.



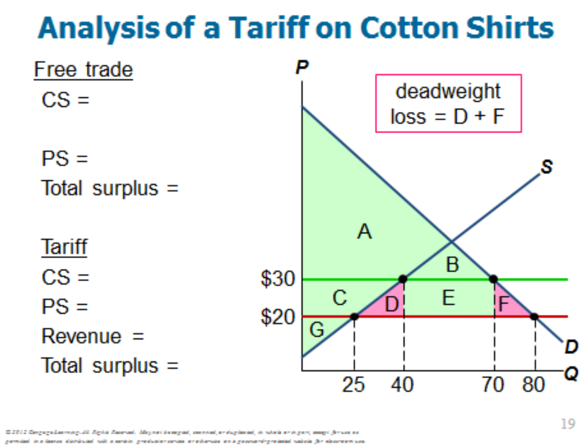


Summary: The welfare effects of trade

	Pd<Pw	Pd>Pw
Direction of trade		
CS		
PS		
TS		

- **Effects of a Tariff?**

<u>Tariff</u>:
Example: Cotton shirts, $\boldsymbol{P_W}$ = $20, Tariff: $\boldsymbol{T}$ = $10/shirt
Consumers must pay _____ for an imported shirt. So, domestic producers can charge ___ per shirt. In general, the price facing domestic buyers & sellers equals ____________.



DWL?

Import Quotas: Another Way to Restrict Trade

1. An **<u>import quota</u>** is a
2. Import quotas are much like tariffs.
   a. Both tariffs and quotas raise the domestic price of the good, reduce the welfare of domestic consumers, increase the welfare of domestic producers, and cause deadweight losses.
   b. However, a tariff raises revenue for the______________, whereas a quota creates profits for the foreign producers of the imported goods.

The Arguments for Restricting Trade

A. The Jobs Argument: Trade destroys jobs in industries that compete with imports. Trade destroys jobs in the industries that compete against imports.

B. The National-Security Argument: An industry vital to national security should be protected from foreign competition, to prevent dependence on imports that could be disrupted during wartime.

C. The Infant-Industry Argument: A new industry argues for temporary protection until it is mature and can compete with foreign firms.

D. The Unfair-Competition Argument: Producers argue their competitors in another country have an unfair advantage, e.g. due to govt subsidies.

E. The Protection-as-a-Bargaining-Chip Argument: Example: The U.S. can threaten to limit imports of French wine unless France lifts their quotas on American beef.

Trade Agreements

A country can liberalize trade with unilateral reductions in trade restrictions or multilateral agreements with other nations (e.g. NAFTA. GATT, WTO)

Suggested problems: Problems and Applications- 2, 3