International Trade
News
Review: Economic Rents
Nations best exploit their comparative advantage by adjusting to world prices.
Surplus and the benefits of trade.
What have we learned?

Recitation Assignment
Answer the following end-of-chapter problems
Chapter 7, Problems 3 and 7
Chapter 8, Problems 4, 7 and 9
Chapter 9, Problems 1-5
Find a news article that describes a comparative advantage of the US in international trade.
Write a 200 word analysis that explains how exploiting this comparative advantage will lead to the creation of jobs and wealth.
See web page for details.

Economic Rent Is Different from Economic Profit.
Economic Rent is that part of the payment for a factor of production that exceeds the factor owner’s reservation price.
Economic profit is driven to zero by competition.
In contrast, economic rent may persist when important production factors cannot be easily duplicated.
Scott Adams loves to draw and has created a well-liked cartoon called Dilbert. When he first started out, Scott earned $3,000 per month drawing Dilbert for subscribing newspapers. Dilbert became popular and now Scott earns $10,000.00 per month drawing Dilbert.

Is Scott Adams receiving economic rent or economic profit?

Is Scott Adams receiving economic rent or economic profit?

A. Economic Profit because his current wage is greater than his opportunity cost.
B. Economic Profit because there is great competition in the cartoon industry.
C. Economic Rent because he is in business for himself.
D. Economic Rent because no other cartoonist is permitted to draw Dilbert.
Scott Adams is earning rent on his unique ability to draw Dilbert.

Copyright laws prohibit others from selling Dilbert images.

Food for Thought

Mario leases 25 acres of vineyard from Gianpierro in Tuscany. With the grapes he grows, Mario makes a “single estate” Brunello wine.

At first, Mario and his wine were little known and Mario made just enough profit to be willing to keep making wine.

Then, wine critic Robert Parker gave Mario’s Brunello a very high rating. The price of the Brunello went from $25 to $60 per bottle.

Will Mario or Gianpierro benefit from the price increase?

International Trade

Costa Rica is a small economy that trades.

Costa Rica can produce coffee and computers.

Let’s take a look at some possible production possibilities graphs for Costa Rica.

Here Costa Rica has constant costs.
Here Costa Rica has increasing costs

Recall The Principle of Comparative Advantage

The Principle says that everyone does best when each country concentrates on the activities for which his or her opportunity cost is the lowest.

Comparative Advantage is the Basis for Trade

The slope of a nation’s PPF gives the internal opportunity cost of computers in terms of coffee.
Prices in world markets gives the external opportunity cost of one computers in terms of coffee.
A nation should use world prices to determine the good(s) for which it has a comparative advantage.

Costa Rica’s Internal Opportunity Cost Depends on its Levels of Production
What external prices does Costa Rica Face?

Suppose we assume that world prices, in dollars, are:
Coffee $10.00 per pound
Computers $500.00 each

The external cost of a computer is 50 pounds of coffee.

Suppose CR Chooses Point DD

Costa Rica benefits from trade.
• Sell 2,000 computers @ $500
• Use $1m to buy 100K lbs of coffee
• Costa Rica gets to point E or F

Use Your Clickers To Answer The Following Non-Graded Question

Should Costa Rica Produce at Point D?
A. Yes, because it benefits from trade at D.
B. Yes, because it can consume more if it does.
C. No, because it will do better by raising computer production.
D. No, because it will do better by lowering computer production.
Can Costa Rica Do Better? YES

G is the optimal combination for Costa Rica
Costa Rica can use trade to locate anywhere along LM

What Is True about Costa Rica's Optimal Production Combination?

At Point G...
Costa Rica’s internal opportunity cost of a computer ...
Equals ...
The opportunity cost of a computer implied by world prices.

Using Demand and Supply To Think About the Effects of Trade

Suppose we assume that world prices, in dollars, are:
Coffee $ 10.00 per pound
Computers $1000.00 each

The external cost of a computer is now 100 pounds of coffee.
The Impact of Trade on the Computer Market

Production falls from 2000 to 1200 computers.
Computer imports rise from 0 to 1600.
Price falls from $1400 to $1000
Consumer surplus increases from $1 million to 1.96 million.
Producer surplus decreases from $1 million to $360 thousand.

The Market for Coffee in Costa Rica

<table>
<thead>
<tr>
<th>Coffee (pounds/year)</th>
<th>Without Trade</th>
<th>With Trade</th>
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<tbody>
<tr>
<td>Domestic demand</td>
<td>100,000</td>
<td>200,000</td>
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<tr>
<td>Domestic supply</td>
<td>120,000</td>
<td>240,000</td>
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<tr>
<td>Consumer surplus</td>
<td>$250K/yr</td>
<td>$40K/yr</td>
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<tr>
<td>Producer surplus</td>
<td>$150K/yr</td>
<td>$600K/yr</td>
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The Impact of Trade on the Coffee Market

Production increases from 100 to 200 thousand pounds.
Exports rise from 0 to 160 K pounds.
Price rises from $7 to $10 per pound.
Consumer surplus decreases from $250 K to $40 K.
Producer surplus increases from $150 K to $600 K.

Winners and Losers from Costa Rican Trade

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<tbody>
<tr>
<td>Winners</td>
<td></td>
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<tr>
<td>Costa Rican coffee producers:</td>
<td>+$.45 mil</td>
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<tr>
<td>Costa Rican computer users:</td>
<td>+$.96 mil</td>
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<td>Losers</td>
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<tr>
<td>Costa Rican coffee drinkers:</td>
<td>-.21 mil</td>
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<tr>
<td>Costa Rican computer producers:</td>
<td>-.64 mil</td>
</tr>
<tr>
<td>National Gain:</td>
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<td></td>
<td>+$.56 mil</td>
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What is the impact of trade?

<table>
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<tr>
<th>Computers per year</th>
<th>Domestic supply</th>
<th>World price</th>
<th>Domestic demand</th>
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<tr>
<td>200</td>
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<tr>
<td>500</td>
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<td>800</td>
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<td>1,200</td>
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- Price of computers ($/computer): 200
- World price: 600
- Domestic demand: 500, 800, 1,200
- Domestic supply: 2,100, 1,200, 600

Use Your Clickers To Answer
The Following Graded Question

Opening the pictured economy to trade raises ...

A. Consumer surplus by $75,000.
B. Consumer surplus by $405,000.
C. Producer Surplus by $60,000.
D. Imports by 300 units.

Protectionist Policies

Protectionism is the view that free trade is injurious and should be restricted

A Tariff is a tax imposed on an imported good
A Quota is a legal limit on the quantity of a good that may be imported
Suppose Costa Rica Imposes a $200 Tariff on Imported Computers

How will this affect the market for computers?
Who will benefit?
Who will lose?

Today we learned that

A copyright or patent can lead to long lived economic rents.
A nation benefits most from trade when it adjusts its internal opportunity cost to world prices.
The total surplus from opening markets to trade is positive but there are winners and losers.