



International Trade

It is a lot easier to grow grapes and make wine in Italy than in Norway. It is easier to hunt reindeer in Norway than Italy. To the extent that Norwegians want Chianti and Italians want reindeer steaks, there is an obvious basis for international trade. Economists never needed to prove that. Nor, given climate and geography, is it hard to understand why Italians traditionally drink Chianti and eat fish, while Norwegians traditionally drink aquavit and eat reindeer and whales. But we all like to experience other peoples' traditions, tastes, and capacities. International trade allows that, to the mutual benefit of all. In this view, national production for national consumption is the cake; international trade is the icing. Of course, no one objects to trade in this sense. But this is not an accurate picture of either the reality of trade today, or the trends and goals of globalization. However, before we tackle the difficulties of globalization, let's look more closely at the classical argument for free trade, an argument that goes well beyond the common-sense picture just sketched.

■ THE CLASSICAL THEORY: COMPARATIVE ADVANTAGE

The case for free trade, like the case for exchange in general, hinges on the assumption that trade is voluntary. Both parties to a voluntary exchange must be better off, in their own estimation, after the trade than before—otherwise they would not have made the trade. Under what conditions is this happy result likely to be the case? The most obvious condition is that of **absolute advantage** in cost differences reflected in the example above. If country A can produce something at a lower absolute cost than country B, while B can likewise produce something else at a lower absolute cost than A, then there is a reason for voluntary exchange, assuming A wants some of B's product and B wants some of A's product in the first place.

Initially economists thought that if one country produced all goods more cheaply than another, there was no basis for mutually advantageous trade between them—the more efficient country would only harm itself by trading with the less efficient country. David Ricardo demonstrated that this was not so—that both countries could benefit from trade even if one country had an absolute advantage in all tradable goods.¹ The key to understanding this is to focus on “comparative advantage” rather than absolute advantage.

A country has an *absolute advantage* if it can produce the good in question at a lower absolute cost than its trading partner. It has a *comparative advantage* if it can produce the good in question more cheaply relative to other goods it produces than can its trading partners, regardless of absolute costs.

Ricardo demonstrated this using a two-country, two-goods numerical example. We will retrace his logic using just such an example shortly. But first it is worthwhile to whet our appetite by noting how proud economists are of this result. Trade theorist R. Findlay referred to comparative advantage as the “deepest and most beautiful result in all of economics.”² Surveys have shown that about 95% of economists support the policy of “free trade.” MIT economist Paul Krugman said that “If there were an Economist’s Creed it would surely contain the affirmations ‘I believe in the Principle of Comparative Advantage,’ and ‘I believe in free trade.’”³ With that fanfare, let’s bring the comparative advantage argument onstage.

Consider a world in which we have two countries, A and B, each producing two goods, coal (C) and wheat (W). Since we want to demonstrate the gains from trade without appealing to absolute advantage, confining our reasoning only to comparative advantage, let’s impose on ourselves a veil of ignorance about absolute cost differences. Specifically, let’s say that country A measures costs in terms of a-units, and country B measures costs in terms of b-units, and that we know nothing about the relation of a to b. Perhaps $a > b$, or $a < b$, or $a = b$. Therefore, we cannot compare costs across countries, as required to know absolute advantage. But we can compare the cost of C and W within each country. The comparative or relative cost of W to C in country A can be calculated and compared to the comparative or relative cost of W to C in country B. That information will be sufficient to demonstrate the possibility of mutual gains from trade between A and B. The argument will depend only on comparative advantage (internal cost ratios), and not on cross country comparisons of cost (absolute advantage) because the latter have been made impossible by assuming incomparable units for measuring costs in the two countries. Table 17-1 summarizes the unit costs of C and W in A and B.

¹D. Ricardo, *On the Principles of Political Economy and Taxation*. 3rd edition. London: John Murray, Albemarle-Street, 1821 (originally published in 1817). Online: <http://www.systemics.com/docs/ricardo/principles.html>.

