Exercise Set 6.5
International Trade

The Gains from International Trade

- The Ricardian model
- Trade between two countries makes both countries better off
- Result due to specialization
  - Each country produces the good in which it enjoys comparative advantage (lower opportunity cost)

Ricardian model: Example

- Two countries: U.S. and Vietnam
- Two goods: Shrimp and computers
- Production of each good requires only labor
- Constant opportunity cost in each country
  – This gives rise to a linear PPF

Production and Consumption Under Autarky

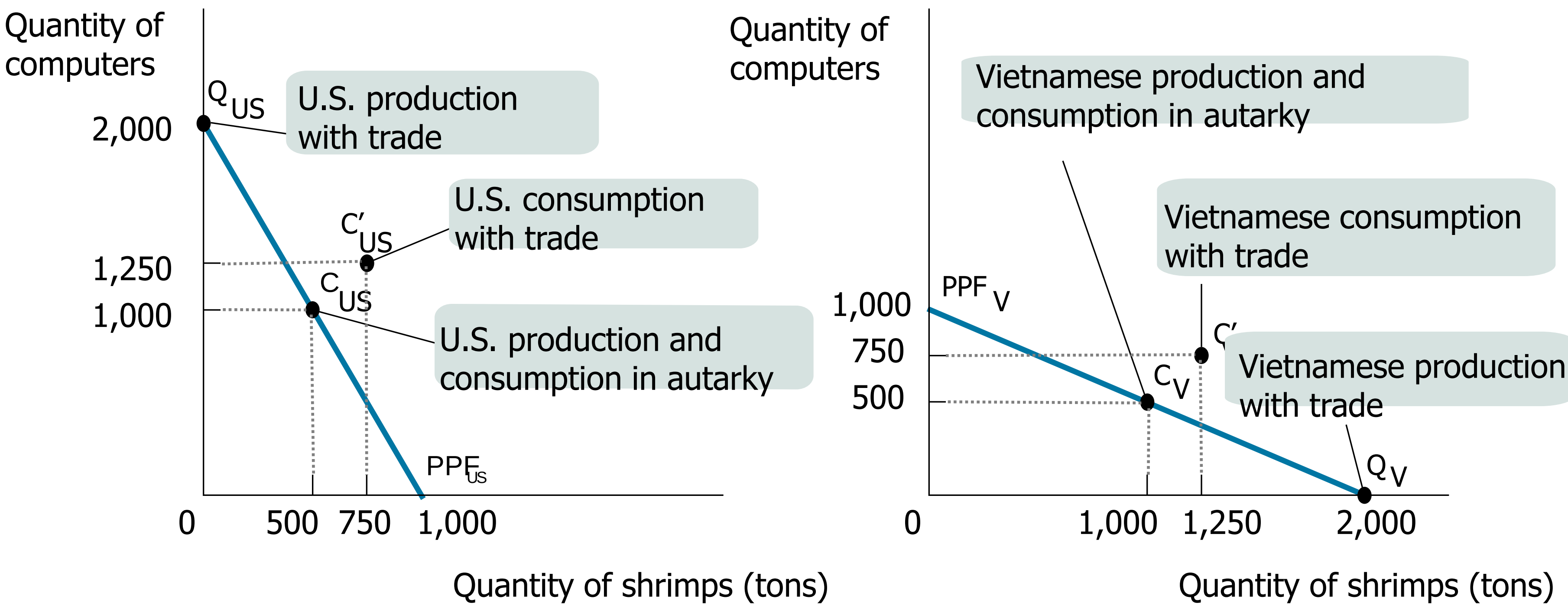
(a) United States	**Production**	**Consumption**
Quantity of shrimp (tons)	500	500
Quantity of computers	1,000	1,000
(b) Vietnam	**Production**	**Consumption**
Quantity of shrimp (tons)	1,000	1,000
Quantity of computers	500	500
(c) World (United States and Vietnam)	**Production**	**Consumption**
Quantity of shrimp (tons)	1,500	1,500
Quantity of computers	1,500	1,500

