INSIDE THE VAULT

An Economic Education Newsletter from the Federal Reserve Bank of St. Louis

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Crossing Borders: The Globalization Debate

Globalization can be defined as a phenomenon of increased economic integration among nations, characterized by the movement of people, ideas, social customs and products across borders. This phenomenon has a long history, dating back to the trade routes developed during the Roman Empire, as well as those pioneered by Marco Polo or ocean voyagers like Columbus and Magellan.

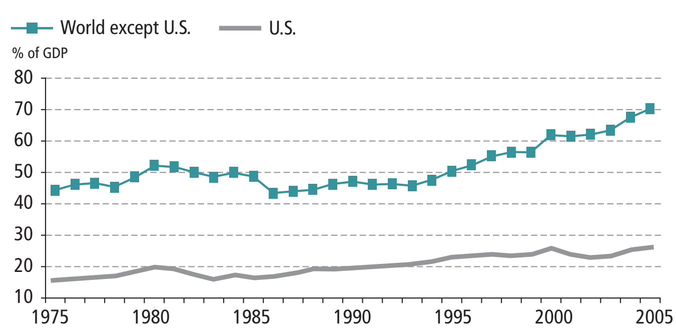
Globalization has been crucial for economic growth over time. In his influential study "The World Economy: A Millennial Perspective," the noted economic historian Angus Maddison argued that economic advancement across time was sustained by three interactive processes:

- the conquest or settlement of relatively empty areas that had fertile land, new biological resources or a potential to accommodate transfers of population, crops and livestock;
- international trade and capital movements; and
- technological and institutional innovations.

As Maddison and others have noted, technological innovations have played a key role in spurring previous globalization episodes. Transfers of technology from Asia and Egypt—such as silk, spices, textiles, glass blowing and rice—helped Venice and its colonies play a key role in the development of Europe. As economic integration spread across continents, political and financial institutions evolved to enhance and regulate the global marketplace.

The current globalization period, which more or less began in the late 1960s, contains many of the same aspects of earlier episodes. Reduced transportation costs, the opening of new markets (such as Asia, Eastern Europe and South America), and the general lowering of tariffs worldwide have helped boost international trade as a share of domestic economic activity. A key development behind the current globalization wave is the revolution in information and communication technologies (ICT). Although shipping merchandise goods is still the dominant form of trade between countries, trade in services that takes place across transoceanic cables or by satellite is of increasing importance.

International Trade Exposure:
United States and the Rest of the World



NOTE: Trade is the sum of merchandise and commercial services imports and exports.
SOURCES: World Bank World Development Indicators and author's calculations

The increased openness of the United States and the rest of the world to international trade can be seen in the figure on this page, which shows the sum of imports and exports of goods and services as a share of all goods and services produced annually in the United States—a figure known as Gross Domestic Product (GDP). Whereas the U.S. share of trade is a little more than

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Q&A

Q. What is the WTO?

A. WTO is the acronym that stands for "World Trade Organization," a forum for governments to negotiate trade agreements and settle trade disputes. It operates a system of trade rules.

Q. What is the IMF?

A. IMF is the acronym for the International Monetary Fund, an international organization of 185 member countries. It was established to promote international monetary cooperation, monetary exchange stability and orderly monetary exchange arrangements; to foster economic growth and high levels of employment; and to provide temporary financial assistance to countries to help ease balance-of-payments adjustments.

Q. What is the balance of payments?

A. The balance of payments is a record of payments that one country pays to and receives from all other foreign countries.

Q. What is the World Bank?

A. The World Bank is a source of financial and technical assistance to developing countries around the world. It is not an actual bank by the common definition. It provides low-interest loans, interest-free credit and grants to developing countries for education, health, infrastructure, communications and other purposes.

The World Bank is made up of two development institutions—the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA). Both institutions support the World Bank's mission to reduce global poverty and improve living standards. The IBRD focuses on middle income and creditworthy poor countries, while the IDA focuses on the poorest countries in the world.

Q. What is the OECD?

A. The OECD (Organisation for Economic Cooperation and Development) is a group of 30 member countries that share a commitment to democratic government and a market economy. Best known for its publications and statistics, the OECD's work covers economic and

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Economic Snapshot

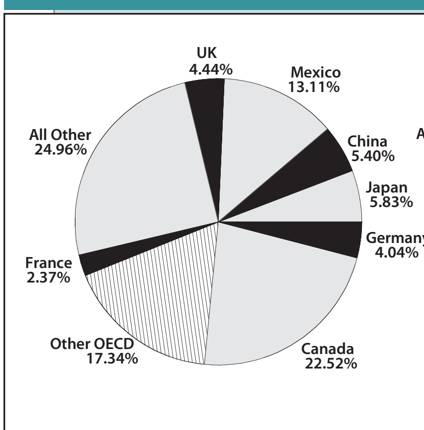
Fourth Quarter 2007

(Percent change at an annual rate from the preceding period)

