

GV103: Introduction to International Relations

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Foregone Benefits of Cooperation

Introduction

- Three goals for this lecture
 - Discuss potential **benefits of free trade**
 - Clarify relationship b/w **exchange rates** and trade
 - Discuss potential **benefits from free migration**

Overview

- $>90\%$ of economists agree barriers to trade \downarrow welfare
- Countries that trade more grow faster
- Removing all barriers could \uparrow world GDP by 3% per year

A Simple Model

- Suppose we have two states, Rich Republic and Pooristan
 - $u_R = 0$ if $\mathcal{E}_R < 8$ and $u_R = \mathcal{L}_R$ if $\mathcal{E}_R \geq 8$
 - $u_P = 0$ if $\mathcal{E}_P < 4$ and $u_P = \mathcal{L}_P$ if $\mathcal{E}_P \geq 4$
 - Each month, R can produce 2 units of \mathcal{E} or 10 units of \mathcal{L}
 - Each month, P can produce 1 unit of \mathcal{E} or 2 units of \mathcal{L}
 - Annual production is simply sum of monthly outcomes

Analysis

- Self-sufficiency
 - Both meet their needs for \mathcal{E}
 - Takes each 4 months to do so
 - With remaining months, R produces 80 units of \mathcal{L}
 - With remaining months, P produces 16 units of \mathcal{L}
- Specialization and trade
 - R spends all its time producing \mathcal{L}
 - P spends all its time producing \mathcal{E}
 - 12 units of \mathcal{E} will be produced
 - 120 units of \mathcal{L} will be produced

Dubious Benefits of Mercantilism

- Public, politicians often worry about **trade deficit**
- Exports are not goals scored, imports goals allowed
- Exports are how we pay for imports, which we get to consume
- Work all day, never buy anything, maximize personal surplus
- Would that maximize your **happiness**?
- Imbalances can be harmful under certain conditions
- But not **intrinsically** harmful

Terminology

Fixed exchange rate

When a currency's value is tied to that of another currency or a particular commodity, such as gold.

Floating exchange rate

When a currency's value is set by supply and demand.

Fixed Exchange Rates

- Downsides to fixed exchange rates
 - Must impose capital controls or lose control of **monetary policy**
 - Monetary policy affects rate of **inflation**
- Upsides to fixed exchange rates
 - Fixed exchange rates promote trade by limiting **uncertainty**
 - Period of British dominance characterized by **gold standard**
 - Those on gold standard traded 30-60% more than other pairs

Migration

- Barriers to **migration** are effectively barriers to **specialization**
- World GDP would **double** if barriers to migration removed
- Many **trillions of dollars** are left lying on the ground