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Chapter 5: The United States in the Global Economy

- 5.1: International Linkages
  - Goods and services flows (trade flows)
    - US exports goods and services to other nations and vice versa
  - Capital and labor flows (resource flows)
    - US firms establishes production facilities in foreign countries
  - Information and technology flows
    - US transmits information to other nations about US products, prices, interest rates, and investment opportunities
  - Financial flows
    - Money is transferred between US and other countries
    - Paying for imports, buying foreign assets, paying interest on debt, purchasing foreign currencies by tourists, and providing foreign aid
- 5.1: The United States and World Trade
  - Volume and Pattern
    - Countries that cannot efficiently produce the variety of goods their citizens want must import goods from other nations
    - Exports may run 25 to 50 percent or more of their gross domestic product
      - GDP – the market value of all goods and services produced in an economy
    - A large and diverse economy like the US's will have a less percent in exports for their GDP
    - Volume
      - Volume of international trade increases absolutely and relative to GDPs
      - US has not had much increase in its exports, but it is still one of the world's leading trading nation
    - Dependence
      - Almost entirely dependent on other countries for goods like bananas, cocoa, coffee, spices, tea, raw silk, nick, tin, natural rubber, and diamonds
        - Competes with domestic markets
      - US crops and electronics also rely on exports
    - Trade Patterns
      - Trade deficit
        - When imports exceed exports
      - Trade surplus

        - When exports exceed imports
      - US imports more than it exports
      - Canada is US's most important trading partner
      - US has sizable deficits with China and Japan
      - US's dependence on foreign oil is reflected in its trade with members of OPEC (Organization of Petroleum Exporting Countries)
      - The most significant US export of services is airline transportation
    - Financial Linkages
      - US is the world's largest borrower of foreign funds
      - Countries with which the US has large trade deficits end up holding large numbers of US dollars
      - Many US dollars are used to buy US real assets (now foreign citizens own US property)
  - Rapid Trade Growth
    - Propelled since World War II
    - Transportation Technology
      - Technology has improved so it is easier to transport items
    - Communications Technology
      - Everyone is more connected, so information travels faster
    - General Decline in Tariffs
      - Tariffs – excise taxes on imported products (duties)
  - Participants in International Trade
    - All countries participate to some extent in international trade
- 5.2: Specialization and Comparative Advantage
    - Open economy – one that includes the international sector
    - US produces more of certain goods (exports) and fewer of other goods (imports)
    - Specialization and international trade increase the productivity of a nation's resources and allow for greater total output than would otherwise be possible
  - Comparative Advantage: Production Possibilities Analysis
    - Assumptions and Comparative Costs
      - Constant costs – each country must give up a constant amount of one product to secure a certain increment of the other product
      - Absolute advantage (relative to something)
      - US has a comparative advantage over Mexico in soybeans
    - Terms of Trade
      - Terms of trade – mutually beneficial to both countries since each can "do better" through such trade than through domestic production alone
    - Gains from Specialization and Trade
      - Specialization based on comparative advantage improves global resource allocation

- 5.2 The Foreign Exchange Market
    - In international markets, sellers set their prices in terms of domestic currencies but buyers have different currencies
    - Foreign exchange market – a market in which various national currencies are exchanged for one another
    - Exchange rates – equilibrium prices in foreign exchange markets
        - Rate at which the currency of one nation can be exchanged for the currency of another nation
  - Dollar-Yen Market
    - When Japanese exporters want yen and not dollars, importers go to the foreign exchange market
        - Price = dollars
        - Product = yen
  - Changing Rates: Depreciation and Appreciation
    - Methods to increase US dollar
        - Several things might increase the demand for –and therefore the dollar price of – yen
        - Incomes may rise
            - Citizens can purchase more foreign goods
            - Demand of yen rises
    - Depreciation of the dollar – when the dollar price of yen increases
        - International value of the dollar has declined
        - Consumers may purchase more domestic goods
        - Each yen buys more dollars → US goods become cheaper to people in Japan and US exports to Japan rise
    - Appreciation of the dollar – when there is a decrease in the dollar price of yen
        - Fewer dollars to buy a single yen
        - US imports rise
        - US exports to Japan fall
    - When the dollar depreciates, US exports rise
    - When the dollar appreciates, US imports fall
- 5.3 Government and Trade
  - Trade Impediments and Subsidies
    - Protective tariffs
        - Excise taxes or duties placed on imported goods
        - Designed to shield domestic producers from foreign competition
    - Import quotas
        - Limits on the quantities or total value of specific items that may be imported
    - Nontariff barriers (nonquota barriers)
        - Onerous licensing requirements, unreasonable standards pertaining to product quality, bureaucratic hurdles and delays in customs procedures
        - Lengthy inspections to impede imports

