INTERNATIONAL TRADE NOTES

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 (as you know from earlier sections) leads to more efficient production. An example of this can be found by considering the relationship between Brazil's sugar industry and the United States' auto-making industry. The climate and environment of Brazil makes growing sugar cane relatively easy. It would be much harder to grow sugar cane in Detroit, for example, which would require large greenhouses, huge sunlamps, and a labor force skilled in the growth of this tropical plant. It is much easier for Detroit (and by extension the United States) to specialize in manufacturing automobiles and then trade for sugar from Brazil. In fact, when each country specializes in what it does best, each country has more to trade. In other words, as both countries take advantages of their strengths, both countries increase their overall economic well-being.

2.) <u>Deficits & Surplus:</u>

- **<u>Trade Deficit:</u>** If IMPORTS exceeds EXPORTS
- **<u>Trade Surplus:</u>** If EXPORTS exceeds IMPORTS

<u>Balance of Trade vs Balance of Payments:</u>

- **<u>Balance of Trade:</u>** Balance of Trade refers to the amount of exports and imports within a country in a given time period. When the products of one nation become more appealing to foreign consumers then exports increases, if at the same time, imports decrease, the nation will discover that the Balance of Trade is improving since more products are flowing outwards than those coming into the country.
- **<u>Balance of Payments:</u>** (BOP) is similar to the Balance of Trade, except it includes the measurement of cash as is flows in and out of the country. As more imports come into the country, then the Balance of Payments worsens because more money is flowing out of the county. On the other hand, as more exports leave the county, more money flows into the country, thus the Balance of Payments is improved.
  - The BOP includes two accounts: **Capital** and **Current**
    - **Capital Account** shows the net change in physical or financial asset ownership for a nation and, together with the current account, constitutes a nation's balance of payments.
    - **Current Account** is defined as the sum of the balance of trade (goods and services exports less imports), net income from abroad and net current transfers.

3.) <u>Advantages of Trade:</u>

<u>Absolute Advantage:</u>

- A country has an ***<u>absolute advantage</u>*** economically over another, in a particular good, when it can produce that good **more efficiently**. Using the same input of resources a country with an absolute advantage will have greater output.
- For example, Brazil has an absolute advantage over the United States in the production of sugar, while the United States has an absolute advantage over Brazil in the production of cars.

<u>Comparative Advantage:</u>

- To maximize the benefits of trade, each country **specializes** in the goods that it produces at the lowest opportunity cost. Simply, countries export what they can produce at a lower opportunity cost and import products that other countries can produce at a lower opportunity cost. Because of this trade, all countries can produce and consume more.
- Put another way, given two countries that can both produce sugar and cars, one country should specialize in producing cars and one country should specialize in producing sugar so that they can trade. **So the difference between absolute advantage and comparative is that a country only has an comparative advantage if, as a result of trade, it can produce something with less resources.**

3.) <u>Current Account and relationship to Balance of Payments:</u>

- The **<u>current account</u>** defined as the sum of the balance of trade (goods and services exports less imports), net income from abroad.
- A **current account deficit** means the value of imports of goods / services / investment incomes is greater than the value of exports. It is sometimes referred to as a **<u>trade deficit or a negative Balance of Payments (BOP)</u>**

4.) <u>Tariffs, Quotas, Embargos, Subsidies & Protectionist Trade Policy:</u>

<u>Protectionist Trade Policy:</u>

- In general, both tariffs and quotas are put in place to make it easier for **domestic producers** to compete against foreign firms who can sell their products in the United States for cheaper. The downside is that foreign products will become more expensive as the government tries to increase tariffs or set quotas on foreign products and raw materials.

- A ***tariff*** is a tax on an imported good. This increases the price of that good, thereby decreasing the quantity demanded. A tariff might help a domestic producer stay in business, even though an imported good would (without the tax) be cheaper for domestic consumers.
- A **quota** functions in a similar way but instead of taxing the import, a quota limits the amount of a good that is allowed into the country. That way, while a foreign good may be cheaper, domestic consumers can only buy so much of it before they have to buy comparable domestic goods instead.
- An ***embargo*** is the stoppage of all imports from a county. For example, the U.S. will not trade with Cuba at all. We will not ship any items to them, not can they ship items to us. Embargo limit trade and thus generate problems for both importer and exporter. The Cubans can't receive American medicines and the U.S. can't receive Cuban sugar, rum, or cigars.
- ***Subsidies*** can be given to domestic suppliers to offset the cost of production, thus making it easier to compete with cheaper imports.

5.) Trade Organizations:

- **NAFTA: North Atlantic Free Trade Agreement** is an agreement between the United States, Mexico, and Canada to gradually eliminate most barriers to trade and investment and to follow specified agreements to protect workers and the environment.
- **EU:** The **European Union** (previously known as the European Community) created after World War II to unite the nations of Europe economically to avoid another war. The European Union supports a free movement of goods, services, capital and labor across member countries. The EU has a variety of programs funded by member countries. It also coordinates economic, social and environmental policies across member countries.
- **ASEAN:** Association of Southeastern Asian Nations. Supports free trade among Indonesian countries
- **WTO: World Trade Organization** was established in 1995 and deals with the rules of trade between nations at a near-global level; it is responsible for negotiating and implementing new trade agreements, and is in charge of policing member countries' adherence to all the WTO agreements

6.) Exchange Rates:

- The **exchange rate** is defined by how much money, or the amount, of a foreign currency you can buy with one US dollar. The exchange rate is how many pesos or euros you can exchange for one US dollar.

Example of Using the Exchange Rate:

- Sometimes, it's easier to think about foreign currency in terms of US dollars. You know how much a soda costs in the US. Pretend you're buying something in France: is a soda in the Paris airport worth two euros? To know what you're paying for the soda in France, it helps to know how many US dollars two euros represents.

Let's turn the example into a word problem.

- You want to buy a soda in the Paris airport. The soda costs two euros. You have $2 US dollars. Do you have enough money? The euro exchange rate is 0.74. That means one US dollar buys, or can be exchanged for, 0.74 euros.
- In order to find out how much two euros is in US dollars, divide 1 (one, as in one dollar) by 0.74 to calculate how many US dollars one euro is worth in Europe: $1.35.
- 1 United States dollar = 0.74 euros and 1 euro = 1.35 USD
- Using the exchange rate, you see that $1 equals a little over .74 euros. Two US dollars equals about 1.48 euros; two euros equals about $2.70 in US money. **You cannot afford the soda.**

7.) Mexican Narrative Example:

Consider the case of two grocery stores: Americo-store and Groceria Mexicana. Americo-store is in Brownsville, Texas, while Groceria Mexicana is right across the border in Matamoros, Mexico. Suppose that the exchange rate between the U.S. dollar and the Mexican peso is 1:10, meaning one U.S. dollar translates to 10 Mexican pesos. Exchange rates move up and down to reflect the worth 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. This means that the new exchange rate is, say, 1:15, meaning an American dollar now translates to 15 Mexican pesos.

Here’s the big question: Which grocery store benefits from the new exchange rate?

If you answered Groceria Mexicana, you would be correct. The appreciated dollar makes U.S. goods more expensive relative to their Mexican counterparts. The dollar can purchase more, but it also raises the price of U.S. goods. Some U.S. customers might take advantage of the strong dollar and cross the border to shop at Groceria Mexicana, since their dollars are worth 15 pesos instead of 10. Similarly, anyone converting pesos to dollars needs to pay 15 pesos for one dollar, rather than 10. In this case, when a person is converting dollars to pesos, his or her purchasing power has increased due to the new exchange rate.