²R. Findlay, “Comparative Advantage.” In J. Eatwell et al., eds. *The New Palgrave: The World of Economics*, New York: Norton, 1991, p. 99.

³P. Krugman, Is Free Trade Passé? *Economic Perspectives* 1(2): 131 (1987).

■ **Table 17.1**

| UNIT COSTS OF COMMODITIES | | | |
|---------------------------|-----------|-----------|--------------|
| | Country A | Country B | Total Output |
| Coal | 1a | 1b | 2C |
| Wheat | 1a | 4b | 2W |
| Total Resources | 2a | 5b | |

Each country needs both coal and wheat, so before trade, each country allocates its resources between the two commodities and produces as much of each as permitted by its unit costs, as shown in the table. A has total resources of 2a. With unit costs of both coal and wheat equal to 1a, it can produce one unit of coal and one unit of wheat with its endowment of 2a resources. Country B has a total resource endowment of 5b. B allocates 4b resources to produce one unit of wheat, and with the 1b remaining can produce one unit of coal. Total world output before trade is $2W + 2C$.

Ricardo has a look at this situation and realizes that we can do better by allowing specialization and trade according to comparative advantage. He notices that W is four times as expensive as C in country B, and only one time as expensive as C in country A. In country B coal is cheaper relative to wheat than it is in country A. Therefore B has a comparative advantage in coal. Similarly, wheat is cheaper relative to coal in country A than it is in B. Consequently A has a comparative advantage in wheat.

Now let each country specialize in the production of the commodity in which it has a comparative advantage and trade for the other commodity. A will specialize in wheat, allocating all of its 2a resources to wheat, and with a unit cost of wheat of 1a will end up producing 2W. B will allocate all 5b units of its resources to production of coal, and with a unit cost of coal of 1b will produce 5C. Total world product after specialization and trade is $2W + 5C$. The world has gained an extra 3C with no extra resources. The world is better off. And we have shown this without ever having to compare costs of wheat in country A with costs of wheat in country B, or costs of coal in country A with costs of coal in country B. Only comparative advantage (a difference in internal cost ratios) matters, not absolute advantage. Suppose we suddenly learned that in absolute terms $a = 5b$, so that country B has an absolute advantage in both C and W. Does that change our conclusion? Not a bit.

Although the world is better off by 3C, one might still wonder which country gets the 3C, or how it is divided between them. We can see that the world as a whole is better off, but how do we know that each country

is better off? Might not one country suffer while the other gains a lot? Ricardo had an answer. How the total gains from specialization and trade, $3C$, will be divided between A and B depends on the terms of trade, the relative price at which W exchanges for C between the two countries. That will depend on supply and demand and bargaining power, so we cannot say exactly how the gains will be divided. But we can be sure, says Ricardo, that neither country will be worse off after trade. How do we know this? Because, since trade is voluntary, neither country will accept terms of trade less favorable than the terms of its own internal cost ratio, the terms on which it can “trade with itself.” A will not trade $1W$ for less than $1C$, because it could do better by reallocating its own resources back from W to C again. Likewise B will not give more than $4C$ for $1W$. So the terms of trade will fall somewhere between the limits of $1C/1W$ and $4C/1W$. Anywhere between those ratios both countries gain a part of the extra $3C$.

■ KINKS IN THE THEORY

Ricardo’s demonstration is indeed interesting and impressive. To more than double coal production, with no sacrifice of wheat production and no additional resources, is a neat trick. Within the world of its assumptions, the logic of the comparative advantage argument is unassailable. But it is time to have a closer look at the assumptions. What are the assumptions, and might they veil some costs that need to be subtracted from the gain of $3C$?

First, it is not really true that the extra $3C$ is produced with no additional resources. There is the obvious increase in the rate of depletion of coal mines and of pollution resulting from burning the coal. What the trade economists mean by “no extra resources” is simply no additional labor or capital. Recall the neoclassical production function discussed earlier, in which output is a function only of labor and capital inputs. But, contrary to the neoclassical assumptions, the resource cost of extra output cannot simply be ignored. Therefore some deduction from the value of $3C$ is required to account for extra depletion and pollution. But let us assume that is done and there are still net gains from trade and specialization.

