International Trade

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INTERNATIONAL TRADE & EXCHANGE RATES
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INTERNATIONAL TRADE

Free Trade

The benefits of trade

WITHOUT FREE TRADE

Country A is able to produce and consume more goods, in total, than country B. However, without free trade country A doesn't have allocative efficiency (This occurs when there is an optimal distribution of goods and services, taking into account consumer's preferences.). It would like access to more resources such as oil which it doesn't have much of, and consumer goods such as beer which it doesn't produce.

Country B is able to produce more of some resources and goods than it needs to consume. It needs to trade with country A to gain access to more goods and services than it could produce itself such as guns, cars, televisions and wine.

WITH FREE TRADE

With international trade, consumers in each country now have access to a wider variety of goods and services in the quantities that they desire (i.e., increased allocative efficiency).

Consumers in country A have access to beer, which it didn't before and has much more oil.

Consumers in country B now have access to cars, guns and TV's and wine.

International trade enables this country to trade goods and services they produce efficiently with the goods and services other countries can produce more efficiently.

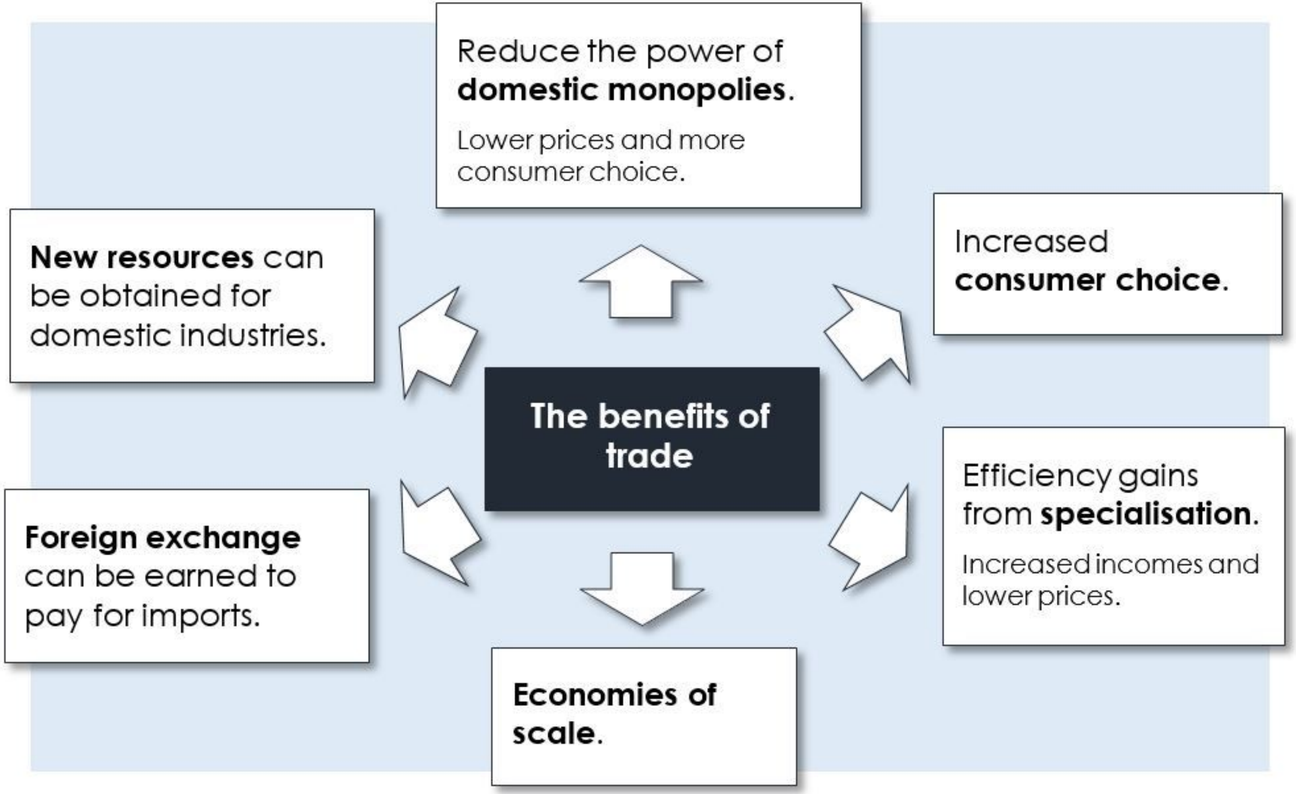
Efficiency gains

Free trade allows countries to specialize in what they are good at. With specialisation there is an increase in production efficiency. With trade, these extra goods and services can be allocated more efficiently.

WITHOUT TRADE A COUNTRY WOULD STILL HAVE TO PRODUCE CARS EVEN IF IF DIDN'T HAVE THE RESOURCES (FACTORS OF PRODUCTION) TO PRODUCE THEM EFFICIENTLY. BECAUSE OF SCARCITY THEY WILL NEED TO GIVE UP PRODUCING QUANTITIES OF GOODS AND SERVICES THEY CAN PRODUCE MORE EFFICIENTLY (OPPORTUNITY COST).

