12

Global Trade, Finance, and Partnerships

NEWS UPDATE

- The textbook addresses politically motivated trade restrictions and it mentions some examples. The Russian attack on Ukraine precipitated numerous sanctions on Russia, including a U.S. halt to over half of Russia's high-tech imports. This alone will harm Russia's industrial base and its ability to exert global influence. Additional financial sanctions will impede other parts of the country's trade structure, and ultimately, its entire economy. Unprecedented supportive actions by U.S. allies will enhance the limitations placed on Russia, and in particular, on its military (The White House, *www.whitehouse.gov*, Feb. 24, 2022).

PURPOSE

The purpose of this fourth international chapter is to introduce the student to the world of international trade and finance, along with global partnerships that have the potential to solve some of the major world problems. If students worry that international trade is difficult, they will fear that international finance is even more difficult. Nevertheless, you can reassure your students that these are straightforward and rely on the graphs the students have seen before: production possibilities and demand and supply. International finance is discussed in Appendix 12–1.

WHAT'S NEW?

1. The opening statements of former President Trump and President Biden couldn't be more different regarding the U.S. role in the world. The first is of the nationalist type — "America First" — and the second envisions that the United States "is back to the world stage!"
2. This chapter continues to explore the unique trade issues for developing countries and additional material focuses on the exploitation of workers.
3. The *Viewpoint* section is new, and it contrasts Trump's nationalist populist viewpoint towards trade with President Biden's perspectives. Nevertheless, Biden does express some populism amid his trade views.
4. A new NAFTA trade deal was negotiated by the Trump administration and called the USMCA (the U.S.–Mexico–Canada Agreement). It is quite similar to NAFTA but includes some requirements that will benefit U.S. car manufacturers, and it places labor and environmental protections directly into the trade agreement. The latter is definitely a good thing, as the separation of the treaty from the labor and global protections with NAFTA was problematic.
5. Once again, there is attention given to structural unemployment that may result from trade, and since Trump regarded these unemployed people as part of his base, it is important to find ways to assist them that do not include trade restrictions.

TEACHING SUGGESTIONS

➢ *Student Interest*

- Because this chapter covers the entire globe and isn't focused on just one region, you may want to learn from students where they have traveled. If you have international students, you may want to ask them where they're from, but don't embarrass them! (It may help to ask them ahead of time if they want you to call on them or maybe even ask if they want to tell the class about their country of origin.)
- I think that many students (as well as the American public) are somewhat intimidated by international economics. It may help to tell your students that they can understand all of the concepts in the text by using the familiar production possibilities graph and the demand and supply model.
- This chapter also presents the opportunity to discuss international trade from the perspective of developing countries. Students (and teachers!) may find this information novel and interesting.
- While international trade in the developing world may not initially seem interesting to students, we can heighten their interest (and perhaps their activism) by raising such issues as sweatshop and slave labor, child labor, fair trade versus free trade, and the impact of U.S. trade restrictions and agricultural subsidies on people of the developing world. My students were so impressed with the DVD *Black Gold* that they organized a campus showing and discussion. They also initiated action on campus to encourage our food service to provide fair trade products.

➢ *Controversy*

- Students may have some preconceived notions and viewpoints that will be challenged in this chapter. You may want to poll students on the following at the outset. At the end of the chapter, repeat the poll!
  1) How many of you believe trade is good for the United States? How many believe it is bad?
  2) How many of you believe it would be good for the United States to be entirely self-sufficient rather than engage in trade? How many believe it would be bad?

➢ *Economic Theory and Models*

- Students will find the first figures showing the production possibilities curve (with no trade) and the consumption possibilities curve (with trade) quite interesting and useful. The main thing is that they recognize trade is not a zero-sum game, and that all trading countries can benefit from trade.
- Figure 12–3 uses the demand and supply model to show the impact of U.S. trade in cotton, revealing which groups of people benefit and which ones lose. (Table 12–3 summarizes these results.) Students may have difficulty locating the quantity of U.S.-produced cotton in the second graph of Figure 12–3. That is one thing that seems to elude many of them.
- Figures 12–4 and 12–5 address the inelastic demand and fluctuating supply for commodities and the resulting price fluctuation. These graphs are similar to those in Chapter 10 showing U.S. agricultural markets.
- The figures in Appendix 12–1 use the demand and supply model to demonstrate exchange rate determination.
- I've found that it becomes too complicated for students when we try to explain the reasons for the downward sloped demand curve and upward sloped supply curve of a nation's currency (in Appendix 12–1). I leave this for a principles or international finance course. (Students are adequately familiar with demand and supply curves by now that they will "accept" the visual slopes we use in this course.)

