Sixth Lecture
Freedom to Protect: International Trade

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

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**
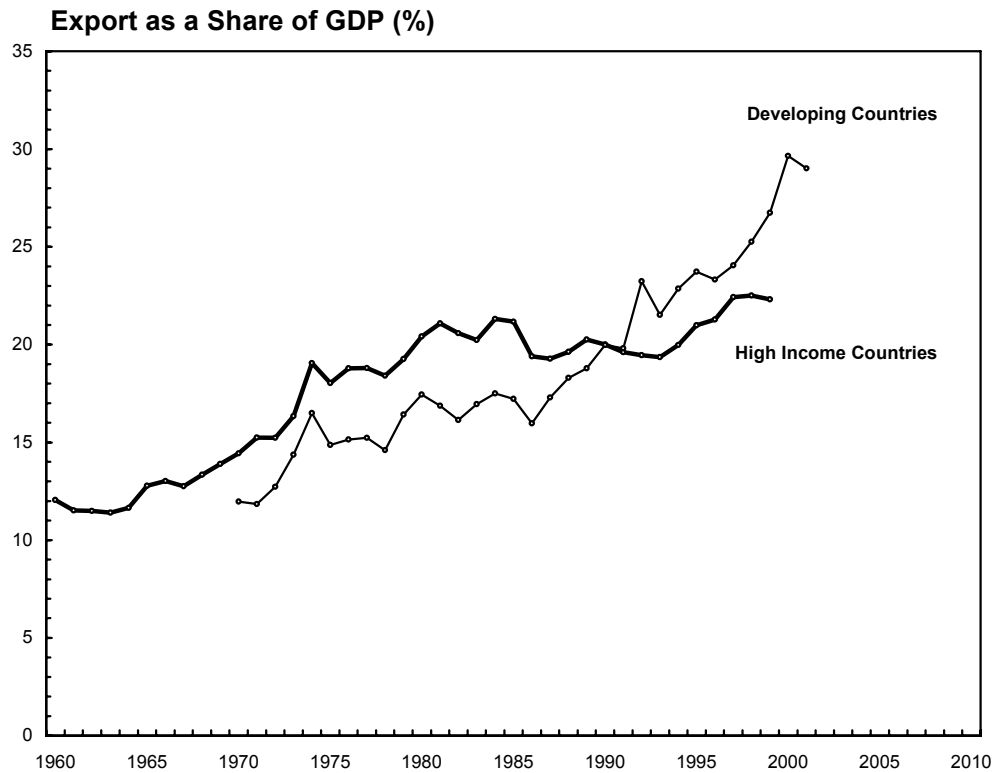- **Spoils**

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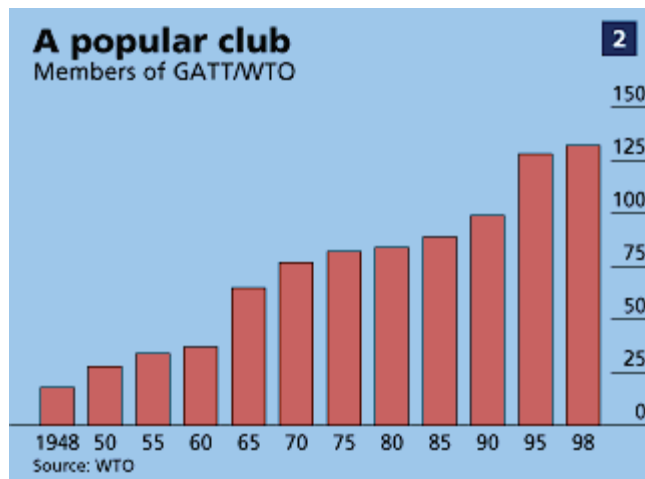- **National**
- **Sectoral**
- **Convergence**

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

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

Export as a Share of GDP (%)

