African Agricultural Marketing Project

Session 2b: Gains from trade

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Topics 1

- What are gains from trade
- Sources of gains from trade
  - Comparative advantage
  - Competition
  - Economies of scale
  - Dynamic gains from trade
- How are gains from trade measured?
- How big are gains from trade?
- Myth: Countries gain from exports but lose from imports
- Comparative advantage
- Myth: If a country is very poor, it may not be competitive in any commodity
- Measuring gains from trade
- Role of the exchange rate

Topics 2

- If trade is so good, why do trade barriers exists?
- Who gains from trade barriers?
- Effect of import barriers
- Effect of export barriers
- Myths: If world markets are distorted, countries cannot gain from trade
- Myth: It doesn’t make sense to import and export the same good
- Politics of trade agreements

Topics 3

- Possible negative effects of trade
  - Country gains, but some will lose
  - Dumping
  - Predatory pricing
  - Costs of transition
  - Deindustrialization
- Policies to compensate for losses
  - Retraining
  - Regional investment in infrastructure
  - Safety net programs

- What are gains from trade?

Gains from trade refer to the benefits to a group of people from exchanging goods and services with other groups of people

1) Usually, we think of gains from trade from countries trading with each other, but it could be districts, villages, or even households
2) It does not mean everyone in the group gains – it means that benefits > losses

- Myth #1: “When two countries trade, one wins and the other loses”
  - Trade is not a zero-sum game
  - Both countries can and generally do benefit from trade, though the benefits may not be equal
  - There are winners and losers in each country
  - Example: If Uganda exports maize to Kenya, both countries gain overall but:
    - Some Uganda maize producers and Kenya maize consumers gain
    - Uganda maize consumers and some Kenya maize producers lose

- Why are there gains from trade?
  - Comparative advantage
  - Competition
  - Economies of scale
  - Dynamic gains from trade

- Comparative advantage
  - Means each country can produce some goods at relatively lower cost than other goods
  - Country will export goods it can produce at relatively lower cost, import goods it costs relatively more to produce

- Comparative advantage (example)
  - Bolivia is a high-cost producer
  - Argentina has absolute advantage in everything
  - What can Bolivia export?

Commodity	Argentina	Bolivia
	Cost in days of labor	
Potatoes	10	10
Beef	15	30
Soap	12	18
Beer	22	66
Shirts	18	45
Radios	25	75

- Comparative advantage (example)
  - Need to look at relative (or comparative) cost
  - Argentina will export beer and radios (where it has the biggest cost advantage)
  - Bolivia will export potatoes and soap (products where it is least inefficient)

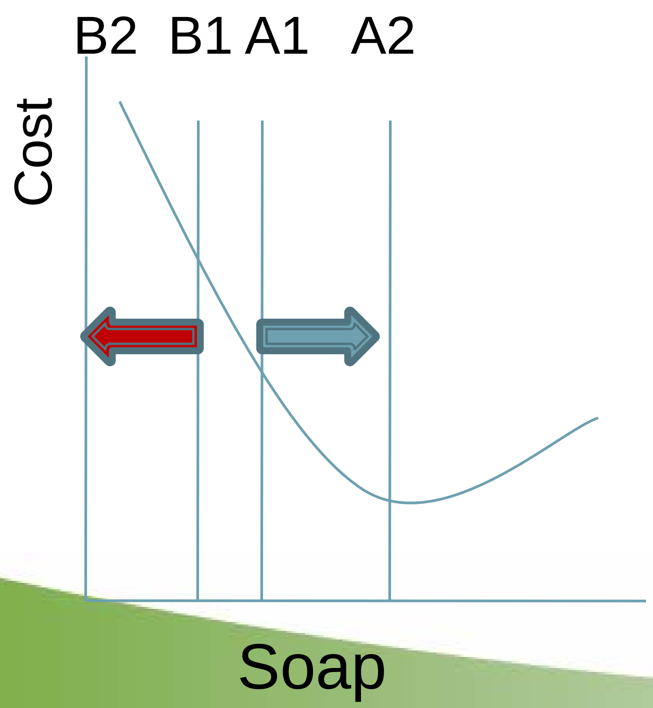
Commodity	Argentina	Bolivia	Ratio
	Cost in days of labor		
Potatoes	10	10	1.0
Beef	15	30	2.0
Soap	12	18	1.5
Beer	22	66	3.0
Shirts	18	45	2.5
Radios	25	75	3.0

