The World Economic System

- With South Sudan becoming an independent state on 9 July 2011, there are now 195 independent sovereign states in the world (including disputed but defacto independent Taiwan).
- There are also about 60 dependent areas, and five disputed territories (like ***Antarctica*** -claims by Argentina, Australia, Chile, France, New Zealand, Norway, and the United Kingdom, the legal status of which remains in suspense under the terms of the Antarctic Treaty of 1959; ***Spratly Islands*** - claimed by PR China, Taiwan, and Viet Nam; portions claimed by Malaysia, and the Philippines, administered by various countries); ***Paracel Islands*** - Occupied by PR China, claimed by Taiwan and Viet Nam; ***West Bank*** - Israeli-occupied, Palestinian Authority; and, ***Western Sahara*** - claimed and administered by Morocco.

- The states of the world may be grouped in various ways. They may be grouped by region; continents or levels of development.
- Goldstein & Pevehouse identified nine regions by which the world has been divided.
- These nine regions include:
  - North America
  - Europe;
  - Old East comprising Russia and the Commonwealth of Independent States (CIS)
  - Japan/Pacific
  - China
  - Middle East
  - Latin America
  - South Asia
  - Africa

- By Continents, the world is divided into 7:
  - Asia – 17,039,000 ml^2
  - Africa - 11,675,000 ml^2
  - North America - 9,348,000 ml^2
  - South America - 6,886,000 ml^2
  - Antartica- 4,700,000 ml^2
  - Europe - 4,033,000 ml^2
  - Australia - 2,989,000 ml^2

- By Levels of development, the world has been divided into:
  - **North-South division**
  - **Three-world classification**
- North-South division of the world depicts the division of the world into two based on level of development of the countries categorised into them.
- Income levels per capita are, overall, more than five times as high in the North as in the South.

- The North is made up of:
  - North America
  - Europe
  - Japan/Pacific
  - Russia/CIS
- The South comprises:
  - China
  - Middle East
  - Latin America
  - South Asia
  - Africa
- The North contains only 20 percent of the world's people but 60 percent of its goods and services.
- The other 80 percent of the world's people, in the South, have only 40 percent of the goods and services.
- Within the global North Russia and the CIS states (a loose confederation of former Soviet republics)lag behind in income levels, having suffered declines in the 1990s.

- In the global South, the Middle East, Latin America and more recently, China have achieved somewhat higher income levels than have Africa and South Asia, which remain extremely poor.
- Even in regions where higher income appears widespread, income is unevenly distributed resulting in so many people wallowing in poverty.
- It should be noted that half of the world's population lives in the densely populated and poor regions of South Asia and China.

- The world can also be divided into three worlds:
  - First World
  - Second World
  - Third world
- The three-world classification has economic, ideological, political and strategic dimensions.
- The first-world: the industrialised western countries are categorised as comprising the first world.
- In economic terms, their populations enjoy the highest levels of mass affluence calculated in GDP terms. In 1983, these countries generated 63 percent of the world's while having only 15 percent of the world's population.
- The Second World consists of the former communist USSR. In so far as they were largely industrialised and capable of satisfying the population's basic material needs, they produced 19 percent of the world's GDP with 33 percent of the world's population.

- The Third World is a general designation for economically dependent countries of Africa, Asia and Latin America.
- The term arose during the cold war, when two opposing blocs—one led by the United States (first), the other led by the USSR (second)—appeared to dominate world politics.
- Within this bipolar model, the Third World consisted of economically and technologically less developed countries belonging to neither bloc.
- Originated by the Martinique-born Marxist writer Frantz Fanon, the designation was essentially negative and not always accepted by the countries concerned.
- Although political and economic upheavals in the late 1980s and early 1990s marked the collapse of the Soviet power bloc, “Third World” remains a useful label for a conglomeration of countries otherwise difficult to categorise.
- Third World countries are less economically developed and suffer widespread poverty. They produced 18% of world’s GDP with 52% of the world’s population.

❖ Economic Systems in the World

➢ *Capitalism*

- Capitalism is based on free enterprise that is, most of the resources needed for production are privately owned.
- Individuals and private firms determine what to produce and sell, and how to use their income.
- Capitalist economic systems exist in Australia, Canada, New Zealand, US and many countries of Europe.
- The former communist countries are going capitalist following the collapse of the USSR.

