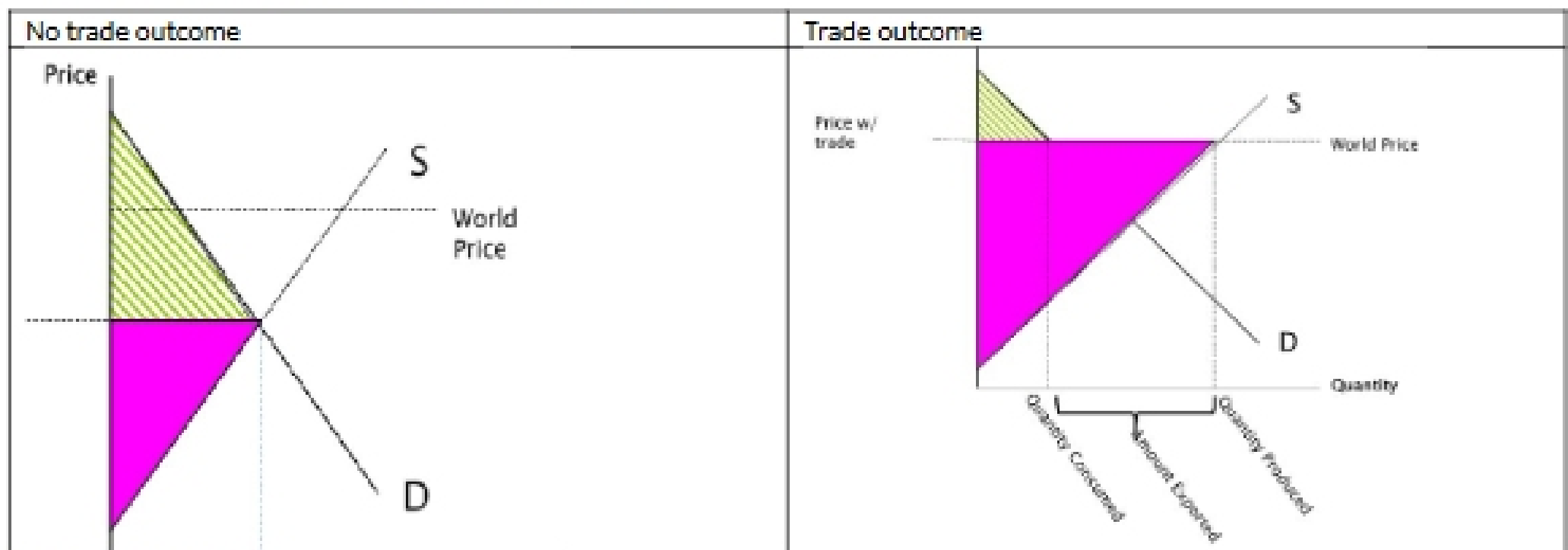


Chapter 16 - Creating an Environment for Growth and Prosperity

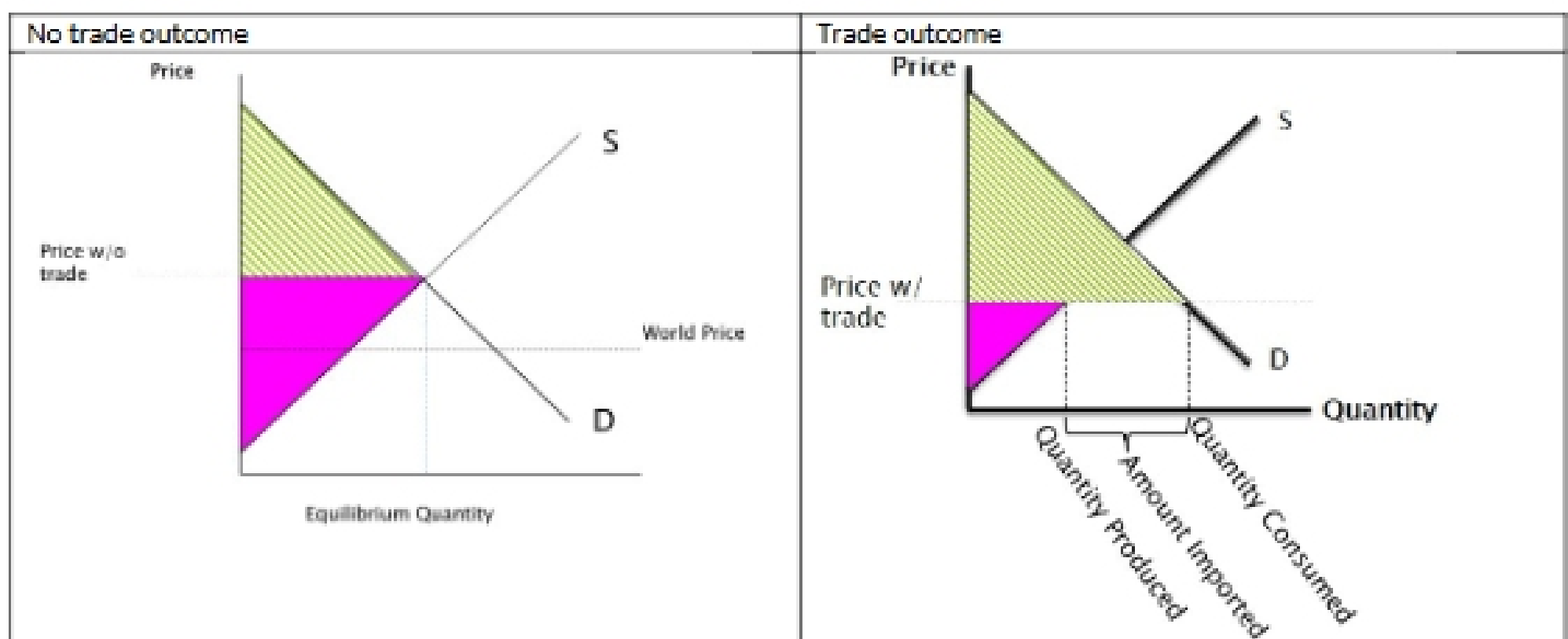
- rule of 70 - if a variable grows at a rate of x percent per year, $70/x$ will approximate the year's required for the variable to double
- major sources of economic growth - gains from trade, entrepreneurial discovery, investment in physical and human capital, and favorable institutional environments
 - gains from trade - trade moves items from people who value them less to people who value them more; allows for division of labor, specialization, and mass production; more trade means more output and growth
 - entrepreneurship and technology - technological advancement and innovation allows us to produce more; the market rewards good ideas and puts a stop to resource draining products
 - investments in physical and human capital - investments in machines and people with skill/knowledge will pay off in the long run
 - institutional environments - institutions - legal, regulatory, and social constraints that impact property rights and enforcement of contracts
- the institutional environment...
 - minimal regulation - regulations make starting a business difficult, regulations often have unintended consequences
 - avoidance of high tax rates - high taxes reduce efficient use of resources, high taxes increase underground activity and labor force dropout
 - open international trade - avoid tariffs, avoid quotas
- other factors that may affect economic growth
 - population growth - people produce, not just consume (Thomas Malthus)
 - natural resources - institutions more important than natural resources, natural resources do not guarantee growth (ex. Japan vs Nigeria)
 - foreign aid - agricultural and monetary donations; aid can have unintended consequences
 - climate and location - far from major markets, tropical climate; institutions are more important than location

