Econ Unit 5
International Trade Notes

Scarcity, Resources, & Specialization

Remember those **productive resources/factors of production?**

- Land, Labor, Capital (human, physical, & financial), and Entrepreneurship

Because each nation has certain productive resources & cannot produce everything it wants, individuals, businesses, & nations must decide what goods & services to focus on

- **Specialization** – a situation that occurs when individuals or businesses produce a narrow range of products to **maximize resources,** increase **productivity,** & make a **profit**
- **Economic interdependence** – a situation in which producers in one nation depend on others to provide goods & services they don't produce (opposite of **isolationism)**

Absolute v. Comparative Advantage

- **Absolute Advantage** – a nation can produce more of a given product using a given amount of resources

- **Comparative Advantage** – a nation's ability to **specialize** & **produce a product most efficiently** given all the other products that could be produced (**lower OPPORTUNITY COST)**

Law of comparative advantage – a nation or person is better off when it produces goods and services for which it has a comparative advantage

Absolute/Comparative Advantage Rules

- **Input** vs. **Output** Problems
- **Output** problems state that you get a certain amount of a product out of a given number of inputs (resources)
  - **Ex:** miles per gallon of gas, pieces of gum per dollar
- **Input** problems state that it takes a certain amount of inputs (resources, time) to get a given output (product)
  - **Ex:** hours to paint the house, apples to make a pie

Absolute Advantage

- For **Output** problems, you look to see who (nation, business, individual) can **produce the most** outputs with the same resources
- For **Input** problems, you look at who uses the **least amount** of inputs to get the output

Comparative Advantage

- For **Output** problems, it's **Other Over**
- For **Input** problems, it's **Other Under**
- You look for the **smallest number**, which signifies the **least Opportunity Cost**
- There can never be a Comparative Advantage **in both products**

Product from 1 ton of peanuts **(Output)**

	Peanut Butter	Peanut Oil
Company A	40	30
Company B	60	20

Company A has the **Absolute Advantage (AA)** in producing Peanut Oil, and Company B has the **AA** in Peanut Butter

Company B has the **Comparative Advantage (CA)** in Peanut Butter (20/60 = 1/3 is less than 30/40 = 3/4) and Company A has the **CA** in Peanut Oil (40/30 = 4/3 is less than 60/20 = 3)

Company A: 1 PB =3/4 PO
Company B: **1 PB = 1/3 PO**

Company B has lowest Opportunity Cost

Company A: **1 PO = 4/3 PB**
Company B: 1 PO = 3 PB

Company A has lowest Opportunity Cost

Apples to make one **(Input)**

	Pie	Juice
Glenda	5	3
David	6	3

Glenda has an **AA** in Pies, and neither have an **AA** in Juice (same # of inputs)

Glenda has **CA** in Pies (5/3 = 1 2/3 is less than 6/3 = 2), and David has **CA** in Juice (3/6 = ½ is less than 3/5)

Trade Barriers & Agreements

Trade Barriers – a trade restriction, used to prevent a foreign product from freely entering a nation's territory

- **Tariffs** – a tax on imported goods
  - Revenue Tariff – tariff enacted to generate revenue/money
  - **Protective Tariff** – tariff imposed to protect domestic industries
- **Import Quotas** – a limit on the amount of a good that can be imported
- **Embargo** – a law that cuts off most or all trade with a specific country
  - **America** has/had an **embargo** on **Communist Cuba** & that's why those cigars are illegal!!!

Protectionists support trade barriers to protect domestic industries & jobs, promote **infant industries**, & protect national security **(Protectionism)**

International Free Trade Agreement - results from cooperation between countries to reduce trade barriers and tariffs to promote trade

Trading Blocs/Agreements

1) North American Free Trade Agreement **(NAFTA)** – agreement between **Canada**, **Mexico** and the **U.S.** to eliminate tariffs and other trade barriers
2) European Union **(EU)** – a regional trade organization of European nations
3) Association of Southeast Asian Nations **(ASEAN)**

World Trade Organization **(WTO)** – a worldwide organization whose goal is to promote free global trade & supervises international trade (anti-Protectionism)

