

## 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?

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## As Americans Stop Buying, Trade Deficit Declines

By EDWARD L. ANDREWS  
Published: October 5, 2009

WASHINGTON — Dire warnings about the need for Americans to save more and spend less didn't work. Nagging China, Japan and Germany to buy more American products didn't work.

### Balance of Trade

The deficit is the excess of imports over exports for goods and services. Amounts are rounded, in billions of dollars, seasonally adjusted.

**August 2009**  
Imports \$158.93 billion  
Exports 128.22  
Balance -\$30.71 billion



No matter how much economists and political leaders warned about huge global trade imbalances and the astronomical foreign debt of the United States, American consumers kept buying more and borrowing more from the rest of the world.

Until the financial crisis, that is.

In a striking case of shock therapy, global trade imbalances have declined by almost half since the financial system nearly collapsed one year ago.

On Friday, the Commerce Department reported that the trade deficit of the United States shrank by another \$1.2

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## 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.

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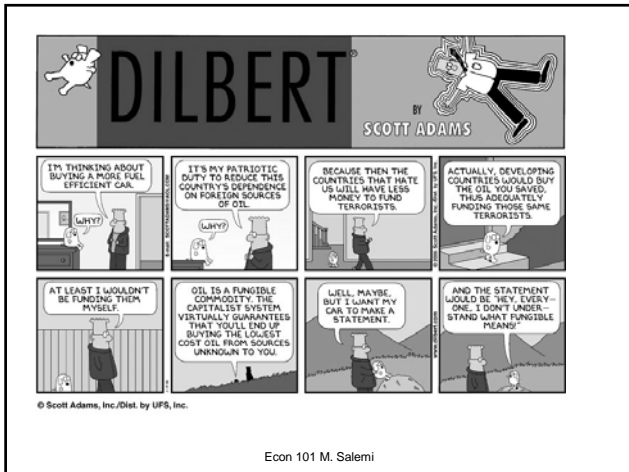
## Economic Rent Is Different from Economic Profit.

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.

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Use Your Clicker  
To Answer The Following  
Graded Question.

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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 profit?

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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.

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Scott Adams is earning rent on his unique ability to draw Dilbert.

Copyright laws prohibit others from selling Dilbert images.

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## Food for Thought

Mario leases 25 acres of vineyard from Gianpiero 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 Gianpiero benefit from the price increase?

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## International Trade

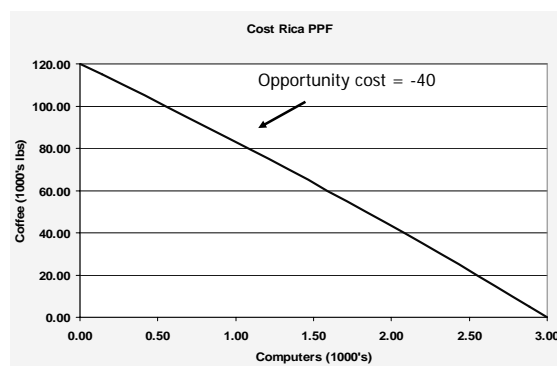
Costa Rica is a small economy that trades.

Costa Rica can produce coffee and computers.

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

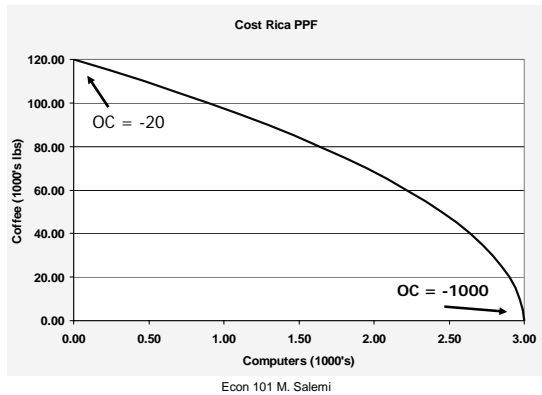
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## Here Costa Rica has constant costs.



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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.

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## Comparative Advantage is the Basis for Trade

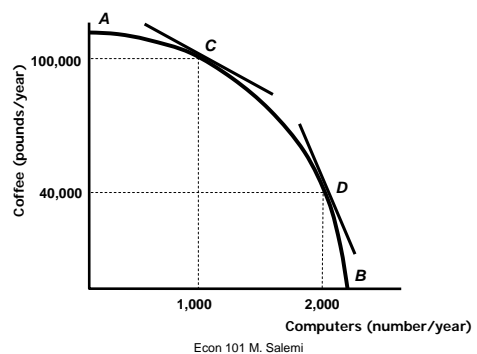
The slope of a nation's PPF gives the internal opportunity cost of computers in terms of coffee.

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.

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## Costa Rica's Internal Opportunity Cost Depends on its Levels of Production



## What external prices does Costa Rica Face?

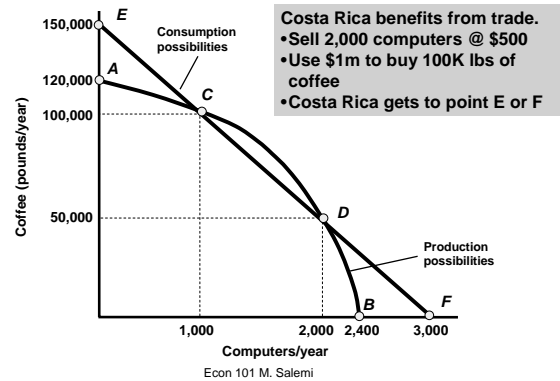
Suppose we assume that world prices, in dollars, are:

Coffee \$ 10.00 per pound  
Computers \$500.00 each

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

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## Suppose CR Chooses Point D



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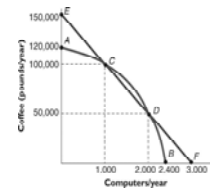
Use Your Clickers To Answer  
The Following  
Non-Graded Question

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## Should Costa Rica Produce at Point D?

