UNIT 6

The International Scene

Most new jobs in the world will change from agricultural to service and professional specialties.

Experts continue to predict increases in worldwide Internet use.

In this unit, read to FIND OUT . . .

- how the United States trades with the rest of the world.
- why many of the world's nations are moving toward a free enterprise economic system.
- how the world is becoming smaller through the Internet.


Two hundred years ago, the United States was a developing nation.
The amount of global travel is expected to double in the next 25 years.
Many of the world's economies are converging toward the same kind of system we have in the United States.
PASSPORT

CONTENTS

CHAPTER 18

Trading With Other Nations

Why It's Important

What percent of goods in American stores are foreign-made? What happens to the dollars Americans spend outside the United States? This chapter will explain the importance of international trade, and how you benefit from it.

To learn about foreign exchange and trade surpluses and deficits, view the **Economics & You** *Chapter 24 video lesson:* **International Trade**

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Chapter Overview Visit the *Economics Today and Tomorrow* Web site at ett.glencoe.com and click on ***Chapter 18—Chapter Overviews*** to preview chapter information.

SECTION 1

The Benefits of World Trade

Cover Story

The Washington Post, February 15, 1999

Mickey makes it to Beijing. Getting [the Disney movie] 'Mulan' into Chinese theaters was seen as an essential part of Disney's business plan for this nation of 1.3 billion, with a growing middle class and eager young customers. The film, about a courageous heroine who disguises herself as a man and secretly takes her ailing father's place in battle against the invading Huns, is based on a 1,500-year-old Chinese legend, and the story is as familiar here as Cinderella or Snow White in the United States. 'Mulan' has earned $299 million worldwide.

Reader's Guide

Terms to Know

- imports
- exports
- absolute advantage
- specialization
- comparative advantage

Reading Objectives

1. What are the benefits of international trade?
2. What is the difference between absolute advantage and comparative advantage?

As you read this section, ask yourself what would happen if the United States could no longer sell goods to other countries or buy goods in return. Before you answer, you should be aware that the value of **imports**–goods bought from other countries for domestic use–is about 14 percent of GDP in the United States. That figure may not seem large, but many inconveniences would result without imports.

imports: *goods bought from other countries for domestic use*

We would have no coffee, chocolate, or pepper. Consider also that more than 60 percent of the radios, television sets, and motorcycles sold in the United States are imported. Many raw materials also come from foreign sources. Nearly 100 percent of the nation's bauxite, from which aluminum is made, is imported.

Benefits of Trade

Imports tell only half the story. Many American workers are employed in industries that export their products overseas. **Exports** are goods sold to other countries. For example, more than 40 percent of the nation's engineering and scientific instruments are sold to consumers overseas. In addition, nearly one-half of the wheat produced in the United States is shipped abroad.

exports: *goods sold to other countries*

Made in the U.S.A.? Sometimes it is hard to distinguish between goods made in America and those purchased abroad, as shown in **Figure 18.1.** In short, international trade affects you whether you know it or not. We have truly entered the age of a global economy, so learning about international trade is simply learning about everyday life.

FIGURE 18.1

Who Made the Parts?

Consider the Boeing 777. This plane is hardly "made in America." International suppliers provide rudders, elevators, outboard flaps, wingtip assemblies, engines, nose-landing gears, nose-landing gear doors, and main-landing gears. Japanese suppliers, in particular, provide cargo doors, fuselage panels, and passenger doors. The complicated Boeing 777 jet aircraft is a jigsaw puzzle in which the pieces come from all over the world.

Differences Among Nations Nations benefit through world trade because each differs in the type and amount of the factors of production it has available for use. The availability of natural resources is one of the most important of these differences.

The type and amount of labor and capital available to a nation are equally important. For example, much of the economy of the United States is based on high-technology production. A highly skilled labor force and large amounts of capital—in the form of advanced equipment and machinery—make this possible. Another nation—with the same natural resources but without the same labor and capital resources—could have a very different economy.

Economic Connection to... MATH

Comparative Advantage

Adam Smith's *Wealth of Nations* supplied powerful arguments for free trade. In the early 1800s, British economist David Ricardo expanded on Smith's ideas by observing that it pays to specialize and trade–even if some potential trading partner is more productive in all economic activities. His work was vital in developing the idea of comparative advantage as an argument in support of free trade.

According to Ricardo's theory, a country does not have to be best at anything to gain from trade. If a country is relatively better at making Product A than Product B, it makes sense to put more resources into Product A and to trade Product A to pay for imports of Product B. Benefits come from specializing in those economic activities which, at world prices, the country is relatively better at, even though it may not possess an absolute advantage in them. The two countries can both gain from trade, provided that they trade along the lines of comparative advantage. ■

Absolute vs. Comparative

If the United States could produce everything *more cheaply* than every other nation, it might not want to import anything. We know this situation does not exist for any nation, however, because of opportunity cost. All nations must make choices in how they use their scarce resources.

Absolute Advantage The particular distribution of resources in a nation often gives it an advantage over another nation in the production of one or more products. Brazil's tropical climate and inexpensive labor make it ideally suited for growing bananas. A country with a moderate climate, such as France, would produce far fewer bananas. Brazil, therefore, has an absolute advantage in banana production over France. A country has an **absolute advantage** when it can produce a product more efficiently (i.e., with greater output per unit of input) than can another country.

A nation often finds it profitable to produce and export a limited assortment of goods for which it is particularly suited. This concept is known as **specialization.** See **Figure 18.2** on page 476. For example, Japan's specialization in consumer electronics has led many nations to import these types of products from Japan.

