CHAPTER

17 International Trade

Section 1
Benefits and Issues of International Trade

Section 2
Trade Barriers

Section 3
Measuring the Value of Trade

Section 4
Modern International Institutions

Case Study
Analyzing Tariffs: Who Wins and Who Loses?

CONCEPT REVIEW

The **global economy** is the sum of all economic interactions that cross international boundaries.

CHAPTER 17 KEY CONCEPT

Economic interdependence involves producers in one nation that depend on producers in other nations to supply them with certain goods and services.

WHY THE CONCEPT MATTERS

Japan is a world-class producer of automobiles, in spite of the fact that it has few mineral resources. How can this be? The answer lies in the realm of international trade, where nations choose to produce some things and trade for others. In the case of Japan, it must trade for the raw materials it uses in order to produce automobiles. It then turns around and trades the automobiles for other goods.

Online Highlights

More at ClassZone.com

Economics Update

Go to **ECONOMICS UPDATE** for chapter updates and current news on how tariffs and subsidies affect the sugar market. (See Case Study, pp. 538–539). ▶

Animated Economics

Go to **ANIMATED ECONOMICS** for interactive lessons on the graphs and tables in this chapter.

Interactive Review

Go to **INTERACTIVE REVIEW** for concept review and activities.

Why do many people believe that U.S. government subsidies to sugar producers are a problem? See the Case Study on pages 538–539.

SECTION 1

Benefits and Issues of International Trade

OBJECTIVES

In Section 1, you will
- determine why nations choose to specialize their economies
- examine the difference between absolute and comparative advantage
- explain how international trade impacts prices and quantity

KEY TERMS

specialization, *p. 510*
economic interdependence, *p. 510*
absolute advantage, *p. 513*
comparative advantage, *p. 513*
law of comparative advantage, *p. 514*
exports, *p. 516*
imports, *p. 516*

TAKING NOTES

As you read Section 1, complete a diagram that shows how the concepts in the section relate to international trade. Use the Graphic Organizer at **Interactive Review @ ClassZone.com**

Resource Distribution and Specialization

KEY CONCEPTS

A nation's economic patterns are based on its unique combination of factors of production: natural resources, human capital, physical capital, and entrepreneurship. For example, a nation rich in arable land but lacking well-educated workers is less likely to develop a strong technology sector than a country with better-educated citizens and diverse natural resources. Economic patterns may also change over time. The United States, for example, once relied heavily on its agricultural sector, but the U.S. economy is now also extremely high-tech and highly skilled.

Because each nation has certain resources and cannot produce everything it wants, individuals and businesses must decide what goods and services to focus on. The result is **specialization**, a situation that occurs when individuals or businesses produce a narrow range of products. Through specialization, businesses can increase productivity and profit—the driving force of world trade. Specialization also leads to **economic interdependence**, a situation in which producers in one nation depend on others to provide goods and services they do not produce.

QUICK REFERENCE

Specialization is a situation that occurs when individuals or businesses produce a narrow range of products.

Economic interdependence is a situation in which producers in one nation depend on others to provide goods and services they do not produce.

Specialization A coal-rich nation that lacks advanced technology can trade its coal for manufactured goods, such as automobiles, from nations with higher levels of technology.

YOUR ECONOMIC CHOICES

SPECIALIZATION

Will you specialize in lawn mowing or babysitting?

Do you have a lawn mower? Do you know children that need to be watched? What other questions might you ask yourself before deciding what you will specialize in?

Mow lawns

Babysit

EXAMPLE Specialization

The concept of specialization can be illustrated by looking at the agricultural production of two nations: Costa Rica and New Zealand. The climate, the labor conditions, and the level of technology of each nation have made some agricultural products more important than others. In other words, each nation has decided to specialize in certain agricultural areas because they have an advantage in doing so.

For Costa Rica, the product of choice is bananas. It is the world's seventh-largest producer and second-largest exporter of bananas. For New Zealand, the product of choice is sheep. It is the world's third-largest producer and second-largest exporter of wool and is responsible for about 50 percent of the world's lamb and mutton exports. What explains each nation's specialization?

Costa Rica has the necessary climate for bananas—warm and wet. In addition, agricultural wages are relatively low, an important point as banana production is quite labor intensive.

On the other hand, New Zealand has the temperate climate, water resources, and vast expanses of open grasslands to support the grazing of millions of sheep. (Today, there are about 10 sheep for every person in New Zealand.) Raising sheep is not nearly as labor intensive as banana production, and this suits the fairly low population density of this remote island nation. Also, scientific breeding practices and mechanized wool- and meat-processing operations are available to a developed nation such as New Zealand.

It makes sense for each nation to specialize as it does and to trade for the things it cannot produce as efficiently.

Economics Update

Find an update on Costa Rica's economy at **ClassZone.com**

APPLICATION Drawing Conclusions

A. Why should nations specialize in what they produce most efficiently and trade for the rest?

ECONOMICS PACESETTER

David Ricardo: The Theory of Comparative Advantage

Many things about London-born economist David Ricardo make him a memorable figure. He was one of 17 children in a Jewish family. At age 14, he went to work in his father's stockbrokerage. He married a Quaker at age 21 and broke from the Jewish faith, at which time his father disinherited him. And finally, when he died at age 51, he left a $126 million fortune.

Ricardo is most remembered, however, for the idea that has become the backbone for free trade—comparative advantage. It states, in short, that a trading nation should produce a certain product if it can do so at a lower opportunity cost than that of another trading nation.

FAST FACTS

David Ricardo

Title: Economist, stockbroker

Born: 1772

Died: 1823

Major Accomplishment: Brilliantly thinking through economic principles and laying the foundation for free trade

Major Work: *On the Principles of Political Economy and Taxation* (1817)

Famous Quotation: *"The labor of 100 Englishmen cannot be given for that of 80 Englishmen, but the produce of the labor of 100 Englishmen may be given for the produce of the labour of 80 Portuguese, 60 Russians, or 120 East Indians."*

EXAMPLE Trading in Opportunity

The prevailing view about international trade in Ricardo's time was based on the idea of absolute advantage, the ability of one trading nation to make a product more efficiently than another trading nation. Most people believed that if Portugal, for example, could make grape juice more efficiently than England, and if England could make cloth more efficiently than Portugal, then trade would be beneficial to both.

David Ricardo

Ricardo, however, set up a different problem, one that challenged this outlook. What if, he thought, Portugal makes both products more efficiently than England? Would trade, at least for Portugal, no longer be beneficial? His surprising answer was that trade would indeed still be beneficial. He based his conclusion on the opportunity costs each nation spends to make its products.

Suppose that in Portugal, it takes two hours of labor to produce a jug of grape juice, while in England, it takes four hours. Suppose also that in Portugal, a yard of cloth takes six hours to make; in England it takes eight hours. Ricardo reasoned that in Portugal, every yard of cloth costs three jugs of grape juice in lost opportunity. In England, however, every yard of cloth costs only two jugs of grape juice. Portugal, then, would be wise to buy cloth from England and to specialize in grape juice. This understanding has become known as the law of comparative advantage: countries gain when they produce items they are most efficient at producing and that have the lowest opportunity cost.

Economics Update

Learn more about David Ricardo at **ClassZone.com**

APPLICATION Applying Economic Concepts

B. Does the law of comparative advantage apply only to nations, or does it apply to individuals as well? Explain your answer.

Absolute and Comparative Advantage

KEY CONCEPTS

Absolute advantage is the ability of one trading nation to make a product more efficiently than another trading nation. Some regions or nations have absolute advantage in producing certain products or services because of the uneven distribution of production factors.

Comparative advantage, in contrast, is the idea that a nation will specialize in what it can produce at a lower opportunity cost than any other nation. When determining comparative advantage, you look not for the absolute cost of a product, but for its opportunity cost.

QUICK REFERENCE

Absolute advantage is the ability of one trading nation to make a product more efficiently than another trading nation.

Comparative advantage is a trading nation's ability to produce something at a lower opportunity cost than that of another trading nation.

EXAMPLE Absolute Advantage

Consider the trade relations between two countries on the Pacific Rim today, China and Australia. Both countries produce iron ore; both also produce steel. Suppose that every week, Australia produces 5,000 tons of iron ore and 1,000 tons of steel. In the same period of time, and with the same amount of labor, China produces 2,700 tons of iron ore and 900 tons of steel. In this case, Australia has an absolute advantage over China in both areas.

Before Ricardo, the standard logic held that, in this situation, the nation that held the absolute advantage for both commodities would trade for neither. But, as you've read, when the important factor of opportunity cost is considered, this logic doesn't stand up. Why would it benefit Australia to import steel from China, in spite of its absolute advantage? The answer is comparative advantage.

What Does Opportunity Cost? Should Australia specialize in mining iron ore (left) and leave the steel production (right) to China? Where does the comparative advantage lie?

