

# ECONOMY

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September 28, 2025

## RECOMMENDED CITATION

Mohammed loot (2025). *ECONOMY*. Encyclopedia of psychology. Retrieved from <https://encyclopedia.arabpsychology.com/?p=10155>

Economy

## The Core Definition of Economy

An **economy** fundamentally represents the intricate system through which a society produces, distributes, and consumes goods and services. It encompasses all activities related to labor, capital, and resources, driven by the interactions of individuals, businesses, and governments. At its heart, an economy is concerned with the allocation of scarce resources to satisfy unlimited wants, a perpetual challenge that shapes human civilization. This broad concept can be applied to a household, a city, a nation, or, as increasingly relevant in the modern era, the entire world.

The **global economy**, therefore, refers to the worldwide interconnectedness of economic activities, where the production, distribution, and consumption of goods and services transcend national borders. It is characterized by international trade, cross-border capital flows, labor migration, and the diffusion of technology. The key idea underpinning the global economy is that events or policies in one part of the world can have ripple effects across continents, influencing everything from commodity prices to employment rates in distant nations. This interconnectedness means that no single country's economy operates in isolation, making understanding global economic dynamics paramount for national prosperity and stability.

In 2020, the global economy faced an unprecedented test with the emergence of the **COVID-19 pandemic**. This health crisis rapidly evolved into a severe economic shock, causing a sharp and widespread contraction in economic activity across virtually all sectors and regions. The fundamental mechanism disrupted was the free flow of goods, services, and labor, as governments implemented measures to contain the virus, leading to significant shifts in consumer behavior, business operations, and international commerce. The subsequent economic slowdown highlighted the fragility of highly integrated systems and the critical importance of coordinated global responses.

## Historical Context of the Global Economy

While the concept of international trade has existed for millennia, the modern notion of a truly integrated **global economy** largely began to take shape after the Industrial Revolution, accelerating significantly in the latter half of the 20th century. Key historical periods and events, such as the post-World War II Bretton Woods Agreement, established institutions like the International Monetary Fund (IMF) and the World Bank, which were instrumental in fostering international monetary cooperation and facilitating global trade. These frameworks laid the groundwork for increased globalization, characterized by reduced trade barriers, advancements in transportation and communication technologies, and the rise of multinational corporations.

The period leading up to 2020 saw an era of increasing economic interdependence, driven by

these historical trends. However, this period also experienced various crises, such as the Asian financial crisis of the late 1990s and the global financial crisis of 2008, which demonstrated the vulnerabilities inherent in a highly interconnected system. These events underscored the need for robust international cooperation and adaptable economic policies. The comparison drawn by the IMF in 2020, estimating a contraction worse than any since the Great Depression of the 1930s, places the **COVID-19 pandemic's** economic impact in a stark historical perspective. The Great Depression, a severe worldwide economic depression that took place during the 1930s, was characterized by widespread unemployment, deflation, and a collapse of international trade, providing a historical benchmark for extreme economic downturns.

The origin of the challenges faced in 2020, therefore, is rooted not only in the immediate health crisis but also in the complex evolution of global economic structures. Over decades, businesses had optimized for efficiency through extensive global **supply chains**, often relying on just-in-time production and single-source suppliers. This optimization, while highly efficient in stable times, proved vulnerable to widespread disruptions. Similarly, labor markets had become increasingly globalized, with significant cross-border movement of workers and reliance on international talent pools. The sudden restrictions on movement and economic activity caused by the pandemic exposed these inherent fragilities, highlighting how historical developments in globalization had created both immense opportunities and significant systemic risks.

### A Practical Example: The Impact of Supply Chain Disruption

To illustrate the practical application of global economic principles and the impact of the 2020 crisis, consider the everyday scenario of a consumer purchasing a new smartphone. This seemingly simple transaction is, in fact, the culmination of a vast and complex global **supply chain**. Components like microchips might originate from Taiwan, screens from South Korea, rare earth minerals from China, and assembly often takes place in Vietnam or India. These components are then shipped across oceans, assembled in factories, and finally distributed to retailers worldwide.

When the **COVID-19 pandemic** struck in 2020, it created immediate and profound disruptions to this intricate process. For instance, factory shutdowns in specific regions, enacted to contain the virus, directly halted the production of critical components. Port closures and reduced shipping capacity led to significant delays in transporting goods across borders. Furthermore, travel restrictions impacted the movement of specialized engineers and technicians crucial for troubleshooting and optimizing these global operations. The "how-to" of this disruption is evident in the cascade of effects:

**Initial Shock:** A factory in a key manufacturing hub, say in Asia, is forced to close due to a local lockdown. This immediately stops the production of a vital component, such as a specific type of

microchip.

