Test Yourself: International Trade

The only way in which a durable peace can be created is by world-wide economic activity and international trade.

James Forrestal

What are imports?

Imports are goods and services purchased from foreign sources.

What are exports?

Exports are goods and services sold to foreign buyers.

What is the trade balance?

The trade balance is the difference between the value of exports and the value of imports.

Trade balance = exports – imports

Any imbalance in America's trade must be offset by reverse imbalances elsewhere.

What is a trade deficit?

A ***trade deficit*** is the amount by which the value of imports exceeds the value of exports in a given time period.

What is a trade surplus?

A ***trade surplus*** is the amount by which the value of exports exceeds the value of imports in a given time period.

What are production possibilities?

Production possibilities are the alternative combinations of final goods and services that could be produced in a given time period with all available resources and technology.

The gains from trade can be illustrated using production possibilities curves.

What are consumption possibilities?

Consumption possibilities are the alternative combinations of goods and services that a country could consume in a given time period.

In the absence of trade, a country's consumption possibilities are identical to its production possibilities, i.e. it consumes what it produces.

When a country engages in international trade, *its consumption possibilities always exceed its production possibilities*.

What is opportunity cost?

Opportunity cost is the most desired goods or services that are forgone in order to obtain something else.

What is comparative advantage?

Comparative advantage is the ability of a country to produce a specific good at a lower opportunity cost than its trading partners.

Comparative advantage refers to the relative (opportunity costs) of producing particular goods.

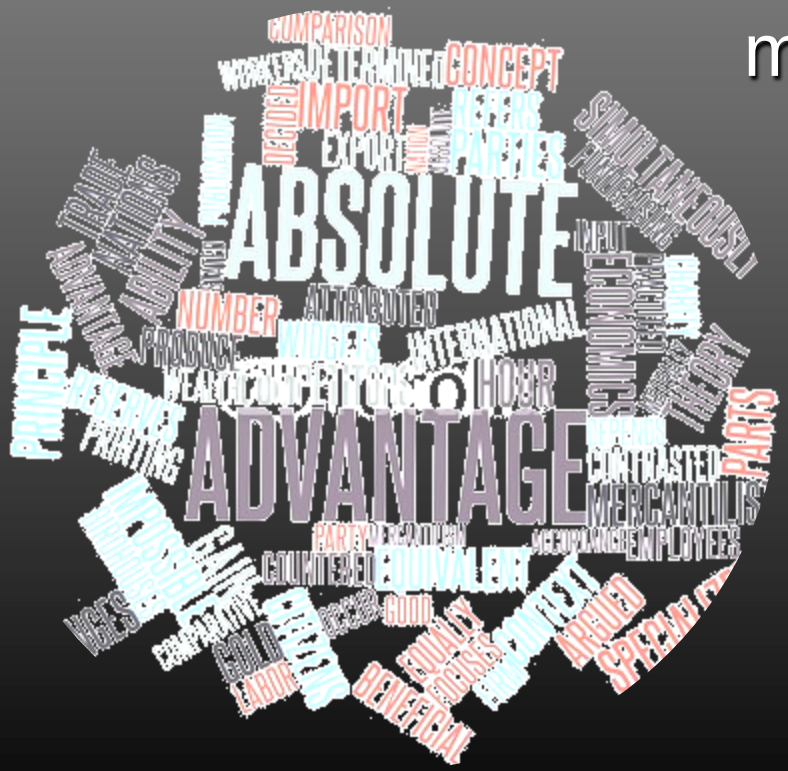
The decision to export is based on comparative advantage.

World output, and thus potential gains from trade, will be maximized when each country pursues its comparative advantage.

What is absolute advantage?

Absolute advantage is the ability of a country to produce a specific good with fewer resources (per unit of output) than other countries.

The absolute advantages in production do not matter.



What are terms of trade?

Terms of trade is the rate at which goods are exchanged – the amount of good A given up for good B in trade.

The terms of trade establish the trading rate.

A country will not trade unless the terms of trade are superior to domestic opportunities.

The terms of trade between two countries will lie somewhere between their respective opportunity costs in production.

Who makes the decision to import or export a particular good?

The decision to import or export a particular good is often left up to the market decisions of individual consumers and producers.

The terms of trade, like the price of any good, will depend on the willingness of market participants to buy or sell at various prices.

What is the relationship between imports and domestic industries?

Imports typically compete with domestic industry.

Affected industries will try to restrict imports in order to preserve their own jobs and incomes.

Workers and producers who compete with imported products – who work in import-competing industries – have an economic interest in restricting trade.

Trade not only alters the mix of output but also redistributes income from import-competing industries to export industries.

Trade restrictions designed to protect specific interests reduce the total gains from trade.
What other arguments are used to restrict trade?

Other arguments used to restrict trade are:

- national security concerns
- dumping
- infant industries
- terms of trade

What is the national security argument for restricting trade?