EXAMPLE Comparative Advantage

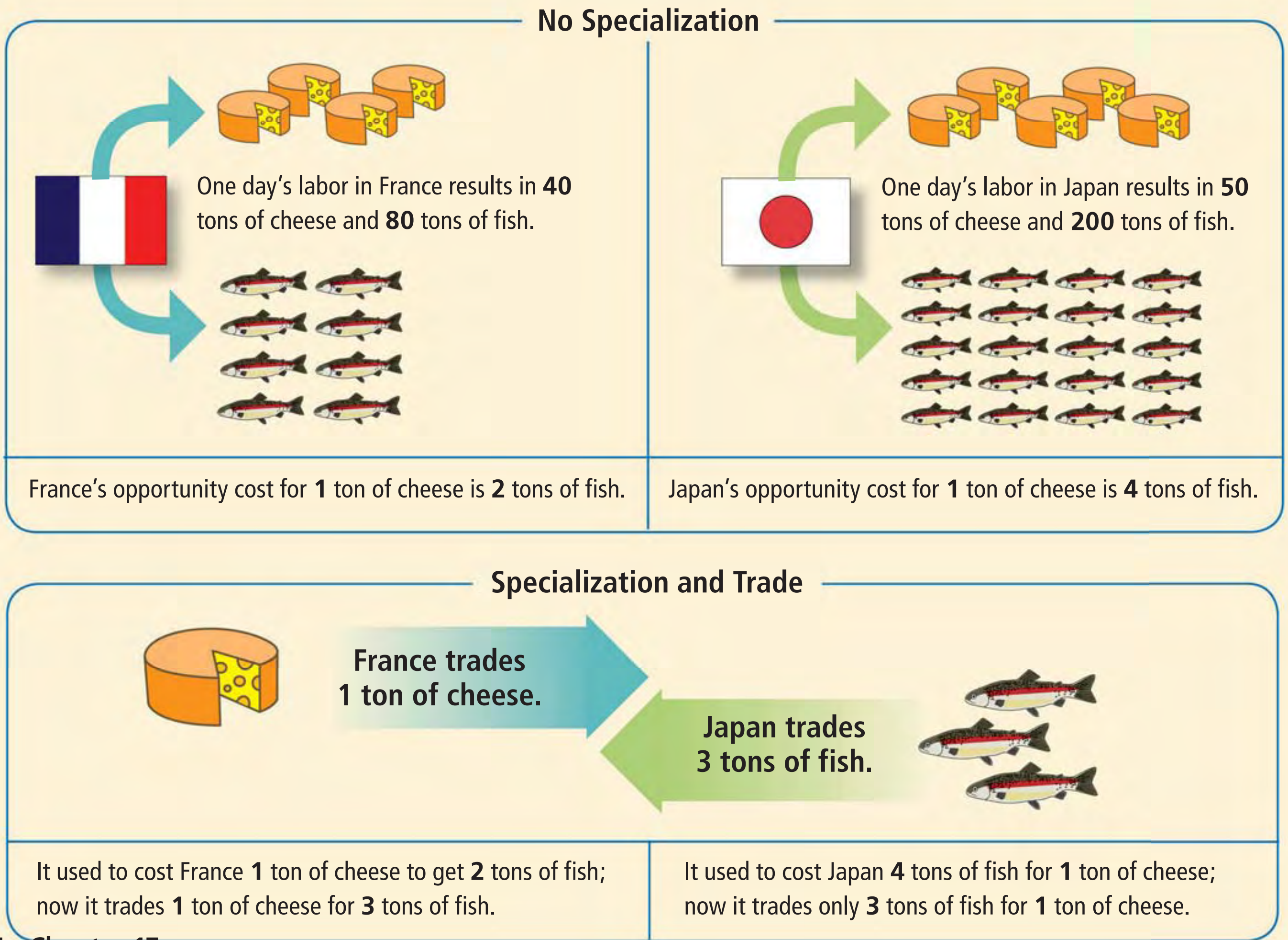
Let's start with a simple example of comparative advantage. After years as an office manager at a law firm by day and a law student by night, Ellen becomes a lawyer and starts her own practice. She charges $150 per hour for her legal services. She hires Miguel to run her office, and she pays him $25 per hour. Although Miguel works hard and is good at his job, Ellen soon realizes that, due to her years of experience, she could run her own office better than Miguel. Should she take over these duties? The answer lies in opportunity cost. Every hour that Ellen spends engaged in the duties that are worth $25 per hour costs her an hour that could be spent doing work that is worth $150 per hour. Clearly it makes sense for her to employ an office manager and concentrate on the legal end of her practice.

Back to our previous example of Australia and China, we see that Australia's production ratio of steel to iron ore is 1:5. In other words, Australia's opportunity cost for one ton of steel is five tons of iron ore. Applying the same logic to China, we find that its production ratio of steel to iron ore is 1:3. Its opportunity cost for one ton of steel is three tons of iron ore. So, in the production of steel, China has a comparative advantage. Australia would benefit by trading for Chinese steel. This is the **law of comparative advantage**: countries gain when they produce items that they are most efficient at producing and that are at the lowest opportunity cost.

QUICK REFERENCE

The **law of comparative advantage** states that countries gain when they produce items they are most efficient at producing and are at the lowest opportunity cost.

FIGURE 17.1 Specialization and Trade



A GLOBAL PERSPECTIVE

Economic Success with Few Natural Resources


The headquarters of the Industrial Development Agency of Ireland, in Dublin

Some economies thrive as a direct result of natural resources—Saudi Arabia and its oil, for instance. But, many nations, such as the Republic of Ireland, thrive economically in spite of a relative lack of natural resources.

It is not rich in mineral resources and relies on imports for the majority of its energy supply. However, it has formulated and carried out certain policies that have helped to produce today's dynamic economy.

In the mid-1950s, Ireland began a continuing process of reversing protectionist tariff and quota policies. The Programmes for Economic Expansion (1958 and 1963) attracted large amounts of foreign direct investment through financial grants and tax concessions. Levels of human capital were increased through educational reforms in the 1960s. It was also an original member of the EU and took advantage of EU funds to shore up its infrastructure. These and other policies set the stage for Ireland's economic boom of the 1990s. During this decade, it became a major manufacturer of high-tech electronics, computer products, chemicals, and pharmaceuticals. It has also become an important center for banking and finance.

CONNECTING ACROSS THE GLOBE

1. **Drawing Conclusions** What specialization has, for the most part, driven Ireland's economic boom?
2. **Applying Economic Concepts** Why might an economy like Ireland's be more desirable than one that relies solely on natural resources?

EXAMPLE Advantages of Free Trade

If China and Australia decide to specialize and trade, they can improve their ratio of return. Previously, China's ratio of steel production to iron ore production was 1:3 and Australia's was 1:5. If the two nations establish a trade ratio of 1:4 (China trades one ton of its steel for four tons of Australian iron ore), both countries win. China now gets four tons of iron ore for a ton of steel; it got three before. Also, one ton of steel now costs Australia only four tons of iron ore; it previously cost five.

When countries specialize and trade, they not only improve their production ratios but they also increase world output. If China specializes in steel and Australia in iron ore, each can make more of their products than the two nations could have made together if they had not specialized. Increased output is a mark of economic growth, which is a factor in raising standards of living.

APPLICATION Interpreting Tables

C. Use the example in Figure 17.1 to explain how output for both nations increases through specialization and trade.

International Trade Affects the National Economy

KEY CONCEPTS

QUICK REFERENCE

Exports are goods and services produced in one country and sold to other countries.

Imports are goods and services produced in one country and purchased by another.

Because of the law of comparative advantage, nations gain through trading goods and services. Goods and services produced in one country and sold to other countries are called **exports**. Goods and services produced in one country and purchased by another are called **imports**.

The costs and benefits of international trade vary by nation. To understand how trade affects a nation's economy, economists use supply and demand analysis. They look at the impact of exports and imports on prices and quantity.

IMPACT 1 Exports on Prices and Quantity

Suppose that a county called Plecona existed and that it did not trade with other countries. Figure 17.2 shows the equilibrium price for Plecona's motorbikes.

What would happen to prices and demand if Plecona decided to become a trading nation and export its motorbikes? In some countries, such as Nepocal, people would give up their bicycles and begin to buy Pleconese motorbikes. This results in an increase in demand for Pleconese motorbikes, shifting the demand curve to the right and establishing a new equilibrium price. Motorbikes will now cost more in Plecona too. However, the greater demand resulting from exporting offsets this by creating more jobs and more income in Plecona, as the motorbike producer invests its profits to expand production and hire more workers.

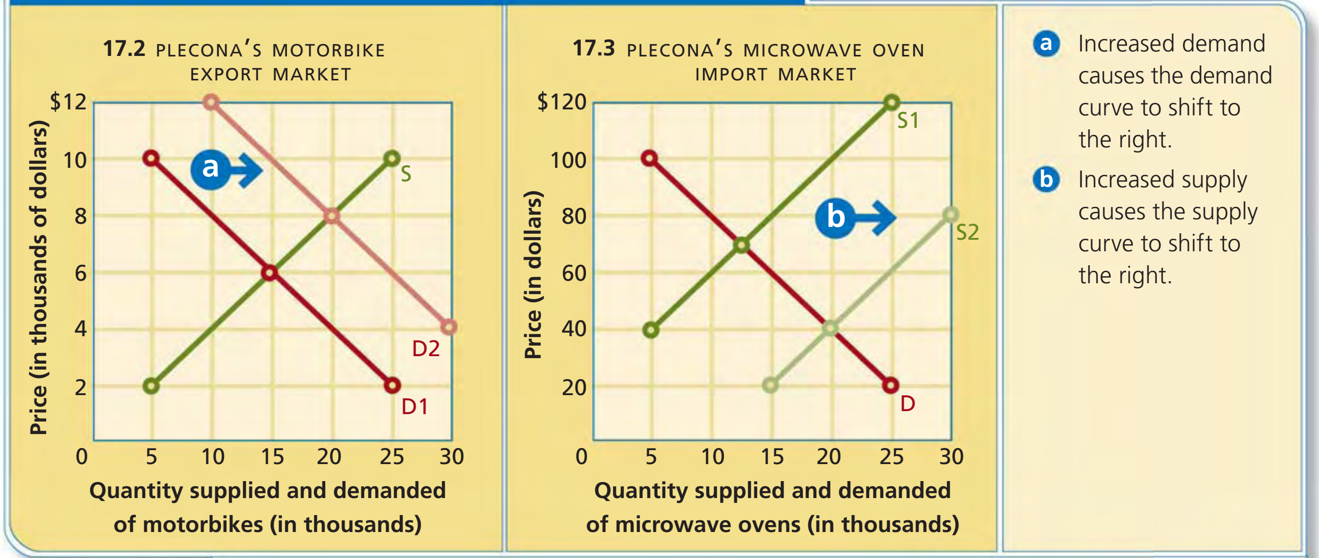
IMPACT 2 Imports on Prices and Quantity

Now suppose that Nepocal and Plecona agree that Nepocal may sell its major product, microwave ovens, in Plecona. Instead of having only Pleconese-made microwaves, consumers in Plecona may now purchase ovens imported from Nepocal. This change adds to the number of microwave oven producers in the Pleconese market. Adding producers shifts the supply curve of microwave ovens to the right and thereby establishes a new, lower equilibrium price. (See Figure 17.3.)

In other words, there are now more microwave ovens in Plecona, and the consumers are paying a lower price for them. However, because of the lower price, Pleconese producers of microwave ovens will choose to offer fewer microwaves for sale. So imports have the effect of initially increasing supply and of providing consumers with greater selection and lower prices. The competition also establishes incentives for domestic producers to become more efficient in production, improve worker productivity, and enhance customer service.

Both consumers and producers, then, benefit from international trade. Consumers benefit from imports because the selection of goods increases and prices decrease. Producers benefit from exports by gaining a new market for their products, and thereby giving them the opportunity to increase revenues and earn a profit.

FIGURES 17.2 AND 17.3 THE EFFECTS OF INTERNATIONAL TRADE



ANALYZE GRAPHS

What are the initial and then post-shift equilibrium prices for motorbikes in Figure 17.2? for microwaves in Figure 17.3?

Animated Economics

Use an interactive supply and demand graph at **ClassZone.com**

IMPACT 3 Trade Affects Employment

As nations specialize in their changing areas of strength, the availability of certain jobs can undergo dramatic changes. For example, if Australia specializes in producing iron ore or providing educational services (another area of strength for that nation) at the expense of making steel, then some Australian steelworkers may lose their jobs. At the same time, however, the overall number of Australian jobs may increase significantly. The Australian Trade Commission estimates that a ten percent increase in exports results in 70,000 new jobs for workers in Australia.

