# International Trade

Trading Goods and Services

# Specialization and Trade: Everyone Benefits

- Specialization: We specialize by doing just one kind of job or producing one kind of product or service.
- We then engage in ***voluntary exchange,*** buying goods and services from others, that we cannot produce ourselves.

# Specialization and Trade: Everyone Benefits

- Specialization increases the total amount of things a society can produce and leads to an efficient use of resources.
- In a similar way:
  - All nations benefit when regions and nations specialize in producing things we cannot produce as cheaply and easily.

# A nation's products depend on its resources:

- Natural resources such as land, water, metals, and climate
- Resources also include:
  - Educated workers
  - Capital goods (computers and other machines)

# Trade

- Each nation sells some of its products to other nations.
- Then it buys things from other nations that it can't produce easily itself.
- This activity is called: TRADE

# Exports and Imports

- Exports:  Goods and services sold to other nations.
- Imports:  Goods and services bought from other nations.

# Specialization and Trade: Everyone Benefits

- Specialization and trade increase the amount and variety of goods available to all nations.
- Big, wealthy nations with many resources benefit from trade just as much as smaller, poorer nations.
- To see why, we look at comparative advantage.

# Comparative advantage

- No region in the continental U.S. has the right climate for growing coffee beans or tea leaves.
- Therefore, we import coffee and tea from other nations, in exchange for manufactured goods.
- We also import goods that we could make ourselves, if we are willing to pay the opportunity costs.

# Comparative advantage vs. Absolute advantage

- Example:
  - The U.S. can produce more sugar than the small nation of Nicaragua.
  - The U.S. can also produce more fertilizers than Nicaragua.
  - Therefore, the U.S. has an **absolute advantage** over Nicaragua in both areas.

# Comparative advantage vs. Absolute advantage

- However, the opportunity cost of producing sugar is higher in the U.S. than it is in Nicaragua.
- To grow and refine enough sugar to supply our nation’s demand, we would need to take land, capital, and workers away from producing other things, such as fertilizer, that we produce more efficiently and profitably.

# Comparative advantage vs. Absolute advantage

- Nicaragua can produce sugar very cheaply, while the opportunity cost of trying to produce their own fertilizer would be too high.
- The U.S. has a ***comparative advantage*** over Nicaragua in producing fertilizer, so we export fertilizer to Nicaragua.

# Comparative advantage vs. Absolute advantage

- Nicaragua has a ***comparative advantage*** over the U.S. in producing sugar, so Nicaragua exports sugar to the U.S.

**Table A** shows the total pounds of each product that the two nations could produce, using the same amount of resources and the same number of workers.

**TABLE A**

| | **Sugar** | **Fertilizer** |
|---|---|---|
| **U.S.** | 80 | 100 |
| **Nicaragua** | 70 | 50 |
| **TOTAL** | 150 | 150 |

- The U.S. has an absolute advantage in both products.
- The U.S. has a ***comparative advantage*** in making fertilizer, because it can make more fertilizer than sugar, using the same amount of resources.
- Nicaragua has a ***comparative advantage*** in growing sugar because it can produce more sugar than fertilizer, using the same amount of resources.

Now imagine that Table B shows the total pounds of each product that the two nations could produce in the U.S. decides to specialize in fertilizer and Nicaragua decides to specialize in sugar. When the two nations specialize and trade, the total amounts of both sugar and fertilizer increase.

**TABLE B**

| | Sugar | Fertilizer |
|---|---|---|
| **U.S.** | 0 | 200 |
| **Nicaragua** | 200 | 0 |
| **TOTAL** | 200 | 200 |

# Comparative advantage vs. Absolute advantage

- There are some industries in which neither of two nations has a comparative advantage, but they still both benefit from trading similar items with each other.
- Example:  The Japanese specialize in small cars, while the U.S., specializes in larger cars and trucks.
- Trading allows consumers in both countries to choose among a wider variety of vehicles.

