

Economics: Global Trade

Introduction:

It is important for students to realize our economy does not take place in a vacuum. Our country's trade policies affect employment and unemployment, monetary policies, government spending, budget-making, and peace-keeping policies.

Key Concepts:

- Opportunity Cost- The decision to produce any good or service has an opportunity cost, which is the amount of another good or service that might otherwise have been produced.
- Absolute Advantage- When a country can produce more of a good with the same resources that another country can, it is said to have an absolute advantage in the production of that good.
- Comparative Advantage- Given any two products, a nation has a comparative advantage in the product with the lower opportunity cost.
- Specialization Terms of Trade-The terms of trade must be such that both countries lower the opportunity costs of the goods they are getting from the trade.

Lesson Objectives:

- Understand the key concepts of global trade
- Recognize that comparative advantage is the basis for trade
- Engage in a comparative advantage activity to better understand this concept

Why Do Countries Trade With Each Other?

1. Write the following quote on the board--- "No nation was ever ruined by trade."--Benjamin Franklin
2. Ask the students: "What do you think Benjamin Franklin meant when he made this statement?"
3. After students' discussion, explain that there are many benefits derived from trading with other countries. Americans drink coffee from Brazil and tea from China, and many American wear Swiss-made watches and watch Japanese-made televisions. Many Americans drive cars made in Japan and Germany. Furthermore, these cars and others made in America are powered by gasoline from Arab countries. Because countries have different natural, human, and capital resources and different ways of using these resources, they are not equally efficient at producing the goods and services that their residents demand.
4. Introduce the concept of opportunity cost. Explain that the decision to produce any good or service has an opportunity cost, which is the amount of another good or service that might otherwise have been produced. Given a choice of producing one good or another, it is more efficient to produce the good with the lower opportunity cost, using the increased production of that good to trade for the good with the higher opportunity cost.
5. When a country can produce more of a good with the same resources that another country can, it is said to have an absolute advantage in the production of that good. If the second country has an absolute advantage in producing a good that the first country wants, both will

be better off if they specialize and trade. Example: A Kansas farmer can grow more corn per acre than a farmer in Colombia, South America. However, the Colombian farmer has an absolute advantage in coffee bean production. In this example, if Kansas farmers specialized in corn production, Columbian farmers specialized in coffee bean production, and the two countries trade their excess production with one another, then the citizens of both countries would be better off. The theory of specializing in what we can do fastest and cheapest is called absolute advantage.

6. Comparative Advantage. Explain that the people in the United States are very fortunate in that we have almost all of the resources we need to produce everything we desire. Other countries may not be as lucky. Some countries cannot grow certain crops because of the weather, or they cannot produce everything because they simply do not have enough people to do so. It should be easy to understand why some countries need and want to trade, but what if one country has the absolute advantage in the production of all goods? Does it still make sense to trade with a country that does not have an absolute advantage? For example, why doesn't a strong country such as the United States produce all of the computers, cameras, automobiles, televisions, and VCRs it wants rather than import such products from Japan? And in turn, why do the Japanese and other countries buy products like wheat, corn, chemical products, aircraft, and manufactured goods from the United States? The answer is explained by the law of Comparative Advantage. Example: For example, I went to school to become a teacher, and I can earn a fairly decent salary in the teaching profession. I am also good at house work. Suppose I hired a teenager to do some of my house work only later to find out that the teenager was only half as fast at these tasks as I am. Was it a good idea for me to hire the teenager who was less efficient in the house work than I am? I can probably make more money by devoting my time to teaching than to doing house work. Consequently, I have a larger comparative advantage with respect to teaching. Likewise, in global trade, one nation might have an absolute advantage in production of two commodities but choose to import the item in which it has the lesser absolute advantage (or comparative advantage) and to export the item in which it has the greater absolute advantage.

Student Activity

Law of Comparative Advantage

List and explain two household chores that you have assigned to other members of the family (or would like to assign) that relate to the Law of Comparative Advantage.

1. Assigned household chore: _____

Explanation: _____

2. Assigned household chore: _____

Explanation: _____

3. Do you have an absolute or comparative advantage in doing something over someone else? Explain.

Discuss student answers and check for understanding of the concepts of absolute and comparative advantage.

7. As a follow-up activity, students may access the following web site to identify who the United States' top trading partners are and to see how much is imported and exported to these countries.

www.doc.gov

DOC Bureaus
International Trade Administration
Trade Statistics
U.S. Foreign Trade Highlight
U.S. Aggregate Foreign trade Data
Table 9 Top 50 Partners

Sources:

Basic Economics, Karl Biedenweg, Mark Twain Media/Carson-Dellosa Publishing Company, Inc., 1999. [Http://ecedweb.unomaha.edu/lessons/FEOGI.htm](http://ecedweb.unomaha.edu/lessons/FEOGI.htm)