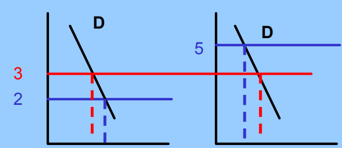
Specialization



Basic Principles

- We all have comparative advantages
- We are all made better off by specializing in our comparative advantage
- Economists refer to this as ***gains from trade.***

Where do you find Specialization?

- Within a business
  - Different employees do different tasks
- With a country
  - Firms tend to buy a lot of inputs from other specialized firms.
  - Miller's Pizzeria does not make its own flour or cheese.
- Between nations

The Growth in Trade

- Transportation and communication costs have fallen, making it profitable to ship many items around the world.
- A series of trade agreements has resulted in significantly lower tariffs (taxes on imports) and other barriers to trade. These include
  - The European Economic Community
  - NAFTA
  - ASEAN
  - The World Trade Organization

The Case for Trade

- The case for International Trade is the same as the case for domestic trade.
  - We can all gain by specialization, and the principle can easily be extended to the international arena.
  - After all, do I personally care whether my car comes from Detroit, Atlanta, or Japan?

A Little History

- Adam Smith and *The Wealth of Nations*
- Mercantilism
  - Stressed self-sufficiency
  - Measures well-being in terms of gold.
- Smith stressed standard of living

An Example

Output Per Day of Work			
	T-shirts	Music CDs	Relative Cost
United States	20	10	2:1
Mexico	5	1	5:1

Key Points

- American workers are more productive than Mexican workers and will have higher wage rates.
- The workers of *each* nation have a comparative advantage.
  - In the CD industry, Americans are ten times as productive as Mexicans are.
  - In the T-shirt industry, American workers are only four times as productive.

The Gains from Trade

- If they trade, both parties will gain, despite
  - The American Worker's fear of competing with "cheap foreign labor".
  - The Mexican Worker's fear of competing against more productive workers.

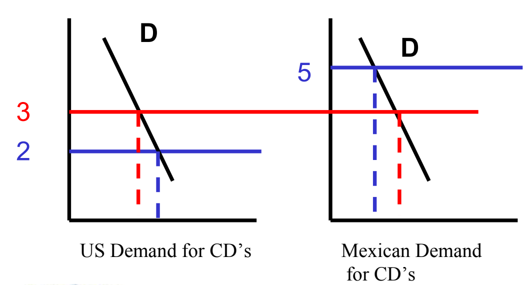
The price of a t-shirt

- Absent International Trade
  - In the US, a Music CD costs two T-shirts, for that is the opportunity cost of producing a Music CD.
  - In Mexico, a Music CD costs five T-shirts, for that is the opportunity cost of producing the Music CD.

The price of a t-shirt

- With International Trade
  - The price of a Music CD, in terms of a T-shirt, the terms of trade, must be the same in both countries.
  - The price must be between 2 and 5 t-shirts; just what depends on supply and demand
- We will *assume* (so that we can get on with this example) that the actual price is 3:1.

Supply and Demand



The Gains from Trade

- Suppose 10 Americans switched from producing t-shirts to music CDs. Then
  - US T-shirt production declines by 200 t-shirts per day
  - US Music CD production rises by 100 music CDs per day.
- The US can trade the music CDs for 300 Mexican t-shirts for a net gain of 100 t-shirts in the US.

KENT STATE UNIVERSITY Specialization

The Gains from Trade

- The Mexicans also gain. If 60 Mexicans switch from producing Music CDs to t-shirts, then
  - Mexican music CD production declines by 60 per day.
  - Mexican t-shirt production rises by 300 per day.
  - Mexicans can trade the t-shirts for music CDs for a net gain of 40 music CDs to Mexico.

KENT STATE UNIVERSITY Specialization

A Tabular Presentation

	US	Mexico
T-shirt Production	-200	300
CD-Production	100	-60
T-shirt imports	300	
CD-imports		100
Net Gains	100 t-shirts	40 CD's

KENT STATE UNIVERSITY Specialization

Summary

- Whenever nations or individuals have comparative advantage, they gain from trade.
  - There are always comparative advantages.
- Other issues:
  - What causes Comparative Advantage
  - Objections to Free Trade
  - A history of trade policy

KENT STATE UNIVERSITY Specialization

End

KENT STATE UNIVERSITY Specialization