**Sixth Lecture**
# Freedom to Protect: International Trade

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*The "cake paradox":*
*Can protectionism increase well being? Can free trade undermine it?*

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**Protectionism: What? Why**
- **The "cake paradox"**

**The post war trade boom**
- **Effective protectionism:**
- **Direct (tariff) and indirect (non-tariff barriers)**

**Gains from trade:**
- **Specialization and comparative advantage**
- **Scale**
- **Proliferation**
- **Competition**

**Who gains from trade?**
- **Ricardo: land and capital**
- **Marx: capital and labour**
- **Heckscher-Ohlin trade theory**
- **Capital vs labour**
- **Skilled vs. unskilled**
- **Industry-specific skills**
- **Monopoly and terms of trade**

**Developing countries**
- **Immiserising growth**
- **Unequal exchange and "inequalizing trade"**

**Why has trade grown ever more liberalized?**

**Hegemomic power**
- **Self destruct?**
- **Hegemony = free trade?**
- **Optimal protection/libaralization mix**

**The "protectionist cycle" and the TNCs**
- **Trade as a pre-requisite for investment**
- **Protectionism as a pre-requisite for profit**

**The post-1945 institutional setting**
- **Birth: Havana**
- **GATT: MFN, equal national treatment, unfair trade practices, multilateralism**

**US leadership**
- **The internal balance of power in the US**
- **European and Japanese reconstruction**
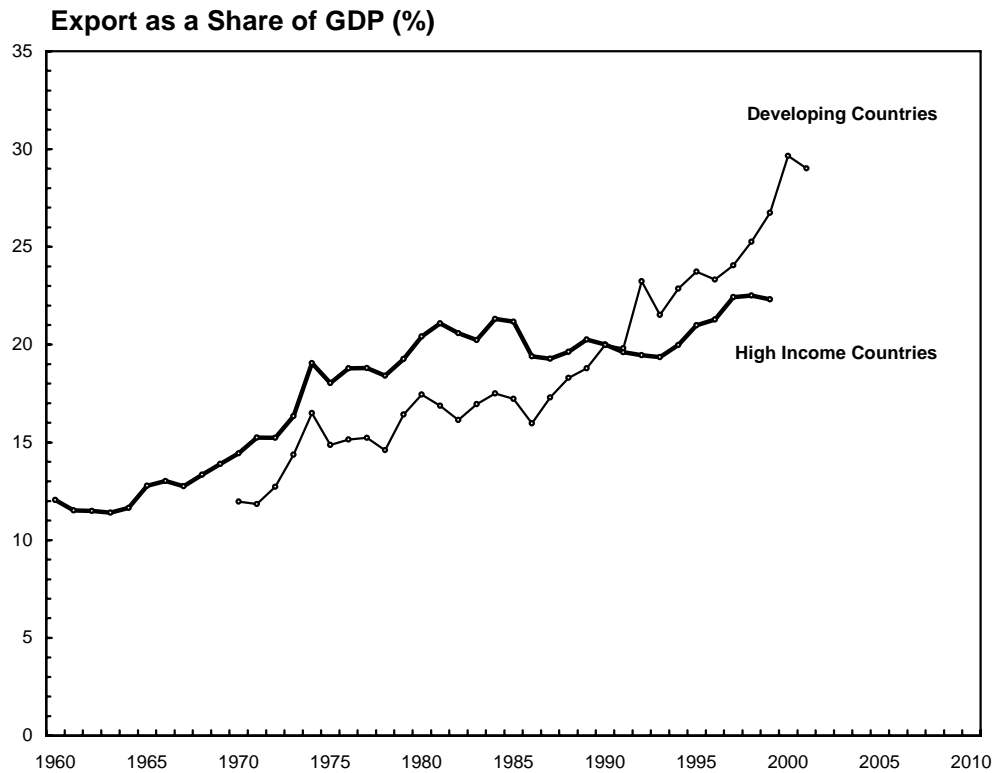- **Spoils**

