TEXT SUMMARY

Natural resources, human capital, and physical capital are unevenly distributed from country to country. Because countries differ so much in resources, they also differ in their ability to produce different goods and services. They will specialize in certain products that they can produce most efficiently. For example, coffee is grown more efficiently in warm areas like Central America than in other parts of the world. Because countries cannot efficiently produce everything their citizens need and want, they engage in trade.

Comparative advantage is the ability of one person or nation to produce a good at a lower opportunity cost than that of another person or nation. The law of comparative advantage states that nations are better off when they produce goods and services they have a comparative advantage in supplying. The money nations make from selling those goods and service can be used to buy the goods and services they cannot produce as efficiently.

An export is a good sent to another country for sale. An import is a good brought in from another country for sale. The United States is the world’s leading exporter followed by Germany and Japan. The United States is also the world’s top importer.

As countries specialize in certain products in which they have a comparative advantage, changes in employment patterns can occur. For example, in the 1970s Japan gained a comparative advantage in producing automobiles. As the American automobile industry lost business, many American workers lost their jobs.

GRAPHIC SUMMARY: Resource Distribution

<table>
<thead>
<tr>
<th></th>
<th>India</th>
<th>Peru</th>
<th>United Kingdom</th>
<th>United States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total area (sq km)</td>
<td>3,287,590</td>
<td>1,285,220</td>
<td>244,820</td>
<td>9,629,091</td>
</tr>
<tr>
<td>Arable land (sq km)</td>
<td>1,664,986</td>
<td>38,400</td>
<td>60,397</td>
<td>1,740,202</td>
</tr>
<tr>
<td>Mineral resources</td>
<td>Coal, iron ore, manganese, mica, bauxite, titanium ore, chromite, natural gas, diamonds, petroleum, limestone</td>
<td>Copper, silver, gold, petroleum, iron ore, phosphate</td>
<td>Coal, petroleum, natural gas, tin, limestone, iron ore, salt, clay, chalk, gypsum, lead, silica</td>
<td>Coal, copper, lead, timber, molybdenum, phosphates, uranium, bauxite, gold, iron, mercury, nickel, silver, tungsten, zinc</td>
</tr>
<tr>
<td>Population</td>
<td>984 million</td>
<td>26 million</td>
<td>59 million</td>
<td>270 million</td>
</tr>
<tr>
<td>Labor force</td>
<td>390 million (1997 est.)</td>
<td>7.6 million</td>
<td>28.2 million</td>
<td>136.3 million</td>
</tr>
<tr>
<td>Literacy rate</td>
<td>52%</td>
<td>89%</td>
<td>99%</td>
<td>97%</td>
</tr>
<tr>
<td>Telephones</td>
<td>12 per 1,000 people</td>
<td>30 per 1,000 people</td>
<td>500 per 1,000 people</td>
<td>600 per 1,000 people</td>
</tr>
<tr>
<td>Airports</td>
<td>343</td>
<td>244</td>
<td>497</td>
<td>14,574</td>
</tr>
</tbody>
</table>

Nations have great differences in their resources and their ability to benefit from them.

REVIEW QUESTIONS

1. Why do countries trade?

2. Chart Skills Which country on the chart has the highest rate of literacy?
Most countries have trade barriers—a means of preventing a foreign product or service from freely entering a country. One type of trade barrier is an import quota, a law limiting the amount of a good that can be imported. A voluntary export restraint is a limit a country imposes on itself on the amount of exports it ships to another country. A tariff is a tax on imported goods.

Trade barriers have both positive and negative effects. For example, United States tariffs will result in higher prices on imported cars. This helps American car makers compete. However, consumers then pay more for imported cars. American manufacturers might lose the incentive to become more efficient and make less expensive cars. Trade wars are another possible negative effect of trade restrictions. When one country restricts imports, its trading partner may try to use similar restrictions. Trade wars can result in less trade.

Protectionism is the use of trade restrictions to protect a nation’s industries. The most basic argument for protectionism is that it protects workers in industries that would be hurt by specialization and trade.

Recent trends have been toward lowering trade barriers and increasing trade through international trade agreements. The World Trade Organization (WTO) attempts to negotiate agreements and resolve trade disputes. The United States has entered into a treaty called NAFTA, the North American Free Trade Agreement, which reduces trade barriers between the United States, Canada, and Mexico.