- Yes, because it benefits from trade at D.
- Yes, because it can consume more if it does.
- No, because it will do better by raising computer production.
- No, because it will do better by lowering computer production.

Buying and Selling in World Markets

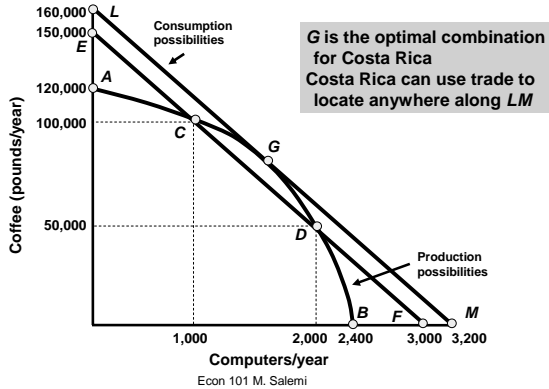


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### Can Costa Rica Do Better? YES



### 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.

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### Using Demand and Supply To Think About the Effects of Trade

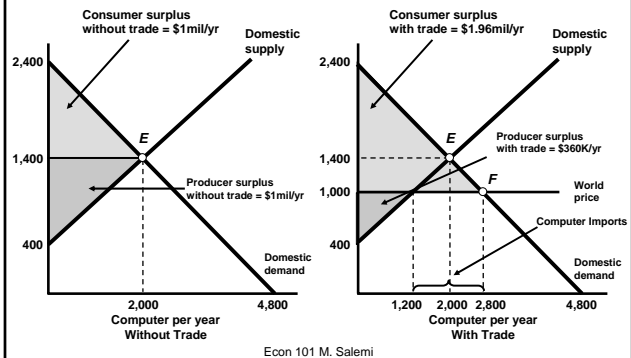
Suppose we assume that world prices, in dollars, are:

- Coffee \$ 10.00 per pound
- Computers \$1000.00 each

The external cost of a computer is now 100 pounds of coffee.

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### The Market for Computers in Costa Rica



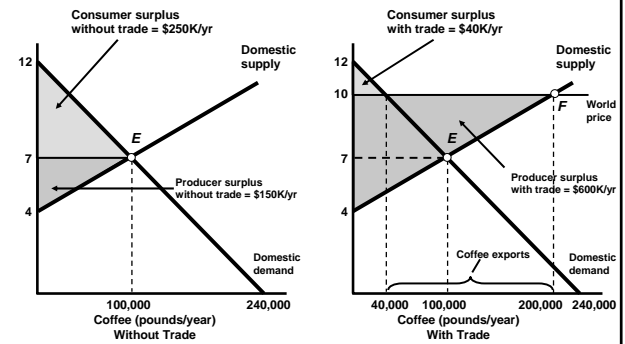
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## The Impact of Trade on the Computer Market

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.

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## The Market for Coffee in Costa Rica



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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.

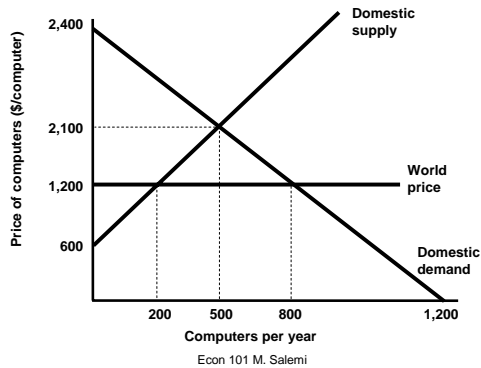
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## Winners and Losers from Costa Rican Trade

Winners  
 Costa Rican computer users: +\$.96 mil  
 Costa Rican coffee producers: +\$.45 mil  
 Losers  
 Costa Rican coffee drinkers: -\$.21 mil  
 Costa Rican computer producers: -\$.64 mil  
 National Gain: +\$.56 mil

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What is the impact of trade?

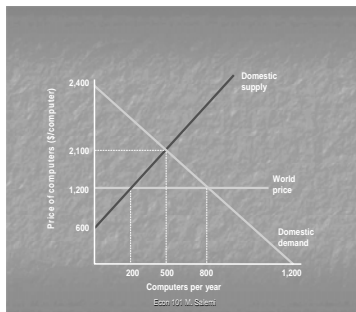


Use Your Clickers To Answer  
The Following  
Graded Question

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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.



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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

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October 1, 2009

### **Solar Panel Tariff May Further Strain U.S.-China Trade**

By **KEITH BRADSHER**

HONG KONG — Companies that import solar panels to the United States are facing up to \$70 million in unexpected tariffs.

The bill comes at a time when the industry is already struggling and could hurt both foreign solar panel makers and foreign and American distributors.

It could also further strain trade relations between the United States and [China](#).

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Suppose Costa Rica Imposes a \$200 Tariff on Imported Computers

How will this affect the market for computers?

Who will benefit?

Who will lose?

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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.

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