



# Lesson 10 – International Markets

## Introduction

In this lesson students apply the model of supply and demand to international markets for goods and services and currencies. Interactive online resources, videos and discussion of contemporary trade issues connect the students to the larger (and sometimes invisible) world in which they exchange.

## Objectives

At the end of this lesson students will be able to:

- Explain how specialization and trade creates wealth
- Compare opportunity costs to determine comparative advantage.
- Use imports and exports to determine the balance of trade.
- Provide examples of things that would influence exchange rates
- Explain why the balance of trade always balances.

## Economic Concepts

Balance of Trade

Exchange Rate

Imports

Comparative Advantage

Exports

Trade Agreements

## Voluntary National Content Standards in Economics

<https://www.fte.org/teachers/teacher-resources/voluntary-national-content-standards-in-economics/>

**STANDARD 5: GAINS FROM VOLUNTARY TRADE:** Voluntary exchange occurs only when all participating parties expect to gain. This is true for trade among individuals or organizations within a nation, and among individuals or organizations in different nations.

**STANDARD 6: SPECIALIZATION AND TRADE:** When individuals, regions, and nations specialize in what they can produce at the lowest cost and then trade with others, both production and consumption increase.

**STANDARD 7: MARKETS:** Markets exist when buyers and sellers interact. This interaction determines market prices and thereby allocates scarce goods and services.



## Presentation Guidelines and Suggestions:

1. Remind students of the Magic of Markets trading game from the first day. Review characteristics of wealth-creating trade: voluntary exchange and mutual perception of benefit.
2. Voluntary trade creates wealth whether the trade is domestic or international. Establish that the decisions people make in international trade are fundamentally the same as those made when participating in domestic trade.
  - Emphasize that *people* – not countries, societies, or governments – trade. *(See slide.)*
  - Ask students whether international trade – buying a Ferrari -- is fundamentally different than buying a hamburger at a local fast-food restaurant. *(See slide.)*
  - Remind students that throughout the week they've heard about rapid economic growth in India and China. Discuss how this growth is related to both countries opening their markets to foreign investment and trade. *(See market slide.)*
3. Define and explain comparative advantage. The wealth-creating benefits of both domestic and international trade derive from specialization based on the principle of comparative advantage.
  - Emphasize that the concept is about relative opportunity costs.
  - Develop an example of comparative advantage in terms of opportunity cost. *(See slide options: Ken & Barbie or Zeke & Zac or best player is best pitcher and best outfielder.)*
  - Emphasize that specialization and trade according to comparative advantage enables greater production and income.
    - Specialization offers lower production costs and market prices for traded goods.
    - Voluntary trade leads to interdependence and greater cooperation between nations.
    - Trade based on comparative advantage increases production and raises incomes.
  - Show video. Made in Mekhe (about female entrepreneur that started a skin care company in Senegal) Play from 14:08 to 17:07. [https://youtu.be/ U1zEuVXDak](https://youtu.be/U1zEuVXDak)
4. Review the definition of transaction costs and provide examples of transaction costs in international trade. Transaction costs in international trade are generally higher than in domestic trade.



