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ECONOMICS

The Global Economy

STIMULUS MATERIAL

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DURATION: 2 hours

plus your additional time allowance

MODIFIED ENLARGED

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Loose sheets for Fig. 2.1 and Fig. 4.3

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Introduction

In the second half of 2013 there were signs that the UK economy was set to enter the recovery phase of the economic cycle. Not only had real GDP increased in two consecutive quarters, but the nature of the recovery gave some economists grounds for optimism because growth was not just confined to the service sector. These economists were confident that such a recovery would have the expected impact on UK unemployment. Such optimism and confidence was not shared by all economists, however. Some were concerned that long term unemployment continued to rise despite the recovery and that this might damage the future potential growth rate of the economy. These economists were also concerned that real wages continued to fall and that there had been little re-balancing of the UK economy away from consumption towards exports.

Part of the concern about future UK economic growth is its loss of international competitiveness. UK government policy to rebalance the economy by encouraging growth in exports and Foreign Direct Investment (FDI) has focused on reforms to the tax system, including tax allowances on investment and cuts in corporation tax. The UK government hopes that such measures will help to increase the international competitiveness of the UK economy over time.

Trade within the European Union (EU) has become more geographically concentrated. In 2011 EU intra-regional trade accounted for as much as 71% of the exports of EU member states. The level of economic integration is in most respects deeper than in other economically integrated areas of the world. There are a number of reasons for the impact of economic integration on the pattern of trade, including the trade creation and trade diversion effects of customs unions.

Global trade had risen in 2013, but the growth in trade remained weak. The rate of growth in trade had more than halved in 2012. Over the longer term, the pattern of global trade continues to change. The share of world trade accounted for by trade between developed and developing economies continues to increase. There is also some evidence of greater regionalisation of trade. Some economists are uncertain about whether these changes in the pattern of trade can be explained by the theory of comparative advantage alone.

Despite the weak performance of global trade and of individual developed economies and regions, globalisation continues to be an economic force that affects the lives of many. However, there is a debate about whether the impacts of globalisation have been largely beneficial to developing economies.

Pre-release stimulus material

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EXTRACT 1

UK enters recovery phase of the economic cycle?

UK GDP grew by 0.6% in the second quarter of 2013. This was double the growth in the first quarter of the year and, at an annualised rate, equivalent to a 2.4% growth in GDP. This was the first time since the middle of 2011 that UK national output had increased for two consecutive quarters. Some economists claimed that the UK's long-awaited recovery had finally begun. The Chancellor of the Exchequer, George Osborne, claimed that the economy was "healing".

Positive signs that the UK economy had entered the recovery phase of the economic cycle included the broad based nature of growth. Output had grown in all four sectors of the economy – services, manufacturing, construction and agriculture. Growth in the services sector of the economy was 0.6% in the second quarter of 2013 leaving its total output only 0.2% below its peak at the beginning of 2008. Services make up around 80% of UK GDP, so they provided the largest contribution to growth. Unemployment also moved in the right direction, falling from its peak of 2.56 million in January 2013 to 2.51 million in May 2013.

However, some economists expressed concerns about the strength of the UK economic recovery and the extent to which it could be sustained into the future. John van Reenen, Professor of Economics at the London School of Economics, was concerned about trends in the labour market. His concerns focused on two aspects in particular. Since the peak of the economic cycle in 2007 he noted:

the continued rise in long term unemployment, with more than 900,000 unemployed for more than a year – 36% of the total number of people unemployed

a fall in the employment rate from 73.1% at the end of 2007 to 71.4% in 2013, despite the rise in employment.

He warned that these trends could adversely affect the future potential growth rate of the economy. The views of two other economists are presented in Figs 1.1 and 1.2.

Fig. 1.1 – The views of David Blanchflower, former member of the Monetary Policy Committee, about the UK economic recovery, July 2013

I see little prospect that this growth rate will be sustained into the future, despite what George Osborne says. There is scant evidence that any of the four components of growth – investment, consumption, net trade or government expenditure – are at ‘blast-off stage’ and net business lending continues to fall.

We need to remind ourselves that the economy has only grown 1.8% in total over the past 11 quarters and, of that, 0.7% is due to investment in the Olympics. In contrast, over the same period, both Canada and the United States of America grew by 5%. Most forecasters are not expecting much, if any, growth in the second half of the year.

