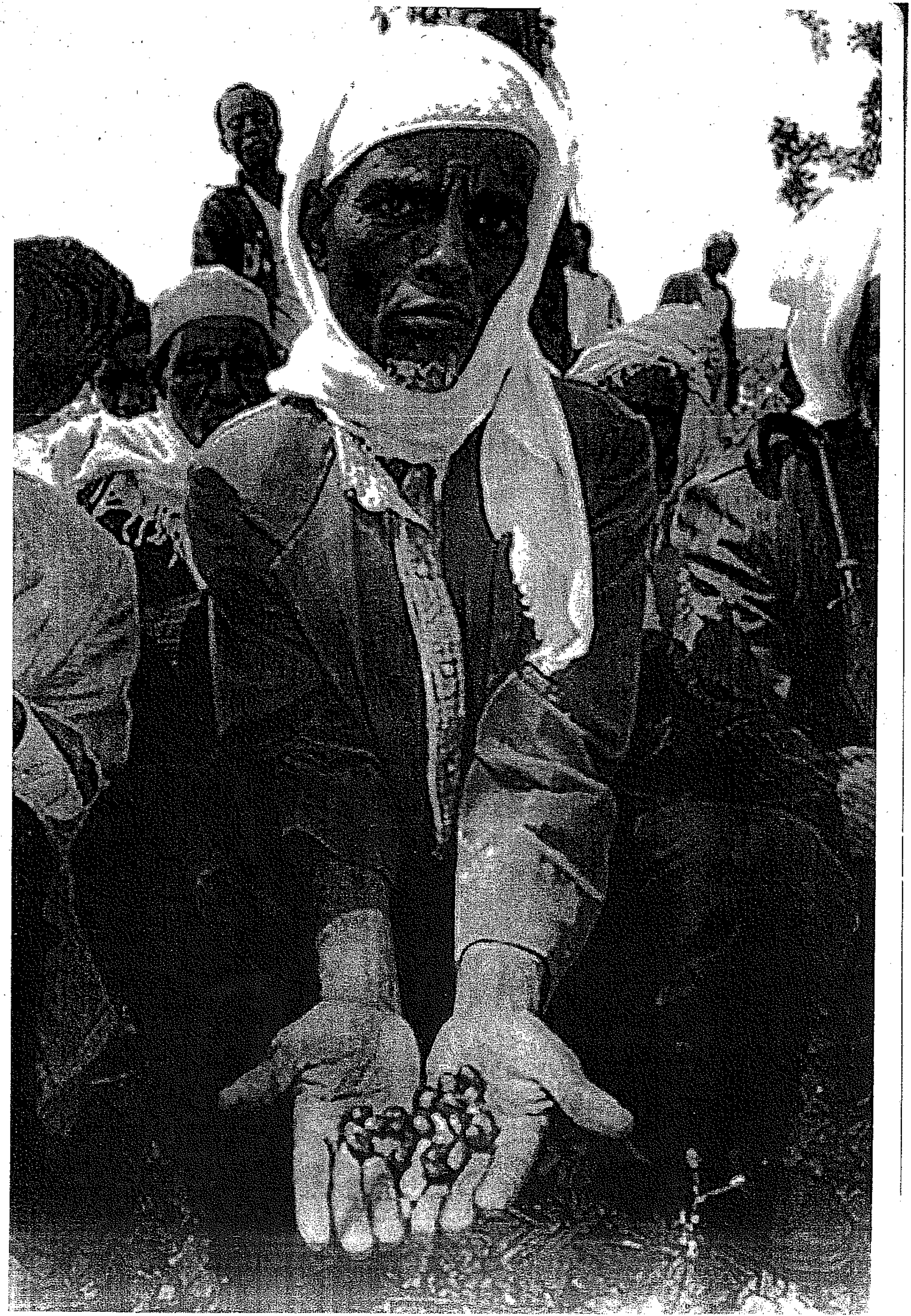


Does specialization and trade continue to provide similar economic benefits when one nation has a ABSOLUTE ADVANTAGE in production of both goods being traded?

