Concept Review:
Trade Makes People Better Off

Back in Unit 1, we discussed how trade makes people better off (Principle #5 of the 7 principles that guide an economic way of thinking). None of us is equally good at doing everything. It makes more sense to concentrate on what we do best (specialization) and trade with others for what they do best. As a result, we end up with more and better choices than by trying to do everything for ourselves.

Concept Review: Absolute Advantage

Back in Unit 3, we discussed the concept of absolute advantage. This is where one group (individual/business/state/country) can produce a given item *cheaper and/or better* than another group. An example discussed in Unit 3 was apples & oranges. Due to its climate, Virginia can produce apples much better (and more cheaply) than Florida. Likewise, Florida can produce oranges much better (and more cheaply) than Virginia. Each state could produce the other fruit, but it would be much more costly (need for greenhouses, artificial lighting, etc., to simulate the climate needed for the other fruit).

In this example, Virginia has an absolute advantage over Florida in producing apples. Also, Florida has an absolute advantage over Virginia in producing oranges. In this example, it would be best if Virginia grows apples for its own use and to sell to Florida, and Florida grows oranges for its own use and to sell to Virginia.

Concept Review: Comparative Advantage

Another concept relating to trade discussed in Unit 3 was that of comparative advantage. This is the ability to perform a task *at a lower opportunity cost* than someone else is able to perform that task. The example discussed was two factories which each could produce computers and/or cell phones with the following production possibilities:

	Factory A	Factory B
Computers	9,000	6,000
Cell Phones	36,000	12,000

Opportunity Costs	
Factory A	**Factory B**

• Opportunity cost for producing **9,000** computers is **36,000** cell phones
  • Opportunity cost for producing ***1*** computer is ***4*** cell phones
• Opportunity cost for producing **36,000** cell phones is **9,000** computers
  • Opportunity cost for producing ***1*** cell phone is ¼ computer
	• Opportunity cost for producing **6,000** computers is **12,000** cell phones
	  • Opportunity cost for producing ***1*** computer is ***2*** cell phones
	• Opportunity cost for producing **12,000** cell phones is **6,000** computers
	  • Opportunity cost is for producing ***1*** cell phone is ½ computer

Factory A has a lower opportunity cost to produce cell phones (¼ computer compared to Factory B's ½ computer). Therefore, Factory A has a comparative advantage over Factory B in producing cell phones. Factory B has a lower opportunity cost to produce computers (2 cell phones compared to Factory A's 4 cell phones). Therefore, Factory B has a comparative advantage over Factory A in producing computers. Because of their relative comparative advantages, Factory A should focus on producing cell phones, and Factory B should focus on producing computers.

What Causes Comparative Advantages?

Differences in Climate. Countries may be able to produce certain crops better than other countries due to their climate being better suited for those crops. For example, tropical countries produce bananas, mangos, and coffee; countries with temperate climate produce grains like wheat and corn. Seasonal variations between the Northern & Southern Hemisphere can also play a part. US and northern hemisphere countries purchase fruits and vegetables from southern hemisphere countries when it is winter in the northern hemisphere (and is the summer growing season in the southern hemisphere).

Differences in Factors of Production. Countries with an abundance of a particular factor of production (land, labor, capital) may have a comparative advantage in the production of goods or services derived from that resource. For example, Canada has extensive forestland, giving it a comparative advantage in producing timber. China has a huge population, giving it a comparative advantage in the production of goods that require large amounts of low-cost labor, like clothing. The US has a relatively high-skilled labor force, giving it a comparative advantage in producing machinery & equipment, aircraft & parts, automobiles & parts, etc.

Differences in Technology. Countries that have developed a high level of technology also enjoy a comparative advantage in producing high-value goods. For example, US software and pharmaceutical industries have a higher level of technology than many others, giving them a comparative advantage in those industries. Japan's advances in engineering and production have given it a comparative advantage over many other countries in auto production.

