

Global Economic Issues and Policies

First edition

UNIT ONE

Introduction to the Global Economy

Chapter 1

Understanding the Global Economy



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Fundamental Issues

- 1. Why study global economic issues and policies?**
- 2. How important is the global market for goods and services?**
- 3. How important are the international monetary and financial markets?**
- 4. What are market supply and demand?**
- 5. What are consumer surplus and producer surplus?**
- 6. How are market prices determined?**

Global Economic Policy and Issues

- Globalization

- The increasing interconnectedness of peoples and societies and the interdependence of economies, governments, and environments.

- Economic Integration

- The extent and strength of real-sector and financial-sector linkages among national economies.
 - ❖ The volume of international trade in the real sector
 - ❖ The global market for goods and services
 - ❖ The volume of trade in the international monetary, and financial markets

The Global Market for Goods and Services

- **Real Sector**
 - A designation for the portion of the economy engaged in the production and sale of goods and services.
- **Financial Sector**
 - A designation for the portion of the economy in which people trade financial assets.

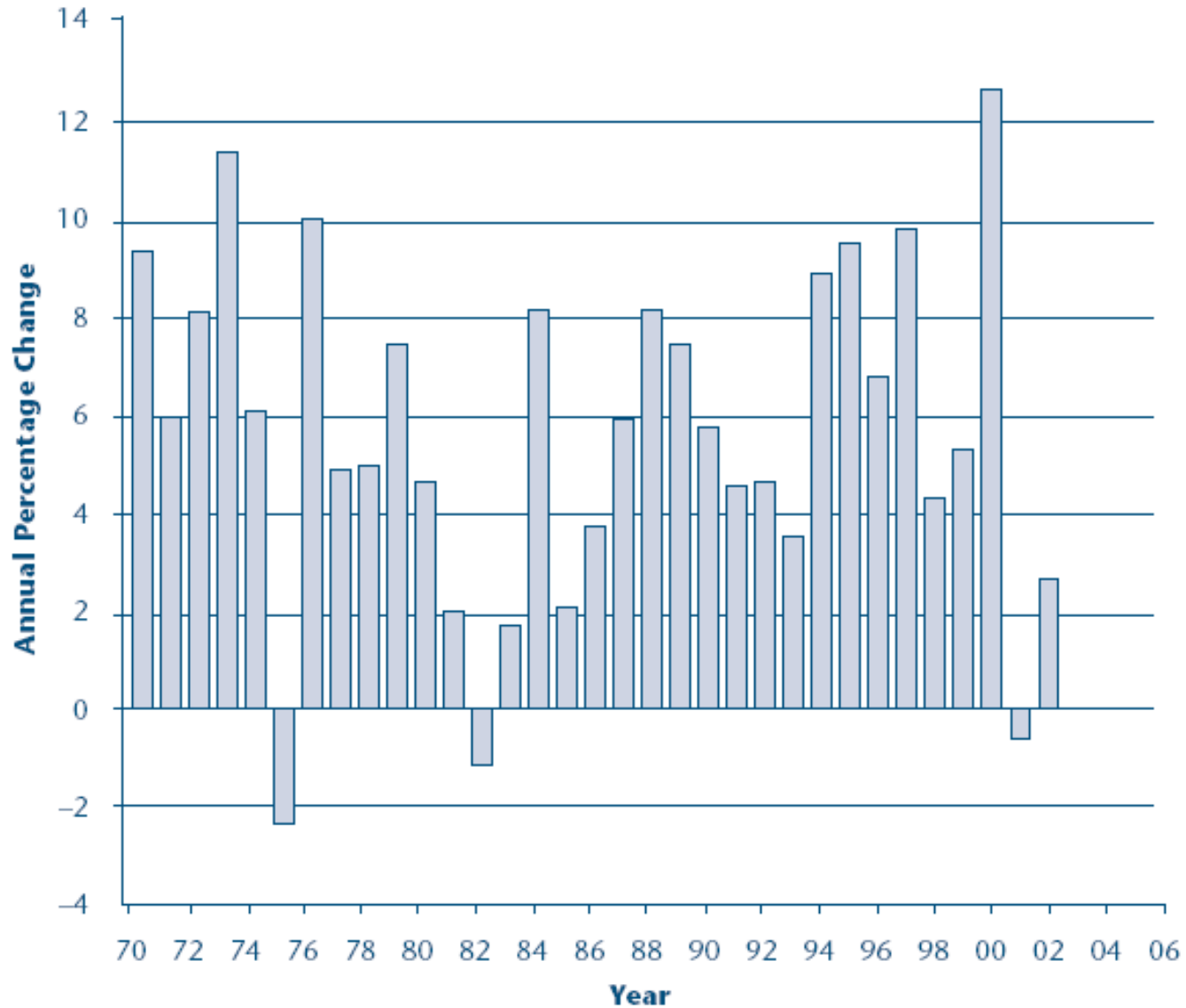
Table 1-1

The Top Twenty Globalized Nations

Rank	Nation	Rank	Nation
1	Ireland	11	Norway
2	Switzerland	12	United States
3	Singapore	13	France
4	Netherlands	14	Germany
5	Sweden	15	Portugal
6	Finland	16	Czech Republic
7	Canada	17	Spain
8	Denmark	18	Israel
9	Austria	19	New Zealand
10	United Kingdom	20	Malaysia

