Global Economy

by Sophia

WHAT'S COVERED

The world is getting smaller. It's also getting more connected. The question is, is this a good thing or a bad thing? This tutorial will cover the topic of the global economy, providing an overview of international trade and the intersection of globalization and business. Our discussion breaks down as follows:

1. Basis of Trade

The way countries trade is based on a couple of key concepts.

- **Absolute advantage:** This is the capacity to produce a higher number of goods or services using the same amount of resources as competitors.

  EXAMPLE Think about Saudi Arabia and oil. They have an absolute advantage because they can produce more oil with the same amount of resources as other countries around the world.

- **Comparative advantage:** This is a trading advantage achieved over another company due to lower opportunity cost.

  EXAMPLE Consider China and shirt manufacturing. There's less of an opportunity cost loss in China to manufacture shirts than other places around the world, which is one way to think of it.

IN CONTEXT

Suppose you coach the Wichita Widgets football team, and you have a brand new player coming to play for you. He can run faster and throw the ball farther than anybody else, so he has an absolute advantage in throwing and running.

However, you can only have him play one position. Do you put him as a tight end, or do you make him a quarterback?

Well, he can only throw a little bit farther than the other quarterbacks but can run a lot faster than the other ends you're going to be playing against. So, you put him in the tight end position, because that gives your team a comparative advantage over the rest of the teams in the league.

Now, countries also talk about a national competitive advantage, and it's a combination of conditions that support an industry.

> EXAMPLE Consider Toyota and the manufacture of cars. In the early 1980s, Toyota was producing a product that specialized in quality--the quality of their automobiles was better than anybody else's. So, when it came time to trade and compete against the United States in their own backyard, they had an absolute advantage in the amount of quality that they had. However, choosing to produce these cars and specialize in that industry gave the nation of Japan a comparative advantage over the U.S. and auto production.

TERMS TO KNOW

Absolute Advantage
The capacity to produce a higher number of goods or services using the same production resources as competitors.

Comparative Advantage
A trading advantage achieved over another company due to lower opportunity cost.

---

2. Balance of Trade

When thinking about trade between the products of two countries, we first need to consider the products in or out:

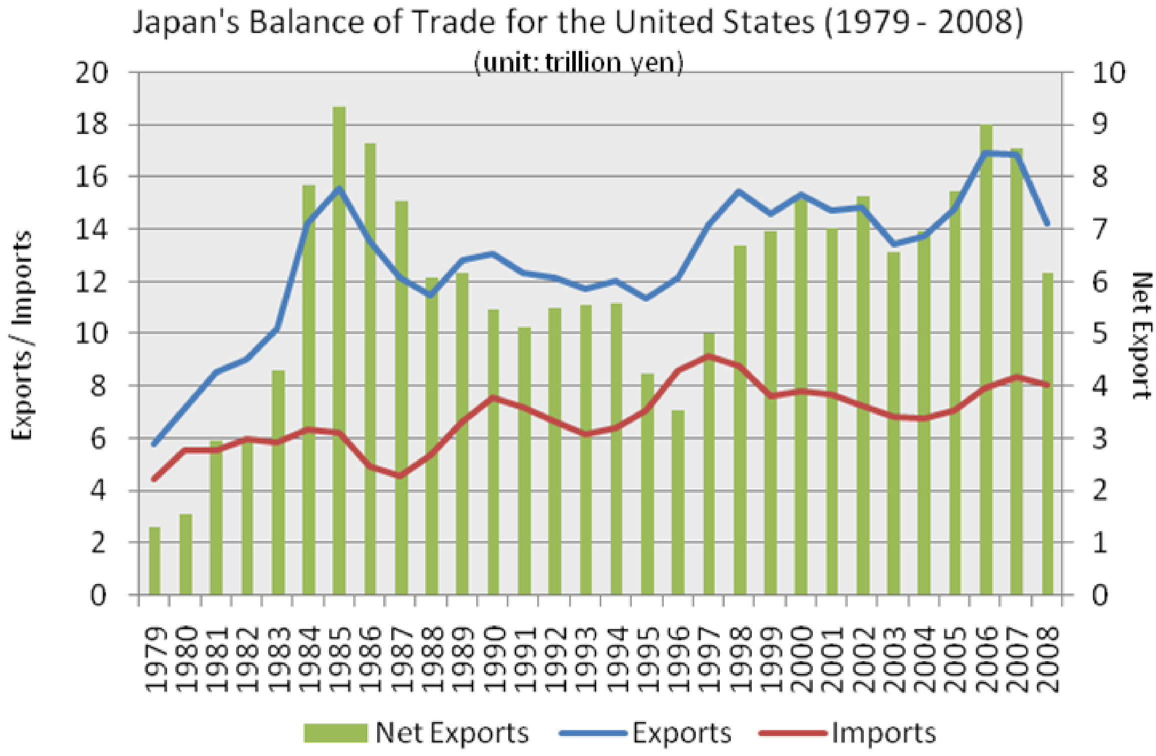
- **Imports:** Goods sold domestically but produced in a foreign nation
- **Exports:** Goods produced domestically but sold to a foreign nation

> EXAMPLE The U.S. grows a lot of peanuts, and they're exported and sold all over the world. On the other hand, if you want to buy a bottle of good French wine, you're going to have to import that from France.

