Everyday Economics:
Why Trade?

Lesson Description

In this lesson, students will examine important concepts about trade, including gains from trade, opposition to free trade and organizations that promote free trade. The lesson begins with a brainstorming activity about the motivations for trading, arriving at the idea that trade occurs when there is a benefit to all involved parties. Next, the class will participate in a trading game to experience how increasing levels of free trade benefit the class. After a discussion of the balance of trade, students will examine how opposition to free trade arises among domestic producers and consumers. Using a Flash interactive, the class will examine four barriers to trade. Last, the class will discuss major international organizations and agreements that promote free trade.

Voluntary National Content Standards in Economics

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.

Instructional Objectives

Students will:

- Define trade as a voluntary exchange of goods or services that only occurs if everyone involved expects to benefit.
- Identify the motivations for opposition to free trade.
- Describe the major types of trade barriers.
- Identify various organizations and agreements that facilitate free trade.

Time Required

One 50-minute class period

Materials Required

SmartBoard
Notebook File
Variety bag of candy

Warning

The first time you teach the lesson, save a master copy to your computer or a flash drive. If you do not, you will not be able to save notes from each class. Before each class, reload the master copy of the notebook file to be certain that all the elements on each page are ready for use.

Procedure

1. **Display Slide 1.** Tell students that the topic of today's lesson is trade.

2. **Display Slide 2.** Review the instructional objectives with the class.

3. **Display Slide 3.** Use the space on the slide to brainstorm answers to the question "Why Trade?" Student responses will vary but may include:
   - To buy something you don't make yourself
   - To purchase things at a lower price
   - To sell to a market that needs or wants your products

   Explain to students that everyone who trades voluntarily expects to be better off after engaging in trade.

4. **Display Slide 4.** Use the table on the slide and the information below to lead the class in an activity that demonstrates the gains from trade.
   - Hand each student a piece of candy from the variety bag. Do not allow students to select their piece of candy.
   - Once every student has a piece of candy, have them rate their satisfaction with what they received on a scale of 1–10. Record the number of students that gave each rating on the table under the column **Before Trade**.
   - Allow students to trade candy within a limited group (a row, a table or a different small group). After trade has occurred, have students rate their satisfaction with the candy they have. Record the responses on the table under the **Limited Trade** column.
   - Allow students to trade with anyone in the class. After they trade, have students rate their satisfaction with their candy a third time. Record student ratings on the table under the **Free Trade** column.

   Use the results of the simulation and the questions and suggested answers below to lead a discussion about how trade affected the satisfaction of the class.
   - Why did the number of people who were fully satisfied (rated satisfaction a 10) never go down?
     No one would ever voluntarily decrease their satisfaction or purposefully harm themselves through trade.
   - How did opening trade, even in a limited way, impact the total satisfaction of the class?
     When students could engage in even limited trade, it gave them the opportunity to find a piece of candy they would prefer. Assuming their trading partner also benefitted, both people would trade and be happier with what they had.
   - Why did free trade further improve the satisfaction of the class?
     When an individual has more potential trading partners, the likelihood of finding a trading partner who benefits from a trade goes up.

5. **Display Slide 5.** Use the pull tabs on the slide and the information below to formalize the "What" and "Who" of trade.

Pull the tab on the left to display the definition of trade.

- With voluntary trade, no parties are forced to participate.
- Therefore, no one who trades expects to be worse off after the transaction. (Refer to the candy trading game.)

Pull the tab on the right to display information about who trades.

- Trade occurs domestically and internationally.
- Trade does not occur between nations. Instead, trade occurs between individuals and organizations (even if these organizations are government-owned or government-sponsored enterprises). In the remainder of the lesson, when a country is said to trade, the reader should infer that it refers to the total trade by individuals and organizations in the country.

6. **Display Slide 6.** Use the graphics on the slide and the information below to explain imports, exports and the concept of balance of trade.

   Pull the tab in from the left and place it on the scale.

   - Imports are goods or services produced or assembled outside a country and then brought in for consumption.
   - If a country has a higher price than the world price for a specific good, the country will become an importer of the good.
   - When a country imports a good that it also produces, domestic prices will fall, domestic production will fall, or both.

   Pull the tab in from the right and place it on the scale.

   - Exports are goods or services produced or assembled inside the country and transported outside the country for consumption.
   - If a country's domestic price for a specific good is lower than the world price, the country will become an exporter of the good.
   - When a country exports a good, the domestic prices will rise, domestic production will increase, or both.

   Tell students that the balance of trade is a comparison of a country's total imports and total exports. When a country imports more than it exports, it runs a balance of trade deficit. When a country exports more than it imports, it is running a balance of trade surplus.

