

# Review Problems: International Trade

Prof. Lutz Hendricks. October 21, 2009

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Jones, Macroeconomic, problems 14.1, 14.3-14.6

## 1 Basics

1. Explain comparative advantage.
2. If a country has an absolute advantage in the production of all goods, how can other countries compete with it in world markets?
3. Why does trade with low wage countries not drive down U.S. wages?
4. Does outsourcing drive down U.S. wages? Does it cost jobs?

### 1.1 Answers: Basics

1. See slides.
2. Absolute advantage means high productivity and low cost. If all goods are cheap in China, world markets do not clear. Either the Chinese currency appreciates or Chinese wages rise until other countries are competitive again.
3. The absolute advantage question in disguise. See above.
4. No – outsourcing is just trade with another name.

## 2 Gains from trade

1. Why do countries gain from international trade?
2. Does foreign productivity growth hurt us?

### 2.1 Answers: Gains from trade

1. The same as for trade between individuals: countries specialize in the production of goods they are good at making.
2. To the contrary. Imports get cheaper.

### 3 Trade Balance

1. Explain how trade can help a country (or person) smooth consumption over time.
2. Under what conditions would we expect a country to run a trade surplus?
3. Can a country run a trade surplus and attract foreign investment at the same time?
4. How would you expect the following events to affect the U.S. trade balance:
  - (a) a slowdown in U.S. growth
  - (b) increasing regulation raises U.S. production costs
  - (c) China artificially cuts wages
  - (d) Foreign tariffs on U.S. exports
5. Is it possible for a country to run a trade deficit forever?

#### 3.1 Answers: Trade Balance

1. See notes surrounding the example on trade across time.
2. Countries run trade surpluses either if investment is low (e.g. low expected productivity growth, high taxes on investment) or if saving is high (e.g. low expected income growth, demographic structure with lots of middle aged people).
3. No. A trade surplus means the country accumulates foreign assets, not the other way around. The country is a net saver.
4. Think about how each shock affects private saving, public saving, and investment. Then use the identity  $NX = S - I$ .
5. Yes. Just like a company can issue bonds forever.