Globalisation
Detailed notes for Edexcel Economics A, unit 4.1.1 on globalisation
Written by Tom Furber, tfurber.com/edexcel-economics

Contents

What is globalisation? Characteristics of globalisation

Globalisation is the increasing interdependence of different economies.

Characteristics of globalisation include:

- **Increased exports and imports between different economies.**
  - For example, world trade as a percentage of GDP has risen from about 10% in 1950 to around 60% in 2011.
- **Increased financial flows across borders.**
  - This includes flows of money such as foreign direct investment (FDI) - investment from abroad into physical capital. This includes machines and factories.
  - FDI is just one example. There are various reasons for money flowing across borders, such as portfolio investment, remittances and foreign aid.
- **It has become quicker to communicate with and travel to other countries.**
  - Transportation has become faster and cheaper. The use of planes and shipping has enabled faster travel and shipping of goods.
  - This has contributed to an increase in migration flows across borders.
  - The internet has also made it easier for customers to buy goods from abroad and for firms to set up subsidiaries abroad.
- **The spread of multinational companies.**
  - Multinational companies (MNCs) are companies operating in multiple countries.
  - Multinational companies such as McDonald's and Coca-Cola can now be found selling to consumers in countries around the world.

    - Companies can also move their production processes abroad. For example Nike has hired over 250,000 workers in Indonesia (as of June 2025).

Which factors have contributed to globalisation?

Here are some key factors contributing to globalisation:

- **Technological improvements.**
    - This includes technological advances in IT/communications and transport.
    - This makes it cheaper and quicker to communicate and travel.
    - As a result, firms may find it easier to sell abroad and to move production abroad.
    - Workers may also find it easier to migrate as a result of improved transport.
        - However, not everyone may benefit from improvements in IT. Those in developing countries or rural areas may not be able to sell to customers abroad or buy imports online.
- **Trade liberalisation**
    - Tariff reduction, trade agreements and trading blocs have reduced costs of importing and increased imports.
    - Examples include the European Union and NAFTA.
    - Tariff reduction also makes it cheaper to export into other countries, increasing exports.
        - However in more recent times, there have been more protectionist policies such as US tariffs on steel or the UK leaving the European Union.
        - Trading blocs may also create common external tariffs on goods coming into the bloc from third countries outside the bloc.
        - Moreover, while tariffs have fallen, many non-tariff barriers remain. These include quotas, subsidies to domestic producers and customs paperwork.
        - These non-tariff barriers may be more important than tariff reduction. This means that even if tariffs are reduced, the non-tariff barriers may prevent a significant rise in trade between countries.
- **Multinational companies**
    - Multinational companies have operations in multiple countries. These companies are incentivised to sell and produce abroad in order to increase profits.
    - These large cross-border companies spread production around the world to achieve lower labour costs by offshoring. Firms can also achieve economies of scale by selling more units abroad. Ultimately this can increase profits.

        - The multinational companies may also find new markets to increase demand for their products, increasing profits on the revenue side of the equation.
            - However cultural differences and language barriers may make it harder for companies to increase demand for their product in other countries.
            - An example is the failure of US supermarket chain Walmart in Germany.
            - Moreover, instability in global supply chains, such as during Covid-19, may reduce the incentive to offshore production and lead to “reshoring” instead.
- **International financial flows**
    - Relaxed capital controls make it easier for money to flow across borders. This leads to higher foreign direct investment, which encourages growth.

<u>What are the impacts of globalisation and global companies?</u>

<u>Workers</u>

- Developing countries:
    - More foreign direct investment in the local area means higher employment.
        - As a result of FDI, there may also be multiplier effects that generate even higher aggregate demand and even higher employment.
    - Workers may receive more training funded by firms offshoring in that country. This could increase workers’ levels of human capital and pay.
    - More generally, higher demand for workers from multinationals could boost wages in developing countries.
        - **However there is a risk of worker exploitation**
        - Various clothing companies have been accused of using “sweatshops”, working in poor working conditions for longer hours.
        - Such treatment may also reduce wages, particularly if these multinational firms exert their market power to force down wages of workers (monopsony power).
        - This could worsen poverty.
- Developed countries:
    - Rising inequality is likely. Some workers may benefit while others may lose out.
    - **Higher demand for some jobs in finance and technology.**
        - This could include for example engineering, technology and finance.
        - This is due to increased demand for transport, technology and increased international financial flows from globalisation.

        - So these workers see higher demand for their labour and hence receive a higher wage.
    - **Offshoring means less demand for other workers**.
        - Offshoring is when firms move part or all of their production process to another country.
        - This is because firms may prefer to use labour from developing economies where wages are lower.
        - This typically applies to work in agriculture and some manufacturing jobs. For example coal and steel plants or car companies.
        - The UK has seen a relative decline in its share of the global car industry. This is in part due to increased international competition from among others Japan, the US and mainland Europe.
    - As a result, globalisation may increase income inequality.