Figure 1-1

Growth of Global Trade in Goods and Services

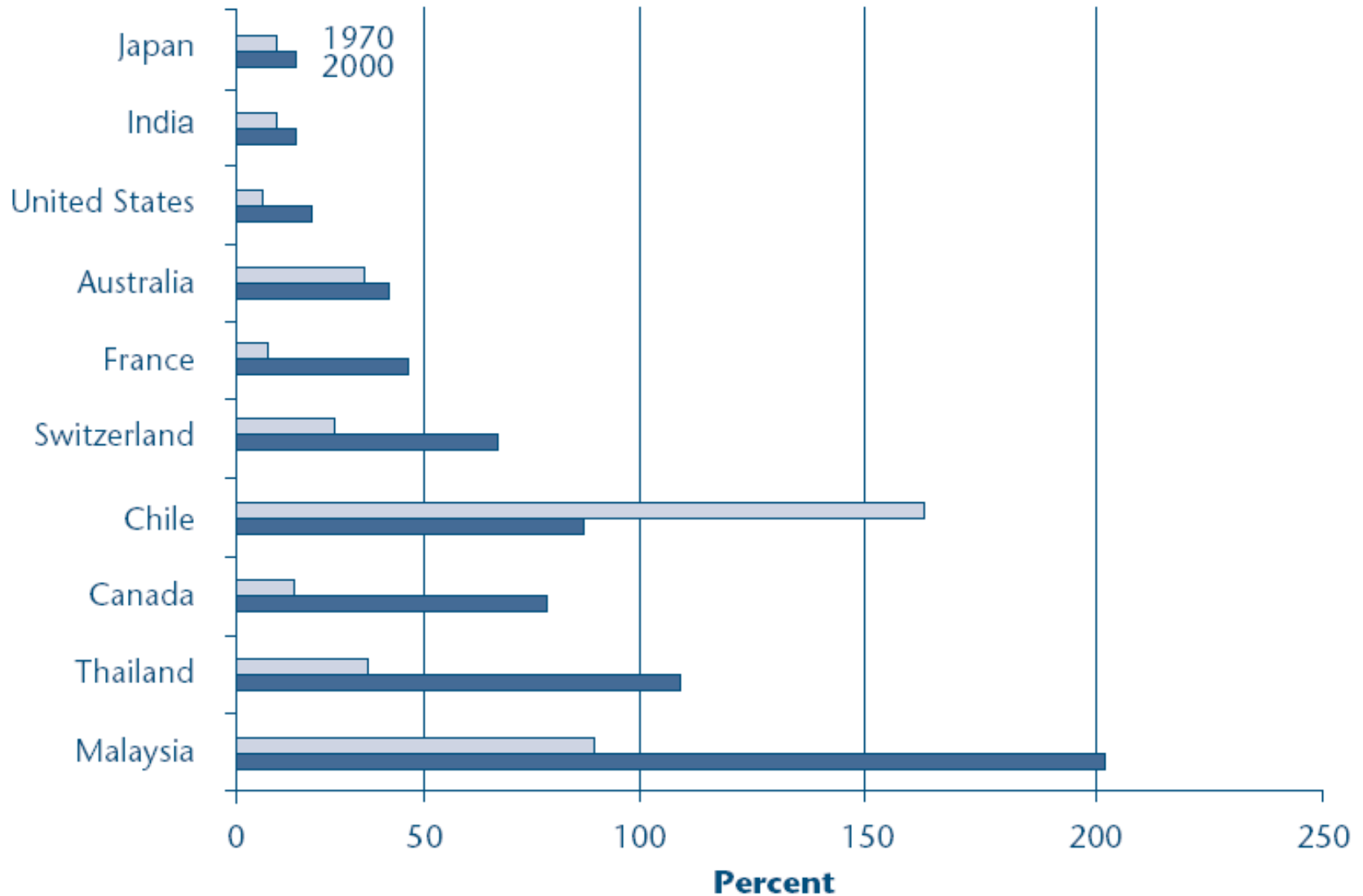


Source: International Monetary Fund, *World Economic Outlook*, various issues.

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Figure 1-2

Selected Individual Nations' Trade in Goods and Services



Source: International Monetary Fund, *International Financial Statistics*, various issues.
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The International Monetary and Financial Markets

- **Foreign Exchange Market**
 - A system of private banks, foreign exchange brokers, and central banks through which households, firms, and governments buy and sell national currencies.
- **Foreign Direct Investment**
 - The acquisition of assets that involves a long-term relationship and controlling interest of 10 percent or greater in an enterprise located in another economy.

