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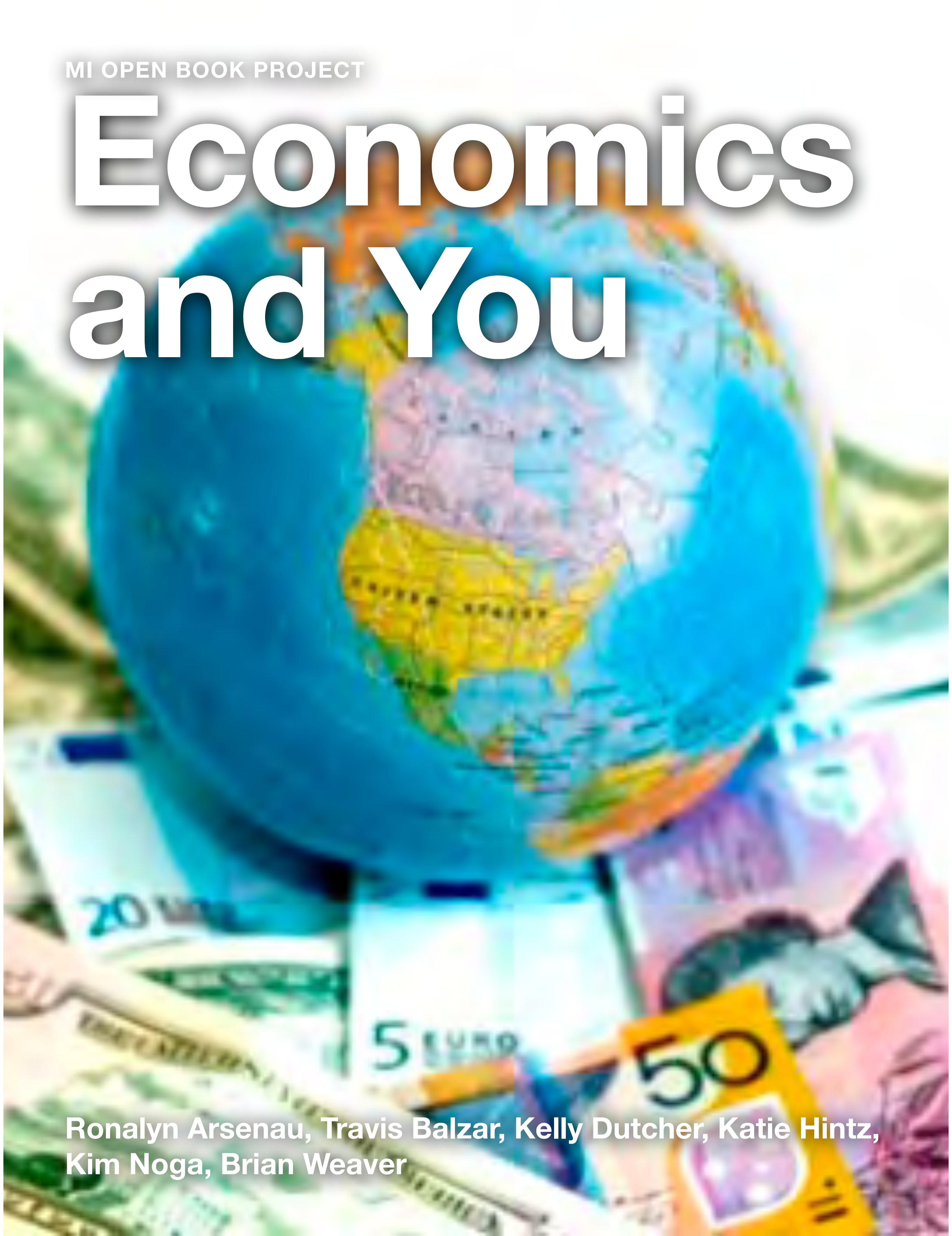
Economics and You



Ronalyn Arsenau, Travis Balzar, Kelly Dutcher, Katie Hintz, Kim Noga, Brian Weaver

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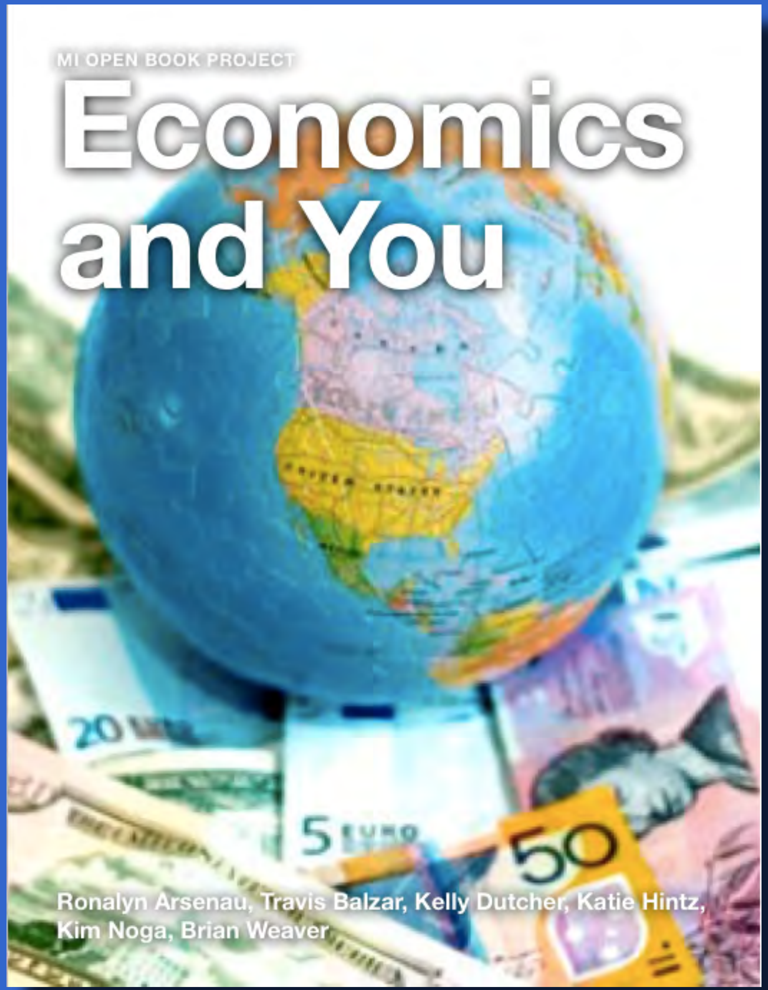

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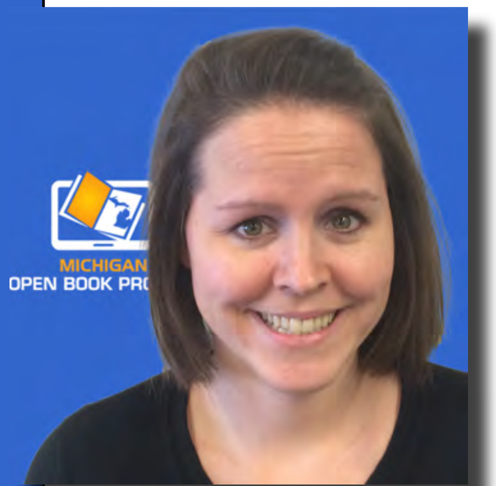

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Kelly Dutcher teaches Economics, Civics, U.S. History, and College Readiness at Harbor Springs High School. Aside from teaching, she is also a Michigan Youth in Government advisor, and class of 2017 sponsor. Mrs. Dutcher is a graduate of Lake Superior State University where she received her BS in Social Studies and Secondary Education. She is currently working towards receiving her MA in American History and Government at Ashland University, and will spend a month this summer as a James Madison Memorial Fellow studying in Washington D.C. Kelly loves teaching at the high school level, and helping bring social studies to life for her students. She shares her life with her husband Jordan and three joyful girls: Daphne, 5; Audrey, 3; Meredith 2.

