

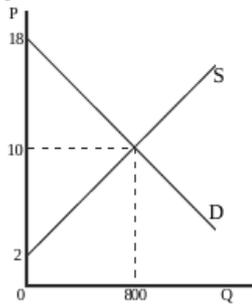
International Trade and Monetary Systems

Prof. Dr. Dennis A. V. Dittrich

2015

1. Discuss the role of institutions in a modern economy. Give two examples of institutions that have served to enable people to capture the gains from dealing with strangers.
2. Explain why economists usually draw indifference curves convex to the origin.

Suppose that, in addition to the manufacturing costs represented by the supply curve, there is also a transport cost of \$4 per pair of shoes. Compared to the case of no transport costs, how does this affect the price of shoes in an importing country and the quantity traded? How does this affect the gains from trade?



...today's topic...

Suppose two countries enjoy gains from trade with each other because they have different factor endowments (their PPFs are different). Then suppose that one economy's PPF shifts out because of economic growth. How are both economies affected by one country's growth? Is the non-growing country better off because of the other economy's growth? Why or why not?

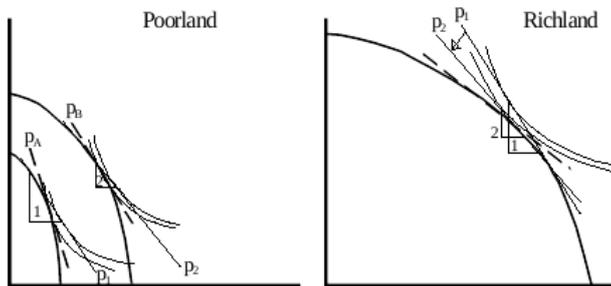


Figure 3
Economic Catch-Up and the Terms of Trade

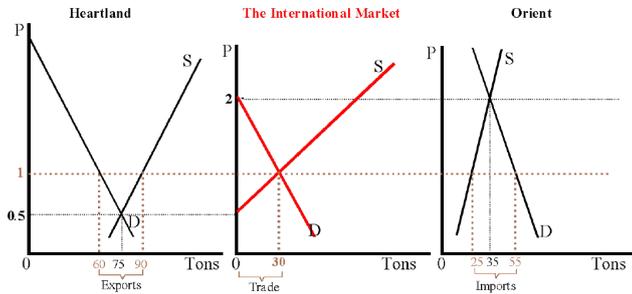
It depends..

- ▶ If the PPFs become more similar, there will be less trade and the non-growing country will be worse off.
- ▶ If the PPFs become even less similar, there will be more trade and the non-growing country will be better off, too.

Analyzing the Effect of Transport Costs on International Trade

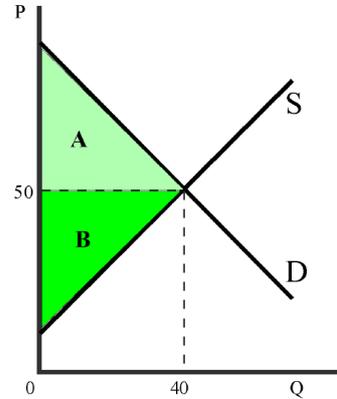
- ▶ Transport costs in effect drive a wedge in between the price received by an exporter and the price paid by a foreign importer.
- ▶ Transport costs increase the cost of products to the final user, and it should not be surprising that they reduce both the volume of trade and the gains from trade.
- ▶ The analysis of transport costs uses the concepts of consumer and producer surplus.

Equilibrium in the International Market



TOURO COLLEGE BERLIN

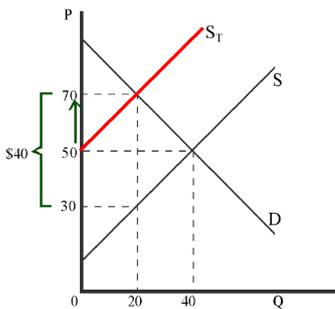
International Market Equilibrium in the Absence of Transport Costs



- ▶ In this international market, the net gains to the importing country are equal to the area A.
- ▶ The exporting country enjoys net gains equal to the area B.
- ▶ The net gains to the world from trade in this product are equal to the areas A + B.

