So What?


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The next time you're at home, look in your closet. What will you see? You'll see clothes that took an economic journey to get there. This economic journey was the result of trade between producers and buyers. You might find the producers and buyers in the same town or country. Or, you might find them in different parts of the world. Why would buyers trade with producers they don't know and will probably never see? That's easy. Buyers want the best products at the lowest prices. And sometimes, they can only get those products from other countries. Producers, in turn, are willing to trade with buyers in other countries because the buyers represent new, profitable markets. Both groups should win when global trade occurs. Will you?

Objectives

A. Explain why global trade is needed.

B. Describe issues in global trade.

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Trading Places

When producers and buyers who engage in trade with each other are located in the same country, their transactions are domestic. For instance, baseball bats made in Kentucky and marketed in California are domestic goods. Caterpillar tractors manufactured in Illinois and sold in Alaska are domestic goods, too. Both transactions are examples of **domestic trade**.


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▲ According to the U.S. Census Bureau, the top 10 countries with which the U.S. trades are Canada, China, Mexico, Japan, Germany, the United Kingdom, South Korea, Saudi Arabia, Brazil, and France.

Global trade, on the other hand, takes place when a product is produced in one country and consumed in another. Your neighbor's MINI Cooper automobile was built in England. Your adidas shoes were probably made in Indonesia or China. And, your aunt's wooden IKEA furniture was likely manufactured in Poland or Sweden. All three of these examples are the result of global trade.

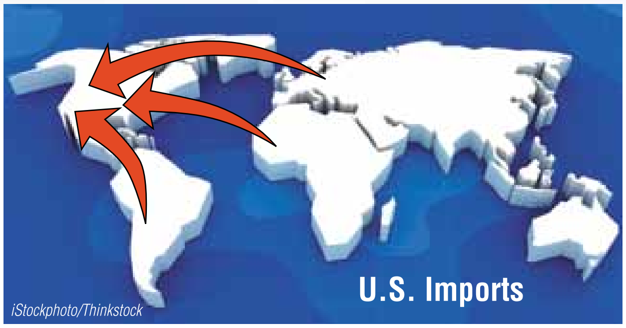
They come, and they go

Goods or services bought from producers in other countries are known as **imports**. While most imports are tangible goods that are shipped to the U.S. for purchase (like the MINI Cooper, adidas shoes, or IKEA furniture), some imports are intangible services such as a college education. What imports have you purchased lately?

Exports are just the opposite. They are goods or services businesses sell to other countries. The United States, for example, exports large quantities of manufactured goods, chemicals, and food products, while Canada exports a great deal of machinery and transportation equipment. Who buys these exports? Individuals (importers), businesses, or even governments.

The Tucci family of Seattle is one of these importers. During an espresso coffee craze years ago, the Tucci's began importing *LavAzza* coffee, the best-selling coffee in Italy. Operating initially from the family's garage, they stored, distributed, and marketed the coffee to small grocery stores, specialty shops, and restaurants in their area.

The Tucci's import business, now known as Italia Imports, continues to grow. In addition to coffee and espresso, their business also sells espresso machines, olive oil, and canned tomatoes (from Italy, of course). And, yes, they've moved out of the family's garage.



▲ U.S. imports include every good or service that the United States purchases from producers in other countries.

▲ U.S. exports include every good or service that American producers sell to other countries.

Most countries have government agencies responsible for regulating imports such as the Tucci family's coffee and other products. The primary purpose of these agencies is to make sure all imports meet legal requirements and are safe for consumers to use or consume. (More on product standards later.)

Unlike importers who find markets in their home nation, exporters find markets for their goods or services abroad. In other words, they locate buyers in other countries. And, like importers, exporters must comply with local and foreign trade regulations. They are responsible for shipping the goods to their foreign buyer—the importer. Luckily, many national, regional, and local governments have agencies to aid exporters in finding new customers.

To trade or not to trade?

Let's say that you and a friend each have 10 video games. Both collections are exactly the same. Would you and your friend trade games? Probably not. There wouldn't be any reason to trade since you each have the same ones. However, what if you and your friend each had 10 different games? Now, there's a good chance that you'd be interested in trading. You could each give up the games that you don't play too much. Both of you could benefit from this trade. You could each get new games to play and get rid of those you don't want.

