Facts and Fiction about Globalization

Test your knowledge about the economics of globalization in my

Globalization Quiz

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For each of the following 10 statements indicate whether you believe it to be correct or wrong by checking the appropriate box. Please explain your answer shortly in words. (In case your answer is based on simple prejudice, no explanation is needed.)

1. Mercantilist fallacy	Correct	wrong
The more goods and services a country exports and the less it imports, the better it is for the economy of that country.		**X**
Rationale A nation's wealth (or economic welfare / standard of living) depends on its ability to produce goods and services, not on its export surplus.		

2. Zero-sum fallacy	Correct	wrong
When an economy grows and the country gets richer, this can happen only at the expense of some other country (or countries) that become poorer.		**X**
Rationale Overall, economic activity is not a zero-sum game. Economic growth (including global growth) is based on gains from specialization and trade. Hence, all parties involved with an economic transaction must benefit from it (called a positive-sum game or win-win-situation). Otherwise the losing party would refrain from the transaction. The wealth of some kings and conquerors in the past may possibly be explained by theft and robbery, i.e. by redistribution. However, this cannot explain the wealth of today's rich nations which rests upon high productivity, international division of labor, and international trade.		

3. Principle of comparative advantage	Correct	wrong
Only the rich and strongly developed countries can participate in and benefit from globalization, since the poor and less developed countries are too weak to profit from globalization.		**X**
Rationale In less developed countries there often exist some areas of production with an absolute advantage in costs of production (as compared to most developed countries). Poor countries always gain from specializing in the production of these fields of production. In every case even the poorest countries have a comparative (or relative) advantage in the production of some goods or services as compared to all other countries. Under free trade poor countries can always benefit from their comparative advantage through specialization and trade (see also question 7).		

4. Exploitation fallacy	correct	wrong
Globalization is a process in which rich countries enrich themselves by exploiting poor countries more and more.		X

Rationale
Voluntary exchange must always be beneficial for all involved parties (i.e. it must be a win-win situation). A country will engage in globalization (by specializing in certain goods and services and trading them internationally) only if the country benefits from doing so (see question 2).
One may criticize that the gains from trade are not necessarily split symmetrically, so that richer countries may profit more from trade than poorer countries - who's profit may be smaller (but not zero – else they would not trade).
This is a valid argument in favor of reducing the market power of some countries or (more often) of global companies dominating some markets. However, it is not a cogent argument against globalization - but in favor of strengthening competition in order to limit market power (see also question 6).

5. Declining incomes fallacy	correct	wrong
The effect of globalization is that the poor become even poorer while the rich always get richer.		X

Rationale
Quite the opposite is true. Many international studies have shown that the number of people with low or very low incomes has decreased significantly and steadily over the last decades. If the global economy is able to sustain its current rate of growth, then the portion of the world population who lives on less than $1 a day is expected drop to a new low of 12.5% by 2015, down from 27.9% in 1990 and 21.1% in 2001. This would more than halve the portion of people in severe poverty in the course of 25 years.
The biggest success in reducing poverty through globalization is probably the case of China where millions of people have improved their economic situation as a result of the country's opening up. According to World Bank data the portion of their population who lives on less than $1 per day declined to 16.6% in 2001, down from 33% in 1990. It is projected that the rate may drop as low as 3% by 2015.
Thus, the observation that incomes have grown faster in rich countries than in poorer countries (i.e. a widening gap in global incomes) does not mean that poorer countries become poorer. The latter is true only for a few unfortunate countries in Sub-Sahara Africa suffering from dictatorial regimes and wars.

6. Ruinous competition fallacy	correct	wrong
A main reason why less developed or poor countries suffer from globalization – and, thus, cannot benefit from it – is that globalization leads to ruinous competition. Therefore, poor countries will benefit from restrictions on global competition.		X

Rationale
Again, the opposite is correct. When countries are said to "suffer" from globalization this is most often the result of a lack of competition and of the openness of markets. This happens when developed countries (e.g. in North America or the European Union) protect their markets from "cheap imports" from less developed countries, e.g. in the markets for agricultural goods.
In this vein, open markets and increased global competition is the best remedy against multinational companies that use their market power against producing countries in some markets, e.g. for raw materials, coffee, fruits, cacao etc. (see also rationale for question 4).
Thus, it is in the general interest of less developed countries to foster global competition and the openness of markets.

7. Trade restriction fallacy	correct	wrong
International trade should be restricted since its enormous increase over the past decades severely harms poor developing countries.		**X**
Rationale Free trade is a prerequisite for a producer or country to benefit from the gains of specialization (see also rationale for question 3). Theoretically and empirically a positive relationship between the openness of markets (and countries) and economic growth is evident and well founded. Foreclosure of markets or countries is devastating for economic growth and living standards (see e.g. Cuba and North Vietnam). There is no example where a country's economic opening has lead to economic decline. Quite to the contrary, China's opening has contributed to its strong growth in the past decade. Any restrictions on trade (e.g. import tariffs and import quota) reduce the gains from trade and specialization, thereby harming producers and consumers likewise.		

8. New phenomenon fallacy	correct	wrong
Globalization is a relatively young phenomenon that has emerged only recently.		**X**
Rationale International trade has existed for thousands of years, e.g. in Asia or the Roman Empire. Following the expeditions of Marco Polo, Vasco da Gama, Christopher Columbus and others, trade between the colonies and Europe developed on a larger scale over several centuries. Powerful trading companies emerged as the first multinationals (e.g. the British East India Company, 1600 - 1858). Between 1650 and about 1850 there existed a triangular trade system between Europe, Africa and the Caribbean / the Americas. Textiles, metal ware, firearms and gunpowder, wool and cotton cloth, linens, knives, beads, jewelry, brandy and rum were shipped from Europe to Africa to be exchanged for slaves who were then brought to the Americas. Goods produced in the New World (such as sugar, molasses, fruit, hardwood, tobacco, furs, indigo, fish) were transported back to European ports. A more recent development (starting after World War II) is the emergence of global or multinational companies that not only trade but produce internationally. Also a newer phenomenon is the existence of global brands (such as Coca-Cola). These developments have been fostered by enormous reductions in costs for transportation and communication, and by reduced trade barriers (advanced by the GATT / WTO in the 20^{th} century).		

9. Keep them poor fallacy	correct	wrong
The rich developed world is able to maintain its wealth and high living standards only if other countries remain poor (since rich countries can profit from the cheap products coming from the third world and continue to exploit poor countries).		**X**
Rationale Under free trade all countries benefit from the gains from specialization and trade unleashed by globalization. These gains do not require some countries to remain poor. The fact that most specialization and trade occurs between highly developed countries shows that the existence of poor countries is not a prerequisite for other countries to improve economically.		

10. Loss of employment fallacy	correct	wrong
Globalization leads to a shift of production towards “low wage” countries. Therefore, the “high wage” countries of the western world are running out of labor to the effect that unemployment will increase dramatically and persistently.		**X**
Rationale The western “high wage” countries will be able to maintain employment by focusing their production on goods and services where they have a comparative advantage. The latter may be based on higher productivity, a higher rate and level of innovation, and a higher level of knowledge or human capital. The more flexible the western labor markets (and employees) are, the easier it will be for “high wage” countries to cope with the changes in the global production patterns, and the lower is the risk for unemployment to rise.		