Comparative Advantage A nation doesn't need to have an absolute advantage in the production of a certain good to find it

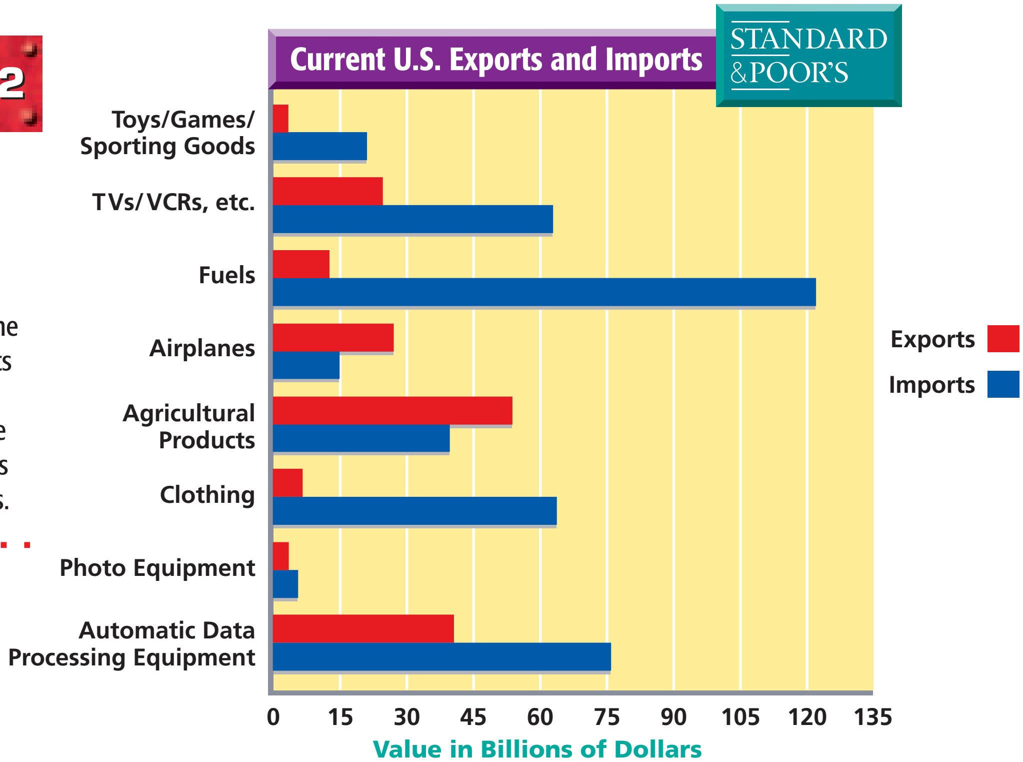
absolute advantage: *ability of one country to produce a product more efficiently (i.e., with greater output per unit of input) than can another country*

specialization: *concept that a nation should produce and export a limited assortment of goods for which it is particularly suited in order to remain profitable*

FIGURE 18.2

Exports and Imports of the United States

Look at the graph to see what products the United States imports and exports. Name the products that the United States exports more than it imports.



Source: Standard & Poor's

ECONOMICS Online

For an online update of this graph, visit ett.glencoe.com and click on ***Textbook Updates—Chapter 18.***

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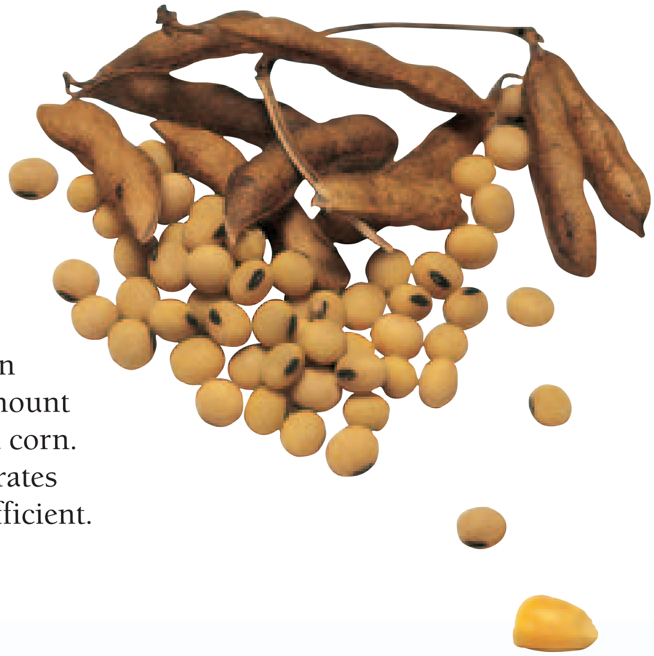
profitable to specialize and then to trade with other countries. For example, consider two imaginary nations, Alpha and Beta. Assume that each country produces only soybeans and corn.

When producing only soybeans, Alpha produces 10 million bushels, while Beta produces only 8 million. The next year, suppose the two countries decide to grow only corn. Alpha produces 50 million bushels, while Beta produces 25 million. According to this example, Alpha has an absolute advantage in the production of both soybeans and corn.

Does this mean that Alpha will produce both crops and, therefore, have no reason to trade with Beta? No. Alpha can produce slightly more soybeans than Beta. In contrast, it can produce a great deal more corn. It would make little sense for Alpha to take land, labor, and capital resources away from the efficient production of corn and use them for the less efficient production of soybeans. Alpha's opportunity cost—what it gives up to get something else—would be less if it invested all its resources in the production of corn. It could export its surplus corn and use the revenues it receives to import soybeans from Beta.

Alpha has a comparative advantage in corn production. **Comparative advantage** is the ability of a country to produce a

comparative advantage: *ability of a country to produce a product at a lower opportunity cost than another country* product at a *lower opportunity cost* than another country. Beta has a comparative advantage in soybean production. It can produce about the same amount of soybeans as Alpha, but only half as much corn. By using its resources to grow only soybeans, Beta is just giving up the relatively inefficient production of corn. Beta, then, has a lower opportunity cost for soybean production than does Alpha. Beta should produce the maximum amount of soybeans, export soybeans to Alpha, and import corn. Both countries benefit when each country concentrates on that production for which it is relatively most efficient.



Practice and **assess** key skills with ***Skillbuilder Interactive Workbook, Level 2.***

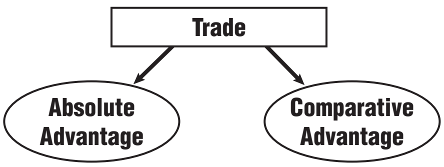
SECTION 1 Assessment

Understanding Key Terms

1. **Define** imports, exports, absolute advantage, specialization, comparative advantage.