- Similarly, when we consider changes that shift the demand or supply of a nation's currency, I use only examples that shift the demand curve to keep the concepts as straightforward as possible.

➢ *Data and Terminology*

- It is important that students understand the meaning of the updated global data on exports, imports, exports plus imports, and the trade balance. They need to understand why we look at these as a share of GDP.

➢ *Fundamentals*

- Inequality in the U.S. is fostered by a lack of attention (or the wrong kind of attention) to the retraining and retooling needs of U.S. businesses and workers as they lose sales and jobs due to changing trade relations.
- Inequality between countries is fostered by U.S. policies that place developing countries at an unfair disadvantage in trade.
- Inequality and racism play a role in the exploitation of foreign labor, often ethnic minorities, the poor, and children.

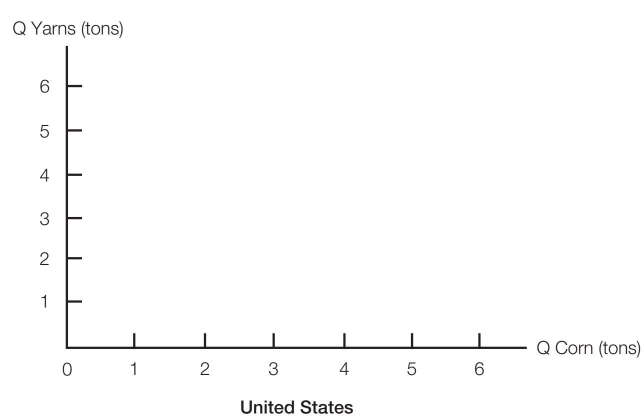
CLASSROOM EXERCISES

1. The following table shows that each U.S. worker can produce either 6 tons of corn or 3 tons of yams per year and each Ugandan worker can producer either 1 ton of corn or 2 tons of yams per year.

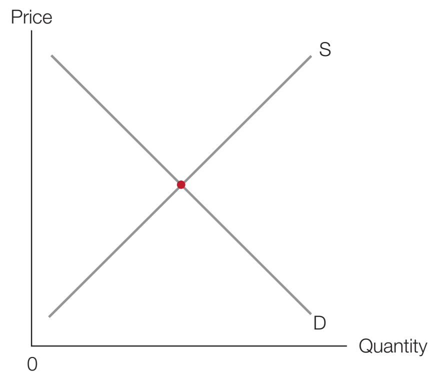
Country	Corn Production (tons)	Yam Production (tons)
United States	6	3
Uganda	1	2

   a. Which country has an absolute advantage in corn production? [U.S.]
   b. Which country has an absolute advantage in yam production? [U.S.]
   c. Which country has a comparative advantage in corn production? [U.S.]
   d. Which country has a comparative advantage in yam production? [Uganda]

2. Based on question 1, draw the (straight-line) production possibilities curve (for 1 worker) in the United States per day. Now suppose the United States decides to specialize completely in corn production and trades with Uganda at a mutually beneficial trade ratio of 1 ton of corn for 1 ton of yams. Draw in the U.S. consumption possibilities curve with free trade. Is the United States better off with or without trade with Uganda? [With trade] Is Uganda better off with trade? [Yes]



