EUROPEAN CENTRAL BANK

EUROSYSTEM

Globalisation and the macroeconomy

Welcome address by Jürgen Stark, Member of the Executive Board of the ECB
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Ladies and Gentlemen,

It is a pleasure for me to open this conference on "*Globalisation and the Macroeconomy*", and I am delighted to welcome all of you to Frankfurt. Given the presence of several eminent academics and policymakers, I am sure that it will be a very fruitful event.

Although the topic of globalisation has received considerable attention in many circles, it remains a phenomenon that we are still striving to understand. Not only can globalisation not be captured in a single measure or index, but its economic impacts are also difficult to isolate given the complexities in disentangling globalisation from other important structural changes that have occurred in parallel in recent years. Not least because of this, disagreements have persisted on both the characterisation of globalisation and its key macroeconomic implications. Against this background, the conference is a valuable opportunity to contribute towards sharpening our understanding of the mechanics of globalisation, on the one hand, and its macroeconomic consequences, on the other.

To set the scene for the conference, I would like to structure this welcome address in three parts. First, I will define what I see as the salient features of globalisation. Second, I will outline what, to my mind, constitute the key macroeconomic impacts of globalisation in advanced economies. Third, I will offer you my views on how I think this conference can contribute to better our understanding of the phenomenon of globalisation.

1. Salient features of globalisation

Globalisation as a concept is open to many definitions and interpretations. Perhaps a useful and succinct definition of the globalisation process would be to describe it as "*a growing interdependence of economies via trade, production and financial market linkages*". Few would doubt that this process has accelerated in the last decades. Two main factors appear to underlie this acceleration. First, the costs of transporting goods, services and information across the globe have been reduced considerably given the surge in information and communication technology. Second, there has been a significant expansion in global productive capacity on account of the opening up of emerging economies to international trade and production, notably the greater involvement of emerging Asia in world trade, as well as Central and Eastern Europe following the collapse of the Soviet Union.

The economic globalisation brought about by these changes has been one of the major trends shaping the world economy in recent years. On the real side, international trade has expanded substantially, with the emerging Asian economies in general – and China in particular – taking a prominent role. Global trade openness – measured as world imports and exports of goods and services as a share of world GDP – has practically doubled over the last 20 years, from 33.9% of world GDP in 1986 to 60% of world GDP in 2006. On the financial side, international capital flows have increased even more rapidly than trade in goods and services, leading to a remarkable rise in cross-border holdings of assets and liabilities. The share of gross international asset holdings in world GDP – which provides a measure of financial openness – has shown an eightfold increase over the last 25 years and now stands at more than 130% of world GDP.

Such openness in real and financial terms has precipitated significant changes in the production process. This can be thought of as having taken place in two steps.[1] First, a decreasing necessity to make goods close to the point of consumption in view of rapidly falling transportation costs – a process which has been ongoing for many decades now – can be termed "first unbundling". More recently, a "second unbundling" has greatly extended this first unbundling, whereby rapidly falling communication and coordination costs has led to a declining necessity to perform different stages of the production process geographically close to one another. In turn, this has implied an increase in offshoring, first in manufacturing tasks and, more recently, in services.

In the long run, these developments would be expected to benefit both advanced and emerging economies through a more efficient resource allocation, along with welfare gains from deepening specialisation, lower prices, greater product choice and, ultimately, higher living standards. In the short run, however, this process likely embeds some adjustment costs and distributional effects.

2. Key macroeconomic impacts of globalisation for advanced economies

The process of globalisation I have been describing up to now would be expected to influence a wide array of macroeconomic developments in advanced economies. In this sense, while many impacts may be envisaged, I would like to focus on the assessment of the impacts of globalisation in two broad macroeconomic areas. First, I would like to touch upon issues related to the international performance of advanced economies, given that globalisation implies an important need for increased specialisation. Second, I will turn my focus to domestic adjustment, which could be expected to stem from globalisation in advanced economies such as the euro area.

Issues related to international performance

Globalisation and its implication of increased specialisation have placed a premium on international competitiveness. This has key impacts on trade flows, trade prices and trade content, and a key challenge remains to further our understanding of how this dimension is evolving within advanced economies such as the euro area.

