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Trade Theory, Agreements, and Patterns



Learning Goals

Once you have completed this chapter, you should be able to:

- Explain the benefits of specialization and international trade, using the concepts of absolute and comparative advantage
- Analyze the costs and benefits to Canadian stakeholders and to the Canadian economy of the global trend toward freer international trade
- Describe the nature and role of the World Trade Organization as an international institution
- Explain the nature of the North American Free Trade Agreement and assess its impact on Canadian stakeholders and the Canadian economy
- Apply economic inquiry to an analysis of public policy issues arising from Canadian trade policy



Key Terms

- international trade
- Globalization
- absolute advantage
- comparative advantage
- Protectionism
- Dumping
- terms of trade
- Tariff
- Subsidy
- Sanctions
- Embargo
- Quota
- General Agreement on Tariffs and Trade (GATT)
- World Trade Organization (WTO)
- Multilateral
- WTO Dispute Settlement Body
- trading bloc
- North American Free Trade Agreement (NAFTA)
- free trade area
- United States-Mexico-Canada Agreement (USMCA)
- customs union
- common market
- Canada-US Automotive Products Trade Agreement (or Auto Pact)
- Free Trade Agreement (FTA)
- intellectual property rights
- Asia-Pacific Economic Cooperation (APEC)
- Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)
- Reciprocity Treaty
- National Policy



Key Terms (continued)

- merchandise trade (or visible trade)
- non-merchandise trade (or invisible trade)
- balance of merchandise trade
- trade surplus
- trade deficit



Trade Theory

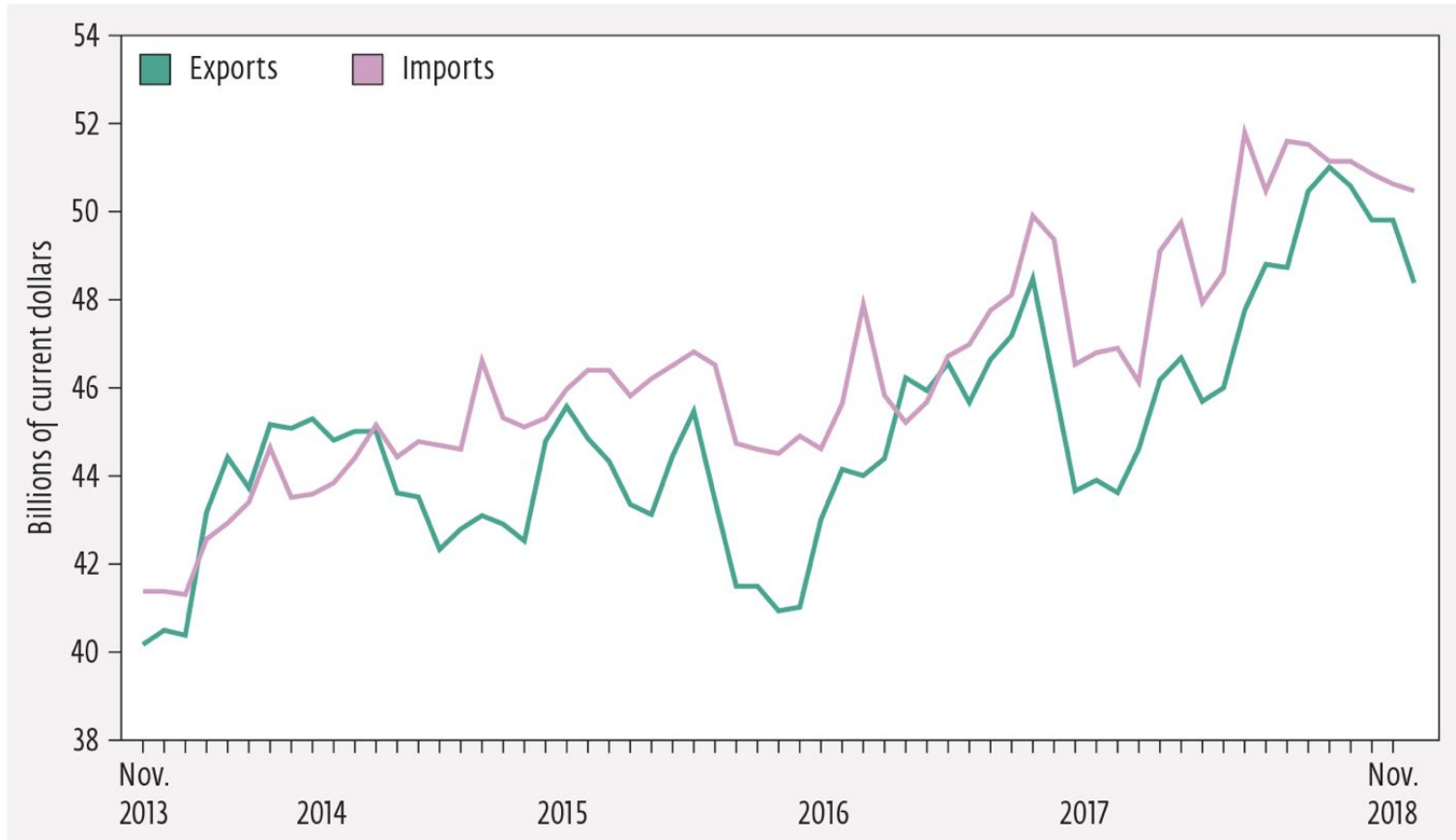
- Today, **international trade** is more important than ever and continues to grow rapidly. International trade is absolutely essential in Canada's economy to maintain the lifestyles enjoyed by Canadians.
 - **International trade:** The exchange of goods or services across international borders.
- The value (and volume) of international trade continues to grow each year, as Figure 20.1 shows (next slide).
- The trend toward increased international trade and investment flows are all part of an economic trend known as **globalization**
 - **Globalization:** A process whereby national or regional economies become integrated through communication technologies, foreign direct investment, international trade, immigration, and the flow of money.



