Economics A-level

Macroeconomics

Contextual Analysis

Contents

1. How the Macroeconomy Works

Determinants of Aggregate Demand (AD)

Consumer spending (C):

- Increase - when the Trump Administration announced **tax cuts** in 2018 for American households and firms, this increased **disposable income** for consumers across the US. This therefore increased their **marginal propensity to consume**, so shifted the AD curve to the right, and contributed to the economic expansion America was experiencing during this period.

- Decrease - due to the coronavirus pandemic, countries all over the world have experienced the highest **unemployment rates** seen in decades, as a result of national lockdowns which have forced non-essential shops to close and have disproportionately affected the hospitality sector. With fears of redundancy in the US, for example, the **marginal propensity to save** has increased, which has therefore shifted the AD curve leftwards. As shown diagramatically, this has contributed to the **recession** the US is currently experiencing in 2020, due to the reduction of GDP from Y2 to Y1.

Investment (I):

- Increase - despite the coronavirus pandemic that has crippled economies across the planet, China has proved itself resilient as the only country in the **G20** projected to see positive economic output at the end of 2020. China also plan to expand their **Belt and Road Initiative (BRI)** and implement their new **Dual Circulation Strategy**. It is clear covid-19 has accelerated the shift in power from the West to the East, which has simply attracted more and more people to invest their money in Chinese firms.

- Decrease - **Brexit** has deterred investors from the UK ever since the EU referendum in 2016. The multiple deadline extensions, fears of a no-deal Brexit and Boris Johnson's tactic to override parts of the international treaty in September 2020 has created more **uncertainty** surrounding the future of an independent UK. In the event of a no-deal Brexit, the UK would be forced to trade on the terms of the World Trade Organisation (WTO). This

would result in much larger tariffs on UK exports, significantly damaging GDP and thus discourage risk-averse investors from channelling their funds into the UK.

Government spending (G):

- Increase - the UK government has planned to spend millions to introduce the new **T-level** courses starting in September 2020. These are 'technical based qualifications', available to 16-18 year olds that last 2 years long and are equivalent to 3 A-level grades. By spending more on vocational training, the government is helping students find jobs easier by equipping them with the relevant industrial skills. Not only will this increase **AD**, but will also shift out the **LRAS** curve, as T-levels are a form of Training and Education (**T&E**).

- Decrease - in 2010, Greece's **public debt-to-GDP ratio** reached 146%, and was eventually bailed out by the eurozone, who forced the government to adopt **austerity** measures. This meant cutting back spending on services such as healthcare and **education**, which contributed to the fall in **AD** that Greece experienced at the time.

Net exports (X-M):

- Increase - in November 2020, the largest ever **Free Trade Agreement** (FTA) was signed. The Regional Comprehensive Economic Partnership (RCEP) covers a market of nearly 2.2 billion people, with the notable member countries being Australia, China, Japan and South Korea. With the **bloc** covering 28% of **global exports**, members will experience a smoother flow of **trade** and investment, and therefore benefit from a boost in net exports.

- Decrease - as mentioned above, with China projected to come out of 2020 the strongest, demand for the **Yuan** (¥) has grown with more overseas **investors** praising the country's response to covid-19. A strong **exchange rate** would, however, make exports dearer but imports cheaper and so, in theory, reduce the net exports of the economy.

Determinants of Short-run Aggregate Supply (SRAS)

Cost of employment:

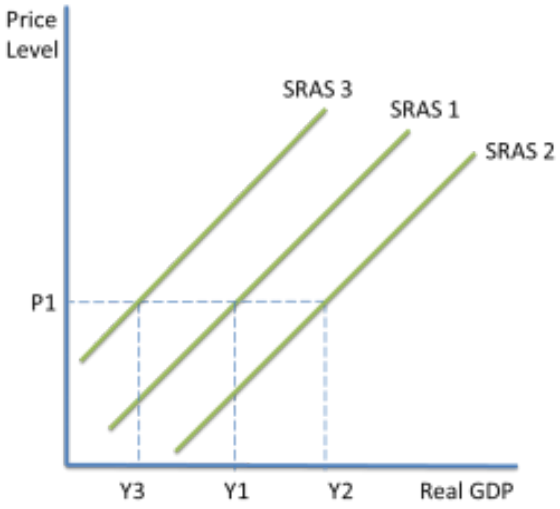
- Increase - during peak seasons at airports (i.e. Christmas), airport baggage handlers are most likely to go on strike with demands for higher wages, as this is the period when airports cannot afford any delays in flights. A rise in **wages** increases the **cost of production** for firms, and therefore shifts the SRAS curve left, from SRAS 1 to SRAS 3.

