

Syllabus reference: 3.1 Why do countries trade?

November 2006 SL 1 Q3

(a) Explain the reasons why countries trade with each other. (10 marks)

(b) Given the benefits of trade, evaluate the economic arguments in favour of protectionism. (15 marks)

Underlying Theory: Specialisation + Trade Absolute and Comparative advantage i.e. comparative cost determines area of specialisation
see webnotes 401 and 402

See 'Division of Labour'- Adam Smith

Gains from Trade:

1. Lower prices
2. Choice
3. Economies of scale
4. Foreign exchange (hard currency)
5. Raw materials (Japan)
6. More efficient resource allocation

Profit

Necessity: Scarcity of the factors of production. The policy of *autarky* does not work

Exchange of ideas and culture political, military and social reasons e.g. Pakistan

Cost Advantages: Economies of Scale. Efficiency. Lower costs of production, lower priced goods.

Economic growth results + Standard of living rises

Risk

- time
- payment
- delivery
- exchange rates

Lack of knowledge:

- legal
- administrative
- language

Problems / Issues in International Trade:

- Free Trade v Protectionism
- LDC v DC
- Role of International Organisations e.g. World Bank and the IMF
- Comparative Advantage / Cost theory is flawed: (see Anderton p169)

- Fair trade issues
- China: fixed/semi fixed exchange rate

Note: strong role for WTO in resolving these issues

Specialisation and trade

based on the concept of

Opportunity Cost