A Level Economics Theme 4
A Global Perspective
2020-2021

Course Companion 2

Globalisation, De-globalisation, FDI

Name: **Teacher:**

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Globalisation

Specification: 4.1.1 Globalisation
a) Characteristics of globalisation
b) Factors contributing to globalisation in the last 50 years
c) Impacts of globalisation and global companies on individual countries, governments, producers and consumers, workers and the environment

Key terms

Globalisation: from an economic perspective, the ever-increasing integration of the world's local, regional and national economies into a single international market.

De-globalisation: This involves countries adopting protectionist policies in order to protect domestic employment. This leads to a decline in specialisation and world trade, lower foreign direct investment and lower levels of short-run money flows between countries

Multinational company or transnational corporation (TNC): a company with significant product operations in at least two countries, e.g. BP, Sony

Transfer pricing: an accounting technique used by transnational corporations for reducing taxes on profits by selling goods at a low price internally from a high-tax country to another part of the company in a low-tax country.

De-industrialisation: A fall in the contribution made by the manufacturing sector to national output, employment and income.

Outsourcing/offshoring: **Outsourcing** is the contracting out of a business process to another party; **Offshoring** means the work is done overseas.

Foreign Direct Investment (FDI): Investment undertaken in one country by companies based in other countries, e.g. Coca Cola setting up a plant in Nigeria to manufacture soft drinks.

Inward investment: Inward investment is where foreign companies invest in the domestic economy

Outward investment: Where domestic firms invest abroad.

Examples of essay questions
1) Evaluate the view that the main cause of globalisation is the increased significance of transnational companies (25m)
2) To what extent do the costs of globalisation outweigh the benefits? (25m)
3) Evaluate the effects of globalisation on inequality in the world economy (25m)

Examples of Data Response questions
1) Explain the characteristics of de-globalisation (5m)
2) Assess the benefits of inward FDI for a country such as Brazil (15m)

Definitions:

Globalisation: the ever increasing **integration** of the world's local, regional and national economies into a single international market.

'The ability to produce any good (or service) anywhere in the world, using raw materials, components, capital and technology from anywhere, sell the resulting output anywhere, and place the profits anywhere.' Peter Jay (BBC Economics Correspondent 1996)

Globalisation refers to the increasing international **interdependence** of economic agents (producers, consumers, governments, entrepreneurs).

Characteristics of globalisation:

1. Increased trade in goods and services

2. The expansion of foreign direct investment (FDI) by trans-national companies (TNCs)/multi-national companies (MNCs)

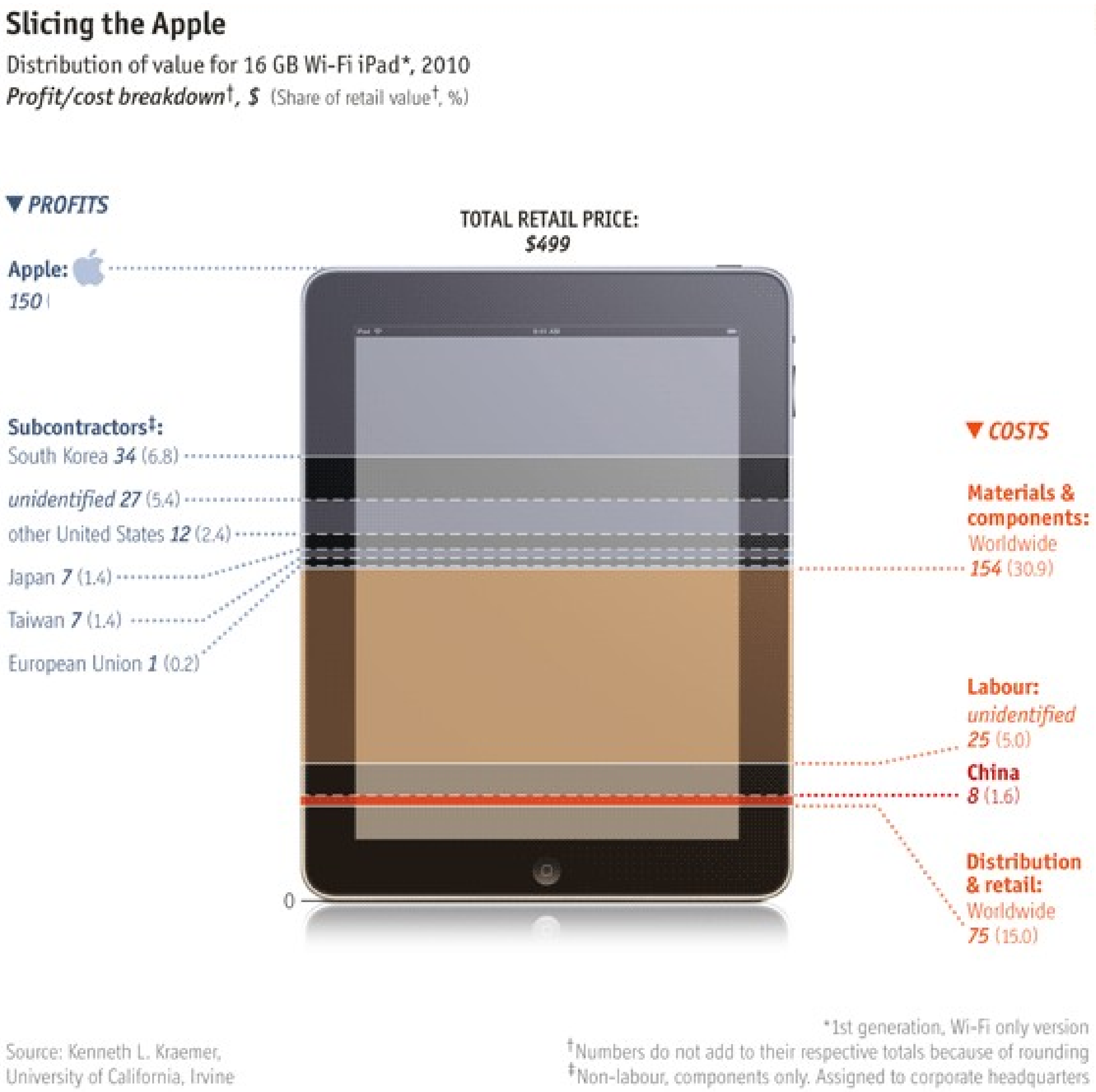
What is a multi-national company?	What is foreign direct investment?
Why do multi-national companies wish to invest in other countries?	

