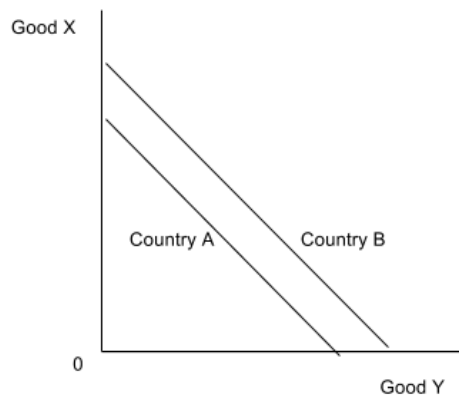


Here, it is different because Country B has the absolute advantage in both good X and Y. Thus, one must determine the comparative advantage. This can be done by looking at the steepness of the PPCs, country A is steeper meaning it has the comparative advantage of good X but country B is flatter thus has the comparative advantage in Good Y.



In this diagram the two curves are parallel to each other, meaning that they have the same opportunity cost. Thus they would not trade. This is known as **autarky prices**.

Sources of Comparative Advantage

- Resource endowments play a large role, a country that possess most of the farmable land in the region is likely to have a comparative advantage in agriculture.
- Countries that have little natural resources but a highly skilled workforce can provide services to the world. Eg. Singapore → services to the region

Determined by

1. Relative abundance of the resource
2. Value of good produced from the resource to the world market

They determine the efficiency of production and opportunity cost.

- It is difficult for countries to determine and exploit their comparative advantage.

Limitations:

- Perils of extreme specialization

A country might devote its entire resources to the production of a single good, making the nation highly dependent on the prosperity of the good. The entire income is bound to the price of the commodity. Which brings high risk to the population's well-being and place the country on a rollercoaster of volatility.

Over specialization is a risk, but moreover in the long-term if a country is trapped in a certain type of production it might limit its potential for development.

Eg. agriculture in the developing world → producing commodities of low market value.

- Unrealistic assumptions

It is criticized for being an inaccurate representation of the actual world trade;

1. Ignore transport costs which could raise costs enough to remove comparative advantage
2. Goods are assumed to be identical; goods are often differential, which makes it difficult to assess true comparative advantage
3. Perfect information about availability and prices is impossible
4. Theory assumes relatively constant costs, PPCs with constant slopes; might mask potential comparative advantage for industries that appear uncompetitive or may overestimate an advantage that is less extreme than appears
5. Two-country model is unrealistic
6. Full employment is a necessary condition of the theory but rarely occurs in practice
7. The assumption that countries practice free trade is highly debatable; many countries still protect markets which makes comparative advantage difficult to discern and harder to realize.

WTO

The World Trade Organisation

Origin:

- After WW2 the belief developed that the extremism, violence and war were a result of economic failure.
- In 1948 the world's government decided to do things differently. Thus GATT was formed with 23 members.
- 50 years later the WTO took over with 123 member states.
- Aimed at one thing; free trade

Aims:

- **Trade without discrimination:** all members must agree to Most Favoured Nation Status, all goods from WTO member countries should be treated equally. Foreign goods should be treated equally to domestic goods.
- **Freer trade through negotiation:** changes to trade policy are through direct dealing and are done gradually, allowing countries to prepare for adjustments.
- **Predictability through binding and transparency:** binding refers to the commitment among members to keep tariffs at or below certain rates allowing importers to assess markets more accurately and make better decisions. Openness also encourages more trade.
- **Promoting fair competition:** Whilst being devoted to free trade the WTO is also devoted to fair trade. Rules against dumping and intellectual property theft are aimed at increasing competition.
- **Encouraging development:** Nearly 2/3 of members are developing countries, they are granted trade concessions because their industries need time and space to grow to a level of global competitiveness.

