CHAPTER

4

The Global Economy

Reading for Meaning

Read the chapter title and write a paragraph describing what you know about the topic. After reading the chapter, summarize what you have learned.

- economic globalization
- international trade
- imports
- exports
- specialization
- comparative advantage
- economies of scale
- migrants
- multinational corporation
- outsourcing
- offshore outsourcing
- capital
- cartel
- exchange rate
- balance of payments
- trade deficit
- trade surplus
- free trade
- trade barrier
- European Union (EU)
- North American Free Trade Agreement (NAFTA)
- World Trade Organization (WTO)

CHAPTER OBJECTIVES

After studying this chapter, you will be able to

- **outline** advantages and disadvantages related to globalization.
- **explain** why countries specialize and how this leads to international trade.
- **analyze** the effect of multinational companies on the global economy.
- **describe** the relationship between currency strength and the balance of trade.
- **cite** examples to show how international trade affects the overall economy, businesses, workers, and consumers.
- **describe** what you can do to develop the skills needed to succeed in a global economy.

Central Ideas

- Globalization is the growing economic interconnectedness of people around the world.
- Globalization presents new opportunities and dilemmas.

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After silencing a Chinese-made alarm clock, an American consumer gets dressed in jeans made in Thailand and a T-shirt manufactured in Israel. Breakfast is cereal sprinkled with California raisins made from grapes picked by Mexican migrant farmworkers. Before leaving, the consumer brushes his teeth with toothpaste made in a Nigerian factory by employees of an American corporation. Once outside, he gets into a vehicle made in the U.S. by a Japanese automaker. He drives to work at a multinational corporation with offices in 30 countries.

Like this fictitious consumer, you live in a world that is becoming increasingly globalized. *Globalization* refers to the process of becoming worldwide in scope. **Economic globalization** is the flow of goods, services, labor, money, innovative ideas, and technology across borders. It is changing the way people communicate, shop, and conduct business.

In recent decades, globalization has intensified. You will need to keep up with this new global environment. Understanding it will help you to hold your own in the job market and in the marketplace.

Flow of Goods and Services

One of the major forces behind globalization is international trade, 4-1. **International trade** is the buying and selling of goods and services across national borders and among the people of different nations. It has been going on for thousands of years. Many of the earliest travelers were traders looking for natural resources, new products, and new markets for their goods. They created trade routes that crisscrossed continents and oceans.

Most trade today occurs between businesses in different nations. Government and individuals are not directly involved. However, governments do regulate and set the parameters for international trade. You will read more about government's role in trade later in the chapter.

4-1
Container and cargo ships carry traded goods between the U.S. and its trading partners.

Linking to... History

The Silk Road

One of the most famous trade routes was called the Silk Road, created around 100 BC. It was a network of roads that connected Europe, North Africa, and Asia. Caravans of traders exchanged gold, glass, perfumes, and other Western goods for the East's silk, ceramics, spices, and iron. People, plants, animals, ideas, knowledge, and culture also flowed back and forth.

International trade is discussed in terms of *imports* and *exports*. **Imports** refer to the goods and services that come into a country from other countries. The *importer* purchases these goods and services. **Exports** are the goods and services grown or made in a particular country and then sold in world markets. The *exporter* is the party who sells these goods or services.

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What Is Traded

For many people, the subject of trade conjures images of giant containers being loaded and unloaded from ships at American ports. This is the trade in products or goods. As you will recall from Chapter 1, goods are physical items—foodstuffs, furniture, toys, computers, car parts, and all other items on store shelves. More than half of the world's imports are intermediate goods that are used to produce other goods.

Trade in services, or work performed, makes up about 20 percent of world exports. These services are provided by businesses in industries including banking, transportation, insurance, law, telecommunications, and entertainment. This sector is rapidly increasing as more professional services in research, consulting, and information processing are needed.

Money also flows between nations. This includes investments. Foreign investors buy U.S. treasury bonds. U.S. companies pay their workers living in foreign countries. You will read more about this later in the chapter.

Law, Public Safety, Corrections & Security

Customs Inspectors

Customs inspectors enforce laws governing imports and exports. They inspect cargo, baggage, and articles worn or carried by people, vessels, vehicles, trains, and aircraft entering or leaving the United States.

Why Trades Occur

Two parties trade with each other because each expects to benefit from the transaction. One party receives a product or service and the other receives payment. You probably make dozens of trades a day. For example, if you go to a bakery and give the clerk some money, you receive a blueberry muffin in return.

Buying what you need is easier and more efficient than trying to make all the items yourself. The same is true for countries. No country can produce all the goods and services that its people and businesses want. However, it can provide a range of products and services. Then it can trade these for whatever it cannot produce. This is called **specialization**. The

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types of goods and services that countries specialize in depend on the following factors.

Natural Resources, Climate, and Geography

Climate, geography, and access to natural resources vary from one country to another. These factors determine in part what a particular country can and cannot produce.

For example, the tropical climate of Costa Rica makes it an ideal place to grow bananas. Thailand and Indonesia produce most of the world's rubber. Bolivia has the largest stores of the lithium used in batteries. The vast natural gas fields of Russia supply that country with more natural gas than it needs. Likewise, Saudi Arabia has vast reserves of oil. The climate and geography in parts of the U.S. make it well suited to grow much of the world's corn, wheat, and soybean crops, 4-2. Each country's excess can be exported.