Production and Consumption After Specialization and Trade

(a) United States	**Production**	**Consumption**
Quantity of shrimp (tons)	0	750
Quantity of computers	2,000	1,250
(b) Vietnam	**Production**	**Consumption**
Quantity of shrimp (tons)	2,000	1,250
Quantity of computers	0	750
(c) World (United States and Vietnam)	**Production**	**Consumption**
Quantity of shrimp (tons)	2,000	2,000
Quantity of computers	2,000	2,000

The Gains from Trade

(a) U.S. Production and Consumption **(b) Vietnamese Production and Consumption**



Trade allows both countries to consume beyond their PPFs.
Both countries are better off under trade than in autarky.

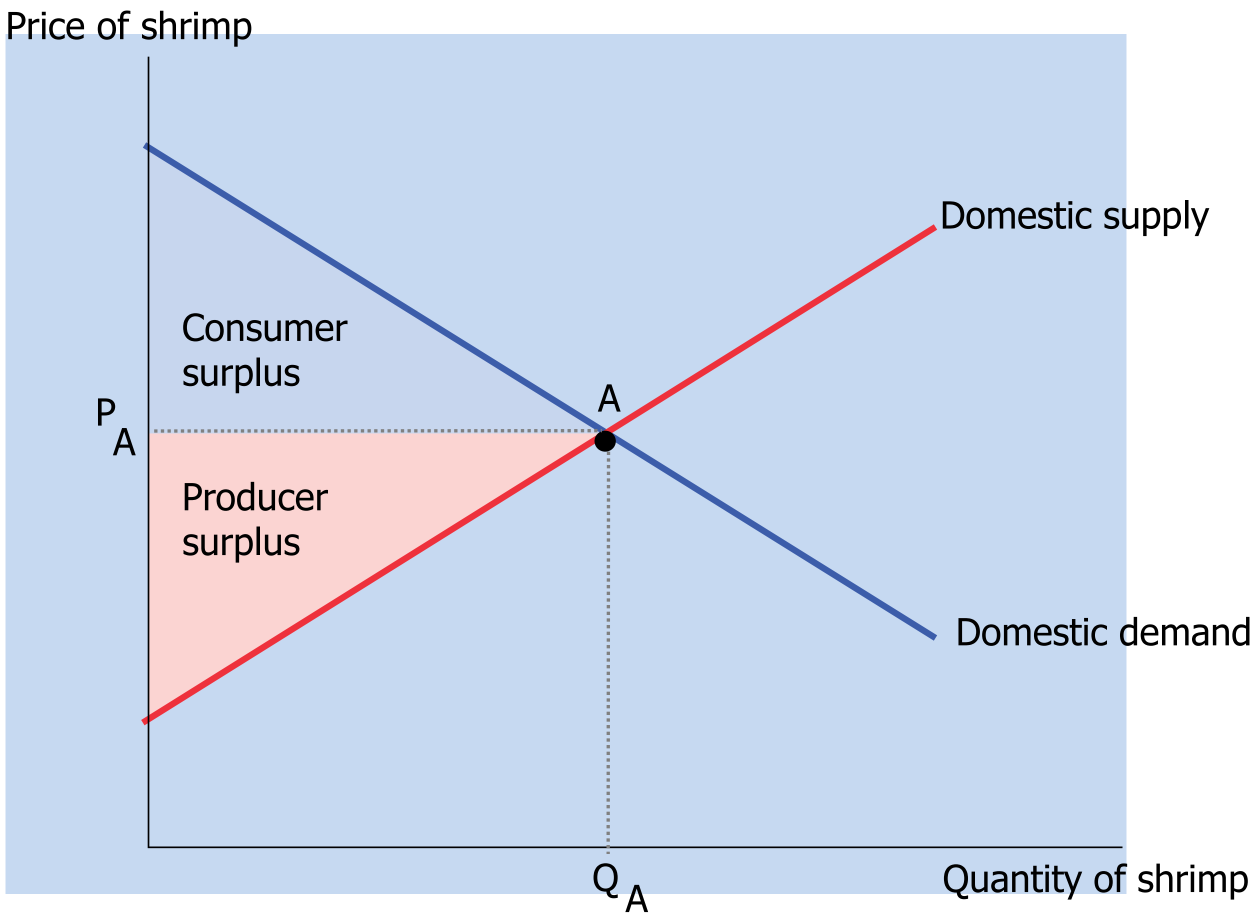
Sources of Comparative Advantage

- **International differences in climate**
  - e.g. winter deliveries of Chilean grapes to the U.S.
- **Differences in technology**
  - Countries export on basis of labor productivity (Ricardian model)
- **Differences in factor endowments**
  - Countries tend to export goods that are *intensive* in the factors they have in abundance (Heckscher–Ohlin model)

