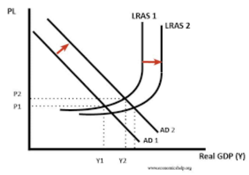
Theme 4

4.1.1 Globalisation and its characteristics

Globalisation refers to the increasing international integration of markets for goods, services and the factors of production.

This results in the LRAS shifting right as companies now have access to wider markets and also due to more workers being available wages will be depressed. Furthermore, competing global resources will improve productivity. Access to the global consumer and an ability to invest anywhere will also shift AD outwards.



Macro economic objectives on the whole will improve:
- However governments can only partly control inflation through controlling aggregate demand. However, they cannot manipulate AS and global supply prices.
- There will never be much wage inflation as there is such a large global labour supply.
- A race to the bottom on taxes will occur.
- The environment will be degraded to a certain extent as more production and transport occurs. However, it also enables technological advances on the environment to spread.

Globalisation causes:
- Goods trade is increasing, with increasing manufactured imports due to developing countries inquiring more capital and knowledge, also accessing cheap labour and efficient forms of transport.
- Service trade is increasing.
- Trade liberalisation, with lower barriers to trade and increasing trade growth. This includes increased treaties and trade blocs such as the WTO and ASEAN. However, trade blocs prevent other countries from participating in trade.
- MNCs are growing in size and number due to exploiting economies of scale and technology to make cheap products. Marketing techniques further spread the knowledge on these goods. They use monopolistic power, influence government decisions and engage in anti-competitive practices to maintain this.
- International financial flows increase from international capital being owned and increased interdependence.
- Foreign ownership of firms is increasing.
- Communications and IT development have shrunk communication time e.g. the internet.

Consumer impact:
- Consumer choice has increased due to more goods and services becoming available. However, arguably goods have been homogenised.
- Prices are falling as production is switched to low cost locations. However higher world income means some products increase due to higher demand and inelastic supply.
- Incomes are rising globally as a whole improving well being and consumption, however this is not true of stagnant incomes in the developed world and those who lose their job to others.

Worker impact:
- Employment has increased in the developing world as they gain more investors. However this leads to structural unemployment being exacerbated in the developed world. It all depends on labour mobility.
- Migration has increased as workers move for either economic or physical reasons. This helps to increase employment and create more jobs. However, this may compete with other workers and put a strain on services. Market failure and government failure creates barriers to this in some cases.
- Wages of low skilled jobs are decreasing on average as there is increased competition. However, high skilled jobs have rising wages as demand increases for these few jobs. This has widened inequality in developed countries but decreased it globally.

- International flows for personal reasons such as holiday house purchase or tax evasion.
- FDI to profit maximise and speculate.
- Governments encourage economic agents to buy their bonds.

Surplus and deficit reasons:

- Natural resources, determining how much you need to import and how much you have to export.
- Underlying competitiveness, showing how attractive your goods are for foreign buyers due to quality and pricing of products. This is determined by productivity.
- Imports may be high due to large consumption domestically.
- Exchange rates, this helps to determine how cheap your exports are and how expensive imports will be.
- Inflation erodes price competitiveness and makes exports seem more expensive and imports seem cheaper.
- Consumer and government spending will be high in times of a boom increasing the volume imported as they have more disposable income.
- Investment and economic growth, will be exported and imported strongly in the case of a strong economy.

How to reduce the current account deficit (this may be expenditure switching/reducing or focus on supply side reforms):