On the other hand, climate, geography, and natural resources can limit what a country can produce. A tropical climate or a desert cannot produce the variety of foods that its people want. Even the U.S., a country with varied climate and geography, cannot grow enough coffee and cocoa to meet consumer demand. Whatever cannot be produced in sufficient quantities to meet demand must be imported.

4-2
The United States exports grain to countries with less plentiful corn, wheat, and soybean crops.

Available Human Resources

The quality of the labor force in a particular country determines what it can and cannot produce. For example, what is the literacy rate? Does a large share of the population have computer skills? How many colleges, universities, and specialized training programs are available?

Industries that require a highly skilled workforce would not take root in a country where most workers are uneducated and unskilled. In these countries, most jobs would be low paying, such as those in the garment-making industry and low-skilled factory work.

Other labor force factors include pay scales and cost of living. Shoes and clothing are examples of labor-intensive products that are made by workers in other countries. These workers generally earn less than U.S. workers who do the same jobs. For example, a worker in an Asian factory may make only $5 a day for a 14-hour workday.

To take advantage of lower labor costs, some companies move their manufacturing operations overseas. The products are then imported into the U.S. for sale.

Consumer Preferences

Some products are imported because they are specialties of particular countries or regions. These products can be made just as efficiently in the importing country. However, the foreign-made products offer style and performance qualities that consumers prefer. This has been the case in high-fashion clothing from European designers, high-performance automobiles from Japan and Germany, and a variety of electronic products primarily from Asia.

Comparative Advantage

If a nation could produce all the goods and services its citizens and businesses need, there are still advantages to trade with other nations. An economic concept called *comparative advantage* explains why. **Comparative advantage** is the benefit to the party that has the lower opportunity cost in pursuing a given course of action. The opportunity cost of a choice is the value of the best option or alternative given up.

The following example explains how this works. Suppose a doctor and a nurse staff a small medical office. The doctor sees 20 patients a day. Each appointment is billed at $100. The nurse is paid $250 per day to run the office.

The doctor is more efficient than the nurse at both treating patients and running the office. Can the doctor save money by firing the nurse and doing both jobs? Looking at opportunity costs provides an answer. Without a nurse, the doctor has less time to see patients. There would be five fewer patients seen. The doctor's fees, which total $2,000 at 20 patients, would be reduced by $500.

For the doctor, the opportunity cost of managing the office is $500. However, the nurse is paid half that amount. It makes financial sense for the doctor to treat more patients and hire a nurse to manage the office.

When individuals, businesses, or nations specialize in the activities for which their opportunity costs are lowest, everyone benefits. Countries tend to export what they produce most efficiently. They import the goods and services produced more efficiently in other countries. When nations trade with each other, consumers gain more choices and lower prices.

One of the reasons for comparative advantage is an economic concept called **economies of scale**. The cost of producing one unit of something declines as the number of units produced rises. The costs of production are spread over more units. If a business can sell more of a product by expanding into overseas markets, it can take advantage of economies of scale.

U.S. Trade

The U.S. is a dominant power in global economic markets. According to the U.S. Bureau of Economic Analysis and the U.S. Census Bureau, the U.S. exported an estimated $1.83 trillion worth of goods and services in 2008. During that same year, the U.S. imported $2.52 trillion worth of goods and services.

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With less than 5 percent of the world's population, the U.S. produces over 20 percent of the world's total output. In recent years, the people and businesses of the U.S. have sold between 10 and 12 percent of their total output in world markets.

The U.S. is the world's largest importer and a major market for more than 60 countries. Millions of people across the globe depend on the U.S. for their livelihoods. When the U.S. economy falters and consumers close their wallets, factories on the other side of the world shut down and workers lose their jobs.

The U.S. was once the world's largest exporter of manufactured goods. However, this is no longer true. According to the U.S. Census Bureau's Foreign Trade Division, the U.S. imported about $338 billion worth of goods from China in 2008. This is almost five times the worth of U.S. goods exported to China. This has created a trade imbalance that you will read more about in the following pages.

The U.S. imports more manufactured goods than it exports, 4-3. However, it exports more services than it imports, 4-4. The U.S. has a trade surplus in services and a trade deficit in goods. Top U.S. trading partners for both imports and exports are listed in 4-5.

U.S. Commerce

Category	Imports	Exports
Industrial Supplies	Crude oil	Organic chemicals
Consumer Goods	Automobiles, clothing, medicines, furniture, toys	Automobiles, medicines
Capital Goods	Computers, telecommunications equipment, motor vehicle parts, office machines, electric power machinery	Transistors, aircraft, motor vehicle parts, computers, telecommunications equipment
Agricultural Products	Cocoa, coffee, rubber	Soybeans, fruit, corn

4-3

The U.S. has a trade deficit for goods, meaning it imports more than it exports.

U.S. Service Exports

Financial services—investing and insurance services
Information services—computer consulting, data processing
Other services—architectural design, construction, engineering, legal, advertising, marketing, accounting, management, technical training, travel, tourism, entertainment, and transportation services

4-4

These are just a few examples of U.S. service exports.

A high percentage of what is consumed in the U.S. is produced in the U.S. However, products and services that cannot be provided in sufficient quantity or quality at the desired price are imported. Imports represent dollars flowing out of the country.