Some countries have a comparative advantage in growing coffee (left) due to their climate. Some have the technology & skilled workforce to produce computer components (right).
(Images courtesy of Zimbio and Sound Stage Live)

Differentiated Products Promote Global Trade

Global trade is not solely a matter of absolute or comparative advantage. Products produced by different firms (and in different countries) are not always identical. These are called differentiated products. **Differentiated products** are products that are essentially the same, but are distinguished from each other by variations in style, materials, and taste. Products will have varying levels of quality. This provides consumers worldwide a wider variety of a given product at different prices based on the level of quality.

Global trade allows for countries to make what they have a comparative advantage at making. If a country has a comparative advantage at making lower-quality, cheaper clothes over other countries, then that is what it does. Higher-quality, more expensive clothes will probably be made by firms in other countries where the resources (especially the skilled labor that would be needed to make those clothes) are more readily available. This gives consumers worldwide the ability to buy inexpensive or expensive clothes based on their personal preferences.

Not all countries (or even individual firms) produce identical items. By focusing on what they have a comparative advantage in making, they can produce products with the quality and features their target markets desire.
(Images courtesy Daihatsu and Lamborghini in Wallpapers)

Money

To better understand the workings of the global economy, we need to understand the role of money in transactions.

Functions of Money

Money has three main functions for an economy:

1. **Medium of Exchange**. Money serves as a medium of exchange. This means that the money is widely and readily accepted in exchange for goods & services. This eliminates the need for barter (which required a coincidence of wants between the two parties involved in order for a transaction to occur). As long as someone is willing to accept the money in exchange for the item, whatever is being used can serve as money (currency, coins, other items).

2. **Measure of Value**. Money also serves as a measure of value. This allows society to place measurable values on items. For example, citizens in the US understand that something worth $50 is more valuable than something worth only $20.

3. **Store of Value**. Money also serves as a store of value. A dollar will always be a dollar. This means you can save money to buy things in the future. However, this does not work well in this function if there is inflation, since that dollar may not have the same purchasing power in the future as it does now, and the item for which you are saving may be more expensive in the future.

Most Nations Have Their Own Form of Money

There is not (yet) a global currency used by every nation. Each nation has its own currency (coins and paper money). Some examples:

- The US uses the US Dollar ($)
- Japan uses the Yen (¥)
- Hong Kong uses the Hong Kong Dollar ($)
- China uses the Yuan Renminbi (¥)

Some nations have agreed to use a common currency for trade. For example, the European Union uses the Euro (€).

Every country in the world issues its own currency.
(Image courtesy of ETF Trends)

Nations Want to Deal in Their Own Currency

Each nation uses its own currency as its medium of exchange, measure of value, and store of value. The prices of goods and services in that country are stated in its own currency. Those businesses expect to be paid in that currency. Wages are set and paid in its currency.

Those nations expect to be paid for their exports in their own currency. The importer must convert his/her currency for the currency of the country from which he/she is buying. The importer is buying that nation's currency with his/her own nation's currency.

Exchange Rate

The exchange rate is the rate at which one currency is exchanged for another. For example, in December 2012, the exchange rate between the US dollar and the Euro was $1 = €0.7690. This means you would receive €0.7690 for every $1 you exchange. If you were trying to convert Euros to dollars, you would receive $1.30 for every €1 you exchange (1 divided by 0.7690).

Fixed or Floating Exchange Rate

Fixed (also called pegged) Exchange Rate

A country uses a **fixed exchange rate** when it ties (or pegs) its currency to another currency. That country will only exchange its currency for the set rate of the other currency. For example, Mexico might fix the exchange rate of its peso to the US dollar at 10 pesos per dollar. The exchange rate of the peso to other currencies will now be based on what the exchange rate of the dollar currently is. So, if you want to exchange pesos for Euros:
You would first need to determine how many dollars those pesos are worth (10 pesos per dollar for our example), then
You would determine how many Euros could be purchased with that amount of dollars ($1.30 is needed to purchase each Euro).

