

# International Relations 101: Trade and Other Delightfully Fun Topics

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# Review Session

- Dewey 2162
- Tuesday, March 5, 8-9 pm
- I will have (basically) nothing prepared. Come with questions.

# Agenda

1. Absolute Advantage
2. Comparative Advantage
3. Domestic Cleavages
4. Capitalist Peace Theory

# Agenda

1. Absolute Advantage
2. Comparative Advantage
3. Domestic Cleavages
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# International Trade

- International trade is *very* popular.
  - World trade (2010): \$27,500,000,000,000
  - U.S. trade (2011): \$3,800,000,000,000

Big question: Why do states  
engage in trade?

# Absolute Advantage

- One reason: some states are better at producing some goods than others.
- States can make what they are good at and trade for what they aren't good at making.

# Example

- California produces a lot of wine.
  - Grapes are easy to grow in the Napa Valley region.
- Mexico produces a lot of tequila.
  - Tequila is a derivative of agave, which grows in Mexican deserts.





# Example

- California produces a lot of wine.
  - Grapes are easy to grow in the Napa Valley region.
- Mexico produces a lot of tequila.
  - Tequila is a derivative of agave, which grows in Mexican deserts.
- California has an absolute advantage making wine, while Mexico has an absolute advantage making tequila.

**Production  
Chart**

Make Wine

California

10

Mexico

2

## Production Chart

California

Mexico

Make Tequila

4

8

Consumption in a  
No Trade World

Wine

Tequila

California

5

2

Mexico

1

4

	Wine	Tequila
California	5	2
Mexico	1	4

**Production in a World  
of Trade**

	Make Wine	Make Tequila
California	10	0
Mexico	0	8

Yo, Mexico, I'll trade you  
three bottles of wine for  
three bottles of tequila.

California

Mexico

Make Wine

Make Tequila

10

0

0

8

Yo, Mexico, I'll trade you  
three bottles of wine for  
three bottles of tequila.

California

¡Claro que sí!

Mexico

Make Wine

Make Tequila

10

0

0

8

Consumption after  
Trade

Wine

Tequila

California

7

3

Mexico

3

5

	Wine	Tequila
California	7	3
Mexico	3	5



Consumption in a  
No Trade World

Wine

Tequila

California

5

2

Mexico

1

4

	Wine	Tequila
California	5	2
Mexico	1	4

## Trade vs. No Trade

	Wine	Tequila
California	$7 > 5$	$3 > 2$
Mexico	$3 > 1$	$5 > 4$

## Trade vs. No Trade

	Wine	Tequila
California	$7 > 5$	$3 > 2$
Mexico	$3 > 1$	$5 > 4$

# Conclusion

- Trade is trivially useful when no state has an absolute advantage in making every good.
- What if one state is better at making *everything*?
  - Is trade still smart?

# Agenda


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2. Comparative Advantage
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# Comparative Advantage

- Rather than focus on absolute advantage, let's switch to comparative advantage.
- Forget about how good I am relative to you.
- Focus instead on *opportunity cost*, what someone has to give up to do something else.



181  
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Ah yes, the golden age of cereal prizes. (imgur.com)  
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Future President (qkme.me)  
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
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
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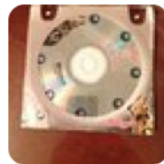
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**TIL that two trapped Australian miners asked for an iPod with music by the Foo Fighters to be sent down to them. Dave Grohl personally included a note saying "I want you to know that when you come home, there's two tickets to any Foos show, anywhere, and two cold beers waiting for you."**

471



**Production  
Chart**

Make Wine

California

10

Mexico

2

## Production Chart

California

Mexico

Make Tequila

10

8

Consumption in a  
No Trade World

Wine

Tequila

California

5

5

Mexico

1

4

	Wine	Tequila
California	5	5
Mexico	1	4

HAHAHHA!!! We don't  
need you anymore.

California

Mexico

Wine

Tequila

5

5

1

4

HAHAHHA!!! We don't  
need you anymore.

California

Jajajaja...OK.

Mexico

Wine

Tequila

5

5

1

4



Production in a World  
of Trade

Make Wine

Make Tequila

California

7

3

Mexico

0

8

Make Wine	Make Tequila
7	3
0	8

California

Trade you three bottles of  
tequila for a bottle and  
two glasses of wine.

Mexico

Wine

Tequila

7

3

0

8

Well...this is awkward.

