

Objectives for Chapter 26: International Economic Relations: 1970 to 2000: Globalization

At the end of Chapter 26, you will be able to answer the following questions:

1. What is meant by “**globalization**”?
2. What are the manifestations of “globalization”?
3. What is meant by “**openness**”? How is it measured?
4. Briefly describe the growing importance of international trade to the United States since 1970.
5. According to international trade theory, what products would you expect the United States to export? What products would you expect the United States to import? How does your expectation compare to the actual data?
6. According to international trade theory, what countries would you expect the United States to export the most to? What countries would you expect the United States to import from? How does your expectation compare to the actual data?
7. Very briefly describe why most economists favor free international trade. (For this answer, you might see Chapter 28 of the Microeconomics text on my web page).
8. Who are the “losers” from a policy of free trade? Explain why they are “losers”.
9. What is a **Free Trade Area**? What is a **Customs Union**? What is a **Common Market**? What is an **Economic Union**?
10. Briefly describe the events leading to the integration of the European economies from the 1950s until today.
11. Briefly describe the **European Monetary System**.
12. Briefly describe the Single European Act.
13. What is a **monetary union**? What is the **Euro**? What were the benefits and the costs of joining the European Monetary Union?
14. What have been the causes of the American trade deficits of the past twenty years?
15. What are the arguments concerning the effects of having trade deficits?
16. What is meant by “**foreign direct investment**”? What is a “**parent company**”? What is a “**subsidiary company**”?
17. Name some suggested **reasons** to explain why foreign direct investment takes place.
18. What are the effects of foreign direct investment on the country of the investing country? What are the effects of foreign direct investment on the host country?
19. What are the arguments that globalization is **good** for the countries involved?
20. What are the arguments that globalization is **bad** for some of the countries involved?

Chapter 26: International Economic Relations of 1970 to 2000: The New Global Economy

Globalization in Perspective

Over the past 30 years, the world has experienced significant integration between the economies different countries. Today, the economies of the world are linked together through financial relationships and trade relationships as never before. This integration has especially affected the United States, whose economy was quite isolated from the other economies of the world at the beginning of the 1970s. But in fact, this economic integration is the continuation of a trend from long ago. From the mid-1800s until World War I (1914), the economies of the world (or at least of Europe and its colonies, the United States, and Japan) became more highly integrated. People 100 years ago were facing the same forces, and fearing the same fears, as people today. This trend toward integration began to reverse with World War I. But world economic integration --- commonly called **“globalization”** --- began again in earnest again in the 1970s and has continued to this day. The economies of the world are more integrated today than they were in the 19th century. This globalization has been very controversial, even sparking “riots” in Seattle in 1999. But the trend seems unstoppable. Let us examine here the manifestations of this globalization that will be considered in this chapter.

One important manifestation of globalization is the increase in the importance of international trade. For the world as a whole, trade is twelve times the amount it was at the end of World War II (1945) while production is only six times the amount it was then. The most common measure of the role of international trade is called **“openness”**.

Openness is calculated by adding up the total of exports plus imports and then dividing by the Gross Domestic Product (GDP). In 1890, this number was 15.8 for the United States. It then declined to 10.9 by 1930 and to 9.1 by 1950. After 1950, openness in the United States began to rise, reaching 12.5 by 1970 and then doubling to 25.4 by 1990. By one estimate, some 70% of American manufacturing companies now face significant competition from companies in other countries.

Another important manifestation of globalization is the increase in the movement of capital. In this case, “capital” refers to both money and to capital goods. In 1995, it was estimated that the value of transactions in the foreign exchange markets totaled \$1.2 trillion every day (and is perhaps \$1.5 trillion per day today). Stock markets have become global. Companies borrow from financial institutions in other countries on a regular basis and with few restrictions. Governments borrow from other countries or from international agencies. As we saw in Chapter 7, this borrowing is called **“portfolio investment”**. The borrowing from international agencies, especially by developing countries, often requires significant changes in policy by the borrowing country --- bringing into question national sovereignty. And **foreign direct investment (the owning**

and controlling of companies in other countries) has also become much more extensive and less restricted. American companies produce all over the world just as companies from many countries are producing in the United States.

A third manifestation of globalization is increase in labor migration. Migration of people from one country to another in search of higher wages is not new at all. In fact, a higher percent of the American population was foreign born 100 years ago than is true today. Yet immigration into the United States, especially from Mexico, Central America, and Asia increased greatly after 1970. Immigration is also significant for some of the European countries. Policies related to immigration have been a source of considerable controversy. We will not consider labor migration in this chapter. (See my Microeconomics, Chapter 26)

And a final manifestation of globalization is the increase in regional integration. This includes the North American Free Trade Agreement (NAFTA) and the possibility of a Free Trade Area of the Americas (FTAA). It includes the integration of the formerly socialist countries into the world economy. And most especially, it includes the integration of Western European countries into the European Union.

Globalization has involved the spread of the ideas of free market capitalism around the world. Indeed, to participate in the global economy, countries must adopt the principles of free market capitalism. Countries may choose not to participate. But those that make this choice have typically paid a high price in terms of inadequate economic growth. The battle of ideas between socialism and free market capitalism is over. There is only one prevailing set of ideas in the global economy. One journalist refers to these ideas as the **“Golden Straitjacket”**. Upon adopting these ideas, a country's economy grows richer but the country's independent political life shrinks (i.e., its policies are chosen for it by the principles of free market capitalism which necessitates a smaller role for government).

The increased globalization that came after 1980 has some important causes. **One cause is the technological revolution** --- computers, telecommunications, miniaturization, compression, and digitization --- and the spread of this technological revolution to most countries of the world. This technological revolution allows production to take place all over the world. The result is to drastically reduce the barriers to entry into almost any business, greatly increasing competition. **A second cause has been the changes in the world of international finance.** From once being dominated by commercial banks, a myriad of new institutions now participate in the world of international finance. This change created the enormously fast shifts of portfolio investment among the countries of the world. **A third cause has been the revolution in information --- the vast amounts of information available to people all over the world and the low cost of gaining access to that information.** While the globalization of the late 19th century was the result of falling costs of transportation, the globalization of the late 20th century was resulted from the falling costs of information. The information revolution both changed the way that companies are managed, allowing production to take place all over the world, and brought the companies much closer to

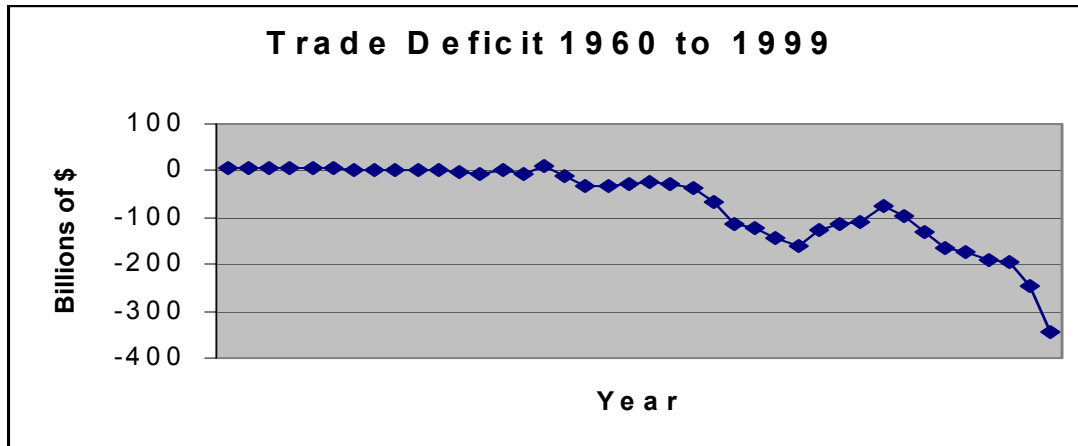
their customers. **A final cause of increased globalization has involved reductions or elimination on previously existing restrictions on trade, on foreign direct investment, and on portfolio investment.** We will discuss some of these changes in this chapter.