In the United States, manufacturing output increased 600 percent between 1950 and 2000. During the same period, however, employment in manufacturing, as a share of total employment, declined by nearly two-thirds. The United States was shifting its specialization from manufacturing to technology. In the process, it became a world leader in technology exports. So, while many manufacturing jobs in some sectors were lost, the shift in specialization and the resulting trade had positive effects on U.S. employment in general. During the 1990s, for example, U.S. exports were responsible for about 25 percent of the nation's economic growth, supporting about 12 million jobs. About 20 percent of all U.S. factory jobs depend on trade. Also, jobs in plants that export their products pay an average of 18 percent higher wages than jobs in non-exporting plants.

Biotech Jobs The U.S. economy's move to the technology sector has meant a sharp rise in biotechnology employment.

The United States in the World Economy

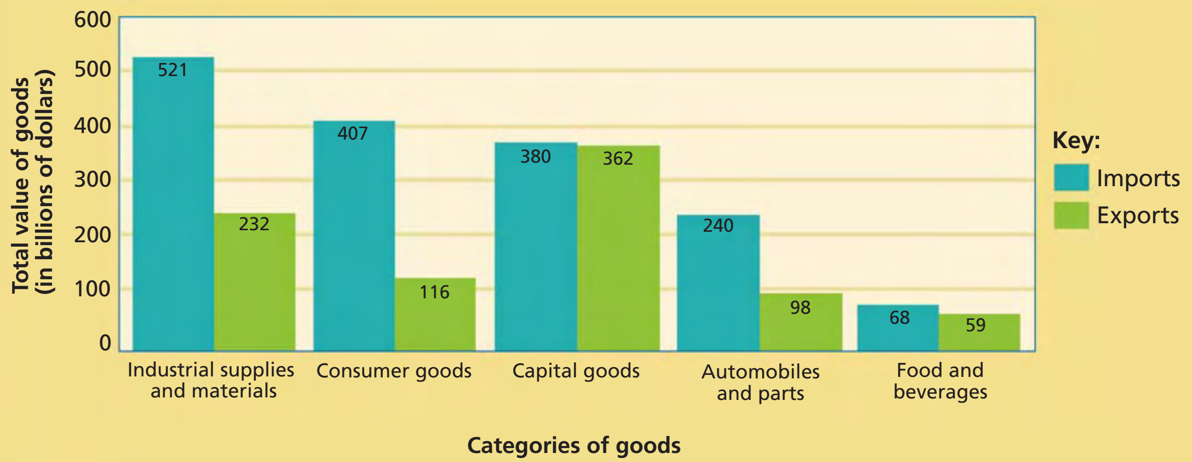
The United States is a leading nation in a number of aspects of the world economy. It is the largest exporter in the world, selling more than $900 billion in goods and services in 2005. The United States mostly exports capital goods (computers, machinery, civilian aircraft, and so on), automobiles, industrial supplies, consumer goods, and agricultural products. It is also the world's largest importer, buying nearly $1.7 trillion worth of goods and services from all over the world. It imports mainly crude oil and refined petroleum products, machinery, automobiles, consumer goods, and industrial raw materials.

While the United States imports more goods than it exports, it exports more services than it imports. Such services as travel and tourism, transportation, architecture and construction, and information systems find ready customers in Europe, Japan, Canada, and Mexico. The four most important trading partners for the United States in goods and services are Canada, accounting for 20 percent of trade, China (12 percent), Mexico (11 percent), and Japan (7 percent). Trade with these four partners accounts for half of U.S. foreign trade.

Economics Update

Find an update on U.S. imports at **ClassZone.com**

FIGURE 17.4 U.S. INTERNATIONAL TRADE IN GOODS BY CATEGORY



Source: U.S. Bureau of Economic Analysis, 2005 data

ANALYZE GRAPHS

1. In what two areas do U.S. export totals approach import totals?

2. What do these graphs show about the United States and specialization?

In recent years, as shown in Figure 17.4, the United States has imported an increasingly larger amount than it has exported. You will learn more about this in Section 4 of this chapter.

APPLICATION Interpreting Graphs

D. In what category of goods is the difference between imports and exports the greatest? Why do you think this is so?

Online Quiz
ClassZone.com

SECTION 1 Assessment

REVIEWING KEY CONCEPTS

1. Explain the difference between the terms in the following pairs:
   a. *specialization* and *economic interdependence*
   b. *absolute advantage* and *comparative advantage*
   c. *export* and *import*
2. What principle explains why nations specialize and trade?
3. Explain why trade is good for nations that produce exports as well as buy imports.
4. What effect do imports have on price and supply? Why?
5. What effect do exports have on price and demand? Why?
6. **Using Your Notes** Write a speech for the president of Australia, explaining why your nation should specialize in the production of iron ore and trade for steel. Use the Graphic Organizer at **Interactive Review @ ClassZone.com**

CRITICAL THINKING

7. **Analyzing Cause and Effect** You have just learned that high-quality electric guitars made in South Korea will soon be exported to the United States. Should you buy a new guitar now or wait until after the imports begin arriving? Explain your answer.
8. **Making Inferences and Drawing Conclusions** Why does the law of comparative advantage explain that all people and nations can trade?
9. **Explaining an Economic Concept** How does international trade help create jobs? How does it shift jobs?
10. **Challenge** Shelley started her own comedy improvisation club right after college, and at first she did everything: developed new material, starred in the show, handled publicity, and sold tickets. As the enterprise grew, however, she hired an assistant to handle publicity and sell tickets, even though she was better at doing those things than he was. Explain why that was a good idea, using terms from this lesson.

ECONOMICS IN PRACTICE

Figuring Absolute and Comparative Advantage

Review the following scenario that describes cordless drill and drill bit production in the fictional nations of Freedonia and Sylvania.

Freedonia and Sylvania both produce cordless drills and drill bits. Over the span of a month, Freedonia can produce 3,000 cordless drills and 21,000 drill bits. During this same period, Sylvania can produce 2,000 cordless drills and 10,000 drill bits.

Drawing Conclusions Use what you've learned in this section to answer the following questions:

1. For each product, which nation has the absolute advantage?
2. What are the production ratios for each nation? What is each nation's opportunity cost for each cordless drill produced?
3. Which country has the comparative advantage in cordless drill production?

Challenge Draw up and explain a scenario whereby Freedonia and Sylvania agree to trade, and each gets a better deal by adjusting its trade ratio.

SECTION 2

Trade Barriers

OBJECTIVES	KEY TERMS	TAKING NOTES
In Section 2, you will • identify barriers to trade • examine the economic consequences of trade barriers • describe protectionism and the arguments for it	trade barrier, *p. 520* quota, *p. 520* dumping, *p. 521* tariff, *p. 521* revenue tariff, *p. 521* protective tariff, *p. 521* voluntary export restraint, *p. 521* embargo, *p. 521* trade war, *p. 522* protectionism, *p. 523* infant industries, *p. 523*	As you read Section 2, complete a chart that shows the causes and effects of trade barriers. Use the Graphic Organizer at **Interactive Review @ ClassZone.com**

Cause	Effect
quota	higher prices

Barriers to Trade

KEY CONCEPTS

In order to offer some short-term protection to jobs and industries located within their borders, almost all nations pass some sort of laws that limit trade. These laws lead to higher prices on the restricted items or to economic retaliation by other nations. In the end, these industries and the jobs they provide can only be saved by becoming more competitive. The issue of trade restrictions is basically political in nature, and governments struggle to find the best policies to enact.

QUICK REFERENCE

A **trade barrier** is any law that limits free trade between nations.

A **quota** is a limit on the amount of a product that can be imported.

Types of Trade Barriers

A **trade barrier** is any law passed to limit free trade among nations. There are five basic types of trade barriers. Most are mandatory, but some are voluntary.

Quota Lifted Chinese textiles cross the Great Wall on their way to markets in the United States and the EU.

Quotas Nations often impose **quotas**, limits on the amount of a product that can be imported. For example, the United States had quotas on the amount of textiles allowed to be imported. These quotas limited supply and kept textile prices relatively high. These quotas expired on January 1, 2005. Chinese producers then flooded the United States (and the European Union) with low-priced textiles. Prices for Chinese textiles increased, however, in other nations. This practice of **dumping**, the sale of a product in another country at a price lower than that charged in the home market, hurts domestic producers but provides consumers a lower price.

Tariffs Another trade barrier is the **tariff**, a fee charged for goods brought into a country from another country. There are two types of tariffs: revenue and protective. **Revenue tariffs**, taxes on imports specifically to raise money, are rarely used today. In the past, however, nations regularly used them as a source of income. Today nations use **protective tariffs**, taxes on imported goods, to protect domestic goods. Protective tariffs raise prices on goods produced more cheaply elsewhere, thereby minimizing the price advantage the imports have over domestic goods. Tariff rates have fallen worldwide since the late 1980s. (See Figure 17.5.)

Voluntary Export Restraint Sometimes, to avoid a quota or a tariff, a country may choose to limit an export. This is called a **voluntary export restraint (VER)**. It usually comes about when a trade ambassador from one nation makes appeals to a counterpart, warning of possible consequences without the VER.

Embargoes An **embargo** is a law that cuts off most or all trade with a specific country. It is often used for political purposes. Since the early 1960s, for example, the United States has had an embargo on trade with Communist Cuba.

Informal Trade Barriers Other trade restrictions are indirect. Licenses, environmental regulations, and health and safety measures (such as a ban on the use of certain herbicides) are, in effect, trade barriers.

QUICK REFERENCE

Dumping is the sale of a product in another country at a price lower than in the home market.

A **tariff** is a fee charged for goods brought into one country from another.