Table 1-2

Annual Turnover in Foreign Exchange Markets

	Foreign Exchange Turnover (in \$ trillions)	World Exports of Goods (in \$ trillions)	Ratio
1979	\$17.5	\$1.5	12:1
1986	75.0	2.0	38:1
1989	190.0	3.1	61:1
1992	252.0	4.7	54:1
1995	297.5	5.0	60:1
1998	372.5	5.4	69:1
2001	300.0	6.6	45:1

Source: Held, David, Anthony McGrew, David Goldblatt, and Jonathan Perraton, *Global Transformations*, p. 209; Bank for International Settlements, *Central Bank Survey of Foreign Exchange and Derivatives Market Activity*, 1998, International Monetary Fund, *World Economic Outlook*, 1998, 2001.
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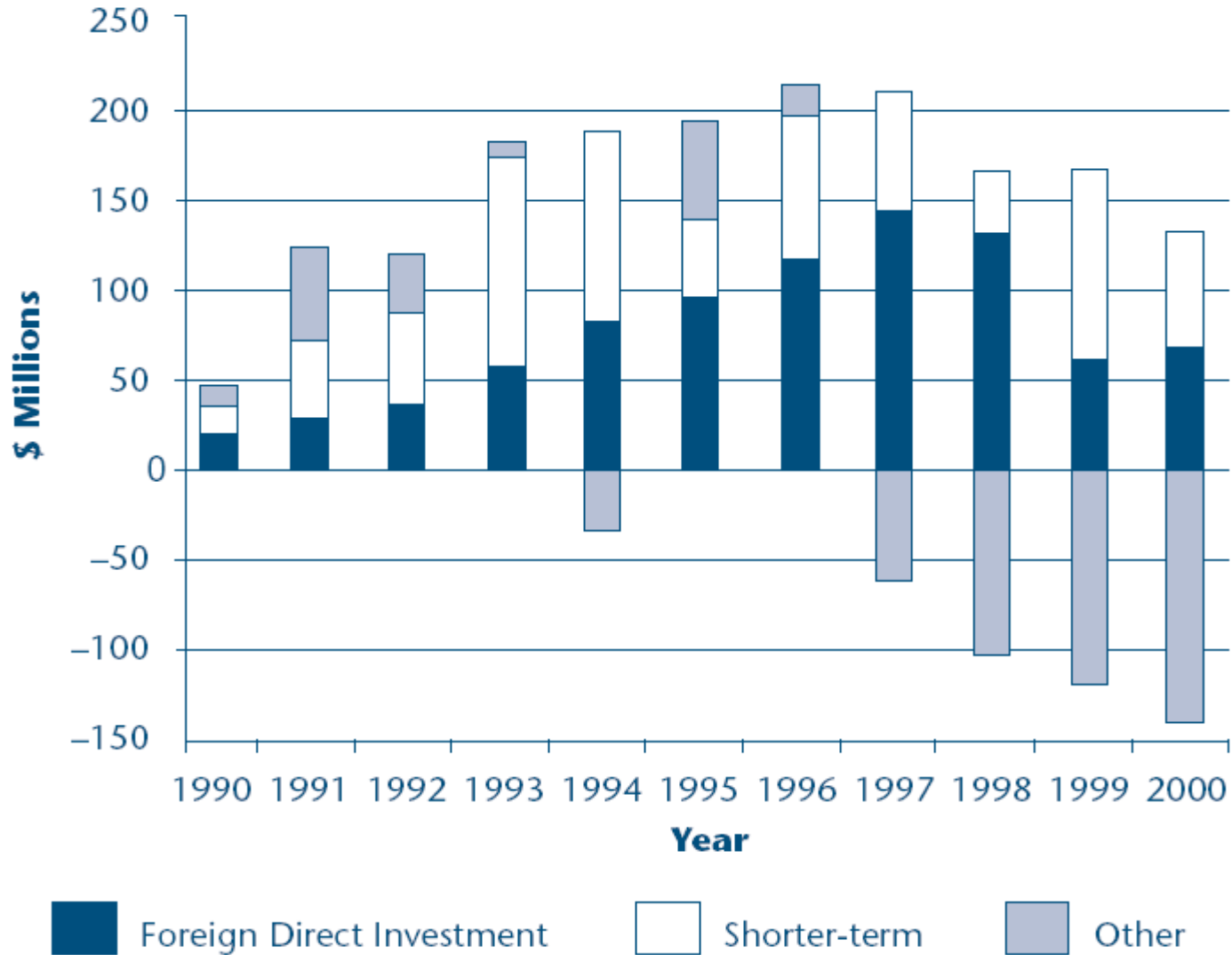
Table 1-3

Global Foreign Direct Investment Flows

	FDI Inflows (Percentage Change)	FDI Outflows (Percentage Change)	World Exports (Percentage Change)
1971–1975	19.8	17.3	24.0
1976–1980	18.5	17.4	18.1
1981–1985	2.1	2.4	–0.5
1986–1990	24.0	27.6	15.0
1991–1995	20.0	15.7	9.5
1996–2000	32.2	27.0	3.5

Figure 1-3

Private Capital Flows to Emerging Economies



Source: International Monetary Fund, *Annual Report*, and *International Capital Markets*, various issues.
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Understanding Global Markets: Supply and Demand

- Demand

- The relationship between the prices that consumers are willing and able to pay for various quantities of a good or service for a given time period, all other things constant.

