Understanding Trade

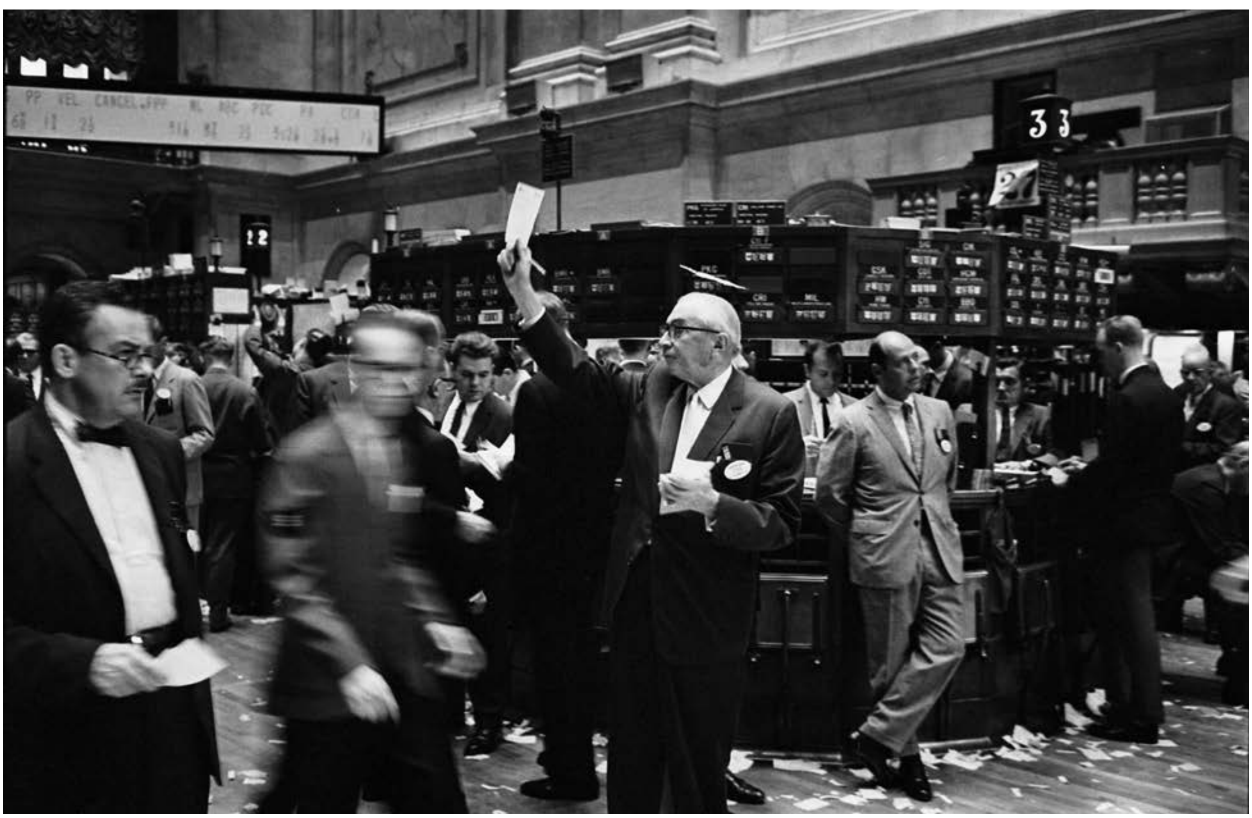
Trade has been a fundamental part of the economic life of human beings for thousands of years. Throughout human history, trade has led not only to the exchange of goods but also to the exchange of scientific, religious, philosophical, and cultural ideas. Today, the international trade of goods (including raw materials and manufactured goods) and services (including things like tourism, computer information services, and education) is worth trillions of dollars.

What are the motivations for trade?

At a most basic level, people trade because it allows them to obtain something they want. Trade can bring economic benefits, including access to a variety of goods that may be less expensive, of better quality, or otherwise unavailable. Without trade, a person would need to produce all of the goods and services that he or she needed. Trade allows people to specialize in the production of goods and services in which they have the resources to be most efficient and successful. They can then trade these goods or services with other people.

