

Name _____

Economics

Unit 8 - The Global Economy

Student Notes Packet

Concept Review: Trade Makes People Better Off

- None of us is equally _____ at doing everything
- It makes more sense to concentrate on what we do _____ and trade with others for what they do best
- End up with more and better _____ than by trying to do everything for ourselves

Concept Review: Absolute Advantage

- One group (individual/business/state/country) can produce a given item _____ and/or _____ than another group
- Example: Apples & Oranges
 - Due to 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).
 - Virginia has an absolute advantage over Florida in producing apples.
 - Florida has an absolute advantage over Virginia in producing oranges.
 - Virginia grows apples for use & to sell to Florida
 - Florida grows oranges for use & to sell to Virginia

Concept Review: Comparative Advantage

- The ability to perform a task at a _____ **opportunity cost** than someone else is able to perform that task

Example

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

Opportunity Costs

Factory A	Factory B
<ul style="list-style-type: none">• Opportunity cost for producing 9,000 computers is 36,000 cell phones<ul style="list-style-type: none">○ Opportunity cost for producing 1 computer is 4 cell phones• Opportunity cost for producing 36,000 cell phones is 9,000 computers<ul style="list-style-type: none">○ Opportunity cost for producing 1 cell phone is $\frac{1}{4}$ computer	<ul style="list-style-type: none">• Opportunity cost for producing 6,000 computers is 12,000 cell phones<ul style="list-style-type: none">○ Opportunity cost for producing 1 computer is 2 cell phones• Opportunity cost for producing 12,000 cell phones is 6,000 computers<ul style="list-style-type: none">○ Opportunity cost is for producing 1 cell phone is $\frac{1}{2}$ computer

- Factory A has lower opportunity cost to produce cell phones ($\frac{1}{4}$ computer compared to Factory B's $\frac{1}{2}$ computer)
 - 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)
 - Factory B has a **comparative advantage** over Factory A in producing computers
- Conclusions:
 - Factory A should focus on producing cell phones
 - Factory B should focus on producing computers

What Causes Comparative Advantages?

- **Differences in** _____
 - Countries may be able to produce certain crops better than other countries due to their climate being better suited for those crops
 - Examples:
 - 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 & 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 _____ 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
- Examples:
 - 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 _____ level of technology also enjoy a comparative advantage in producing high-value goods
- Examples:
 - US software and pharmaceutical industries have a higher level of technology than many others, giving it 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

Differentiated Products Promote Global Trade

- Global trade not _____ a matter of absolute or comparative advantage
- Products produced by different firms (and in different countries) are _____ always identical
 - **Differentiated products** – products that essentially the _____, but are distinguished from each other by variations in style, materials, and taste
- Products will have varying levels of _____
 - Provides consumers worldwide a _____ variety of a given product at different prices based on the level of quality

Functions of Money

- Medium of Exchange
 - Widely and readily _____ in exchange for goods & services
 - Eliminates the need for barter (coincidence of wants)
 - 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)
- Measure of Value
 - Allows society to place measurable _____ on items
- Store of Value
 - A dollar will _____ be a dollar
 - You can save money to buy things in the _____
 - Does not work well in this function if there is _____

Most Nations Have Their Own Form of Money

- There is not (yet) a _____ currency used by every nation
- Each nation has its _____ currency (coins and paper money)
- Examples:
 - US = US Dollar (\$)
 - Japan = Yen (¥)
 - Hong Kong = Hong Kong Dollar (\$)
 - China = Yuan Renminbi (¥)
- Some nations have agreed to use a common currency for trade
- Example:
 - European Union = Euro (€)

Nations Want to Deal in Their Own Currency

- Each nation uses its _____ currency as its medium of exchange, measure of value, and store of value
 - Prices of goods & 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 _____ for their exports in their own currency
 - The importer must _____ his/her currency for the currency of the country from which they are buying
 - Importer is _____ that nation's currency with his/her own nation's currency

Exchange Rate

- The rate at which one currency is exchanged for another
- Example:

- \$1 = €0.7690
 - You will receive €0.7690 for every \$1 you exchange
 - You will receive \$1.30 for every €1 you exchange (1 divided by 0.7690)

Fixed or Floating Exchange Rate

• **Fixed (also called pegged) Exchange Rate**

- One country _____ (or pegs) its currency to another currency
- That country will only exchange its currency for the _____ rate of the other currency
 - 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

• **Floating Exchange Rate**

- Exchange rate of a country's currency to any other country's currency will go _____ and _____ based on the supply and demand of that currency
 - Exchange rates determined by the _____ 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