In this chapter, we will examine international trade first. We will examine the reasons for the growth of world trade, the benefits of expanding world trade, and the costs of expanding world trade. Second, we will examine regional economic integration, especially of Europe. We will examine the American trade deficits that began in the 1980s --- what caused them and what have been their effects. Third, we will examine the growth of foreign direct investment – the owning and controlling of companies in another country. Fourth, we will consider the arguments for globalization and the arguments against globalization. A final section will summarize and provide conclusions.

International Trade

As was said above, **international trade became much more important for the United States after 1970.** In 1970, American exports were \$57 billion, equal to 5.5% of GDP. By 1999, American exports had grown to \$990 billion, equal to 10.6% of GDP. The same growth occurred for imports. In 1970, American imports were \$55.8 billion, equal to 5.4% of GDP. By 1999, American imports had risen to \$1,244 billion, equal to 13.4% of GDP. **American companies depend more on exporting their products today than they did in the past. And American companies face more competition from foreign imports than was true in the past.** (Although this point is more relevant for American manufacturing companies, it is also true for American companies providing services.)

Notice in the above numbers that in 1970, exports exceeded imports. But in 1999, the opposite was true --- **imports exceeded exports.** This difference is called the **trade deficit.** Actually, the numbers above include both goods and services. The United States has consistently exported more services to the rest of the world than it has imported. But the **trade deficit in manufactured goods has become very large indeed, as shown in the graph below (minus indicates a trade deficit).** These trade deficits will be considered later in this chapter.



According to a famous theory of international economics, each country should export those products that use factors of production that are abundant. And each country should then import those products that use factors of production that are relatively scarce. In the United States, physical capital, skilled labor, and arable land are relatively abundant. Therefore, one would expect the United States to export goods that require a considerable amount of physical capital (such as automobiles), goods that require a considerable amount of skilled labor (such as high technology goods), and goods that require a considerable amount of good arable land (such as certain agricultural goods). In the United States, less skilled labor is relatively scarce (compared to other countries). Therefore, one would expect the United States to import goods that require a considerable amount of less skilled labor (such as textiles).

Test Your Understanding

Go to the following Internet site: <http://www.census.gov/foreign-trade/www/press.html#current>

1. Examine Exhibit 7. What are the most important export products of the United States at the present time? Is this answer consistent with the explanation in the previous paragraph?
2. Examine Exhibit 8. What are the most important import products of the United States at the present time? Is this answer consistent with the explanation in the previous paragraph?
3. Notice that the United States exports computer-related products and also imports computer-related products? How would you explain this?

In recent years, the trade deficits of the United States have involved most of our trade partners. So for example, in 2001, of the total American trade deficit, 13% was with Canada, 7% was with Mexico, 14% was with the countries of the European Union, 2% was with the countries of Eastern Europe, almost 18% was with China, 16% was with Japan, 10% was with the OPEC oil producing countries, nearly 5% was with the newly industrialized countries of Hong Kong, Singapore, Korea, and Taiwan, and 2% was with South America. The United States experienced a trade deficit with all of these countries.

Test Your Understanding

1. Examine the products that international trade theory predicts the United States would export and the products the United States would import. Based on these predictions, to which countries do you believe the United States would export most? Why? From which countries do you believe the United States would import most? Why?
2. Go to the same Internet site as in the previous assignment. Examine Exhibit 14-A. To which countries does the United States export the most? From which countries does the United States import the most? How do the actual data compare to your predictions in question 1?
3. In the late 1990s, the American economy experienced a rapid expansion. Many of the other countries of the world experienced recession or very slow economic growth. Use this information to explain why the United States had a trade deficit with almost every area of the world in this period.

The growth of international trade has been the result of deliberate policy decisions of the United States and many other countries of the world since 1946. In the 1930s, the Smoot Hawley Tariff had created very high American tariff rates. Other countries had responded by raising their tariff rates to very high levels as well. The resulting reduction in world trade ultimately hurt all of the countries. After World War II, there came an attempt to reduce these tariff rates in order to increase world trade. This attempt has been largely successful. In a succession of international meetings, **tariff rates have been consistently lowered until today they are very low for most industrial countries.** The argument on behalf of opening international trade is discussed in detail in Chapter 28 of the Microeconomics textbook on my web site. That argument will not be repeated here. However, it would help for you to examine the argument there. Economists are almost universally in favor free international trade. There is arguably more agreement among economists on this point than on any other. As noted above, in a world of free international trade, each country will come to specialize in those goods and services that use factors of production that the country has in relative abundance. **If each country specializes in those goods and services, total world production, as well as production in each of the trading countries, will be greater.** Each country can have more of all of the goods and services it desires. In addition, openness to trade brings in materials and capital goods that a country otherwise could not have for itself. It also brings in ideas --- new ways of doing things. Economists attribute a significant part of the increase in the standard of living found in most of the countries of the world since the end of World War II to the freeing of international trade. Some economists also argue that those countries that are relatively open to international trade have experienced the fastest rise in their standard of living while the relatively closed economies have stagnated. (The evidence seems to suggest that countries that have experienced rapid economic growth have also become more open to international trade. However, countries that have become more open to international trade have not necessarily experienced rapid economic growth. **Openness to trade seems to be necessary, but nor sufficient, for rapid economic growth.**)