California

Trade you three bottles of  
tequila for a bottle and  
two glasses of wine.

Mexico

Wine

Tequila

7

3

0

8

Consumption in a  
World of Trade

Wine

Tequila

California

5.5

6

Mexico

1.5

5

	Wine	Tequila
California	5.5	6
Mexico	1.5	5

Consumption in a  
No Trade World

Wine

Tequila

California

5

5

Mexico

1

4

	Wine	Tequila
California	5	5
Mexico	1	4

## Comparison

Wine

Tequila

California

$5.5 > 5$

$6 > 5$

Mexico

$1.5 > 1$

$5 > 4$

## Comparison

	Wine	Tequila
California	5.5 > 5	6 > 5
Mexico	1.5 > 1	5 > 4

# Comparative Advantage

- Every bottle of wine California makes is one fewer bottle of tequila it makes.
- Every bottle of wine Mexico makes is four(!) fewer bottles of tequila it makes.
  - Mexico pays a higher opportunity cost to make a bottle of wine.
  - Thus, Mexico still specializes in tequila and California still specializes in wine.



# Transportation

- Trade was frictionless in the example.
- Reality: You have to pay to get a product from point A to point B.
- Cheap transportation costs → globalization.

# Agenda

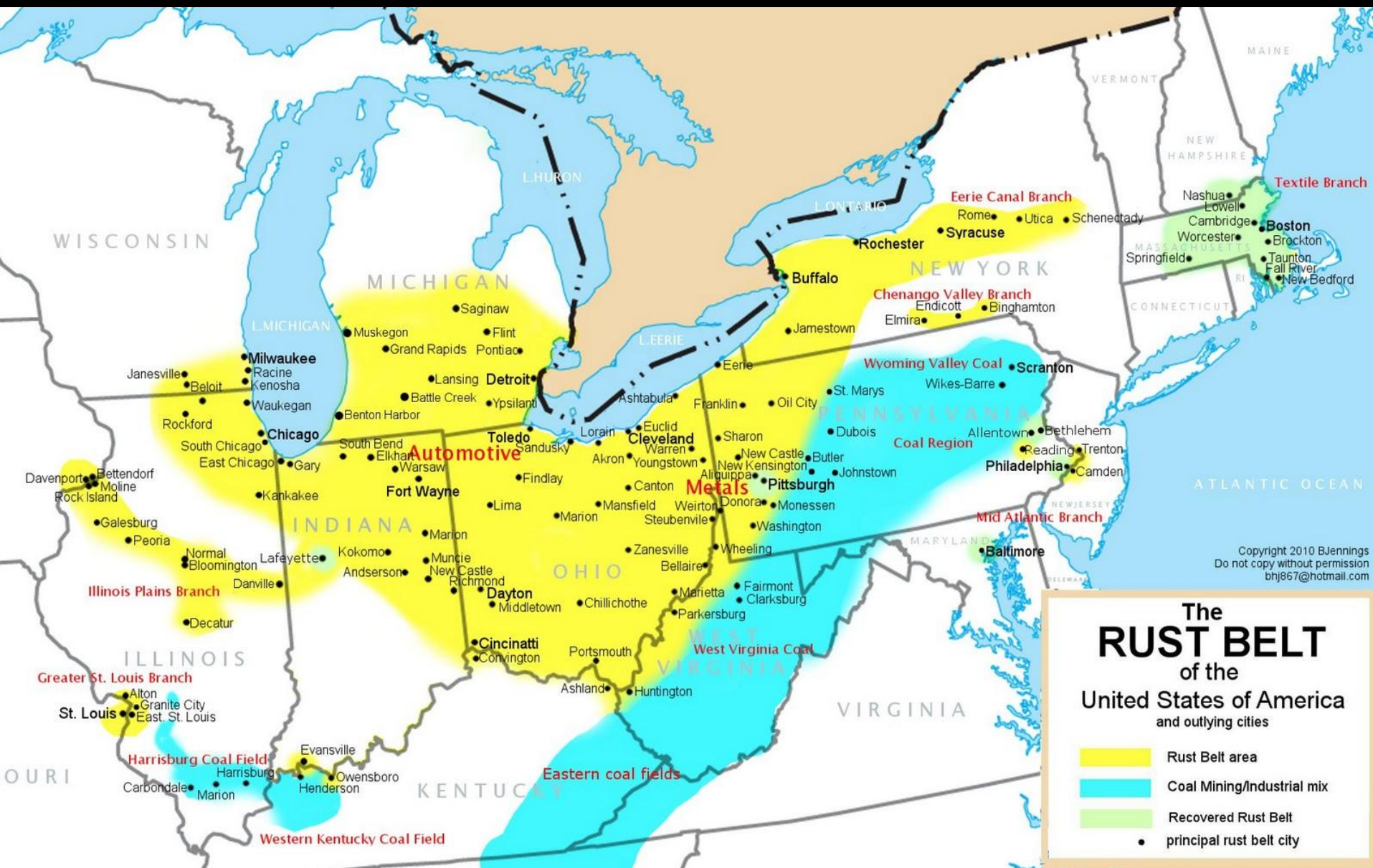
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# Benefits of Trade

