Unit 6

International Economics

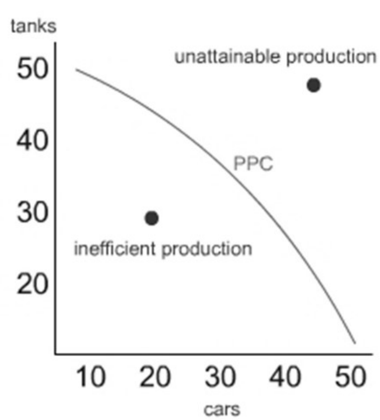
Macro-MacroEconomics

A good way to think of this unit is “macro-macroeconomics .” While microeconomics covers the interaction of a single market and macroeconomics views the larger national picture, international economics views an even larger picture: how the various national economies interact to form a world economy. The growth of massive multinational corporations is one sign that the world’s economy is becoming more interconnected each year. As national economies become more interconnected, international economic issues such as trade agreements and trade barriers become more important.

International trade allows a country to concentrate on what it does best and trade for what it can’t or doesn’t produce. In effect, trade allows a country to specialize in certain goods, which leads to more efficient production.

When a country has an absolute advantage over another country, it simply means that the country can produce more of a good than another country. Absolute advantage refers to an individual, firm, or country using the fewest inputs to produce the same amount of output or the individual, firm, or country producing the largest number of units of output given the same productive resources. (SSEIN1a)

While large countries will probably have an absolute advantage in production over smaller countries, when any two countries are producing two goods (like cars and sugar), one country will always have a comparative advantage over the other in the production of one of the two goods. Comparative advantage in production of a good or service exists when one individual, firm, or country has the lowest opportunity cost for producing the good or service. (SSEIN1a).



	Tanks	Cars
USA	50	50
Germany	20	30

__Absolute Advantage:__ when a nation can produce a product __more efficiently__ than can another nation. This means producing more output per unit of input.

Even when one nation enjoys an absolute advantage in the production of all goods as in this case, trade between it and another nation is still beneficial.

__Comparative Advantage__: the ability to produce a product relatively more efficiently, or at a __lower opportunity cost__.

	Tanks	Cars
USA	50	50
Germany	20	30

Absolute and Comparative Advantage Practice

In each example below indicate which country has the absolute advantage and comparative advantage for each item. ***Show work for Comparative Advantage***.

	Radios Installed		Speakers Installed	
Mark	6 $\frac{2}{6}$	$\frac{1}{3}$ spkr	2 $\frac{6}{2}$	$\frac{3}{1}$ 3 radio
Doreen	10 $\frac{5}{10}$	$\frac{1}{2}$ spkr	5 $\frac{10}{5}$	$\frac{2}{1}$ 2 radio

Absolute Advantage

Radios **Doreen** Speakers **Doreen**

Comparative Advantage

Radios **Mark** Speakers **Doreen**

The key to trade, whether among people, states or countries is <u>specialization</u>.

Different regions of a country specialize in certain economic activities in much the same way.

Ex. New York – Financial markets
Detroit – Automobiles
Midwest – Wheat Farming
Florida & California – Citrus Fruit

If you want to find out what a nation specializes in, look at its <u>exports</u>.

<u>Exports:</u> the goods and services that one nation produces and then <u>sells</u> to other nations.

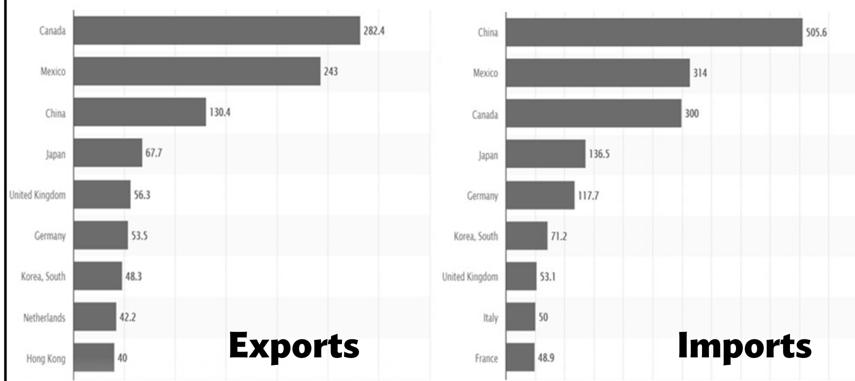
<u>Imports:</u> the goods and services that one nation <u>buys</u> from other nations.