A government can be involved in this exchange by regulating or controlling the trade across its borders. This may take the form of policies that encourage international trade or policies that aim to limit trade. Governments raise political as well as economic concerns about trade.

Like individuals, countries also can gain from trade. There can be economic gains, for example, new markets to sell goods. There also can be political gains, such as strengthening international relationships or boosting the economies of allies and neighboring countries.



O'Halloran/Library of Congress, Prints & Photographs Division, LC-DIG-ppmsca-03199.

Traders at the New York Stock Exchange, 1963. A stock exchange is a place for buyers and sellers to trade shares (or stocks) in companies. A share is money that an investor gives to a company, in exchange for returns (money) when the company makes a profit. Stocks are an important way for companies to raise money in order to do business. Many countries or regions of the world have their own stock exchanges. In 1963, when this photo was taken, stock trade was still conducted on paper. Today, traders use computers to buy and sell stocks.

What is comparative advantage?

A business or person with the resources to produce a good or service more efficiently than another business is said to have a "comparative advantage." Countries also can have comparative advantages. For example, Saudi Arabia has a comparative advantage in producing petroleum, but it also needs rice and other food products for its citizens. Although Saudi Arabia could produce rice, it makes more economic sense for it to produce petroleum and trade with a country with a comparative advantage in rice production. Trade allows countries to produce what they are best at and consumers gain access to a wider variety of goods that may be of better quality or less expensive.

What are some of the negative effects of trade?

Trade also can have negative effects on people and countries. International trade can disrupt local economies, putting some companies out of business while others flourish. Governments may choose to focus their resources on industries in which they have comparative advantages. As a result, there may be fewer resources for other sectors of its economy. For example, a country that has a comparative advantage producing beans may decide to put most of its resources towards increasing bean exports and will have less resources for other sectors such as clothing manufacturing.

Not every person or every country benefits equally from trade. The resources and capabilities of a country also affect how it fares in international markets. For example, a country like Costa Rica, which depends on exports of agricultural goods like bananas and pineapples, is likely to earn far less from its exports than a country like Germany, which exports goods like cars and machinery. Similarly, people without critical resources such as money or a developed infrastructure are less likely to gain from international trade.

At the same time, rich and poor people from around the world have benefited greatly from being able to purchase the wide variety of less expensive goods that have become available as a result of international trade. Much of the debate about trade is focused on who gains and who loses from trade, and how these unequal effects should be addressed.

The Pressures of Globalization

Globalization is a term that refers to the economic, political, cultural, and social transformations occurring throughout the world. It reflects the increased interdependence of various countries and people today. The migration of large numbers of people and the growth of the internet and technology have helped spread ideas and establish connections among cultures that did not exist before.

> ***"[G]lobalization has produced enormous benefits. From 1970 to the 2008 financial crisis, global output quadrupled, and the benefits did not flow exclusively to the rich. ...the number of people living in extreme poverty in developing countries fell from 42 percent in 1993 to 17 percent in 2011, while the percentage of children born in developing countries who died before their fifth birthday declined from 22 percent in 1960 to less than 5 percent by 2016."***
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> —Francis Fukuyama, director of the Center on Democracy, Development and the Rule of Law, Stanford University, December 6, 2016

What are the effects of globalization?

With globalization, economies around the world have grown increasingly interdependent. The production of goods now takes place on a global scale. For example, a good that used to be produced by a single business within one country may now be produced by the labor of many businesses located all around the world. An expanding international commitment to free trade among countries has given people around the world access to goods that were previously unavailable.

Ours is not the first era to experience globalization; other periods in history have seen globalization of varying forms. But globalization today distinguishes itself by its speed and magnitude. Though the seeds of transformation were sown long before, the end of World War II marked the beginning of this new global era. The wave of globalization since 1945 has dramatically altered the lives of people around the world.

How has economic globalization affected the U.S. economy?