TOURO COLLEGE BERLIN

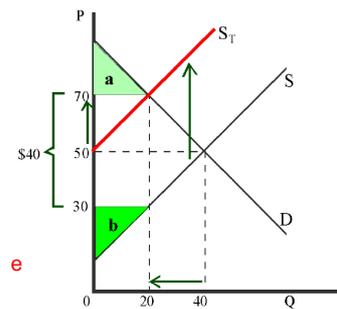
Transport Costs Reduce Trade



- ▶ Transport costs of \$40 raise the effective international supply curve from S to S_T .
- ▶ Transport costs drive a wedge between what suppliers receive and consumers pay.
- ▶ The volume of trade falls from 40 to 20.

TOURO COLLEGE BERLIN

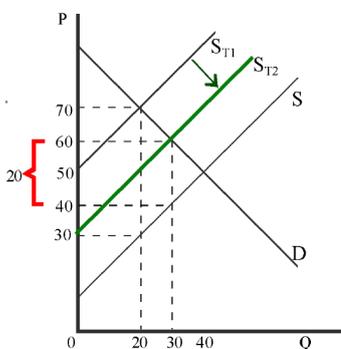
Transport Costs Reduce Trade



- ▶ The volume of trade falls from 40 to 20.
- ▶ Net gains from trade are reduced to the areas a + b.

TOURO COLLEGE BERLIN

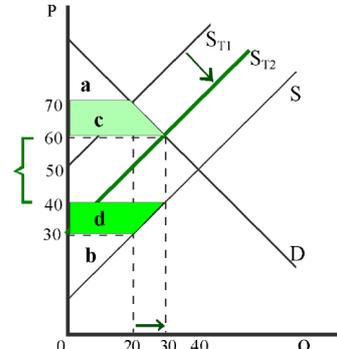
A Decline in Transport Costs Expands International Trade



- ▶ Suppose transport costs fall from \$40 to \$20.
- ▶ The International supply curve shifts down by \$20.
- ▶ The wedge between the export price and the importers cost is now \$20.

TOURO COLLEGE BERLIN

A Decline in Transport Costs Expands International Trade



- ▶ The wedge between the export price and import cost is now \$20.
- ▶ The volume of trade rises to 30.
- ▶ Net gains from trade in this market rise by c + d.

TOURO COLLEGE BERLIN

Trade and Transport Costs

- ▶ An increase in transport costs reduces the gains from trade for both the importing and exporting countries.
- ▶ A decline in transport costs increases the gains from trade.
- ▶ Most of the expansion of trade during the past two centuries has been attributed to improvements in the efficiency of transportation.
 - ▶ Canals
 - ▶ Railroads
 - ▶ Steamships
 - ▶ Refrigeration
 - ▶ Trucks
 - ▶ Paved highways
 - ▶ Aircraft
 - ▶ Containerization
 - ▶ Communications

TOURO COLLEGE BERLIN

Modern container facilities, such as this one in Tacoma, Washington, have greatly reduced handling costs and shrinkage losses.



Similarly, bulk goods handling at ports has improved from the days when individual bags were carried on board ships on the backs of workers.

TOURO COLLEGE BERLIN

Many Costly Barriers to Trade Remain

- ▶ Shrinkage
- ▶ Time
- ▶ Weather
- ▶ Financing
- ▶ Information
- ▶ Documentation
- ▶ Disasters

TOURO COLLEGE BERLIN

Explicit Trade Policies to Restrict Trade

- ▶ Tariffs
- ▶ Import quotas
- ▶ Trade sanctions
- ▶ Boycotts
- ▶ Antidumping duties
- ▶ Countervailing duties
- ▶ Buy domestic regulations

TOURO COLLEGE BERLIN

Trade and Transport

The internet can move data, take orders, process payments, provide information, and handle other marketing activities, but the goods still have to be physically delivered.