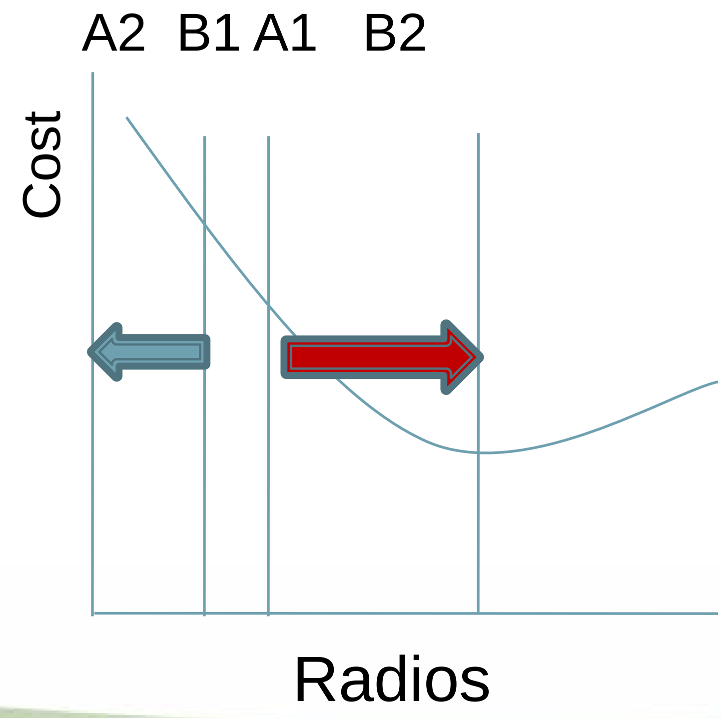
- Myth #2: "Some countries are so inefficient that they don't have a comparative advantage in anything"
  - Some countries may not have an absolute advantage in anything
  - Every country has a comparative advantage in something
  - Although it may be difficult to predict ahead of time

- Competition (2nd type of gain from trade)
  - Without trade, some industries can act as monopolists and charge higher prices
  - With trade, companies have to compete and offer prices close to costs

	Argentina	Argentina	Bolivia	Bolivia
	No trade	Trade	No trade	Trade
	Price with trade and without trade			
Potatoes	10	10	10	10
Beef	15	15	15	15
Soap	15	12	15	12
Beer	25	22	25	22
Shirts	20	15	20	15
Radios	30	25	30	25

- Returns to scale (3rd type of gain from trade)
  - Without trade, Argentina and Bolivia produce less than the least cost amount of soap and radios
  - With trade, each specializes and exports one good, stops producing and imports the other