Global trade takes place for reasons similar to yours and your friend's. Different countries have different resources. The United States, for example, can produce some goods more efficiently than other countries because of better access to certain raw materials, workers with special skills, or more up-to-date machinery.

Countries are more efficient when they produce and trade the goods and services for which their resources are best suited. As an example, the U.S. specializes in the production and exchange of automobiles, while Malaysia specializes in palm oil production. Americans benefit more if they concentrate on producing and selling autos than if they tried to produce both automobiles and palm oil. Likewise, Malaysians benefit more if they concentrate on producing and selling their specialties.

When one country is able to produce a good or service at a lower cost than another country can, it has an **absolute advantage** over the other country. Therefore, if the U.S. can produce automobiles more cheaply than Malaysia can, it has an absolute advantage over Malaysia in the production of autos. And, if Malaysia can produce palm oil less expensively than America, Malaysia has an absolute advantage over the United States in the production of palm oil.

What if the United States were able to produce both palm oil and automobiles more cheaply than Malaysia could? Would the United States still trade with Malaysia? The answer depends on whether a **comparative advantage** exists. A comparative advantage is the benefit a country obtains from specializing in and producing the goods and services at which it is *relatively* most efficient. Let's stick with our palm oil and automobile example, but let's give the U.S. producers an absolute advantage in both cases.

Production Costs

Country	Palm Oil	Automobiles
United States	$4 pint	$10,000 each
Malaysia	$6 pint	$14,000 each

Objective A

When a nation can produce a good or service at a lower cost than another nation can, it has an **absolute advantage** over the other nation.

A nation has a **comparative advantage** if it specializes in and produces the goods and services at which it is *relatively* most efficient.

From the chart, it's easy to see that the producers in the United States can produce a pint of palm oil for $2 less than producers in Malaysia and an automobile for $4,000 less than in Malaysia. But what about the comparative advantage?

To determine the comparative advantage, the countries have to figure out how much of one product they would have to give up to produce more of another product. In this case, it would cost the United States 2,500 pints of palm oil ($10,000/$4) to produce one automobile. Malaysia would have to forgo 2,333 pints of palm oil ($14,000/$6) to produce one auto. Malaysia would have a comparative advantage in producing automobiles since the cost of what is being given up (2,333 pints of palm oil) is less than the amount that the United States would have to give up (2,500 pints of palm oil).

If a U.S. importer suggested trading 2,400 pints of U.S. palm oil for one Malaysian automobile, would it be a good deal? You bet. The Malaysian producer would get more pints of palm oil for one automobile than if it traded domestically within Malaysia. Likewise, the Malaysian auto would cost the U.S. importer fewer pints of palm oil than if the trade occurred within the United States. In this way, both nations benefit. Countries should produce and sell those goods and services for which they will have a comparative advantage.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▲ Countries around the world trade with each other to obtain goods and services that they don't have or are less efficient in making.

Why do it?

When countries trade with each other, they benefit. They use their absolute and comparative advantages to trade goods and services, and they obtain other goods and services that they lack or that they are less efficient in making. Some specific benefits of global trade include:

1. A better variety and quantity of goods and services
2. An improved standard of living for the citizens in both trading countries
3. Access to and availability of scarce resources, such as oil and diamonds
4. Lower prices for goods and services due to increased competition
5. Possible exchange of ideas and technology among countries
6. Enhanced relations among trading countries
7. Increased income for the shipping and/or airline industries due to increased freight and tourism

Summary

The buying (importing) and selling (exporting) of goods and services between countries is global trade. Countries should specialize in the production of goods and services for which they have absolute and comparative advantages. Global trade can be a win-win for all countries involved.

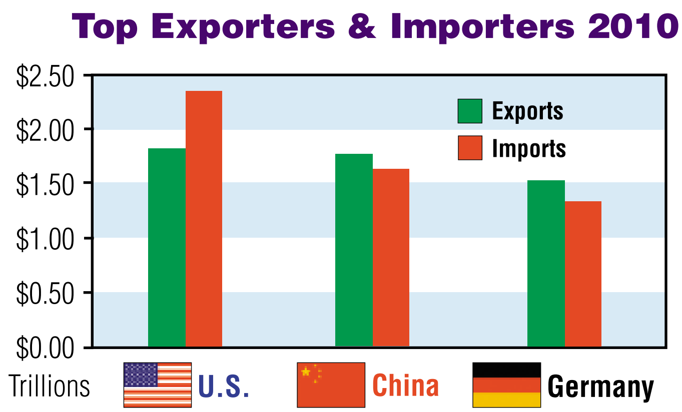
1. What is global trade?
2. What is the difference between imports and exports?
3. Why does global trade take place?
4. What is the difference between absolute and comparative advantage?
5. Identify five benefits of global trade.