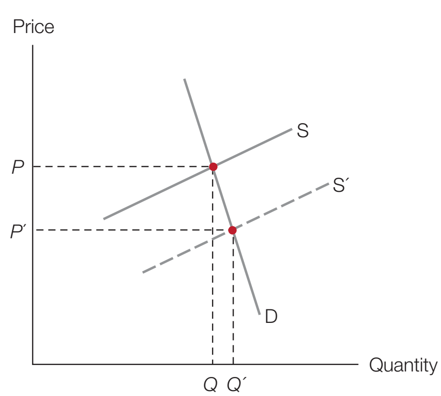
3. Consider a graph of the U.S. market for tobacco, assuming the United States is a large producer of tobacco and all tobacco is identical. Label the initial equilibrium point (E) within the graph, and label the equilibrium price (P) and equilibrium quantity (Q) along their respective axes. Shift the curve that occurs if the United States begins to freely import tobacco (shift it forward to S^T), and label the new free trade price (P^T) along the price axis, and the quantity demanded (Q^D) by U.S. consumers of tobacco and quantity supplied (Q^S) by U.S. producers of tobacco along the quantity axis. Note that Q^D is found at the intersection of the new free trade price with the demand curve, and Q^S is found at the intersection of the new free trade price with the original supply curve. What is the effect of free trade in tobacco on the following groups of people? (Answer gain or lose.)



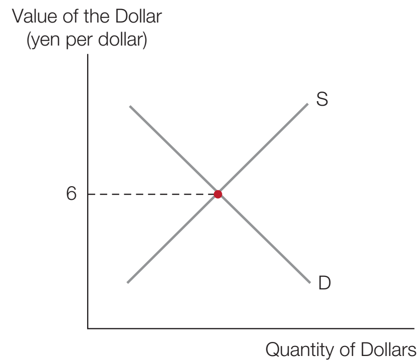
   a. U.S. consumers of tobacco [gain]
   b. U.S. companies that produce tobacco [lose]
   c. U.S. workers in the tobacco industry [lose]
   d. U.S. producers of export products [gain]
   e. The U.S. as a whole [gain]

4. Now suppose that the U.S. government places a quota on the import of tobacco. What is the impact of this trade restriction on each of the following groups?
   a. U.S. consumers of tobacco [lose]
   b. U.S. companies that produce tobacco [gain]
   c. U.S. workers in the tobacco industry [gain]
   d. U.S. producers of export products [lose]
   e. The U.S. as a whole [lose]

5. What two characteristics of the cocoa market are represented by the following demand and supply curves? (Hint: The combination of these two characteristics results in unstable cocoa prices.)
   a. Inelastic demand
   b. Weather-related supply fluctuation



6. (*Appendix 12–1*) Consider the following graph of the market for the U.S. dollar relative to the Japanese yen. (Assume Japan and the United States are the only two countries in the world.) Shift the demand curve for the dollar that occurs if more Japanese people travel in the United States. What is the effect on the value of the dollar relative to the yen? [Increase] What is the effect on the value of the yen relative to the dollar? [Decrease]



Market for U.S. Dollars

7 Set up a table showing that each U.S. worker can produce either 5 tables or 10 pineapples per day, while each Bolivian worker can produce either 1 table or 4 pineapples per day. Which country has an absolute advantage in table production? [the U.S.] An absolute advantage in pineapple production? [the U.S.] A comparative advantage in table production? [the U.S.] A comparative advantage in pineapple production? [Bolivia] Can the United States still benefit from trade with Bolivia? [Yes]

8. Based on information in the previous question, draw the (straight-line) production possibilities curve (for 1 worker) in the United States per day, placing the quantity of tables on horizontal axis and the quantity of pineapples on the vertical one. Draw the U.S. consumption possibilities curve with trade, assuming the United States decides to specialize in table production and trades with Bolivia at a mutually beneficial trade ratio of 1 table for 3 pineapples. Is the United States better off with or without trade? [With trade] And Bolivia? [With trade] (Note: The trade ratio was negotiated because it is mutually beneficial, or it evolves for the same reason.)

9. Draw a graph of the U.S. rice industry, assuming the United States is a large producer of rice and all rice is identical. Label the equilibrium point [E] within the table. Shift the curve to show what occurs if the United States begins to freely import rice. [Shift it forward.] Label the new equilibrium point (E') within the graph. Label the free trade price (P^T) along the price axis; and the new quantity demanded (Q^D) by U.S. consumers and quantity supplied (Q^S) by U.S. producers of rice along the quantity axis. Who gains and who loses? [Gainers are U.S. consumers of rice, foreign producers of rice, U.S. producers of export products, and the U.S. as a whole; but U.S. rice producers suffer.]

