

International Trade

Elias Yannopoulos

November 26, 2012

Why do we trade?

- Easter Island example of trade
- What happens when there is no trade?
- You have to produce everything you consume
(Protectionism)
- With trade you can produce only some (or none) of what you consume
- Specialization in production and trade **(Free Trade)**
- Remember voluntary trade helps both sides
- We trade because production cost are too high (opportunity cost)
- Produce if and only if: your production costs $<$ Cost of buying

Absolute Advantage

- First, **Absolute Advantage** - The ability to produce using less resources than others
- Micro example, Macro example
- When each party has an absolute advantage in a different good then specialization is obviously beneficial
- It is still beneficial to specialize and trade even if a country has an absolute advantage in all goods (proof to come)
- In order to understand the benefits of trade we need to know about comparative advantage
- **Comparative Advantage** - The ability to produce something at a lower opportunity cost than other producers