

ECON 101: Principles of Economics I

Lecture Note 7

University of Michigan at Ann Arbor

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Lecture 7: International Trade

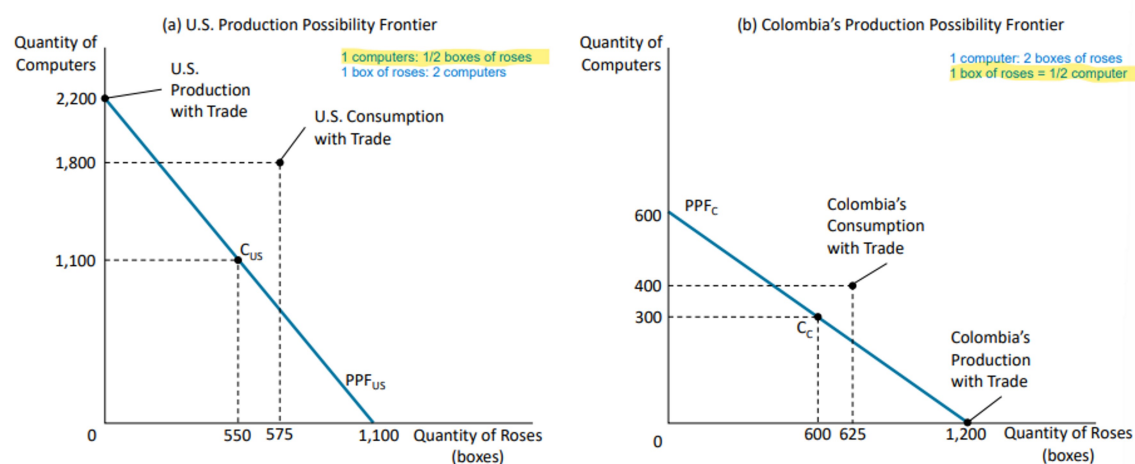
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Comparative Advantage

Comparative advantage - An individual (country) has a comparative advantage in producing a good if the opportunity cost of producing the good is lower for that individual (country) than for other individuals (countries)

Ricardian model of international trade - An international trade model that assumes constant opportunity cost (that is, it assumes production possibility frontiers are straight lines.)

Autarky - A country that does not trade with other countries



Sources of Comparative Advantage

The main sources of comparative advantage for international trade are:

- International differences in climate
- Technology
- Factors endowments
- According to the Heckscher-Ohlin model, a country has a comparative advantage in a good whose production is intensive in the factors that are abundantly available in that country.

Supply, Demand, and International Trade

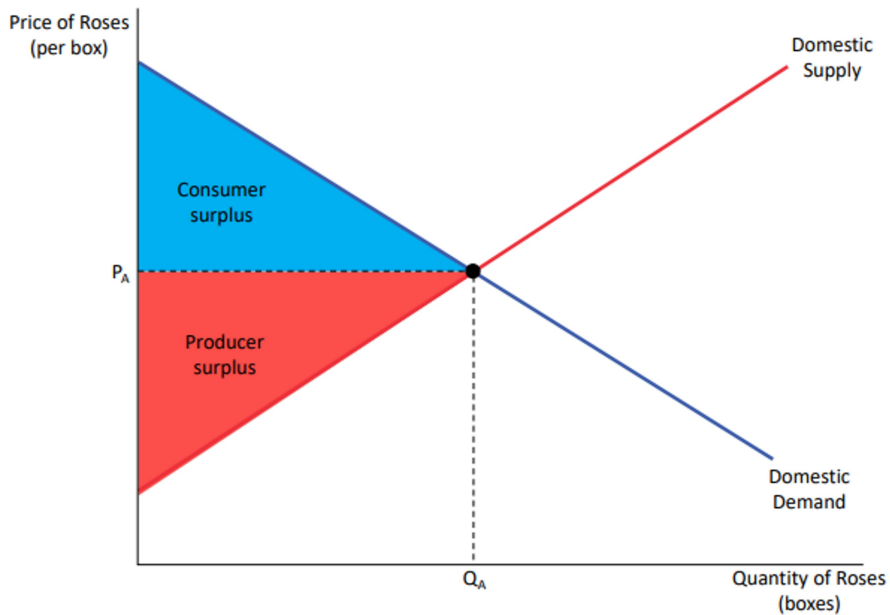
Domestic demand curve - shows how the quantity of a good demanded by domestic consumers depends on the price of that good

