3.1.1 – Growing economies

Globalisation

- This is the process in which national economies have become increasing integrated and interdependent.
- Causes of globalisation **–** Trade liberalization, trading blocs, growth of MNC's, technological advancements and mobility of labour and capital.

Indicators of growth

- GDP
- Human development Index
  - Life expectancy
  - Years spent in school
- Literacy rates
- Health indicators
  - Infant mortality rates
  - Incidence of diseases
  - Access to clean water
- Mobile phone use

Growing power of Asia (China and India)

	CHINA	INDIA
POPULATION	World's biggest: 1 in 5 of people worldwide live there. By 2019 – 1.4 billion. This will fall after 2030. One child policy slowed growth	By 2022 expected to surpass China's population and become the largest
POPULATION STRUCTURE	Aging population – known as the 4-2-phenomenon. Reduced supply of labour and upward pressure on wages	Young population (ICT literate and 50 million English speaking). Good for jobs and economic growth
GOVERNMENT	Communist Government (less strict than previously). Setting up a business requires Gov. permission	Democratic Government but not keen on foreign businesses in India (wants to retain culture)
GDP GROWTH	Annual GDP growth from 1989-2011 was 9.3%. Likely to become world's largest economy in 2020	Annual GDP growth from 2004-2011 was 8.3%. will overtake China by 2020 as fastest-growing economy.

Why has the labour force grown?

<u>Industrialisation</u>

- Process moves from a primarily agricultural industry to manufacturing of goods. Mainly seen in developing and emerging economies
- An example of this developing would be the movement of workers from rural to urban areas in China.

<u>Globalisation</u>

- Workers can take advantage of job opportunities across the world rather than just in their home country – wider availability of jobs and labour.

<u>Increasing level of aspiration/education</u>

- Education system improves giving the children higher aspirations and opportunities due to their higher ability.

Growing power of other emerging countries

<u>Mexico</u>

- Mexico is attracting increasing levels of foreign direct investment (FDI).
- Economists forecast Mexico's economy to grow to the fifth-largest in the world by 2050, primarily as a result of growth in its manufacturing and energy sectors.
- This growth is expected to add to the rising income levels and purchasing power of Mexico's middle-class consumers.

<u>Mongolia</u>

- Mongolia's economy is projected to accelerate to 5.2% growth in 2023 from 4.7% in 2022 as mining and exports expand and the post-pandemic recovery in services continues.
- Growth is also anticipated to be supported this year (2023) by household consumption, which is expected to remain steady as the labour market improves, along with substantial public investment.

3.1.1 – Growing economies

Growing power of Africa

- Historically, African countries have had a number of weakness such as the following factors:
  - Low standards of living
  - High birth rates
  - Undeveloped level of manufacturing and uncompetitive
  - Dependent on commodities for export earnings and therefore vulnerable to changing prices
  - Poor communication due to difficult terrain as telephones do not penetrate the rural areas that many people live in.
- Africa gains aid from China and by the end of 2009, they received 45.7% of China's cumulative foreign aid. It is important to China as a foreign policy instrument as they may have access to the natural resources in Africa. Africa's economy grew by 5% in comparison to 1% in Europe. The savings rate of Africa is 17%, which is half of the average in middle income countries which makes it more expensive for the public and private sectors to get funds as they have higher borrowing costs. Rapid population growth has complicated efforts to reduce poverty and eliminate hunger in Africa. The current population of 1.1 billion is expected to double by 2050, which is not sustainable.
- South Africa has grown steadily since 2009 with the manufacturing sector developing (now 30% of GDP) but this growth slowed after 2011. In Nigeria, incomes have risen steadily since the 1980s, but they are threatened by the low oil prices from the Middle East.

Implications of economic growth for individuals and firms – Trade opportunities for firms

- Opens up new markets
  - Increasing wealth in countries such as China who want Western brands
  - British provenance creates opportunities for individuals with the appropriate skills
    - Fashion
    - Finance
    - Cars
    - Arts
    - Education
- Access to raw materials
- Greater movement of goods and services between countries
- Opportunities for cheaper production
- Greater investment opportunities

Implications of economic growth for individuals and firms – Increased profits for firms

- Trade opportunities will arise in new markets leading to an increase in demand and increased revenue and profit
- The owners of businesses will see an increase in income e.g. through higher dividends
- Businesses can use retained profits to reinvest into productive capacity e.g. new machinery
- Access to growing economies will create business confidence benefiting the UK economy as a whole
- As economies get wealthier the UK will start to produce even more highly differentiated products to meet global demand. This will lead to changes in employment patterns as businesses will demand highly skilled workers

Implications of economic growth for individuals and firms – Rationalisation opportunities for firms

- Rationalisation is a reorganisation in the scale of a firm's operations in order to increase efficiency
- This can be through reducing or increasing the scale of production
- Economic growth will impact on the firm by creating the demand that will lead it to increase in size
- Firms have been able to rationalise operations by moving operations abroad. This has led to:
  - Economies of scale e.g. bulk buying
  - Restructuring to increase efficiency
  - Turning around poor performance
  - Focusing on core business opportunities globally
  - Selling off less profitable parts of the business to improve overall performance
- Consolidating operations in certain countries, particularly ones that offer low cost labour and utilities, has enabled firms to benefit through lower costs and increased efficiency

3.1.1 – Growing economies

Implications of economic growth for individuals and firms – Shifting employment patterns

- Increased economic growth leads to improvements in the standard of living for consumers
  - Increased income allows people to spend more on necessities at lower levels of income and more on luxuries at higher income levels
- As real wages increase labour can substitute work for leisure and see dramatic changes in their level of income
- At some point, they might wish to substitute leisure for work as, at higher levels of income, they satisfy their financial requirements. This will change employment patterns
- Increased incomes allow workers more free time and the ability to retire, and enjoy the quality of their life, at an earlier age
- There will also be a shift in the type of employment, moving from more agricultural or low skilled jobs to more technological and high skills jobs

Rising incomes

- Pay has risen for most citizens and goods are cheaper therefore consumers have more spending power. Consumption rises causing AD to increase as a result and even cause demand-pull inflation.
- People with scarce skills see their wages rise more rapidly than others as higher paid workers will be in high demand and firms pay higher wages to entice workers. This causes wage poverty and inequality to increase (disparity of wealth) as money is not evenly distributed.
- In developing countries, rising incomes can lift people out of poverty as it is estimated in China that half a billion people were lifted out of poverty due to the average 10% growth rate.
- The main measure used is Gross Domestic Product (GDP) per capita

$$\text{GDP Per Capita Formula} = \frac{\text{Real GDP}}{\text{Population}}$$

- This is the most commonly used method to measure a country's living standards. As GDP per capita rises, it is assumed that living standards in that country also rise
- It is common for GDP per capita to be expressed in US$'s, which allows for direct comparison between nations

Conversion of nominal to real values

- Nominal value is expressed in monetary terms. It does not take into account inflation (the average level of prices)
- Real value does takes into account inflation.

$$Real\ national\ output = \frac{Nominal\ national\ output}{Average\ price\ level}$$

$$Real\ value = \frac{Nominal\ value}{Price\ index} \times 100$$

- Short-run economic growth is measured by the annual percentage change in real national output, real national income or real GDP

<u>Constant and current prices</u>

- Constant prices are prices that have been adjusted for inflation.
  - They are real values.
- Current prices are prices that have not been adjusted for inflation.
  - They are nominal values.

3.1.1 – Growing economies

Index numbers

- An index measures changes in a representative group of data.

$$\text{Index Number} = \frac{\text{Value in Period of Interest}}{\text{Value in Base Period}} \times 100$$

- Indices are commonly used in economics and business in order to analyse raw data.
  - Common examples are the CPI, the RPI and the FTSE 100.
- Business leaders and economists frequently use index numbers when making comparisons over time
- An index starts on a given number e.g. year, the base number or base year, at an index number of 100
  - This is called the base period
- In subsequent years, percentage increases may push the index number above 100 and percentage decreases push the figure below 100
  - An index number of 102 means a 2% rise from the base year, and an index number of 98 means a 2% fall from the base year
- Index numbers help to understand the significance of a change
- They are easier to interpret than large numbers
- We always compare with a base number or year

Example

YEAR	POPULATION OF COUNTRY X	% CHANGE	INDEX NUMBER
1 (base year)	1 147 569		100
2	1 846 227	61	161
3	2 213 904	93	193

3.1.2 – Trade and growth

Increasing trade liberalisation

- Exports are the selling of goods and services to other countries
  - If the UK sells a car abroad the money flows into the UK
  - If a tourist from abroad visits the UK the money flows into the UK
- Imports are the buying of goods and services from other countries
  - If a UK business buys raw materials from abroad the money flows out of the UK
  - If a UK business buys the film rights for a foreign film the money flows out of the country
- Exports minus imports makes up the Balance of Payments on Current Account.
  - This explains the financial relationship between the UK and the rest of the world
- As global demand changes so will imports and exports
  - A strong economy will import goods and services in order to meet its needs
  - This might lead to an increase in domestic consumption
  - However, it might be components or raw materials required in the production process for goods and services
  - These products might then be exported
- As global demand and supply changes so will imports and exports
  - If an economy increases its productive capacity this will allow it to increase supply to the rest of the world
  - This will lead to an increase in exports
  - Of course, countries will need to supply goods and services that are in demand to be able to do this
- The US is the biggest economy in terms of global imports
  - However, newly rich countries are dramatically increasing their demand for goods and services
  - As these countries see economic growth the state of the world economy changes, as does the pattern of imports and exports
- China is the biggest economy in terms of global exports
  - They have used their low costs to supply everything from textiles to electronics
  - As China sees economic growth their costs will increase e.g. higher wage costs making it more difficult to maintain demand for exports
  - Many countries utilise their natural resources in order to export e.g. Saudi Arabia is oil rich

The role of specialisation and increasing specialisation by country

- Specialisation occurs when economic units such as individuals, businesses, regions or countries concentrate on producing specific goods or services
- Specialised use of workers within an organisation is called the division of labour
- Specialisation is likely to lead to increased output per worker (productivity) as the workforce have a better understanding of their job role
- This will help provide a competitive advantage as businesses improve the quality of their products
- Specialisation increases output as economic units become more effective and efficient in what they produce due to:
  - Greater understanding of the requirements of production
  - Each economic unit can specialise in what they are best at
  - Efficient use of time as there is no switching between tasks
  - Technical economies of scale as capital equipment is used to produce goods and services
- The increased output can then be exchanged for other goods and services that the economic unit is not as good at producing
- Specialisation allows for the exchange of goods and services between the economic units

BENEFITS	DRAWBACKS
Countries increase output in their specialised product so they can achieve economies of scale → lower average costs	Countries can become too reliant on the export of their specialised product → poor weather conditions etc. may cause uncertainty about export earnings
Higher volume of exports will lead to higher sales revenues → further investment	Prices in international markets may fall → appreciation of currency will make them less price-competitive
If the specialised product is price inelastic, higher prices can be charged → steady flow of income and higher profit margin	Countries become dependent on imports of products they don't have → become vulnerable tariffs
Exports increase leading to higher demand for the currency so the exchange rate may rise → raw materials (imports) become cheaper	Competitors may enter the market with substitute products or form trading blocs with other countries → fall in prices so lower export earnings

3.1.2 – Trade and growth

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	DISADVANTAGES
– 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.	– 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

- Globalisation is the process of greater integration and inter-connectedness between countries
- Globalisation usually includes the following features and characteristics:
  - Free movement of goods and services
  - Free movement of labour
  - Free movement of capital
  - Increased cultural exchange
- The International Monetary Fund (IMF) define globalisation as "The process through which an increasingly free flow of ideas, people, goods, services and capital leads to the integration of economies and societies."

<u>Reduced cost of transportation and communication</u>

- This has made the movement of goods and services across the globe faster and cheaper
- Improved transportation services such as shipping and airlines have made this possible
- Improved infrastructure e.g. roads and internet has also made globalisation easier
- Use of the internet, e-commerce and mobile technology has made it quicker and easier to communicate
- Advances in technology have revolutionised communications, making it easier to communicate globally and lowered the cost of communication e.g. teleconference and Skype v face to face meetings

<u>Increased significance of global (transnational) companies</u>

- Many large organisations have taken advantage of lower trade barriers, labour mobility and cheaper transportation to grow rapidly and enter previously untapped markets

<u>Increased investment flows (FDI)</u>

- There has been a significant relaxation on the rules and regulations surrounding the movement of capital, which can move either freely or at very low cost quickly across the globe.
  - This has led to an increase in foreign direct investment.
- The greater freedom of movement of capital enables businesses to invest outside their country of origin.
- This may lower their own costs of production and improve economic prospects and job opportunities in the invested

3.1.2 – Trade and growth

Trade liberalisation and economic growth (continued)

Growth of the global labour force

- Growth, in terms of both quantity and quality, has led to a diverse international workforce. With increasingly freer movement of labour this has transformed workforces globally
- In many economies, such as the UK, we are seeing low skilled foreign workers employed in industries that do not require high rates of human capital
- At the same time we are seeing highly skilled workers from the same countries, but employed in industries where there is a high human capital requirement

Structural change

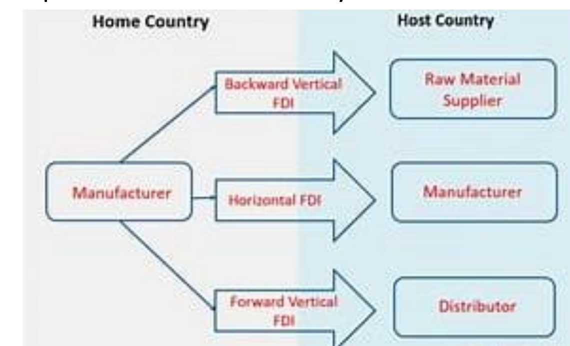
- National economies have been transformed with countries moving away from the primary sector to manufacturing, whilst other economies have moved from the secondary sector to services

Foreign direct investment (FDI) and link to growth

- Foreign Direct Investment (FDI) is investment made by a business or other entity from one country into the production capacity of a business or other entity from another country e.g. factories.
- Most FDI is horizontal, with the duplication of production facilities in different countries. Some vertical FDI occurs where different stages of the production process occur in different countries.
- It was originally believed that FDI occurred due to differing interest rates in different countries. Businesses would transfer money globally to where they could obtain the highest interest rate.
- Other theories believe that businesses cluster production together geographically or operate in countries that are close to them geographically.
- Japanese theorist Terumoto Ozawa developed the ideas of Michael Porter, believing that businesses would operate where they could gain a competitive advantage.
- At first, we have a less developed country that can be exploited in terms of costs e.g. labour by multinational corporations. This benefits the MNC but also creates income and wealth in a country.
- This leads to economic growth that attracts inflows of FDI but also creates wealthier domestic businesses. As a result the economy and domestic businesses grow.
- Finally, rising standards of living and greater use of technology lead to more FDI, both in and out of the country. Domestic businesses have acquired the skill and knowledge base of the MNC. External economies of scale occur, where domestic businesses grow in order to supply the MNC. Eventually, some domestic businesses are so large that they start to invest abroad themselves.

Types of FDI

- Horizontal FDI: Here, investors put their money on foreign companies that operate in the same industry—niche in which the investor operates domestically. This way, firms expand their existing business into different nations.
- Vertical FDI: When a company acquires or merges with a foreign company to add more value to its supply chain, it is called a vertical FDI. For example, if an automobile company invests in a foreign company manufacturing semi-conductor chips, the vertical integration would improve supply chain.
- Conglomerate FDI: Here, investors invest in completely different segments—unrelated to their existing operations.
- Platform FDI: It is a unique form of FDI—businesses invest in a foreign company to manufacture goods. They then sell the finished product in a third country.



3.1.2 – Trade and growth

Pros and cons of FDI

Advantages of FDI for business making it

- → Access to cheap labour – not always regulated labour laws in developing countries
- → Access to resources/raw materials – may invest in oil-rich countries for better access to develop oil fields
- → Avoidance of tariffs – may not have to pay foreign tariffs if they invest to a country inside a trade bloc
- → Reduced transport costs – e.g. as Nissan is producing in the UK, they have lower costs to sell in the UK as well
- → Use of local knowledge for markets – better knowledge from local workers
- → Tax exemptions – some countries offer tax-free options for businesses to encourage FDI
- → Access to markets – e.g. through location within a trade bloc

Advantages of FDI for recipient country

- → Use of locals in employment means job creation, boosting employment in the foreign country and can increase the skill level of the country
- → Recipient country can benefit from improved knowledge and expertise of the foreign MNCs, may learn a new way of production e.g. kaizen may be transferred across economies.
- → Profits of the business are taxed, increasing Government revenue which can be used to invest in infrastructure and improve their development.
- → Corporations may pay higher wages and have better working conditions causing the economic wellbeing of citizens to improve if groups such as Fairtrade become involved.

