CAIE Geography Pre-U

2A: Trade, Debt and Aid

Detailed Notes

Global capital transfers

Trade

Trade is the **exchange of goods, money and services between countries and regions**. If a country's imports are greater than their exports then they are said to have a **trade deficit**. If a country's exports are greater than their imports then they are said to have a **trade surplus**. **Higher-income countries (HICs)** and **newly industrialised countries (NICs)** tend to produce manufactured goods and services which have a high value and a high value added whereas **lower-income countries (LICs)** export mainly primary products which have a low value and a low value added.

Foreign direct investment

FDI is the **purchase of land, equipment or buildings or the construction of new equipment or buildings in a foreign country**.

Aid

Aid is the **international transfer of money, goods, or services from a country or international organization** for the benefit of the recipient country or members of its population.

Remittances

Money sent out of a country to someone's home country. These remittances have **four times the value of all foreign aid** for development. The money from remittances goes directly to families and so has **no chance of corruption**. Most of the remittances sent home are put into that country's economy and so through the multiplier effect can give the country an even greater economic boost. However, it can cause a labour drain and cannot be substituted for a large scale, well-targeted overseas aid.

Debt

Money owed to a company, country or person. This can be as a result of **aid or trade deficits**. Some countries are spending more on repaying debt than they are spending on health care or education. This creates **heavily indebted poorer countries (HIPCs)**.

Patterns of world trade and its consequences and management

Patterns of world trade

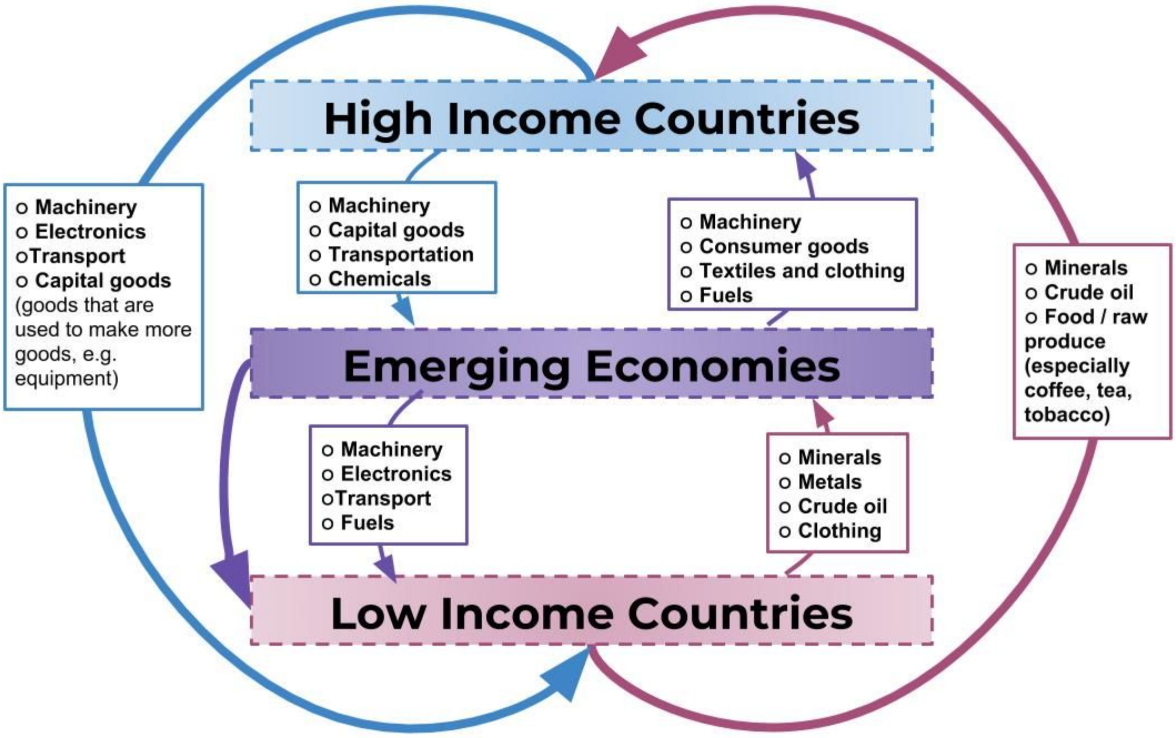
	Importers	**Exporters**
Raw materials	HICs and NICs Cheap to buy	LICs Doesn't make much money
Commodities	HICs and NICs Cheap to buy	LICs Doesn't make much money
Manufactured goods	All	HICs and NICs