- A currency depreciation will make your imports look more expensive and exports cheaper. This is more effective if elasticities are high and there is a small amount of cost-push inflation, as if there is high inflation in the long run you may switch to import from abroad. You can do this from raising interest rates and fixing exchange rates.
- Factors such as reducing government spending, will majorly affect the economy however it is large scale to just affect the deficit which is the smallest composition of AD.
- Reducing spending from increasing interest rates and by increasing the tax rate.
- Increasing investment domestically from decreasing interest rates and creating subsidies.
- Deflationary policies will reduce investment and consumption also allowing exports to rise by firms thus switching sales to foreign markets. This will be more effective if the marginal propensity to import is high and the relative rate of inflation falls.
- Supply side policies result in a more productive innovative economy, thus looking in the long term and increasing the economy's competitiveness. These however, take time and are not guaranteed resulting in a fiscal deficit.
- Protectionist measures reduce imports thus improving the current account in the short run. However, this may reduce exports due to becoming uncompetitive and may result in retaliation.
- Currency controls restrictions limiting the amount of foreign currencies and thus imports that can be brought. However, this results in a black market and inefficiency.

If you are in a deficit, AD shifts inward, resulting in lower economic growth and also unemployment as you are supplying less goods globally. The UK is able to sustain its deficit due to the capital and financial account surplus (showing a strong position), the deficit can thus easily be financed by investors. Furthermore, if the deficit is due to the importing of capital goods to increase future growth it is not as bad.

This also tells us you are dependent on foreign markets, also indicating you are uncompetitive globally decreasing longer term sustainable growth.

A surplus increases AD and economic growth also showing a competitive economy. However this may not always be good as it results in lower living standards as you are producing more for others than yourself. Furthermore it may result in demand pull inflation.

4.1.8 Exchange rate systems

- Quality increases through randd increases competitiveness due to the uniqueness and increase in inelasticity of demand.
- Taxation decreases competitiveness as it results in decrease in profits to invest and increase factors of production.
- Research and development increases product uniqueness and reduces costs of production increases competitiveness.

Benefits of competitiveness:
- Current account surplus with countries likely to export more than they import, with surpluses freeing them from constraints of a deficit.
- International investment occurs with a surplus allowing the surplus of assets overseas on which interest, profit and dividends can be earned. A competitive economy also attracts FDI and TNCs as a selling or export base. Furthermore, foregin companies may want to buy domestic companies to exploit their competitiveness. This all transfers skills, knowledge and technology further increasing competitiveness.
- Employment increases as high volumes of exports creates jobs domestically.
- Economic growth occurs due to greater efficiency and demand for exports encouraging investment and larger AD and AS.
- Reduces inflation through resulting more efficient production techniques increasing supply and also allowing the price to fall.
- Wage growth, especially in developing countries where low wages allows international competitiveness increasing demand for workers and wages.
- A higher domestic purchasing power, due to higher income growth and a appreciation of the currency allowing more goods to be purchased, as wella s allowing foods to be lower in price due to increase in competitiveness.

Problems of competitiveness sustaining (not always true e.g. Germany):
- Low wages that make countries competitive erode as they develop.
- Costs such as land and materials, rise as a country becomes more competitive.
- A current account surplus could appreciate a currency eroding their competitive advantage.
- A less competitive foreing country may impose trade barriers eroding a competitive advantage.

Government policies to increase competitiveness:
- Supply side policies such as improvements in education or tax incentives which reduce costs, increase innovation and competition through means like education. This is the most sustainable way to change international competitiveness, however it depends on AD, results in inequality and causes a deficit.
  - Labour market reforms, such as the ease of hiring workers, minimum wage levels and retirement age. This increases inequality and also may make no difference if it is already a flexible market.
  - Privatisation to increase competitiveness and efficiency.
  - Measures to increase FDI, only effective if confident.
- Exchange rate policies to devalue a currency this is short term and does not change the quality of your product. Some countries should leave the eurozone allowing deflation.
- Control of inflation and macroeconomic stability, stopping inflation and wage spirals along with interest rate cuts. Also this encourages stability and investment increasing innovation and exports.
- Increase trade barriers.

Firms strategies to increase competitiveness:
- Invest in RandD, innovation and marketing. This depends on government policy, confidence and costs. This is arguably expensive and takes time.
- Pricing strategies and better customer services.
- Improved reliability.

4.2.1 Inequality

increase the foreign exchange gap as exports are low in comparison to imports reducing savings. This is hard to attract if the country lacks legal structure and stability.

