Contents: Chapter 7 (Global Markets in Action)

Class Plan

• Review Ch.6 and finish Ch. 6
  – Covered: government actions in markets and how they create inefficiencie–price floors, price ceilings, and taxes
  – Production Quotas
  – Subsidies

• Chapter 7
  – Global Markets
  – Gains and Losses from Trade
  – International Trade Restrictions

1 Global Markets

• **Imports**: goods and services we buy from other countries
• **Exports**: goods and services we sell to people in other countries

• Global trade is a big deal; global exports and imports were $22 trillion in 2011, which is about a third of the value of global production.

• The US is the world’s largest international trader

What drives international trade?

• Same thing that drives domestic trade

• **National comparative advantage**: situation in which a nation can perform an activity or produce a good or service a a lower opportunity

• Countries will produce what they have a comparative advantage in
  – Have the comparative advantage if your price is lower than world price

(Figure Global Markets)

2 Gains and Losses from Trade

Gains and losses of imports/exports measured by their effect on total surplus levels (consumer+producer)
2.1 Gains and Losses from Imports

- Some producer surplus shifts to consumer surplus
- Additional increase in total surplus through consumers

(Graph Imports)

2.2 Gains and Losses from Exports

- Some consumer surplus shifts to producer surplus
- Additional increase in total surplus through producers

(Figure Exports)

Overall, international trade brings gains for both countries involved.
3 International Trade Restrictions

Governments use four sets of tools to influence international trade and protect domestic industries from foreign competition:

1. Tariffs
2. Import quotas
3. Other import barriers
4. Export subsidies

**Tariff**: tax on a good that is imposed by the importing country when an imported good crosses its international boundary

- Price rises, quantity bought decreases, and quantity produced in US increases
- Raises revenue for the government
- Domestic consumers of the good lose; domestic producers of the good gain
- Domestic consumers lose more than domestic producers gain
- Society loses total surplus; deadweight loss arises

(Figure Tariff)

**Import Quota**: restriction that limits the maximum quantity of a good that may be imported in a given period
• Price rises, quantity bought decreases, and quantity produced in US increases
• Domestic consumers of the good lose; domestic producers of the good gain
• Domestic consumers lose more than domestic producers gain
• Importers of the good gain
• Society loses total surplus; deadweight loss arises

(Figure Quota)

Figure 5: Quota

For a quota set at the same quantity of imports that results from a tariff, all effects are the same except a tariff brings in revenue for the government while a quota brings a profit for the importers.

Other Import Barriers

• Health, safety, and regulation barriers (e.g. FDA restrictions)
• Voluntary Export Restraints: when foreign exporters voluntarily limit their exports (not very common, e.g. Japanese car market in the 1980s)

Export Subsidies: payment by the government to the producer of an exported good

• Illegal under a number of international agreements, including NAFTA and WTO
• Make it harder for producers in other countries to compete in global markets

Why do governments choose to restrict international trade?

• Tariff revenue from imports
• Rent seeking: lobbying for special treatment by the government to create economic profit or divert consumer surplus or producer surplus away from others (remember there are individual winners from tariffs and quotas, such as domestic producers of imported items)