- Explain the operation of international currency markets.
    - Payment systems may require currency conversions at prevailing exchange rates.
    - Currency exchange rates reflect the expected relative purchasing power of national currencies.
  - There are benefits and costs to countries adopting common currencies to facilitate international trade.
    - Some benefits include ease of exchange when crossing borders and the simplicity of international contracts using common currency.
    - Some costs include the loss of seigniorage to fund domestic government spending and local control over banking regulations, and, perhaps most importantly, the loss of control over monetary policy.
  - Develop example of the European monetary union as a response to the transactions costs that existed because European countries didn't have a common currency.
    - Illustrate the problems of vacationing in Europe, pre-Euro, when travelers had to change currencies each time they entered another country. From this example, lead into the transaction costs of trade across countries.
  - Provide examples of transaction costs related to logistics of moving products across borders. *(See slide of Mexican trucks at border crossing.)*
    - Transportation systems may involve detailed logistics of transfer, warehouse, and inspections at borders.
  - Provide examples of transaction costs generated by government regulation. *(See slide of banana size regulations.)*
    - Trade agreements that specify rules, rights and regulations that govern trade between cooperating countries, may raise or lower transaction costs.
5. Policies that restrict international trade inhibit the ability of markets to create wealth. Provide examples of policies that restrict international trade and agreements that facilitate it.
- Identify and give examples of types of trade restrictions (tariffs, quotas, content regulations, etc.) and the adverse effects they impose on both buyers and sellers.
    - Trade protection policies are often short-sighted, focusing on the benefits to import-competing industries and ignoring the impact on export-producing industries and on the prices of traded goods.



- Show the video on Ghana trade in Bananas.  
<http://www.youtube.com/watch?v=blvxPshCDe4> (This is also listed as an alternative problem in Lesson 4, “Markets in Action.” See discussion questions there. See also <http://www.banana.com/farming.html>) Ask students how the restrictions on banana “length and weight” affect total trade? Individual consumers? Individual producers?
    - At one point in the video, the packing of bananas shows that the cartons contain the label “FAIR TRADE.” (See slide of Fair Trade logos. What is fair trade? Explain that bananas bearing the Fairtrade Certification Mark (see <http://www.fairtrade.net/bananas.html>) have been produced by small farmer organizations or in plantations that meet very high social and environmental standards. Farmers who produce Fairtrade Certified Bananas are guaranteed a floor price (Fairtrade Minimum Price) to cover the average cost of production, and a Fairtrade Premium of 1US\$ per box of bananas to invest in social and economic initiatives in their communities.) Explore the economic effects of the “FAIR TRADE” label on farmers and consumers.
  - All participating countries benefit from international trade agreements and associations that reduce barriers to trade.
    - Identify examples – USMCA, NAFTA and GATT /WTO - of international agreements designed to reduce barriers to trade among nations. (See slides of organization logos and graph showing increased US aggregate trade from NAFTA. See slide notes for significant changes in USMCA)
  - Explain the European Union and the Euro zone, discussing the benefits and costs of countries using a common currency. ([http://europa.eu/index\\_en.htm](http://europa.eu/index_en.htm)).
6. Changes in international exchange rates affect the relative purchasing power of a nation’s currency. Illustrate the effect of changes in the value of the dollar on U.S. imports and exports: impacts (and who bears them) of strong dollar and weak dollar.
- When the U.S. dollar falls in value relative to other another country’s currency, imports from that country become more expensive for American buyers and exports to that country become cheaper for the foreign buyers.
  - When the U.S. dollar rises in value relative to another country’s currency, imports from that country become less expensive for American buyers and exports to that country become more expensive for the foreign buyers.
7. Balance of trade: Restrict this discussion to the definitional/descriptive level. Please **Do NOT** develop a statistical illustration of balance of trade accounting.



- The balance of payments measures both goods and services (current account) and financial (capital account) trade flows.
- A trade deficit occurs when imports of goods and services exceed exports. However, a deficit in goods and services (current account) must be accompanied by a surplus in the financial account (capital account.)
- A surplus in financial transactions means Americans are net borrowers from foreign countries and foreign countries are net investors in the U.S.
- The balance of trade always balances.

## Conclusion

- International trade is similar to all other trade – people choose to trade.
- Trade allows people to specialize in their lowest opportunity cost production.
- Comparative advantage encourages specialization and trade, both domestically and internationally.
- Specialization increases productivity and economic growth.
- Exchange rates reflect supply and demand for nations' currencies and changes in currency values affect the flow of trade.
- Trade in goods, services, capital, and financial assets always balances. Balance of Payments accounting provides information about exchanges of goods, services, and financial transactions among people in different countries.