

TRADE AND AGRICULTURE

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Why Do Countries Trade?

- Differences in productive capacities
 - Climate and weather;
 - Differences in the stock of capital;
 - Differences in technology and labor quality;
 - Differences in natural resources.
- These differences lead to different patterns of abundance and scarcity across regions or countries.

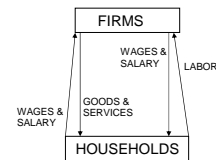
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The Doctrine of “Comparative Advantage”

- Countries will tend to specialize in the production of those things for which they have a clear cost (productivity) advantage in comparison with other countries.
 - Notice that there is no mention here of the demand side of the market—and so a country may produce a large quantity of some commodity for which there is little demand;
 - This superfluous production must then be exchanged for commodities NOT being produced in that country.
- Japan produces far more automobiles than its population can purchase and so Japan sells some of those cars in the U.S. and in other countries.
- The US produces far more wheat and cotton than we can consume and so we export both commodities to other countries.

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Firms and Households in a Single Country



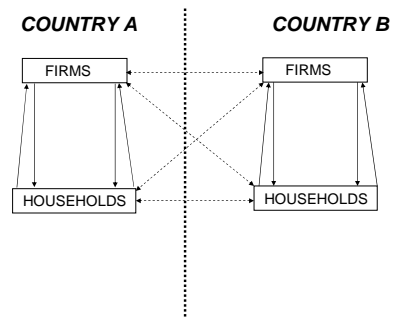
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Now consider international trade

- We can think of firms and households in a similar fashion except that they are now in two different countries;
- Trade is simply the movement of goods across a national boundary.

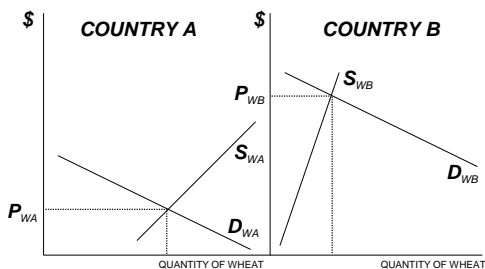
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Firms and Households in Two Countries



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Trade is a process that evens out differential supply and demand conditions across space.



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More important—trade evens out price differences across space

- Notice how much higher P_{WB} is than P_{WA}
 - This shows us that the major benefit of trade is that it can reduce prices in those places with a limited ability to produce certain commodities.
- But notice that producers in country **B** are the beneficiaries of high prices for wheat
 - Producers in country B could thus be expected to advocate policies that keep out foreign goods;
 - An example is U.S. sugar producers;

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Exports and Export Taxes

- When a commodity from *Country A* moves through international markets to *Country B* it is called an export from *Country A* and an import to *Country B*.
- Some countries will put an export tax on commodities traded in world markets;
 - This raises revenues for the exporting country;
 - This tax will also make those exports a little more expensive in world markets;

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Imports and Import Taxes

- Country B might levy an import tax (often called a “duty”) on goods coming in from other countries;
 - This duty makes imports more expensive;
 - And by being more expensive, this can be one way to restrict imports;
- Another strategy to keep imports out of a country is to have policies that actually restrict certain commodities.
 - The U.S. has a sugar import quota that works to keep cheaper imported sugar out and keep the price to U.S. sugar producers higher than it would otherwise be.

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A dominant reason for the World Trade Organization (WTO) is to prevent countries from erecting barriers to trade in the hopes of keeping producer prices high.

- The WTO is part of the United Nations system;
- It has played a key role in promoting trade policies that have contributed to globalization of world markets.

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Questions to Consider

- Why would you want to increase production in those countries with restricted supply conditions?
- What can be done to increase production in those countries with restricted supply conditions?
- How can we expect current producers to respond when the price of their output drops because of imports?

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