Going, Going, Gone—Global!

Can you imagine having to wait two to three weeks to get a message from a friend who lives somewhere else in the world? Probably not. Luckily, thanks to satellites, cell phones, and the Internet, you can communicate instantly and cheaply with your friend. Technology helps to bring the people of the world closer together.

As our world *shrinks*, it becomes more and more obvious that events in one country can have an important, and often immediate, impact on others. Countries react to stock-market changes, environmental disasters, political unrest, and product shortages in other parts of the world. All of these world events—plus more—affect businesses across the United States.

Global trade is significant to the U.S. economy. As one of the world's largest exporters and importers, the United States exports roughly $1.8 trillion worth of goods and services each year. At the same time, the U.S. imports more than $2.3 trillion worth of goods and services. What does this all mean for the U.S. and its trading partners? Read on to find out.



Source: World Trade Organization, World Trade 2010.

A nation's bank account

Just as you keep track of your cash, a nation tracks the money coming into and going out of the country. It uses an annual accounting record, known as the **balance of payments**, to track all of its monetary transactions with other countries.

The Gray Zone

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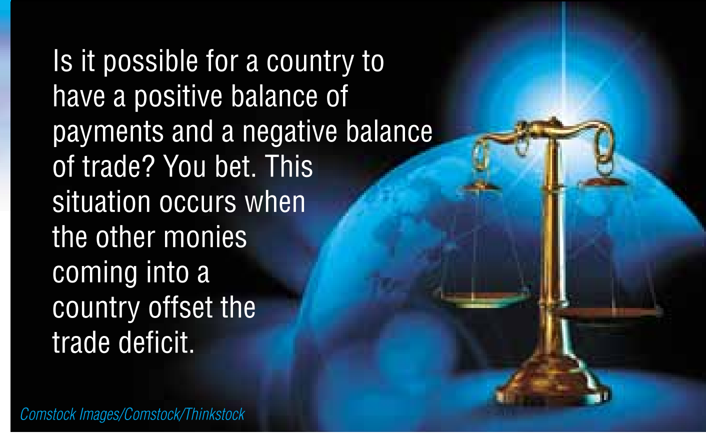
What should a highly profitable American corporation care about more: safe working conditions and fair wages for its overseas suppliers' employees, or making money?

That was a question facing Apple in 2012. Reports from multiple news sources documented that Chinese workers employed by an Apple supplier were required to assemble products for near-slave wages under dangerous conditions. Can you imagine working six 12-hour shifts in just one week for less than $2 per hour? It was everyday reality for these employees. On top of all that, they put their lives at risk each day at work—in 2011, four workers were killed and 77 were injured in the course of two explosions at just one factory in Chengdu, China. And, these workers couldn't even resign without trouble from the police.

So, what is a corporation's responsibility? Should American corporations ensure that their overseas suppliers' employees are treated fairly, even if it means raising prices on their own products as a result? Or, is it okay for foreign suppliers to require whatever they like of their employees, so long as the products that they sell to U.S. corporations are good quality?

Objective 3



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A country's balance of payments includes exports, imports, foreign aid, business investment abroad, and money spent by tourists. Money coming into a country, exports, and money spent by tourists increase the balance of payments. Imports and business investment abroad, on the other hand, represent money going out and therefore reduce the balance of payments.

Just like you and businesses, a nation needs to have more money coming in than going out. A favorable balance of payments occurs when more money comes in than goes out. If the balance of payments is unfavorable, a country's leaders need to review and change its trade policies.

If you look at the difference between the value of a nation's imports and exports, you can see the country's **balance of trade**. When a country exports more goods and services than it imports, a **trade surplus** exists. Trade surpluses can increase the value of a nation's currency and improve its standard of living. In effect, a trade surplus increases a country's gross domestic product.