**Creeping protectionism: background**
- **National**
- **Sectoral**
- **Convergence**

**Competitiveness**
- **LDCs**
- **Japan and Europe**

**Disruptions**
- **US trade balance slips into deficit**
- **Stagflation**
- **Floating exchange rates**

**Export as a Share of GDP (%)**

Developing Countries

High Income Countries

SOURCE: *World Development Indicators*

**A popular club**
Members of GATT/WTO

Source: WTO
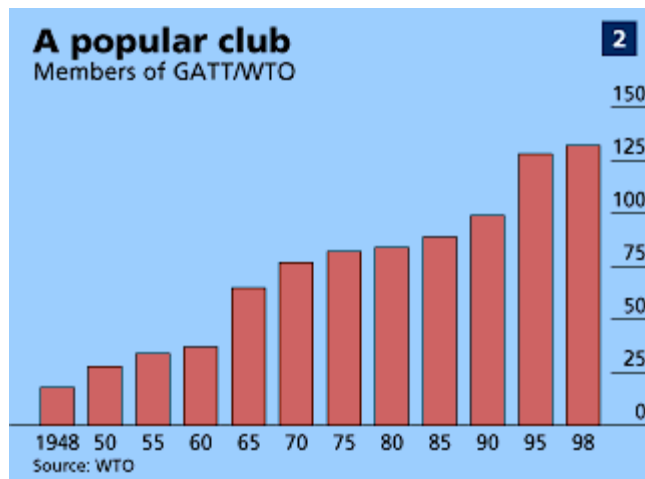
SOURCE: "Time for Another Round: Survey of World Trade," *The Economist*, October 8, 1998

# **Comparative advantage and gains from trade**

Suppose each Chinese workers can produce 2 software packages or 4 microprocessors a month, and that a US worker can make 1 software package and 1 microprocessor:

| **Productivity** | Software packages a month | Microprocessors a month |
|---|---|---|
| Chinese worker | 2 | 4 |
| US worker | 1 | 1 |

Obviously, China has an absolute advantage in the production of both. But it has a comparative advantage only in the production of microprocessors:

| **Relative prices** | Price: software / microprocessors | Price: microprocessors / software |
|---|---|---|
| China | 2 | ½ |
| US | *1* | 1 |

Suppose the two countries have 100 workers each, split evenly between the two industries, and suppose there is no trade:

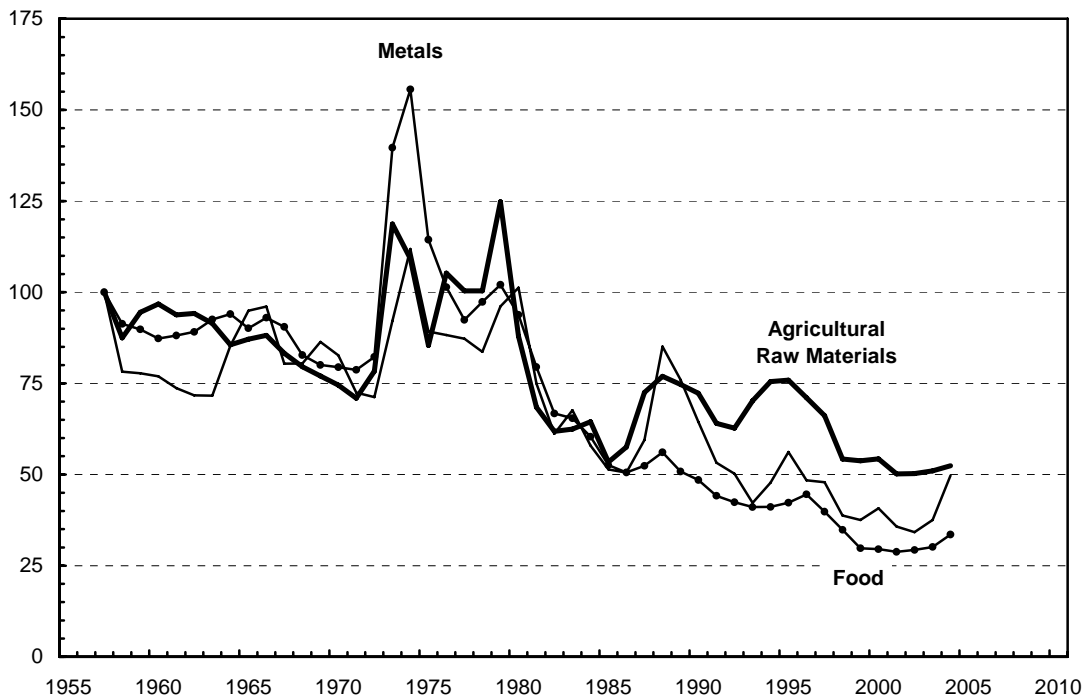| **Output** | Software | Microprocessor |
|---|---|---|
| China | 50 * 2 = 100 | 50 * 4 = 200 |
| US | 50 * 1 = 50 | 50 * 1 = 50 |
| Total | 150 | 250 |