Reviewing Objectives

2. How important is international trade to the United States economy?
3. **Graphic Organizer** Create a diagram like the one below to explain the difference between absolute advantage and comparative advantage.



Applying Economic Concepts

4. **Comparative Advantage** List at least three activities in your daily life in which you have a comparative advantage (such as cooking or lawn maintenance). Describe how you and those who live at your house could use comparative advantage in order to "trade" to get more accomplished.

Critical Thinking Activity

5. **Synthesizing Information** Use **Figure 18.2** to answer the following question: In what two products do trading partners seem to have the greatest absolute advantage or comparative advantage over the United States? Explain.

Applying the Writing Process

Researching and writing allow you to organize your ideas in a logical manner. The writing process involves using skills you have already learned, such as taking notes, outlining, and synthesizing information.

- Select an interesting topic. Do preliminary research to determine whether your topic is too broad or too narrow.
- Write a thesis statement that defines what you want to prove, discover, or illustrate in your writing. This will be the focus of your entire paper.
- Research your topic by formulating a list of main ideas and preparing note cards listing facts and source information for each main idea.
- Your report should have an introduction, a body, and a conclusion summarizing and restating your findings.
- Each paragraph should express one main idea in a topic sentence. Additional sentences support or explain the main idea by using details and facts.

Practice and **assess** key skills with ***Skillbuilder Interactive Workbook, Level 2.***

Learning the Skill

Use the guidelines listed on the left to help you apply the writing process.

Practicing the Skill

Suppose you are writing a report on international trade. Answer the following questions about the writing process.

1. How could you narrow this topic?
2. What are three main ideas that should be included in this report?
3. Name three possible sources of information about international trade.
4. What maps, charts, and graphs might you include with your report?

Application Activity

Research and write a short report on the manufacturing of your favorite automobile. What parts, if any, were imported?

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SECTION 2

Financing World Trade

COVER STORY

THE COLUMBUS DISPATCH, SEPTEMBER 7, 1999

If the price of buying a car starts rising in the United States, consumers may need to look no further than the dollar's recent slide against major foreign currencies.

On the other hand, economically depressed Midwestern farmers may find it easier to sell surplus grain overseas if a weak dollar makes it cheaper for foreigners to buy U.S. goods.

The dollar spent much of last week on the skids, flirting with its lowest level of the year against the Japanese yen. . . . It also has lost ground to the euro.

READER'S GUIDE

Terms to Know

- exchange rate
- foreign exchange markets
- fixed rate of exchange
- International Monetary Fund (IMF)
- devaluation
- flexible exchange rates
- depreciation
- balance of trade

Reading Objectives

1. Why do nations need a system of currency exchange rates?
2. How do the forces of supply and demand determine flexible exchange rates?
3. How do exchange rates affect the balance of trade?

The United States uses the dollar as its medium of exchange; Mexico, the peso; India, the rupee; and Japan, the yen. As you read this section, you'll learn that to engage in world trade, people must have a way of knowing the **exchange rate**—what the price of their currency is in terms of another nation's currency. They must also be able to exchange one type of currency for another. Why is this so?

exchange rate: *the price of one nation's currency in terms of another nation's currency*

A Japanese digital video disk (DVD) manufacturer who exports DVD systems to the United States probably does not want American dollars in payment. The firm needs Japanese currency to pay its workers and suppliers. Fortunately, international

foreign exchange markets: *markets dealing in buying and selling foreign currency for businesses that want to import goods from other countries*

trade is organized so that individuals and businesses can easily and quickly convert one currency to another. **Foreign exchange markets** allow for these conversions. People in these markets deal in buying and selling foreign currency for businesses that want to import goods from other countries. Some of the currency trading also takes place through banks. **Figure 18.3** shows you what information a typical exchange rate lists on a given day.

Fixed Exchange Rates

fixed rate of exchange: *system under which a national government sets the value of its currency in relation to a single standard*

From 1945 to the early 1970s, the foreign exchange market operated with a **fixed rate of exchange.** Under this system, national governments set the value of their currency in relation to a single standard—usually the amount of gold held in reserve. With a fixed rate of exchange, a government could compare its