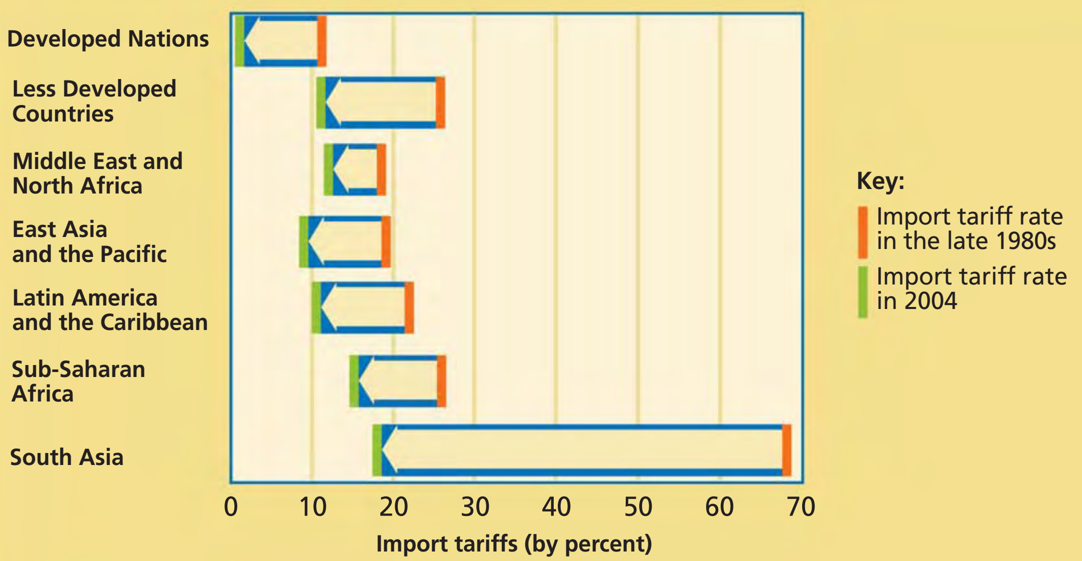
A **revenue tariff** is a tax levied on imports specifically to raise money.

A **protective tariff** is a tax on imported goods to protect domestic goods.

A **voluntary export restraint (VER)** is a country's self-imposed restriction on exports.

An **embargo** is a law that cuts off trade with a specific country.

FIGURE 17.5 TARIFF RATES ARE FALLING



Source: United Nations Human Development Report, 2005

APPLICATION Categorizing Economic Information

A. Aside from imposing an embargo, how might one nation limit the import of a product from another nation?

The Impact of Trade Barriers

QUICK REFERENCE

trade war succession of increasing trade barriers between nations

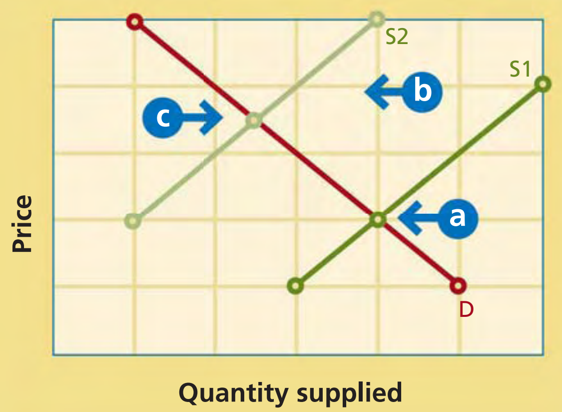
KEY CONCEPTS

Trade barriers have numerous effects. They may temporarily save domestic jobs in certain industries, but without competition, those industries might continue to operate inefficiently. In the end, consumers pay higher prices. Further, limits on trade sometimes lead to a **trade war**, a succession of trade barriers between nations.

IMPACT 1 Higher Prices

Trade barriers raise prices or keep them high. For example, in the early 2000s, the United States and Japan, who both produce semiconductor chips, imposed tariffs on chips from South Korea. The reason for the tariff was that the Korean government had subsidized the chip maker, allowing the chips to be sold at a very low price. The result was a higher price in U.S. and Japanese markets for both the Korean chips (up 27 to 44 percent) as well as for those produced domestically. (See Figure 17.6.)

FIGURE 17.6 THE EFFECT OF AN IMPORT TARIFF ON PRICE



a This is the pre-tariff price of an imported good.

b A tariff increases the price, moving the supply curve up the demand curve by the amount of the tariff.

c There is less demand at the new, higher price, so the supply of imported goods is reduced.

IMPACT 2 Trade Wars

Trade wars often occur when nations disagree on quotas or tariffs. One recent trade war, however, came about in 1999 when the European Union banned the importation of hormone-treated U.S. beef. Many U.S. ranchers treat their cattle with hormones, which cause the animals to develop muscle faster than untreated animals. But EU scientists, citing health concerns, helped push through a ban. In response, the United States levied 100 percent tariffs on a range of EU products, including ham, onions, mustard, chocolate, and Roquefort cheese.

APPLICATION Applying an Economic Concept

B. Boeing, a U.S. airplane producer, and Airbus, its European competitor, each claim the other receives unfair governmental support. Why does each object to the alleged unfair support?

Arguments for Protectionism

KEY CONCEPTS

Considering all the disadvantages of trade barriers, why would a country enact such laws? The answer lies in the concept of **protectionism**, the use of trade barriers between nations to protect domestic industries. Protectionists argue that trade barriers protect domestic jobs, promote **infant industries** (new industries that are often unable to compete against larger, more established competitors), and protect national security.

QUICK REFERENCE

Protectionism is the use of trade barriers between nations to protect domestic industries.

Infant industries are new industries that are often unable to compete against larger, more established competitors.

ARGUMENT 1 Protecting Domestic Jobs

Between 2000 and 2003, Stark County, Ohio, lost ten percent of its manufacturing jobs, including hundreds at a plant that makes Hoover vacuum cleaners. Imports from Asia and Mexico forced a ten percent drop in the price of vacuum cleaners. The U.S. workers, many of whom earned high wages to do their skilled work, were understandably upset by the shift of their jobs to overseas facilities.

In Ohio and elsewhere, people argue that trade barriers are needed to protect domestic jobs, even though, in reality, these actions generally protect inefficient production and result in higher prices for everyone. Voters in industrial areas bring their voices to the national debate about foreign trade. By doing so, they have helped bring about federal job training programs for workers who find themselves unemployed as a result of the movement of jobs to places where the per unit cost of labor is lower.

Irish Success Bono suggested that Ireland's ability to protect its industries helped the Irish economy become stronger.

ARGUMENT 2 Protecting Infant Industries

What was an Irish rock star, Bono, doing at the 2006 World Economic Conference in Davos, Switzerland? For one thing, this performer, known for his commitment to Africa, was arguing that African infant industries should be protected. Referring to the history of his own country, he said that Irish infant industries were protected in their day but that such protection is "denied . . . to the poorest countries in the world."

The idea behind protecting infant industries is to assist newly developing industries in their growth process until they are able to compete with better-developed foreign rivals. This argument is often used by newly developing nations to keep out goods from economically well developed nations. In Africa, for example, Uganda has received protection for its infant industries in the form of tariffs on exports from neighboring Kenya. However, even with these protective tariffs, Ugandan industry has not yet found a way to become competitive on its own and continues to request extensions of the tariff.

This example points to a potential problem. Critics say that, provided with a sheltered existence that is free from the need to compete on equal terms, these industries settle into perpetual infancy. And a perpetual infant needs perpetual support.

A GLOBAL PERSPECTIVE

Non-Economic Trade Barriers

French movie poster

Some nations impose trade barriers for religious reasons. Iran, for instance, has banned any Western movies that portray secularism, feminism, and other activities deemed unethical. Western popular music has also been deemed indecent and "un-Islamic" and, therefore, banned. These barriers have driven demand for Western movies and music underground, where they can be found on the black market.

Some nations enact trade barriers based on more general notions of culture. During the 1994 round of negotiations related to the Global Agreement on Tariffs and Trade (GATT), the French movie industry won a victory on a principal close to its heart.

It's known as the cultural exception, and it basically states that cultural goods are different from other goods and should not be covered by trade agreements. The cultural exception has been used, notably by France and Canada, to boost domestic television and film industries (through subsidies and quotas) and limit foreign competition, mostly from the United States.

Without these protections, the exception's proponents say, a handful of U.S. media multinationals would be able to dominate the area of audiovisual entertainment, thereby overwhelming the traditional cultures of other nations.

CONNECTING ACROSS THE GLOBE

1. **Explaining an Economic Concept** Some would argue that all trade barriers lack sound, economic reasoning. Do you agree? Why?
2. **Making Inferences and Drawing Conclusions** Which one of the three arguments for protectionism most resembles the actions taken by France and Canada? Explain.

ARGUMENT 3 Protecting National Security

National security affects the trade of industries that nations consider to be vital to their safety. The energy industry is considered vital by most. In 2005, a government-run Chinese company bid on U.S. oil company UNOCAL. Many in Congress and elsewhere in the United States warned against allowing a foreign government to take over an important U.S. energy supplier. After the House of Representatives voted 398 to 15 to ask President Bush to step in, the Chinese company withdrew its bid.

But sharp political differences exist over what industries are truly vital to national security. In 2006, a company from Dubai, which had purchased the rights to operate port facilities in New York, Miami, New Orleans, and elsewhere, was forced to abandon the deal in light of political pressure over port security. Many analysts were skeptical of the security concerns, however, and worried more about the implications of interference in free international trade for purely political reasons.

APPLICATION Making Inferences and Drawing Conclusions

C. Do you think that political pressure for protectionist trade barriers rises or falls during a recession? Explain your answer.

SECTION 2 Assessment

Online Quiz
ClassZone.com

REVIEWING KEY CONCEPTS

1. Explain the relationship between the terms in the following pairs:
   a. *trade barrier* / *quota*
   b. *tariff* / *voluntary export restraint*
   c. *trade war* / *protective tariff*
   d. *infant industries* / *protectionism*
2. Why would a country engage in dumping?
3. How does a trade war get started? What effects does it have?
4. Why do some people feel that barriers to free trade are essential for national security?
5. Who benefits from trade barriers, inefficient or efficient producers?
6. **Using Your Notes** Take a position on free trade vs. protectionism and explain your position in a brief essay. Refer to your completed cause-and-effect chart. Use the Graphic Organizer at **Interactive Review @ ClassZone.com**

Cause	Effect
quota	higher prices

CRITICAL THINKING

7. **Analyzing Cause and Effect** In 1996, the United States expanded the embargo against Cuba, declaring that any foreign corporation that engaged in trade with Cuba would lose its privilege of trading with the United States. Give two possible effects of this embargo expansion.
8. **Solving Economic Problems** If you were the CEO of a manufacturing company facing stiff foreign competition, what are some ways you could adjust your business to stay competitive? What are the advantages and disadvantages of these changes?
9. **Applying Economic Concepts** Give three examples of U.S. citizens earning an income by selling products domestically that were made in other countries. Give three examples of U.S. citizens earning an income by selling products or services that are ultimately purchased by people in other countries.
10. **Challenge** A trade agreement between Kenya and some nations in Europe requires Kenyan farmers, most of whom have small peasant farms, to comply with 400 conditions before they can export their produce to European countries. They must be able to document the fertilizers, pesticides, and other additives used in the growing of their crops. How would you categorize this trade restriction? What impact do you think it will have on Kenyan exports and prices in the European nations?