Now suppose that instead we can trade, and each country specializes in what it has comparative advantage, so China emphasizes microchips and the US software:

| **Output** | Software | Microprocessor |
|---|---|---|
| China | 40 * 2 = 80 | 60 * 4 = 240 |
| US | 80 * 1 = 80 | 20 * 1 = 20 |
| Total | 160 | 260 |

## Exports as a Share of World Total (%)
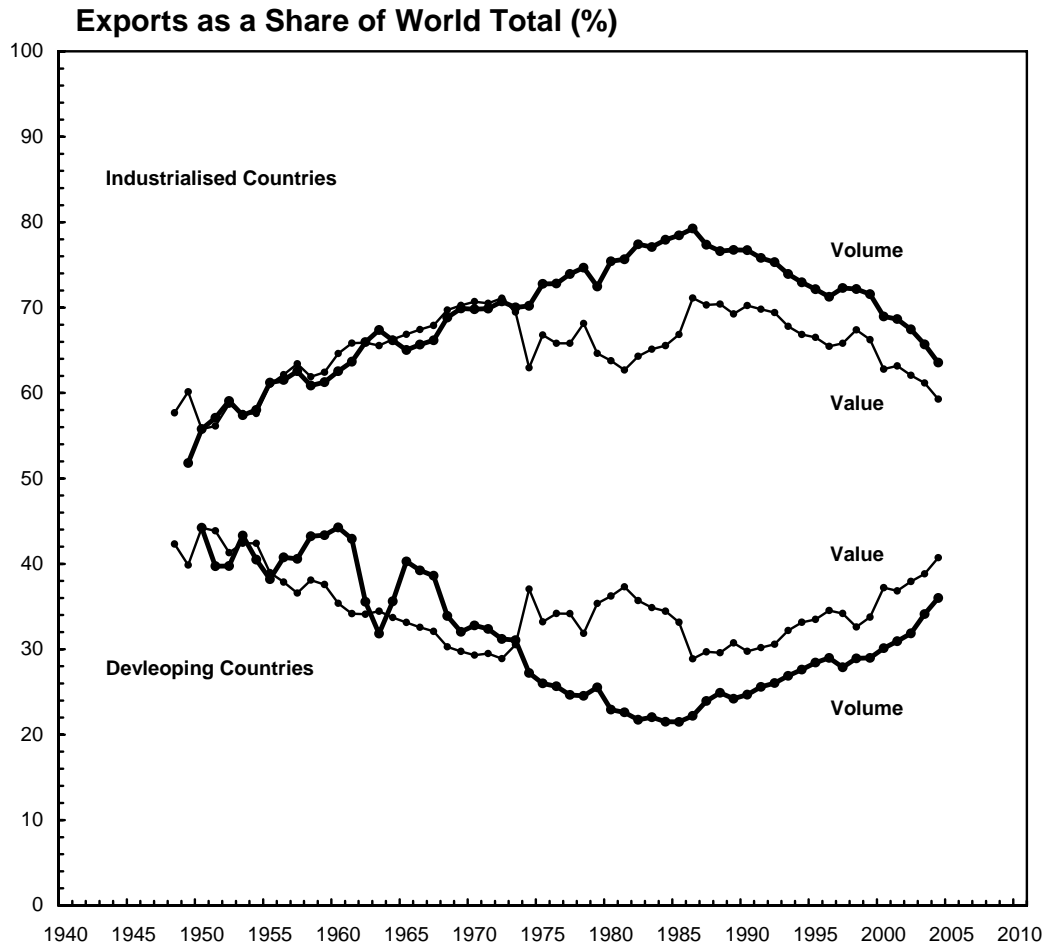


