

LM06 · ECONOMICS · CFA LEVEL I

International Trade

Why nations trade, how governments restrict trade, and how global transactions balance

What This Reading Covers

This module explains why countries gain from exchanging goods, services, and capital. You will learn the **theory** of why trade creates wealth (absolute vs. comparative advantage, Ricardian and Heckscher-Ohlin models), the **mechanics** of trade restrictions (tariffs, quotas, VERs, subsidies, domestic content, anti-dumping), the **accounting** of cross-border payments (current, capital, and financial accounts), and the **institutions** that govern global trade (WTO, IMF, World Bank).

Learning Outcome Statements

- LOS a** Describe the benefits and costs of international trade
- LOS b** Contrast comparative advantage and absolute advantage
- LOS c** Compare the Ricardian and Heckscher-Ohlin models of trade and the source(s) of comparative advantage in each model
- LOS d** Compare types of trade restrictions (tariffs, quotas, export subsidies, VERs, minimum domestic content) and their economic implications
- LOS e** Explain motivations for and advantages of trading blocs, common markets, and economic unions
- LOS f** Describe the balance of payments accounts including their components
- LOS g** Explain how decisions by consumers, firms, and governments affect the balance of payments
- LOS h** Describe the functions and objectives of the IMF, the World Bank, and the WTO

Exam Tip: The two highest-yield mechanics in LM06 are: (1) working **opportunity costs** from an output-per-worker table to identify comparative advantage, and (2) drawing the **tariff/quota welfare diagram** and labelling the A, B, C, D regions (consumer-surplus loss, producer-surplus gain, government revenue / quota rent, and deadweight loss).

LOS A · BENEFITS AND COSTS OF TRADE

Why Do Nations Trade?

BENEFITS VS. COSTS — A GENERAL CONSENSUS

BENEFITS

- Gains from specialization (comparative adv.)
- Higher export prices / lower import prices
- Economies of scale → lower costs
- Greater product variety for consumers
- Competition reduces monopoly power
- Knowledge spillovers / tech exchange

COSTS

- Loss of jobs in import-competing sectors
- Workers need retraining
- Potential for greater income inequality
- Decline of some domestic industries
- Less-efficient firms go out of business

Long-run consensus: benefits > costs

Benefits (LOS a)

- 1 **Gains from exchange and specialization** — importing countries buy at lower prices than their domestic supply could produce; exporting countries receive a higher price than they could obtain at home.
- 2 **Specialization by comparative advantage** arising from differences in *technology* and *factor endowments* — the two sources analyzed in the Ricardian and Heckscher-Ohlin models.
- 3 **Greater economies of scale** — access to global markets lets industries produce at larger, more efficient scale.
- 4 **Product variety** for households and firms.
- 5 **Increased competition** — reduces monopoly power of domestic firms and forces them to become more efficient; resources reallocated.
- 6 **Knowledge spillovers** — freer flow of technical expertise and ideas.

Costs

- 1 **Loss of jobs** in import-competing industries (workers must retrain).
- 2 **Income inequality** may widen — especially where low-skilled labor competes with cheaper foreign labor.
- 3 **Decline of some domestic industries** — less-efficient firms exit the market.

General consensus: In the long run, *aggregate* benefits exceed costs. Overall welfare rises even when individual workers and firms are hurt.

LOS B · ABSOLUTE ADVANTAGE VS. COMPARATIVE ADVANTAGE

Two Kinds of Advantage

ABSOLUTE ADVANTAGE (AA)

A country can produce **more** of a good (or produce it with **fewer resources**) than another country.

"Who is the better producer in raw terms?"

COMPARATIVE ADVANTAGE (CA)

A country can produce a good at a **lower opportunity cost** than another country — i.e., sacrificing less of the other good.

"Who gives up the least to produce one more unit?"

Key insight

Specialization and trade are driven by *comparative*, not *absolute*, advantage. Even a country with absolute advantage in *both* goods gains by specializing in the good where its CA is largest and importing the other.

The Classic Ricardian Table (Portugal & England)

Output per unit of labor in each country:

COUNTRY	YARDS OF CLOTH	BOTTLES OF WINE
Portugal	100	110
England	90	80

Read each cell as: output produced by one unit of labor in that country.

