Global Interdependence

**Definition**

Globalisation

The freer movements of goods, services, investment, ideas and people around the world

Trade

The buying and selling of goods and services between economies

Trade Intensity

The measure of the average value of exports and imports (both goods and services) as a percentage of GDP ( [1/2 (X+M) / GDP] x 100 )

Competitiveness

The degree to which a country can produce goods and services which meet the test of international markets while simultaneously maintaining and expanding the real income of its people over the long term

Trade Weighted Index (TWI)

A ‘basket’ of currencies weighted according to their importance within trade flows with Australia

**Model;**

Production Possibility Frontier (PPF)

A curve in which depicting all of maximum output possibility given for two goods with a given set of input.

**Concepts;**

Globalisation;

The idea of freer flow of international trade with reduced barriers. The growth of world and domestic trade and growth of economies.

Competitiveness;

A productive economy that leads to growth. A fall in competitiveness indicated it is difficult for Australian producers to find foreign buyers. Rise in competitiveness indicates improved national income and easier to find foreign buyers.

Trade Intensity;

A way to measure importance of international trade. Factors such as size of economy – location – barriers – transport costs.

**Lists**

For Globalisation Against Globalisation; Factors Affecting Trade;

- Access to wider variety of goods. - Lower Wages - Exchange Rate

-Lower prices - Destroy Local Culture - World/Dom Econ Growth

-More & Better payed jobs - Worsen Poverty - Relative Inflation Rate

-Reduce Global Poverty - Erodes Democracy - Relative Interest Rate

- Productivity & Cost Eff.

Drivers of Competitiveness; Global and Reginal Blocs

-Economic Performance (dom econ, international trade) - United Nations (UN)

-Government Efficiency (fiscal pol, institutional framework) - World Trade Organisation (WTO)

-Business Efficiency (productivity, labour market, twi) - Group 20 major economies (G20)

-Infrastructure (basic, technological, health, education) - Asia-Pacific Economic Corp (APEC)

Effects of Competitiveness;

-International Trade – national production – employment – income - Affects standard of living

Significant Australian Industry; commodities, manufactures (55) mining (13) services (22)

Free Trade and Protection;

**Definitions**

Tariff

Tax placed on Imports to increase the price of the foreign good or service so that the competing domestic good receives a price benefit

Subsidy

Grants or payments made out by the government to domestic producers.

Protection

Any action given by the government designed to give the domestics producers an artificial advantage over foreign product.

**Model;**

Tariff

Aimed to increase the price of a foreign good or service

and gives revenue to the government

Subsidy

Paid out of tax revenue and directly lower the producers

cost of production.

Demand and Supply for Gains of Trade

Determines the relative price of a good – opportunity cost – comparing the domestic price to world prices – if price is lower = more efficient at producing the good.

**Lists**

Significance of International Trade

-Aus is open economy (unrestricted)

-Trade is important – expand consumption possibility by providing access to other production through imports

-Exports ^ production – Imports ^ consumption

-Permits ^ in specialisation ^ productivity

-Level exports determined by size and structure, relative competitiveness,location.

Arguments for Trade Liberalisation

-Countries gain when specialise – lower opp cost then other countrys

-^ production and consumption through X and M

-Increase income

-Increase living standard

Arguments for Protection

-Infant Industries – new require temporary support to set up (counter – rely on support – decrease initiative to innovate and become competitive)

-Diversification – shouldn’t put all input into one good – diverse industry – increase productivity and competitiveness (counter – no CA in one area)

-Anti-dumping – exports at lower price then sold at home – eliminate competitors

-National Defence – retain key industries necessary at times or war (counter – all say they’re necessary)

-Cheap Foreign Labour – Low wage – products cheaper due to cheap labour

-Favourable trade balance – tariffs reduce trade deficit and they’re bad (tariffs will increase prices)

-Employment – shift spending to domestic consumers

Free Trade and Protection;

Trade Agreements; Bilateral (two countries) AUSFTA, CHAFTA Multilateral (3 or more) ASEAN, APEC

Sources of Comparative Advantage; Gains from Specialisation;

-Quantity and Quality of resources - Able to produce more output with the same input

-Quantity and Quality of labour -Increased productivity

-Technological Process -Lower opportunity cost

-Difference in Climate

Gains from Specialisation and Trade;

-Specialise in tasks which are best suited, that they have an advantage in.