TOURO COLLEGE BERLIN

Many people equate international trade with either the loss or gain in the number of jobs in their economy.

How does the HO model address the Jobs issue?

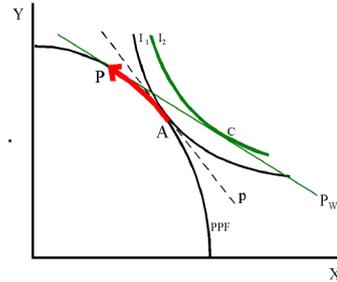
Does trade create or destroy jobs?

TOURO COLLEGE BERLIN

In the real world, economies adjust only gradually to trade because it takes time to shift resources from one industry to another, to close down plants and open new ones, and to shift labor from one area to another.

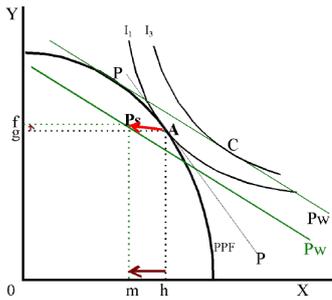
Adjusting to Free Trade

According to the HO model, a shift to free trade means the economy specializes in Y, and production shifts from A to P.



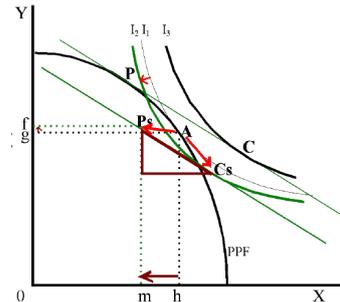
- ▶ The movement of factors from one industry to another implies moving expenses and other costly adjustments.
- ▶ Even if factors move quickly and with few costs, their prices will change, thereby changing the incomes of their owners.

Adjusting to Free Trade



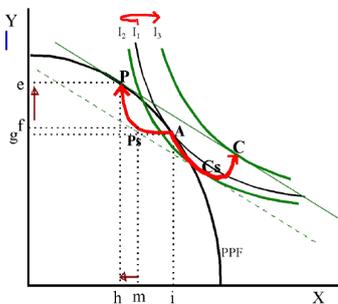
- ▶ A change in relative prices from P to Pw may, in the short run, reduce production of X but not increase output of Y much.
- ▶ Production thus moves to Ps, below the PPF.
- ▶ Output of X falls from h to m, and output of Y rises only slightly from fg.

Adjusting to Free Trade



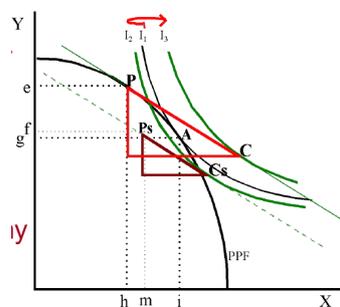
- ▶ When production moves to Ps, below the PPF, the best consumers can do is to consume at Cs.
- ▶ With production at Ps, the economy does not even reach the no-trade indifference curve.
- ▶ Thus, in the short run a shift to free trade may reduce welfare!

Adjusting to Free Trade



- ▶ Only in the long run does the economy reach the standard free trade points P and C.
- ▶ The orange arrows trade dynamic paths from A to P and from A to C.
- ▶ In the short run, welfare declines, in the long run it rises.

Adjusting to Free Trade



- ▶ The dynamic path of trade and specialization implies a gradually changing trade pattern.
- ▶ In the short run, the brown trade triangle results.
- ▶ In the long run, under the assumptions of the HO model, the economy trades according to the larger orange trade triangle.

- ▶ Illustration of exchange between four people.
- ▶ Psychological research and happiness studies that shows why income distribution matters.
- ▶ Externalities associated with trade.