



# Thinking About International Trade and Trade Policy



Ann Tepovich's Econ Class, Drake High School  
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## National Economic Education Delegation

- **Vision**

- One day, the public discussion of policy issues will be grounded in an accurate perception of the underlying economic principles and data.

- **Mission**

- NEED unites the skills and knowledge of a vast network of professional economists to promote understanding of the economics of policy issues in the United States

- **NEED Presentations**

- Are **nonpartisan** and intended to reflect the consensus of the economics profession

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- **Disclaimer**
  - NEED presentations are designed to be nonpartisan.
  - It is, however, inevitable that the presenter will be asked for and will provide their own views.
  - Such views are those of the presenter and not necessarily those of the National Economic Education Delegation (NEED).



## Economics Informs Almost Everything

- |                                |                              |
|--------------------------------|------------------------------|
| • <b>Prices</b>                | • <b>Climate Change</b>      |
| • <b>Incentives</b>            | • <b>Immigration</b>         |
| • <b>Externalities</b>         | • <b>Housing</b>             |
| • <b>Cost-Benefit Analysis</b> | • <b>Education</b>           |
| • <b>Growth</b>                | • <b>Health Care</b>         |
| • <b>Inflation</b>             | • <b>Gun Control</b>         |
| • <b>Interest Rates</b>        | • <b>International Trade</b> |



## What is Globalization?

- **The growing interdependence of the world's:**

- Economies
- Cultures
- Populations

- **Brought about by cross-border flows of:**

- Goods and services
- Technology
- Investment
- People
- Information



## What Drives Globalization?

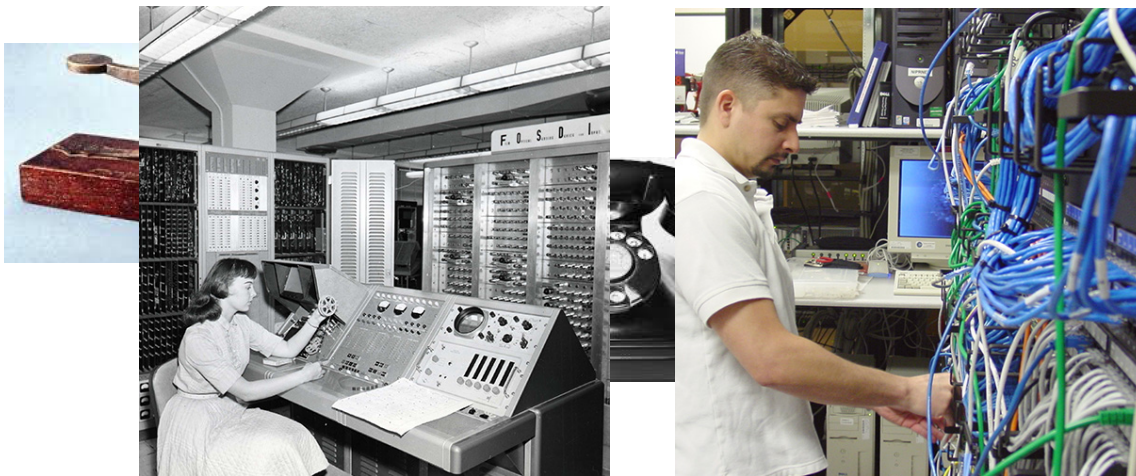
- **Transportation**
- **Technology**
- **International Cooperation**



# Transportation



# Technology



# International Cooperation



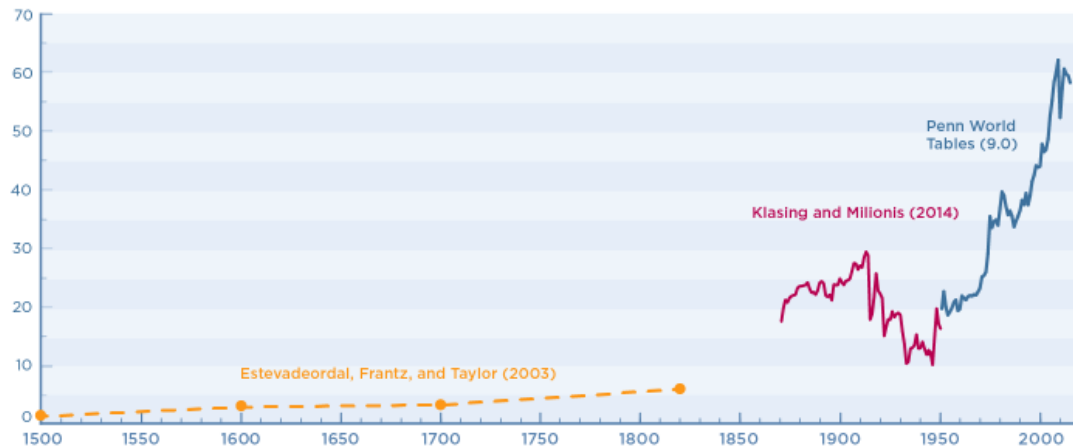
## 1995 World Trade Organization (WTO)

The modern trading system governed by rules is established, replacing the GATT.