- Law of Demand

- An economic law that states that there is an inverse, or negative, relationship between the price that consumers are willing and able to pay and the quantities that they desire to purchase.

Table 1-4**An individual Consumer's
Demand Schedule**

Price	Quantity
\$1.95	1
\$1.90	2
\$1.85	3
\$1.80	4
\$1.75	5

Table 1-5**An individual Firm's
Supply Schedule**

Price	Quantity
\$1.95	250
\$1.90	200
\$1.85	150
\$1.80	100
\$1.75	50

Understanding Global Markets: Supply and Demand (cont'd)

- The Demand Schedule

- An individual's demand schedule tabulates the price the consumer is willing and able to pay for various quantities of a good or service during a specified time period, all other things held constant.

Table 1-4

An individual Consumer's Demand Schedule

Price	Quantity
\$1.95	1
\$1.90	2
\$1.85	3
\$1.80	4
\$1.75	5

Understanding Global Markets: Supply and Demand (cont'd)

- **Supply**

- The relationship between the prices of a good or service and the quantities supplied to the market by producers within a given time period, all other things constant.

- **Law of Supply**

- An economic law that states that there is a positive or direct relationship between the prices producers receive and the quantities that they are willing to supply to the market.

Understanding Global Markets: Supply and Demand (cont'd)

- The Supply Schedule

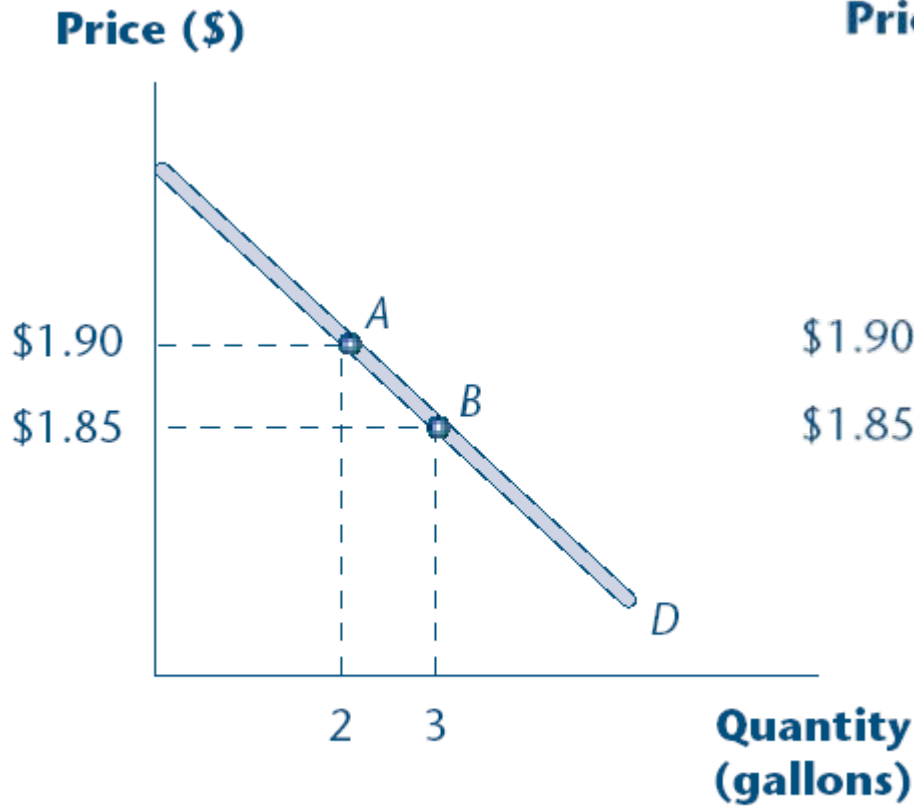
- A schedule that tabulates the minimum price a supplier is willing to accept for various quantities supplied of a good or service.