Unfortunately, while a country as a whole may be better off with free international trade, not all members of that country are better off. **International trade creates both “winners” and “losers”.** This also is covered in Chapter 28 of the Microeconomics

textbook and is repeated here. To repeat the above argument, if trade is free, *a country will export those goods that require factors of production that are relatively abundant and import those that require factors of production that are relatively scarce*. For the United States, this means exporting goods that use large amounts of arable land, capital, and highly skilled labor. It also means importing goods that require large amounts of unskilled labor. Suppose, as is likely, that the United States specializes in production of computer software because of our abundance of highly skilled workers. The ability to trade, and therefore to sell in foreign countries, increases the demand for American computer software. This increased demand both increases the quantity of computer software products sold and also increases their prices. Both the increased quantity sold and the increased prices will increase the profits of owners of computer software companies. They will also increase their demand for workers, increasing the number of people employed in the computer software industry as well as their wages. **Therefore, the owners of computer software companies and their workers are both “winners” from international trade.** On the other hand, assume, as is likely, that the United States does not specialize in textile products because of our relative scarcity of less skilled workers. With free trade, the United States would import textile products that can be produced for a lower cost in other countries. The imports will increase the supply of textile products in the United States, decreasing their prices. The decrease in prices will reduce the profits of the owners of American textile companies. The decrease in prices will also decrease the demand for American textile workers, causing both the number of jobs for American textile workers and their wages to decrease. **Therefore, the owners of American textile companies and their workers are “losers” from international trade. In general, for the United States, free trade benefits owners of arable farmland and capital as well as highly skilled workers. Free trade hurts unskilled and semi-skilled workers.** In a middle-income country such as Mexico, the opposite occurs. *In Mexico, free trade should benefit unskilled and semi-skilled workers as well as the owners of the companies that employ them. In Mexico, free trade should hurt highly skilled workers. Certain owners of arable land in Mexico are “winners” (e.g., those whose land can grow strawberries or bananas) while owners of other arable land are “losers” (e.g., those whose land can grow wheat).*

The analysis by economists of the benefits of free trade shows clearly that **the gain to the “winners” from free trade exceeds the harm to the “losers”**. We know this because we know that the United States as a whole (and the world as a whole) is better off with free trade. Yet, the “losers” in the United States are the most disadvantaged. In political decision-making, they have often been able to prevent free trade policies.

Test Your Understanding

1. You will be assigned a site from A, B, C, or D below.
 - A. Go to the site of the **AFL-CIO**. <http://www.aflcio.org/>. There, you can examine the position of the AFL-CIO concerning free trade. You may read any of their position statements that relate to trade policy. Explain the position of the organization as regards free trade.
 - B. Go to the site of the **United States Chamber of Commerce**. First, explain whom this organization represents. Then, explain the position of the organization as regards international trade. The site is: <http://www.uschamber.org/policy/index.html>

- C. Go to the site of the **Business Roundtable**. First, explain whom this organization represents. Then, explain the position of the organization as regards international trade. The site is: <http://www.brtable.org/issue.cfm/9>
- D. Go to the site of the **Sierra Club**. First, explain whom this organization represents. Then, explain the position of the organization as regards international trade. The site is: <http://www.sierraclub.org/trade/>
2. You will be assigned one of the following:
- A. Read the Chapter on International Trade (Part V) in **The Economy of Japan** on my web site <http://daphne.palomar.edu/llee>. Write a brief summary on the trade disputes between the United States and Japan. What is the American position in this dispute? What is the Japanese position?
- B. Read the Chapter on International Trade (Part V) in **The Economy of China** on my web site <http://daphne.palomar.edu/llee>. Write a brief summary on the trade disputes between the United States and China. What is the American position in this dispute? What is the Chinese position? Why has China desired so strongly to enter the World Trade Organization (WTO)?
- C. Read the section on the North American Free Trade Agreement (NAFTA) in Chapter 28 of the Microeconomics textbook on my web site (<http://daphne.palomar.edu/llee>). What were the arguments made by those in favor of NAFTA? What were the arguments made by those against NAFTA?

International Economic Integration

Let us begin by defining some of the forms of economic integration. As stated above, economic integration refers to an increase in trade and investment (both portfolio and direct) between countries. The simplest form of economic integration is called a **Free Trade Area**. In a Free Trade Area, all tariffs and quotas are eliminated by all of the countries involved. The next level of economic integration is called a **Customs Union**. In a Customs Union, there is a Free Trade Area. But also, all countries agree to have a common tariff (tax rate) against countries that are non-members. The third level of economic integration is called a **Common Market**. In a Common Market, there is a Customs Union. But in addition, the countries agree to the free movement of both labor and capital between themselves. In other words, when countries agree to form a Common Market, they agree to have no tariffs or quotas on any goods shipped from one member country to another, they agree to have the same tariff on all goods shipped from a non-member country, they agree to allow citizens of the member countries to lend money in any of the countries and to own companies in any of the countries, and they agree to allow people to move freely between any of the countries. The final stage of economic integration is called an **Economic Union**. In an Economic Union, there is a Common Market. But in addition, the countries that are members of the Economic Union have the same money and the same standards and regulations. In addition, the countries that are members of the Economic Union coordinate their macroeconomic policies. The fifty states of the United States are an example of an Economic Union. Until the late 1980s, most economic integration in the world occurred through changes in tariffs, quotas, or other trade policies. In the 1990s, economic integration involved very sensitive national issues such as labor standards, environmental policies, antitrust policies, and so forth.

The European Union

The modern economic integration of Europe began with the Treaty of Rome in 1957. This treaty created the **European Economic Community (EEC)**, with six original member countries (Belgium, Netherlands, Luxembourg, Germany, France, and Italy). The early European Economic Community was a **Customs Union**, having free trade between the member countries and having common tariffs against non-member countries. Over the time, the membership grew. Six countries joined the EEC between 1973 and 1986 (United Kingdom, Denmark, Ireland, Greece, Spain, and Portugal). Three additional countries (Austria, Finland, and Sweden) joined in 1995, bringing the total number of member countries to 15. As of 1996, the 15 member countries contained 372 million people and had a collective GDP approximately equal to that of the United States.

Beginning in 1979, the member countries began a policy of trying to link their currencies together with the creation of the **European Monetary System (EMS)**. Between these countries, there would be **fixed exchange rates**, as each country's currency would be tied to a weighted average of the other countries' currencies. This weighted average was called the **European Currency Unit (ECU)**. (For example, the German Mark was set at DM 1.89 to one ECU. The French Franc was set at FF6.55 to one ECU. This made the exchange rate between Germany and France F3.46 per mark (6.55 divided by 1.89).) If the market exchange rate differed from the agreed rate by more than a specified amount, each country's central bank pledged to intervene in its foreign exchange market to bring about the proper rate (review the Bretton Woods system of intervention). One goal of the EMS was to make it easier for people to trade between countries and to undertake direct investment. (Review the advantages of fixed exchange rates.) Another goal of the EMS was to pave the way for a single currency (see below). The EMS succeeded in linking the currencies of the member countries until the early 1990s.

Test Your Understanding

In the early 1990s, West Germany took over East Germany. The country became "Germany". Since the former communist East Germany lagged badly behind West Germany, the German government undertook a program of increased government spending in East Germany to improve production there. This increase in government spending was financed by German government borrowing. Fearing inflation, the German central bank raised interest rates in Germany.

1. Explain what would happen in the foreign exchange markets as German interest rates rose. What would the central banks of Britain and of France have to do in order to maintain the fixed exchange rates? Why would this ultimately create a problem for the European Monetary System? (To aid your answer, review the breakdown of the Bretton Woods System.)
2. France chose to raise its own interest rates in order to match the interest rate increase in Germany. By doing so, France would preserve the European Monetary System. What effects would raising interest rates have on the French economy?

