

International Trade

A. Specialization & Interdependence

1. International trade – the exchange of goods & services between people & institutions in different nations
 - a. Since the quantity & quality of productive resources available in different nations vary widely, international trade promotes greater specialization, which increases total world output
 - (1)
 - (2)
 - b. Since we live in an increasingly global economy where what is done in one nation affects the rest of the world, economic issues must be analyzed by examining trends in trading levels, investments, foreign exchange values, & changes in public policies affecting these sectors
2. Productive resources are distributed unevenly around the world, which gives rise to differences in opportunity costs that make it desirable to specialize & trade
 - a. Absolute advantage – when a nation can produce more of a product with a greater efficiency than can its partner in trade
 - (1)
 - (2)
 - (3)
 - b. It is possible for one nation to have multiple absolute advantages over its partner in trade
 - (1)
 - (2)
 - c. The existence of an absolute advantage does *not* mean that the nation with the absolute advantage will produce everything while the other nation produces nothing, rather this is determined by identifying ***comparative advantage***
3. Comparative advantage – when a nation can produce a product at a lower opportunity cost than can its partner in trade

- a. If Costa Rica devoted all its resources to producing coffee, it could produce 25 million pounds per year; or if Costa Rica devoted all its resources to producing bananas it could produce 5 million pounds per year
 - (1)
 - (2)
- b. If Panama devoted all its resources to producing coffee it could produce 12 million pounds per year; or if Panama devoted all its resources to producing bananas it could produce 4 million pounds per year
 - (1)
 - (2)
- c. By comparing the opportunity costs of maximizing production in both countries, comparative advantage has determined who should produce what
 - (1)
 - (2)
- d. Comparative advantage can change over time because of changes in a nation's economy or events occurring in other nations

B. Trade Barriers

1. Despite the benefits of international trade, many nations restrict the free flow of goods & services through **trade barriers** (government actions designed to protect domestic industries & jobs from foreign competition)
 - a. Barriers to trade include **tariffs** (special taxes on imported goods), quotas, **embargoes** (laws that cut off both imports & exports from a country), the formation of cartels, controls on the freedom to exchange currencies, & restrictions of immigration
 - (1) Exports
 - (2) Imports
 - b. Such obstacles distort the pattern of prices, production, consumption, & distribution of income in international markets
2. Trade barriers established to *protect* a domestic economy can *hurt* the economy it was designed to protect

- a. U.S. restricting importation of Japanese cars & Philippine sugar will encourage the production of American automobiles & sugar
 - (1)
 - (2)
 - (3)
- b. Because of trade barriers, patterns of production in the U.S., Japan, & the Philippines may change in undesirable ways with productive resources moving from more efficient into less efficient uses
- 3. While ***free trade*** (international trade not subject to government regulation) among nations will raise worldwide production levels & material standards of living, in the short run some groups are likely to be hurt by the effects of increased international competition

C. Foreign Exchange

- 1. Since different currencies are used in different countries, extensive international trade requires an organized system for exchanging money between nations
 - a. When a business in one country imports items, it makes payments in the exporting nation's currency
 - (1)
 - (2) Exchange rate
 - b. Exchange rates can be set in a free market, established through controls imposed by national governments, or allowed to fluctuate within price ranges before triggering government action designed to stabilize the exchange rates between currencies
- 2. A change in exchange rates can have a significant effect on the flow of trade between nations & on a nation's domestic economy
 - a. When the exchange rate between currencies change, it changes the relative prices of goods & services traded by the two countries
 - (1)
 - (2)

- b. Changing exchange rates commonly mean one nation will gain, while the other nation loses

- (1)

- (2)

- c. When the American dollar equaled more Japanese yen, an American would gain more than when it equaled less Japanese yen

D. Balance of Payments

- 1. Balance of payments (B/P) – an annual accounting record of all the international transactions that involve the payment or receipt of foreign exchanges

- a. The B/P accounts are reported in three sections

- (1)

- (2)

- (3)

- b. Transactions recorded in the B/P are commonly separated into two portions

- (1) Current account

- (2) Capital account

- 2. Countries often run surpluses or deficits in either their current or capital accounts, but the overall B/P account for a country must balance

- a. The ***balance of trade*** figures regularly reported in the media include only the deficit or surplus portion of the current account

- (1)

- (2)

- b. The B/P as a whole is what is important, since it helps a nation to understand the state of its economic relationships with the rest of the world & helps nations make appropriate decisions about their policies concerning world trade & finance

E. International Aspects of Growth & Stability

- 1. Economic growth – a sustained rise in the production of goods & services

- a.

- b.
- 2. The international transfer of technology & the exchange of productive resources & finished goods & services have led to increased interdependence among nations
 - a.
 - b. Problems of inflation & unemployment can be transmitted from one country to another through flows of trade & money
 - (1)
 - (2)
- 3. Public policies affecting foreign trade impose costs & benefits on different groups of people & decisions on these policies often reflect economic & political interests & forces