Absolute advantage?

Portugal produces **more of both** goods per unit of labor ($100 > 90$ cloth, $110 > 80$ wine) — Portugal has **AA in both goods**. Naively, it looks like Portugal should make everything. Ricardo showed this is wrong.

Exam Tip: Level I often shows an output-per-worker (or hours-per-unit) table and asks "which country has the comparative advantage in X?" Always translate to opportunity cost — do not just compare raw outputs.

LOS B · COMPARATIVE ADVANTAGE — WORKED CALCULATION

Finding CA from an Output Table

WORKED EXAMPLE

Portugal vs. England — Cloth and Wine

GIVEN

COUNTRY	CLOTH (YARDS/LABOR)	WINE (BOTTLES/LABOR)
Portugal	100	110
England	90	80

FIND

Which country has the **comparative advantage** in cloth? In wine?

SOLUTION — STEP BY STEP

- 1 Opportunity cost of 1 cloth = wine given up.** To make 1 unit of cloth you redirect 1/(cloth output) of labor, which would have produced (wine output)/(cloth output) wine.

$$OC(\text{cloth}) = \text{wine output} \div \text{cloth output}$$

- 2 Portugal:** $OC(\text{cloth}) = 110/100 = 1.10 \text{ wine}$. $OC(\text{wine}) = 100/110 \approx 0.909 \text{ cloth}$.

$$\text{Portugal: } 1 \text{ cloth} \leftrightarrow 1.10 \text{ wine} \mid 1 \text{ wine} \leftrightarrow 0.909 \text{ cloth}$$

- 3 England:** $OC(\text{cloth}) = 80/90 \approx 0.889 \text{ wine}$. $OC(\text{wine}) = 90/80 = 1.125 \text{ cloth}$.

$$\text{England: } 1 \text{ cloth} \leftrightarrow 0.889 \text{ wine} \mid 1 \text{ wine} \leftrightarrow 1.125 \text{ cloth}$$

- 4 Compare OCs.** England gives up *less wine* (0.889) per cloth than Portugal (1.10) → **England has CA in cloth**. Portugal gives up *less cloth* (0.909) per wine than England (1.125) → **Portugal has CA in wine**.

ANSWER

Portugal — AA	In BOTH goods
Portugal — CA	Wine
England — CA	Cloth
Trade pattern	Portugal exports wine ≠ imports cloth

TAKEAWAY

Even though Portugal is absolutely more productive in both goods, *both countries* gain by specializing by CA and trading. Total world output of cloth *and* wine rises — this is the gain from trade.

LOS C · RICARDIAN AND HECKSCHER-OHLIN MODELS

Two Theories of Comparative Advantage

Both models explain *why* countries have different opportunity costs — but they point to different root causes.

1. RICARDIAN MODEL

Source of CA

Differences in technology (labor productivity) across countries.

Assumptions

- **Labor is the only variable factor** of production
- Technology varies across countries (different productivity per worker)
- Returns to scale are constant

Prediction

Each country specializes in the good in which its labor is *relatively* more productive.

2. HECKSCHER-OHLIN MODEL

Source of CA

Differences in factor endowments — relative amounts of labor and capital (K/L ratios).

Assumptions

- Identical technology across countries within an industry
- **Both labor AND capital** are variable factor inputs
- Countries differ in their endowment of K vs L

Prediction

A country's CA lies in goods produced with its *relatively abundant* factor. A **capital-abundant** country (higher K/L) specializes in **capital-intensive** goods; a **labor-abundant** country specializes in **labor-intensive** goods.

Side-by-Side Comparison

	RICARDIAN	HECKSCHER-OHLIN
Source of CA	Technology differences	Factor endowment differences
Variable factors	Labor only	Labor and capital
Technology across countries	Different	Identical within industries
Implication for distribution	All labor gains	Income of abundant factor rises; scarce factor loses

Exam Tip: Ricardo = **Technology**. Heckscher-Ohlin = **Endowments** (of labor and capital). In H-O, the factor that is *relatively scarce* loses from trade in distributional terms — this is a common free-response trap.