Table 1-5

An individual Firm's Supply Schedule

Price	Quantity
\$1.95	250
\$1.90	200
\$1.85	150
\$1.80	100
\$1.75	50

Figure 1-4 The Demand for and Supply of Gasoline



(a)



(b)

Factors Influencing Demand and Supply

- **Demand Factors**

- **Changes in consumer preferences**
- **Changes in income**
- **Changes in the prices of related goods**
- **Changes in the number of consumers**

- **Supply Factors**

- **Changes in the cost and availability of inputs**
- **Advances in technology**
- **Changes in the prices of related goods of services**
- **Taxes and producer subsidies**
- **Change in the number of producers**

Table 1-6

Factors Influencing Demand

Factor	How It Affects Demand
Changes in consumer preferences	An increase in consumer tastes or preferences for an item increases the demand for that item. A decrease in consumer tastes or preferences for an item decreases the demand for that item.
Changes in income	An increase (decrease) in a consumer's income increases (decreases) the consumer's demand for <i>normal goods</i> and decreases (increases) the consumer's demand for <i>inferior goods</i> .
Changes in the prices of related goods	An increase (decrease) in the price of a <i>complement good</i> decreases (increases) a consumer's demand for a related good. An increase (decrease) in the price of a <i>substitute good</i> increases (decreases) a consumer's demand for a related good.
Changes in the number of consumers	An increase (decrease) in the number of consumers in a market increases (decreases) the demand for a good or service.

Table 1-7

Factors Influencing Supply

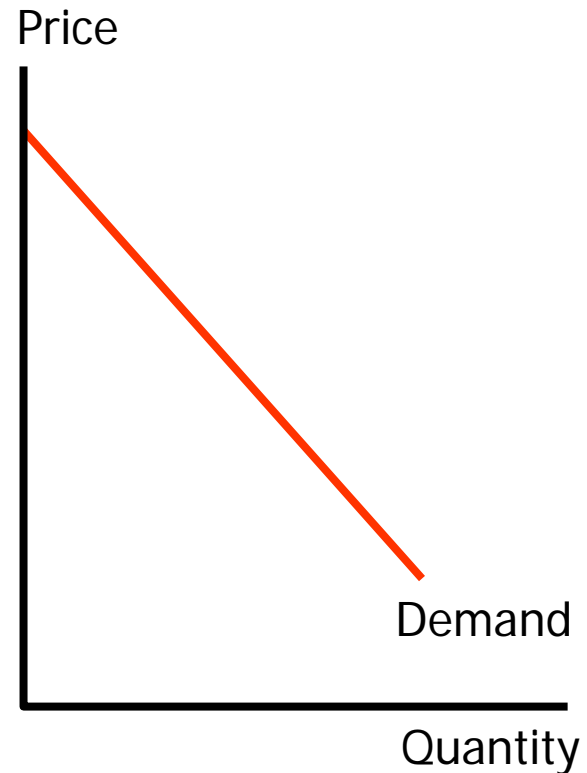
Factor	How It Affects Supply
Changes in the cost and availability of inputs	Supply increases when input costs decrease. Supply decreases when input costs rise.
Advances in technology	An advance in technology allows a firm to produce more units of a good or service with the same amount of resources. Hence, at any given price, the firm can produce more units than it could previously.
Changes in the prices of related goods or services	An increase (decrease) in the price of a <i>substitute good in production</i> results in a decrease (increase) in the supply of the related good. An increase (decrease) in the price of a <i>complement good in production</i> results in an increase (decrease) in the supply of the related good.
Taxes and producer subsidies	A production tax causes supply to decrease, while a production subsidy increases supply.
Change in the number of producers	An increase (decrease) in the number of producers in a market increases (decreases) the supply of a good or service.

Market Demand And Supply

- Market Demand

- A curve that illustrates the prices that consumers are willing and able to pay for various quantities of a good or service for a given time period, all other things constant.

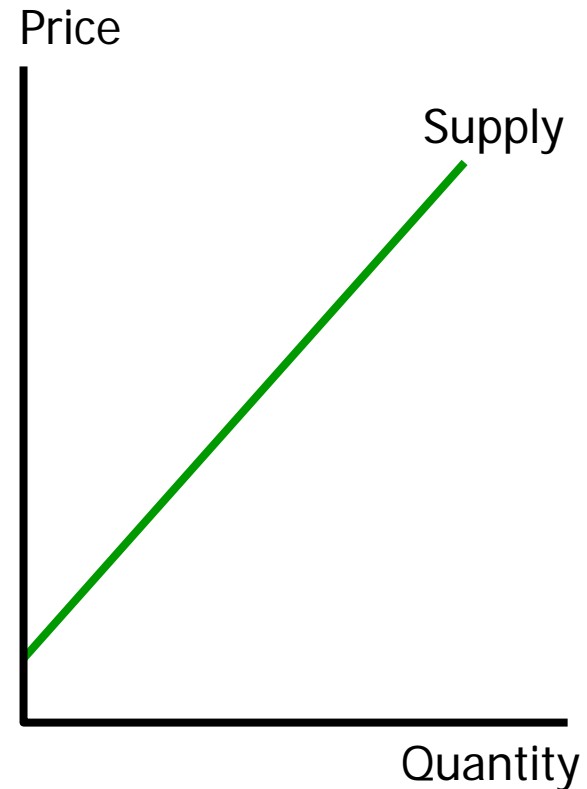
- ❖ Because of the negative relationship between price and quantity demanded, the demand curve slopes downward.



