

International economic issues

A-Level Economics

Why countries trade

international trade 国际贸易 lets countries buy and sell with each other. Trade lets each country **specialise** 专业化 in what it makes best, so the world makes more in total.



A container port: international trade moves goods between countries in huge volumes

Image: Trougnouf, CC BY 4.0 (commons.wikimedia.org)

Absolute and comparative advantage

- a country has an **absolute advantage** 绝对优势 in a good if it can make **more** of it with the same resources than another country.
- a country has a **comparative advantage** 比较优势 in a good if it can make it at a **lower opportunity cost** 机会成本 than another country.

Comparative advantage is the key idea: a country should make the goods it gives up least to produce, and trade for the rest. Look at this example, where each country uses the same resources:

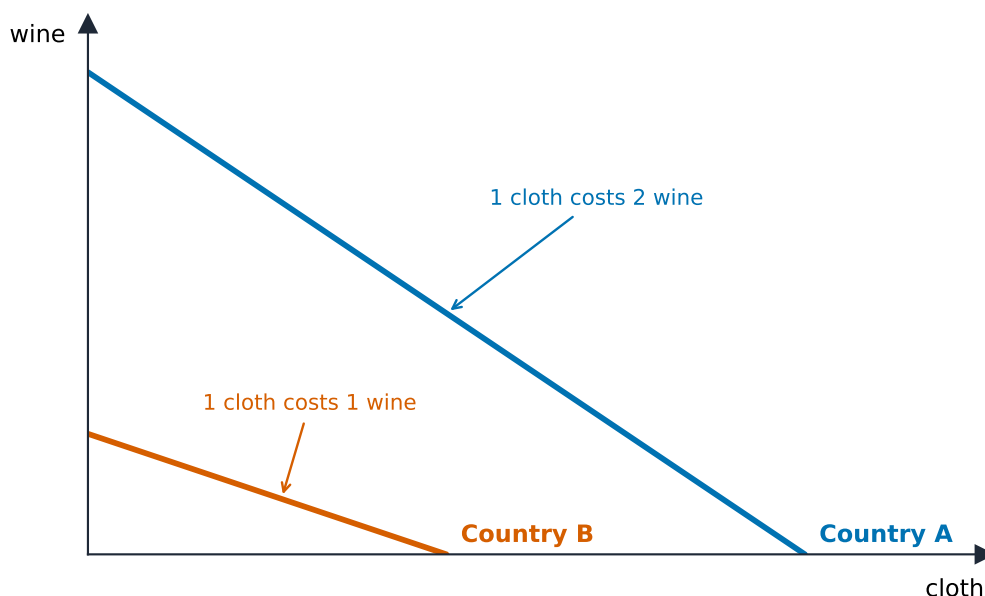
Country	Wine (units)	Cloth (units)
Country A	20	10
Country B	5	5

Country A is better at both (absolute advantage in both). But think about opportunity cost:

- in A, making 1 cloth means giving up 2 wine.

- in B, making 1 cloth means giving up 1 wine.

So B gives up less to make cloth —B has the comparative advantage in cloth. A has it in wine. If A makes only wine and B makes only cloth, and they trade, **both** can end up with more than before.



Country A can make more of both goods, but its PPC is steeper: it gives up 2 wine per cloth, while B gives up only 1, so B has the comparative advantage in cloth.

Terms of trade

The **terms of trade** 贸易条件 measure the price of a country's exports compared with the price of its imports. It is worked out as an index:

$$\text{terms of trade} = \frac{\text{index of export prices}}{\text{index of import prices}} \times 100.$$

If export prices rise faster than import prices, the terms of trade "improve" —the country can buy more imports for the same exports.

Worked example. Over a year, a country's export price index rises from 100 to 110, while its import price index rises from 100 to 105. Find the new terms of trade.

$$\text{terms of trade} = \frac{110}{105} \times 100 = 104.8.$$

The figure is above 100, so the terms of trade have **improved**: each unit of exports now buys about 4.8% more imports than before.

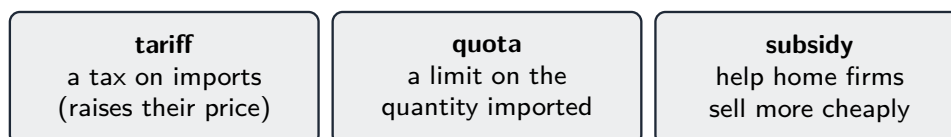
Limits of the theory

The gains are real, but the simple theory assumes no transport costs, no trade barriers, and that costs do not change with output. In the real world these do not fully hold, and

specialising in one good is risky if its price falls.