SOURCE: *World Development Indicators*

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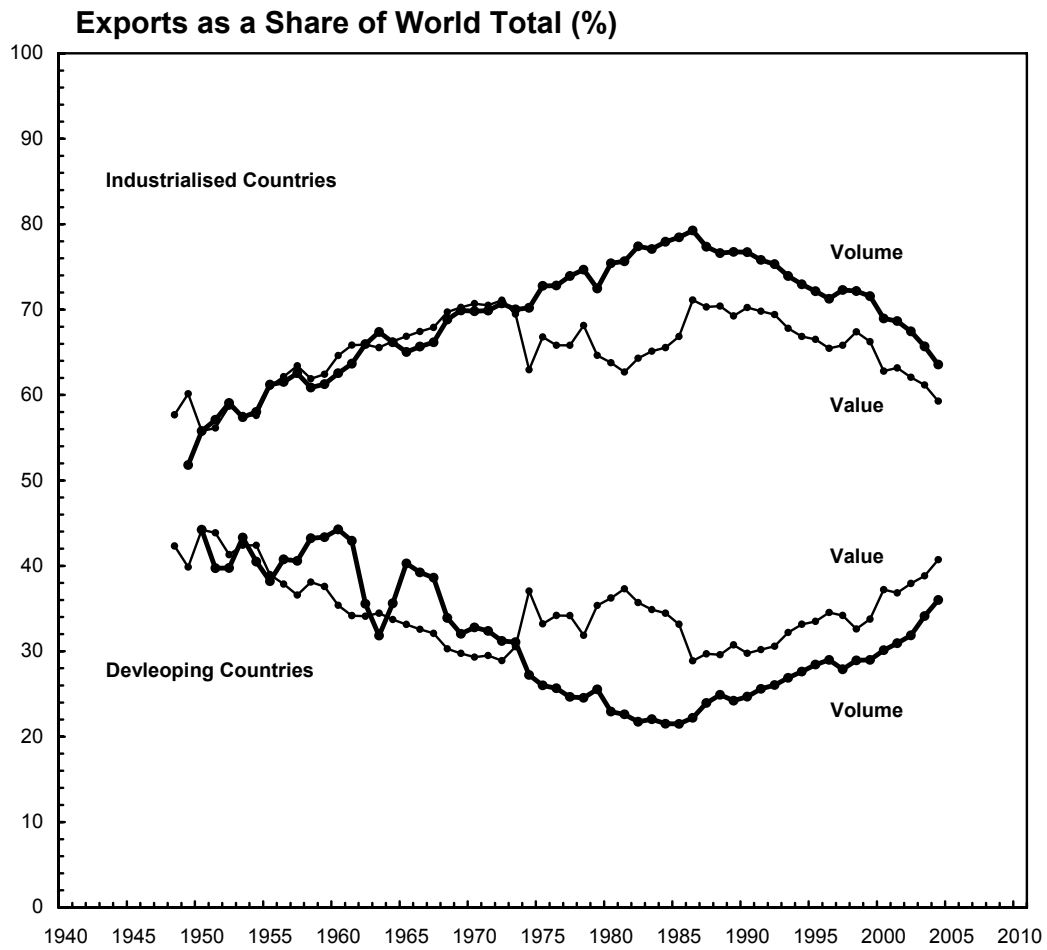
Relative prices	Price: software / microprocessors	Price: microprocessors / software
China	2	½
US	*1*	1