ECONOMICS IN PRACTICE

Analyzing Tariff Rates

Look at the graph below showing selected U.S. tariff rates for nations with which it has "Normal Trade Relations" (NTR), also known as the "most-favored nation" (MFN) status.

Item	NTR/MFN Tariff (%)
Ceramic tableware	4.5
Cars	2.5
Trucks	25.0
Most bicycles	11.0
Sports footwear	10.5

Analyzing and Interpreting Data How much does the cost of a $32,000 truck increase because of the tariffs? If you pay $245.31 for a bicycle, what amount is the tariff?

Challenge Suppose a pair of imported running shoes costs $10. With the tariff added, the importer has to pay $11.50. The importer, however, has to raise the price of the shoes to cover the expense of selling and shipping them to retailers, and retailers have to raise the price to cover their expenses in selling the shoes. Assuming the price increases by 50 percent at each stage of the process, what amount does the initial $1.50 tariff grow into?

SECTION 3

Measuring the Value of Trade

OBJECTIVES

In Section 3, you will

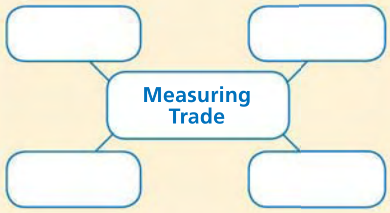
- describe how nations determine the value of their currency in a world market
- explain why nations want a favorable balance of trade

KEY TERMS

foreign exchange market, *p. 526*
foreign exchange rate, *p. 526*
fixed rate of exchange, *p. 526*
flexible rate of exchange, *p. 527*
trade weighted value of the dollar, *p. 528*
balance of trade, *p. 529*
balance of payments, *p. 529*
trade surplus, *p. 529*
trade deficit, *p. 529*

TAKING NOTES

As you read Section 3, complete a cluster diagram summarizing key information about measuring trade. Use the Graphic Organizer at **Interactive Review @ ClassZone.com**



Foreign Exchange

KEY CONCEPTS

If a certain good costs $100, how many euros does it cost? How many Mexican pesos? Or Russian rubles? International trade requires some way to establish the relative value of the different currencies of the nations doing the trading. So nations have worked out systems that facilitate the exchange of currencies between buyers and sellers. One key element is the **foreign exchange market**, a market in which currencies of different countries are bought and sold. This market is a network of major commercial and investment banks that link the economies of the world. Another key element in facilitating international trade is the **foreign exchange rate**, the price of one currency in the currencies of other nations.

QUICK REFERENCE

In the **foreign exchange market**, the currencies of different countries are bought and sold.

The **foreign exchange rate** is the price of a currency in the currencies of other nations.

With a **fixed rate of exchange**, the currency of one nation is fixed, or constant, in relation to other currencies.

Rates of Exchange

During the 1800s and early 1900s, gold was the standard against which the value of a nation's currency was determined. Nations traded on the basis of a **fixed rate of exchange**, a system in which the currency of one nation

Currency Exchange The Mexican peso, the Australian dollar, and the Chinese yuan are all bought and sold on the foreign exchange market.

is fixed, or constant, in relation to other currencies—in this case to gold. After the profound economic disruption of World War II, other currencies were “pegged” to the stable U.S. dollar. That is, their currency was valued according to its relation to the U.S. dollar. The price of an ounce of gold was fixed at $35.

The volatile 1970s brought another change. As the United States ran up a trade deficit and the dollar declined in value, the standard of $35 per ounce of gold was no longer sustainable, and the **flexible rate of exchange**, also called the floating rate, became predominant. This is a system in which the exchange rates for currencies change as the supply of and demand for the currencies change. For example, suppose that one British pound (GBP) is worth two U.S. dollars (USD). If an American importer wants to buy 100 British-made watches valued at 100 GBP each, then the importer would sell 20,000 USD in the foreign exchange market to obtain the necessary 10,000 GBPs. As the supply of dollars increases, their relative value drops. So the next time the importer wants to buy watches, the exchange rate might be 1 GPB:2.5 USD, and the watches would cost 25,000 U.S. dollars, making them less attractive as imports. Over time, the flexible exchange rate acts as a regulator on foreign exchange, balancing imports and exports.

QUICK REFERENCE

The **flexible rate of exchange** is a system in which the exchange rate for currency changes as supply and demand for the currency changes.

MATH CHALLENGE

FIGURE 17.7 Calculating Exchange Rates

Suppose you want to buy a book in Germany, where the currency is the euro (€). The book costs €25, and the seller wants you to pay in euros, but you have U.S. dollars. To buy the book you must first buy euros.

To find out how much €25 costs in U.S. dollars, you must know the exchange rate. In this case, let’s say the exchange rate is 1.25, which means that one euro costs $1.25. Now use the following formula.

					Example Calculation
Amount of currency you want to buy	×	Exchange rate	=	Cost in currency you have	€25 × 1.25 $/€ = $31.25

To buy €25, you must pay $31.25.

Reciprocal exchange rate The exchange rate 1.25 can be written as a fraction: $1.25/€1. You can use this fraction to find the exchange rate a German must use to buy U.S. dollars with euros. First take the reciprocal of the fraction by swapping the numerator and the denominator; then use a calculator to write the fraction as a decimal.

The reciprocal of	$\frac{\$1.25}{€1}$	is	$\frac{€1}{\$1.25}$,	which is 0.80 €/$

So to convert from U.S. dollars to euros, multiply by the exchange rate 0.80.

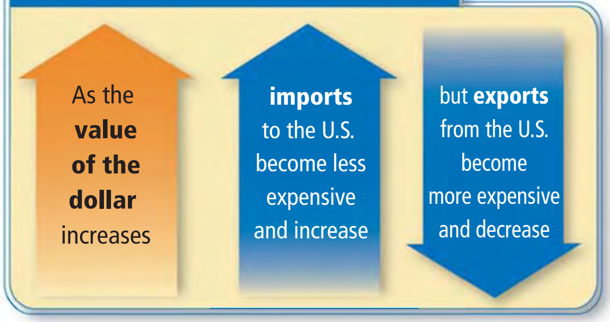
Strong and Weak Currencies

QUICK REFERENCE

The **trade-weighted value of the dollar** is a measure of the international value of the dollar.

The Federal Reserve keeps a measure of the international value of the dollar called the **trade-weighted value of the dollar**. It determines if the dollar is strong or weak as measured against another currency. Because of the flexible exchange rate, as currencies are traded, some increase or decrease in value when measured against another currency.

FIGURE 17.8 THE STRONG DOLLAR AND U.S. TRADE



For example, if the U.S. dollar becomes stronger in comparison to the Mexican peso, then the U.S. dollar buys more Mexican pesos than it could previously. What this means is that imports from Mexico now cost less. As you can see in Figure 17.8, importers in the United States benefit because they are able to buy foreign goods and services relatively cheaply.

At the same time, however, goods made in the United States may have a hard time competing with these inexpensive imports in the U.S. domestic market. Also, the strong dollar has a negative effect on U.S. exporters, since goods made here would be more costly to purchase abroad at the strong dollar rate. The weak dollar has the same effects but in reverse, as imported goods become more expensive and exporters are able to sell relatively cheaply.

YOUR ECONOMIC CHOICES

STRONG DOLLAR AND WEAK DOLLAR

Which sweater will you buy?

The U.S. dollar is very weak versus the Hong Kong dollar (HKD). How might this influence your decision to buy a new sweater made in the United States, or one imported from Hong Kong?

Domestically produced

Imported from overseas

APPLICATION Applying Economic Concepts

A. If you are an American exporter, does a strong dollar help your business? Explain.

Balance of Trade

KEY CONCEPTS

In Chapter 12, you read about net exports as an economic measure. Another name for the difference between the value of a country's imports and exports is its **balance of trade**. It is tallied through the **balance of payments**, a record of all the transactions that occurred between the individuals, businesses, and government units of one nation and those of the rest of the world. The U.S. balance of payments includes the goods and services traded between it and other nations, as well as the investments foreign interests make in the United States and those made by Americans in a foreign country. A nation is said to have a favorable balance of trade if it has a **trade surplus**—that is, it exports more than it imports. If a nation imports more than it exports it has a **trade deficit**, also known as an unfavorable balance of trade.

QUICK REFERENCE

A nation's **balance of trade** is the difference between the value of its imports and exports.

The **balance of payments** is a record of all the transactions that occurred between the individuals, businesses, and government units of one nation and those of the rest of the world.

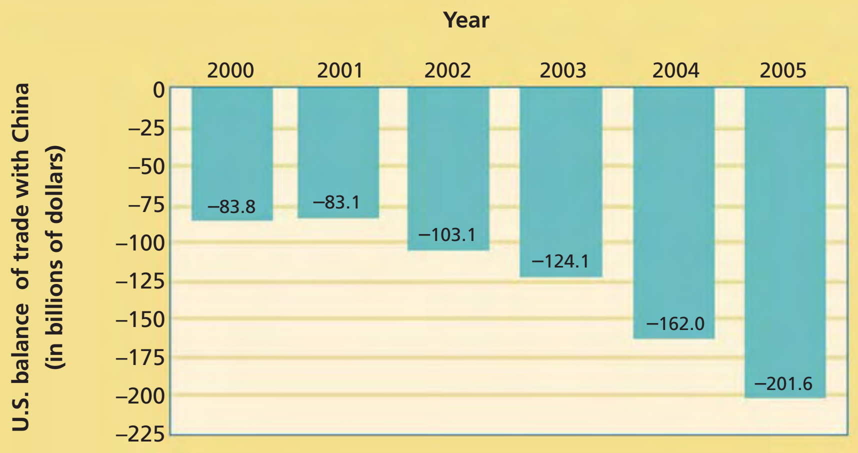
A nation with a **trade surplus** exports more than it imports.

A nation with a **trade deficit** imports more than it exports.

EXAMPLE U.S.-China Trade

In recent years, China has undergone one of the most rapid industrializations in history. In addition to its fast-growing output of manufactured goods, the Chinese currency, the RenMinBi (RMB), or yuan, has also been weak compared to the U.S. dollar. The yuan's weakness versus the dollar resulted from China's decision to peg its value at a fixed rate versus the dollar, beginning in 1994. This artificially weak position helped make the United States the number-one destination for Chinese exports. By 2005, China had a record trade surplus of just over $200 billion with the United States. The surplus helps China fuel its continued manufacturing growth.

FIGURE 17.9 BALANCE OF U.S. TRADE WITH CHINA



Source: U.S. Census Bureau Foreign Trade Statistics

ANALYZE GRAPHS

1. Between which two years did the trade deficit with China grow the most?
2. If the dollar were weaker than the yuan, would you expect the trend shown in the graph to continue? Why?