-Surplus production can be traded for other goods and services

-Opposite being self-sufficiency having to grow own food and make own resources

-Made possible due to uneven distribution and quality of resources between people.

-Quality and quantity will affect the cost of supplying goods and services.

Comparative Advantage Absolute Advantage

If the opportunity cost of If a country can produce a

producing a good is lower good more efficiently then another country. then another country.

Balance of Payments

**Definitions**

Balance of Payments

Systematic record of all economic transactions between residents within a country and residents around the world.

Financial Account

Comprises transactions associated with changes in the ownership of Australia’s foreign financial assets and liabilities.

Current Account

Records transactions between Australian residents and non-residents.

Capital Account

Comprises capital transfers and the acquisition and disposal of non-produced non-financial assets.

**Models**

NET Exports Formula

Value of total exports – Value of total imports

Structure of BOP

Current Account Capital Account Credits

-Trade Balance - Copyright infringements Export of good and services, inflow $

> Imports and Exports Debits

-Primary Income Financial Account Imports of good and service, outflow $

> Dividends, Shares -Borrowing/Lending

Profits, Interest Payments. -Buying/Selling of Assets

**Concepts**

5 Types of Transactions;

-Exports and Imports of goods; iron ore, computers, cars

-Export and import of services; shipping, insurance, tourism expenditure.

-Income flows; dividends, shares, profits, interest payments.

-Transfers; foreign aid

-Financial flows; investment in shares

Types of Investment

Portfolio Investment; overseas firm purchasing less 10% of Australian company – no ownership

Direct Investment; overseas firm purchasing more 105 of Australian company - ownership and control

Current Account Deficit?

A CAD means that Australia is spending more than saving – hence investment savings gap. Investment needed to feed the savings. Deficit caused through imports, interest payments and any kind of outflow of money. TREND; 2016 CAD = $73 b / 2017 CAD = $9.2 b

**Lists**

Reasons the CAD increases;

-Fall in TOT – balance on goods and services fall – exports fall relative to imports.

-Decline in International Competitiveness – productivity decline – exports less competitive

-Increased Economic Growth – increase national income – increase spending (debit)

-Decline in National Savings – if fall – CAD increase – use savings to maintain consumption

-Increase in National Investment – increase = increase CAD repayments

Structural Causes of CAD Cyclical Causes of a CAD

-Investment-savings Gap -World & Dom business cycle

-Foreign Debt/Investment - Exchange rate & Commodity prices & TOT.

Terms of Trade

**Definitions**

Terms of Trade;

Index which measures the relative movements in the price of exports and imports.

**Concepts**

What is the Terms of Trade;

Shows a measure of quantity of imports a country can obtain in exchange for a given value of exports.

Favourable Movement; Export prices increase relative to import prices – as more imports can be bought with the same value of exports. (Imports show wealth)

Unfavourable Movement; Export prices decreasing relative to import prices. Less imports can be purchased for the same value of exports.

Movement in TOT

Increase in terms of trade is an increase in export income. Export prices are higher.

Decrease in terms of trade is a decrease in export income. Export prices are lower.

Move if either imports/exports increase/decrease.

How to Calculate TOT

Export Price Index / Import Price Index X 100 (EPI/MPI X 100)

Year 1 2 3

TOT X 600 630 672 Year 2 – Year 1 / Year 1 x 100

EPI 100 105 112 **Year 1 (100/100 x 100)**

TOT M 700 770 805 **Year 2 (105/100 x 100)**

MPI 100 110 115 **Year 3 (112/115 x 100)**

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TOT 100 95.45 97.4

**Lists**

Effect changes in TOT

* Business Cycle; living standard and GDP growth either increase or decrease
* Output and Employment; purchasing power increase/decrease
* Trade/Current Account; CAD/CAS, export income increase/decrease
* Exchange Rate; appreciation (increase) depreciation (decrease) in value
* Investment; more/less valuable assets.

Causes of Movements in the TOT

Favourable

* Exports increase significantly – imports increase slightly
* Exports increase – imports stable
* Exports increase – imports decrease

Unfavourable

* Imports increase significantly – exports increase slightly
* Imports increase – exports stable
* Imports increase – exports decrease.