The economy that Osborne inherited was also growing at 0.6% per quarter, and that continued for a couple more quarters until his reckless austerity policy and talking down of the economy took effect. Plus he still has no growth plan. Moreover, the last time there was growth of 0.6% was in the third quarter of 2011 which was followed by –0.1%, zero and –0.5% growth in the following three quarters.

Fig. 1.2 – The views of Liam Halligan, Chief Economist at Prosperity Capital Management, about the UK economic recovery, July 2013

We remain locked in the most feeble economic recovery in our history.

Beyond the headline numbers, real wages continue to fall as inflation erodes purchasing power. Including population growth, UK real GDP per head is actually some 7% below its 2007 peak.

In addition, there has been no sign of the ‘rebalancing’ away from consumption and towards exports and investment that the Coalition Government said it wanted. Back in 2010, Osborne declared his confidence in ‘a march of the makers’, claiming that manufacturers would power growth via a surge in exports. It hasn’t happened.

Despite the pound falling some 20% against our main trading partners in recent years, UK exports have slumped, doing nothing to foster growth, improve our national accounts, or tackle the chronic job insecurity felt by millions. The UK’s external sector remains a drag on growth, adding to our ever-deepening indebtedness.

So, yes, the UK economy has grown for two consecutive quarters. Yet, by 2015, Osborne will have borrowed more in five years than Gordon Brown did in over a decade. The UK’s national debt is now £1100 bn, up from £580 bn in 2008 and set to soar above £1500 bn over the next few years.

EXTRACT 2

UK net trade and international competitiveness

A loss of comparative advantage is an important concern for future economic growth in the UK. Net trade continues to be a drag on such growth. As the UK economy enters the recovery stage of the economic cycle, net trade continues to be negative (see Fig. 2.1 on the loose sheet).

The UK government stated in its 2011 Plan for Growth that it would aim to ‘rebalance’ the economy by encouraging growth in UK exports and FDI. This was one of the government’s four priorities for achieving growth. The others were:

reforms to the tax system

measures intended to make the UK a more attractive place to start a business

measures intended to create a more educated and a more flexible workforce.

As a result of the globalisation of the world economy, the long-run economic performance of an individual economy is increasingly determined by its international competitiveness. There is no single measure of an economy’s international competitiveness. Many measures, such as the terms of trade and relative unit labour costs, focus on price and cost competitiveness. Other measures, such as the Global Competitiveness Index produced by the World Economic Forum (WEF), create an index of competitiveness using many different

indicators. The Global Competitiveness Index uses a range of indicators which measure:

the effectiveness of institutions

the quality of infrastructure

macroeconomic performance

health and primary education

higher education and training

the efficiency of goods and labour markets

technological readiness

the sophistication of business

innovation.

On this measure of international competitiveness the UK has gradually improved since 2008/09. Ranked 12th in the world in 2008/09, the UK economy had risen to 8th place in the WEF's global competitiveness rankings in 2012/13. The UK Treasury welcomed the WEF assessment: 'The UK is becoming more competitive thanks to this government's reforms – creating a more flexible and educated workforce; simplifying our tax system, and reducing the main rate of corporation tax, as well as scrapping burdensome regulation and simplifying planning rules.'

Fig. 2.2 shows a number of policies which the UK government believes will further improve the international competitiveness of the UK economy.

Fig. 2.2 – Selected UK government policies to improve international competitiveness, July 2013

Investment in infrastructure	<p>public sector investment in infrastructure worth over £100 bn by 2020</p> <p>government guarantees for lenders financing infrastructure projects</p>
Increasing access to finance for business	<p>the creation of a Funding for Lending Scheme which allows banks and building societies to borrow from the Bank of England at less than market rates for up to four years</p> <p>the creation of a £1 bn Business Bank to help smaller businesses access finance and support</p>
Encouraging businesses to invest	an increase in the tax allowance on investment from £25 000 to £250 000
Cutting corporation tax	a reduction in corporation tax from 23% to 20% by 2015
Simplifying business regulation	for every new regulation, the government has committed to remove two regulations
Creating an educated workforce	<p>changes to the curriculum to improve literacy and numeracy</p> <p>improving training and apprenticeships</p>

EXTRACT 3

Regional economic integration in the global economy

The World Trade Organization (WTO) publishes an annual report on world trade. Its 2013 report noted a trend towards greater regionalisation of trade, particularly in both Asia and Europe. For example, EU intra-regional trade accounted for 71% of exports of EU member states in 2011.

