Basics of Economics

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Principles of Microeconomics: August 2016 - December 2016

1 Global Markets

International trade is driven by comparative advantages. A nation has a comparative advantage in producing a good if it can produce it at a lower opportunity cost than any other nation.

1.1 Markets with Imports

If the world price is less than the domestic equilibrium price, imports will occur. Domestic consumers benefit from this while producers are harmed by this. However, there is a net gain.

1.2 Markets with Exports

If the world price is greater than the domestic equilibrium price, exports will occur. Domestic consumers are harmed by this while producers benefit from this. There is a net gain overall.

1.3 Protecting Domestic Producers: Trade Restrictions

1.3.1 Tariffs

A tariff is a tax imposed on imports by the importing country. For example, India imposes a 100% tariff on wine imported from California. Domestic producers benefit from import tariffs while consumers are worse off. The government gains tariff revenue, but there is a still a deadweight loss because consumers lose more than the amount gained by producers and the government.

1.3.2 Import Quotas

An import quota is a limit on the quantity that can be imported. For example, the US imports quotas on dairy products, chocolate, cotton, and brooms. Domestic producers benefit from import quotas while domestic producers are worse off. Importers gain profit, but there is still a deadweight loss because consumers lose more than the amount gained by producers and the government.

1.3.3 A Comparison of Tariffs and Quotas

Given a desired level of imports, the same price is paid by consumers, the same
quantity is traded, the same amount of produced by domestic suppliers, and
there is the same deadweight loss. With tariffs, the government gains revenue,
while with quotas, importers gain profit.

