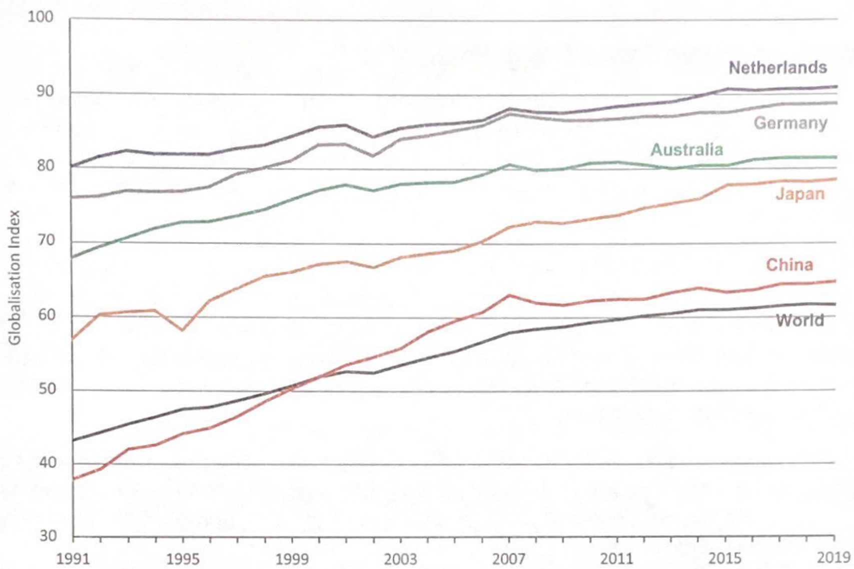

Figure 1.10 The KOF index of globalisation

experienced a consistent rise in their index from 1991 to 2010. But since 2010, the index has plateaued due to the weaker world economy and opposition to free trade. The 2020 pandemic is likely to have a negative effect on each countries index.

Factors facilitating globalisation

There have been a number of important drivers of globalisation. The first has been the liberalisation of markets to the flow of goods, services and investment. This process began after World War II with the establishment of a number of United Nations organisations, including the GATT, the International Monetary Fund (IMF) and the World Bank. Chief of these was the GATT – the General Agreement on Tariffs and Trade. This was set up in 1947 with the aim of reducing barriers to trade to increase general living standards and promote full employment.

Originally, the GATT was supposed to become a full international organization like the World Bank, but it remained an agreement until superseded by the WTO in 1995. Since 1990 world tariff rates have fallen from an average of 15 per cent to just 5 per cent. Today average tariff rates are below 4 per cent in high income economies and 11 per cent in low income countries. Regional trading groups (or trading blocs) such as the European Union, NAFTA and ASEAN have also flourished and have encouraged the expansion of free trade by reducing or eliminating trade barriers. Australia, for example, has been very active in pursuing free trade agreements with both individual countries and with regional groups.

A second factor driving recent globalisation has been technology. Advances in transport and communication have resulted in 'the death of distance'. Transport costs and travel time have been drastically cut, helping to boost the volume of merchandise trade and increase tourist travel to record numbers. Advances

International agencies fostering globalisation

The World Trade Organisation (WTO) - the successor or 'son of GATT' was established in 1995 and is the only international organization dealing with the global rules of trade between nations. Its main function is to ensure that trade flows as smoothly, predictably and freely as possible. It does this by administering trade agreements, acting as a forum for trade negotiations and settling trade disputes.

The International Monetary Fund (IMF) - is an organization of 186 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world. The IMF was established at the end of World War II with the responsibility of overseeing the international monetary system to ensure exchange rate stability and encouraging members to eliminate exchange restrictions that hinder trade.

The World Bank - was also established in 1944 with the purpose of reducing world poverty by promoting global economic development. It does this by providing low or no interest loans and grants for economic and social development projects to developing countries that have limited access to international credit markets.

in information technology have enabled the growth of trade in services. Many services that were once thought of as non-tradable are now being outsourced to countries such as India - business services such as accounting, marketing and IT support. India has now become the world's leading exporter of IT services.

Multinational corporations have also played an important role in promoting globalisation. Multinational corporations (MNCs) are very large firms with headquarters in one country and subsidiaries in one or more other countries. These firms establish production and/or retail and distribution facilities in other countries. Think of major global firms such as Facebook, Apple, Nike and Microsoft from the United States, Shell and Vodafone from the United Kingdom, Toyota and Sony from Japan, Samsung and Hyundai from Korea, Nestle from Switzerland and Volkswagen from Germany. Even Australia has several MNCs, including BHP and Rio Tinto. Over the last 40 years, the number and size of multinational corporations has increased dramatically.

