UNIT 1
THE ECONOMIC ACTIVITIES

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1 **ECONOMIC ACTIVITY. COMPONENTS AND SECTORS**

1.1 **ECONOMIC ACTIVITY**

**ECONOMIC ACTIVITY**: One possible definition is: “combination of tasks undertaken by people in order to obtain the goods (material) and services (immaterial) required to meet their needs”.

“Actions and processes governing the production, distribution and consumption of commodities (goods and services) in an economy for the satisfaction of needs of individuals or collectives.”

**COMMODITIES (ECONOMIC GOODS).**
- **Goods (or products)**: material commodity which satisfy human needs and wants, provide utility, and are generated by economic activity.
  - They are classified according to:
    - Elaboration:
      - Raw materials: products extracted from nature for their use in further processes.
      - Semi-finished products: Used for other processes, such as machinery and components.
      - Finished products: Ready for direct consumption.
    - Function regarding consumption:
      - Consumer goods.
      - Means of production (needed for other products).
    - Expiration:
      - Durable.
      - Non-durable.
- **Services**: Intangible commodity created directly or indirectly to satisfy human needs and wants.
  - Tourism would be direct.
  - I.e. education would be indirect.

**DESIRE**:
- **Needs**: Something necessary, something required. If not fulfilled, negative outcome (i.e. death, illnesses, dysfunction, etc.).
  - Basic needs: food, shelter, dress, energy, etc.
  - Non-basic needs: car, computer, etc.
  - Desires. Non-basic needs. If not fulfilled, nothing bad happens. If met, they raise our well-being.

They are considered to be:
- Infinite: New needs appear over time.
- Selective: First, the most urgent. Then the others.
- They tend to become fixed: Turn into habits.
- They vary in intensity.

1.2 **COMPONENTS OF ECONOMIC ACTIVITY**

**PRODUCTION**

It is the combined number of goods that result from economic activities. It is also the process of combining different material and immaterial inputs (factors of production) in order to make something for consumption (output). Therefore, it is the act of creating a good or a service which has value and contributes to the utility of individuals.
**DISTRIBUTION**

It is the transfer of products from the producers to the consumers and their sale on the market.

**Market:**
- Where producers (supply) and consumers (demand) meet → Law of supply and demand.
- Where goods and services are traded (sold, bought or exchanged):
  - Bartering: exchange of goods.
  - Monetary system: exchange of goods and means of payment used as unit of equivalence (money): metals, coins, papers (banknotes), cheques, etc.
- There are different types of markets depending on products, resources, customers, etc.: consumer, shares, industrial, raw materials, etc.

**CONSUMPTION**

It is the acquisition of the goods and services that result from production.

### 1.3 FACTORS OF PRODUCTION

Resources, or inputs are what is used in the production process to produce output—that is, finished goods and services.

**NATURAL RESOURCES**

Resources provided by nature, from the environment. They are biological (animal, vegetal, etc.), mineral and sources of energy.

And they can be:
- **Renewable**: they are naturally renewed or replaced over a short period of time
- **Non-renewable**: when they are used they become exhausted or it takes a long time to be renewed or replaced.

Main problems of natural resources:
- Exhaustion
- Overuse
- Geopolitical problems: international conflicts.

**CAPITAL AND TECHNOLOGY**

**CAPITAL**: Combination of non-natural resources needed for production.
- Physical capital: facilities, machinery, etc.
- Financial (capital): funds available (money or credit). Investments.
- Human capital: people’s productive capacity. Workforce, knowledge, skills, etc.

**TECHNOLOGY**: Combination of knowledge, methods and procedures:
- Manual
- Mechanised
- Automatic or robotised.

### 1.4 ECONOMIC SECTORS

All economic activity → Grouped into three groups depending on what it is produced. We will study them in further units.
- **Primary sector**: it is the sector of economic activity which consists on the extraction of natural resources to be used in production, distribution or consumption.
  - Agriculture, livestock farming, fishing, forestry, etc.
- **Secondary sector**: the transformation of natural resources (raw materials) into products that
enable human needs to be met. Mining, industry, construction, energy production.

- **Tertiary sector:** it is the sector of economic activity which comprises the activities that provide services (ie. non-material commodities).
  - Transport, tourism, trade, education, health care, etc.