Disadvantages of FDI for recipient country

- → This gives MNCs controlling rights within foreign countries which may influence the politics of the country against public interest
- → The jobs created are likely to low-wage jobs with bad conditions which will only disadvantage workers
- → Most of the profits will likely return to the investing economy as there are economic leakage and profits are repatriated

3.1.3 – Trading blocs

Trading blocs

- Trading blocs are when the governments of a group of countries agree to trade together freely i.e. normally with no trade barriers
- The countries are normally grouped together geographically e.g. the European Union (EU)
- The members of a trading bloc make preferential economic, and sometimes political, arrangements to boost trade within the member states

Trade creation

- Trade creation is when trade shifts as a result of membership of a trading bloc from a high cost producer to a low cost producer
- Membership allows the business to buy from the most efficient producer, that is also a member, without having to pay tariffs

Trade diversion

- Trade diversion is when trade shifts as a result of membership of a trading bloc from a low cost producer to a high cost producer
- A member shifts from buying from a low cost supplier outside of the trading bloc to a high cost producer within the trading bloc. This is due to not having to pay tariffs to that producer

Types of trading blocs

- Preferential trade areas
  - Members agree to either reduce or eliminate trade barriers for a select number of goods or services, resulting in partial trade liberalisation
- Free trade areas
  - Members agree to either reduce or eliminate trade barriers for all goods and services, resulting in trade liberalisation
- Customs unions
  - Members agree to the removal of trade barriers amongst themselves and a common approach to trade barriers when dealing with countries outside of the bloc
  - In a sense the bloc is now acting as one homogenous group
- Common markets
  - Members agree to the removal of trade barriers as well as the freedom of movement of factors of production within the bloc
  - Often also involves the agreement of common economic policies
- Economic unions
  - Comprises of the features of both a customs union and a common market, including common economic policies

Customs union

- The EU is not a free trade area as such, but a customs union
- A free trade area is a group of countries that have removed most or all tariffs and/or quotas
- A customs union will involve internal free trade amongst member states, but also includes a common external tariff
- Each member of the customs union cannot pursue their own international trade policy, instead trade negotiations are conducted on behalf of all member states
- The EU is the biggest customs union in the world with a 15.5% share of world trade
- It is important to differentiate a customs union from the Single European Market (SEM), which in addition to having no internal trade barriers and a common external tariff, also involves the free movement of goods, services, capital and labour which promotes deeper economic integration and market liberalisation

3.1.3 – Trading blocs

The Single European Union

From member point of view	
Advantages	**Disadvantages**
Trade creation Trade is encouraged within member states because there are no barriers, so additional trade is created within the bloc.	**Trade diversion** The existence of the common external tariff diverts trade away from the EU. Goods within the SEM may be more expensive, and this could damage consumer welfare.
Competition Stronger competitive forces within the SEM can drive productive and dynamic efficiency, which will benefit consumers.	**Monopolies** In some markets e.g. gas and electricity, tariffs have seen significant merger activity and the creation of large monopolies seeking to exploit the available economies of scale.

From non-member point of view	
Advantages	**Disadvantages**
Access to markets The SEM creates a market of 28 countries and a population of over 500m, offering significant scope for businesses to expand.	**Unemployment** In some countries, workers may lose their jobs as production is transferred to member states with lower labour costs.
Freedom of movement There is the right to live and work anywhere within the SEM without restriction which boosts labour mobility.	**Cost** Membership of the SEM costs the UK around £15b per year.

Customs union VS Single market

- A single market is a deeper form of integration than a customs union.
- A single market involves the free movement of goods and services, capital and labour.
- In addition to a common external tariff, a single market also tries to cut back on the use of non-tariff barriers such as different rules on product safety and environmental standards replacing them with a common set of rules governing trade in goods and services within the common market.
- Countries such as Norway and Switzerland are outside of the European Union, but they are members of the EU single market, paying into the EU budget to take advantage of some of the benefits of the free flow of capital, labour, goods and services.

Trading bloc VS Customs union

- Trading bloc
  - A trading bloc is essential an agreement between countries to lower their import tariffs and perhaps extend this to reducing the use of non-tariff barriers to trade.
  - In a free trade area, each country continues to be able to set their own distinct external tariff on goods imported from the rest of the world.
- Customs union
  - A customs union is different from a free trade area, in which means no tariffs are charged on goods and services moving within the area.
  - It adds on a common external tariff on all products flowing from countries outside the customs union, unless specific trade deals have been established.
  - Revenues from import tariffs are combined for all member states. The countries in a customs union negotiate as a bloc when discussing trade deals with countries outside the union.
  - A good example is the recently introduced bilateral trade deal between the European Union and Japan.

3.1.3 – Trading blocs

Stages of economic integration

Different stages of economic integration between countries	No Internal Trade Barriers	Common External Tariff	Factor and Asset Mobility	Common Currency	Common Economic Policy
Free Trade Area	X				
Customs Union	X	X			
Single Market	X	X	X		
Monetary Union	X	X	X	X	
Economic Union	X	X	X	X	X

EU enlargement

- Since its inception in 1958, the EU has grown from 6 to 28 member states, with Croatia the most recent country to join in 2013
- In 2016 the UK voted to leave the EU
- At the current time there are a further 5 candidate countries for EU membership i.e. Iceland, Macedonia, Montenegro, Serbia and Turkey
- Potential positive implications of enlargement include:
    - EU enlargement has increased the potential for economies of scale and free trade across a larger geographical area and population
    - For consumers, the increased competition may drive down production costs leading to lower prices and increased choice and quality
    - For businesses, they will be able to take advantage of the relative low wages of new accession countries
- However, there are some potential negatives to EU enlargement, which include:
    - Can the UK cope with the influx of migrant workers from new accession countries?
    - New countries may require additional support from the EU, which may be partly funded by stronger nations
    - EU enlargement may increase bureaucratic costs for all existing members

ASEAN

- The Association of Southeast Asian Nations (ASEAN) was founded in 1967
- Its members are Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar (Formerly Burma), the Philippines, Singapore, Thailand and Vietnam
- It is one of the fastest growing markets in the world and is a major producer of manufactured products, many of which are exported to the US and European countries
- As it grows in size it looks to rival the EU and NAFTA in terms of economic power
- If it was a single country ASEAN would be the fourth largest economy in the world
- At 600m it has a bigger population than both the EU and North America. With real GDP growth of over 5% over the years 2000-2013 it looks likely to become a significant economic powerhouse
- It is a diverse market with rich cultural differences and differences in GDP per capita, with Singapore one of the richest countries in the world in terms of per capita income
- As its economy continues to grow rapidly it will be able to compete effectively with the EU and NAFTA

3.1.3 – Trading blocs

NAFTA

- The North American Free Trade Association (NAFTA) was founded in 1994
- It is a trilateral agreement between the USA, Canada and Mexico
- Its aim is to eliminate any barriers to trade between the three countries
- The agreement led to significant FDI into Mexico, particularly from the USA
- Often, production was transferred from the USA to Mexico, creating significant tension amongst American workers
- However, it is clear that NAFTA has led to significant growth since its introduction

Impact on firms of trading blocs

- There are a large number of potential impacts, both positive and negative. Some of these include:
  - Free trade within the bloc encouraging specialisation and trade
  - Easier access to knowledge, workers and components
  - Economies of scale
  - Take advantage of favourable differences between members e.g. taxes or labour costs
  - May reduce trade with countries outside of the bloc
  - Not all members may have same power
  - May damage domestic industries

Pros and cons of trading within a trading bloc (e.g. EU or NAFTA)

Benefits	Constraints
• Access to member country markets without trade restrictions means export levels increase. • No tariffs on imports from bloc members; lower prices benefit business and consumers. • Possibility of economies of scale. • Spreading of risk. • A trading bloc creates a larger market which attracts foreign direct investment (FDI). • Greater competition within the trade bloc can increase incentives for firms to strive for efficiency, cutting costs and prices.	*For free trade areas:* • No protection for domestic industries competing with other bloc members. • Stiffer competition for domestic producers. • Reaching agreement with member states is a slow process. *For common markets:* • A common external tariff can increase costs of raw materials or supplies from outside the bloc. • Harmonised regulations may not suit all businesses, especially those without ethical commitments.

Growing interdependence

- Trading blocs create growing interdependence between member states as it is easier to trade with them
- This leads to a growing relationship with more imports to and exports from member states
- Closer contacts with economic agents leads to greater vulnerability as the impact on one member state has a greater impact on others
- This can be seen with the impact on the rest of the EU with the financial problems caused by the Greek debt crisis

3.1.4 – Trade policy and trade negotiations

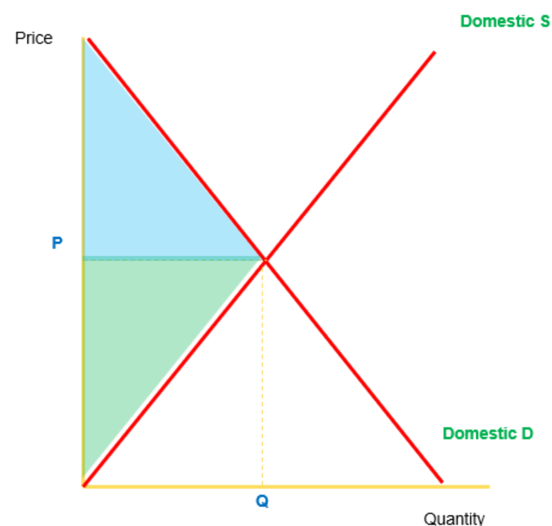
Protectionism

- Protectionism is when a country takes action to protect its own industries by restricting trade with other countries
- Through countries having a comparative advantage and empirical data it is clear that there are strong economic reasons for international trade to occur
- However, it can also be seen that developed and developing nations may benefit in different ways, or not at all
- As a result, there are a number of arguments that might justify the implementation of protectionist measures
- Infant industries
    - Young industries are unlikely to be able to compete against established MNCs in developed countries, thus require protection, at least in the short term
- Dumping
    - Over-production in developed countries may be released into the markets of developing nations, which undercuts domestic prices and domestic producers may be forced to leave the market
- Domestic employment
    - Protectionist measures might help to protect domestic jobs if infant industries are allowed to grow or local businesses aren't undercut by MNCs from developed countries
- Externalities
    - Some goods, such as illegal drugs and weapons, may be considered to have significant harmful effects on society and should be blocked from domestic markets
- Balance of Payments
    - Placing restrictions on imports may help to reduce a balance of payments deficit on current account

Protectionism measures

- Tariffs
    - Taxes placed on imported goods that are not applied to domestic goods
    - Consumers face a higher price
    - However, domestic industries are protected from overseas competition
- Import quotas
    - A physical limit on the volume of imports entering a country
    - For example, Thailand has imposed a quota of 54,440 tonnes of corn on China
- Government legislation
    - Countries might employ measures such as complex legal forms, health and safety inspections and specific product specifications
    - These will discourage imports by raising costs
- Domestic subsidies
    - Government payments to domestic businesses to help reduce production costs and improve competitiveness
- Embargoes
    - A total ban on imported products
    - The UK has imposed embargos on Syrian oil exports as a political measure

Diagrammatic representation of tariff – Without international trade



Without international trade the domestic supply and demand curves show the market equilibrium price at P.

Consumer surplus is the difference between the price a consumer is willing to pay for a product and the price that they actually pay.

Producer surplus is the difference between the price a producer is willing to supply a product at and the price actually received for the product.

Blue represents consumer surplus and green producer surplus without trade.

3.1.4 – Trade policy and trade negotiations

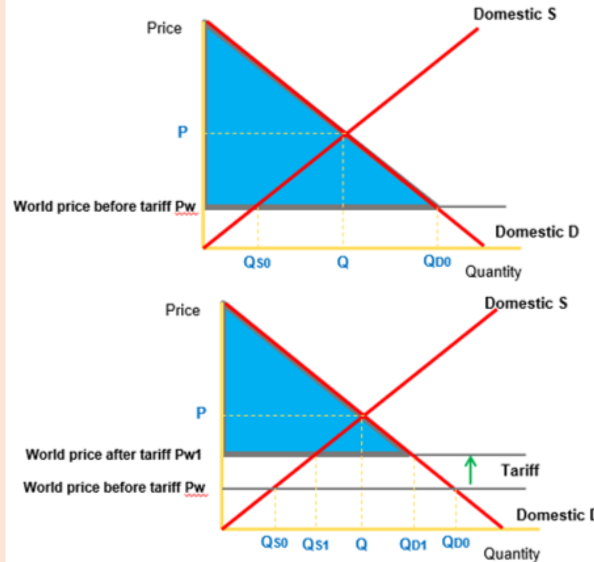
Diagrammatic representation of tariff – With international trade

With international trade the price is lower at Pw as it can be imported from world markets. At this price consumers demand QD0. Domestic suppliers will supply Qso and QD0 – Qso will be imported.

Consumer surplus has increased as shown by the blue triangle as the price has become cheaper due to imports. However, domestic producer surplus has decreased.

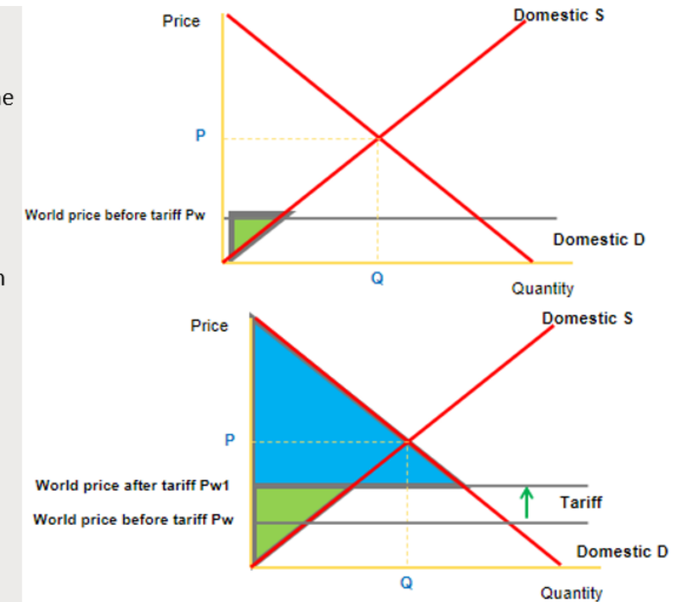
The government wish to protect domestic suppliers from imports by placing a tariff on the product. This increases price to Pw1. Demand falls to QD1. Domestic supply Increases to QS1 and imports fall to QD1 - QS1.

Consumer surplus has decreased as shown by the difference in size of the two blue triangles.

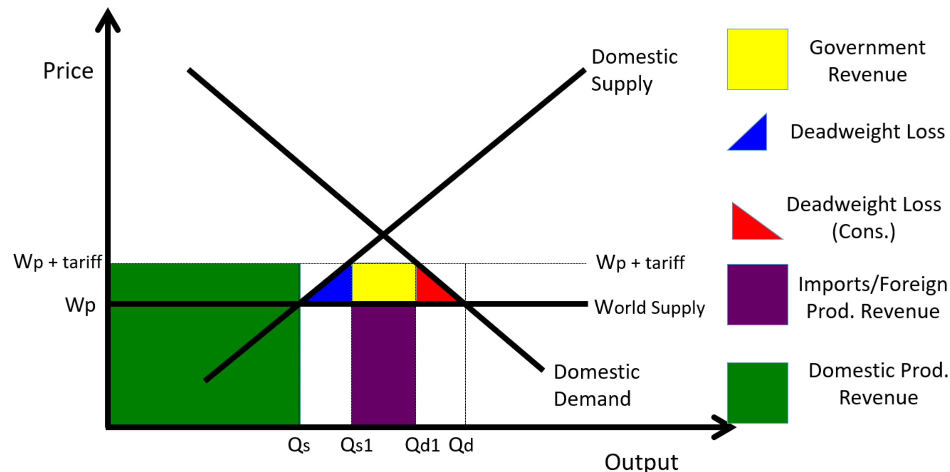


Diagrammatic representation of tariff – With international trade

- With trade, price is lower at Pw. Producer surplus decreases to the amount shown by the green triangle.
- The tariff increased price to Pw1.
- Producer surplus has increased as shown by the green triangle.
- However, the fall in consumer surplus is greater than the increase in producer surplus so there is a welfare loss.



Tariff diagram with labels

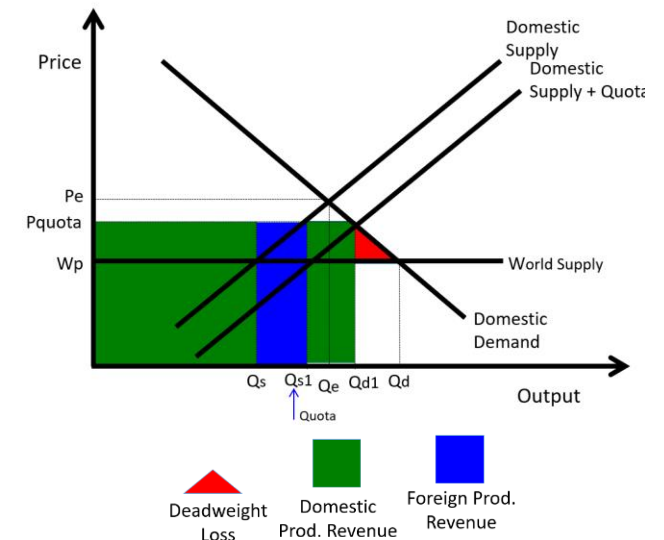


Diagrammatic representation of import quota – With quota imposed

A country that operates under conditions of free trade will have a perfectly elastic world supply curve. Price will be P1, output Q1.

Imposing quotas on imports will restrict world supply.

- Imposing a quota of Q2-Q3 will restrict the supply of imports and increase the amount supplied by domestic producers.
- These will now supply 0-Q2 and Q3-Q4. Price rises to P2.
- Before the quota, imports were Q1-Q2. The quota limits imports to Q2-Q3.