Market Demand And Supply (cont'd)

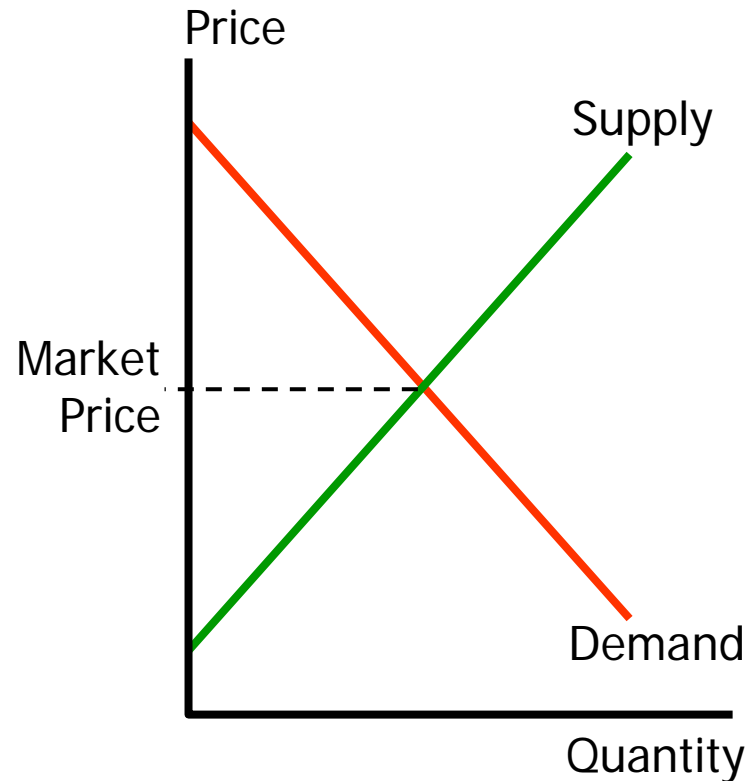
- Market Supply

- A curve that illustrates the prices that producers are willing to accept for various quantities of a good or service they supply to the market for a given time period, all other things constant.
 - ❖ Because of the positive relationship between price and quantity supplied, the supply curve slopes upward.



Market Demand And Supply (cont'd)

- **Market Price**
 - The price determined by the interactions of all consumers and producers in the marketplace.



Consumer and Producer Surplus

- Consumer Surplus

- The benefit that consumers receive from the existence of a market price.

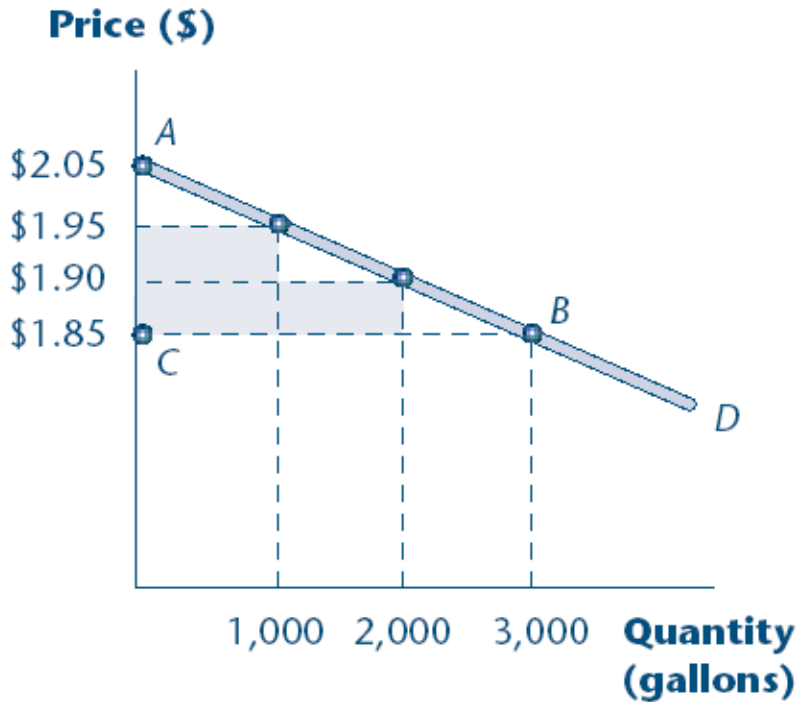
- ❖ The difference between what consumers are willing and able to pay for a good or service and the market price.

