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A2 GCE ECONOMICS

F585/01/SM The Global Economy

STIMULUS MATERIAL

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INSTRUCTIONS TO CANDIDATES

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- You should make yourself familiar with the stimulus material before you take the question paper. A clean copy of the stimulus material will be given to you with the question paper.

INFORMATION FOR CANDIDATES

- The following stimulus material has been adapted from published sources. It was correct at the time of publication and all statistics have been taken directly from the published material.
- This document consists of **16** pages. Any blank pages are indicated.

Introduction

Until 2008, globalisation was increasing at a rapid rate, with rises in global trade, Foreign Direct Investment (FDI) and migration of workers being some of the most obvious indicators. The increasing volume of world trade owed much to reductions in trade barriers. The process of globalisation as a whole, however, has been driven by a range of factors. Globalisation has attracted much controversy, but economists are generally agreed that specialisation and trade can bring benefits to all of the world's economies. The global financial and economic crises of 2007–08 appeared to threaten the march of globalisation, but such fears were short-lived.

While the volume of world trade has increased, balance of payments imbalances have emerged. These imbalances can be seen not only in the current account positions of economies such as the USA and China, but also in the current account performance of other developed and developing economies. These current account imbalances have not always responded to changes in exchange rates, leading some economists to seek explanations for the imbalances in international financial flows. Such flows have responded to macroeconomic imbalances between economies.

Developing economies dependent on exports of commodities benefitted greatly from the growth of the world economy prior to the global economic and financial crises of 2007–08. As commodity prices increased significantly, economies of countries such as Zambia were able to put measures in place to improve a number of indicators of development. It was feared that the sharp decline in commodity prices in 2008–09, which led to a fall in Zambia's terms of trade, would have a significant impact on its economy. The recovery of world economic growth and trade, however, dispelled such fears.

The greater global mobility of labour has also increased international financial flows in the form of remittances. For many developing economies these are now more significant than flows of Official Development Assistance (ODA) and play an important role in reducing poverty and promoting development. However, their impact on development also brings costs.

Zambia's macroeconomic performance has benefitted not just from the increase in global commodity prices in the first decade of the 21st century. It has also undergone a shift in the composition of its aggregate demand which may enable it to increase long run economic growth. Private sector investment is now much more important and has replaced a dependence on public sector investment and public and private sector consumption. This is likely to have a favourable effect on the supply-side performance of the economy. Nevertheless, the growth of private sector investment has recently slowed down, as fears of 'resource nationalisation' have deterred FDI. Reforms to the supply-side of the economy are seen by some as the key to promoting long run economic growth in Zambia.

Pre-release stimulus material

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Extract 1

Globalisation and world trade

Since the start of the 21st century trade in goods and services has become more globalised, as have capital and labour markets. The closer links between the world's economies are seen in a number of indicators. These indicators include:

- the value of trade in goods and services as a percentage of world GDP is increasing
- FDI as a percentage of world GDP has increased six-fold since 1980
- the number of migrant workers has trebled since the 1960s.

It is argued that globalisation brings significant benefits both to individual economies and to the global economy as a whole. It opens up markets throughout the world, promoting specialisation and division of labour as economies focus production according to their comparative advantage. Economies can access larger markets than would be the case without globalisation. They can access more capital goods and more advanced technology, as well as larger markets for their exports. At the same time they can benefit from cheaper imports. Economic theory provides strong support for the process of globalisation in terms of the benefits of increased economic efficiency.

One of the many factors promoting globalisation has been a reduction of trade barriers, including import tariffs. Access to a wider range of goods and services at lower prices not only provides benefits to consumers but also encourages domestic industries to increase their competitiveness. Exports create jobs and, for many developing countries, are a source of economic growth. Fig. 1.1 shows the change in trade in goods and services (exports plus imports) as a percentage of GDP for four different economies:

- Malawi – a low income economy
- Zambia – a lower-middle income economy
- Brazil – an upper-middle income economy
- Australia – a high income economy.