Top U.S. Trade Partners

Exports	Imports
Canada	Canada
Mexico	China
China	Mexico
Japan	Japan
Germany	Germany
United Kingdom	United Kingdom
Netherlands	Saudi Arabia
Korea	Venezuela
Brazil	Korea
Belgium	France

Source: Foreign Trade Division, U.S. Census Bureau

4-5

These are the top nations the United States trades with in the world market, ranked by 2008 U.S. total value of goods.

Flow of Labor

In addition to increasing the movement of goods and services between countries, globalization increases the flow of labor. People who move from one place or country to another are **migrants**. Today almost 1 in 40 people in the world are migrants. Some are refugees or asylum-seekers who flee their birth country because of persecution. They may be members of a minority ethnic or religious group who are denied basic rights by their government. Millions of people cross borders to escape war, economic crisis, and natural disasters. Some leave to escape rampant crime and corruption.

However, many are economic migrants seeking better opportunities to work and earn a living wage. The gap between wealth and poverty in countries is a major cause of migration, both legal and illegal. For example, a Mexican can earn on average nine times more working in the United States than working in Mexico.

The developed countries, such as the United States, are beacons for people seeking economic opportunities. More than 30 million people, or 11 percent of the U.S. population, were born in another country. Most recent migrants came from Latin America, Asia, and the Caribbean.

As American businesses open offices and factories in foreign countries, a growing number of Americans are becoming economic migrants. However, their numbers are much smaller than the number of migrants coming into the U.S.

Government & Public Administration

Consular Officers

Consular officers receive and review applications for nonimmigrant visas. They also provide a range of services to American citizens overseas.

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Impact of Multinationals

Much of globalization is driven by the growth of multinational corporations. A **multinational corporation** is a business that operates in more than one country. Some multinationals are so large that their assets are greater than the GDPs of entire countries. These large companies have greatly increased the amount of global trade.

Multinationals are created when several companies in different countries are combined. An example of a multinational corporation is Johnson & Johnson. With corporate headquarters in New Jersey, it is comprised of 250 subsidiary companies in 57 countries. A *subsidiary* is a business that is controlled by another business.

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American multinationals employ millions of people in their subsidiaries across the globe. Also, millions of Americans work for U.S.-based subsidiaries of multinational corporations headquartered elsewhere. For example, Japanese auto maker Toyota had 38,340 employees in North America in 2005. Before the economic downturn in 2008, Toyota had plans to build a $1.3 billion plant in Mississippi. Multinationals have altered world trade in important ways that are discussed in the following sections.

One Product, Many Origins

A product label that reads *Made in the U.S.A.* or *Made in China* only tells part of the story. Many of the world's largest companies operate across the borders of several countries. The parts and labor that go into the production of almost anything today come from many different countries.

Take a popular brand of a smart phone, for example. Researchers at the University of California in Irvine found 451 parts in a 2005 model. Each part was traced back to the supplier who made it and to the country where it was made. The hard drive was traced to an electronics manufacturer in Japan. This manufacturer used factory workers in China and the Philippines. Other parts were traced back to companies located in the U.S., Korea, and Taiwan.

Researchers found that the manufacture of smart phones created 41,000 jobs around the world. About 14,000 of these were in the U.S., consisting of marketing, design, engineering, and retail sales jobs. The 27,000 overseas jobs were mostly low-paid manufacturing jobs.

Outsourcing occurs when companies move sections of their business to other companies or to their own subsidiaries. **Offshore outsourcing** refers to moving sections of a business to another country. It usually occurs because a business wants to take advantage of lower labor costs, productive resources, and other benefits in other locations, 4-6. When an American company moves a piece of its operations to another country, it creates jobs in that country. Often those jobs offer better opportunities than the workers previously had.

4-6
Labor-intensive industries, such as the textile industry, have moved to Africa and Asia where the cost of labor is cheaper.

While outsourcing can offer companies substantial cost savings and greater productivity, it can result in job losses for workers at home. These newly unemployed workers may be forced to take lower-level jobs with less pay and fewer benefits or to relocate themselves. Retraining and upgrading skills often are necessary to find new jobs. This is one painful reality of globalization.

Case Study: The World Economy

Profit Squeeze

Walter owns a small business in Illinois. In recent years the cost of running his business has increased across the board. The cost of doing business threatens to reduce profits to the point that it is not worth Walter's time, effort, and investment to keep his business going.

Walter has two options. He can either increase his prices or he can decrease his production costs. Nothing about Walter's business requires him to be located in Illinois. Cost savings is the chief advantage of moving all or part of a business to a country with low-cost labor and a favorable tax structure. In addition, there would be far less government interference and oversight.

Unfortunately, if Walter decides to do this, his 70 employees will be left jobless. Relocating them would be impossible.

Case Review

1. Do you think Walter is justified in moving his business to another country? What other alternatives might he have?
2. If Walter decides to move the business, what do you think he should do about the employees he must let go? Has he a responsibility to them?
3. What do you think could be done in the United States to encourage businesses to stay in the country? How does the economy suffer when businesses leave?

Flows of Capital Investment

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The growth in multinational corporations has increased the flows of capital, money, and investments around the world. **Capital** is money used to generate income or to invest in a business or asset. Many economists believe that this flow, rather than the flow of goods and services, is the most powerful force driving globalization today.

Money flows from one country to another when a parent company builds a factory overseas or lends money to a foreign subsidiary for expansion. One-third of global trade today is the movement of raw materials, goods, services, and product parts from one subsidiary of a multinational to another.