3. The development of global brands that serve markets in higher and lower income countries. Examples of global brands:

4. Global supply chains – for example out-sourcing and off-shoring of production and support services as production supply-chains have become more international.
As an example, the iPhone is part of a complicated global supply chain. The product was conceived and designed in Silicon Valley; the software was enhanced by software engineers working in India. Most iPhones are assembled/manufactured in China and Taiwan by TNCs such as FoxConn

Apple: example of global supply chains

Out-sourcing and off-shoring of production and support services has made production supply-chains more international. As an example, **the iPhone is part of a complicated global supply chain**. The product was conceived and designed in Silicon Valley; the software was enhanced by software engineers working in India. Most iPhones are assembled/manufactured in China and Taiwan by TNCs such as FoxConn



The Economist – 21st April 2012

1. Name 5 countries which are part of the supply chain

2. Calculate Apple's profit as a percentage of the sales price.

3. Calculate the labour costs as a percentage of the sales price.

The causes of globalisation

https://www.youtube.com/watch?v=3oTLyPPrZE4

Causes and effects of globalisation: Watch the video clip (dated 2011) and take your own notes on the causes and effects of globalisation. Note examples, facts, figures etc.

1. By how much has the cost of a telephone call from New York to London fallen since 1930?

2. By how much has the cost of transportation dropped since 1930?

3. Why is this?

4. Freight charges for a ton of coffee delivered from Asia to Europe only account for …….% of its price

5. What barriers have many countries worked towards reducing since the 1980's and what is this process known as?

6. What does the clip say about FDI spending in 1970 and today?

7. What has been the growth in the number of MNCs in the clip from 1990s to today?

Factors contributing to globalisation in the last 50 years

1. **Trade liberalisation**

Trade barriers such as tariffs and quotas have been significantly reduced in recent decades, especially for manufactured goods. This has happened for many reasons:

- Former Communist countries such as China and Russia have joined the global trading system. These countries have moved from being planned economies to market based economies. They have opened up to international trade and Foreign Direct Investment.
- Global trade agreements have been signed at the World Trade Organisation

2. **Reduced cost of communications**

There has been a reduction in the cost of transmitting and communicating information – sometimes known as "the death of distance"

Give examples:

Why has this encouraged foreign direct investment?

3. **Decreased cost of transport**

For example, containerisation – the costs of ocean shipping have come down, due to containerisation and the use of larger container ships.

Why has this reduced the cost of transporting goods?

Why has this encouraged foreign direct investment?

4. **Rising skill levels in developing countries**

Multinational companies have been able to benefit from a pool of skilled labour in developing countries. For example, IBM have outsourced some of their work to Bangalore in India. This is only possible because India produces many Computing graduates. Another example is the outsourcing of call centre services to India.

Why have companies such as BT decided to outsource call centre jobs to India?

Impacts of globalisation

Country examples UK & China: Watch **Made in Britain** on college media server (part 1 of 3, from 9.15 to 28.57)

1. What 3 principles should be followed to become a successful nation?

2. Why did the Yorkshire specialise in textiles during the Industrial Revolution?

3. How has China been able to achieve in 2 decades what Britain achieved in 200 years?

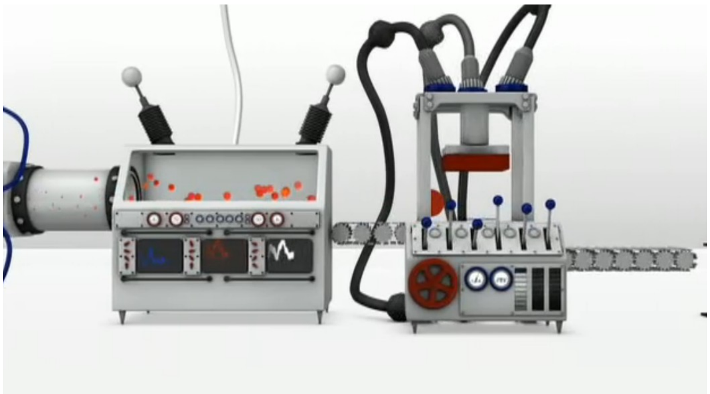
4. Why does it make financial sense to produce suits in China?