Essential defense-related goods are vital during times of war.

A war could disrupt this flow leaving us vulnerable.

Too, exporting vital technology to a potential enemy is not wise.

What is the dumping argument for restricting trade?

Import-competing industries are placed at risk when goods are consistently dumped in a nation.

Dumping is the sale of goods in export markets at prices below domestic prices.

What is the infant industries argument for restricting trade?

Even normal export prices might make it difficult or impossible for a new domestic industry to develop.

These industries may need temporary protection from imports.

(But trade restrictions are justified only if there is tangible evidence that the industry can develop a comparative advantage reasonably quickly.)

What is the terms of trade argument for restricting trade?

The distribution of the gains from trade depends on the terms of trade.

Putting restrictions on imports can move the terms of trade in our favor

We would end up with a larger share of the gains from trade.

What is the impact of protectionist policies?

Protectionist policies reduce the quantities of foreign goods and services supplied to the country that imposes the restriction. Such policies shift the supply curve to the left for the good or service whose imports are restricted.

What are embargoes?

The sure-fire way to restrict trade is simply to eliminate it.

An ***embargo*** is a prohibition against trading particular goods.

What is an equilibrium price?

The equilibrium price is completely determined by domestic demand and supply curves.

Equilibrium price is the price at which the quantity of a good demanded in a given time period equals the quantity supplied.

What is a tariff?

A more frequent trade restriction is a tariff.

A ***tariff*** is a tax (duty) imposed on imported goods.

A tariff on imported goods makes them more expensive to domestic consumers and less competitive with domestically priced goods.

"This is great. They're inflatable trade barriers !"

What is the “Beggar-Thy-Neighbor” result of tariffs?

The curtailment of imports looks like an easy solution to the problem of domestic unemployment.

But tariffs inflict harm on foreign producers.

When foreign countries retaliate with tariffs of their own, world trade shrinks and unemployment increases in all countries.

Domestically, tariffs raise the price of imports and shift the import supply curve upward.

Domestic prices rise, domestic production rises and domestic consumption falls.

What are quotas?

The same effects of a tariff can be attained more directly by imposing an import quota.

A ***quota*** is a limit on the quantity of a good that may be imported in a given time period.

The effect of quotas on trade is different than the effect of tariffs.

Quotas are a greater threat to competition than tariffs because quotas preclude additional imports at any price.

What are voluntary restraint agreements?

Voluntary restraint agreements are a variant of quotas that has been used in recent years.

A ***voluntary restraint agreement*** (***VRA***) is an agreement to reduce the volume of trade in a specific good – a “voluntary” quota.

What other methods are used to restrict trade?

Embargoes, export controls, tariffs and quotas are the most visible barriers to trade, but they are only the tip of the iceberg.

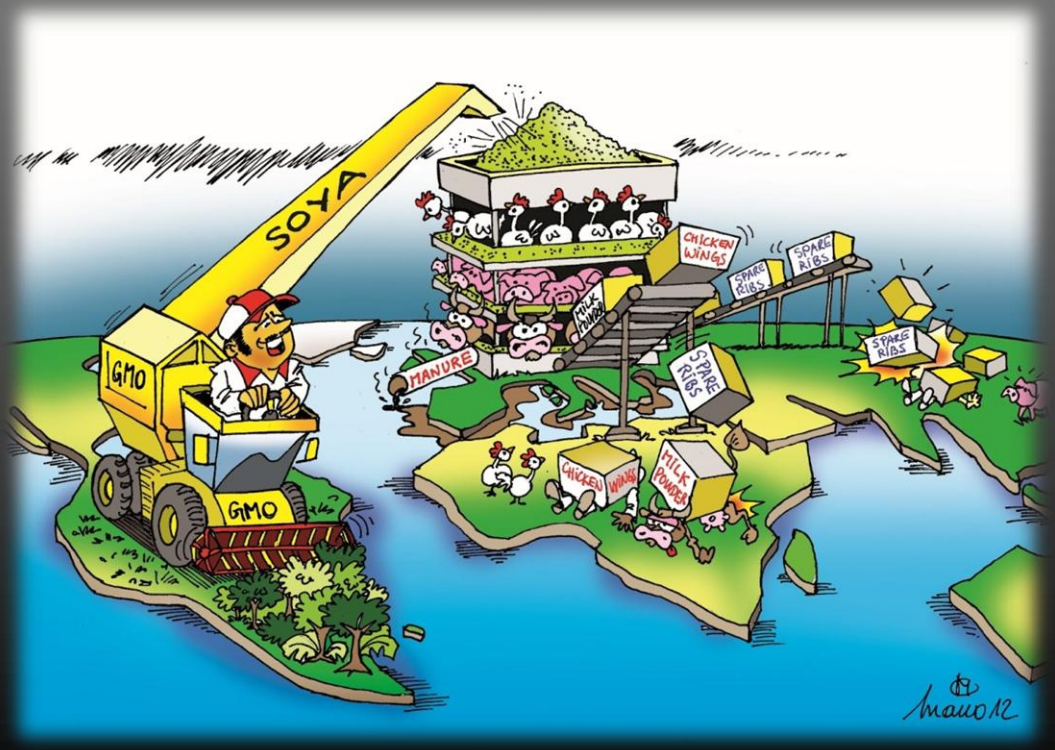
The US restricts roughly 15% of imports using:

- product standards
- licensing restrictions
- restrictive procurement practices
- other nontariff barriers

What are the results of free trade?