Second, we have neglected or abstracted from transport costs, implicitly assuming them to be zero. Wheat has to be shipped from A to B, and coal from B to A. If the energy costs of that transportation were $3C$ or greater then the world would gain nothing. It is worth noting that transportation is energy intensive, and currently energy is not only directly subsidized, but, in addition, many of its external costs are not internalized in its price. Consequently, international trade is indirectly subsidized by energy prices that are below the true cost of energy. But let us suppose that there is still a net gain from trade after deducting fully counted transport costs.

Third, we also assumed that in each country the cost of specialization was negligible. But there are two important costs to recognize. First, in A all coal miners must become wheat farmers, and in B all wheat farmers must become coal miners. Making such a shift is costly to all whose livelihood is changed. Also in the future the range of choice of occupation has been reduced from two to one—surely a welfare loss. Most people derive at least as much life satisfaction from how they earn their income as from how they spend it. Economists practically identify welfare with increased range of choice among commodities, but are strangely silent about the welfare effects of the range of choice among jobs. Second, after specialization countries lose their freedom not to trade. They have become vitally dependent on each other. One's access to essential items depends on the cooperation of people on the other side of the world, who, however, admirable they may be, have different customs, different values, different interests, and different types of government. Remember that the fundamental condition for trade to be mutually beneficial is that it be voluntary. The voluntariness of “free trade” is compromised by the interdependence resulting from specialization. Interdependent countries are no longer free not to trade and it is precisely the freedom not to trade that was the original guarantee of mutual benefits of trade in the first place.

True enough, as Ricardo pointed out, if the terms of trade become too disadvantageous the country getting the worse end of the deal can opt out and despecialize—put some of its wheat farmers back in the coal mines, reinvest in mining equipment, reactivate mining legislation, re-employ exporters and importers, and so on. But this is both costly and socially disruptive in reality. The model assumes specialization is reversible, while in fact it is closer to being irreversible—that is, reversible but at a high cost. Countries specializing in non-essential products—bananas, sugar, cocoa, and so on—are especially vulnerable to hardship from having lost their freedom not to trade. It is easier to drive a hard bargain if you are selling essentials and buying nonessentials than vice versa. Clearly there should be some further deduction from the 3C resulting from the above costs of specialization.

THINK ABOUT IT!

Many countries specialize in only one or few commodities for export. For example, Ecuador specializes in bananas, Ghana in cocoa, and Cuba in sugar. What happens to the price of these commodities when lots of other countries start producing them? What happens to the price when growing conditions produce a global bumper crop? What happens to export income for each country when some regions have great growing conditions, and other regions lousy ones? Look up price trends for these commodities. Do you think specialization in agricultural commodities is a good development strategy?

■ CAPITAL MOBILITY AND COMPARATIVE ADVANTAGE

But suppose we still have a net gain. Can we then conclude that the argument for free trade on the basis of comparative advantage holds true? In fact, there is an often-overlooked provision of the theory, one of great relevance today in the debate over globalization, that suggests that it does not hold true. Note that our numerical demonstration of comparative advantage implicitly assumes factor (labor and capital) immobility between country A and B. Only coal and wheat crossed borders. Labor and capital stayed at home and were reallocated domestically between coal and wheat according to the principle of comparative advantage. Since it is usually the capitalist who makes the investment allocation decisions let us just focus on capital and its mobility or lack thereof. Clearly our model implicitly assumes that capital is mobile between sectors within each country, but immobile between countries. Capitalists cannot even compare costs or profitability between A and B because, thanks to our veil of ignorance, they cannot compare a-units with b-units. Therefore they could not possibly know whether or not investment in the other country would be profitable or not.

