

## 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 or 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

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

ability per resource

$$OC = \frac{\text{giving up}}{\text{doing}}$$

INPUT APPROACH

resource per ability

$$OC = \frac{\text{doing}}{\text{giving up}}$$

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

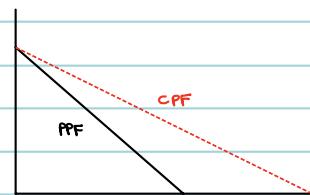
With trade, we can construct a consumption possibility frontier, outside of the PPF

Reasons for Comparative Advantage

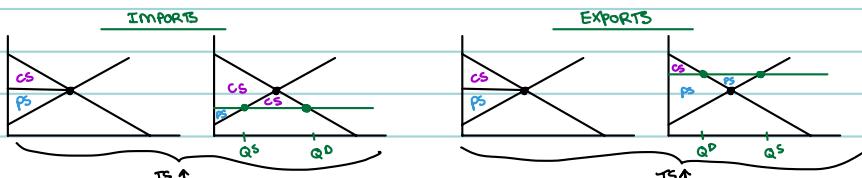
· differences in resource endowment (Heckscher-Ohlin Theorem: more resources → comparative advantage)

· skills / know how / technology

· economies of scale



WELFARE WITH TRADE:

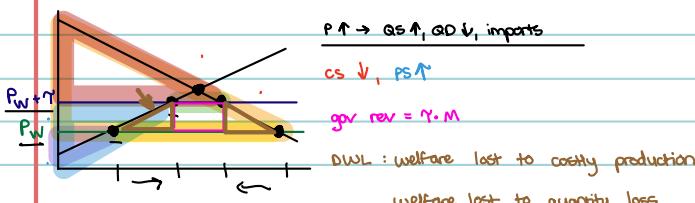


trade balance = exports - imports

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