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

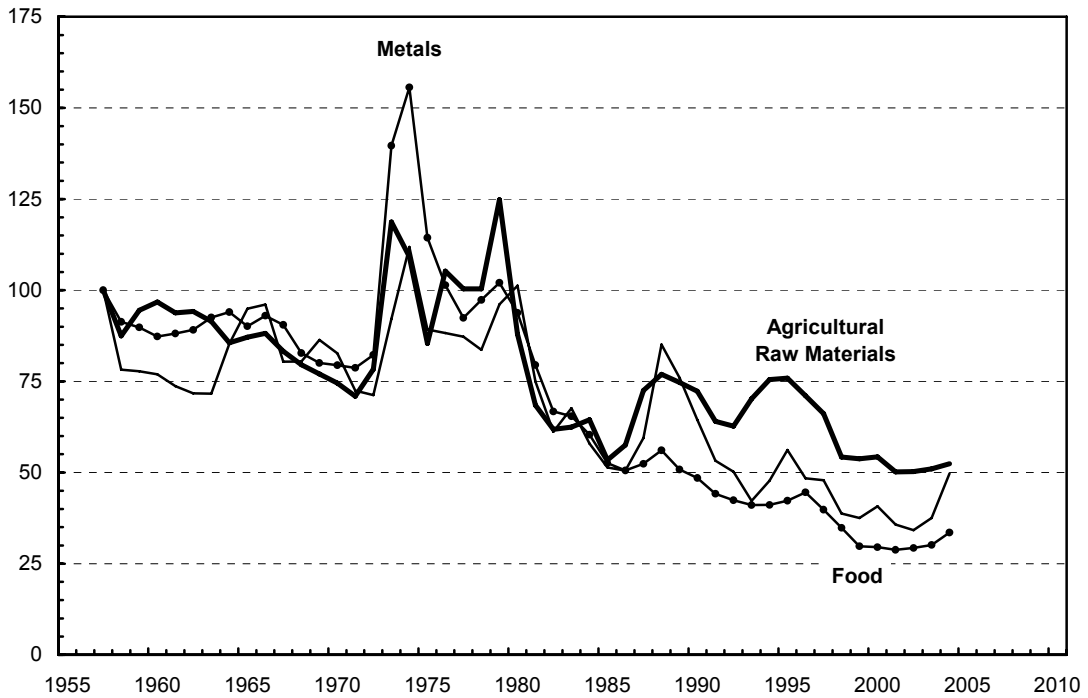| Output	Software	Microprocessor
China	50 * 2 = 100	50 * 4 = 200
US	50 * 1 = 50	50 * 1 = 50
Total	150	250

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 (%)