One other way to show the implicit assumption of immobile capital in modern texts is to note that the examples, like ours, are usually in terms of barter—wheat for coal, with no money involved. Barter trade is always necessarily balanced. No monetary or short-term capital flows are required to balance the differences in exports and imports of bartered goods. The **current account** is the difference between the monetary value of imported and exported goods and services. If imports are greater than exports, the current account is in deficit. If exports are greater than imports, the current account is in surplus. **Capital accounts** are the difference between monetary flows, used to purchase various assets, into and out of a country. Such assets include stocks, bonds, real estate, and other assets that remain in the country. When more money flows into the country than out, the capital accounts are in surplus. The current account of the balance of payments is always balanced in barter, so there is no need for a compensating imbalance on capital account. Therefore, barter examples assume balanced trade, and balanced trade means no capital mobility.

Immobile capital does not mean that producer goods cannot be exchanged on current account. Machines and tractors, “materialist capital” can be traded just like shoes and sugar. What is immobile is capital in the “fundist” sense, money, or liens on the future product of the deficit country. Immobile capital in the fundist sense is the same thing as balanced trade on the current account, or trade that requires no compensating transfer of fundist capital on capital account. In other words, immobility

of capital does not prevent Brazil from importing machines and tractors and paying for them with exports of shoes and sugar. It just prohibits Brazil from importing machines and tractors *faster* than it can pay for them by exporting shoes and sugar, and thereby paying for the extra machines and tractors by issuing liens against its future production of shoes and sugar.

The capital immobility assumption is often hidden by examples in terms of individuals who specialize and trade, rather than nations. A favorite example is the lawyer and her secretary. The lawyer happens to be a champion speed typist. She has an absolute advantage over the secretary both in typing and of course in practicing law, since the secretary is not a lawyer. But the lawyer nevertheless finds it advantageous to hire the secretary to do the typing, and both benefit from this exchange. Although the lawyer is a better typist than the secretary, she is not much better. But she is a much better lawyer. So the secretary has a comparative advantage in typing (although an absolute disadvantage), and the lawyer has a comparative (and absolute) advantage in law. So they specialize according to comparative advantage. The lawyer is not so silly as to spend her time typing when she could be billing clients at \$300 per hour. Where is the assumption of capital immobility in this example? It is hidden by the obvious fact that it is impossible for the productive energy and capacity of the secretary to be transferred to the absolutely more efficient person of the lawyer. The lawyer is not a vampire that can suck the lifeblood and energy out of the hapless secretary in order to employ it more efficiently. In other words, productive capacity, “capital” is immobile between the lawyer and her secretary, so the logic of comparative advantage works.

Between countries, however, it is not impossible for productive capacity, capital, to be transferred from one country to another in response to absolute advantage. Capital mobility has to be explicitly ruled out for comparative advantage argument to work between countries. Although each country as a whole benefits under comparative advantage trade, not every citizen or group of citizens will benefit. Everyone could benefit, but only if winners were to compensate losers—that is, only if coal miners in B compensate wheat farmers, and wheat farmers in A compensate coal miners for the costs of changing their livelihood. As we move to absolute advantage (capital mobility internationally), some entire nations may lose, but the world as a whole will gain and could compensate the losing country, just as within countries the government could compensate the losing industry. Such compensation usually does not take place within nations, and almost never takes place between nations. Within nations there are at least institutions of community that could carry out internal transfers. At a global level there are no such

institutions. The move from comparative advantage to absolute advantage seems to be part of the general retreat from the Pareto to the Hicks-Kaldor (often referred to as “potential Pareto”) welfare criterion. The latter represents a retreat from the condition that no person be made worse off to the weaker condition that winners could, if they so choose, compensate losers and still be better off. Similarly, the former is a retreat from the condition that no nation be made worse off to the weaker condition that winning nations could compensate losing nations, if they choose to, and still be better off. In both cases the weaker criterion takes compensation as only potential, not actual, and in the case of trade the compensation condition is seldom even mentioned.