QUIZ 1 · CHECKPOINT

Test Your Understanding: Benefits, Costs & Theory

Q1. Which of the following is *least likely* a benefit of international trade?

Q2. Country X produces 40 units of food or 20 units of cloth per worker; Country Y produces 10 units of food or 10 units of cloth per worker. Which country has the comparative advantage in cloth?

Q3. In the *Heckscher-Ohlin* model, the source of comparative advantage is:

Q4. Which assumption is specific to the *Ricardian* model (and *not* the Heckscher-Ohlin model)?

LOS D · TYPES OF TRADE RESTRICTIONS

Government Policies That Limit Trade

Why governments restrict trade

Protect domestic industries (especially infant or declining) · protect domestic employment · protect strategic industries (national security) · generate tariff revenue · retaliate against another country's restrictions.

Five Common Restrictions

- 1 **Tariffs** — taxes a government levies on imported goods.
- 2 **Quotas** — limits on the absolute quantity of a good that can be imported over a period.
- 3 **Export subsidies** — government payments to firms that export goods.
- 4 **Voluntary export restraints (VERs)** — the *exporting* country voluntarily caps the quantity it will send abroad, often to avoid tariffs/quotas by the trading partner.
- 5 **Minimum domestic content provisions** — require that some percentage of a product's value-added or components be of domestic origin.

Related Counter-Measures

Anti-dumping duties

Tariffs levied when foreign firms sell exports below fair value (or below cost) in the importing country's market.

Countervailing duties

Tariffs levied by the importing country against *subsidized* exports entering the country — offsets the subsidy.

Capital Restrictions

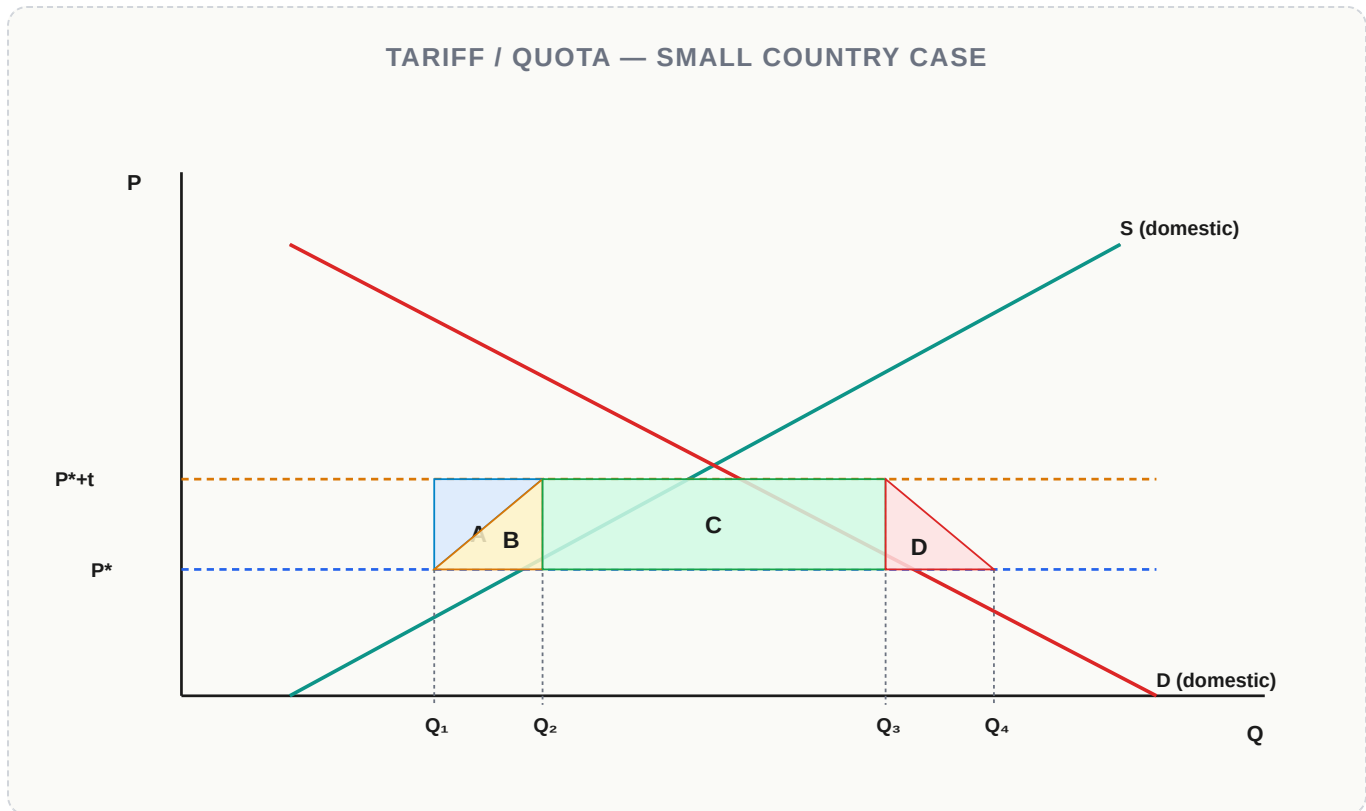
Capital restrictions are controls on foreigners' ability to own domestic assets, or on domestic residents' ability to own foreign assets. Examples:

- Outright prohibition of foreign investment in the domestic country
- Prohibition of (or taxes on) income earned on foreign investments by domestic citizens
- Restrictions on foreign investment in certain (strategic) industries
- Restrictions on repatriation of earnings by foreign entities operating locally

Overall, capital restrictions are thought to *decrease* welfare, but they can protect developing countries from volatile swings as foreign capital moves in and out.

LOS D · TARIFF EFFECTS ON SURPLUS

The A-B-C-D Tariff Diagram



What Each Region Represents

REGION	TARIFF	QUOTA
A	Gain in producer surplus (domestic producers win)	
B	Deadweight loss — higher-cost domestic production replaces imports	
C	Government tariff revenue	Quota rent — captured by exporter (or by government if it auctions import licenses)
D	Deadweight loss — consumers forced out of the market by the higher price	

Consumer-surplus loss = $A + B + C + D$

Consumers always lose the *entire* trapezoid when a tariff or quota is imposed.

Tariff

Net welfare change = $-(B + D)$. Producers gain A,

Quota (rent to foreign exporter)

Net welfare change = $-(B + C + D)$. No government

government gets C.

revenue — C leaves the country.

Exam Tip: Key distinction: a tariff keeps C *inside* the country (government revenue); a quota typically lets C escape as **quota rent** to the foreign exporter, making quotas more costly than an equivalent tariff unless import licenses are auctioned.

LOS D · TARIFF — WORKED NUMERICAL EXAMPLE

Computing A, B, C, D in Dollars

WORKED EXAMPLE

Small-Country Tariff on Imports

GIVEN

World price (P^*)	\$5 / unit
Tariff (t)	\$1 / unit (20%)
Free-trade domestic demand (Q_4)	200,000 units
Free-trade domestic supply (Q_1)	110,000 units
Imports (free trade)	90,000 units ($Q_4 - Q_1$)
With tariff: new domestic supply (Q_2)	130,000 units
With tariff: new domestic demand (Q_3)	170,000 units
Imports (with tariff)	40,000 units ($Q_3 - Q_2$)

FIND

(1) Loss of consumer surplus; (2) gain in producer surplus (A); (3) government revenue (C); (4) deadweight loss (B + D).

SOLUTION

1

Loss of consumer surplus = A + B + C + D. This is the trapezoid with height \$1 (tariff) between $Q_1=110,000$ and $Q_4=200,000$ — but measured correctly as a rectangle on Q_3 plus the triangle above it.

$$\Delta CS = 1 \times 170,000 + \frac{1}{2} \times 1 \times 30,000 = 170,000 + 15,000 = \$185,000$$

2

Producer-surplus gain (A) = rectangle on Q_1 plus triangle up to Q_2 .

$$A = 1 \times 110,000 + \frac{1}{2} \times 1 \times (130,000 - 110,000) = 110,000 + 10,000 = \$120,000$$

3

Government revenue (C) = tariff $\times$ units imported after the tariff.

$$C = 1 \times (Q_3 - Q_2) = 1 \times (170,000 - 130,000) = \$40,000$$

4

Deadweight loss (B + D) = the two triangles outside A and C.