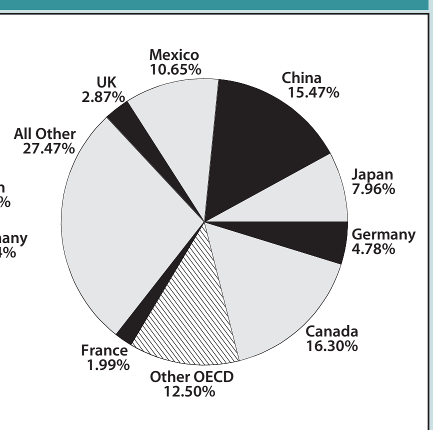
	Q1-'07	Q2-'07	Q3-'07	Q4-'07
Growth rate — Real Gross Domestic Product	0.6%	3.8%	4.9%	0.6%*
Inflation rate — Consumer Price Index	3.7%	4.6%	2.8%	5.0%
Civilian Unemployment Rate	4.5%	4.5%	4.7%	4.8%

**Preliminary estimate*

Goods Export Shares, 2006



Goods Import Shares, 2006



What is the difference between the two pie charts at left?

The "Goods Export Shares, 2006" chart indicates the percentage of total goods that the United States sells to other countries. The "Goods Import Shares, 2006" chart shows the percentage of goods the United States purchases from other countries.

For 2006, what two single countries—considering both exports and imports—are the United States' largest trading partners?

When adding both exports and imports for each single country listed, Canada and Mexico are the United States' largest trading partners. The Organisation for Economic Cooperation and Development (OECD) represents several countries; so, it does not qualify as a "single" country. (See "Q and A" for more information.)

For 2006, to which single countries did the United States export a greater share of goods than it imported?

In 2006, the United States exported a greater share of goods to the United Kingdom, Canada, Mexico and France than the share imported from these countries.

For 2006, from which single countries did the United States import a greater share of goods than it exported?

In 2006, the United States imported a greater share of goods from China, Japan and Germany than the share it exported to these countries.

Globalization

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a quarter of GDP, the rest of the world's exposure to international trade is much larger: 70 percent.

The Benefits of Globalization

The benefits of globalization are essentially based on the benefits of free trade. International trade is beneficial because of the principle of comparative advantage, which allows a country to specialize in the activities that it does best, given its labor, natural resources and technology. The estimated net benefits that flow from free trade are substantial. According to a study by economists Bradford, Grieco and Hufbauer, international trade has increased real household income by between $7,000 and $13,000. Removing all existing barriers to trade, they argue, would produce an additional real income gain of between $4,000 and $12,000.

In addition to the fact that people and nations can produce more goods and services when they specialize, thereby increasing the total amount of goods and services produced worldwide, free trade also increases the variety of goods and services available to consumers. Without trade, coffee drinkers in the United States would pay much higher prices because the nation's supply would depend solely on Hawaiian or Puerto Rican sources. Scarce resources would need to be redirected to produce more coffee, leaving fewer resources to produce other goods and services.

Similarly, Honda or BMW drivers would be forced to drive Chevrolets or Fords. Given that technological innovation in the automotive industry, as well as other industries, often arise from competition, the quality of cars might also be much lower for all car manufacturers.

The competitive forces of globalization have also been important factors in boosting U.S. labor productivity growth in recent years. This growth can occur in a couple of ways. First, increased competition spurs domestic firms to invest in equipment and software embodied with the latest technology. Second, moving less-skilled labor to low-wage countries increases the relative demand for higher-skilled, higher-productivity labor.

Proponents of globalization argue that increased economic integration benefits workers in relatively poor countries by providing them access to new ideas and new technologies; this exposure increases their productivity and real wages. According to Harvard professor Xavier Sala-i-Martin, this has helped to reduce world income inequality over the past 20 years.

The Downside of Globalization

Although free trade benefits society because it increases the world output of goods and services, it also creates losers in certain industries which cannot compete with foreign manufacturers. The biggest losers are both the workers and the owners (shareholders) in these industries, such as the U.S. television manufacturing industry which could not compete with foreign competition. If producers can substitute a cheaper foreign source of labor relative to the domestic wage rate, many will choose to move their production overseas, creating increased unemployment.

The largest unemployment effects are probably among less-skilled workers employed in ordinary production processes that can be done much cheaper overseas, such as making products like T-shirts or baseballs or reading service manuals at call centers. Since high-skilled workers are paid a premium for their labor, moving lower-skilled work offshore increases the domestic demand for higher-skilled workers relative to lower-skilled workers. Only one-third of the current U.S. labor force has graduated from college, however, and increasing that percentage will take time. At the end of WWII, the college-educated share of the labor force was 6 percent. At that rate, economists predict that reaching 50 percent of the labor force will not come about until 2047.

