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A2 GCE ECONOMICS

F585/01/SM The Global Economy

STIMULUS MATERIAL (Clean Copy)

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Introduction

The start of 2016 saw the global economy in a state of flux. Some of the economies that had seen rapid growth for many years in the new millennium were in the process of slow down, for example China. Some were even suffering recession such as Brazil and Russia. On the other hand others, including India, continued along a rapid growth path. In the developed northern hemisphere it was an equally chequered picture with the likes of the USA, and in particular, the UK showing signs of slow but nevertheless consistent growth, averaging around 2.5% annually, while others such as Germany, France and Italy struggled to achieve an average of 1%. Japan, another leading G7 economy was barely able to average 0.5%.

While the short term picture in the UK was rosier than most, the signs were that the recovery being experienced was more a case of short run increased capacity usage rather than long run growth. The lack of inflationary pressure present in the economy, despite employment numbers being at an all-time high, was indicative of such. With the Chancellor still firmly focused on deficit reduction, it was difficult to see where the necessary investment funds would materialise from in order to pay for, for example, infrastructure projects, so necessary for facilitating long run capacity growth.

The globalised economy of 2016 was far more interdependent than in the past. Uncertainty within large and established markets impacted greatly on the economies of emerging and developing countries. One policy option for nations heavily dependent on the sales of basic commodities was to allow their currencies to depreciate on foreign exchange markets. This could potentially provide a boost to exports, and in consequence, a vital injection into sluggish domestic markets. Alternatively, where appropriate, for example in Brazil, the removal of import barriers was seen as a potential option to solve domestic problems. For, despite the very considerable gains made in that country in terms of greater equality and development, it was experiencing the scourge of stagflation.

Another policy option available to less developed nations is to join the increasing bid to attract foreign direct investment (FDI). This is typified by the Cuban example that is the Special Economic Development Zone of Mariel. This multi-million dollar project to establish a giant free trade zone and container port is a flag ship investment to attract foreign capital investment.

Friday 25th of March 2016 saw the Rolling Stones play a free concert in Havana to an audience of half a million locals. This was the first of its kind in Cuba and it followed hot on the heels of President Obama's visit to the island – the first by a US president in almost 90 years. Both events are seen as significant signs of the opening up of one of the world's last remaining command economies. A major step in its transition will be to attract inward capital investment. A major hurdle will be to try and overcome a lack of business confidence amongst foreign companies considering dipping their toes into, historically, such an overtly communist country.

Pre-release stimulus material

Extract 1: UK in the Vanguard of Recovery, but Chancellor Sounds a Note of Caution

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Extract 3: Brazil

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Extract 1

UK in the Vanguard of Recovery, but Chancellor Sounds a Note of Caution

Extract 2

Uneven Prospects for Global Growth in 2016

Adapted from World Economic Outlook (WEO), 'Adjusting to Lower Commodity Prices', October 2015, www.imf.org, International Monetary Fund. Item removed due to third party copyright restrictions.

Fig. 2.1 World Economic Outlook: Overview selected world output growth figures.

Extract 3

Brazil

Brazil is both South America's most populous country and largest economy, with a GDP of $2.4 trillion in 2014. Since the turn of the millennium there have been improvements in a number of development indicators: reductions in poverty, a fall in the Gini co-efficient, improvements in health care provision and a rise in school attendance. However, such progress did not prevent the Brazilian Government from facing serious criticism, both over the need for structural reform and with regard to its current economic crisis.

Between 2000 and 2014, 26 million people were lifted out of poverty and Brazil's HDI score improved from 0.683 to 0.755; the Gini co-efficient fell 6% in 2013 to 0.54. The income of the bottom 40% of the population grew on average 6.1% in real terms between 2002 and 2012, notably faster than the income of the total population. Inequality was gradually being reduced.

Brazil significantly increased educational expenditure from 3.8% of GDP in 2002 to 5.8% in 2010. There was a rise in enrolment across the primary, secondary and university sectors. This significant rise in investment in human capital yielded more modest returns than anticipated. At secondary level, for example, students in both Chile and Mexico achieved higher levels of attainment despite lower levels of public investment. In Brazil, low teachers' salaries led to staff moonlighting and many students dropped-out before the completion of their course.