Domestic supply curve - shows how the quantity of a good supplied by domestic producers depends on the price of that good

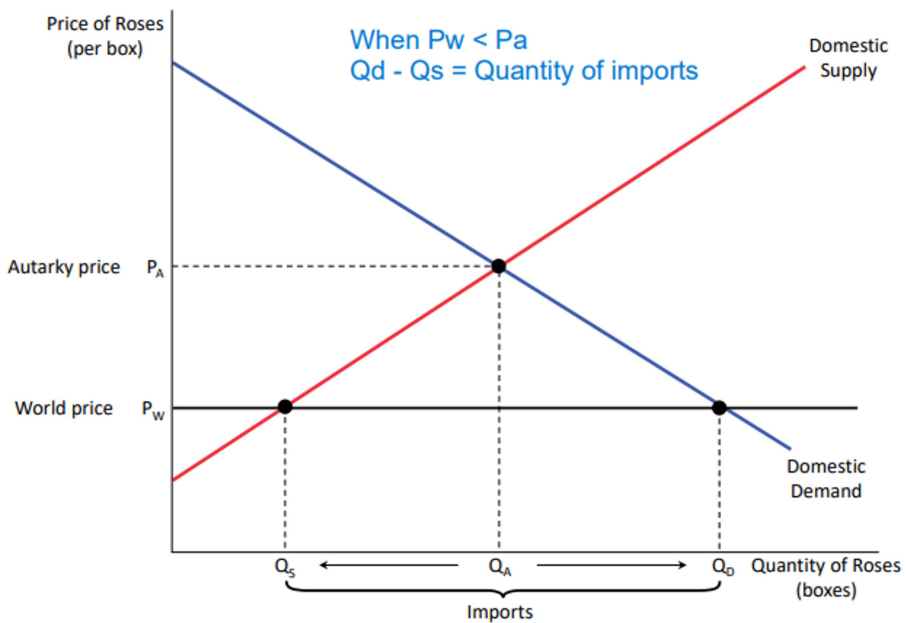
World price for a good - the price at which that good can be bought or sold abroad

Assumption: The domestic market is sufficiently small that it cannot affect the international market.