- Producer Surplus

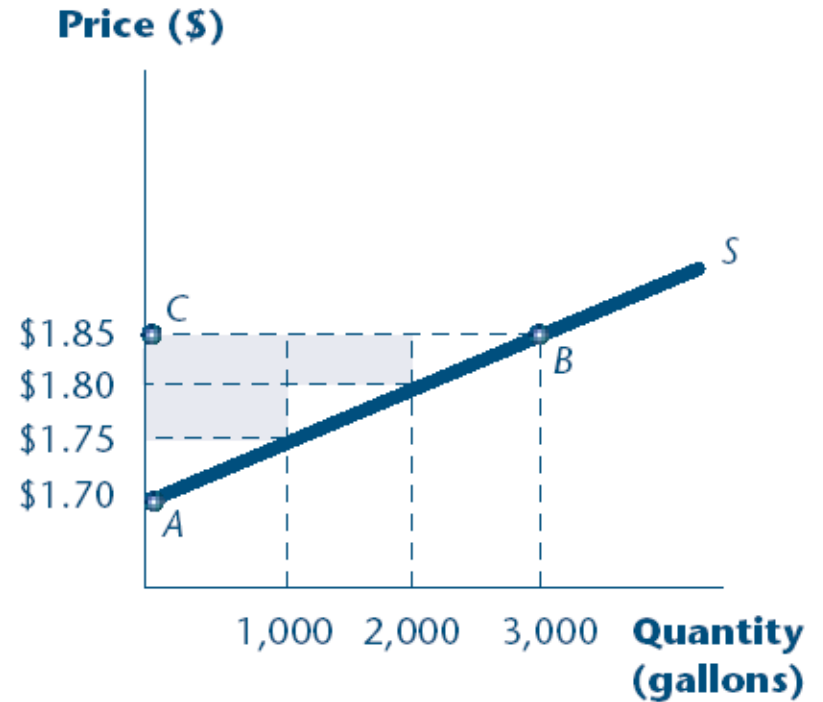
- The benefit that producers receive from the existence of a market price.

- ❖ The difference between the price that producers are willing to accept to supply a particular quantity and the market price.

Figure 1-5 Consumer and Producer Surplus



(a)

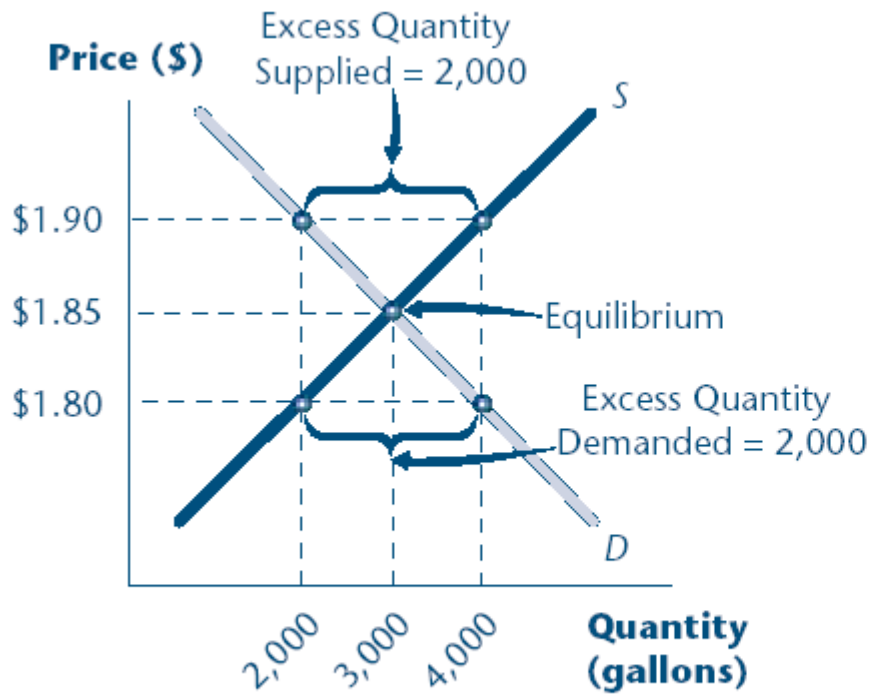


(b)