- Decrease - due to national lockdowns to prevent the spread of coronavirus, the UK government has implemented a **furlough scheme**, which **subsidises** wage bills as 80% of

monthly salaries are covered by the government, with the remaining 20% covered by employers. This should lower the **cost of production** for firms, shifting the curve from SRAS 1 to SRAS 2.

Cost of raw materials:

- Increase - in 1973, the Organisation of Petroleum Exporting Countries (**OPEC**) imposed an oil embargo against the United States due to geopolitical factors in the Middle East. As the country was very reliant on **oil** at that time, and that OPEC controlled roughly 75% of the global supply, an embargo forced the price of oil upwards, which increased the **cost of production** for many firms.



- Decrease - as the issue of **climate change** is becoming increasingly clear, people have started the transition to becoming 'greener', and leaving less harmful impacts on the planet, e.g. through the use of **renewable energy** sources such as wind and solar, as opposed to coal and natural gas. As mentioned above, by shifting away from non-renewable energy sources, countries are less reliant on **OPEC** for oil, as multiple alternatives are available. This in turn reduces the overall cost of production for firms, shifting the curve from SRAS 1 to SRAS 2.

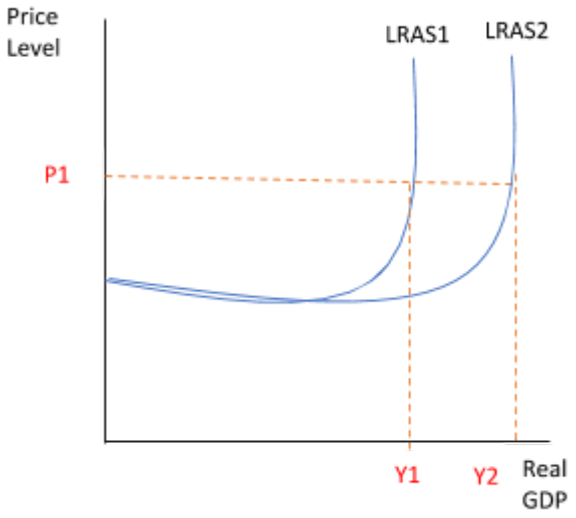
Government regulation:

- The European Union has pledged to become **climate-neutral** by 2050, and in order to achieve this goal, they plan to implement a Border Carbon Adjustment (**BCA**) mechanism by 2022. This is effectively a tax levied on imports that are not produced by environmentally-friendly methods. Firms will therefore either have to pay the tax, or invest in 'green' technology to exempt themselves from it. Either way, firms will see an increase in **cost of production**. As more countries pledge to cut harmful emissions, similar policies will be introduced, to which firms will have to adapt to.

Determinants of Long-run Aggregate Supply (LRAS)

Technological advances:

- In 2015, China made a ten-year plan, "Made in China 2025", to expand their high-tech sectors in order to become a "manufacturing superpower". This involves Research & Development (**R&D**) **subsidies** in the aviation industry, railway equipment, Information Technology, etc. As shown in the diagram, this will shift the LRAS curve to the right, expanding output to Y2 whilst still maintaining the price level at P1.



Changes in relative productivity:

- **Government intervention** (as a result of covid-19), has triggered low **interest rates** and easier access to **credit**, i.e. loans. From this, we have seen a rise in '**zombie firms**', broadly defined as unproductive businesses. If not also for the **furlough scheme** that has subsidised wage bills, the pandemic would have forced these firms into insolvency, but being able to obtain loans easily has kept these uncompetitive firms going. This damages the overall **productivity** of the UK economy, as 'zombie firms' have little incentive to invest in **R&D**. With the pandemic projected to become a long-term issue, more government intervention could further prevent these 'zombie firms' from entering insolvency.