	More expensive	High value-added
Services	All but mainly HICs and NICs	HICs Very high value-added
High-tech goods	HICs and NICs Expensive	HICs and NICs High

These patterns of world trade create trade imbalances. HICs and NICs gain a trade surplus whereas LICs have a trade deficit. This means that HICs and NICs can continue growing in wealth by buying cheap raw materials from LICs and adding large amounts of value to it.

Changing patterns of world trade

- **Colonial and neo-colonial patterns:** since 1900 most countries have become independent from their colonisers. Colonisers often forced the colonised country to produce fewer types of crops and mainly **produce cash crops** that would produce a lot of money. This meant that when the country became independent, the country's economy was reliant on one crop with not enough food crops. When a country was under colonial influences, most of the resources produced in the country were removed, making it difficult for the country to develop. Many countries today are under neo-colonial control. This can be seen in China's continuing investment in African countries. Neo-colonialism can create trade links between countries and provide LICs with infrastructure and new technologies. However, it can also create **dependency**, exploitation and loss of resources.
- **The rise of NICs:** More goods are being manufactured in NICs due to cheaper labour and greater access to resources. The first NICs were known as the **Asian Tigers** and included Taiwan, Hong Kong, Singapore and South Korea. These countries became NICs between the 1960s and the 1990s. This means that HICs are now focusing on services and design rather than manufacturing. This is known as **de-industrialisation**.
- **Terms of trade:** A measure of a country's export prices in relation to its import prices. If a country's terms of trade improve, it means that for every unit of export product or service sold it can buy more units of imported products or services. Since the 1990s, LICs have tended to see their terms of trade decrease as a result of increased supply and decreased demand for their primary goods. HICs have seen an increase in their terms of trade as primary products are becoming cheaper with a steady rise in the price of their manufactured goods.
- **The changing nature of goods being traded:** HICs are moving away from manufacturing and specialising in services where they can gain the most value-added. The manufactured goods are now being produced in NICs where there is cheaper labour, but the decision making and investments for these goods are still taking place in HICs. LICs are focusing on manufacturing and exporting one specialised good but are still focusing mainly on exporting primary produce.