The balance of the three sectors in an economy has to take into account the level of employment in each of the sectors and their participation in the Gross Domestic Product (GDP) ➔ Give idea of the level of development of a country. Generally, more developed areas have seen a decrease of the importance of the primary sector, and an increase of the tertiary.

## 2 ECONOMIC AGENTS AND THEIR RELATIONSHIPS

The economic agents are the subjects responsible for undertaking economic activity. Therefore, they organise the production and distribution of goods and services, and consume ➔ They take decisions over what, how and for whom to produce, and what to consume, therefore they exchange labour, commodities and services of payment.

They are also defined as “people, or groups of people, carrying out economic activities”. Their interactions result in the different **economic systems** (see section 4).

We classify them into:
- Private sector
- Public sector
- Families

The concept of **agency** (or agent) is used in Social Sciences, and it is related with the concept of **structure**.

**Structure:** it would be the framework, the link joining individuals and collectives.
We have to imagine the structure of a building.

**Agency:** capacity for acting autonomously or independently, taking decisions ➔ but never fully independently ➔ limit: structure.

There can be limits and regulations, either explicit or implicit.

*In the case of the economy, we have to imagine the economic systems as structure, and the action of the agents as actors inside it.*

### 2.1 THE PRIVATE SECTOR (BUSINESSES)

The function of the private sector is to produce, distribute and sell goods and services to consumers (which can be individuals or other businesses) ➔ Ultimate **goal** ➔ PROFIT.

**Type of companies:** they can be grouped in different ways.

- **Size:** micro-sized (less 10 employees), small-sized (10-50), medium (50-250) and large (more than 250).
  - PYMES (*Pequeñas y medianas empresas*)

- **Capital ownership:**
  - Public: capital provided by the State (ie. Renfe, Adif, Metro de Madrid, EMT, Canal Isabel II, etc.)
  - Private
  - Mixed: combining private and public (partial privatisations) (Iberia, Red Eléctrica Española, ENAGAS, Navantia, Correos, RTVE, Hispasat, etc.).

- **Social organisation:** that is, depending on how the ownership is organised.
  - Individual owner (regular shop, for example).
• Groups of people:
  ▪ Limited company: capital divided into partners.
  ▪ Public licensed partners: capital divided into shares.
  ▪ Cooperatives: collectively managed by those who provide the capital.

  o Geographical origin and realm of action:
    ▪ Domestic: origin and action in the same country.
    ▪ Foreign: it is doing business in a country which is different of its origin.
    ▪ Multinational corporation: owns or controls production of goods or services in one or more
countries other than their home country.

2.2 FAMILIES
Families are basic units of consumption → their main function is to spend in order to acquire
goods and services to meet their needs.
For that decision they take into account:
  ▪ Preferences
  ▪ Income: salary (exchange of human resources -ie. workforce, knowledge, skills, etc.- with
money) and family assets (properties, interests from savings, inheritances, etc.)
They take rational decisions over obtaining maximum satisfaction and well-being at the available
cost → COMPANIES should know the preferences and be able to produce goods and services adjusted to
the different levels of income and expenditure → Marketing.

2.3 THE STATE, OR THE PUBLIC SECTOR
It has a very complex role in economy, since it participates in:
  o Production
  o Consumption
  o Regulation (laws) → The State creates laws for regulating the actions of the other economic agents
   (ie. labour policies, environmental laws, etc.)
Also, its intervention in economy consists in:
  - Redistribution of capital → Income (taxes, etc.) and expenditure (salaries, subsidies, etc.).
  - Offering goods and services considered necessary (welfare) at a minimum cost to the population
   (education, health care, army, water supply, roads, etc.)
   Therefore → → It produces public services for society.
   Consumes goods and services for private companies.

Objective → To achieve the highest possible standards of living for the greatest number of people.

In Spain: local, provincial, regional, central administration and European Union.

3 THE WORLD OF LABOUR
LABOUR: factor of production.
   Physical or intellectual effort made by people in order to produce wealth.
   Necessary for businesses to produce goods, and for the workers to earn money (salaries).

EMPLOYMENT AND UNEMPLOYMENT:
Division of the population:
  - Active population (labour force): people doing paid work and are available to enter in the labour
market.
- Employed (occupied): with paid work and provide labour in the production of goods and services.
- Unemployed (unoccupied): available to work, but without a job.
- Inactive population: those who do not have a paid work and are not available in the labour market. Pensioners, students, home-makers, etc.