Free trade allows the import of an unlimited quantity of foreign supplies at the world price.

Free trade results in reduced prices and increased consumption.



What are multilateral trade pacts?

The granddaddy of the multilateral, multiyear free-trade pacts was the ***General Agreement on Tariffs and Trade*** (GATT).

The 1994 GATT pact created the ***World Trade Organization*** (WTO) to enforce free-trade rules.

The WTO has become the world's trade police force.

What are regional trade pacts?

Groups of nations have moved even faster toward open markets by developing regional trade pacts.

In December 1992, the United States, Canada and Mexico signed the ***North American Free Trade Agreement*** (NAFTA).

The ultimate goal of NAFTA is to eliminate all trade barriers between these three countries.

What is the EU?

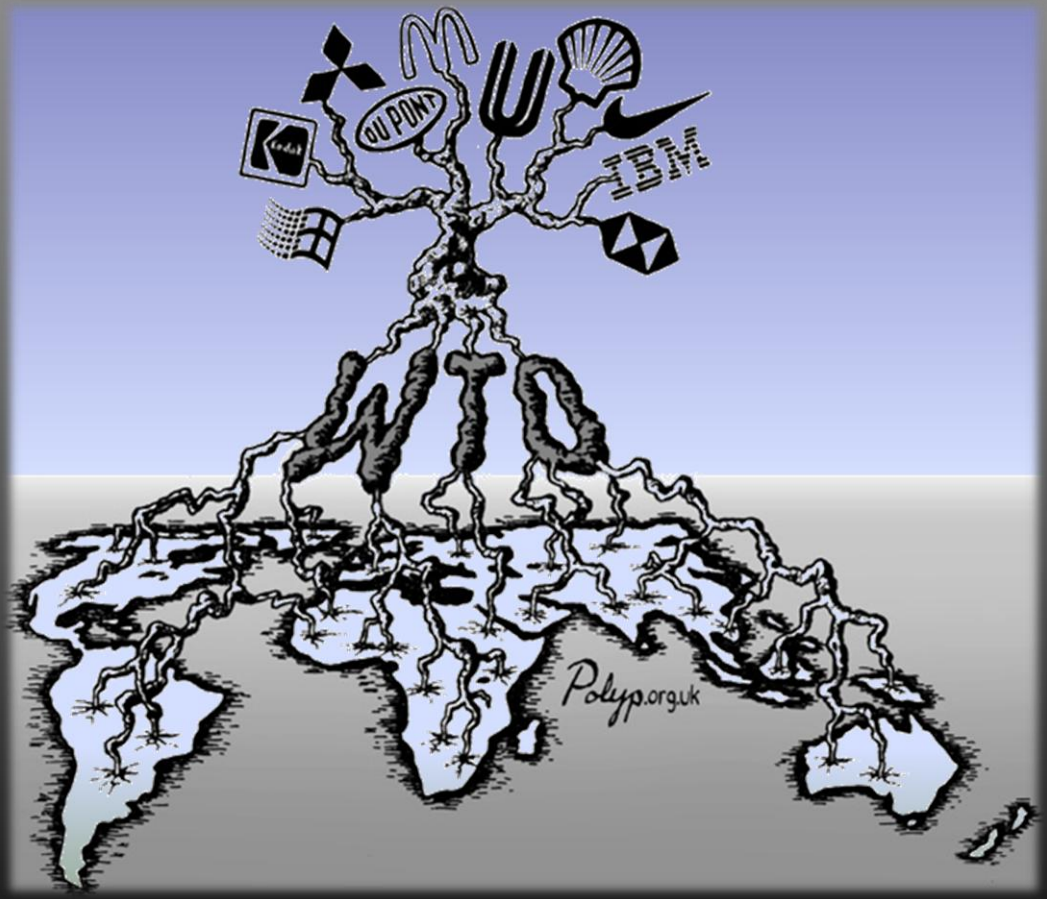
The ***European Union*** (EU) is a regional pact that virtually eliminates national boundaries between 15 countries.

The EU has not only eliminated trade barriers, but also permitted full inter-country mobility of workers and capital.

In 1999, eleven of the EU nations also created a new currency (the euro) that replaced the German mark, the French franc and other national currencies.

In effect, Europe has become one large unified market.

How did you do?! If you didn't do as well as you'd like, review the margin notes and presentations and test yourself again.



THE END