3.1.4 – Trade policy and trade negotiations

The role of G20

- The Group of 20 (G20) is a forum through which 20 leading countries can debate a wide range of international issues linked to international financial stability
- Its membership consists of 19 countries and the EU, together accounting for 80% of world trade
- It holds an annual summit, most recently held in China in 2016 and Germany in 2017
- G20 has been criticised for its exclusivity as most countries of the world have no direct say in its meetings

Conflicts between trading blocs and WTO

- The WTO seeks to reduce trade barriers in order to promote world trade.
- Trading blocs might conflict with the WTO because they:
  - Distort trade by creating barriers
  - Negatively impact on non-members
  - Allocate resources in an inefficient manner
  - Lead to protectionist policies between trading blocs
  - Contravene a key requirement for WTO membership in that all members must have MFN status

The role of The World Bank

- The World Bank provides finance and other assistance e.g. expertise to developing countries
- This takes a number of forms, including:
  - Low interest loans, credit and grants
  - Investment in education, health infrastructure and an array of other areas that benefit social welfare
- It has set two specific goals to be achieved by 2030:
  - To end extreme poverty, limiting the number of people who survive on $1.90 a day to 3% of the population
  - Promoting shared prosperity by supporting income growth for the bottom 40% of people in all countries

The role of The World Trade Organisation (WTO)

- Progress towards complete trade liberalisation has increased in recent years. One of the main organisations involved in this has been the World Trade Organisation.
- Established in 1995, its purpose is to promote free trade by persuading countries to abolish import tariffs and other barriers
- The WTO is the only international agency overseeing the rules of international trade
- It polices free trade agreements and settles trade disputes between governments and organises trade negotiations
- WTO decisions are absolute and every member must abide by its rulings
- There are currently 160 members
- Most Favoured Nation (MFN) status is required for all members providing trade advantages such as reduced tariffs

The role of the International Monetary Fund (IMF)

- The International Monetary Fund (IMF) is comprised of 189 member countries that looks to promote monetary cooperation e.g. exchange rates and international payments and to facilitate trade globally
- A key area is helping macroeconomic stability in developing countries
- This helps to promote economic growth and the reduction of poverty

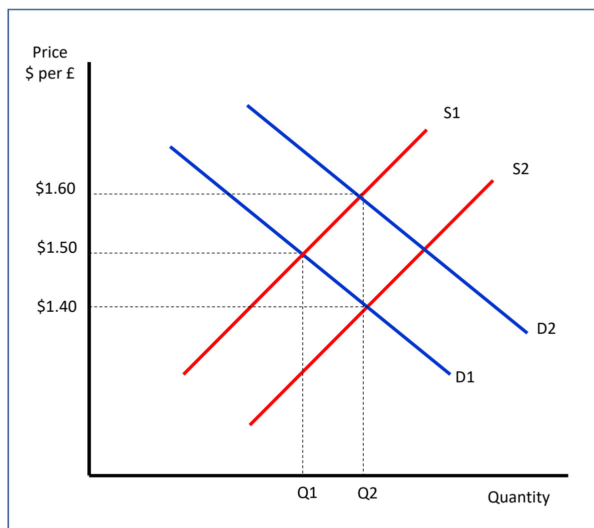
Bilateral trading agreements

- Bilateral trading agreements take place between two countries or trading blocs
- Preferential trade agreements will take place that remove barriers to trade such as protectionist policies
- The UK is likely to negotiate bilateral trading agreements with a number of countries after Brexit
- As a member of the EU it could not do this as it had to adhere to membership rules

3.1.5 – Exchange rate changes

The impact of movements in exchange rates

- Imagine an exchange rate is in equilibrium at D1S1 with £1 able to buy $1.50.
- If there was an appreciation in the exchange rate, this would increase the D for £s and there would be a shift to D2. This would mean that £1 is now able to buy $1.60.
- A depreciation in the exchange rate might mean that £1 is now able to buy $1.40.



The impact of exchange rate changes on inflation rate

- A strong pound
  - SPICED
    - Strong Pound Imports Cheaper Exports Dearer
- A weak pound
  - WPIDEC
    - Weak Pound Imports Dearer Exports Cheaper
- This leads through to the rate of inflation
  - A strong £ leads to cheaper imports and lower inflation
  - A weak £ leads to dearer imports and higher inflation
- However, if a product is price inelastic then we will continue to import it even if its price has increased due to a weak pound

The impact of exchange rate changes on businesses

- There is a significant impact on businesses of movements in exchange rates. In general:
  - If the exchange rate appreciates this will make exports less attractive in terms of price competitiveness and imports more attractive
  - However, a stronger pound will lower the relative price of imports and may reduce the cost of imported materials
  - There is no certainty as to the exact price of a currency on a daily basis, meaning that businesses will struggle to budget as they do not know their exact costs
- When an exchange rate weakens, it increases the price of imports, and potentially the rate of inflation. This is especially true for businesses who rely on the import of primary raw materials
  - This might deter investment made by businesses as they do not know the expected return on investment
  - Given that we are looking at global businesses it is likely that there will be both benefits and disadvantages of exchange rate movements
    - e.g. if the £ appreciates against the $ then UK subsidiaries of the business will benefit from cheaper imports and the opposite will happen to the American subsidiary
- Changes in exchange rates can eliminate profits for a business or increase returns dependent on which way they move
  - For example, in June 2016 the £ hit a 31 year low against the $ after the UK voted to leave the EU. As a result, when US businesses convert their UK profits into dollars there will be a significant loss as each £ buys less $
  - In the same way, British businesses that operate heavily in the US market, such as Burberry and Top Shop, should see a significant increase in profit as they turn $s into £s

3.1.5 – Exchange rate changes

The impact of exchange rate changes on economic growth & employment/unemployment

- If we assume the £ is strong (If we assume the £ is weak, the opposite will happen)
  - Aggregate demand
    - Encourages imports and discourages exports leading to a fall in AD
  - Economic growth
    - Output and investment will be cut in the short term leading to a fall in GDP
  - Employment
    - Reduced output leading to lower employment
  - Current account
    - Fall in exports and rise in imports leading to a worsening BoP on current account

The Marshall-Lerner Condition (MLC)

- This states that a depreciation of the exchange rate will only improve a balance of trade deficit, if the sum of the elasticities of demand for net exports is greater than 1.
- If the elasticity of demand for net exports is less than one the current account (balance of trade) will worsen.
- A depreciation will lead to a positive quantity effect as imports will fall and exports will increase.
- However, there will be a negative cost effect as we will pay more for our imports.
- If the quantity effect is greater than the cost effect, then the MLC holds true.
- Currency devaluation
  - For a currency devaluation to lead to an improvement (e.g reduction in deficit) in the current account, the sum of price elasticity of exports and imports (in absolute value) must be greater than 1

Marshall-Lerner Condition example

The UK imports 1000 units of goods at £1 per unit. Imports are **£1000**.
The UK exports 1000 units of goods at £1 per unit. Exports are **£1000**.

We have a balanced trade. The £ depreciates in value by 10%.

Imports have a price elasticity of demand of **0.7**. An increase in price of IMPORTS, caused by the depreciation, leads to a DECREASE in demand of IMPORTS. Exports have a price elasticity of **0.2**. A decrease in price of 10% leads to INCREASE in demand of EXPORTS. The sum of the price elasticities for X and M equals 0.9

The UK imports 930 units of goods at £1.10 per unit. Imports are £1023

The UK exports 1020 units of goods at £1.00 per unit. Exports are £1020

Therefore, the depreciation of the currency has led to a deteriation of the balance of trade because the sum of the price elasticities of X and M is less than one.

The impact of exchange rate changes on FDI flows

- 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.
- A depreciation in the currency means the country's wages and production costs have fallen relative to other countries. This makes the country more internationally competitive and it is likely to attract more FDI.

Short term capital flows

- These are comprised mainly of speculative capital movements by wealthy individuals and companies
- They can form "hot money" flows in currency markets or shifts in stock prices around the globe
- Whilst it forms billions of dollars on a daily basis, it can be highly volatile in nature and create significant disturbance to the balance of payments as well as upsetting confidence and expectations in an economy

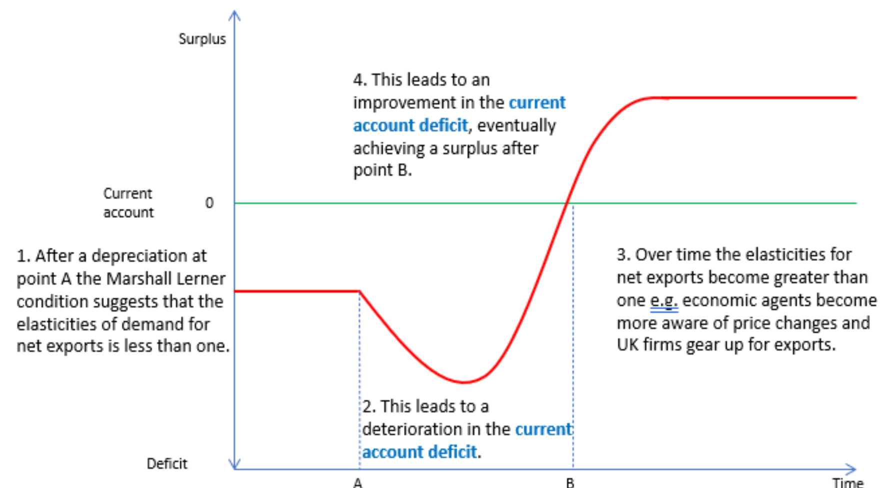
Long term capital flows

- These are comprised mainly of FDI, long term investments or sources of finance for governments and MNCs
- These can help enhance supply side improvements through making finance available on a global level and not just within a domestic economy
- However, only large MNCs tend to participate in this, which may distort competition at the expense of smaller firms
- The global economy has become increasingly reliant on long-term capital flows for the expansion of globalisation, but as the credit crunch of 2008-12 demonstrated, the integration of capital investments across borders can create major problems in the event of weakness in one area of the market (in this case, mortgage debt)

3.1.5 – Exchange rate changes

The J curve

- The J curve states that a depreciation can lead to a short term deterioration of a trade deficit before improving in the longer term
- This gives an explanation as to why the Marshal Lerner Condition often tends to less than one in the short term but greater than one longer term
- In the short run there will be a worsening of the trade deficit
- Over time the deficit will start to improve



The Eurozone

- The Eurozone is a Monetary Union
  - A monetary union is a group of independent countries that share a single currency
    - This is also known as a currency union
- Technically, the UK has a monetary union (across England, Scotland, Wales and Northern Ireland) but the largest currency union globally is the Eurozone
- The Eurozone came into existence on 1st January 2002, and initially had 12 members
- This has now expanded to a currency union of 19 countries (Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, and Spain)

Conditions necessary for the success of the Eurozone

- The conditions for a country joining the Eurozone are known as the 'convergence criteria'. These include:
  - Control of inflation in line with the 3 best performing nations
  - Controlling the government deficit as a % of GDP
  - Controlling the government debt as a % of GDP
  - Control of interest rates in line with the 3 best performing nations
  - Managing the exchange rate so it does not deviate from a central exchange rate

Pros and cons of belonging to the Eurozone

Advantages	Disadvantages
Price Transparency, Competition and Efficiency In a currency union, price comparison is straightforward. This may help firms cut costs, as they will be able to find the cheapest product more easily and should encourage greater competition as there is greater transparency in prices. This should help increase efficiency as firms are forced to remain competitive.	**"One Size Fits All" Monetary Policy** A currency union requires a single monetary policy. This means interest rates being set centrally for all Euro countries. E.g. if an individual country is suffering a downturn in economic activity, but the rest are booming the central Bank may want to increase interest rates, but that would simply worsen the recession for that country.
Inward Investment Members of the currency union should be able to access other members markets and equally the country may attract FDI, releasing the potential for additional economic growth.	**Loss of National Sovereignty** The transfer of money and fiscal competencies from national to community level, means economically strong and stable countries would have to co-operate in the field of economic policy with other, weaker, countries.
Elimination of Exchange Rate Uncertainty Joining a currency union should end currency instability and a country should be more secure against currency speculation. Moreover, businesses would not face hedging costs to insure themselves against currency fluctuations.	**Economic Shocks** External economic shocks may have an adverse impact which is exacerbated by constraints on monetary and fiscal policy meaning an individual government may find it difficult to react to economic shocks.
Elimination of Currency Conversion Costs Converting between currencies has a cost for individuals and firms. Joining a currency union will remove these costs.	**Transition Costs** Joining a currency union involves short term transition costs which would disappear once the new currency was fully established. For example, new money has to be issued and the old withdrawn, vending machines have to be adapted to take the new coins, and foreign exchange departments may shrink in size in some financial institutions.

3.2.1 – Conditions that prompt trade

Push factors

- Push factors are those that force a business to leave the market in which they currently operate to look for new income streams in the future
- Saturated markets occur when nearly all potential customers already have the product that a business sells, or a close substitute of it
    - Therefore, most sales are likely to be replacement ones. This means that a business will eventually see sales revenue fall
- Competition suggests that a business will struggle to survive in markets where other businesses might have a competitive advantage or where the return on capital employed in the market is not worth the risk to remain in operation
    - Therefore, the business will look to undertake new market development as a strategy for the future
    - This suggests that a business believes that it will struggle to break even in its current market and must take steps to ensure its survival
    - To maximise sales revenue this type of business might look to move into global markets

Off-shoring

- Off-shoring occurs when a business relocates production and operations to another country
- The key reason for this is cost minimisation as the production process can be undertaken at a reduced cost in comparison to the domestic economy
- Closeness to market will reduce transport costs for businesses and might allow for easier access to consumers, particularly if operating in the country being targeted e.g. Jaguar Land Rover have set up production in China

Outsourcing

- Outsourcing occurs when a business contracts out production to another business. This might lead to a loss of quality control but can allow the business to match supply to meet demand
- The outsource business might be a specialist, which is likely to lead to an improvement in the quality of the product

Pull factors

- Pull factors are those that attract a business to a global market
- Economies of scale occur because a business can benefit from operating in a global market by significantly reducing costs as the scale of the business increases
    - This may be through purchasing economies as its buying power increases and it negotiates cheaper unit costs through bulk buying
- Risk spreading means that the business becomes less reliant on the vagaries of one or just a few markets. For example, the UK market might experience a shock such as Brexit that impacts on the sales of some businesses
    - By moving into different markets the business can negate such risks

Re-shoring

- Reshoring happens when a transnational business decides to bring previously off-shored manufacturing back to the home country.
- Reshoring is often motivated by the business objective of producing intermediate and finished products with the cheapest input factor.
- The strong rise in wage / unit labour costs in many emerging countries in recent years has accelerated the process of reshoring.
- Other aims include improved certainty around delivery times (including shorter delivery times) and minimising the risk of supply chain disruptions perhaps at a time of growing trade tensions between countries.

Extending the product life cycles by selling in multiple markets

- One of the main reasons for operating in a global market is to extend the life cycle of a product
- As the product being sold reaches the decline stage in a mature market the business can increase the product's life by introducing it to other, mainly less mature, markets
- This might require adapting the product to suit local tastes or a large promotional budget to raise awareness
- However, if successful, this might extend the life of the product for a number of years
- Each market is different so this will require local knowledge if it is to be successful

3.2.1 – Conditions that prompt trade

Raising capacity utilisation

- Expanding production into foreign locations can benefit firms through creating increased demand due to:
    - Closeness to markets, allowing speed and lower costs e.g. transport
    - Lower capital costs such as machinery with reduced land costs allows for lower prices
    - A better understanding of local markets
    - Cheaper wage costs can help to reduce prices
- All of this allows for an increase in capacity utilisation as spare capacity is used, making the firm more competitive

Capacity Utilisation Formula

Capacity utilisation (expressed as a percentage) is calculated using this formula:

$$\frac{\text{Actual level of output}}{\text{Maximum possible output}} \times 100$$

3.2.2 – Assessing the potential of different economies (Factors influencing expansion into a market)

Factors influencing expansion into a market

- Levels and growth of disposable income
- Ease of doing business
- Infrastructure
- Political stability
- Exchange rate

Levels of growth and disposable income

- Disposable income is the total income an individual has available to spend after paying income taxes and any other statutory payments.
- At the end of 2020 median household disposable income in the UK was £30,800.
- Those countries with high levels of disposable income will be seen as attractive to UK businesses as they can target them with highly differentiated products.
- This can already be seen with the EU and USA as significant trading partners.
- However, those countries who have high growing levels of disposable incomes e.g. China can be seen as rising stars and will be perfect for new market development.

Ease of doing business

- The ease of doing business is how accessible markets are for a business. For example, is their excessive bureaucracy, where rules and regulations increase the time taken to do business e.g. paperwork when exporting products.
- Often this is to do with the regulatory framework set by the government in a country, both local and national.
- Singapore is seen to be one of the easiest countries in the world to do business. Therefore, it is attractive as a market as costs will be reduced.
- In contrast, the significant market that is mainland China, although seen as very attractive in terms of size and growth, is more difficult to trade with, increasing business costs.
- The ease of doing business index was created by the world bank to compare this.

Political stability

- Political stability has increased in some areas of the world whilst declining in others.
- Poor governance, particular in some less developed countries, has made it difficult to trade successfully. In some countries corruption is rife and is a major element in being able to do business.
- Civil wars continue to impact in areas throughout the world. When there is a greater likelihood of civil unrest it means that a business is less confident in investing time and effort in doing trade with that country.