$$B + D = \frac{1}{2} \times 1 \times (130,000 - 110,000) + \frac{1}{2} \times 1 \times (200,000 - 170,000) = 10,000 + 15,000 = \$25,000$$

5

Check: A + C + (B + D) must equal ΔCS .

$$120,000 + 40,000 + 25,000 = 185,000 \checkmark$$

ANSWER

Consumer-surplus loss (A+B+C+D)	\$185,000
Producer-surplus gain (A)	\$120,000
Government revenue (C)	\$40,000
Deadweight loss (B + D)	\$25,000
Net welfare effect	-\$25,000

LOS D · COMPARING ALL TRADE RESTRICTIONS

Effects on Surplus — Master Table

Memorize these four columns. Every common Level I question about trade policy draws from this grid.

IMPACT ON →	TARIFF	QUOTA	EXPORT SUBSIDY	VER
Who imposes it?	Importing country	Importing country	Exporting country	Exporting country (voluntarily)
Producer surplus (dom.)	Increases	Increases	Increases	Increases
Consumer surplus (dom.)	Decreases	Decreases	Decreases	Decreases
Government revenue	Increases	Increases <i>only if</i> quota rent captured (auctioned licenses)	Decreases (spending ↑)	No impact
National welfare (small country)	Decreases	Decreases	Decreases	Decreases
National welfare (large country)	<i>Could</i> increase	<i>Could</i> increase	Decreases	Decreases
Domestic price	Increases	Increases	Increases	Increases
Domestic production	Increases	Increases	Increases	Increases
Domestic consumption	Decreases	Decreases	Decreases	Decreases
Trade flows	Imports ↓	Imports ↓	Exports ↑	Imports ↓

Key nuances

- **Quota rent** = the area C in the tariff diagram. With a quota, that rent flows to whoever holds the import license — typically the *exporting* country. If the importing government auctions licenses, it recaptures C.
- **VER** — the exporting country voluntarily restricts quantity. Domestic government gets *no* revenue; the quota rent goes to foreign exporters who hold the scarce quota. National welfare of the importing country falls.

- **Export subsidy** — shifts sales from the domestic market to exports, so domestic price *rises* by the amount of the subsidy in the small-country case. In the large-country case, world price *falls*. Government outlays rise.
- **Large-country case** — a tariff or quota can improve national welfare if the country is big enough that foreign exporters cut their price to keep market share (terms-of-trade gain).

QUIZ 2 · CHECKPOINT

Test Your Understanding: Restrictions & Welfare

Q5. A quota differs from a tariff (of equivalent restrictive effect) most importantly because:

Q6. A small importing country imposes a \$1 tariff on an imported good. Pre-tariff imports were 90,000 units; post-tariff imports are 40,000 units. The tariff revenue equals:

Q7. A *voluntary export restraint* is imposed by:

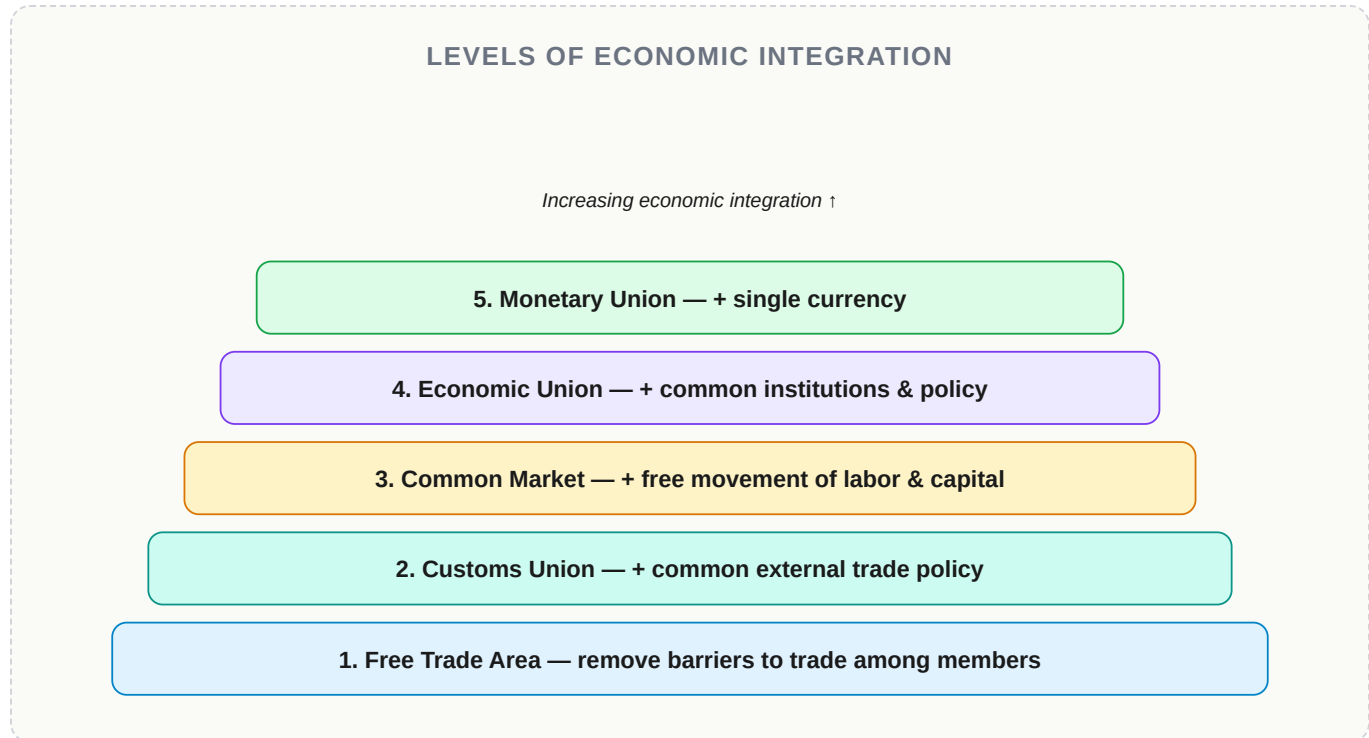
Q8. Which of the following trade restrictions is *most likely to decrease* a government's budget balance?

Q9. A countervailing duty is *best* described as a tariff imposed by an importing country to:

LOS E · TRADING BLOCS & REGIONAL INTEGRATION

The Integration Ladder

Each level of integration *includes* the provisions of the level below it.



Detail on Each Level

LEVEL	ADDS...	EXAMPLE
Free Trade Area	Removes barriers to trade in goods/services among members (each keeps own external policy)	NAFTA / USMCA
Customs Union	+ Common external trade policy vs. non-members	Mercosur (goods)
Common Market	+ Free movement of labor and capital among members	European single market (goods-side)
Economic Union	+ Common institutions and coordinated economic policy	European Union
Monetary Union	+ Single common currency	Eurozone

Trade Creation vs. Trade Diversion

Trade Creation (welfare ↑)

Higher-cost domestic production is replaced by *lower-cost* imports from member countries. Price falls, consumption rises.

Trade Diversion (welfare ↓)

Lower-cost imports from *non-member* countries are replaced with higher-cost imports from members (because members face no tariff). Resources are misallocated.

Net welfare effect of regional integration is positive if **trade creation > trade diversion**.

Motivations & Challenges

Motivations / Benefits

- Same benefits as free trade
- Reduces potential for conflict among members
- Long-run growth becomes interconnected
- Convergence in living standards
- Consumers gain choice; competitive firms gain productivity

Challenges / Costs

- May hurt low-skilled workers in wealthier members
- Less-competitive firms may fail
- Cultural/historical frictions (past conflicts)
- Limits on independent economic/social policy
- Labor mobility may thwart national wage policies

LOS F · BALANCE OF PAYMENTS ACCOUNTS

Tracking Cross-Border Transactions

The **balance of payments (BoP)** is a double-entry record of all transactions between residents of a country and the rest of the world. Because every transaction is recorded twice (debit and credit), the accounts must *balance*.