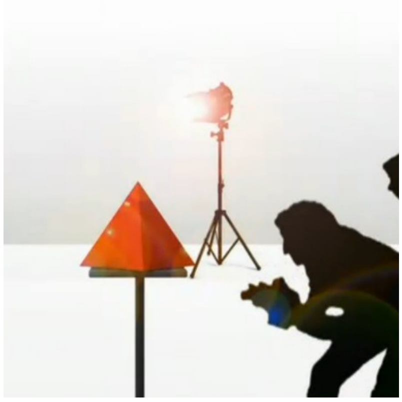
5. Why do the Chinese specialise in low paid work?

6. If the Chinese get only 20% of the retail price of the suit, where does the rest go?

7. How have consumers benefitted from the ‘China effect’?

Country example: UK: Watch **Made in Britain** on college media player (part 2 of 3, 12.54 to 18.30)





1. What are the 3 stages in the value chain?

2. Why does it make sense for Britain to specialise in stages 1 and 3?

3. How much of the $300 price of an i-pod go to:

- The Chinese who assemble the products
- Apple for the design and branding

4. Take notes on the history of Glaxo (now GSK) explaining how they moved up the value chain.

Benefits of globalisation

1. Cheap imports

Explain the effect of globalisation on UK prices/inflation/living standards

2. Increased exports

Domestic firms which have a comparative advantage have been able to exploit this and export their goods and services to the global market place.
Define the term comparative advantage

Give examples of sectors where the UK may hold a comparative advantage

Explain how an increase in exports may affect the macro-economic objectives

3. <u>Increased inward investment</u>
Globalisation has resulted in significant inflows of foreign direct investment (FDI) from the rest of the world. What are the economic benefits?

4. <u>Reduced absolute poverty in developing countries</u>
Why has globalisation reduced absolute poverty in developing countries such as China and India?

Problems with Globalisation

1. **Increased foreign competition**

   This has resulted in de-industrialisation in the UK as domestic firms have been unable to compete with cheaper or better quality goods from the rest of the world. There has also been a huge amount of outward investment and outsourcing from the UK economy. This has affected sectors of the economy where domestic firms have lost their comparative advantage.

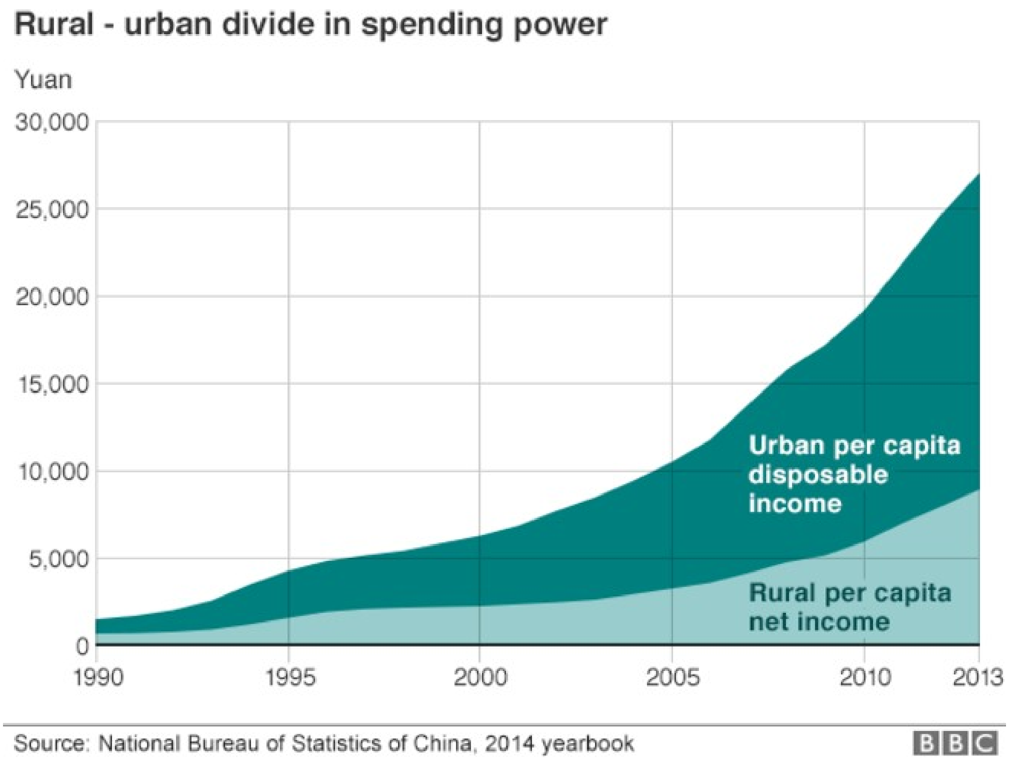
   Give some examples of manufacturing industries that have declined in the UK

   How has increased foreign competition had a harmful effect on macro-economic performance?

2. **Increased inequality**

Country example China:

What happened in the UK in 1851, the United States in 1920 and in the World in 2008? These three years mark the estimated year when the size of a given urban population overtook the size of the rural population. And now China has reached this significant landmark. The Chinese Bureau for National Statistics reported recently that in 2011, the proportion of urban population reached 51.27 percent (1.3% higher than in 2010) with the urban population standing at 690.79 million persons, an increase of 21 million persons in a year. China's rural population stood at 656.56 million persons and for the first time her urban population was 34.23 million persons more than the rural population. Source: Tutor2uSource:



Why has globalisation resulted in **greater inequality within** developed countries such as the UK/USA and developing countries such as India/China?