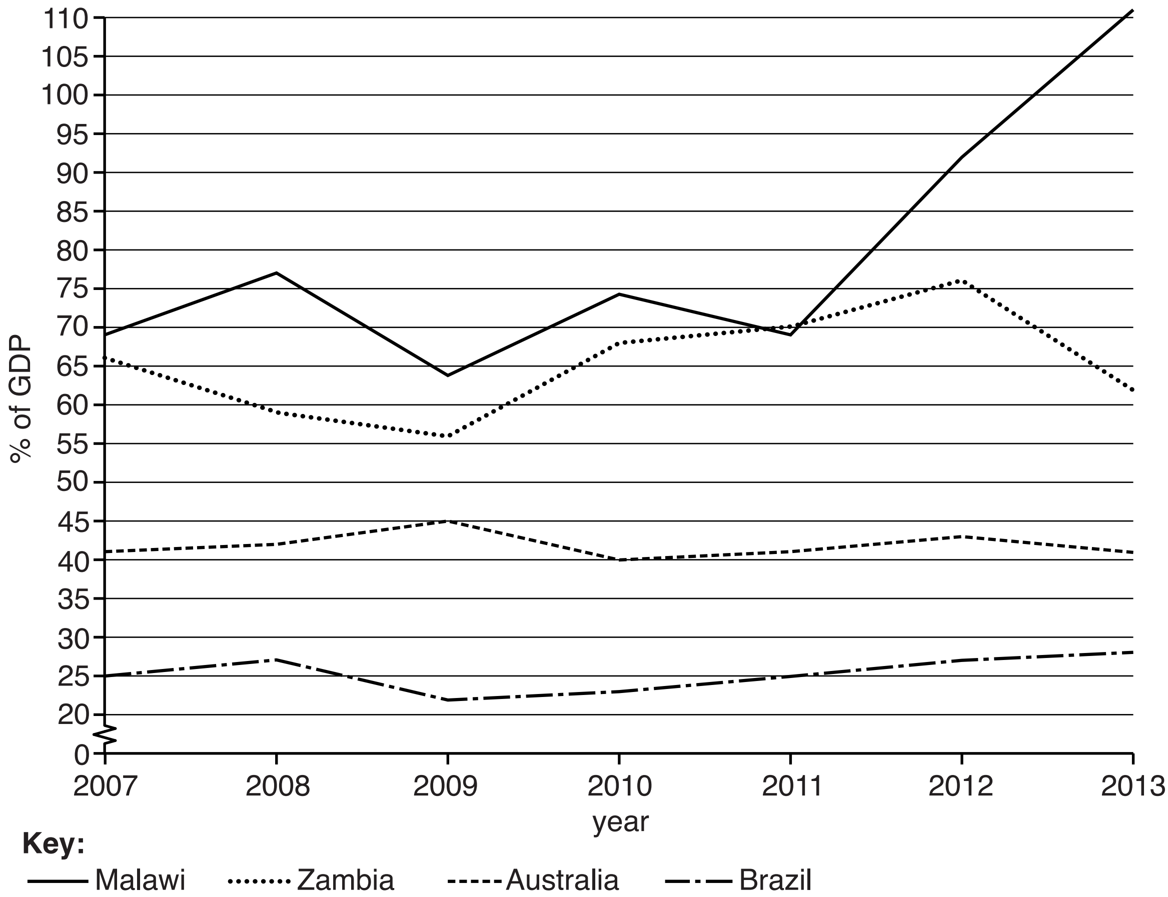


Fig. 1.1 Trade as a percentage of GDP for four selected economies

In 2007–08, financial and economic crises in high income developed economies reduced the growth in world trade as their effects spread to the global economy. There was a fear that the sharp increase in unemployment, particularly in developed economies, would lead to protectionist measures. However, fears of global trade wars quickly subsided and the growth in world trade recovered in 2010.

Extract 2

Globalisation and balance of payments imbalances

While globalisation has brought about an increase in the volume of world trade, it has also increased balance of payments imbalances. Much of the discussion about these global imbalances has focused on China's current account surplus and the USA's current account deficit. Fig. 2.1 shows the trend in the balance of payments on the current account of China and of the USA.