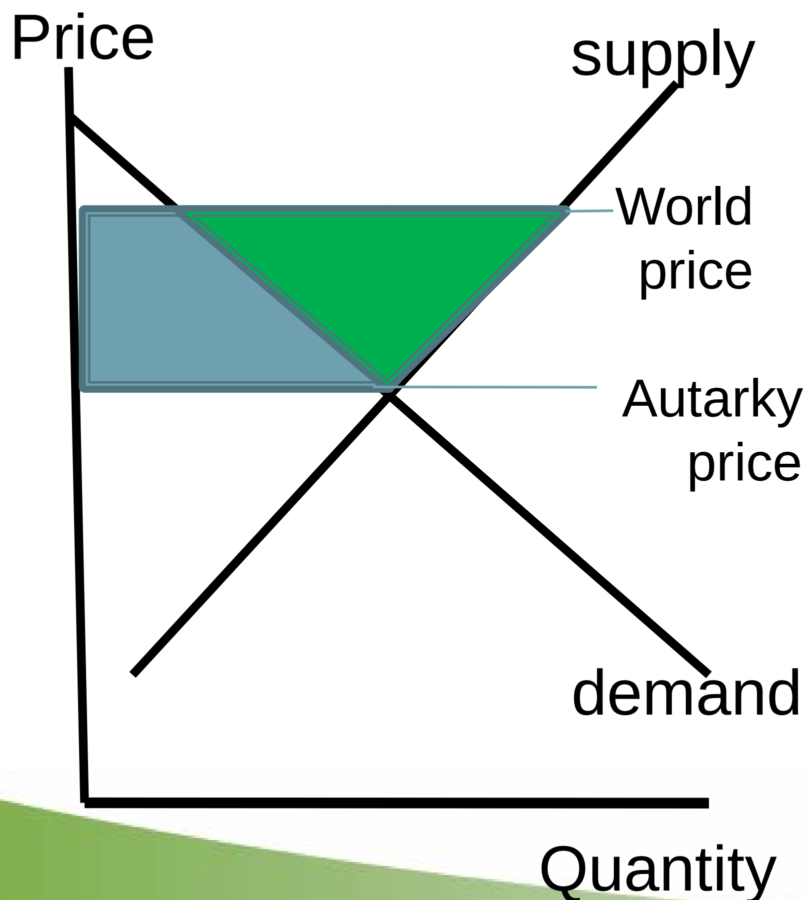


- Dynamic gains from trade (4rd type)
  - Static gains mean that trade gives one-time increase in income (GDP)
  - Dynamic gains means that trade increases rate of growth in income (GDP)
  - Why?
    - Competition spurs innovation and investment
    - Trade allow new technology and inputs
    - Open trade policy increases investment, particularly foreign investment
      - Signal of good investment climate
      - Allows foreign companies to invest to cater to home customers

- Myth #3: "The country should promote exports and restrict imports."

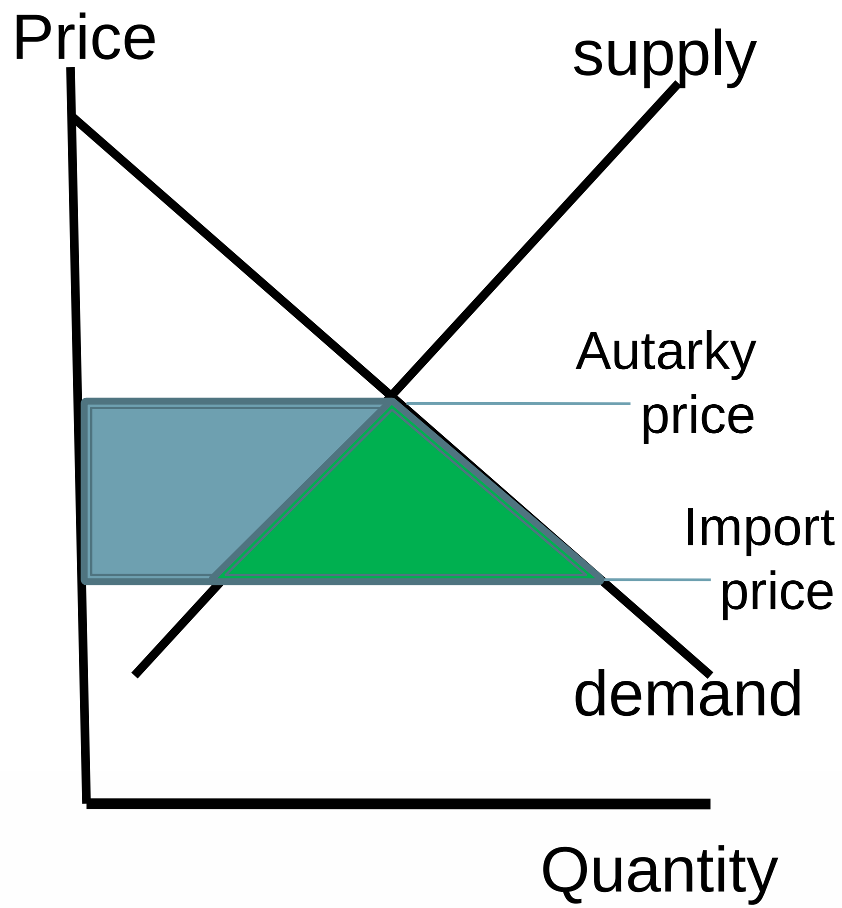
- Mercantilist philosophy (1500s): maximise exports and minimise imports
- But this is flawed: the only reason to export is to be able to pay for imports (either now or later)
- Exports help economy through jobs created
- Imports help economy by lowering cost and increasing variety of inputs for producers and goods for consumers