# Balance of Trade and Balance of Payments

- A nation's **Balance of Trade** is the difference between the value of its imports and the value of its exports in a given year.
- Example: If a nation imports $1 million worth of goods and services in the year 2007 and exports $3 million worth of goods and services, it has a positive balance of trade, or a **trade surplus**, of $2 million.

# Balance of Trade and Balance of Payments

- **Trade Deficit**
  - If a nations imports are worth \$3 million and its exports are worth \$1 million, it has a negative balance of trade or a **trade deficit**, or -\$2 million.

# Balance of Trade and Balance of Payments

- A nation's balance of trade represents only part of its economic transactions with other nations.
- To get a fuller picture, look at other transactions between the households, firms, and governments of one nation and those of other nations.

# Balance of Trade and Balance of Payments

- These transactions include:
  - Transfer payment between individuals or households
  - Tourism
  - Military spending
  - Interest payments on loans
  - Corporate dividends
  - The buying and selling of land and businesses
  - Bank deposits
  - Buying and selling of currency

# Balance of Trade and Balance of Payments

- Any transaction that brings money into a nation is a **credit**.
- Any transaction that takes money out of a nation is a **debit.**
- The difference between the total amount of money coming into a nation and the total amount leaving is called its **balance of payments.**

# Balance of Trade and Balance of Payments

- Ideally, a nation’s balance of payments should be zero or a positive number.
- Just as in a family budget, the amount of money going out should not be greater than the amount of money coming in, or the nation will be in debt.
- In recent decades, the U.S. has suffered from a negative balance of payments because of our trade deficit.
- (Including the cost of imported oil, foreign aid, and military investment abroad.)

# Terms

- Goods and services bought from other nations:

- Imports

# Terms

- Goods and services sold to other nations.
- Exports

# Terms

- Ability to make more of something than another nation can make.
- Absolute advantage

# Terms

- Ability to make something at lower opportunity costs than another nation can make.
- Comparative advantage

# Terms

- Situation that exists when a nation's imports are worth more than its exports.

- Trade deficit

# Terms

- Situation that exists when a nation's exports are worth more than its imports.

- Trade surplus

# Terms

- Difference between a nation’s credits and a nation’s debits.
- Balance of payments

# Terms

- Any transaction that brings money into a nation.

- Credit

# Terms

- Any transaction that takes money out of a nation.

- Debit

# Thinking it Through

- In the year 2000, nation A sold exports worth \$5 million and bought imports worth \$8 million. Which of the following statements is DEFINITELY true about nation A in the year 2000?
- A. It had a positive balance of payments.
- B. It had a negative balance of payments.
- C. It had a trade surplus.
- D. It had a trade deficit.

# Answer:

- D. Trade deficit.

# Thinking it Through

- Countries A and B will probably NOT trade power tools and corn if which of the following is true?
- A. Country A can produce more power tools and corn than country B.
- B. Country B can produce enough power tools and corn to satisfy the demand of its public.
- C. The opportunity costs of producing power tools and corn are the same in both countries.
- D. The opportunity cost of producing power tools is greater in country A than it is in country B.

# Answer

- C. The opportunity costs of producing power tools and corn are the same in both countries.

# Thinking it Through

| | **Corn** | **Soybeans** |
|---|---|---|
| U.S. | 75 | 100 |
| Russia | 60 | 40 |

**Imagine that the table shows how many thousands of bushels of corn and soybeans the U.S. and Russia can produce in one day. Which conclusion can be drawn?**

A. The U.S. has an absolute advantage in corn; Russia has an absolute advantage in soybeans.

B. The U. S. has an absolute advantage in soybeans; Russia has an absolute advantage in corn.

C. The U.S. has an absolute advantage in both crops.

D. Russia has an absolute advantage in both crops.

# Answer:

- C. The U.S. has an absolute advantage in both crops.