Changes in education and skills:

- As previously mentioned, the new **T-levels** introduced to 16-18 year olds will increase the quality of **human quality**, as the younger generation will be equipped with the skills that potential employers are looking for. This will shift the LRAS curve to the right, boosting the **productive capacity** of an economy.

Competition policy:

- The "Airline Deregulation Act" was passed by Congress in 1978 to effectively remove '**red tape**' in the aviation industry by no longer allowing the U.S. government to control air routes or fares. This allowed more firms to enter the market, which increased **competition** due to the presence of a **profit-motive**.

2. Economic Performance

The causes of unemployment

- Structural unemployment - Due to **technological advances** across a wide range of industries, a high proportion of jobs are at risk of automation. For example, in the automotive industry an increasing number of workers are at risk of **redundancy** from the introduction of robots and machines to perform the same jobs at a fraction of the **cost**. This is classed as structural unemployment because the redundant workers will most likely have no qualifications or **training** in other industries.

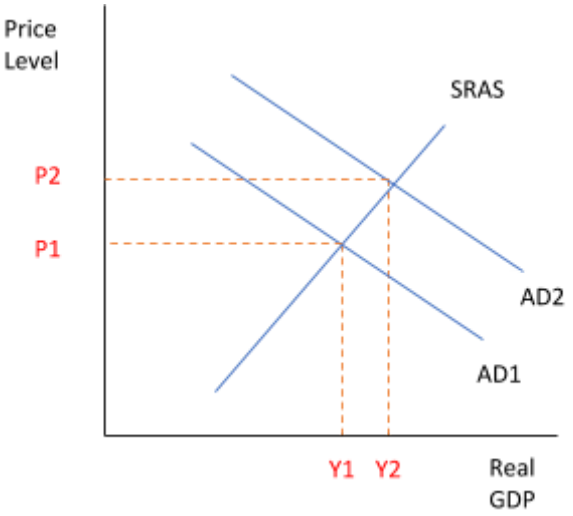
- Structural unemployment - The coronavirus pandemic has forced the UK government to impose multiple national lockdowns over the course of 2020, which has forced people to work from home, if possible. As many jobs in London are **service based** (investment banking, trading, etc.), adapting to this hasn't been an issue as Londoners can work from their home computers. However in the North, a large proportion of jobs are based in the **manufacturing industry**, where it isn't possible to work from home. This links in with **geographical immobility** of labour, as Northerners are unable to travel to work, so are at risk of unemployment. This has also widened the **North-South divide**, with the UK now having the most regionally unbalanced economy in Europe (see notes).

- Seasonal unemployment - **Christmas** is classed as a 'peak season' for firms across many industries. For example, during this 'peak season', Amazon employs temporary workers to cope with the large rise in demand for goods. But these workers would then be laid-off in January.

- Cyclical unemployment - Covid-19 has accelerated the increase in **cyclical unemployment** for those working in the hospitality sector, as these services are classed as non-essential. Government-imposed lockdowns have therefore forced these firms into insolvency, such as pubs and leisure centres, due to a lack of demand from **consumers**.

The causes of inflation

- Demand-pull - Around the christmas period, countries experience **seasonal inflation**, as a result of high demand for goods. As the AD curve shifts to the right, the price level increases from P1 to P2, and economists refer to this period as "**Santa's rally**".



- Cost-push - Talks of a '**great decoupling**' between China and America have grown, as tensions between the world's two largest economies become more apparent. By no longer integrating itself with East, American firms have lost the benefit of low prices for raw materials, as they must now look for alternatives. This cumulatively raises the cost of production for firms, which will be passed on to consumers in the form of **higher prices**.

- During the 1973 oil crisis - whereby **OPEC** imposed an oil embargo on the U.S. - the American economy experienced an increase in **inflation**. This is because oil was a major raw material for most firms, and so a sudden reduction in the supply of it sent the **costs of production** soaring, which firms dealt with by charging consumers higher prices, hence a higher rate of inflation.

