World Economy and International Markets

The world economy and current international markets constitute a "whole" compound of nearly two hundred interlinked national economies; a network of countries, markets, sectors and populations, as well as entities, standards, and international organizations that we call, generically, "institutions".

In order to study world economy, with a vision focused on the pursuit of economic development, we use the term "structure" to highlight these multiple interrelations; with an approach that seeks to identify and analyse more permanent, "structural" characteristics.

To study the different national economies that make up the structure of these markets we need the series of tools and basic techniques presented in this manual. They include indicators and economic ratios, national accounts and macroeconomic pictures.

Although the structural and most permanent analysis of international business tends to reflect the stronger of these features, its convergence with short-term changes and trends is unavoidable; hence the need to understand and analyze the main indicators in the different national markets.

Economic indicators. Economic indicators are simple values that provide information about specific aspects of an economy in a given period of time. We can group them by *blocks of indicators.*

Production indicators (indices of agricultural production, livestock, industry, services and others). **Labour market indicators** (such as the number of affiliates to the Social Security, the registered unemployment, or the survey of the active population). **Indicators of wages and prices** (such as the consumer price index, the CPI, or industrial prices). **Demand indicators** related to private consumption (such as retail sales), public consumption (refers to the public administration, such as wages paid to public sector workers), investment or gross capital formation (purchases of machinery and equipment), and exports and imports (listed in the foreign trade statistics). **Indicators of the monetary and financial situation** (such as interest rate levels or the growth of credit to businesses, families or the public sector).

By tracking these indicators we can obtain relatively long time series which make it possible to deduce trends and behaviors. These time series are the succession of values of an economic magnitude of constant definition over time. Such monitoring is necessary to the extent that economies evolve in time seasonally and experience more or less intense fluctuations. Although such fluctuations, called cycles, are not regular, they recur and may have comparable intensity.

We talk about cycles only when the duration of fluctuations is greater than one year. Lower amplitude movements are usually seasonal (such as the sale of cement in winter) or specific variations (an increase in the price of oil, for example). According to duration, cycles can be divided into: 1) short cycles, between three and five years, which often coincide with the political and electoral cycles in developed countries; (2) medium cycles, between seven and ten years; (3) long cycles, called *Kondratieff*, of 40 years or more.

When assessing the evolution of each indicator we must take into account what is known as the **reference cycle**. This reflects the cyclical developments in the economy as a whole, and it can be compared with the cycles of each indicator. If an indicator has regular cycles with minimum and maximum points about three months ahead of the corresponding points of the reference cycle, it is an **advanced** indicator (e.g. the consumption of electrical energy). **Retarded indicators** are those in which the cycles take place about three months after the reference cycle. The remaining are **coincident** indicators (e.g. industry order-book levels).

In the so-called "classic cycle", GDP or income level decreases in the contraction phase (as happened in the US in 1929, 1973, 1993, or 2009). This is usually followed by a phase of recovery or expansion, which reaches a maximum or peak, to be succeeded by a phase of contraction or recession, with a minimum or valley. In the so-called "growth cycle", in the contraction phase the GDP does not decrease. It may grow more or less but it never falls.

Despite the temporary or "cyclical" nature of many indicators, we must highlight the need to study them, as some of those "short-term" variables in many countries have become permanent or "structural" problems (public deficit, debt, inflation, unemployment, etc.) In such cases, a normal development of markets of goods and services is impossible, preventing any chance of economic development; hence the need to undertake the so-called "structural reforms".

Structural or economic ratios are expressed as relationships between two or more economic variables, usually measured in percentage terms. They indicate

the more permanent characteristics of national economies. The most important are public deficit and public debt (which are defined later), tax burden, the external trade openness coefficient, investment rates, exports to imports ratio, propensity to consumption or to import, and others, which could be more or less useful in providing specific features, depending on each market.

Also the "*natural base*" or "physical infrastructure" (in the terminology of Professor Perpiñá Grau) can facilitate or hinder economic development and starts with the spatial or geographic location, and the possibility to enjoy locational advantages. The size of the internal market, which conditions the possibility to exploit economies of scale, is another important factor. Other elements are the determinants of agricultural productivity, the costs of transportation and water resources, climate, orography and hydrography, and, finally, soil, vegetation and the subsoil, in terms of fertility and eventual mineralogical potential.

Some nations, however, such as Switzerland, Spain or Japan, had an adverse "natural base" for the development of productive activities. Complicated communications, poor subsoil or decompensated climatology require very high levels of investment and accumulation of capital to remedy the "natural base" disadvantages. Building communication infrastructures, tunneling through mountains, constructing dams, building bridges and ports, reforesting or improving the environment, require vast accumulations of inter-generational savings.

Macroeconomic pictures represent a synthesis of the national accounts, and in this sense we could say that a macroeconomic picture is nothing more than an ordered set of data that allows us to know the main characteristics and magnitudes of the economy. They always include two or more past years and some forecasts. They are presented and included in the annual government budgets in most countries. Macroeconomic pictures can be used, among other things:

- As a summary and synthesis of the economic situation of a country; something like the ID, or the balance sheet of a company.
- To reveal the relationships that exist between the different economic variables.
- As a tool to analyze the economic development process of a country during certain years or in comparison with other countries during the same period.
- As a model of the economic reality that allows us to make simulations of the reactions in some variables as a result of changes in others.
- In many countries they are used to replace the national accounts, which are more complex.

