

# Responding to Global Economic Challenges

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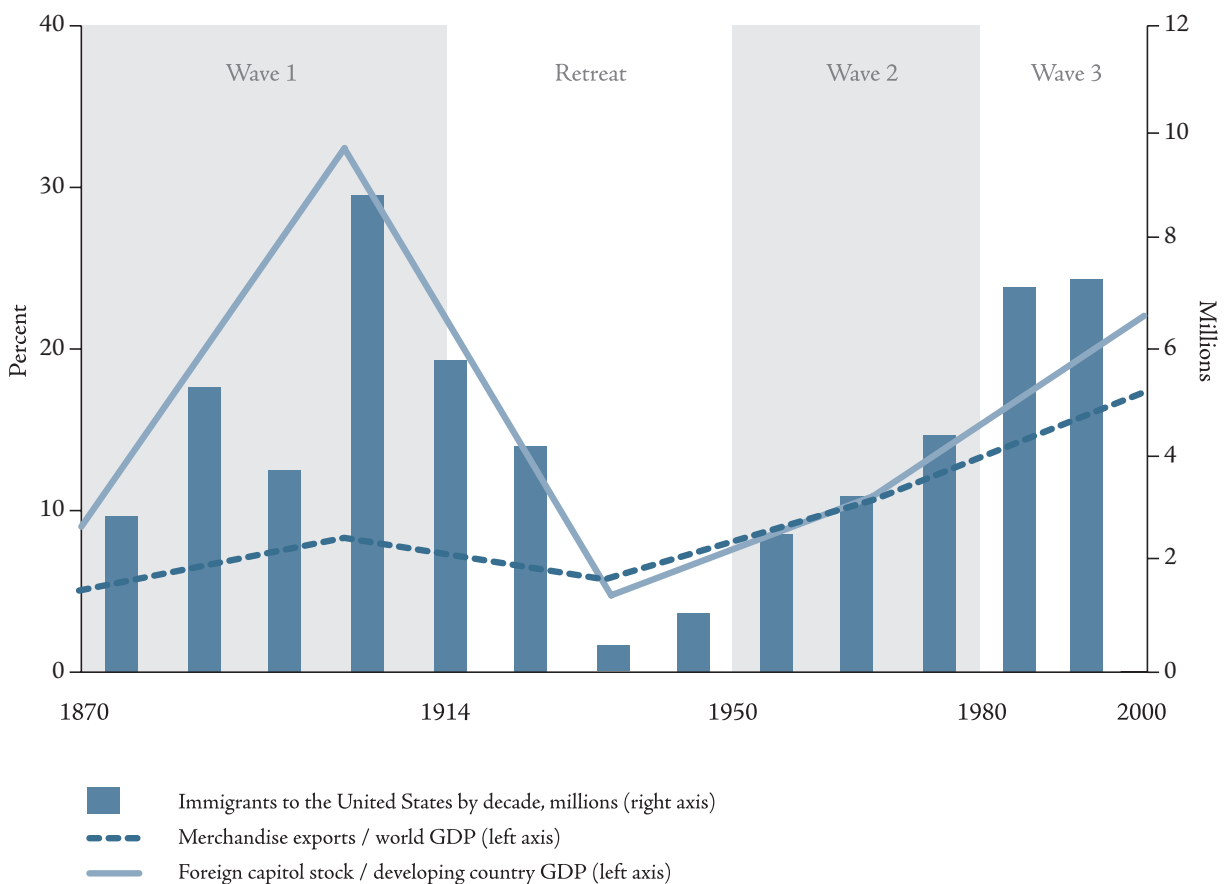
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## Responding to global economic challenges

The increasing speed of movement of goods and services, people, capital and technology around the world presents challenges and opportunities. With the appropriate policy responses, we can make the most of these opportunities to deliver benefits to all.

The world is currently experiencing a period of rapid change and economic integration. But this is just the latest of a number of phases of globalisation in modern history.

Figure 1: Indicators of global economic integration



Source: Globalization, Growth, and Poverty: Building an Inclusive World Economy, by Paul Collier and David Dollar, 2002.

The century leading up to 1914 saw rapid growth in trade, driven by major advances in industrial and transport technologies. This was accompanied by growing international flows of capital and labour. These trends were reversed by the outbreak of the first World War, and the protectionism and depression of the 1920s and 1930s.

Following the second World War, successive GATT agreements resulted in progressive lowering of trade barriers, helping to facilitate a second phase of globalisation. During this period, the world economy grew to deliver unprecedented rates of global economic growth.