The United States is an economic giant. The U.S. dollar serves as the most important currency in international trade and is widely used by foreign governments. The United States is one of the world's top exporters and maintains a lead in many of the most promising industries, including biotechnology, space technology, and computer software. U.S. corporations have sought a competitive edge by taking advantage of cheap labor in Latin America and Asia. Meanwhile, Japanese and Western European companies have invested in the United States, hoping to tap into U.S. markets.

But the United States no longer dominates the world economy as it did in 1950. While total manufacturing output in the United States has grown, the U.S. share of global manufacturing has fallen from half of the world output in the 1950s to about 17 percent today. People in the United States have watched their automobile, steel, and consumer electronics industries lose ground to foreign competition. With these changes, the employment security and stability of the past have been swept away.

The relative change of the U.S. position in the international economy does not mean that the United States as a whole has become poorer. On the contrary, U.S. per capita income (average income per person) has continued to increase even as countries in Western Europe and Asia have caught up economically with the United States.

Heng in Lianhe Zaobao, Singapore. CWS/Cartoonists International. Reprinted with permission.

At the same time, inequality between those with the highest incomes and the lowest incomes in the United States continues to grow. Inequality between the rich and the poor has grown since the 1970s. In 1976, the top 1 percent of the income earners in the United States received about 10.5 percent of the total national income and the bottom 50 percent of the population earned about 20 percent of the total. By 2014, the top 1 percent earned about 20 percent, and the bottom 50 percent's share had decreased to 12.5 percent.

"[I]ncome inequality has reduced middle-class household income growth. It very likely has increased disparities in education, health, and happiness in the United States."

—Lane Kenworthy, professor of sociology and political science, 2014

While globalization may have contributed to gains in the U.S. economy, the gains have gone disproportionately to the wealthiest people.

How has globalization affected trade?

Globalization has created new opportunities in international trade for many countries. In the next twenty-five years, countries in Africa, Latin America, and Asia are likely to account for much of the increase in world imports.

Overall, economic globalization has had mixed and unequal effects. Some countries have been successful, because they have the resources to expand production worldwide and to create goods that are in demand internationally. Individuals and small businesses have access to much larger markets and to new buyers. On the other hand, some countries and individuals have been hurt, because they are not able to compete with strong foreign producers.

"More global trade is a good thing if we get a piece of the cake. But that's the problem. We're not getting our piece of the cake."

—Patrick Duijzers, dock worker in the Netherlands, reflecting on his work experiences, September 22, 2016

Globalization has forced businesses to learn to compete on a global scale or be left behind. Economists have noted that many businesses in the United States have, for the most part, benefitted from globalization.

Although globalization began as a U.S.-dominated phenomenon, in recent years, European businesses have grown larger than their U.S. rivals. Many of the biggest and richest companies in the world today are from rapidly industrializing countries like India, China, and Brazil. Some of these companies have even bought out their U.S. competitors. Additionally, there has been a dramatic increase in the amount of low and middle income countries' participation in trade. Much of this growth can be attributed to the rise in trade agreements among countries throughout the world in recent years.

Trade Agreements

Trade agreements—agreements aimed at increasing trade between specific countries—became popular after World War II, when U.S. policy makers began promoting international economic cooperation. A country might sign a trade agreement for any number of reasons, including to guarantee markets for its exports or to ensure a steady supply of a specific good like oil. Many of these agreements are signed with an aim to reduce barriers and create freer trade between countries. Others are much more ambitious. For example, the countries of the European Union have developed a single market, a single currency, and a political governing body, in addition to free trade among European Union member states.

Some trade agreements are described as preferential, which means that only those countries who sign the specific agreement will trade on those terms. For example, while the United States might lower its tariffs on lumber from Canada according to a trade agreement, it will not lower its tariffs on lumber from other countries.

The vast majority of trade agreements are bilateral, that is, agreements between two countries. There are also multilateral agreements, which are between multiple countries. Some multilateral agreements are known as regional trade agreements, because they are among countries within a specific region. In 2016, there were 425 regional trade agreements in effect around the world.

There is significant debate both within the United States and around the world as to whether trade agreements are beneficial for individual economies. While many argue that everyone benefits from an increase in trade, some worry that by tying economies closer together, countries become too dependent on each other.