This is not surprising given the widening and deepening of regional economic integration in Europe. The EU has its roots in the signing of the Treaty of Rome in 1957. Not only has the EU grown to include more economies through a series of enlargements, but the level of economic integration has deepened from the original formation of a customs union. This customs union resulted in both trade creation and trade diversion. Fig. 3.1 identifies the key elements of economic integration in the EU. This contrasts with economic integration in other regionally integrated areas of the world.

Fig. 3.1 – Key elements of economic integration in the EU

FOCUS OF INTEGRATION	PROGRESS IN THE EU
Tariffs and quotas	Trade between members of the EU is free of tariffs and quotas.

External trade policy	Members of the EU agree to a common external trade policy, which means that there is a common approach to tariffs and quotas on trade with non-members.
Non-tariff barriers to trade	These have been significantly reduced through a common approach to product standards and state aid to industry.
Common policies	Members of the EU share common policies in a number of areas, including agriculture, fisheries, the environment, competition and taxation.
Free movement of labour and capital	There are no restrictions on the movement of labour and capital within the EU, with the exception of transition arrangements for new members of the EU.
Economic policy-making	There have been some attempts to co-ordinate economic policy-making in the EU with, for example, some degree of tax harmonisation.
Monetary policy	17 of the current 28 members of the EU share a common currency, the euro, and therefore a common monetary policy. In addition, three of the remaining 11 member states belong to a fixed exchange rate system against the euro (ERM II).

EXTRACT 4

Trends in world trade and the pattern of global trade

The WTO's 2013 World Trade Report also highlighted a fall in the growth of world trade from 5.2% in 2011 to 2.0% in 2012. This growth in trade was below the average rate of 5.3% for the previous 20 years. The reasons for this were slow growth in GDP in developed economies and the continued uncertainty about the future of the euro. Growth in world trade in the first quarter of 2013 remained sluggish, despite continued positive economic developments in the USA which had experienced 2.3% growth in GDP in 2012. Weak performance by economies in the EU offset the positive impact on world trade of the sustained growth in GDP in the USA.

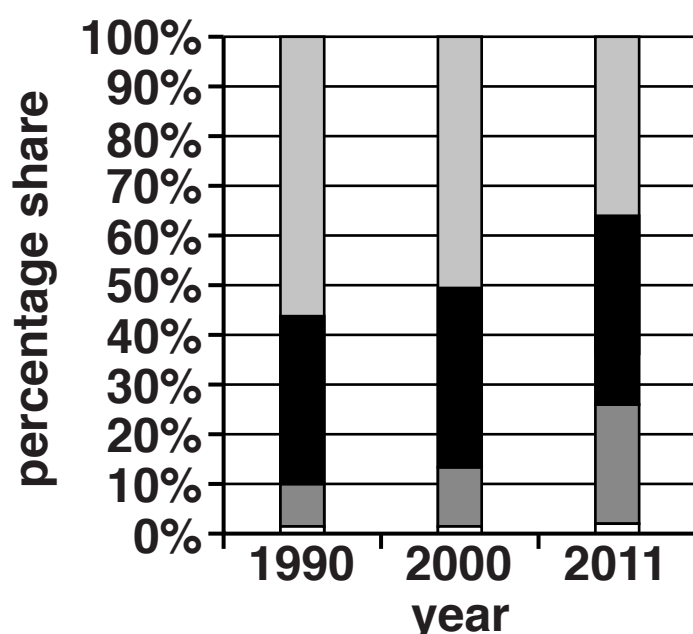
Fig. 4.1 gives a comparison of growth rates in selected countries, regions and types of economy in 2012.

Fig. 4.1 – A comparison of growth rates, 2012

	Real GDP growth (%)
Africa	9.3
China	7.8
USA	2.3
Japan	1.9
Newly industrialised Asian economies	1.8
Developed economies	1.2
EU	–0.3

The WTO's World Trade Report of 2013 also provided useful insights into the pattern of global trade and changes in comparative advantage for selected economies and industries. Figs 4.2, 4.3 and 4.4 provide a summary of some aspects of the global pattern of trade. The extent of intra-industry trade is measured using an index. The closer this index is to 100, the more significant intra-industry trade is for a country. The closer this index is to 0, the more a country imports and exports goods and services produced by different industries. Fig. 4.5 shows changes in comparative advantage for selected industries and countries.