Why has globalisation resulted in **less inequality between** developed countries such as the UK/USA and developing countries such as India/China?

3. **Greater macro-economic instability**
Economic problems in one part of the world can quickly spread to other parts of the world. Can you give an example of this?

4. **Loss of power of national governments**
The rise of multi-national companies has reduced the power of national governments. It is difficult to impose regulations or taxes on MNCs as they can move to another country. This prevents governments from making laws to protect workers' rights or the environment or from regulating banks. **Using the examples on the next two pages, give any example of MNCs abusing their power through:**

a) **Tax avoidance**

Country example Ireland:
Ireland has responded to EU pressure and will shut its so-called 'double Irish' corporate tax loophole next year to new companies and from 2020 for existing companies. The tax loophole exploited differences in Irish and US rules about residency. Under US law, a company registered in the USA has to pay tax on its profits in the USA. However, a US-registered company can own a company abroad. This second company is then not taxed in the USA under US law unless it sends profits back to its parent company in the USA. Under Irish law, a company registered in Ireland pays taxes on its profits from the country from which they are run. So, an Irish registered company can run part of its company from a tax haven like Bermuda where taxes on profits are zero, and not pay any tax in Ireland on that company.

US companies like Microsoft, Google, Apple, and Facebook have exploited the 'double Irish' loophole to minimise the tax they pay on their operations outside the USA. For example, the Irish subsidiary of Google funnelled €8.8 billion of royalty payments through a subsidiary company in Bermuda. This was €8.8 billion which was not taxed in Ireland and not taxed in the USA. The tax saving is greater because a number of companies push European sales through Ireland. Google, eBay, and Amazon, for example, had sales in the UK of $13 billion in 2012. But only $2.8 billion of this was recorded for tax purposes in the UK because the sales were routed through Ireland. The $2.8 billion was commission on sales and marketing services according to the companies. The result is that profits are pushed into low-tax Ireland and away from higher-tax countries like the UK.
Source: Anderton (Adapted from Financial Times, 15/12/2014).

Give examples of Multi national companies accused of tax avoidance:

Explain how transnational corporations can avoid tax, using the text above.

b) <u>Exploitation of workers</u>

Watch the video clip on exploitation of workers at the Foxconn's Chinese factory making i-phones for Apple at: https://www.youtube.com/watch?v=Jk-xqPKOxl4

Make notes on the exploitation of labour:

Watch the following video clip at: https://www.youtube.com/watch?v=NxBzKkWo0mo

Make notes on why might sweatshops may benefit the poor

Do you think governments should take measures to improve working conditions in sweatshops?

Do you think consumers should boycott products made in sweatshops?

c) <u>Exploitation of the environment</u>

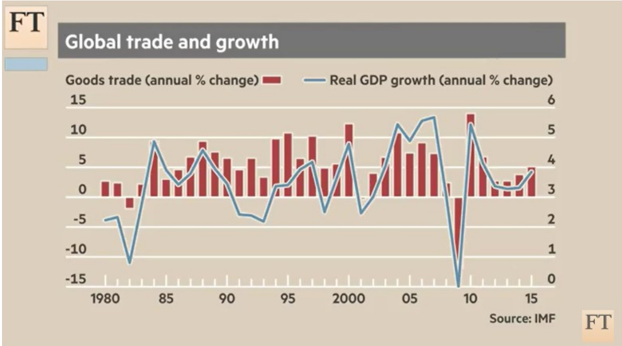
Watch the video clip on Shell's exploitation of the environment in Nigeria at: https://www.youtube.com/watch?v=YmI3xjZk_y0 and answer the following questions:

Why has the Nigerian government been reluctant to revoke Shell's license to produce oil in Nigeria?

How has the oil pollution affected the local community?

De-globalisation

Watch the clip: Globalisation to localisation and take notes on recent trends in globalisation
https://www.youtube.com/watch?v=T9lgZper-W4



Edited from The Economist: The steam has gone out of globalisation, Jan 2019

https://www.economist.com/leaders/2019/01/24/the-steam-has-gone-out-of-globalisation

When America took a protectionist turn two years ago, it provoked dark warnings about the miseries of the 1930s. Today those ominous predictions look misplaced. Yes, China is slowing. And, yes, Western firms exposed to China, such as Apple, have been clobbered. But in 2018 global growth was decent, unemployment fell and profits rose. In November President Donald Trump signed a trade pact with Mexico and Canada. If talks over the next month lead to a deal with Xi Jinping, relieved markets will conclude that the trade war is about political theatre and squeezing a few concessions from China, not detonating global commerce.

Such complacency is mistaken. Today's trade tensions are compounding a shift that has been under way since the financial crisis in 2008-09. As we explain, cross-border investment, trade, bank loans and supply chains have all been shrinking or stagnating relative to world GDP (see Briefing). Globalisation has given way to a new era of sluggishness. Adapting a term coined by a Dutch writer, we call it "slowbalisation".

Globalisation has slowed from light speed to a snail's pace in the past decade for several reasons. The cost of moving goods has stopped falling. Multinational firms have found that global sprawl burns money and that local rivals often eat them alive. Activity is shifting towards services, which are harder to sell across borders: scissors can be exported in 20ft-containers, hair stylists cannot. And Chinese manufacturing has become more self-reliant, so needs to import fewer parts.

