International Trade.

2 Frameworks will be used:

↳ Partial Equillibrium framework (one good traded b/w 2 countries)
↳ General Equillibrium framework (many goods traded b/w 2 countries)

(i) International trades b/w 2 countries- Home (H) & Foreign (F)
Domestic & Foreign prices levels are given by P_H & P_F.

(ii) The price at which the international trade occurs is called
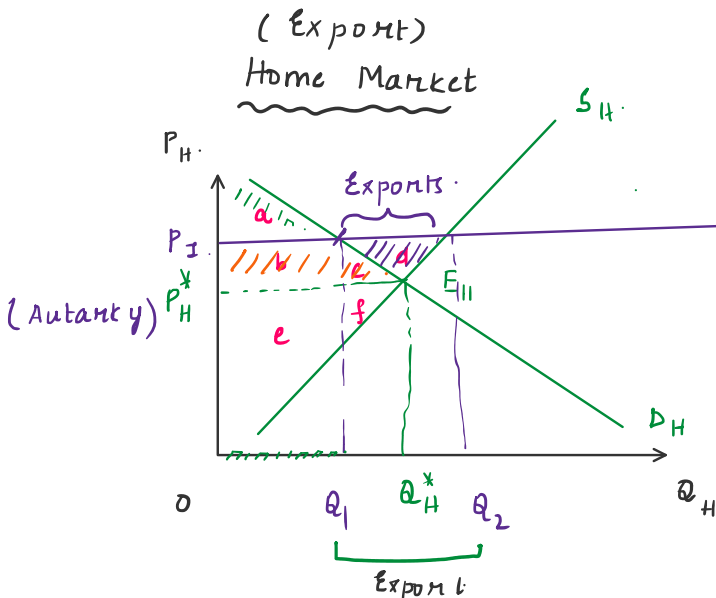as World price/ International price (P_I)

Q. Why does trade occur? [Because it is gainful]

If world economy consists of countries — Home (H) & Foreign (F).
If $P_I > P_H$: H is an exporter of the good.
If $P_I < P_H$: H is an importer of the good. } same logic for (F)
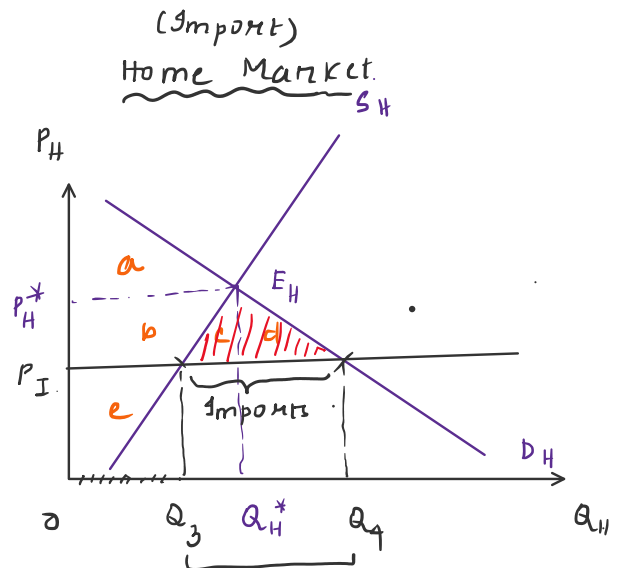
Now consider the Home country

· Economic welfare = CS + PS.

(Export)
Home Market

(Import)
Home Market

under autarky (closed economy)

welfare = (a + b + c) + e + f.

under trade:

under autarky (closed economy

welfare = a + b + c

under trade:

welfare = (a + b + c) e + f.

under trade:

$CS = a$

$PS = b + c + d + e + f$

welfare $= a + b + c + ⓓ + e + f$

∴ Welfare under trade >
   Welfare under autarky

Hence trade is gainful.

Welfare gain = area of region `d`.

$$= \frac{1}{2}\left(P_I - P_H^*\right) \cdot \text{Exports}$$

under trade:

$CS = a + b + c + d$

$PS = e$

welfare $= a + b + c + d + e$

∴ welfare under trade >
   welfare under autarky.

∴ Hence trade is gainful.

Welfare gain = area of $(c+d)$

$$= \frac{1}{2}\left(P_H^* - P_I\right) \cdot \text{Imports}$$

Note: (i) Under trade it is not necessary that all the participating agents are better off. The welfare gain by one of them dominates the welfare loss by the other. Hence on the overall level trade is gainful.

(ii) Under export scenario, loss of welfare by consumers = $(b+c)$ = post-trade welfare gain by producers. If the govt devices a transfer scheme such that amt $(b+c)$ is taxed from the producers & given to the consumers, then post-trade consumer welfare $= (a+b+c)$ = pre-trade consumer welfare. Post-trade $PS = (e+f+d)$ > Pre-trade $PS = (e+f)$.

"Hence no agent is worse off but atleast one is better off" — hence trade is Pareto superior outcome.

[Hicks-Skitopsky transfer principle]

(iii) Pre-trade autarky price = P_H^*.

Int. price = P_I = Post-trade autarky price.

If $P_I > P_H^*$ ⟹ Exporter.

If $P_I > P_H^*$ $\Rightarrow$ Exporter.

If $P_I < P_H^*$ $\Rightarrow$ Importer.

If $P_I = P_H^*$ = not participate in trade.

$\therefore$ Trade occurs only when autarky prices differ.