In 1987, the **Single European Act** was passed. It was to be fully implemented by 1993. The Single European Act was based on the so-called four freedoms: **free movement of goods, services, capital, and labor**. By this act, the European Economic Community would shift from a Customs Union to a Common Market. To implement the Single European Act, there had to be an elimination of passport controls at borders

between member countries. There had to be an agreement on common product and safety standards. There had to be common tax policies, common subsidy policies, and common public procurement policies (so as to avoid a country giving an advantage to its own companies). And there had to be an effective safety net for the large-scale adjustment that the opening to trade would generate. All of these were difficult to accomplish. (In the case of harmonizing tax rates, the goal could not be accomplished at all.) But as of the present, there are no restrictions on trade of either goods or services between the 15 member countries. Workers can migrate between the countries just as California workers can move to New York. And capital can also move freely between the countries, either as portfolio investment or as direct investment.

A very significant element of European economic integration was the decision made in 1991 to **move to a common currency and to create a European central bank**. This is called a *“monetary union”*. The European central bank makes monetary policy for the entire region much as the Federal Reserve does for all 50 American states. This decision forced the member countries to give up their ability to make their own monetary policy, a significant loss of national sovereignty. The European currency, the **Euro**, went into existence in 1999. At that time, it was only a unit of account. National currencies continued to exist along with the Euro. The Euro became a medium of exchange in 2002, replacing the national currencies such as the German Mark, French Franc, Italian Lira, and so forth. The Euro is now the common currency for eleven of the fifteen members of the European Union. Only Britain, Denmark, Sweden, and Greece are not part of the monetary union.

The period from the decision in 1991 to form a monetary union until 1999, when the monetary union went into effect, was a period for the member countries to **harmonize their monetary and fiscal policies**. This required each country to maintain a stable exchange rate and to have the same interest rates as the other countries. It also required each country to keep its inflation rate low and to reduce its government budget deficits, policies that tended to keep unemployment rates high in Europe in the 1990s.

Sacrificing the ability to pursue an independent monetary policy and being forced to undertake policies that increase unemployment would seem to be significant costs of becoming a member of the monetary union. On the other hand, the benefits --- elimination of the costs of converting from one currency to another and reduction of exchange rate uncertainty --- would seem relatively small. We will consider the European crisis of 1992 in the next chapter.

Trade Deficits of the United States

As you saw in the chart earlier, the United States has experienced continual trade deficits since the early 1980s. This means that the imports of the United States have exceeded the exports of the United States. (*The trade deficit considers only goods. The current account deficit considers both goods and services.* Both have been in deficit.) Some of these trade deficits have been quite large. The timing of these trade deficits coincides with the beginning of the very large budget deficits of the United States

government. At one time, these were called the *“twin deficits”*. Indeed, there was some connection between them. When the United States government incurs a budget deficit (meaning that it spends more than it collects in tax revenues), it must borrow the difference. This borrowing causes interest rates to increase. The higher interest rates, as we saw in Chapter 7, increases the demand for dollars (that is, the supply of foreign money) while decreasing the demand for foreign money. The result is that the American dollar appreciates. An appreciated American dollar reduces American exports (by making American exports more expensive) and increases American imports (by making imported products cheaper for Americans to buy). However, such an analysis of the trade deficits is too simplistic. In the 1990s, the budget deficits of the United States government became smaller. Indeed, from 1998 to 2001, the United States government had a budget surplus. Yet the trade deficits continued and even increased at this time. Clearly, there is more involved with creating the trade deficits than just the budget deficits of the United States government.

To get a fuller picture, let us return to the circular flow model in Chapter 10. There it was shown that, in equilibrium, the following holds:

Savings + Taxes + Imports must equal Business Investment Spending + Government Spending + Exports

The variables on the left side are the so-called *“leakages”* from the circular flow. The variables on the right side are the so-called *“injections”* into the circular flow. Let us rearrange this equation:

(Exports – Imports) equals (Savings - Business Investment Spending) + (Taxes – Government Spending)

(Exports minus imports) is the trade deficit (if it is a minus number). From the early 1980s until 1998, part of the trade deficit was caused by the government spending exceeding the tax revenues (the United States government budget deficit). **But another part of the trade deficit was caused by Business Investment Spending exceeding Savings.** Business investment spending was generally low in the United States until 1995. But from 1995 through 2000, there was a boom in Business Investment Spending in the United States (especially on computers and computer related equipment). As was covered in Chapter 14, **Savings in the United States have been consistently low --- too low to pay for all of the Business Investment Spending.** If the United States has a trade deficit, it is buying more from foreigners than it is selling to them. The difference is used by the foreigners in one of two ways. The first way is that they lend that difference --- either to American businesses to pay for the Business Investment Spending (that is, to supplement the inadequate Private Savings of Americans) or to the American government to pay for the budget deficit (that is, to pay for the desired American government spending that is not paid for by the American tax revenues). This, as we have seen, is called *“portfolio investment”*. The second possible use for this difference between American exports and imports is that the foreigners buy or build American companies. This, as we have seen, is called *“foreign direct investment”*. In doing so, they are adding to the amount of capital goods available in the United States. ***In summary, for most of the past twenty years, there are two causes of the American trade***

deficits: the budget deficits of the United States government (except for the late 1990s) and the low rate of savings by Americans (a rate too low to finance all of the desired business investment spending).

Test Your Understanding

Go to the site of the Economic Report of the President – Statistical Tables in Spreadsheet Format. <http://w3.gpo.gov/usbudget/fy2003/erp.html> From Table B-1, (Gross Domestic Product), what is the Current Account Balance of the United States equal to in the most recent year? From Table B-32, what is the Gross Private Saving of the United States equal to in the most recent year? How much of this is Personal Saving and how much is Gross Business saving? What is the Gross Government Savings of the United States equal to in the most recent year? (This is the budget deficit or surplus of the government, considering all levels of government.) And finally, what is Gross Private Investment in the United States in the most recent year? Add this to the Gross Government Investment. Plug these numbers into the equation above (there may be a statistical discrepancy). How much of the current account deficit is being used to finance the excess of private investment spending over private savings? And how much of the current account deficit is being used to finance the budget deficits of the governments?

Are trade deficits necessarily bad for the United States? Our accounting identity above does not tell us the cause of the trade deficits? The trade deficits could result because savings are low. This would be bad. Or they could result because business investment spending is high. This would be good. Both of these results have occurred at various times over the past twenty years.

One interpretation of the trade deficits is that they allow the American businesses to spend more on investment spending than they otherwise would be able to. This investment spending increases the American ability to produce and therefore raises the American standard of living. Such an interpretation would be valid for the period 1995 to 2000. *Another interpretation of the trade deficits is that they are the result of the high confidence that foreigners have in the United States.* Because of this confidence, foreigners want to buy American bonds and stocks. Their desire to do this appreciates the American dollar. The stronger dollar reduces exports and increases imports, increasing the trade deficits. In effect, the trade deficits provide the means by which foreigners obtain the dollars they want in order to buy bonds or stocks in the United States. Both of these interpretations indicate that the trade deficits should not be seen as a problem.