**Review Questions**

1. Identify positive and negative effects of trade barriers.
2. Graph Skills In what year was the tariff rate the highest?
SECTION 3  MEASURING TRADE

TEXT SUMMARY

Before you can spend money in a foreign country you have to exchange your U.S. dollars for the currency of that nation. The value of that currency in relation to your own is the exchange rate. Exchange rates go up and down daily. An increase in the value of a currency is called appreciation. When a nation’s currency appreciates, its products become more expensive to other nations, leading to a decrease in its exports. However, its imports become cheaper and usually increase in number. The opposite happens with depreciation, a decrease in the value of a nation’s currency.

The foreign exchange market, which consists of about 2,000 banks and other financial institutions, helps companies and nations exchange currencies, thus making international trade possible. The world’s countries work together to compare and keep track of exchange rates. A fixed exchange-rate system keeps the value of currencies constant against one another. Since 1973 the United States and many governments have adopted a flexible exchange-rate system, which allows exchange rates to be determined by supply and demand. Some European countries, members of the European Union, use the same currency, called the Euro, and the same central bank.

The relationship between imports and exports is called balance of trade. A trade surplus occurs when a nation exports more than it imports. A trade deficit occurs when a nation imports more than it exports. The United States had a large trade deficit in the 1980s and 1990s.

GRAPHIC SUMMARY:  Foreign Exchange Rates

<table>
<thead>
<tr>
<th>Currency</th>
<th>Value of $1 U.S.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australian dollar</td>
<td>1.541</td>
</tr>
<tr>
<td>United Kingdom pound</td>
<td>0.6252</td>
</tr>
<tr>
<td>Canadian dollar</td>
<td>1.478</td>
</tr>
<tr>
<td>Japanese yen</td>
<td>114.3</td>
</tr>
<tr>
<td>European Union euro</td>
<td>0.9516</td>
</tr>
<tr>
<td>Mexican peso</td>
<td>9.33</td>
</tr>
<tr>
<td>Chinese renminbi</td>
<td>8.28</td>
</tr>
</tbody>
</table>

Foreign exchange rates change every day. According to this chart, one U.S. dollar can be exchanged into about one and a half Canadian dollars.

REVIEW QUESTIONS

1. Which system do the United States and many other countries use to compare exchange rates between their currencies?

2. Chart Skills  How many yen can be exchanged for one U.S. dollar?
IDENTIFYING MAIN IDEAS

Write the letter of the correct answer in the blank provided. (10 points each)

1. Nations specialize when they
   A. have few natural resources.
   B. produce certain goods and services more efficiently than others.
   C. import more than they export.
   D. export more than they import.

2. Comparative advantage is the ability of a country to
   A. have more physical capital than another.
   B. produce everything its people need and want.
   C. produce a good at a lower opportunity cost than another country.
   D. borrow more money from other countries.

3. Which statement illustrates the law of comparative advantage?
   A. A country makes the goods it produces most efficiently and trades for others.
   B. A country makes all the goods it needs.
   C. A country buys all its goods from other nations.
   D. A country exports all its raw materials and imports all manufactured products.

4. What is the purpose of import quotas?
   A. to increase the amount of certain imported goods
   B. to decrease the amount of certain imported goods
   C. to lower trade barriers
   D. to create a self-imposed limitation on imports

5. A tariff is a tax on
   A. raw materials.
   B. exported goods.
   C. imported goods.
   D. any form of international trade.

6. The most basic argument in favor of protectionism is that it
   A. protects workers.
   B. protects consumers.
   C. defends nations against trade wars.
   D. helps a country's currency appreciate.

7. Which of the following is an example of a trade war?
   A. Two countries reduce all trade restrictions on each other.
   B. Two countries compete to see which can produce the most of a certain good.
   C. Consumers in two countries refuse to buy the goods of the other country.
   D. Two countries impose tariffs on each other's products.

8. Recent trends toward trade restrictions have been to
   A. lower only those trade barriers related to technology.
   B. shield a country's automobile industries.
   C. increase trade barriers.
   D. decrease trade barriers.

9. When a nation's currency appreciates, which is the most likely result?
   A. Its exports and imports will increase.
   B. Its exports and imports will decrease.
   C. Its exports will increase and its imports will decrease.
   D. Its exports will decrease and its imports will increase.

10. A country that imports more than it exports has a
    A. trade deficit.
    B. trade surplus.
    C. balance of trade.
    D. export quota.