When it comes to international trade, countries examine the balance of trade between themselves and other countries--one country at a time, specifically. They have trade surpluses and trade deficits.

- Trade surpluses occur when the balance of trade between two particular countries is in one country's favor
- Trade deficits occur when that balance of trade is in another country's favor.

Look at the graph below, which shows net imports and exports for Japan from 1979 to 2008. The imports are shown in red and the exports are in blue.



Source: Ministry of Finance Japan *Trade Statistics of Japan*

As you could see, for this period of time, Japan had a balance of trade that was positive, so they had a trade surplus.

TERMS TO KNOW

Imports

Goods domestically sold that were produced in a foreign nation.

Exports

Goods produced domestically and sold to a foreign nation.

---

3. Globalization

Globalization is the expansion of business into international markets. Now, much of this is due to less restriction, both physical and nonphysical. We have better modes of transportation and fewer trade restrictions on countries around the world. It's becoming a flattening world.

HINT

In his book, *The World Is Flat*, by Thomas Friedman, he talks about the world flattening. By this, he means that the world is going through a globalization process where countries are freer to trade globally, and goods and services from all over the world are available in many different places.

This process started happening since World War II when international trade really started to take off because of many different trade agreements.

Now, **international business** is essentially what we've been discussing this whole time, and it's defined as business that is conducted between two or more nations. The simple fact that we're talking about globalization, and the fact that it's become such a significant part of everyday business, no matter what company you work for, goes to show that Friedman is probably right.

TERMS TO KNOW

Globalization
The expansion of business into international markets.

International Business
Business conducted between two or more nations.

---

4. Business and Trade

Now, let's discuss business and trade on an international level. International management of trade is rather unique. You see, products that work well at home may not necessarily work well overseas. You also have to consider the actual demand for that product you're going to sell overseas, depending on the cultures and the norms of that particular nation. Will the product be accepted? Are there any changes that you have to make in packaging or marketing that will improve the acceptance of that product overseas?

Here are some other issues to consider in the context of business and trade:

- Do you need to use an independent agent? You may need to hire somebody within that country that understands the lay of the land to help market the product for you?
- Would a strategic alliance with a company already doing business in that same sector be a good idea?

> EXAMPLE Pepsi Cola works with drink manufacturers in other countries who already understand the taste preferences and uniqueness of that culture in the country to help move their products along in that nation.

- Will there be licensing required? Are there legal loopholes that you have to jump through in order to sell your product? You may need to get it certified or licensed in order to sell that product overseas, like medical devices or drugs.
- Will you need to open additional offices overseas? If the volume that you foresee happening overseas requires you to open an office there, that may affect your decision to market and sell that product there. It will also affect your bottom line as far as selling that product.
- What are the legal requirements? There may be taxes that you have to pay on the money that you make overseas. Are there employee restrictions? What's the law on owning buildings or offices? Or will you have to rent them? Is there a risk of a national takeover of your business? These are all things to consider, which is why doing business on an international level is unique.
- Will you make the product domestically and ship it overseas, or will you make it in the place you're going to be selling it? It could be a combination of both, depending upon which will work best and be most advantageous for your company.

SUMMARY

Today we learned about the **basis of trade** and the **balance of trade**. Products in and out are known as imports and exports. We also learned about **globalization**, as well as **business and trade**, focusing on the unique problems that are associated with managing international trade versus conducting business domestically only.

Good luck!

Source: adapted from sophia instructor james howard

ATTRIBUTIONS

- Japan's Balance of Trade for the US (1979 - 2008) | **Author:** Wikipedia | **License:** Creative Commons

TERMS TO KNOW

Absolute Advantage
The capacity to produce a higher number of goods or services using the same production resources as competitors.

Comparative Advantage
A trading advantage achieved over another company due to lower opportunity cost.

Exports
Goods produced domestically and sold to a foreign nation.

Globalization
The expansion of business into international markets.

Imports
Goods domestically sold that were produced in a foreign nation.

International Business
Business conducted between two or more nations.