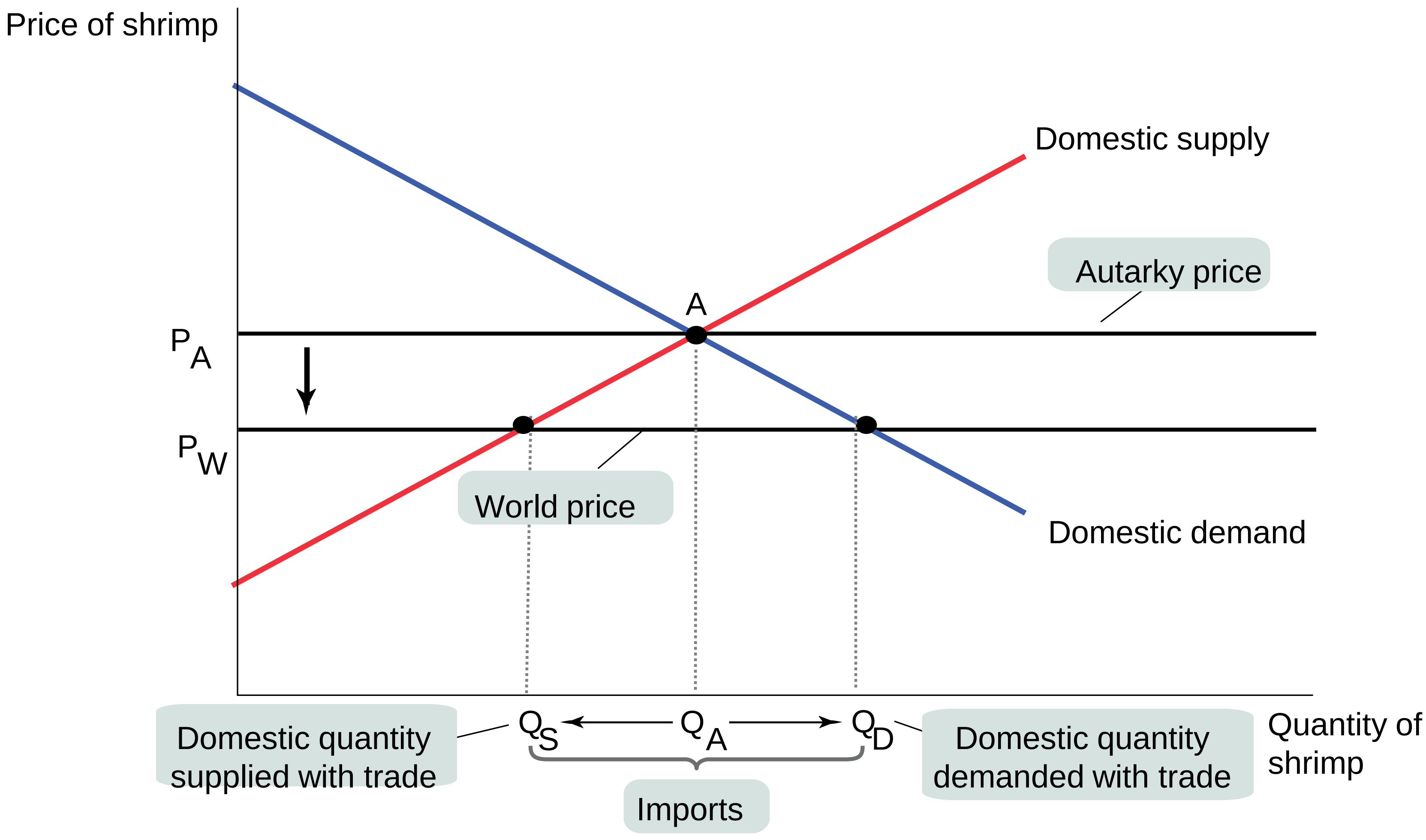
Supply, Demand, and International Trade

- The **domestic demand curve** shows how the quantity of a good demanded by domestic consumers changes with the price of that good.
- The **domestic supply curve** shows how the