WHY ECONOMICS?

What students should know about economics and why: 6 Key Ideas

#6 Why Can I have Strawberries All year Round?

An understanding of 21st century globalization begins with one principle, the principle of exchange. People will only exchange if they expect to gain more than they give. When they exchange, they give up something of lesser value to themselves for something they want more. As a result, both parties are better off. Juan trades Maria his apple for her orange. He likes the orange better than the apple; she likes the apple better than the orange. Both Juan and Maria are better off after the trade. (If Juan is trading with Maria just to get to know her better, he is still gaining more than he gives even if he doesn't like oranges at all!) The value of the exchange is subjective. The principle of exchange states that voluntary exchange benefits both parties and increases the well-being of both traders.

No one would disagree with the principle of exchange if Juan and Maria both live in the same country. But is it still true if they live in different countries and their purchase of foreign products reduces employment in their home country? If Swedes buy Chevrolets instead of Volvos, is that a good thing for the Swedes who buy the Chevrolet? Of course it is for the consumers; but what about Volvo workers?

To address this issue, we should look at the law of comparative advantage. Assume that Mike and Laura have to clean the house before their parents get back from a long weekend. Mike is better at doing dishes than at tidying up. The law of comparative advantage asks which activity Mike is "better" at. If he is three times as fast at doing dishes and four times as fast at cleaning rooms, he should clean rooms and his sister should do the dishes; they will finish both chores more quickly. Similarly, if folks in California are better at producing both corn and microchips than people in Nebraska, Californians should produce the product they are "better" at, and Nebraskans should produce the other product.

If we put these two ideas together, production according to comparative advantage and increase in well-being through exchange, we have a powerful case for open borders in reference to trade. The world can produce more things more efficiently. Consumers are better off with a higher quantity and quality of goods at lower prices. The lower prices mean that workers' real incomes have increased. Open trade maximizes world output and consumer well-being.

What about producers and their workers? Producers whose products can compete internationally and their workers who make the products gain from globalization. Producers and their workers who can't

compete will go under. Because profits can only be earned in a competitive market by finding the lowest cost production methods, some workers will suffer as their jobs are outsourced to those who demand lower wages.

So, are they winners or victims? Today's students can guard against job loss by developing the skills that are in high demand in a 21st century global economy. While there will be many jobs for relatively low skilled labor, those jobs will allow workers to maintain a minimum life style. Those who will prosper are those who develop the skills that are in high demand and transferable from one job to another. The students who enter the labor market today are likely to change jobs six times and careers three times in their working lives. That means that each time they re-enter the labor market, they will have to come with more and better human capital than the last time they entered; they will never leave school!

Consider a few myths.

Outsourcing and off shoring are bad.

Outsourcing simply means that a firm contracts out for a service. The service provider is not necessarily foreign. Off shoring means that a firm contracts with foreigners to provide a service. To many people, outsourcing seems unpatriotic and the argument becomes emotional. Some argue that the U.S. does as much "in-shoring" as it does out-shoring. In other words, there are as many Americans who work for foreign firms as foreigners who work for American firms.

Nations trade.

Nations do not trade; people trade. If Germans buy personal computers, it is not the German government that is buying the computers; it is some individual German consumers. If an American buys a dress that is made in China, neither the American nor the Chinese government is necessarily involved in the transaction.

Americans can't compete with low wage foreign labor.

In fact, because of capital equipment, highly developed infrastructure, (that some say is now crumbling), and technology, the average American worker in many industries is far more productive than some low wage foreign workers. It is not the wage that is so important; it is the total cost per unit of output. American workers who develop the skills of the 21st century will succeed and those who don't won't.

Globalization is not simply a matter of goods and services traded across borders. It includes questions of child labor, slave labor, the environment, human rights, endangered species and many others.

So how do we stop it? The plain and simple answer to that is that we don't. Globalization is not a new phenomenon. It has gone on to varying degrees since recorded history. All world empires are examples of globalization. When Columbus and his crew set foot on the new world, they ushered in an era of globalization that dramatically changed the world. But today's globalization is unique in its scope and its nature. Technology and the resulting communication possibilities mean that information travels

around the world at warp speed. So the question is not how we stop globalization but how we teach students to use this knowledge to their advantage. Students who recognize the challenges and opportunities of globalization will better understand why and how they benefit from investing in their human capital.

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