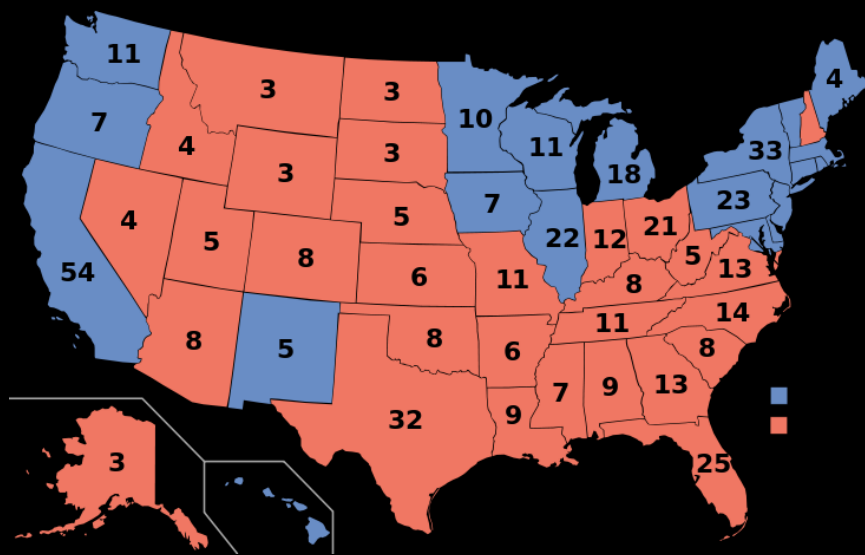
- Trading improves overall societal welfare.
  - This says *nothing* about individual welfare.
  - Trade has winners and losers.



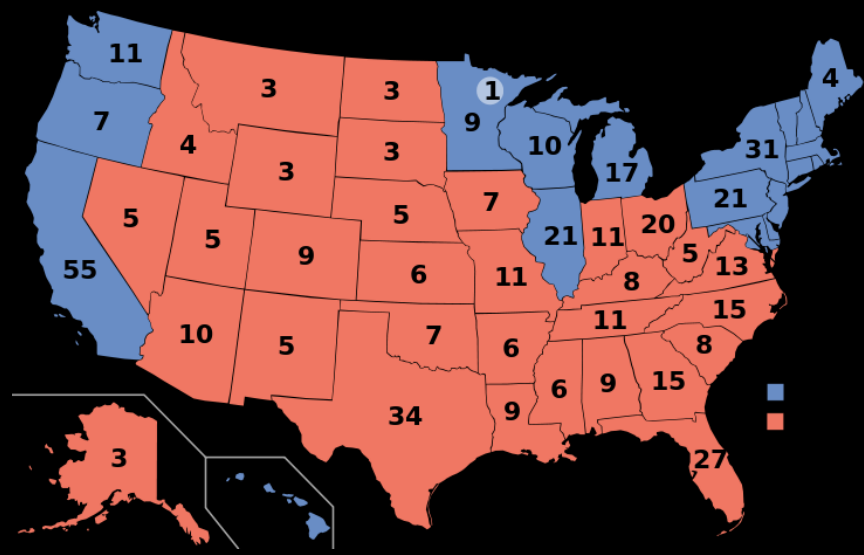
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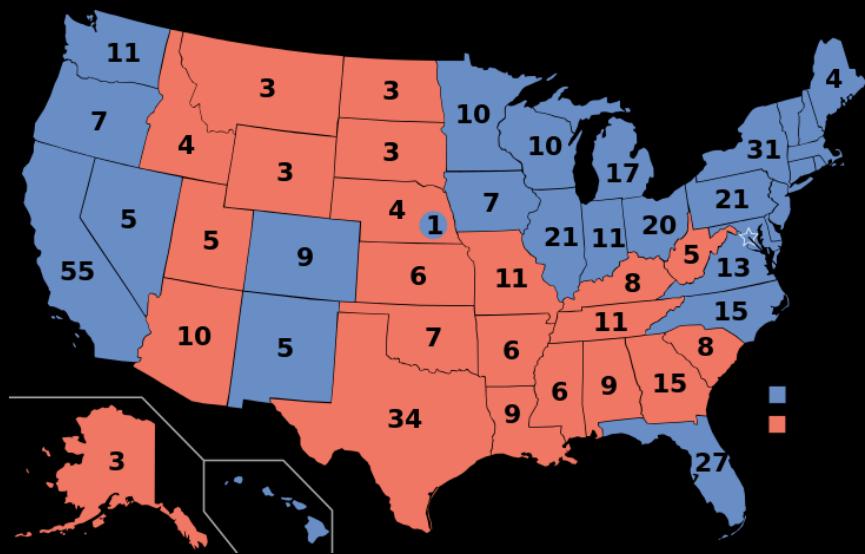