7. **Display Slide 7.** Use the graphic organizer on the slide and the information below to demonstrate how consumers might be damaged by free trade.
   - If the world price is greater than the domestic price for a specific good or service, the country will become an exporter of that good or service.
   - When this happens, the domestic producers benefit from access to a new market, with additional demand for their product, and are able to raise their price.
   - Domestic consumers are subjected to the new higher prices and are worse off.

8. **Display Slide 8.** Use the graphic organizer on the slide and the information below to explain how producers might be damaged by free trade.

- When the domestic price for a specific good or service is higher than the world price, the country will begin to import the good or service.
- When a country begins to import the good or service, the domestic price will fall. Falling prices are good for consumers but cause domestic producers to make less money or potentially go out of business.
- Unlike exporting, where the harm of free trade is spread across all consumers through a relatively small price increase, the harm from free trade to specific producers is often concentrated and significant.
- It is common for producers to organize and demand government protection for their industries. These protections are called **barriers to trade**.

9. **Display Slide 9.** Use the information below and on the slide to discuss barriers to trade.
   - Since the harm from trade is concentrated among a relatively small number of producers, it is possible for them to effectively organize and lobby the government.
   - Their goal is to protect a higher domestic price and profit by excluding more efficiently produced goods and services from the domestic market.
   - Groups that advocate for trade barriers are called protectionists. The practice of protecting domestic markets from international competition is called protectionism.

10. **Display Slide 10.** Use the interactive on the slide and the information below to explain four major barriers to trade.
    - Touch the bollard labeled tariffs to display a definition for tariffs.
      - Tariffs are taxes on imports. They can be broad based, country specific or even good specific. This protects domestic consumers by making foreign goods' prices higher and less competitive in the domestic market.
    - Touch the bollard labeled quotas to display a definition for quotas.
      - Quotas are limits on the quantity of imports. This helps to protect domestic producers from falling prices by limiting the supply of imported goods that will be available to compete domestically.
    - Touch the bollard labeled voluntary export restrictions to display a definition for VERs.
      - VERs are limits on exports that countries adopt to limit the quantity of exports that originate from the nation. In spite of the name "voluntary," they are often adopted under political pressure from other nations.
    - Touch the bollard labeled export subsidies to display a definition for an export subsidy.
      - Export subsidies are government payments to producers of certain goods that might not be competitive internationally. By subsidizing the production, the government and the domestic taxpayers lower production costs in the targeted industry, making it more competitive in the global market.

11. **Display Slide 11.** Use the graphic organizer on the slide and the information below to explain the consequence of protectionism.
    - Restrictions to free trade cause domestic prices to rise. If domestic consumers could purchase something from an international supplier, but are unable to do so because of a trade barrier, they will pay the higher domestic price to purchase the same goods.

- Often, when one country imposes a trade barrier, the countries affected by the barrier will retaliate. This retaliatory action will further decrease the quantity of free trade in the world. These are sometimes called "beggar-thy-neighbor tariffs."
- With higher domestic prices for protected goods, the standard of living of all consumers of the good is harmed. The gains to the producer may or may not be enough to balance the loss of welfare, but rarely are the consumers fully compensated.
- The harms from protection extend to other industries that are competing for resources in a country with trade barriers. If a trade barrier keeps the price of a productive input above the world price, all of the industries, along with their consumers, will be harmed.
- When export subsidies are provided for certain industries, those industries are incentivized to produce more than the market would otherwise demand. This overproduction bids up the price of resources used in the production of the subsidized good and damages other industries that use the same resources.

12. **Display Slide 12.** Use the graphic on the slide and the information below to introduce a few major organizations and agreements that are attempting to open trade.
    - **NAFTA –** The North American Free Trade Agreement creates a free trade area between Canada, the United States and Mexico. The agreement removed all quotas and tariffs on goods and services moved between the countries. Other regional free trade agreements have been negotiated in other parts of the world.
    - **GATT –** The General Agreement on Tariffs and Trade existed from 1948 until 1994 to reduce trade barriers and standardize the rules of trade across the world. The agreement sought to make world trade more free through group negotiations, called rounds. GATT led to the eventual creation of the World Trade Organization.
    - **WTO –** The World Trade Organization is the successor to GATT that seeks to continue to open trade across the world. The WTO also works with nations to help use trade to reduce poverty and increase standards of living.

Closure

1. Why does trade occur?
Trade occurs because people see an opportunity to benefit through transactions. In a voluntary trade, all the parties believe they will be better off after the trade or it will not occur.

2. What are the four barriers to free trade?
Tariffs are taxes on imports. Quotas are quantity restrictions on imports. Voluntary export restrictions are self-imposed limitations on exports. Export subsidies are payments from the government to producers in specific, export-related industries.

3. What are the four consequences of protectionism?
Higher domestic prices, lower standard of living, retaliation by other nations, damage to related industries.