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Katie is completing her seventh year as a teacher at Gladwin High School, where she has taught every Social Studies course available, including: American Government, Sociology, Current Events, World History, Economics, Social Problems in the United States, and Law. A graduate of Saginaw Valley State University's Secondary Education Program, she majored in History, minored in Sociology and earned a Social Studies Endorsement. As Social Studies Department Chair, she was inspired to participate to the Open Book Project because of the disjointed resources that most economics teachers are forced to scrape together to create a captivating curriculum.

Currently, she is working on completing her Masters in Global History at with American Public University. Her final thesis on the Food Industry is due to be published September,

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Kim has a B.A. in History/ Social Studies and an M.A. in Curriculum and Teaching, both from Michigan State University. For the past 14 years she has been employed at Ionia High School where she teaches Economics, U.S. History, and Humanitarian Studies. Her hobbies include reading and traveling the world.

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Chapter 6

Global Interactions and Decision Making

QUESTIONS TO GUIDE INQUIRY

To what extent are globalization and international trade creating a better world?

Do the benefits of economic development and globalization outweigh the costs?

What factors encourage or hinder economic development?

Does the end result of economic transition outweigh the internal challenges a nation faces in the process?

Despite the challenges globalization incites, has economic freedom for a majority of the world's population been achieved?

Are we better off when we trade with other countries?

Why do nations trade with each other?

How has trade changed over time?

What can governments do to encourage or discourage trade?

Image source: Shutterstock/Rawpixel

Section 1

Globalization and Economic Development

QUESTIONS TO GUIDE INQUIRY

1. **To what extent are globalization and international trade creating a better world?**
2. **What factors encourage or hinder economic development?**
3. **Does the end result of economic transition outweigh the internal challenges a nation faces in the process?**
4. **Despite the challenges globalization incites, has economic freedom for a majority of the world's population been achieved?**

Follow the links below to observe some pictures that illustrate the differences that exist between countries at different levels of development. Feel free to google image search additional countries that come to mind as "developed" or "developing" to further your research.

Interactive 6.1 20 Powerful Photos of Kids Bedrooms From Around the World

Interactive 6.2 Material World - A Snapshot of Possessions

Discussion Questions

What similarities do you notice between the pictures?

What differences do you notice between the pictures?

What are your overall impressions of these pictures?

What questions do you now have?

Do the Benefits of Economic Development and Globalization Outweigh the Costs?

Scarcity means that individuals as well as entire countries have to make choices about what to do with their resources. How a country answers the three fundamental economic questions (What to produce? How to produce? Who receives what is produced?) determines what type of economy it possesses. These decisions are also made on a global level, meaning the coordination of the planet's resources involves making decisions on what should be made, how it should be made, and to whom it will be distributed. Thanks to improved transportation and communication, demand in one country may be easily met by a country in the opposite hemisphere. Of course, this give-and-take has been going on for centuries, but international trade over the past half-century has reached new heights, resulting in globalization, or the growing interdependence of countries upon one another. Countries are now dependent on one another for basic goods and services that might have once been produced within their own political boundaries. We have already learned how the law of comparative advantage explains why it is economically beneficial for each country to specialize in certain markets and then export its surplus to other countries. More and more, the United States, as well as other countries, is specializing and because of that, depending on other countries to sell their products to the U.S.

Decreased costs in trade, due to improved technology and the loosening of trade restrictions have encouraged countries to cooperate with each other as partners in commerce. While this global economic growth is commendable, it is important to remember that problems which once were isolated to a single nation now largely impact the global market. Many of these problems then become so big that it requires multiple nations to collaboratively work together to overcome them. These issues are frequently discussed in the news, such as climate change, deforestation, financial collapses, national credit ratings, and terrorism. As you can see from the list, many of these issues are directly economical, while others appear geographical or political. Ultimately, the problems we face as a planet are best understood by looking at them in their entirety under a global economic lens.

Interestingly, with improved communication and the growing popularity of social networking sites like Facebook, many developed democratic countries have grown more aware of the plight of some lesser developed nations, leading to a concern for citizens of other nations. Should we be concerned how our products are being produced? How they are getting to us? Whether the people making them are being treated fairly? Have safe working environments with a quality of living wage? Are guaranteed the same democratic rights as we are?

Economic Indicators and Data

Economic indicators are data measurements utilized by economists to help make generalizations about a country's economic growth and level of development. You might wonder why it matters how countries stack up against one another, but this information is critical to understanding the global economy. Information gathered about different countries helps countries to make decisions about how to handle international trade, military conflicts, political agreements, and diplomatic relations. A lack of this knowledge about the rest of the world is a deterrent to achieving a better world through globalization and continued development.

Gross Domestic Product (GDP)

Pure economic growth is often measured by calculating a nation's gross domestic product, or GDP. GDP is the total monetary amount of goods and services produced within a country for a given year. Using GDP to measure a country's wealth is a simple and straightforward way to categorize a country as rich or poor. However, if a country has an incredibly high GDP and also a huge population, this number might misrepresent the overall well being of the inhabitants of that country. For instance, China's estimated GDP in 2013 was approximately $13.39 trillion. The United States' GDP for the same year was $16.72 trillion. While their GDPs are comparable, the average income of their inhabitants is not. China has a population close to 1,355 million, whereas the United States has only a fraction of that with 314 million. Once you divide the total GDP by the total population, you discover that the GDP per capita for China is $9,800 while the United States' is $52,400. What GDP per capita represents is the division of a nation's production amongst the people that live there. GDP per capita is a useful economic indicator to demonstrate the relative productive capabilities of a country, but is this all that matters? Many economists, politicians, and human rights activists, would argue that only looking at GDP per capita as a measurement of economic growth is inadequate in gathering a complete picture of a country's development.

Other Factors Utilized to Measure Development

GDP as a measurement of economic growth is just one way economists reflect on a country's development. A nation's level of energy consumption, the distribution of its workforce, the availability of consumer goods, and social indicators are other important factors in determining whether a country is more or less developed.