Chapter 18 - Gaining from International Trade

- comparative advantage - the ability to produce a good at a lower opportunity cost than others
- relative costs - determine the comparative advantage; as long as comparative costs differ, gains from trade are possible!
- absolute advantage - a nation can produce more of a good than another nation; trade isn't based on absolute advantage
- trade between nations leads to: an expansion in total output, gains for each trading partner, and higher incomes for both nations
- gains from international trade: (1) gains from large-scale production, (2) gains from more competitive markets, and (3) more pressure to adopt sound institutions
- impact of exporting
 - domestic price will rise to world price
 - domestic producers of good → winners; domestic consumers of good → losers
 - country overall → gains to producers are greater than losses to consumers
- if the world price is greater than the domestic price, another country has a comparative advantage in producing the good; the domestic country will benefit if they export the good



- impact of exporting
 - domestic price will rise to world price
 - domestic producers of good → winners; domestic consumers of good → losers
 - country overall → gains to producers are greater than losses to consumers
- if the world price is less than the domestic price, another country has a comparative advantage in producing the good; the domestic country will benefit if they import the good



- impact of importing
 - domestic price will fall to world price
 - domestic producers of good → losers; domestic price of good → winners
 - country overall → winners; gains to consumers are greater than losses to producers, but producers losses are visible (consumer gains are harder to see)
- trade openness index - measures income levels and growths of countries (note: U.S. is rated #16)
- tariff - a tax leveled on goods imported into a country; benefits domestic producers and government; hurts domestic consumers; causes deadweight loss; encourages lobbying by domestic producers
- import quota - a specific limit or maximum quantity of a good permitted to be imported into a country during a given period; benefits domestic and some foreign producers; hurts domestic consumers; causes deadweight loss; encourages lobbying by producers
- trade restrictions create special interest groups, prevent voluntary exchanges, and reduce overall output, and causes deadweight loss; trade restrictions provide visible benefits for a few while spreading the costs over many
- national defense argument against free-trade
 - trade opponents say: certain industries are vital to our national defense
 - reality: this argument is often abused; the government could buy and store resources during peacetime; economic growth of a strong defense
- infant-industry argument against free trade
 - trade opponents say: new domestic industries just need a chance to develop
 - reality: once protection is granted, it is difficult to remove; over 100 years ago sugar quotas, manufacturing tariffs, and steel tariffs were put into place
- antidumping argument against free trade
 - dumping - selling a good in a foreign country at a lower price than its sold for in the domestic market
 - trade opponents say: foreign producers will cut prices to drive out competition, then use power to gauge consumers
 - reality: firms can reenter the industry, competition keeps prices low
- trade fallacies
 - myth: trade restrictions that limit imports save jobs
 - reality: trade restrictions increase employment in protected industries, trade restrictions destroy jobs in domestic sectors that export, trade restrictions hurt domestic consumers and producers via higher prices, and restrictions reshuffle jobs/reduce incomes
 - myth: free trade with low-wage countries will reduce U.S. wages
 - reality: lower prices increase consumers purchasing power and productivity difference is the source of wage differences