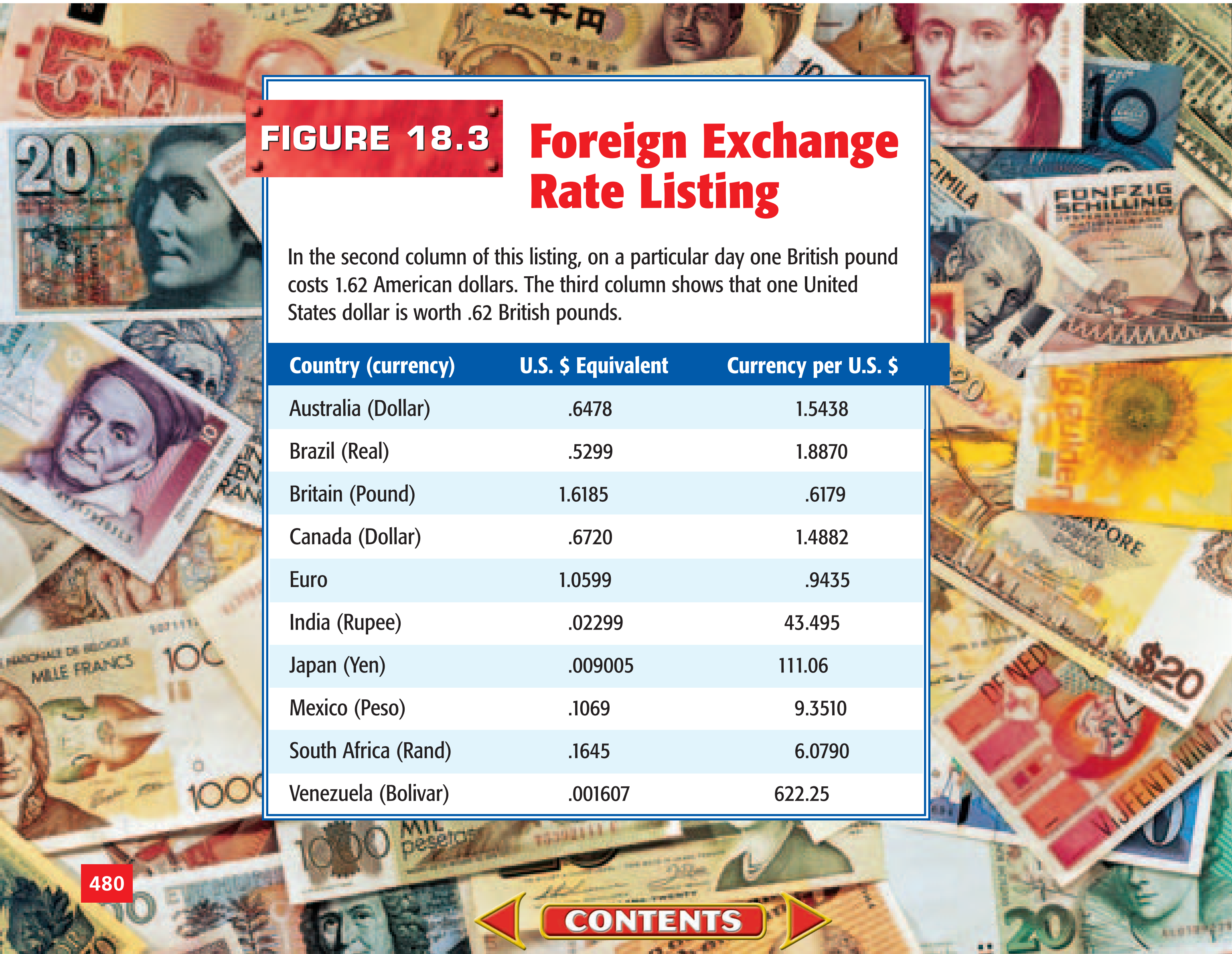

FIGURE 18.3 Foreign Exchange Rate Listing

In the second column of this listing, on a particular day one British pound costs 1.62 American dollars. The third column shows that one United States dollar is worth .62 British pounds.

Country (currency)	U.S. $ Equivalent	Currency per U.S. $
Australia (Dollar)	.6478	1.5438
Brazil (Real)	.5299	1.8870
Britain (Pound)	1.6185	.6179
Canada (Dollar)	.6720	1.4882
Euro	1.0599	.9435
India (Rupee)	.02299	43.495
Japan (Yen)	.009005	111.06
Mexico (Peso)	.1069	9.3510
South Africa (Rand)	.1645	6.0790
Venezuela (Bolivar)	.001607	622.25

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FIGURE 18.4

Effects of Devaluation These charts show how devaluation of the Japanese yen affects consumers in the United States. ***Do you think an American consumer would prefer to buy a DVD system before or after devaluation? Why?***

Effects of Official Devaluation of Japanese Yen

Before Devaluation

Japanese DVD costs 20,000 yen

Exchange Rate: 100 yen = $1 U.S.

$$\text{DVD} = \frac{20{,}000 \text{ yen}}{100 \text{ yen per } \$} = \$200.00$$

An American would have to pay $200 for the Japanese DVD

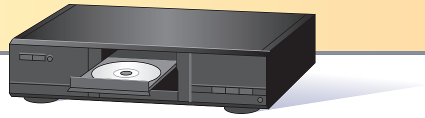
After Devaluation

Japanese DVD costs 20,000 yen

Exchange Rate: 200 yen = $1 U.S.

$$\text{DVD} = \frac{20{,}000 \text{ yen}}{200 \text{ yen per } \$} = \$100.00$$

An American would have to pay $100 for the Japanese DVD



currency to that of other countries. The **International Monetary Fund (IMF)** supported a fixed exchange rate system. Member governments of the IMF (including the United States) were obligated to keep their foreign exchange rates more or less fixed.

A fixed rate of exchange had some advantages for world trade. Importers and exporters knew exactly how much of a foreign currency they could purchase with their own nation's money. Also, the system allowed central banks to affect the level of exports and imports in their country by devaluing the currency. **Devaluation** means lowering a currency's value in relation to other currencies by government order. **Figure 18.4** shows how the cost of a Japanese DVD system would decrease if Japan devalues its yen by one-half.

This system of fixed exchange rates eventually proved impractical. The basic problem was the difficulty of holding exchange rates fixed in an international economic climate that was constantly changing. Suppose one nation such as the United States suffered from high inflation, and a trading partner such as Japan did not. Then American goods would become very costly for the Japanese to buy. Because the price of Japanese goods would not be rising, Americans could use their inflated, or "cheaper," dollars to buy more Japanese products. The United States would be importing huge quantities of Japanese goods but exporting little to Japan.

International Monetary Fund (IMF): *agency whose member governments once were obligated to keep their foreign exchange rates more or less fixed; today it offers monetary advice and provides loans to developing nations*

devaluation: *lowering a currency's value in relation to other currencies by government order*

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ECONOMICS Online

Student Web Activity Visit the *Economics Today and Tomorrow* Web site at ett.glencoe.com and click on ***Chapter 18—Student Web Activities*** to learn about increased efficiency in international trade.

Flexible Exchange Rates

flexible exchange rate: *arrangement in which the forces of supply and demand are allowed to set the price of various currencies*

depreciation: *fall in the price of a currency through the action of supply and demand*

On August 15, 1971, President Richard Nixon officially announced what would become the end of fixed American exchange rates. Most of the world's nations turned to a **flexible exchange rate** system. Under this arrangement, the forces of supply and demand are allowed to set the price of various currencies. With flexible exchange rates, a currency's price may change, or float, up or down a little each day. For example, Japanese currency might be trading at 115.6 yen to the dollar on one day and 118.2 yen to the dollar on the next.