Measuring Trade

- Foreign Exchange Market – a market in which currencies of different countries are bought & sold
  - **Market where money is bought and sold**
- Foreign Exchange Rate – the value of one foreign nation's currency in relation to another nation's currency
  - Fixed Rate of Exchange – system in which currency of one nation is fixed, or constant, in relation to other currencies (gold)
  - Flexible Rate of Exchange – system in which the exchange rates for currencies change as the supply & demand for the currencies change (floating rate)

Determining the Rate of Exchange Example:

- 1 Dollar = 12 Mexican Pesos
- Hotel room costs 500 Pesos per night 500/12 = $41.66

Strong v. Weak Dollar

- The Fed keeps a measure of the international value of the dollar called the trade-weighted value of the dollar to determine if the value of the dollar is strong (**appreciated**) or weak (**depreciated**) as measured against other currencies
- **As the value of the dollar increases, IMPORTS to the U.S. become less expensive & increase, but EXPORTS from the U.S. become more expensive & decrease**
- **The weak dollar has the reverse effect; IMPORTS become more expensive & EXPORTS are able to sell relatively cheaply**

Think of it this way: When 2 countries trade; technically they aren't buying products, but currency (money). Whichever country has the cheaper currency will be able to export more, and the country with the more expensive currency will import more

Balance of Trade & Payments

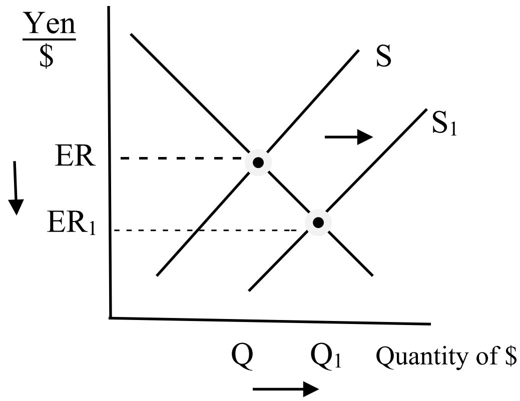
- Balance of Trade – the difference between the value of a country's imports & exports
  - **Favorable Balance of Trade:** nation has a trade surplus (exports more than it imports)
    - Ex: China
  - **Unfavorable Balance of Trade:** nation has a trade deficit (imports more than it exports)
    - Ex: America

Remember that the FOREX determines which nation's will export (weaker currency) and import (stronger currency)

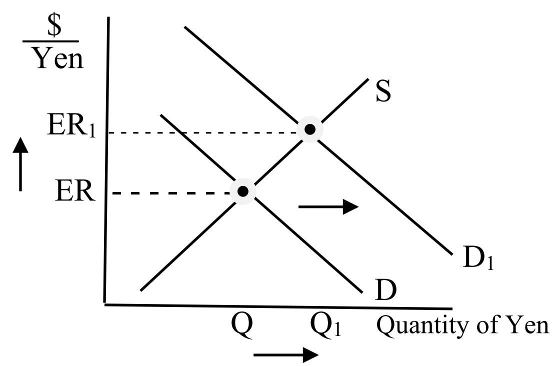
- Balance of Payments – a record of all the transactions that occurred between the individuals, businesses, & gov't units of one nation & those of the rest of the world

FOREX Graphs

EX: Japanese currency (Yen) is weaker compared to the stronger U.S. dollar ($) in the Foreign Exchange Market (**FOREX**). Therefore, America will import more cheaper Japanese goods and Japan will export their cheaper products.



U.S will Supply more dollars to Japan to buy cheaper Japanese products. This will eventually **Depreciate** the value of the American $ as shown by the graph above.



Japan will export more of their cheaper goods, causing an increase of demand for Yen and the Japanese currency will then **Appreciate** in value.

Over time the trading relationship between the U.S. and Japan will flip-flop as the U.S. dollar **depreciates** (becomes weaker) due to an increase in Supply, while the Japanese Yen **appreciates** (becomes stronger) due to an increase in Demand. This is what is meant by a **Flexible Rate of Exchange** in International Trade