HEALTH CARE COSTS ARE THE PRIMARY DRIVER OF THE DEBT

Source: Congressional Budget Office (August 2011)

www.bipartisanshipolicy.org
7 International Trade
International Trade

- Trade Is Mutually Beneficial
- Why Do All Countries Restrict Trade?
- Patterns of Trade Restrictions
- International Institutions and Trade
International Trade

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  - Why Do All Countries Restrict Trade?
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Trade Is Mutually Beneficial

• Opportunities
• New Markets
• More efficiency
• Cheaper Products
Trade Is Mutually Beneficial

- Division of labor
- Specialization
Trade Is Mutually Beneficial
Trade Is Mutually Beneficial

- Absolute advantage
- Comparative advantage
Trade Is Mutually Beneficial

Adam Smith on comparative advantage:

"If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage."
**Trade Is Mutually Beneficial**

**Table 7.1: Merchandise Exports as a Percentage of GDP, 1820–1998**

<table>
<thead>
<tr>
<th></th>
<th>1820</th>
<th>1870</th>
<th>1913</th>
<th>1929</th>
<th>1950</th>
<th>1973</th>
<th>1998</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>1.3%</td>
<td>4.9%</td>
<td>7.8%</td>
<td>8.6%</td>
<td>7.6%</td>
<td>15.2%</td>
<td>28.7%</td>
</tr>
<tr>
<td>Germany</td>
<td>n.a.</td>
<td>9.5</td>
<td>16.1</td>
<td>12.8</td>
<td>6.2</td>
<td>23.8</td>
<td>38.9</td>
</tr>
<tr>
<td>Netherlands</td>
<td>n.a.</td>
<td>17.4%</td>
<td>17.3</td>
<td>17.2</td>
<td>12.2</td>
<td>40.7</td>
<td>61.2</td>
</tr>
<tr>
<td>Great Britain</td>
<td>3.1</td>
<td>12.2</td>
<td>17.5</td>
<td>13.3</td>
<td>11.3</td>
<td>14.0</td>
<td>25.0</td>
</tr>
<tr>
<td>Spain</td>
<td>n.a.</td>
<td>3.8</td>
<td>8.1</td>
<td>5.0</td>
<td>3.0</td>
<td>5.0</td>
<td>23.5</td>
</tr>
<tr>
<td>United States</td>
<td>2.0</td>
<td>2.5</td>
<td>3.7</td>
<td>3.6</td>
<td>3.0</td>
<td>4.9</td>
<td>10.1</td>
</tr>
<tr>
<td>Mexico</td>
<td>n.a.</td>
<td>3.9</td>
<td>9.1</td>
<td>12.5</td>
<td>3.0</td>
<td>1.9</td>
<td>10.7</td>
</tr>
<tr>
<td>Brazil</td>
<td>n.a.</td>
<td>12.2</td>
<td>9.8</td>
<td>6.9</td>
<td>3.9</td>
<td>2.5</td>
<td>5.4</td>
</tr>
<tr>
<td>China</td>
<td>n.a.</td>
<td>0.7</td>
<td>1.7</td>
<td>1.8</td>
<td>2.6</td>
<td>1.5</td>
<td>4.9</td>
</tr>
<tr>
<td>India</td>
<td>n.a.</td>
<td>2.6</td>
<td>4.6</td>
<td>3.7</td>
<td>2.9</td>
<td>2.0</td>
<td>2.4</td>
</tr>
<tr>
<td>Japan</td>
<td>n.a.</td>
<td>0.2</td>
<td>2.4</td>
<td>3.5</td>
<td>2.2</td>
<td>7.7</td>
<td>13.4</td>
</tr>
<tr>
<td>World</td>
<td>1.0</td>
<td>4.6</td>
<td>7.9</td>
<td>9.0</td>
<td>5.5</td>
<td>10.5</td>
<td>17.2</td>
</tr>
</tbody>
</table>
Trade Is Mutually Beneficial

Factors of production

1. Land
2. Labor
3. Capital
Trade Is Mutually Beneficial

- What is a country’s advantage?
- Heckscher-Ohlin trade theory

![Diagram showing the relationship between capital and labor abundant countries and their respective goods]

- Capital intensive goods
- Labor intensive goods
- Labor abundant country
- Capital abundant country
The Heckscher-Ohlin model

- Nation 1 is the L-abundant nation
- X is the L-intensive commodity
- So Nation 1 can produce relatively more of commodity X
Trade Is Mutually Beneficial

Figure 7.1: Importance of Trade to the U.S. Economy, 1960–2009
Trade Is Mutually Beneficial

In general, any policies that hinder trade hurt welfare and productivity.

Puzzle: If trade is mutually beneficial, then why do all countries restrict it?
International Trade

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Why Do All Countries Restrict Trade?

Trade restrictions

• Tariffs
• Quotas
• Nontariff barriers
• Subsidies
• Prohibitions
Why Do All Countries Restrict Trade?

Trade barriers redistribute income from consumers and foreign producers to domestic producers.
Patterns of Trade Restrictions

Domestic preferences in trade policy:
Factor-based preferences
(The Stolper-Samuelson Approach)
International Trade

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Patterns of Trade Restrictions

Domestic preferences in trade policy: Specific Factors-based preferences (The Ricardo-Viner Approach)
Patterns of Trade Restrictions

- Some actors enjoy advantages in political power over trade policy
- Collective action
- Policy change as a public good
Patterns of Trade Restrictions

Figure 7.A: The Cost of Sugar
Patterns of Trade Restrictions

Political institutions affect power over trade policy
Patterns of Trade Restrictions
Patterns of Trade Restrictions

Compensation and trade policy:
Trade produces winners and losers
International Trade

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International Institutions and Trade

- Interaction: trade policy of one country depends in part on policies of other countries
- International trade policies a result of strategic interaction among states
International Institutions and Trade

• Everyone wants to have consumers to sell to

• No one wants others to have access to their own consumers
The Prisoner’s Dilemma

If two countries, A and B, both act like mercantilists . . .

B has a choice

A has a choice

- close
- open

3rd best for both
- worst
- best

2nd best for both
- worst
- best

- worst
- best

- worst
- best
International Institutions and Trade

Global Trade Agreements (GATT)

- Norms of reciprocity and national safeguards
- Negotiating rounds addressed different issues or sectors
International Institutions and Trade

• The World Trade Organization (WTO) replaced the GATT in 1994
• Differences between GATT and WTO
Why the WTO?

• With more members, a stronger institution was needed

• GATT addressed the easiest issues, such as visible tariffs, yet stalled on more contentious ones, such as services and agriculture
International Institutions and Trade
International Institutions and Trade

Figure 7.2: Agricultural Subsidies for Selected Countries, 2007–2009
International Institutions and Trade
International Institutions and Trade
Map 7.1: Selected Regional Trade Agreements
International Institutions and Trade

Map 7.1: Selected Regional Trade Agreements
International Institutions and Trade

Interests: producers, consumers, importers, exporters, capital, labor, land

Interactions: Prisoner’s Dilemma

Institutions: Can promote cooperation
Political Science 12: International Relations