The forces actually determining exchange rates are the supply and demand of goods and services that can be bought with a particular currency. For example, suppose the amount of dollars wanted by Japanese exporters is greater than the quantity of dollars supplied by Americans who want to buy Japanese goods. Because the quantity demanded exceeds that supplied, the American dollar will become more expensive in relation to the yen. It will take more yen to equal one dollar. In contrast, if the quantity of dollars American importers supplied is more than the quantity demanded by Japanese exporters, the price of a dollar will become cheaper in relation to the yen. Fewer yen will equal one dollar.

When the price of a currency falls through the action of supply and demand, it is termed **depreciation.** As with devaluation, depreciation of a country's currency improves its competitive edge in foreign trade.

Besides import-export transactions, political or economic instability within a country may encourage people to exchange their currency for a more stable currency, often the United States dollar. In that case, the value of the dollar would rise in relation to the other nation's currency. A country that is experiencing rapid inflation will find its currency falling in value in relation to other currencies.

Global Economy

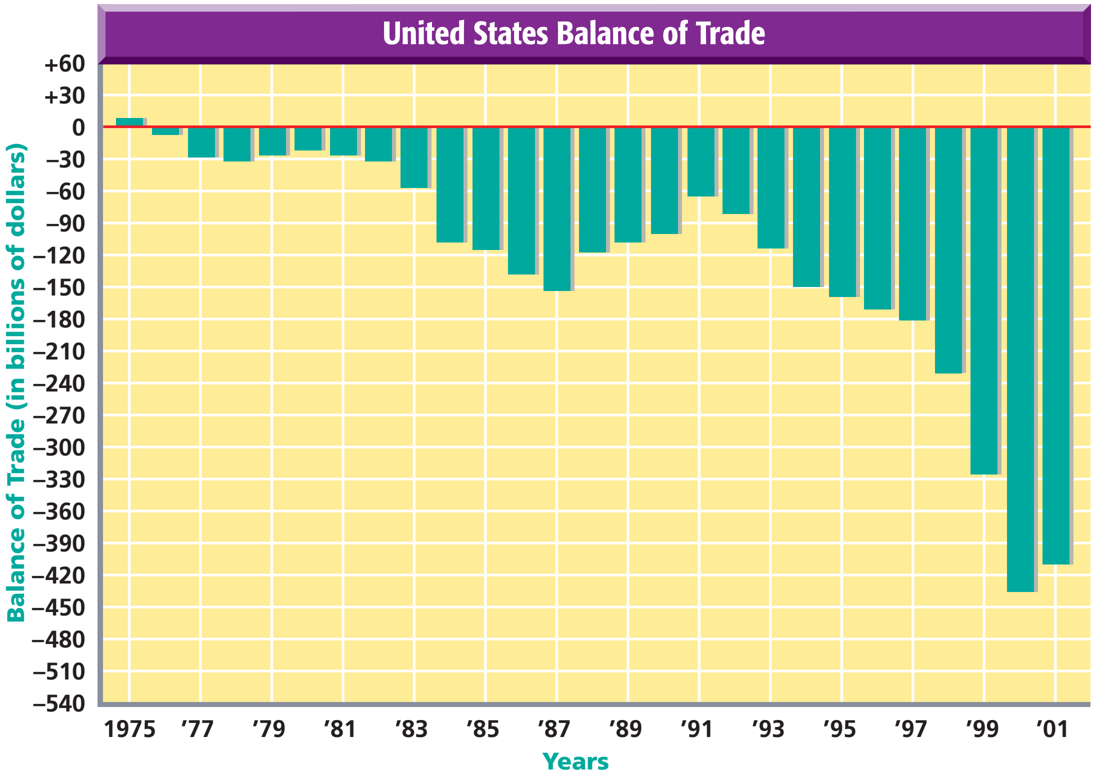
The Big Mac Index

One way to see whether a currency is devalued or overvalued against the U.S. dollar is to use the "Big Mac Index" developed by *The Economist.* Economists compare the price of a Big Mac hamburger in the United States to what it costs in another country's local currency. Converting the foreign price to U.S. dollars shows whether the price of a Big Mac is undervalued or overvalued against the U.S. dollar. For example, a Big Mac may cost $2.49 in the United States and 262 yen in Japan (which converts to $2.01 in U.S. currency). The Japanese yen, therefore, is undervalued against the U.S. dollar. ■

	Big Mac Prices		
Country	in local currency	in U.S. dollars	Percent under (–) or over (+) valued against dollar
U.S. (Dollar)	2.49	$2.49	---
Brazil (Real)	3.60	1.55	–38
China (Yuan)	10.50	1.27	–49
Israel (Shekel)	12.00	2.51	+1
Mexico (Peso)	21.90	2.37	–5
Russia (Ruble)	39.00	1.25	–50

FIGURE 18.5

Balance of Trade This graph shows how the United States has had a negative balance of trade for the most part since the 1970s.



Source: *Statistical Abstract of the United States*, 2002

ECONOMICS Online

For an online update of this graph, visit ett.glencoe.com and click on ***Textbook Updates—Chapter 18.***

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Balance of Trade

A currency's exchange rate can have an important effect on a nation's **balance of trade.** See **Figure 18.5.** The balance of trade is the difference between the value of a nation's exports and its imports. If a nation's currency depreciates, or becomes "weak," the nation will likely export more goods because its products will become cheaper for other nations to buy. If a nation's currency increases in value, or becomes "strong," the amount of its exports will decline.

When the value of goods leaving a nation exceeds the value of those coming in, a positive balance of trade is said to exist. In this case, the nation is bringing in more money as payments for goods

balance of trade: *difference between the value of a nation's exports and its imports* than it is paying out. A negative balance of trade exists when the value of goods coming into a country is greater than the value of those going out. This situation is called a *trade deficit.* The United States has had a negative balance of trade, or trade deficit, for many years beginning in the 1970s.