EXAMPLE The U.S. Trade Balance

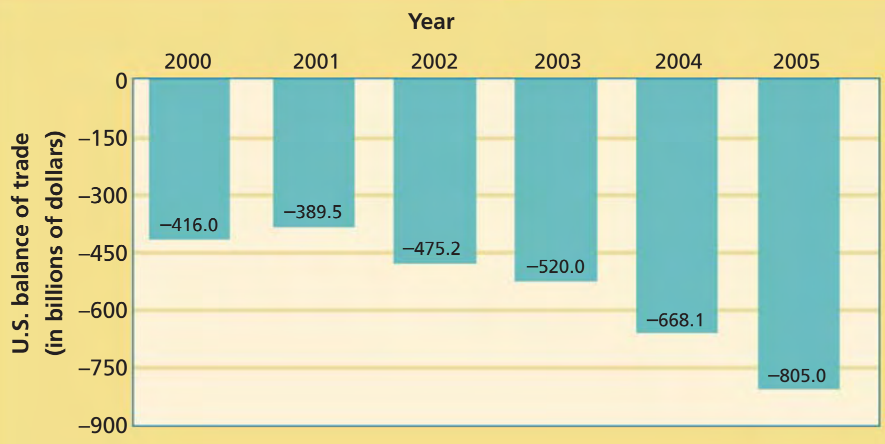
The balance of trade in the United States has gone through roughly five phases. From about 1770 to 1870, the young nation had a deficit in goods and services but a surplus in capital investment from foreign countries that recognized the nation's potential for growth. Between 1870 and 1920, the nation was paying back foreign debts from the previous phase, but it was also exporting more goods and services than it was importing. In the years between 1920 and 1945, the United States had a surplus in exports but a deficit in foreign investments, as the nation sought to help rebuild Europe after World War I. From 1945 to 1980, the nation had a deficit in merchandise and continued its deficit in foreign investments as large amounts of money went to post–World War II reconstruction.

In the current phase, the United States has a large surplus of foreign investment, which is attracted by a relatively low inflation rate and a generally stable economy. However, high rates of consumer spending (versus low rates of saving), as well as high oil prices (which significantly increased the dollar value of U.S. imports) have helped create a very large merchandise deficit. An advantage of this deficit is that it allows U.S. consumers to buy low-priced imports. A disadvantage is that financing the deficit may require borrowing money from the rest of the world, selling off assets, or tapping into foreign currency reserves.

Economics Update

For an update on the U.S. balance of trade go to **ClassZone.com**

FIGURE 17.10 U.S. BALANCE OF TRADE



Source: U.S. Department of Commerce, Bureau of Economic Analysis

ANALYZE GRAPHS

1. In what year did the U.S. balance of trade improve?
2. Does this overall trend point to rising or falling prices for U.S. consumers?

APPLICATION Analyzing Cause and Effect

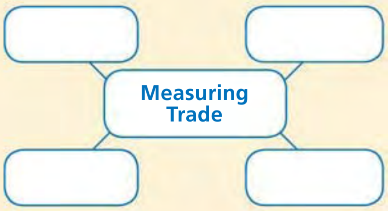
B. Between 1870 and 1920, the United States was exporting more goods and services than it imported. What does this say about the relative strength of the dollar during this period?

SECTION 3 Assessment

Online Quiz
ClassZone.com

REVIEWING KEY CONCEPTS

1. Explain the differences between the terms in each of these pairs:
   a. *foreign exchange market* / *foreign exchange rate*
   b. *fixed rate of exchange* / *flexible rate of exchange*
   c. *trade surplus* / *trade deficit*
2. What is an advantage of a trade surplus? A disadvantage?
3. What is an advantage of a trade deficit? A disadvantage?
4. How does the value of the U.S. dollar affect the U.S. trade surplus or deficit?
5. How does a flexible exchange rate help to stabilize trade balances?
6. **Using Your Notes** Write a brief essay arguing for or against a single world currency. Refer to your completed cluster and use the section's key words.



Use the Graphic Organizer at
Interactive Review @ ClassZone.com

CRITICAL THINKING

7. **Analyzing Cause and Effect** In July 2005, the Chinese RMB became fixed to a "market-basket" of currencies, including the U.S. dollar and the Japanese yen, removing a decade-long peg to the U.S. dollar alone. The new formula slightly raised the value of the RMB. If China's trade surpluses continue, what will happen to the value of the RMB?
8. **Applying an Economic Concept** While you are in France on a business trip, you find out that the euro has gained strength against the U.S. dollar. Will your hotel room and food now be more or less expensive? Why? What about the goods you're trying to sell on your trip; will they be more or less expensive to your customers in France? Why?
9. **Making Inferences and Drawing Conclusions** Japan has the world's largest foreign currency reserves, followed by China. State two conclusions you can draw about the economies of these two nations based on their foreign currency reserves.
10. **Challenge** What are the advantages of a large supply of foreign investment in a domestic economy? What are the disadvantages?

ECONOMICS IN PRACTICE

Understanding Exchange Rates
Just as there are stock markets for trading company shares, there are currency markets for trading currencies. The picture shows the prices of three currencies in dollars and how the prices have changed.

	One			
Buys	U.S. Dollar	Euro	Chinese Yuan	Indian Rupee
U.S. Dollar	1.00	1.32	0.13	0.02
Euro	0.76	1.00	0.10	0.02
Chinese Yuan	7.82	10.33	1.00	0.18
Indian Rupee	44.48	58.72	5.69	1.00

Average rates, December 2006

Analyze Data Use this exchange rate table to answer the following questions.

- How much of each of the other currencies will $5 U.S. purchase?
- If the exchange rate from euros to dollars changed from 1.32 to 1.40, which currency has gotten weaker?
- How would that affect EU businesses that export to the United States?

Challenge Why might businesses need to buy foreign currencies?

SECTION 4

Modern International Institutions

OBJECTIVES	KEY TERMS	TAKING NOTES
In Section 4, you will • describe what agreements were made to start the free-trade movement • identify international and regional trade groups • explain what role multinationals play in world trade	free-trade zone, *p. 532* customs union, *p. 532* European Union, *p. 532* euro, *p. 533* NAFTA, *p. 533* OPEC, *p. 535* cartel, *p. 535* WTO, *p. 535*	As you read Section 4, complete a summary chart like the one shown, using the key concepts and other helpful words and phrases. Use the Graphic Organizer at **Interactive Review @ ClassZone.com**

Regional	International

Regional and World Trade Organizations

QUICK REFERENCE

A **free-trade zone** is a specific region in which trade between nations takes place without protective tariffs.

A **customs union** is an agreement that abolishes trade barriers among its members and establishes uniform tariffs for non-members.

The **European Union**, the EU, is an economic and political union of European nations established in 1993.

KEY CONCEPTS

Following the failed protectionist policies of the 1930s, nations have sought to expand trade and reduce or eliminate trade barriers. They have organized regional trading groups to create **free-trade zones**, specific regions in which trade between nations takes place without protective tariffs. Some have created **customs unions**, agreements that abolish trade barriers among the members and establish uniform tariffs for non-members. Some of these organizations are called common markets. As a result of these efforts, global tariffs have dropped by about one-third.

GROUP 1 The European Union

In 1957, six European nations recognized the benefits of abolishing trade barriers and formed a customs union called the European Economic Community. It was widely known as the Common Market. In 1993 the Common Market evolved into the **European Union**, or EU , which tightly bound its member nations to one another both economically and politically. The political nature of the EU, the fact that its members surrender some sovereignty in specified areas, makes it unique among

EU Expansion Lithuanians celebrate their nation's admission to the EU in 2004.

trading groups. The Treaty on European Union had monetary union and a common foreign policy as key goals. Monetary union was established in 2002, as 12 member states adopted the **euro**. (See "The Euro as Common Currency" on p. 292.)

The six original members were Belgium, France, Germany, Italy, Luxembourg, and the Netherlands. In 1973, Denmark, Ireland, and the United Kingdom became members. Greece joined in 1981, and Portugal and Spain in 1986. In 1995, after the Common Market became the European Union, Austria, Finland, and Sweden joined. In 2004, ten nations became members: Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, and Slovenia. In 2007, Bulgaria and Romania joined, raising the total number of members to 27.

The EU accounts for about 20 percent of global exports and imports, making it the world's biggest trader. It has removed barriers to free trade among member nations, with the ultimate goal that Europe's national borders will be no more a barrier to free trade than are the borders of U.S. states.

QUICK REFERENCE

The **euro** is the currency of the European Union.

GROUP 2 NAFTA

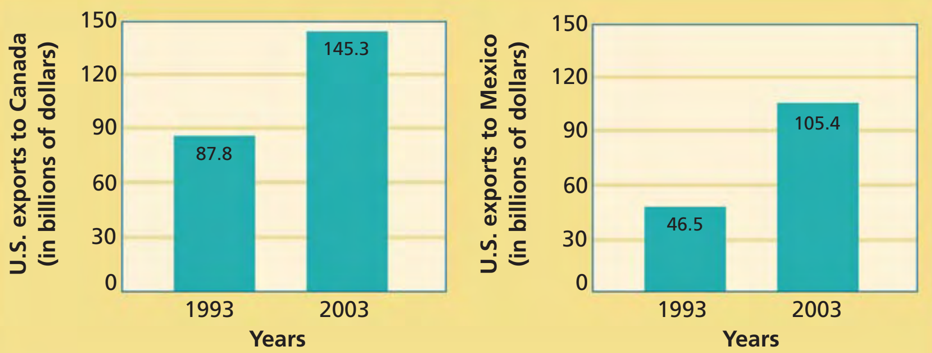
In 1990, negotiations began on a free-trade agreement among the United States, Canada, and Mexico. The result of these negotiations, the North American Free Trade Agreement, or **NAFTA**, created the largest free-trade zone in the world. When it went into effect on January 1, 1994, it immediately eliminated tariffs on half of the goods exported to Mexico from the United States. The agreement called for an eventual phase-out of all trade barriers on goods and services. It also called for improved protection of intellectual property rights, stronger environmental and worker protections, and standardized investment policies.

The advantages of NAFTA include specialization and increased efficiency, a competitive advantage over the EU and Japan, expanded markets, and new jobs. And while some object to NAFTA on a number of political, social, and even environmental grounds, the economic results appear robust. (See Figure 17.11.) Between 1993 and 2003, Mexico and Canada experienced economic gains as well. Two-way agricultural

QUICK REFERENCE

NAFTA, the North America Free Trade Agreement, is designed to ensure trade without barriers between Canada, Mexico, and the United States.

