23.1 Introduction to International Trade

1. International trade refers to the exchange of goods and services between different economies.

23.2 Absolute Advantage and Comparative Advantage

2. With the same amount of resources, a country has an absolute advantage over another country in the production of a good if it can produce more of the good than the other country.

3. A country having an absolute advantage in producing a good means:

- It can produce the same amount of the good using *(more / fewer)* units of resources than another country.
- It has a *(higher /lower)* productivity in producing the good.

4. A country has a comparative advantage over another country in the production of a good if it can produce the good at a lower opportunity cost than the other country.

5. The table below shows the amount of labour input required to produce toys and food by Country A and Country B.

	1 unit of toys	1 unit of food
Country A	4 man-hours	6 man-hours
Country B	5 man-hours	10 man-hours

Based on the above information,

(a) which country has an absolute advantage in producing toys? Explain.

Country A has an absolute advantage in producing toys because Country A can produce 1 unit of toys using fewer units of resources than Country B.

(b) which country has a comparative advantage in producing toys? Explain.

Country A's opportunity cost of producing 1 unit of toys = 0.67 (= 4 / 6) units of food

Country B's opportunity cost of producing 1 unit of toys = 0.5 (= 5 / 10) units of food

As Country B can produce toys at a lower opportunity cost, Country B has a comparative advantage in producing toys.

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6. Given two countries and two goods, determine whether each of the following statements is correct.

Statement	Correct	Incorrect
(a) If a country has an absolute advantage in producing a good, it also has a comparative advantage in producing the good.		✓
(b) If a country has an absolute advantage in producing a good, it has an absolute disadvantage in producing the other good.		✓
(c) Suppose a country has an absolute advantage in producing a good. It may import the good from the international market.	✓	
(d) A country can have absolute advantages in producing two goods at the same time.	✓	
(e) If a country has a comparative advantage in producing a good, it has a comparative disadvantage in producing the other good.	✓	

23.3 The Principle of Comparative Advantage

7. The principle of comparative advantage states that if each country specialises in the production of a good in which it has a lower opportunity cost, the total output will increase.

8. Based on Question 5, according to the principle of comparative advantage, explain which country will export toys.

As the opportunity cost of producing toys in Country B is lower, Country B will export toys.

23.4 Terms of Trade and Gains from Trade

9. For terms of trade to be mutually beneficial, it must lie between the opportunity cost of producing the good for the exporting country and that for the importing country.

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10. The following table shows the quantities of apples or clothing produced by Country A and Country B with 1 unit of resources.

	Apples (units)		Clothing (units)
Country A	4	OR	16
Country B	5	OR	15

(a) Calculate the opportunity costs of producing 1 unit of apples for the two countries.

Country A's opportunity cost of producing 1 unit of apples = 4 (= 16 / 4) units of clothing

Country B's opportunity cost of producing 1 unit of apples = 3 (= 15 / 5) units of clothing

(b) Find the range of terms of trade for apples over which exchange between the two countries is mutually beneficial.

3 units of clothing < 1 unit of apples < 4 units of clothing

(c) Suppose the exchange ratio is 1 unit of apples for 3.5 units of clothing.

- Calculate the gain from trade for the apple-exporting country from exporting 1 unit of apples.

  3.5 units of clothing – 3 units of clothing = 0.5 units of clothing

- Suppose the apple-importing country has to pay a transportation cost of 0.2 units of clothing for each unit of import. Calculate the gain from trade for the apple-importing country from importing 1 unit of apples.

  4 units of clothing – 3.5 units of clothing – 0.2 units of clothing = 0.3 units of clothing

11. Identify which of the following is/are the factor(s) that cause(s) two countries to stop trading. Put a tick (✓) in the appropriate box(es).

(a) The two countries have the same opportunity cost in producing the same good.	☑
(b) The two countries have the same factor endowment.	☐
(c) The terms of trade of a good does not lie between the two countries' costs of producing the good.	☑
(d) The transportation cost paid by the two countries is higher than their total gain from trade.	☑

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