<u>Firms</u>

- **Firms have access to cheaper inputs.**
    - More international competition and the ability to mine raw materials directly make raw materials cheaper.
    - Firms can also reduce production costs by offshoring factories to countries with lower labour costs .
    - This means the short-run aggregate supply curve shifts right.
    - But if firms are exposed for reducing costs by exploiting workers with poor wages and conditions, this could harm firms by reducing their revenue and hence sales.
- **Economies of scale.**
    - As firms grow in size, particularly multinational firms, they may experience economies of scale.
    - That is their long-run average costs fall as output increases.
    - For example firms may be able to bulk-buy inputs at a per-unit discount.
    - But there could also be diseconomies of scale.
- **Access to new markets**
    - While on the revenue side, firms can access new markets abroad more easily.
    - This increases the demand for firms' products abroad, boosting exports.
    - At the economy level, this can boost aggregate demand (AD). This is because exports are a component of AD.
- **Higher profits especially for multinational companies**.

- This all means higher profits for firms, which may be reinvested into improving the quality of the product or reducing costs.
- It may also make the shareholders of the firm better off.

- **Other firms may be worse off from greater competition.**
    - Yet there are some firms that may be worse off as a result of international competition.
    - Local firms in developing economies may be crowded out by multinationals that pay higher wages to their workers.
    - In addition, primary and secondary sector firms in developed economies see reduced demand owing to increased international competitors that can produce the same goods more cheaply.

<u>Consumers</u>

- **Lower prices**
    - Consumers see a reduction in prices because of reduced tariffs, increased international competition and reduced firm costs from offshoring being passed on to the consumer.
    - A tariff diagram could show the increase in consumer surplus as a result of trade liberalisation.
- **Effects on variety and quality**
    - With greater competition may come more options. For example fruits that can only be grown in certain countries or at certain times of year.
    - There may also be competition on a quality basis, driving up the quality of goods.
        - However there could be a "race to the bottom" in quality standards as firms compete to reduce costs.
- **Consumer boycotts**
    - Consumers may care about factors other than just cost. Consumers could protest with a boycott of certain products to push up workers' wages and working conditions for example.
    - An example of this is the Fairtrade initiative to give a fair price for those who produce coffee beans.
- **More imports**
    - At a macroeconomic level, there may be more imports as a result of the wider choice of consumers.
    - This may improve consumers' standard of living but may lead to a shift left in aggregate demand, as well as a greater leakage from the circular flow of income.

    - This depends on how self-sufficient the country is as well as its marginal propensity to import.

<u>Government</u>

- **Governments may reduce their corporation tax rates** or other tax rates to attract multinational companies. Throughout the last few decades, most OECD countries have seen corporation tax rates decline.
- **Governments may also lose revenue** because of companies relocating or because companies may redirect their profits to low tax areas.
    - But more recently we have seen an agreement signed by 136 countries to have a minimum corporation tax of 15%. In theory, this may mitigate some of the profit shifting.
- **There may be deregulation** to encourage businesses, particularly multinationals who may have bargaining power over governments, to use that country for business.
    - This could for example harm workers' rights.
    - One could argue that bodies such as the United Nations could come up with international agreements in order to stop this but this may be difficult in practice.
- When it comes to more advanced economies, higher pay for skilled workers may mean **more government revenue**.
    - However higher unemployment in primary resource and manufacturing industries, due to offshoring, may mean higher government spending on welfare benefits.

<u>The environment</u>

- Greater use of transportation and shipping, as well as increased industrialisation around the world, are likely to increase emissions of greenhouse gases, harming the environment. Building roads and airports may destroy habitats.
- Specialisation under free trade and comparative advantage could lead to overexploitation of resources and lower biodiversity. Deforestation in Brazil may serve as an example of this.
- However improvements in efficiency driven by specialisation may reduce the emissions from production. There may also be increased awareness of harms to the environment because of greater information sharing. Consumers could boycott products that harm the environment more, for example.

Impact on the country

Aggregate demand

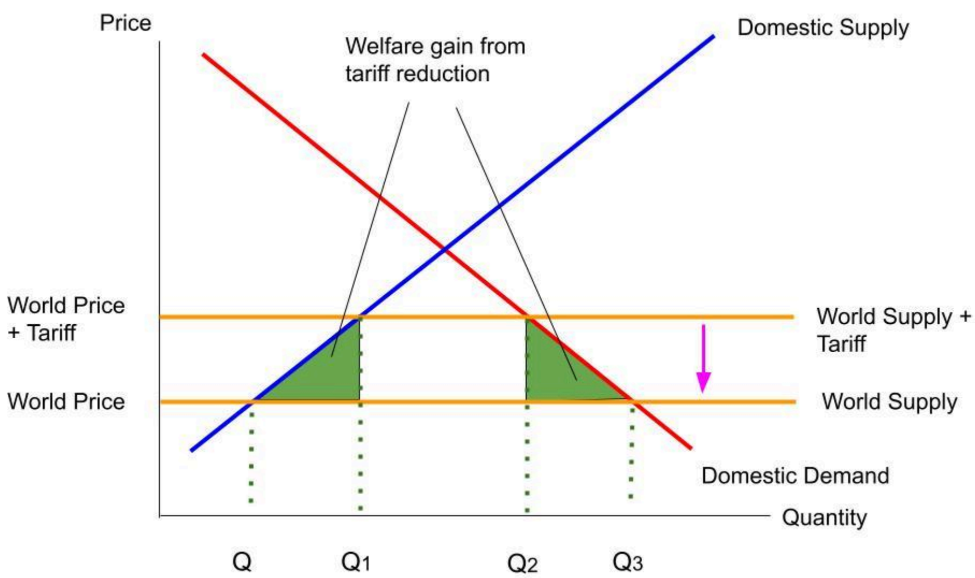
- Globalisation makes it easier for producers to access new markets. This could increase exports, which could boost aggregate demand.
- However globalisation also makes it easier to import goods from abroad. This could increase imports, which could lower aggregate demand instead.