THE THREE BOP ACCOUNTS

1. CURRENT ACCOUNT

Merchandise trade
Services
Income receipts
Unilateral transfers

*Flow of goods, services
& current income*

2. CAPITAL ACCOUNT

Capital transfers
(debt forgiveness, gifts,
inheritance, migrant funds)
Non-produced, non-financial
asset sales (natural resource
rights, intangibles)

Small / infrequent items

3. FINANCIAL ACCOUNT

Portfolio investment
(debt, equity securities)
Foreign direct investment
(production, infrastructure)
Official reserve assets

Investment flows

Current Account — Detail

Merchandise trade	All commodities and manufactured goods bought, sold, or given away
Services	Tourism, transportation, engineering, business services, fees on patents & copyrights (software, books, movies)
Income receipts	Dividends and interest earned on foreign investments
Unilateral transfers	One-way transfers — foreign direct aid, remittances (income earned abroad sent home)

Capital Account — Detail

Capital transfers	Debt forgiveness, migrants' transfers, gift/inheritance taxes, death duties, transfers tied to fixed-asset sales
Non-produced, non-financial assets	Rights to natural resources, sale/purchase of intangible assets

Financial Account — Detail

Assets abroad	Official reserve assets (gold, forex, government securities), government assets, private assets (foreign securities held domestically)
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Foreign-owned assets at home Official foreign assets (bonds, stocks, MBS) plus other direct investment and foreign liabilities

The BoP Identity

Under the standard accounting convention:

$$Current\ Account + Capital\ Account + Financial\ Account = 0$$

A country with a **current-account deficit** (imports > exports) must fund it with a **capital/financial-account surplus** — it borrows from the rest of the world. Conversely, a current-account surplus is matched by net lending abroad.

LOS G · SAVING, INVESTMENT & THE TRADE BALANCE

From National Income to the Trade Balance

Starting from the national-income identity, we can derive a powerful relationship between *private* decisions (saving and investment), the *government* budget, and the *trade* balance.

Step-by-step derivation

$$\text{Income} = \text{Expenditure} : C + S + T = C + I + G + (X - M)$$

$$\text{Cancel } C : S + T = I + G + (X - M)$$

$$\text{Rearrange} : S - I = (G - T) + (X - M)$$

$$(X - M) = (S - I) + (T - G)$$

SYMBOL	MEANING
C	Consumption
S	Private saving
I	Private investment (PP&E)
G	Government spending
T	Taxation (net of transfers)
X – M	Net exports (approximates the current-account balance)
T – G	Government surplus (fiscal balance)
S – I	Excess of private saving over domestic investment

Interpretation

A country's **trade balance** ($X - M$) equals the sum of **(private saving – investment)** and the **government surplus**.

- A **current-account deficit** ($X - M < 0$) is associated with *low private saving*, a *fiscal deficit* ($T - G < 0$), and/or *high domestic investment*.
- A deficit that funds high investment (rather than high consumption) can *raise* future productive capacity — it is not automatically bad.
- A current-account *surplus* means the country is a net lender to the world: $(S - I) + (T - G) > 0$.

Alternative forms of the same identity

$$CurrentAccount = Y - (C + I + G)$$

$$If CA < 0 \Rightarrow country must borrow from abroad$$

$$If CA > 0 \Rightarrow country must be lending abroad$$

Exam Tip: Level I loves the question "A country has a widening current-account deficit — which of the following is *most likely* to explain it?" Valid answers draw from the identity: falling private saving, rising domestic investment, or a larger fiscal deficit.

LOS H · INTERNATIONAL TRADE ORGANIZATIONS

IMF, World Bank, and WTO

THREE GLOBAL INSTITUTIONS — ONE MISSION EACH

IMF

Monetary cooperation
Exchange rate stability
Balance of payments
lender of last resort
Stability & payments

WORLD BANK

Low-interest loans
Grants & interest-free credits
Developing countries
Fight poverty
Development & poverty

WTO

Trade flows freely
Multilateral agreements
Dispute resolution
Enforce trade rules
Rules & disputes

International Monetary Fund (IMF)

Facilitates trade by **promoting international monetary cooperation and exchange-rate stability**, assists in setting up international payments systems, and acts as **lender of foreign exchange** to member countries facing significant external deficits / BoP problems.

