Imports, Exports, and Exchange Rates: Crash Course Economics #15

Crash Course: Economics
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=====Introduction (0:00)=====

Adriene: Hi, I'm Adriene Hill.

Jacob: And I'm Jacob Clifford and welcome to Crash Course: Economics. Today, we're gonna talk about international trade.

Adriene: So, we all know our stuff is from everywhere: Bangladesh, China, Vietnam, China again. But what does it actually tell us about the global economy or the U.S. economy? And who's benefiting from all this trade?

Jacob: And who's gonna clean all this up?

[Intro Plays]

=====Imports and Exports (0:29)=====

Jacob: International trade is the lifeblood of the global economy. Basically, when a good or service is produced in, let's say Brazil, and sold to a person or business in the U.S., that counts as an export for Brazil and an import for the U.S.

As you might expect, the U.S. is the world's largest importer because Americans love their stuff. In 2014, Americans imported over 2 trillion dollars worth of stuff like oil, cars and clothing, from countries all over the world. And if you look around your local big box store, it feels like everything is made in China. And we do import a lot of things from China, but in terms of both imports and exports, our largest trading partner is not China, it's Canada.

The U.S. and Canada trade over 600 billion dollars worth of goods and services each year. The U.S. imports a lot from Canada, but exports almost as much. In fact, the United States is the world's second largest exporter. It sells high tech things like pharmaceuticals, jet turbines, generators and aircraft to countries all over the world. It also exports intellectual goods like Kanye West albums and Pixar movies, as well as bulk commodities like corn, oil and cotton.

The annual difference between a country's exports and imports is called net exports. So, if Brazil exports 250 billion dollars worth of goods and imports 200 billion, then its net exports are 50 billion. That means Brazil has a trade surplus. In 2014, net exports in the U.S. were negative 722 billion dollars. That's what you call a trade deficit.

=====Trade Deficit (1:47)=====

Adriene: Some people assume that having a trade deficit is inherently bad. Why does the U.S. import nearly all of its clothing? Why can't we clothe ourselves? U.S. producers could easily make more than enough clothing to keep all of us dressed, but they don't because they focus on other things that they're better at producing. The U.S. buys its clothes from other countries because it's cheaper than if we made them here.

This is the value of international trade. It doesn't make sense to make everything on your own if you can trade with other countries that have a comparative advantage.

It's worth mentioning here that these savings sometimes come with other costs, especially for the people who are producing these goods overseas. Unsafe and unfair working conditions and environmental degradation can be ugly side effects of international trade, and we're gonna talk about that. For today, though, let's get a handle on trade deficits.

It can seem like exporting would make a country wealthy, while importing would make it poor. After all, if we buy products produced in other countries, then we're shipping jobs overseas, right?

Well, only to an extent. Imagine I had the choice of buying an American made TV or a TV made in Malaysia. Because of lower labor costs in Malaysia, the imported TV costs 200 dollars less than the American made one. So I buy the imported TV.

That might cost jobs at a TV factory in the U.S., but I save 200 dollars by buying the imported TV. And what am I gonna do with those 200 dollars? I'm gonna spend them on something I couldn't have afforded if I bought the U.S. TV. Like maybe taking my family out to a baseball game or to a restaurant. That creates jobs in those industries that wouldn't have existed if I would've bought the more expensive TV.

Economic theory suggests that international trade reshuffles jobs from one sector of the economy to another. Like from the TV factory to the restaurant. But the quality of these jobs can be markedly different. The guy assembling TVs at the U.S. factory was probably making a lot more at his manufacturing job before he got reshuffled to the burrito assembly line at Chipotle. Which is just to say that all this is really complicated and what is good in the aggregate is not necessarily good for individuals.

For example, look at the North American Free Trade Agreement, or NAFTA. It was established in 1994 to drop trade barriers between Canada, the United States and Mexico.

Critics point out that NAFTA significantly increased U.S. trade deficits and they say it decreased the number of manufacturing jobs in many states as companies moved out of the U.S. Proponents of free trade point out that the U.S. economy boomed in the 1990s, creating millions of jobs, including manufacturing jobs, and that free trade has decreased the price of all sorts of consumer goods, from vegetables to cars.

So, despite the fact that some workers in industries were clearly hurt, economists would tell us that NAFTA has had a net positive impact on all three countries. By the way, you know Thought Café, the makers of the Thought Bubble? They're Canadian. These graphics are imported.

The debate over the value of specific trade agreements continues, but it's unlikely that the world's largest economies will return to strict protectionism. Protectionist policy, like placing high tariffs on imports and limiting the number of foreign goods, usually hurts an economy more than it helps.