Devaluation

- **Devaluation** = a situation where one currency is _____ purchasing power relative to another currency
 - 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
 - Example: a Mercedes Benz that would have cost \$87,775 (€ 67,499) at the old exchange rate now costs \$89,775 at the new exchange rate
- Devaluation of one country's currency relative to another country makes imports _____ expensive from that other country
 - Usually results in _____ imports into that country
- Devaluation of one country's currency relative to another country makes exports _____ expensive to that country
 - Usually results in _____ exports out of that country
 - Some economists argue that this can _____ a country whose economy is not performing well
 - Cheaper exports can _____ Gross National Product (GDP + Net Exports)

- Devalued currency makes it _____ for government to pay off debt it owes to other countries

Trade

- **Exports** = goods and services a country _____ other countries
- **Imports** = goods and services a country _____ other countries
- **Balance of Trade** = the _____ between exports and imports between two countries
 - Also referred to as the **Balance of Payments**
 - Calculated as:

$$\text{Exports} - \text{Imports}$$

- **Trade Surplus** = imports are _____ than exports
 - Exports are _____ than imports
 - Who benefits
 - _____ that export
 - More of their goods and services are being demanded
 - Often results in _____ profits for owners
 - _____ in industries that export
 - More demand for their _____
 - Often results in _____ unemployment and/or _____ wages for workers in those industries
 - Who might be harmed
 - Consumers
 - The additional money coming into the economy could result in _____ 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 _____ between the benefits (domestic producers) and costs (inflation & possible impact on standard of living) of having a trade surplus
- **Trade Deficit** = imports are _____ than exports
 - Exports are _____ than imports
 - Who benefits
 - Consumers
 - The imports tend to be _____ expensive than identical items produced domestically
 - Consumers can afford to _____ more
 - Overall standard of living goes _____
 - Who might be harmed

- Domestic businesses that _____ with the goods & services being imported
 - Less of their goods & services may be demanded (unless products are sufficiently differentiated to justify a higher price)
 - May result in _____ profits for owners
- Workers in industries that compete with goods & services being _____
 - Less demand for their _____
 - May result in _____ unemployment and/or _____ wages for workers in those industries
- There are tradeoffs between the benefits (higher overall standard of living) and costs (challenges for domestic producers) of having a trade deficit

Strong vs. Weak Dollar

- **“Strong dollar”** – refers to when the U.S. dollar is _____ in value relative to another currency
 - Dollar can buy _____ of that other currency
 - _____ from that other country become cheaper for the U.S.
 - _____ to that country become more expensive for that country
 - Effects of “strong” dollar:
 - Imports go _____
 - 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 _____
 - Can negatively impact GDP due to lower production of products that compete with the imports and reduced exports
 - Investment flows _____ 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
- **“Weak dollar”** – refers to when the U.S. dollar is _____ in value relative to another currency
 - Dollar can buy _____ of that other currency
 - _____ from that other country become more expensive for the U.S.
 - _____ to that country become cheaper for that other country
 - Effects if a “weak” dollar:
 - Imports go _____
 - 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 _____
 - Helps the economy overall as GDP grows due to increases in purchases of domestic products and increases in exports
- Investment flows _____ 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

Trade Barriers

- **Free Trade** = unrestricted _____ of goods and services between countries
- **Trade Barriers** = restrictions to _____ between countries
 - Known as **protectionism**
 - Normally done to shield domestic markets from foreign competition

Types of Trade Barriers

• **Protective Tariffs**

- A _____ on imported goods
 - The _____ must pay the tariff
 - The price of the tariff is passed on to the _____ in the form of higher prices
 - Ex: the U.S. imposes a 4% tariff on felt-tip pens
- Used to:
 - Raise tax revenue
 - Protect domestic competition from cheaper foreign goods
- Who benefits
 - Specific domestic producers (those whose products compete with the imports)
 - Tariff pushes prices of imported goods _____
 - Don't have to worry about lowering prices to _____ with cheaper imports
- Who is harmed
 - Consumers
 - Have to pay _____ prices for products than if there were free trade
- Other consequences
 - Trade war
 - Other countries may _____ and impose tariffs on your country's exports
 - Can slow or even _____ trade between the two countries, hurting both in the process

- **Import Quotas**

- Limits the _____ 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
- Used to _____ domestic industries
 - Do _____ raise any revenue for the government
- Who benefits
 - Specific domestic industries
 - They don't have to worry about an _____ amount of cheaper foreign goods being imported
- Who is harmed
 - Consumers
 - They end up having to pay higher prices for domestic goods once all the cheaper foreign imports are purchased

- **Trade Embargoes**

- Imposes a _____ on trade with a country or group of countries
 - No imports from or exports to that country are allowed
- Usually done for _____ reasons
 - Intent is to put economic pressure on the country to change its political policies
- Example: the U.S. has a trade embargo on Iran, Cuba, & North Korea