The amount of energy a nation utilizes is closely related to its level of industrialization. Industrialization is how an economy organizes itself around the purpose of manufacturing. Because almost all types of manufacturing require large amounts of energy, it's easy to draw the conclusion that high levels of energy consumption equals high levels of industrial activity which occur in developed countries. Conversely, a lower level of energy used usually indicates a low level of industrial activity, characteristic of less developed countries.

Another factor important for consideration in the development level of a nation is the distribution of its workforce. Specialization is a critical component of this factor. If the majority of a nation's population are subsistence farmers, only raising food for themselves, few are available to work in industry where specialization occurs, thus greatly contributing to a nation's ability to generate cash income needed to advance its economy.

The amount of consumer goods a nation can produce on a per capita scale is also an indicator as to the nation's level of development. If a large number of nonessential goods are available, this indicates that a large number of a nation's people not only have essential goods but also have enough extra income to purchase nonessential goods such as cars, appliances, and technology, thus indicating a higher level of development.

Social indicators that are used to measure the level of a nation's development are often literacy rate--the percentage of population (usually over age 15) that can read and write, life expectancy--the average person's life span, and infant mortality rate--the number of deaths that occur in the first year of life for every 1,000 live births within a country.

Additional indicators that tend to occur in developed nations include higher levels of consumer spending which are also associated with a healthy population with low infant mortality rates, high life expectancy rates, higher levels of productivity, high literacy rates, steady levels of urbanization and a secure infrastructure.

Economists often discuss the development of a nation in an attempt to describe the living conditions within a country. Nations are categorized as either being more or less developed. Whether a country is more or less developed does not reflect the worth of a country or its people, but instead the material well-being of a nation. Being labeled as a developed country does not make it superior to a less developed country. Instead, a country's level of development tells us what it is like for the people that live there and provides a glimpse into the quality of life for that nation. Countries are then categorized as either more or less developed based on the data collected.

MDCs: More Developed Countries

More developed countries are also sometimes referred to as "developed countries," because they are industrially advanced and have high rates of production as a result. Higher productivity leads to a higher standard of living because of the relatively inexpensive access to a variety of goods and services. These populations also have higher life expectancies due to high quality health care and lower birth rates. As a result of higher productivity, these countries tend to have higher gross domestic production (GDP). Higher levels of GDP coupled with lower population growth rates leads to higher GDP per capita, or the amount of GDP divided by the population.

GDP per capita = (Consumption Spending + Investment Spending by Businesses + Government Spending) + (Net Exports)/Population

Image source: http://pixabay.com/en/tractor-vehicles-farm-machinery-387275/

LDCs: Less Developed Countries

Less developed countries, sometimes also referred to as "emerging markets," are countries that have lower standards of living compared with more developed countries. LDCs tend to have lower per capita GDP, meaning people within these countries tend to make very small incomes resulting in many people living in poverty. These countries are called "less developed" because they are not equipped with the modern industry that more developed countries typically have. Lacking industry, LDC economies are usually based on agriculture and therefore unable to trade in more lucrative global markets.

To understand what distinguishes MDCs from LDCs, let's begin with the most basic needs for humans: food and shelter.

Food in MDCs

A plentiful food source is the most basic requirement for any population to thrive. Think back to your World History Course, and how it was necessary for any major civilization to first have an abundant and sustainable food source. MDC's, through industrialized agriculture, have found a way to get the most out of their land by using genetically modified seeds, fertilizers, pesticides, and machinery to grow high-yielding crops. The successful use of technology to greatly improve farming in MDCs has allowed for very large quantities of food to be produced at a relatively low cost and with very little labor. For instance, in the United States, approximately 2% of the population actively farms, and despite this low participation rate, one-third of farmed land is designated for exports. Due to the highly innovative agricultural techniques utilized by MDCs, farming has become a specialized form of production that has freed many industrial nations from laboring in the fields as well as from hunger. Having a plentiful food supply allows for people to branch out into other areas of specialization.

Food in LDCs

Food insecurity is a constant problem in many LDC's because farming is largely subsistence in nature, meaning families farm their land to provide for themselves and have little left over to sell to others. Inadequate food sources requires that LDCs import food from other nations to meet their needs. However, for many that are too poor to purchase food, undernourishment is a serious concern. Poor diets coupled with limited access to health care leads to other problems that are exemplified in looking at the life expectancy and infant mortality rate. While life expectancy, or the average age one lives up to, is approximately 80 years in MDCs, the average life expectancy in LDCs is 61.5 years.

Country	MDC/LDC	Life Expectancy[1]
United States	MDC	78.8 years
Japan	MDC	81.4 years
Sierra Leone	LDC	45.6 years
Nepal	LDC	68.4 years

Interactive 6.3 Life Expectancy Data

Use this website to look up the life expectancy in different countries to compare it to others.

Shelter in MDCs

In many MDCs there are building codes that specify certain safety requirements that must be met for a house to be considered livable. Among these requirements are that the house have running water, working ventilation and heating systems, structurally safe construction, smoke detectors, and properly installed electrical wiring. While these codes are frustrating, and cost money to enforce, they are there to protect the safety of inhabitants.

While shelter is referring to the actual housing that people live in, when discussing the development of a nation it should also take into consideration the location in which one resides. Many MDCs are already urbanized, meaning large percentages of people reside in the cities, usually 80% or more. Urbanization, meaning a movements of people from the country to the city, is a growing global trend. However, many MDCs already have a significant population living in their cities and so the rate at which they are urbanizing is relatively low. The cities in MDCs tend to have a strong infrastructure in place, meaning they have maintained roads, adequate electrical grids, effective sanitations systems, public education, and modern health care available.

Shelter in LDCs

Comparatively, LDCs tend to have approximately half of their populations living in rural areas and the other half living in cities. Food is not as industrialized in LDCs and so more people have to farm to create an adequate food source for the entire population. LDCs are urbanizing at a much faster rate than MDCs. This makes sense considering most MDCs already have a substantial percentage of their population living in their cities, whereas LDCs have greater numbers in rural, or country, areas. Part of the reason the shift is so significant is because a large proportion of people in LDCs are living in rural areas, and are seeking out the amenities that are only available in the larger hubs of such countries. These amenities are part of the infrastructure of a city, and include access to educational opportunities, electricity, health care, and housing. Many of the largest and fastest growing cities are in LDCs because there is such a large percentage of the population in these countries living in rural areas who would like to pursue a life outside of the instability of farming. This fast rate of urbanization poses problems in and of itself. With an increasing population, the infrastructure of the city is often strained and pushed to the brink. Power outages, problems with sanitation, and crime are prevalent in LDC cities. For instance, LDCs do not have the same building codes on the books as MDCs, and so their shelter is constructed largely based off of cultural traditions. Without the proper regulation, many people end up living in barely livable tenant houses that threaten the health and safety of its inhabitants.