➢ ***Communism***

- This system is traditionally based on government ownership of most productive resources.
- The government also plays a large role in deciding what goods to produce and how to distribute income.
- Communism was once the main economic system in Soviet Union and many nations of Eastern Europe.

- However, these nations began to decrease government control over their economies in the late 1980s and early 1990s.
- Today, only a few countries claim to run their economies on communist principles.
- Even china and other countries that are often thought of as communist have loosened government control over economic activities.

Mixed Economies:

- Mixed economies combine both private and government control.
- Under a mixed economy , the government may own such industries as banks, railroads and steel. However, other industries are privately owned.
- The government does some economic planning, but it also allows much private choice. Denmark, Norway, Sweden and some less developed countries have mixed economies.

❖Economic Indicators

- An economic indicator is a number that shows how well an economy is performing.
- Such numbers measure a variety of factors, including the production of goods and services, employment conditions, and consumer needs, beliefs, and behaviours.
- Economic indicators help the governments, businesses and the public understand economic conditions and make informed decisions.

- Over time economies tend to behave in a cyclical manner. That is, they experience periods of boom or prosperity when production, income, and employment are rising, followed by periods of contraction or recession when production, income, and employment are falling.
- This cyclical activity does not follow a predictable path.
- Sometimes the booms are long and sometimes they are short. The same is true of the contractions.

- Consequently, no one can predict the path of the economy with great accuracy.
- But in an effort to better anticipate the economy's cyclical movement, a set of leading economic indicators has been developed.
- These leading economic indicators are data series that help to develop an overall picture of the economy.
- But it should be noted that no single data series is a perfect leading indicator, so a number of them have been combined into an index of leading indicators.

- **Types of Economic Indicators**
- There are three main types of economic indicators:
- **1) Leading indicators**
  - Leading indicators signal future changes. That means, they usually change before the economy itself changes. This makes them extremely useful for short term predictions of economic developments.

- **2) Lagging indicators**
- Lagging indicators usually change after the economy as a whole changes.
- For that reason, they cannot directly be used to predict economic changes (since those have happened already).
- They are more useful to confirm specific patterns (e.g. economic cycles) and make further predictions from there.

- **3) Coincident indicators.**
- Coincident indicators occur at about the same time as the changes they signal.
- Therefore, they can provide valuable information about the current state of the economy.
- An example of a coincident indicator is personal income.
- If the economy is strong and business is going well, personal income rates will increase at about the same time.

- **Major Types of Leading Economic Indicators**

- **1) Stock Market**
- The stock market is the most well-known and widely followed leading indicator.
- Because stock prices are based in part on what companies are expected to earn, the market can indicate the economy’s direction if earnings estimates are accurate.
- For example, a strong market may suggest that earnings estimates are up and therefore that the overall economy is preparing to thrive.
- Conversely, a down market may indicate that company earnings are expected to decrease and that the economy is headed toward a recession.

- **2) Manufacturing Activity**
- Manufacturing activity is another leading indicator of the state of the economy.
- This influences the GDP (gross domestic
- product) strongly; an increase in which suggests more demand for consumer goods and, in turn, a healthy economy.
- Since workers are required to manufacture new goods, increases in manufacturing activity also boost employment and possibly wages as well.

- **3) Inventory Levels**
- High inventory levels can reflect two very different things: either that demand for inventory is expected to increase or that there is a current lack of demand.
- ***Case #1***, businesses purposely bulk up inventory to prepare for increased consumption in the coming months. If consumer activity increases as expected, businesses with high inventory can meet the demand and thereby increase their profit. Both are good things for the economy.
- **Case #2**, high inventories reflect that company supplies exceed demand. Not only does this cost companies money, but it indicates that retail sales and consumer confidence are both down, which further suggests that tough times are ahead.

- **4) Retail sales**
- Retail sales are particularly important metrics and function hand in hand with inventory levels and manufacturing activity.
- Most importantly, strong retail sales directly increase GDP, which also strengthens the home currency.
- When sales improve, companies can hire more employees to sell and manufacture more product, which in turn puts more money back in the pockets of consumers.