Trade Theory

FIGURE 20.1

The value of Canada's trade in goods, from November 2013 to November 2018



Trade Benefits All Parties

- One of the important economic principles of international trade is that both buyer and seller benefit from the transaction.
- Specialization is often identified as the most important mutual benefit from international trade.
- There are clear economic advantages in allowing countries to concentrate their industrial activity on the mass production of goods for which they have the necessary resources and the ability to use them most efficiently.



Absolute Advantage

- One country has an **absolute advantage** if it makes a product or service more productively than other countries.
 - **Absolute advantage:** The capacity of one economy to produce a good or service with fewer resources than another.
- Countries export products or services in which they have an absolute advantage, and they import products or services in which other countries have an absolute advantage.
- Generally, it makes more sense for each country to specialize in products in which they have an absolute advantage.



Absolute Advantage

- In figure 20.2, each country uses all of its resources to produce each product.
- In figure 20.3, after specialization, each country only produces one product.

FIGURE 20.2

Each country uses its resources to produce two products

Country	Apples	Peaches
Canada	1 000	600
United States	800	1 400
Total	1 800	2 000

FIGURE 20.3

Each country specializes in one product

Country	Apples	Peaches
Canada	2 000	0
United States	0	2 800
Total	2 000	2 800

Comparative Advantage

- Does specialization and trade continue to provide similar economic benefits when one country has an absolute advantage in the production of both goods being traded?- answer is YES
- **Comparative advantage:** The capacity of one economy to produce a good or service with comparatively fewer resources than another (for example, having a lower opportunity cost).
- Even if one country has an absolute advantage in every field of production, it will likely hold a greater advantage in some fields than in others.
- This comparative advantage, is required to make specialization and trade economically beneficial for individuals, regions, and countries.



For example, assume that China has enough resources to produce either smartphones or computers. China can produce 10 computers or 10 smartphones. Computers generate a higher profit.

Therefore, the opportunity cost is the difference in value lost from producing a smartphone rather than a computer. If China earns \$100 for a computer and \$50 for a smartphone then the opportunity cost is \$50. If China has to choose between producing computers over smartphones it will select computers.

Comparative Advantage

- Comparative advantage is the foundation for specialization and trade. If countries produce items in which they have a comparative advantage and import from other countries the products in which those other countries have a comparative advantage, both countries benefit.
- Although international trade involves millions of products and many countries, the study of absolute and comparative advantage demonstrates that trade is beneficial to all countries.



Protectionism and Trade Barriers

- Even though the gains from trade normally benefit both trading partners, historically, arguments have been made for the restriction of trade.
- **Protectionism:** An economic policy that aims to restrict imports through tariffs, quotas, and regulations in an effort to boost domestic industry.
- Protectionist arguments usually focus on the protection of domestic industries from foreign competition and on the protection of the domestic economy from foreign influence and control.



Barriers to Trade

International trade is restricted by various barriers listed below (detailed in Figure 20.8 in the textbook).

- Tariffs, or import duties
- Subsidies
- Transportation costs
- Export taxes
- Voluntary export restraints
- Trade sanctions and embargoes
- Quotas



Trade Patterns

FIGURE 20.9

Canada's balance of trade, 2008–2018

Canada has run a trade deficit (that is, it imports more than it exports) for most years since 2012. From 2008 to 2009, Canada had a large trade surplus, with exports exceeding imports.



Trade Patterns

FIGURE 20.10

Canada's top six merchandise exports and imports, Q3 2018 (in CAD millions)*