FIGURE 17.11 NAFTA'S FIRST TEN YEARS



Source: Office of the U.S. Trade Representative

ANALYZE GRAPHS

1. Which nation, Canada or Mexico, increased its trade with the United States by a larger percentage?
2. Is an increase in trade typically beneficial for nations? Explain.

trade between Mexico and the United States increased 125 percent—from $6.2 billion in 1993 to $14.2 billion in 2003. Productivity in Mexico increased a remarkable 55 percent. Canada's exports to its NAFTA partners increased by 104 percent, and its overall economy grew by over 30 percent. Overall trade between the three partners more than doubled during this period, from $289.3 billion in 1993 to $623.1 billion in 2003.

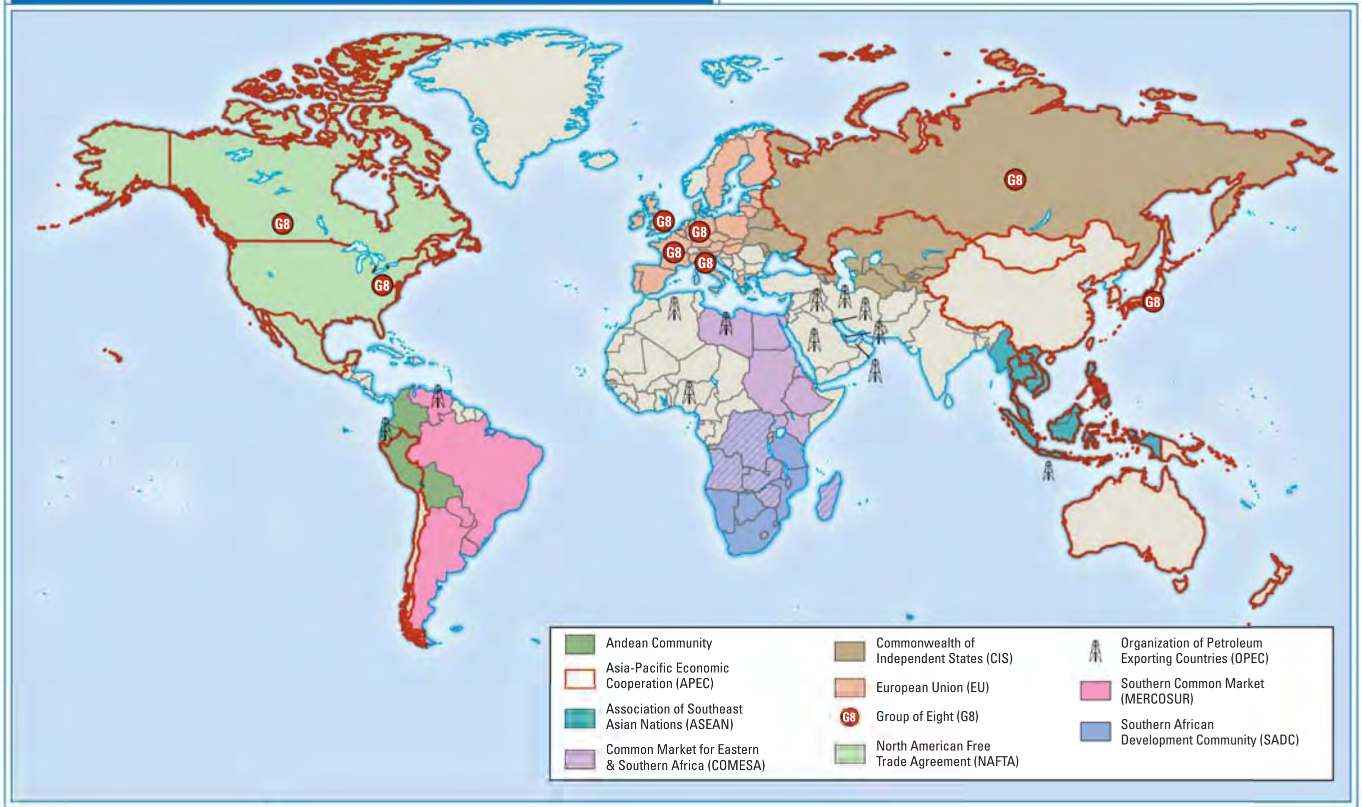
GROUP 3 Other Regional Trade Groups

Throughout the world, nations are forming trade organizations to specialize, promote free trade, and stay competitive with other trade groups. Descriptions of a number of these agreements from all parts of the world follow:

Mercosur (*Mercado Comun del Cono Sur*) This group promotes the movement of goods and people in South America. Formed in 1995, Mercosur eliminated tariffs on 90 percent of goods traded between the group's full members (Argentina, Brazil, Paraguay, and Uruguay). Venezuela became a full member in July of 2006. Counting associate members Mexico, Chile, Bolivia, and Peru, Mercosur has become the world's fourth-largest trade association.

ASEAN The Association of Southest Asian Nations was formed in 1967 to accelerate economic growth, social progress, and cultural development in the region, and to promote regional peace and stability. Its members include Indonesia, the Philippines, Singapore, Thailand, Vietnam, Laos, Cambodia, and others.

FIGURE 17.12 Some Regional Trade Groups



ANALYZE MAPS

How many trading groups do the United States and Canada belong to? Why does it make sense for such developed nations to be part of multiple trading groups?

APEC The Asia-Pacific Economic Cooperation group is a trade organization of nations on the Pacific Rim—those that are adjacent to or within the Pacific Ocean. It includes developed nations such as Australia, Japan, and the United States, transitional economies such as Russia and China, as well as less developed countries such as Thailand, Papua New Guinea, and Chile. The group has set ambitious goals for trade liberalization throughout the region by 2020. However, since all APEC decisions require a unanimous vote, progress toward its goals has been slow.

OPEC The Organization of Petroleum Exporting Countries is a **cartel**—a group of producers who regulate the production, pricing, and marketing of a particular product. In OPEC's case, that product is petroleum, or oil. It has had mixed results in controlling the oil market since its formation in 1960. However, surging demand, from nations such as China and the United States, and periods of regional political instability have strengthened OPEC's position in recent years.

QUICK REFERENCE

OPEC is the Organization of Petroleum Exporting Countries.

A **cartel** is a group of producers that regulates the production, pricing, and marketing of a product.

SADC Founded in 1979, the South African Development Community's original goal was to act as a counterbalance to the region's main economic power—South Africa. (After South Africa finally abandoned minority white rule—the apartheid system—it also became a member in 1994.) A regional free-trade zone was established in 2000.

Dedication to free trade is a key element in boosting the region's economies. However, corruption, political instability, various health issues (most importantly, AIDS), substandard education, and poor infrastructure consistently hamper development. (You'll learn about these and other development issues in Chapter 18.)

GROUP 4 World Trade Organization

In 1944, the Allied nations met to plan for recovery after World War II. Among other important outcomes, they produced the General Agreement on Tariffs and Trade (GATT), which laid out rules and policies for international trade. In 1995, the GATT principles were incorporated into a new organization, the **World Trade Organization**, or WTO. At the end of 2005, the WTO had 149 member nations.

QUICK REFERENCE

The **World Trade Organization**, or **WTO**, is a group of nations that adhere to the policies of the General Agreement on Tariffs and Trade.

The purposes of the WTO include negotiating and administering trade agreements, resolving trade disputes, monitoring the trading policies of member nations, and providing support for developing countries. The principles underlying these purposes are that trade rules should apply equally to domestic and imported products. To that end all member nations should extend one another Normal Trade Relation (NTR) status, formerly known as Most Favored Nation (MFN) status. This means that no nation should extend more favorable trade terms to one WTO member than it does to another. Members should also work toward lowering trade barriers of all kinds and support fair trade as well as free trade.

To varying degrees, the WTO has been successful. It has helped reduce tariffs on manufactured goods, lower trade barriers in agriculture, and promote intellectual property rights. It has also resolved disputes among members while maintaining each nation's sovereignty, and promoted stability among member nations.

APPLICATION Making Inferences and Drawing Conclusions

A. Why do you think the term *most favored nation* has been replaced by *normal trade relations*?

Multinationals Bring Changes to International Trade

KEY CONCEPTS

Multinational corporations (see Chapter 8) cross many borders and must deal with tariffs, labor restrictions, and taxes in different nations. They often bring jobs and technology to developing nations, while boosting overall levels of international trade—something that benefits everyone involved.

International Trade Within Multinationals

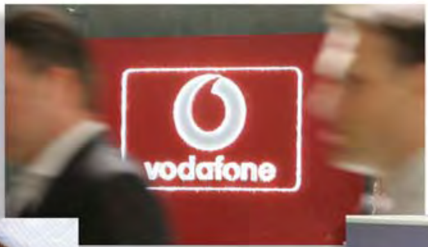
As multinationals have become more prevalent, trade between the various divisions of multinationals has become an area of increasing interest. Intrafirm trade, as it is known, can simply be the exchange of goods between two parts of a multinational. But international intrafirm trade also covers the coordination of production between parts of a multinational. This means, for instance, that when a U.S. parent company sends parts to an overseas affiliate to assemble, that is counted in the export column for U.S. statistics on trade. Likewise, when the assembled goods are shipped back to the U.S. parent from its overseas affiliate, that is counted in the import column. In general, intrafirm imports account for about 40 percent of total U.S. imports. Intrafirm exports account for about one-third of total U.S. exports.

EXAMPLE A Multinational Telecom Corporation

Consider the case of Worldwide Cellular, a U.S.-based multinational that makes, markets, and services cellular phones. It imports an essential raw material from its mining arm in Australia, manufactures the phones at its facility in South Korea, markets the phones in Europe, and then directs customers who have questions or complaints to technical support and customer service representatives in India. Throughout the process, the people and the economies of each nation benefit.

▲ Australian mining

▼ South Korean manufacturing



▲ European marketing and sales

▼ Indian call center

APPLICATION to come

B. In 1969, there were about 7,200 known multinationals. By 2000, that number had grown to more than 63,000. Give three possible contributing reasons for that growth.

SECTION 4 Assessment

Online Quiz
ClassZone.com

REVIEWING KEY CONCEPTS

1. Explain the relationship between the terms in each of these pairs:
   a. *free-trade zone* *customs union*
   b. *EU* *NAFTA*
   c. *OPEC* *cartel*
2. What circumstances led to a liberalization in global trading?
3. How do customs unions help member nations?
4. How is the EU different from other regional trading groups?
5. What are some advantages of NAFTA?
6. **Using Your Notes** Write a brief summary of the major regional and international trade organizations. Refer to your completed summary chart and use the section's key words. Use the Graphic Organizer at **Interactive Review @ ClassZone.com**

Regional	International

CRITICAL THINKING

7. **Making Inferences and Drawing Conclusions** Some regional trade associations are viewed as an attempt by less developed countries to protect themselves and their regions from globalization's aggressive momentum. Explain how regional groups might have that effect.
8. **Analyzing Cause and Effect** Many multinationals grew out of exporting businesses. How might the exporting business prepare a company to become a multinational?
9. **Predicting Economic Trends** Before NAFTA was passed, some experts predicted a reduction in illegal immigration from Mexico to the United States. In fact, in the first few years after NAFTA went into effect, illegal immigration increased. What reasoning might have explained the prediction that illegal immigration would decline? What reasons might explain the increase?
10. **Challenge** At the Hong Kong gathering of the World Trade Organization in 2005, Supachai Panitchpakdi, secretary general of the United Nations Conference on Trade and Development (UNCTAD) said: "Rich countries will have to reject not just protectionism, but populism, too. They will have to speak honestly to their people about the changing economies of the 21st century, and about global interdependence and the fact that prosperity elsewhere means prosperity and jobs at home." Write a brief essay that "speaks honestly" to the rich countries about the changing economies of the 21st century.