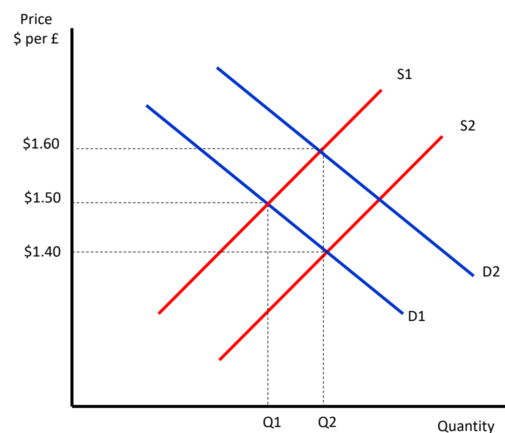
Infrastructure

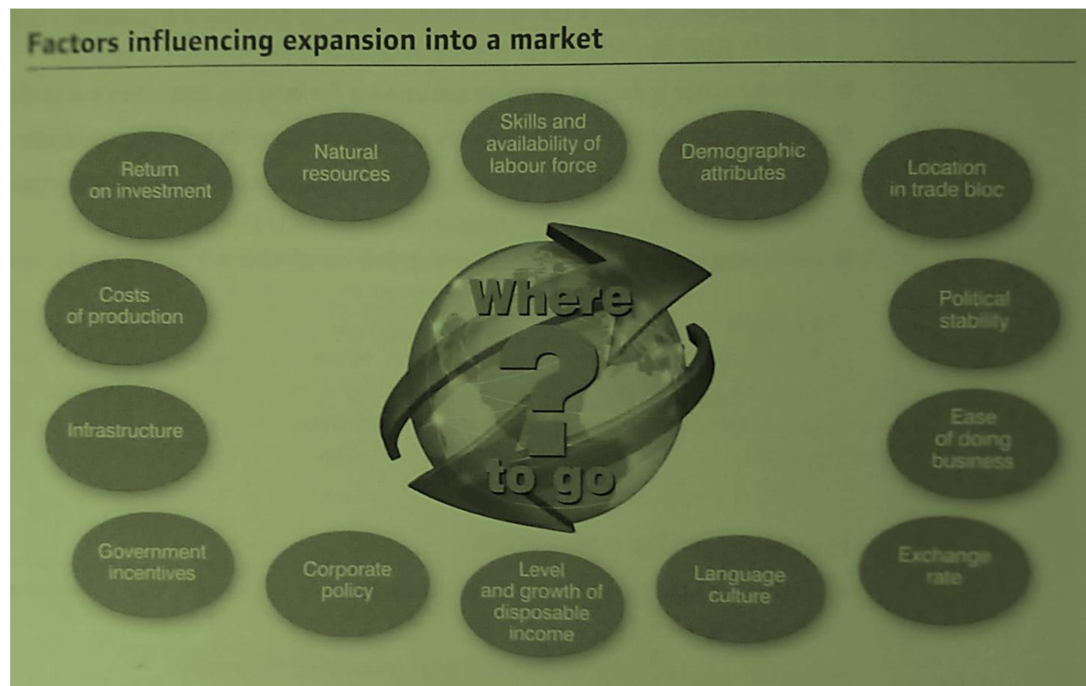
- Infrastructure is the physical systems that a country, or business, require to operate effectively.
- This will include transport e.g. roads, railways and airports, communication e.g. phone and internet facilities and ease of use, utilities such as electricity, gas and water.
- Developed countries such as the EU and USA tend to have better quality infrastructure making it easy to do business e.g. getting a flight to the UK.
- However, developing countries have invested heavily e.g. internet speed and may therefore be seen as a more attractive destination to do trade.
- Foreign governments will look to improve the infrastructure to help businesses operate more effectively. This will include the:
    - Transport network
        - Improves ease and speed of connections e.g. rail, road and air
    - Provision of utilities
        - Ensuring electricity, gas, water etc. are adequately supplied
    - Provision of information
        - Ensuring access to fast information e.g. broadband

3.2.2 – Assessing the potential of different economies (Factors influencing expansion into a market)

Exchange rate

- Exchange rates have a significant impact on the profits of a business operating in foreign markets.
- If the exchange rate of the £ appreciates then it is more expensive to export to foreign countries.
- Any profit made in the foreign country from providing goods and services will be more expensive to repatriate (send back) to the UK as the business will have to turn the foreign currency into £s.
- This will impact negatively on profits of the business.





3.2.2 – Assessing the potential of different economies (Factors influencing location of production sites)

Factors influencing the location of production sites

- Costs of production
- Skills and availability of labour force
- Infrastructure
- Location in trade bloc
- Government incentives
- Ease of doing business
- Political stability
- Natural resources
- Likely return on investment

Location in trade bloc

- Locating in a trade bloc such as the EU, NAFTA and ASEAN allows easier access to markets within those countries, with lower export taxes.
- This will increase the benefits of setting up production inside of the trade bloc.
- Often, FDI will be invested into countries that reside in a trade bloc e.g. Nissan have said a main reason why they have located in the UK is because of its membership of the EU. After the vote to leave the EU there might be a reduction in future investment into the UK.
- However, it is sometimes the case that countries can get favourable access to trade blocs despite not being members e.g. Norway and the EU.

Skills and availability of labour force

- The UK is seen to have a highly skilled labour force. However, despite this, there is often a shortage of suitably skilled workers i.e. a lack of availability.
- This can be resolved by locating in other countries and utilising the skills of workers there.
- This often involves training workers to the required standard. However, as this leads to a rise in the individual worker's living standards, there is often plenty of supply of labour for these jobs.

Costs of production

- In highly competitive mass markets having low costs of production will be a significant issue.
- This means low wage cost economies will see FDI in order to take advantage of the labour force. This allows businesses to drive costs down, allowing them to follow a low cost strategy if required.
- Other costs, such as land, might also be significantly lower in areas such as Eastern Europe in comparison to the UK. Again, this will lead some businesses to produce in foreign countries.

Infrastructure

- As seen infrastructure is very important when businesses look to move into new markets.
- The same can be seen when a business looks to locate production in another country. Clearly, transportation links are vital in moving any goods around the geographical region.
- At the same time communication is vital, particularly for services, in order to be able to communicate with customers and other businesses.

Government incentives

- National and local government can provide incentives e.g. grants if a business were to invest in the UK.
- This could be provided in order to create jobs, particularly in deprived regions.
- Nissan were given a grant by the UK government in order to locate in the unemployment blackspot of Sunderland in NE England.
- It might also be the case that governments wish to transfer intellectual property e.g. the skills and knowledge base of the new business locating in the country.

Ease of doing business

- The ease of doing business in terms of location is how responsive governments are to demands of the business. Again, excessive bureaucracy will increase both time and costs for a business e.g. paperwork required for a location permit.
- Governments might not want a business to compete with domestic businesses and therefore take a difficult stance in allowing them to set up in a location, even if this appears to breach regulations of the trade bloc within which they exist e.g. the EU.
- At other times, Governments can pick and choose who they want to locate in their country as so many businesses want to be close to the market e.g. China.

3.2.2 – Assessing the potential of different economies (Factors influencing location of production sites)

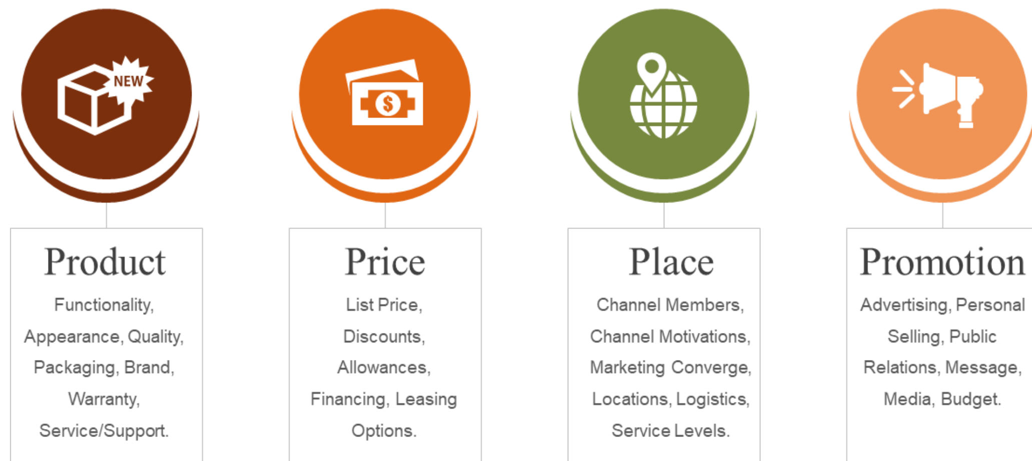
Political stability	Natural resources	Likely return on investment
• It is perhaps even more difficult for a business to locate in a country due to political stability than it is to export products to that country. • Corruption has been seen to be a major influence on whether large foreign businesses are allowed to set up in some countries. Normally, this is the MNC paying a bribe to local civil servants in order to cut through bureaucracy and use their local influence to get things done. • Even if a business manages to obtain planning permission for new production facilities it is often difficult to get skilled management to oversee operations, particularly in war torn countries.	• Some countries are blessed with an abundance of natural resources that can be used for economic gain e.g. fossil fuels such as gas and oil and minerals such as diamonds and metals. • Therefore, it is sensible to set up production in order to ensure a supply of these resources. • This has led to MNCs moving into countries globally and having a significant influence on those countries. • For example, BP has been operating in the Middle East for over 100 years.	• As is the case for most businesses, the bottom line is profit. • A business will take into account all of the previous factors discussed and decide whether the return on investment is worthwhile. • This is strategic decision making. Heavy investment is required to move into new countries. When a decision to proceed is under way, it is not easy to undo. • Location in a foreign country is dynamic, because of the major number of factors that have to be taken into consideration. However, the most important question, in summary, is what return will the business get on its investment?

3.3.1 – Responding to global demand

Globalisation vs glocalisation

- A global marketing strategy is the adaptation of a marketing strategy to target all markets on a worldwide scale.
- This has evolved from national and international marketing where businesses market their products in the domestic market or in another country or group of countries.
- The traditional marketing mix or 4Ps is used with the aim of sending an identical message to all countries.
- This will have to be adapted e.g. in terms of language or religion but changes are kept to a minimum in each market.

The 4 P's of the marketing mix



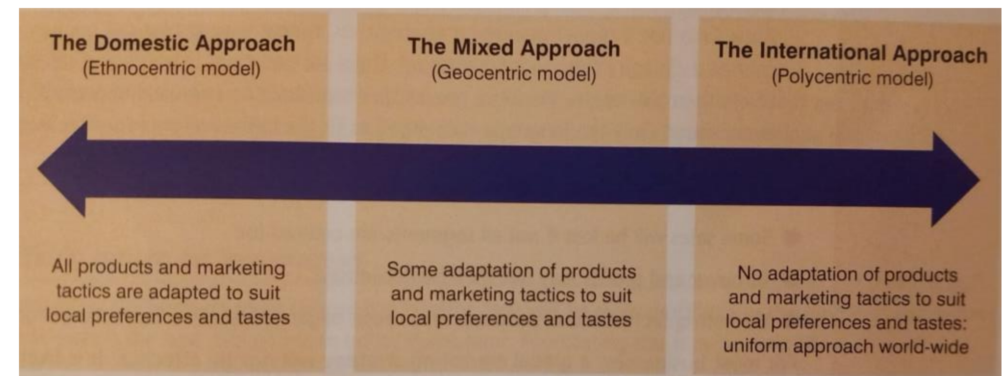
Glocalisation

- Glocalisation is the adaptation of a global marketing strategy in order to meet the requirements of local geographic markets. The term is a mix of globalisation and localisation.
- A business is more likely to be successful if its global product can meet local requirements and fit in with the customs and religions of the geographic area.
- Although global companies would like to sell a standard product in a global market it requires significant investment in market research in order to understand local requirements.
- Often, it is the local people and practices that create the glocalisation rather than the business. In China, McDonald's is seen as a place for young couples to have their first date!

- **Globalisation** is a process by which national and regional economies, societies, and cultures have become integrated through the global network of trade, communication, immigration and transportation.
- Glocalization (a blend of words: globalisation and localisation) is a term that describes the adaptation of international products around the particularities of a local culture in which they are sold.

The EPG model

- The EPG model is a framework that can used to look at marketing approaches used by global firms.
- The home nation is where the business originated e.g. the USA.
- The host nation is where the target market or subsidiary of the business is based e.g. India.



3.3.1 – Responding to global demand

Different approaches to global markets: domestic/ethnocentric

- Ethnocentricity as a marketing approach is where the promotion of the product is undertaken based on the beliefs of the home nation of the business and is presented to the host nation as such.
- In a sense it is suggesting that the values of the home nation are superior to other nations.
- Therefore, products are marketed in foreign countries based on the perceived superiority of the host nation's values. To some extent, this approach ignores local customs, culture and religion.
- Decision making is centralised and key personnel from headquarters are sent to oversee marketing operations in other countries. This restricts promotion prospects for key marketing people who are not from the home nation and marketing ideas from the local area.
- This could be contentious if it offends the local population. However, often, the marketing is of an inoffensive nature in the first place.

Different approaches to global markets: mixed/geocentric

- Geocentricity as a marketing approach is where the promotion of the product is undertaken based on a global or worldly point of view. Therefore, it is not based on the perspective of either the home or host nation.
- Marketing is undertaking for the benefit of the business on a global basis.
- It does not matter where the headquarters or the subsidiary is located; they are a seamless entity, working as one rather than individually. What matters is that each element of the business helps in meeting its global objectives. Employees are selected based on ability rather than nationality.
- Therefore, products are marketed in foreign countries based on whatever is required for the business to succeed. This might entail marketing based on the home nation's values or based on the host nation's. This will depend upon the nation being targeted.
- This marketing approach mixes elements of ethnocentric with elements of polycentric.

Different approaches to global markets: international/polycentric

- Polycentricity as a marketing approach is where the promotion of the product is undertaken based on the beliefs of the nation in which the business is operating.
- In a sense it is the direct opposite of ethnocentrism, suggesting that the values of the nation being targeted are all important.
- Therefore, products are marketed in foreign countries based on the foreign nation's values, fully taking into account local customs, culture and religion.
- Decision making is decentralised and key personnel need to be recruited from the nation being targeted. This can create significant problems as recruitment might be difficult and there is a loss of control of marketing operations. Local knowledge can be used in the marketing.
- However, there might be a loss of sales as the product is no longer differentiated from other local competition.

Price competition in global markets

- In emerging markets, disposable income is lower than in developed markets (lower prices needed) as Western pricing tactics may not work.
- Examples of this is the Tata Nano which is a cheap car but also McDonalds have cheaper items on their Indian menu.
- In China, cheaper prices can signify fake, and higher priced products signify genuine items and the richer people value premium priced products.

3.3.1 – Responding to global demand

Non-price competition in global markets

Product

- Technological goods such as the iPad, need little adaptation for different markets (globally standardised). Food and drink must be adapted to local tastes.
- As a larger market is served, development costs can be quickly recovered. Clothing manufacturers will have to adapt sizes.
- There may be backward innovation – creating cheaper, simpler versions of a product to reach people on low incomes.

Promotion

- Has to link into the culture and language must be accurately translated as literal translations of advertising slogans are likely to fail (mistranslation of Pepsi slogan in Chinese market and Chevy Nova in Latin America).
- Images must not be offensive to religious/cultural norms.
- Time and effort are needed to find most effective promotional message in a new market

Place

- Traditional channels of distribution (place) may not work in many emerging economies due to rural areas.
- Poor infrastructure can mean than supply chains are unreliable.
- In emerging economies, luxury products are sold in opulent and prestigious shopping malls.
- In countries where internet use is lower, online retailing is reduced.
- One example is how Unilever has a Shakti programme which recruits village women to sell small packages of soap, shampoo etc. to family/friends on a commission basis.

Branding and differentiation in global markets

- Global branding ensures that multinational corporations can sell there products in all countries
- Firms such as Apple, Coca Cola and McDonalds use their marketing power to impact on the globe as one market. This can be seen in their marketing through global events such as the Olympics and World Cup
- However, these brands still need to differentiate themselves in order to compete as markets differ e.g. geographically or based on socio-economic factors
- One factor that does stand out though, is quality. This means the ability to meet customer expectations and is a key differentiator between the global brands and less successful one

3.3.2 – Demand-side factors in global markets

Cultural/social factors

- Cultural/social factors are the lifestyle, customs and values of a group of people.
- It is important for a business to recognise these factors when targeting markets.
- Without an insight and understanding it is likely that a business will fail to establish a significant presence in the market.
- It is essential that a business understands the requirements of the target market, whilst at the same time ensuring that it does not use inappropriate marketing, very likely innocently, to upset them.

Different tastes

- As part of these cultural differences it is apparent that people have different tastes. Taste is subjective and is dependent on the individual. However, upbringing and the environment in which one lives have had a significant impact on this.
- This means that businesses can use their understanding of culture to help market their products. Promoting products based on ethnicity, for example, will ensure that a marketing budget is more likely to be spent effectively.
- Again, having self-awareness and an understanding of where other people are coming from, ensures that the business is likely to be more successful.

Inappropriate/inaccurate translations

- Inappropriate and inaccurate translations occur when the language being used to promote a product is not converted accurately.
- This can cause significant embarrassment for a business and will impact on the brand name in the short term.
- There are numerous examples of businesses advertising their products through offensive terminology as the business hasn't undertaken adequate research.
- In a similar vein, an inaccurate translation, maybe only changing a single letter, can lead to the business having to quickly remedy an awkward situation.

Cultural differences

- Cultural differences occur because different types of people have different lifestyles, customs and values. Therefore, their perception of situations is different.
- Language, behaviour and gestures are interpreted differently. This means that businesses must employ people that have an awareness of the cultures of the markets in which they are operating.
- This becomes more complex when dealing with a variety of cultures at the same time e.g. often seen in cosmopolitan centres such as London.
- Understanding other people's behaviour, whilst being able to put forward ones own views in a respectful way, are clearly important.

Language

- Language barriers can cause significant issues when doing business. Often, English is seen as the business language and it is clear that many business people are happy to negotiate using English.
- However, with vast new markets, such as the BRICS countries, having opened up in the past two decades, being able to market products in other languages effectively is increasingly important.
- It looks unprofessional and can compromise a deal if the marketing of a product is let down by poor language. A poor letter of application might mean not getting an interview. In the same way, poor advertising based on language can lose customers.

Unintended meanings

- Unintended meanings occur when the message being portrayed by the business is taken to mean something else by the potential market.
- Often this is based on factors such as gestures and hidden connotations.
- Without appropriate insight into different cultures and societies this can cause significant problems for a business, even destroying its reputation.
- This means that the business would have to redress the situation by increasing the marketing budget to restore its brand image.

3.3.2 – Demand-side factors in global markets

Global niche markets

- Global market niches are subcultures in world society. These share common interests and can be identified as market segments on a global scale.
- Although a niche targets a smaller market, on a global scale this can be sizeable.
- This is particularly profitable when we recognise that these are likely to be highly differentiated products rather than low cost.
- This means that the world's wealthiest consumers can be targeted, with the quality of the product being the most important factor.
- Other common features of global niche markets include:
    - Require high levels of customer service as demanding customers pay for quality not quantity
    - Highly skilled employees with the expertise and, at times, the reputation required to create and sell the desired products

Adapting marketing strategies for niche markets

- Product innovation is essential in order to produce the highly differentiated products that customers require
- A high level of market research is required in order to understand the specific needs of the market on a global basis
- The marketing mix needs to be applied effectively to global niche markets in order to be of use to the business.
- A business will have to invest in each element of the marketing mix numerous times in order to meet the requirements of the variety of consumers that they are targeting.
- This will require expertise and insight into these specific markets.
- Product will be the most important factor. The quality must be extremely high in order to target wealthier individuals on a global basis.
- This means that businesses must undertake significant market research and research and development in order to meet customer requirements.
- Businesses will be able to charge high prices as they are targeting the world's wealthiest consumers. In essence, price is not an important factor to the consumer.
- The high levels of disposable income that people have mean that, although sales volume is low, there is significant added value for each product sold.
- Global promotion will be targeted through niche channels. This may be through specific social media as the target market are likely to be up to date with the very latest social media. However, it could be very carefully planned and specifically targeted, with one-to-one service provided to meet the needs of demanding clients.
- Finally, place will be through carefully selected channels. It may well be that the business goes to the client, offering high quality individual customer service.

