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Economics & Society



Lecture 11 Labor Market & Trade

1

Previously in E&S...

- ★ The commodity market 
households, firms, the government, foreign sector
- ★ Equilibrium in the commodity market 
when $Y = C + I + G$
- ★ Links between the markets:
 - ▶ Output \rightarrow money demand \rightarrow interest rate
 - ▶ Interest rate \rightarrow investment \rightarrow output.
- ★ Fiscal policy through G vs. t
- ★ Monetary policy and stabilization
- ★ Crisis

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2

2

Labor Market – Trade

Estimated duration: 90min



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3



30

Local vs. Global

Geographical

Cultural

Historical / Geopolitical

Political / Ideological

Economical

31

World trade > International trade

- ★ Once uncommon, foreign products are now **everywhere**
from toothpicks to electric cars
- ★ Nowadays, it is **not easy** to even tell **where** a product was really made
- ★ Take, **for instance**, the most iconic US product, the **iPhone**:
 - ▶ **Designed** in California
 - ▶ **Assembled** in China
 - ▶ From **parts** produced in Korea, Germany, Japan, and the US
 - ▶ By **natural resources** extracted in Russia, South Africa etc.
- ★ **Services** follow a similar pattern of **outsourcing**:
 - ▶ **Customer** support
 - ▶ **Services** that can be communicated electronically

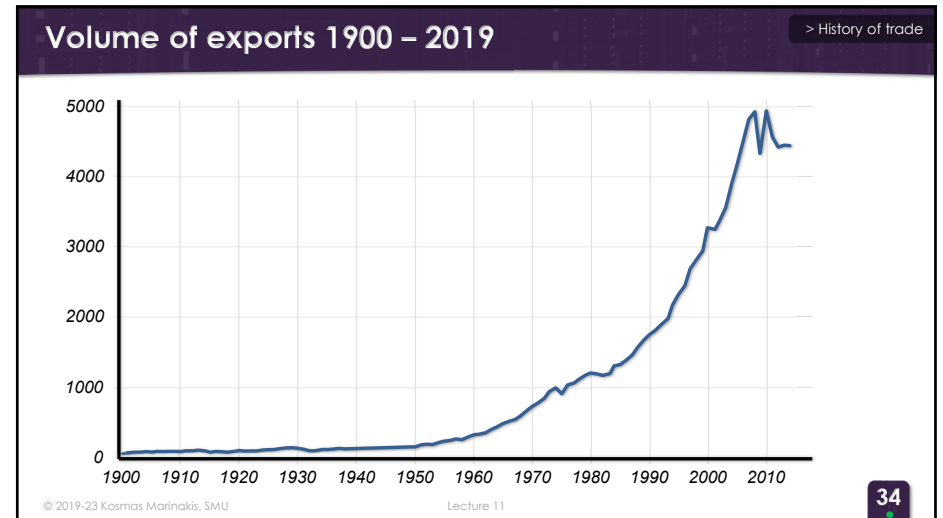
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32

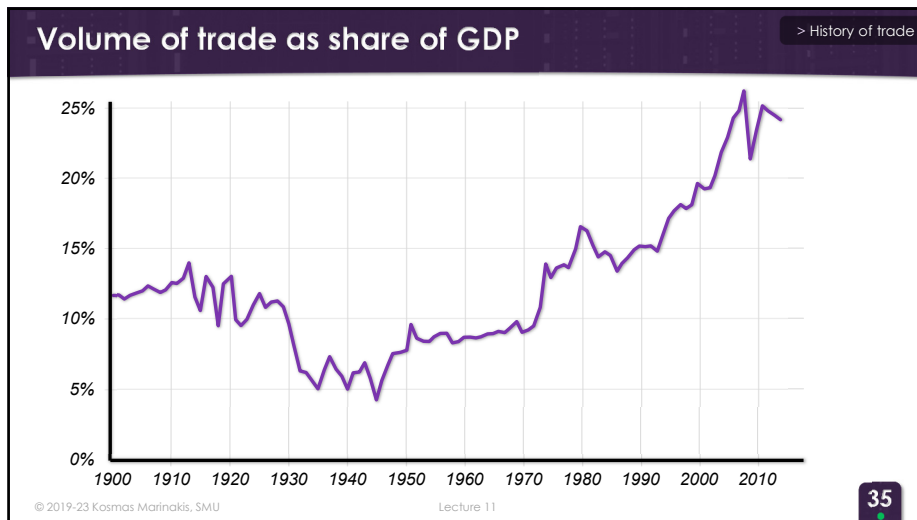
32



33



34



35

1900 – 1959

> History of trade

- ★ It became possible to have global trade after having in place several **basic technologies**
 - ▶ railroad – steamship – telegraph
- ★ The **beginnings** of the global economy was in fact more than a century ago
 - ▶ people in **England** were able to buy **Chinese tea** in the 1910s
- ★ Between the two World Wars international commerce was **reduced** as a share of the GDP:
 - ▶ Not so much because of the **war**
 - ▶ Because of **restrictions** such as tariffs and quotas.
- ★ **By 1960** trade as a share of GDP was **below** the level of **1910**.

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36

36

1960 – today

> History of trade

- ★ There has been an **increase** in the volume of world commerce from 1960
- ★ Supported by two new **technological breakthroughs**:
 - ▶
 - ▶
- ★ Till the 1980s the increase has been **moderate** relative to the size of the economy
- ★ International commerce **increased rapidly** from the **1990s**
 - ▶ this period sometimes is referred to as **“hyper-globalization”**
- ★ There is some evidence that nowadays international trade has **leveled off**.