■ ABSOLUTE ADVANTAGE

Ricardo, to his credit, was very explicit about his assumption of immobile capital between countries. If capital were mobile internationally, it is obvious that capitalists would seek the greatest absolute profit and consequently the lowest absolute cost of production. In our example, if capital were mobile and the capitalists knew that $1a = 5b$, so that B had an absolute advantage in both coal and wheat, they would invest in B and forget about A. Comparative advantage would be irrelevant. If capital is mobile, absolute advantage is the relevant criterion. The only reason the capitalist would ever be interested in comparative advantage is if capital were immobile internationally. If capital cannot follow absolute advantage abroad, the next best thing is to follow comparative advantage specialization at home and trade for the foreign product. Comparative advantage is a clever second-best adaptation to the constraint of international capital immobility. But without that constraint, it has no reason to be, and absolute advantage is all that counts.

Why is the capital immobility assumption so important? Because it is utterly counterfactual in today’s world. Capital is mobile all over the world in trillion dollar amounts at the speed of light.

Why is this overlooked? The nice thing about the comparative advantage argument is that both countries benefit from free trade, and gains are mutual—at least in theory, if not always in fact. The problem with absolute advantage is that both countries do not necessarily gain. If one country has an absolute disadvantage in both commodities, it will lose jobs and income as capital moves abroad. But under absolute advantage, world production will still increase. In fact, it would in theory increase by more than under comparative advantage. This is because in moving from comparative to absolute advantage, we relax a prior constraint on world product maximization—namely, the condition of capital immobility. Mo-

bile capital can seek out more productive opportunities than it could when it was confined to its country of origin. But while there is certainly a case for absolute advantage, it lacks the politically very convenient feature of guaranteed mutual benefit that was part of the traditional comparative advantage argument for free trade. All countries still could be better off if there were some regulatory institution whereby winners could compensate losers. But that would no longer be “free” trade. The focus of policy has shifted away from the welfare of nations to the welfare of the globe as a whole. And that brings us to the issue of globalization, or more specifically of globalization versus internationalization as alternative models of world community.

■ GLOBALIZATION VS. INTERNATIONALIZATION

Internationalization refers to the increasing importance of relations between nations: international trade, international treaties, alliances, protocols, and so on. The basic unit of community and policy remains the nation, even as relations among nations, and among individuals in different nations, become increasingly necessary and important.

Globalization refers to global economic integration of many formerly national economies into one global economy, by free trade, especially by free capital mobility, and also, as a distant but increasingly important third, by easy or uncontrolled migration. Globalization is the effective erasure of national boundaries for economic purposes. National boundaries become totally porous with respect to goods and capital, and increasingly porous with respect to people, viewed in this context as cheap labor, or in some cases cheap human capital.

Ricardo and the classical economists who argued for free trade based on comparative advantage were basically nationalists and retained their fundamental commitment to the nation even as they advocated internationalization.

In sum, globalization is the economic integration of the globe. But exactly what is “integration”? The word derives from *integer*, meaning one, complete, or whole. Integration means far more than “interdependence”—it is the act of combining separate albeit related units into a single whole. Integration is to interdependence as marriage is to friendship. Since there can be only one whole, only one unity with reference to which parts are integrated, it follows that global economic integration logically implies national economic disintegration—parts are torn out of their national context (disintegrated), in order to be reintegrated into the new whole, the globalized economy. As the saying goes, to make an omelet, you have to

break some eggs. The disintegration of the national egg is necessary to integrate the global omelet.

■ THE BRETTON WOODS INSTITUTIONS

At the end of World War II there was a conference of nations held in Bretton Woods, New Hampshire, for the purpose of reestablishing international trade and commerce, which had been disrupted by the war. The international diplomats and economists, led by John Maynard Keynes of England, and U.S. Secretary of the Treasury Henry Morgenthau and his aide Harry Dexter White, were successful in negotiating the charter that set up the **Bretton Woods Institutions**, the **International Monetary Fund (IMF)** and the **International Bank for Reconstruction and Development (World Bank)**. These two institutions are made up of member nations. They were founded on the federal model of internationalization, as just discussed, not the integral model of globalization. Their founding, almost 60 years ago, was a wonderful achievement of international cooperation and diplomacy. It symbolized the end of an era of economic depression followed by war and destruction, and the beginning of a hopeful era of peace and production in which “swords would be beaten into plowshares.”