Adapting marketing strategies for mass markets

- A global mass market is when a business is trying to sell a largely homogenous product to a large market.
- Modern marketing, whilst still targeting mass markets, has become increasingly personalised
- Firms have adapted to changes in technology and to the influence of social media
- Big data has allowed them to personalise their marketing to greater suit the needs of the target audience
- As technology and the use of data gathered by firms improves so will the ability to cater for individual needs when mass marketing products

Mass vs Niche

Mass market – products and services that will appeal to the whole market.

Examples include:

- drinks
- mobile devices
- toiletries.

Niche market – products and services that are intended for a specific group.

Examples include:

- medical equipment
- specialist food
- software for accountants.

3.3.2 – Demand-side factors in global markets

Pros and cons of global niche market

BENEFITS FOR CONSUMERS	BENEFITS FOR FIRMS
More innovation	Less competitors, so higher chance of success
Specialist and quality products	High profit margins (on smaller turnover)
High level of customer satisfaction	Customer loyalty and repeat sales more likely
	More market expertise

Disadvantages of a niche market are the:

- Lack of economies of scale
- Risk of dependence on one market/product
- Likely to attract competition if successful
- Very vulnerable to market changes

MARKETING MIX	NICHE MARKET	MASS MARKET
Price	High	Low/competitive
Product	Limited outlets	Wide distribution and available everywhere
Promotion	Narrow focus	Wide/broad appeal
Place	Specialised	Standardised

3.4.1 – The impact of multinational corporations (MNCs)

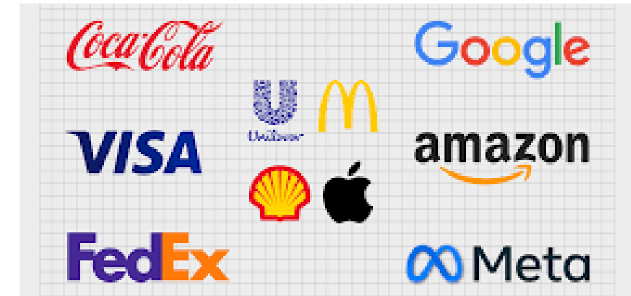
Multinational corporation (MNC)

- A multinational corporation (MNC) has facilities and other assets in at least one country other than its home country.
- A multinational company generally has offices and/or factories in different countries and a centralised head office where they coordinate global management

Characteristics of MNCs

- Dominant players in the market
- Complex structures, multi site and multi product
- Grown through organic and inorganic growth
- Heavy investment in R&D
- Globally recognised brands

Examples of MNCs



Impact of MNCs on the local economy

	Benefits	Negatives
Local community and environment	– Higher employment, less poverty, lower crime – Improved infrastructure e.g. hospitals and roads – Improved education – Increased funds for local governments from the payment of taxes – Projects to improve environmental standards	– Environmental disasters – Loss of traditions and cultures – Damage to traditional industries e.g. land for farmers
Local labour, wages, working conditions and job creation	– Create jobs with better opportunities e.g. training, shared expertise, full-time, promotions – Push wages up improving overall standard of living – Skills development – Better working conditions as businesses look to maintain their own reputation	– Creates wage inflation for local businesses – May look to exploit cheap workers – Bring in own managers only offering low skilled jobs to workers – Working conditions may be poor – Lack of union representation
Local firms	– Local firms supplying MNCs (ancillary businesses) will have increased business. – MNCs may help develop reliable infrastructure if they require it for business e.g. Chinese Harbor Engineering in Sri Lanka built a port which stimulated investment.	– If local regulations are poor, MNCs may manipulate this to the detriment of others – Less demand is present for local firms and workers may get unskilled work – no change.

3.4.1 – The impact of multinational corporations (MNCs)

Impact of MNCs on the national economy

	Benefits	Negatives
FDI flows	– The costs associated with setting up operations abroad is likely to be substantial – An injection into the host economy will cause: ○ Economic growth (GDP) ○ Generation of revenue for the local government ○ Job creation and related wealth	– However following the initial investment a lot of the profits are likely to flow back to the domestic economy
Economic growth	– Rising GDP in both the domestic and host countries – This leads to increased demand and employment – Tax revenues increase allowing for reinvestment into infrastructure and on welfare – As individuals earn more and the profits of local firms increase there is more finance available for investment, further increasing economic growth in the future	– However, inflationary pressure can occur if the economy has little spare productive capacity – Resources are used up and negative externalities may occur
Balance of payments	– A record of a country's trade/transactions with the rest of the world ○ A surplus is when the sum of exports of goods, services, investment income and transfers is greater than imports ○ A deficit is when the sum of exports of goods, services, investment income and transfers is less than imports – FDI represents a flow of investment into the host country and will therefore improve the BoP – Exports sold from the MNC will also represent an inward flow of cash	– However, if materials and services are imported to support the MNC in the host country this represents an outward flow and will have a negative impact on the BoP
Technology and skills transfer	– New technologies and skills will be introduced to the host economies – Collaborative work between countries to further development – Spread of technology and skills across sectors and to domestic companies	– However, may lead to "brain drain" ○ Brain drain occurs when skilled individuals leave their home nations to take advantage of better opportunities elsewhere.
Consumers	– Wider choice of goods and services – Access to global brands – Better quality products	– However, may lose local, more traditional, businesses
Business culture	– May introduce more aggressive cultures based on a profit motive – Traditional businesses may be more likely to be family based – Encourage enterprise due to recognising capitalism	
Tax revenues	– Taxes paid within the host country will boost the governments revenue allowing for greater spending on public services such as health care and infrastructure	– However, MNCs may spread their tax liabilities amongst a number of countries many of which will have different rates of tax ○ This allows MNC to minimise its tax liability
Transfer pricing	– The price charged by one company to another within the same MNC – Should be appropriate: ○ Price that the supplier would be willing to supply at in the market ○ Price that the buyer would be willing to pay in a market – Can be used by MNCs to manipulate profits between subsidiaries and hence tax liabilities – Governed by legislation	

3.4.1 – The impact of multinational corporations (MNCs)

Impact of MNCs on host countries

Positives to host countries	Negatives to host countries
– **Provision of significant employment and training to the labour force in the host country** – Transfer of skills and expertise, helping to develop the quality of the host labour force – MNCs add to the host country GDP through their spending, for example with local suppliers and through capital investment – Competition from MNCs acts as an incentive to domestic firms in the host country to improve their competitiveness, perhaps by raising quality and/or efficiency – MNCs extend consumer and business choice in the host country – Profitable MNCs are a source of significant tax revenues for the host economy (for example on profits earned as well as payroll and sales-related taxes)	– Domestic businesses may not be able to compete with MNCs and some will fail – MNCs may not feel that they need to meet the host country expectations for acting ethically and/or in a socially-responsible way – MNCs may be accused of imposing their culture on the host country, perhaps at the expense of the richness of local culture. Might MNCs reduce cultural diversity around the world as they continue to expand, particularly into less developed or developing countries? – Profits earned by MNCs may be remitted back to the MNC's base country rather than reinvested in the host economy. – MNCs may make use of transfer pricing and other tax avoidance measures

Example question and answer

1. List the positive and negative impact factors of McDonald's on the national economy of the countries it operates in?

Answer	
Positive factors	**Negative factors**
– **Job creation - McDonald's, as a multinational corporation, plays a significant role in job creation within the countries it operates.** – **Tax revenue** - McDonald's contributes to the government's revenue, which can be used for public services and infrastructure development. – **GDP** – high market share in the fast food market contributes significantly to the Gross Domestic Product (GDP) of the countries it operates in – **Innovation and improvements to supply chain** – more innovation drives change and efficiently	– **Healthcare factors** - McDonald's is the potential strain on the national healthcare system – **Environmental concerns** - McDonald's, is often criticised for its environmental footprint as well as increased litter – **Income Inequality and Low-Wage Employment –** criticism regarding the wages it pays to its employees, particularly those in entry-level positions – **Infrastructure strain and competition** - The rapid expansion of McDonald's and other fast-food chains can lead to increased urbanisation and strain on local infrastructure. As well as forcing smaller firms out of the market.

3.4.2 – Ethical issues

Stakeholder conflict

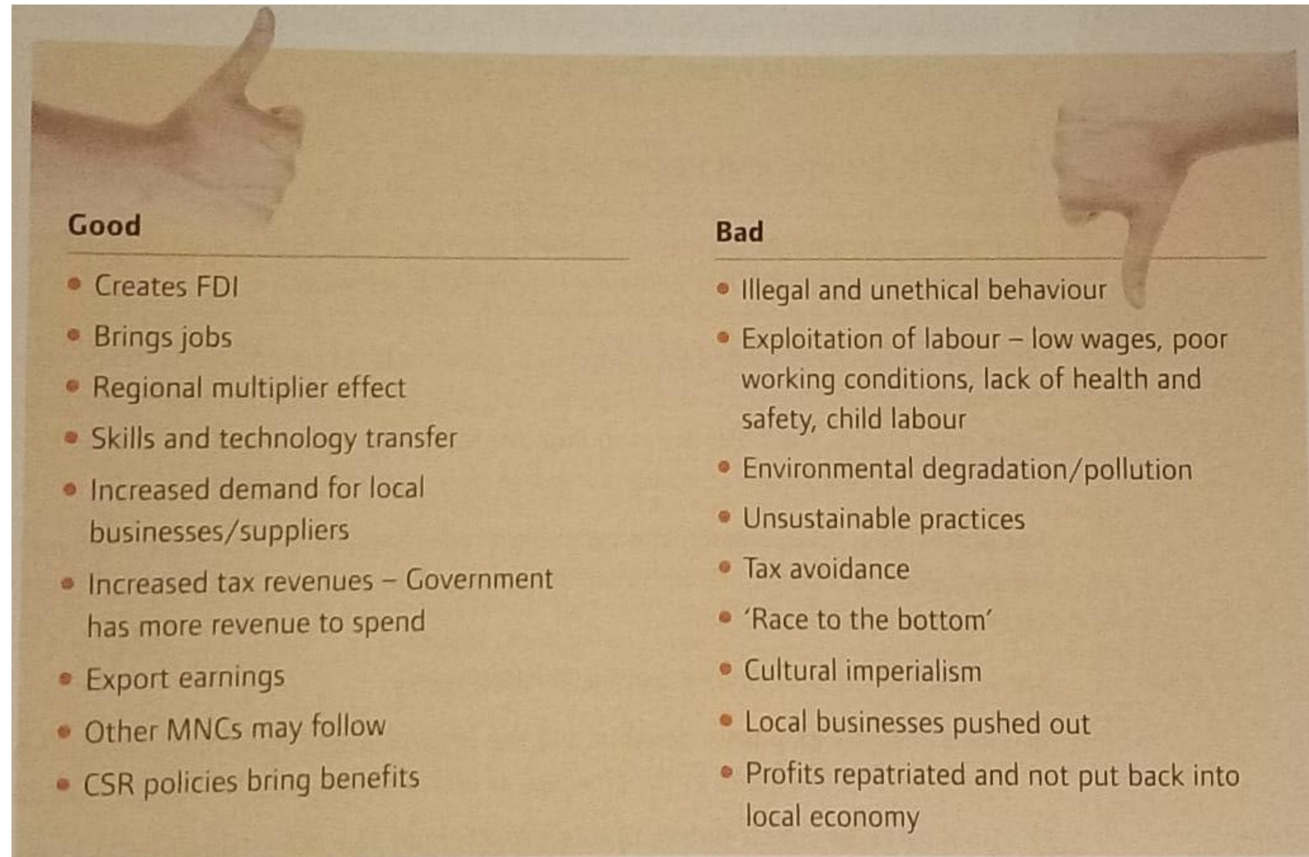
- A stakeholder is anyone with an interest in how a business is run. For example, the possible stakeholders of an MNC could be:
  - The shareholder: Shareholders want the firm to make a large profit, so the share price increases and the value of their dividend goes up.
  - Employees: They aim for high wages and good working conditions.
  - Consumers: They want goods of a high quality and a low price.
  - Managers: They want to earn large bonuses and salaries, as well as personal benefits, such as leisure time and company cars.
  - Government: Governments aim to earn tax from the firm's profits, such as corporation tax.
  - Suppliers: Firms are the customers of suppliers. Suppliers want firms to remain in business so they still have customers.
- When there are many stakeholders, their objectives might conflict. For example, it is hard to make sure costs are kept at their lowest in order to maximise profits if employees are demanding higher wages.
- The principal-agent problem can be linked to the theory of asymmetric information.
  - This is when the agent makes decisions for the principal, but the agent is inclined to act in their own interests, rather than those of the principal.
  - For example, shareholders and managers have different objectives which might conflict. Managers might choose to make a personal gain, such as a bonus, rather than maximise the dividends of the shareholders.

Ethical issues

PAY & WORKING CONDITIONS	ENVIRONMENTAL CONSIDERATIONS	SUPPLY CHAIN CONSIDERATION	MARKETING CONSIDERATIONS
– Opportunity for MNCs to exploit local workers with low pay and poor working conditions – However: o Introduce western standards o Create jobs	– Emissions and waste disposal – UK legislation is strict e.g. all publically listed companies have to report their greenhouse gas emissions and abide by laws on how waste is disposed – but is this true in all countries? – Global impact of industrialization – Growth of e-waste	– Exploitation of labour o The International Labour Organisation (ILO) promotes fair and decent work for workers across society o Pay, choice and working conditions – to achieve social justice o Responsibility of MNCs throughout the whole supply chain – Child labour o Exploitation of children who have no power o Low wages o Unacceptable conditions o No education o Kidnapping from families o Slavery	– Misleading product labelling o In the UK this is governed by the Trade Descriptions Act – but not applicable in other countries o UK legislation includes labelling such as size/quantity, price, ingredients, endorsements, how, where and when made, health claims o Stricter in certain industries e.g. food and pharmaceuticals o Often pursued by pressure groups and consumer organisations such as watchdogs o Inappropriate promotional activities o Promoting directly to children o Cultural difference e.g. the culture of gift giving in China o Promoting a life style that goes against cultural or religious difference – Inappropriate promotional activities o Promoting directly to children o Cultural difference e.g. the culture of gift giving in China o Promoting a life style that goes against cultural or religious difference

3.4.2 – Ethical issues

Pros and cons of MNCs



3.4.3 – Controlling MNCs

Controlling MNCs

- It is difficult to control an MNC as laws and other regulations passed only applies to the business operating within that country.
- Therefore, if there was a production subsidiary set up in a different country which violated regulations, the parent company would not be liable so the MNC is effectively unpunished.
- However, regulatory bodies do enforce what they can, through charging fines when firms fail to follow regulations, which causes a disincentive to break rules.
- Some larger firms may prefer to pay fines as it is proportionally easier for them to pay fines rather than change their way of operating.
- Factors to consider:
    - Political influence
    - Legal control
    - Pressure groups
    - Social media

Political influences

- Politicians can act to influence the operations and strategies of MNCs
    - Trade initiatives and trade delegations
        - Offering financial and non-financial support
        - Hosting trade events
        - Parliamentary visits abroad to promote UK industries
    - Subsidies and tax incentives
    - Protectionism
    - Trading blocs

Pressure groups

- Pressure groups are organisations who fight to influence the actions of others for the good of a particular cause
    - They seek to influence:
        - Government policies
        - Consumer behaviour
        - Business activities
    - Actions include:
        - Media attention
        - Protests and lobbying
        - Boycotting

Criticisms

- Companies are often interested in profit at the expense of the consumer. Multinational companies often have monopoly power.
- Tax avoidance.
- Cash reserves – Apple has cash reserves of $193bn, 93% of which is overseas. This represents deadweight welfare loss. It is not being used for investment.
- MNC market dominance makes it difficult for local small firms to thrive.
- In developing economies, big multinationals can use their economies of scale to push local firms out of business.
- In the pursuit of profit, multinational companies often contribute to pollution and use of non-renewable resources which is putting the environment under threat.
- 'Sweat-shop labour' MNCs have been criticised for using 'slave labour'.
    - 'Sweat-shop labour occurs when workers are employed at low wages and under unhealthy or oppressive conditions.
- Outsourcing to cheaper labour-cost economies has caused loss of jobs in the developed world.

Legal control

- Regulatory controls
    - Competition policy
    - Employee legislation
    - Environmental protection
- Taxation rates to influence location decisions
    - Both vary significantly between countries

Social media

- Social media is the use of virtual communities to communicate with actual and potential customers
    - e.g. the use of blogs, online forums, viral marketing, podcasts, social networking sites
- Reach a wide audience including:
    - global reach
    - younger demographic
        - culture of sharing e.g. like, share, favourite and retweet
- Powerful way to raise awareness using a range of media

3.4.3 – Controlling MNCs

Self-regulation

- Self-regulation occurs when firms in an industry regulate themselves and monitor their own standards
- This is less costly and might persuade a business to be morally and ethically upstanding
- However, moral hazard suggests that the behaviour of these firms is difficult to police and relies more on individuals within the organisation, especially when standard procedures are not set out in the organisation
- Profit maximisation can mean that firms chase profits rather than behave in an ethical manner

Examples of the factors to consider

Factors that can control the behaviour of MNCs

Agent	Description	Example
Public Opinion	The way people feel about a company can influence its actions. If the public decide not to buy a certain product or brand because they disapprove of the company's actions it can persuade them to change policies.	The boycott of Nestlé is the world's longest running. It began in 1977 in response to aggressive marketing of Nestlé baby milk formula in poorer countries. Public concern over phone hacking by the media led to the closure of the News of the World.
Pressure Groups	An organised group that seeks to influence either the political and legal process or whole industries or individual companies. **Pressure groups** can organise campaigns, protests or even direct action.	Greenpeace campaigns for environmental causes. *Action on Smoking and Health* (ASH) is a campaigning public health charity that works to eliminate the harm caused by tobacco. Tescopoly is concerned with the negative impact of supermarkets' power and Tesco in particular.
Social Media and the Internet	More and more campaigns aimed at affecting the behaviour of MNCs make use of the internet and sites such as Facebook and Twitter. These speed up the flow of information and can make the actions of groups and individuals much more effective.	SOMO is an organisation which investigates multinational corporations and the consequences of their activities for people and the environment around the world. It uses Twitter, Facebook and YouTube to spread its information and campaigns.

