Why do Countries Trade? Part I

AED/IS 4540
International Commerce and the World Economy

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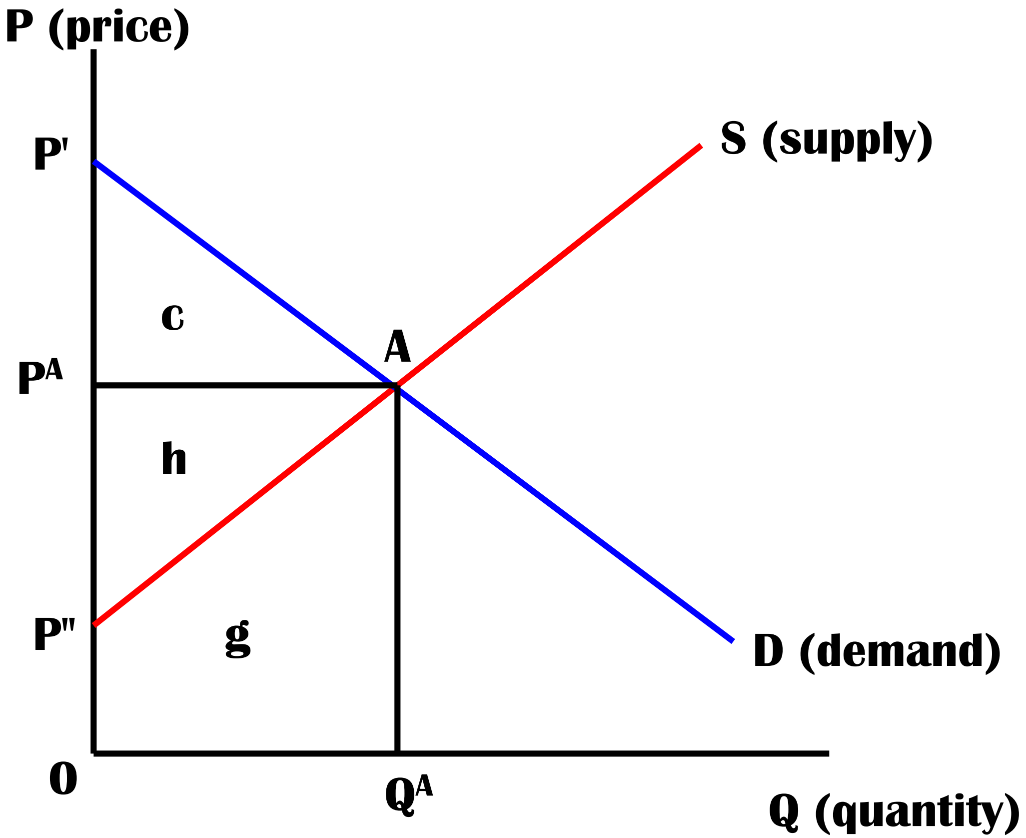
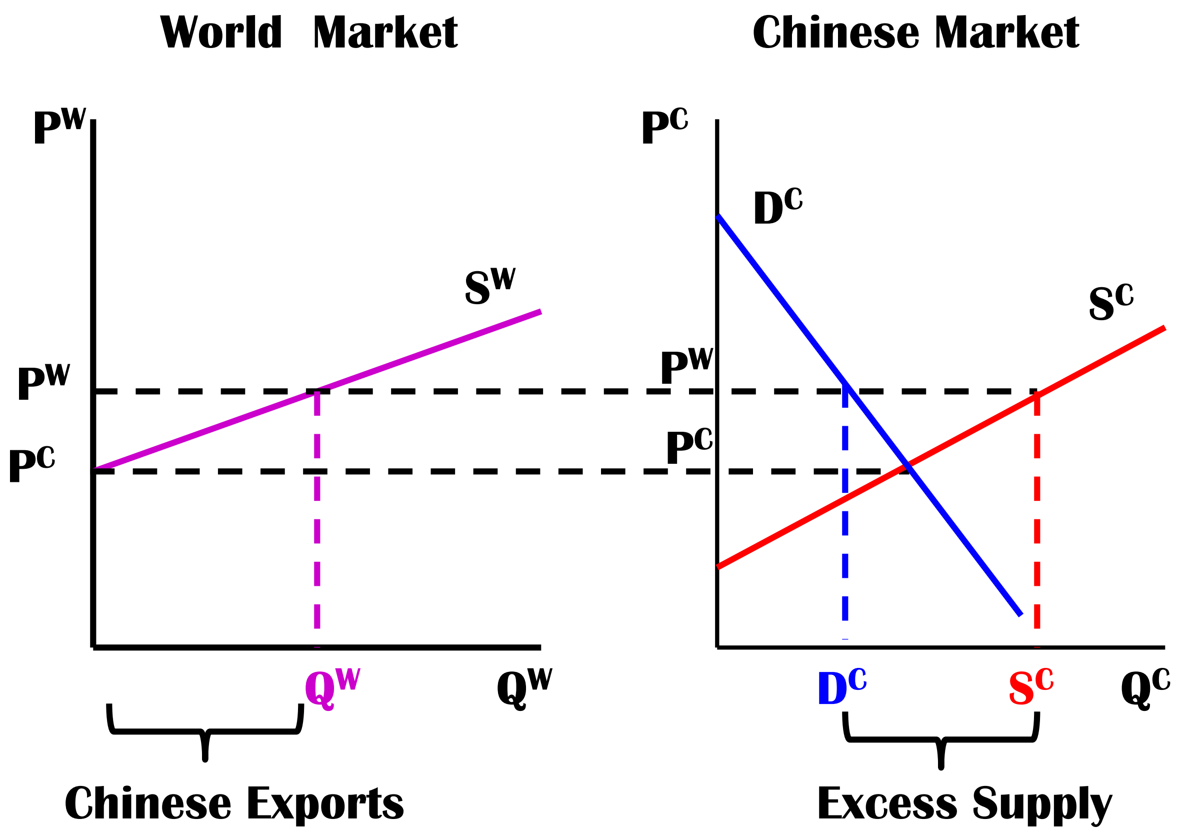
A Single Market under Autarky

