

Introduction to the Global Economy

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Multiple Choice Answers

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

Short Answer Questions

Question 1

- a) Globalisation is the process of increased integration between different economies and the increased impact of international influences on all aspects of life and economic activity.
- b) A correct answer may include any ONE of the following:
- Global financial flows are cross-border financial transactions, usually of a speculative nature. They are the largest and most integrated aspect of globalisation.
 - Foreign direct investment (FDI) flows are movements of funds between economies either to establish a new business or for the purchase of 10 per cent or more in a business. FDI flows are generally of a productive nature.
 - Technology flows between economies facilitate the expansion of trade and investment flows and encourage the spread of new production methods across the global economy.
 - Labour flows between economies have seen an increase in flows of high skilled labour generally towards high income economies, and a growing international market for lower skilled labour.
- c) The expansion of global free trade agreements will result in a decrease in global protection levels, removing artificial barriers to global free trade and increasing global trade flows. The increase in the number of transnational corporations (TNCs) will increase trade in semi-finished products between global TNC production centres, increasing global trade flows.
- d) Both global trade flows and global financial flows have increased during the globalisation era. Annual growth in trade flows has been twice the rate of growth of gross world product. However, the growth in financial flows has been far greater. Deregulation of financial markets and technological change have resulted in financial flows becoming the most globalised aspect of the global economy.

- e) Transnational corporations (TNCs) are companies which operate without borders, with production activities in multiple economies. TNCs have been responsible for higher levels of global integration as part of their production activities. Trade flows have increased as a result of greater trade in semi-finished products between production locations. Foreign direct investment flows and technology transfers have increased as TNCs establish production facilities and engage in mergers and acquisitions. However, TNCs often exploit the lower environmental standards of developing countries to reduce their production costs, which can result in environmental degradation. In addition, TNCs are often blamed for lowering labour standards in developing economies as they seek to lower their production costs by seeking out and negotiating the cheapest labour conditions. As a result, whilst TNCs do benefit developing economies by providing FDI and additional jobs (though with low labour standards), most of the profits are sent back to the headquarters in high income economies, which preserves existing levels of global inequalities.

Question 2

- a) The foreign exchange market is the market where currencies are bought and sold.
- b) Foreign direct investment (FDI) refers to the movement of funds to establish new production activities or the purchase of 10 per cent or more of an existing company. They tend to be long term and productive in nature. Financial flows, by contrast, tend to be short term and speculative in nature. The volume of financial flows is far greater than the volume of FDI flows, however, financial flows tend to be more volatile than FDI flows.
- c) Exporters and importers of goods and services must purchase and sell currency in the foreign exchange (FOREX) market in order to conduct trade. Importers must give up their own currency and purchase the currency of the exporters. Foreign investors must give up their currency for another when purchasing financial assets such as shares or property. Trade and investment flows, however, make up only a small proportion of all FOREX transactions. The largest proportion of FOREX transactions is due to speculators. Speculation, which accounts for 95 per cent of all FOREX transactions, is the short term buying and selling of currency to make a short term gain off fluctuations in the exchange rate.
- d) Financial flows are short term movements of funds and are generally speculative in nature. They are the most globalised aspect of the global economy. Changes in financial markets can work quickly to spread economic conditions across economies as global investors can move in a herd mentality. For example, the collapse of the US sub prime mortgage market in 2007 spread throughout global financial markets creating a global downturn in 2008. Global financial flows are, therefore, often the start of a global downturn, as rapid changes in financial markets spread negative economic conditions, often forcing policymakers or the International Monetary Fund to intervene. Global financial flows can also reinforce an upturn in the international business cycle. For example, the strength of the US share market over the 1990s due to the technology boom led to an increase in share markets worldwide. The main role of global financial markets is the ability to rapidly spread changes in economic activity across the world, often marking the beginning of a global downturn.

Question 3

- a) The international business cycle refers to changes in the level of economic activity in the global economy over time.
- b) First, while the United States was the main driver of global economic growth over the 1990s, developing economies have been the main driver of global growth over the 2000s. Secondly, the pattern of economic growth is synchronised, however economic growth rates have not necessarily converged into the same rate.
- c) Global trade flows can transmit economic conditions across economies and strengthen the international business cycle. 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 flows will increase when there are strong economic conditions in developed economies, and the higher global investment levels will raise global economic growth rates. Transnational corporations (TNCs) conduct production operations across national borders. An increase in production by TNCs will increase economic growth rates across all economies where production takes place. Also, TNCs are responsible for the majority of global FDI flows.

- d) The international business cycle is a synchronisation of economic growth patterns across the global economy which depends upon the degree of integration of an economy with the global economy. Highly integrated economies, such as newly industrialising economies, experience a pattern of economic growth that is very similar to the rest of the global economy. However, less integrated economies, such as transition economies, can experience patterns of economic growth that are significantly different from the global economy. For example, over the 1990s, transition economies contracted by an average 1 per cent per year despite strong global growth. Although the pattern of economic has become synchronised, the pace of economic growth has not necessarily converged. Differences in development levels cause economies to grow at different paces. Newly industrialising economies tend to grow at a rapid pace due to their strategy of export led development and high FDI integration. Developing economies, which rely on primary industry exports with volatile prices, such as agriculture, experience a more volatile pattern of growth. Over the 2000s, developed economies grew at a slower rate than developing economies as the main drivers of economic growth shifted towards major manufacturers like China and India.

Skills Revision

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

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