

Trade

Why do nations trade?
INTERNATIONAL ECONOMICS

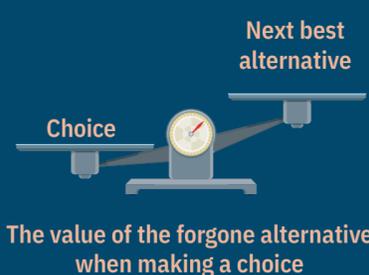
Trade Terminology

Individuals, businesses, and countries exchange goods and services when the parties involved expect mutual benefits.

FACTORS OF PRODUCTION (productive resources)



OPPORTUNITY COST



The value of the forgone alternative when making a choice

SPECIALIZATION



Produce both? Or just one?

IMPORTS

Goods and services

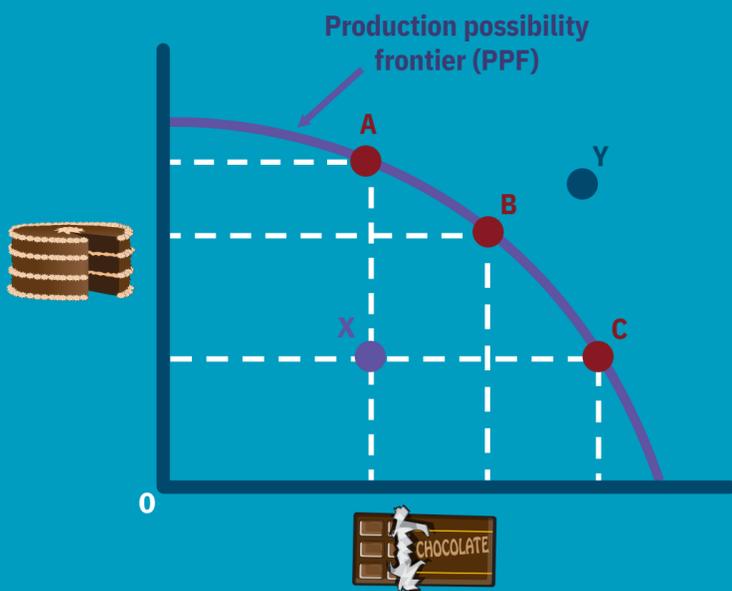


EXPORTS

Goods and services

Production Possibilities Frontier

The graph below represents the trade-offs an economy faces given fixed resources and an economy at full employment. In such an economy, these are the maximum outputs possible given specific inputs (productive resources).



A, B, & C

Examples of production combinations at which the production of chocolate cakes and chocolate bars is most efficient

X

A point at which resources are not being used efficiently to produce chocolate cakes or chocolate bars

Y

A point at which output is not attainable based on the current production resources

Absolute versus Comparative

Output per hour of labor

	Chocolate bars	Cakes
Country A	20	4
Country B	10	5

Opportunity cost

	1 chocolate bar	1 cake
Country A	1/5 cake	5 bars
Country B	1/2 cake	2 bars

Absolute advantage

The ability to produce a larger amount of a good or service than another producer given the same input



Country A has the absolute advantage in producing chocolate bars. Country B has the absolute advantage in producing cake.

Comparative advantage

The ability to produce a good or service at a lower opportunity cost than the other producer



Country A has the comparative advantage in producing chocolate bars. Country B has the comparative advantage in producing cake.

Trade Barriers

Quotas

Limits on the quantity of imports

Export Restrictions

Self-imposed limits on the quantity of exports



Tariffs

Taxes on imports

Subsidies

Payments to the producers of certain goods for export or to producers competing against imports

Free Trade versus Protectionism

Free trade

- Promotes efficient production
- Stimulates economic growth
- Increases consumption
- Lowers prices

PROS

Protectionism

- Safeguards domestic industries and jobs
- Insulates infant industries

- Increases structural unemployment
- Weakens infant industries

CONS

- Allocates resources inefficiently
- Discourages innovation
- Limits variety of goods and services
- Raises prices