

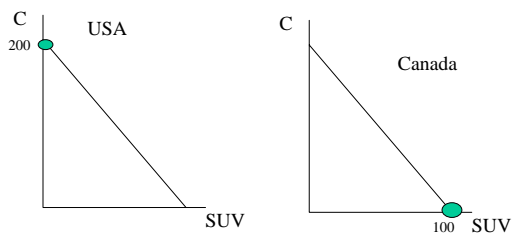
Comparative Advantage and International Trade

Why do we trade?
How do we trade?

Specialization and Trade

- If we specialize ----- we must rely on others to produce the “other good”
- Continuing our car/SUV example, consider the two plants now as two countries (e.g. Canada (Plant B) and United States (Plant A))
- So, the US specializes in cars, Canada in buses

Specialization and Trade II



If each country produces according to its comparative advantage, they produce at the corners of their PPFs

Total World Production = 200 cars and 100 SUVs – There is a gain from trade

Specialization and Trade III

- We are still producing on each PPF, but now have the ability to CONSUME outside the PPF of each country.
- But, how are we able to get the goods that the other country produces?
- DEFINITION The terms of trade tell us the rate at which a country can trade domestic products for imported products.

Terms of Trade

- For trade to take place, we need to find a ratio of cars/SUVs that makes both countries better off. This occurs when each country is able to obtain the non-specialized good more cheaply than if it produced it.

Where does this ratio fall?

In between the opportunity costs for each country.

Terms of Trade II

	<u>CARS</u>	<u>SUVs</u>
US	2 bus	2 cars
Canada	1 bus	1 car

The numbers above are the domestic opportunity costs to produce a Car/SUV in each country.

What is an “international” opportunity cost (Terms of Trade) that allows both countries to benefit? At what ratio can the US and Canada trade cars/SUVs to lower their opportunity costs?

Terms of Trade III

- Another example:
- Japan - can produce 10 computers for every 1 tractor
- China - can produce 4 tractors for every 1 computer

1) Who produces what good? Who has the comparative advantage in tractors? In computers?

2) What would be a terms of trade that would benefit both countries?

Terms of Trade IV

Note:

- 1) There can be more than 1 terms of trade that will benefit both countries.
- 2) Even if you have an absolute advantage, there can still be gains from trade - trade is determined by specialization and comparative advantage, NOT absolute advantage.

ISSUES IN TRADE POLICY

- We have shown that “free trade” (no restrictions) leads to gains for all involved. Then why do we see restrictions of trade.
- Trade restrictions --- not efficient from a production standpoint
- Then why don't we ever really seem to see free trade?

Trade Policy Definitions

DEFINITIONS:

- 1) Free trade is when there is no government intervention in trade.
- 2) Managed Trade(Protectionism) occurs when the government sets policy that restricts the flow of trade between nations (usually to protect domestic firms from foreign competition)

What are the forms of protection??

- 1) Tariffs
- 2) Non-tariff barriers

Tariff and Non-tariff Barriers

DEFINITIONS:

- 1) A tariff is a tax imposed by the government when an imported good enters the country.
- 2) A non-tariff barrier is any other action that limits international trade.

Examples of Non-tariff barriers:

- 1) QUOTAS
- 2) VERs (Voluntary Export Restraints)
- 3) Others
 - a) Licensing agreements
 - b) Safety standards
 - c) Product quality standards
 - d) Environmental standards

Why Do Trade Barriers Exist?

- 1) National Security
- 2) Infant-industry protection
- 3) Dumping
- 4) Others
 - a) Job protection
 - b) cheap foreign labor
 - c) property rights protection
 - d) environmental regulation
 - e) political concerns/human rights

Are all of these legitimate reasons for trade protection?

Who governs trade policies outside of the individual governments??

Major Trade Accords

- 1) NAFTA
- 2) EU
- 3) GATT
- 4) WTO
- 5) Others
 - a) MERCOSUR
 - b) ASEAN