Another type of international investment occurs when investors buy or sell the stocks and bonds of foreign companies. Investors include individuals, businesses, and groups of people who pool their money in pension and

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mutual funds. These funds are then used for international investments. You will read about stocks, bonds, and mutual funds in Chapter 12.

Collusion and Cartels

Many multinational corporations have achieved worldwide dominance in their industries. For example, some large agribusiness companies control the world market for seeds and other agricultural products. The enormous wealth and power of some corporations gives them significant influence over governments and global trade policies.

Chapter 2 covered several forms of market control. Monopoly occurs when one firm controls the entire market for a particular good or service. An oligopoly exists when a few large companies control an industry and set prices.

A **cartel** is a group of countries or firms that control the production and pricing of a product or service. It has the same economic effect as a monopoly. An example of a cartel is the Organization of Petroleum Exporting Countries, or OPEC. OPEC nations collude to set prices for oil by controlling the supply. Their decisions determine market prices and, ultimately, the amount you pay for fuel to run your car and heat your home.

International Monetary System

When people in the same country buy and sell goods to one another, they use the same currency. In the U.S., that is the dollar. However, when buyers and sellers are in countries that use different currencies, they must first figure the value of one currency in relation to the other. This involves the *foreign exchange market*, or *foreign currency market*.

The Foreign Exchange Market

Different types of currency are bought and sold on the foreign exchange market. A currency, like a product, has a price. The **exchange rate** is the value of one currency compared to another. The exchange rate tells you how much you must pay in dollars to buy a unit of foreign currency.

Exchange rates are constantly changing. Buyers and sellers in the foreign exchange market generally set currency values. The currencies of countries that are politically and economically stable are more desirable to investors. The more desirable a currency is, the greater the demand for it.

Also, the value of a nation's currency can be affected by changes in interest rates. The higher an interest rate, the greater is the return on an investment. Higher interest rates draw foreign investors and this increases the demand for a currency.

Buying and Selling U.S. Dollars

The foreign exchange market affects your life every day. It determines how much you pay for the goods and services you rely on. However, most people only learn of the foreign exchange market when they travel to another country, 4-7. The foreign exchange rates are available on the pages or Web sites of business publications.

For example, someone who is going to Canada may need to exchange American dollars for Canadian money. If the exchange rate is $1.10 Canadian for each U.S. dollar, a traveler should get $110 Canadian for each $100 U.S., minus fees. You can exchange money at banks, airports, and currency exchanges. Airports usually charge the highest fees. A number of online currency conversion calculators are available, including the Universal Currency Converter at www.xe.com.

Businesses must also use the foreign exchange market when conducting business in other countries. For example, suppose a business located in China wants to buy road-building equipment from a U.S. company in Peoria, Illinois. The equipment costs $500,000. To make the purchase, the Chinese need to convert their currency, the Yuan Renminbi (RMB), into USD, or U.S. dollars. How much Chinese currency do they need to convert?

Suppose that the foreign exchange rate on the day of purchase is:

1 USD (U.S. dollar) = 6.835 RMB (Chinese currency).
500,000 USD = 3,417,500 RMB. They may need a little extra to cover fees.

However, when U.S. businesses buy Chinese products, they do not have to convert dollars into Chinese currency. This is because many countries, including China, accept the USD because of its stability relative to other currencies. The USD is the *international reserve currency*.

4-7
American tourists and business travelers get more for their money when the U.S. dollar is strong.

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Trade and Exchange Rates

The value of a nation's currency, including the USD, goes up and down with the demand for it in other countries or in world markets. At times, the value of U.S. dollars is high, or strong.

When the dollar is strong,

- goods and services imported into the U.S. cost less. This raises demand for imports. When the value of the dollar is high compared with the currency you are buying, you get more for your money. Your dollars go further when you travel in that country.
- foreign buyers must pay more for exports from the U.S., so they buy less. When the dollar is strong, foreign investors must pay more for U.S. companies, real estate, and stock, so they tend to invest less.

Case Study: The World Economy

Talia Makes a Switch

Talia is a freshman in college. She wants to work on immigration issues after graduation. The ability to speak Spanish would be an advantage in her chosen field. She wants to apply for a study abroad program in Spain so she can become fluent in the language.

Unfortunately, the cost of the program increased and the value of the U.S. dollar dropped. The airfare also increased more than 30 percent because fuel prices have risen. It looks like a semester in Spain is no longer an option.

Though she is disappointed, Talia is still determined. She is considering several options including a summer program rather than a full semester. She could also choose a semester in a South American country where the dollar goes further and the airfare would be lower.

Case Review

1. Which alternative would you choose if you were Talia? What are the pros and cons of study abroad programs? Would one of these opportunities interest you?
2. Why does the falling value of the dollar increase the cost of going to other countries?
3. How does the value of the dollar affect prices at home such as gasoline, imported products, travel, and food?
4. Why does a devalued dollar attract foreign visitors to America? How does it affect students from abroad studying in the U.S.?

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When the dollar is weak,

- goods and services imported into the U.S. cost more. This reduces demand for imports. Traveling in other countries costs more because dollars buy less.
- foreign buyers pay less for exports from the U.S., so they buy more. Foreign citizens, businesses, and governments get more for their money when they invest in the U.S. They tend to invest more.

Exchange rates change daily. They are published regularly and can be found in travel sections as well as the financial pages of most major newspapers.