Urbanization by Country

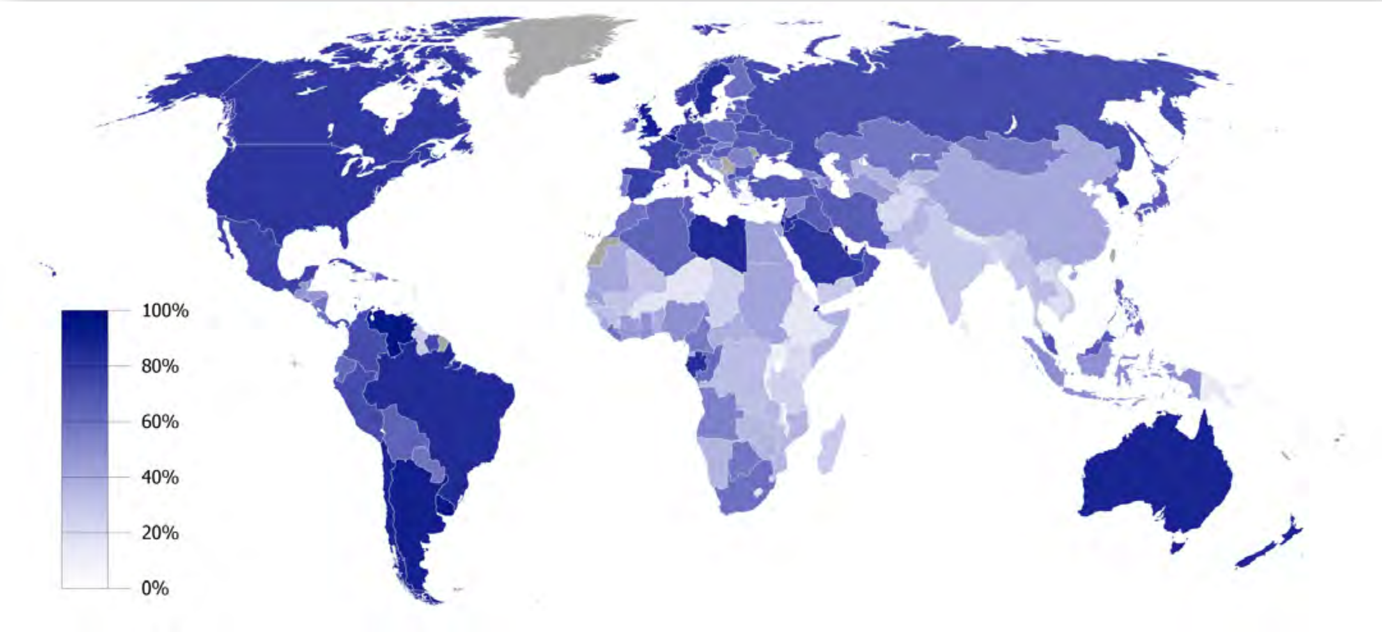


Image source: https://en.wikipedia.org/wiki/Urbanization_by_country#/media/File:Urbanized_population_2006.png

Which parts of the world have the largest urban populations?

Which parts of the world have the least urbanized populations?

Using your knowledge of economic systems in various countries, explain how these observations match up with the urbanization of a country.

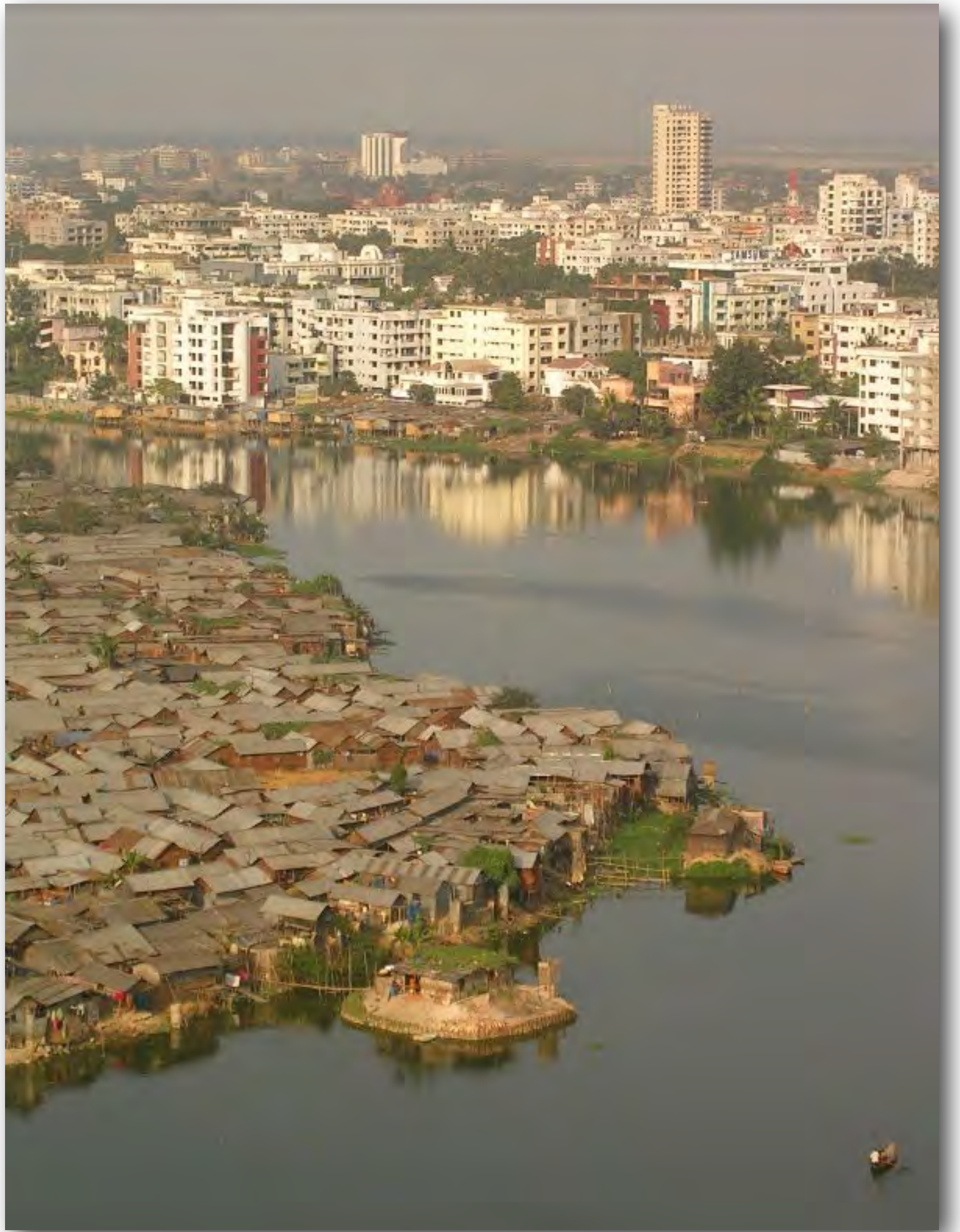


Image source: http://en.wikipedia.org/wiki/Slum#/media/File:Riverside_slum_in_Bangladesh.jpg

