ADVANCED GCE

ECONOMICS

The Global Economy

STIMULUS MATERIAL

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INFORMATION FOR CANDIDATES

- This document consists of **12** pages. Any blank pages are indicated.

Introduction

International trade disputes tend to come and go. However, the dispute about trade in bananas between the USA (home to many of the multinational corporations owning banana plantations in Latin America), some Latin American countries and the European Union (EU) had lasted for 16 years. In 2009 the so-called 'banana wars' came to an end when the EU finally agreed to reduce tariffs on bananas from Latin America. Caribbean countries, which had previously enjoyed tariff-free preferential access to the EU market (along with African and Pacific producers), claimed that the deal would hit their small family-owned banana farms hard and damage their economies. The world market for bananas, like other global markets for primary products, exhibits price volatility. This has significant implications for the export revenues of countries dependent on trade in bananas.

Production of bananas is concentrated in developing economies. Whilst these economies share many common characteristics they are also a diverse group of nations, both in the structure of their economies and in their levels and rates of development. Measuring economic development is not easy. However, the United Nations' Human Development Index (HDI) allows useful insights and comparisons to be made between countries.

The ending of the 'banana wars' in 2009 coincided with the second year of a global economic downturn. Caribbean economies were not immune from the consequences of this downturn because of their integration into the global economy. Globalisation had, in the past, brought many benefits to Caribbean economies, especially as a result of the growing levels of foreign direct investment (FDI) in the region. Much of this had gone into tourism, allowing some Caribbean economies to gain from their comparative advantage in this sector. For some Caribbean economies, tourism is a major source of export revenue. The global downturn reduced the demand for tourism, as well as for exports of primary commodities such as bauxite. Negative economic growth in the Caribbean had severe consequences for unemployment in the region and for the fiscal position of many countries.

Some Caribbean nations, as a result, looked to deepening regional economic integration through the creation of a single market and economic union. The hope was that this would, alongside the existing monetary union, provide for the small economies of the Caribbean, the economic benefits enjoyed by the EU and provide insulation from the immediate downsides to globalisation experienced in 2008 – 2009.

