

Economics 101

Section 5

Lecture 7
February 3, 2004

Sources of Comparative advantage, objections, and
restrictions

Overview

- Sources of comparative advantage
- Objections to free trade
- Restrictions to free trade
- Protectionism – a few statements

Sources of Comparative advantage

- Countries often specialize in products based on their own particular endowments of natural resources.
 - Natural resources are not the only basis for comparative advantage

Table 7 Examples of National Specialties in International Trade

Country	Specialty Resulting from Natural Resources or Climate
Saudi Arabia	Oil
Canada	Timber
United States	Grain
Spain	Olive oil
Mexico	Tomatoes
Jamaica	Aluminum ore
Italy	Wine
Israel	Citrus fruit
Specialty Not Based on Natural Resources or Climate	
Japan	Cars, consumer electronics
United States	Software, movies, music
Switzerland	Watches
Korea	Steel, ships
Hong Kong	Textiles
Great Britain	Financial services

Sources of Comparative advantage

- Countries often develop strong comparative advantages in the goods they have produced in the past
 - This is generally regardless of why they began producing those goods in the first place
 - Retention of comparative advantage may be due to
 - Existing stock of physical capital
 - Existing stock of human capital
 - Existing institutional framework

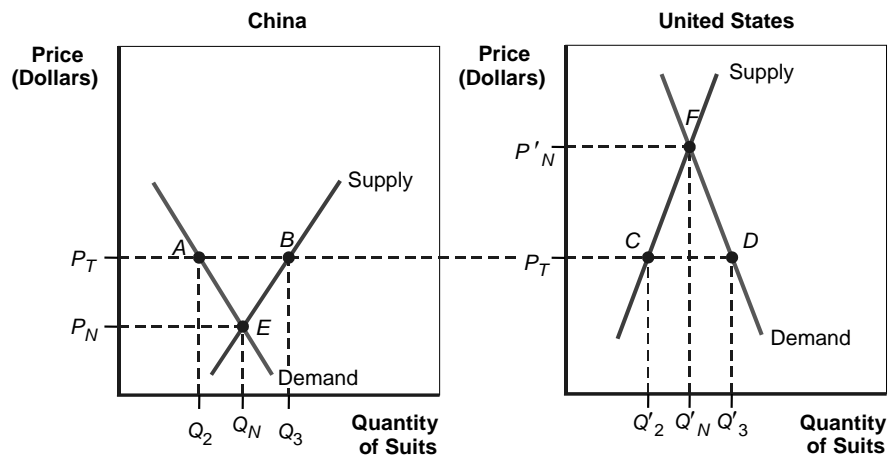
Objections to free trade

- Have we shown that countries as a whole can unambiguously gain from free trade?
 - Yes!
- If so then why are there objections?
 - Countries which join the World Trade Organization (WTO) set up restrictions to trade
 - Groups arguing against free trade with developing nations

Objections to free trade

- Objections arise because some groups in the short run are made worse off by free trade even while the entire nation as a whole gains

Figure 1 The Impact of Trade



Objections to free trade

- When the opening of trade results in increased exports of a good:
 - the producers of the good are made better off and will support increased trade (higher prices)
 - Consumers of the good will be made worse off and will oppose increased trade (higher prices)

Objections to free trade

- When the opening of trade results in increased imports of a product:
 - Domestic producers are made worse off and will oppose increased trade (lower prices)
 - Consumers are better off and will favor the increased trade (lower prices)

Table 8 Attitudes Toward Free Trade

	In Export Sectors that Enjoy Comparative Advantage	In Import Sectors That Suffer from Comparative Disadvantage
Pro Trade	Owners of firms, workers	Consumers
Anti Trade	Consumers	Owners of firms, workers

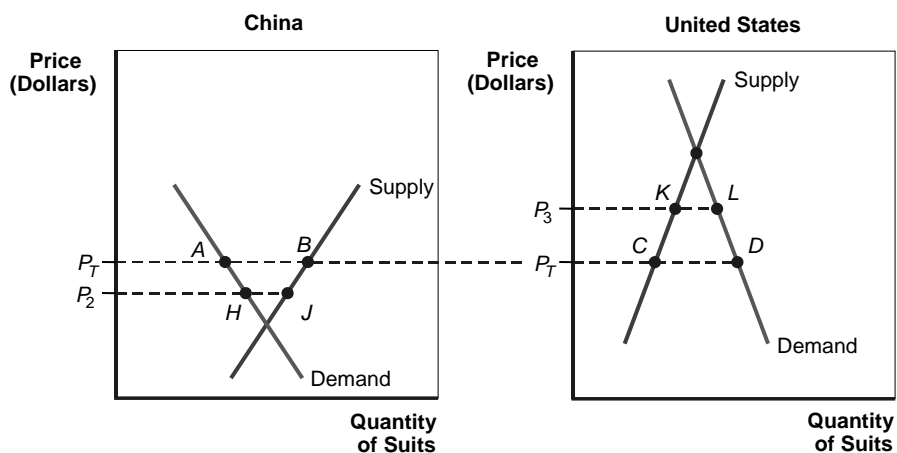
Restrictions to free trade

- Instead of compensating the losers or help them transition, governments generally find it easier to block free trade

Restrictions to free trade

- Tariffs (import tariff)
 - Reduce the volume of trade and raise the domestic prices of imported goods.
 - In the country that imposes the tariff, producers gain and consumers lose.
 - Increased revenue for the country which imposes the tariff
- Over all there is a lose to society as a whole since tariffs reduce the volume of trade and therefore decrease the gains from trade.

Figure 2 The Effects of a Tariff on Suits



Restrictions to free trade

- Quotas (import quota)
 - Restrict trade similar to tariffs
 - Reduce quantity exported and raise domestic prices
 - Helps domestic producers (higher prices)
 - Hurts domestic consumers (higher prices)
 - No domestic revenue for importing country

Protectionism

- Protectionism
 - The belief that a nations industries should be protected from foreign competition
 - Often producers are better organized than consumer groups
- Some myths
 - The basis for many anti-trade arguments tend to confuse absolute and comparative advantage

Protectionism

- Even if a country has an absolute advantage in the production both goods, the low productivity country still has an advantage will some goods
- Example of suits and computers

	Per Suit	Per Computer
China	125 hours	625 hours
United States	50 hours	100 hours

A thought on trade

- What if the following are the hourly requirements for suits and computers

	Hours to produce each good	
	Suits	Computers
China	100 hours	200 hours
US	50 hours	100 hours

- Does either country have a comparative advantage?
- Should they trade?
- What would be the gains from trade