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HSC Economics

HSC Economics Topic 1: The Global Economy

Lesson 1

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HSC Economics Term 1: The Global Economy
Lesson 1

Syllabus Dot-points covered:

- International Economic Integration
- The Global Economy
- Gross World Product
- Globalisation
    - trade in goods and services
    - financial flows
    - investment and transnational corporations
    - technology, transport and communication
    - international division of labour, migration

International Economic Integration

The global economy

- The global economy is where economies of individual countries are linked to each other and changes in a single economy can have ripple effects on others

Gross World Product

- The aggregate value of all goods and services produced worldwide each year in the global economy (sum of total output of g/s by all economies in the world over a period of time

<u>Globalisation</u>

- Globalisation is the integration between different countries and economies and the increased impact of international influences on all aspects of life and economic activity.

Forms of economic integration

- **Free Trade Area**
  - Where groups of member countries abolish trade restrictions between themselves but retain restrictions against non-member countries. e.g. NAFTA
- **Customs union**
  - Member nations abolish trade restrictions and adopt a set of trade restrictions against non-member countries. e.g. EU
- **Common market**
  - Features of customs union but also free mobility of labour and capital within common market countries. e.g. EU
- **Monetary union**
  - Features of common market but also adoption of a common currency and coordination of monetary policy through a single central bank. e.g. Economic and monetary union (EMU)

Characteristics of globalisation

- **New markets**
  - Growing global markets in banking, finance, insurance, media and transport

   - New deregulated financial markets 'working around the clock'. New instruments traded such as derivatives
   - Deregulation of anti-trust laws, proliferation of mergers and acquisitions
   - Global consumer markets with global brands of products and services of TNCs

- **New actors**

   - TNCs integration production and dominating world production
   - WTO first multilateral organisation to enforce national governments' compliance with rules on free and fair trade
   - International criminal court system
   - Booming international network of NGOs (non-government organisations) providing aid - e.g. World Vision
   - Regional trading blocs proliferating and gaining importance
   - More policy co-ordination groups -e.g. G7, G8, G20, OECD

- **New rules and norms**

   - Greater privatisation and liberalisation
   - Adoption of democracy
   - Human rights conventions and instruments
   - Consensus goals and action agendas for development
   - Multilateral agreements in trade

- **New tools of communications**
   - Internet and electronic communications
   - Global spread of digital technology, communications and e-commerce

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<u>Economic indicators of globalisation</u>

Financial flows

- Most globalised feature - money moves more quickly than g/s or people
- Major role in linking economies around the world
- Allows countries to obtain funds to finance domestic investment, which overall, increases investment and therefore eco growth. This not possible without overseas finance
- However, speculators cause significant volatility in FOREX markets and domestic financial markets (due to herd mentality)
    - Caused currency falls and financial crises: GFC, East Asia '97, Argentina '02, COVID crash March 2020
- Regulated by the IMF (stabilises individual economies experiencing currency crises or financial turmoil to prevent flow-on effects on other economies)
- Financial flows have expanded significantly - due to:
    - Financial deregulation (of e.g. controls on foreign currency markets, flow of foreign capital, banking interest rates and overseas investments in share markets)
    - New technology and global communications
- Measured by exchange-traded derivatives – major instruments in global financial markets:
    - Includes futures, options, swaps and forward rate agreements
    - Reached $US 120t in 2018 – greater than GWP.
- Interest rates are a controlling influence - if foreign interest rates are higher, people would move funds (financial flows) internationally.
- FOREX – refers to the exchange of currency - growth with US$5.1b in 2019 (daily turnover)

- Growth in foreign exchange transactions reflect growth in world trade and investment
- Influenced by speculators: investors who b/s financial assets for short term profit; short price movement
- A key driver is the expansion of foreign exchange as a financial asset (through investment strategies such as carry trade)
- Mainly International investment banks (38.9%) and hedge funds (47.7%)

Investment and transnational corporations

- Global financial flows are short term, speculative shifts of money
- Global direct investment long term flows of money to buy/establish businesses as investments
    - Measured by foreign direct investment (FDI) - movement of funds invested in economic activity/purchase of companies
    - FDIs account for <20% total investment (>80% within national economies), therefore investment mainly a national affair
- FDIs – acquisition of 10% or more of voting power through:
    - Incorporating a wholly owned subsidiary or company
    - Acquiring shares
    - Merger and acquisition
    - Participating in an equity joint venture with another investor or enterprise
- Influenced by reforms (led to surge of FDI flows in '80s; 10 fold increase in the past 3 decades) and economic activity (fall in FDI in GFC)
    - This includes financial deregulation and floating exchange rates
    - Central banks removed direct lending controls, allowing a greater role for market forces to allocate saving and investment resources

