Economic and policy implications of greater global integration

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Key messages

Economies are more integrated across national borders

- Trade and financial integration have increased considerably since the 1990s.
- Emerging market economies are more integrated into the global economy.
- Multinationals and global value chains also transmit shocks across borders.
- The US dollar is dominant in global transactions.

Enhanced integration improves living standards, but also raises the strength of external shocks, with implications for domestic policy

- Financial markets are increasingly linked by the global financial cycle.
- Greater integration and changed cross-border links amplify external shocks.
- Monetary policy needs to respond more to external shocks, but less to domestic ones.
- Collective policy action has become more effective.

Policy choices need to reflect the risks of spillovers and the opportunities to benefit from multilateral co-operation

- Domestic policy choices need to enhance resilience and help those affected by shocks.
- Collective action is important to address common global challenges.
- Global standards and continued multilateral dialogue are essential.
Trade integration has increased substantially

Trade in goods and services, % of GDP

Note: Trade and GDP are measured in volumes in US dollars at market exchange rates. Trade is measured as the average of import and export volumes. The 1995 data refer to 1996 for Brazil and 1997 for India.
Source: OECD Economic Outlook 103 database.
Global value chains make trade linkages more complex

Value-added trade

Note: The bubble size reflects the share of world trade in value-added terms in 2014 of a country or economic area. The thickness of the lines between two bubbles measures the amount of bilateral trade of value added in final demand between trading partners. Bilateral trade flows between countries that are less than 0.2% of total world trade flows are not shown. DAE denotes the Dynamic Asian Economies and OEM a group of the 129 emerging and developing countries that account for around 10% of world trade. Source: OECD TiVA database; and OECD calculations.
International assets and liabilities have expanded rapidly, and their composition has changed.

*International investment assets and liabilities, % of world GDP*

Note: Sum of international assets and liabilities for advanced and selected emerging market economies (Argentina, Brazil, China, Chile, Colombia, Hungary, India, Indonesia, Mexico, Poland, Russia, South Africa and Turkey).

Source: IMF Balance of Payments Statistics; and OECD calculations.
EMEs have become more integrated in the global economy, especially on the trade side.

Trade volumes
% of world total

Sum of international assets and liabilities
% of world total

Note: Trade volumes refer to the average of import and export volumes at market exchange rates. International assets and liabilities in US dollars. Selected EMEs include: Argentina, Brazil, China, Chile, Colombia, Hungary, India, Indonesia, Mexico, Poland, Russia, South Africa and Turkey.

Source: IMF Balance of Payments Statistics; and OECD Economic Outlook 103 database.
**Rising cross-border sales and FDI income have increased firms’ exposure to the global economy**

### Share of foreign sales in total net sales

*median company listed on the stock exchange, %*

- **Nikkei 225**
- **STOXX 600**
- **S&P 500**

### Foreign Direct Investment income

% of GDP

- **United Kingdom**
- **France**
- **Canada**
- **Germany**
- **United States**
- **Japan**
- **Russia**
- **Italy**
- **South Africa**
- **Brazil**
- **India**
- **Indonesia**
- **China**

**Note:** The share of foreign sales incorporates changes in composition of the stock indices. For the Nikkei 225, the listed firms 2011 are used for the period 1995-2011. For the STOXX 600, listed firms in 1999 are used for 1995-99. For the firms considered as national in the euro area, foreign sales include sales to the rest of the euro area. FDI income is for the years indicated, or the closest available.

**Source:** Thomson Reuters Worldscope; IMF Balance of Payments Statistics; and OECD calculations.
Global flows of people and data have also deepened integration

International migrant stock
Million people, host countries

Global IP traffic
Exabytes per month

Note: High-income, Middle-income and Low-income countries are as classified by the World Bank. Russia is included in the IP data for Europe.
Source: United Nations; Cisco; OECD Digital Economy Outlook 2015; and OECD calculations.
ENHANCED INTEGRATION AND EXTERNAL SHOCKS
Global factors increasingly link national equity markets and are becoming more important for GDP growth.

