

Objectives: To explain patterns of international trade and protectionism.

1 Key terms

- absolute vs. comparative advantage
- opportunity cost
- factor endowment
- Heckscher-Ohlin model
- Stolper-Samuelson theorem
- Ricardo-Viner model
- economies of scale
- tariff
- protectionism
- collective action problem
- public good

2 Key readings

- UNCTAD Report on RCEP (2021)
- Posen, “The Price of Nostalgia” in *Foreign Affairs* (May/June 2021)

3 Key ideas

Question: What explains international trade patterns?

Answer: Comparative advantage (i.e., the good a state can produce at a *relatively* lower cost) drives patterns of trade. The Heckscher-Ohlin model argues that comparative advantage comes from factor endowments, thus relative factor abundance determines what a country trades (e.g., a capital-rich country exports capital-intensive goods and imports labor/labor-intensive goods). The Ricardo Viner model argues that comparative advantage comes from industry-specific factors instead, so relative efficiency determines what a country trades (e.g., a capital-rich country exports capital-intensive goods that are relatively efficient to produce and imports capital-intensive goods that are relatively inefficient to produce).

Question: Why is most trade growth after 1945 between the most advanced industrial economies, in contrast to the predictions of the comparative advantage trade models?

Answer: (1) Consumers love variety, so we observe trade in similar but differentiated products, and (2) international trade creates larger markets, driving economies of scale and consequently variety in goods.

Question: Who are the “winners” and “losers” of free trade?

Answer: The Stolper-Samuelson theorem, which is derived from the Heckscher-Ohlin model, suggests that in capital-rich countries, capitalists win and labor loses (so high skill workers and capitalists will support free trade, whereas low skill workers support protectionism). But in capital-scarce countries, capitalists lose and prefer protection, while labor wins and prefers free trade. Under the Ricardo Viner model, capitalists and labor in the *sector* with comparative advantage wins (so trade preferences will reflect sector-affiliation not class affiliation).

Question: Why is protectionism puzzling?

Answer: Protectionism is suboptimal because states could be better if they specialized in and traded goods in which they have comparative advantage. Free trade increases the overall size of the “economic pie.”

Question: Why do pro-protection groups win political battles?

Answer: Suppose that lobbying for free trade is a public good (i.e., it benefits all consumers, and those benefits are sprinkled throughout society). The free trade lobby then faces a collective action problem (i.e., individuals face costs for participating so have incentives to free ride on the work of others). Pro-protection groups are able to more readily overcome this collective action problem because the gains from cooperation

are distributed among a smaller group of people, making gains larger for each individual member.

4 Additional review questions

- If a country has an absolute advantage over all types of goods, why would it still bother to trade?
- What are the general types of factor endowments?
- Why do states impose tariffs?
- What factors might a state consider when retaliating against tariffs imposed by another state?
- Why does Posen describe America's current trade policy as a "self-defeating economic retreat"?
- What explains the tariff concessions in the RCEP?