    - Export subsidies
      - Government payments to domestic producers of export goods
      - Reduction of production costs allows producers to charge lower prices and thus to sell more exports in world markets
  - Why Government Trade Interventions?
    - Misunderstanding the Gains from Trade
      - True benefit created by international trade – overall increase in output obtained through specialization and exchange
      - International trade allows an economy to reach a point of consumption beyond its domestic production possibilities curve
    - Political Considerations
      - Trade may harm particular domestic industries and particular groups of resource suppliers
    - Costs to Society
      - Tariffs and quotas benefit domestic producers of the protected products but harm domestic consumers
        - Would reduce competition in protected industries
- 5.3 Multilateral Trade Agreements and Free-Trade Zones
  - Reciprocal Trade Agreements Act
    - Of 1934
    - Started downward trend of tariffs
    - Aimed at reducing tariffs
    - Negotiating authority – authorized president to negotiate with foreign nations agreements that would reduce existing US tariffs by up to 50 percent
    - Generalized reductions – mirror image other nations' tariffs
    - NTR – normal-trade-relations status
  - General Agreement on Tariffs and Trade
    - Reciprocal Trade Agreements Act only provided bilateral (between two nations) negotiations
    - 23 nations signed the General Agreement on Tariffs and Trade (GATT)
    - 1. Equal, nondiscriminatory trade treatment for all member nations
    - 2. the reduction of tariffs by multilateral negotiation
    - 3. the elimination of import quotas
    - Eliminated or reduced tariffs on thousands of products (overall tariffs dropped by 33 percent)
  - World Trade Organization
    - Uruguay Round agreement established the WTO as GATT's successor
    - 153 nations belonged to WTO in 2008
    - Oversees trade agreements reached by the member nations and rules on trade disputes among them

        - Provides forums for further rounds of trade negotiations
        - Doha Round – ninth and latest round of negotiations
    - In general
        - GATT and WTO have been positive forces in liberalizing world trade
        - Controversy: exploiting low wages in foreign countries and lack of environment laws in foreign countries
    - The European Union
        - Regional free-trade zones (trade blocs)
            - Most extreme example: European Union
        - The EU Trade Bloc
            - Abolished tariffs and import quotas on nearly all products traded among the participating nations
            - Liberalized the movement of capital and labor within the EU
            - Trade bloc – a group of countries having common identity, economic interests, and trade rules
            - Effects on the US
                - Peaceful and increasingly prosperous EU makes its members better customers for US exports
                - US firms and other non member firms are faced with tariffs
        - The Euro
            - In 2008, 15 countries switched over to using the Euro as common currency
            - Economists expect the adoption of the Euro to raise the standard of living of the Euro Zone members over time
            - No more inconvenience and expense of exchanging currencies
    - North American Free Trade Agreement
        - NAFTA
        - Established a free-trade zone that has about the same combined output as the EU but encompasses a much larger geographic area
        - Eliminated tariffs and other trade barriers between Canada, Mexico, and the United States for most goods and services
        - Between Canada, Mexico, and United States (in 1993)
        - Concern: foreign countries building plants in Mexico and transporting goods tariff-free to the US
        - However, employment has increased by 22 million workers and the unemployment rate decreased from 6.9 to 4.7 percent
- Trade-Related Issues
        - Trade liberalization and increased international trade raise total output and income
        - Disrupts existing patterns of production and resource allocations
    - Trade Adjustment Assistance

        - A nation's comparative advantage in the production of a certain product changes
            - National economies evolve
            - Size and quality of labor forces may change
            - Volume and composition of capital stocks may shift
            - New technologies may emerge
            - Quality or land and quantity of natural resources may be altered
        - Trade Adjustment Assistance Act of 2002
            - Introduced new and novel elements to help those hurt by shifts in international trade patterns
            - Provides cash assistance for up to 78 weeks for workers displaced by imports or plant relocations abroad
            - Supported by economists because it not only helps workers hurt by international trade but also helps create the political support necessary to reduce trade barriers and export subsidies
            - However, some economists argue "what makes losing one's job to international trade worthy of special treatment, compared to losing one's job to, say, technological change or domestic competition?"
    - Offshoring of Jobs
        - Some US jobs are lost to globalization of resource markets
        - Outsoourcing of work abroad is increasingly profitable
        - Offshoring – shifting work previously done by American workers to workers located in other nations
        - Offshoring is a wrenching experiences for many Americans who lose their jobs
        - Not necessarily bad for the overall economy
            - Offshoring reflects a growing specialization and international trade in services
        - Offshoring increases the demand for complementary jobs in the US
            - Ex. Lower price of writing software code in India = lower cost of software sold in the US and abroad
- 5.4 Global Competition
    - Globalization – the integration of industry, commerce, communication, travel and culture among the world's nations
    - Positive – improvements to general standards of living
    - Negative – impacts on the environment, unionized workers, and the poor
    - Has brought intense competition both within the US and across the globe