Why countries trade:

- Country = self sufficient when it makes everything it consumes within its borders.

ADAM SMITH:

"it's better to specialise in a couple of goods & services and trade with other countries, countries have different resources"

- Countries could have a absolute or comparative advantage in trade.

Comparative Advantage

* Ability of a party to produce a good / service at a lower marginal and opportunity cost over another.

Absolute Advantage

* Ability of a party to produce more of a good / service than competitors, using the same amount of resources.

Where Comparative Advantage comes from

- **Technology** (Japan = high tech country, producing computers, etc.)
- **Resource Endowments** (SA = lot of minerals such as platinum, gold)
- **Different tastes or Demand** (Holland = good in producing bicycles, they have long history with this)

Trade Policy:

Import tariffs:

TAX or duty levied on products that are imported to a country

Revenue Tariffs:

- No industry to protect BUT
- G wants to make extra income – they tax imports

Protective Tariffs:

- G wants to protect a local industry from cheap imports
- They impose a tariff on imports to make the product more expensive

Two categories of import tariffs:

1. **Specific Tariffs:** Specific amount taxed on each unit imported. Example: R1 000 tariff on each car imported.
2. **Ad Valorem Tariffs:** % of value is taxed.
   Example: 20% on price of all new imported cars.

TRADE POLICY - Other measures

- **Import Quotas** (restriction on amount of certain import allowed)
- **Subsidies** (Instead of taxing overseas companies, G can give the money to local companies)
- **Non-tariff barriers** (Rules and regulations set on standard of imports – how food should be packed / size of fruit)
- **Exchange controls** (Foreign currency needed for foreign trade, by restricting FOREX, foreign trade is restricted)
- **Exchange rate policy** (Exchange rate influences trade)

AIM of trade policies = to protect and support local producers from cheap international brands.

Economic Impact of a Tariff:

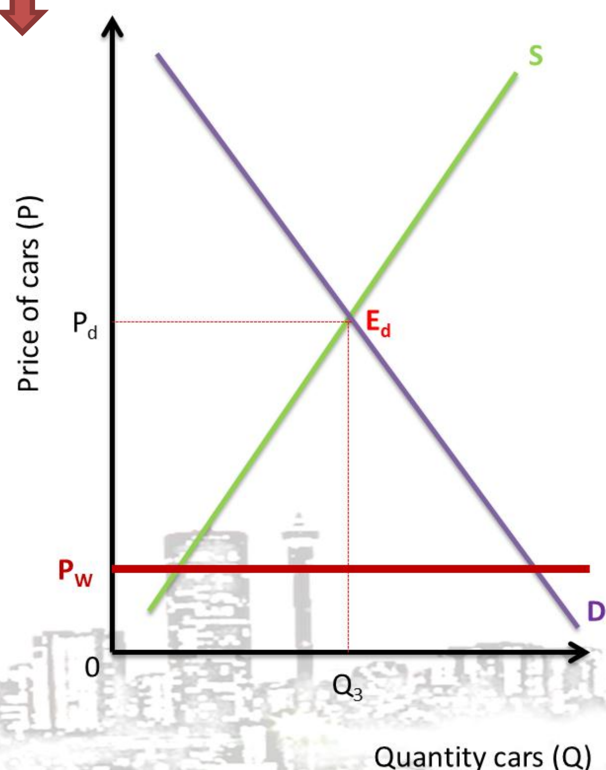
Example: Market for Cars (**with no foreign trade)**

Equilibrium Price = Pd

Equilibrium QTY = Q3

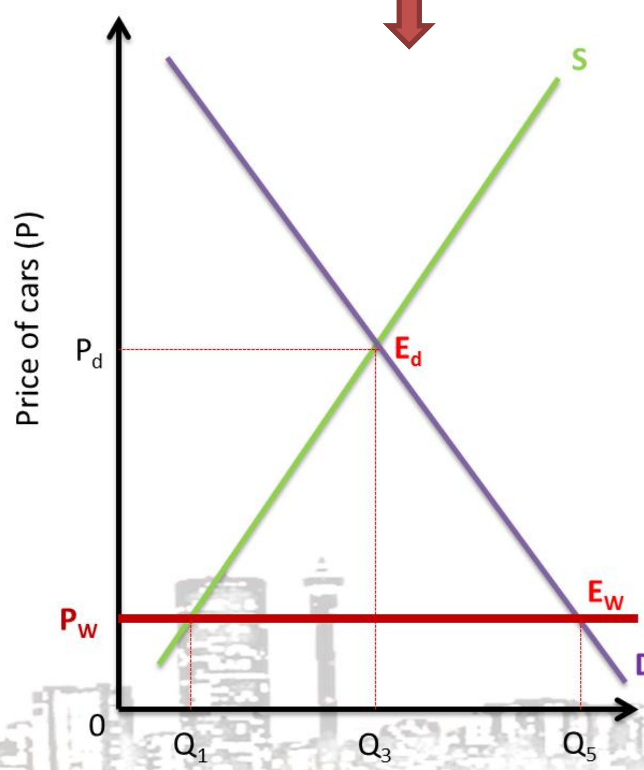
Equilibrium = Ed

Due to other countries that have **comparative advantage** in producing cars, the world price = Pw