Aggregate supply

- A reduction in tariffs reduces import costs. This may reduce the costs of production for firms that import some of their inputs. For example, car companies relying on steel imports would see lower costs. This could shift SRAS right.
- Increased global competition between firms could also increase productivity in order for firms to survive. This could shift LRAS right.

Tariff reduction and welfare

- One aspect of globalisation is that countries have reduced trade barriers over time.
- A tariff reduction may lead to welfare gains according to the tariff diagram.
- Specifically, after reducing tariffs, the gain in consumer surplus may outweigh the fall in producer surplus and loss of government revenue.
- This results in a welfare gain from two areas shaded in green below.



Specialisation

- Globalisation involves the reduction of transport costs and trade barriers.
- Hence globalisation moves the global economy closer to one satisfying the assumptions for the theory of comparative advantage.
    - Assumptions for the theory of comparative advantage include no trade barriers and no transport costs.
- [Comparative advantage]() is when one country has a lower opportunity cost in producing a good or service.
- The theory of comparative advantage states that countries should specialise in the good or service where they have a comparative advantage. To consume other goods, countries can then engage in trade.
- As a result of globalisation and free trade, countries can achieve "gains from trade".
- In other words, countries can use trade to move beyond their domestic production possibility frontier. This expands the range of production possibilities available to the country.

Other evaluation points for globalisation

Use of retraining schemes

- Some workers may lose out from globalisation, with some jobs being offshored to countries with lower labour costs.
- However retraining schemes may help to train workers in sectors where demand is rising due to globalisation. This could include financial services and IT.
- This helps to prevent a fall in wages for some workers after globalisation.

Progressive taxation and welfare payments in response to globalisation

- Globalisation can lead to winners and losers in labour markets. For example workers in finance may see higher demand and wages, while other workers see lower labour demand due to reshoring.
- However fiscal policy could be used to redistribute the gains to make sure no worker is worse off after globalisation.
- This could involve using progressive taxation to tax the winners from globalisation at higher rates.
- The extra tax revenue could then be used to support workers who have lost their jobs, by issuing welfare payments.
- An example of this is the US Government's Trade Adjustment Assistance. This is a program which includes welfare payments for those who lose their job because of competition from imports.

Consumer awareness may prevent worker exploitation by global companies

- Globalisation may also increase consumers' awareness of how multinational companies operate in other parts of the world.
- Consumers may reduce demand for products if they find out workers may have been exploited in the production process for that good.
- Therefore global companies have an incentive to treat their workers well and pay them well, to maintain consumer loyalty.

The coordination of global regulation on global companies

- For example, over 140 countries have agreed a minimum corporation tax rate of 15% worldwide.
- This may discourage global companies from moving countries or lobbying governments for lower tax rates.

Is globalisation in reverse?

- Instead of globalisation, some commentators argue that there is "deglobalisation". In other words, economies may be becoming less and less integrated.
- Economic policy has turned towards protectionism in some countries, such as with US tariffs and the UK's decision to leave the European Union.
- Also the Covid-19 pandemic, which highlighted the fragility of global supply chains, may encourage some companies to bring production closer to home.

Practice exam style question on globalisation

This is a practice question written in the style of Edexcel Economics A. It features a short extract followed by a practice question.

Extract: *The UK has faced deindustrialisation, in part because of greater international competition. In 1966 manufacturing represented 30% of all UK employment but this is down to 7.7% as of 2019. However the UK's financial sector has benefitted from globalisation. Globalisation has led to some companies moving their production overseas to countries with lower costs, including many clothing companies like Nike. However there have been accusations of poor working conditions in some of these clothing factories.*

Question: Evaluate the effects of globalisation on workers **and** on the UK economy. (15 marks)

Related resources for Edexcel Economics A

Edexcel Economics A notes, model answers and practice questions:
https://tfurber.com/edexcel-economics

Edexcel Economics A Theme 4 notes, model answers and practice questions:
https://tfurber.com/theme-4-edexcel-economics/

Related topics:

- Comparative advantage and specialisation in international trade.
- Restrictions on free trade (protectionism).