Some supporters of free trade policies claim that regional agreements hurt free trade, because barriers are only lowered for specific countries and not for trade overall. They further argue that trade agreements take attention away from efforts to create worldwide free trade, and most particularly the efforts of the World Trade Organization (WTO).

What is the WTO?

The World Trade Organization (WTO) is an international organization aimed at liberalizing trade. In February 2017, it had a membership of more than 164 countries that conduct nearly all of world trade.

Seattle Municipal Archives.

In 1999, more than forty thousand protesters organized in Seattle, Washington against the WTO, globalization, and trade agreements, which they believed helped corporations while hurting workers' rights and the environment.

The WTO began in 1995 as a successor to the General Agreement on Tariffs and Trade (GATT). WTO member states meet periodically to negotiate new trade regulations and to lower barriers to trade. The WTO oversees the agreements that are signed and helps member states settle disputes. Disputes arise when one state believes another is violating a WTO agreement and has an unfair advantage in trade. For example, the EU and the United States have each accused the other of providing unfair subsidies (financial support) to major aircraft manufacturing companies that are in competition with each other. In addition to subsidies, another common problem is "dumping," in which companies flood markets with goods priced far below what they cost to produce. Dumping disadvantages producers who are not subsidized. These producers lose business to the dumpers, who are able to sell below market value.

In order to settle disputes, other WTO member states consult experts and rule on whether a violation has occurred. If a country is found in violation of an agreement, it is asked to change its policies. Between 1995 and 2016 there were approximately five hundred disputes filed with the WTO.

Why do some groups criticize the WTO?

Some complain that the WTO's processes are too secretive and undemocratic. They argue that, despite the fact that every country gets one vote, some countries have more power than others. They claim that richer countries have more strength in negotiating, because they have more political power.

Oftentimes, WTO negotiations expose rifts between high income and lower income countries. Many low income countries express concern that richer countries push through agreements that hurt poorer countries. For example, the Uruguay round of negotiations in the 1990s placed heavy obligations on poorer countries to protect intellectual property rights (things like copyrights or trademarks) but did little to limit the massive subsidies that rich countries use to support their agricultural industries.

Among the general public, regular large-scale protests at WTO meetings highlight the unease generated by the evolving international economic system. Organized labor unions, human rights activists, environmentalists, and nongovernmental organizations (NGOs) continue to protest the WTO and the free-trade policies that it represents. Many argue that WTO agreements do not do enough to make sure that trade helps alleviate poverty. Demonstrations against "globalization without representation" continue whenever the WTO convenes a meeting.