1.3.4 Example

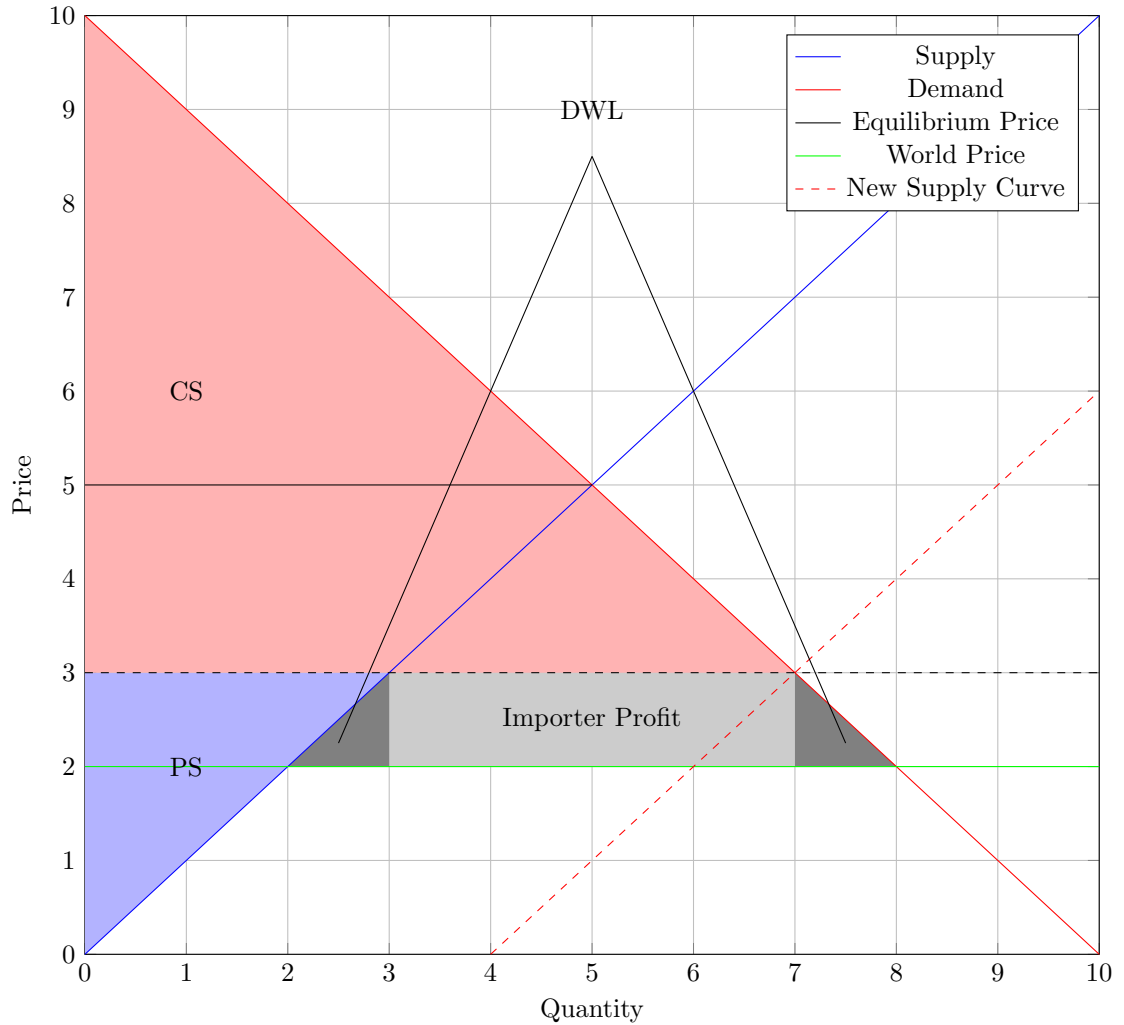$$Q_{supplied\ domestic} = P$$

$$Q_{demanded\ domestic} = 10 - P$$

$$P_{world} = 2$$
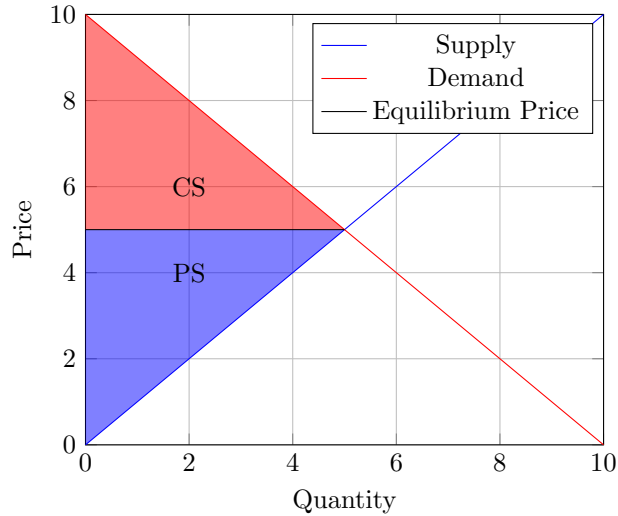
$$P^* = 10 - P^*$$

$$P^* = 5 \text{ (equilibrium price)}$$

Opening the Market to Free Trade with a Quota of 4 Units

$$4 + P^{**} = 10 - P^{**}$$

$$2P^{**} = 6$$

$$P^{**} = 3$$

1.4 Common Arguments For/Against Trade Restrictions

- Argument: They help infant industries grow.

- Counter-argument: They also protect firms that are not producing efficiently.

- Argument: They counteract dumping.

- Counter-argument: Dumping is very hard to detect because it is hard to know a firm's costs. A low price might be set by a producer because she faces elastic demand.

- Argument: They save domestic jobs.

- Counter-argument: They might create jobs in one sector and destroy jobs in another.

- Argument: They allow us to compete with cheap foreign labor.

- Counter-argument: Wages are determined by productivity. High productivity workers get higher wages and low productivity workers get lower wages.

- Argument: They protect rich countries from exploiting poor ones.

- Counter-argument: By trading with poor countries, we increase the demand for their labor and increase their income.

You can find all my notes at `http://omgimanerd.tech/notes`. If you have any questions, comments, or concerns, please contact me at
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