This is the fragile backdrop to Mr Trump's trade war. Tariffs tend to get the most attention. If America ratchets up duties on China in March, as it has threatened, the average tariff rate on all American imports will rise to 3.4%, its highest for 40 years. (Most firms plan to pass the cost on to customers.) Less glaring, but just as pernicious, is that rules of commerce are being rewritten around the world. The principle that investors and firms should be treated equally regardless of their nationality is being ditched.

Evidence for this is everywhere. Geopolitical rivalry is gripping the tech industry, which accounts for about 20% of world stockmarkets. Rules on privacy, data and espionage are splintering. Tax systems are being bent to patriotic ends—in America to prod firms to repatriate capital, in Europe to target Silicon Valley. America and the EU have new regimes for vetting foreign investment, while China, despite its bluster, has no intention of giving foreign firms a level playing-field. America has weaponised the power it gets from running the world's dollar-payments system, to punish foreigners such as Huawei. Even humdrum areas such as accounting and antitrust are fragmenting.

Trade is suffering as firms use up the inventories they had stocked in anticipation of higher tariffs. Expect more of this in 2019. But what really matters is firms' long-term investment plans, as they begin to lower their exposure to countries and industries that carry high geopolitical risk or face unstable rules. There are now signs that an adjustment is beginning. Chinese investment into Europe and America fell by 73% in 2018. The global value of cross-border investment by multinational companies sank by about 20% in 2018.

The new world will work differently. Slowbalisation will lead to deeper links within regional blocs. Supply chains in North America, Europe and Asia are sourcing more from closer to home. In Asia and Europe most trade is already intra-regional, and the share has risen since 2011. Asian firms made more foreign sales within Asia than in America in 2017. As global rules decay, a fluid patchwork of regional deals and spheres of influence is asserting control over trade and investment. The European Union is stamping its authority on banking, tech and foreign investment, for example. China hopes to agree on a regional trade deal this year, even as its tech firms expand across Asia. Companies have $30trn of cross-border investment in the ground, some of which may need to be shifted, sold or shut.

Fortunately, this need not be a disaster for living standards. Continental-sized markets are large enough to prosper. Some 1.2bn people have been lifted out of extreme poverty since 1990, and there is no reason to think that the proportion of paupers will rise again. Western consumers will continue to reap large net benefits from trade. In some cases, deeper integration will take place at a regional level than could have happened at a global one.

Yet slowbalisation has two big disadvantages. First, it creates new difficulties. In 1990-2010 most emerging countries were able to close some of the gap with developed ones. Now more will struggle to trade their way to riches. And there is a tension between a more regional trading pattern and a global financial system in which Wall Street and the Federal Reserve set the pulse for markets everywhere. Most countries' interest rates will still be affected by America's even as their trade patterns become less linked to it, leading to financial turbulence. The Fed is less likely to rescue foreigners by acting as a global lender of last resort, as it did a decade ago.

Second, slowbalisation will not fix the problems that globalisation created. Automation means there will be no renaissance of blue-collar jobs in the West. Firms will hire unskilled workers in the cheapest places in each region. Climate change, migration and tax-dodging will be even harder to solve without global co-operation. And far from moderating and containing China, slowbalisation will help it secure regional hegemony yet faster.

Globalisation made the world a better place for almost everyone. But too little was done to mitigate its costs. The integrated world's neglected problems have now grown in the eyes of the public to the point where the benefits of the global order are easily forgotten. Yet the solution on offer is not really a fix at all. Slowbalisation will be meaner and less stable than its predecessor. In the end it will only feed the discontent.

Using the above article explain:

1. Why has globalisation slowed down?

2. What political reasons are reversing globalisation?

3. What happened to Chinese investment into Europe and America in 2018?

4. What might this new ‘slowbalisation’ look like?

5. What are the potential disadvantages of ‘slowbalisation’?

Impacts of globalisation

Advantages	Evaluation: Disadvantages, limitations, possible solutions, depends on…
Households	

Countries	

Foreign Direct Investment

The development of multi-national companies has resulted in a huge amount of foreign direct investment (FDI) in the global economy. FDI is long-term investment by multi-national companies (MNCs) or governments in other countries. FDI usually occurs in one of two ways:

1. MNCs either build new plants or expand their existing facilities in foreign countries or
2. MNCs merge with or acquire (buy) existing firms in foreign countries

Inward investment is where foreign firms invest in the domestic economy
Can you give examples of inward investment into the UK?

Outward investment is where domestic firms invest abroad
Can you give examples of outward investment from UK firms?