**LABOUR MARKET:**
Supply of work → Offered by companies.
Offer of work → Offered by people.

**Law of supply and demand** → a worker would be more demanded if s/he has the skills demanded by companies.
- Qualified workers → fewer in number. Higher training, stability and salaries.
- Non-qualified workers → more in number → Less wages. More unstable.

**PROBLEMS OF THE LABOUR MARKET:**
- Globalisation of economy: international migrations at larger scales and offshoring (production is sent from developed to developing or underdeveloped countries).
- Working conditions in developing countries: low regulation → Exploitation, discrimination, etc.
- Temporary and part-time jobs. Good idea at first (flexibility), but adopted in the wider picture → Precariousness, lack of stability.
  - Seasonal jobs: jobs that occur mostly in specific seasons of the year (ie. Christmas, summer, etc.)
- Unemployment → high unemployment: bad for a country because lower income (taxes), more expenditure in social provisions (unemployment benefits), less economic activity, etc. → Less consumption → less production → lesser economic activity.

**4 ECONOMIC SYSTEMS**
Different ways of organising and carrying out economic activity.
- Way agents are linked to one another.
- Way work is organised.
- Way of distributing goods and services.

Way of answering what to produce, how to produce and for whom to produce depending on objectives (efficiency, growth, well-being, liberty, equality, etc.)

There are no pure economic systems.

**4.1 CAPITALISM (FREE MARKET ECONOMY)**
- Private property of the companies and resources.
  - **Objective**: individual profit → it may not imply collective well-being.
- Economic activity regulated by the market (prices, salaries, etc.) → Law of supply and demand
  - Supply: amount of something offered in the markets.
  - Demand: amount of something required and its price (purchasing power).
- Free competition among companies (corporate Darwinism).
  - Self-regulation.
- Secondary role of the State.
- Division and specialisation of labour → Workforce, companies and territories → EFFICIENCY.
4.2 **SOCIALISM (PLANNED ECONOMY)**

Socialism → Economic branch of Communism.
- Planned economy → all economic activity is controlled by the State.
  - Property of resources and companies.
  - No competition → State monopolies (one company controls one sector).
  - State decides over production, distribution, prices, salaries, etc.
  - Objective: shared welfare and social equity.

4.3 **CURRENT ECONOMIC TRENDS**

**THE SPREAD OF CAPITALISM: NEOLIBERALISM AND KEYNESIANISM**

Within capitalism there are different ideologies, varying the degree of economic liberalisation and the extent of state intervention in the economy.

**NEOLIBERALISM**: Purer version of capitalism.
From 1979 (Reagan and Thatcher onwards).
- Complete liberalisation → Removal of controls → the only possible regulation is the market itself.
- State: obstacle to freedom. Minimum public expenditure, privatisation of public companies.
- Salaries → Should be reduced in order to increase ‘efficiency’, competitiveness and profit.

**KEYNESIANISM** (Social-democracy, welfare State)
From World War II onwards. State as corrector of the problems created by capitalism → Collective point of view + defence of entrepreneurs. Also seen as defence against the Communist bloc.
- Public sector: basic infrastructures and services.
- Existence and encouragement of private property.
- Broad social provision:
  - Against the effects of poverty.
  - Citizens safe against loss of income: sickness, unemployment, retirement, etc.
- Regulation: public institutions. Labour rights, consumer rights, environment, competition, etc. → Public policies.
- Progressive taxation → the richer pays more percentage than the poorer ones.

**SUBSISTENCE ECONOMY:**
- Based on production for self-consumption.
- It takes place in the poorest areas of the world.
- Barely any mechanisation or technology.
- Hardly any economic or social development.

4.4 **PROBLEMS OF CAPITALISM**

Current capitalist economies face various types of problems such as:
- Political: weaker political power because of the strength of large companies. This challenges the democratic rule of society.
- Economic:
  - Monopolies: the elimination of the competition alters the markets because of the establishment of prices independent of the law of supply and demand.
  - Generation of crises: less profit → less workers → more unemployment → less demand of products → fail of business → more unemployment. Eventually, there is a re-structuration of the labour market.
- Social: Endangering of poorer groups because of the reduction of public expenditure, and also because of the search of profit of companies (ie. less wages).
5 CURRENT ECONOMIC TRENDS: ECONOMIC GLOBALISATION

Economic globalisation is the growing integration of national economies into a global market economy. Therefore, the whole world is economically interconnected.

