

International Economics

THEORY & POLICY

Seventh Edition



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Chapter 1

Introduction

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Preview

- International trade is about how nations interact through trade of goods and services, and through investment.
 - ◆ Gains from trade
 - ◆ Income distribution
 - ◆ Explaining trade patterns (comparative advantage)
 - ◆ Effects of trade policies



What Is International Trade About?

- Importance continues to grow as countries become ever more tied to the international economy.
- Nations are more closely linked through trade in goods and services and through investment than ever before.
- International trade as a fraction of the U.S. economy has tripled in the past 40 years.
- Compared to the United States, other countries are even more tied to international trade.

What Is International Trade About?

Exports, imports
(percent of U.S.
national income)

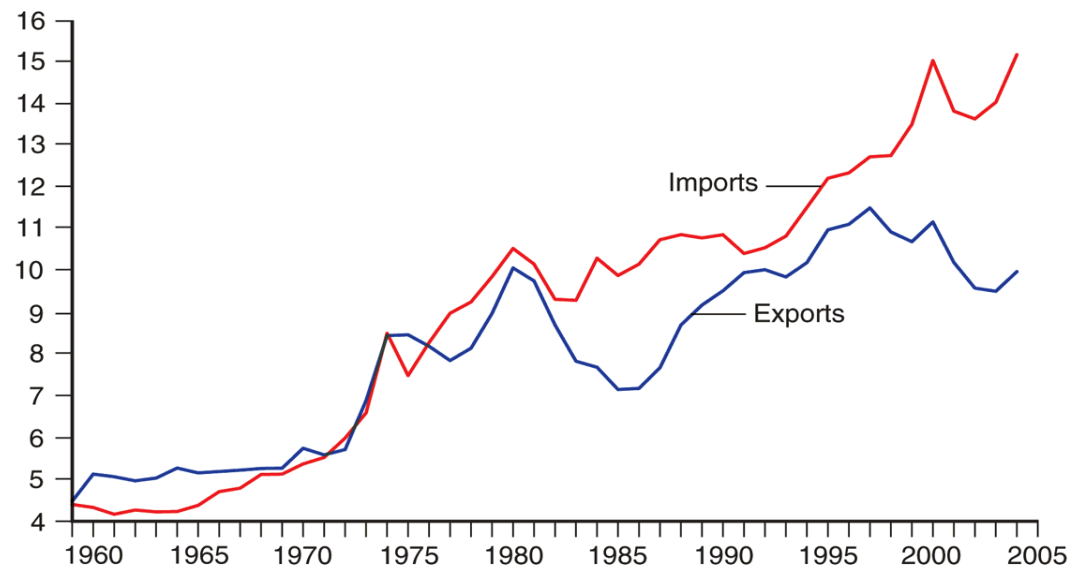


Figure 1-1

Exports and Imports as a Percentage of U.S. National Income

From the 1960s to 1980, both exports and imports rose steadily as shares of U.S. income. Since 1980, exports have fluctuated sharply.

What Is International Trade About?

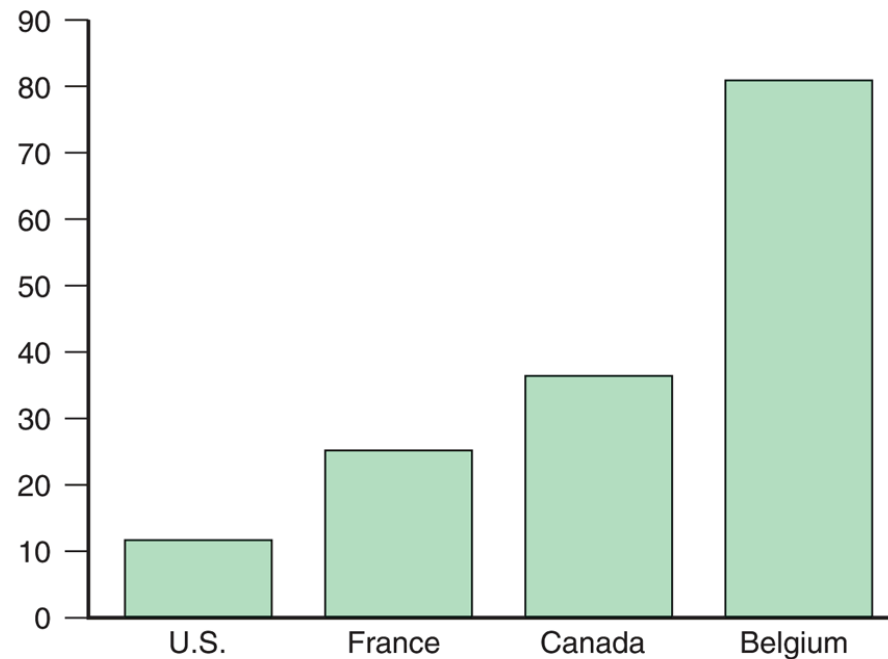
Figure 1-2

Exports and Imports as Percentages of National Income in 2003

International trade is even more important to most other countries than it is to the United States.

Source: Organization for Economic Cooperation and Development.

Exports, imports
(percent of
national income)





Gains from Trade

- Several ideas underlie the gains from trade:
 1. When a buyer and a seller engage in a voluntary transaction, both receive something that they want and both can be made better off.
 - Norwegian consumers could buy oranges through international trade that they otherwise would have a difficult time producing.
 - The producer of the oranges receives income to use to buy other goods.



Gains from Trade

2. How could a country that is the most (or least) efficient producer of everything gain from trade?
 - ◆ With a finite amount of resources, countries can use those resources to produce what they are most productive at (compared to their other production choices), then trade those products for other goods and services that they want to consume.
 - ◆ Countries can specialize in production, while consuming many goods and services through trade.
 - ◆ Even a country bad at everything is least bad at something.



Income Distribution

- Trade benefits *countries as a whole*, but may harm *particular groups within a country*.
 - ◆ International trade can adversely affect the owners of resources that are used intensively in industries that compete with imports.
 - ◆ Trade may therefore affect the distribution of income within a country.
 - ◆ Conflicts about trade can arise between groups within countries.



Patterns of Trade

- Why does international trade occur – why do some countries export certain products and import others?
- Comparative advantage explains trade patterns.
- Comparative advantage stems from various differences across countries:
 - ◆ Differences in *labor productivity* across sectors (industries).
 - ◆ Differences in *relative supplies of factors such as capital, labor and land*.



Effects of Trade Policies

- Policy makers affect the amount of trade through
 - ◆ *tariffs*: a tax on imports or exports,
 - ◆ *quotas*: a quantity restriction on imports or exports,
 - ◆ *export subsidies*: a payment to producers that export,
 - ◆ or through other regulations (e.g., product specifications) that discriminate against foreign products.
- What are the costs and benefits of these policies?
- Who gains and who loses?



International Trade Versus International Finance

- International trade focuses on transactions of real goods and services across nations.
 - ◆ These transactions usually involve a physical movement of goods or a commitment of tangible resources like labor services.
- International finance focuses on financial or monetary transactions across nations.
- This course covers international trade only.