ECONOMICS IN PRACTICE

The Effects of NAFTA

Between 1993 and 2002, the total trade among Canada, the United States, and Mexico more than doubled. The table below shows export figures for NAFTA members Canada and Mexico in each of those years.

	Exports (in billions of dollars)	
Nation	**1993**	**2002**
Canada		
to United States	113.6	213.9
to Mexico	.9	1.6
Mexico		
to United States	31.8	136.1
to Canada	2.9	8.8

Analyzing and Interpreting Data Canada has a higher export amount than Mexico, but did its level of trade increase more than Mexico's in the interval? Explain.

Challenge Can Canadian companies produce, package, and market products for both of its NAFTA partners in the same way? Explain why or why not.

Case Study

Economics Update Find an update on this Case Study at **ClassZone.com**

Analyzing Tariffs—Who Wins and Who Loses?

Background Tariffs on foreign sugar have been around almost as long as the United States itself. Although early tariffs were a form of revenue, their purpose expanded in the 19th century to provide protection for the domestic sugar industry. That protection continues to this day.

Globalization, however, is having a direct impact on the way nations trade. Agricultural subsidies and tariffs have become a point of contention in recent WTO talks, with less-developed countries unhappy about the lack of market access for their goods and about their price disadvantage.

What's the issue? How do the trade barriers set up by the U.S. government affect producers (both foreign and domestic) and consumers?

A. Online Article

This article describes how the U.S. government supports sugar prices. Note that sugar subsidies are paid to the processor, rather than the farmer. The farmer receives a share once the sugar is processed.

Sugar Interests Harm the National Interest

USDA loan rates set floor on price of sugar.

The [government] program allows sugar processors to take out loans from the USDA [U.S. Department of Agriculture] by pledging sugar as collateral. The loan rates—18 cents per pound for cane sugar, 22.9 cents per pound for beet sugar—are significantly higher than average world sugar prices. These loans must be repaid within nine months, but processors also have the option of forfeiting their sugar to the government in lieu of repaying their debt.

This arrangement effectively guarantees that the processors receive a price for their sugar that is no lower than the loan value: If prices fell below that level, they would simply forfeit their sugar and keep the government's money.

In order to avoid that scenario, the USDA must prop up the domestic price of sugar. It does this by controlling supply through two mechanisms. First, it sets quotas on how much foreign sugar can be imported without facing prohibitive tariffs; second, it regulates the amount of sugar that domestic processors can sell.

Source: Jason Lee Steorts, *National Review,* July 18, 2005

Thinking Economically In your own words, describe the mechanisms by which the U.S. government props up domestic sugar prices.

B. Government Report

This information from the U.S. Department of Agriculture charts U.S. raw sugar prices versus raw sugar prices for the rest of the world.

FIGURE 17.13 U.S. AND WORLD RAW SUGAR PRICES

Source: U.S.D.A., Economic Research Service, Sugar and Sweeteners Yearbook, 2006

Thinking Economically On average, how much greater are U.S. raw sugar prices than those for the rest of the world?

C. Trade Association Web Page

The American Sugar Alliance's Web site makes the case that the U.S. sugar industry is an important part of the overall U.S. economy.

Sweetener's Impact on the U.S. Economy

The American sweetener industry has a significant impact on the nation's economy.

- Economic impact: $21.1 billion of economic activity in 42 states is generated in the U.S. each year by the sugar and corn sweetener industries.
- Beet sugar industry: Over 1,400,000 acres of sugarbeets are grown in 12 states and are processed in 25 sugarbeet factories. The industry creates 88,200 full time direct and indirect jobs for people across the nation.
- Cane sugar industry: Seven cane refineries and 22 mills process sugar cane raised in four states: Florida, Hawaii, Louisiana and Texas. The production and processing of sugarcane creates 71,900 full time direct and indirect jobs.
- Jobs: 372,000 jobs in the U.S. rely on a strong U.S. sweetener industry.

Source: www.sugaralliance.org

Thinking Economically Why does the American Sugar Alliance want to emphasize the economic impact of the sugar industry?

THINKING ECONOMICALLY Synthesizing

1. Which argument for protection does document C seem to make? Use the document and pages 523 and 524 to formulate your answer. Is this argument economically valid? Explain.
2. Is the difference in price shown in document B an unavoidable outcome of the program outlined in document A? Explain your answer.
3. How does U.S. government intervention in the sugar industry limit the functioning of the economy as a free market? Use examples from the documents in your answer.

Interactive Review

Review this chapter using interactive activities at **ClassZone.com**

- Online Summary
- Quizzes
- Vocabulary Flip Cards
- Graphic Organizers
- Review and Study Notes

Online Summary

Complete the following activity either on your own paper or online at **ClassZone.com**

Choose the key concept that best completes the sentence. Not all key concepts will be used.

absolute advantage	NAFTA
balance of trade	protectionism
comparative advantage	quota
economic interdependence	revenue tariffs
embargo	tariff
exports	trade barrier
foreign exchange market	trade deficit
foreign exchange rate	trade surplus
free trade zone	trade war
imports	WTO

When nations can produce something at a lower cost than other nations, they are said to have a(n) __1__. This is different from a(n) __2__, which means that goods or services are produced at a lower opportunity cost. Through trade, nations develop __3__, relying on one another.

Policies of __4__ have created __5__ between nations, including __6__—limits on imports—and __7__—fees charged on goods brought into a country.

International trade would not be possible without the __8__, where currencies of different countries are bought and sold. Nations keep track of their __9__, the difference between their exports and their imports. With a __10__, large reserves of foreign currency accumulate. With a __11__, domestic consumers enjoy lower prices.

The trend since the end of World War II has been toward free trade. Nations have formed regional __12__ that abolish trade barriers among members. In 1994 the United States became part of a trading organization with Mexico and Canada known as __13__.

CHAPTER 17 Assessment

REVIEWING KEY CONCEPTS

Benefits and Issues of International Trade (pp. 510–519)

1. How do nations gain by specializing in products for which they have a comparative advantage?
2. How does trade affect a national economy?

Trade Barriers (pp. 520–525)

3. Name and describe four trade barriers.
4. What three reasons are protectionists likely to offer to support their position?

Measuring the Value of Trade (pp. 526–531)

5. Explain how an importer purchases a foreign product and what effect those actions would have on the value of each currency.
6. What does the term *strong dollar* mean?

Modern International Institutions (pp. 532–539)

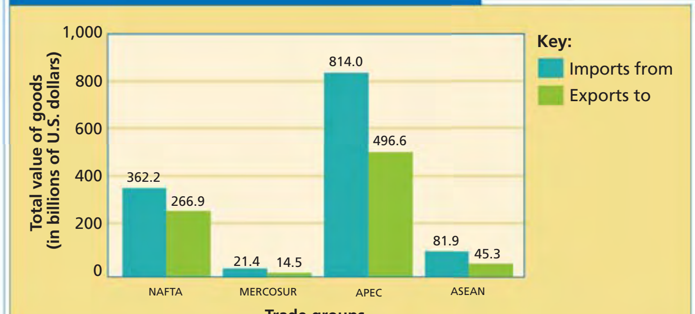
7. What agreements helped launch the free trade movement?
8. Create a fictional multinational and explain how it might operate from raw materials all the way through marketing the finished product.

APPLYING ECONOMIC CONCEPTS

Look at the graph below showing U.S. imports and exports to and from various trading regions.

9. To which group does the United States export the lowest dollar value of goods and services?
10. With which group does the United States have the largest trade deficit? the smallest trade deficit?

FIGURE 17.14 U.S. TRADE WITH REGIONAL GROUPS



Source: www.eurunion.org

CRITICAL THINKING

11. Creating Graphs Create a bar graph to illustrate the following trade data for selected regions. The EU25 is made up of the 15 countries that were members of the European Union in 2003 and the 10 that would become members in 2004.

FIGURE 17.15 IMPORTS AND EXPORTS FOR SELECTED REGIONS

Country or region	United States	EU25	Japan
Total imports (billions of U.S. dollars)	1,517	1,047	477
Total exports (billions of U.S. dollars)	1,021	1,250	597
World import share (percent)	22.9	14.0	6.8
World export share (percent)	13.8	13.1	8.5

Source: Eurostat, 2003 data

Use SMARTGrapher @ **ClassZone.com** to complete this activity.

12. Analyzing and Interpreting Data Which two of the three trading entities in the table above are likely to have good reserves of foreign currency?

13. Synthesizing Economic Data In which trading entity in the table above are imports the highest percent of total trade value? The lowest?

14. Comparing and Contrasting Economic Information What are developed nations hoping to gain through reduced global trade barriers? What are developing nations hoping to gain?

15. Challenge The World Trade Organization, unlike GATT, has an organizational structure to implement its principles. However, it has no authority to force a nation to do something against its own laws. How is it able, then, to resolve disputes among members?

SIMULATION

The Advantages of International Trade

The concept of comparative advantage explains why specialization and international trade are so important to economic success. Complete this exercise with a partner to help further your understanding.

Each of you will represent a trading nation. One of you will be El Estado, and the other will be Lichtenbourg. Both countries produce lemons and televisions. The following table shows monthly production by each nation.

	El Estado	Lichtenbourg
Lemons (in pounds)	20,000	9,000
Televisions	4,000	3,000

Step 1 Decide whether El Estado or Lichtenbourg has the absolute advantage for each product. Explain why this is so.

Step 2 Each student should calculate what his or her nation's production ratio is. Express your ratio in terms of opportunity cost. How many pounds of lemons does it cost to make one TV?

Step 3 With your ratios calculated, decide which nation has the comparative advantage in the production of TVs. On this basis, decide which nation should specialize in the production of each product.

Step 4 Now that you've decided to specialize and trade, calculate a trade ratio that makes trade between your two nations even more advantageous. Explain how the new ratio achieves this goal.