More Developed Countries

More Developed Countries	Less Developed Countries
More industrialization	More agrarian based economy
High levels of specialization	Local markets and small scale trade
Effective and widely accessible healthcare	Poor medical services; infectious, respiratory, and parasitic diseases common
GDP is high	GDP is low
Population growth rate is low/declining	Population growth rate is relatively high
GDP per capita is high	GDP per capita is low
Public education systems provided for all	Limited/restricted access to educational opportunities
High literacy rates	High illiteracy rates; lack of technological knowledge
Farming is commercialized and highly mechanized leading to high crop yield	Populations tend to be rural with a growing impoverished urban population
Overabundance of food is sometimes a concern for health	Sometimes inadequate access to food
Service and manufacturing industries are prominent in the economy	Poor housing and few public services are available to the people
Very few people are involved in agriculture	High birth rates and death rates;
Low birth and death rates; large proportion of the population is over age 65	High levels of malnutrition resulting from lack of access to a diverse diet with adequate source of protein

Using the chart above as well as the map on the previous page, make generalizations about which nations look to be LDC's - make historical connections to imperialism, colonialism, or natural wealth?

It would be simple to categorize MDCs as "rich" and LDCs as "poor," and in terms of material wealth, this would be true. However, it is important to remember that there are consequences to development that are not reflected in GDP per

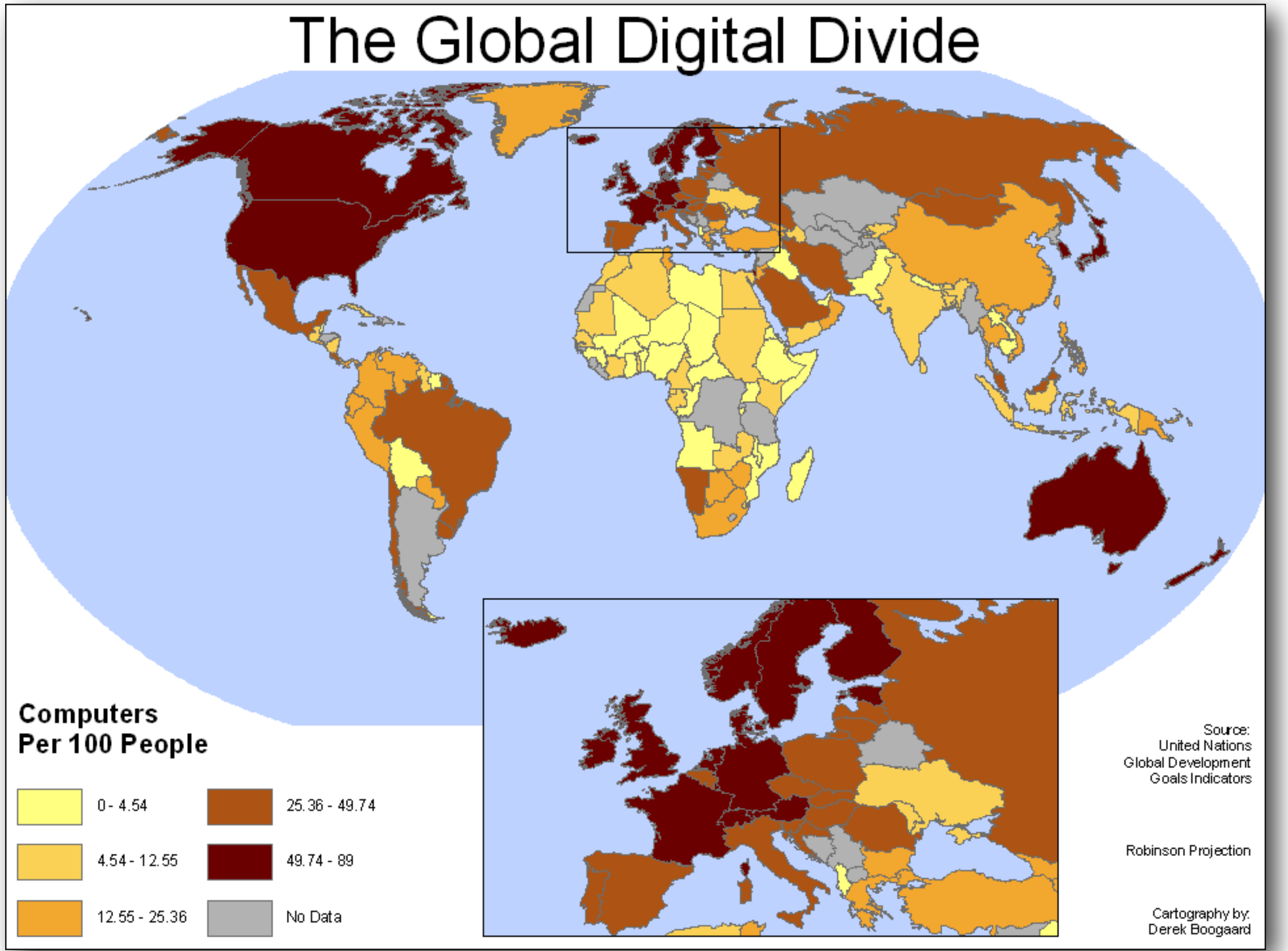


Image source: https://en.wikipedia.org/wiki/Digital_divide#/media/File:Global_Digital_Divide1.png

capita. The ramifications of globalization and development are discussed later in this chapter.

HDI Human Development Index

Interactive 6.4 Human Development Reports

Use this website to choose two countries to compare the elements in the blue box below.

Qualitative v. Quantitative points of comparison.

Measures of Development

Per capita GDP
literacy rate

life expectancy

infant mortality rate

industrialization

subsistence agriculture

world population clock

Primary (harvesting resources), secondary (industrialization), tertiary economic activity (service)

Urban living rural living population

What factors encourage or hinder economic development?

Analysis of factors leading to the labeling of a country as developed or less developed can provide a detailed image as to the quality of life of a nation. However, many nations face hindrances to continued development that a label cannot solve such as rapid population growth, limited resources and capital, political obstacles, and a lack of large sums of money from either internal financing sources or foreign investment to finance development on a large scale.

Despite huge, and at times, difficult challenges that less developed nations face, several public, international organizations exist to promote economic development. Some of the most prominent are the United Nations Development Program, the International Monetary Fund, and the World Bank.

Founded during WWII (1944), the mission of the World Bank is to raise money on world financial markets in order to offer loans to less developed countries. Additionally the World Bank works with other organizations to promote economic development all over the world and also provides advice to LDCs on the most effective ways to help build their economies. The United Nations Development Program (UNDP), through grant funding, is dedicated to earmarking 90% of its funding to eliminating poverty in 90% of the world's poorest nations. And through economic policy advice and technical assistance, the International Monetary Fund promotes economic development of LDCs.

Other independent groups known as nongovernmental organizations (NGOs), raise money to fund aid and development programs. Organizations such as the Red Cross, CARE, and the World Wildlife Fund to name a few, often focus their aid in the form of food or medical help often when natural disasters happen or wars occur.