Other interpretations of the trade deficits come to different conclusions. *One such interpretation is that the trade deficit reflects the lack of competitiveness of American companies.* A company, of course, can always sell its product. But it may have to accept a lower price in order to do so. (Even the Yugo sold in the United States.) The lower prices mean that the companies are earning less. Lower earnings of these companies also lead to lower wages for the workers. The standard of living of Americans rises more slowly than we would like it to. While this argument may have had some relevance in the 1980s, it does not seem very relevant today. There are very few areas today in which American companies lack competitiveness. *Another interpretation stresses that the trade deficit increases the American dependence on foreign investments.* This creates a debt for the United States that must be paid. At present, this debt is not a problem for a

country as large as the United States. However, it does make American somewhat vulnerable to sudden shifts in the expectations of these foreign investors. Both of these interpretations indicate that the trade deficits should indeed be seen as a problem.

One result of the trade deficits was very important. Faced with a greater difficulty in selling in export markets and faced with greater competition from imports, many American companies made great efforts to become more efficient. The process was very painful. Thousands of workers and managers lost their jobs, a process known as “*downsizing*”. New technologies were implemented as rapidly as possible. **By the 1990s, American companies had emerged as much more efficient competitors internationally.** As noted above, there are few areas today where American companies would lack competitiveness. This large increase in efficiency is one of the keys to the great prosperity of the latter part of the 1990s.

Direct Foreign Investment

In Chapter 7, *direct foreign investment was defined as the ownership and control of a company in another country.* “Control” implies that one owns at least 10% of the stock of a company located in another country. A company that owns and controls companies in more than one country is called *a multinational company (or a transnational company)*. The dominant company in the investing country is called *the parent company*. The companies in the host country are called *subsidiary companies*. Indeed, in 1994, about 36% of American exports and 43% of imports were transfers from one part of a multinational company to another part. Increasingly common today is the use of *alliances*. The multinational company allies with a local company who serves as an affiliate or subcontractor. For example, Cisco has 34 factories around the world making its Internet-related equipment. However, only two of these factories are actually owned by Cisco.

While direct foreign investment rose throughout the 20th century, its fastest growth came in the period from the early 1950s to the early 1970s. In this period, the companies doing the investing were mainly American companies locating in other countries. From the early 1970s until the early 1980s, direct foreign investment grew slowly. But in the mid-1980s, it began growing quickly again. The leading host country in the 1980s was the United States. Especially significant was foreign direct investment in the United States by Japanese companies. (After 1992, this investment slowed. Much direct foreign investment since 1992 has been in developing countries. But this has gone primarily to only eight countries.) For the first time, the United States found itself with large numbers of companies on its soil owned and managed by foreigners.

As of 1992, total direct foreign investment in the world totaled about \$2 trillion. Of this, about ¼ (\$487 billion) had come from the United States --- mostly into Europe and Canada. Most of the rest came from the other industrialized countries. Of the \$484 billion worth of foreign direct investment in North America (the United States and Canada), \$170 billion had come from Japan. On the other hand, Japan has allowed very little foreign investment into its country. (In 1992, the Wall Street Journal asked its readers to name which of the following cars is made exclusively in the United States:

Pontiac LeMans, Chevrolet Lumina, Mercury Capri, Honda Accord Coupe, Dodge Stealth, Mercury Tracer, and Plymouth Voyager. The answer turned out to be the Honda Accord Coupe.)

People are ambivalent about foreign direct investment. Many Americans are opposed to foreign direct investment by American companies in countries like Mexico. They fear loss of American jobs. Other Americans are opposed to foreign direct investment by foreign companies in the United States. They fear excessive influence and control by foreigners. Yet many others are supportive of foreign direct investment, as they see great benefits to both investing and host country. In order to consider these concerns, we must try to explain why foreign direct investment occurs.

Companies that own and control companies in other countries would seem to be at a disadvantage. They do not know the local laws, languages, and customs in the foreign country and would therefore seem to have major difficulties trying to do business there. In addition, it is often difficult and costly to try to manage an operation that is spread all over the world. Yet, companies do engage in foreign direct investment on a large scale. There have been several reasons suggested as to why foreign direct investment occurs. ***One main reason suggested is that the investing company has some advantage not held by its competitors in the host country.*** Its advantage could involve its technology, its access to capital, its superior ability to market its product, or its superior management. It seeks to exploit its advantage in the foreign country for the sake of greater profit. And it maintains control over the foreign company because it does not want others to gain the same advantage and be able to compete with it. This explanation seems relevant to explain the large amount of foreign direct investment by high technology companies (who have a technology advantage), automobile companies (who have an advantage in access to large amounts of capital), and food companies (who have an advantage in marketing). Japanese companies seemed to have advantages in organizing and supervising workers. ***A second suggested reason for foreign direct investment is that it might allow the company to exploit a position of monopoly.*** Because it is large and efficient, the company may be able to eliminate the local competition. When it becomes the only seller, it can charge higher prices and reap greater profits. This explanation would seem relevant for foreign direct investment in small, Third World countries but not for investment in the United States or Europe. ***A third suggested reason for foreign direct investment is that it allows a company to use labor that is cheaper.*** This argument also may have relevance for foreign direct investment into Third World countries. But the argument would not be relevant for foreign direct investment into the United States. And remember that just because the wages are low in Third World countries, it does not follow that labor costs are low. The low wages often reflect low productivity. If the workers in the Third World countries are not very productive, it would not be desirable to hire them even if their wages are relatively low. ***A fourth suggested reason for foreign direct investment is that it occurs because companies fear that barriers to international trade will be created in the future.*** This fear was a major reason for the investment of Japanese companies in the United States in the 1980s.

Fearing that the United States government will impose restrictions on imports of Japanese cars, Honda built a plant in Ohio, Nissan built a plant in Tennessee, and so forth. *A fifth suggested reason for foreign direct investment is that companies use it to get around the laws of their native country.* One example of this involves the **tax laws**. By arbitrarily setting the prices that one subsidiary company charges to another subsidiary company, the company can claim its profits were earned in that country that has the lowest tax rates. Another example is the possibility that companies will locate in other countries in order to not have to obey the **environmental and labor laws** of their native country. This example would not fit investment into the United States. It could be of some relevance for foreign direct investment by American and European companies into Mexico or Asia, although there is little evidence to support the proposition. Labor standards of multinational companies are typically higher than those of the native companies. And most companies seem aware that an anti-environmental image will hurt their sales in the United States.