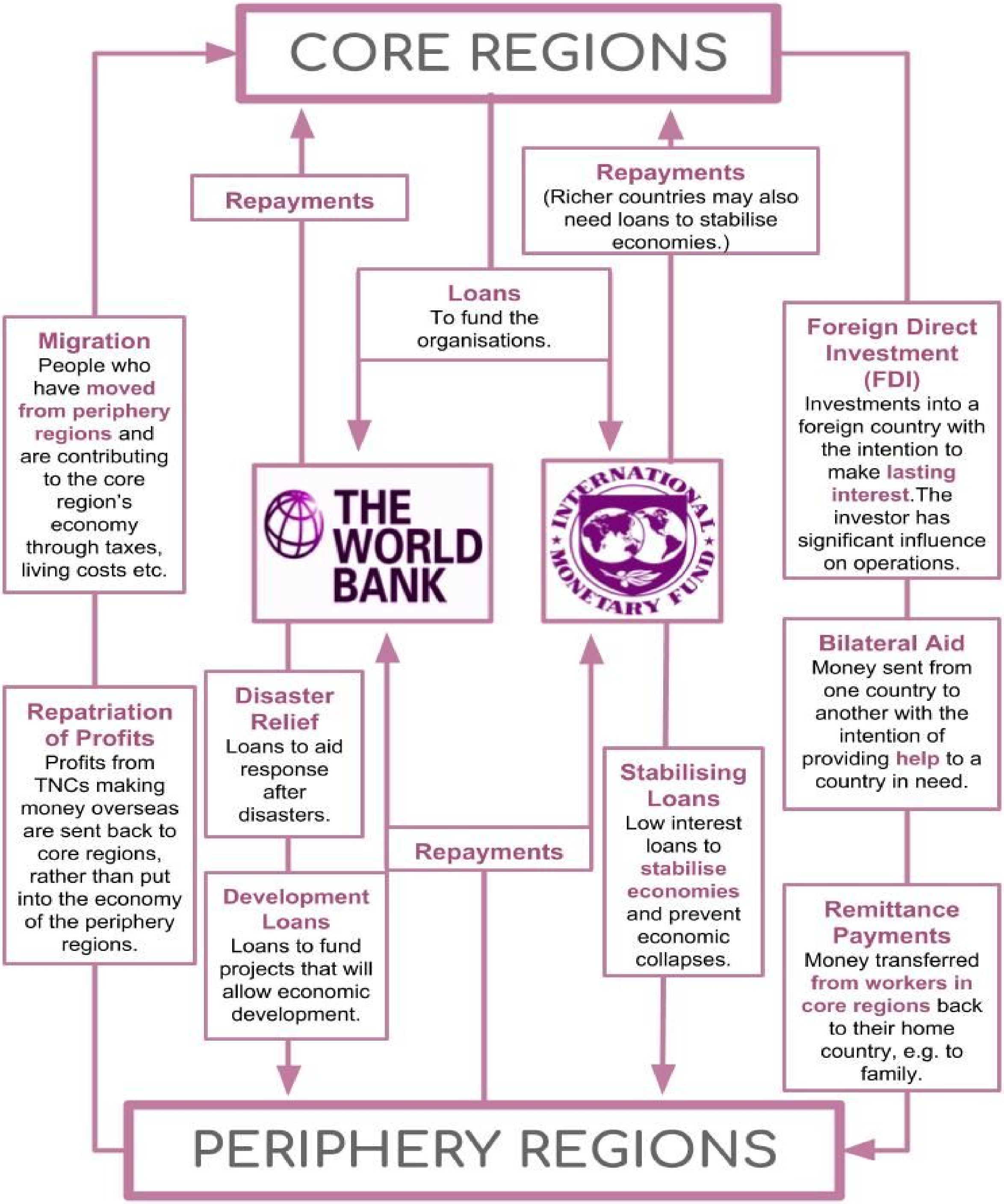
Factors contributing to the patterns of world trade

- **Comparative advantage:** Where a country can produce a good or service at a lower **opportunity cost** than another. This means that a country or company can produce a good relatively cheaper than would be done in other countries. So countries are better off **specialising in fewer goods** and then trading with other countries for the other goods they require. This forces countries to trade with each other and creates increasing **interdependence**. It increases the output of all goods and countries can use fewer resources and increase the production of fewer goods. However, transporting goods leads to **pollution** and the use of resources for packaging. It also can lead to **diminishing returns** which is when a country specialises in a certain product and so increases production and intensity. This can then have a detrimental effect leading to diminishing returns. LICs are also usually not at an advantage. By producing goods that they have a comparative advantage in, which is normally primary produce, it means that they are focusing on products which are of lower worth and can vary massively in demand and so in price. This can stop the economy diversifying into more profitable industries. Watch this video on comparative advantage.
- **Levels of economic development:** HICs tend to trade with other HICs. This makes it harder for LICs to trade, especially when they are just starting off exporting a certain good which will cost more.
- **Trade blocs:** Trade between countries increases when they are part of a trade bloc and it makes goods cheaper. However, it means that trading between non-members more difficult and as most LICs are not part of trade blocs it makes it difficult and more expensive for LICs to trade. It also **protects inefficient traders** within the trade bloc and diverts trade away from the more efficient traders outside the bloc. This is known as **protectionism** and it is mainly as a result of tariffs. For more detail and examples on trade blocs see case studies.