Typically, trade deficits have been associated with *balance of payments* problems. A nation's balance of payments takes into account all international transactions, including the buying and selling of services, stocks, bonds, and business interests. When a nation has a balance of payments deficit, it is sending more of its currency abroad than it is receiving.

Trade Deficit—Good or Bad? It is important to realize that a continued trade deficit is not necessarily a bad thing. A trade deficit continues because there are opportunities for foreigners to invest in the United States economy. For example, many Japanese automobile companies have built factories in the United States to satisfy the U.S. demand for Japanese cars. This creates jobs and supporting industries that benefit U.S. citizens.

Practice and **assess** key skills with ***Skillbuilder Interactive Workbook, Level 2.***

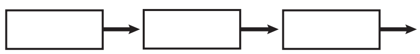
SECTION 2 Assessment

Understanding Key Terms

1. **Define** exchange rate, foreign exchange markets, fixed rate of exchange, International Monetary Fund (IMF), devaluation, flexible exchange rates, depreciation, balance of trade.

Reviewing Objectives

2. Why do nations need a system of currency exchange rates?
3. How do the forces of supply and demand determine flexible exchange rates?
4. **Graphic Organizer** Create a diagram like the one in the next column to explain how exchange rates affect the balance of trade.



Applying Economic Concepts

5. **Flexible Exchange Rates** In what ways does depreciation of a country's currency improve that country's competitiveness in foreign trade?

Critical Thinking Activity

6. **Synthesizing Information** How does a weak American dollar affect you as a consumer? How does a strong American dollar affect you?

People & Perspectives

James Tobin

ECONOMIST (1918–2002)

- **Member of John F. Kennedy's Council of Economic Advisers, 1961–1962**
- **Awarded the Nobel Prize in Economics in 1981**
- **Author/editor of 16 books and more than 400 articles on economics**
- **Holds the position of Sterling Professor of Economics Emeritus at Yale University**

Nearly 30 years ago, economist James Tobin suggested that a tax should be imposed on foreign exchange transactions to discourage speculation in the foreign exchange markets. With the rise of the global economy and the Internet, economists are reviewing the issue of foreign exchange speculation—and the "Tobin tax"—once again. In the following paragraphs, Tobin explains what the Tobin tax is and how it would work.

"There are 1.3 trillion dollars a day in foreign exchange transactions. Those transactions would be taxed, at a very low rate, something like one tenth of one percent per dollar per transaction. The taxes would be levied by each country on transactions that originate in the country, and collected by the usual tax authority of that country.

If people are involved in making a lot of transactions every day, every week, they would have to pay the tax a lot of times. So they are discouraged from doing that just by the existence of the tax."

Even though there is discussion among economists about the Tobin tax, Tobin himself is doubtful that it will ever be implemented:

"I am not optimistic about that. I don't think the financial community, including ministers of finance in major countries and the central banks of those countries, have any use for those taxes. They don't want it. . . . The International Monetary Fund is not going to go for it.

People do not like to be taxed. They think it is an interference with the free market."

Checking for Understanding

1. **What is the Tobin tax? What is its purpose?**
2. **Why, according to Tobin, will the Tobin tax not be implemented?**

SECTION 3

Restrictions on World Trade

Reader's Guide

Terms to Know

- tariff
- revenue tariff
- protective tariff
- import quota
- embargo
- protectionists
- General Agreement on Tariffs and Trade (GATT)
- World Trade Organization (WTO)
- North American Free Trade Agreement (NAFTA)
- European Union (EU)

Reading Objectives

1. How can a nation restrict imports?
2. What are three arguments for and against free trade?
3. What are some current international and regional trade agreements?

Cover Story

Business Week, January 18, 1999

The mood was giddy just about everywhere on the Continent as Europe's new currency, the euro, made its grand debut. . . . After years of skepticism from critics on the Continent and abroad, Europe has its common currency.

The long-term effects of melding an 11-nation, $6.5 trillion, 290 million-person region into one economic and financial bloc are giving Continental Europe new [power]. Companies around the world are eager to exploit what they hope will become a true single market.

To trade or not to trade? The difficulties that different currencies cause are only one problem of world trade. There are also natural barriers, which include the differences in languages and cultures between various trading partners. As you read this section, you'll learn that some nations may set restrictions to discourage or limit trade.

Three Ways to Restrict Imports

Three major barriers to world trade are tariffs, quotas, and embargoes. The most commonly used barrier to free trade is the **tariff**, a tax on imports.

tariff: *tax placed on an imported product*

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Tariffs Two types of tariffs can be applied to an import. A **revenue tariff** is used primarily to raise government revenue without restricting imports. Although tariffs today account for less than 2 percent of the federal government's income, they were the major sources of federal funding until the early 1900s.

A **protective tariff** is one designed to raise the cost of imported goods and thereby protect domestic producers. Some protective tariff rates have been as high as 62 percent of the value of the imported goods.

revenue tariff: *tax on imports used primarily to raise government revenue without restricting imports*

protective tariff: *tax on imports used to raise the cost of imported goods and thereby protect domestic producers*

Quotas An alternative method for restricting imports is the quota system. An **import quota** usually restricts the number of units of a particular good that can be brought into the country. The United States has placed quotas on imports of sugar, dairy products, various types of apparel, and cloth.

import quota: *restriction imposed on the number of units of a particular good that can be brought into the country*

Embargoes An **embargo** is a complete restriction on the import or export of a particular good. Often embargoes are enacted for political reasons. For example, in 1998 an embargo was ordered against Serbia for its actions in neighboring Kosovo.

The United States has also ordered embargoes on goods *from* certain countries. An embargo on trade with Cuba has been in place for more than four decades because that country's leader is Communist.

embargo: *complete restriction on the import or export of a particular good*

protectionists: *people who argue for trade restrictions to protect domestic industries*

Arguments Against Free Trade

The pros and cons of trade restrictions are still often the subject of intense public debate. **Protectionists** are those who argue *for* trade restrictions. There are three main arguments for trade protection.

Job Security Protectionists argue that many domestic workers will be unemployed if foreign competitors sell goods at lower prices than American firms. In the 1980s, for example, American steel mills laid off many workers because of foreign competition.