- Also, by increased level of international mergers and takeovers - e.g. Volkswagen & Porsche <<this is in line with global eco conditions (e.g. GFC fell from $1.6t to 932b; 07-08)
- Benefits developed nations of the OECD as developed economies dominant source of FDI

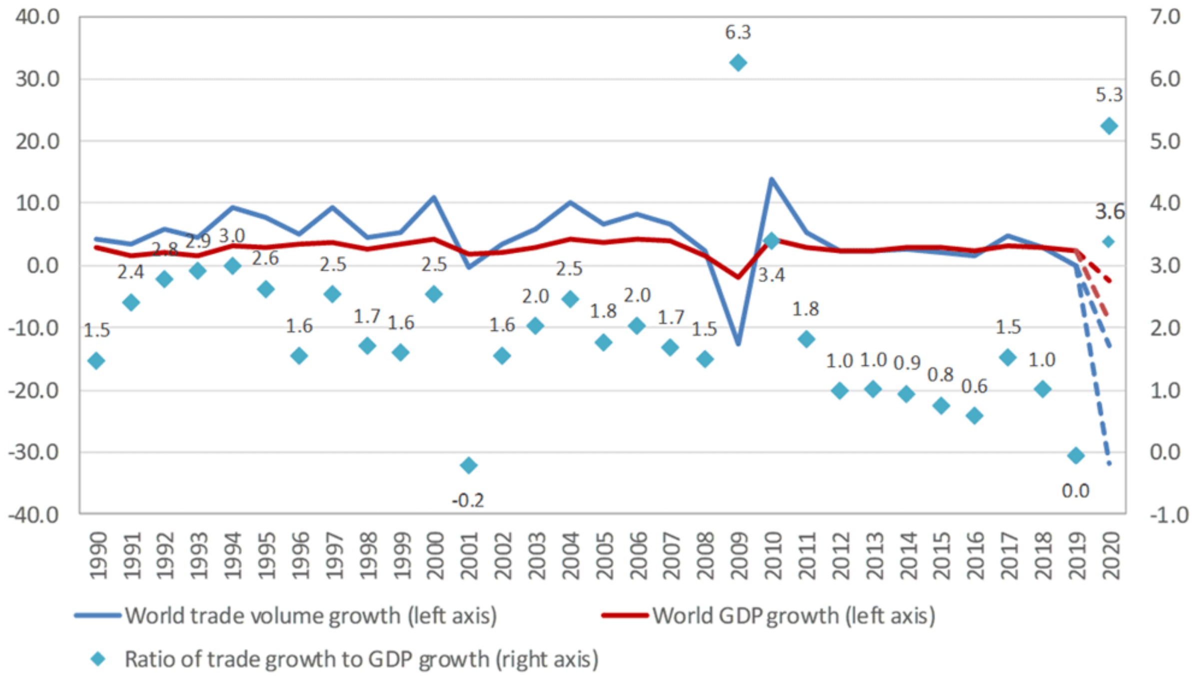
- TNCs are responsible for most FDIs as they set up subsidiaries in other countries to gain access to global markets
    - Governments encourage TNCs to set up in their country through subsidies, tax concession, access to infrastructure, less stringent labour and environmental regulations
    - They cause an outflow of funds in the host country's BOP
    - FDIs provide source of investment funds for an economy, increasing economic growth and creation of employment opportunities
    - TNCs set up production facilities around the world, bringing new technology, knowledge and skills that can improve efficiency of the production process and increase living standards
    - They train Host Country Nationals (HCNs) to work in multinational businesses
    - Examples: Wal Mart Stores, Royal Dutch Shell, BP, Toyota

Trade in goods and services

- Important as it measures how goods and services are consumed in other economies around the world
- Key indicator of Gross World Product (GWP) as it measures how goods and services produced domestically are being consumed in foreign economies
- Shows economies do not produce all goods in need or not produce as efficiently and have to import goods and services

- GWP increased 10 times from 1950 but GWP increased >40 times, indicating effect of globalisation

- World trade is more volatile than Real GDP as shown in the WTO figures for 2020.