**Supply Shortage:** Manufacturers of smartphones, located elsewhere, cannot receive the necessary microchips. Their production lines slow down or halt entirely, leading to a shortage of finished products.

**Rising Costs:** The limited supply of available components drives up their prices. Shipping costs also increase due to reduced capacity and new logistical challenges. These increased costs are then passed down the chain.

**Consumer Impact:** For the consumer, this translates into higher prices for new smartphones, limited availability of desired models, and longer waiting times for pre-orders. A product that might have been readily available at a certain price point suddenly becomes scarce and more expensive, directly reflecting the global economic upheaval and the breakdown in international **supply chains**. This example vividly demonstrates how macro-level disruptions in the global economy directly affect individual purchasing power and market availability.

## Significance and Impact of Global Economic Dynamics

Understanding the dynamics of the **global economy** is of paramount importance to the field of economics and indeed to policymakers, businesses, and individuals worldwide. The events of 2020 underscored just how interconnected national economies have become, demonstrating that a crisis originating in one sector or region can rapidly cascade across the globe. The IMF's projection of a 4.4% contraction in the global economy, the worst since the Great Depression, highlights the scale of this impact. Such downturns lead to widespread job losses, business failures, and significant reductions in living standards, making the study of global economic resilience and recovery strategies critical.

The impact is not merely theoretical; it manifests in tangible ways, such as the sharp rise in global **unemployment**. The International Labour Organization (ILO) estimated that nearly 200 million people could have been affected by job losses globally in 2020, a figure that profoundly affects social stability and human welfare. This widespread joblessness reduces consumer demand, further exacerbating economic contraction in a vicious cycle. Moreover, the disruption to global trade, particularly impacting export-dependent nations like China and Germany, demonstrated how essential open and functional international markets are for sustaining national economic growth and prosperity.

The concept of the global economy is applied today in various critical domains. Governments utilize insights into global economic trends to formulate national fiscal policy (e.g., government spending and taxation) and monetary policy (e.g., interest rates and money supply), aiming to stabilize their domestic economies and foster sustainable economic growth. International

organizations like the IMF and the World Trade Organization (WTO) use this understanding to coordinate global responses to crises, promote free trade, and provide financial assistance. Businesses, particularly multinational corporations, rely on detailed analysis of global economic conditions to make strategic decisions regarding investment, production location, and market entry. Furthermore, the crisis spurred accelerated adoption of new technologies and the development of green technologies, presenting new pathways for future economic growth and environmental sustainability.

## Connections and Relations in the Global Economy

The study of the **global economy** is intricately linked to several other key psychological terms and theories, particularly within the subfields of behavioral economics and decision-making under uncertainty, though here we focus on its core economic connections. It primarily belongs to the broader category of **Macroeconomics**, which focuses on the behavior of the economy as a whole, including phenomena such as inflation, price levels, economic growth, national income, gross domestic product (GDP), and unemployment. Within Macroeconomics, it often falls under **International Economics**, which specifically examines the economic interactions between countries.

Several critical concepts are directly related to the functioning and analysis of the global economy:

**Fiscal Policy:** This refers to the use of government spending and taxation to influence the economy. In response to the 2020 crisis, governments worldwide implemented substantial fiscal measures, such as stimulus packages and aid to businesses and households, to mitigate the economic contraction and stimulate demand.

**Monetary Policy:** Managed by central banks, this involves controlling the supply of money and credit to influence interest rates and inflation. Central banks globally enacted expansive monetary policies, including asset purchases and interest rate cuts, to reduce borrowing costs and support economic activity during the pandemic.

**Inflation:** This is the rate at which the general level of prices for goods and services is rising, and subsequently, purchasing power is falling. While stimulus measures were crucial for recovery, they also introduced the risk of future inflation, a key concern for economic stability.

**Supply Chains:** These are the networks between a company and its suppliers to produce and distribute a specific product to the final buyer. The 2020 pandemic highlighted the vulnerability of extended global supply chains to disruptions, leading to shortages and affecting global trade.

**Unemployment:** This refers to the state of being jobless while actively seeking employment. A severe consequence of economic downturns, global unemployment surged in 2020 as businesses

scaled back operations or closed entirely.

The intertwined nature of these concepts means that changes in one area, such as a shift in a nation's fiscal policy, can have far-reaching effects on global trade, inflation, and unemployment rates across the world. The challenges and opportunities observed in 2020 underscore the perpetual need for a holistic understanding of these connections to navigate the complexities of the global economic landscape.

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