- **The World Trade Organisation (WTO)** is an intergovernmental organisation which is concerned with the regulation of international trade between nations. It settles trade disputes, acts as a forum for negotiations, operates a system of global trade rules and supports the needs of developing countries. However, it has sometimes favoured and supported trade rules which are unfavourable towards LICs, promotes protectionism and has forced LICs to choose **transnational corporations (TNCs)** rather than local businesses and contractors.

Benefits and problems of trade

- **Balance of payments and trade deficits/surpluses:** The balance of payments includes the balance of trade (exports vs imports) together with any invisible earnings and costs such as those from tourism, banking and insurance. Trading can benefit a country if they have a trade surplus as they can then spend this money on improving infrastructure or public services. However, if the country has a trade deficit then money to pay back loans and debt services has to be removed from the money supplying public services such as health and education as well as improving infrastructure.
- **Foreign currency:** Countries may hold foreign currencies in their central bank, these are known as **foreign exchange reserves**. They are mainly kept to ensure that if a country's currency quickly devalues it has backup funds. Some countries also hold foreign currencies (mainly the US dollar) to make trading easier as most trading is done in this currency. Countries can also stockpile a certain currency which raises that currency value compared with their own currency. This makes their exports cheaper than the goods made in other countries.
- **Overdependence of primary produce:** Many LICs are dependent on their primary products due to the principles of comparative advantage. The prices of primary products are **highly volatile due to inelastic demand** and their production and supply are also volatile as they are **heavily influenced by the weather or natural hazards**. This can mean that LICs struggle to develop due to trade deficits and are also vulnerable to dependence on TNCs and FDI.
- **Neo-colonial control:** HICs or TNCs are reliant on LICs for their cheap raw materials and LICs are reliant on HICs or TNCs for trade and infrastructure. This creates dependence but LICs are more dependent on the HIC or TNC and this can put them in a vulnerable position if the country or company decides to move elsewhere.
- **Trade as a political weapon:** Trade and trade restrictions are often used to force policies in countries. For example, during the six-day war between Saudi Arabia and Israel in 1967, Saudi Arabia (who dominated world oil trade) placed an embargo on exports of oil to the US and other countries who supported Israel.


CORE REGIONS
Repayments
Repayments
(Richer countries may also need loans to stabilise economies.)
Loans
To fund the organisations.
Migration
People who have moved from periphery regions and are contributing to the core region's economy through taxes, living costs etc.
Foreign Direct Investment (FDI)
Investments into a foreign country with the intention to make lasting interest. The investor has significant influence on operations.
THE WORLD BANK
INTERNATIONAL MONETARY FUND
Bilateral Aid
Money sent from one country to another with the intention of providing help to a country in need.
Repatriation of Profits
Profits from TNCs making money overseas are sent back to core regions, rather than put into the economy of the periphery regions.
Disaster Relief
Loans to aid response after disasters.
Repayments
Stabilising Loans
Low interest loans to stabilise economies and prevent economic collapses.
Development Loans
Loans to fund projects that will allow economic development.
Remittance Payments
Money transferred from workers in core regions back to their home country, e.g. to family.
PERIPHERY REGIONS

Management of global trade

- **The WTO:** see earlier notes on the WTO.
- **Fairtrade:** is an institutional arrangement designed to **help producers in developing countries gain better trading conditions**. It introduces improved wages for workers, removes discrimination, eliminates the need for child labour due to fair wages, allows small business owners to become competitive on the international market, uses organic techniques and produces are ensured a minimum price no matter what happens. However, there are high fees to join and so small companies might not be able to join, there is a limited base of customers around the world due to higher prices and there is little drive for producers to improve efficiency as they are guaranteed a minimum price.