Fig. 4.2 – Shares of trade between developed countries, between developed and developing countries and between developing countries, 1990–2011



Please see loose sheet for Fig. 4.3.

Fig. 4.4 – Index of intra-industry trade for selected economies, 1996 and 2011

COUNTRY	1996	2011
Hong Kong	70	66
Singapore	65	65
USA	61	62
EU (27)	N/A	60
Zambia	18	17
Central African Republic	8	2

Fig. 4.5 – Changes in comparative advantage, 1990–2011

PRODUCT	COUNTRIES GAINING COMPARATIVE ADVANTAGE	COUNTRIES LOSING COMPARATIVE ADVANTAGE
Manufactures	Chile, China, France, Hungary, Malaysia, Mexico, Poland, Singapore, Thailand, Turkey	Australia, Brazil, Canada, Finland, India, Norway, Russian Federation, South Africa, Sweden, UK
Office and telecom equipment	Chile, China, Czech Republic, Greece, Hungary, Hong Kong, Indonesia, Mexico, Poland, Slovak Republic	Australia, Austria, Brazil, Canada, Ireland, Italy, Japan, Russian Federation, Switzerland, UK
Machinery	Chile, China, Estonia, Greece, Iceland, Indonesia, Republic of Korea, Mexico, Thailand, Turkey	Australia, Germany, Ireland, Israel, Poland, Russian Federation, Spain, Sweden, Switzerland, UK

EXTRACT 5

Characteristics and impact of globalisation

Globalisation is a process through which national economies have become increasingly integrated and inter-dependent. It has a number of characteristics, including:

greater trade in goods and services between the world's economies

greater transfer of financial capital between the world's economies and greater FDI

greater transfer of technology and information between the world's economies

greater specialisation in production, including outsourcing and offshoring

greater labour migration, both within and between the world's economies

the development of global brands

the inclusion of more economies in the global trading system, including Central and Eastern European economies, China and other so-called emerging economies.

The impact of globalisation remains an issue which divides economists. Figs 5.1 and 5.2 present the views of the IMF and Joseph Stiglitz, former chief economist of the World Bank, respectively.

Fig. 5.1 – IMF overview of globalisation

There is substantial evidence, from countries of different sizes and different regions, that as countries ‘globalise’ their citizens experience benefits. These benefits include access to a wider variety of goods and services, lower prices, more and better paid jobs, improved health and higher overall living standards. As a number of countries have become more open to global economic forces over the past 20 years, the percentage of the developing world living in extreme poverty – defined as living on less than US\$1 per day – has been cut in half.

However, there is much more to be done. Regional disparities persist: while poverty fell in East and South Asia, it rose in sub-Saharan Africa. The United Nations Human Development Report notes there are still around 1 billion people surviving on less than US\$1 per day and 2.6 billion living on less than US\$2 per day. Supporters of globalisation argue that this is not because of too much globalisation, but rather too little. The biggest threat to continuing to raise living standards throughout the world is not that globalisation will succeed, but that it will fail. It is the people of developing economies who have the greatest need for globalisation, as it provides them with the opportunities that come with being part of the world economy.

Fig. 5.2 – Joseph Stiglitz on globalisation, ‘Making Globalisation Work’

The current process of globalisation is generating unbalanced outcomes, both between and within countries. Wealth is being created, but too many countries and people are not sharing in its benefits. They also have little or no voice in shaping the process. Seen through the eyes of the vast majority of women and men, globalisation has not met their simple and legitimate aspirations for decent jobs and a better future for their children. Many of them live in the limbo of the informal economy without formal rights and in a swathe of poor countries that subsist precariously on the margins of the global economy. Even in economically successful countries some workers and communities have been adversely affected by globalisation. Meanwhile the revolution in global communications heightens awareness of these disparities... these global imbalances are morally unacceptable and politically unsustainable.

The World Commission on the Social Dimensions of Globalisation found that 59% of the world's people were living in countries with growing inequality, with only 5% in countries with declining inequality. Even in most of the developed countries, the rich were getting richer while the poor were often not even holding their own. In short, globalisation may have helped some countries – GDP may have increased – but it has not helped most of the people in these countries.

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