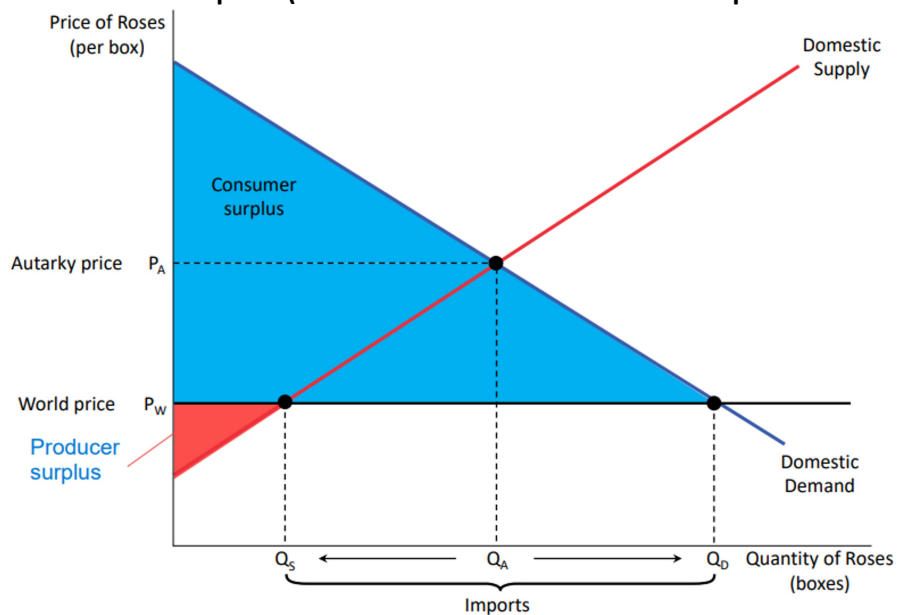
The Welfare of Autarky



The Domestic Market with Imports

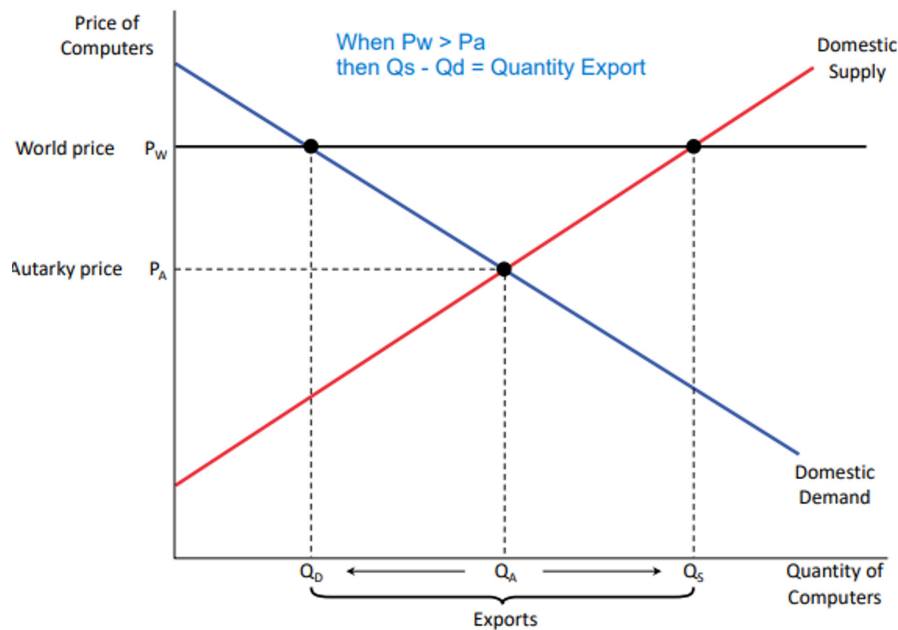


The Welfare of Imports (More efficient because the total surplus increases)

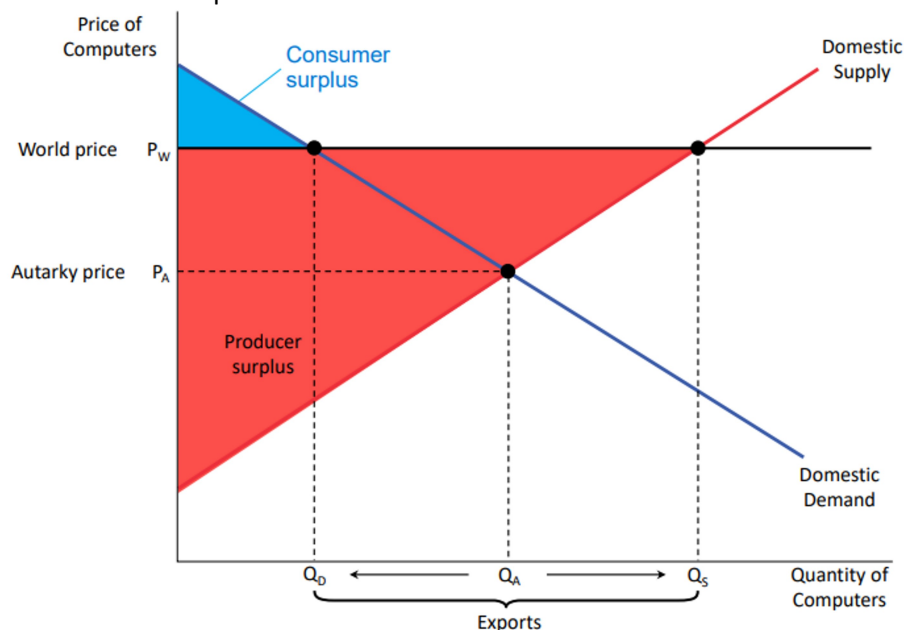




The Domestic Market with Exports



The Welfare of Exports



The Larger Impact of International Trade

International trade leads to an expansion of exporting industries and a contraction of import-competing industries.

- **Exporting industries** - produce goods and services that are sold abroad
- **Import-competing industries** - domestically produce goods and services that are also imported

This change in industries will affect their factor markets.