One potential consequence of this is rising income inequality between low-skilled and high-skilled workers. According to the Organisation for Economic Cooperation and Development (OECD), increases in income inequality have been most pronounced in the United States, the United Kingdom and some smaller European countries. Increases in the demand for skilled labor are clear market-based incentives for workers to boost their education levels and, perhaps, for firms to increase their workforce training. The demand for high-skilled workers over the long run can also be boosted by research and development, which is often the genesis of new ideas that boost economic growth and living standards over time.

A key difference between the current globalization episode and those from the past is the sheer magnitude of the number of workers who have entered the labor pool. The rise of China and India as important exporters of goods and services means that many of their workers are now directly competing with workers in countries like the United States, Japan or Mexico. Economically, an increase in the supply of labor puts downward pressure on wages assuming no change in labor demand.

Conclusion

As global competition has increased, so have the voices of protectionism. Ultimately, policymakers must decide whether the costs of maintaining relatively free trade—by expanding public programs to compensate the losers of trade, or those who perceive themselves as losers—is a small price to pay for maintaining a global economic system that has produced large benefits for most parts of the world.

This article was adapted from Trading Barbs: A Primer on Globalization, *which was written by Kevin Kliesen, an economist at the Federal Reserve Bank of St. Louis, and was published in the October 2007 issue of* The Regional Economist, *a St. Louis Fed publication.*

Classroom Discussion

1. What are some historical examples of globalization?
2. Explain how globalization may increase the demand for higher-skilled workers and decrease the demand for lower-skilled workers in the United States.
3. What are some arguments for and some arguments against free trade?

For a **lesson plan** to accompany this article, go to www.stlouisfed.org/education/itv_lesson_plan.html.

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social issues from macroeconomics to trade, education, development and science, and innovation.

Q. What is outsourcing?

A. Outsourcing is subcontracting a process such as customer service, product design or product manufacturing to a third party. The third party might be another organization within or outside of the state, region or country.

Q. What are NGOs?

A. NGO is an acronym that stands for "non-governmental organization." An NGO is an organization that is not affiliated with the government, yet has a significant impact on the political, social or economic status of a region. Since the mid-1970s the number of NGOs worldwide has increased significantly. The World Bank describes NGOs as "private organizations that pursue activities to relieve suffering, promote the interests of the poor, protect the environment, provide basic social services or undertake community development."

Q. What is comparative advantage?

A. The principal of comparative advantage demonstrates that countries benefit from trade when they specialize in producing goods and services that they are able to produce at a lower opportunity cost than other countries.

Q. What is the balance of trade?

A. The "balance of trade" (or net exports) is calculated by subtracting the monetary value of imports from exports in an economy over a certain period of time. A positive balance of trade is known as a "trade surplus," which means that the value of a country's exports exceeds the value of its imports. A "trade deficit" is a negative balance of trade, which means that the value of a country's imports exceeds the value of its exports.

Web Site Sources:

- International Monetary Fund
- Organisation for Economic Cooperation and Development
- Virtual Economics, National Council on Economic Education
- World Trade Organization
- World Bank

Federal Reserve Bank of St. Louis
P.O. Box 442
St. Louis, Mo. 63166-0442

Inside the Vault is written by Dawn Conner, economic education coordinator, and Mary Suiter, manager of economic education, at the Federal Reserve Bank of St. Louis, P.O. Box 442, St. Louis, Mo., 63166. The views expressed are those of the authors and are not necessarily those of the Federal Reserve Bank of St. Louis or the Federal Reserve System. Please direct all comments and questions about the publication to 314-444-4662 or mary.c.suiter@stls.frb.org.

Summer School at the Fed

NEW COURSES FOR EDUCATORS | JUNE 2008

Sponsored by the Federal Reserve Bank of St. Louis, the Center for Entrepreneurship and Economic Education (University of Missouri–St. Louis) and the Office of Economic Education and Business Research (Southern Illinois University Edwardsville)

Session 1: June 9, 10, and 11—The Global Market: Why Does It Matter?

Session 2: June 12, 13 and 16—Making Sense of Money and Banking

Session 3: June 17, 18, and 19—Technology: Tools for Teaching Social Studies and Personal Finance

Teachers' choice: Attend one, two or all three sessions. Take for graduate credit or noncredit.

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To register: Registration is required through either SIUE or UMSL for both graduate credit and noncredit enrollment. One hour of graduate credit will be awarded to educators for completing each session for which they register. To register through SIUE, contact **Mary Anne Pettit at 618-650-2583** or by e-mail mpettit@siue.edu. To register through UMSL, contact **Barbara Flowers at 314-516-5561** or by e-mail at bflowers@umsl.edu.