A balance of trade records the value of all goods and services exported from a country minus the value of all goods and services imported from outside the country. This is often referred to as the "trade surplus" (if exports exceed imports) or the "trade deficit" (if imports exceed exports). (SSEIN1c)

Exports > Imports = Trade Surplus

Exports < Imports = Trade Deficit

Top Trading Partners of the United States (2017)



The sheer volume of trade between nations of such different geographic, political and religious characteristics is proof that trade is beneficial. Without trade, many products would not be available on the world market.

Barriers to International Trade

Trade Barriers are laws passed or actions taken by the government of a country with the intention of restricting the flow of goods and services between itself and another country or countries. Except for embargoes, the motivation for trade barriers is protection of a domestic industry or domestic jobs.

Barriers to Trade (SSEIN2a)

1. Tariff: A tariff is a tax on an imported good.

2. Quota: A quota is similar to a tariff, but instead of taxing the import, a quota limits the amount of a good that is allowed into the country.

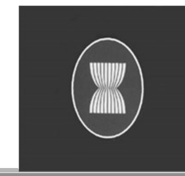
Barriers to Trade (SSEIN2a)

3. Embargo: An embargo on a particular good is like a quota set at zero; a government completely prohibits the import of that item.
4. Standards: Governments employ standards to ensure the safety of imported goods and to make sure that these goods comply with local laws . For example, the use of lead in paint is prohibited in the United States.
5. Subsidy: With a subsidy, the government makes payments to a local supplier to reduce the production costs of the supplier.

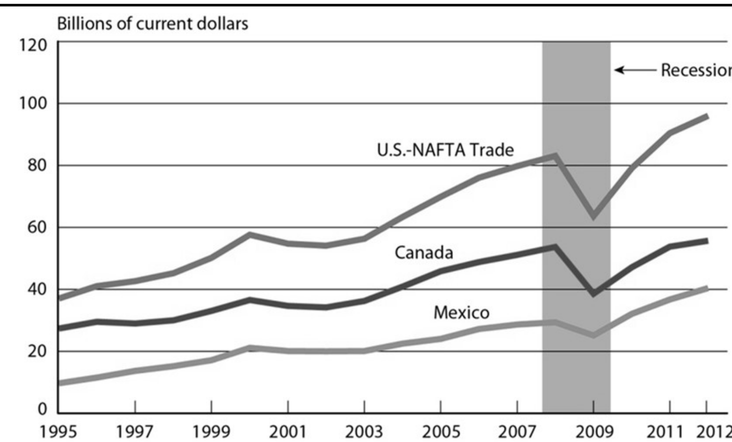
Trading Blocs

Trading blocs are formed in order to reduce barriers to trade. In theory, this will lead to lower prices for buyers (citizens) within the trading nations as well as for firms that are more competitive on the international market (because of increased competition). The North American Free Trade Agreement, NAFTA, is one such trading bloc; its goal is to eliminate barriers to trade—most notably tariffs—between Canada, Mexico, and the United States. The European Union (EU) allows for free movement of goods and workers across country borders. ASEAN is the Association of Southeast Asian Nations. It was established to promote economic growth, free trade, and economic collaboration between member nations. (SSEIN2c)

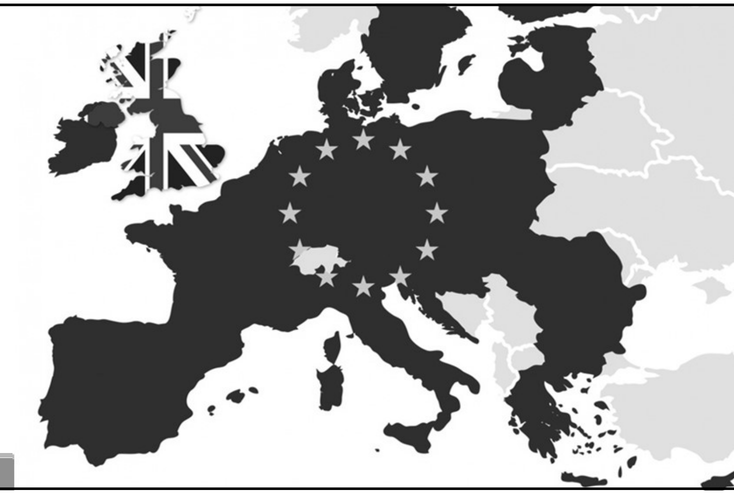




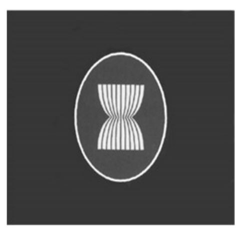
- **North American Free Trade Agreement (NAFTA): This is an agreement to reduce or eliminate trade barriers by reducing tariffs between the U.S., Canada, and Mexico**

- European Union (EU): A group of European nations banding together to reduce trade barriers. The EU is a single market where workers, money and goods and services can move between borders. Citizens hold common passports, can vote in European elections, and can travel anywhere in the EU to work, shop, save, or invest. In 2002, the EU introduced a single currency, called the euro, to replace the majority of individual currencies.