The U.S. Trade Deficit

To understand international trade, you need to know the meaning of *balance of trade*. This is the difference between total imports and total exports of goods and services. These numbers are recorded in the **balance of payments**. This is an account of the total flow of goods, services, and money coming into and going out of the country. When a country buys, or imports, more products than it sells, a **trade deficit** develops. The country has an *unfavorable balance of trade*. If it sells, or exports, more than it buys, the country has a **trade surplus**. The country then has a *favorable balance of trade*.

The United States has run a substantial trade deficit since 1976. It imports more goods and services than it exports, 4-8. Currently the U.S. runs the largest deficit and China runs the largest surplus among worldwide trading nations.

The deficit makes it possible for China and other nations to accumulate more U.S. dollars. With accumulated dollars, these nations can buy more U.S. goods, services, and assets such as real estate, securities, and businesses.

The U.S. actually needs more foreign investors to buy treasury bills, corporate securities, and real estate to help pay off the growing national debt. However, many economists feel that, in the long run, this is not a healthy situation. They feel that trade deficits and budget deficits coupled with the growing national debt weaken the U.S. economy and its leadership position in the world.

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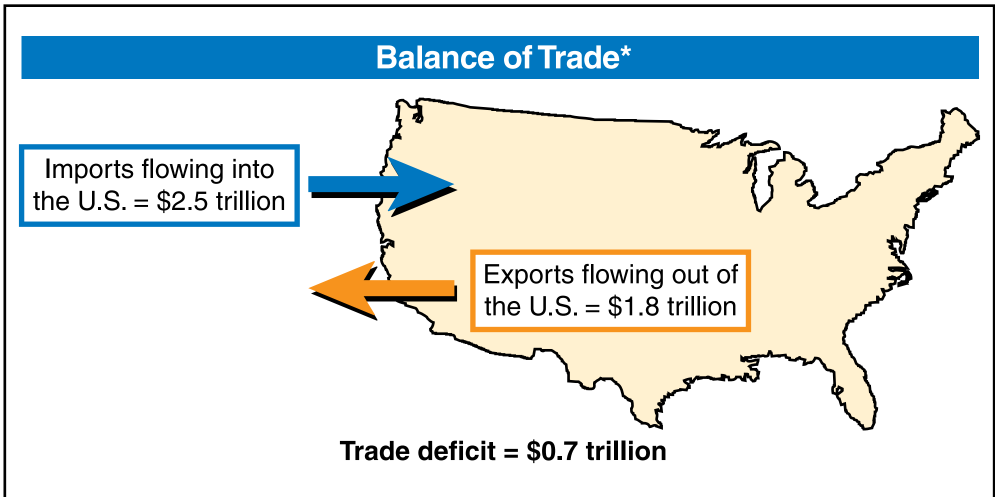
Government's Role in Global Trade

Governments regulate trade. Government trade policies are often described as *free trade* or *protectionism*. **Free trade** is a policy of limited government trade restrictions. Individuals and businesses are generally



* 2008 figures from the U.S. Dept. of Commerce, Census Bureau, Foreign Trade Division

4-8
The flow of money out of the U.S. to pay for imports exceeds the flow of money into the country to pay for exports. This is the trade deficit.

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free to buy and sell goods and services from people and businesses in other countries. Governments generally favor free trade that opens markets for the goods and services they export. Imports may be restricted. Trade restrictions are often called *protectionism*. It is designed to protect businesses at home from foreign competition.

Why Nations Favor Free Trade

Theoretically, trade among nations benefits all the trading nations. Therefore, everyone benefits when tariffs and other impediments to trade are kept to a minimum. Some of the arguments for free trade have been discussed earlier in this chapter. In summary, free trade is beneficial because it

- stimulates growth and raises productivity and living standards in the countries that open their economies to world markets.
- allows countries to specialize in those goods and services they produce most efficiently and trade for those that they produce less efficiently, 4-9. This is the comparative advantage argument.
- produces a greater variety of goods and services at lower prices as a result of worldwide competition and innovation. Consumers enjoy a greater selection of goods and services at lower prices.
- generates more innovation and product improvements as a result of competition and the international exchange of ideas and technologies.
- creates new investment opportunities stemming from capital flows across international borders.
- promotes cooperation and peaceful relations among nations who become trading partners. When a country needs and wants goods and services produced in other nations, there is a strong incentive to maintain relations.

4-9
Some countries produce and export automobiles, which increases competition.

Why Nations Favor Restricted Trade

Nations, including the U.S., restrict trade for various reasons.

- ***To protect domestic industries.*** Governments often seek to protect home-based industries from foreign competition.

- ***To protect the jobs of workers.*** Labor, capital, and materials often cost less in other countries compared with the U.S. Foreign companies can offer their goods at lower prices. If these goods are allowed into the U.S. marketplace, U.S. companies making similar goods could not compete. This could drive them out of business and lead to job losses.
- ***To reduce dependence on single sources of necessary items.*** For example, the U.S. depends on OPEC sources of oil. These oil-producing countries can cut the supply of oil or raise prices, causing serious problems in the U.S.
- ***To control the distribution of products or technology that can threaten national security.*** For example, the export of technological know-how and materials that could be used to build weapons to attack the U.S. are restricted.
- ***To address unfair trade practices.*** For example, importers may engage in *dumping*. This refers to the sale of imported products at lower prices than those charged in the domestic market for similar products. Once the imported products dominate the market and drive the domestic producers out of business, the importer raises the price. The government of the importing country may tax these imports to raise their prices so domestic companies can better compete.