Other evident weaknesses threaten the achievement of further development gains in Brazil. The Global Competitive Index produced by the World Economic Forum reveals a marked deterioration in Brazil's competitiveness over recent years. In 2012–13 Brazil ranked 48th of 144 countries, but by 2015–16 had sunk to 75th of 140 countries. Particular problems included hiring and firing practices; the effect of taxation on incentives to work and invest; the quality of infrastructure and the burden of government regulation. It can take in excess of 100 days to start a business. It should be no surprise that the informal economy accounted for 16% of GDP in 2014, featuring significantly in the construction and manufacturing sectors. Trade restrictions made matters worse. Brazil is one of the world's most protected economies.

More immediate concerns related to current macroeconomic indicators. At the beginning of 2016, Brazil was experiencing its worst recession in more than a century: GDP fell by around 4% in 2015 and was expected to fall by a further 2.0% in 2016; unemployment was rising and inflation was running at approximately 9%. The fiscal deficit, which was 2% of GDP in 2010, stood at 10% in 2015. Brazil's policy options in the face of stagflation were limited: increasing interest rates to tackle inflation would discourage much needed investment, while cuts in government spending could similarly suppress aggregate demand. One economic commentator remarked that Brazil was "living on the edge" and faced "a period of prolonged adjustment".

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Extract 4

Cuba opens a door to the world

Adapted from www.zedmariel.com, Zedmariel. Item removed due to third party copyright restrictions

Extract 5

More evidence of a changing Cuba

Unilever and British American Tobacco invest: A new realism in Cuba

The global consumer products company Unilever Plc has just announced a $35 million investment in Cuba's Special Development Zone at Mariel. Late last year, Brascuba, a joint venture with a Brazilian firm, Souza Cruz, owned by the mega-conglomerate British American Tobacco (BAT), confirmed it would build a $120 million facility in the same location. Brascuba will be moving its operations from an existing factory to the ZED Mariel site. So far, these are the two biggest investments in the much-trumpeted Cuban effort to attract foreign investment, outside of traditional tourism. However, it reflects a new willingness of Cuban authorities to accede to the corporate requirements of foreign investors. At last the Cuban government appear to grasp that Cuba is a price-taker, and that it must fit into the global strategies of their international business partners. Cuban negotiators can strike smart deals, but they cannot dictate the over-arching rules of the game.

Cuba still has a long way to go before it reaches the officially proclaimed goal of $2.5 billion in foreign investment inflows per year. Total approvals last year for ZED Mariel reached only some $200 million, and this year are officially projected to reach about $400 million. For many potential investors, the business climate remains too uncertain, and the project approval process too opaque and cumbersome. But the Brascuba and Unilever projects are definitely movements in the right direction.

In the design of the new joint venture, Cuba has allowed Unilever a majority 60% stake. Furthermore, in the old joint venture, Unilever executives complained that low salaries, as set by the government, contributed to low labour productivity. In ZED Mariel, worker salaries will be significantly higher: firms like Unilever will continue to pay the same wages to the government employment entity, but the entity's tax will be significantly smaller, leaving a higher take-home pay for the workers. Hiring and firing will remain the domain of the official entity, however, not the joint venture. Similarly, Brascuba will benefit from the new wage regime at Mariel. At its old location, Brascuba considered motivating and retaining talent to be among the firm's key challenges; the higher wages in ZED Mariel will help to attract and retain high-quality labour.

Brascuba believes this is a good time for expansion. Better-paid workers at Mariel will be well motivated, and the expansion of the private sector is putting more money into consumer pockets. The joint venture will close its old facility in downtown Havana, in favour of the new facility at Mariel, sharply expanding production for both the domestic and international markets (primarily, Brazil). A further incentive for investment today is the prospect of the lifting of US economic sanctions, even if the precise timing is impossible to predict. Brascuba estimated that US economic sanctions have raised its costs of doing business by some 20%.

The Unilever and Brascuba renewals suggest a new realism in the country. At ZED Mariel, Cuba is allowing their foreign partners to exert management control, and to hire a higher-paid, better motivated workforce. And thanks to the forward-looking diplomacy of Raúl Castro and Barack Obama, international investors are also looking forward to the eventual lifting of US economic sanctions.

US hotel company Starwood has become the first American firm to agree a deal with the Cuban authorities since the revolution of 1959.

Starwood will renovate and run three hotels in the Cuban capital, Havana. A spokesman for the company said they would be making a “multimillion-dollar investment to bring the hotels up to our standards”. The news comes on the eve of President Obama’s visit to the island – the first by a US president in almost 90 years. The deal is a welcome reminder of how far things have come between the two nations since they decided to normalise ties. Tourism in Cuba is at an all-time high, with a sharp rise in the number of US visitors, especially since travel restrictions were eased by President Obama.

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