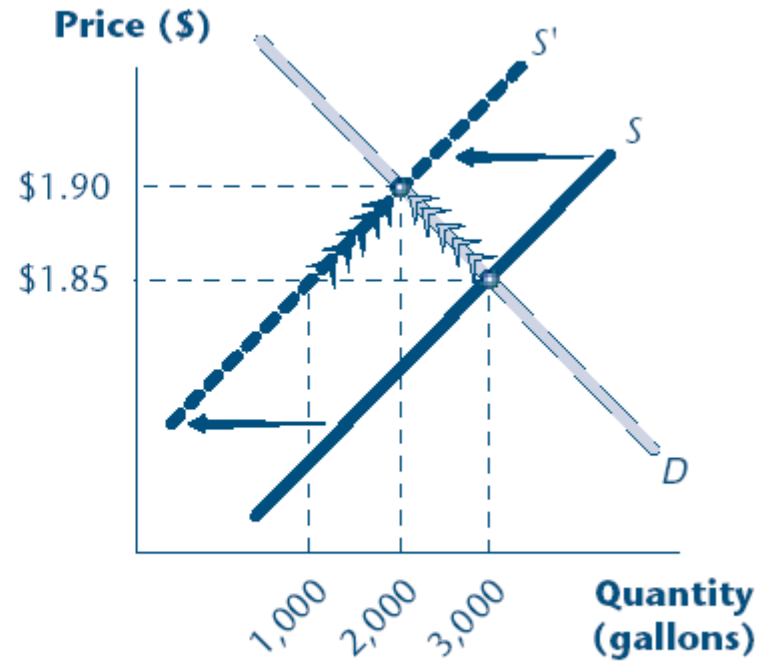
How Market Prices Are Determined

- **Excess Quantity Supplied**
 - The amount by which quantity supplied exceeds quantity demanded at a given price.
- **Excess Quantity Demanded**
 - The amount by which quantity demanded exceeds quantity supplied at a given price.
- **Market Clearing or Equilibrium Price**
 - The price at which quantity supplied equals quantity demanded because neither an excess quantity demanded nor an excess quantity supplied exists at this price.

Figure 1-6 The Equilibrium Market Price



(a)

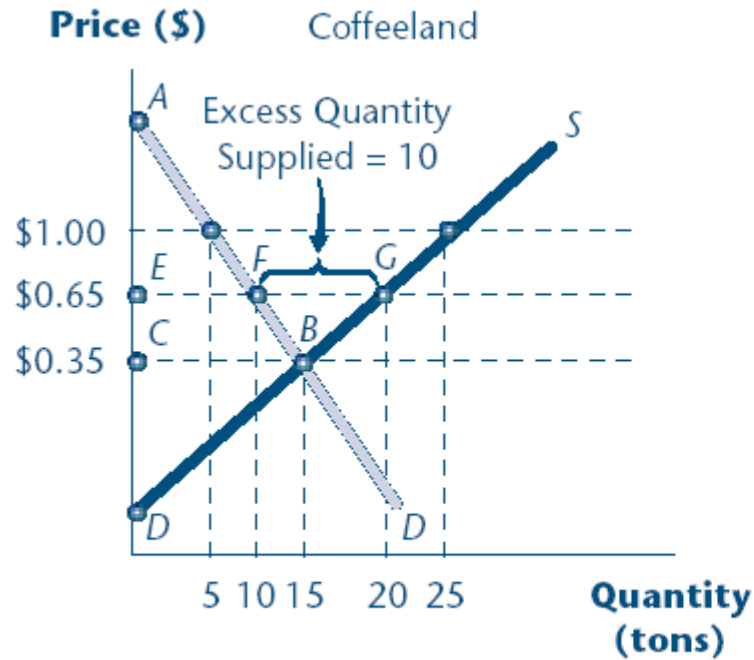


(b)

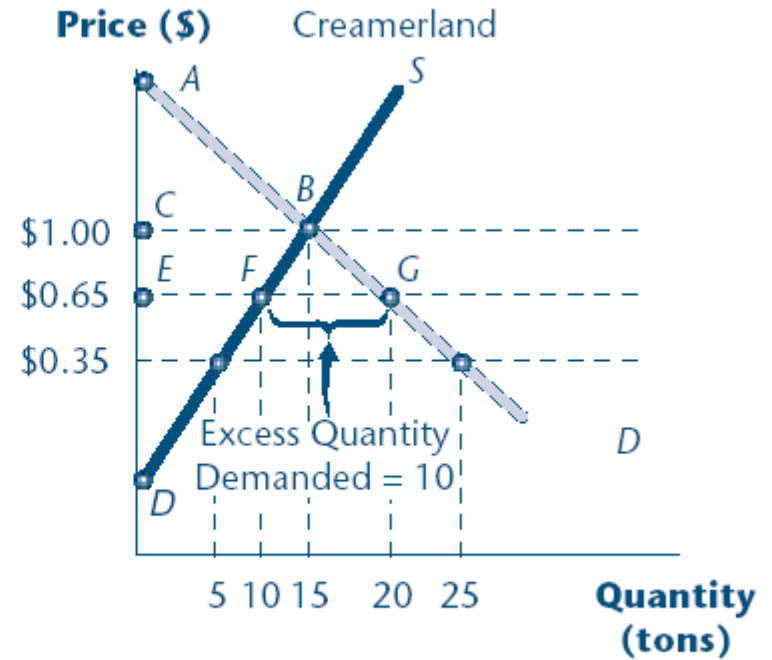
How Market Prices Are Determined (cont'd)

- For an Individual Nation
 - The market-clearing price, or equilibrium price, occurs when there is neither an excess quantity demanded nor an excess quantity supplied.
- For Nations Engaged in International Trade
 - The global equilibrium market price arises when excess quantities demanded, or imports, equal excess quantities supplied, or exports.

Figure 1-7 The Global Coffee Market



(a)



(b)