The ABCs of Personal Finance

A ST. LOUIS FED ANNUAL CONFERENCE FOR EDUCATORS

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- **A Personal Finance Primer**
- **Understanding Assets**
- **Understanding Liabilities**

Dates and Locations:

Louisville Branch
Wednesday, June 25, 2008 (5-12)

Little Rock Branch
Wednesday, July 23, 2008 (K-12)

Little Rock Branch, Springdale, Ark.
Thursday, July 24, 2008 (K-12)

St. Louis
Tuesday, Oct. 28, 2008 (9-12)
Wednesday, Oct. 29, 2008 (5-8)

Memphis Branch
Wednesday, Nov. 5, 2008 (elementary)
Thursday, Nov. 6, 2008 (secondary)

To register: Visit www.stlouisfed.org/education/conferences.html.

Federal Reserve Bank of St. Louis Memphis Branch

Personal Finance: A Perfect Fit

This two-day workshop is designed to help educators increase their understanding of economics and personal finance. The Tennessee Department of Education has approved this training for certification to teach high school personal finance.

Dates and Locations:

April 3-4, 2008—Federal Reserve Bank of St. Louis Memphis Branch

April 17-18, 2008—Jackson, Tenn.

June 25-26, 2008—Dyersberg, Tenn.

To register:

E-mail Cathy Martin at cathy.e.martin@stls.frb.org.

Calling K-12 Educators: We Need Your Help!

We are conducting a survey regarding economics and personal finance curriculum. We plan to use the information to make decisions about the curriculum and materials we develop. Help us by completing the brief survey online at www.stlouisfed.org/education.

Federal Reserve Bank of St. Louis—Louisville Branch

Right Start

An Institute for New and Beginning Teachers of Economics

Sponsors: Federal Reserve Bank of St. Louis—Louisville Branch, the Kentucky Council on Economic Education and the Foundation for Teaching Economics

When and Where: June 9-12, 2008 at Rough River State Park in Falls of Rough, Ky.

For more information: Visit http://www.econ.org/programs/rightstart.html or call the KCEE at 502-267-3570 or 1-800-I-DO-ECON.

Federal Reserve Bank of St. Louis—Memphis Branch

Focus on the Economy

Contemporary Topics in Economics

When:	June 17-19, 2008
Where:	Mississippi State University
Sponsors:	Federal Reserve Bank of St. Louis—Memphis Branch and the Mississippi Council on Economic Education
To register:	Visit www.mscee.org and click on "Focus on the Economy."

Federal Reserve Bank of St. Louis—Little Rock Branch

Spotlight on Economics

Lessons in Personal Finance

A Financial Literacy Symposium for K-12th-grade Teachers

When:	July 22-23, 2008—Little Rock, Ark. July 24-25, 2008—Springdale, Ark.
Sponsors:	Hosted by the Little Rock Branch of the Federal Reserve Bank of St. Louis, Economics Arkansas, the Arkansas Securities Department and the Springdale Professional Development Center
To register:	Visit www.stlouisfed.org/education/conferences.html, or call Julie Kerr at 501-324-8296.

Federal Reserve Bank of St. Louis Little Rock Branch

What: Basics of Economics and Financial Literacy: Arkansas Frameworks Connections

When and Where:
July 1, 2008—Pine Bluff, Ark.
Aug. 1, 2008—El Dorado, Ark.

Sponsors: Federal Reserve Bank of St. Louis—Little Rock Branch, Economics Arkansas, and the Arkansas Securities Department

This is a program for K-12 teachers that is designed to improve economic and personal finance content knowledge. Teachers will learn basic economic and financial literacy skills from speakers and will receive activities and resources that are free or inexpensive.

To register: Contact Julie Kerr at 501-324-8296, or e-mail her at julie.a.kerr@stls.frb.org.

Federal Reserve Bank of St. Louis Louisville Branch

What: Personal Finance Summit in the Bluegrass

When: June 25-26, 2008

Where: Marriott East Hotel, Louisville, Ky.

Sponsors: Kentucky Council on Economic Education and the Federal Reserve Bank of St. Louis—Louisville Branch, along with other corporate and nonprofit sponsors

This event brings educators and policymakers together to address the need for change in policies and practices regarding personal financial literacy in Kentucky schools. For more information, contact David Ballard at david.b.ballard@stls.frb.org.

Bank Contacts

Little Rock – Billy Britt 501-324-8368
Louisville – David Ballard 502-568-9257
Memphis – Jeannette Bennett 901-579-4104
St. Louis – Dawn Conner 314-444-8421
St. Louis – Mary Suiter 314-444-4662