29. International Trade

CHARACTERISTICS

Wider Choice
Countries can consume products they don't produce domestically

↑Competition
Lower prices for consumer (and higher efficiencies)where producers compete

↑Productivity Allows economy to Produce more efficiently. Better use of scarce resources (exploit comparative advantage), technology, innovation and 'best practice' ideas

↑ Standard of Living (SOL)
- **Individual** worker gains by specialisation of labour
- **Country** is able to enjoy a higher SOL by concentrating on what its good at

Improved Relations
> Contact with outside world and neighbours

Provides Markets For **Excess Output**

BASIS

Absolute Advantage

One country can produce a good cheaper than others

	Chemicals	Coal
Ireland	**1000**	2000
UK	500	**3000**

Law of Absolute Advantage
Each country should specialise in producing a good in which is has an **absolute advantage**

Comparative Advantage

One country is relatively more efficient producing a both goods **(output per worker)**

	Beer	Bread
Ireland	**50**	80
Denmark	100	**90**

Compared with 'Beer', Ireland produces 'Bread' at a much closer level to the Danish level than 'Beer'

Law of Comparative Advantage
(**Aka Ricardo's Theory**)
Each country should specialise in producing a good at which it is *relatively **most*** efficient (and fulfil its other requirements through trade)
- Why would Country **A** differ to **B**? **Different 'endowments' (available quantities)** of key **factors of production (FOPs)** [aka Heckscher-Ohlin Theory)
- This maximises **economic welfare** (through specialisation of what you're good at doing)

What determines Comparative Advantage
(i.e. cost of production)

- **Factor Endowments** (and their quality)
- Investment in **R&D**
- Tariffs/ Quotas
- Long Term **Inflation Rate**
- **Exchange Rate** Changes

How Valid is this Law/Theory?

- Ignores **Transport Costs**
- Assumes **Constant Returns to Scale**
- Assumes FOPs (i.e. Labour) Will **Move Across Occupations**
- Assumes **Free Trade Exists**
- Assumes **Specialisation can occur unhindered**

Summary: What is Free Trade?

Exchange
Buy what they cant produce cheaply

Specialisation
Exploit economies of scale

The Government and Free Trade

Why Government Intervenes

Protect from **competition by low wage countries**

Protect an **'Infant Industry' from competition**

To prevent **'Dumping'** of low price goods (from Asia)

To protect **domestic workers** (and industry)

For **political purposes** i.e. US embargo of Cuba

How a Government Intervenes

1. **Tariffs**
   - Tariffs increase the price of an imported good (after it arrives). This can be ad valorem (% of selling price) or a specific 'duty' amount
   - Earn revenue
   - Reduce level of imports (depending on elasticity of demand)

2. **Quotas**
   - Physical limit placed by government on the import limit of a good
   - Raises no revenue
   - Limits market size

3. **Exchange Control**
   - Allows Imports are limited to a certain money value (in foreign currency)

4. **Embargoes**
   - Complete ban on the importation of certain goods
   - Political/Health & Safety reasons

5. **Administrative Barriers**
   - "Red Tape" Obstacles for importers i.e. excessive documentation, length processing delays

6. **Subsidies**
   - Provide incentives to exporting firms to encourage exports i.e. grants, low interest loans, marketing assistance