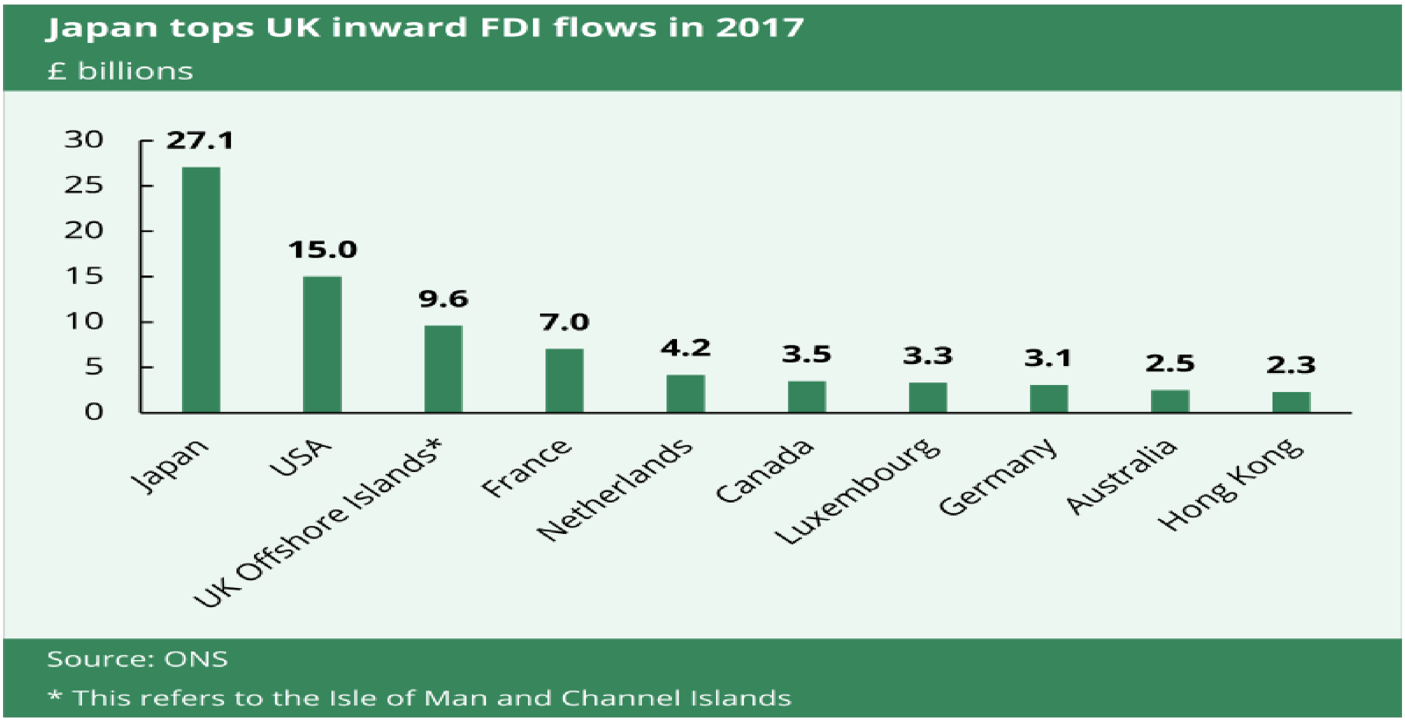
This is different to **outsourcing** which is the process by which firms buy services, components or finished products from independent suppliers, rather than try to do everything themselves.
Can you give examples of outsourcing by UK firms?

In the table below, identify whether these operations decisions are examples of offshoring or outsourcing:

Scenario	Offshoring?	Outsourcing?
A UK business sets up its own call-centre in Bangalore (India) to serve UK customers		
A toy manufacturer contracts with overseas suppliers to produce certain components which it imports into the UK		
A UK-based firm hands over its payroll and IT transaction processing activities to a specialist supplier in the UK		
A UK supermarket retailer opens its first stores in the USA managed by a team based in the USA		

Inward investment for the UK economy

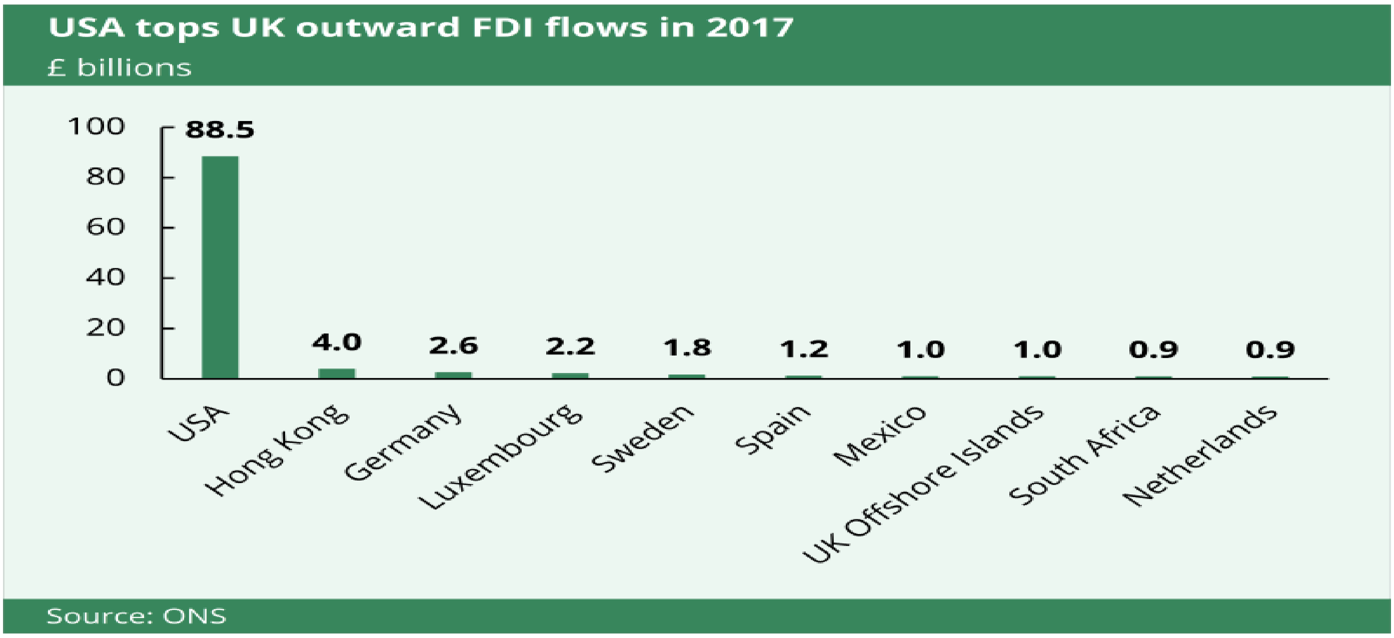
Japan was the single largest investor in the UK in 2017, accounting for 29% of all inward FDI flows (up from 1% in 2016), followed by the USA.