quantity of a good supplied by domestic producers changes with the price of that good.
- The **world price** of a good is the price at which that good can be bought or sold abroad.

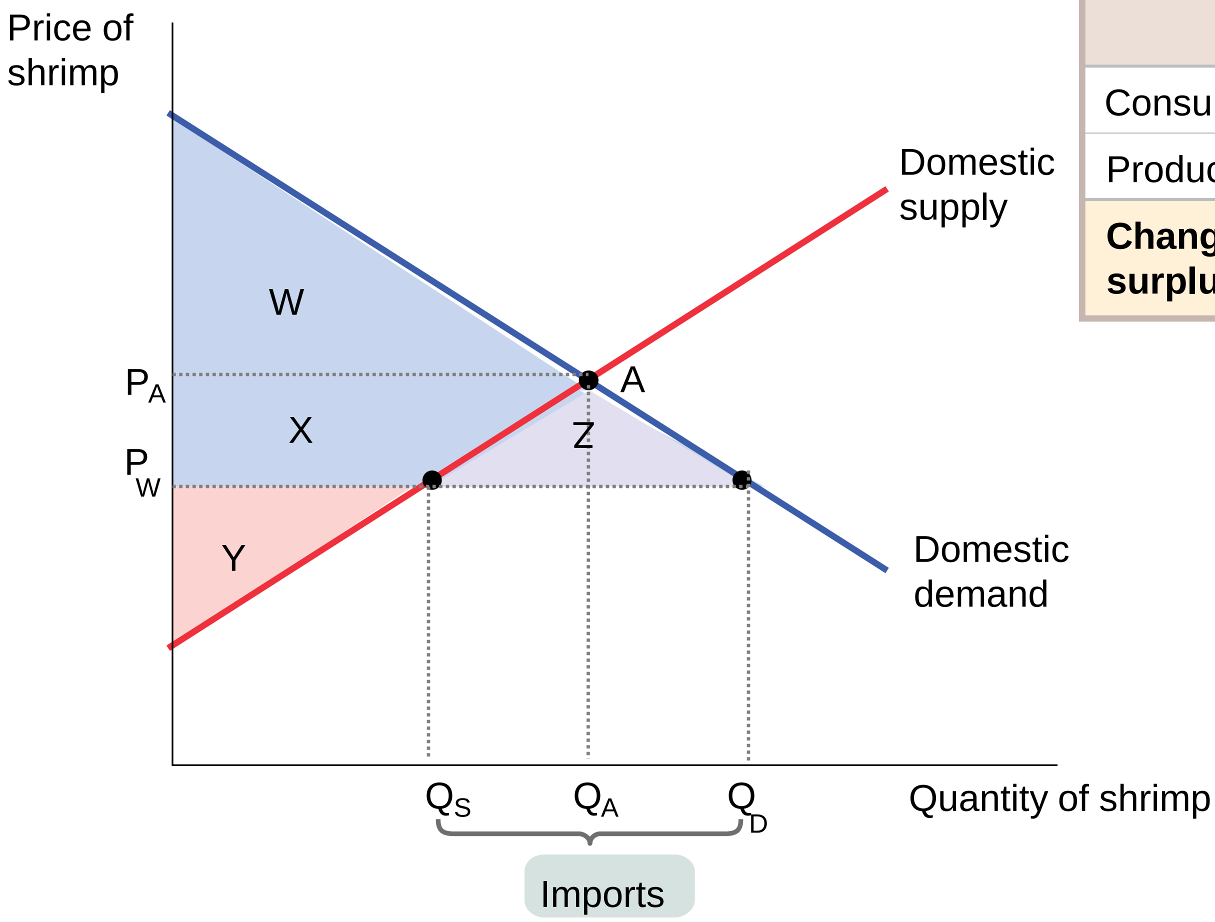
Consumer and Producer Surplus in Autarky