10. Now suppose the U.S. producers of rice convince the government to place a quota on of imported rice. What is the effect on U.S. producers of rice? [Gain] U.S. consumers of rice? [Lose] U.S. producers of export products? [Lose] The U.S. as a whole? [Lose] Foreign producers of rice? [Lose]

11. Ask if students believe the demand for tea is inelastic. Draw a fairly steep (inelastic) demand for tea. Ask students if they think the supply of tea fluctuates and why. Show this in the graph. What is the implication of these two characteristics of the tea market in the short run? [Price fluctuation] Show this in the graph.

SAMPLE TEST QUESTIONS

Multiple Choice Questions

1. Which of the following is true? Since 1960, as a share of GDP, our imports and exports have:
   a. increased.
   b. decreased.
   c. remained remarkably constant.
   d. This information is not provided in the text.

2. The table in the text shows that the United States has:
   a. a trade surplus.
   b. a trade deficit.
   c. a trade balance of zero.
   d. an enormously important trade sector as a share of U.S. GDP.

3. Some countries, such as Luxembourg and Vietnam:
   a. have enormously important trade sectors as a share of their GDP.
   b. have large values of exports as a share of their GDP.
   c. have large values of imports as a share of their GDP.
   d. all of the above

4. The three main U.S. trading partners include:
   a. China.
   b. Canada.
   c. Mexico.
   d. All of the above

5. Exports minus imports is the:
   a. budget balance.
   b. trade balance.
   c. exchange rate for the dollar.
   d. international debt.

6. Which of the following contributes to higher labor productivity?
   a. Training
   b. Modern capital
   c. Modern technology
   d. All of the above

7. A situation whereby one country can produce a good with lower opportunity cost than another country defines:
   a. comparative advantage.
   b. absolute advantage.
   c. situational advantage.
   d. advantage by proxy.

8. One benefit of trade is the improved ____________ achieved by specialization according to comparative advantage.
   a. equity
   b. efficiency
   c. political stability
   d. government borrowing

9. A country with wages and labor productivity three times higher than another country will have:
   a. much higher labor costs for each unit of production.
   b. much lower labor costs for each unit of production.
   c. identical labor costs for each unit of production.
   d. We don't have enough information to answer this question.

10. Which of the following *does not* gain from free trade in imports of handbags?
    a. The country as a whole
    b. Handbag consumers in the country
    c. Handbag producers in the country
    d. Export producers in the country

11. Producers of U.S. exported products may suffer when the United States imposes trade restrictions on imports because:
    a. other countries may retaliate with their own trade restrictions.
    b. other countries may purchase fewer U.S. products because their incomes may fall.
    c. exchange rate changes may result in foreigners purchasing fewer U.S. exports.
    d. all of the above

12. A tariff is:
    a. a tax on an imported good.
    b. a restriction on the quantity of an imported good.
    c. a requirement for quality of imported goods.
    d. all of the above.

13. U.S. trade restrictions on imports result in:
    a. a loss of gains from specialization for the United States as a whole.
    b. a greater opportunity for market power in the United States.
    c. losses to U.S. exporters.
    d. all of the above

14. Primary commodities generally have:
    a. inelastic demand.
    b. stable prices.
    c. supply that does not fluctuate.
    d. all of the above

15. "A situation where the prices of a country's exports decline relative to the prices of its imports" is the definition for:
    a. comparative advantage.
    b. voluntary export restraint.
    c. declining terms of trade.
    d. retaliation.

16. Which of the following is *not* true? Demand for developing country exports has declined:
    a. due to the development of synthetics.
    b. due to developed country trade restrictions.
    c. and contributed to declining terms of trade.
    d. and contributed to rising prices of exports of developing countries.

17. Which of the following was *not* a member of the North American Free Trade Agreement?
    a. Russia
    b. Canada
    c. United States
    d. Mexico

18. Which of the following is an international trade problem for a developing country?
    a. Lack of diversity in exports
    b. Reliance on exporting primary commodities
    c. Price instability
    d. All of the above

19. Which was *not* a result of the recent U.S. Great Recession?
    a. Foreign companies hired more workers.
    b. There was a decline in world trade.
    c. Americans lost jobs.
    d. Foreign companies cut production.