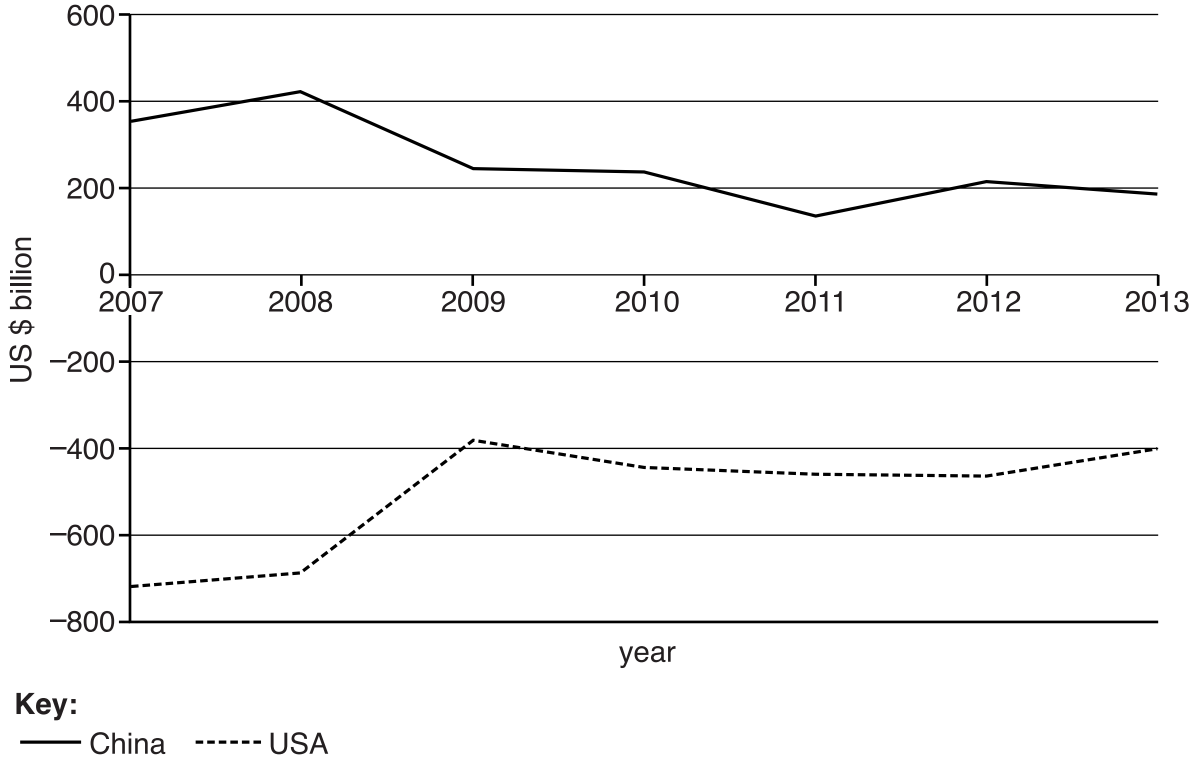


Fig. 2.1 Current account balances of China and of the USA

The period between 2007 and 2013 saw fluctuations in the current account deficit of the USA and in its effective exchange rate index*. Changes in its effective exchange rate (see Fig. 2.2) did not always have the expected impact on the USA's current account deficit.

* *the effective exchange rate index is a weighted average value of a country's currency relative to all major currencies, with the weights determined by the importance of trade conducted in each currency*