Interactive 6.5 CIA Fact Book

How do the policies of these specific institutions actually affect various developing countries (Asia, Africa, Central America), as compared with developed countries (Western Europe, America)? Grab at least two countries from each region to complete a case study on.

Does the end result of economic transition outweigh the internal challenges a nation faces in the process?

Currently many countries are undergoing the economic transition from a less developed country to a more developed country. For many countries undergoing this type of economic transition, the growth has been rapid; other nations are experiencing a complete change of their economic system. The process of privatization--selling or transferring government-owned businesses to individuals, is one of the first steps many countries are taking toward a market economy.

Although it might appear that privatization is always a step in the right direction toward the achievement of a market economy, it can be a painful process. Often political and economic changes are dramatic, resulting in initial hardships. For example, the uneven distribution of income frequently occurs resulting in the rise of corruption and widespread organized crime. Other problems include heavy reliance on the export of natural resources, increased pollution, depletion of natural resources, sporadic poverty and unemployment, growing gaps between classes, continued reliance on subsistence farming, overdependence on natural resources, health epidemics, and political unrest or instability. Despite these challenges, nations continue to persevere because the interconnectedness of producers, consumers, and financial systems is becoming tighter at a more rapid rate than ever before.

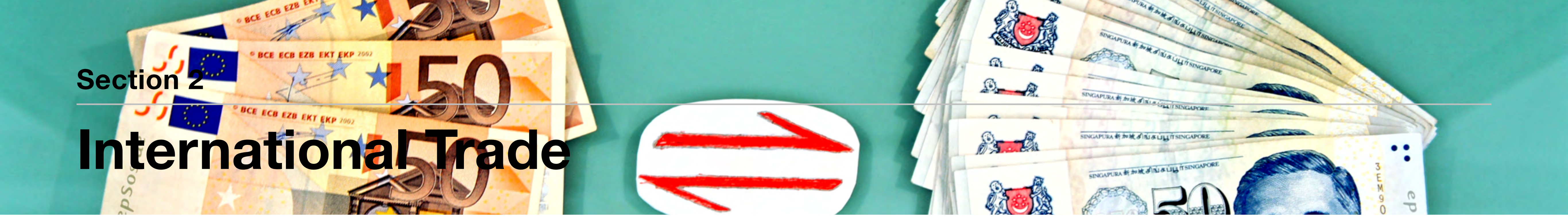
Despite the challenges globalization incites, has economic freedom for a majority of the world's population been achieved?

While globalization is a huge part of life today, it is also responsible for the creation of many modern-day challenges. Interconnected financial markets can be responsible for widespread financial crisis throughout many nations due to the widespread ripple effect for both investors and ordinary people.

And while multinational corporations tend to have huge amounts of capital to introduce technology to developing countries, critics sometimes complain that these corporations do little to assist less developed nations. Structural unemployment is another issue associated with globalization. Offshoring--companies who move parts of their operations to other countries resulting in job loss. Additionally, the chase for job opportunities can cause rapid urbanization for which countries are not prepared to handle. As time passes and globalization continues to create new opportunities for many, multiple challenges lie ahead.

Economic development has often come at the hands of protection of the environment. While sustainable development--meeting current development needs without depleting resources needed by future generations is the goal, exploitation of resources does occur. Deforestation has become a major issue. In addition, the competition for additional resources such as water and fuel cause other economic issues. And while other challenges exist, the pressure to innovate in order to solve current challenges will only become greater as each day passes.

Arguments Against Globalization	Arguments in Support of Globalization
Multinational corporations seeking to make a profit exploit people through their labor, and abuse the environment.	Free trade and the effects of comparative advantage increases our productivity as a planet, and thereby improves the average standard of living for all countries.
Developing countries have governments that have lower standards of protection for labor and the environment.	Consumers benefit from the increased productivity, and will have a larger variety of goods available at lower prices.
Laborers in developing countries often have unsafe working environments, and receive low wages.	In countries where workers are supposedly exploited, there are long waiting lists of hopeful future employees who want to get hired in with the multinational corporations.
As a result of multinational corporations seeking out the lowest cost options, they will move many of their factories and jobs to other countries, resulting in lower job availability in developed countries. (**Outsourcing**)	Multinational corporations often provide higher wages and better benefits in developing countries compared with what local businesses are able afford.



Section 2

International Trade

QUESTIONS TO GUIDE INQUIRY

1. **Are we better off when we trade with other countries?**
2. **Why do nations trade with each other?**
3. **How has trade changed over time?**
4. **What can governments do to encourage or discourage trade?**

Take a moment to make a mental list of items you have purchased recently. Have you purchased a cell phone? Athletic shoes? If you have, chances are they were manufactured outside of the US. Why is that? Surely, America has enough resources to make most, if not all, of what we need, right? Not so fast. We need to go back to a concept from Chapter 1 to answer that question. It is all about the factors of production.

Quick Review- Name and describe the three factors of production.

Image source: http://www.europas.irtea.gr/wp-content/uploads/2012/09/Inta-1.jpg

Land

Scarcity explains why different countries have different resources and therefore have come to rely on a wide variety of economic activities. For example, Saudi Arabia relies heavily on the extraction of petroleum, while the central US relies heavily on agriculture.

Labor

Labor refers to the size of a country's workforce. Certainly, a large workforce has the potential to lead to a high GDP (gross domestic product).

Capital

Realistically, though, it is capital that economists usually focus on. Having a large labor force is not as important as having a well-educated labor force. It is human capital that leads to innovation and the development of physical capital.

The United States is fortunate to have abundant resources (land) and capital and, therefore, has first-world status. Many countries in Sub-Saharan Africa actually have vast deposits of mineral resources, but still have third-world status. While it is true that unequal distribution of resources can explain differences between nations, culture also plays a large role. Historically, political unrest has interfered with economic activity. Today, there are countries that discourage the education of women. When half of a country's potential labor force is not allowed to develop its human capital, the economy suffers.

Resource Distribution

	Mali	Poland	Saudi Arabia	United States
Natural Resources	gold, phosphates, kaolin, salt, limestone, uranium, gypsum, granite, hydropower	coal, sulfur, copper, natural gas, silver, lead, salt, amber, arable land	petroleum, natural gas, iron ore, gold, copper	coal, copper, lead, molybdenum, phosphates, rare earth elements, uranium, bauxite, gold, iron, mercury, nickel, potash, silver, tungsten, zinc, petroleum, natural gas, timber, arable land
Total Land	1,240,192 sq km	312,685 sq km	2,149,690 sq km	9,826,675 sq km
Arable Land	5.6%	36.2%	1.5%	16.8%
Population	16,455,903	38,346,279	27,345,986	318,892,103
Labor Force	5.538 million	18.26 million	11.22 million	156 million
Literacy Rate	38.7%	99.8%	94.7%	99%
Internet Users	249,800	22.452 million	9.774 million	245 million
Education Expenditures	4.8% of GDP	4.9% of GDP	5.1% of GDP	5.2% of GDP

Source: CIA World Factbook- https://www.cia.gov/library/publications/resources/the-world-factbook/

Because no country has the factors of production to produce all that it wants and needs, countries specialize and trade with each other. Due to climate conditions, the US can produce vast quantities of grains which it can trade to a country like Brazil, that can produce vast quantities of coffee. So, the U.S. has to trade for coffee because the U.S. cannot produce it themselves. What about things that can be produced within the country? Should a country always produce the products it is able to produce? It may surprise you to learn that countries are actually better off when specialization and trade occurs. The reason for that lies in the concept of comparative advantage.

