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Globalisation: the End of National Economic Policy? New Forms of International Business Cycle Linkages

Edited by
Joachim Scheide, Thomas Straubhaar
and Rainer Winkelmann

Duncker & Humblot · Berlin

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Editorial

This supplement to *Applied Economics Quarterly* reports on the 66th Annual Meeting of the Association of German Economics Research Institutes (ARGE), which took place in Berlin on May 15, 2003. The topic was

"Globalisation: the End of National Economic Policy? New Forms of International Business Cycle Linkages"

Annette Kuhn (IfW Kiel) and Roland Doehrn (RWI Essen) were responsible for the conceptual preparation of the conference. The opening address was given by Willi Koll (BMWA – Federal Ministry of Economics). Subsequent sessions were organized in the form of presentations, each followed by a discussant's statement. The following authors contributed to the conference: Volker Clausen (Essen); Christian Dreger (Halle / Saale); Horst Entorf (Darmstadt); Ferdinand Fichtner (Cologne); Gerhard Flaig, Jan-Egbert Sturm and Ulrich Woitek (Munich); Gustav-Adolf Horn (Berlin); Andre Jungmittag (Wuppertal); Willi Koll (Berlin); Annette Kuhn (Kiel); Bernd Lucke (Hamburg); Torge Middendorf and Nils A. Radmacher-Nottelmann (Essen); Manfred J. M. Neumann (Bonn); Michael Schroeder (Mannheim).

Next year's Research Meeting is scheduled for April 22 / 23, 2004 in Berlin and will deal with

"*Reformstau:* a Logjam of Reform in Europe and the Economics of Reform".

The next meeting will be organized in association with non-German European research institutes.

June 2003

Joachim Scheide
Thomas Straubhaar
Rainer Winkelmann

Contents

Economic Policy in the Light of New Forms of International Business-Cycle Convergence

By Willi Koll*

Since the massive and synchronous world-wide economic slump of 2000/2001, the topic of "business-cycle convergence" has been the object of intensive discussion by academics and policymakers. But there are significant differences between many of the perspectives taken and conclusions drawn. We must therefore be clear about what we mean by the term "business-cycle convergence" and about the economic processes and phenomena it involves; for it is of central importance for economic-policy conclusions and recommendations for action.

1. Business-Cycle Convergence from the Perspective of Economic Policy

The synchronous trend of growth rates is not a reliable yardstick for determining the degree of integration of the global economy and for identifying the genuine influence of global economic impulses on domestic economic trends.

The following is a good illustration of this point: a simple correlation of growth rates indicates a decrease rather than an increase of convergence of business cycles among Germany, the United States, and the world economy since the seventies (in the nineties there was even a counter-trend!). Some recent studies (which are making use of more refined methodologies) also arrive at a conclusion of diminished business-cycle convergence (Fig. 1 see page 10).

But great care should be taken for policymakers not to look at the diminished convergence and draw any premature or false conclusions about the actual significance of global economic inter-action and the resulting need for political action. From the economic policy perspective, it is important clearly to distinguish three different dimensions or levels of business-cycle convergence, and to ask:

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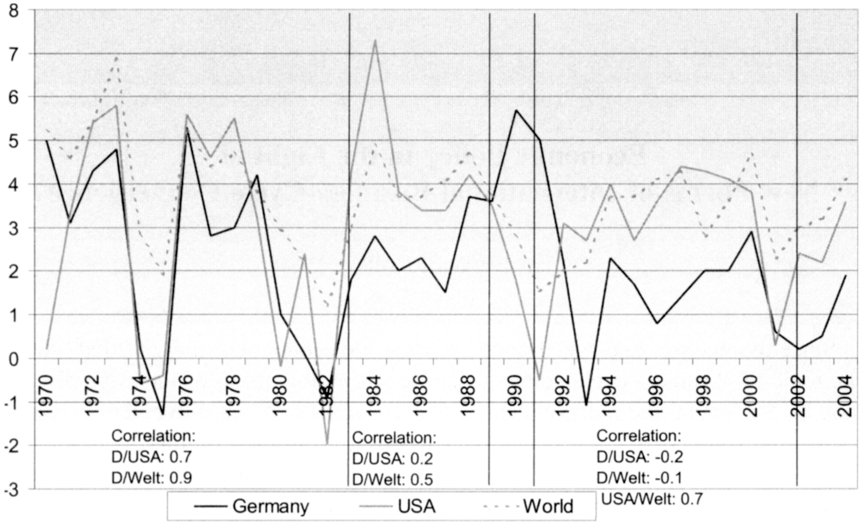
* This paper is based on a publication by the Federal Ministry of Economics and Technology (2002): Germany's Integration in Global Economic Processes – The Increasing Significance of "New" Transmission Mechanisms.