In 1970, there were just 7,000 MNCs, whilst today there are over 100,000 parent companies operating with around one million subsidiaries or affiliates in almost all industries and countries in the world. Multinational corporations account for around a quarter of global GDP. Why do multinational firms expand into foreign markets? Basically to increase their sales, market share and profits. To increase sales to a foreign market a firm has a choice of either exporting to the foreign location or establishing a subsidiary through foreign direct investment. Foreign direct investment (FDI) occurs when a firm in one economy acquires at least 10 per cent ownership of a foreign firm. Foreign direct investment has become an important link in the process of globalisation. In developed economies, FDI tends to be associated with mergers and acquisitions of foreign companies. In developing economies FDI is more associated with the construction of new facilities and is known as 'greenfield' investment.

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The effects of globalisation

Globalisation has become a controversial issue. On one side are the economic rationalists who argue that globalisation will improve economic welfare. On the other side are the critics who argue that globalisation, while creating benefits for some, imposes costs on poorer economies and on disadvantaged workers. They argue that globalisation is simply making the rich richer and the poor poorer. First lets focus on the arguments against globalisation. Meetings of the WTO and other global groups such as the G20 are often plagued by violent demonstrations against free trade. Globalisation is seen as favouring the richer, developed nations of the world at the expense of the less developed countries. Global poverty has not been reduced and income inequality around the world appears to have increased. Anti–globalisers argue that free trade results in job losses in less competitive economies. By erecting barriers to trade such as tariffs, local jobs can be protected against unfair foreign competition. Free trade is also seen as leading to greater environmental damage due to increased industrialisation. Some argue that globalisation destroys cultural diversity with local markets being overrun by global brands. The recent increase in global financial flows is also seen as the cause of financial crises in many developing economies.

How do the advocates of globalisation respond to the critics? Most economists understand the economic case for free trade and see the modern form of globalisation as part of this process. The case for trade was put succinctly by the WTO Director General Mike Moore. He regards trade as an important ingredient to improved living standards:

> *"Trade works its wonders in many ways. Higher exports pay for goods and services that are more cheaply priced abroad. The need to compete in world markets forces companies to become more efficient. And exporting firms provide good, high paying jobs...Imports too bring many benefits. Cheaper food and clothing for working families. Cheaper and better cars and electronic goods. Cheaper inputs to make businesses more competitive. And last but not least, new technologies and greater competition, both of which boost economic growth."*

Arguments for globalisation	Arguments against globalisation
It provides access to a wider variety of goods and services	It results in higher unemployment among low-skilled workers
It lowers prices	It lowers wages
It provides more and better-paying jobs	It destroys local cultures
It increases competition & efficiency	It erodes democracy
It reduces global poverty	It increases poverty
It increases economic growth	It is unfair to developing countries
It increases overall living standards	It increases environmental damage
It has enabled developing economies to access foreign investment	Volatile capital flows have destabilised developing economies
It increases multiculturalism	It can enable the rapid spread of a pandemic

There is substantial evidence that as countries 'globalise' their people benefit, in the form of access to a wider variety of goods and services, lower prices, more and better-paying jobs, improved health, and higher overall living standards. The evidence shows that over the past 30 years, as the number of countries engaging in globalisation has increased, the percentage of people living in extreme poverty (defined as living on less than $1 per day) has been cut in half.

A core element of globalisation is the expansion of world trade through the elimination or reduction of trade barriers, such as import tariffs. Greater imports offer consumers a wider variety of goods at lower prices, while providing strong incentives for domestic industries to remain competitive. The East Asian miracle is testament to the success of export led growth. Producing for the world market promotes efficiency and enhances national competitiveness. Open economies lead to more jobs, higher wages and better standards of living. Greater openness can also attract foreign direct investment (FDI), which helps to boost domestic production and employment and is an important source of new technologies – thus promoting higher productivity. Foreign direct investment (FDI) is a key element in international economic integration. FDI creates direct, stable and long-lasting links between economies. It encourages the transfer of technology and know-how, and is also an additional source of funding for investment

"It has been said that arguing against globalisation is like arguing against the law of gravity." (former UN Secretary General Kofi Annan).

Globalisation unites people around the world by promoting a common culture. The more economically interdependent the world becomes, the more people will trade and communicate with one another. This leads to inherent stability and the promotion of world peace. Notice that the most politically unstable and violent time of the 20th century was the period between 1914 and 1945. This was the period of 'protectionism' when globalisation went underground.