Image sources:

http://halloftheblackdragon.com/reel/wp-content/uploads/2012/05/cute-coffee-shop-girl.jpg

http://financialpress.com/wp-content/plugins/RSSPoster_PRO/cache/dfc91_130215110119-low-pay-jobs-barista-340xa.jpg

Imagine that Maria and Charlie work at a coffee shop. In one hour, Maria can make 8 sandwiches or 24 lattes. In that same time, Charlie can make 5 sandwiches or 10 lattes. Maria has an absolute advantage over Charlie, because she can produce more of both goods than he can given the same amount of resources. Should Maria strive for self-sufficiency by making all of her own lattes and sandwiches? Or, should she specialize in making either lattes or sandwiches? What about Charlie? Should he make lattes, sandwiches, or both? To answer that question we need to determine Maria's and Charlie's comparative advantages, so that each can produce the menu item for which he or she has the lowest opportunity cost.

1. Maria's opportunity cost for producing 8 sandwiches is _____ lattes. Her opportunity cost for producing 1 sandwich is _____ lattes.

2. Charlie's opportunity cost for producing 5 sandwiches is _____ lattes. His opportunity cost for producing 1 sandwich is _____ lattes.

3. Maria's opportunity cost for producing 24 lattes is _____ sandwiches. Her opportunity cost for 1 latte is _____ sandwiches.

4. Charlie's opportunity cost for producing 10 lattes is _____ sandwiches. His opportunity cost for 1 latte is _____ sandwiches.

5. ____________ has the lower opportunity cost for producing sandwiches and should produce sandwiches.

6. ____________ has the lower opportunity cost for producing lattes and should produce lattes.

7. What affect will specialization have on the coffee shop?

Advantages of Specialization

Comparative advantage is what makes it possible to gain by trading. People and companies produce and sell the things they can make for a lower cost and purchase the things that other people or companies can make for a lower cost. The coffee shop with produce more and make more money when Maria makes lattes and Charlie makes sandwiches than when Maria and Charlie both make lattes and sandwiches. The same principle applies to countries.

Disadvantages of Specialization

Specializing and trading does foster interdependence between nations, meaning they may have to rely on each other for products or resources they need. Disputes or trade barriers can slow or stop trade, which would require nations to find new sources for products or to start producing items for themselves. It may be tempting to just skip trade all together to eliminate possible problems, but that would mean a lower standard of living in both countries due to higher opportunity costs and lower production.

How has trade changed over time?

During the colonial era the U.S. often traded for raw materials and agricultural products with a small amount of simple manufactured goods. Today the U.S. doesn't trade finished products as often as it trades for components.

Interactive 6.6 How A T-Shirt Is Made

Watch these 6 short videos to help understand more about the characteristics of trade today.

Characteristics of trade today

1. One country or company does not usually excel at make every part of complex manufactured products. Parts can come from multiple companies within multiple countries.

2. Companies are not tied to specific locations because of the local availability of resources (i.e. an iron mine)

3. The value of physical materials is often small compared to the value of the technology that goes into a product. For example the plastic parts and wiring that go into manufacturing computers is relatively small compared to the value of the ideas it takes to make computers carry out the advanced processes.

4. In earlier times, products, such as agricultural products, were used up after they were sold. Technologies can be reused multiple times in new products. Developing new technologies can give a company an advantage over its competitors at the time it is developed and into the future.

Impact of Trade on US Economy

What can governments do to encourage or discourage trade?

Trade Barriers- a restriction that prevents foreign products from entering a country

- tariffs- a tax on imported goods

- quotas- a limit on the amount of a good that can be imported

- regulations- licensing requirements and safety and environmental standards can act as informal trade barriers. If regulations are too strict, many companies may decide that it is just not worth the effort to try to meet them and sell their products in other countries with less restrictions.

- sanctions- A sanction is used by a nation or group of nations to punish another nation. For example, the United States placed an embargo, or total ban, on all products made in Cuba in response to the Cuban nationalization of American-owned oil refineries without compensation. More recently, the international community has levied sanctions on Russia because of its annexation of Crimea in Ukraine. Iran has also faced heavy sanctions in an attempt to force them to shut down their nuclear program.

trade wars

protectionism- sheltering industries from foreign competition by imposing trade barriers. People in favor of protectionism often argue it is necessary in the interests of protecting

infant industries, saving jobs, or national security.

free trade- the lowering or eliminating or trade barriers.

Trade Agreements

- WTO- World Trade Organization- 1995
- EU- European Union- 1993
- NAFTA- North American Free Trade Agreement- 1993
- DR-CAFTA (Central American Free Trade Agreement plus Dominican Republic- 2003, 2005 and FTAA (Free Trade Area of the Americas)- failed, 2005
- APEC- Asia-Pacific Economic Cooperation
- MERCOSUR- Southern Common Market
- CARICOM- Caribbean Community and Common Market
- ASEAN- Association of Southeast Asian Nations
- TPP- Trans-Pacific Partnership- failed, 2015- Article

Interactive 6.7 You Can't Stop The Global Trade Machine

Learn more about world trade agreements in this short article from the Washington Post.