The balance of payments on current account

- In November 2020, the World Trade Organisation (**WTO**) allowed the EU to impose **tariffs** on nearly $4 billion of US goods, as a result of the unlawful **subsidies** the U.S. granted to Boeing. Airbus and Boeing (the aviation **duopoly**) are based in Europe and America, respectively. These new tariffs will widen the U.S. **current account deficit**, as the economy will experience more **outflows** of money in order for firms to pay the EU tariffs.

- Being a global leader in innovation, Germany has a considerable current account surplus. One of the driving forces behind this is its low prices (as a result of **R&D** subsidies), which has triggered a boost in **exports**, and Germany is home to many natural resources, so there is little need for **imports**.

- Covid-19 has disrupted global **supply chains** due to national lockdowns and countries closing their borders to outsiders. This has triggered the shift towards more '**domesticated**'

supply chains, which would make countries less prone to **economic shocks** from overseas. One potential implication of this is that current accounts will now be less dependant on the economic conditions of other countries.

Possible conflicts between macroeconomic policy objectives

Economic growth vs the environment:

- As climate change is becoming more of a priority for global leaders, more measures will be implemented to prevent the effects on the environment. But the **trade-off** between the two is becoming increasingly clear. For example, the 2006 Stern Report suggests that climate change is costing the world 20% of **GDP** every year. Governments around the world are being forced to sacrifice economic growth to save the environment. For example, the EU Emissions Trading Scheme (**ETS**) adopts a "cap and trade" approach, whereby firms are capped on how much harmful gases they can emit. Unless firms adapt to these policies, they are at risk of insolvency, which will harm **GDP growth**.

Unemployment vs inflation:

- In 1958, William Phillips plotted a graph of inflation against unemployment for the years that led up to that date, and noticed an inverse correlation between the two indicators. This was named the **Phillips curve** (see notes), and has been used by economists ever since. As unemployment goes down (i.e. more people are in work), the demand for goods and services rises so that prices eventually follow - hence higher inflation. Conversely, as unemployment increases, more people save and inflation falls. However, occasionally there have been periods of high unemployment complemented with high inflation, like seen during the 1970's. This is referred to as **stagflation**, and is frowned upon by many economists as it triggers deep recessions.

3. Macroeconomic Policy

Monetary policy

- Low interest rates - following the EU referendum - in which the UK chose to leave the trading **bloc** - the Bank of England reduced interest rates to 0.25%, as low interest rates theoretically stimulate demand. This was done **preemptively** to prevent a reduction in GDP growth, as Brexit created **uncertainty** for the UK economy, which resulted in less **investment** from overseas as well as from domestic firms.

- Low interest rates - governments have responded to the coronavirus pandemic by drastically reducing interest rates, in order to cope with the lack of **demand** and **investment** in the global economy.

- High interest rates - from 2009 to 2020, America experienced their longest ever **economic expansion,** to which the Fed responded by increasing interest rates near the end of this period, to prevent **demand-pull inflation** which would have harmed the economy in the future. However these rates were then dropped amid the U.S.-China **trade war** that was projected to adversely impact both economies. Following the 2008 Global Financial Crisis (**GFC**) and the coronavirus pandemic, high interest rates will be extremely rare in major economies, as low interest rates are "locked in for the long term", as the Chancellor of the Exchequer Rishi Sunak stated in early 2020.

- Now that more governments are responding to the 21st century climate crisis, more is being done to mitigate the drastic effects it will have on society. **Green Quantitative Easing** is gaining popularity by many central banks. As opposed to conventional QE, banks would only buy **bonds** off companies that fund environmentally-friendly projects.

- A perfect example of when we saw central banks act as a **lender of last resor**t was during the 2008 Great Financial Crisis (**GFC**). The Federal Reserve, the central bank in the U.S., lent to several Wall Street banks to prevent insolvency. However, many argued that too much government intervention would promote the idea of "**moral hazard**". This concept refers to when parties purposely act irresponsibly and inefficiently because they know the risk is transferred to a third-party member. So, in the cast of the GFC, banks knew that if governments would bail them out then, they would bail them out in the future and so could continue to participate in risky investments. This idea is often referred to as banks being "too big to fail". The Fed therefore decided not to lend to the Lehman Brothers (a bank), and allowed them to become insolvent to prevent **government failure**.