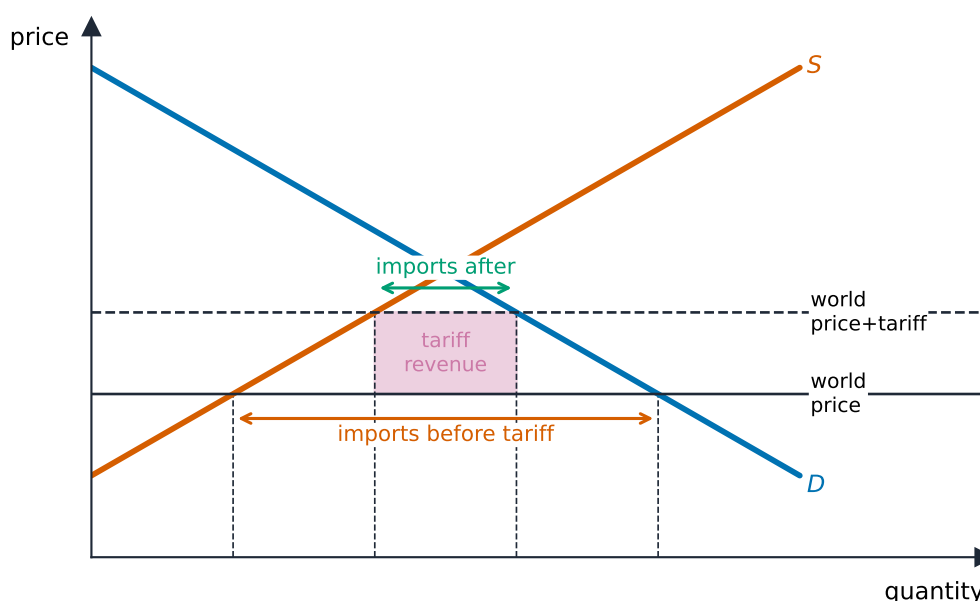
Protectionism

protectionism 贸易保护主义 means a government protecting home producers from foreign competition. The main tools:



Three tools of protection: tariffs, quotas and subsidies

- a **tariff** 关税—a tax on imports, which raises their price.
- a **quota** 配额—a legal limit on the quantity of a good that may be imported.
- a **subsidy** 补贴 to home producers, so they can sell more cheaply than foreign rivals.
- an **embargo** 禁运—a complete ban on trade with a country or in a good.
- **administrative barriers** 行政壁垒—extra paperwork and tough standards that make importing hard.



A tariff raises the price from the world price to "world price + tariff": domestic supply rises, demand falls, and imports shrink; the shaded box is the government's tariff revenue.

For and against

Arguments **for** protection include protecting an **infant industry** 幼稚产业 (a young industry that needs time to grow), saving jobs, and stopping **dumping** 倾销 (foreign firms selling below cost to destroy local rivals).

Arguments **against** are strong: protection raises prices for consumers, protects weak firms so they stay inefficient, and can lead to **retaliation** 报复—other countries hitting back with their own barriers.

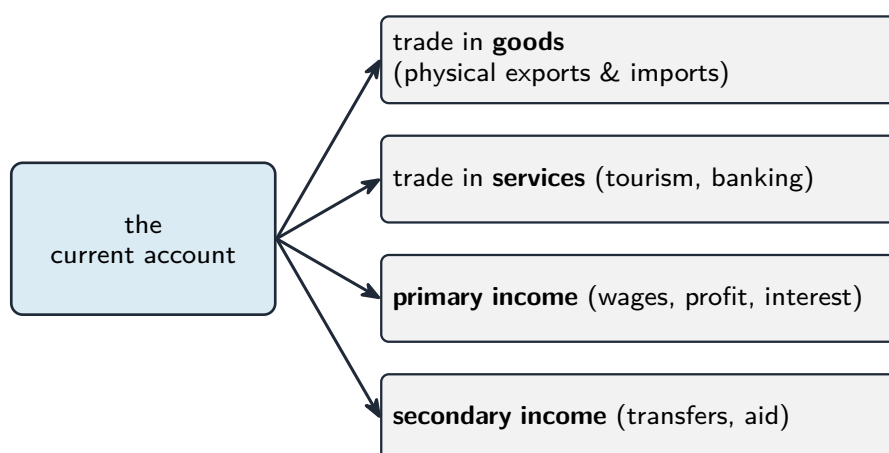
Effects on stakeholders

A tariff affects each **stakeholder** 利益相关者 differently: home producers gain, the government gains tariff revenue, but consumers lose (higher prices, less choice) and foreign producers lose sales.

The balance of payments

The **balance of payments** 国际收支 is a record of all money flows between one country and the rest of the world. Its most-studied part is the **current account** 经常账户, which has four parts:

- **trade in goods** 货物贸易—exports and imports of physical goods.
- **trade in services** 服务贸易—exports and imports of services (tourism, banking).
- **primary income** 初次收入—income from work and investment abroad (wages, profit, interest).
- **secondary income** 二次收入—transfers with nothing given back, like foreign aid.



