THE FEDERAL RESERVE BANK OF ATLANTA

# Trade

Why do nations trade?

INTERNATIONAL ECONOMICS

## Trade Terminology

**Individuals, businesses, and countries exchange goods and services when the parties involved expect mutual benefits.**

### FACTORS OF PRODUCTION (productive resources)

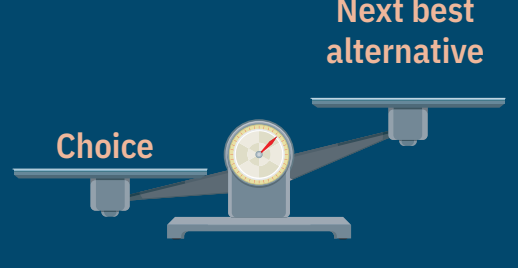
LAND (natural resources)

LABOR

CAPITAL

Entrepreneurship

### OPPORTUNITY COST




The value of the forgone alternative when making a choice

### SPECIALIZATION

Produce both? Or just one?

### IMPORTS

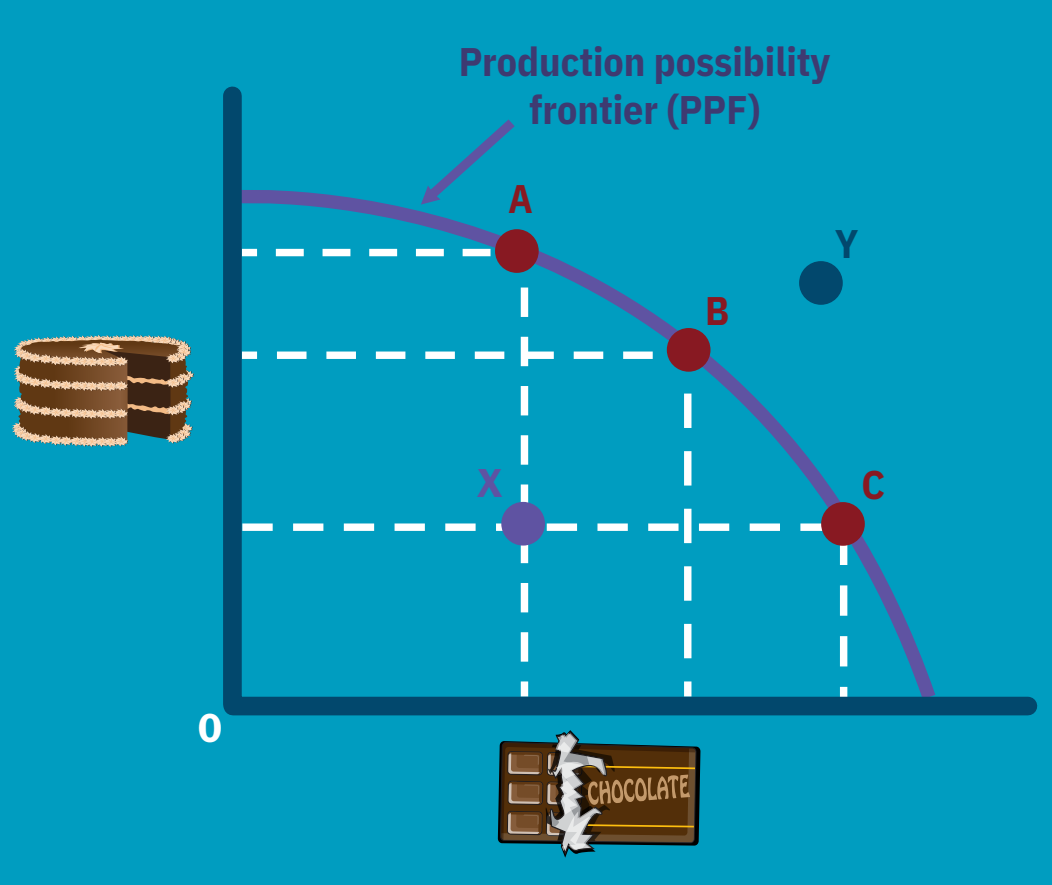
Goods and services

### EXPORTS

Goods and services

## Production Possibilities Frontier

**The graph below represents the trade-offs an economy faces given fixed resources and an economy at full employment. In such an economy, these are the maximum outputs possible given specific inputs (productive resources).**




**A, B, & C**
Examples of production combinations at which the production of chocolate cakes and chocolate bars is most efficient

**X**
A point at which resources are not being used efficiently to produce chocolate cakes or chocolate bars

**Y**
A point at which output is not attainable based on the current production resources

## Absolute versus Comparative

### Output per hour of labor

| | Chocolate bars | Cakes |
|---|---|---|
| Country A | 20 | 4 |
| Country B | 10 | 5 |

### Opportunity cost

| | 1 chocolate bar | 1 cake |
|---|---|---|
| Country A | 1/5 cake | 5 bars |
| Country B | 1/2 cake | 2 bars |

### Absolute advantage

The ability to produce a larger amount of a good or service than another producer given the same input

Country A has the absolute advantage in producing chocolate bars. Country B has the absolute advantage in producing cake.

### Comparative advantage

The ability to produce a good or service at a lower opportunity cost than the other producer

Country A has the comparative advantage in producing chocolate bars. Country B has the comparative advantage in producing cake.

## Trade Barriers

### Quotas

Limits on the quantity of imports

### Export Restrictions

Self-imposed limits on the quantity of exports

### Tariffs

Taxes on imports

### Subsidies

Payments to the producers of certain goods for export or to producers competing against imports

## Free Trade versus Protectionism

| Free trade | | Protectionism |
|---|---|---|
| • Promotes efficient production<br>• Stimulates economic growth<br>• Increases consumption<br>• Lowers prices | PROS | • Safeguards domestic industries and jobs<br>• Insulates infant industries |
| • Increases structural unemployment<br>• Weakens infant industries | CONS | • Allocates resources inefficiently<br>• Discourages innovation<br>• Limits variety of goods and services<br>• Raises prices |

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