↳ YES - why? OPPORTUNITY COST & OPPORTUNITY COST & COMPARATIVE ADVANTAGE

↳ one nation has greater advantages in some industries over others ... this is due to differences in relative efficiencies OR comparative advantage

↳ comparative advantage is all that is required to make specialization and trade possible

CANADA / MEXICO EXAMPLE - CAN. enjoys an absolute advantage over MEX. in producing both WHEAT & RADIOS

C	M			
10	2	WHEAT	→ 5:1 ratio	→ CAN. a comparative advantage in WHEAT Production OR relatively greater absolute advantage
30	10	RADIOS	→ 3:1 ratio	

production & output without specialization and trade

→ example does not account for transportation costs or the value of each country's currency

→ terms of trade difficult to predict but somewhere in betw 3 and 4

OPP. COST CAN. 1 WHEAT TO 3 RADIOS
MEX. 1 WHEAT TO 5 RADIOS

> trade 1 WHEAT FOR 4 RADIOS

↓

"terms of trade" - the rate at which a country's exports are exchanged for its imports

- both parties share the trade benefits realized through specialization & trade

* trade keeps prices competitive in both nations ... in MEX. price of RADIOS 5 times cost of WHEAT BUT with trade reduced to 4 times the cost of WHEAT

Trade Restrictions

Reasons
- ① protection of domestic industry from foreign competition
- ② protection of domestic economy from foreign influence & control (FDI)
  - ↳ ↑ imports leads to an ↑ in the outflow of domestic currency held by foreign interests

Economic Arguments

① Protection of domestic employment – ↑ imports w/out ↑ exports results in exporting jobs

② Retaliation
- reduces benefits of specialization & trade liberalization
- objective to punish more than suffer ... depends on power balance

③ Protection against dumping – protect domestic prices by eliminating surpluses

④ Diversification – hedge against economic vulnerability inherent in a reliance on few exports / single trading partner
– restrictions allow for development of new domestic industries and export markets

⑤ Protection of vital industries – restrictions on exporting products of a strategic nature or that may compromise nat'l/global security

⑥ Improvement of Terms of Trade – relationship betw control over trade volume and ability to affect prices
– leverage to negotiate more favourable terms of trade

⑦ Protection against the "race to the bottom" – maintain/enforce environmental and/or health & safety standards

** restrictions mean a trade-off betw
- global economic efficiency AND
- political/economic sovereignty of nations (stability/equity)

↳ as forces of economic globalization prevail the national agenda will continue to diminish

The Balance of Payments

- tracking of int'l payments and receipts OR imports and exports OR DC outflows and inflows
- 2 parts to balance of payments account
  - ① CURRENT ACCOUNT
  - ② CAPITAL / FINANCIAL ACCOUNT

① CURRENT ACCOUNT
- ⓐ goods balance of trade (CDN export more than import)
- ⓑ services balance of trade (CDN import more than export)
- ⓒ investment income – foreign investors ROI from CDN investments compared to CDN investor ROI from foreign investments

② CAPITAL / FINANCIAL ACCOUNT
- ⓐ Capital inflows and outflows of money to CDN:
- ⓑ financial investment
  - direct (CDI) outflow as CDNs invest abroad OR (FDI) inflow as foreigners invest in CAN.
  - portfolio – foreigners invest in CDN stocks/bonds (inflow)
    - CDNs invest in foreign stocks/bonds (outflow)

When ① & ② combined are in surplus – official reserves ↑
when ① & ② combined are in deficit – official reserves ↓

In the case of CAN. – generally ...

