

## TEACHER EDITION

### Middle School Version

*Page One Economics®* is an informative accessible essay on timely economic issues. The Teacher Edition provides the essay; student questions with answers; and additional lesson ideas for classroom, extra credit, or make-up assignments.

National Common Core State Standards (see page 9)



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## International Trade: Why Do People and Nations Trade?

Scott A. Wolla, Ph.D., Senior Economic Education Specialist



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### GLOSSARY

**Comparative advantage:** The ability to produce at a lower opportunity cost than another producer.

**Exports:** Goods or services that are produced domestically but sold abroad.

**Imports:** Goods or services that are produced abroad but sold domestically.

**Opportunity cost:** The value of the next-best alternative when a decision is made; it's what is given up.

**Mutually beneficial:** A trade in which the benefits outweigh costs for both sides of the transaction.

**Specialization:** Limiting production to fewer goods and services than consumed, perhaps those whose production entails the lower opportunity cost.

"Every man lives by exchanging."

—Adam Smith

- 1 Have you traded anything recently? Maybe a cookie for potato chips in the school cafeteria? Anyone who has traded one item for another knows the basics of trade—you trade to make yourself better off. Is this also true for international trade? Does the United States benefit when it trades with another country?
- 2 **The Basics: Costs and Benefits**

There are costs and benefits to trade. The cost of a trade is whatever is given up in the trade, and the benefit is whatever is gained in the trade. Consider Sam, who trades a cookie with Selena for potato chips. For Sam the cost is the cookie that he trades away, and the benefit is the potato chips he gains. Sam will make this trade only if potato chips give him more satisfaction than a cookie. And Selina will make this trade only if a cookie gives her more satisfaction than potato chips. Notice that both Sam and Selina trade only if they think the trade will make them better off. For that reason, trade is considered to be **mutually beneficial**—it benefits both sides. So, trade is not like a basketball game where every event has both a winner and loser. Rather, trade makes both sides better off. If it didn't, the participants would not have traded in the first place.
- 3 Countries trade for the same reasons that Sam and Selena trade. In fact, while we often talk about international trade in terms of one country trading with another country, it is actually the people within those countries who are the trading partners. For example, a business owner in St. Louis might order goods made by a Chinese company to sell in her store. Or, a Canadian farmer might order parts for his tractor from an American company. These individual transactions by consumers and businesses are added up and reported as international trade statistics. And just like Sam and Selina, the trades provide benefits for both sides.

## U.S. Imports

International trade plays a larger role in the U.S. economy than it ever has. Imports of goods and services have doubled since 1998.



SOURCE: FRED®, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/graph/?g=7n3C>, October 3, 2016.

4 These transactions are reported as imports and exports. **Imports** are goods or services that are produced in another country but sold in the United States. **Exports** are goods or services that are produced in the United States but sold in another country. The United States both imports and exports a lot of goods and services. For example, in 2015, the United States exported \$10.5 billion of soybeans to China<sup>1</sup> and imported \$64.6 billion of cell phones and other household goods from China.<sup>2</sup> That is a lot of stuff moving across the ocean!

### 5 Why Do People and Countries Trade?

People trade to get something they don't have. Countries trade for the same reason. Trade allows people to have a broader selection of goods and services. Walk around your home and investigate where things were produced. You might be surprised. And, many of your favorite things likely wouldn't be available to you, or too expensive, without trade.

6 But, why don't countries just produce these goods themselves? Different countries have different terrains, climates, and resources. As a result, some

countries will be able to produce some goods that other countries cannot produce or could produce at only a very high cost. Japan does not have oil resources, but Saudi Arabia has enormous oil resources. Bananas do not grow well in the United States, but they grow easily in Honduras. If American farmers decided to grow bananas, they might have to build huge greenhouses and use a lot of water and fuel to create the right climate. This would be very costly. Instead, the United States has a climate and resources that enable it to grow soybeans very easily.

7 The United States also has the resources to produce aircraft, automobiles, and medicines.<sup>3</sup> In fact, it is a leader in these industries. So, the United States is better off using its resources to grow and produce these things and trading with other countries to get the goods more costly to produce, such as bananas and cell phones.

8 Notice that countries consider cost when they decide what to produce. More specifically, it is the **opportunity cost**—what is given up—that matters. For example, it would likely require a huge amount of resources to grow bananas in greenhouses. Those

resources would not be available to produce the soybeans, wheat, and corn grown easily across a huge swath of the United States. The United States would have to give up a lot of soybeans, wheat, and corn to produce bananas. A better idea is for countries to produce goods and services that they can produce at a lower opportunity cost than their trading partners, which means they have a **comparative advantage** in producing that good. They produce and export those goods and services and import the goods and services that have a high opportunity cost. So, for example, the United States exports soybeans and imports bananas.

- 9 Because countries can trade with each other and don't have to make everything, there is specialization. **Specialization** means to produce some goods but not all goods. Specifically, countries specialize in producing goods for which they have a comparative advantage. For example, American workers produce (and export) jet airplanes but import most televisions. American companies produce movies and music for young people around the world, but they import many of the toys and gadgets that Americans play with.

## 10 Conclusion

Countries trade for the same reasons that people trade—it will make them better off. Countries have different resources, and, as a result, some goods are more costly to produce in some countries than in others. Countries tend to specialize in producing the goods that have lower opportunity costs. Because these areas of specialization determine what kinds of goods are produced, it also determines what types of jobs people have—and where you might work someday. Think about that next time you trade a cookie for potato chips.

## Notes

<sup>1</sup> U.S. Census Bureau. "U.S. Exports to China by 5-Digit End-Use Codes." Accessed September 27, 2016; <http://www.census.gov/foreign-trade/statistics/product/enduse/exports/c5700.html>.