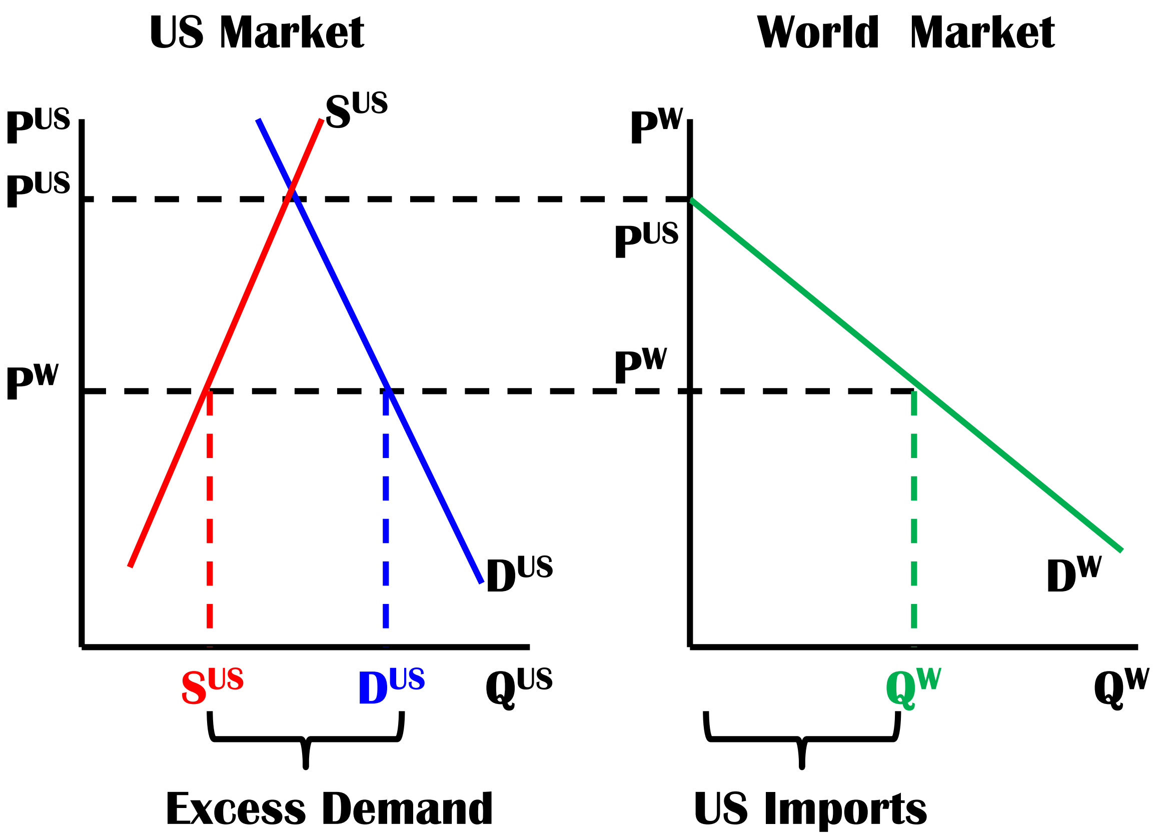


- Market with no trade – ***autarky***
- Equilibrium at A, with price P^A, quantity Q^A
- c is consumer surplus
- h is producer surplus
- g are variable costs
- total benefit is (c+h)