Floating Exchange Rate

If a country has a **floating exchange rate**, the exchange rate of a country's currency to any other country's currency will go up and down based on the supply and demand of that currency. The exchange rates determined by the currency market. Supply & demand of the currency from another country is determined by the exports & imports between the two countries; the exchange is needed for each country to pay for its imports. Exchange rates between any two countries' currencies go up and down daily.

The exchange rates on currencies with floating exchange rates change daily based on the supply of and demand for that currency on the global market. *(Image courtesy of Bloomberg.com)*

Devaluation

Devaluation is a situation where one currency is losing purchasing power relative to another currency. For example, if the exchange rate for the dollar goes down from €0.7690 to €0.7500 ($1.33 for each Euro), it will now cost you more dollars to purchase a euro than before. Anything you are buying that you must pay Euros for will be more expensive to you. Imagine you were trying to import a Mercedes Benz automobile. That Mercedes Benz would have cost $87,775 (€ 67,499) at the old exchange rate; it now costs $89,775 at the new exchange rate.

Devaluation of one country's currency relative to another country makes imports more expensive from that other country. It also usually results in fewer imports into that country. If the dollar devalues against the Euro, imports to the US from Europe will now be more expensive. Based on the Law of Demand, the higher price of European imports will result in lower demand for those imports, and fewer European goods and services will be imported.

Devaluation of one country's currency relative to another country makes exports less expensive to that other country. This usually results in more exports out of that country whose currency has devalued. If the dollar devalues against the Euro, US goods and services will be cheaper for Europeans to buy. Based on the Law of Demand, the lower price of US goods and services in Europe will result in higher demand for those goods and services, and more US goods and services will be exported to Europe.

Some economists argue that currency devaluation can help a country whose economy is not performing well. The cheaper exports can boost a country's Gross National Product (GDP + Net Exports). Also, the devalued currency makes it easier for the government to pay off the debt it owes to other countries. A country normally borrows money in its own currency. Lenders (like other countries) must convert their currency into the borrower's currency when making the loan. That original country also repays the debt in its own currency. The lending country receives the repayment in the borrowing nation's currency, and must then convert the money into its own currency in the currency market. Since the borrower's currency will buy less of the lending nation's currency when repayment occurs, the lending nation receives back less than what it originally anticipated, and it could actually receive back less than it loaned out if the currency has devalued too much.

In 2001, the exchange rate between the US dollar and the Euro was 1.1432 Euros for each dollar. Ten years later (in 2011), the exchange rate was 0.7057 Euros for each dollar. For a $1,000,000 loan to the US from Europe (not factoring in interest), the value of that loan (in Euros) would have fallen from €1,143,200 to only €765,930 during that 10-year period. If the European country hasn't demanded a high interest rate on the loan to offset the loss due to devaluation, it will effectively lose money on the loan.

Trade

Exports are goods and services a country *sells* to other countries. **Imports** are goods and services a country *buys* from other countries. The term **Balance of Trade** refers to the difference between exports and imports between two countries. It is also referred to as the **Balance of Payments**. To calculate the balance of payments, you subtract the dollar value of the country's imports from it exports.

Balance of Payments = Exports – Imports

Trade Surplus

A trade surplus occurs when imports are less than exports; exports are greater than imports.

Who benefits from a trade surplus?

- **Businesses that export**. More of their goods and services are being demanded. This often results in higher profits for owners.
- **Workers in industries that export**. There is more demand for their labor because there is more demand for the products they produce. This often results in lower unemployment and/or higher wages for workers in those industries.

Who might be harmed by a trade surplus?

- **Consumers**. The additional money coming into the economy could result in inflation as that money is chasing relatively few goods & services. If wages are not rising at the same pace as inflation, this could hurt the standard of living for those consumers.

There are tradeoffs between the benefits (domestic producers) and the costs (inflation & possible impact on standard of living) of having a trade surplus.