How does foreign direct investment affect the investing country? Much more foreign direct investment has gone out of the United States than has gone into it. Whether this has been good or bad for the United States depends on who you are. *Generally, foreign direct investment out of the United States has been bad for some working Americans.* There are fewer jobs for these American workers than would exist had the production taken place in the United States and then been exported. A lower demand for American workers should have an effect in lowering wages. Much foreign direct investment has occurred in industries in which workers had strong labor unions. **This investment has acted to weaken these unions.** But given the large size of the American economy, any effect that foreign direct investment would have on overall employment or wages would have to have been small. *Secondly, foreign direct investment could be bad for American taxpayers to the extent that the companies can avoid paying American taxes by the means noted above.* If these companies pay less in taxes, either other taxpayers will have to pay more in taxes or there will be less money to pay for government programs. *On the other hand, foreign direct investment is good for the owners of these companies (the stockholders).* If these stockholders are Americans, then the gain to the stockholders will be greater than the loss to the others and America as a whole will be better off.

Besides the “winners” and “losers”, foreign direct investment may have other effects on the United States. *One effect is the possibility that these companies may be able to obtain preferential benefits from the American government because of their ability to threaten to take their production to other countries.* These benefits for the companies may or may not be in the national interest. *Another effect is the possible loss of what are called “external technological benefits”.* Even though companies try to keep the source of their advantage a secret, this information can spill over to others, making others more efficient and competitive. People do change jobs. And people in different companies do often work on joint research projects. If the production takes place in other countries, it is possible that these external benefits will occur there. As one example, some people argue that the movement of the production of television sets out of the

United States took away from American companies the ability to develop the technology that led to the VCR. The VCR was developed in Japan where most of the production of television sets was taking place. *And finally foreign direct investment may act to depreciate the American dollar.* This occurs because foreign-owned companies are more likely to buy their materials in other countries than are domestic American companies. This buying increases the demand for foreign monies and therefore raises the price of the foreign monies (that is, depreciates the American dollar).

How does foreign direct investment affect the host country? There are clear advantages to the citizens of the host country. *First, foreign companies bring new jobs and often bring higher wages. Second, foreign companies often bring technologies that spill over to local companies and allow them to produce better products or to produce more efficiently (external technological benefits). Third, foreign companies bring new capital goods. This is especially important for poor countries that typically are very deficient in capital goods. Fourth, foreign companies bring tax revenues to the governments of the host countries. And finally, foreign direct investment may benefit local supplying companies if the foreign-owned company buys its materials in the host country.* Of course, there are also some “losers” in the host country. **These would include stockholders in local competing companies and possibly consumers (if the foreign company is able to obtain a monopoly position in the host country).** The host country could also be faced with politically powerful multinational companies that are able to force political changes that may not be in the interest of the host country’s citizens. Nonetheless, many host countries, especially developing countries, have seen the benefits of foreign direct investment as very significant. Since the mid-1970s, they have removed restrictions on foreign direct investments into their countries and have even offered incentives and subsidies to attract foreign investors. The United States government, as well, has taken little action to limit foreign direct investment into the United States.

Foreign direct investment has become a major part of the globalization that has taken place. While economic theory predicts net overall benefits from foreign direct investment, there are certainly many “losers” that result from it. Because some people gain while other people lose, foreign direct investment, like foreign trade, is a very contentious issue. Let us now conclude this chapter with an evaluation of globalization.

Test Your Understanding

1. The North American Free Trade Agreement (NAFTA) went into effect in 1994. One area of contention about this agreement involved foreign direct investment. The agreement made it easier for American companies to locate in Mexico. Generally, the Republican Party supported this agreement. The Democratic Party supported it with reservations and with many Democrats in opposition. The Reform Party (Ross Perot) opposed the agreement strongly. The Green Party also strongly opposed the agreement. Look up the sites of these four political parties on the Internet. <http://www.google.com> Find some evidence of the position of the party as regards either NAFTA or foreign direct investment in general. Explain the position of the party, citing some evidence.

2. Read the article by Professor Gerber of San Diego State University at <http://www-rohan.sdsu.edu/faculty/gerber/USFDI.pdf>. The article contains data on the amount of foreign direct investment into Mexico. Has foreign direct investment into Mexico increased significantly since 1994? In what categories has it increased? Why might the change you described have occurred?

The Arguments For and Against Globalization

As was stated at the beginning of this chapter, the western world became much more “global” in the period from 1870 to 1910. However, from 1910 through 1960, this “globalization” was reversed. If you were taking this course in the early 1960s (as I did), you would study the United States only. Relationships between the United States and the rest of the world would be considered very little, as they were not very important to American economic life. As we have seen, all of this has changed since the 1960s. Unlike the period of 1870 to 1910, **the “globalization” of the recent period has included most of the countries of the world – capitalist and former communist countries, northern and southern countries, rich and poor countries.** This new “globalization”, a result of both the falling costs of transportation and communication and of the removal of restrictions on trade and movements of capital, has created a very vocal controversy. From both the political left and the political right, there has been loud opposition. As you saw in the questions above, there was strong opposition to the North American Free Trade Agreement (NAFTA) from both the political left and the political right. The protests at the annual meetings of the World Trade Organization (WTO) or Finance Ministers of the G-7 countries have occasionally turned violent. On the other hand, opening to the new global economy is strongly supported by moderate Democrats and by Republicans. Indeed, most economists are in favor of policies that open the world to greater international trade and greater foreign direct investment. Here, we will consider the arguments on both sides of this important issue. After reviewing the arguments, you will be able to form your own opinions.

But before we review the arguments, we need to be sure that we do not overstate the amount of globalization that has already taken place. Certainly, international trade and foreign direct investment are much more significant than they were thirty years ago. But **national boundaries are still very significant.** In a recent study of Canada, a country very open to trade and foreign direct investment, it was found that dealings between the Canadian provinces were more significant than those between Canada and the United States. For example, companies in Vancouver British Columbia were more likely to deal with companies in Toronto Ontario (2,000 miles away) than with companies in Seattle Washington (150 miles away). It is possible that in the future we will see the countries of the world as open as we see today between the fifty American states. But that amount of openness does not exist as of yet (2003).

The Case for Globalization

Those who are supportive of globalization tend to make the following arguments. **The first argument focuses on foreign direct investment.** The rich nations have large

amounts of capital. With so much capital, the returns from investing in capital are not high (supply and demand). But the poor nations have limited capital. With scarce capital, the returns from investing in capital goods are much higher. *In a global economy, people in the rich countries will invest in the poorer countries where their returns are greater. Those people in the richer countries will benefit from the higher returns. But the people in the poorer countries will also benefit from having more capital, better technology, more jobs, and higher incomes* (due to the increase in the productivity of the workers in these poorer countries that results from the increased capital they have to work with and from the improved technology that the capital brings).

The second argument focuses on international trade. *The increase in international trade benefits consumers in all of the trading countries.* The consumers have more products available to them, enhancing their ability to choose. And with more goods available, the prices of the consumer goods they buy should be lower.

Third, the increase in international trade benefits those producers in all of the trading countries that produce for export. These producers, of course, gain from international trade by having a wider market for their products. *But the increase in the size of the market may also allow these companies to produce their products at a lower cost.* This ability to produce at lower cost should be passed on to consumers as lower prices. (The ability of larger companies to produce cheaper than smaller companies is called “**economies of scale**” and is covered in Chapter 15 of Microeconomics.)