On the other hand, if a country (such as the U.S.) imports more than it exports, a **trade deficit** exists. Trade deficits can lower the value of a country's currency and result in fewer job opportunities, thereby reducing a country's gross domestic product.

Competition is an ongoing process. Nations around the world face many challenges, including:

- Training their workforce to compete globally
- Investing in factories and equipment
- Obtaining adequate wages for all workers
- Protecting the environment
- Finding new trading partners and dealing with trade barriers

Competing for customers

In business, as in sports, competition is the key. Competition forces companies to keep their prices low. It also encourages companies to produce better products. Businesses that can't compete will fail.

Before World War II, businesses in the United States competed with each other. There were few foreign competitors. Today, this has all changed. American automakers must compete with car manufacturers in such countries as Japan, Italy, Germany, and South Korea. The competitive environment has caused domestic car manufacturers to change the way they do business. They have had to reexamine their manufacturing facilities, equipment, product line, assembly techniques, and decision-making policies.

The automakers are not alone. In today's shrinking world, all businesses have to evaluate their goods and services against those of domestic and global competitors. Why is this? If they fail to offer a better good or service than a competitor does, their customers may switch to the competitor's product.

Competition is also good for an economy. It keeps it lean and efficient. Those who can't produce quality goods or services are forced out. Those who can, profit. Some of the factors that can affect a country's ability to compete worldwide include inflation; high unemployment levels; government support (or lack thereof); and new, emerging economies.

Show me the money

The value of currencies fluctuates due to many economic and political activities taking place around the world. Because of this, a country's currency is worth more at certain times than at other times. Just as you shop where your money will buy the most goods and services, so do global businesses. For example, if Canada's currency is worth more than the U.S. dollar, Canadians could get more goods and services for their money by buying in the U.S. rather than in Canada. On the other hand, if the value of Canada's currency was lower than that in the U.S., Canadians would probably buy domestically—in their own country.

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▲ Would you rather trade with a country that has a strong currency or a weak currency? Why?

A strong or highly valued currency increases imports from countries with lower valued currency because the foreign goods are less expensive to buy. It discourages exports since foreign customers would have to pay more for the goods. The reverse is also true. A weak currency decreases imports because it costs more to buy outside the country. It increases exports, though, because foreign customers would pay less to buy goods outside their home countries.

Government control of global trade

Since global trade can have a significant impact on a country's economy, a nation may attempt to limit its trade with other countries. This action, referred to as **protectionism**, is usually used to avoid trade deficits or to protect domestic industries against foreign competition. Protecting homegrown businesses can provide more employment, but it can also reduce competition. It may cause consumers to pay higher prices at home while creating trade problems with other nations.

Governments limit global trade through a variety of trade barriers, or restrictions. The most frequently used trade barriers are tariffs, quotas, subsidies, licenses, and product standards.

Tariffs are taxes on certain imported goods. They are used to provide revenue for governments or to protect industries that might not be able to withstand foreign competition. Most consumers are unaware of these hidden taxes, which are levied per pound or per unit on foreign goods when they enter the country. The net effect of tariffs is to raise the price of imported goods. Let's say that the U.S. charges a tariff on foreign-made computers. This allows American-made computers to be sold at lower prices than those of their foreign competitors. The global trend today, however, is to reduce or eliminate tariffs.

Quotas limit the volume of exports or imports that move into or out of a country. Limiting the amount of imports tends to aid domestic industries by limiting foreign competition. In the past, the U.S. set quotas on wood, steel, and textiles. However, the trend in the United States is to eliminate or greatly reduce existing quotas.

Subsidies also protect domestic industries from foreign competition. If the government subsidizes a particular domestic producer, it pays the producer for each good or service that it produces. But, the government expects nothing in return (no product, money, etc.) for providing the subsidy. Because the producer receives a virtual "payment" from the government for each unit of product, it can offer the product to its customers at a lower price. And as a result of the low price, customers are likely to shop domestically rather than buy higher priced imports.

Licenses are import permits that nations use to keep track of imports and regulate the level of imports by individual businesses. If a country wants to limit the number of imports allowed into the country, it can limit the number of licenses issued to foreign exporters. At the same time, licenses can also be required of domestic exporters in an effort to keep products in the country's own economy.

