

Chapter 35 Globalisation

Answers to Knowledge checks

- 35.1** The sharing of knowledge can help firms to keep abreast of advances in product design and production technology. It can help consumers to know about new products and how to source them. Workers can learn about job opportunities. All of these things can result in intensified competition, which may encourage efficiency.
- 35.2** No: it is comparative advantage that creates the potential for gains from specialisation and trade.
- 35.3** The terms of trade have deteriorated, and the country will be able to receive a lower volume of imports in exchange for a given volume of exports.
- 35.4** Given that developing countries tend to have labour and land but often lack capital goods, the possibilities for diversification will most likely be labour-intensive craft-based manufacturing or activities that make use of the land, perhaps tourism. Another possibility might be to process primary goods instead of exporting them raw.
- 35.5** The way in which employment will be affected will depend upon the nature of the multinational corporation (MNC) involved. It may be looking to use local labour, in which case there may be a beneficial impact on employment. However, the MNC may poach all the best workers, at the expense of local firms. Or it may be more interested in exploiting mineral resources, bringing its own skilled labour in order to do so.
- 35.6** Such action will hold the exchange rate below its equilibrium level, so maintaining competitiveness of exports.

Answers to Exercises and Case studies

Exercise 35.1

- a** If Here produces 200 scooters, it can produce 400 coats, and if There produces 100 scooters, it can produce 300 coats, so total coat production is $400 + 300 = 700$.
- b** The number of scooters produced is the same as before: 300. However, the production of coats is now **800**. The net result is that total world output has increased. This illustrates the potential gains from trade, as both countries could be made better off than in the no trade position. A separate question is how those gains will be distributed between Here and There.

Exercise 35.2

The interpretation of the terms of trade rests on its definition as the ratio of export prices to import prices. Let's start with United Arab Emirates (UAE), where the terms of trade index increased to 192.6 in 2015 compared with the base year of 2000. This suggests that the price of UAE's exports relative to the price of its imports increased by 92.6 per cent between 2000 and 2015. This reflects the fact that UAE is an oil exporter, and the price of oil increased substantially between these dates. Sierra Leone was in a very different situation, seeing its export prices fall (relative to import prices) by 55.9 per cent. Bolivia's terms of trade changed hardly at all over this period.

Exercise 35.3

The arguments for and against globalisation have been rehearsed in the book. Now it is time for you to decide where you stand. Try to base your views on objective economic reasoning, and do not be distracted by the subjective factors that abound surrounding this topic. In particular, you need to consider the trade-off between the flow of benefits in good times and the contagion that may occur in times of crisis.

Exercise 35.4

Your discussion here will depend upon what is happening. Perhaps the trade war has escalated and world trade is in decline. Or perhaps the World Trade Organization has intervened. Or perhaps things have reverted to normal.

Case study 35.1

FDI and developing countries

There are many points for discussion here. In thinking about the question you may find it helpful to begin by listing the possible advantages that a developing country would hope to achieve from attracting a multinational corporation (MNC). These might include capital & technology, employment tax revenue, etc. Think also about the nature of MNCs: their characteristics and objectives. And be careful: MNCs are likely to be looking to maximise global after-tax profits, they are not humanitarian institutions looking to provide development assistance to low-income countries. In light of these characteristics, think about how significant will be the gains under each possible advantage. You may find that you begin to wonder whether MNCs really do offer significant benefits to developing countries. However, you should also be aware that some countries, such as the 'tiger' economies, China and others, have gained from FDI, and many other countries are keen to attract more MNCs. How do you think that a developing country could strengthen its bargaining position?

Answers to end-of-chapter questions

A Multiple-choice questions

- 1 c. It can produce pasta relatively more efficiently than another country
- 2 b. More competition from global brands
- 3 b. The same volume of exports will purchase a lower volume of imports

B Knowledge and understanding questions

- 4 The Marshall–Lerner condition is the condition that devaluation will have a positive effect on the current account only if the sum of the elasticities of demand for exports and imports is negative and numerically greater than 1.

A full explanation of the Marshall–Lerner condition	2 marks
A vague or partial explanation of the Marshall–Lerner condition	1 mark

- 5 Ways may include:
 - Easier movement of goods and services
 - Absolute and comparative advantage
 - Division of labour
 - Economies of scale
 - Easier movement of labour
 - Easier movement of capital
 - Easier movement of technology/innovation

Two ways explained	4 marks
One way explained AND one way identified	3 marks
One way explained OR two ways identified	2 marks
One way identified	1 mark

- 6** The theory of comparative advantage argues that there may be gains from trade arising when countries specialise in the production of goods or services in which they have a comparative advantage.

Benefits may include:

- Economies of scale
- Increase in *AD*
- Economic growth
- Increased taxation revenue
- Improvements in technology
- Consumption beyond the *PPF*

Explanation of a benefit of international trade to an economy using comparative advantage theory	4 marks
Explanation of a benefit of international trade to an economy	3 marks
Identification of a benefit of international trade to an economy	2 marks
Understanding of comparative advantage	1 mark

C Stimulus response question

- 7 a** The primary sector is the sector of the economy that deals with extraction, farming and production of natural resources.

A full explanation of the primary sector	2 marks
A vague or partial explanation of the primary sector	1 mark

- b** A negative trade balance is a situation where imports exceed exports.

A full explanation of a negative trade balance	2 marks
A vague or partial explanation of a negative trade balance	1 mark

c

AO1 Knowledge	1 mark
AO2 Application	1 mark
AO3 Analysis	3 marks
AO4 Evaluation	3 marks

Knowledge (1 mark) is likely to include:

- Globalisation

Application (1 mark) is likely to include:

- Application to the Togo economy

Analysis (3 marks) is likely to include:

Analysis of the possible positive consequences, for example:

- Easier movement of goods and services
- Absolute and comparative advantage
- Division of labour
- Economies of scale
- Easier movement of labour
- Easier movement of capital
- Easier movement of technology/innovation

Evaluation (3 marks) is likely to include:

Evaluation of the possible negative consequences, for example:

- A negative trade balance, leading to a reduction in *AD*
- Loss of domestic industry
- Loss of cultural diversity

A judgement of the likely consequences of globalisation on the Togo economy

D Essay question

8

AO1 Knowledge	6 marks
AO2 Application	6 marks
AO3 Analysis	6 marks
AO4 Evaluation	7 marks

Knowledge (6 marks) is likely to include:

- Comparative advantage
- International trade

Application (6 marks) is likely to include:

- Application to international trade patterns

Analysis (6 marks) is likely to include:

- Analysis of how comparative advantage may explain international trade patterns

Evaluation (7 marks) is likely to include:

- Evaluation of why comparative advantage may not explain international trade patterns
- Evaluation of factors, other than comparative advantage that may explain international trade patterns

A judgement of the extent to which comparative advantage explains international trade patterns