Patterns of FDI and its consequences and management

Global patterns of FDI

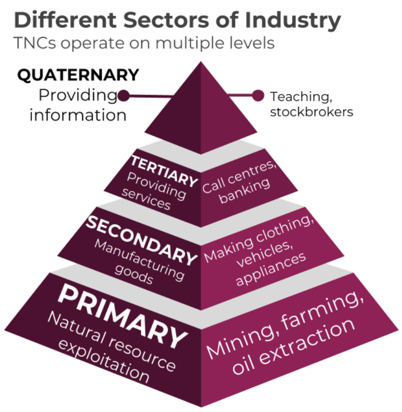
China, Hong Kong and the US were the top three recipients and the top three donors in 2014. Latin American countries had their inward flowing investments increase eightfold between 1980 and 1999. The inflows and outflows for OECD (Organisation for Economic Cooperation and Development eg UK, US, Australia) countries both increased from 1981 to 1999.

Benefits of FDI

- **Improves infrastructure** in the recipient country such as roads, airports and schools.
- **Invests in the economies of developing countries** and can be better at improving living conditions compared with aid.
- **Encourages political stability** as companies will only invest in countries if they are stable.
- **Offers a large range of consumer goods at cheaper prices**.
- **Offers employment** to people in poorer countries
- Donor countries are **closer to raw materials** which makes it **cheaper** for them as they have **reduced transport costs** and they can **avoid tariff barriers**.

Role of TNCs

A **transnational corporation (TNC)** is a corporation that is registered and operates in more than one country at a time. They are mainly operating in developing countries to exploit low costs and access to raw materials. This includes companies such as **Apple** and **Coca Cola**. However, they can have massive **negative impacts on the environment** and can **exploit the local population** by having **low safety standards**, **long working hours and low wages**.

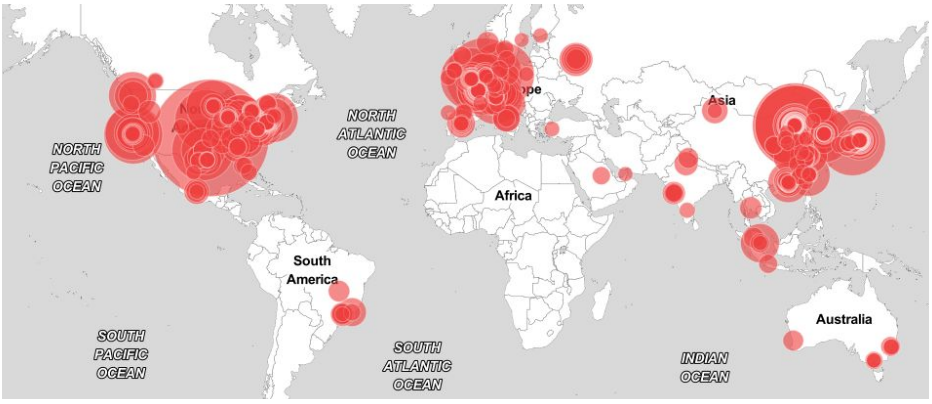


These companies usually work by having their headquarters, production, and sales all in **different countries across the globe**, meaning they are a crucial aspect of globalisation.

These corporations can provide raw products, manufactured goods, services, or information - they exist in different **industries (sectors)**. Overall, TNCs make **products**, produce **jobs**, **invest** in countries, and sometimes contribute to **cultures**. Some TNCs are very powerful, and can even have **political influence**, e.g. the pressuring of some countries to reduce taxes and create SEZs so that the TNC will invest there.

