1.23. THE GLOBAL ECONOMY

Many of the things we use and enjoy every day were made in other countries. In the global economy, goods and services are exchanged across **national boundaries** in a process described as "international trade." Goods and services purchased from other countries are ***IMPORTS***. Goods and services which companies sell to other countries are ***EXPORTS***. Look around your house and you will see that your TV was made in Japan, robe is from India, your comb was made in Mexico, your sweater in Scotland, you eat chocolate made by a Swiss company, and read the magazine which was printed on paper manufactured in Finland. We all depend on goods and services from other countries. International trade is based upon the principles of absolute and comparative advantage.

ABSOLUTE ADVANTAGE

Some areas produce goods others cannot. For example, because of Florida's warm climate and soil, farmers there grow oranges but not wheat. Kansas farmers grow no oranges, but they do grow wheat. Since people in Florida and Kansas like to have both wheat and oranges, they specialize in their crops and trade the surplus. Of course, Kansas farmers could build **greenhouses** for growing oranges, and Florida farmers might find a way to grow wheat, but the **costs** of doing so are probably very high. So by trading in their specialities, both areas benefit. The same happens in industry. When businesses in a nation can produce an item more **efficiently** than another, they are said to have an ***ABSOLUTE ADVANTAGE***.

COMPARATIVE ADVANTAGE

Not all nations have absolute advantages. Still, they engage in foreign trade because of the principle of comparative advantage. A nation has a comparative advantage in the production of a **particular** item when the opportunity costs of producing that item are lower than the opportunity costs of producing another. The law of comparative advantage explains why it pays nations to specialize in the production of those goods and services in which they have the greatest comparative advantage. When every country does what it can do best, all countries can benefit because more of every good or service can be produced without wasting labor, capital, and natural resources.

THE BARRIERS TO INTERNATIONAL TRADE

Despite the many advantages of trade between nations, most countries **restrict** that trade in many ways.

TARIFFS. A tariff is a duty, or tax on imports. There are two basic types of tariffs.