Critics of free trade have other arguments. In the U.S., they claim that free trade increases the U.S. trade deficit in world markets as the U.S. continues to import more than it exports. Others say it benefits larger companies and developed nations at the expense of smaller businesses and emerging nations. They claim it also threatens cultural identity and individuality as large international corporations replace smaller, less competitive local businesses.

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How Governments Restrict Trade

The government can limit opportunities for foreign companies to sell their products or services on an equal footing with domestic companies. *Protectionism* refers to government policies that restrict trade. Protectionist policies can backfire as other countries retaliate by imposing their own trade barriers.

Trade Barriers

Government policies can discourage imports through *trade barriers*. A **trade barrier** is any action taken to control or limit imports. There are several types of trade barriers.

- A *tariff* is a tax on imports that makes them more expensive to consumers. It is intended to make U.S. products more cost competitive with imports.
- An *import quota* is a limitation on the number or quantity of imports allowed into the country.

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- A *non-tariff barrier* is a type of regulation, such as environmental quality regulations or a U.S. safety requirement.
- An *embargo* is a law used by a government to prohibit trade with a particular country for political reasons.

Subsidies

Subsidies, which were discussed in Chapter 2, are another form of protectionism. A *subsidy* is a payment, tax break, or other incentive paid by government to a local business or industry. Subsidies allow businesses to offer their goods for sale at lower prices. This enables the goods to compete successfully with foreign products. Subsidies are often attacked for creating an unfair advantage for the business receiving the incentive.

For example, suppose an electronic company in another country receives subsidies from its government. The company ships its products to the U.S. Since the company receives subsidies, it can charge less for its products than a U.S. company making similar products. The U.S. company cannot afford to meet the low selling price. Eventually, the majority of customers buy the cheaper import and the U.S. company goes out of business.

Currency Manipulation

Currency manipulation refers to action taken, usually by a government or central bank, to increase or decrease the value of a specific currency. The value of the U.S. dollar is determined by the forces of supply and demand in the foreign currency exchange markets. This is true of most other currencies as well. When a nation sets the value of its currency without regard for the market, it is said to be "manipulating its currency."

If a nation artificially lowers the value of its currency, it can gain competitive trade advantages. The International Monetary Fund prohibits currency manipulation for the purpose of gaining unfair trade advantages. When a nation's currency is weak, its exports become cheaper in world markets. Its imports, however, become more expensive. As a result, the country tends to increase its exports and decrease its imports. This creates a trade surplus. A weak currency also invites more foreign investment into the country. This often translates into new factories, new jobs, and more products for export.

For trading partners, the consequences include trade deficits and unfair competition in domestic markets. For example, in recent years China has kept its currency artificially low, 4-10. This allows China to sell its products in the U.S. at lower prices than similar products manufactured in this country. In some industries, this unfair advantage can drive firms out of business. American workers lose their jobs. In addition, the U.S. trade deficit with China continues to grow and China's trade surplus with the U.S. increases. These low-priced imports are a short-term advantage for U.S. consumers, but it is not a healthy situation for the U.S. economy long-term.

Trade Organizations and Agreements

4-10

The currency of the People's Republic of China is the Yuan RMB.

The United States has existing trade agreements and partnerships with a number of other individual nations and regions of the world. The goal of these agreements is to create economic benefits and opportunities for all participating nations as a result of free trade and investment across their borders. Figure 4-11 lists some of the many trade organizations in the world today.

The **European Union (EU)** is the largest trade sector in the world, surpassing any individual country. As of 2008, the EU had the largest GDP. According to the World Trade Organization, it was the largest importer and exporter of goods and services. Also as of 2008, 27 nations belonged to the EU. Fifteen of these countries share a common currency called the *euro*.

North American Free Trade Agreement (NAFTA) between the U.S., Canada, and Mexico lowered trade barriers and opened markets among the three countries. Canada and Mexico are top trading partners of the U.S. and trade has increased dramatically among the three nations.

Trade Organizations

Abbreviation	Organization	Country Members
ASEAN	Association of South East Asian Nations	Brunei Darussalam, Burma (Myanmar), Cambodia, Indonesia, Laos, Malaysia, Philippines, Singapore, Thailand, Vietnam
CAFTA-DR	Central America-Dominican Republic Free Trade Agreement	Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua
EU-27	European Union-27	Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden, United Kingdom
NAFTA	North American Free Trade Agreement	U.S., Canada, Mexico
OPEC	Organization of the Petroleum Exporting Countries	Algeria, Angola, Ecuador, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, United Arab Emirates, Venezuela
SADC	South African Development Community	Angola, Botswana, Democratic Republic of Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia, Zimbabwe

Source: International Trade Administration, U.S. Dept. of Commerce.

4-11

These are some of the many trade organizations around the world.

REAL LIFE CONNECTIONS

The "Anti-Globalization" Movement

Some people and groups do not view international trade agreements and groups positively. The label *anti-globalization* describes individuals and groups who oppose globalization. These include labor, environmental, and human rights groups all over the world.

Many of these groups say that they are not against globalization. They object to a type of globalization driven by the needs of wealthy countries and multinational corporations. They charge that trade agreements and global economic institutions put profits above the well-being and livelihood of people. For example, critics of NAFTA say it hurts small farmers, especially in Mexico. Lowered trade barriers opened the Mexican market to U.S. agribusiness. Unable to compete with cheap imports, many Mexican farmers lost their livelihoods and became migrants.