Thus, international trade allows specialisation and more can be produced and consumed **->**Incomes will increase as production increases. As supply increases, the price decreases **->**Thus, producers and consumers are better off with international trade.

Why are the following consider benefits?

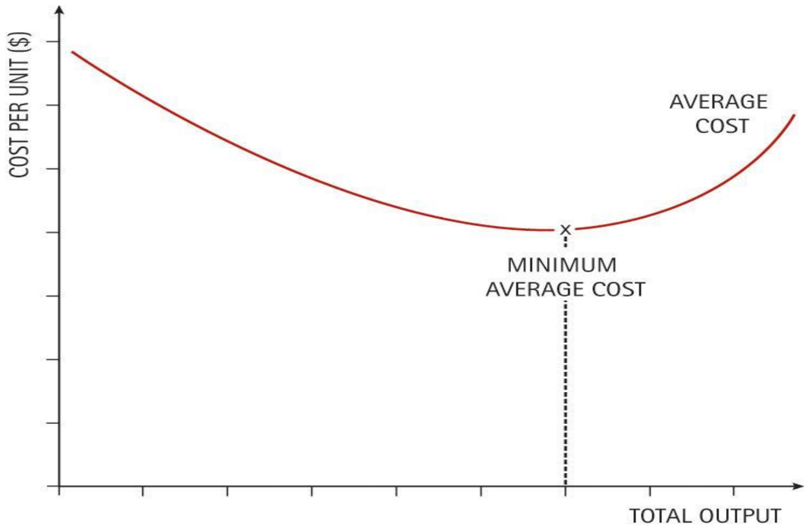


Economies of scale

Why can Domino's Pizza afford to sell Pizzas at a lower cost than a local Pizza restaurant with only one outlet?

What are economies of scale?

They are **cost savings** from increasing the scale of production in a firm or industry



Internal economies of scale

Increasing the size of a firm provides an opportunity to change the way it is organized, run and financed to reduce the average or unit cost of production

External economies of scale

These are cost savings enjoyed by firms in large industries compared to firms in smaller industries

Internal economies of scale

PURCHASING ECONOMIES e.g. discounts for bulk purchases

MARKETING ECONOMIES e.g. mass advertising; own distribution network

FINANCIAL ECONOMIES e.g. ability to borrow more at lower interest rates

TECHNICAL ECONOMIES e.g. ability to afford and employ advanced equipment

RISK-BEARING ECONOMIES e.g. offering a range of different products

External economies of scale

These are cost savings enjoyed by firms in a large industry such as the car manufacturing

These may be:

- **Access to a skilled workforce** because firms can recruit workers trained by other firms in their industry
- **Ancillary firms** that develop and locate nearby large firms in other industries to provide them with the specialized equipment and business services they need
- **Shared infrastructure:** for example, the growth of an industry may persuade firms in other industries to invest in new infrastructure such as power stations, dock facilities and airports to meet increasing demand for these services

A simple way to think about how trade enables economies of scale

International trade allows:

- Greater access to markets, which means more customers
- Access to cheaper resources
- Access to more skilled labour and capital goods

All of this can help a firm grow

Can firms grow too large?

Firms can experience problems if they expand scale too much and too quickly

Falling productivity and rising average costs result from **diseconomies of scale**

- A large firm may have to raise wages to attract sufficient numbers of workers
- A large firm may find it difficult to attract new customers
- A large firm may suffer more industrial disputes because production lines are automated and work tasks are uninteresting
- A large firm may suffer from internal communication and coordination problems, especially if it has many locations, many managers and many different activities

The WTO

WORLD TRADE ORGANIZATION

According to the WTO (164 member states), ideal trade would be:

- Non-discriminatory
  - Can’t informally have free trade with country A, but with another have very strong protectionist measures. Everything must be done formally.
- Free from barriers
  - Less protectionism
- Predictable
  - Unpredictability makes investment decisions harder to make, leading to less growth
- Promote fair competition
  - Allows for fair protectionist measures, e.g to allow infant industries the chance to grow
- Beneficial for developing countries through special provisions
  - Emerging economies are given time to development before WTO rules and policies apply

Benefits of the WTO

The 10 benefits

1. The system helps promote peace
2. Disputes are handled constructively
3. Rules make life easier for all
4. Freer trade cuts the costs of living
5. It provides more choice of products and qualities
6. Trade raises incomes
7. Trade stimulates economic growth
8. The basic principles make life more efficient
9. Governments are shielded from lobbying
10. The system encourages good government

WORLD TRADE ORGANIZATION

Criticisms of the WTO

- The WTO undermines state sovereignty
- It undermines representative democracy
- Member nations are prevented from protecting the environment
- Members are unable to uphold laws guaranteeing workers’ rights
- The WTO is controlled by the larger nations
- The WTO represents the interests of large corporations and wealthy citizens