Macroeconomic pictures provide information:

1. *On the demand side:* offering information about domestic demand (private consumption, public consumption and gross capital formation) and the external balance (exports minus imports).

2. *On the supply side:* indicating the sectoral composition of GDP so we can know how much each sector (agricultural, industrial and services) contributes to GDP. Some differential sub-sectors may appear for specific reasons: thus «construction» may be included in the industrial sector and «tourism» within services, for example.

Adding the information from the demand and the supply side we get GDP. Its evolution and growth rate will depend on the variables that influence it.

The macroeconomic picture is often accompanied by other indicators considered basic for the knowledge of the economy, such as public deficit, GDP per capita, productivity, or others.

Economic development determinants. In this course we will identify the impediments that hinder the processes of sustainable growth of countries, and therefore the development of markets that meet their needs. By "sustainable" we mean that they can be maintained in the long term, for future generations. In this sense, the new objectives (post 2015) of the United Nations Millennium Development Goals, fixed for 2030, declared a set of 17 goals through 169 indicators.

If we were to synthesize the key variables for the economic development of any country, apart from the strengthening of the institutions, we could identify ten:

1) Price stability. It is a necessary condition, but is not sufficient, for the development of countries. Inflation runs as an invisible tax that discourages saving and creates uncertainty about the investment process. The central bank of each country is the key institution to control inflation.

2) Control of public deficit. The public deficit relates (with respect to GDP) the difference between income and expenditure of the public sector.

$$\text{Public deficit indicator} = (\text{Income} - \text{Expenditure}) / \text{GDP} \times 100$$

A growing government deficit restricts credit and the capacity of investment of families and businesses.

3) Control of public debt. It is also measured as a percentage of GDP. A high indebtedness of countries, through successive deficits, loans and state bonds, increases financial expenses and interest rates. It is particularly harmful for economic growth if the debt is used for unproductive ends.

$$\text{Debt ratio} = \text{Debt} / \text{GDP} \times 100$$

If the borrowing necessity is covered through foreign savers, the country will experience even more limitations, as happened after 2010 in Greece, causing a default, which will cause international sources of liquidity to disappear. Both high public deficit and public debt will carry interest rates upward, making credit, investment, consumption and exports still more difficult.

4) Legal certainty. The existence of a stable legal framework which is agile and reliable, along with an independent court of justice, generates the confidence that social and economic agents need to enable the development of countries. The simple creation and existence of property records (non-existent in many countries), is another *sine qua non* condition for the development of markets.

5) To promote the agricultural sector. There is no country that has come to be developed without starting from accumulations of capital and savings arising from its agricultural sector. The search for productivity gains and the tendency to achieve self-sufficiency are especially critical in the first stages of development; hence the importance of promoting and regulating agriculture.

6) Reliable statistical institutes which make it possible to analyze the economic situation of countries, and compare their evolution though time and with other markets. The lack of such solvent statistical data in many countries is an added difficulty for economic development.

7) Education and renowned academic centers. Bribes and the possibility of buying and selling academic titles in developing countries constitute another impediment to economic development. The lack of reputed centers or mechanisms to generate and select a ruling class able to lead the processes of economic growth successfully has similar effects.

8) Indicator of corruption. This indicator is becoming increasingly important. It is used by the international debt rating agencies more than by the United Nations, and is a determinant of good governance and the accountability of public administrations.

9) The institutional role of women. It is also relevant to determinate the potential and degree of economic development. If a country marginalizes a part of its potential active population it will be in a worse position to escape from poverty or to overcome underdevelopment. A good example was the case of Ataturk, father of modern Turkey, who passed the European Civil Code establishing the equality of women, eliminating polygamy, the right of repudiation, the compulsory use of certain garments and the ban on training for women.

10) Values. Understood as a set of traditions, usages, religion and manners of a population or a particular country. Values are intangibles that influence the settings of each economy. Thus the possible prohibition or not in a market of eating a specific product has consequences in the development of the sector of activity and therefore, on the economy as a whole (living standards and income of its inhabitants). The Bible is full of references or incentives of an economic nature, such as the talents, that of the tree that bears no fruit and is thrown into the fire, and many others. Values related to the family also determine different degrees of social cohesion and the propensity to save or to make unproductive expenditure. In the end, values generate different incentives on individual behaviors.

Remember, finally, the School of Salamanca. As Cellorigo Gonzalez said in his "Memorial of the necessary policy, (1600),"gold does not support States, nor is the wealth of them". In the global economy we can identify rich countries (in terms of raw materials or natural resources) but with poor people and small domestic markets; and countries with poor natural resources (Japan, Switzerland, Spain) with rich people and large markets. We can say, finally, that the development of international markets and countries has been compared with the ascent of a mountain. There is no direct route of ascent; what is necessary is to have a clear idea of the general orientation and tactics to be adopted, discarding mistaken paths which would be costly to have to repeat and imply many lost years or decades in terms of development.

We hope that this text, produced thanks to the efforts of professors Gonzalo Sanz-Magallón, Gregorio Izquierdo Llanes, José Terán, Graham Jones, José María Larrú, and Margarita Núñez, will help you to understand and analyze the structure of international markets, and to identify the measures to promote their development, identifying "obstacles" to be removed –using Jovellanos term– and the structural reforms to be tackled.

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