National Economic Security Protectionists argue that certain industries are crucial to the economy of the United States. They believe that

CAREERS

Customs Inspector

Job Description

- Inspect cargo and collect appropriate duties or fees
- Ensure that all goods entering the United States comply with U.S. laws

Qualifications

- U.S. citizen at least 20 years of age
- Bachelor's degree, civil service exam

Average Salary: Not Available

Job Outlook: Average

—*Occupational Outlook Handbook*, 2002–03 entire industries, such as oil, should be protected against foreign competition. See **Figure 18.6.**

Infant Industries Protectionists believe that tariffs and quotas are needed as temporary protection for new, infant industries. If foreign competition is restricted for a time, a young industry may become strong enough to compete in the world market.

Arguments For Free Trade

People who argue for free trade believe that exports and imports should not be restricted. There are three main arguments in support of free trade.

Improved Products Foreign competition encourages United States firms to improve their technology and production methods. As you learned in Chapter 7, better technology increases the production and supply of goods and services available, which raises our standard of living.

Export Industries American workers involved in export industries are hurt or may become unemployed when trade restrictions are implemented. One reason is that when the United States imports fewer goods, there is less American money available outside the United States to buy American exports. Another reason is that when the United States restricts imports, other nations may retaliate and restrict their own imports.

Specialization and Comparative Advantage Those in favor of free trade admit that too much economic specialization allows the country to be at the mercy of world demand. However, some specialization benefits consumers because comparative advantage in production results in more goods at lower prices.

FIGURE 18.6

National Security
Protectionists believe that certain industries, such as those that are energy-based, should be protected so that the United States is not vulnerable to other nations during times of crises.

Trade Agreements

After World War II, numerous bilateral trade agreements were brought together in the **General Agreement on Tariffs and Trade (GATT).** Under GATT, countries met periodically to negotiate tariff reductions that were mutually advantageous to all members. In 1994, GATT members signed a treaty establishing the **World Trade Organization (WTO)**, which came into being the following year with 76 member nations. The WTO constitutes the most far-reaching global trade agreement in history.

General Agreement on Tariffs and Trade: *trade agreement under which countries met periodically to negotiate tariff reductions that were mutually advantageous to all members*

World Trade Organization: *world's largest trade agreement currently among 144 nations*

Regional Trade Agreements In many parts of the world, regional trade agreements have been reached in order to increase free trade. Certain nations in Southeast Asia as well as in Central and South America have such regional trade agreements. The United States formed one with Canada and Mexico called the **North American Free Trade Agreement (NAFTA).** The U.S. Congress approved NAFTA in 1993. Since then, trade has increased among the 3 nations to the general benefit of all.

Perhaps the most important regional trade agreement in the world today is the **European Union (EU).** Currently, the EU consists of France, Germany, Great Britain, Denmark, Italy, Spain, Greece, Portugal, Luxembourg, Belgium, the Netherlands, Finland, Sweden, Austria, and Ireland. Starting in 2004, 10 additional countries planned to join the EU. On January 1, 1993, the EU began eliminating most of its restrictions on trade among its member countries. On January 1, 1999, 11 of the 15 member nations started putting into place the euro as a common currency. Those 11 nations and Greece abandoned their own national currencies as of January 1, 2002. Eventually, the EU will have a common currency for over 370 million European consumers. It will rival the United States in market size. See pages 494–495.

North American Free Trade Agreement: *trade agreement designed to reduce and gradually eliminate tariff barriers among Mexico, Canada, and the United States*

European Union: *organization of European nations whose goal is to encourage economic integration as a single market*

Practice and **assess** key skills with ***Skillbuilder Interactive Workbook, Level 2.***

SECTION 3 Assessment

Understanding Key Terms

1. **Define** tariff, revenue tariff, protective tariff, import quota, embargo, protectionists, General Agreement on Tariffs and Trade, World Trade Organization, North American Free Trade Agreement, European Union.

Reviewing Objectives

2. How can a nation restrict imports?
3. What are three arguments for and against free trade?
4. **Graphic Organizer** Create a chart like the one below to list and describe at least three trade agreements.

Agreement	Purpose

Applying Economic Concepts

5. **Free Trade** Assume you are (a) a startup computer software producer, (b) the owner of a retail dress shop, (c) a steelworker whose company just closed, (d) a student working in fast-food service. Write a short argument for or against free trade from the standpoint of each individual.

Critical Thinking Activity

6. **Summarizing Information** Research the benefits and costs of the North American Free Trade Agreement (NAFTA) on the Internet. Scan several articles to identify which groups support NAFTA and which groups oppose the trade agreement. Evaluate the reasons each group gives for supporting or opposing NAFTA.

BusinessWeek

Spotlight on the Economy

Mexican Makeover

Check It Out! In this chapter you learned about regional trade agreements. In this article, read to learn how NAFTA has helped to create the world's newest industrial power.

Mexico's economy is undergoing a stunning transformation. Five years after the launch of the North American Free Trade Agreement (NAFTA), it is fast becoming an industrial power. Free trade with the U.S. and Canada is turning the country from a mere assembler of cheap, low-quality goods into a reliable exporter of sophisticated products, from auto brake systems to laptop computers. Since 1993, exports have more than doubled, to $115 billion. Manufactured goods now make up close to 90% of Mexico's sales abroad, up from 77% five years ago. . . .

Mexico's industrial surge also means that North America is winning back thousands of jobs that had been lost to Asia as U.S. and Canadian companies shifted production to lower-cost production sites in the last decade. Now, for example, IBM is making computer components in Guadalajara that were formerly made in Singapore. And clothing retailers such as Gap Inc. and Liz Claiborne are increasingly buying garments from Mexican contractors, who can offer faster delivery than Asians. . . .

But the makeover of Mexican industry goes far beyond export and investment numbers. From small entrepreneurs to executives of the country's new multinationals, Mexican managers are becoming more confident as they respond to heightened competition at home and to the tough demands of foreign customers.