Free trade does create winners and losers. However the winners gain more than the losers, so that it is possible to compensate the losers and result in a net gain for the economy. It is a similar argument to the effects of technological change. Technology imposes costs on some sections of the community but also leads to net gains. Should the world stop the advance in technology? Of course not. Research carried out by the World Bank found that since 1980, globalisation has contributed to a reduction in poverty as well as a reduction in global income inequality. They found that in 'globalising' countries in the developing world, income per person grew three–and–a-half times faster than in 'non-globalising' countries'. In general, they concluded that 'higher growth rates in globalising developing countries have translated into higher incomes for the poor.'

More recent events such as the China/United states trade war, the United Kingdom exiting the European Union (Brexit) and the COVID-19 pandemic signal that the world maybe moving away from globalisation. A new political climate is developing in which trade liberalisation is increasingly unpopular. The IMF believes that the failure to support displaced workers and others affected by globalisation has encouraged protectionist sentiment in many countries. To prevent the world from slipping into a new protectionist era, governments should not only focus on economic growth but also on reducing inequality. It is prudent to conclude the discussion of the globalisation debate with a quote from one of the world's leading economists, and Nobel Prize winner, in the field of economic development, Amartya Sen:

> *"Over thousands of years, globalisation has contributed to the progress of the world, through travel, trade, migration, spread of cultural influences, and dissemination of knowledge and understanding (including of science and technology). To have stopped globalisation would have done irreparable harm to the progress of humanity."*

Worksheet 1

Read the introductory sections of the chapter to answer these questions:

1. What are the key elements in the definition of globalisation?
2. Why do open economies grow faster?
3. Describe the main linkages between economies.
4. Why is merchandise trade much larger than trade in services?
5. Explain why there is a positive relationship between trade and economic growth.
6. What is the largest category of world trade?
7. Describe the main types of services that are traded.
8. Manufactured goods account for ____ % while services account for ____ % of world trade.
9. Which three countries are the world's leading exporters?
10. Explain why China has become the world's largest exporter.
11. Explain how a currency depreciation will affect a country's trade?
12. How will an increase in productivity affect Australia's trade?

Worksheet 2

Read the competitiveness and globalisation sections to answer these questions:

1. Define international competitiveness.
2. Explain the key factors that affect a country's international competitiveness.
3. What are the important drivers of competitiveness according to the WEF and the IMD?
4. What is the trade weighted index?
5. What impact does an appreciation have on a country's international competitiveness?
6. Describe the purpose of the 'Big Mac' index.
7. What does purchasing power parity mean?
8. Explain why the prices of Big Macs are not the same worldwide.
9. Define globalisation.
10. What is the 'engine of globalisation'?
11. How is trade openness measured?
12. Describe four different indicators of globalisation.
13. Describe three main causes of globalisation?
14. Outline three arguments against globalisation and three arguments for globalisation.

Multiple Choice

1. Which of the following describes an effect of globalisation?
   a. There has been a greater divergence in world economic systems.
   b. There has been an increase in global poverty.
   c. There has been an increasing trend towards regulation of markets.
   d. There has been an increase in the flow of financial capita.l

2. What would limit the globalisation process among nations?
   a. Increases in the number of free trade agreements.
   b. Increases in the flow of direct foreign investment.
   c. Increases in the volume of trade flows.
   d. Increases in tariffs.

3. Which of the following describes a role of the World Trade Organisation?
   a. it promotes international financial stability.
   b. it regulates investment in public infrastructure.
   c. it advocates protectionist policies for developing countries.
   d. Iit monitors developments in world trade and reviews barriers to trade.

4. Multinational corporations
   a. seek to maximize profit margins in all of their subsidiary operations.
   b. cannot exist without global markets.
   c. are the merger of companies from two or more countries.
   d. invest and/or operate in more than one country.

5. Which of the following is not an international capital flow?
   a. An American depositing money in a bank account in Switzerland.
   b. A Canadian purchase of a Japanese-made automobile.
   c. A Brazilian firm borrows from an Argentine bank.
   d. A Korean car company buys a factory in California.

6. Critics of globalisation generally argue that globalisation
   a. helps spread the best of each country's culture.
   b. reduces income inequality.
   c. causes a degradation in the world's environment.
   d. helps each country safeguard the best of its own culture.

7. Which international organisation is mainly responsible for monitoring and enforcing global multilateral trade agreements?
   a. The Global Trade Network.
   b. Asia Pacific Economic Co-operation.
   c. World Trade Organisation.
   d. International Monetary Fund.

8. What is the role of the International Monetary Fund (IMF)?
   a. To implement and advance global trade agreements.
   b. To settle industrial and trade disputes between members.
   c. To help poorer countries with their economic development.
   d. To maintain international financial stability in global financial markets.

9. Which of the following would increase Australia's competitiveness?
   a. An increase in Australian tariffs.
   b. An increase in Australian wage rates.
   c. An increase in productivity.
   d. An increase in inflation in Australia.