Pre-release stimulus material

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Extract 1

The world market for bananas

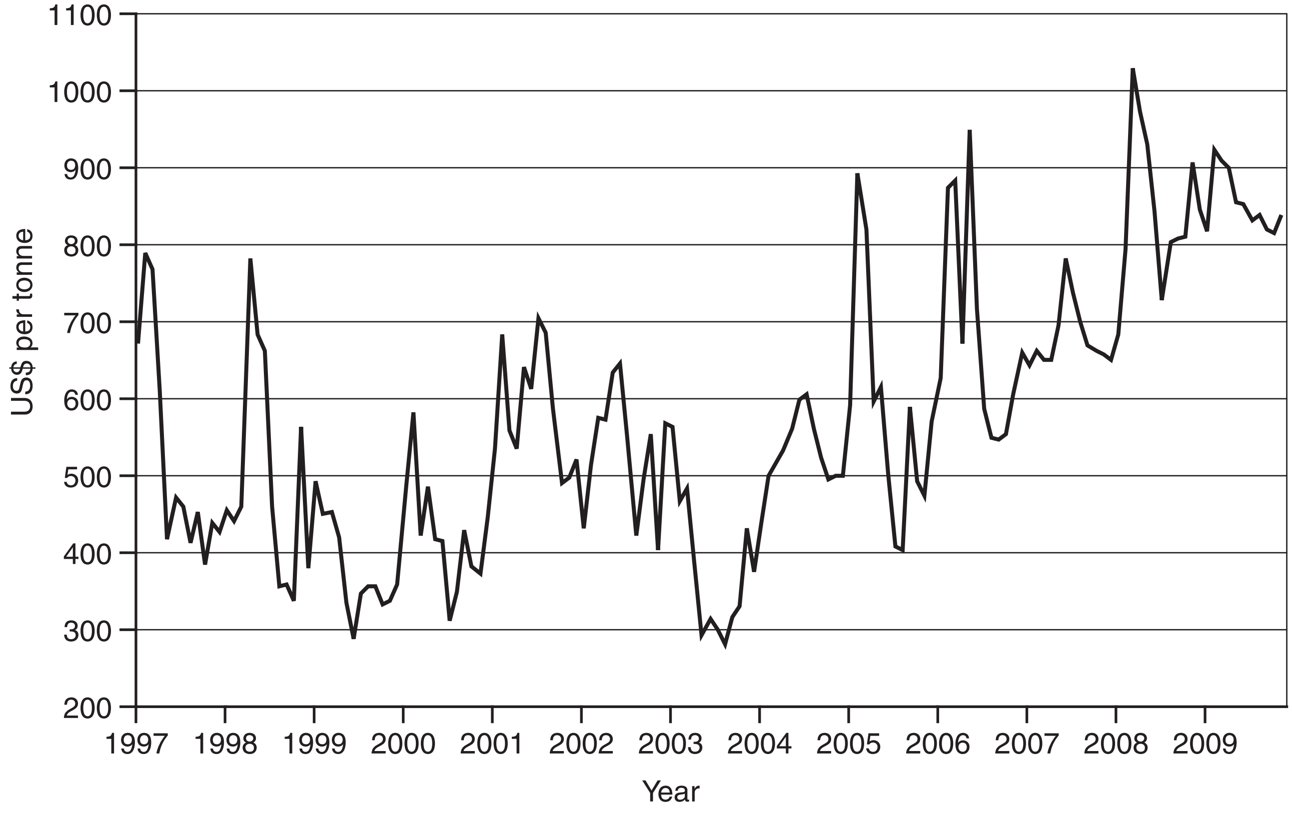
Bananas are grown in all tropical regions of the world and are especially important for the economies of many developing countries. Banana production takes place in over 85 countries. In terms of volume and value, they top the list of the world's most exported fresh fruit. However, the world's largest producers, India and Brazil, mainly produce bananas for domestic consumption.

The world's biggest exporters of bananas include Ecuador, Costa Rica, the Philippines and Colombia. Together these four countries accounted for around 64% of total world banana exports in 2006. Production in these countries takes place on large mechanised plantations owned and operated by US multinational companies such as Dole, Del Monte and Chiquita. Ecuador is the world's largest exporter of bananas, and the industry is the second biggest source of Ecuadorian export revenue after oil. In the Caribbean, bananas are equally important for developing economies. In the Windward Islands (the source of over 30% of EU banana imports), for example, banana production is the biggest sector of the economy, employs the most people and accounts for 80% of export earnings. Yet the Caribbean's share of world trade in bananas amounts to a little over 8%. Banana production in the Caribbean is characterised by a large number of small, labour-intensive, family-run farms. These farms are high cost because the steep slopes on which bananas are cultivated are unsuitable for irrigation or large-scale production. The result is that yields are less than 50% of those in Ecuador and the farms are also subject to drought and hurricanes.

The world's largest importers of bananas are the EU and the USA. Together they account for over 60% of world imports of bananas. The banana trade could not be more different in these two areas. Access to the USA banana market is unlimited for developing economies and the trade in bananas is not subject to any tariffs. In comparison, in the EU there is a complex system of tariffs and quotas. The EU has operated a common trade policy for bananas in all member states since 1993. Under this trade policy, African, Caribbean and Pacific (ACP) states were allowed to export bananas to the EU tariff free, up to a maximum of 857 000 tonnes. Bananas from Central and South America were given a quota of two million tonnes on which the EU imposed a tariff of €100 per tonne. Imports in excess of either of these quotas faced punitive tariffs to prevent the EU market being over-supplied and to maintain high prices for banana producers in the Canary Islands and Martinique (territories of Spain and France). The combined result of this trade policy was that EU consumers in the 1990s were paying up to twice the world price for bananas.