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Think About It

1. How has NAFTA affected Mexico's exports?
2. How has NAFTA affected Mexico's entrepreneurs?

CONTENTS

CHAPTER 18 Summary

ECONOMICS Online

CLICK HERE

Chapter Overview Visit the *Economics Today and Tomorrow* Web site at ett.glencoe.com and click on ***Chapter 18—Chapter Overviews*** to review chapter information.

SECTION 1 The Benefits of World Trade

- Trade is important because **imports** supply us with many goods and natural resources, and many American workers are employed in industries that **export** products abroad.
- **Absolute advantage** is the ability of one country, using the same amount of resources as another country, to produce a particular product at a lower absolute cost.
- **Comparative advantage** is the ability of a country to produce a product at a lower opportunity cost than another country.

SECTION 2 Financing World Trade

- **Foreign exchange markets** allow businesses around the world to exchange their currency for another currency.
- Under a **fixed exchange rate,** a nation's currency was tied to a certain standard—usually the amount of gold the nation held in reserve.
- Under a **flexible exchange rate** system, the forces of supply and demand are allowed to set the price of various currencies.
- The rate at which a currency is being exchanged can have an important effect on a nation's **balance of trade.**
- If a nation's currency **depreciates,** the nation will likely export more goods and services. If a nation's currency increases in value, the amount of its exports will decline.

SECTION 3 Restrictions on World Trade

- Three major barriers to world trade are **tariffs, quotas,** and **embargoes.**
- **Protectionists** are in favor of trade restrictions to protect American jobs, to protect national security, and to protect infant industries.
- Those who argue for free trade believe that competition results in better products at lower prices and that restricting imports hurts export industries.
- Recent trade agreements such as the **World Trade Organization,** the **North American Free Trade Agreement,** and the **European Union** have worked to lower trade restrictions.

CHAPTER 18

Assessment and Activities

ECONOMICS Online

Self-Check Quiz Visit the *Economics Today and Tomorrow* Web site at ett.glencoe.com and click on ***Chapter 18—Self-Check Quizzes*** to prepare for the Chapter Test.

CLICK HERE

Identifying Key Terms

Write the letter of the definition in Column B that correctly defines each term in Column A.

Column A

1. absolute advantage
2. comparative advantage
3. embargo
4. protectionists
5. balance of trade
6. devaluation
7. depreciation
8. revenue tariff
9. exchange rate

Column B

a. price of one country's currency in relation to another country's currency
b. lowering of a currency's value in relation to other currencies
c. complete restriction on the import or export of a particular good
d. difference between the value of a nation's exports and its imports
e. ability of a nation to produce a product more efficiently than can another country
f. drop in the price of a currency in response to supply and demand
g. ability of a country to use the same amount of resources as another to produce a product at less cost
h. those who oppose the relaxation of trade restrictions
i. tax on imports to raise money

Recalling Facts and Ideas

Section 1

1. How does a country determine whether it has a comparative advantage in the production of certain goods?
2. What does the United States gain from international trade?
3. "America can produce more DVDs per labor hour than can any other country in the world." Is this an example of an absolute advantage or a comparative advantage?

Section 2

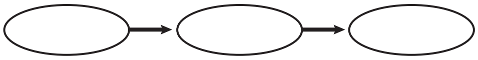
4. Why are foreign exchange markets necessary?
5. Why was it difficult to maintain a system of fixed rates of exchange?

Section 3

6. What is the difference between a revenue tariff and a protective tariff?
7. What are three arguments against free trade?
8. What is also affected when restrictions are put on imports?

Thinking Critically

1. **Making Predictions** If the value of the dollar fell in relation to other currencies, what would you expect to happen to American exports?
2. **Understanding Cause and Effect** Create a diagram like the one below to show how protecting infant industries will allow them to grow.



Applying Economic Concepts

International Trade Although international trade accounts for only about 13 percent of the American economy, it affects all Americans. To understand how international trade affects you, try to describe what your world would be like if international trade were outlawed. You can do this by writing a list of all the products you would *not* be able to purchase or whose price would go up dramatically without international trade.

Cooperative Learning Project

Working in groups of four, concentrate on one or more countries from the following list:

- Mexico
- Canada
- Japan
- Kenya
- Morocco

Each member of the group will research one of the following items:

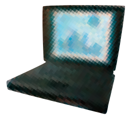
- The size of the international sector within each country (i.e., the percentage of GDP accounted for by imports or exports)
- The natural resource base of the nation
- The top three items that are exported
- The top three items that are imported

Each group will decide what the relationship is between the natural resource base and what is exported and imported. Finally, each group will write a summary of how life in each country would be different if international trade were prohibited.

Reviewing Skills

Applying the Writing Process There are virtually no restrictions on trade within the 50 states, mainly because the Constitution of the United States forbids it. Write a one-page description of problems that might have arisen if the Constitution had been silent on trade among the states. Include in your paper the section or sections in the Constitution that prohibit at least one restriction on international trade.

Technology Activity



Developing Multimedia Presentations Study the list of topics below. Choose one of the topics and explain how you would use at least three types of media in a presentation to best teach the topic to your class.

1. U.S. Exports and Imports
2. Foreign Exchange Markets
3. U.S. Balance of Trade
4. North American Free Trade Agreement

Analyzing the Global Economy

Use the Internet to find out more about international trade. Type *international trade* into your search engine. From the list of Web sites that appears on the monitor, select at least three. Read and summarize your findings.

CONTENTS

Global *Economy*

The European Union

The European Union (EU) is an organization of 15 independent European nations whose goal is to create a unified and strong market. The map below shows the value of trade between the EU and other world regions.

Beginning January 1, 2002, the currency used in all EU member countries except Denmark, Great Britain, and Sweden is the euro. After 2002, coins in the national currencies of the 12 countries adopting the euro will have no value. People will be able to exchange their bills for euros for many years, however.

Thinking Globally

1. With which regions of the world does the EU have a trade surplus? A trade deficit?

2. Which region is the EU's biggest trade partner?

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