

"Gains from trade"

Nuances

June 25, 2018

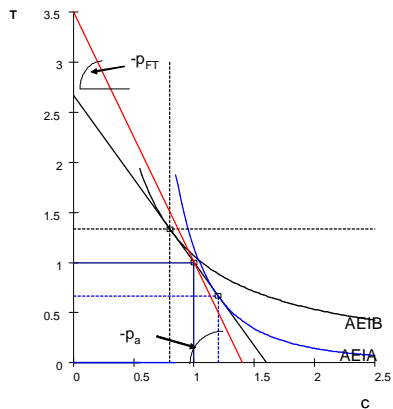
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Introduction

- Joe Sixpack versus the High Priests
- What economic analysis doesn't imply
 - Everybody is made better off
 - More people are made better off than are hurt
 - "Society" is better off.
- Mankiw: "Ten Key Principles in Economics:"
 - "Open for trade: Trade can make all parties better off."
 - What could this mean?
- What economic analysis does imply: subtle

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Winners and losers



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Andy, Bob, and CESM's

- Preferences

$$U_A = \begin{cases} T_A + 10C_A - (C_A)^2 & \text{if } 0 \leq C_A \leq 5 \\ T_A + 25 & \text{if } C_A > 5 \end{cases}$$

$$U_B = \begin{cases} T_B + 10C_B - (\frac{1}{3})(C_B)^2 & \text{if } 0 \leq C_B \leq 15 \\ T_B & \text{if } C_B > 15 \end{cases}$$

- Endowments

$$\begin{aligned} \bar{C}_A &= \bar{C}_B = 5; \\ \bar{T}_A &= \bar{T}_B = 25. \end{aligned}$$

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Andy and Bob and CESM's

- Autarkic equilibrium

$$\hat{p}_a = 5; \hat{C}_A = 2.5; \hat{C}_B = 7.5$$

$$\hat{T}_A = 37.5; \hat{T}_B = 12.5;$$

$$U_A(\text{autarky}) = 56.25; U_B(\text{autarky}) = 68.75$$

- FT

$$p_{FT} = 6; \tilde{C}_A = 2; \tilde{C}_B = 6;$$

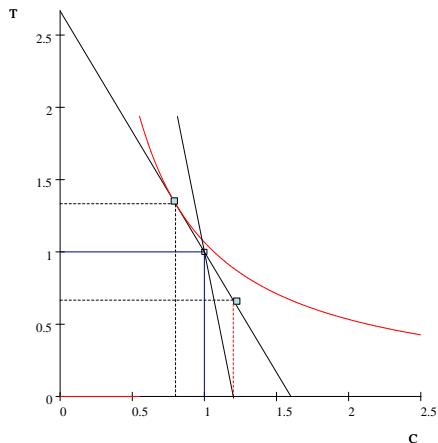
$$\tilde{T}_A = 43; \tilde{T}_B = 19$$

$$U_A(FT) = 59; U_B(FT) = 67.0$$

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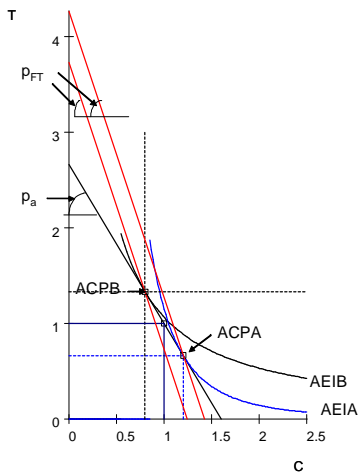
Substitutability

How would the diagram look if the indifference curves were "very flat?"