> ***"[S]o unfair has the trade agenda been, that not only have poorer countries not received a fair share of the benefits; the poorest region in the world, Sub-Saharan Africa, was actually made worse off as a result of the last round of trade negotiations."***
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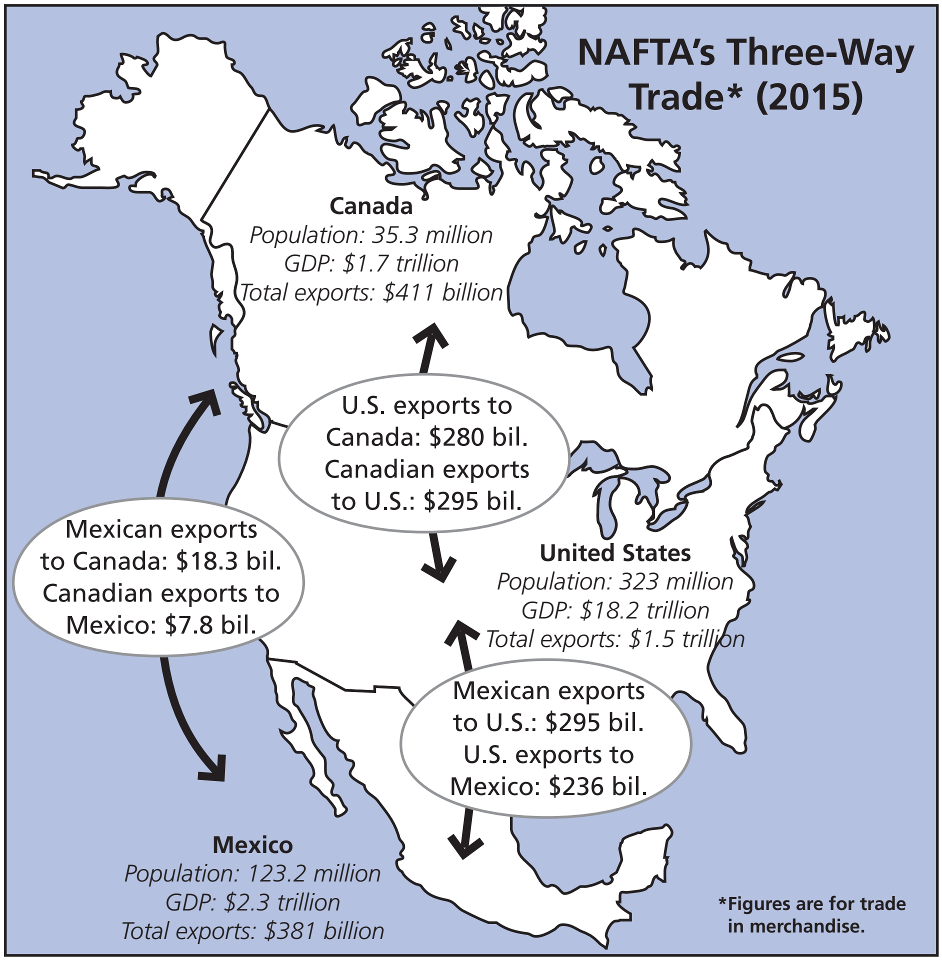
> —Joseph E. Stiglitz, Nobel Prize winner in economics, in his book *Globalization and its Discontents*, 2002

Some trade activists have introduced the term "fair trade" as an alternative to free trade. Supporters of fair trade lobby for reform of international trade—and the WTO in particular—to create an international marketplace in which everyone has an equal opportunity for gain. There may always be winners and losers, say fair trade advocates, but the winners should aim to level the playing field. Fair trade would involve reducing government subsidies to industries and lowering tariffs on imports in rich countries as well as banning the practice of dumping.

Other opponents of the current trade system in the United States fear that the authority of the WTO will increase at the expense of U.S. sovereignty. Under the General Agreement on Tariffs and Trade (GATT), each participating country had the power to veto GATT decisions. The WTO has eliminated this veto power. Instead, member states are obliged to comply with WTO rulings in international trade disputes.

Environmentalists, labor union leaders, and consumer advocates argue that foreign countries will use the WTO to attack U.S. regulations as unfair trade barriers. Laws intended to protect the environment, workers' rights, and the health and safety of consumers could be especially vulnerable. Other critics raise concerns about the membership of the WTO and suggest that the United States should restrict trade relations with countries that do not respect basic human rights.



Sources: U.S. Census Bureau, the NAFTA Office of Mexico in Canada, and the CIA World Factbook.

What other trade partnerships does the United States have?

In addition to its membership in the WTO, the United States has separate trade agreements with many countries, including numerous bilateral and multilateral agreements. These agreements are aimed at reducing tariffs and increasing cooperation. The United States has established Free Trade Agreements (FTAs) with twenty countries.

The United States is also a part of the North American Free Trade Agreement (NAFTA), a regional trade agreement between the United States, Canada, and Mexico that took effect in 1994. NAFTA was created to lower barriers to trade among North American countries.

As a candidate for the presidency, President Donald Trump (2017-) promised to rethink the U.S. approach to trade and renegotiate NAFTA, which he called a bad deal for the United States. He also said the United States would not pursue the Trans-Pacific Partnership (TPP), a trade deal with Australia, Canada, Chile, Japan, Malaysia, Singapore, Vietnam, and other Pacific nations. The TPP had been negotiated during the Obama administration (2009-2017).

In the next section of the reading, you will consider how trade policies and globalization affect people around the world. How have recent changes helped people in the United States and in other countries? How have they been harmful? As you read, keep in mind that when you have finished the reading you will be asked to formulate your own policy for U.S. trade.