Trade Deficit

A trade deficit occurs when imports are greater than exports; exports are less than imports.

Who benefits from a trade deficit?

- **Consumers**. When a trade deficit occurs, the imports tend to be less expensive than identical items produced domestically. Because of this, consumers can afford to buy more, and their overall standard of living goes up.

Who might be harmed by a trade deficit?

- **Domestic businesses that compete with the goods & services being imported**. Since the imports generally tend to be cheaper than their products, less of their goods & services may be demanded unless their products are sufficiently differentiated (i.e. better quality, more features, etc.) to justify a higher price. This may result in lower profits for owners.
- **Workers in industries that compete with goods & services being imported**. There is usually less demand for their labor since there is less demand for the products they produce. This may result in higher unemployment and/or lower wages for workers in those industries.

There are tradeoffs between the benefits (higher overall standard of living) and the costs (challenges for domestic producers) of having a trade deficit.

Trade deficits tend to drive down the cost of imports, like the containerized cargo coming into this major port, benefiting consumers but hurting domestic competitors. Trade surpluses tend to boost imports, benefiting businesses that export.
(Image courtesy of Mango World Magazine)

Strong vs. Weak Dollar

Closely related to trade deficits and surpluses are the concepts of a "strong" or "weak" dollar.

The term **"strong dollar"** refers to when the U.S. dollar is *increasing* in value relative to another currency. In other words, the dollar can buy more of that other currency. Imports from that other country become cheaper for the U.S. However, exports to that country become more expensive for that country.

The effects of "strong" dollar:

- **Imports go up**. This benefits individuals (especially those with lower incomes who rely on purchasing cheap imports for day-to-day living) in the economy because they can purchase more inexpensive imports to improve their standard of living.
- **Exports go down**. This can negatively impact GDP due to lower production of products that compete with the imports and reduced exports.
- **Investment flows into the U.S. from the other country**. Investments made by investors from the other country, when converted back into their currency, will make more due to the each dollar buying a larger amount of their currency.

The term **"weak dollar"** refers to when the U.S. dollar is *decreasing* in value relative to another currency. In other words, the dollar can buy less of that other currency. Imports from that other country become more expensive for the U.S. However, exports to that country become cheaper for that other country.

The effects if a "weak" dollar:

- **Imports go down**. This can hurt individuals (especially those with lower incomes who rely on purchasing cheap imports for day-to-day living) as the price of imports goes up.
- **Exports go up**. This helps the economy overall as GDP grows due to increases in purchases of domestic products and increases in exports.
- **Investment flows out of the U.S. to the other country**. Investments in the other country that pay off will, when converted back into U.S. dollars, will make more because each unit of their currency will buy a larger amount of dollars.

"Strong" and "weak" do not necessarily mean "good" and "bad". Each has its positives & negatives. Some aspects of the economy benefit from either. Some are possibly harmed by either. "Good" or "bad" will be a matter of perspective, depending on whether you specifically benefit or are harmed by the resulting effect on the economy.

Both a strong dollar and weak dollar have positive and negative effects on the economy, as they affect both the level of imports and exports of goods and services as well as the flow of capital investment in and out of the U.S.
(Image courtesy of Wordpress.com)

Trade Barriers

Free trade is the unrestricted movement of goods and services between countries. **Trade barriers** are restrictions to trade between countries. This is known as **protectionism**. It is normally done to shield domestic markets from foreign competition.