- **5) Building Permits**
- Building permits offer foresight into future real estate supply levels. A high volume indicates the construction industry will be active, which forecasts more jobs and, again, an increase in GDP.
- **6) Level of New Business Startups**
- The number of new businesses entering the economy is another indicator of economic health. In fact, some have claimed that small businesses hire more employees than larger corporations and, thereby, contribute more to addressing unemployment.
- Increases in small businesses are an extremely important indicator of the economic well-being of any capitalist nation.

- **Major Lagging Indicators**
- **1) Changes in the Gross Domestic Product (GDP)**
- GDP is typically considered by economists to be the most important measure of the economy’s current health.
- When GDP increases, it’s a sign the economy is strong. In fact, businesses will adjust their expenditures on inventory, payroll, and other investments based on GDP output.

- **Gross Domestic Product (GDP**)

- This is the most widely used economic indicator.
- GDP is the market value of all goods and services produced within a country during a given period.
- GDP excludes production by facilities that are owned by a nation’s citizens but operate in other countries.

- **Gross National Product (GNP)**

- GNP includes all production by a nation’s firms, regardless of the firms’ locations and excludes production by a foreign-owned facilities.

- **The difference between GDP and GNP**
- GDP is the market value of all the goods and services produced in an economy over some period of time.
- GNP is the market value of the goods and services produced by an economy's productive resources over some period of time.
- Here's an example that can highlight the difference. Adamu is an Nigerian working in Ilorin, so his production is included in both Nigerian GDP and GNP.
- If Adamu takes a new job in Accra, his production is no longer included in Nigerian GDP because he is no longer producing within the geographic boundaries of the economy.
- As long as he is a Nigerian citizen, however, his production is still included in Nigerian GNP.
- GNP measures the production of Nigerians whether they are working in Nigeria or abroad.

- **2) Income and Wages**
- If the economy is operating efficiently, earnings should increase regularly to keep up with the average cost of living.
- When incomes decline, however, it is a sign that employers are either cutting pay rates, laying workers off, or reducing their hours.
- Declining incomes can also reflect an environment where investments are not performing as well.

3) Unemployment Rate

- This represents the percentage of jobless individuals in a community’s total labour force that is, in the segment of the population that is willing and able to be employed.
- In a healthy economy, the unemployment rate will be anywhere from 3% to 5%.

4) The Consumer Price Index (CPI)

- CPI represents the prices of various items
- CPI, is a statistical construct that measures the average behaviour of the prices of goods and services purchased by the typical household.
- When consumer prices, on average, are rising, the CPI increases and there is inflation.
- When consumer prices are decreasing, the CPI decreases and there is deflation.
- The CPI is frequently interpreted as a measure of the cost of living. That is, an increase in the CPI means the typical household needs more money to purchase typical goods and, therefore, the typical household’s cost of living has increased.

- **5) Currency Strength**
- A strong currency increases a country’s purchasing and selling power with other nations.
- The country with the stronger currency can sell its products overseas at higher foreign prices and import products more cheaply.
- **6) Interest Rates**
- Interest rates are another important lagging indicator of economic growth. They represent the cost of borrowing money and are based around the federal funds rate, which represents the rate at which money is lent from one bank to another and is determined by the Federal Open Market Committee (FOMC). These rates change as a result of economic and market events.

- **7) Corporate Profits**
- Strong corporate profits are correlated with a rise in GDP because they reflect an increase in sales and therefore encourage job growth.
- They also increase stock market performance as investors look for places to invest income.
- That said, growth in profits does not always reflect a healthy economy.

- **8) Balance of Trade**
- The balance of trade is the net difference between the value of exports and imports and shows whether there is a trade surplus (more money coming into the country) or a trade deficit (more money going out of the country).
- Trade surpluses are generally desirable, but if the trade surplus is too high, a country may not be taking full advantage of the opportunity to purchase other countries’ products.
- Trade deficits, however, can lead to significant domestic debt. Over the long term, a trade deficit can result in a devaluation of the local currency as foreign debt increases.