SOURCE: IMF *Internatiional Financial Statistics* through WEFA-DRI

## Real Commodity Prices*

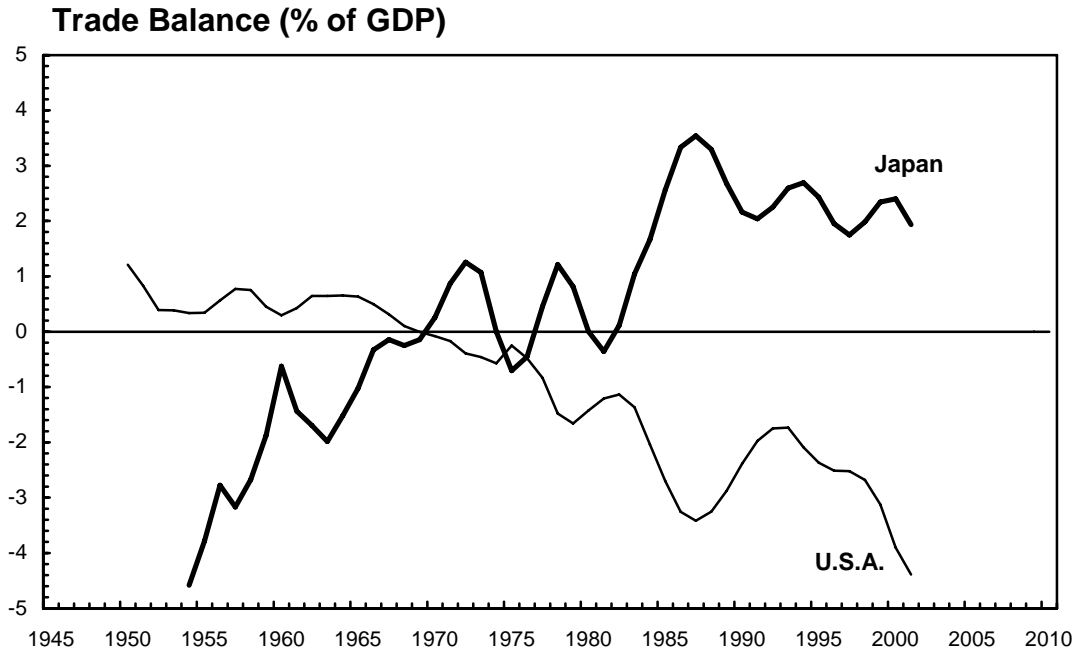**Metals**

**Agricultural
Raw Materials**

**Food**

* Commodity prices in $U.S. deflated by the U.S. Consumer Price Index.
SOURCE: IMF *Internatiional Financial Statistics* through WEFA-DRI
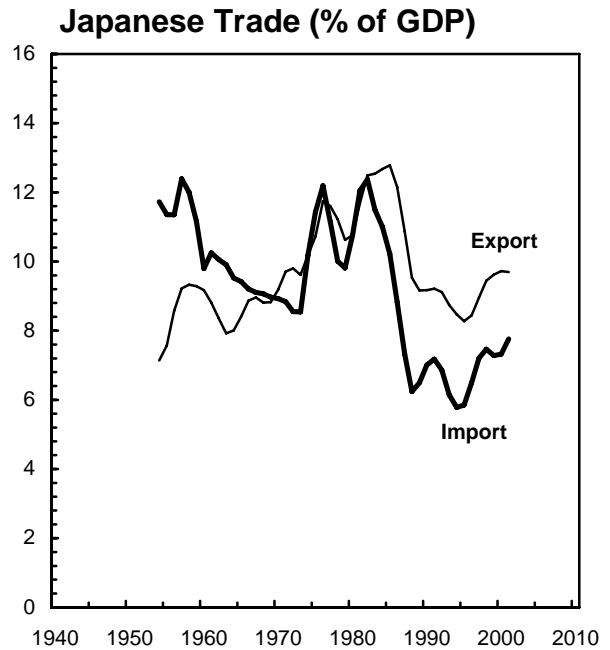
## Export Prices