Types of Trade Barriers

There are four major types of trade barriers:

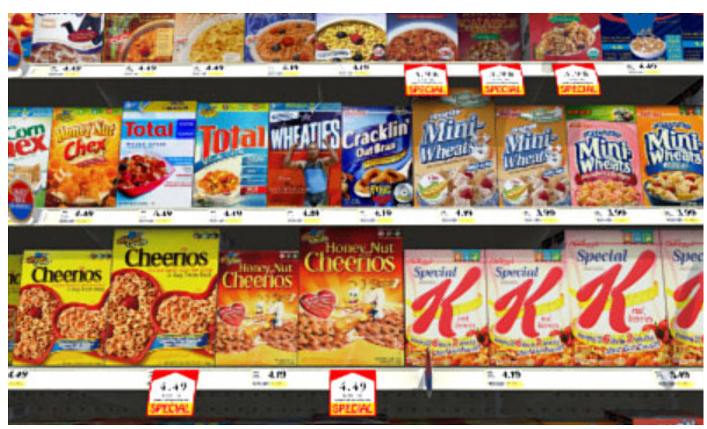
Protective Tariffs

Protective tariffs are a tax on imported goods. The importer must pay the tariff. The price of the tariff is passed on to the consumer in the form of higher prices. An example of this is related to felt-tip pens. The U.S. imposes a 4% tariff on felt-tip pens. Tariffs are used to raise tax revenue and protect domestic competition from cheaper foreign goods.

Who benefits from tariffs? The biggest benefactors from tariffs are the specific domestic producers whose products compete with the imports. The tariff pushes prices of imported goods higher. This means that those domestic producers don't have to worry about lowering prices to compete with cheaper imports.

Who is harmed by tariffs? Consumers are ultimately hurt by tariffs because they have to pay higher prices for products than if there were free trade. Since they are paying higher prices for those products, they have less to spend on other goods and services. This has a negative impact on their overall standard of living.

There are other potential consequences to an economy because of a tariff. Tariffs can result in a **trade war**. Other countries may retaliate and impose tariffs on your country's exports. This can slow or even halt trade between the two countries, hurting both in the process.



Tariffs on imported sugar increase the price of sugar and all products using sugar, like cereal. These products now cost the consumer more than they would have if the market was allowed to operate freely and domestic sugar producers had to compete with foreign sugar producers.
(Image courtesy of Turbosquid.com)

Import Quotas

Import quotas limit the quantity of a good that can be imported during a specified period of time. Once the quota of the import is reached, no further imports of the good are allowed. Import quotas are also used to protect domestic industries; however, they do not raise any revenue for the government.

Who benefits from import quotas? As with tariffs, the biggest benefactor from import quotas are the specific domestic industries who compete with the imports. They don't have to worry about an unlimited amount of cheaper foreign goods being imported.

Who is harmed by import quotas? Just like with tariffs, consumers are the most harmed by quotas. They end up having to pay higher prices for domestic goods once all the cheaper foreign imports are purchased. This has the same impact on their standard of living as tariffs do.

When an import quota is reached, any additional units of the item under an import quota are held at the port of entry and not allowed to enter the market until the next quota period begins.
(Image courtesy Mira Images)

Trade Embargoes

A **trade embargo** is when one country imposes a ban on trade with a country or group of countries. No imports from or exports to that country are allowed. Embargoes are usually done for political reasons. The intent is to put economic pressure on the country to change its political policies. For example, the U.S. has a trade embargo on Iran, Cuba, & North Korea. The intent is to try to convince them to stop developing their nuclear weapons capability.

Voluntary Export Restraints (VER)

A **voluntary export restraint (VER)** is when a country voluntarily limits the quantity of a good that can be exported to a specific country during a specific time period. It is actually a self-imposed export quota. It is normally done at the insistence of the importing country. The importing country often threatens harsher & more restrictive tariffs & quotas if the exporting country doesn't voluntarily restrict itself. For example, the Japanese in the 1980s imposed a VER on automobile exports to the U.S. when the U.S. threatened to impose more severe restrictions on Japanese auto imports.

The Debate over Trade Restrictions

The Jobs Argument

The main argument for trade restrictions is based on jobs. Proponents of trade restrictions argue that allowing cheap imports into a country destroys jobs. The domestic companies must cut costs, lay off workers, or even go out of business. Proponents of trade restrictions that use the jobs argument also assert that highly paid workers in the U.S. can't compete with low-wage workers in poorer countries, and the only way to protect American jobs is to make cheap imports more expensive and/or less available so goods produced by American workers are demanded.