The volume of world trade in bananas has grown over a number of decades and, until 1997, so too did the value of banana exports. The value of banana exports for developing countries depends critically on the world price of bananas. This price is volatile in the short term, yet there are distinct trends in price over the medium term. From 1997 to 2003 the world price of bananas fell (see Fig. 1.1) and with it the value of banana exports. Since 2003 the world price has increased. As the volume of banana exports increased too, there has been a significant increase in the value of banana exports. These trends have important implications for developing countries dependent on banana exports and for their terms of trade.

Fig. 1.1 World price of bananas January 1997 – November 2009



Extract 2

Banana exporting countries

Banana exporting countries are largely developing economies. As such they share a number of common characteristics which help to define and explain their lack of development. For example, the banana exporting countries listed in Fig. 2.1 are heavily dependent on primary commodities as a source of export revenue, with the exception of the Dominican Republic. Four of these six countries are also lower middle-income economies according to their GDP per capita in 2007 (see Fig. 2.2). As such they are likely to have low living standards. Despite these common characteristics, there is a degree of diversity between banana exporting countries. This can be seen in their economic structures, the extent to which their economies are dependent on exports of bananas and in their level and rate of development.

Guatemala and St Lucia, for example, share common characteristics, yet in important respects are different. The economic structure of Guatemala and St Lucia is different in that agriculture contributes a larger percentage to GDP in Guatemala and employs a larger percentage of the workforce. Whilst both economies are dependent on the export of primary commodities, Guatemala is less dependent on trade in bananas. St Lucia has attracted large amounts of FDI, especially in offshore banking and tourism which are important export sectors, whereas Guatemala's lack of a skilled workforce and poor infrastructure has been a constraint on FDI. With a GDP per capita less than half that of St Lucia, living standards are significantly lower in Guatemala.

Fig. 2.1 Export structure of selected banana exporting countries (average 2004 – 2009)

Country	Region	Revenue from banana exports as % of total export earnings	Primary commodities as a % of total volume of exports	Exports of food as a % of total volume of exports
Ecuador	South America	9.3	91.8	32.4
Guatemala	Central America	5.9	51.2	40.0
Dominican Republic	Caribbean	6.8	16.4	15.1
St Lucia	Caribbean	19.7	64.9	41.9
Côte d'Ivoire	Africa	na	74.9	45.6
Cameroon	Africa	na	91.0	18.7

Fig. 2.2 Measures of development for selected banana exporting countries

Country	GDP per capita (US$) 2007	GDP per capita (PPP US$) 2007	Average annual % growth rate of GDP per capita 1990 – 2007	HDI 2007	Average annual % growth rate in HDI 1990 – 2007	Average % of population living below US$2 a day 2000 – 2007
Ecuador	3335	7449	1.2	0.806	0.47	12.8
Guatemala	2536	4562	1.4	0.704	1.40	24.3
Dominican Republic	3772	6706	3.8	0.777	0.90	15.1
St Lucia	5834	9786	1.3	0.821	n/a*	40.6
Côte d'Ivoire	1027	1690	–0.7	0.484	0.26	46.8
Cameroon	1116	2128	0.6	0.523	0.44	57.7

*No HDI growth rate is available since HDI was not calculated for St. Lucia in 1990.

Extract 3

Impact of the global downturn on economies in the Caribbean

Speaking at a World Bank conference in 2007, Takatoshi Kato, Deputy Managing Director of the International Monetary Fund (IMF), said that:

"The Caribbean region is particularly well placed to benefit from globalisation. Its rich democratic history, generally strong institutions, and impressive social indicators (notably on education and health) provide a solid foundation for competing effectively in the global economy. The region has already proven adept at seizing on its comparative advantage by developing a thriving tourism sector, and it is now broadening the market to new visitors such as those from Asia and Eastern Europe."

A year later, the global economic crisis of 2008 – 2009 had exposed the negative aspects of greater integration into the global economy for the economies of the Caribbean. In 2009 the IMF forecast a reduction in GDP in Caribbean economies of 2.5%. Even stronger economies rich in gas and oil reserves, such as Trinidad and Tobago, were not expected to be immune from this downturn.

