Introduction to the Global Economy 1

Multiple Choice

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

Short Answers

Question 1

(a) The World Trade Organisation provides a forum to promote global free trade, as well as implementing and resolving trade disputes between economies.

(b) The global trade in goods and services affects the changing level of gross world product (GWP). International trade has increased rapidly in recent decades, and this flows of goods and services between economies contributes to a higher level of total global output. Investment between economies has also increased the level of GWP over the last two decades. This is due to funds being directly invested in foreign economic activity, or being used to purchase a foreign company.

(c) Global trade flows act as a key indicator of GWP as it measures how goods and services produced domestically are being consumed in foreign economies. Both global trade and global output have increased due to globalisation, however the rise in trade flows is far greater, at over 40 times its level in 1950. GWP has only increased by 10 times over this same period. With reference to the stimulus, on an annual basis the growth in global trade is generally around twice the level of global economic growth. However, during periods of a global economic downturn the contraction in international trade is far greater than the fall in GWP. This is most evident during the 2008-09 global economic recession.

(d) Global trade flows have increased rapidly over recent decades, but the direction of international trade has shifted as the relative economic strength of different economic regions has changed. Since the 1990s there has been a fall in the share of global export flows from high income economies, and towards countries in the East Asia and Pacific region. This reflects the rapid economic growth from emerging economies in this high investment, manufacturing-driven region. At the same time, high income economies continue to play an important role in international trade, as they remain the largest importers of the goods and services which are produced by the newly industrialised economies. On a more individualised scale, the formation of trading blocs such as the European Union, regional groups such as the Asia-Pacific Economic Co-operation, and free trade agreements such as the Australian-ASEAN-New Zealand Free Trade Agreement will increase trade flows between these economies. At times the larger volumes and freer flows of trade within these countries will be at the expense of reduced trade flows with other economies.

Question 2

(a) Financial flows refer to the short-term, speculative movement of funds between economies for loans, or the purchase of less than 10 per cent of shares in an existing company. In contrast, 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.

(b) FDI flows provide a source of investment funds for an economy that might otherwise have a relatively low level of domestic investment or national savings. This allows for an increase in economic growth and creation of employment opportunities, which would not be possible without foreign funding. A second benefit is that when transnational corporations set up production facilities around the world, they also bring new technologies, knowledge and skills to those economies. This can improve the efficiency of the production process and increase living standards.

(c) With reference to the graph, FDI flows have grown rapidly since the late 1980s. 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. However, in both 2001 and 2008 FDI flows fell from both developing and developed economies. This was due to the dot com bubble burst and the global financial crisis respectively. Both these events saw a sharp contraction in global economic activity, and a decrease in cross-border mergers and acquisitions. The recovery following each global downturn is followed by an increase in FDI flows. Whilst the recovery in investment may be gradual, if uninterrupted FDI will increase to a level higher than its previous peak.

(d) Global financial flows play 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. 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. The effect is that trends in economic growth become increasingly synchronised around the world.

Question 3

(a) With reference to the graph, one recent trend is that all countries experienced a sharp downturn in economic growth in 2009 due to the global financial crisis. Secondly, advanced economies such as the United States and Europe were the main driver of global growth over the 1990s, but to a lesser extent over the 2000s.

(b) The increasing share of traded goods and services is strengthening the international business cycle, as global trade flows transmit changes in economic conditions across economies. An upturn in one economy will increase demand for imports, which raises the exports levels and economic growth in another economy. 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.

(c) In the East Asian region, the strong and sustained economic growth throughout the past decade is largely due to the rapid industrialisation of economies such as China and Vietnam, as well as strong growth in economies such as Korea and Singapore. It has only been in recent years that the increased integration between Asian economies has led to a stronger, more interlinked region. The fall in economic activity due to the global financial crisis was less pronounced in the East Asian area compared to other regions around the world, and this reflects the higher average level of growth in the emerging economies within this region.

(d) Regional business cycles refer to patterns of economic growth within different economic regions, as some regions may tend to grow above or below global averages. The first factor that can cause differences in growth trends is that different regions may be at different stages of economic development. Newly 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 shape a regional business cycle because of the way that their changing growth levels flow onto other economies in their region. Examples include China in the Asian region, or Brazil in Latin America. Thirdly, common economic policy settings in a region will result in growth rates becoming much more closely linked. This can be through a common monetary policy or common currency, such as in the 16 nations forming the Eurozone. Fourthly, economic crises can intensify regional business cycles as a loss of confidence in one economy can often spread quickly to neighbouring economies. This has been seen on many occasions, including during the Greek and Irish financial crises in 2010, and in the Asian financial crisis of 1997-1998.