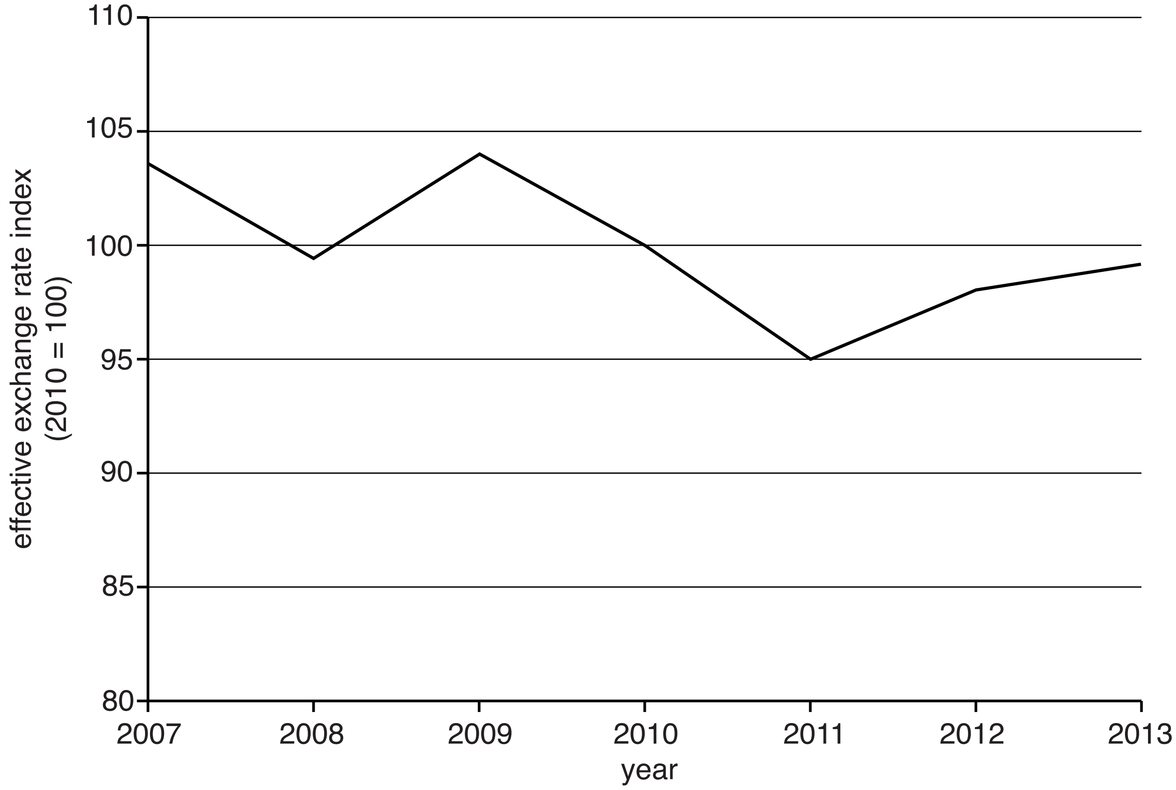


Fig. 2.2 Effective exchange rate index of the US dollar (2010 = 100)

The other part of the picture of global imbalances is reflected in international financial flows from developing to developed economies. Savings from poor countries have flooded into the USA seeking returns in US government bonds and in the US housing market. These international financial flows help fund consumer spending in the USA and they provide an outlet for excess savings in developing economies where financial markets are not always developed. These international financial flows are recorded on the financial account of the balance of payments of individual economies. Countries with a current account deficit experience inflows on the financial account of the balance of payments, and countries with a current account surplus experience outflows. So international finance flows from poor to rich countries such as the USA.

Extract 3

Primary commodity dependence and the terms of trade

A number of developing countries are heavily dependent on exports of commodities for foreign exchange earnings. For example, approximately three quarters of Zambia's export revenue comes from copper. Rises in commodity prices can bring significant benefits to economies such as that of Zambia, including increases in tax revenue which can be used to improve development (see Fig. 3.1).

Indicator/Year	**2000**	**2007**	**2013**
Life expectancy at birth (years)	42	50	58
Primary school enrolment (%)	84	119[1]	108[1]
Mean years of schooling	5.9	6.4	6.5
Expected years of schooling	10.4	12.2	13.5
GNI per capita, PPP (US$)	2138	1922	2898

Fig. 3.1 Key development indicators for Zambia

However, fluctuations in commodity prices can also have a significant impact on the terms of trade of a developing country such as Zambia. The trend in Zambia's terms of trade, for example, is shown in Fig. 3.2.

