International Economics Checklist

Content 3.1	Definition	Diagram	Theory/Explanation	~~Real Life Example~~

International Trade
- Benefits of Trade
- Absolute and Comparative Advantage
- The World Trade Organization
- Trade protection
- Arguments for and against trade protection

Free Trade = International trade with no govt. intervention imposing trade restrictions.

The benefits of trade
+ Greater choice for consumers
+ Economies of scale benefits for producers as market size increases
+ Increased competition - increase efficiency
+ Lower prices for ~~customers~~ consumers
+ Greater flow of ideas & technology
+ Leads to economic growth.

Limitations of theory of Comparative Advantage
1) Unrealistic assumptions:
- Constant production costs
- Perfect labor mobility within countries but not between.
- No transport costs.
- Perfect competition
- Free trade

2) Excessive specialization

World Trade Organization (WTO)
- Promotes free trade across countries
- Trade liberalization
- It creates rules that should be followed
- It settles trading disputes

Absolute advantage
Absolute advantage - when a country can produce a good with fewer resources.
More productively efficient.

Not trade barriers

Country B for Good Y & country A for Good X

The country with PPC more out is have absolute advantage.

- Free trade will lead to greater production & consumption for both as they specialize to produce one single good. - Allocative efficiency
- But, if one country has wider curve for both goods, theoretically is will not engage in free trade.

Comparative Advantage
Comparative Advantage: when a country can produce with lower opportunity cost.

$$\text{Opportunity cost} = \frac{\text{Other good Q}}{\text{Q of good}}$$

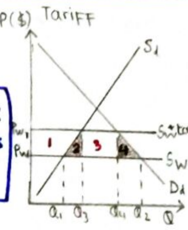
If gradient is not same, then there is room for international trade.

Here, B got Absolute advantage. But, not comparative

Pros and Cons for Trade Protection
+ Reduce unemployment. Protects jobs.
+ Correct trade deficits.
+ Protect against dumping.
+ Enhance govt. revenues.
+ Protect 'infant' industries.

- It leads to inefficiencies as domestic producers are protected.
- It limits competition & increases monopoly power.
- Leads to higher price for consumers.
- Increase import costs for producers. Thus, increasing prices.
- Leads to retaliation
- Limits technological development & awareness due to limited inflows of ideas & technologies. Limited collaboration.
- Limits options for consumers.

Tariff

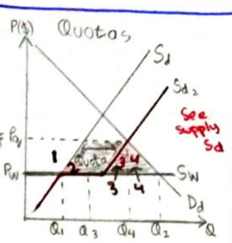


Tariff: tax on imports.
Specific or Ad Valorem
Imports decrease to $Q_4 - Q_3$

Δ Consumer W.: $-(1,2,3,4)$
Δ Producer W.: $+1$
Δ Social W: $-(2+4)$ as govt earns 3

- Increase domestic price
- Increase domestic production
- Decrease consumption
- Decrease consumer surplus.
- Increase producer surplus.
- Create tariff revenues
- Production inefficiency
- Consumption inefficiency
- Welfare loss

Quotas



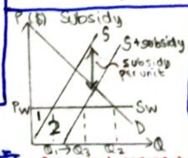
Quota: restriction on quantity of imports

The ΔP and ΔQ is same as tariff. But, welfare loss is higher as no govt. revenue.
Basically, the govt. revenue becomes welfare loss as it is 'quota rents'. Earned by foreign firms who are getting higher prices.

Δ consumer W: $-(1,2,3,4)$
Δ producer W: $+1$
Δ social W: $-(2,3,4)$

- Increase domestic price.
- Increase domestic production.
- Decrease consumption.
- Decrease consumer surplus.
- Increase producer surplus
- 'Quota rents' is area 3
- Production inefficiency. Consumer inefficiency
- Welfare loss. (Assuming that quota rents are collected by ~~consumer~~ foreigners)

Subsidy



Do not take new equilibrium. P remains P_W and Q↑ to Q_3. So, imports decrease to $Q_2 - Q_3$.
Δ consumer W: 0
Δ producer W: $+2$
Δ social: Tax burden due to subsidy on society. So, still negative. Resource misallocation

- No change in price.
- No change in consumption.
- Increase domestic production.
- Consumer welfare = 0 change.
- Producers are better off.
- Resource misallocation
- Increase burden on tax payers.
- Can create trade frictions.

- Subsidy - we don't care about equilibrium. Everything happens at world price.
- Quota - we care about final equilibrium. It determines production (trace left) and consumption.
- Tariff - we change world price for domestic consumers. Not difficult to draw.