The most recent phase of globalisation has been the most dramatic. It has been marked by four trends:

1. accelerated reductions in transport and communication costs
2. greater international specialisation driven by continued liberalisation
3. increasing trade in services due to the digital revolution, and
4. the increasing integration of major emerging markets into the world economy.

These trends make this latest phase of globalisation the fastest, and broadest in scope.

## Opportunities and challenges

Globalisation, and the rapid emergence of new economic powers, is accelerating the pace of economic change, creating new opportunities and new challenges. With the pace of innovation faster than at any previous time, the scale of industrial transformation greater, and the breadth of competition more global, the answer lies not in protectionism, but in rapidly upgrading skills, science and technology.

As barriers fall and economic activity moves across borders, new economic opportunities are created, opportunities for increasing employment, raising incomes, and reducing poverty. The rapid growth of China and India in particular, as they liberalise their economies and integrate them with the rest of the world, has lifted hundreds of millions out of poverty, helping to reduce global inequality. According to the World Bank, the developing economies that have increased their integration with the world economy and created an attractive investment climate have seen the fastest economic growth<sup>1</sup>.

But some countries have yet to benefit, and the unprecedented speed of global economic change presents a major challenge. Individuals and economies that can cope well with change should adjust quickly and thrive on the new opportunities. Those that cannot will find themselves at a disadvantage and may need help to adjust. So the challenges of globalisation affect us all:

- workers, who may need to adapt and obtain new skills;
- industries, that may have to change or relocate to remain competitive;
- governments, that must help firms and individuals to adjust, providing them with the social and physical infrastructure needed to realise their potential; and
- regional and global organisations, that must work to provide an international system that safeguards stability and provides growth opportunities for all.

This suggests that the challenges of globalisation must be addressed at many levels, domestic, regional and global.

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<sup>1</sup> Globalization, Growth, and Poverty: Building an Inclusive World Economy, by Paul Collier and David Dollar, 2002

## The domestic policy challenge

Globalisation will place new pressure on all economies to be more flexible, open, dynamic and entrepreneurial. The benefits of pursuing good economic policies are higher, but the cost of poor policies is more severe.

The economic challenge for governments is to provide a policy environment that enables individuals and firms to make the most of the opportunities, and helps them to overcome the challenges.

There are several policies that are key to maximise the benefits of globalisation:

- Establishing **macroeconomic stability** through sound fiscal and monetary frameworks to help individuals and firms to cope with the shocks and volatility of a rapidly changing global economy
- Facilitating the growth of a **flexible and entrepreneurial business sector**. Governments should establish an investment environment that supports FDI, which can facilitate inflows of capital, technology, and expertise. And multinationals should act responsibly and support the communities in which they operate
- Promoting **innovation** to take to advantage of the greater returns to technology available in the global market, and adopting new technologies to accelerate productivity and improve quality of life
- Enabling individuals to obtain and update their **skills** to make the most of new opportunities
- Ensuring **fairness** for all, through comprehensive welfare systems that incentivise work whilst providing security and support for those who need it
- Increasing innovation and adaptability in the use of **energy and resources** to ensure that economic growth is compatible with preserving the global environment
- Ensuring the **property rights** system creates a fair and law-based environment.

### Box 1: Learning from best practice

No country has achieved the perfect economic model, and a one-size-fits-all approach is inappropriate in a world of complex economies and diverse communities. The following are just some of the examples where policies have become an important source of stability and / or competitive advantage.

- Strong **workforce skills** help firms and individuals adapt to change, and compete in an increasingly open global economy. Governments are responding. For example, the number of graduates is rising fast across the world – almost half of young Australians now go through higher education, and China has more than doubled the number of university students in the last five years.
- **Labour force flexibility** is important in maintaining high employment in the face of structural change. There are many aspects of flexibility: the US has a relatively low regulatory burden on employers and a high degree of geographical mobility, whilst Sweden has effective re-training schemes and generous childcare provision to maximise employment opportunities for women
- **Infrastructure** provides the fundamental services without which a modern economy cannot function. Governments that anticipate and meet demands for infrastructure can help to prevent the bottlenecks that constrain growth. China, for example, has invested massively to provide the infrastructure needed to facilitate growth.

## The global policy challenge

As a global phenomenon, many of the challenges presented by globalisation require an international response. They can only be solved by countries working in partnership at a global level:

- promoting trade openness rather than protectionism in order to increase the opportunities of globalisation and ensure they are available to all. The potential gains from global trade reform are huge – the World Bank estimates that completing the current round of WTO negotiations could lift 140 million people out of poverty.

