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 (%)

Developing Countries
High Income Countries

SOURCE: World Development Indicators

Comparative advantage and gains from trade

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

<table>
<thead>
<tr>
<th>Productivity</th>
<th>Software packages a month</th>
<th>Microprocessors a month</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chinese worker</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>US worker</td>
<td>1</td>
<td>1</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Relative prices</th>
<th>Price: software / microprocessors</th>
<th>Price: microprocessors / software</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>2</td>
<td>$\frac{1}{2}$</td>
</tr>
<tr>
<td>US</td>
<td>$1$</td>
<td>1</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Output</th>
<th>Software</th>
<th>Microprocessor</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>50 * 2 = 100</td>
<td>50 * 4 = 200</td>
</tr>
<tr>
<td>US</td>
<td>50 * 1 = 50</td>
<td>50 * 1 = 50</td>
</tr>
<tr>
<td>Total</td>
<td>150</td>
<td>250</td>
</tr>
</tbody>
</table>

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:

<table>
<thead>
<tr>
<th>Output</th>
<th>Software</th>
<th>Microprocessor</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>40 * 2 = 80</td>
<td>60 * 4 = 240</td>
</tr>
<tr>
<td>US</td>
<td>80 * 1 = 80</td>
<td>20 * 1 = 20</td>
</tr>
<tr>
<td>Total</td>
<td>160</td>
<td>260</td>
</tr>
</tbody>
</table>
Exports as a Share of World Total (%)

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

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

Export Prices

SOURCE: IMF International Financial Statistics through WEFA-DRI
Trade Balance (% of GDP)

NOTE: Series expressed as 3-year moving averages.

U.S. Trade (% of GDP)

NOTE: Series expressed as 3-year moving averages.

Japanese Trade (% of GDP)

NOTE: Series expressed as 3-year moving averages.
World Agricultural Prices

1957=100

U.S. CPI
($, left)

Raw Agricultural Commodities
($, left)

"Terms of Trade"
(Ratio of Agricultural Prices to the U.S. CPI, right)

SOURCE: IMF.