

Chapter 1

THE INTERNATIONAL ECONOMY AND GLOBALIZATION

CHAPTER OVERVIEW

This chapter introduces students to the international economy and to globalization. The first part of the chapter emphasizes the high degree of economic interdependence that characterizes today's economies. Economic interdependence includes international trade and international finance.

The chapter also focuses on the United States as an open economy. Data is provided that shows U.S. exports as a percent of gross domestic product and the value of U.S. trade with its major trading partners. The chapter notes that many U.S. firms source a portion of the production of their goods in foreign countries, and that goods from all over the world are available in our local stores.

The chapter discusses the nature of international competitiveness--for firms, industries, and nations. It is noted that exposure to global competition tends to improve the efficiency of firms.

A new section discusses the ongoing debate about whether free trade should apply to cigarettes. Free trade normally increases consumption of a product, but where cigarettes are concerned, is this a good thing? Do countries have the right to ban products they deem unhealthy?

This chapter discusses the potential effects that international trade has on workers, and concludes with a look at the backlash against globalization that has emerged in recent years. The advantages and disadvantages of globalization are summarized.

After completing the chapter, students should be able to:

- Define economic interdependence.
- Discuss the importance of international trade for the U.S. economy.
- Examine the factors that make a company *American*.
- Discuss the nature of competitiveness and how it applies to firms, industries, and nations.
- Identify the advantages and disadvantages of globalization to workers and others.

BRIEF ANSWERS TO STUDY QUESTIONS

1. Interdependence among today's economies reflects the historical evolution of the world's economic and political order. Since World War II, Europe and Japan have reindustrialized. What is more, the formation of the European Community and the Organization of Petroleum Exporting Countries, as well as the rise of multinational corporations, has contributed to closer economic and political linkages.
2. Proponents of an open trading system maintain that free trade leads to lower prices, the development of more efficient production methods, and a greater range of consumption choices. Free trade permits resources to move from their lowest productivity to their highest productivity. Critics of an open trading system maintain that import competition may displace domestic firms and workers. It is also argued that during periods of national emergency, it is in the best interests of a nation to protect strategic industries.
3. For the United States, growing economic interdependence has resulted in exports and imports increasing as a share of national output. Profits of domestic firms and wages of domestic workers are increasingly being affected by foreign competition.
4. The volume of international trade is governed by factors including the level of domestic economic activity (e.g., prosperity versus recession) and restrictions imposed by countries on their imports.
5. The chapter describes three fallacies of international trade:
 - a. Trade is a zero sum activity
 - b. Imports reduce employment and burden the economy
 - c. Tariffs and quotas will save jobs and promote a higher level of employment
6. International competitiveness refers to the extent to which the goods of a firm or industry can compete in the marketplace; this competitiveness depends on the relative prices and qualities of products. No nation can be competitive in, and thus be a net exporter of everything. Because a nation's stock of resources is limited, the ideal is for these resources to be used in their most productive manner. Nations will benefit from specialization and trade by exporting products having a comparative advantage.
7. Researchers have found that global competitiveness is a bit like sports. You get better by playing against folks who are better than you. This means companies are exposed to intense global competition tend to be more productive than those who aren't.
8. International trade benefits most workers, especially those in exporting industries. In addition to providing them jobs and income, it allows them to shop for consumption goods that are cheapest and of the highest quality. However, workers in import-competing industries often feel threatened from competition of cheap foreign labor.
9. Among the challenges confronting the international trading system are maintaining fair standards for labor and promoting environmental quality.
10. The threat of international terrorism tends to slow the degree of globalization and also make it become costlier. With terrorism, companies must pay more to insure and provide security for overseas staff and property. Heightened border inspections could slow shipments of cargo, forcing companies to stock more inventory. Tighter immigration policies could reduce the liberal inflows of skilled and blue-collar laborers that permitted companies to expand while keeping wages in check. Moreover, a greater preoccupation with political risk has companies greatly narrowing their horizons when making new investments.