

8 International Trade

8.1 Lecture 18: International Trade

8.1.1 What is international trade?

- The extent to which countries participate in international trade can be described by two quantities: **exports** (or the value of the goods a country sells to the rest of the world) and **imports** (or the value of the goods a country buys from the rest of the world)

8.1.2 Production possibilities frontier

- **Production possibilities frontier** shows the maximum combination of outputs that can be produced from a given set of inputs.
- An **economy of scope**: it is more efficient to produce goods jointly than separately. Graphically, it is represented by a convex production possibilities frontier.

8.1.3 Comparative advantage and gains from trade

- We say a country has a **comparative advantage** in the production of a good when the opportunity cost of producing a particular good is lower in any one country.
- Differences in opportunity costs lead to comparative advantage in different goods.
- Even when countries have an **absolute advantage** in producing a good, there can be comparative advantage.
- When countries have different comparative advantages in production of different goods, there are potential gains from trade through **specialization** – each country produces what it has a comparative advantage in producing.
- Comparative advantages can come from:
 - Differences in **factor endowments** (for example, Canada is a major exporter of lumber & paper products since so much of that country is forested — this gives them a comparative advantage in that area)
 - Differences in **technology** (for example, Japan is a major exporter of autos despite no natural factor endowment advantage)

8.1.4 TO KNOW – Conceptual Understanding

- Distinguish between comparative advantage and absolute advantage

8.1.5 TO KNOW – Graphical and Math Understanding

- Given costs of production for two nations, determine, for each good, which country has an absolute and/or comparative advantage
- In diagrams and math, show the welfare impact of imports and exports in US markets

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