

Chapter 34 Project

International Trade

Purpose

After finishing this chapter, you have learned that gains from trade are made when countries specialize in the production of the goods for which they have a comparative advantage. Let’s explore how such gains could apply to everyday life.

The purpose of this exercise is to help you understand absolute and comparative advantage and how society benefits from trade based on comparative advantage.

Directions

This exercise has two parts. In the first, you will identify the absolute and comparative advantages of two producers of food and clothing. In the second, you will consider the gains that could emerge from trade between the two producers and how trade benefits society.

Part 1 - Absolute and Comparative Advantage

Consider two nonprofit disaster relief agencies, The Green Triangle and The Pink Heart, that provide food and clothing to disaster areas. Assume that both The Green Triangle and The Pink Heart pursue the same mission of maximizing the provision of food and clothing in disaster areas. Instead of competing, suppose the two organizations agree to behave like countries and specialize in the production of food or clothing, trade with each other in order to obtain units of both food and clothing, and then distribute the units to different disaster areas. The agencies believe that such an agreement will allow for a greater achievement of their similar missions.

The following table shows the possible combinations of food and clothing The Green Triangle agency can provide with a fixed budget per year:

Food (units per year)	Clothing (units per year)
60,000	0
40,000	10,000
20,000	20,000
0	30,000

Create a table similar to the previous one, and fill it out for The Pink Heart so that The Green Triangle has an absolute and comparative advantage in the production of food and The Pink Heart has an absolute and comparative advantage in the production of clothing.

Based on the tables for the two agencies, answer the following questions:

1. What is the opportunity cost of The Green Triangle producing one unit of food (in terms of clothing)?
2. What is the opportunity cost of The Green Triangle producing one unit of clothing (in terms of food)?
3. What is the opportunity cost of The Pink Heart producing one unit of food (in terms of clothing)?
4. What is the opportunity cost of The Pink Heart producing one unit of clothing (in terms of food)?
5. Explain why The Green Triangle has an absolute and comparative advantage in the production of food.
6. Explain why The Pink Heart has an absolute and comparative advantage in the production of clothing.

Part 2 - Gains from Trade and Social Benefit

In Part 1, you identified absolute and comparative advantages for two hypothetical relief agencies. Write an essay analyzing the agreement between the relief agencies. Your essay should be at least three paragraphs long and address these questions:

1. Which relief agency should provide food and why?
2. Which relief agency should provide clothing and why?
3. From the economist's perspective, how should society benefit from the agencies' agreement to specialize and trade? How does the outcome of the agreement compare to the alternative of the agencies being self-sufficient?
4. Does your answer to #3 change if you consider the question from the perspective of an individual living in a disaster area?

Completion of #4 requires you to think about potential gains from this hypothetical agreement between disaster relief agencies in the context of your own everyday life.

Checklist

Part 1

- ☐ Create and fill out a table illustrating absolute and comparative advantage.
- ☐ Understand and calculate opportunity cost.
- ☐ Explain absolute and comparative advantage.

Part 2

- ☐ Decide which good each agency should produce.
- ☐ Understand specialization and trade.
- ☐ Discuss the economic and individual benefits of the agencies' agreement to specialize and trade.