- Trade Increased because governments joined trade groups e.g. WTO, EU, ASEAN (association of south east Asian nations)
    - Resulted also from reduction in policy barriers to cross border trade and capital flows, also due to improvements in ICT and transport
- Direction of trade flows have evolved over time
    - High income economies (mainly North America, Western Europe) decreased in share of global trade (83%->69%)
    - Fast growing economies (East Asia/Pacific, i.e. China, Indonesia, Vietnam) increased in share (7->13%)
- Reflects changing importance of different eco regions

Technology, transport and communication

- Major change includes the information technology (IT) revolution
- Benefits:
  - Tech developments facilitate integration of economies
  - Drives trade/investment – boost trade of software/computer equipment
  - Also drives foreign investment - e.g. Google/IBM's global operations invest in new countries (education/training)
  - Trade allows spread of new technology - innovation
  - The better the technology, the better for trade transportation, communication etc
  - New technology allows greater productivity of labour and capital in production and reduced costs of conducting international business (economies of scale)
  - 2 billion internet users highlight rapid spread of technologies across countries and increased interconnected nature of the global economy
- The concept of technology diffusion:
  - Technology created by countries are exported to the rest of the world
  - High technology products dominate export expansion due to high value adding in production
- Transport includes the proliferation of roads, railways, ports, waterways, airports, air traffic control
  - However, improvements in technology and communication has caused congestion and pollution
  - Freight technology: containerisation (standardised shipping containers), cargo tracking facilitates greater trade in goods

- Broadband – high speed internet increase provision of commercial services to customers leading to cheaper, reliable international communication
    - Computer communications network allow money to move very fast (facilitate globalisation)
    - Communication tech of International and mobile telecommunications allow TNCs to function efficiently
- E-commerce refers to use of the internet and the rise of online shopping e.g. Amazon

International division of labour and migration

- Migration is the permanent movement of labour for 12months+
- Refers to the specialisation of people according to labour tasks in production process
    - Linked with operation of TNCs in establishing subsidiaries (offshoring) to utilise low cost labour
- Labour markets are the least globalised as people do not move between jobs and countries freely
    - 3% (200m ppl) of the world have migrated to work in different countries
- Highly skilled workers attracted to richest economies (USA, large European economies due to high pay/opportunity)
    - 7% to 11% in past 2 decades
    - increased share of immigrants in advanced economies
    - Highlighted by workers' remittances – reached 1.6% of developing countries' GDP in 2018
    - This is known as the "Brain Drain" as human capital is leaving the country and thus taking away from the economy's future productive capacity

- There are two types of international division of labour
    - People move to jobs where their skills are needed, but barriers such as immigration, language, cultural can be restrictive.
    - Corporations also "offshore" their production in search of the most efficient and cost-effective labour
    - Reflects comparative advantage of nations with cheap labour
- Examples:
    - Establishing of manufacturing plants by TNCs to utilise abundant supply of cheap local unskilled labour
    - Outsourcing of telecommunications/computing, etc to offshore locations
    - Migration of unskilled labour from emerging/developing economies to work in primary, manufacturing and service industries in advanced economies

Additional notes:

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Practice Short Answer Questions

1. Define globalisation. (1)

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2. What is meant by the term Gross World Product. (1)

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2. Discuss TWO factors which can increase the speed of globalisation. (4)

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3. What is meant by the international division of labour. (4)

Sample Answers.

1. Globalisation is defined as the increasing integration of economies around the world resulting in greater cross-border flows of trade, finance, labour and technology.

2. Gross World Product is defined as the sum of all output generated by all economies over a given period.

3. Two factors which can increase the speed of globalisation include increases in trade flows between economies and increased financial flows. Increasing trade flows through the signing of free trade agreements or removal of protectionist policies can link the economic performance of two countries. For example, Australia's economic growth is heavily dependent on China's demand for Australia's exports of mineral resources. If there was an economic downturn in China, that would negatively impact Australia's economy. Furthermore, trade flows allow the spread of new technologies through the process of technological diffusion. For example, the development of new smart phones in the United States and in China have only been accessible in Australia through trade. Increased financial flows in the form of portfolio investment or direct investment also plays a significant role in linking economies. Advanced economies which have an excess of capital can deploy that capital in emerging economies, providing much needed finance to acquire capital, build infrastructure and start businesses. Profit from these enterprises are often remitted back to the advanced economy, thereby linking the performance of the two economies.

4. The international division of labour refers to how different labour groups are utilised in different aspects of the production process. It acknowledges the existence of a global supply chain whereby production may be in one economy and marketing/distribution may be in another. There are two main forms of the international division of labour: the movement of labour to economies which are able to pay them more and thus make better use of their skill set and the movement of corporations to economies with cheap labour in order to reduce production costs.