Widely cited theories linking trade to labour market outcomes, such a those of Heckscher-Ohlin-Samuelson and Ricardo, would argue that comparative advantage across countries should result from either different factor intensities or relative technology differences. These factors should lead to benefits for advanced economies in the form of increased demand for their exports, while also implying increased import competition – particularly where comparative advantage is weak. In considering how advanced economies such as the euro area have adjusted to this increasingly competitive environment, I will focus my discussion of issues relating to international performance on three components: trade flows, trade prices and competitiveness indicators.[2]

Starting with **trade flows**, an analysis of export developments in selected advanced economies indicates some loss in export market share as result of competitive forces, but such negative impacts may be offset by rapid growth in foreign demand due to globalisation. It can be argued that this loss in market share has mainly been the consequence of the sharp increase in emerging economies' share of the world market. In terms of imports, the euro area is experiencing rapid import penetration and a rising import content of exports, primarily due to increased imports from low-cost countries. Such imports are not only final goods, but also represent an increase in intermediate imported inputs corresponding to the fragmentation and internationalisation of production. Ultimately, factors such as product and geographical composition, technological and structural competitiveness, and growing foreign direct investment may be contributing to induce considerable changes in trade flows.

Turning to **trade prices**, two salient features emerge. First, globalisation has notably been associated with a substantial relative price shock. On the one hand, there are the downward pressures on manufacturing import prices in advanced economies owing to the rising import shares of low-cost countries, which are the topic of frequent discussion.[3] On the other, there have been significant increases in import prices of oil and non-oil commodities over recent years, attributable to some extent to the burgeoning global demand emanating particularly from emerging markets. Second, globalisation may have changed the degree of exchange rate pass-through to trade prices and may also have affected the impact of exchange rate movements on euro area trade and GDP.

Ultimately, measuring **competitiveness** is not straightforward, given that several measures, including real exchange rate analysis, relative export prices, sectoral productivity analysis and sectoral indicators of revealed comparative advantage, may be used to make an assessment. Ultimately, no single measure can give a comprehensive impression of specialisation patterns. Rather, the review of a combination of indicators may allow for a breakdown by technological intensity and by sector, thereby giving an indication of extent and nature of aggregate structural changes that are taking place now and are likely in the future. In general, international competitiveness in a global environment appears to be strengthened by exposure to direct export competition from emerging markets and weakened in the presence structural rigidities in labour and product markets that hinder necessary changes in export specialisation.

Issues related to domestic adjustment

Globalisation has implied domestic macroeconomic adjustment for advanced economies in several areas, permeating product markets, factor markets and – importantly from a central bank's perspective – prices. I would like to focus my remarks on these aspects in four key areas:

productivity and the supply side of the economy, domestic spending patterns, labour market effects and implications for price determination.

It is now commonly accepted that globalisation is closely linked to the process of technological advancement, with important consequences for **productivity** developments. Several channels may be of importance in this process, of which three deserve special mention. First, globalisation may constitute a form of "technology transfer" both directly through imports of capital goods and indirectly through the transfer of multifactor productivity. This latter form of technology transfer may be of particular importance for advanced economies given international spillovers of best practices, notably in management practices and the organisation of production. Second, higher average productivity may result from both the composition of firms (whereby competition forces inefficient firms to exit the market) and the possibility for firms to increase the scale of their operations. Lastly, firms may choose to be more innovative in response to stronger global competitive pressures. According to all of these arguments, globalisation would be expected to boost productivity growth. Such effects, however, may take some time to materialise given adjustment frictions which vary from region to region.

Globalisation has also surely embodied changes in **domestic spending** patterns within advanced economies. Probably most evident is the decreasing home bias of both households and firms in line with a significant boost that globalisation has given to the choices both sectors have in allocating their resources. Such a development can be thought of as permeating several macroeconomic indicators, such as firms' profits, firms' investment and household consumption patterns – both on the aggregate and with important distributional changes. Globalisation has also likely played a less direct, but nonetheless important, role in influencing domestic spending decisions in advanced economies by propagating technological change and financial innovation.

The influence of globalisation on **labour market** conditions has perhaps been one of the sources of greatest controversy in advanced economies. While a role of globalisation in changing the distribution of sectoral, occupational and skill composition in advanced economies has been the focus of much attention, equally important productivity effects often receive less attention in the public debate. Increased product and labour market competition, increased efficiency and an enhanced ability to access foreign knowledge in order to raise productivity levels should have a positive impact on labour demand. On top of this, international labour mobility may help to simultaneously address labour shortages, while also yielding palpable productivity effects for receiving nations in the form of knowledge transfer. Of course, I would not argue that the changing specialisation implied by globalisation does not imply important distributional changes, but I would underline that the aggregate effects of such shifts are unclear. Indeed, the extent to which "skill-biased change", simultaneously weakening the labour market outcomes of low-skilled workers in advanced economies while strengthening the respective outcomes of high-skilled workers, can be attributed to globalisation – as opposed to technological change, for instance – is not straightforward. Moreover, adjustment frictions might be amplified by public policies that impede the mobility of labour from declining to expanding activities. Ultimately, I would argue that the evolution of wages and employment in response to globalisation rests on the aggregation of the pure redistributive aspects of a distributional shock and the interplay of these with positive productivity effects.

