

UNIT 6: INTERNATIONAL ECONOMICS

FOREIGN TRADE

Essential Question: Why do individuals, businesses, and governments trade goods and services?

In this Unit, you will study the fundamental concepts of international economics. You will analyze how various trade policies, barriers, and agreements cause individuals, firms, and nations to respond in predictable ways. You will discuss how decisions made by one trading partner cause intended and unintended consequences for others and how international exchange rates affect the balance of trade between nations. You will apply the law of comparative advantage to their nation’s production and specialization decisions. You will also evaluate the costs and benefits of their trading relationships and explain why and how various productive resources must often be redirected to other industries when new trading relationships develop.

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).

Absolute Advantage: when a nation can produce a product _____ 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 _____, or at a _____.

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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	2
Doreen	10	5

Absolute Advantage

Radios _____ Speakers _____

Comparative Advantage

Radios _____ Speakers _____

	Cars	Computers
United States	12	4
Japan	10	6

Absolute Advantage

Cars _____ Computers _____

Comparative Advantage

Cars _____ Computers _____

	Potatoes	Cabbage
Anna	4	6
Barry	24	12

Absolute Advantage

Potatoes _____ Cabbage _____

Comparative Advantage

Potatoes _____ Cabbage _____

	Oranges	Coffee
United States	20	8
Columbia	5	15

Absolute Advantage

Oranges _____ Coffee _____

Comparative Advantage

Oranges _____ Coffee _____

	Clean an Office	Clean a Bedroom
Andy	60 minutes	30 minutes
Hannah	20 minutes	15 minutes

Absolute Advantage

Clean Office _____ Clean Bedroom _____

Comparative Advantage

Clean Office _____ Clean Bedroom _____

	Vacuum a Room	Wash Dishes
Mike	60 minutes	30 minutes
Debbie	45 minutes	45 minutes

Absolute Advantage

Vacuum _____ Wash Dishes _____

Comparative Advantage

Vacuum _____ Wash Dishes _____

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NAME _____

Balance of Trade

The key to trade, whether among people, states or countries is _____. Different regions of a country specialize in certain economic activities in much the same way.

- Examples: New York – _____
- Detroit – _____
- Midwest – _____
- Florida & California – _____

If you want to find out what a nation specializes in, look at its _____.

Exports: the goods and services that one nation produces and then _____.

Imports: the goods and services that one nation _____.

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 = _____

Imports > Exports = _____

Calculate the Net Exports for 2017 for each country below using the data on the slide. Label each as a surplus or a deficit.			
Canada		United Kingdom	
Mexico		Germany	
China		South Korea	
Japan			

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 _____ on an imported good.
2. **Quota:** A quota is similar to a tariff, but instead of taxing the import, a quota _____.
3. **Embargo:** An embargo on a particular good is like a quota set at zero; a government completely _____.
4. **Standards:** Governments employ standards _____ 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 _____ to reduce the production costs of the supplier.

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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 _____.

European Union (EU): A group of European nations banding together _____. 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 _____, 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 _____, 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 _____ through specialization.



Arguments against Free Trade, or Promoting Restricted Trade (SSEIN2d)

- Infant industries (new industries in the early stage of development) are protected by trade barriers This _____.
- Free trade _____. Companies may move overseas to utilize cheaper labor and increase profits.
- Labor standards are not the same in all countries. Some countries may _____.
- Some industries are _____. These industries should be protected even if they cannot compete internationally.

Review

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.

The economic model explaining the how two entities can benefit from trade is the law of comparative advantage. **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.

The country with the lowest opportunity cost for producing a good or service should specialize in that good and then trade with another country for the other good. By producing those goods for which it has the lowest opportunity cost, countries can consume beyond the production possibilities of their own country. Specialization allows countries to allocate resources to their best possible use and creates greater economic efficiency.