- Although most **central banks** are now independent of their respective governments (e.g. the BoE gained independence in the 1990's), covid-19 has become a threat to this. The response to the pandemic has resulted in **quantitative easing** programmes on an unprecedented scale. The European Central Bank (**ECB**) announced a €750 billion Public Sector Purchase Programme (PSPP), to which the German High Court opposed, as they

felt the ECB exceeded their powers. This has sparked debates as to whether central banks should be under the control of their governments.

- In 2020, the **Federal Reserve** (the central bank in the U.S.) announced their plans to change the way they set inflation rate targets, and named it the **Flexible form of Average Inflation Targeting (FAIT)**. Put simply, in the past the Fed has set a target of 2.0% annual inflation. However, with the new FAIT system, the Fed will now ensure 2.0% inflation in the long-run (i.e. on a more average basis). For example, if in 2025 the inflation rate was 5%, but in 2026 the inflation rate was 0.1%, as long as it is 2.0% on average, the central bank will still be seen as achieving their targets. This means the Fed will have a much more laid-back approach to inflation (often referred to as a dovish approach), which means lower interest rates and more credit expansion is expected to come.

- **Monetary Financing** - a term used when central banks directly buy **bonds** from their governments as a way to finance their spending. Covid-19 has brought this term under the spotlight as the pandemic has forced major **fiscal stimulus** packages across the world, to which central banks felt almost as if they had to pay for. This is yet another threat to the independence of central banks, but by constantly paying for stimulus packages, it encourages reckless spending by the government, which could lead to higher **inflation** rates. The Bank for International Settlements (**BIS**), a group of central banks, stated that the "*fine line between monetary policy and government debt management has become blurred*".

- Covid-19 has triggered a shift from **monetary** to **fiscal** policy, as we begin to see the limits of the former:

➔ The independence of central banks is threatened (explained above).

➔ The vast majority of **interest rates** around the world are very low, and cannot be lowered further to stimulate demand before entering negative territory.

➔ We are starting to see how Quantitative Easing programmes are subject to the law of **diminishing returns** (see notes). As many central banks have bought billions of dollars worth of government and corporate bonds, the effect of this being able to stimulate demand is diminishing - hence the name. Despite having the money from central banks to **invest**, firms in many countries are choosing to delay this due to high levels of uncertainty brought by covid-19, as investment is a **derived demand**.

Fiscal policy

- **Corporation tax** in the UK decreased by 9% from 2010 to 2019, which, in theory, would shift the LRAS curve to the right by stimulating more **investment**, however this was delayed by uncertainty from Brexit and the US-China trade war. Therefore, when we disregard the **ceteris paribus** assumption, economic theories do not always manifest into the real world.

- In 2013, the UK government made further reductions in corporation tax, and this attracted around 40 different overseas firms to set up bases in the country. The surge of investment should have boosted the economy by creating more jobs, however once the UK public voted to leave the **European Union** in 2016, there was a high level of uncertainty amongst firms, and so they decided to delay their investment plans. This cancelled out the increases in investment in 2013, so had no overall effect on the economy.

- Now that **climate change i**s becoming an increasingly worrying issue, more investment plans are being scrutinised by the public, for example Heathrow Airport's plans for a third runway were rejected by the court of appeal after the adverse environmental effects were assessed, even though it would have boosted economic growth by creating more **jobs**.

- In 2019, Boris Johnson promised a "**triple-tax lock**" in his manifesto. His pledge was that, under a conservative government, VAT, income tax and National Insurance Contributions would not rise. However after the recent covid-19 pandemic, whether he will stick to his manifesto is unknown but the effects of this 'tax lock' could prove to significantly improve the state of the economy, as households will now have more disposable income so their **marginal propensity to consume** will rise.

- Although the idea of **budget deficits** for prolonged periods of time is frowned upon, the coronavirus pandemic has meant that for many governments this has become the new norm. For example, during the 2008 Global Financial Crisis, the UK government deployed several large stimulus packages (e.g. cutting VAT), to which Germany regarded as "**crass Keynesianism**", i.e. the UK were spending recklessly. Germany has always been strong advocates of balanced budgets, but covid-19 has brought even this country into the territory of budget deficits.