Problems:

- It is not sufficient as investment may be wasted if there are not factors to complement it like educated labour to operate it.
- It may be wasted on arms (there may be corruption of aid for personal reasons). This may mean there is capital flight, to more secure economies.
- There may also be inflation resulting in little growth from savings.
- There may be a low MPC resulting in little savings increase. Furthermore, not all investment being productive.

CASE STUDY:
The Dominican Republic and Haiti are on the same island. The Dominican Republic has a savings rate 700 times higher than that of Haiti and receives 100 times more FDI. GDP per capita in the Dominican Republic is 10 times higher than Haiti.

➔ Savings and Investment are a small part of the overall picture related to development, the Harrod Domar model is therefore very narrow in scope, as a reliable financial system is needed before this is even important.
➔ Countries have achieved very high levels of growth despite low levels of savings, such as Thailand as other forces like labour productivity drives growth.

12. Debt

- Historically developing countries were encouraged to borrow increasing the value of the dollar due to a rise in demand and interest rates. This increases loan repayment and further increased borrowing. Failing to repay results in banks reducing lending and results in increased debt repayments than aid. This meant money flowed from poor to rich countries. The borrowed money traditionally was not invested well in corrupt countries, worsening the situation as it is not reinvested in productivity for the future due to the opportunity cost of debt repayments. This worsened the PPF.
  ➔ Some debt was written off or reduced, in size or repayments (happened to the heaviest indebted countries. This creates a moral hazard problem along with inflationary problems and a lack of trust of these countries.

13. FDI

- FDI is investment by a private sector company and can be internationally done. This transfers knowledge and capital creating a climate for success. This increases consumption and exports also absorbing international techniques having a multiplier effect.
- This results in a loss of sovereignty and also increases dependence with the repatriation of profits. Some argue it also increases exploitation due to lower costs and regulations.

14. Remittances

- This reduces unemployment in developing countries with not enough jobs and results in temporary work. This is sent home as remittances (stable source) and is a large export earner on the balance of payments for developing countries. This increases GDP and employment for a population internationally aiding economic development at home through injections into AD. This also may allow opportunities and upskilling for higher output than was available at home. Although they show there are problems in the domestic labour market.
  ➔ This results in lower levels of skilled labour domestically prohibiting the agglomeration effect and domestic supply side potential hurting the long run economic growth of the economy.
  ➔ This depends on how it is spent as demerit consumer goods will not fuel long run economic development.

15. Gender inequality

- Women in developing countries are disadvantaged so are less educated, reducing human capital, whilst being excluded from jobs and basic needs. This results also in discrimination able to be replaced by the current capital and workers in the industry).

- This development is shown in countries like the UK with most work done in the productive service sector resulting in a high HDI and GDP. Higher wages are also earnt from increases in worker productivity being reflected in the value thus reducing absolute poverty, increasing the HDI and AD whilst also resulting in increased supply side improvements due to worker upskilling and producing more output due to being more productive. The final good is also worth more increasing income nationally.
  - ➔ Industries are arguably also more productive, due to specialisation and training of workers.
- No economy has come out of poverty without industrialising such as the Asia tigers.
  - ➔ Forced industrialisation does not always work if industries fail or there is not the capital to work this industrialisation. Such as a lack of savings meaning they cannot invest in education to work these factories and advanced modern sectors resulting in little growth. Arguably industrialisation is a result of growth not a cause.
  - ➔ This also result in wide scale money in order to industrialise, this may increase debt. This would also result in a increase in imports, to create this capital.
  - ➔ They also have to compete with large TNCs that are well established making it hard to gain a advantage and competitivity.
  - ➔ There often is not a comparative advantage in this industry meaning a country cannot grow through export led growth due to lacking price and quality competitiveness also resulting in an inefficient allocation of resources slowing global economic growth.
  - ➔ They do not have enough industries resulting in low pay continuing especially due to a lack of legislation thus not relieving absolute poverty. Whilst these urban areas experiencing migration are highly overpopulated with far to few people left in the countries comparative advantage, resulting in worse consequences.