- **Voluntary Export Restraints (VER)**

- A country voluntarily _____ the quantity of a good that can be exported to a specific country during a specific time period
 - Actually is a self-imposed export quota
- Normally done at the insistence of the importing country
 - Importing country often threatens harsher & more restrictive tariffs & quotas if the exporting country doesn't voluntarily restrict itself
- 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

- Argument for:
 - Allowing cheap imports into a country destroys _____
 - Domestic companies must cut costs, lay off workers, or even go out of business
 - Highly paid workers in the U.S. can't _____ with low-wage workers in poorer countries
 - Only way to _____ American jobs is to make cheap imports more expensive and/or less available so goods produced by American workers are demanded
- Argument against:
 - Tariffs & quotas cost _____ jobs than they save
 - Higher prices on raw materials (like steel) drive _____ the cost of inputs for those using those materials
 - Prices on all goods using those materials go up, resulting in _____ demand, hurting those domestic industries
 - Workers in US can _____ with lower-wage workers in foreign countries
 - Lower wages in foreign countries are usually _____ productive
 - Jobs will go where productivity (output per unit input) is _____
 - Consumers pay _____ for items whose price is higher than what the market would normally dictate
 - Hurts overall standard of living because consumers can buy _____ items overall if prices are kept high

The Debate over Trade Restrictions: The National Security Argument

- Argument for:
 - Certain industries are vital for national security
 - Don't want to rely on certain items critical for the U.S. from countries who might become enemies
 - Tariffs & quotas will allow domestic industries deemed vital for national security to stay in business
 - Businesses providing products for national defense
 - Critical raw materials like oil, steel, & basic foods (wheat, corn, etc.)

- Argument against:
 - Some industries might be _____, so trade barriers might be justified when the country's security is at stake
 - Most calls for trade barriers using this argument come from the _____ 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

The Debate over Trade Restrictions: The Infant Industry Argument

- Argument for:
 - Newly formed industry in a country needs _____ to become competitive
 - Trade barriers are needed to _____ them until they become strong enough to "stand on their own"
- Argument against:
 - Assumption is that industry will actually become competitive & is therefore worth protecting
 - New firms must be willing to accept start-up losses if they believe they can become profitable in the long run

The Debate over Trade Restrictions: The Unfair Competition Argument

- Argument for:
 - Some countries "cheat" by providing _____ to their industries to help them compete with foreign firms
 - Those industries can afford to sell more _____ since the subsidy is covering their losses
 - Trade barriers are justified to _____ domestic industries from subsidized foreign imports
 - Trade barrier can drive the cost back _____ to what it would be if that foreign industry was not receiving a subsidy from their government
 - Some countries "dump" their products on foreign markets
 - Sell in foreign markets for less than it costs to make the product
 - Hope to drive domestic producers out of market and raise price back up
 - Trade barriers can offset the practice of "dumping"
- Argument against:
 - Benefits to consumers of cheaper imports outweigh costs to domestic producers
 - It is nearly impossible to detect "dumping"
 - Difficult to determine foreign firm's costs
 - What may appear to be "dumping" may actually be comparative advantage at work

The Debate over Trade Restrictions: The Protection as Bargaining Chip Argument

- Argument for:
 - Trade restrictions can be used as a bargaining tool in trade negotiations
 - Threats of trade restrictions will persuade other country to remove or reduce its trade barriers
- Argument against:
 - Strategy can backfire
 - If other country doesn't give in, you must either carry out the threats or back down
 - Either option leaves country worse off

The Debate over Trade Restrictions: The Environmental & Labor Standards Argument

- Argument for:
 - Countries with _____ 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
 - To make trade fair, countries with _____ laws should impose tariffs against countries that do not uphold these standards
- Argument against:
 - Countries with lax standards are often _____ countries with few resources to devote to worker and environmental protection
 - As they develop their economies, in part through global trade, they will be able to pay _____ attention to labor & environmental standards
 - Restricting trade would slow the _____ at which they could make improvements

Trade Agreements

- Agreements between two or more countries to _____ trade barriers
 - Goal: export more products
 - Increased trade benefits all involved
- Some involve just a _____ countries
 - Example: the North American Free Trade Agreement (NAFTA) involves just the U.S., Canada, & Mexico
- Some involve a _____ number of countries
 - Example: the World Trade Organization (WTO) involves 153 countries
- All countries involved in the agreement agree to abide by the trade _____ established in the agreement
 - Countries involved in the agreement meet periodically to discuss & negotiate trade agreements to _____ trade among member countries