TNCs are very influential to a country's level of globalisation and interconnectivity; some TNCs have larger revenues than entire countries' GDPs. Furthermore, in 2016, the top 200 TNCs accounted for 25% of the world's economic activity but only employed 1% of the world's population. However, TNCs are not entirely beneficial, as some exploit the environment and population in favour of maximising profits and manufacturing efficiency.

The Headquarters of TNCs are usually located in **high income countries**. HQ is responsible for the **big decisions**, such as **investments**, **meetings with global organisations** etc.



(Source: http://fortune.com/global500/visualizations/?iid=recirc_g500landing-zone1)

This map shows the Headquarters of Fortune 500's largest companies. The majority of headquarters are heavily concentrated within the USA, Europe, Japan, as well as many in the emerging economy of China.

TNCs create **links** between countries and with other companies. Linkages are created in order to **benefit the TNC**, and often includes **expanding** the company.

The World Bank

Provides **low-interest loans, zero to low-interest credits and grants to developing countries**. These funds support investments in areas such as **education, health and infrastructure**. Some of these projects are co-financed by governments or other multinational institutions. They have supported **12,000 projects** and given around **$46 billion in financial assistance**.

International monetary fund

- Fosters global monetary cooperation
- Secures financial stability
- Facilitates international trade

- Promotes high employment
- Promotes sustainable economic growth
- Reduces poverty around the world
- 0% interest rate on loans to low-income countries

Watch this video about the IMF.

Negatives of FDI

- Exploits cheap labour.
- Profits can leave the country and so won't go to the development of the nation.
- They are able to remove investment from the country at any time they want, this is known as **caravan capitalism.**
- Can **avoid paying full taxes** or can benefit from government **subsidies** and so they won't be contributing to the economy as much as they could be.
- Lead to environmental degradation.
- Poor health and safety.

Debt

Debt is mainly caused by:

- Overabundant supply of cheap money.
- Insufficient monitoring of aid.
- Loans spent unsustainably.
- Recipient country not generating enough funds to repay the loans.
- Rising world interest rates.
- Countries investing in infrastructure and other economic enticements in order to attract TNCs but this could make them go into debt if they are unsuccessful.

Relieving the debt burden placed on countries can come in several ways:

- **Rescheduling** to allow it to be paid back in more manageable amounts or halting the repayment until the country has become more financially stable.
- **Debt-for-nature swaps** where companies or countries agree to pay back some or all of the debt in exchange for creating conservation zones or other environmental strategies in that country.
- **Debt forgiveness or cancellation.**
- **Debt-for-equity swaps** are where the debt is swapped for shares in a company.

The World Bank, the IMF and other multilateral, bilateral and commercial creditors began the **HIPC initiative in 1996**. This structured program was designed to ensure that the poorest countries in the world will not be **overwhelmed by unmanageable or unsustainable debt burdens**. Positives of the HIPC initiative include:

- Gives countries a **fresh start** so they can spend more money on improving their economy and infrastructure as their debt has been brought down to a manageable level.
- In Ghana, savings from the HIPC funds helped to provide **microcredit schemes to 43,000 farmers** and also contributed to constructing **509 new classrooms**.
- There is **flexibility** in the amount of debt relief a country receives and this can be changed if there is an unexpected increase in the burden of debt.

However, there are also some negatives of the HIPC initiative:

- There are many **complex conditions** and so joining can be difficult.
- More to do with ensuring that the debt can be repaid rather than cancelling the debt to reduce poverty and increase economic growth.
- There are certain **conditionalities** which are tied with the HIPC initiative and this could be detrimental to the country.
- The debt reduction on offer is **often too small** to make a difference and often the process takes too long.

Watch this video on whether debt should be cancelled.