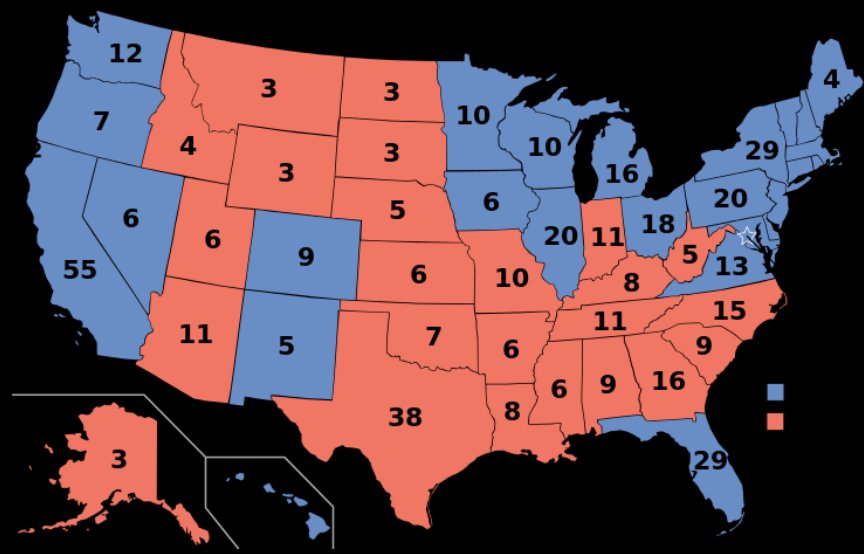
2000



2004



2008



2012

# From the Declaration...

- “All men are created equal.”

# From the Declaration...

- “All men are created equal.”
- Should say: “All men are created equal. But voters living in Ohio and Florida are more equal than others.”



# Thinking Strategically

- Voters in California are voting for the Democrat. Voters in Texas are voting for the Republican.

# Thinking Strategically

- Voters in Ohio are up in the air.
  - Candidates must therefore be more responsive to Ohio-people desires.

