



# 3055 BA SANGAM COLLEGE

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## WORKSHEET 13

### LESSON NOTES

School: Ba Sangam College

Year: 11

Name: \_\_\_\_\_

Subject: Economics

<b>Strand 4</b>	International Trade
<b>Sub Strand 4.1</b>	International Trade
<b>Content Learning Outcome EC11.4.1.1</b>	Discuss the different aspects of international trade.

### FIJI AND INTERNATIONAL TRADE

**International trade** - refers to all economic transactions which takes place between a country and the rest of the world.

**Domestic Trade** relate to trade within the country.

### GAINS FROM INTERNATIONAL TRADE

Free International trade promotes international specialization and encourages increases in productivity and total output. Nations specialize in those goods and services in which they have some kind of advantage over other nations.

Economies can gain from international trade through **Absolute Advantages** and **comparative advantages**

**Absolute Advantages** - a nation has absolute advantage in a production of an item if it is able to produce more of the commodity than the other nation.

Country	Wheat Units	cheese units
Australia	50	10
Fiji	10	20

Australia has an absolute advantage in production of wheat and Fiji has absolute advantage in production of cheese.

**Comparative Advantage** A nation has comparative advantage over a trading partner in production of an item if it produces that commodity at a lower opportunity cost than its partner.

Country	Wheat Units	Cheese units
Australia	50	40
Fiji	10	20

The table shows that Australia has an absolute advantage in both wheat and cheese because Australia is able to produce more of both goods.

To determine which country has a comparative advantage in which particular commodity we must calculate the opportunity cost of producing wheat and cheese in each country.

Country	Wheat Units	Cheese units
Australia	50 F/G= 40/50 = 0.8	40 F/G =50/40 = 1.25
Fiji	10 F/G = 20/10 = 2	20 F/G = 10/20 = 0.5

From the table we can see that in Australia, producing 1 unit of wheat, the opportunity cost is 0.8 units of cheese and this is much cheaper than Fiji whose opportunity cost is 2 units of cheese.

For Fiji, the opportunity cost of producing 1 unit of cheese is 0.5 units of wheat and for Australia, the opportunity cost of cheese 1.25 units of wheat.

Thus Australia has a lower opportunity cost in the production of **wheat therefore has comparative advantage in wheat while Fiji has lower opportunity cost in the production of cheese therefore comparative advantage in production of cheese.**

**Terms of Trade (T.O.T):** Price ratio at which two countries are prepared to exchange goods, must therefore lie somewhere between the two countries domestic cost.

Formula for Calculating Terms of Trade

$$\text{Terms of Trade} = \frac{\text{Index Of Export Price}}{\text{Index Of Import Price}} \times \frac{100}{1}$$

**Example:**

Year	Export	Import
2007	105	90
2008	80	102

Base year 2006: 100.

Calculate the T.O.T for:

- i. 2007
- ii. 2008

**Solution:**

$$\text{i Terms of Trade} = \frac{\text{Index Of Export Price}}{\text{Index Of Import Price}} \times \frac{100}{1}$$

$$= \frac{105}{90} \times 100$$

$$= \frac{90}{102} \times \frac{100}{1}$$

$$= 116.67(\text{favorable})$$

ii Terms of Trade =  $\frac{\text{Index Of Export Price}}{\text{Index Of Import Price}} \times \frac{100}{1}$

$$= \frac{80}{102} \times \frac{100}{1}$$

$$= 78.43 (\text{unfavorable})$$

### Interpreting Terms of trade

A rise in TOT index for a particular year indicates a favorable movement. This can be viewed as follows:

1. Given value of export can be buying a greater quantity of import than a previous year.
2. Some value of import can be now financed by a smaller value of export.
3. A favorable movement in T.O.T. maybe the result of:
  - Export price increasing more than import price
  - Export price increasing while import price remains constant
  - Export price remains constant while import price falls
  - Import price falls faster than export price.

### ACTIVITY

#### Question 1

The table below shows the production of tea and coffee in Country A and B using the same quantity of resources.

	Tea (tons per day)	Coffee (tons per day)
Country A	3 562	956
Country B	6 574	478

#### Required:

Use the information in the above table to answer questions that follows

- 1) State the difference domestic trade and international trade.

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(2 marks)

- 2) State **two** reasons for international trade

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(2 marks)

3) Define absolute advantage.

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(1 mark)

4) Which country has absolute advantage in the production of:

Coffee \_\_\_\_\_

Tea \_\_\_\_\_

(2 marks)

5) Which country has comparative advantage in the production of tea?

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(2 marks)

### Question 2

Study the table given below and use your knowledge to answer the question that follows.

Year	Export Price Index Index	Import Price Index
2017	80	100
2018	160	110

Base year index: 100

Calculate the terms of trade for 2018. (Show all the working)

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(1 mark)

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**The End**