Agent	Description	Example
The Media	Newspapers and TV programmes can mount campaigns to mobilise public opinion and affect MNCs' behaviour.	The BBC Panorama programme investigated working conditions in Primark's supply chain.
Self-regulation	Many MNCs follow a code of conduct which sets their own standards of behaviour. This may be because of altruism or to prevent adverse criticism.	Multinational seed companies, Emergent Genetics and Proagro, have launched a scheme of incentives and disincentives to persuade their suppliers to discontinue the use of child labour on their farms.
Government Control & Regulation	Governments can set up regulatory bodies to monitor the behaviour of businesses or industries. They can have advisory or legally enforceable powers. Governments can insist that MNCs form joint ventures.	In the UK the Competition and Markets Authority (CMA) has far reaching powers to investigate a business or industry. For a time, China insisted on joint ventures for FDI projects.
Legal enforcement	All countries have legal codes, i.e. laws, and MNCs that break them are subject to prosecution.	National Minimum Wage Act, Health and Safety at Work Act and similar laws in other countries.
Shareholder Groups	Shareholders who are the owners of a business can try to affect an MNC's behaviour by protest or votes at the AGM.	BP shareholders mounted a rebellion and protest at BP's AGM over its plans for Canada's oil sands.

3.5.1 – Employment patterns

Employment patterns – Globalisation

- Globalisation has led to greater freedom for firms to operate in different labour markets
- This has seen movement of labour between countries
- It has also seen production relocated to other countries, particularly low wage economies
- Sometimes, relocation has occurred in order to be closer to a market or to benefit from that market e.g. China
- This has had a dramatic effect on employment patterns throughout the world

Employment patterns – Economic growth

- Increased economic growth has led to improvements in living standards:
    - Increased income allows people to spend more on necessities at lower levels of income and more on luxuries at higher income levels
    - As real wages increase labour can substitute work for leisure and see dramatic changes in their level of income

Employment patterns – Increased income

- At some point, they might wish to substitute leisure for work as, at higher levels of income, they satisfy their financial requirements. This will change employment patterns
- Increased incomes allow workers more free time and the ability to retire, and enjoy the quality of their life, at an earlier age

Growth of the global labour force

- Demographic changes and increased opportunity has led to a growth of the global labour force
    - Industrialisation has led to workers moving from rural to urban areas
    - This has led to decreases in the labour force working in agriculture and increases in manufacturing
- Hundreds of millions have escaped absolute poverty as economic growth through manufacturing has led to higher GDP per capita.
    - Developed economies have switched production to low wage economies, creating more jobs in developing economies
- Global population growth and more women working has led to a greater supply of labour
    - Many of these workers have emigrated to countries with higher wages and greater job opportunities
    - This has led to improved living standards
- Increased supply of labour has led to increased competition in domestic labour markets
    - This has impacted on the price of labour i.e. the wage rate
    - Both low and high skilled workers have joined new labour markets, allowing for increased capacity and often improved productivity

Structural change

- As developing countries took on more low skilled jobs there was a structural change in their economies
    - Less workers worked in agriculture and less people ran their own farms
    - Instead, they worked in factories and earned enough money to buy their own food. This helped to reduce poverty
- At the same time, it has led to the rise of mega cities, as millions leave the countryside to work in the city
    - This has led to workers learning new skills, different from the traditional skills required for working in farming
    - However, it has also led to increased use of technology, which creates a threat to employment in the future
- As developing countries took on more low skilled jobs, advanced countries started to specialise in highly skilled areas
    - This led to the deskilling of many workers e.g. textiles and other areas of manufacturing and deindustrialisation
    - Therefore, reskilling was required as the structure of the economy changed from manufacturing to services
- As developing economies such as China and India grew they had more money to spend on imports
    - This has led to an increased demand for specialist skills in advanced economies, partly fuelled by the newly rich emerging economies

3.5.1 – Employment patterns

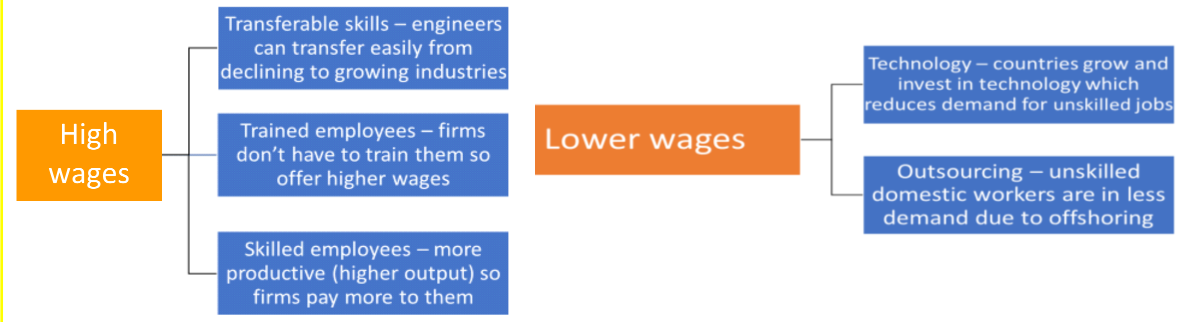
Interdependence of labour markets

- Many firms have relocated to low wage economies in order to produce goods
    - However, often these goods are designed and finished in the developed economies
    - For example, the UK car industry might see designers researching and developing new ideas for car components
- These components might then be manufactured in a low skilled economy
    - The semi-manufactured parts of the car are then sent back to the UK where the finished car is produced
    - This means UK workers are dependent on workers from other labour markets
- Many jobs in advanced nations have been transferred to low wage economies
    - As this has happened jobs have been lost
    - Some countries responded to this faster than others by facilitating the move from manufacturing to services. However, the process has been painful.
- Emerging economies such as India and China are now moving into the service sector. This will lead to further changes in global labour markets
    - However, the increased demand from emerging economies as they grow richer will lead to new markets being created that countries such as the UK can benefit from e.g. the market for education

3.5.2 – Wage rates

Monetary factors influencing supply in labour markets

- Monetary factors are the financial rewards for a worker supplying their labour to a firm
- The reward for labour is a wage
  - The higher the wage the more people will offer their services
  - Wage is however related to skills, qualification and experience
- Workers as economic agents seek to maximise their earnings



Non-monetary factors influencing supply in labour markets

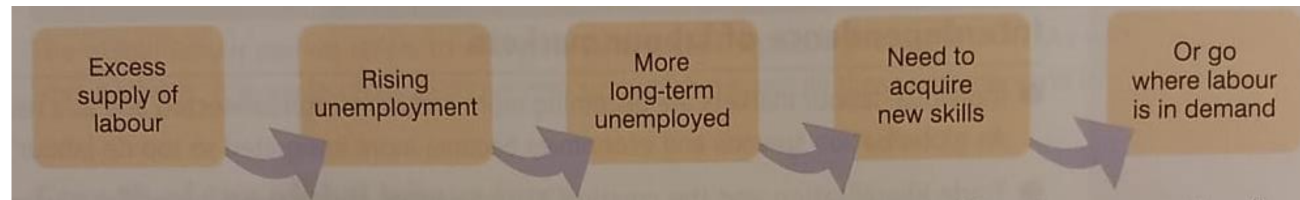
- Non-monetary factors are the non-financial rewards for a worker supplying their labour to a firm

Fringe benefits e.g. company car	▪ Fringe benefits enhance the overall compensation package, making job offers more attractive to potential employees. ▪ Competitive fringe benefits can differentiate an employer in the labor market, attracting a larger pool of qualified candidates. ▪ Comprehensive fringe benefits contribute to job satisfaction, reducing turnover rates.
Working conditions e.g. office environment	▪ Working conditions is the environment within which the workforce operate ▪ This will include job hours, safety, the physical environment and mental demands put on the workforce ▪ Health and safety requirements in countries such as the UK ensure that there is a high level of protection for the workforce ▪ However, in some developing countries poor working conditions can lead to severe stress and even death
Job satisfaction/dissatisfaction	▪ Job satisfaction/dissatisfaction is the fulfilment achieved from working for a firm ▪ This will vary from worker to worker ▪ Some workers will seek promotion ▪ Others might look for a secure job or social interaction in the workplace
The economic welfare derived from leisure time	▪ Economic welfare for an individual is the combination of benefits received from work and leisure time. ▪ This might include the financial and non-financial rewards associated with work and the satisfaction achieved from the individual's leisure time e.g. spending time with family and friends. ▪ Leisure time has an opportunity cost due to the income lost when not working. ▪ There is a positive substitution effect between work and leisure. Higher wages lead to workers substituting more work for leisure ▪ There is a negative income effect between work and leisure. Higher wages mean that workers supply less work as they can work fewer hours for the same income ▪ Workers derive economic welfare from their leisure time ▪ They will take this into account when supplying their labour to a firm ▪ Higher wages will act as an incentive for a worker to supply more of their time to a firm but also mean that workers don't have to work as long for the same rewards

3.5.2 – Wage rates

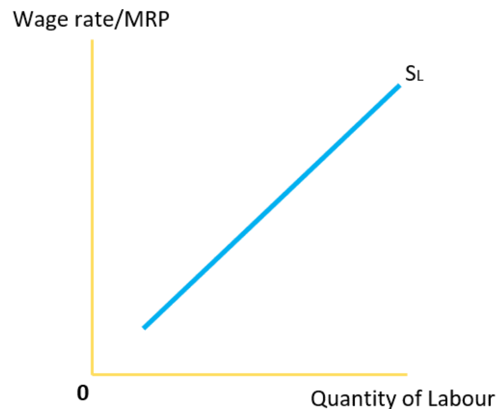
Factors influencing the supply of labour

Population migration	– Increase the supply of labour as more people come into a country seeking employment – Often willing to work for the minimum wage – EU offers free movement of labour
Income tax and benefits	– High income tax and high benefits act as a deterrent to the supply of labour
Government regulations	National minimum wage: – An increase in the minimum wage may encourage more people to supply their services – However, it may also cause a fall in demand
Trade unions	– Improve pay and working conditions attracting more people to supply labour – Take industrial action to withdraw the supply of labour – Push wage rates up through negotiations with employers



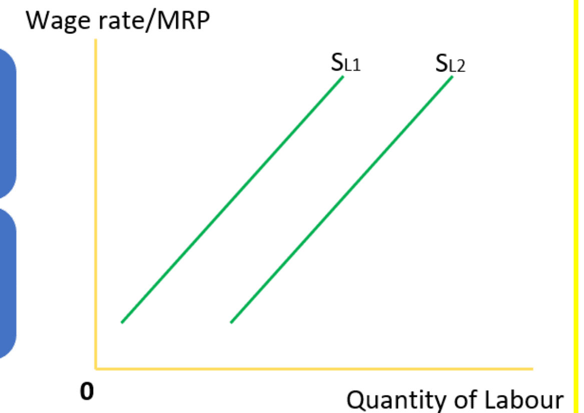
The supply curve for labour

- The supply curve for labour (SL) is upward sloping.
- It shows the amount of work that labour is willing and able to supply at any given wage rate.
- An increase in the wage rate will lead to more workers offering themselves for work.
- This could be workers from within the industry working more hours or new workers from outside of the industry attracted by the higher wage rates.



Shifts in the supply curve for labour

- The supply curve for labour will shift if there is a change in the number of workers in the economy e.g. immigration.
- Supply of labour to specific industries will change according to whether that industry is seen to be more or less attractive than other industries.



3.5.2 – Wage rates

Market failure in labour markets

- Labour immobility occurs because it is difficult for labour to be put to alternative uses due to lack of skills or experience
- The immobility of labour can result in a misallocation of resources. This leads to market failure. Labour immobility can occur for:
    - Lack of appropriate skills
    - Lack of appropriate training
    - Lack of appropriate education

Labour immobility and market failure

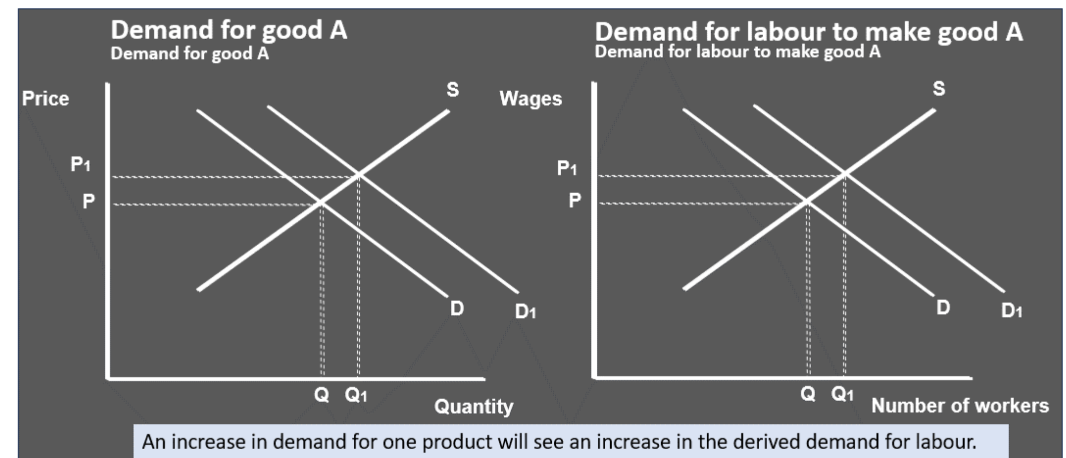
- Labour immobility can lead to a misallocation of resources and therefore market failure
- If labour is immobile then markets will find it difficult to clear when there is a change in supply and demand
- If demand increases but supply is fixed due to immobile labour then there will be distortions in the market and it will take time for market equilibrium to be reached

Factors that influence the demand for labour

- Labour is demanded by employers
- Demand is derived
    - Contributes towards productivity and therefore the profit of the firm
- The cost of labour is wages
    - At high wage rates demand will be low
    - At low wage rates demand will be high
- Demand for labour is directly linked to demand for the product being made
- Elasticity of demand for labour is directly linked to the elasticity of demand for the product being made

Derived demand

- Derived demand for a factor of production occurs as a result of demand for a product.
- All finished products create derived demand for factors such as labour and capital.
- The demand for labour will be influenced by its productivity.



An increase in demand for one product will see an increase in the derived demand for labour.

Marginal revenue product of labour

- The demand curve for labour tells us how many workers a business will employ at a given wage rate in a given time period.
- In the theory of competitive labour markets, the demand curve for labour comes from the estimated marginal revenue product of labour (MRPL)
- Marginal revenue product of labour (MRPL) is the extra revenue generated when an additional worker is employed
- $MRPL = marginal\ product\ of\ labour \times marginal\ revenue$

Example

- Let us assume that each extra worker employed costs the firm $160 per day – this is called the marginal cost of labour
- At this wage rate of $160 the firm should employ 6 workers
- A profit maximising firm should employ workers up to the point where the marginal revenue product of labour = the marginal cost of labour. In this case, when 6 people are employed MRPL and MCL both equal $160.
- Employing the 7th worker would lead to a fall in total profits.

3.5.2 – Wage rates

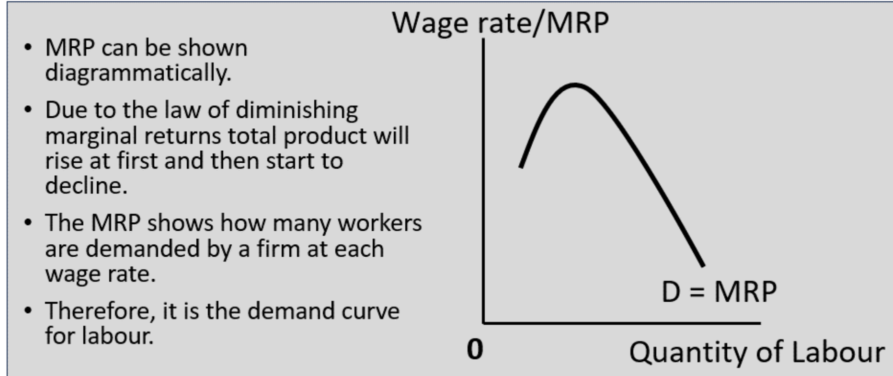
Marginal physical product (MPP)

- This is the extra output that an extra worker produces.
- Due to the law of diminishing returns, in the short run, there is usually a diminishing marginal product when increasing the number of workers.

Marginal revenue product (MRP)

- Marginal revenue (MR) is the addition to revenue of selling an additional unit of output:
  - $marginal\ revenue = \frac{\Delta\, total\ revenue}{\Delta\, quantity}$
- Marginal revenue product (MRP) is the change in total revenue from the employment of an extra unit of labour
- MPP looks at production in terms of physical units whilst MRP looks at production in terms of monetary units
- If we multiply the additional to total output (MPP) by the revenue received from that extra output (MR) we find the addition to total revenue (MRP) or:
  - $MRP = MPP \times MR$

MRP curve



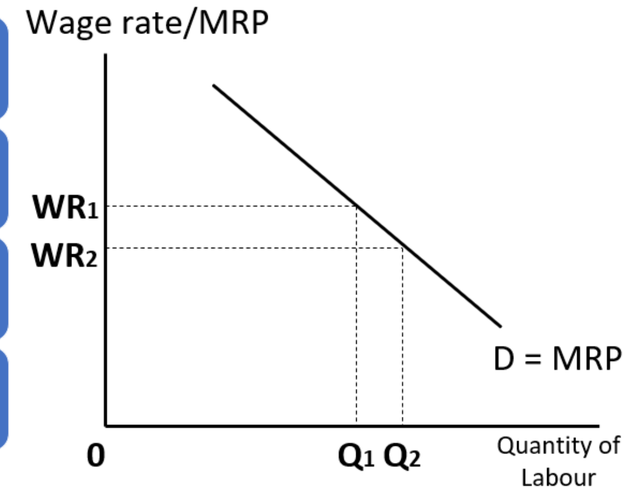
The demand curve for labour

Demand and supply theory for labour is similar to demand and supply theory for a product.