The atmosphere of eager optimism was expressed by Morgenthau,⁴ who envisaged: “a dynamic world economy in which the peoples of every nation will be able to realize their potentialities in peace . . . and enjoy, increasingly, the fruits of material progress on an earth infinitely blessed with natural riches.” Morgenthau went on to say that “prosperity has no fixed limits. It is not a finite substance to be diminished by division.” The same note was sounded by Keynes: “In general, it will be the duty of the Bank, by wise and prudent lending, to promote a policy of expansion of the world’s economy. . . . By expansion we should mean the increase of resources and production in real terms, in physical quantity, accompanied by a corresponding increase in purchasing power.” The “empty world” vision of the economy was dominant. Notions of ecological limits to growth were not on the horizon, much less on the agenda. The founders of the Bretton Woods Institutions felt that they had far more pressing issues to deal with in 1945, and they were surely right. But the world has changed a lot in 60 years. Population has roughly tripled, and resource throughput has increased more than ninefold,⁵ moving us a long way from the “empty” toward the “full” world.

⁴Morgenthau and Keynes quotes are from B. Rich, *Mortgaging the Earth*, Boston: Beacon Press, 1994, pp. 54–55. For an interesting history of the Bretton Woods Conference see also the biography of Keynes by R. Skidelsky, *John Maynard Keynes*, Vol. III, “Fighting for Freedom, 1937–1946,” New York: Viking Press, 2000.

⁵Calculated from data in J. B. Delong, *Macroeconomics*, Burr Ridge, IL: McGraw-Hill, 2002, chap. 5. The data are labeled GNP, but in the text Delong refers to it as “material output,” what

The division of labor between these institutions was that the IMF would focus on short-term balance-of-payments financing (the current account of the balance of payments), while the World Bank would concentrate on long-term lending (the capital account).⁶ The word “reconstruction” in the World Bank’s proper name referred to reconstruction of war-torn countries. That function, however, was largely taken over by the Marshall Plan, leaving the World Bank to focus almost entirely on lending for the development of underdeveloped countries.

One of Keynes’ ideas, rejected by the conference in favor of the present IMF, was for an International Clearing Union for settling trade balances. In Keynes’ plan, all trading countries would have an account with the Clearing Union, denominated in an international monetary unit called the “bancor,” which would be convertible into each national currency at a fixed rate, like gold. Clearing of accounts would be multilateral; that is, if country A had a surplus with B and a deficit with C, and the two partially cancelled out, then A would have to settle only the difference with the Union.

The innovative feature of Keynes’ plan was that interest would have to be paid to the Union on credit balances as well as debit balances, at least when the balances exceeded a certain amount. In other words, there would be a penalty for running a balance of trade surplus, as well as for running a deficit. All nations would have an incentive to avoid both a surplus and a deficit, to balance their trade accounts, leading to less international debt and reduced capital flows. We think this proposal merits reconsideration today. It is superior to massive IMF bailouts of debtor countries that continue to run trade deficits. It also puts pressure on countries, like Japan, that are addicted to running huge trade surpluses.

■ THE WORLD TRADE ORGANIZATION

The **World Trade Organization (WTO)** is of more recent birth than the IMF and World Bank, having its origins in the General Agreement on Trade and Tariffs (GATT) rather than in the Bretton Woods conference.⁷ The purpose of GATT was to reduce tariffs and other barriers to international trade. The WTO is frequently lumped together with the World Bank and IMF, however, because the three institutions have common

we call throughput. There is not a 1:1 correlation between GNP and throughput, but Delong’s figures show a nearly tenfold increase in GNP from 1950 to 2000. A ninefold increase in throughput from 1945 to the present is probably in the ballpark.