**1949=100**

**Ratio of Industrialised Countries
to Non-Oil Developing Countries**

SOURCE: IMF Internatiional Financial Statistics through WEFA-DRI

**Trade Balance (% of GDP)**



NOTE: Series expressed as 3-year moving averages.
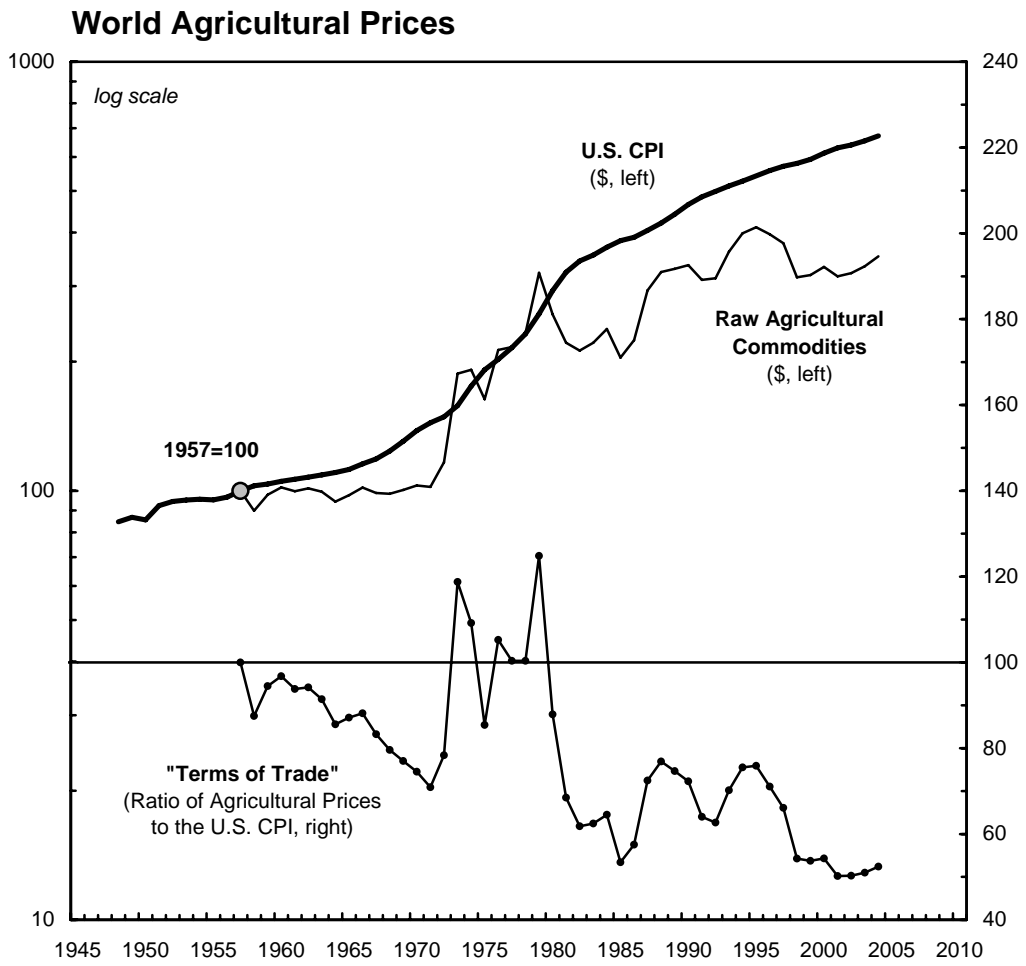SOURCE: IMF, *International Financial Statisitics* through WEFA-DRI

**U.S. Trade (% of GDP)**



NOTE: Series expressed as 3-year moving averages.
SOURCE: IMF, *International Financial Statisitics*
through WEFA-DRI

**Japanese Trade (% of GDP)**



NOTE: Series expressed as 3-year moving averages.
SOURCE: IMF, *International Financial Statisitics*
through WEFA-DRI

## World Agricultural Prices



SOURCE: IMF.