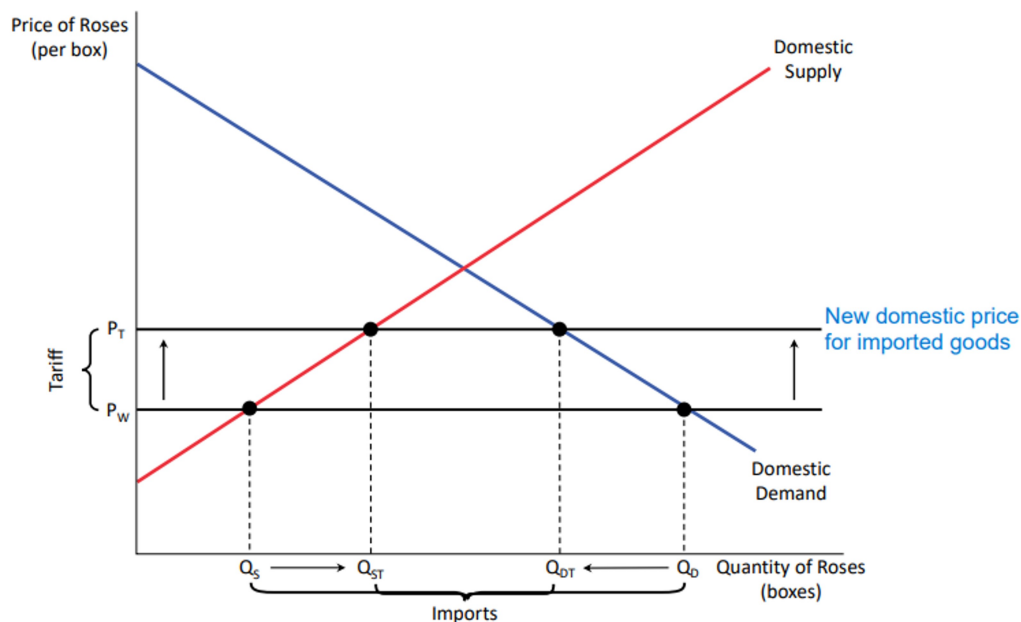
Trade Protection

Free trade - government does not attempt either to reduce or to increase the levels of exports and imports that occur naturally as a result of supply and demand.

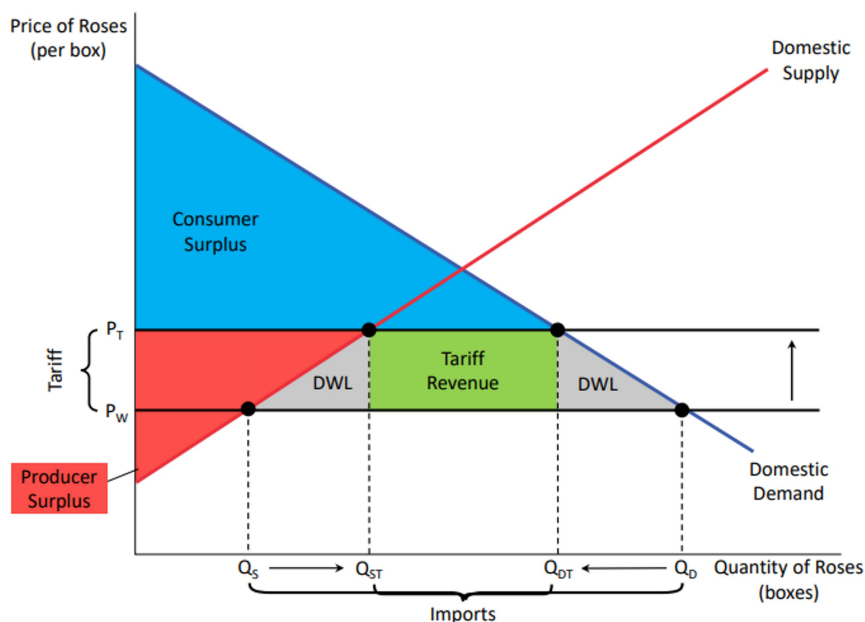
Trade protection or protection - Policies that limit imports

- **Tariff** - a tax on imports
- **Import Quotas** - a legal quantity limit imports

The Domestic Market with Imports



The Welfare of a Tariff



Arguments for Trade Protection

Advocates of tariffs and import quotas offer a variety of arguments. Three common arguments are:

- **National Security** - What happens if the country with whom we are trading becomes our enemy?
- **Job Creation** - How can we survive if there are not any more jobs?
- **The Infant Industry Argument** - How can we create a comparative advantage if we don't protect emerging industries?