- How do we measure gains from trade?
  - Static gains from trade vs no trade for exporter

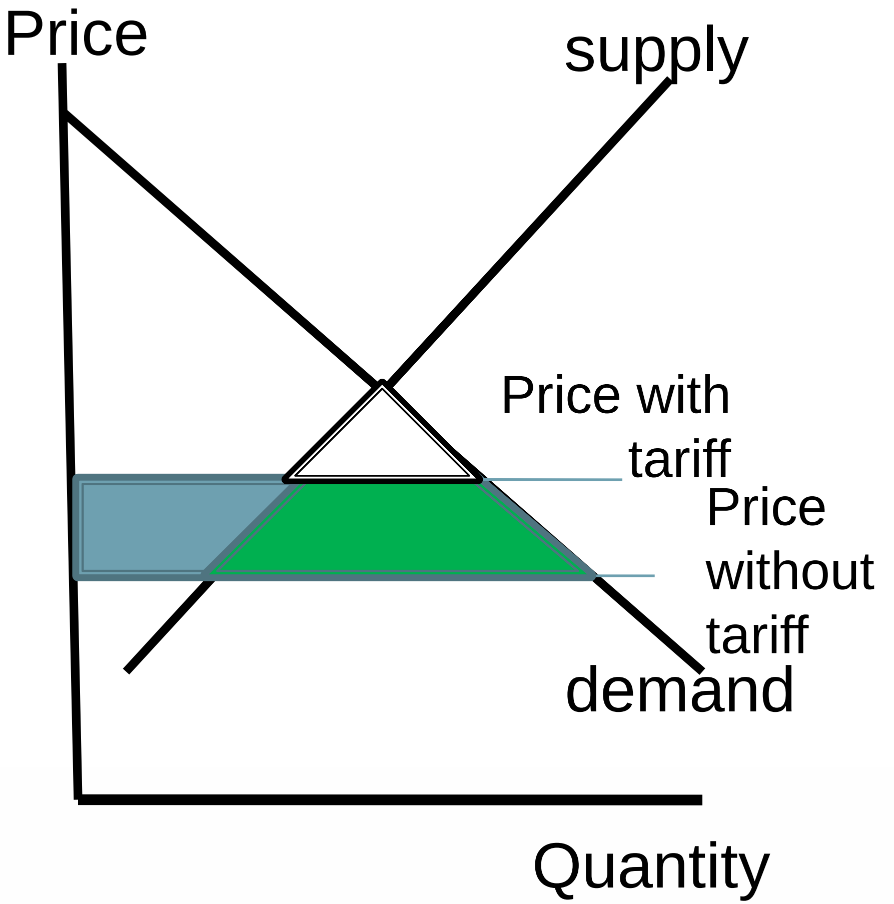


- Export price is higher than autarky price
- Consumer benefit from lower price = blue+green
- Producer loss from lower price = blue
- Net gain = green

- How do we measure gains from trade?
  - Static gains from trade vs no trade for importer
  - Import price is lower than autarky price
  - Consumer benefit from lower price = blue+green
  - Producer loss from lower price = blue
  - Net gain = green



- How do we measure gains from trade?
  - Static gains from reducing import barriers
  - Price with tariff is higher than price without tariff
  - Consumer benefit from lower price = blue+green
  - Producer loss from lower price = blue
  - Net gain = green