<sup>2</sup> U.S. Census Bureau. "U.S. Imports to China by 5-Digit End-Use Codes." Accessed September 27, 2016; <https://www.census.gov/foreign-trade/statistics/product/enduse/imports/c5700.html>.

<sup>3</sup> Central Intelligence Agency. "The World Factbook: North America: United States: Economy—Overview." Accessed October 17, 2016; <https://www.cia.gov/library/publications/the-world-factbook/geos/us.html>.

Name \_\_\_\_\_ Period \_\_\_\_\_

Federal Reserve Bank of St. Louis *Page One Economics*®:**“International Trade: Why Do People and Nations Trade?”**

Effective reading often requires reading the same text several times. Use the following close reading strategies to guide your reading:

1. Read the article once. As you read, make the following marks on your paper:

☆ = Important idea

? = “I’m confused.” or “This seems odd.”

[ ] = An important phrase or sentence

○ = A word to look up

a. What are the important ideas? (Hint: These are items you starred when you marked the essay.)

b. What ideas seem confusing?

c. In your own words, what is the main idea of this article?

2. Read the essay again. Answer the following key questions about the content.
  - a. Use the word “cost” and “benefit” correctly in the statement below to create a true statement.  
  
Trade makes people better off if the \_\_\_\_\_ of the trade is greater than the \_\_\_\_\_ .
  - b. Explain why trade is mutually beneficial and not like a basketball game where there is always a winner and a loser.
  - c. Countries import some goods and export others. What determines which goods they import and which goods they export?
3. The last paragraph says that comparative advantage and specialization might determine your job someday. Explain why you think that might be true.

## Teacher's Guide

Federal Reserve Bank of St. Louis *Page One Economics*®:

### “International Trade: Why Do People and Nations Trade?”

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a. What are the important ideas? (Hint: These are items you starred when you marked the essay.)

- Trade is mutually beneficial—it benefits both sides of the transaction.
- Countries have different resources, which means countries are better at producing some goods than others.
- Countries produce goods with lower opportunity costs. This is their comparative advantage.
- Countries trade (import) goods with higher opportunity costs.
- Producing some goods and not others leads to specialization.

b. What ideas seem confusing?

Answers will vary.

c. In your own words, what is the main idea of this article?

People and countries trade to make themselves better off. The items countries trade are determined by the opportunity costs of producing them. That is, countries specialize in producing the goods with the lower opportunity costs and trade (import) the goods with the higher opportunity costs.

2. Read the essay again. Answer the following key questions about the content.

a. Use the word “cost” and “benefit” correctly in the statement below to create a true statement.

Trade makes people better off if the benefit of the trade is greater than the cost.

- b. Explain why trade is mutually beneficial and not like a basketball game where there is always a winner and a loser.

People will only trade if they think it will make them better off (the benefit is greater than the cost). People will not trade if it will make them worse off. This is true for both sides of the trade. So, when a trade occurs, both sides are usually better off.

- c. Countries import some goods and export others. What determines which goods they import and which goods they export?

Countries tend to produce goods and services they can produce at lower opportunity costs, which means they have a comparative advantage in producing those goods. They export those goods and import goods that have high opportunity costs.

3. The last paragraph says that comparative advantage and specialization might determine your job someday. Explain why you think that might be true.

People and businesses within countries produce goods and services that have lower opportunity costs, and trade (import) the goods that have higher opportunity costs. The goods and services that are produced within a country determine the jobs that workers have. In other words, countries specialize in producing some goods and services, and people are more likely to have jobs producing those goods and services.

## For Further Discussion

Trade has resulted in consumers having a larger variety of goods available to them than would be available without trade. Ask students to investigate the items in the classroom, on their desks, and in their lockers. Tell them to try and find markings that indicate where those things were produced. List the items on the whiteboard along with the country where each item was produced.

After you have listed the items on the board, ask students to use key words from the article (cost, benefit, trade, import, export, comparative advantage, and specialization) to describe why goods from the countries on the list are in your classroom.

## Additional Resources

Econ Lowdown® of the Federal Reserve Bank of St. Louis provides numerous economic education resources for teachers to use with their students. These include lesson plans, online modules, interactive whiteboard lessons, podcasts, and videos. These free resources are available at <https://www.stlouisfed.org/education>.

Use the resource below from Econ Lowdown to help teach about international trade:

### **“The Global Economy, It’s a Small World After All” (Page One Economics Classroom Edition)**

To understand why people trade, suppose you were limited to consuming only items you could find within walking distance of your house. Or, perhaps even worse, only items you could produce yourself. For most of us, this restriction would severely diminish the variety of goods and services we enjoy on a daily basis. Learn more about the benefits of trade and comparative advantage in this essay with accompanying classroom materials.

<https://www.stlouisfed.org/education/page-one-economics-classroom-edition/the-global-economy-its-a-small-world-after-all>

## National Standards

### Common Core State Standards

#### Grades 6-12 Literacy in History/Social Studies, Science, and Technical Subjects

- **Key Ideas and Details**

RH.6-8.1: Cite specific textual evidence to support analysis of primary and secondary sources.

RH.6-8.2: Determine the central ideas or information of a primary or secondary source; provide an accurate summary of the source distinct from prior knowledge or opinions.

- **Craft and Structure**

RH.6-8.4: Determine the meaning of words and phrases as they are used in the text, including vocabulary specific to domains related to history/social studies.

## National Standards for Financial Literacy

### Standard 5: 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.

- **Benchmarks: Grade 8**

5. Imports are foreign goods and services that are purchased from sellers in other nations.

6. Exports are domestic goods and services that are sold to buyers in other nations.