CASE STUDY:
Ghana in order to grow should start producing chocolate due to exporting 1/5th of global cocoa supplies along with 1/100th of global chocolate. (five times more value), increasing their GDP. Through developing this industry the country would be able to follow the Lewis model. Although, this requires vast supplies of capital and will be hard to do initially to be competitive on prices and quality with established brands, with them lacking the human capital. However, they could play on the guilt. of western consumers and call it a luxury charitable brand.

China mirrored the predictions of the Lewis model to achieve growth and development. Migration also removes the supply shortage in the agricultural sector and gradually starts to push up wages in these rural areas however slowing FDI as a result.

- ➔ This puts social strain on both regions with also often many unemployed in urban areas (market failure).
- ➔ This sector may just be capital intensive and help TNCs profit.
- ➔ Mass migration may just remove the wage gap.

9. Diversifying industries through developing primary industries (highly government policy dependent).
   - This occurs as a country has a comparative advantage in certain primary commodities like oil increasing income and employment.
   - This can be advantageous or disadvantageous due to price swings and natural disasters like drought resulting in varying output annually.
   - This results in successful economic development occurring when revenues are reinvested to diversify the economy and thus result in a smaller GDP proportion coming from the sale of these commodities reducing vulnerability.

- Poverty trap and unemployment trap, as people becoming worse off when their gross income rises. Poor families on means-tested benefits find that, on receiving a pay increase, they pay extra tax and national insurance and they lose housing benefit and income support. The unemployment trap refers specifically to some people being better off unemployed than being employed.
- The national debt will increase, this is especially if interest rates are rising. This may reduce the governments credit rate and also increase the level of repayments. FDI may also fall as it indicated a weak economy with cyclical and structural problems creating the need for this spending.
  - ➔ QE would reduce this impact, and even could mean increased borrowing reduces national debt payments.
  - ➔ Credit ratings are relative to other countries.
- Interest rates and demand, through increasing borrowing, puts more pressure on loans resulting in interest rates rising and crowding out private sector spending arguably resulting in no thus stimulus.
  - ➔ This depends on the borrowing size, if there is monetary policy counteracting this, it may just be covering a demand side drop in a recession or the borrowing may be external.

4.5.3 Macroeconomic policies in a global context

Trade and globalisation has resulted in there being a increase in impact of global forces on the economy and a increase in ineffectiveness of policy due to impacts of global economies and decisions.

Fiscal policy is used to- provide goods and services, increase equality, ensure fiscal sustainability, correct market failure and improve macro economic positions (demand management with a multiplier).

Reduce fiscal deficit:
- After the financial crisis there was an increase in fiscal deficit and national debt, which was eroding future investment.
  - ➔ There was a level of austerity spending (government spending inefficient), although due to reduced economic growth this also resulted in less cutting of national budget due to lower growth and thus revenues along with lower future growth.
  - ➔ The government may just wait for automatic stabilisers to occur and GDP to rise, this may however result in some countries debt spiralling out of control.

Measures to reduce debt:
- Having a fiscal surplus.
- Inflation eroding debt value.
- Economic growth.
- Quantitative easing.

Monetary policy in a global context;
- We have to increase interest rates, if others do if we want to stop a depreciation of the currency. This may also be to battle global inflation from supply shocks.
  - ➔ Arguably we should only let central banks response to demand pull not cost push inflation. This is due to otherwise the large economic growth opportunity cost whilst not fixing the crisis.
  - ➔ QE often just fuels inflation not aggregate demand due to low confidence.

A direct control addresses one issue in the economy such as through a maximum price, these are easy to understand and address a issue but do not combat market distortions and have external impacts.

External shocks can be of two types:
- Supply side shocks, these are usually rising prices of goods and services that we import and rely upon. This could be caused by conflict in other countries.