The wage rate is the price of labour rather than the price of a product.

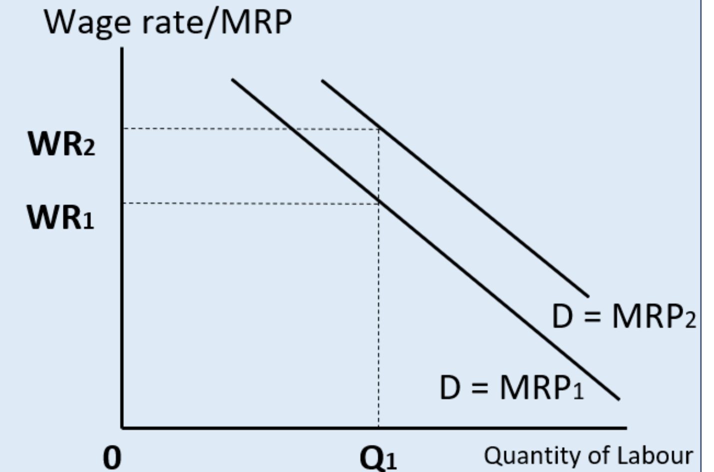
At a wage rate of WR1

the quantity demanded of labour will be Q1. If the wage rate falls to WR2 the quantity demanded for labour will increase to Q2.



Shifts in the demand curve for labour

- The demand curve for labour will shift if either the productivity of labour or the price of the product sold changes.
- A shift in the demand curve from MRP1 to MRP2 means that the MRP for labour has increased at any given output e.g. Q1.



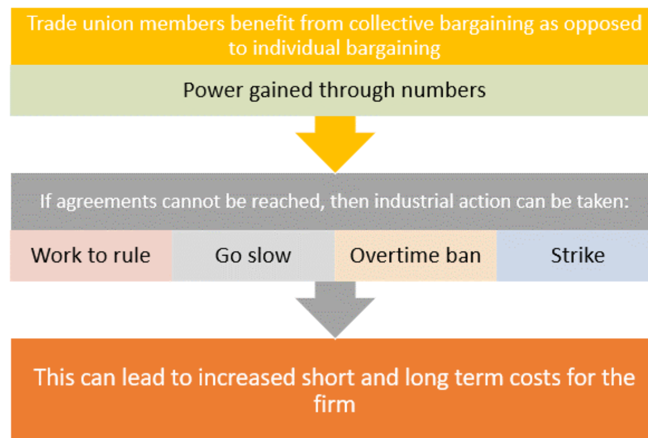
3.5.2 – Wage rates

The importance of skills, training, and education

- On average, those with a degree earn more over their lifetime than those who gain just A Levels.
- Jobs which require more training and education offer higher wages. Training workers is expensive for firms, so they compensate for this by offering higher wages to workers who have already undergone education and training.
- The wage gap between skilled and unskilled workers has increased in the UK recently. This is due to technological change and globalisation, which has shifted production abroad.
- Skilled workers produce higher outputs than unskilled workers because they are more productive, so the demand for their labour is higher. This means they can demand higher wages.

Impact of trade unions and professional bodies

- Individual bargaining occurs when one employee negotiates with an employer on their own behalf.
- Collective bargaining occurs when a trade union negotiates with an employer on behalf of all employees.
- Industrial action occurs when trade union members engage in activities designed to reduce productivity in the workplace. This is a tool used to persuade employers to accept union demands.
- Collective bargaining and industrial action are used to influence wages and levels of employment.

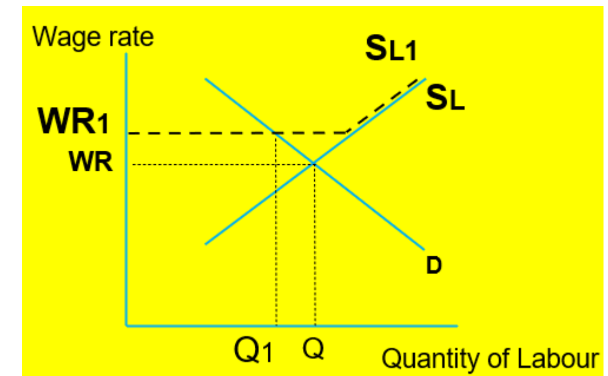


The impact of global competition, recession and redundancies

- Global competition, recession and redundancies all have the effect of lowering wage rates
- Demand for labour is impacted by a recession, leading to redundancies
- Redundancies create a surplus supply of labour, thus forcing down wage rates
- Globalisation has allowed global firms to cut wage costs by moving to developing countries where wages are not as high
- Global competition thus has a negative impact on wage rates

The effect of trade unions and professional bodies on perfectly competitive labour markets

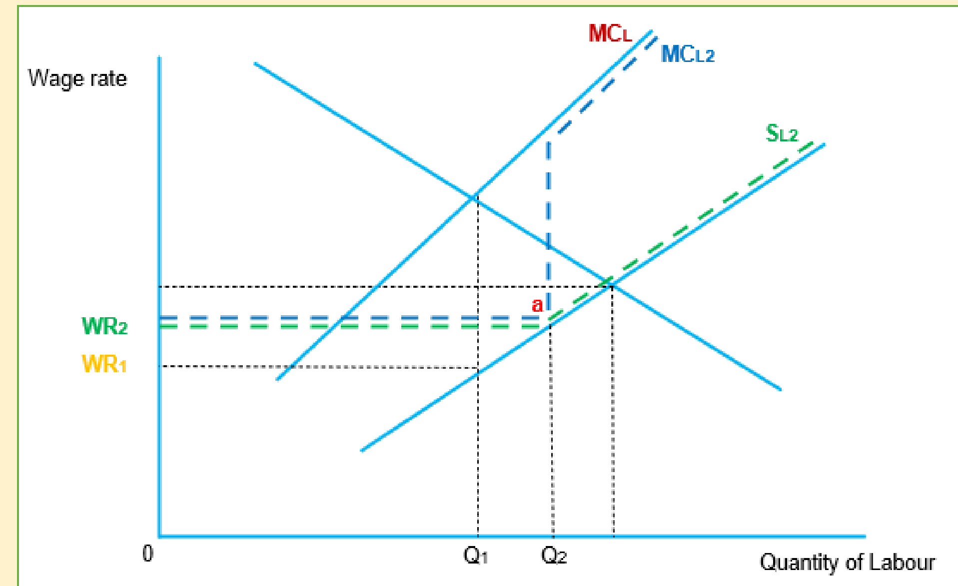
- A perfectly competitive labour market is in equilibrium where D = S.
- If a trade union operated they might be able to bargain a wage rate above that of the market equilibrium price e.g. at WR1.
- This would lead to a higher wage rate and therefore a greater supply of labour.
- This would create a new supply curve, S1.
- However, demand for labour would fall leading to excess supply of labour and higher unemployment of Q – Q1.



3.5.2 – Wage rates

The effect of trade unions and professional bodies on a monopsony labour market

- If a trade union exists in a monopsonist market it can lead to higher wages **and** higher employment than under conditions of monopsony on its own.
- The perfectly competitive market for labour would operate at Q with a wage rate of WR.
- Under monopsony the new equilibrium would be Q1 and WR1.
- If a trade union was to operate alongside a monopsonist this would see an equilibrium of Q2 and WR2.
- If a trade union also works in a market with a monopsonist they might be able to bargain a higher wage rate e.g. WR2. This will create a new supply curve, SL2.
- A new MC curve will be created. It will follow the supply curve up to point **a** as all additional workers up to this point will be paid the same wage rate. After point a it returns to its original position. To attract more workers the firm will have to pay higher wages to all workers meaning that the MC curve becomes steeper than the supply curve. The combination of a trade union and monopsony will lead to a new equilibrium at Q2 and WR2.



3.5.3 – Minimum wage legislation

Monopsony

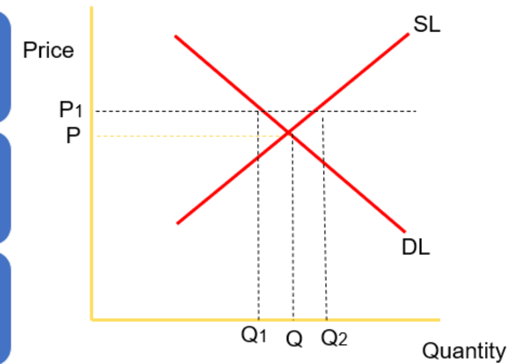
- A monopsony is a market structure in which a single buyer substantially controls the market as the major purchaser of goods and services offered by many would-be sellers.
- Most examples of monopsony have to do with the purchase of workers' time in the labor market, where a firm is the sole purchaser of a certain kind of labor.
- The classic example of a monopsony is a company coal town, where the coal company acts the sole employer and therefore the sole purchaser of labor in the town.

Minimum wages

The imposition of a minimum wage at P1 will lead to excess supply of labour of Q1 Q2 as individuals will wish to supply more at a higher price.

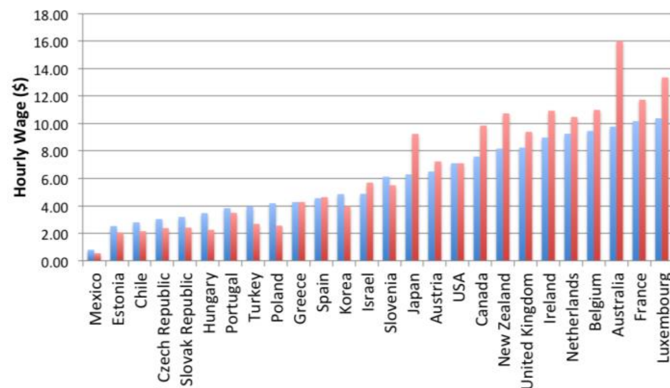
The national minimum wage was introduced by the Labour Government in 1998 in attempt to redistribute income to low paid workers.

The theory suggests that the demand for workers will be lower than the equilibrium level and there will be an excess supply of labour.



Minimum wages in developing countries

- A minimum wage in a developing country might lead to better standards of living
- As workers earn more demand will increase and this could lead to higher tax revenues for the government
- However, this could lead to significant problems in terms of international wage competitiveness
- Developing countries often rely on low wages to create a competitive advantage
- Multinational corporations will look to locate production in low cost economies and might relocate if wage costs become too high
- This is particularly important as developing countries tend to produce products e.g. textiles that are sold in competitive markets
- Therefore, a minimum wage might be counterproductive



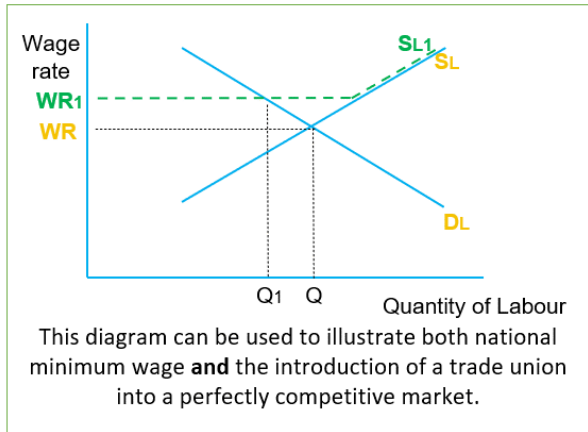
UK national minimum wage

- The National Minimum Wage Act 1998 was introduced to pay a fair wage to low paid workers
- Firms must pay at least a minimum wage per hour for a job
- The national minimum wage impacts on firms because:
  - Wage costs will be higher
  - Or less jobs will be offered!
- Firms could be taken to court for ignoring it
- The reputation of the firm may suffer if they fail to comply
- Firms in London have voluntarily signed up to a living wage

Should the national minimum wage be increased?	
Arguments for:	Arguments against:
• Encourages people to supply labour • Reduces inequalities • Reduces welfare burden • Increase aggregate demand • Improves standards of living	• May create unemployment • Interferes with the workings of the market mechanism leading to the misallocation of resources • Reduces UK competitiveness • Lowers aggregate supply

3.5.3 – Minimum wage legislation

The effect of a national minimum wage on perfectly competitive labour markets



This diagram can be used to illustrate both national minimum wage **and** the introduction of a trade union into a perfectly competitive market.

A perfectly competitive labour market is in equilibrium where D = S.

If a national minimum wage existed firms would have to pay a wage rate above the market equilibrium price e.g. at WR1.

This would lead to a higher wage rate and therefore a greater supply of labour.

This would create a new supply curve, SL1.

However, demand for labour would fall leading to excess supply of labour and higher unemployment of Q – Q1.

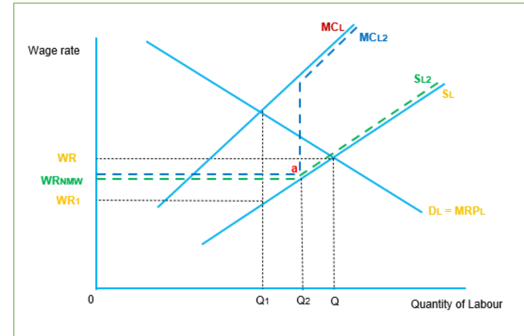
Skills shortages and their impact on international competitiveness

- Minimum wage legislation should lead to an increase in the supply and quality of labour
- As wages rise over time more workers will offer their services to the labour market
- To do this they will require appropriate skills
- This will be more problematic in the short term; in the long term it will see workers being trained and educated
- However, minimum wages will attract more skilled workers from lower wage economies
- These will ensure that those economies with higher minimum wages have a greater supply of skilled workers
- This will increase productivity and lead to greater international competitiveness
- This will adversely affect those economies that they leave

Migration within economies

- Workforces show greater flexibility within economies e.g. movement between regions in the UK
- In emerging economies such as China minimum wages are set by local governments e.g. Shanghai

The effect of a national minimum wage on a monopsony labour market



- If a national minimum wage is created in a monopsonist market it can lead to higher wages and higher employment than under conditions of monopsony on its own.
- The perfectly competitive market for labour would operate at Q with a wage rate of WR.
- Under monopsony the new equilibrium would be Q1 and WR1.
- If a national minimum wage was introduced in a monopsony market this would see a new employment and wage level of Q2 and WRNMW.

Inequality and incentives

- Minimum wage legislation can help to reduce inequality in society by reducing wage differentials
- It can help to provide a wage closer to one required for a sustainable standard of living but only if it is effectively implemented
- However, the minimum wage is often below the level required to maintain decent living standards
- In some areas, such as London, high demand for labour has meant that the wage rate in most jobs is higher than the minimum wage, making it superfluous to requirements
- As wages rise there is a greater incentive to work for low paid workers
- In the UK, reductions in welfare payments have increased the incentive even more, as the differential between the minimum wage and welfare benefits increase

Migration between economies

- Workers are more willing to move across national borders in search of employment at higher wage rates. Free movement of labour has made this much easier
- Globalisation allows the best talent to move quickly and easily across borders, creating a ‘brain drain’
- Less skilled workers can undercut wages in developed economies as the workforce of poorer countries seek to better their standard of living

3.6.1 – Poverty and inequality

Poverty

- Poverty occurs when individuals or households are deprived of material possessions and income which stops them from having a decent standard of living
- Absolute poverty means that individuals or households are deprived of basic human needs
- Relative poverty occurs when individuals or households are poor in comparison to the rest of the population
- Inequalities in the distribution of income and wealth are a main reason for poverty

Causes of poverty

Age	– As the economy grows each generation is richer than the previous one – Many retired people rely on the state pension – This is linked to inflation but has fallen behind the level of real earnings – Therefore, older people are more likely to suffer relative poverty
Low wages and unwaged	– Average earnings growth has outstripped that of unemployment benefit payments – Low skilled workers have found earnings are not enough to pay for basics such as heating – The national minimum wage was introduced in 1998 to help alleviate this and firms in London have signed up to a 'living wage' – Supply of labour is elastic in low paid industries leading to low wage rates

Measures of national poverty

- Minimum income standards (MIS) – a measurement of what is required to achieve a minimum acceptable standard of living
  - Income is a main way of measuring poverty. Less equal distribution of income and wealth will lead to increased poverty as more people live below the poverty line leading to a less fair and less inclusive society
- Households Below Average Income (HBAI) – based on government statistics, the poverty line is said to be where household income is below 60% of median household incomes
  - The poverty line is 60% of the median household income and is used as a measure in EU and OECD countries
  - The headcount ratio is the percentage of the population below the poverty line
  - This is seen as the minimum income required for a decent living standard
- Material deprivation – how affordable a basket of goods and services is in order for individuals to have an acceptable standard of living in their own country
  - Material deprivation looks at measuring poverty over the long-term
  - It looks at the impact on households over a long period of time
  - These are less likely to be able to build up any wealth or possess assets that individuals often take for granted e.g. house and car
  - Other measures can be used but are often difficult to measure e.g. poor family environment, poor health, poor schooling and bad household debt
- Consumption can be used to measure poverty
  - This is more likely to take into account the ability to purchase goods and services
  - Income is often measured pre-tax and therefore does not give an accurate measurement of purchasing power
  - For example, an individual working on a low income might have less disposable income than an individual claiming welfare benefits and not working
- If people don't feel a part of society and have enough means for a decent standard of living, greater social problems are likely to occur leading to:
  - Increased crime
  - A less safe environment for all
  - Social tension
  - Reduced happiness

3.6.1 – Poverty and inequality

Measures of international poverty

- The international poverty line is a global measurement of poverty
- It looks at the purchasing power of individuals within a country in dollar terms
- This uses purchasing power parity to take into account the cost of living in each country
- In 2022 the World Bank used an income of $2.15 a day, below which an individual lived in extreme poverty
- The poverty gap index measures how far, on average, individuals are from the poverty line
- This takes into account the depth of poverty in a country

Effects of poverty

- Income will be redistributed back to higher earners with increased saving and wealth
- There may be increased investment as the returns for entrepreneurs improve e.g. lower tax rates
- Capitalism can exacerbate levels of inequality as the capitalist owns the means of production
- The ownership of assets will lead to higher income leading to even greater inequality in the future

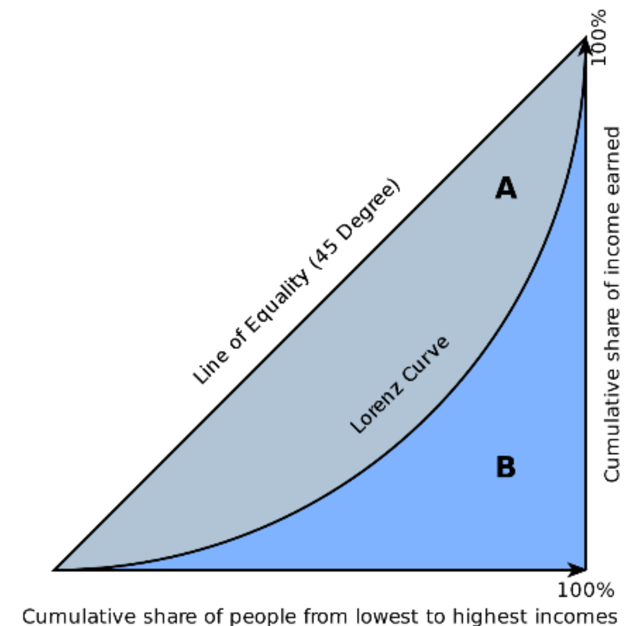
The Lorenz Curve

- It shows the distribution of income within a country.
- The straight line is indicative of perfect equality (distribution of income).
- The further away the curve is from the line of perfect equality, the more unequal the distribution of income in that country.
- The graph itself shows % of households plotted against % of income.