CURRENT ACCOUNT – a surplus as export more than import
- foreigners demand CDN \$ to buy CDN exports
- CAN. supplies CDN \$ by importing foreign goods/services
- thus, supply of CDN \$ insufficient if trade surplus

CAPITAL/FINANCIAL ACCOUNT – CAN. must finance foreign demand for CDN \$ by recording more <u>outflows</u> of CDN \$ than <u>inflows</u> of foreign money
↳ i.e. run a deficit to balance out surplus in current ~~capital~~ account

Buying and Selling Internationally

OBJECTIVE — understand how different currencies complicate trade among nations
- understand the basics of the exchange rate system

KEY – buying and selling / imports and exports internationally require the use of different currencies
- exporters demand payment in own currency thus exchange rates become and important factor in trade
- importers must obtain funds in exporter's currency from the foreign exchange market

DEFn
- Export (receipt) – an int'l transaction in which a foreign currency must be converted into a domestic currency
- Import (payment) – an int'l transaction in which a domestic currency must be converted into a foreign currency
- Exchange Rates – the price at which one currency can be purchased for another
  - currency value measured by its price in terms of other currencies (the more a domestic currency can buy of foreign currency the more it appreciates in value)
  - rates are determined by demand and supply
  - determined by market forces, gov't intervention, or a combination of both

DEMAND – in the foreign exchange market for domestic currency (DC)
- demand for DC created by demand for domestic exports
- IF DC depreciates demand for exports ↑ (as exports less expensive)
- the more a DC depreciates the more DC demanded

SUPPLY – of DC in the foreign exchange market
- IF DC appreciates then supply of DC ↑ as demand for imports ↑ as less expensive (more DC supplied)
- IF DC deppreciates then supply of DC ↓ as demand for imports ↓ as more expensive (less DC supplied)

Causes of Fluctuations in the Exchange Rate

- changes in the exchange rate (ExR) affect flow of imports and exports, <u>but</u> what causes the ExR itself to change? - multitude of factors

(A) Change (shift) in demand

- factors
  - growth or slowdown in economy of trading partners
  - Domestic interest rates affect the demand for DC (foreign capital seeks interest rate profits) which ↑ DC value

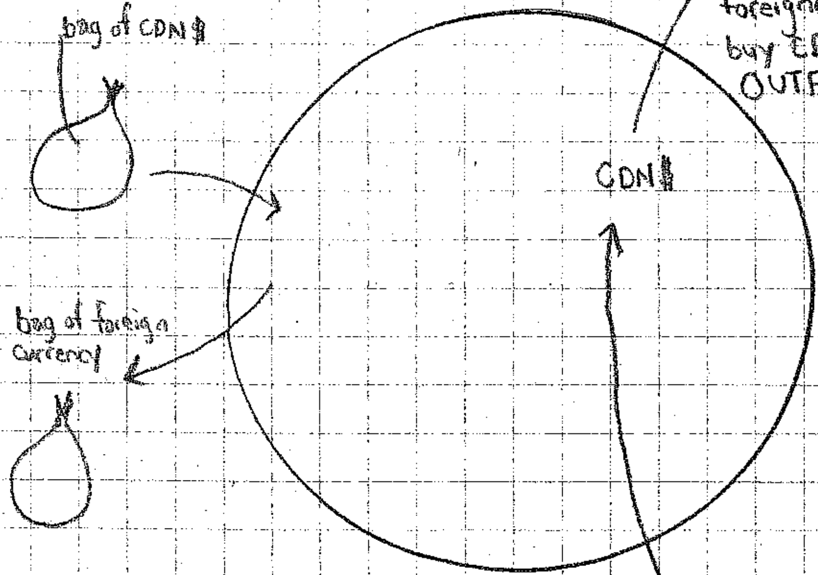
(B) Change (shif) in supply

- ↓ in supply causes domestic currency to appreciate
- ↑ in supply causes DC to depreciate
- ↑ in supply of dom. currency (shift right) caused by an ↑ in demand for imports due to growth in domestic economy
- ↓ in supply of DC (shift left) caused by a ↓ in demand for imports

Foreign Exchange Market

① Exports LINKED to demand for DC in FXM

② Imports LINKED to supply of DC in FXM



demanded by foreigners to buy CDN exports OUTFLOW

NEED INFLOW to balance outflow ... i.e. CDN purchasing imports thus dumping CDN $ in FXM (↑ supply) & CDN investment abroad

IF supply of CDN $ cannot be maintained by mkt./imports "deficit" or imbalance corrected/managed by central bank and CDN $ reserves

412 q.2 → deficit in trade means ...
→ link to supply / demand for CDN $
→ link to exchange rate
→ impact on CDN exports/imports