The current account adds up four flows: trade in goods and services, plus primary income (from work and investment) and secondary income (transfers)

A **current account deficit** 经常账户赤字 means a country buys more from abroad than it sells. A **current account surplus** 经常账户盈余 is the opposite. A long deficit can mean rising debt to other countries; a large surplus can mean the country saves a lot but consumes little.

Exchange rates

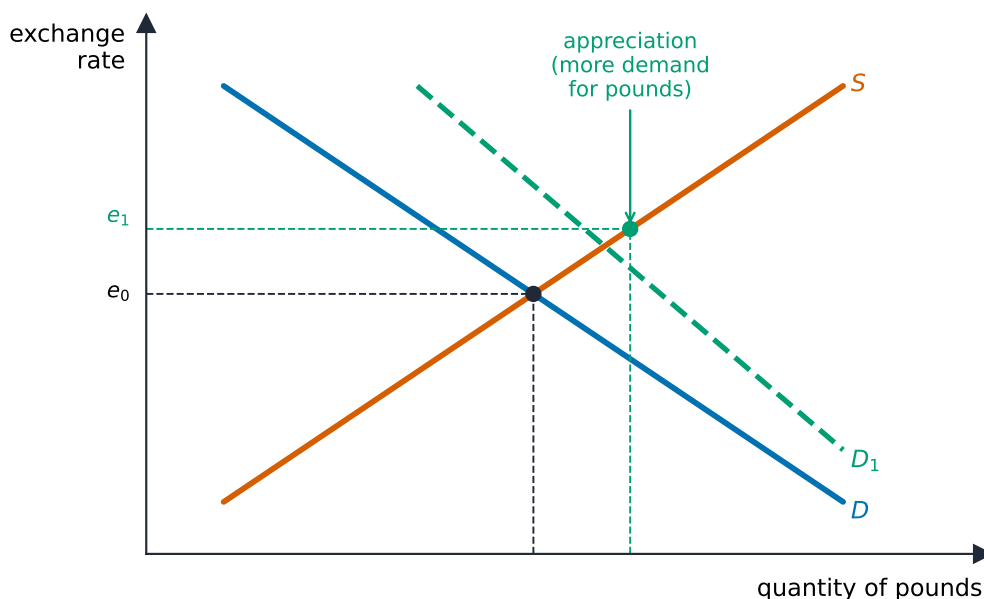
An **exchange rate** 汇率 is the price of one currency in terms of another. There are three main systems.



A currency exchange: the exchange rate is the price of one currency in terms of another.

Image: D-Stanley, CC BY 2.0 (commons.wikimedia.org)

- a **floating exchange rate** 浮动汇率 is set freely by the demand for and supply of the currency. If more people want a currency (to buy its exports), its value rises.
- a **fixed exchange rate** 固定汇率 is held at a set value by the central bank, which buys and sells the currency to keep it there.
- a **managed exchange rate** 管理浮动汇率 mostly floats, but the central bank steps in now and then to steady it.



A floating exchange rate is set where demand for the currency meets supply. More demand for pounds ($D \rightarrow D_1$) raises the rate —an appreciation.

Appreciation and depreciation

Under floating rates:

- **appreciation** 升值 is a rise in the currency's value. Exports become dearer for foreigners, and imports become cheaper.
- **depreciation** 贬值 is a fall in the currency's value. Exports become cheaper, and imports become dearer.

A depreciation can therefore raise export sales and cut imports, helping the current account —but it can also raise inflation, because imports cost more.

Worked example. Suppose the exchange rate is $\text{£}1 = \$1.40$.

A UK exporter's $\text{£}200$ machine costs an American buyer $\text{£}200 \times 1.40 = \280 . If the pound then appreciates to $\text{£}1 = \$1.60$, the same machine costs $\text{£}200 \times 1.60 = \320 —dearer for the American, so fewer are sold. Going the other way, a $\$700$ invoice from a US supplier costs a UK firm $\$700 \div 1.40 = \text{£}500$.

Correcting a current account deficit

A government can use three kinds of policy to cut a deficit:

- **expenditure-reducing** 支出减少 policies lower total demand (higher taxes or interest rates), so people buy fewer imports. But they also slow growth and raise unemployment.
- **expenditure-switching** 支出转换 policies move spending away from imports towards home goods (a tariff, or a lower exchange rate). But they can cause retaliation or inflation.

- **supply-side** policies raise the **competitiveness** 竞争力 of home firms (better skills and technology), so exports rise. These work best in the long run but are slow.

Exam tips

- Explain **comparative advantage** through opportunity cost (specialise where you give up least) and state its assumptions and limits.
- Evaluate **protectionism** (tariffs, quotas): it can protect jobs but raises prices and risks retaliation.
- Read the **balance of payments** (the current account covers trade, income and transfers).
- A **depreciation** makes exports cheaper and imports dearer, helping the current account only if demand is elastic enough (Marshall-Lerner).