Create a scenario with two imaginary countries and two goods that they produce and fill in the blank table below

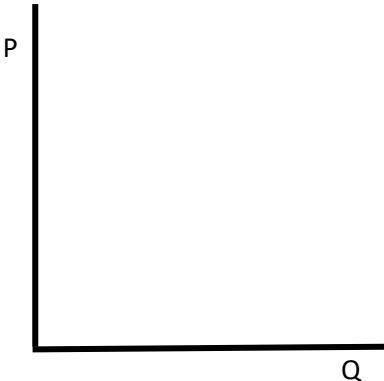
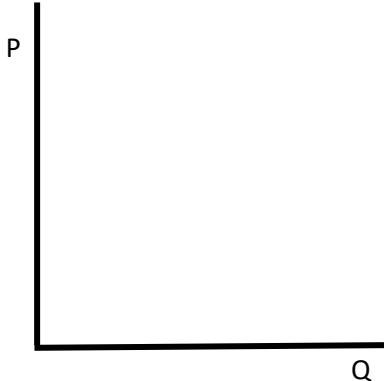
Countries	# of units of _____	# of units of _____

For each product, which country has an absolute advantage?

Explain which country has a comparative advantage in which product and how you got to that conclusion.

EOC QUICK REVIEW

Define Equilibrium: _____

Examine the Market for Gasoline:	
<p>New battery technology makes electric cars cheaper and more efficient.</p> 	<p>The U.S. Government removes all speed limits and lowers the driving age to 14.</p> 

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Exchange Rates

Exchange rates move up and down to reflect _____
 _____. 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)

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 _____ of one currency relative to another.

Depreciation refers to a _____ of one currency relative to another.

The table below shows the price of the U.S. dollar expressed in terms of other currencies for Year 1 and Year 2. In Year 1, a dollar cost .49 pounds. In Year 2, a dollar cost .52 pounds. Since the dollar was more expensive for people holding British pounds in Year 2 than in Year 1, the dollar appreciated against the pound. In Year 1, a dollar cost 5.17 Danish krone. In Year 2, a dollar cost 4.83 krone. Since the dollar cost less for people holding Danish krone in Year 2 than in Year 1, the dollar depreciated against the krone.

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

The value of the dollar appreciates in relation to the Mexican peso.

Mexican prices for US imports will _____. (increase/decrease)

The amount of US imports from Mexico will _____. (increase/decrease)

The U.S. balance of trade with Mexico will move towards a trade _____. (deficit/surplus)

The value of the Euro depreciates in relation to the Indian Rupee.

European prices for Indian imports will _____. (increase/decrease)

The amount of European exports to Indian will _____. (increase/decrease)

The Indian balance of trade with Europe will move towards a trade _____. (deficit/surplus)

The value of the dollar becomes weaker relative to other currencies.

US imports will _____. (increase/decrease)

US exports _____. (increase/decrease)

The price of imports in the U.S. will _____. (increase/decrease)

The U.S. balance of trade will move towards a trade _____. (deficit/surplus)