Product standards are criteria for determining a product's ability to meet specified guidelines or requirements. Such requirements prevent the import of goods that do not meet U.S. government standards. They are often used to protect consumers and/or the environment. As an example, the U.S. requires vehicles shipped into the country to meet certain emission and safety standards that comply with regulations of the U.S. Environmental Protection Agency (EPA).

Government support of global trade

You may think by now that all government activities limit trade. That is simply not the case. In fact, several organizations and trade agreements worldwide have been established to encourage global trade. These organizations and trade agreements include the following:

The **European Union (EU)** reduces trade barriers among its members—Europe's major industrial countries as well as many smaller nations. This regional free-trade agreement has united its member nations into one economy. It is a good example of **globalization**: the rapid and unimpeded flow of capital, labor, and ideas across national borders. As one trade zone, the EU countries have more power when dealing with nations outside the EU than the countries had when they negotiated individually.

The **World Trade Organization (WTO)** is a global organization that essentially sets the rules of trade among nations throughout the world. Established in 1995, its membership has grown to roughly 150 countries. Headquartered in Geneva, Switzerland, the WTO administers trade agreements, handles trade disputes, and acts as a forum for trade negotiations for its member nations. All of the world's strongest economies are members, including the U.S., Canada, China, Japan, and Germany.

The **North American Free Trade Agreement (NAFTA)** has eliminated almost all trade barriers between Canada, the U.S., and Mexico. These barriers included tariffs, quotas, and customs regulations. NAFTA allows the free movement of goods and services among the three countries. This historic agreement has created a North American trade zone with over 500 million consumers.

Objective 3

▲ Trade talks often focus on reducing inflation, improving growth and employment, and settling disputes among participating nations and trade organizations. The ultimate goal of trade talks, though, is to improve global trade.

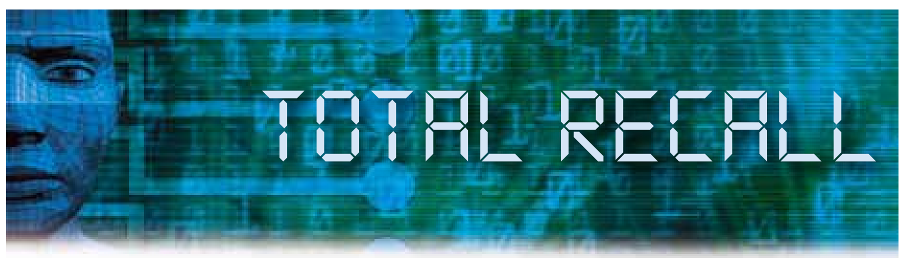
Many countries also use other methods to improve their global trade relations. For instance, **trade centers**, located in most major cities throughout the world, assist exporters through the export process and share information about tariffs, product standards, and other regulations with importers. **Trade missions** also facilitate global trade. Business executives and government officials who take part in trade missions travel to foreign countries to promote trade. Finally, **trade talks** (such as economic summits involving Canada, the European Union, Japan, Russia, and the United States) are used to improve global trade relations. Trade talks usually place high priority on reducing inflation, improving growth and employment, and settling disputes among participating nations and trade organizations.

Summary

Just as technology has improved our ability to communicate globally, it has also improved global business practices. Most countries engage in some form of global trade, importing and/or exporting a variety of goods and services. The difference between the value of a nation's exports and its imports is the country's balance of trade. Due to globalization, businesses must compete domestically and globally. The value of a nation's currency impacts the flow of products into and out of the country. Governments may use tariffs, quotas, subsidies, licenses, and product standards as barriers to global trade. Most countries, however, support global trade. World and regional organizations such as the European Union and the World Trade Organization work to improve the climate for global business.

Make It Pay!

What goods and services are produced in your community? Which of these products are exported to other countries? If you don't know, what products do you *think* could be exported? For instance, could your local chocolatier sell its candy overseas? Or, how about the cars manufactured by the factory down the street? Could those autos be exported? Why or why not?



1. What is the difference between balance of payments and balance of trade?
2. Explain benefits of a trade surplus.
3. Discuss problems associated with a trade deficit.
4. What role does competition play in business and global trade?
5. How does the value of a nation's currency affect global trade?
6. Describe five types of trade barriers used to limit global trade.
7. What is the purpose of the:
   a. European Union (EU)
   b. World Trade Organization (WTO)
   c. North American Free Trade Agreement (NAFTA)

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