# Trade Relations

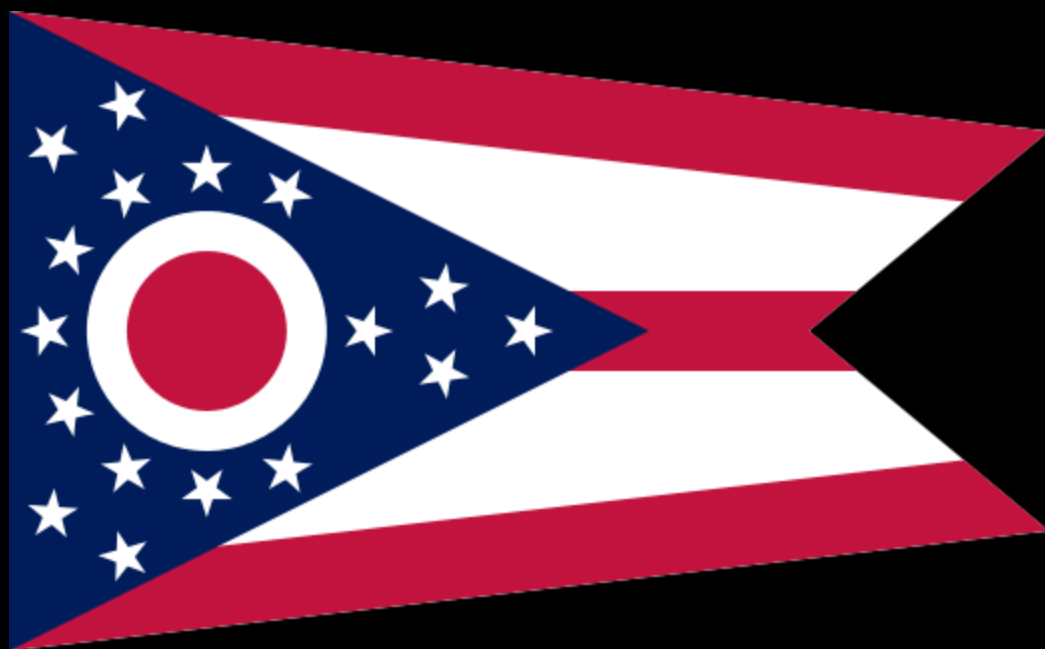
- On the whole, states are better off eliminating tariffs than engaging in trade wars.

# Trade Relations

- On the whole, states are better off eliminating tariffs than engaging in trade wars.
- But there are winners and losers.

# Trade Relations

- A steel company in the United States wants tariffs on imported steel.
  - Makes steel more expensive for US consumers but increases US steel producers' profits.



# Rogowski

- Suppose oil shoots up to \$1000 a barrel tomorrow.
- Who is disproportionately better off in the U.S.? Worse off?

Takeaway: Political pandering  
distorts free trade.



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# Capitalist Peace Theory

- Countries that trade a lot with each other tend not to fight wars against each other.

# Capitalist Peace Theory

- Countries that trade a lot with each other tend not to fight wars against each other.
- Correlation does not imply causation.
  - Perhaps causation goes the other way.
  - Can we explain why capitalism might *cause* peace?

# Explaining the Peace

- Last unit: trade creates a surplus.
  - Splitting the surplus makes everyone better off.

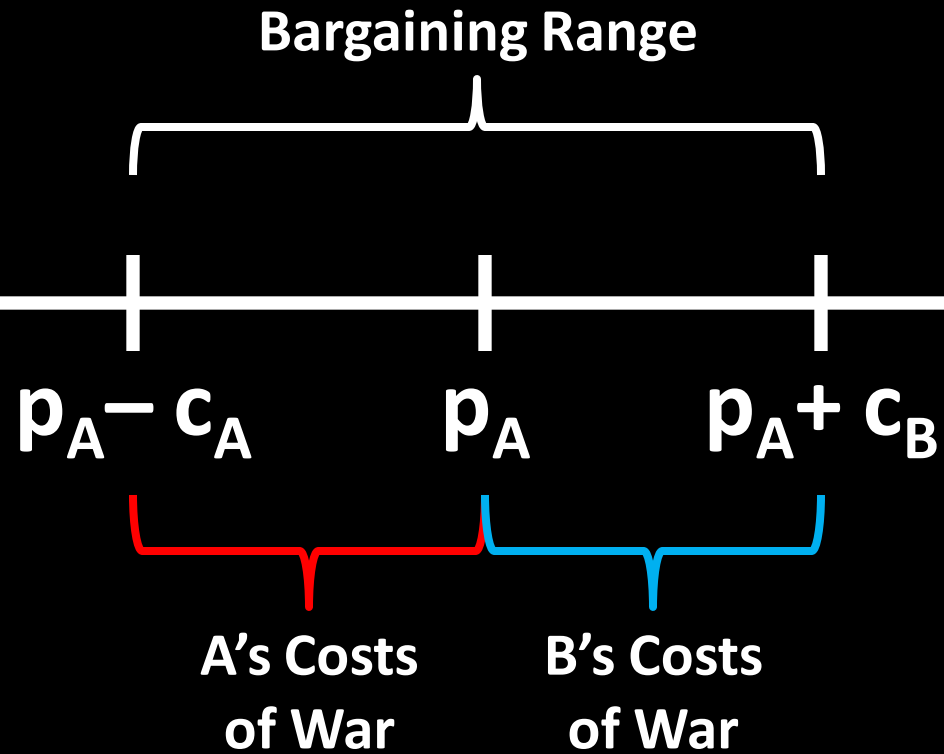
# Explaining the Peace

- Last unit: trade creates a surplus.
  - Splitting the surplus makes everyone better off.
- Two units ago: peaceful bargains are easier to reach when war is costlier.