- Another way governments could deal with their large **national debt** is by becoming supporters of **financial repression**. This concept explains how funds are channelled from savers to the government as a method of eroding the value of their debt. In practice, governments try to boost the **inflation rate** and lower **interest rates**, so the former is higher than the latter. Governments can now simply grow their economies out of debt, however the low interest rates mean **savers** lose out as their rate of return is not as high as it used to be.

- During the 2010-12 **European debt crisis**, Greece was forced to cut spending and raise taxes to deal with their national debt. This increased unemployment and decreased economic growth by 25%. Another victim of Greece's **fiscal austerity** programme was training and education (**T&E**), as spending on this was reduced by 20%. This shifted the SRAS curve to the left due to lower productivity from workers, and further contributed to lower economic growth.

- In most cases, fiscal austerity is politically difficult as it tarnishes the reputation of those in charge. For example, in 2019 the French president, Mr Macron, announced his **pension** reforms that sparked protests across the country, even though they were clearly stated in his manifesto during his election campaign.

- British Airways was **privatised** in 1987, and has since then witnessed remarkable increases in efficiency. The aviation industry also saw a major decrease in regulation as a result of the **Airline Deregulation Act** in the 1970's, which allowed new firms to enter the market and challenge **incumbents**.

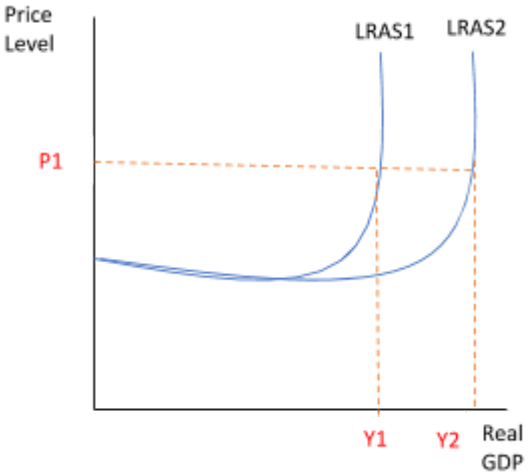
- The UK government announced a new regulatory body within the Competition and Markets Authority, called the **Digital Markets Unit (DMU)**. This unit will regulate firms that have a "strategic market status" and are funded by digital advertising, so namely Facebook and Google. This particular approach is called "**ex ante**" regulation, as opposed to the conventional "**ex post**" regulation. Ex post is when the government intervene in the market following the evidence of market power abuse, e.g. if Google exploits consumer data the government will then set rules banning them from collecting data. Ex ante regulation refers to government intervention prior to any market power abuse, so the government will essentially tell firms how to behave rather than punishing them after they have misbehaved. The DMU will arguably strengthen ties with the EU, who share the same view on tech regulation as the UK. However, the UK must make sure not to impose too much regulation on these firms, else it will deter them from investing in the country.

Supply-side policy

- In 2019, the UK government spent £400 million on improving **schools**, and has pledged to raise teachers' salaries to £30,000 by 2022. A rise in wages means teachers are more motivated to work, resulting in a better quality of education and therefore workers with better skills.

- In 2020, Boris Johnson announced his new **immigration** plans that would allow migrants citizenship if they had sufficient educational qualifications. This would result in a much more **skilled workforce** across the UK, which would improve the productive capacity of the economy as firms would become more efficient. However, current British citizens may have less of an incentive to find jobs if they know they are competing against a more skilled applicant, and so may simply apply for universal credit instead, which would increase the **natural rate of unemployment**.

- In 2015, China made a ten-year plan, "Made in China 2025", to expand their high-tech sectors in order to become a "manufacturing superpower". This involves Research & Development (**R&D**) **subsidies** in the aviation industry, railway equipment, Information Technology, etc. As shown in the diagram, this will shift the LRAS curve to the right, expanding



output to Y2 whilst still maintaining the price level at P1.