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# Trade has skyrocketed in the past century

World trade as percent of world GDP (1500–2014)

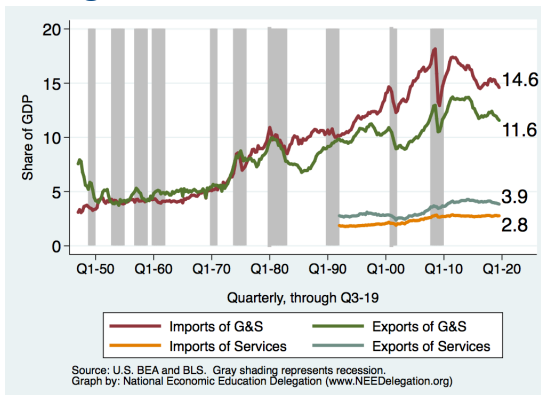


**Note:** This chart displays data from three sources. Data from 1500 to 1820 is the average of the upper and lower bound and only includes the years 1500, 1600, 1700, and 1820. Data not available from 1821-1869.

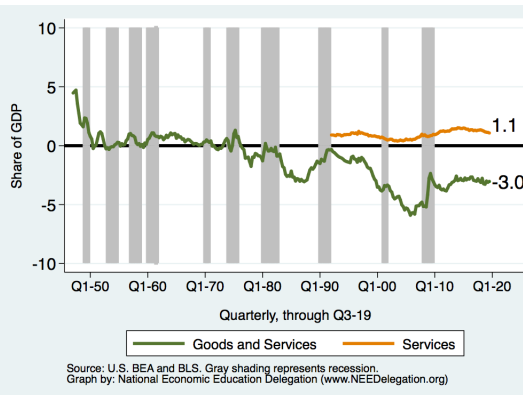
**Sources:** See chart, "Globalization over 5 centuries," at <https://ourworldindata.org/trade-and-globalization> for full citations.

## Importance of US trade

### • US goods trade as % of GDP



### • US trade balance as % of GDP



## What Do We Trade? 3 Boxes

### • Goods

- Agricultural products, cars, computers, other tangible things

### • Services

- Software, legal, accounting, architecture, call centers, tourism, education

### • Financial instruments

- Stocks, bonds, buildings, land, gov't debt

## What Goods do We Export? (\$1.7 Trillion)

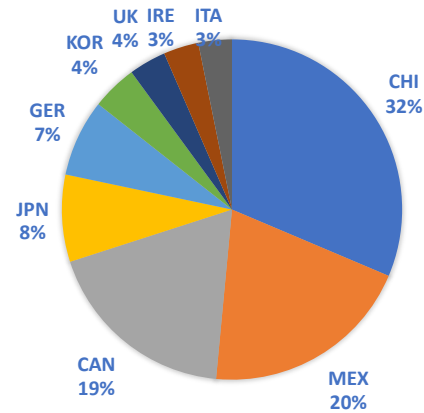
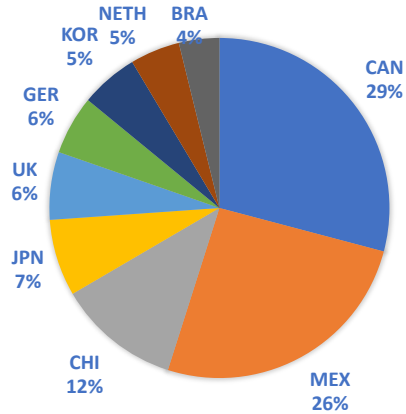
| Rank | Export Product | 2018 Value |
|------|----------------|------------|
| 1    |                | \$94.2 B   |
| 2    |                | \$51.4 B   |
| 3    |                | \$47.2 B   |
| 4    |                | \$45.5 B   |
| 5    |                | \$37.7 B   |

## What Goods do We Import? (\$2.4 Trillion)

| Rank | Import Product | 2018 Value |
|------|----------------|------------|
| 1    |                | \$178.5 B  |
| 2    |                | \$163.1 B  |
| 3    |                | \$111.2 B  |
| 4    |                | \$93.7 B   |
| 5    |                | \$71.7 B   |

## Top US Trade Partners (Goods, 2018)

- Top 10 US export destinations
- Top 10 US import sources



## Why Do Countries Trade?

- Competition
- Varieties
- Efficiency



## Comparative Advantage – Key Notion

- **Two kinds of advantage: absolute and relative**
- **E.g., Babe Ruth vs Madison Bumgarner**
  - Babe Ruth: ERA – 2      Batting average - .350
  - Madison Bumgarner      ERA – 3      Batting average - .185
- **Babe is better at both**
  - *Absolute advantage*
- **If only one can bat and one can pitch, who does what?**
  - *Relative advantage*



## Relative Advantage

- **Is Babe RELATIVELY better at one than the other?**
  - Pitching: Babe is 33% better      (era of 2 vs 3)
  - Hitting: Babe is 100% better      (.350 vs .185)
- **Babe has a relative advantage in hitting**
  - So: Babe should hit and Madison should pitch.
- **Relative advantage determines comparative advantage**
  - Babe has a COMPARATIVE ADVANTAGE in hitting.
  - Madison has a COMPARATIVE ADVANTAGE in pitching.