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37

37



38

The economic driving force

> The economics of trade

- ★ Trade allows for **division of labor** and **specialization**
- ★ Those make the world **richer** in **2 ways**:
 1. Allow nations to **concentrate** on what they can do better:
 - ▶ Greece is better than Singapore in **hospitality**
 - ▶ Singapore is better than the US in **trade services**.
 2. Allow for the development of **economies of scale** focusing on **less industries** → producing **higher quantities** → **lower AC**

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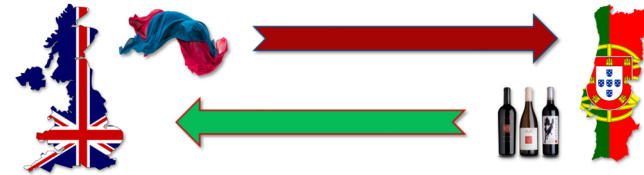
39

39

Absolute advantage

> The economics of trade

- ★ In 1817, the British economist **David Ricardo** offered the first example for the benefits from trade:
 - ▶ England is better in the production of **cloth**
 - ▶ Portugal is better in the production of **wine**.



- ★ A country has the **absolute advantage** in the production of a good when it can produce it **using fewer resources**

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40

40

Comparative advantage

> The economics of trade

- ★ What if a country is **better** in the production of **both** goods?:
 - ▶ Singapore can produce either **100 units of banking** OR **50 units of tourism** per year
 - ▶ Cyprus can produce either **50 units of banking** OR **40 units of tourism** per year.
- ★ **1 unit of tourism costs:**
 - ▶ **2 units of banking** to Singapore
 - ▶ **1.25 units of banking** to Cyprus.
- ★ **1 unit of banking costs:**
 - ▶ **0.5 units of tourism** to Singapore
 - ▶ **0.8 units of tourism** to Cyprus.
- ★ Singapore should focus on **banking**, Cyprus on **tourism**, and **trade**
- ★ Singapore has the **comparative advantage** in **banking** and Cyprus in **tourism**
a country has the **comparative advantage** in what it can produce at a **lower opportunity cost**

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41

41

Trade and prosperity

> The economics of trade

- ★ What if a country is **better** in the production of **both** goods?:
 - ▶ Singapore can produce either **100 units of banking** OR **50 units of tourism** per year
 - ▶ Cyprus can produce either **50 units of banking** OR **40 units of tourism** per year.
- ★ If countries rely on **autarky** (splitting their resources 50-50):
 - ▶ Singapore can produce **50b** and **25t**
 - ▶ Cyprus can produce **25b** and **20t** } **Total 75b** and **45t** will be produced.
- ★ If countries **trade**:
 - ▶ Singapore can produce **80b** and **10t**
 - ▶ Cyprus can produce **0b** and **40t** } **Total 80b** and **50t** will be produced.

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42

42

Inequality

> Inequality

★ In general, trade allows for a **larger pie** to be distributed:

- ▶ In the L-R, **more winners** than losers
- ▶ In the S-R, there can be a **significant number of losers**.

★ For **instance**, when **China** opened up in 1989:

- ▶ It made the West **richer on average**
- ▶ But brought **unemployment** to some local communities
- ▶ Costs and benefits of globalization were **NOT distributed equally**.

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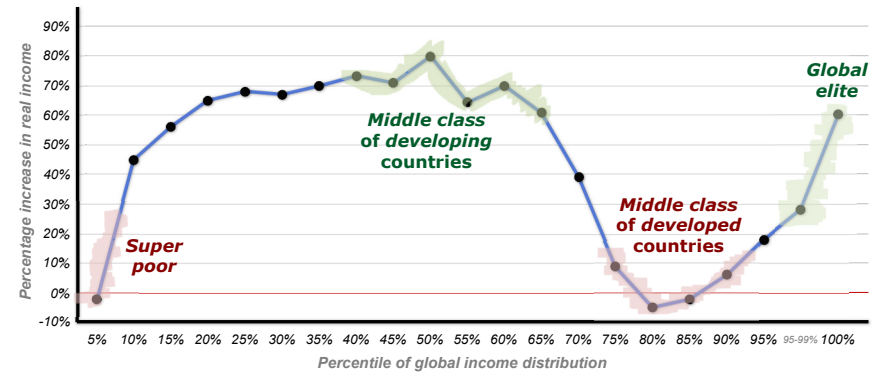
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43

43

The Lakner-Milanovic curve (1988 – 2008)

> Inequality



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44

44

Political change

> Inequality

★ It was the latter group that got disappointed, turned **against globalization** and **drove** the recent political turn towards “economic nationalism”

Donald Trump, Brexit, radical parties gained power in Europe.



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45

45

Should we roll back globalization?

> Inequality

- ★ Globalization undoubtedly **has contributed** to inequality
BUT technology also brings inequality (yet **nobody** demands to roll it back)
- ★ Reversing globalization will bring an **all-new social shock**:
 - ▶ **Tariffs** on goods may have unpredictable reverse effects
 - ▶ **Communities** have adapted (factories closed, technologies evolved, people left).
- ★ We could have **mitigated** the adverse effects with **policies**:
public goods, social safety nets, reskilling
- ★ But its always easier to **put the blame** on those on the other side of the border
especially when these people are of slightly **different color, religion or culture**.

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46

46

The end!

(you are welcomed to stay for consultation or discussion)

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