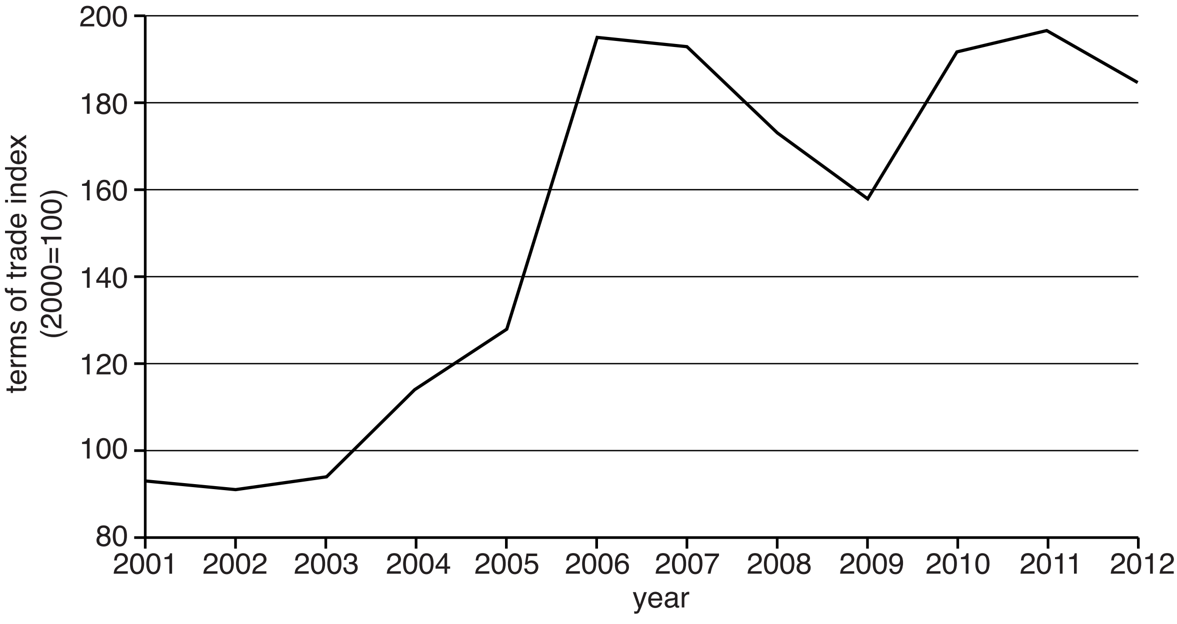


Fig. 3.2 Zambia's terms of trade

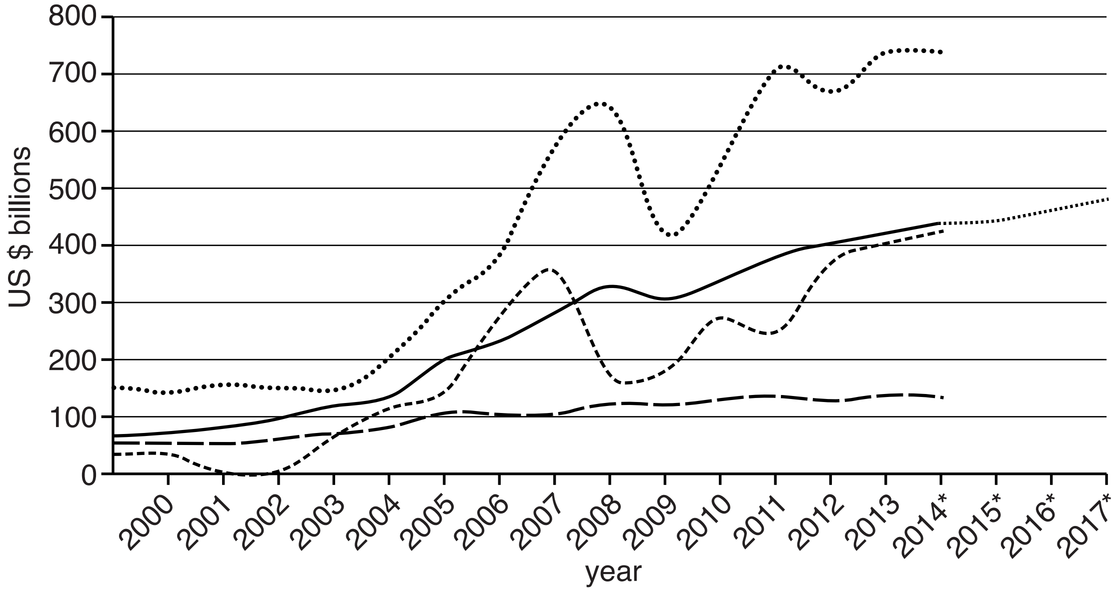
[1] *primary school enrolment measures the number of people in primary education as a percentage of the primary school age population; this figure exceeds 100% because it includes adults enrolled in primary education*