The Domestic Market with Imports

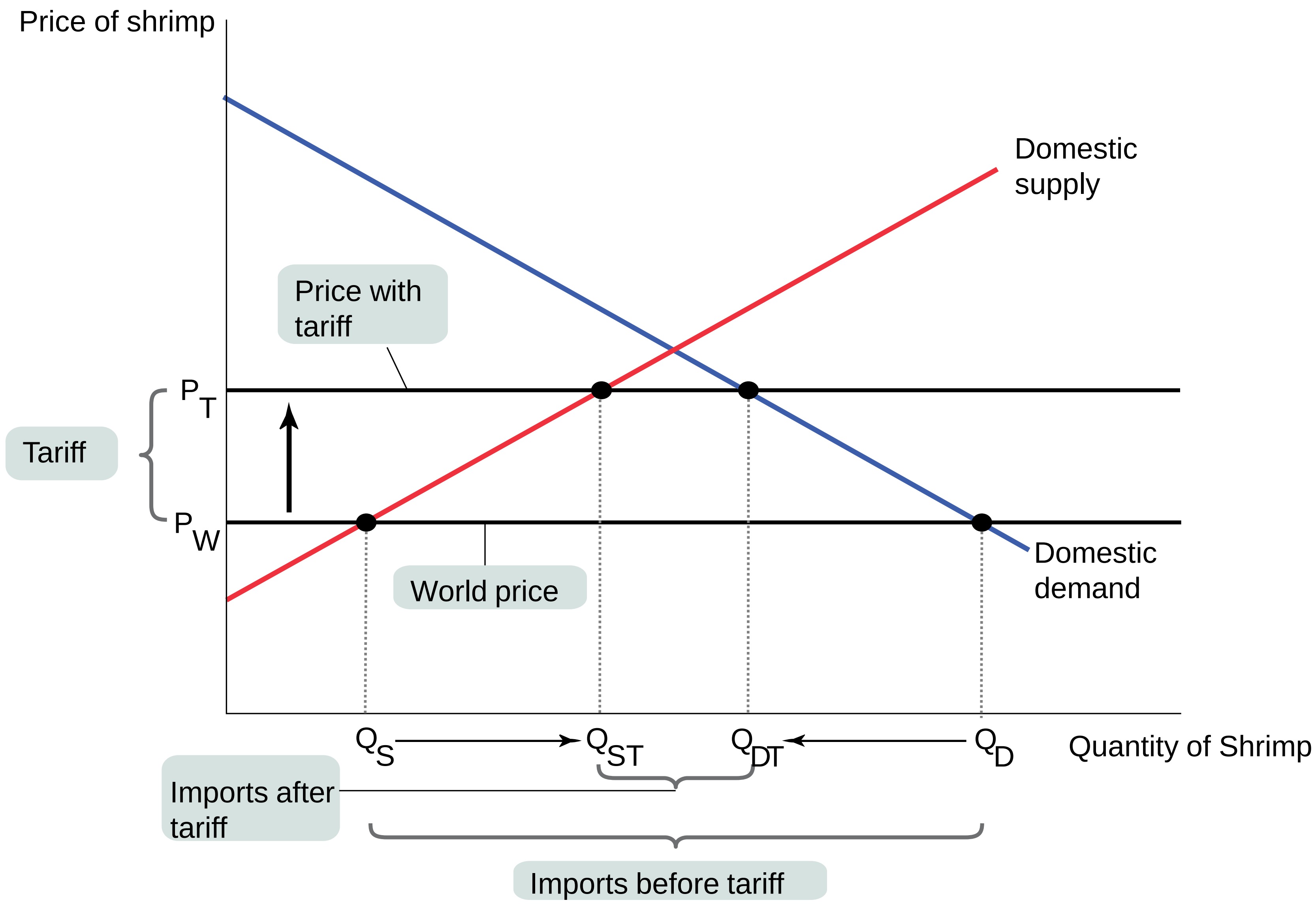


The Effects of Imports on Surplus

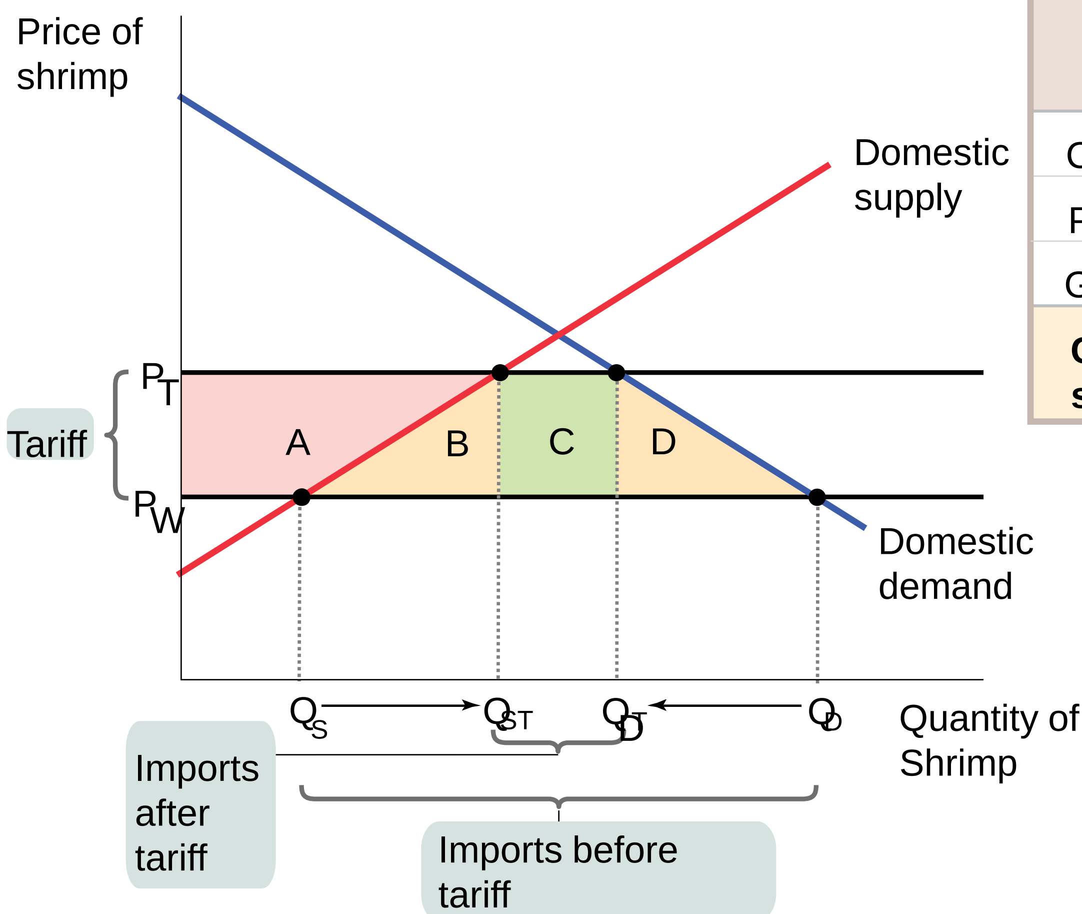


	Changes in surplus	
	Gain	Loss
Consumer surplus	X + Z	
Producer surplus		- X
Change in total surplus	**+ Z**	

The Effect of a Tariff



A Tariff Reduces Total Surplus



	Changes in surplus: Gain	Changes in surplus: Loss
Consumer surplus		–(A+B+C+D)
Producer surplus	A	
Government revenue	C	
Change in total surplus		**–(B+D)**

Video

http://www.screencast.com/t/Y0BwYwZ3XgO