CAUSES OF GLOBALISATION

- Advances in telecommunications → information and contact.
- Improvement to means of transport → transfer of commodities and people.
- Spread of capitalist economy → promoted by international institutions and multinational companies.
  - **Institutions**: The World Bank (WB), the World Trade Organisation (WTO), the International Monetary Fund (IMF) and the G20 promote the global adoption of market economies across the world.
    - At a regional level, there are organisations of several countries (geographically close, economic and cultural ties, etc.) such as the European Union (EU), the African Union (AU), the North America Free Trade Agreement (NAFTA) or Mercosur (South America). The countries in this organisations offer each other assistance and have a common political and economic ideology. There are no duties or tariffs within their borders.
  - **Multinational corporations**: they operate with a global strategy in order to obtain the highest profit.

THE COMPONENTS OF ECONOMIC ACTIVITY IN A GLOBALISED ECONOMY

**PRODUCTION** → organised at a global scale (extraction of resources, factories, design, etc.)
- Offshoring.

**DISTRIBUTION** → global dimension, favoured by the improvements in transportation.

**CONSUMPTION** → more uniform throughout the world (mass dissemination of common tastes through advertising, for example).

CONSEQUENCES OF GLOBALISATION

<table>
<thead>
<tr>
<th>ADVANTAGES</th>
<th>DISADVANTAGES</th>
</tr>
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<tbody>
<tr>
<td>Increase of employment where multinational companies and their subsidiaries are located</td>
<td>Increase of the inequalities among the geoeconomic areas of the world.</td>
</tr>
<tr>
<td>Reduction of production costs, implying (not always) a reduction of prices</td>
<td>Multinationals may interfere economically and politically in less developed countries</td>
</tr>
<tr>
<td>Promotion of the competition, leading to greater qualities</td>
<td>Favourable for large businesses and</td>
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<tr>
<td></td>
<td>Offshoring is encouraged</td>
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</tbody>
</table>

6 GEOECONOMIC AREAS OF THE WORLD

The world can be divided into different geoeconomic regions depending on their integration into the global economy and their degree of development. Nowadays, the world is experiencing changes regarding which countries lead the world’s economy: China and USA are the leaders, and some traditional European economies are losing power. The main groups are the following:

- **Traditional economic focus**: the Triad.
  - North-America (USA and Canada), the European Union and Japan. Australia is generally included here.
o Despite their importance, they have less global influence.

o Regarding economic sectors:
  ▪ Primary sector: very little importance
  ▪ Secondary sector: focused on technology. Heavy industries have been offshored.
  ▪ Tertiary sector: the most important. Investments in science and technology. Importance of education.

o Very high consumption.

o Very high standards of living.

- **BRICS:**
  o Brazil, Russia, India, China and South Africa.
  o The most emerging countries in the world.
  o Rapid economic growth, and growing importance in the world’s economy.
  o Based on industrialisation (offshoring of multinational companies) because of flexible regulations, cheaper labour costs, etc.
  o Limited consumption because of limited salaries.

- **Historically underdeveloped countries with rapid growth:**
  o Asia: South Korea, Taiwan, Singapore, Malaysia, Indonesia, Turkey, Saudi Arabia, etc.
  o America: Mexico, Argentina, etc.
  o They can be either offshoring locations, or based on abundance of natural resources (oil, gas, minerals, etc.). Importance of primary-sector exports, raw materials and industrial products.
  o Great social divisions.

- **Underdeveloped areas:**
  o Mostly in Africa, Asia and Sub-Saharan Africa.
  o Traditional agrarian activities, with little and barely advanced industry.
  o Very low consumption due to low standard of living.
  o In most of the cases, marginal place in global economy.