Despite the fact that copper accounts for over 75% of Zambia's export revenue, it still only contributes 10% to government tax revenue. The Zambian government has expressed concerns that multinational companies engaged in the extraction of copper, and international commodity traders, have been evading paying tax. As a result, the Zambian government temporarily suspended exports of copper in 2011 as it considered rules to improve revenue collection from the sector. This was seen by many as part of a trend in Africa towards so-called 'resource nationalisation' as African governments sought a larger share of the profits from mines, as well as expanding state control. The Zambian government has been in talks with multinational companies to acquire a 51% stake in mining operations to ensure that the benefits of resource extraction are more widely distributed among the population of Zambia. Some economists are worried that greater state involvement and higher taxes might discourage investment in mining and in other sectors of the economy, resulting in a reduction in the growth of output.

Extract 4

Migration and remittances

As globalisation has increased there has been a surge in international financial flows to both developed and developing countries. One of these financial flows, remittances, has become increasingly important for developing economies. An estimated 232 million people worked outside their home country in 2013. These workers often sent some of their earnings home in the form of remittances. In 2013 over US$400 billion of remittances were received by developing countries, far exceeding the amount received in ODA (Official Development Assistance). Remittances accounted for more than 10% of GDP in many developing countries. The extent of remittances relative to other international financial flows is shown in Fig. 4.1.



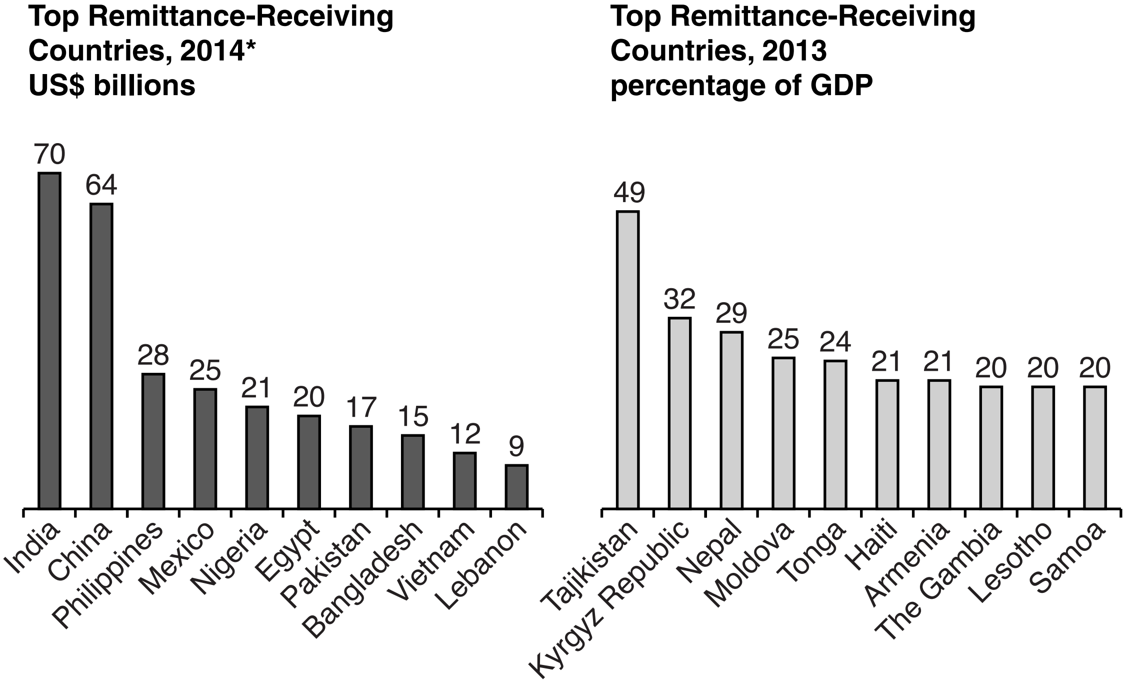
* *estimates*

Key:
- ······ FDI
- —— remittances
- — — ODA
- ----- debt and portfolio investment

Fig. 4.1 International financial flows to developing economies

Remittances are a much more stable form of international financial flow than some other financial flows and they bring many benefits to developing economies. It is suggested that migration and remittances can be significant in reducing poverty and increasing development. However, to set against this is the impact of the loss of skilled labour. According to the World Bank, smaller developing countries tend to have the highest rates of skilled emigration. Almost all doctors trained in Grenada, Dominica and Ghana, for example, now live and work abroad.