I would like to conclude my discussion of domestic macroeconomic adjustment to globalisation with a discussion of its impacts on **prices** – undoubtedly of considerable interest to a central banker such as myself. I would, however, argue that any impacts of globalisation on consumer price inflation are limited to the short term since, over the medium to longer-term, inflation is determined by monetary policy alone. In the short term, however, globalisation could influence aggregate prices in several ways. The first – and perhaps most visible effect of globalisation for consumers – is its implication for relative prices. In particular, globalisation has attenuated increases in some prices through global supply channels – for example, from imports of manufactured goods or cheaper inputs into the production process – while accentuating increases in other prices given global demand pressures – for example, those related to strong global growth for energy and other commodities. Although such relative price shocks need not have any effect at all on aggregate inflation, adjustment frictions and imperfect information could imply prolonged impacts of sizeable relative price shocks and associated consequences for aggregate price movements.[4] A second channel through which globalisation can affect aggregate consumer price inflation involves the impact of increased competitive pressures. Such effects could include changing firms' mark-up behaviour, labour cost moderation and productivity enhancement. Some estimates point to an important role for this channel in the evolution of consumer prices, although the indirect nature of such changes make it inherently difficult to isolate the impacts of globalisation in this regard.[5] Third, openness associated with globalisation may have contributed to weaken the link between consumer price inflation and standard domestic measures of macroeconomic slack. The notion that domestic inflation has become increasingly sensitive to measures of foreign slack, with domestic demand less constrained by domestic supply conditions, has also been difficult to validate empirically, and the quantitative extent of any such impacts still remains contested in the literature.[6]

3. How can this conference contribute to better our understanding of globalisation?

With all of these issues in mind, I would like to close my remarks by highlighting different analytical and policy questions that this conference may help address. As I see it, the main objectives of the conference are to improve our understanding of the pace and changing characteristics of globalisation so we may more accurately identify the various channels through which it affects the macroeconomy. In particular, I hope that the conference will improve our understanding of the phenomenon and our approach to its measurement, and that the insight we gain will help us both to quantify the effects of globalisation on economic activity and inflation and to assess how globalisation may be changing the transmission of shocks to the economy.

In my view, there are several different analytical and policy questions that I think this conference can fruitfully address:

- In Session 1 on the globalisation of production and new trade paradigms, the main challenge is to see to what extent existing models and frameworks on trade are still valid in a rapidly changing global environment. In particular, the key issues to be addressed include the extent to which the developments observed are in line with those predicted in existing models and to what extent we would need to revise these models to take new paradigms into account.
- In Session 2 on globalisation, trade and exchange rates, the main challenge is to assess how globalisation is changing both global trading patterns and the role for exchange rates in such a setting. In particular, the key issues to be addressed include the role of new production paradigms in generating domestic macroeconomic adjustments, the role of global competition in generating an observed decline in the exchange rate pass-through of developed economies, and the role of the exchange rate in policymaking.
- In Session 3 on the macroeconomic impacts of globalisation, the main challenge is to understand how globalisation is affecting key macroeconomic variables, such as labour market outcomes and price inflation. In particular, the key issues to be addressed include quantifying the impacts of globalisation on labour markets and inflation in advanced economies.

These sessions will undoubtedly raise many major economic issues and policy challenges, and indeed the last part of the conference takes up these issues from a more policy-oriented perspective.

I now look forward to a stimulating discussion and debate over the next two days and hope that you will also benefit and take new ideas and approaches back to academia, central banks and other institutions.

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[1] See, for instance, Baldwin (2006).
[2] This section draws upon the analysis contained in ECB (2005a), Baumann and di Mauro (2007), and ECB (2005b).
[3] See, for instance, ECB (2007) and ECB (2006).
[4] Estimated aggregate impacts of relative price shocks remain controversial. Compare, for instance, the finding of a significant impact of openness on euro area prices in the euro area in Pula and Skudelny (2007) with the arguments of Ball (2007) on negligible price impacts associated with globalisation.
[5] Chen et al. (2004) find that increased trade could account for as much as one-quarter of European disinflation over the period 1988-2000 based on productivity and firms’ mark-up channels.
[6] Compare, for instance, the empirical findings of a significant open economy channel on Phillips Curves reported in Borio and Fillardo (2006) with the finding of a negligible role in Ihrig et al. (2007).