Functions:

- Forum for trade negotiations
- Execute WTO agreements
- Evaluate and rule on trade complaints by member countries
- Provide technical assistance to developing countries on trade issues
- Track changes in member trade policies
- International banking

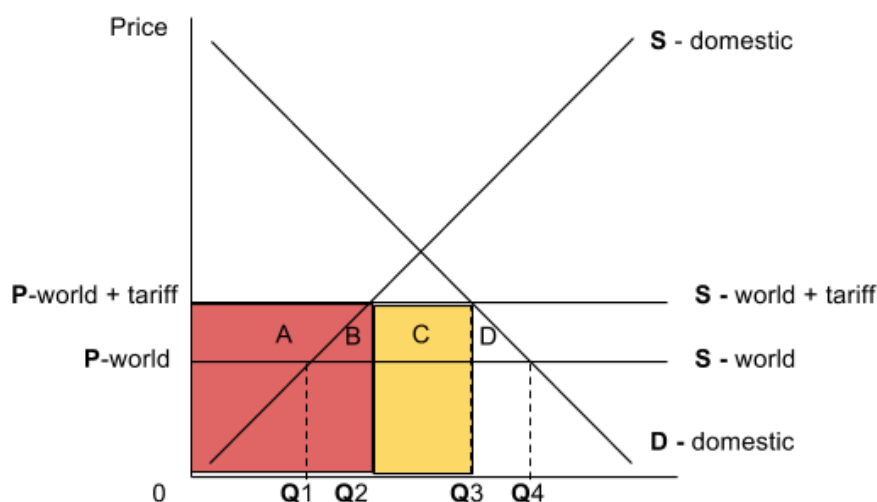
Trade Protection

Protectionism

- The placement of legal restrictions on international trade and includes tariffs, quotas, subsidies and other bureaucratic barriers.

Tariff

- A tax placed on imported goods, with attempt to restrict imports and potentially raise government revenue.



Preferential Trade Agreements

- Give preferential access to certain products from certain countries by reducing or eliminating tariffs, or by other agreements relating to trade.
- If a group of countries wish to become more open and trade more freely with each other, they may attempt to remove trade restrictions between themselves but maintain them with other countries.

Bilateral (WTO) Trade Agreements

- Preferential trade agreements between two countries
- Easier to implement

Multilateral (WTO) Trade Agreements

- Preferential trade agreements between three or more countries
- Beneficial to more people

Trading Blocs

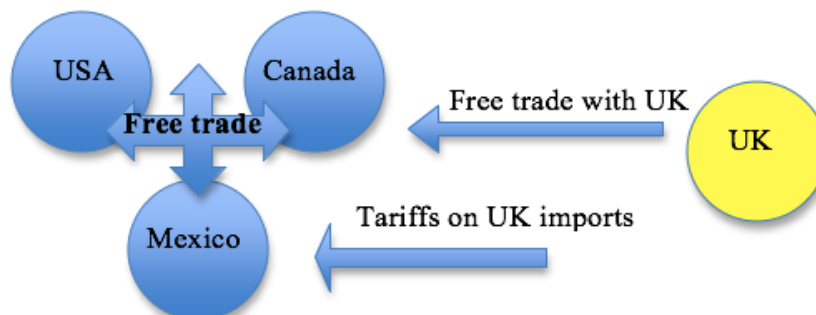
- A group of countries that join together in some form of agreement in order to increase trade between themselves and/or to gain economic benefits from cooperation.

Stage of Economic Integration	No Internal Trade Barriers	Common External Tariff	Factor and Asset Mobility	Common Currency	Common Economic Policy
Free Trade Area	X				
Customs Union	X	X			
Single Market	X	X	X		
Monetary Union	X	X	X	X	
Economic Union	X	X	X	X	X

- Economic integration will increase competition among producers within the trading bloc.
- Different forms of economic integration allow member countries to gain from economies of scale.

Free Trade Area

- Member countries remove tariffs and quotas between themselves, but retain whatever restrictions each member chooses with non-member countries.
- Some provision will have to be made to prevent imports from outside coming into the area via the country with the lowest external tariff.



- No internal trade Barriers

Customs Union

- A customs union is like a free trade area, but in addition members must adopt common external tariffs and quotas with non-member countries.