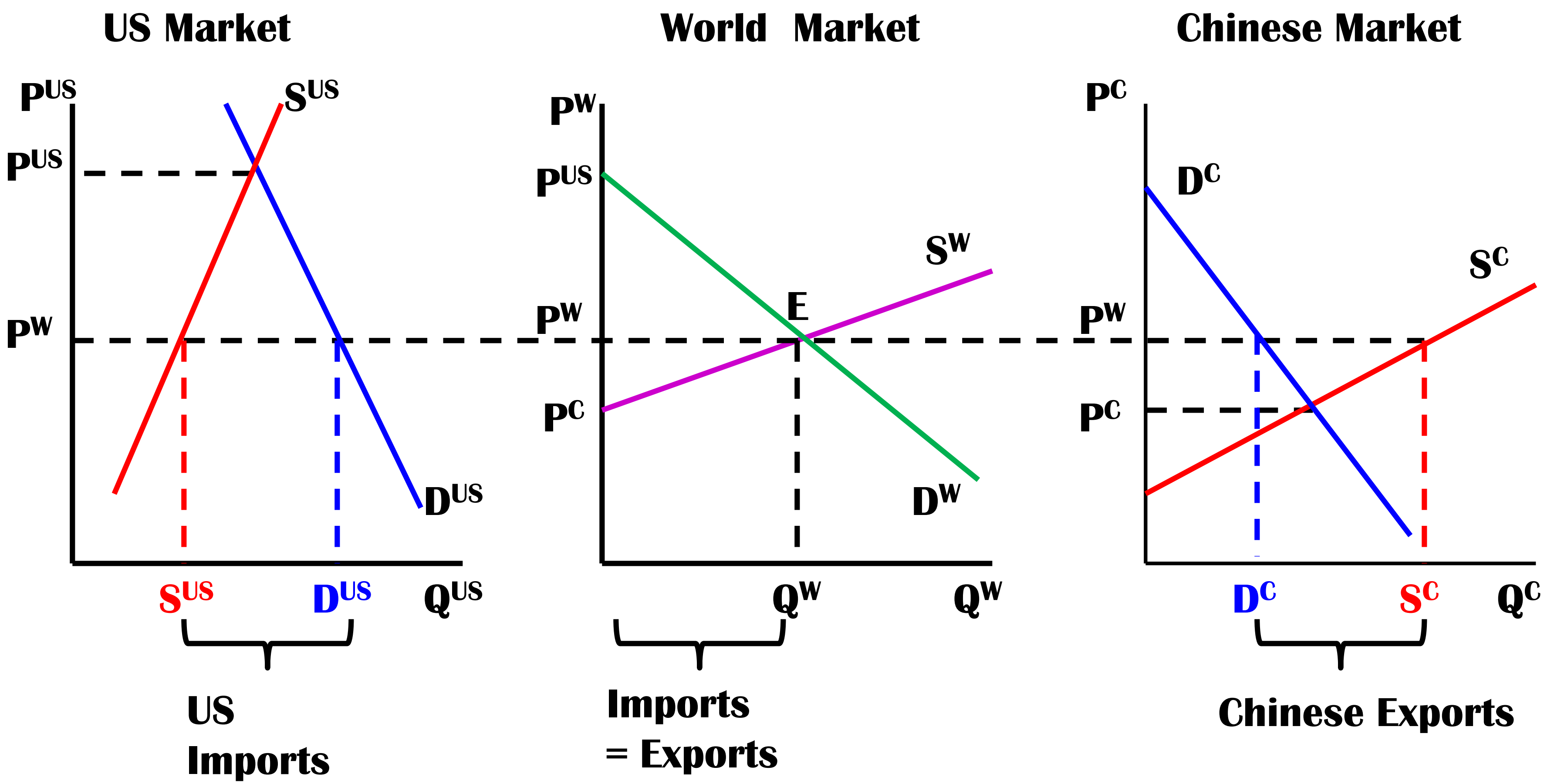
Excess Supply - Exports



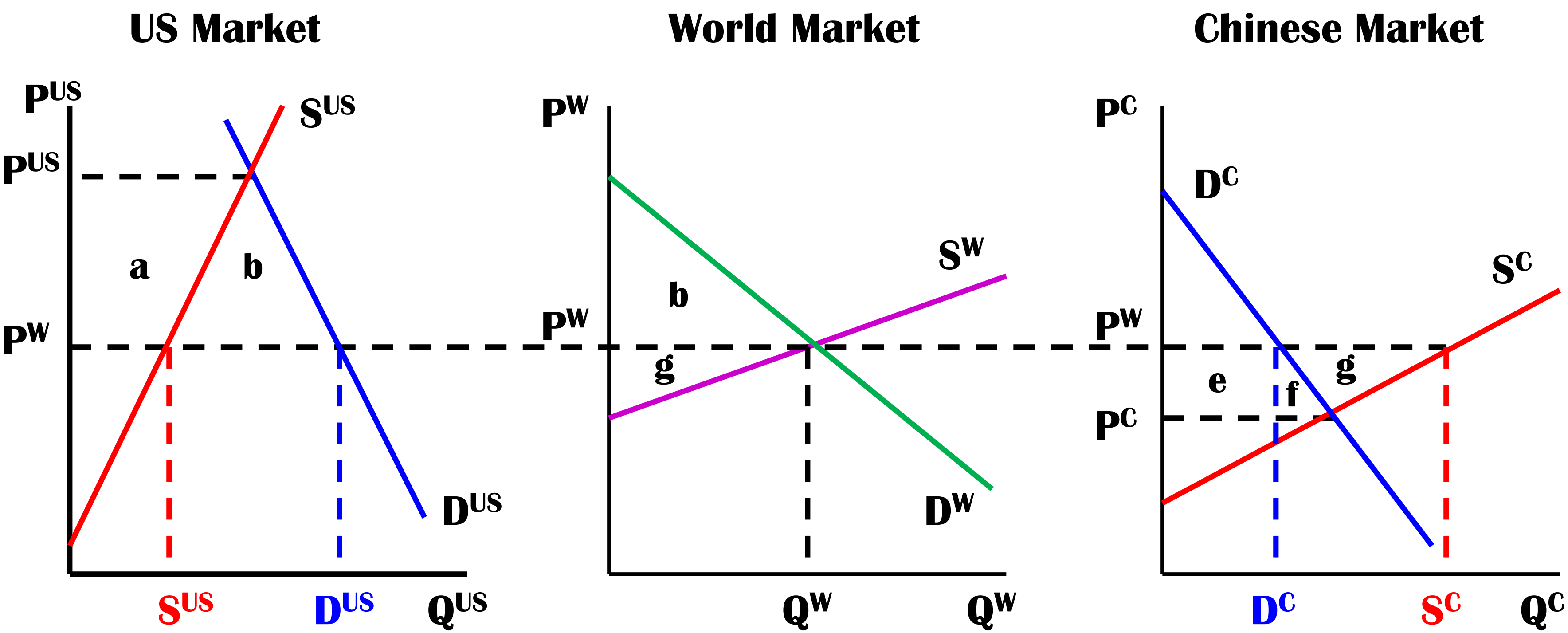
Excess Demand - Imports



A Single Market with Trade



Who Wins and Who Loses?



Consumer gain (a+b)
Producer loss (a)
Net benefit (b)

Gains from trade (b+g)

Consumer loss (e+f)
Producer gain (e+f+g)
Net benefit (g)

Who Wins and Who Loses?

- In each country, there are net gains, i.e., consumer surplus b in US, and producer surplus g in China
- Consequently, the world gains from trade, i.e., it is a positive-sum activity
- However, gains from trade are not necessarily evenly distributed across countries, i.e., b > g in this particular example
- Trade depends on there being a difference between autarky prices – why might they differ?
- Could be technology, or could be relative resource endowments