20. Which of the following are part of the United Nations (UN)?
    a. The Children's Fund (UNICEF)
    b. The Educational, Scientific, and Cultural Organization (UNESCO)
    c. The World Health Organization (WHO)
    d. All of the above

21. The mission of the International Criminal Court is to try cases involving:
    a. war crimes.
    b. genocide.
    c. crimes against humanity.
    d. all of the above

22. (*Appendix 12–1*) Which of the following is *not* a current member of the Group of Seven?
    a. Russia
    b. Canada
    c. United States
    d. Germany

23. (*Appendix 12–1*) The price of one country's currency in terms of another country's currency is the:
    a. exchange rate.
    b. balance of payments.
    c. Group of Eight.
    d. current account.

24. (*Appendix 12–1*) In a two-country world consisting of the United States and Canada, an increase in the value of the U.S. dollar means:
    a. the U.S. dollar appreciates relative to the Canadian dollar.
    b. the Canadian dollar depreciates relative to the U.S. dollar.
    c. the value of the Canadian dollar decreases relative to the U.S. dollar.
    d. all of the above

25. (*Appendix 12–1*) Canada and Germany belong to:
    a. the Group of Seven.
    b. the Six Markets Group.
    c. Mercosur.
    d. all of the above

True / False Questions

1. Absolute advantage is defined as a situation whereby a country can produce a good with lower opportunity cost than another country. **(F)**
2. Assuming two countries and two goods, a country that has an absolute advantage in production of both goods cannot possibly benefit from trade. **(F)**
3. When considering labor costs to a firm, both wages and labor productivity must be considered. **(T)**
4. The benefits of trade to a country include increased market power. **(F)**
5. U.S. trade restrictions on imports may result in retaliation by other countries. **(T)**
6. If our exports are greater than our imports, we have a trade deficit. **(F)**
7. With trade, a country may achieve a consumption possibilities curve superior to its production possibilities curve. **(T)**
8. A quota is a restriction on the quantity of an imported good. **(T)**
9. The term *primary commodity* is defined as a country's most important export product. **(F)**
10. Increased competition made possible through trade can reduce the likelihood of market power. **(T)**
11. Inelastic demand and fluctuating supply result in relatively stable prices. **(F)**
12. Declining terms of trade means the prices of a country's exports decline relative to the prices of its imports. **(T)**
13. An embargo is a restriction on trade for political reasons. **(T)**
14. Studies show that the United States has suffered a great deal of unemployment as a result of NAFTA. **(F)**
15. The General Agreement on Tariffs and Trade (GATT) has been replaced by the World Trade Organization (WTO). **(T)**
16. As a share of GDP, the United States has the world's largest exports plus imports. **(F)**
17. The U.S. trade balance was positive in 2016. **(F)**

18. As a share of GDP, U.S. exports are the largest in the world. **(F)**
19. U.S. producers of exported products benefit from U.S. trade restrictions on imports of other goods. **(F)**
20. Overall, the United States benefits from free trade. **(T)**
21. U.S. agricultural policies benefit poor, developing country farmers. **(F)**
22. U.S. economic conservatives have traditionally opposed free trade. **(F)**
23. U.S. agricultural policies were a controversial aspect of the Doha Round of trade talks. **(T)**
24. The opening quotes to this chapter refer to the trade policies of Presidents Obama and Trump. **(F)**
25. Traditional economic conservatism is the basis for Donald Trump's trade policies. **(F)**
26. (*Appendix 12–1*) An exchange rate is the price of one country's currency in terms of another country's currency. **(T)**
27. (*Appendix 12–1*) Most of the industrialized world uses a (largely) flexible (floating) exchange rate system. **(T)**
28. (*Appendix 12–1*) In a two-country world consisting of the United States and Japan, the demand for yen by U.S. citizens is the same as the supply of dollars by U.S. citizens. **(T)**
29. (*Appendix 12–1*) An increase in U.S. interest rates will cause a decrease in the value of the dollar relative to other currencies. **(F)**
30. (*Appendix 12–1*) The Group of Seven refers to seven industrialized countries that cooperate on policies to influence exchange rates. **(T)**

Critical Thinking Question

Thinking about the world as a whole, and not just the United States, do you think the world would be better off with or without trade? Why? Do you believe there should be any restrictions or regulations on free trade? Think about the economics of trade, as well as exploitation of labor and the environment.