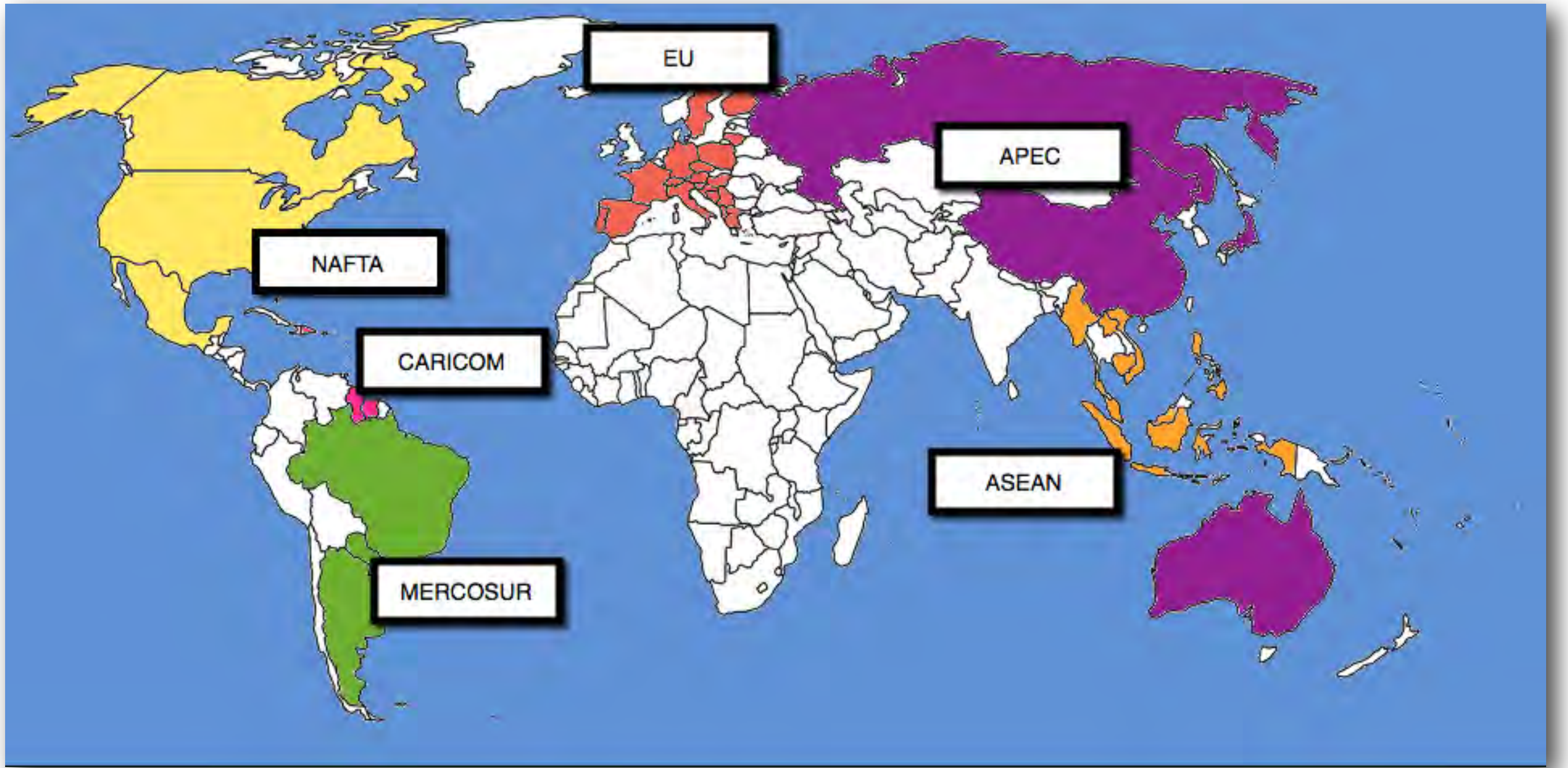
Discussion Questions

1. What argument does Fareed Zakaria make about NAFTA?

2. What argument does he make about the TPP?

3. What evidence does he offer to back up his claim?

4. Do you find his argument to be be convincing? Why or why not?



Map showing areas covered by trade agreements- APEC, ASEAN, CARICOM, EU, MERCOSUR, and NAFTA.

Discussion Questions

1. What do you notice about the locations covered by trade agreements?

2. What do the nations that belong to APEC have in common? What might lead them to form a trade agreement?

3. What areas of the world are not covered by trade agreements? Why do you think that might be?

Multinational Corporations

MNCs are headquartered in one nation but do business in multiple countries. Some multinational corporations have assets that exceed the GDP of some of the smaller countries in which they do business. They can often use that advantage to influence those countries to pass laws favorable to their businesses.

How do Multinational Corporations fit into international trade on a global scale?

MNCs are headquartered in one nation but do business in multiple countries. Some multinational corporations have assets that exceed the GDP of some of the smaller countries in which they do business. They can often use that advantage to influence those countries to pass laws favorable to their businesses.

Sometimes a MNC is a single company that only produces or manufactures one product. Most often, however, a MNC is a conglomerate--a group of businesses that come together under one name and one organization but produce or manufacture many different products. Ford Motor Company is a good example of a conglomerate because Ford companies around the globe make various products such as tools, radios, and of course, automobiles.

Proponents of MNCs believe that they are good forms of business because they help keep the price of consumer goods down in the U.S. and also help people in poorer countries by creating badly needed jobs in that country. Additionally, this sometimes leads to MNCs providing or building housing for workers, paying taxes to that country's government, and helping in building or improving parts of an infrastructure such as roads, airports, or docks for more efficient shipping of products out of that country.

Opponents of MNCs claim that some have more money than the countries where they build their factories. Many also add that MNCs use their wealth to influence government leaders and sometimes political policy as well. Additionally, opponents believe that MNCs are the leading cause of unemployment in the U.S. thus weakening the U.S. economy. And, because workers in developing countries are often paid much less money than workers in the U.S., the savings that are sometimes passed on to consumers through lower prices in the U.S. perpetuates the cycle of continuing to purchase cheap labor outside of U.S. borders.

What do you think? Are MNCs ultimately helping or hindering the U.S. economy?

How Do Exchange Rates Impact a Country's Balance of Trade?

Case Study: US trade with China

The US tends to export agricultural products, computers, large machinery, engines, and commercial aircrafts to China. China tends to export shoes, small appliances, and toys to the US. The education level of workers who make airplanes and computers is different from that of workers who make shoes and toys. So, the US has a comparative advantage over China in producing goods that require more high-skilled labor and technology, and China has a comparative advantage over the US in producing goods that utilize more low-skilled labor and less technology.

Obviously, trade on a global scale will continue to be critical to the survival of most nations. But what are some factors that impact trade at this level? One of those factors is the exchange rate--the price of a country's money in terms of another country's money.

Exchange rates can go up or down without warning thus contributing to changes in trade balances. For example, if the value of the U.S. dollar increases (this is known as appreciation), U.S. importers can benefit because consumers in the U.S. will purchase more imported goods. However, If the value of a nation's currency decreases (this is known as depreciation) that nation's products become cheaper to other nations. In the U.S.

for example, a weakened dollar means that foreign consumers will be able to better afford products made in the U.S. and usually results in increased exports. Simultaneously, in the U.S. products from other nations become more expensive so consumers purchase fewer imports.

U.S. Trade with Selected Countries, 2014 (in millions) [U.S. Census Bureau]

Country	Exports	Imports	Balance
Australia	26,667.7	10,669.9	15,997.8
Brazil	42,418	30,336.6	12,081.5
Canada	312,032	346,062.6	-34,030.6
China	124,024	466,656.5	-342,632.5
India	21,627.6	45,228.2	-23,600.6
Germany	49,442.6	123,181.0	-73,738.5
Japan	66,964.1	133,938.7	-66,974.6
Mexico	240,326.2	294,157.5	-53,831.3
Russia	10,767.7	23,691.9	-12,924.2
Vietnam	5724.9	30,583.6	-24,858.7
TOTAL	1,623,273.1	2,345,777.6	-722,504.5

Interactive 6.8 The Big Mac Index

Learn a little more about how all of these principles work in the real world by visiting this website and learning about the Big Mac Index.