Fig. 4.2 shows the top ten recipients of remittances in US$ billion and as a percentage of GDP.



* estimate

Fig. 4.2 Top ten recipients of remittances

Extract 5

Structural issues in the Zambian economy

Compared with the rest of Africa the Zambian economy has enjoyed much more stable economic growth and was less affected by the global financial and economic crises of 2007–08. Since 2009, economic growth in Zambia has averaged over 6% per annum and inflation has fallen from around 10% to 6.5% in 2013. The tripling of global copper prices from 2009 to 2011 had a significant impact on production in the mining sector.

Zambia has gone some way in reducing its dependence on private and public sector consumption towards a greater reliance on private sector investment. However, the growth rate of private sector investment fell after 2010. In comparison, the growth of public sector investment has increased since 2010. The composition of aggregate demand and the contribution made to GDP growth by consumption, investment and net trade in Zambia is shown in Fig. 5.1.

Components of aggregate demand	**Percentage of GDP (current price)**		**Percentage changes (volume)**			**Percentage contribution to real GDP growth**		
	2001	**2009**	**2010**	**2011**	**2012**	**2010**	**2011**	**2012**
Gross capital formation	**18.9**	**21.1**	**14.7**	**4.6**	**6.5**	**4.0**	**1.4**	**1.9**
Public	11.0	3.5	13.0	30.0	25.0	0.6	1.5	1.5
Private	7.9	17.6	15.0	–0.5	1.8	3.4	–0.1	0.4
Consumption	**97.3**	**76.3**	**8.2**	**7.1**	**7.9**	**6.8**	**6.0**	**6.6**
Public	10.1	19.3	4.9	3.4	3.4	0.9	0.6	0.5
Private	87.2	57.0	9.1	8.1	9.0	5.9	5.4	6.1
External sector	**–16.2**	**2.6**	n/a	n/a	n/a	**–4.2**	**–0.9**	**–1.8**
Exports	28.1	34.6	6.8	5.6	6.0	2.7	2.2	2.4
Imports	–44.3	–32.0	13.7	5.7	7.8	–6.9	–3.1	–4.2
Real GDP growth rate	n/a	n/a	n/a	n/a	n/a	**6.6**	**6.5**	**6.7**

Fig. 5.1 The composition of aggregate demand in Zambia and contributions to real GDP growth

An assessment of the key structural issues facing the Zambian economy is shown in Fig. 5.2. This highlights the aspects on which government economic policies need to be focused in order to promote long run economic growth in Zambia.

A good business environment and increased private investment underpinned Zambia's resilience to the global financial and economic crises. The Zambian government is committed to accelerating private sector investment in order to increase and diversify economic growth. Its Private Sector Development Reform Programme (PSDRP) aims to reduce the cost of doing business and to ensure a stable environment for private investment and economic growth. To maintain annual economic growth of at least 7%, a substantial improvement in the business and investment climate is required to make it easier for private sector companies to 'do business' in Zambia. However, there remain a number of constraints on the supply-side of the economy including:

- poor access to credit
- poor infrastructure
- excessive bureaucracy
- regulation and licensing requirements.

The mining sector is expected to grow substantially. Zhonghui Mining Group of China plans to invest more than US$3 billion in copper mining in Zambia. There are various other mining projects awaiting an environmental impact assessment. About US$1 billion of investment at the Konkola Copper Mines (KCM) aims to increase the output of processed copper. KCM plans to spend about US$170 million on a plant with a capacity to process 12 million tonnes of copper ore each year. Vale Mining Company of Brazil and South African-based Rainbow Minerals have jointly agreed to spend more than US$1 billion over five years to develop the Konkola North copper mine.

Two economic zones are being developed in Lusaka, Zambia's capital. It is hoped that these zones will help expand Zambia's manufacturing base and reduce the country's dependency on imports.

Fig. 5.2 Demand and supply-sides of the Zambian economy

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