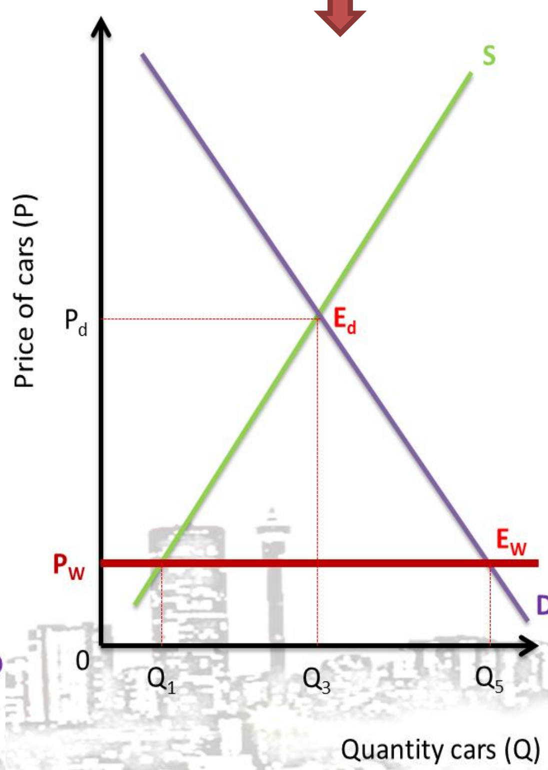
If the trade opens:

* New price for cars = Pw
* Supply of cars in local industry fall to Q1
* Demand in local country will increase to Q5
* MEANING: shortage in domestic supply will be filled with imports
* New Equilibrium = Ew; Price = Pw; Qty = Q5



IF G imposes a Tariff:

* Price will increase
* At Price Pt, Local supplier will supply Q2
* Consumers will demand Q4
* Imported amount is now Q2-Q4
* Equilibrium = Et; Price = Pt; Qty = Q4



TRADE BARRIERS

Government induced restrictions on international trade

For:

- **Balance of payments** (If import decrease = improve balance of payments)
- **Dumping** (foreign country selling its products much cheaper than in its own country)
- **Export subsidies** (Foreign companies often subsidies, difficult to compete within)
- **Infant industry** (G helps company to start-up)
- **Employment** (Employment falls if local firms closes down due to foreign competition)
- **G Revenue** (G makes income from tariffs)
- **National Security** (Politically its necessary that no too much of a products enters the country, e.g. weapons)

Against:

- **Retaliation by Trade partners** (If SA imposes a tariff, other countries might do the same to SA)
- **Welfare costs to society** (Tariffs increase prices, could have ripple effect, companies and consumers have to pay more)
- **Inefficiency** (other countries produce because they are more efficient, by restricting trade local companies keep producing inefficiently)

Balance of payments

Record each country keep on its transactions with the rest of the world

- Balance of Payments
  - Current Account
    - Exports and Imports
    - Surplus = Exports> Imports
    - Deficit = Exports< Imports
  - Financial Account
    - Financial flows between countries
    - Surplus = net inflow of foreign capital
    - Deficit = net outflow of foreign capital
  - Capital transfer account
  - Unrecorded transactions

Current Account:

- An important good traded in SA = Gold
- Service trade = transport, construction, etc.
- Income receipts shown separately (income earned by SA in other countries)
- Income payments = money earned by non-SA citizens in SA
- Current transfers, money, gifts, service traded for "nothing" in return

Financial Account:

- Direct investments (Investments made in order to over take management)
- Portfolio investment (Purchasing assets e.g. bonds or shares)
- Other investments (not classified as either direct or portfolio)
- Unrecorded transaction = used to balance account

Gold & Foreign Reserves:

- EXPORTS = country GETS foreign currency
- IMPORTS = country PAYS foreign currency
- **IF EXPORTS < IMPORTS = foreign reserves decrease**
- **IF EXPORTS > IMPORTS = foreign reserves increase**
- Portion of SA foreign reserves are held in gold
- Amount of gold = position of balance of payments
- Gold & foreign reserves ensures smooth flow of international trade. Prevents large fluctuations.

Balance of payments & economic activity & policy in SA

- EXPORTS = major drive in economic growth (G stimulates exports)
- Developing countries import intermediary goods to increase capacity of the economy
- SA imports consumer goods (highly unstable)

Exchange rates:

- How much of one currency you need to buy another (e.g. Euros for Rand)
- Assume R10 for 1x Dollar (R10: $1)
- If this change to R11:$1 it means Rand **depreciation** against Dollar (weaker)
- Also Dollar **appreciated** against the rand (Stronger)
- **Foreign exchange market determines the exchange rate**

TERMS OF TRADE:

- Ratio between EXPORT PRICES & IMPORT PRICES
- IF export price fall relative to import prices a country becomes poor
- REASON: Country uses more FOP (factors of production) to increase exports in order to afford imports

Graph info

- **Demand for Dollars in SA** (South Africans Buy goods / service or travel to America as a tourist)
- **Supply for Dollars in SA** (Americans buy goods / service or travel to SA as a tourist)
- **Demand and Supply determines exchange rate**
- Equilibrium E1 = $1 = R8; Equilibrium qty = amount of **$** that will be traded for **R** at that rate
- IF **crime** is reported of SA in America, tourists decline thus affecting supply of $
- New Equilibrium E2 =$1 = R9 (Rand depreciated but Dollar appreciated)
- If SARB has enough foreign reserves they intervene to stabilise the exchange rate.
- SARB can supply $ - Effect will be:
- R8.50 for $1 (see E3)