The GINI coefficient

- The Gini coefficient measures the inequality among the values of a frequency distribution, such as levels of income.
- The Gini coefficient is derived from the Lorenz curve.
- A value of 0 means complete equality of income distribution whilst a value of 1 means complete inequality of income distribution (one person/household holds all income).
- It is calculated using the Lorenz curve together with this formula, where A+B shows all of the income within an economy:

$$\text{Gini} = \frac{A}{A+B} = \frac{\text{Area between curve and line of equality}}{\text{Area under curve}}$$



3.6.2 – Reducing poverty

Economic development and economic growth

- Economic development – The process of improving people's economic well-being and quality of life.
- Economic growth – An increase in the long-run productive capacity of an economy.
- The definition of economic development is perhaps a little vague and therefore open to interpretation, however broad themes include:
  - Higher living standards
  - Improved availability of basic needs
  - Expansion of opportunity via education and enhanced healthcare
  - Improved resource allocation and sustainability
- Economic development is very difficult to achieve without economic growth but if a country enjoys economic growth it does not automatically follow that economic development is occurring

The Human Development Index (HDI)

- The HDI was constructed by the United Nations and is a composite measure of
  - Life expectancy
  - Mean and expected years of schooling
  - Gross National Income per capita
- The Human Development Index (HDI) is therefore a summary measure of average achievement in key dimensions of human development: a long and healthy life, being knowledgeable and having a decent standard of living
- The three measurements are equally weighted
- They are ranked in an index from best to worst
- The top mark is 1 and the bottom 0
- However, it does not take into account poverty or other measures of deprivation
- The index is set out like a league table with four divisions:
  - Very high human development
  - High human development
  - Medium high human development
  - Low high human development

Characteristics of less developed countries

- The term less developed country covers a wide variety of different types of country with different challenges, but broadly speaking, less-developed countries have the following typical characteristics:
  - High dependence on agriculture and over-reliance on the primary sector
  - Low savings and investment rates
  - Core infrastructure problems
  - Poor human capital
  - Limited technological capacity
  - High debt burden of central government limiting capacity to invest in capital
  - Limited ability to access free trade areas
  - Weak financial institutions that amplify difficulty in attracting FDI
  - Rapidly growing populations
  - Poor governance / corruption / unstable governments
  - Unequal distribution of income
  - A general focus on economic growth over economic development

Indicators of economic development

- The standard measure of economic development is GDP per capita, however this is a very limited approach because it fails to address the following issues:
  - The extent of income distribution
  - The pace and scale of resource depletion
  - The pace and scale of pollution and environmental degradation
  - The failure to include quality of life measures
- As a consequence, GDP per capita is quite a poor measure of economic development
- A far more inclusive measure of economic development is the Human Development Index (HDI)

3.6.2 – Reducing poverty

Years of schooling

- This is subdivided into:
  - Mean years of schooling of those aged 25
  - Expected years of schooling of those entering school

Factors that affect development and growth

- Investment
  - Investment in capital is vital for the long-term growth and development of a country. With a stagnant infrastructure and weak capital stock, a country will find it difficult to enhance GDP per capita
  - In addition, core infrastructure weaknesses in, for example, healthcare will hamper life expectancy – a core component of the HDI
- Education
  - The educational dimension of economic development is vital and involves both access to schooling and its quality
  - With enhanced education, occupational mobility can improve alongside productivity
- Training
  - Training is slightly different to education in that training involves the acquisition of specific workplace skills
  - With better access to quality training, a country's citizens are better able to enhance their employability and occupational mobility, and with it their income levels
  - With higher income levels, citizens may be able to improve their access to healthcare too

Barriers to development and growth

- Corruption
  - The dishonest or fraudulent conduct by government officials or others in positions of power and influence can significantly hamper growth and development
  - Often, in less-developed countries, corruption is widespread and pervasive in all areas of life
  - This leads to a poor and/or inefficient use of scare resources, higher prices and acts as a disincentive for overseas investors
- Institutional factors
  - A country's primary institutions such as governments, financial markets, judiciary and public administration are vital in the efficient daily operation of a country
  - Less-developed countries tend to suffer from weak public institutions that are either poorly funded, poorly managed or both. They may also suffer from corruption which exacerbates problems
  - In contrast, the UK with a fully independent Bank of England guiding monetary policy, is far better placed to help the UK grow and develop
- Poor infrastructure
  - Less developed countries typically have poor core infrastructure in terms of roads, railways and telecommunications
  - For businesses operating in these countries this makes it difficult for them to access markets, raises costs or take advantage of technological progress
  - Infrastructure is typically funded by public institutions, and if these are also weak or corrupt then infrastructure projects are likely to be underfunded or poorly targeted
- Inadequate human capital
  - The collective knowledge, skills and abilities of the labour force are vital in driving forward growth and development
  - Less-developed countries require continuous investment in their labour force, which is often lacking through a combination of poor infrastructure and weak public sector institutions that fund education and training programmes
- Lack of property rights
  - Less-developed countries often suffer from a lack of clearly defined property rights, which act as a major obstacle to growth and development
  - Building a strong domestic productive capacity requires the effective operation of property rights in terms of patents, copyrights, trademarks, geographical indications and industrial design
  - Without these, insufficient incentives are given to individuals and firms to trade, innovate and develop

3.6.2 – Reducing poverty

Corruption perceptions index

- The Corruption Perceptions Index, compiled by Transparency International, measures the perceived levels of public sector corruption worldwide
- A country or territory's score indicates the perceived level of public sector corruption on a scale of 0 (highly corrupt) to 100 (very clean)

Top 10	Index	Bottom 10	Index
Denmark	91	Somalia / North Korea	8
Finland	90	Afghanistan	11
Sweden	89	Sudan	12
New Zealand	88	South Sudan	15
Netherlands / Norway	87	Angola	15
Switzerland	86	Libya / Iraq	16
Singapore	85	Venezuela / Haiti	17
Canada	83	Yemen / Syria	18
United Kingdom / Germany	81	Uzbekistan	19

Arguments For Giving aid	Arguments Against Giving aid
Basic human decency.	Foreign aid may not promote faster growth but may in fact hold it back by substituting for domestic savings and investment.
Improve the country's international image.	Aid is generally focused on the growth of the modern industrial sector. Therefore, it increases the gap in living standards between the rich and the poor in Third World countries because aid is poorly distributed and poorly managed.
Build positive working relationships with other governments.	If the aid given is concerned with unproductive fields or obsolete technology, it will have the effect of increasing inflation in the country.
Promote the conditions for peace and stability, because many governments genuinely believe we'll be safer and happier when everyone else is safe and happy.	The biggest objection is that donor countries make interference in the economic and political activities of the recipient country.

International aid and improvements in welfare

- Both aid and trade have a significant role to play in reducing poverty
- The extent to which each should have a role however is a key source of debate amongst economists
- Aid can be defined as the voluntary transfer of resources from one country to another
- There are many different types of aid that exist for less-developed countries

Types of aid

- Emergency Aid / Disaster Relief
  - One off injections of cash to help a country facing a humanitarian crisis e.g. 2010 Haiti earthquake
- Tied Aid
  - One country donates money or resources to another (bilateral aid) but with conditions attached.
- Bilateral Aid
  - Bilateral aid is assistance given by a government directly to the government of another country; typically capital flows from a developed nation to a developing nation. It is often directed according to strategic political considerations as well as humanitarian ones
- Multilateral Aid
  - Multilateral aid is assistance provided by many governments who pool funds to international organizations like the World Bank, United Nations and International Monetary Fund that are then used to reduce poverty in developing nations
- Developmental Aid
  - Funds are used to finance a particular project, such as a school or a hospital
- Debt Relief
  - Debt forgiveness can save less-developed countries vital funds that can be re-directed to internal investment projects

3.6.2 – Reducing poverty

Poverty and non-governmental organisations (NGOs)

- A non-governmental organisation (NGO) is one that is not-for-profit and is independent of government
- NGOs cover a variety of diverse areas, including the fight against poverty
- Aid is often channelled through an NGO, who have the infrastructure and capacity to deal with funding and aid placement
- They are seen as a third force, aligned with governments and multinational corporations as helping to defeat poverty
- However, as they are often funded by these organisations, they are sometimes believed to have ulterior motives linked to the wishes of governments and businesses

Poverty reduction policies

- There are a wide range of policies that might be used to reduce poverty
- They can be generally classified as:
  - Market based strategies
  - Interventionist strategies

Market based strategies

- Privatisation and de-regulation
  - The removal of government influence and control from business activities should help to drive efficiency and productivity gains
- Establishment and enforcement of property rights
  - If property rights can be established and enforced, this can help to drive business innovation and development
- Trade liberalisation
  - Countries that open their borders to international trade can benefit from specialisation and the principals of comparative advantage
- Macroeconomic stability
  - If the government can achieve macroeconomic stability, this is likely to give more confidence to investors and consumers as well as attract crucial FDI. It will also give more funds that can be spent on vital public services such as schools, hospitals and infrastructure

Interventionist strategies

- More centralised state planning
  - It could be argued that with a more command control economy the government can direct public funds and ensure that resource allocation is maximised and environmental depletion and degradation minimised
- Infrastructure investment
  - It is likely that if left to the free market, core infrastructure such as roads, railways, bridges and telecommunications would be underprovided, hence large scale intervention in these projects is required
- Education and training
  - Similarly, it is likely that if left to the free market, sufficient education and training opportunities would not be provided, thus intervention in this area is vital for economic development
- Protectionism
  - Often, less developed economies are unable to compete on international markets in terms of price, choice and quality, so protectionist measures that support exports and domestic industry can promote a cycle of inward development that isn't hampered by global capitalism

3.6.3 – Impact of inequalities on economic agents

Inequalities in income and wealth

- Income inequality occurs when there is a disparity in the flow of earnings of individuals or households.
  - The greater the differential, the greater the inequality.
- Wealth inequality occurs when there is a disparity in the stock of financial assets e.g. houses owned by individuals or households.
  - The greater the differential, the greater the inequality.
- Inequalities in income and wealth occur when there are differentials in their distribution for individuals and households
- An individual's ability to consume goods and services depends upon his/her income and wealth
- An unequal distribution of income and wealth may result in an unsatisfactory allocation of resources

Impact of inequality on firms

- Low income is a sign of low productivity as the marginal revenue product of an individual is likely to be lower
- Lower productivity levels will lead to a less competitive organisation
- As those on low incomes have a marginal propensity to consume close to 1 it is likely that demand for goods and services will be lower
- If income was redistributed to low income earners greater demand would benefit firms

Impact of inequality on individuals

- Inequality impacts on the standard of living and quality of life on individuals
- Lower income means that there is less purchasing power, so less consumption of goods and services
- There is an inability to consume merit goods such as education and health
- This exacerbates the inequality as the individual will find it harder to improve their human capital
- With little or no income left after consumption the individual does not have the means to undertake saving, therefore an inability to buy assets
- With little or no income left after consumption the individual does not have the means to undertake saving, therefore an inability to buy assets
- This means that there is likely to be significant wealth inequality and an inability to earn income from the ownership of assets e.g. shares
- Wealth is passed on through the family line, inherited by children
- This leads to wealth, and income, inequality passing through generations

Impact of inequality on economy

- Government will continue to redistribute income and wealth to poorer earners
- This is paid for through taxation and will affect government borrowing
- Less funding will be available for infrastructure
- This will impact on the capacity of an economy, leading to less economic growth in the future
- Individuals with high incomes and wealth will save, leading to a withdrawal from the circular flow and less demand in the economy

3.6.4 – Re-distribution of income and wealth

Definitions

- Income is measured by the flow of earnings of individuals or households.
- Wealth is measured by the stock of financial assets e.g. houses owned by individuals or households.

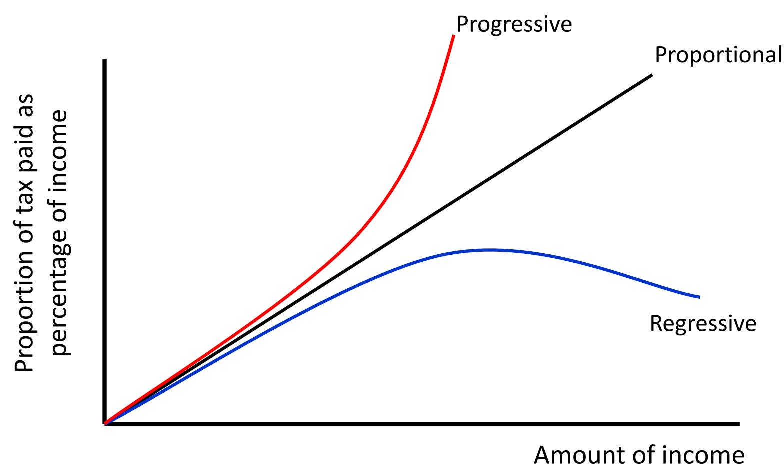
Income and wealth

- There is a correlation between income and wealth
- Wealth is a stock concept
  - Assets owned e.g. buildings, land, savings, shares
  - Human wealth e.g. skills and education
- Income is a flow concept
  - Money generated from wealth e.g. wages, rent, interest
- As income flows from the stock of assets a nation's income and wealth are directly correlated

Tax definitions

- A proportional tax is also known as a flat tax .
- A progressive tax means that a higher rate of tax is paid as incomes increase. This can be seen with our current income tax system.
- A regressive tax is one where a lower rate of tax is paid as incomes increase.

Progressive, regressive and proportional taxation



Distinction between income and wealth

- The distribution of income and wealth looks at the differences for individuals and households
- This might be geographically, occupationally or by gender
- An individual's ability to consume goods and services depends upon his/her income and wealth
- An unequal distribution of income and wealth may result in an unsatisfactory allocation of resources

Incentives and poverty trap

- The Poverty Trap is any mechanism that stops those on low incomes from getting out of poverty
- This may occur because they would be financially worse off by working so there is a lack of incentive to find employment e.g. unemployment benefit is greater than low paid work
- By remaining unemployed the individual becomes more deskilled e.g. not benefitting from any work-based training
- Confidence in one's own abilities continues to decline and it becomes even harder to find work in the future
- Governments have looked for different ways out of the poverty trap. Providing incentives to work can take a variety of forms:
  - Increasing the tax threshold – this means that workers do not pay income tax on a proportion of their income. In 2016-17 this will rise from £10 600 to £11 000
  - Universal Credit sets strict guidelines for individuals that can claim welfare benefits. By reducing benefits there is a greater incentive to work
  - Support e.g. in the form of education, training and advice helps individuals improve their human capital. This gives access to better jobs

3.6.4 – Re-distribution of income and wealth

Taxation and the provision of services

- Government policies can be used to make society more equal by creating incentives and providing services. For example:
    - Progressive taxes
    - Increasing inheritance tax
    - Extending universal benefits
    - Increasing the National Minimum Wage
    - Increased spending on public and merit goods
- Universal credit is replacing a number of means tested benefits such as jobseeker's allowance and housing benefit.
    - It will also replace child benefit.
- A proportional tax is one with a constant marginal rate
- As income rises so does the amount of tax
- For example, with a proportional rate of tax of 20%:
    - Earnings of £10 000 would pay £2 000 in income tax

Advantages

- simple to understand
- easy to calculate
- greater transparency so might lead to less tax evasion

Disadvantages

- burden falls on poorer members of society
- therefore, creates greater inequality

- The Government
    - Government policy redistributes income from richer to poorer members of society
    - A progressive tax will increase the proportion of tax as workers earn more, a regressive tax the opposite
    - The UK has a welfare system e.g. the National Health Service and Universal Credit that redistribute income to the less well off in society through welfare benefits
    - Merit goods such as education and health are deemed important in re-distributing income and wealth
- Labour market incentives can be enhanced through the creation of incentives to work via the tax system
- The threshold before individuals start paying income tax has increased from £10 660 in 2015-16 to £11 000 in 2016-17 providing a greater incentive for low paid workers to join the workforce
- In the UK, income tax is a progressive tax system meaning that, as incomes rise, the greater the proportion of their income an individual pays in tax