Fourth, the increase in international trade would seem to hurt those companies that produce products that compete with the imported products. But in the longer run, the competition from imported products may be good for them. *The competition may force these companies to learn how to produce more efficiently. It may also force them to learn how to produce better products.* The increased efficiency of the American automobile companies and their ability to produce better automobiles when confronted with competition from Japanese automobile companies represents an important example of this point.

Fifth, greater integration between countries accelerates the transfer of technology between countries. Gaining access to the most modern technologies is an extremely important way for poorer countries to become richer. So, for example, the shifting of some of the production of computers and computer-related parts to Taiwan also brought computer technology to Taiwan. With access to this new technology, Taiwan is a much richer country than it was three decades ago.

Sixth, many of the complaints made against globalization don't really have anything to do with globalization. One example is the decline in the relative wages of American blue-collar workers. Not only have their wages declined relative to other American workers but also the proportion of American workers who work as blue-collar workers in manufacturing has declined. However, these trends have been going on throughout the 20th and 21st centuries. They began long before “globalization” became an issue and have many other causes.

Finally, some see great non-economic benefits from globalization. For example, it is claimed that globalization makes the costs of going to war much higher for both countries that might be involved. While not ending wars, it does create incentives for

countries to avoid war making. One journalist notes that no two countries that have a McDonalds have ever gone to war since each got its McDonalds! Or more seriously, since the beginning of the creation of a free trade area in Europe, France and Germany, traditional enemies, have not gone to war.

The heart of the argument then is that globalization leads to a richer world --- richer for all of the countries that are integrated into the global economy. Indeed, the evidence seems to show that *those poor countries that have had the greatest economic growth are the most integrated into the global economy*. Not only have many of the relatively open countries grown economically, their standards of living actually converged with those of the richer countries over the period 1970 to 1989. China, India, and Mexico --- countries that doubled their ratio of trade to GDP and countries that contain 3 billion people --- experienced an increase in GDP per capita of 5% per year in the decade of the 1990s. On the other hand, *those poor countries that are not integrated into the global economy, especially in Africa and the Middle East, have had little economic growth*. In these countries, the poverty rate has increased. (According to one study, being an open economy for twenty years brought about a cumulative 50% increase in the standard of living compared to being a closed economy, other things the same.)

The Case Against Globalization

As noted earlier, those who oppose globalization are found on both the political right and on the political left. Generally, they oppose agreements to expand trade and lower tariffs. They also oppose policies that remove restrictions to foreign direct investment. Some of their arguments include the following.

First, they argue that, as we have noted above, opening trade benefits certain people in a country but harms others. For the United States, those benefited include those with high skills. Those harmed include the less skilled and less educated – the most disadvantaged. *Therefore, globalization has contributed to the increase in inequality in the United States*. This increase in inequality has contributed to many adverse social effects in the United States, including a higher incidence of crime, a more generally hostile and aggressive society, a weakening of the sense of community, and so forth. The use of resources to control crime and aggressiveness, instead of to produce new goods and services, reduces the productive potential of the economy. Inequality may also reduce the economy's productive potential by discouraging trust and the ability to co-operate in situations in which there is conflict. In this argument, inequality has increased significantly in most countries that have participated in the global economy. For example, in Chile, the Gini Index rose from 0.46 to 0.58 between 1971 and 1989 as it opened to international trade and investment. (The Gini Index is a number between 0 and 1 to measure inequality. The higher the number, the greater is the inequality.)

The period of globalization has also been associated with increased inequality between the rich and the poor countries. The richest countries had 44 times the income of the poor countries in 1973 and 72 times in 1992.

Second, opponents of globalization see increased foreign direct investment by American corporations as a means of escaping American laws. The use of foreign direct investment to avoid American taxes has already been noted. **It is also argued that American corporations use foreign direct investment to escape American labor laws.** In some developing countries, these corporations are able to pay a wage much below the minimum wage in the United States. And they may also be able to create working conditions that would definitely be illegal in the United States (called “sweatshop” conditions). The production of clothing and shoes in Asia by companies such as Nike and Reebok are often cited as examples. **Foreign direct investment is also used by corporations to reduce the influence of American labor unions. In addition, American corporations may use foreign direct investment to avoid American environmental laws.** In some countries, production methods can be used that would not be allowed in the United States. (As noted above, the extent of the use of foreign direct investment to circumvent American labor or environmental laws is quite small.)

Third and related to the second argument, opponents of globalization argue that it reduces the ability of a country to enforce its own laws. There are many examples of this claim. For example, the United States has a law banning tuna that is harvested in a manner that sacrifices dolphins. Mexico charged that this law was a violation of the trade agreement in that its purpose was to restrict Mexican tuna sales in the United States. The World Trade Organization adjudicates this charge. It cannot force the United States to change its laws. But it can enact a financial penalty on the United States if it sides with Mexico. Another example involves trucks from Mexico coming into the United States. Under the trade agreement, truck companies in either country can operate freely inside the other country. But the United States charges that Mexican trucks do not meet American safety laws or American pollution standards. The trade agreement reduces the ability of the United States to keep these trucks off its roads. A similar example involved the avocado growers of San Diego County. They claimed that avocados from Mexico would bring in pathogens that would cause disease to the avocado plants in California. Mexico claimed that this was only a ploy by California avocado growers to keep Mexican avocados out of California. The trade agreement forces the burden of proof on to the United States. **One political economist has argued that globalization is simply inconsistent with a world in which nation states are significant and in which many countries are political democracies.** Either globalization will have to be restricted, he argues, or the sovereignty of countries becomes limited.

If an economy is closely integrated with other economies, it may also lose much of its ability to make monetary policies and fiscal policies in its own interests. Indeed, this was one of the problems that led to the demise of the classical gold standard and the Bretton Woods System. European integration was discussed above. Another example is Argentina who completely gave up its monetary policy by anchoring its money (the peso) to the American dollar. The result has been considerable unemployment in Argentina, unemployment that the Argentine government can do nothing to reduce.

A fourth and related argument is that globalization generates the spread of economic problems from one country to another. Countries have less ability to isolate themselves from problems that begin in other countries. For example, the Asian financial crisis of 1997 will be described in Chapter 27. This crisis spread throughout the countries of Asia. One country that was largely spared was China. The reason China was spared is that, while China had indeed opened itself to trade, it had restricted the buying or selling of its foreign exchange for speculation purposes. More “globalized” countries would not be allowed to do this.

In the new global economy, the main anxiety comes from the fear of rapid change caused by economic and technological forces that cannot be seen or controlled --- fear that one’s workplace or community can be changed at very short notice. *Because globalization increases a country’s exposure to risk coming from other countries, it increases the demand for social insurance programs (such as unemployment benefits, welfare, and so forth).* It has been consistently found that, because of this demand for social insurance programs, *where trade is a higher percent of GDP, governments tend to be bigger.* Dealing with the enhanced anxiety is one of the challenges of the new global economy.