The basic goal of many groups in the anti-globalization movement is to promote social justice and human rights. They especially work for the elimination of inequities between the poor and the rich around the world.

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World Trade Organization

Most governments believe that fair and open trade among nations benefits all. Governments, even friendly allies, constantly negotiate trade terms with one another. Disputes often involve access to markets. Trade disputes arise over certain policies and practices that create unfair competition, in the view of at least one country.

Issues of protectionism and unfair trade are controversial and complicated. They often involve more than economic considerations. Trade restrictions, or trade sanctions, are political weapons that can be used against the economies and governments of other countries.

The General Agreement on Tariffs and Trade (GATT) was formed after World War II by the Allied nations to aid post-war recovery. This is a set of international agreements that promote free and fair trade among nations. GATT agreements attempted to reduce the use of tariffs, quotas, and other trade restrictions.

In 1995, the **World Trade Organization (WTO)** was created to expand the work of the GATT. The WTO is an international organization that mediates trade disputes among 151 member nations and establishes trade practices that are acceptable and fair to all nations. WTO agreements are signed by practically every trading nation in the world. Besides trade in goods, the WTO is also involved in the regulation of trade in services, inventions, and intellectual property.

Other Important Global Organizations

Besides the WTO, many of the world's nations have come together in other organizations and forums to achieve mutual goals. These goals include the establishment of world peace, elimination of hunger, poverty, and disease, and sustainable growth and development. Many of the groups, which often work together, directly or indirectly influence trade and global economics.

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World Bank

The World Bank has a membership of 186 countries. Its primary mission is to fund specific projects that promote economic development, reduce poverty, and raise living standards. To this end, the Bank provides financial and technical assistance to developing countries. Financial assistance consists of grants and low- or no-interest loans. For more information, check out its Web site at www.wto.org.

International Monetary Fund (IMF)

The primary mission of the International Monetary Fund is to oversee the international monetary system. It works to stabilize exchange rates and eliminate trade barriers. Its 184 member countries are advised on how to better manage their economies. The IMF also helps member nations head off and resolve economic crises.

Like the World Bank it provides loans and technical assistance to countries. However, unlike the World Bank, these monies are not intended to fund specific projects, but to stabilize the overall economy of the country and promote growth. The IMF Center is located in Washington D.C. Its Web site is www.imf.org.

G20

The Group of Twenty Finance Ministers and Central Bank Govenors (G20) is a forum for 19 countries plus the European Union. Besides the United States, the G20 countries are Great Britain, Japan, Italy, France, Russia, Canada, Germany, Australia, Argentina, Brazil, China, India, Indonesia, Mexico, Saudi Arabia, South Africa, South Korea, and Turkey. The heads of state of G20 countries meet annually to discuss issues ranging from health and the environment to trade and terrorism. The leadership role rotates among the member countries.

United Nations (UN)

The United Nations, headquartered in New York City, is an international organization of 192 member countries, 4-12. When it was created after WWII, its primary purpose was to maintain peace and security in the world. The UN is known as the entity that provides humanitarian assistance in areas ravaged by war and natural disasters. It is a forum where member countries can condemn political aggression and human rights violations. Its programs promote better living standards for people around the world. For more information about the UN, go to www.un.org.

4-12
The United Nations headquarters is located in New York City.

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Globalization and You, the Student

Globalization presents advantages and disadvantages, hopes and fears, pros and cons. It dramatically affects economic conditions and trade in every nation. Both consumers and producers operate in world markets. This is why it is important to understand the role of globalization in your economic life.

For example you are already buying goods and services from other countries. As a worker, the goods or service your company produces will likely be sold in other countries. You may work for a multinational corporation at some point in your life. Your managers and coworkers may be foreign-born. You will be competing for jobs with workers around the world.

As a Worker

Globalization affects you as a worker because it influences demand for both goods and services. This, in turn, influences job creation and opportunities. Increased exports mean growth, and growth means jobs.

For example, when an American company gains access to foreign markets and competes successfully in the sale of its products and services, the company will grow and expand. It will need more workers. There will be more jobs. This also is true when foreign companies open plants or offices in the United States. This creates new jobs in the U.S.

As a worker, you may be unfavorably affected if you work in areas that are subject to foreign competition. Foreign competition may also lead to a loss of jobs for U.S. workers in certain sectors. When U.S. companies must compete with popular imports, as happened with the auto market in recent years, U.S. workers may lose their jobs. In some industries there also may be layoffs and shifts in employment as a result of offshore outsourcing.

Jobs commonly outsourced are those in the manufacturing industries. However, service and professional jobs, especially those in information technology, are also being outsourced. For example, when you call a computer company's service department, the person who answers is often a half a world away. Accountants living in another country can prepare taxes. X-rays and other test results can be read and interpreted by non-American medical professionals.

Interpreters

Interpreters translate or interpret written or oral communication into another language. They need to be sensitive to the cultures associated with the languages they translate.

What You Can Do

You need to be prepared for employment in a global market and for the changing cultural and political landscape that lies ahead of you. Here are a few ideas.

- **Continue your education.** Completing high school and getting postsecondary education and training are more important than ever. With offshore outsourcing and the Internet, competition for jobs is global. Jobs for the uneducated and unskilled are moving to places where workers are paid a small percentage of a U.S. worker's salary.

