

CHAPTER 8: GAINS FROM TRADE

MAIN IDEA: specialize according to comparative advantage & then trade to maximize gains from trade

gains from trade: = benefits that come from reallocating resources, goods & services to better uses

↳ arise largely from opportunity costs

Law of Specialization: = do what you have the comparative advantage in

comparative advantage: to be better by comparison

↳ lower opportunity cost

absolute advantage: to be better by some objective measurement

↳ uses fewer resources

DAILY PRODUCTION
(1) loads of laundry (2) rounds of dishes

A	5	5
B	2	4

- A has absolute advantage in (1) & (2)
- B has comparative advantage in (2)
- A opportunity cost in (2) is 1 (1)
- B opportunity cost in (2) is 1/2 (1)
- A has comparative advantage in (1)
- A opportunity cost in (1) is 1 (2)
- B opportunity cost in (1) is 2 (2)

WHO SHOULD DO SOMETHING?

ROADMAP: imagine person A does it & calculate their opportunity cost

imagine person B does it & calculate their opportunity cost

calculating opportunity cost: OUTPUT APPROACH | INPUT APPROACH

ability per resource | resource per ability
 • $OC = \frac{\text{giving up}}{\text{doing}}$ | • $OC = \frac{\text{doing}}{\text{giving up}}$

person w/ the lower opportunity cost has the comparative advantage & should do it

Division of Labor: each person specializes in one small part of the production process

CHAPTER 9: INTERNATIONAL TRADE

We use the PPFs of countries to determine opportunity costs & therefore comparative advantage

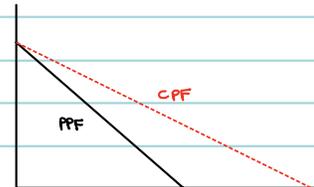
Law of Comparative Advantage: the country w/ the lower opp cost should specialize in production

prices: signals, incentives, bundles of info ... higher opp cost → higher price

price differences between countries → International Trade

terms of trade: = the ratio at which a country can trade domestic goods for imported goods

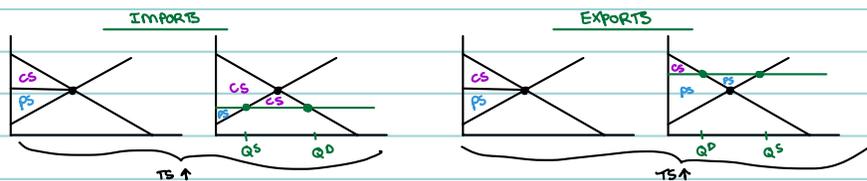
with trade, we can construct a consumption possibility frontier, outside of the PPF



Reasons for Comparative Advantage

- differences in resource endowment (Heckscher-Olin Theorem: more resources → comparative advantage)
- skills / know how / technology
- economies of scale

WELFARE WITH TRADE:

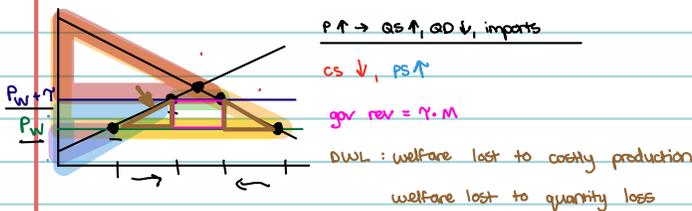


trade balance = exports - imports

trade surplus: exports > imports

trade deficit: imports > exports

BARRIERS TO TRADE



PROTECTIONISM:

PROS: National defense income Infant industry antidumping / retaliation regulations	CONS: DWL indirect effects rent seeking retaliation discourages innovation
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