Author's address: Federal Ministry of Economics and Labour, Berlin



Source: IMF, World Economic Outlook, April 2003.

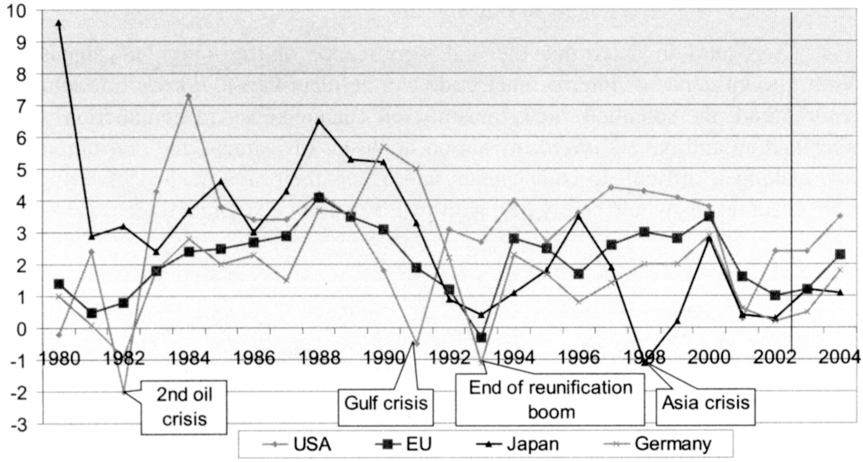
Figure 1: Germany, USA, World: Real Growth – % change from previous year

➢ First: **What impulses or "shocks" – global or country-specific – trigger the economic fluctuations?**

The seventies and eighties were largely characterized by shocks, such as the two oil crises, that impacted all economies worldwide both similarly and above all simultaneously, and for this very reason produced synchronous developments. By contrast, important impulses to economic activity in the nineties – German reunification and the Asia crisis are examples – in the initial phase affected only individual regions and, in terms of their timing of positive and negative events (such as the Gulf War / reunification at the beginning of the nineties), had an internationally contrary impact, and thus an offsetting effect. These offsetting, country-specific "shocks" of the nineties have masked over the increasing significance of business-cycle transmission and thus resulted in an underestimation of global economic interaction with the consequence of contributing to serious mistakes in growth forecasting in recent years (Fig. 2 see page 11).

➢ Second: **What are the actual transmission mechanisms?**

There is far-reaching agreement (including IMF, OECD, EU Commission, German Council of Economic Experts) that global economic integration has appreciably increased, in particular as the result of the "new transmission mechanisms," which I will return to in greater detail in the next chapter. Global changes have a far stronger and faster impact on domestic economic dynamics than even only a few years ago.



Source: IMF, World Economic Outlook, April 2003; Arbeitsgemeinschaft deutscher wirtschaftswissenschaftlicher Forschungsinstitute, April 11, 2003.

Figure 2: USA, Japan, Europe and Germany: Real Growth – % change from previous year. 2003 and 2004 projections in research institutes' spring report

➢ Third: **How are global economic changes handled by the domestic economy?**

The ability to adapt, flexibility on the part of the domestic economy, and the possibilities of policy response ultimately determine – as key links in business-cycle convergence – the extent to which global economic changes translate into growth losses or growth impulses. The strengthening of resilience to global economic shocks is therefore a central challenge to be confronted by national economic policy. Above all, this aspect should not be overlooked with regard to the question of the impacts of international business-cycle influences.

"Business-cycle convergence" thus appears as the result of the interaction of the three elements "shock," "transmission," and "resilience."

2. New Transmission Mechanisms

Developments of the past several years show that global economic impacts on the German economy – regardless of whether they impede or stimulate – may be explained less and less only in terms of the so-called "classic mechanisms of transmission" (i.e. exchange-rate / interest-rate convergence, foreign trade). Increasing