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**GLOSSARY**

<table>
<thead>
<tr>
<th>Economic activity</th>
<th>Primary sector</th>
<th>Economic system</th>
</tr>
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<tbody>
<tr>
<td>Goods</td>
<td>Secondary sector</td>
<td>Capitalism</td>
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<tr>
<td>Services</td>
<td>Tertiary sector</td>
<td>Socialism</td>
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<tr>
<td>Needs</td>
<td>Economic agents</td>
<td>Neoliberalism</td>
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<tr>
<td>Production</td>
<td>Private sector</td>
<td>Keynesianism</td>
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<tr>
<td>Distribution</td>
<td>Families</td>
<td>Economic globalisation</td>
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<tr>
<td>Factors of production</td>
<td>Public sector</td>
<td>The Triad</td>
</tr>
<tr>
<td>Capital</td>
<td>Labour</td>
<td>BRICS</td>
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<tr>
<td>Natural resources</td>
<td>Labour market</td>
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</tbody>
</table>
VIDEO – ECONOMIC SYSTEMS AND MACROECONOMICS: CRASH COURSE ECONOMICS #3

1. Why can’t we have all we want?
2. What are the three questions all economic systems answer?
3. What is the main difference between free market and planned economies?
4. What is the ‘invisible hand’, according to Mr. Clifford?
5. What is the role of the government in the free market economy?
6. What does the ‘circular flow model’ reflect?
7. Is there any better economic system? Why?
8. Why do most countries have mixed economic systems?

REVISE

1. Complete the diagram about the economic activity.

2. Think about five different goods or services you or your family have acquired in the last month, and try classifying them (see section 1). Explain briefly what type of needs they have satisfied.

3. Explain what type of resources the following are:
   A forest
   Coal
   Sea water
   Livestock
   Rain
   Wind
   Iron ore
4. Link the concepts and characteristics.

1. Goods

2. Neoliberalism

3. Needs

4. Secondary sector

5. Distribution

6. Tertiary sector

7. Natural resources

8. Capital

9. Services

10. Primary sector

11. Consumption

12. Technology

a) Combination of non-natural resources for production

b) They can be either basic or non-basic

c) All activities that provide services

d) Transfer of products

e) Agriculture, livestock farming, forestry, silviculture.

f) Intangible commodity

g) Transformation of natural resources into products

h) It combines knowledge, methods and procedures

i) Post-1979 capitalism

j) Material commodity

k) Biological, mineral and sources of energy

l) Acquisition of commodities

5. Comment the following graphs.

a. What type of graph is this? What is it about?

b. What elements appear in each of the axis?

c. Taking into account the information of the graph, what can you say about the importance of each economic sector in the economy of this country?

d. What type of country is reflected here? (in what geoeconomic region is it?) Justify your answering by also writing about the characteristics of the other regions.
6. Complete the diagram about the economic agents with the following actions.
   e. Pay taxes
   f. Regulate. Provide infrastructure, services and funding. Buy goods and services.
   g. Sell labour (workforce), purchase goods and services
   h. Pay taxes. Sell goods and services
   i. Provide infrastructure, services and funding (subsidies, help, etc.).
   j. Hire workers, pay wages, sell goods and services.

7. Classify the following jobs, and mention the possible problems they may face taking into account the contents of section 3.
   a. Lawyer
   b. Bricklayer
   c. Homemaker
   d. Secondary school student
   e. Shepers
   f. Taxi driver
   g. Doctor
   h. Beekeeper
   i. Assembly line worker in a factory
   j. Farmer
   k. Waiter in a restaurant in Benidorm
   l. Professional basketball player

8. Copy the following table in your notebook, and complete it.

<table>
<thead>
<tr>
<th>ECONOMIC SYSTEMS</th>
<th>FREE MARKET ECONOMY</th>
<th>PLANNED ECONOMY</th>
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<tbody>
<tr>
<td>Called</td>
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<td>Control of the economy</td>
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<td>Property of companies and resources</td>
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<td>Price regulation</td>
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<td>Competition</td>
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<td>Role of the State</td>
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<td>Role of businesses</td>
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<td>Main objective</td>
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Do globalisation and world trade fuel inequality?

Rising inequality since the 1980s is clearly a serious problem that merits political attention. But focusing solely on trade is not the way to resolve it.

Jeffrey Frankel.

Inequality has become a major political preoccupation in the advanced economies – and for good reason. In the US, according to the recently released World Inequality Report 2018, the share of national income claimed by the top 1% of the population rose from 11% in 1980 to 20% in 2014, compared to just 13% for the entire bottom half of the population. Qualitatively similar, though less pronounced, trends characterise other major countries such as France, Germany, and the UK.