Practice Test

- _____1. If the U. S. government disagrees with a foreign country’s politics and wants to prevent trading with that country, the MOST effective action the U .S. government can take is to
- A. place high tariffs on all goods from that country.
 - B. place an embargo on all goods from that country.
 - C. enforce safety standards on all goods from that country.
 - D. enforce a quota on all goods shipped from that country.
- _____2. Which definition BEST describes the term balance of trade?
- A. the difference between a country’s exchange rate and the value of a country’s imports
 - B. the value of a country’s goods and services that are exported divided by its per capita income
 - C. the difference between the yearly value of a country’s exports and the yearly value of goods it produces
 - D. the value of a country’s exported goods and services minus the value of goods and services a country imports
- _____3. What is the MOST LIKELY result of an increase in the value of the U .S. dollar against the Chinese currency?
- A. U .S. workers in the United States would benefit.
 - B. Chinese importers of U .S. goods would benefit.
 - C. U .S. consumers of Chinese goods would benefit.
 - D. Chinese consumers of Chinese goods would benefit.
- _____4. Which of the following is an example of an import quota?
- A. A 7% tax on the potential profits from an imported good
 - B. A 621,780 kilogram-limit of an imported good
 - C. A tax of \$220 dollars per ton of an imported good
 - D. A tax of 5% of the value of an imported good
- _____5. Which statement BEST describes the situation illustrated in the U.S. Balance of Trade graph?
- A. The United States is increasingly selling more goods abroad than it buys.
 - B. The United States has increased its trade deficit every year since 1974.
 - C. The United States is increasingly buying more goods from abroad than it sells.
 - D. The United States trade deficit doubled between the years 1982 and 2002.
- _____6. What is a major disadvantage in the use of import barriers to make domestic goods cheaper?
- A. Domestic manufacturers create more jobs for both citizens and immigrants.
 - B. Other nations might retaliate with barriers of their own, leading to a trade war.
 - C. Domestic manufacturers will become more profitable
 - D. The line between imported and domestic goods becomes harder and harder to draw.
- _____7. U.S. industries like steel, computers, and energy need to be protected from foreign competition for what reason?
- A. Their production is economically advantageous
 - B. These industries are usually the least profitable
 - C. These industries are critical for national defense
 - D. These industries are very inefficient
- _____8. What happens when a nation’s currency depreciates?
- A. Its products become more expensive to other nations.
 - B. Its trade balance increases.
 - C. Its products become cheaper to other nations.
 - D. Its trade balance decreases.



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- ____ 9. Ecuador has a comparative advantage in the production of bananas over the United States. Which of the following statements is true?
- A. Ecuador also has an absolute advantage in the production of bananas.
 - B. The United States has an absolute advantage in the production of bananas.
 - C. Ecuador can produce bananas more efficiently and at lower cost than the United States.
 - D. The United States cannot produce bananas.
- ____ 10. Suppose the United States decreases the tariff on imported tuna. What would the consequences be?
- A. There would be a decrease in the number of imported tuna.
 - B. There would be an increase in the number of imported tuna.
 - C. There would be an increase in the number of exported tuna.
 - D. There would be no change whatsoever; that’s a trick question; that ain’t even funny.

Use the following figures to answer the next four questions:

Year	Value of 1 Euro in US dollars	Value of \$1 in Euros
2008	1.25	0.79
2009	1.42	0.70

- ____ 11. If you took \$1000 to Europe in 2008 and exchanged it for Euros, how many Euros would you have received?
- A. 1,250
 - B. 790
 - C. 1,420
 - D. 700
- ____ 12. If a European tourist brought €1,000 Euros to the United States in 2008 and exchanged it all for dollars, how many dollars would the tourist have received?
- A. 125
 - B. 700
 - C. 1,250
 - D. 7,000
- ____ 13. Which currency depreciated in value from 2008 to 2009?
- A. the euro
 - B. both
 - C. the dollar
 - D. neither
- ____ 14. Based on the figures provided above, which of the following statements is most likely accurate?
- A. US exports to Europe rose between 2008 and 2009
 - B. US imports from Europe rose between 2008 and 2009
 - C. American items became more expensive for Europeans to purchase
 - D. European items became cheaper for Americans to purchase

Match each term with the correct statement below:

a. NAFTA	b. World Trade Organization (WTO)	c. European Union (EU)	d. appreciation	e. trade war
f. import quota	g. comparative advantage	h. absolute advantage	i. protectionism	j. export

- ____ 15. the ability of one person or nation to produce a good at an opportunity cost that is lower than that of another person or nation
- ____ 16. the use of trade barriers to protect a nation’s industries from foreign competition
- ____ 17. a worldwide organization whose mission is to reduce trade barriers and to settle international trade conflicts.
- ____ 18. a regional trade organization made up of European nations
- ____ 19. agreement that will eventually eliminate all tariffs and other trade barriers between Canada, Mexico, and the United States
- ____ 20. a limit on the amount of a good that can be imported
- ____ 21. a good that is sent to another country for sale
- ____ 22. an increase in the value of a currency