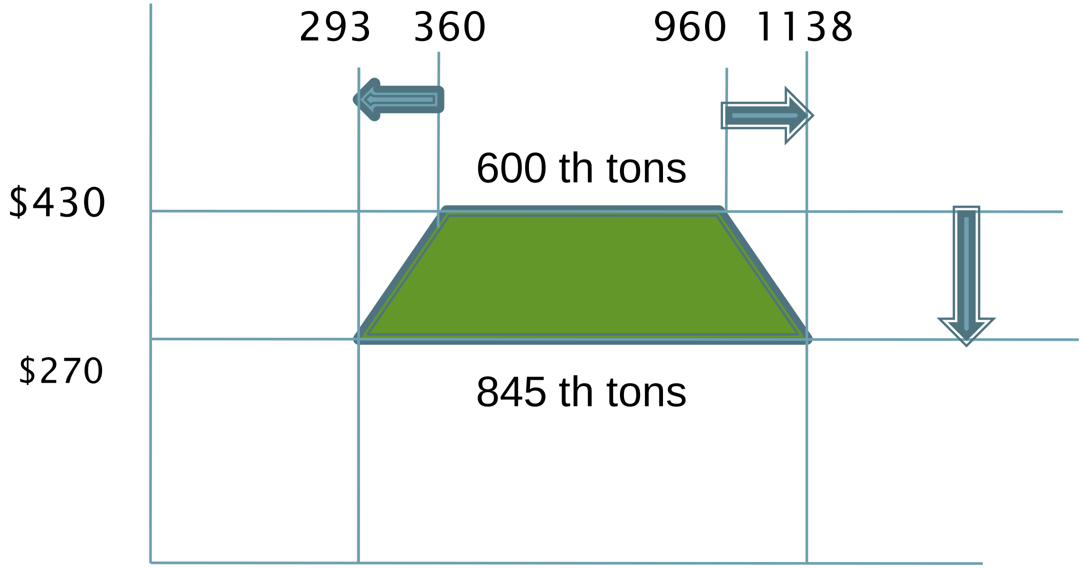


- How big are gains from trade?
  - Static gains from trade
    - Most studies of trade liberalization show gains of 1–6% of GDP, depending on how restrictive trade policy was before liberalization
  - Dynamic gains from trade
    - Harder to measure but generally much larger
    - Wacziarg and Welch (2008)
      - Econometric study of dozens of countries over 1950–1998
      - Trade liberalization increase trade/GDP ratio 5–10 pct points
      - Trade liberalization increases GDP growth rate 1.5 to 2 percentage points
      - Over 10 years, this represents a GDP that is 22% higher

- How big are gains from trade?
  - Information needed to calculate static benefits of eliminating an import tariff (green area)
    - Current level of imports with tariff (Mt)
    - Current price with tariff (Pt)
    - What price would be with no tariff (Pn)
    - What imports would be no tariff (Mn)

Net benefit = Area = 0.5x(Mt+Mn) x (Pt−Pn)

- How big are gains from trade?
  - Example: wheat import tariffs in Kenya



- Net benefit = Area = 0.5x(Mt+Mn) x (Pt–Pn)

  = 0.5x(600+845)x(430–270) =

  = 725 th tons x US$160/ton = US$ 116 million

- If there are gains from trade, why do government's impose restrictions on trade?
  - Political influence of producers
    - Usually larger, better informed, and better organized than consumers, who would gain from import liberalization
  - Infant industry argument
    - Problem of infants who never grow up
  - Concern about impact on poverty
    - If producers are poorer than consumers
  - Dependence on tariff revenue
  - Cost of transition

- If there are gains from trade, why do government's impose restrictions on trade?
  - Main reason in most cases: political influence of producers

ws > Article

Kenya wheat farmers block road in protest at prices

Mon Jun 30, 2008 10:50am EDT

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NAROK, Kenya, June 30 (Reuters) - Farmers in Narok, gateway to Kenya's famed Maasai Mara Game Reserve, blocked a road and prevented the gathering of wheat harvests in the area on Monday after the government lowered import duty on the grain.

Some 2,000 farmers, who started harvesting their grain a month ago, joined the protest against falling wheat prices.

"The lowering of import duty has led to a wheat glut in the country, forcing farm prices to plummet," said Jackson Kamuye, protest leader and a councillor at Narok's county council.

Kamuye, also a local leader of the Kenya National Chamber Of Commerce and