A successful conclusion to the Doha Round is essential, and should include: increased market access for developing countries, particularly in agriculture; substantial reductions in all trade-distorting subsidies, including the elimination of export subsidies; effective special and differential treatment for developing countries; and opportunities for expanded trade in services. Developed countries should also encourage knowledge and technology transfer to developing countries, whilst ensuring intellectual property rights are protected.

However, not all countries will benefit in the short-term from a reduction in trade barriers. Some countries lack the capacity and infrastructure to compete effectively in international markets; for others, the transitional costs of moving to more open markets will be substantial. Therefore we need to do more to help developing countries build the capacity to trade competitively, and provide assistance to help meet the costs of adjusting to more open markets and protecting vulnerable people.

- working to eliminate poverty and achieve the Millennium Development Goals (MDGs), requires a partnership between developing countries, who need to incorporate the MDGs into their national development strategies, and developed countries, who must fulfil their commitments to mobilise aid and debt relief to support these strategies. 2005 has been a year of progress on this agenda, with donors committing to increase aid levels by \$50bn between 2004 and 2010. Innovative financing mechanisms can help by frontloading the aid where it can make the greatest contribution to the MDGs, and by enhancing the predictability of aid flows.
- Maintaining the stability of the global economy in an environment of ever-closer global integration and growing international financial flows. The new shape of the world economy requires new methods, with stability based on internationally agreed codes and standards, and transparent assessments of whether they are met.
- Meeting the challenge of climate change requires coordinated action to reduce carbon emissions and to assist those most at risk. The programme of action and ongoing dialogue agreed at Gleneagles is an important milestone – building a partnership between G7 countries and fast-growing emerging markets such as China and India, but progress must accelerate if this challenge is to be overcome.

Effective international institutions play an important role in tackling global challenges, providing:

- a forum for global cooperation and agreements
- an authoritative source of expertise and advice to help governments cope with global challenges and share in the benefits of globalisation, especially the poorest
- independent and objective surveillance of countries' economic policies
- a mechanism for enforcing international agreements

Informal groupings and partnerships, such as the G20, can also play an important role, promoting dialogue and understanding between key economic partners, and providing a forum for the exchange of best practice in tackling global challenges.

The IMF and World Bank's effectiveness and credibility as cooperative institutions must be safeguarded and further enhanced. We need to ensure an adequate voice for all members and a distribution of IMF quotas and voting power that reflects developments in the world economy.

### Box 2: The key International Financial Institutions

The IMF, World Bank, and WTO are global institutions with significant roles in managing the world economy.

**IMF:** The International Monetary Fund plays a critical role as the guardian of international economic stability, providing early warning of potential vulnerabilities and providing assistance to countries in preventing and resolving crises.

**World Bank:** The World Bank plays a key role in the shared international effort to eliminate poverty and a key institution providing advice and finance to support low-income countries' efforts to reduce poverty.

**WTO:** The World Trade Organisation provides the forum for global trade liberalisation negotiations. It also provides technical assistance to allow poorer countries to participate fully in these negotiations, and, through its Dispute Resolution Mechanism, provides independent arbitration of trade disputes.

## The regional policy challenge

Economic integration at a global level, driven by global forces, can also be complemented by regional economic integration, again presenting both opportunities and challenges. Regional co-operation and co-ordination can also help the process of integration across a range of policy areas. Regional co-operation can take many forms.

In East Asia, the Chiang Mai Initiative has produced a growing number of bilateral currency swap agreements between governments. The swaps can be used to help stabilise currencies in the event of a crisis.

The foremost example of regional economic integration has been the European Union, the world's first modern trade bloc. The EU has, over fifty years, facilitated deep economic integration, and it will continue to evolve in the face of new global challenges.

But it is important that regional integration should not be at the expense of international financial co-operation or global trade liberalisation. Regional organisations should resist the temptation to shield economies from change by retreating behind protectionist barriers, a policy which can only undermine standards of living. And efforts at regional harmonisation should not undermine the flexibility that individuals and firms need to compete effectively in a globalising world.

## Conclusion

Globalisation brings both opportunities and challenges. All governments have a responsibility to provide a policy environment that enables their citizens and enterprises to make the most of the opportunities, and helps them to overcome the challenges.

Developing countries, LDCs in particular, face their own challenges in responding to globalisation, and need the flexibility to decide, plan and sequence their policies to fit with their respective development strategies.

And there is a need for action at a global level, largely through international institutions. Regional co-operation can also play a part as a complement to global co-operation.