Edexcel (B) Economics A-level

Theme 3: The Global Economy

3.1 Globalisation

3.1.2 Trade and growth

Notes

Increasing trade liberalisation:

Free trade is the act of trading between nations without protectionist barriers, such as tariffs, quotas or regulations. World GDP can be increased using free trade, since output increases when countries specialise. Therefore, living standards might increase and there could be more economic growth.

Since WW2, global trade has increased significantly. The increasing number of trading blocs, the rise of emerging markets such as China and India and greater participation from previously communist nations has led to a change in the pattern of trade.

Trading blocs have led to trade creation between members, since there is free trade within the bloc. However, trade has been diverted from outside the bloc, since protectionist barriers are often imposed on countries who are not members.

The WTO promotes world trade through reducing trade barriers and policing existing agreements. It also settles trade disputes, by acting as the judge, and organises trade negotiations.

Every member of the WTO must follow the rules. Those who break the rules face trade sanctions. In addition to trade in goods, the WTO covers the trade in services and intellectual property rights.

As of 2015, there are 161 member states in the WTO.

The role of specialisation and increasing specialisation by country

There has been a recent growth in the exports of manufactured goods from developing countries to developed countries. This is because developing countries have gained an advantage in the production of manufactured goods, due to their lower labour costs, so production shifted abroad.

The deindustrialisation of countries such as the UK has meant the manufacturing sector has declined. This means that production of manufactured goods has shifted to other countries, such as China, whilst the UK now focuses more on services, such as finance.

This has led to the industrialisation of China and India. Their share of world trade has and the volume of manufactured goods that they export has increased.

However, since China's population is now ageing, their wage competitiveness has fallen. This is also due to the rise of the middle class in China, who demand higher wages and consume more.

- **Specialisation in the production of goods and services to trade:**

- Countries can specialise in the production of certain goods. For example, Norway is one of the world's largest oil exporters. Countries trade to get the goods and services they are unable to produce.

- Countries can exploit their **comparative advantage** in a good, which means they can produce a good at a lower opportunity cost to another.

- **Absolute advantage** occurs when a country can produce more of a good with the same factor inputs.

- **Advantages:**

  - Greater world output, so there is a gain in economic welfare.
  - Lower average costs, since the market becomes more competitive.
  - There is an increased supply of goods to choose from.
  - There is an outward shift in the PPF curve.

- **Disadvantages:**

  - Less developed countries might use up their non-renewable resources too quickly, so they might run out.
  - Countries could become over dependent on the export of one commodity, such as wheat. If there are poor weather conditions, or the price falls, then the economy would suffer.

Trade liberalisation and economic growth

Free trade is the act of trading between nations without protectionist barriers, such as tariffs, quotas or regulations.

Free trade provides the following benefits:

- Countries can exploit their comparative advantage, which leads to a higher output using fewer resources and increases world GDP. This improves living standards.

- Free trade increases economic efficiency by establishing a competitive market. This lowers the cost of production and increases output.

- By freely trading goods, there is trade creation because there are fewer barriers. This means there is more consumption and large increases in economic welfare.

- More exports could lead to higher rates of economic growth.

- Specialising means countries can exploit economies of scale, which will lower their average costs.

Foreign direct investment (FDI) and link to growth

FDI is the flow of capital from one country to another, in order to gain a lasting interest in an enterprise in the foreign country.

FDI can help create employment, encourage the innovation of technology and help promote long term sustainable growth. It provides LEDCs with funds to invest and develop.

With the spread of globalisation came more trade between nations and more transfers of capital including FDI (foreign direct investment). Moreover, brands developed globally and labour has been divided between several countries. There is more migration and more countries participate in global trade, such as China and India, as well as higher levels of investment.

The flow of capital and FDI across international borders has increased. China and Malaysia have financed their growth with capital flows. Also, the foreign ownership of firms has increased. There has been more investment in factories abroad. The removal of capital controls has facilitated this increase.