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10. Which of the following could decrease Australia's competitiveness?
    a. An decrease in Australia's inflation rate.
    b. A fall in interest rates in Australia.
    c. An appreciation of the Australian dollar.
    d. A decrease in average weekly earnings in Australia.

11. The largest category of global trade is
    a. agriculture.
    b. manufacturing.
    c. oil.
    d. services.

12. If the same basket of goods cost $400 in Australia and 200 pounds in the UK, then according to the purchasing power parity theory
    a. goods must cost half as much in the UK as in Australia.
    b. the exchange rate should approach $2 per pound.
    c. the exchange rate should approach $0.50 per pound.
    d. goods must cost half as much in Australia as in the UK.

13. If the purchasing power parity theory is true then
    a. the price of a traded good should be the same everywhere in the world.
    b. exchange rates should be the same everywhere in the world.
    c. interest rates should equalise around the world.
    d. inflation rates should equalise around the world.

14. Research by the World Bank has concluded that globalisation has
    a. increased world poverty and income inequality.
    b. decreased world poverty and income inequality.
    c. decreased world poverty but increased environmental damage.
    d. increased income inequality but decreased world poverty.

15. One possible argument against globalisation is that it may
    a. lead to higher rates of domestic inflation.
    b. create short term structural unemployment in less efficient industries.
    c. result in increasing deficits in Australia's trade balance.
    d. lead to lower rates of economic growth.

16. Which of the following is not likely to be associated with globalisation?
    a. Higher levels of protection against cheap foreign imports.
    b. An increase in exports as a proportion of nations' Gross Domestic Product.
    c. Growth in the influence of multinational corporations.
    d. Higher rates of economic growth for countries becoming more open.

17. Governments have facilitated globalisation by
    a. encouraging democracy.
    b. reducing restrictions on international businesses.
    c. encouraging people to buy domestic production only.
    d. introducing subsidies.

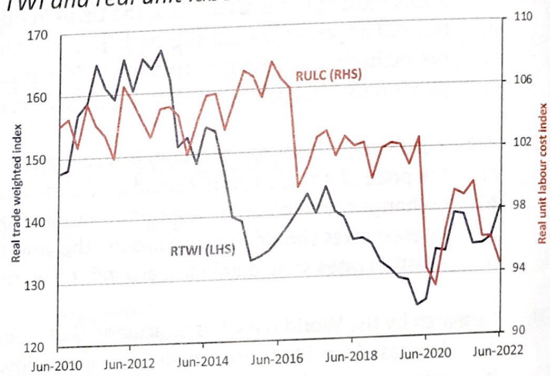
18. Australia's international competitiveness will most likely increase if
    a. the Australian dollar appreciates relative to our trading partners' currencies.
    b. the Australian Government spends more on ports and railroads.
    c. Australian workers' wages increase faster than their productivity.
    d. GDP growth is higher in Australia than in other countries.

19. Australia's international competitiveness would improve if
    a. the nation's trade intensity was reduced.
    b. wage costs rose faster than productivity.
    c. the Trade Weighted Index rose.
    d. industry subsidies and tariffs were further reduced.

20. Which of the following would support economic growth in a developing economy?
    a. Increased government control of key industries and resources.
    b. Government policies aimed at national self-sufficiency.
    c. Ttariffs on imports to support local industries.
    d. Greater integration into the world economy.

Data interpretation

Refer to the graph showing Australia's real TWI and real unit labour costs.



1. What does the real trade weighted index measure?
2. Explain the change in the real TWI between 2017 and 2020. How would this affect Australia's tourism and education sectors?
3. Explain the effect of the following on RULCs:
   i. an increase in productivity;
   ii. an increase in inflation.
4. Explain why a rise in real unit labour costs decreases competitiveness.

Extended responses

Each of the following questions should be answered in 2-3 pages of writing. Include diagrams and examples if appropriate. Pay attention to the allocation of marks when writing your answer.

1. Explain the meaning and significance of the concept 'international competitiveness'. What factors are important in determining a country's competitiveness? [20 marks]

2. a. Discuss the nature of globalisation and the factors that have facilitated globalisation. [10 marks]

   b. Evaluate the arguments for and against globalisation. [10 marks]

3. Consider Stiglitz's definition of globalisation. What examples can you offer of "the closer integration of the countries and peoples of the world"? Why have the costs of transportation and communication come down so dramatically? What "artificial barriers" do you think Stiglitz is referring to? [20 marks]

4. a. Describe the linkages between economies, including trade, investment, tourism and immigration. [10 marks]

   b. Discuss the economic effects of globalisation. [10 marks]