Industrialised Countries
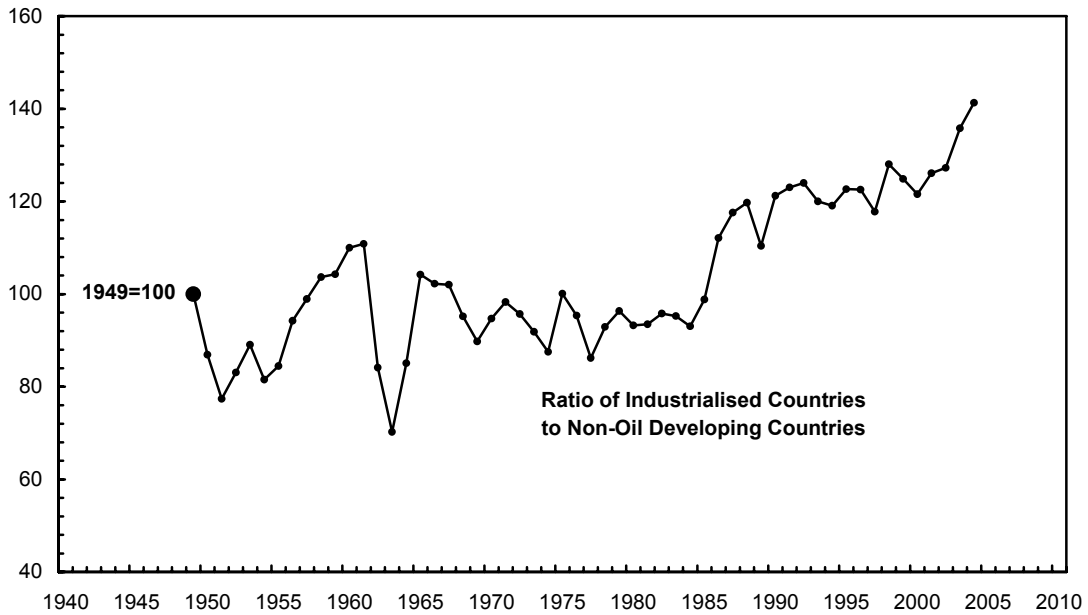
Volume

Value

Devleoping Countries

Value

Volume

SOURCE: IMF *Internatiional Financial Statistics* through WEFA-DRI
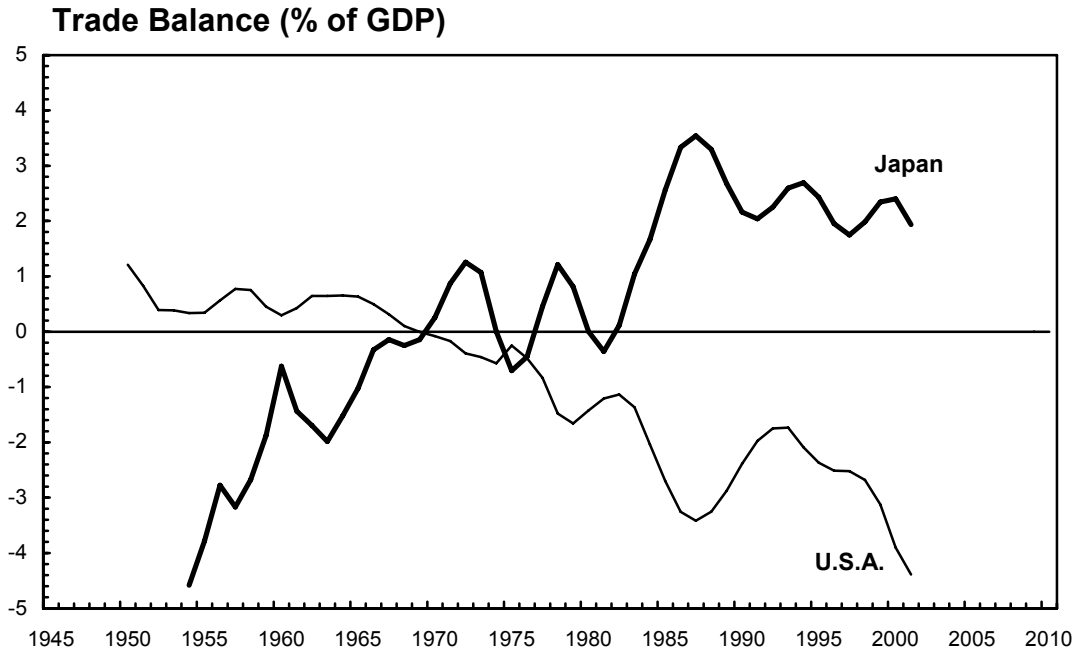
Real Commodity Prices*

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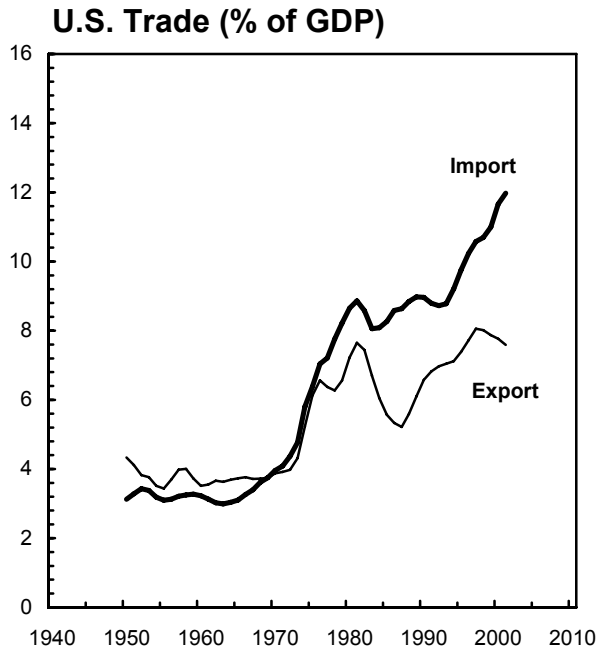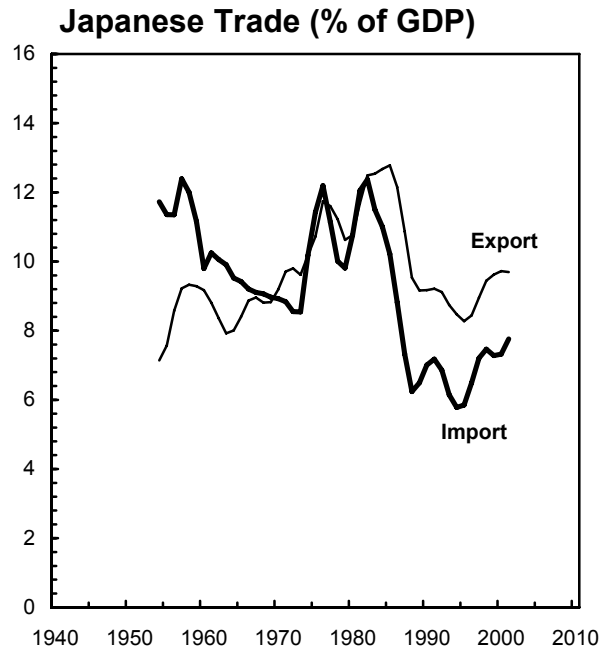SOURCE: IMF *Internatiional Financial Statistics* through WEFA-DRI