- Association for Southeast Asian Nations (ASEAN): a 10 nation group working to promote regional peace and stability, accelerate economic growth and liberalize trade policies.



Arguments in Favor of Free Trade (SSEIN2d)

- Free trade increases competition, which reduces costs for buyers and improves quality of goods.
- Free trade allows for domestic goods to be sold all over the world and protects export industries.
- Free trade allows the country to exercise comparative advantage through specialization.

Arguments against Free Trade (SSEIN2d)

- Infant industries (new industries in the early stage of development) are protected by trade barriers This allows infant industries to grow.
- Free trade hurts domestic workers. Companies may move oversees to utilize cheaper labor and increase profits.
- Labor standards are not the same in all countries. Some countries may treat their workers poorly.
- Some industries are critical to the country's national security. These industries should be protected even if they cannot compete internationally.

Exchange Rates

Exchange rates move up and down to reflect the value of one country's currency in comparison to another. If there is a great demand for U.S. products, people need more U.S. dollars to purchase these goods. This drives the demand for U.S. dollars up, causing the dollar to appreciate, or strengthen. At the same time, the peso has depreciated, or weakened, relative to the dollar. (SSEIN3b, c)

Exchange Rates

Most exchange rates between currencies fluctuate based on supply and demand. The terms appreciation and depreciation describe changes in the value of one currency in terms of another.

Appreciation refers to an increase in the value of one currency relative to another.

Depreciation refers to a decrease in the value of one currency relative to another.

RATES TABLE

1 US Dollar Rates table

Top 10 US Dollar	1.00 USD	Oct 09, 2018 21:40 UTC inv. 1.00 USD
Euro	0.870216	1.149140
British Pound	0.761061	1.313955
Indian Rupee	74.109600	0.013494
Australian Dollar	1.407631	0.710413
Canadian Dollar	1.294824	0.772305
Singapore Dollar	1.382575	0.723288
Swiss Franc	0.991981	1.008083
Malaysian Ringgit	4.157610	0.240523
Japanese Yen	112.986727	0.008851
Chinese Yuan Renminbi	6.922431	0.144458

U.S. Dollar, end of Year 1			*U.S. Dollar, end of Year 2*			*Change to a Dollar*
	One US Dollar	***In US dollars***		***One US Dollar***	***In US dollars***	
British pound	*0.49*	*2.06*	*British pound*	*0.52*	*1.92*	Appreciate
Danish Krone	*5.17*	*0.19*	*Danish Krone*	*4.83*	*0.21*	Depreciate
Euro	*0.69*	*1.44*	*Euro*	*0.67*	*1.49*	
Japanese Yen	*114.69*	*0.0087*	*Japanese Yen*	*121.3*	*0.0082*	
Mexican Peso	*10.71*	*0.093*	*Mexican Peso*	*15.02*	*0.067*	
Swiss Franc	*1.17*	*0.86*	*Swiss Franc*	*1.06*	*0.94*	
Thai baht	*31.7*	*0.03*	*Thai baht*	*36.8*	*0.027*	

If 1 Euro = $1.14, then business suits valued at 1,000 Euros in Paris would cost an American importer $1,140 each. The U.S. firm would go to an American bank and buy 1,000 Euros for $1,140 plus a small service fee.

Today, 2 kinds of exchange rates exist– fixed and flexible. For most of the 1900's the world depended on fixed exchange rates. This system was popular when the world was on a gold standard. A certain amount of a nation's money supply was backed by gold deposits. If a country allowed its money supply to grow too fast and its money was spent on imports, the country receiving the currency had the right to demand that it be converted into gold.

STRONG DOLLAR

- *Appreciates*
- U.S. exports will fall
  - Price of exports rise
- U.S. imports will rise
  - Price of imports fall
- Trade balance moves towards a deficit

WEAK DOLLAR

- *Depreciates*
- U.S. exports will rise
  - Price of exports fall
- U.S. imports will fall
  - Price of imports rise
- Trade balance moves towards a surplus