The more education and professional and technical skills you develop, the more opportunities and security you will gain.

- **Consider science- and math-related occupations.** The U.S. currently imports workers to fill many jobs that require science and math backgrounds. There is a great need for workers who have solid foundations in these subject areas, 4-13.
- **Keep your skills sharp.** After you enter the work world, keep the door to education open. Stay informed about trends in your field. Take advantage of retraining and educational opportunities on and off the job. Go back to school to learn new skills.
- **Learn a foreign language.** Fluency in almost any foreign language will become a key asset in the work world. Those who become proficient in Chinese (Mandarin) and other Asian languages, Russian, or Arabic will open doors to job opportunities around the world.
- **Learn about world affairs.** Regularly read newspapers, magazines, and Web sites that report extensively on international affairs and foreign policy issues. Seek out books about areas of the world that interest you. Tune in to radio and television programs broadcast from other countries.
- **Travel or live abroad.** Enroll in a student exchange program. Spend a summer working, studying, or doing volunteer work abroad. Visit relatives and friends who live in other countries. Learn about other cultures while having the adventure of your life. As the world grows more interconnected, global issues will become more important to everyone.

4-13

Workers who have education and training in science and technology fields will have better job opportunities in the future.

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The citizens of every nation will become in a sense citizens of the world. Common interests will include policies governing the use and sharing of resources, environmental concerns, and controlling terrorism. Other issues include broad access to necessary medicines and health care services, alleviating poverty, and educating citizens for life in a global society.

As the globe grows smaller, the United States will have to decide whether it will become more involved with other nations in a variety of areas. Nations will need to cooperate with one another in addressing issues such as the environment, poverty, terrorism, AIDS, and disaster recovery. Peace keeping in areas of conflict will continue to call for international cooperation.

The future is likely to hold both more cooperation and more competition in global markets. There will need to be international agreements on the use of world resources. You will also likely see a continued increase in the exchange of ideas and developments in the fields of science and technology.

Chapter Summary

Economic globalization is the increasing economic interconnectedness among governments, businesses, and citizens of the world. Goods and services, money, labor, technology, and ideas all move rapidly across national borders. International trade plays an essential role in economic systems. It influences supply and demand, prices, competition, consumer choice, and government policies. It affects job opportunities and living standards.

As nations trade with each other, they export those goods and services they can produce efficiently and in abundance. They import goods and services they cannot produce efficiently or in adequate quantities to meet the nation's needs.

The exchange rate refers to the value of one nation's currency compared to another. The value of a currency goes up and down with the demand for it in world markets. The strength of a nation's currency affects its trading position in the world.

The balance of payments refers to the difference between a country's total imports and exports. When a nation imports more than it exports, it develops a trade deficit. If exports are greater than imports, a surplus develops. When a domestic industry cannot compete successfully with imports, there is a tendency to protect the domestic industry with some form of trade restraint. The goal of world trade organizations and agreements is to promote fair trade among nations for the benefit of all.

Review

1. What is economic globalization?
2. What is the role of specialization in trade between nations?
3. How does comparative advantage affect trade with other nations?
4. What are migrants and what role do they play in globalization?
5. What is the role of multinational corporations in globalization?
6. What is the difference between outsourcing and offshore outsourcing?
7. Why does the value of the dollar go up and down in relation to other currencies?
8. Explain the difference between a trade deficit and a trade surplus.
9. List two advantages and two disadvantages of free trade.
10. What is protectionism? What forms can it take?
11. List three ways international trade affects you.

Critical Thinking

12. How does the current value of the dollar affect U.S. trade with other nations?
13. Discuss the current U.S. account deficit and its consequences. What steps can the country take to reduce this deficit?

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14. What are some of the immediate advantages and disadvantages of free trade?
15. If you were to lose your job to offshore outsourcing, what steps would you take to find a new job and recover financially? What do you think your employer and the government could and should do to assist you?
16. Outline what young people can do today to prepare for working in a global economy and to protect themselves against future job dislocations. What can you do personally?

Academic Connections

17. **Social studies, speech.** Trace the history of trade agreements over the past 50 years and present an oral report on your findings.
18. **Research, writing.** Write a paper on the European Union's origin and goals. Also discuss the EU's position in world trade. Include problems the EU nations experienced in converting to a single currency, and the advantages it has created in trade with other nations and in tourism.
19. **Social studies, research, writing.** List at least three trade agreements of the U.S. with other nations. Research and discuss the pros and cons of these agreements.

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20. **Speech.** Debate international trade, with teams taking sides for and against open markets. Discuss some of the problems and disputes that have arisen among nations over trade policies.

Math Challenge

21. You want to buy two books published only in the U.K. The cost of the books is £17.98. The current exchange rate is $1 = £0.60797.
    A. What is the cost of the books in U.S. dollars? (Round up to the nearest cent.)
    B. Shipping from the U.K. is £9.97. What is the total cost of your purchase including shipping in U.S. dollars?

Tech Smart

22. Research current exchange rates for various currencies against the U.S. dollar. Include the British pound, Japanese yen, Indian rupee, Canadian dollar, Mexican peso, Chinese yuan, and the euro.
23. Using the Internet, look up and compare the U.S. economy with that of three other nations. Compare the following factors: type of government, gross domestic product (GDP), income per capita, literacy rate, significant natural resources, growth and inflation rates, annual exports and imports, and cost of living.

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