The defense against the "jobs argument" is that tariffs and quotas cost more jobs than they save. Higher prices on raw materials (like steel) drive up the cost of inputs for those businesses using those materials. Prices on all goods using those materials go up, resulting in lower demand, hurting those domestic industries.

Another defense against the "jobs argument" is that workers in US can compete with lower-wage workers in foreign countries. Lower-wage workers in foreign countries are usually less productive than similar workers in more developed countries. Jobs will go where productivity (output per unit input) is highest.

Tariffs on cotton are intended to protect the jobs of workers in the domestic cotton industry from cheaper imports. Those workers are protected; however, cotton (and items made from cotton) are more expensive to the consumer.
(Image courtesy of Dreamstime)

A third defense against the "jobs argument" relates to what the trade restrictions do to price. If prices are artificially kept high through trade restrictions, consumers pay more for items whose price is higher than what the market would normally dictate. This hurts the overall standard of living because consumers can buy fewer items overall if prices are kept high.

The National Security Argument

Another argument for trade restrictions relates to national security. According to this argument, certain industries are vital for national security. The U.S doesn't want to rely on certain items critical for the U.S. from countries who might become enemies. The tariffs and quotas will allow domestic industries deemed vital for national security to stay in business. Businesses that make products for national defense, like those providing military hardware (fighter jets, weapons, etc.), should be protected from competition that might put them out of business. Some examples of industries that provide critical raw materials are oil, steel, and basic foods (wheat, corn, etc.).

There is a defense against the "national security argument." Opponents to trade restrictions based on the "national defense argument" do acknowledge that some industries might be critical, so trade barriers might be justified when the country's security is at stake. However, most calls for trade barriers using this argument come from the industries themselves, not the military or intelligence communities. Industries facing stiff foreign competition have a selfish interest in proclaiming their importance to the country's security, so we must be wary of who is claiming to be vital to national defense.

The Infant Industry Argument

Another argument in support of trade restrictions relates to "infant industries," which are newly formed industries in a country that need time to become competitive. They claim that trade barriers are needed to protect them until they become strong enough to "stand on their own."

The main defense to the "infant industry argument" is that there is an assumption that the industry involved will actually become competitive and is therefore worth protecting. In a market economy, new firms must be willing to accept start-up losses if they believe they can become profitable in the long run.

The Unfair Competition Argument

Another argument in support of trade restrictions is the "unfair competition argument." Those using this argument claim that some countries "cheat" by providing subsidies (monetary support) to their industries to help them compete with foreign firms. Because of this, those industries can afford to sell more cheaply since the subsidy is covering their losses. Therefore, trade barriers are justified to protect domestic industries from subsidized foreign imports. The trade barrier can drive the cost back up to what it would be if that foreign industry was not receiving a subsidy from their government. Additionally, those making this argument claim that some countries "dump" their products on foreign markets. **Dumping** is when a business will sell in foreign markets for less than it costs to make the product. They hope to drive domestic producers out of market and raise price back up once their competition has been eliminated. Trade barriers can offset the practice of "dumping".

The defense against the "unfair competition argument" is that the benefits to consumers of cheaper imports outweigh costs to domestic producers. The fact that consumers in general will have cheaper products available, therefore being able to afford more goods and services in general and can therefore have a higher standard of living, far outweighs any supposed harm to domestic producers. Also, it is nearly impossible to detect "dumping." It is difficult to determine foreign firm's costs; what may appear to be "dumping" may actually be comparative advantage at work.

The Protection as Bargaining Chip Argument

Some that support trade restrictions argue that the trade restrictions can be used as a bargaining tool in trade negotiations. They claim that the threats of trade restrictions will persuade other country to remove or reduce its trade barriers.