Fifth, opponents of globalization argue that the period during which the world experienced the greatest increase in globalization (after 1980) has not been a good period for the poor and medium income countries of the world. For example, Mark Weisbrot et. al. of the Center for Economic and Policy Research compared the period 1980 to 2000 with that of 1960 to 1980 (a period of less globalization) for five groups of countries. They found that **the poorest group of countries (those with a per capita GDP of \$375 to \$1,121 in 2000 dollars) experienced negative growth in 1980 to 2000**, after slow positive growth in the preceding period. Those countries with per capita GDP of \$1,121 to \$1,826 (in 2000 dollars) had their growth rates fall from 2.1% per year to 0.8% per year. And those with per capita GDP of \$1,826 to \$3,364 (the United States per capita GDP was \$22,331) had their growth rates fall from 3.6% to less than 1%. They also found that **the period of more rapid globalization saw less improvement in life expectancy, reducing infant mortality, and literacy** than occurred in the preceding period. This does not prove that globalization alone caused this worsening situation. But it could give pause to those who support globalization.

The argument given by those who support globalization is that those countries that have been the most “globalized” have had the greatest growth on per capita GDP and the greatest reduction in poverty. But a closer look at the evidence reveals that **there are very few highly “globalized” countries that have had economic success. These include China and India**, home to about one quarter of the world’s population and half of the world’s poor people. Vietnam and Uganda might also be included on this short list. *Most of the economies of the other poor countries of the world did not do well at all during the period of globalization.* An examination of the economic history of those countries that were once poor but have become more developed (Japan, Korea, Taiwan) reveals that they had many restrictions to international trade and foreign direct investment. *Latin America seems to be the region that has become the most*

“globalized”. ***In the 1990s, it suffered slow economic growth rates, rising inequality, and significant volatility.*** Most of the countries that would be considered to have the most successful economies today, including the United States, started their economic growth with very high tariff rates. These tariff rates were only lowered after the economies became successful.

Finally globalization is opposed by people who distrust market economies in general. They argue that markets erode the relationships that form people into communities. With a global economy, people move around too much to form stable communities. It becomes much harder to create policies to specifically benefit all of the people in the community. To understand this, consider the problems that Americans have had with the large number of immigrants and with the increased presence of Japanese companies. **They also argue that globalization acts to homogenize peoples and cultures** --- known as a Coca Cola world. The value of the possible loss of cultural diversity is incalculable. **Finally, they argue that it is very alienating for so many people around the world to feel so out of control of their own lives,** to have their lives controlled by a large number of faceless, nameless money managers, corporate executives, and so forth from countries all over the world.

Test Your Understanding

1. “Look closer at the Chinese experience and you discover that it is hardly a poster child for globalization. China’s economic policies have violated virtually every rule by which the proselytizers of globalization would like the game to be played.”

Read the Chapter on International Economic Relations in the Economy of China on my web page. Then briefly describe how “globalized” the Chinese economy has been during its period of economic success. Consider the ways it became integrated into the global economy and the ways it did not. How accurate is the quote above?

2. “Argentina ... tried harder than any country to endear itself to international capital markets. The Argentine strategy ... was solidly grounded in the theories expounded by U.S. based economists”.

Get on the Internet. As a group, find some articles and data on the Argentine economy. To what extent did it pursue policies of globalization? (That is, how accurate is the quote?) Document the economic success or failure of the Argentine economy during the period of globalization.

3. Answer the same questions as in Question 2 for Mexico. You can get some information by reading my sections on trade and foreign direct investment under The Economy of Mexico on my web page.

4. There is a current proposal for a Free Trade Area of the Americas (FTAA). Go on the Internet and find exactly what this is intended to be. Then, if you were a supporter of the Free Trade Area of the Americas, what arguments would you make? And, if you were an opponent of the Free Trade Area of the Americas, what arguments would you make?

Conclusion

Globalization involves an increase in international trade, an increase in portfolio investment, and an increase in foreign direct investment as restrictions against these are

lowered or removed. It has been argued that increased globalization is inevitable. Indeed, falling costs of transportation and communications provide good evidence for this argument. Trade, which has gone on for thousands of years, is hardly likely to be stopped. There are many benefits to be achieved from this increase in globalization. These have been documented above. No country that has a successful economy today has cut itself off from international trade or from direct foreign investment. **Virtually all countries that have experienced economic growth over time have also experienced a rise in the share of foreign trade as a percent of GDP.** But there are also many problems that have resulted --- again documented above. **Indeed, no country that has a successful economy today has opened itself completely to international trade and to direct foreign investment.** Instead, this opening was done slowly. One supporter of globalization put it this way: “ I am .. a believer that a bet on increased international economic integration is our best hope for rapidly moving to a truly human world... But I think that this bet in increased international economic integration is a *bet*. It is not a sure thing.” How do we change the rules of the global economy to realize more of the benefits and incur fewer of the costs? How do we preserve a sense of identity, home, and community while still participating in, and gaining the benefits of, the global economy? These are likely to be some of the most important questions of the 21st century.

Practice Quiz for Chapter 26

1. Globalization has been defined as including
 - a. an increase in international trade
 - b. an increase in foreign direct investment
 - c. an increase in labor migration
 - d. all of the above
2. Since the early 1980s, the United States has experienced continual
 - a. trade deficits
 - b. trade surpluses
 - c. current account surpluses
 - d. trade balance
3. If a country has a trade deficit, which of the following would be a cause?
 - a. the country saves too little
 - b. the country spends too little on business investment spending
 - c. the country has a budget surplus
 - d. all of the above
4. As of now, Europe has a
 - a. free trade area
 - b. customs union
 - c. common market
 - d. economic union
5. If the United States expanded its trade with Mexico, who of the following Americans would be a “loser”?
 - a. an American computer engineer
 - b. an American textile worker
 - c. an American owner of capital goods
 - d. an American construction worker
6. Which of the following is an example of foreign direct investment?
 - a. Honda builds a factory in Ohio
 - b. Bill buys Mexican pesos
 - c. Maria opens an account in a Mexican bank
 - d. Jose sends dollars back to his family in Mexico

7. Which of the following is likely to be an effect on the United States if American companies have foreign direct investment in South America?
- a. stronger labor unions in the United States
 - b. greater tax revenues for the United States government
 - c. higher profits for the stockholders of the American companies
 - d. an appreciated American dollar
8. Which of the following is likely to be an effect on South America if American companies have foreign direct investment in South America?
- a. more jobs
 - b. better technology available
 - c. greater tax revenues
 - d. all of the above
9. Those who believe that globalization is good would make which of the following arguments?
- a. Globalization leads to a richer world
 - b. Globalization spreads technological advances to the poorer countries
 - c. Globalization enhances competition, making all companies more efficient
 - d. All of the above
10. Those who believe that globalization is bad would make which of the following arguments?
- a. Globalization increases equality in the United States
 - b. Globalization makes it easier for the United States to conduct its own monetary and fiscal policies
 - c. Globalization makes it easier for companies to do things that would be illegal under American laws
 - d. All of the above