International Trade & Finance

There are three main areas the AP test will cover regarding International Trade & Finance

1. How economists keep track of international transactions (a country's transactions with other countries). This is done using a country's balance of payment accounts that has two components, the **CURRENT ACCOUNT** and **FINANCIAL ACCOUNT**. You will need to be able to identify transactions as one or the other.

2. What external changes cause currencies to appreciate or depreciate internationally? We will use **"TIPI":** Tastes, Incomes, Price level, Interest rates.

3. Properly **analyzing and reflecting changes** in supply and demand of loanable funds based on changes in "TIPI" on a **properly labeled FOREX graph**

Vocab

Open economy: An open economy is an economy in which there are economic activities between domestic community and outside, e.g. people, including businesses, can trade in goods and services with other people and businesses in the international community, and flow of funds as investment across the border.

Closed economy: An economy that does not interact with the economy of any other country. On the AP test, you might see a description of a situation and that the country involved is a closed economy. This is done to isolate a specific topic and not confuse you with outside influences like trade and the FOREX

ROW: Refers to the Rest of the World, like, the U.S. dollar has appreciated relative to ROW, as opposed to one country (U.S. dollar has appreciated relative to the Euro)

Tariff: Used to restrict trade, as they increase the price of imported goods and services, making them more expensive to consumers. They are a tax on an import. They are often used to protect a country's goods from foreign competitors and have the overall effect of increasing prices for consumers.

Quota: In international trade, a government-imposed limit on the quantity of the goods or services that may be imported. Import quotas are also used to protect domestic goods from foreign competition and have the effect of increasing prices for consumers.

M41 | Topic #1

The Story…

In our first unit we talked about trade and how we can determine if two countries could benefit from trade. Comparative advantage (lower opportunity cost) is the key, and all countries have a comparative advantage in something and a comparative disadvantage in something.

In our second unit we talked about how we measure domestic economic growth (**GDP**) by adding up consumer spending on goods and services (C), investment spending (I), government spending on goods and services, including transfer payments (G), and the value of exports minus imports (X-IM).

In our last unit, we will continue the story by looking at how economists keep track of international transactions (a country's transactions with other countries). This is done by using a country's ***balance of payments accounts***. The international version of GDP, which is domestic only!

There are two main parts to the balance of payments accounts: **Current Accounts and Financial Accounts**. These will "balance" each other out, theoretically.

Current Account: The most important component of current accounts is the trade balance, the difference between a country's exports and imports of goods & services

> *Simple Example*: the value of U.S. wheat ($1) and steel exports ($1) vs. the value of U.S. oil ($2) and electronics imports ($2) equals a Net current account of $2-$4= **-$2**.

Financial Account: The key difference between CA and FA is that a CURRENT ACCOUNT is a simple transaction for a good or service that is complete once it is done and creates no "liability" or future payment.

> *Simple example*: the U.S. exports ten tons of steel (current account) vs. the U.S. buying a French bond (financial account). The bond is a promise to pay interest and principal in the future, a "liability" whereas the steel transaction ends with no future payments.

Financial Account: Net sales of assets, such as currencies, securities (stocks/bonds), and factories, to foreigners. One country sells these assets for money (called financial capital) which is simply money from savings that are available for investment spending.

Practice Time on 7-1, AC/DC and some practice MC questions.

(AC/DC 5.1) http://www.youtube.com/watch?v=W0YwGLz50TA