

## lecture20

### How do we know whether a country will import a good or export a good?

Consider the following scenario. Suppose that rugby balls are produced in the US and in Russia, and that initially, international trade is prohibited. The price in the US ( $P_{US}$ ) is \$25 and the price in Russia ( $P_R$ ) is \$40. The no-trade prices are sometimes called autarky prices. You may remember this terms from comparative advantage the first week of class. Autarky means self-sufficiency, here no trade.

Now, suppose trade is allowed. We know that the new, world equilibrium price will lie between \$25 and \$40. Will the US import or export rugby balls?

Consider US consumers first. They were buying rugby balls for \$25 in the US. Now, a new source of supply is opened up. This new source of supply, initially, involves a price of \$40. Are consumers particularly enthralled about importing \$40 rugby balls? The answer is no.

Next consider US producers. When trade is opened up to them, a new source of demand, one where initially, (Russian) consumers are willing to pay \$40 is newly available. Are US producers enthralled about selling rugby balls to these consumers? The answer here is yes. The US will export balls to Russia.

So, when  $P_R > P_{US}$ , the US exports rugby balls.  
It follows that when  $P_R < P_{US}$ , the US imports rugby balls.

### Can this be done graphically? Is there more to learn? Answer, yes.

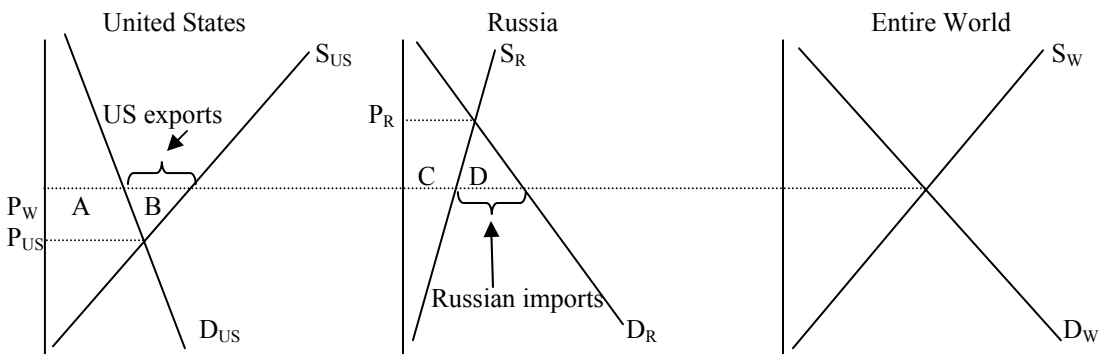
Consider the first two graphs only. Initially, there is not trade allowed. Equilibrium in each of the countries is simply found by the intersection of the Supply and Demand curves in that country. These intersections give us the autarky prices.

Now, trade is allowed, and the world market is applicable. We horizontally sum each of the countries supply and demand curves to come up with the world market. Notice you don't really have to draw this graph if you don't want to. We could also find the equilibrium world price by finding where US exports = foreign imports. Why? See the picture below.

Better off: US producers. They gain producer surplus (A + B).  
Russian consumers. They gain consumer surplus (C + D).

Worse off: US consumers. They lose consumer surplus (A).  
Russian producers. They lose producer surplus (C).

Better off: US as a whole. US producers gain more than US consumers lose (Net gain is B).  
Russia as a whole. Russian consumers gain more than Russian consumers lose (Net gain is D).



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This analysis naturally assumes that there is some good that US consumers are willing to import from Russia. Think back to comparative advantage. It seems, here, that the US producers have a comparative advantage in the production of rugby balls. There is some good in which Russia has a comparative advantage to export to us.

One more twist. I have already done the work of converting the price in Russia into \$. If I gave you an exchange rate and a price denominated in Russian Rubles, you could first convert the Russian price into dollars and repeat the above analysis.

### Myths about international trade

1. International trade is different. No, international trade is just another economic activity - only difference is currencies and xenophobia. More international trade  $\Rightarrow$  more specialization and more gains from trade. No different than trading with interstate, intercity, interpersonal, etc.
2. International trade is not about competition. No, it's about mutually beneficial exchange. Trade is done because it is mutually beneficial. Else it would not be done. When you walk into Tiger Town and trade money for beer, are you competing with Tiger Town? No. Trade restrictions reduce wealth. Just like exchange made both parties better off on Robinson Crusoe's island, so does international trade.
3. Exports are the goal of international trade. No, Imports, not exports are the goal of international trade. We want goods that other countries produce. You don't go to the pizza shop to export money; you go to import pizza. Unfortunately, other countries don't want our money. They want goods. Thus, we must export goods to pay for our imports. We pay for imports with exports. (Wouldn't it be great if we could print up money and trade it to other countries for TVs - money is pretty cheap to print). Any restriction on imports will eventually lead to a reduction in exports.
4. International trade creates / destroys jobs. No, international trade neither creates nor destroys jobs. There are an infinite number of jobs. International trade may reallocate jobs. There might be a steelworker who has a \$45,000 job with excellent work conditions. The steel industry will face more competition without trade restrictions. Tough cookies. He may have to take a job with a lower salary and less desirable working conditions. When he says that the government should impose trade restrictions to save his jobs, what he means to say is: I don't want a different job with less desirable working conditions where I can't make as much money. We all would like to reduce competition. This is not specific to international trade.

Also, since reducing the amount of imports reduces the amount of exports, saving jobs in the steel industry (the import competing sector) will cause a reduction in the number of jobs in say computer production, ocean liner loading, etc. That is jobs that are related primarily to exports will be lost. Do they ever tell you about this in the article?

5. We need a new partnership between business and government. No, when the government gets involved, watch out. Producers of those goods will benefit at the expense of consumers of the goods. You'll pay a higher price for a TV, and the TV producers will earn more money. They are stealing your wealth.