The economies of the Caribbean had been hit hard by a 30% decline in revenue from tourism, a fall in remittances[1], the cancellation of many large scale construction projects and the collapse of commodity prices. Production of bauxite in Guyana, Jamaica and Suriname had been heavily hit (production, for example, fell by 61% in Guyana) and Jamaica had temporarily ceased production of alumina (which is made from bauxite and 90% of which is used in the manufacture of aluminium metal). The international aluminium industry is directly dependent on global economic growth. Growth in aluminium consumption tends to rise more rapidly than GDP during periods of economic growth, but also falls at a much faster rate than GDP during a recession. The global demand for aluminium fell by over 7% in 2009, more than twice the decline in world GDP. In the Caribbean's main markets for exports of bauxite and alumina, North America and Europe, demand fell by around 15% in 2009.

The result of this decline in economic activity in Caribbean economies has been a sharp rise in unemployment and an increase in levels of poverty. In addition, government debt in many economies has risen to over 100% of GDP (see Fig. 3.1). Such high and rising debt levels pose a threat to fiscal stability and to future economic development in the region.

Fig. 3.1 Government debt (% of GDP) in selected Caribbean economies, 2009

Country	Government debt (% of GDP)
St Kitts	182%
Jamaica	122%
Grenada	109%
Guyana	109%
Barbados	96%
Trinidad and Tobago	27%

[1] remittances are transfers of money to friends and relatives from workers employed abroad

Many Caribbean economies experienced large current account and fiscal deficits as a direct consequence of the global economic crisis and found it difficult to attract private external finance. As a result, they were not able to put in place policies which might have made the impact on output and employment less severe. During 2009, Jamaica was in the process of negotiating borrowing arrangements with the IMF. Other countries, such as Guyana and Trinidad and Tobago, however, had built up substantial international reserves in the decade before the global economic crisis. In addition, as food and fuel prices dropped in 2009, most Caribbean economies were able to relax monetary policy as inflationary pressure had eased. Nevertheless, it was expected that many Caribbean economies would still be in recession even after recovery had started in the USA and Europe.

Extract 4

The move to deepen regional economic integration in the Caribbean

St Lucia is an island nation in the Caribbean and is one of the Windward Islands. It achieved full independence from the United Kingdom in 1979. Its economy is heavily dependent on offshore banking, tourism and the banana trade. Its well educated labour force and well developed infrastructure have increased FDI in recent years, mainly in offshore banking and tourism. This has been helped by economic reforms ending price controls and privatisation of the state banana company.

St Lucia has pursued regional economic integration through membership of the Caribbean Community (CARICOM), the Organisation of Eastern Caribbean States (OECS) and the Eastern Caribbean Currency Union (ECCU).

Including St Lucia there are 15 members of CARICOM. Membership of CARICOM had not brought about the expected benefits of trade creation which might have been anticipated from economic integration as Fig. 4.1 shows. As a result, St Lucia and 11 other CARICOM members sought to deepen economic integration in the Caribbean by establishing the CARICOM Single Market and Economy (CSME) in 2006. The CSME has brought about:

- the free movement of goods and services by abolishing trade barriers between the members and harmonising product standards;
- the free movement of capital through the elimination of exchange controls;
- the free movement of labour by establishing common standards for qualifications, harmonising social services and allowing the transfer of social security benefits for workers working in different member states;
- a common trade policy including a common external tariff applied by all members to products imported from countries outside the single market;
- the harmonisation of laws relating to business;
- the harmonisation of monetary and fiscal policy, including the coordination of national indirect taxes and budget deficits.

St Lucia is one of nine members of the OECS, all but one of which share the same currency, the Eastern Caribbean dollar. As part of this monetary union, St Lucia's monetary policy is set by the Eastern Caribbean Central Bank, which has been responsible for the common currency since 1983.

Fig 4.1 Exports of CARICOM members 1993 – 2003 (US$ million)