## Same Holds True for Countries



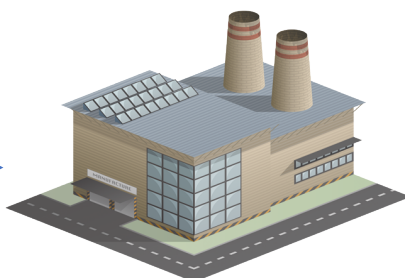
- **Every country has a good or a set of goods that it is RELATIVELY better at producing.**
  - Those are the goods that it will export.
  - It will import the other goods.
- **There are exceptions.**
  - Varieties and competition
  - May find countries trading the same goods back and forth.



## How to Think About Imports

- **Think about international trade as the introduction of a new technology.**

Soy beans  
(Exports)



Laptops/iPhones  
(Imports)



## Trade Contributes to Growth

- **EFFICIENCY:**
  - Allocates production across countries efficiently so that countries can specialize in what they are best at producing.
- **Varieties**
  - More choice for consumers.
  - Better inputs for our production.
- **Competition**
  - Brings in cheaper goods.
    - Makes consumers better off.



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## Costs of Trade

- **Trade with low-wage countries will lower the earnings of low-wage workers as a group in the U.S.A.**
- **Perhaps more importantly, however, is that the adjustment costs are big.**
  - People do not like to move.
  - Getting laid off can be very traumatic.
  - Wages likely fall.



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## Another Problem: Statistics

- **Massive Trade Deficit**

- \$621 Billion
- 3.0% of US GDP

- **Massive Trade Deficit with China**

- 2/3 of US Trade Deficit



## How to Think About the Trade Deficit

- **A trade deficit is when:**

- **VALUE of imports > VALUE of exports.**

- **Why does this happen?**

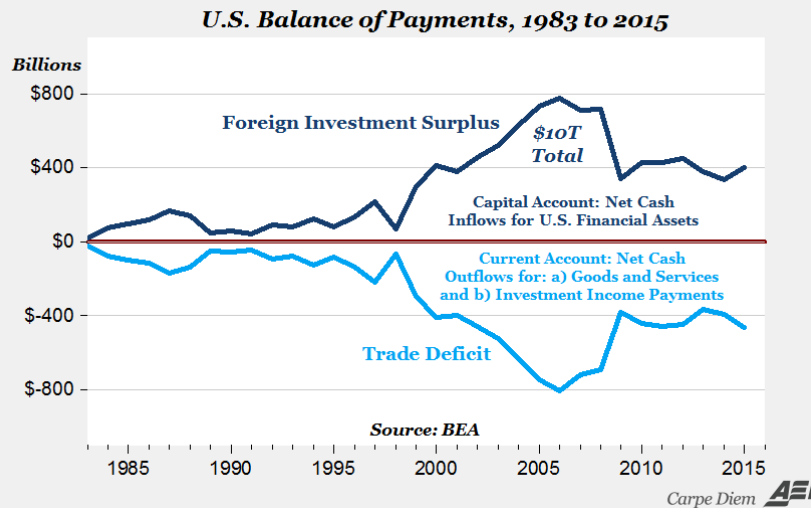
- **International transactions include:**

- Imports and exports of goods and services
- ALSO: imports and exports of assets (investments)
- Current Account
- Capital Account

- **The TRADE DEFICIT only looks at the Current Account**



## Trade and Investment Flows Balance Out



## Exchange Rates Prevent an Overall Deficit

- **As the trade deficit grows:**
  - The price of the dollar declines.
- **As the price of the dollar declines:**
  - Investing in the United States becomes more attractive.
- **As investing in the US is more attractive:**
  - The financial account surplus grows.
- **The financial account surplus offsets the trade deficit.**
- **Balance on international accounts is restored.**

## Policy Solutions:

If we must ...  
How do we “fix” the trade deficit?



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## Protect Domestic Markets and Workers

- **Tariffs**
  - Tax on imports
- **Quotas**
  - Simply limit the amount of imports



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## Tariffs:

- Are a tax that is paid by the importer of the product
- Raise prices.
  - Final goods (*consumers*)
  - Intermediate goods (*producers who use imported inputs*)
- Make our exports more expensive in foreign markets.
- Invite retaliation, lowering demand for our exports.
- Does it work to protect labor or reduce a trade deficit?
  - Yes and No
  - It's like putting rocks in your harbor: **hurts both imports and exports!**



## Balanced Budgets & Increased Savings

- Reducing federal borrowing would reduce pressure on trade deficits.
- More savings would mean more domestic investment and less borrowing from abroad.



## Conclusions

- **Trade and growth are positively related, but:**
  - Gains from trade can be widespread (lower prices for consumers)
  - Losses from trade can be highly concentrated
- **Trade deficits are not a big source of concern. Why?**
  - They are but one side of our international accounts.
- **Bilateral deficits are even less important.**
- **Lack of domestic investment funds drives the deficits.**
  - A result of a SURPLUS on financial accounts. (Capital Account)



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## Thank you!

# Any Questions?

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