The biggest problem with the "protection as a bargaining chip argument" is that the strategy can backfire. If the other country doesn't give in, you must either carry out the threats or back down. Either option leaves your country worse off. You either have to impose trade restrictions, which will result in all the negatives already discussed concerning trade restrictions, or your country will lose its ability to bargain, because you never carry through on your threats.

The Environmental & Labor Standards Argument

One last argument for trade restrictions relates to the different environmental and labor standards each country enforces. According to this argument, countries with lax environmental or labor laws have an economic advantage over countries that must comply with stricter laws. They don't have to spend the money on worker and environmental protection. Therefore, in order to make trade fair, countries with stricter laws should impose tariffs against countries that do not uphold these standards.

The response to the "environmental and labor standards argument" is that countries with lax standards are often poorer countries with few resources to devote to worker and environmental protection. However, as they develop their economies, in part through global trade, they will be able to pay more attention to labor & environmental standards. Therefore, restricting trade would slow the pace at which they could make improvements.

Some argue for trade restrictions in order to pressure developing countries with minimal or non-existent labor laws and/or environmental protection laws. *(Images courtesy Flickr and BGR.com)*

The Debate Over Trade Restrictions

	The Argument	The Response
Jobs Argument	• Allowing cheap imports in destroys jobs • High-paid US workers can't compete with low-wage foreign workers	• Tariffs & quotas cost more jobs than they save • US workers can compete because they are usually more productive than low-wage (and low-skill) foreign workers • Trade restrictions keep prices artifically high, hurting consumers more than they help the workers protected by the trade restrictions
National Security Argument	• Certain industries are critical to national defense • The US doesn't want to have domestic producers in those industries fail and not have them available in times of war	• Some industries are vital to national defense and should be preserved • Many claims of being vital to national security come from the industries themselves, not the military or intelligence communities, calling into question the rationale for their claim
Infant Industry Argument	• A newly formed industry in a country may not be able to compete with foreign competitors who have been involved in that industry for longer • Trade restrictions are needed to help that infant industry until it catches up with the competition	• Country assumes that industry will actually become competitive (not a guarantee) • New businesses in a market economy must be able to cover start-up costs and not expect to be "bailed out" if they can't compete
Unfair Competition Argument	• Some countries subsidize their industries, giving businesses in those industries the ability to charge lower prices • Some businesses "dump" products at less than their cost to try to drive out their competition • Trade restrictions will offset this risk	• Benefits of cheaper imports to consumers overall outweigh the potential loss of jobs in the targeted industries • Practically impossible to detect dumping; may just be comparative advantage
Protection as Bargaining Chip Argument	• Trade restrictions can be used as a bargaining chip in trade negotiations • Threats of trade restrictions may be enough to convince other country to reduce or remove existing trade barriers	• This strategy could backfire if other country doesn't give in • Lose-lose situation: either impose restrictions and possibly cause trade war, or don't do anything and lose your credibility and bargaining power
Environmental & Labor Standards Argument	• Some countries have lax environmental or labor laws • This gives industries in those countries a competitive advantage since they don't have to pay as much to comply with more strict laws • Trade restrictions will force them to comply to avoid the restrictions	• These countries are generally poorer and cannot afford to have more strict laws and be able to compete • As their economies develop, they will be more able to afford higher labor and environmental standards; trade restrictions would slow this development

Trade Agreements

Trade agreements are agreements between two or more countries to reduce trade barriers between countries. The goal is for all countries involved to export more products to each other. The increased trade benefits all involved.

Some trade agreements involve just a few countries. For example, the North American Free Trade Agreement (NAFTA) involves just the U.S., Canada, & Mexico. Some trade agreements involve a large number of countries. For example, the World Trade Organization (WTO) involves 153 countries.

All countries involved in the agreement agree to abide by the trade rules established in the agreement. Countries involved in the agreement meet periodically to discuss & negotiate trade agreements to improve trade among member countries.

Trade agreements allow for more trade between the countries. Goods and services can move more freely across borders.
(Image courtesy of Mexico Trucker Online)