- Reducing **corporation tax**, among other factors, made the UK appealing to Jaguar Land Rover (JLR) as an investment hotspot. They therefore made plans to build a warehouse in the West Midlands, opening up multiple job opportunities for local residents and therefore reduced unemployment. Although it didn't make a huge impact, the state of the UK budget deficit was improved as JLR had to start contributing towards tax revenues.

- Privatisation does not necessarily result in productivity improvements, as perfectly illustrated by the **probation industry**. Firms operating in this industry were handed over to private ownership in 2014, with the hopes of improving efficiency. However since then, these firms have been **bailed out** by the government several times, until the government announced plans to **re-nationalise** these firms by 2021. Therefore, we can argue that firms in certain industries operate more efficiently in the hands of the government.

- The Conservative party have already started plans to build two of the largest **rail infrastructure** projects in Europe, with the total cost estimated at around £80 billion. **HS2** is a high-speed railway that connects through London, Birmingham and Manchester. The government hopes to improve **labour mobility** across the UK, i.e. the ease of workers to move around the country.

- Margaret Thatcher, a former prime minister (regarded as the "iron lady"), disliked the idea of **trade unions** and saw them as an 'obstacle to economic growth', as workers would negotiate higher wages and better work conditions through these unions, which increased the **cost of production** for firms. Therefore, by diminishing the power of these unions, firms would save a lot of revenue and fewer costs are passed down to consumers in the form of higher prices. However if politicians were to deal with unions with an oppressive approach in today's modern society then, like with many policies, there would be **unintended consequences**. For instance, employees would start adopting a "**work-to-rule**" approach to their jobs. This is when workers do no more than the bare minimum that is required by them by their employers, as they no longer want to work extra hours with no extra pay - like they may have once done before had it been for the influence trade unions once had. This can damage the overall productivity of firms, and can therefore have drastic effects for the macroeconomy.

4. The International Economy

Exchange rates

- **FOREX** markets are incredibly volatile and exchange rates are constantly changing in all countries, as investors weigh up the risks and benefits of buying currencies by assessing factors such as geopolitics (i.e. current affairs between countries), the current economic climate, etc.

- In 2015 - prior to the EU referendum - the Pound (£) rose against the Euro (€), but by memorising the **WIDEC** and **SPICED** acronyms we can explain how this wasn't necessarily a 'win' for the UK. As the UK has a stronger currency than those countries within the **eurozone**, exports become more expensive (and EU imports follow suit). This scenario is exemplified by what happened to 'Oxford Instruments' in 2015. This firm produces high technology tools and systems for multiple industries and, following the **appreciation** of the Pound, reported a loss of all exports to Russia as a result of the price change.

- Prior to the Covid-19 pandemic, America was experiencing its longest ever economic expansion since the Global Financial Crisis (**GFC**). It was also seen as winning the **trade war** between itself and China, as its counterpart was facing an economic slowdown at that time. Both these factors contributed to a strong dollar ($), as investors saw America as a haven for high returns with minimal risk. However, as currency appreciations trigger cheaper imports, multiple domestic firms reported a loss in profits, because consumers found cheaper goods in other countries.

- Although floating exchange rates have their many benefits, it isn't uncommon that countries decide to implement **fixed exchange rates against** other currencies, for example the United Arab Emirates (UAE) with America. The UAE stated that this is to promote exchange rate stability, in particular the stability of oil prices following several shocks that have triggered global recessions, i.e. the **1973 oil crisis** (see notes). As the exchange rate is fixed, there are low levels of uncertainty amongst investors, which the UAE are currently trying to attract as their supply of oil is limited and they attempt to find other ways of remaining a powerful nation.

- The Chinese government has admitted to managing their exchange rates on multiple occasions for the benefit of their economy. Before the coronavirus pandemic hit, Chinese policymakers would cut **interest rates** in order to boost exports. By cutting interest rates, there is a net outflow of **hot money** - money that moves around countries in search of the best return - as the rate of return was considerably lower. The Yuan (¥) is then **devalued**, which makes exports cheaper, hence a rise in demand for them. The Chinese hoped that by doing this it would diminish the power America had over the trade war.