Export Prices

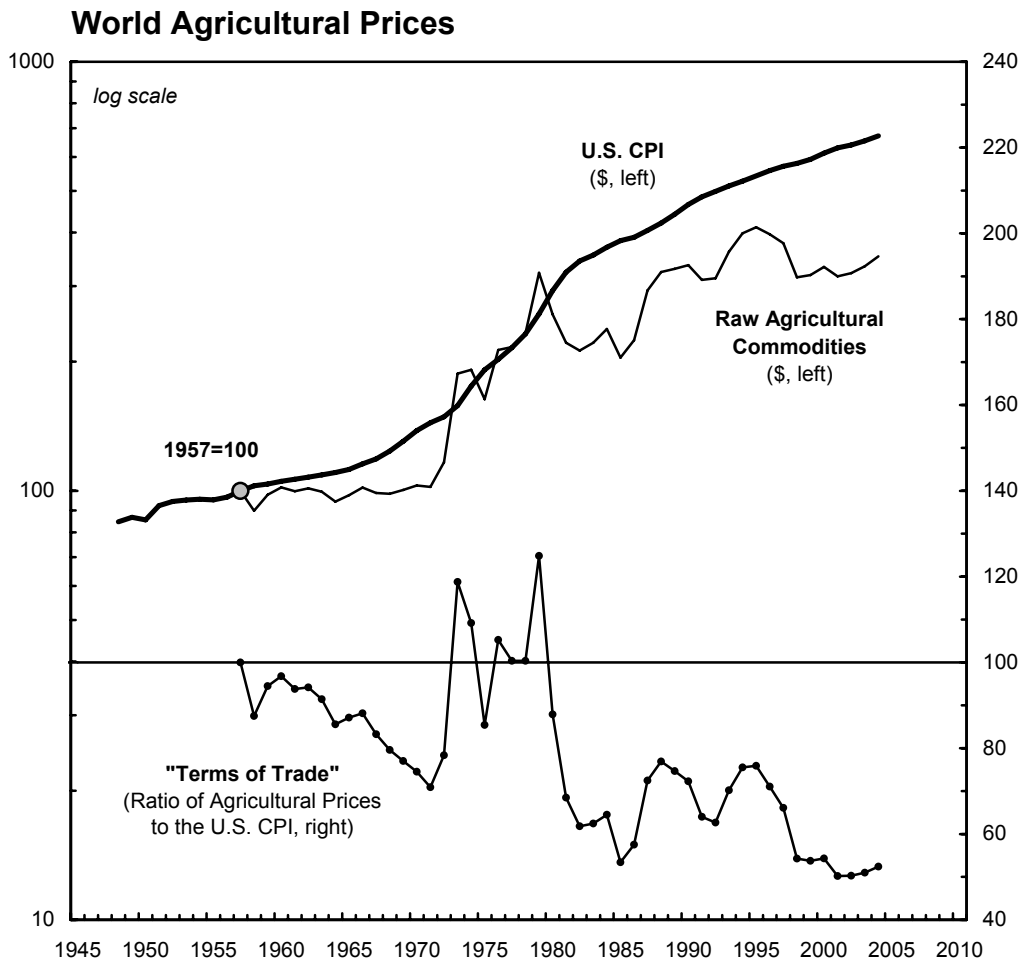SOURCE: IMF Internatiional Financial Statistics through WEFA-DRI

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.