There are now several organizations designed to eradicate protectionism, most notably the World Trade Organization, or WTO. The WTO has been effective in getting countries to agree to specific rules and help settle disputes. But it's also been accused of favoring rich countries and not doing enough to help the environment or workers.

Trade between countries depends on the demand for a country's goods, political stability and interest rates. But one of the most important factors is exchange rates. Basically, this is how much your currency is worth when you trade it for another country's currency. And let's engage in some foreign trade now by going to the Thought Bubble:

=====Thought Bubble - Currency Exchange (5:43)=====

Suppose the U.S./Mexico exchange rate is 15 pesos to the dollar. If an American's on vacation to Mexico and wants to buy some sunscreen that costs 60 pesos, they'll have to trade four dollars for pesos. Likewise, if someone from Mexico is on vacation in the U.S. and wants to buy a 20 dollar t-shirt, she will have to exchange 300 pesos for dollars.

Now, let's think about what happens if the exchange rate goes up to 20 pesos per dollar. Now to buy that 60 peso sunscreen in Mexico, it'll cost that American three dollars instead of four. We say that the dollar has appreciated. At the same time, the Mexican tourist who wants to buy the 20 dollar t-shirt will need 400 pesos instead of 300.

It works the same way with imports and exports. When the dollar appreciates, it gets cheaper for U.S. consumers to import foreign goods and U.S. exports to other countries get more expensive. U.S. imports rise and exports fall.

On the other hand, what if the exchange rate fell to 10 pesos per dollar? Now to buy that sunscreen, the American tourist needs six dollars. Each dollar has gotten less powerful. We say that the dollar has depreciated. At the same time, the Mexican tourist who wants to buy the 20 dollar t-shirt needs only 200 pesos.

So when the dollar depreciates, foreign imports get more expensive, which makes them fall and U.S. exports to other countries gets cheaper, which means they rise.

[End of Thought Bubble]

Jacob: Most currencies like the peso and the dollar have floating exchange rates that change based on supply and demand. When the U.S. imports more products from Mexico, they exchange dollars for pesos. This will increase the demand for pesos, and the peso will appreciate. At the same time, the dollar will depreciate.

Now, some countries have elected to peg their currency to another currency. This is when a country's central bank wants to keep the exchange rate in a certain range. And they buy or sell currencies to keep it in that range.

The Chinese government was well known for buying U.S. dollars to keep the Chinese currency artificially depreciated. When the U.S. imported goods from China, the yuan would appreciate. Then the Chinese government would turn around and buy dollars, which kept the exchange rate about the same. This kept Chinese exports cheap for Americans.

=====Financial Assets (7:47)=====

Jacob: Up to this point, we focused on importing and exporting goods and services, but there's a whole other side of international trade that involves financial assets. Let's look at something called the balance of payments. It might feel more like accounting than economics, but it helps show how flow of money, and flow of goods and services, are opposite sides of the same coin.

Every country keeps an accounting statement called the balance of payments that records all international transaction. It's made up of two sub accounts: the current account and the financial account, sometimes called the capital account. The current account records the sale and purchase of goods and services, investment income earned abroad and other transfers like donations and foreign aid. So when the U.S. buys 50 billion dollars of computers from China, that's recorded in the U.S. current account.

So this is a simplification, but when Americans spend money on Chinese goods, the people in China, in theory, have only two things they can do with that money. They can buy U.S. goods or they can buy U.S. financial assets like stocks and bonds. These transactions are recorded in the other sub account: the financial account.

There is a reason why the flow of goods and the flow of money are symmetric. If consumers, businesses and government want to buy more stuff than their country is producing domestically, they have to import it. So there's a trade deficit. That country has to sell assets to pay for those imports and that's recorded in the financial account.

The United States has a very low savings rate, which means it's consuming everything it's producing and it sells assets to pay for the additional output it brings in from overseas. Americans are choosing to run a trade deficit.

=====Conclusion (9:05)=====

Adriene: International trade, like everything else in economics, is about trade-offs and choices and winners and losers. In purely economic terms, trade deficits and surpluses are the result of people and nations seeking their own self-interest. But while everyone is acting in a self-interested way, international trade doesn't always meet our individual interests. What may be good for the wider global economy might be really bad for me or my hometown. But in the aggregate, trade does improve the global standard of living. It's just sometimes hard to see up close. Thanks for watching, we'll see you next week.

=====Closing and Credits (9:42)=====

Jacob: Crash Course: Economics was made with the help of all these nice people. You can support Crash Course at Patreon, where you can help keep Crash Course free for everyone, forever. And you get great rewards! Thanks for watching. DFTBA!

[End Screen]