Globalisation and trade

- The **Covid-19** pandemic forced countries around the world to close their borders to foreigners in order to reduce the spread of the virus. This also meant a temporary halt to imports and exports between countries. However this has forced firms across the planet to rethink their structuring of **supply chains** - as these chains have clearly proven to be more vulnerable to economic shocks than once thought. The virus has therefore encouraged a shift towards more **'domesticated'** supply chains, i.e. within a country's borders. Although firms think it will benefit them in the long term - by providing more stability - it may in fact do the opposite. If countries become less globalised and consumers turn to buying domestic goods only, there is potential for prices to rise, as the benefits from **economies of scale** (see notes) are eradicated because goods and services are now produced in smaller amounts to suit a smaller market. In addition, domesticating supply chains may in fact make firms *less* resilient, such as in the case of weather strikes, which would disrupt production lines. Firms would be unable to turn to other countries as they once did in a globalised world, and this can actually be seen in North Korea, whereby crop failures result in mass famines as the country refuses to import from overseas.

- As China is on the rise to becoming a global superpower, foreign firms are starting to move supply chains away from the country as they transition away from the 'Low Income Country' status, which means wage rises and higher costs for firms. This movement is referred to as "**China plus one**".

- Although globalisation and Foreign Direct Investment (FDI) usually complement each other, the latter tends to come with its disadvantages. For instance, FDI can "**crowd out**" domestic investment, and governments would prefer domestic investors as the profits are injected back into its own economy. FDI can also threaten **economic welfare**, as foreign investors are less aware of **consumer preferences** than domestic ones. This can be seen in Tesco, a supermarket chain that set up bases in Malaysia, but then had to compete with firms who were more aware of what Malaysian consumers demanded. This eventually led to Tesco selling all their foreign stores in 2020.

- In many cases, **tariffs** and **quotas** arise from geopolitical factors between countries. For example, the World Trade Organisation (**WTO**), an intergovernmental organisation that regulates international trade, settled a decade-long argument between the EU and America regarding subsidies. The US was accused of illegal subsidies to Boeing, an American aerospace corporation. By providing subsidies, the firm's costs of production were reduced, which meant they were able to lower prices to consumers. This had adverse impacts for the competitiveness of Airbus, the European-owned counterpart to the aviation duopoly. The EU therefore took the issue up with the WTO, and was permitted to add tariffs to $4 billion worth of US imports to compensate for the loss of profits to Airbus.

- Globalisation does not always benefit countries, as trade liberalisation has encouraged firms from the West (i.e. the UK, America and Europe) to **outsource** their factories to the

East (i.e. Asia and the Middle East). Low Income Countries in the East offer cheap labour, and therefore attract foreign firms as a way of reducing costs. However, this resulted in mass **structural unemployment** in countries in the West, particularly regarding the textiles and manufacturing industries.

- As the UK has officially left the European Union, politicians are promising a more "global Britain", i.e. a Britain that has more influence in international markets. However so far all Brexit has done is damage confidence in the UK, as one of the conditions of the EU withdrawal agreement was to leave Northern Ireland a part of the **single market** in order to prevent a "hard border" with itself and the republic. This has narrowed the gap towards Northern Ireland and the Republic removing the border between them. On top of this, talks of a Scottish referendum are gaining popularity, which further weakens the reputation of the UK - or what's left of it. Therefore even though lowering interest rates, tariffs and taxes attract foreign investors into the UK as economic theory suggests, in reality it's a completely different story once we disregard the "**ceteris paribus**" assumption.

Economic development

- The rise of China from a third world country to one of the largest economies in the world can be traced back to years of economic reforms in the 20th century. In the 1960's, under the command of Mao, China played by the rules of a '**command economy**', whereby there was an abundance of regulation with no room for market-based policies. This proved unsuccessful in boosting China's economy, and in the 1970's (under a new leader), Deng brought China under a '**market economy**', by incentivising hard work and bringing 700 million people out of extreme poverty. Deng also opened China up to the world, by creating 4 **Special Economic Zones** (SEZ's) that were subject to unique economic regulation and allowed in **FDI** and imports from overseas. This proved successful and opened the pathway for Deng's successors to continue boosting China's economy until it became the global superpower we see today.