In 2017, the UK accounted for 1% of world inward FDI flows (down from 11% in 2016) and 5% of the EU's total inward FDI flows (down from 37% in 2016). Since 2015, the UK has been ranked third behind the USA and Hong Kong. In 2017, the value of the stock of inward FDI in the UK was $1.6 trillion, behind Hong Kong at $2.0 trillion and the USA at $7.8 trillion (the stock of FDI inward FDI essentially means the accumulated total of inward FDI into the UK over the years).

Outward investment for the UK economy

By individual country, the UK's highest level of outward FDI was in the USA – this amounted to £88.5 billion, followed by Hong Kong at £4.0 billion.

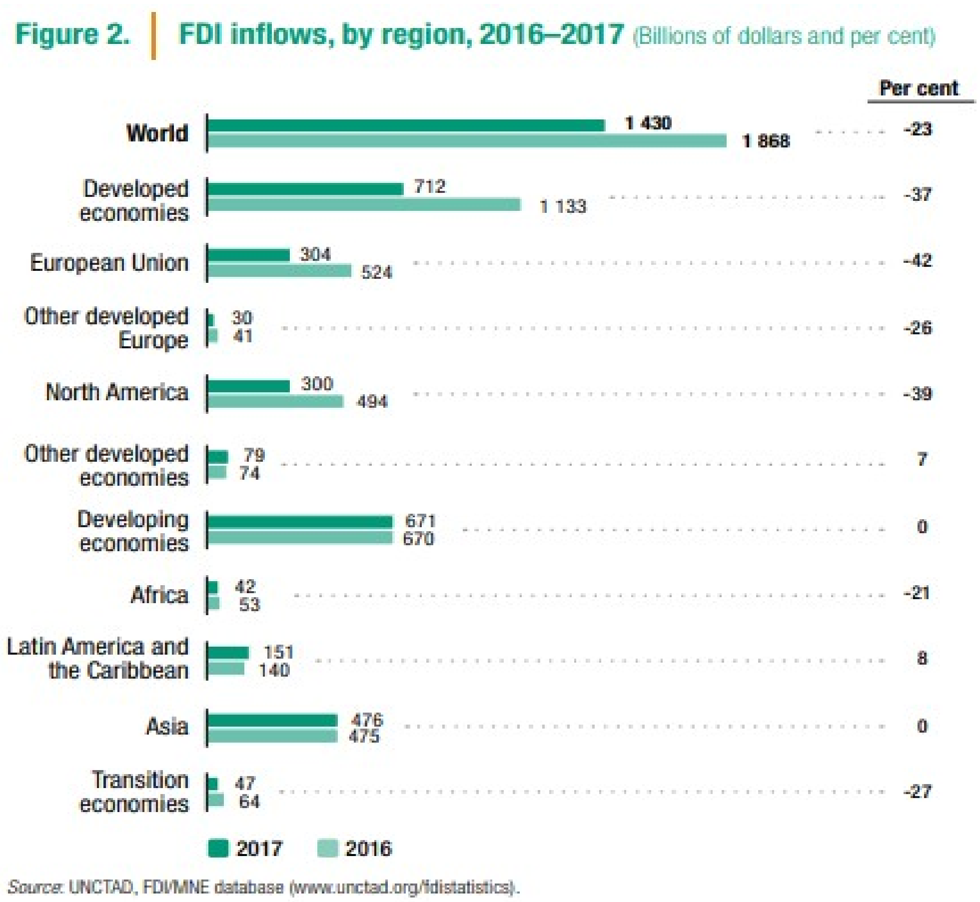


In 2017, the UK accounted for 6% of world outward FDI flows and was the fourth largest investor abroad in the world (after the USA, Japan and China); this follows a three-year trend of net disinvestment.

In 2017, the UK held 5% of the world total of outward FDI stock, fifth in the world behind the USA, Hong Kong, Germany and the Netherlands.

The chart below shows the UK's world ranking in terms of the stock of FDI held abroad since 1990. Over this period, the UK's position in the world has fluctuated between fifth and second, while the United States has ranked first every year. The UK was the second largest holder of FDI stock abroad between 2000 and 2015, before falling to third in 2016 (behind the USA and Hong Kong) and to fifth in 2017 (behind the USA, Hong Kong, Germany and the Netherlands).

Global FDI data



Questions

1. What are the largest sources of inward investment for the UK?
2. What are the largest destinations for outward investment for the UK?
3. What % of Global FDI is to developing countries?
4. Why is the % of FDI to developing countries increasing?

Economic benefits of FDI:

1. Economic growth, employment and inflation

a) Explain how Inward Investment would affect Aggregate Demand

b) Explain how inward investment would affect Aggregate Supply

c) Using an AS/AD model, show how inward investment from a MNC can affect the recipient country's growth, employment and inflation in the short run and long run:

d) Investment is an injection into the circular flow, so it has the potential to kick off a multiplier effect. Explain how this works:

Evaluation: What factors affect the size of the multiplier?