Patterns of international aid and its consequences

Different forms of aid

- **Long term development aid:** Comes in the form of grants, loans, debt cancellation or technical assistance for supporting long term projects with the aim of improving living standards and the country's economy.
- **Short term relief aid:** The aim is to alleviate a short term hazard after famines, natural disasters or wars in order to get the country back to where it was before the event.
- **Bilateral:** From one country to another, usually is top-down aid so supports big projects with the hope that the wealth with trickle down.
- **Multilateral:** Given by an organisation and is usually in the form of bottom-up aid which involves smaller-scale projects at grassroots.
- **Tied aid:** Where the money made from the project must be spent on goods or services from the donor country.

Majors donors and recipients of aid

OECD countries have a required goal of donating 0.7% of their GDP on aid. Here are the top 5 donors of aid in the world based on a percentage of GDP:

- Norway: 1.07%
- Sweden: 1.02%
- Luxemburg: 1.00%
- Denmark: 0.85%
- UK: 0.72%

The top 4 recipients of aid are:

- Pakistan
- Ethiopia
- Nigeria
- Sierra Leone

Notice how Pakistan receives the most aid even though ranked by GDP per capita it is 133 out of 187, this was mainly due to military aid given by the USA.

Reasons aid is given

- To relieve suffering.
- Improve living conditions.
- Donor country might benefit financially as a result of interest being repaid.
- Donor country may receive a better price on produce.
- Makes allies for potential future conflicts.
- Wins support for the government at home and internationally.

Consequences of aid

- **Corruption**: Some governments will use the money from aid for themselves. An example of this is the use of the World Bank's aid given to Chad which was used to buy weapons and support the president's regime.
- Can have a damaging effect on the **environment** such as the Pergau Dam which will be explained in more detail in the case studies.
- Creates **dependency** on aid.
- **Distorts local markets**, especially food aid which undercuts local farmers' prices and puts them out of business thus creating dependency and leaving the country worse off.
- Skewed towards **political allies** not necessarily those most in need.
- Can introduce technologies which are **too expensive** or are difficult to manage.
- Can **displace poor people**.
- Might only **benefit the richer people** thus increasing **inequalities** within the country.
- Can put pressure on the recipient country and **force tied aid**.

See case studies for examples of aid projects

Globalisation

Globalisation is the process of increased interconnectedness among countries through an increased variety and volume of cross border transactions. Watch this video on Globalisation.

Causes of globalisation

- **Improved transport** which allows greater movement of people and goods.
- **Containerisation**: The use of steel containers which makes trade easier and cheaper.
- **Improved technology** allows better **communication** and sharing of resources and information worldwide.
- Reducing national barriers as a result of **trade blocs.**
- Growth and spread of **multinational corporations and transnational corporations.**
- **Increased mobility of labour** which increases the transfer of money in the form of **remittances.**

Positives of globalisation

- The global competition encourages **creativity and innovation** and **keeps prices in check**.
- Developing countries are able to **benefit from current technologies** without having to go through developing those technologies.

- Governments are able to **work together towards a common goal** now that there is an advantage in cooperation, an improved ability to interact and coordinate and a **global awareness of issues**.
- Greater access to **foreign cultures**.
- Developed countries becoming **more aware of the issues facing people in the developed world** and also global issues such as global warming, so tackling these issues becomes more likely.
- **Free movement of labour** around the world.

Negatives

- **Outsourcing** takes jobs away from one country, leaving many without opportunities.
- **Cultures can become diluted** and individuality begins to fade.
- Increased chance of **disease spreading** worldwide.
- Increased spread of **invasive species** which can have negative effects on the ecosystem.
- **Little international regulations** which could have negative impacts on the safety of the people and the environment.
- **Makes the rich richer** and allows more **exploitation of poor people.**
- Free movement of labour can lead to a **labour drain** which can lead to a cycle of poverty in a country. Also causes an increase in the number of far-right groups due to increased numbers of migrants.
- **Overconsumption** which leads to decreasing resources and increased environmental effects.
- **The deindustrialisation** of HICs can leave derelict buildings and cause chemical and industrial waste to leak into water supplies and soils.