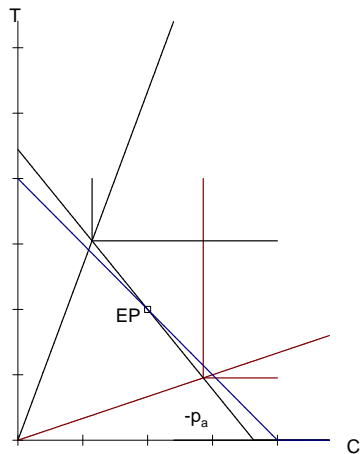
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PPI's



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Substitutability



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PPI's

- There exists a hypothetical redistribution of resources under free trade such that, if this redistribution took place, and it was costless, then at least someone would be better off and no one would be worse off than was the case under autarky.
 - It could be that everybody would be better off.
 - A thought experiment: it doesn't say that compensation takes place.
 - In reality, paying compensation would be problematic and would use up resources.
- General issue in policy; we say that if we compare two situations (I and II) and if there exists a hypothetical redistribution of resources under II such that, if this redistribution took place, and it was costless, then at least someone would be better off and no one would be worse off than was the case under I, then this change represents a PPI (or equivalently, satisfies the Kaldor-Hicks Compensation Criterion).

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The critique

- Some famous economists
 - "What in the way of policy can we conclude from the fact that trade is a *potential* boon? ...we can actually conclude very little." (P S)
 - "The introduction of changed prices leading to trade cannot, of course, be expected always to better each and every individual. After trade, the prices of items chiefly consumed by a particular individual may have risen, making him worse off." (Paul Samuelson)
 - "...ought it not to be made clear...that theories...which attempted to sum social gain or loss, were not, strictly speaking, economic science?...not possible to say that economic science showed that free trade was justifiable..." (Robbins)
 - "The idea that there exists some *a priori* ground for saying that free trade is desirable is the direct result of having a welfare theory which ignores the distribution of real income." (Little)
 - "The implicit assumption that free trade is a good thing...is very likely to give rise to accusations of cant and hypocrisy against those economists, or politicians, who make this assumption." (Little)

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The response

- An "average" result
- A policy chosen from behind a veil of ignorance
- Fairness

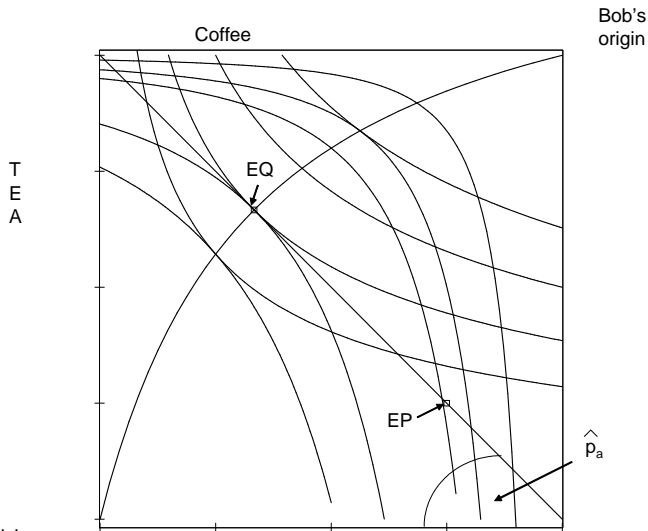
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Conclusions

- Scratching the surface
- What about jobs?
- Importance of substitutability

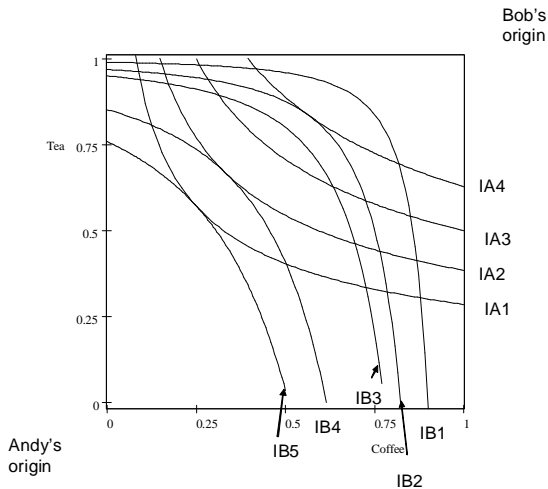
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EB: extending beyond identical endowments



Frame Title

Frame Subtitle



Games from trade

A is endowment pt, what are others?