⁶Current accounts and capital accounts are described in detail in Chapter 18.

⁷An international trade organization was proposed at Bretton Woods but was ultimately rejected by the U.S. and replaced by GATT.

policy goals of free trade, free capital mobility, and export-led growth—in other words, globalization. To the extent that the World Bank and the IMF push a policy of globalization, they run into conflict with the internationalist model of world community underlying their charter, a model very different from that of globalization, as we have already emphasized. The WTO's commitment to globalization is evident in the statement of its former director-general, Renato Ruggiero: "We are no longer writing the rules of interaction among separate national economies. We are writing the constitution of a single global economy."⁸ This is a clear affirmation of globalization and rejection of internationalization as defined earlier. Of course, different directors-general may alter policies.

But meanwhile, if the IMF-WB are no longer serving the national interests of their member countries, according to their charters, whose interests are they serving?

What are the advantages of an internationalized economic system over a globalized one? One is that nation-states that can control their own boundaries are better able to set their own monetary and fiscal policy, as well as such things as environmental standards and a minimum wage. Markets hate boundaries, but policy requires boundaries.

It is worth remembering that international free trade is not really trade between nations, but rather trade between private firms or individuals residing in different nations. Their transactions are carried out for the private benefit of the contracting parties, not for the larger benefit of their national communities. The policy of free trade represents the assumption that if these transactions benefit the private contracting parties, then they will also benefit the larger collectives (nations) to which each party belongs. "What's good for General Motors is good for the USA," to recall a famous statement.

Let's apply the assumption to another collective, the corporation. Do corporations allow their individual employees to freely contract with employees of another corporation in pursuit of their own self-interest? This happens, but if the employees are caught, they are usually sent to jail. All transactions initiated by employees are supposed to be in the interests of the corporation, not the employee, and must be judged so by officers of the corporation. Corporations regulate the trades negotiated by their employees. Why should nations not regulate trade negotiated by their citizens? Advocates of an internationalized economy argue that nations must have the ability to regulate their corporate citizens, just as a corporation regulates the behavior of its employees.

⁸From a speech to the United Nations Conference on Trade and Development's (UNCTAD) Trade and Development Board in October 1996. Online: <http://r0.unctad.org/en/special/tb43pr05.htm>.

Advocates of a globally integrated economy argue that nations are obsolete, and that they have been responsible for two world wars in the twentieth century. True enough, it is important to remember the real evils of nationalism. We agree with the Bretton Woods delegates, however, that the answer to nationalism is internationalism, not globalism. “A world with no boundaries” is a good song lyric, but taken literally, it makes policy in the interest of local community impossible. We see world community as a community of local and national communities—as a community of communities. Consequently, the problems we see with the Bretton Woods Institutions arise not from their historical charter, but from their institutional tendency to forget their charter and substitute globalism for internationalism.

■ SUMMARY POINTS

What are the critical points to take home from this chapter? First, globalization is entirely different from internationalization. Under globalization, all national economies are integrated into one global economy and must obey the laws laid down by a global economic institution—currently the WTO. Under internationalization, relations between countries grow increasingly important, but the nation remains the basic unit of community and policy.

Second, the concept of comparative advantage is largely irrelevant in a world of mobile financial capital. We must instead look at absolute advantage. While absolute advantage is likely to lead to greater overall gains, it will also produce both winners and losers on an international level. Without the elegant theoretical conclusion of comparative advantage that free trade is a win-win affair for all countries, it is necessary that we look at the empirical evidence regarding each country’s absolute advantage to determine winners and losers under a regime of global integration. In the next chapter, we focus on globalization and its likely consequences.

BIG IDEAS to remember

- Comparative vs. absolute advantage
- Capital mobility and comparative vs. absolute advantage
- Globalization vs. internationalization
- Bretton Woods Institutions (IMF and World Bank)
- World Trade Organization (WTO)