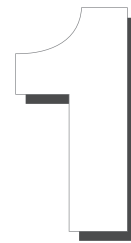
Introduction to the Global Economy



Multiple Choice

1	C	**6**	C	**11**	D	**16**	B
2	B	**7**	D	**12**	C	**17**	D
3	B	**8**	C	**13**	B	**18**	C or D*
4	B	**9**	A	**14**	B	**19**	C
5	D	**10**	D	**15**	A	**20**	B

*** Note:** This is an example of an exam question where there is some debate about which answer is best, which happens from time to time even in HSC examinations. C is the best answer because cheaper global transportation is a causal factor that has driven trade growth. However D is also a good answer since transnational corporations have increased trade growth, and specifically by using global supply chains TNCs have increased statistical measures of trade volumes, since goods may be counted two, three, four or more times in trade statistics as goods are traded as raw resources, then intermediate goods, and the final products as they move through a production process involving several countries. Strictly speaking, it is the lower cost of transportation that has resulted in global supply chains and a greater role for TNCs, so that C is the best answer – but our view is that D should probably also be accepted as a correct answer.

Short Answers

Question 1

(a) Gross world product refers to the sum of total output of all goods and services by all economies in the world over a period of time.

(b) One indicator of globalisation is global trade in goods and services. International trade has increased rapidly in recent decades, and has grown at a rate of around twice the level of world economic growth. This has been due to improvements in transport technology, trade agreements and the role of transnational corporations. A second indicator of globalisation is international financial flows. Finance is the most globalised feature of globalisation, and has grown rapidly since financial deregulation in the 1970s and 1980s, as well as with improvements in technology and global communications.

(c) With reference to the diagram, between 1995 and 2008 the composition of global trade has remained dominated by manufactures (57 per cent in 2008, down from 62 per cent in 1995). The dominance of manufactured goods reflects the fact that there are very high economies of scale in manufacturing. Globally, manufacturing has shifted to low-cost manufacturing exporters like China who have rapidly expanded exports, at the same time as supply chains have become more globalised. Between 1995 and 2008 trade in fuels and minerals almost doubled in total share from 7 per cent to 13 per cent. This reflects higher world prices for raw materials and sources of energy such as oil, gas and coal, also driven by the rapid growth of the Chinese economy and its impact on commodity prices. The global share of trade in food and agriculture decreased slightly from 10 per cent to 8 per cent between 1995 and 2008. This may reflect lower prices for agricultural products on world markets, as well as the protectionist policies of economies such as the United States and European Union.

(d) Global trade flows have increased rapidly over recent decades. One factor which has contributed to this trend is the increased importance of transnational corporations (TNCs). TNCs have production facilities in multiple countries around the world, using different countries to source inputs, undertake each stage of manufacturing, and then package and market their goods. The transfer of semi-finished products between countries by TNCs accounts for a large part of global trade flows. A second factor which has increased global trade flows is technological developments in transport and communications. This has allowed greater quantities of goods to be traded between economies by reducing transportation costs. Examples include developments in freight technology such as standardised shipping containers and more efficient logistics systems. Technology also represents a major trade opportunity itself, with technology-producing high income economies such as the United States exporters of technology. While this facilitates cross-border technology transfers, developing economies have very limited access to technologies in high income economies, thereby worsening global inequality.

Question 2

(a) Foreign direct investment (FDI) refers to the movement of funds between economies to establish new production activities or to purchase 10 per cent or more of shares in an existing company. They tend to be long term and productive in nature. Financial flows, by contrast, refer to the movement of funds between economies for loans or the purchase of small share holdings (less than 10 per cent of shares in an existing company). They tend to be short term and speculative in nature.

(b) One benefit of FDI flows is that they provide a source of investment funds for an economy that might otherwise have a relatively low level of domestic investment or a low level of national savings. For example, in Australia much of the large-scale investment in the mining and resources sector would not have been possible without FDI inflows. A second benefit of FDI flows is that when transnational corporations set up production facilities around the world, they also bring new technologies, knowledge and skills. This allows for the transfer of technology between different economies, which can improve the efficiency of the production process and increase living standards.

(c) With reference to the graph, FDI flows have grown rapidly since 1988. This has been due to a number of factors, such as fewer restrictions on foreign ownership throughout the global economy, the growth of transnational corporations and an increased level of cross-border mergers and takeovers. From 1988 to 2007 total world FDI flows increased uninterrupted. However, in 2008 FDI flows decreased by approximately $US10,000 billion. This was due to the global financial crisis, which saw a sharp contraction in global economic activity and a decrease in cross-border investment flows. In 2009 FDI flows recovered, and by 2010 the long-trend of growth in FDI flows had seen the level of FDI surpass the previous peak in 2007.

(d) Global financial flows have had a major role in linking economies around the world. They are the most globalised feature of the world economy because money moves between countries much faster than goods, services or people. International financial flows have grown substantially since financial deregulation in the 1970s and 1980s, as well as with the development of new information technology. Financial flows enable countries to obtain funds that are used to finance domestic investment, allowing a country to achieve higher levels of investment and economic growth. On the other hand, the speculative nature of global financial flows means that short term financial flows can create significant volatility in foreign exchange markets and domestic financial markets, making trends in economic growth more synchronised around the world.

Question 3

(a) The international business cycle refers to the synchronisation of economic growth trends in the global economy. In contrast, regional business cycles are synchronised growth trends across an economic region, such as in Europe or East Asia.

(b) With reference to the graph, one recent trend in the international business cycle is that all countries experienced a sharp downturn in economic growth in 2009 due to the global financial crisis. Second, the United States was the main driver of global growth over the 1990s, but not to the same extent over the 2000s – for the past decade, developing economies such as China have been driving world economic growth, which explains why the US growth rate has been below world growth.

(c) The increasing share of traded goods and services is strengthening the international business cycle as global trade flows link economies more closely together and therefore transmit changes in economic conditions across economies. An upturn in one economy will increase demand for imports, which increases the exports of another economy, increasing the other economy's economic growth rate. Foreign direct investment (FDI) flows also strengthen the international business cycle. FDI flows will increase when there are strong economic conditions in developed economies, and the higher global investment levels will raise global economic growth rates.

(d) Regional business cycles refer to patterns of economic growth within different economic regions, through which some regions may tend to grow above global averages or below global averages. There are several factors that can cause differences in growth trends across different regions. Firstly, different regions may be at different stages of economic development, with industrialising economies (such as in East Asia) experiences higher rates of growth while mature industrialised economies (such as in Europe) experience much lower growth rates. Secondly, one or two large economies may create a regional business cycle because of the way that changes in their growth rate flow through to other economies in their region, such as with China in the Asian region or Brazil in Latin America. Third, common economic policy settings such as a common monetary policy and common currency will result in growth rates in a region becoming much more closely linked, as in the 16 nations in the euro-zone. Fourth, economic crises can intensify regional business cycles because a loss of confidence in one economy can often spread quickly to neighbouring economies that may be affected by a sudden change in economic and financial conditions of their neighbour. This has been seen on many occasions, including during the Greek financial crisis and the Irish financial crisis in 2010, and in the Asian financial crisis in 1997-1998.

Skills Revision

The economic terms on page 11 should appear in the following order:

- Global Economy
- Transnational Corporations (TNCs)
- International Division of Labour
- Speculation
- International Monetary Fund
- World Trade Organisation
- Globalisation
- Foreign Direct Investment
- International Business Cycle
- Brain Drain
- Gross World Product
- Foreign Exchange Market