Evaluation: Discuss the elasticity of the AS, the size of the output gap, the magnitude of the investment when you evaluate the impact of the investment.

2. Jobs

a) Why might investment by an MNC not increase local employment?

b) How might an MNC exploit local workers?

3. Tax revenue

a) FDI by an MNC is likely to result in greater tax revenue for the recipient country. Why might this benefit the country's economy?

b) Give examples of MNCs who have avoided tax

4. Improve the current account on the balance of payments

a) Where on the balance of payments will the initial FDI by the MNC appear?

b) Once the MNC is established, where on the B of P do the profits made by the MNCs appear?

c) Once the MNC is established, where on the BoP do any exports sold by the MNCs appear?

Evaluation of FDI: More than third of foreign investment is multinationals dodging tax. Edited from The FT September 2019

https://www.ft.com/content/37aa9d06-d0c8-11e9-99a4-b5ded7a7fe3f

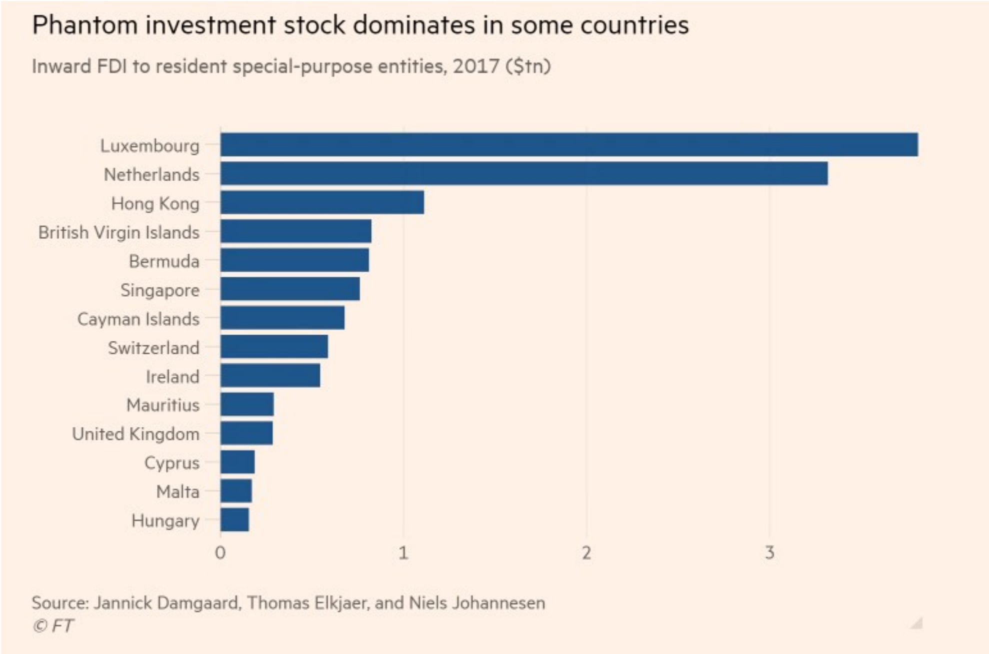
A large proportion of the world's stock of foreign direct investment is "phantom" capital, designed to minimise companies' tax liabilities rather than financing productive activity, according to research. Nearly 40 per cent of worldwide FDI — worth a total of $15tn — "passes through empty corporate shells" with "no real business activities", the study by the IMF and the University of Copenhagen found. Instead they are a vehicle for financial engineering, "often to minimise multinationals' global tax bill", said researchers Jannick Damgaard, Thomas Elkjaer, and Niels Johannesen, who carried out the study.

The findings come at a time when governments are trying to clamp down on multinational corporate tax avoidance. Tax reform features high among the priorities of the G7 group of countries. Recent unilateral moves by France to tax global tech groups operating in the country have increased the pressure on other G7 members to reach an agreement. The OECD has been charged with identifying globally acceptable solutions by next year.

Nearly half of the phantom FDI the researchers identified was in Luxembourg and the Netherlands. Other countries in which less than half of FDI is "genuine" included Malta, Ireland, Switzerland and a number of British overseas territories and crown dependencies, according to the study's authors.

Brad Setser, an international economist at the Council on Foreign Relations in New York, said the study showed that "these structures — phantom companies or phantom investments — are optimised for minimising firms' global tax". "Apple does not produce its iPhones in Ireland, nor does Apple design them or develop the majority of its operating system in Ireland [but] one of the most valuable US foreign direct investments now is Apple's ownership stake in Apple Ireland," Mr Setser said.

Nearly two-thirds of Ireland's inward investment is "phantom", the IMF study found. Despite recent international efforts to prevent companies from shifting profits internationally for tax purposes, the study showed that phantom capital was growing as a share of overall FDI. As late as 2010, phantom FDI made up 31 per cent of the total FDI stock; by 2017 it had reached 38 per cent. Behind the global number, countries differ widely. The UK's share of phantom inward FDI jumped from just 3 per cent in 2009 to 18 per cent in 2017, the estimates show. In Belgium and Sweden, the share fell from about 30 per cent to single digits in the same period.



Questions:

1. What does it matter that nearly 40% of FDI creates "no real business activities"?

2. Which countries have most phantom FDI and why might firms be moving money to them?

3. Explain the Apple operations in Ireland

4. Why is it so hard for governments to clamp down on phantom FDI?