To explain the rise in inequality that began in the 1980s and has accelerated since the turn of the century, many have pointed out that indicators of globalisation, such as the trade-to-GDP ratio, have also risen since 1980. But does that correlation imply a causal link between trade and inequality?

There are certainly reasons to doubt it. The global trade-to-GDP ratio peaked in 2008 at 61%, after a 35-year climb, falling back to 56% by 2016 – at precisely the time when fear of globalisation reached political fever pitch.

What if we look at the world as a whole, rather than individual countries? As Columbia’s Xavier Sala-i-Martin pointed out in 2002 and 2006, even as inequality has risen in nearly every country, inequality across countries has decreased, owing largely to the success of developing countries such as China and India in raising their per capita incomes since the 1980s.

Multiple factors, including urbanisation, high savings rates, and improved access to education, undoubtedly underlie these countries’ impressive performance. But, if one uses geography to isolate exogenous determinants of trade, it becomes apparent that trade has been among the most powerful drivers of Asia’s economic success, and thus the convergence between the developed and developing worlds.

For someone such as the US president, Donald Trump, this would indicate that Asia’s success has come at America’s expense. This view of trade as a zero-sum game was a feature of the mercantilist theory that reigned three centuries ago, before Adam Smith and David Ricardo made the case that trade would normally benefit both partners, by enabling each to take advantage of their comparative advantages.

But the Smith-Ricardo theory has a key limitation: it does not distinguish among a country’s citizens, and therefore cannot address the question of income distribution within a country. [...]

The theory [the Heckscher-Ohlin-Stolper-Samuelson model], which dominated international economic thinking from the 1950s through 1970s, predicted that international trade would benefit the abundant factor of production (in rich countries, the owners of capital) and hurt the scarce factor of production (in rich countries, unskilled labour). Workers could command higher wages if they did not have to compete against abundant labour in poorer countries.

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1 The trade-to-GDP ratio is an indicator of the relative importance of international trade in the economy of a country.

2 Mercantilism is a national economic policy that is designed to maximize the trade of a nation. Mercantilism was dominant in modernized parts of Europe from the 16th to the 18th centuries. It promotes government regulation of a nation’s economy for the purpose of augmenting state power at the expense of rival national powers.
It was [in the 1980s] that the Heckscher-Ohlin-Stolper-Samuelson trade theory’s prediction that free trade would hurt lower-skill workers in rich countries apparently began to materialise.

Yet not all of the Heckscher-Ohlin-Stolper-Samuelson theory’s predictions have come true. As Pinelopi Goldberg and Nina Pavcnik reported in 2007, the expectation that trade would reduce inequality in the countries with the most unskilled workers, because their services are in greater demand in an integrated world market, has not been borne out. They write: “There is overwhelming evidence that less-skilled workers in developing countries are generally not better off, at least not relative to workers with higher skill or education levels.” In the same year, Branko Milanović and Lyn Squire also found that tariff reduction is associated with higher inequality in poor countries.

Ten years later, inequality continues to worsen within developing countries, including the so-called BRICS emerging economies. In Brazil, the top 1% accounts for 25% of national income. In Russia, the income share of the top 1% of the population increased from 4% in 1980 to 20% in 2015. Likewise, in India, that figure rose from 6% in 1982 to 22% in 2013. In China, it surged from 6% in 1978 to 14% in 2015. And, in South Africa, it rose from 9% in 1987 to 19% in 2012. A look at the top 10% of earners shows similar trends.

Answer the following questions in your notebook:
1. Look for the meaning of the underlined words and concepts.
2. How has inequality changed over the last 40 years?
3. What does paragraph 2 mean?
4. What differences are found when economists look at the world, and not just to individual countries, when speaking about inequality?
5. What factors are to be taken into account when speaking about Asia’s recent economic success?
6. What did Adam Smith and David Ricardo think about trade competition?
7. What did the different authors or models say about labour? What have the consequences of the process of globalisation been?
8. How has globalisation affected unskilled workers around the globe?
9. What is the main problem of the BRICS?
EXTRA WORK - ANALYSE THESE ADS

After studying the economic activities and their role, as well as how consumers decide about consumption, comment these ads of Apple Computers. Analyse as well the type of product it advertises, the factors of production needed for its production, how the processes for their production are, etc.