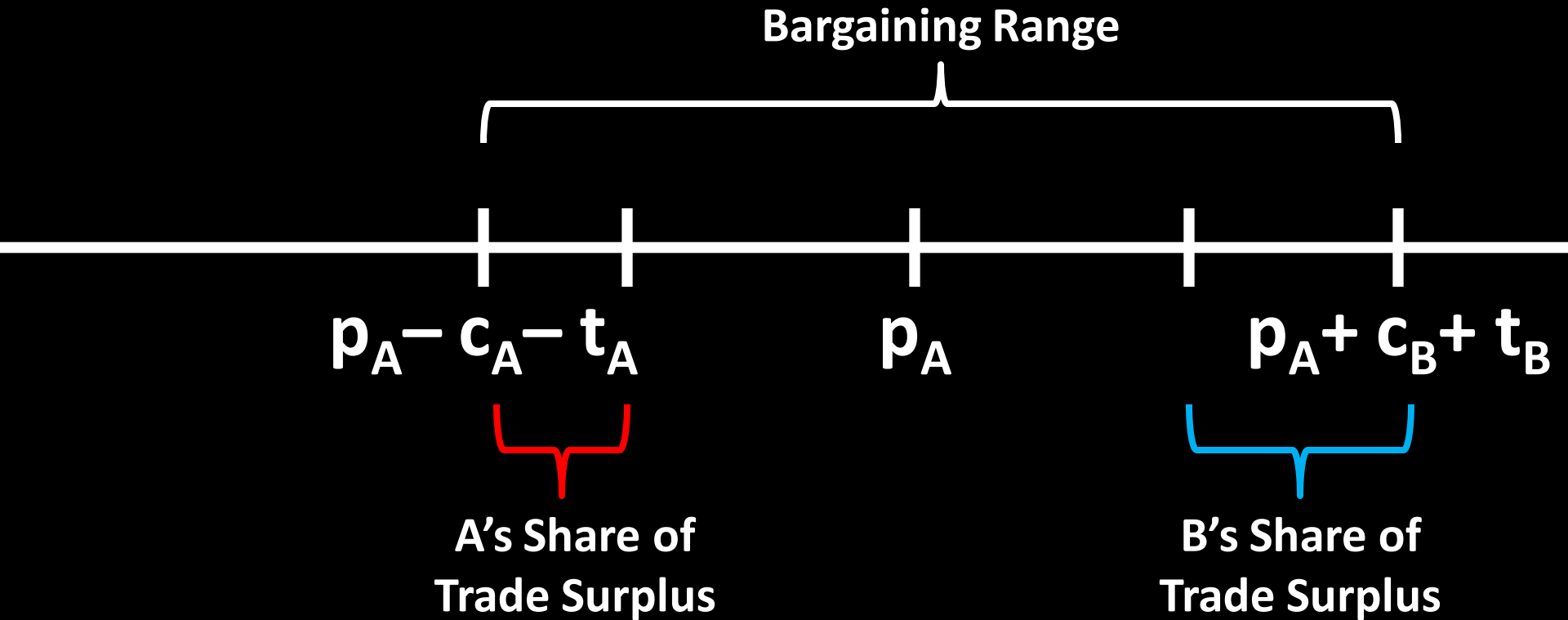
# Explaining the Peace

- Last unit: trade creates a surplus.
  - Splitting the surplus makes everyone better off.
- Two units ago: peaceful bargains are easier to reach when war is costlier.
  - States cannot trade if they are at war.
  - So the trade surplus makes war costlier!

# Bargaining without Trade



# Bargaining with Trade





**Bargaining Range with Trade**



**Bargaining Range without Trade**



# Explaining the Peace

- Trade makes war less appealing.
- The less appealing war is, the less likely information problems or shifting power will lead to fighting.

# Capitalist versus Democratic Peace

- The democratic peace might just be an artifact of the capitalist peace.
- Democratic countries are more likely to be capitalist than non-democracies.
  - But the trade causes the peace, not democracy.