World Bank

Provides **low-interest loans, interest-free credits, and grants** to developing countries for specific purposes. Also provides resources and knowledge, and helps form public/private partnerships, with the overall goal of **fighting poverty** and promoting environmentally sound economic growth.

World Trade Organization (WTO)

Ensures that **trade flows freely and works smoothly**. Its main focus is instituting, interpreting, and enforcing **multilateral trade agreements** and **resolving trade disputes** among member countries.

One-line mnemonics

IMF → International Money & Forex stability · lender in BoP crises

World Bank → Bank for poor countries — *loans & grants* to fight poverty

WTO → Trade agreements & disputes — rules of the game

QUIZ 3 · CHECKPOINT

Test Your Understanding: BoP, Blocs & Institutions

Q10. Which integration level first adds *free movement of labor and capital* among members?

Q11. Foreign direct investment and portfolio investment in securities are recorded in the:

Q12. A country's private saving is 18% of GDP, domestic investment is 22% of GDP, and the government budget deficit is 3% of GDP. Its current account balance ($X - M$) is closest to:

Q13. Which institution's *primary* objective is to provide low-interest loans and grants to developing countries to fight poverty?

Q14. A regional trade agreement produces a net welfare *gain* when:

MODULE COMPLETE

Your Scorecard

0 / 14

LM06 Key Takeaways — Exam-Ready Cheat Sheet

Why Nations Trade

- 1 **Gains from trade:** specialization by CA, scale economies, variety, competition, knowledge spillovers. Long-run benefits > costs.
- 2 **Absolute advantage:** produces more with the same inputs. **Comparative advantage:** lower opportunity cost. Trade is driven by CA.
- 3 **Ricardian:** CA from *technology* differences; labor is only variable input. **Heckscher-Ohlin:** CA from differences in *factor endowments* (K/L); both factors variable, technology identical.

Trade Restrictions & Welfare (A-B-C-D)

- 4 **All restrictions** raise domestic price, raise domestic supply, lower demand, and reduce imports (or raise exports for subsidies). Consumers always lose; producers always gain.
- 5 **Tariff:** gov't gets area C. **Quota:** C becomes quota rent (usually to exporter, unless licenses are auctioned). **VER:** exporting country's choice; no gov't revenue at home. **Export subsidy:** gov't spending rises; domestic price rises by subsidy; world price falls in the large-country case. **Minimum domestic content:** fraction of value-added must be domestic.
- 6 **Deadweight loss** = B + D for a tariff; B + C + D for a quota whose C leaves the country.
- 7 **Anti-dumping duties** offset below-fair-value imports. **Countervailing duties** offset foreign export subsidies.
- 8 **Capital restrictions** limit cross-border asset ownership; generally welfare-reducing but dampen capital-flow volatility in developing markets.

Integration & Institutions

- 9 **Integration ladder:** FTA → Customs union → Common market → Economic union → Monetary union. Each level adds to the previous.
- 10 **Net welfare gain** from integration requires *trade creation* > *trade diversion*.
- 11 **IMF** → monetary cooperation, exchange-rate stability, BoP lending. **World Bank** → development loans & grants, poverty reduction. **WTO** → enforce multilateral trade agreements, resolve disputes.

Balance of Payments

- 12 **Three accounts:** Current (goods, services, income, transfers), Capital (debt forgiveness, non-produced assets), Financial (FDI, portfolio, reserves). They sum to zero.
- 13 **CA deficit** ⇔ net borrowing from abroad ⇔ surplus in capital + financial accounts.
- 14 **Master identity:** $(X - M) = (S - I) + (T - G)$. A trade deficit is driven by low private saving, high investment, or a fiscal deficit.

Last-Minute Exam Checklist

OC of 1 X = (Y output) / (X output) — lower OC ⇒ CA

Ricardo = technology · **H-O** = factor endowments (K/L)

Tariff diagram: A = producer gain · B+D = DWL · C = gov't revenue (tariff) or quota rent (quota) · CS loss = A+B+C+D

VER: exporting country restricts quantity; no domestic gov't revenue

$(X - M) = (S - I) + (T - G)$ — the whole trade-deficit story in one line

BoP sums to zero — a current-account deficit is funded by the financial account

IMF (monetary) · **World Bank** (poverty) · **WTO** (trade rules)