**Trends;**

TOT increased until 2009 – mining boom and high commodity prices

TOT plummeted in 2009 due to GFC – Increased again until mining boom peak in 2011

TOT decreased from 2011 – 2016 following end of mining boom.

Exchange Rate

**Definitions**

Exchange Rate

Prices of the currency relative to another countries currency

Trade Weighted Index

A ‘basket’ of currencies weighted according to their importance within trade flows with Australia

Appreciation

An increase in the value of a currency

Depreciation

A decrease in the value of a currency

Free Floating Exchange Rate

Allowing market forces of demand and supply to set the exchange rate.

Fixed Exchange Rate

Artificially setting the exchange rate within a set limit

Managed Exchange Rate

Official intervention in the foreign exchange market by the reserve bank.

Clean Float

A countries currency flows free from interference from the bank.

Dirty Float

The reserve bank set the value of a currency at a set point

Lightly Managed Float

The bank only occasionally interferes to smooth and test the underlying trends in the exchange rate.

**Concepts**

Types of Exchange Rates

* Free Floating exchange rate (market forces) (Australia’s)
* Fixed/ Pegged exchanged rate (artificially set)
* Managed exchange rate (intervention in foreign exchange market, buyer & seller

RBA Involvement;

* Enter as either a buyer or seller to a) buyer stop AUD falling to low ( increase demand ) b) seller stop AUD rising to high ( increase supply )
* Effecting Monetary policy set short term interest rates to attract foreign investment to increase demand which appreciates the dollar.

Exchange Rates effecting BOP

Advantages

* Automatic adjustment to BOP – reduce swings in CA – insulates economy from shock

Disadvantages

* Uncertainty for buyers and sellers, increase cost of international transactions.

Appreciation

* Causes an increase in imports (stronger PP)
* More expensive for domestic consumers
* Decrease in exports – more expensive foreign buyers
* Cheaper to pay back foreign debt – make the CAD smaller

Depreciation

* Increases foreign investment – cheaper to invest
* Increases exports – cheaper for foreign buyers
* Decrease imports – more expensive for domestic consumers

Exchange Rate

**Models**

Supply and Demand Model; TWI Supply and Demand Model; Exchange Rate

J- Curve **Lists**

Determines demand for countries currency

* Exports (G&S) – Foreign Investment – Income from overseas

Determines supply for countries currency

* Imports (G&S) – Investment abroad – income to overseas

Effects of Depreciations

* Demand for a currency decreases and supply increases
* Imports decrease – too expensive – exports increase – cheaper
* Increase foreign investment – cheaper to invest

-Reduce trade deficit

Effects Appreciation Ways to determine price of countries currency

-Demand for a currency Demand and supply determines the price

increases and supply decreases - increase demand = appreciation

-Imports increase – cheaper for domestic - increase supply = depreciation

consumers –exports decrease – expensive

for foreign consumers

Advantage of Free Floating ER Disadvantage or Free-Floating ER

Automatic adjustment to BOP Uncertainty for buyers and sellers

reduce swings in CA – insulates increased cost of international

economy from shock transaction

-Cheaper to pay back debt

-Increase trade deficit

-Decrease aggregate demand

-Reduce inflation rates – reducing prices of imports

Factors affecting ER

* Relative Inflation; ^ = decrease demand for AUD, increase supply for AUD
* Movement in TOT; ^ = increase demand for AUD, currency increase
* World econ growth; ^ = increase commodity $ - ^ demand AUD
* Dom econ growth ^ = increase demand – increase import – increase supply AUD
* Relative interest ^ relaive to AUD, decrease capital inflow – increase capital outflow D(AUD)
* International Interest Attraction in AUS is higher in D(AUD) increase – AUD increase.

**Trends**

Foreign Investment

**Definition**

Foreign Investment

Foreign [investment](https://www.investopedia.com/terms/i/investment.asp) involves capital flows from one country to another, granting extensive ownership stakes in domestic companies and assets

Foreign Liabilities

Australian residents borrow money from overseas or sell assets such as shares to foreign residents.

Australia’s net international investment position

Records the stock or level of foreign investment into Australia (FIA) and the level of Australian investment abroad (AIA)