Factors explaining economic and financial developments in 15 advanced economies

*Equity price growth, %*

*GDP growth, %*

Note: Factors are estimated using dynamic factor models with annual data for the periods shown. They capture all features driving the co-movements of a given variable across a group of countries. A global factor affects all countries, and the country-specific factor captures everything else. The figures show the average contributions across all countries in a given sample.

Source: OECD calculations.
Changes in trade patterns and trade openness affect spillovers from shocks

GDP growth effects of a negative demand shock of 2%pts in China

With different trade patterns
%points, average in first two years

With different trade openness
%points, average in first two years

Note: Difference from baseline, following a decline of 2 percentage points in the growth rate of domestic demand growth in China for two years. The initial simulation is shown in the blue bar and the difference in the second simulation in the red bar. Commodity exporting economies include Australia, Brazil, Indonesia, Russia, South Africa and other non-OECD oil-exporting economies. Lower and higher trade openness refer to two different starting points for the shock, with the ratio of trade to GDP rising by 11 percentage points in the median economy between these starting points.

Source: OECD calculations.
A stronger policy response is needed to mitigate adverse spillovers from higher integration

Change in policy interest rates in response to a negative demand shock in China

With different trade patterns

%pts, second year of shock

- With different trade openness

%pts, second year of shock

Note: Difference from baseline, following a decline of 2 percentage points in the growth rate of domestic demand growth in China for two years. The initial simulation is shown in the blue bar and the difference in the second simulation in the red bar. Commodity exporting economies includes Australia, Brazil, Indonesia, Russia, South Africa and other non-OECD oil-exporting economies. Lower and higher trade openness refer to two different starting points for the shock, with the ratio of trade to GDP rising by 11 percentage points in the median economy between these starting points. Source: OECD calculations.
Higher integration enhances the multipliers and spillovers from collective fiscal action

GDP impact of raising public investment by 0.5% of GDP in the G7 economies

Impact in G7 economies
% change in GDP, first year of shock

Spillovers from collective G7 expansion
% change in GDP, first year of shock

Note: Difference from baseline, following a permanent rise in public investment of 0.5% of GDP in the G7 economies, either undertaken individually or collectively. All groups weighted together using PPPs. In the first chart the orange bar shows the impact from expansion in only one country, the green bar shows the additional impact from all countries expanding investment. The G7 column in the second chart shows the overall weighted impact on the G7 economies as a whole in the collective shock.

Source: OECD calculations.
Financial integration raises spillovers from financial shocks

Impact of a 1 percentage point rise in the US equity risk premium

Change in GDP
%
second year of shock

Change in policy interest rates
%points
second year of shock

Note: Difference from baseline, following a rise of 1 percentage point in the US equity risk premium for two years. The lower equity market integration scenario is based on pre-1995 linkages and the higher equity market integration scenario on linkages over the past decade. The initial scenario is shown in the blue bar and the difference in the second scenario in the red bar. Source: OECD calculations.
The US dollar’s dominance in international trade and finance strengthens the global transmission of US shocks

**Invoicing in US dollars and euros**

% of total imports

![Bar chart showing invoicing in US dollars and euros across various countries.](chart1)

**Share of US dollar in financial liabilities**

% of total

![Line chart showing the share of US dollar in financial liabilities.](chart2)

**Note:** Data in LHS panel for 2016 apart from Australia (2015-16), Indonesia (2010-15), India (2012-13) and Brazil (2011). Merchandise trade for all countries apart from Russia (goods plus services). Data for all European countries only cover extra-EU trade. **Source:** national sources; Eurostat; Bank for International Settlements; and OECD calculations.
Currency moves can have sizeable revaluation effects

Change in net foreign assets following a 10% appreciation of the US dollar against all other currencies

% of GDP

United States  Turkey  Russia  Indonesia  India  South Africa  Germany  France  Brazil  Mexico  Italy  Australia  Argentina  China  Japan  Korea  United Kingdom  Canada

Note: Calculations are based on foreign assets and liabilities (excluding derivatives when the data are available) for 2017 and their currency composition as of 2012, as estimated by Bénétrix et al. (2015).

Trade volumes have become less responsive to exchange-rate driven relative price changes

Change in the long run impact of relative price movements

Difference between 2005 and 2014 OECD estimates

A. Export volumes

B. Import volumes

Note: A negative value indicates a decline in the long run relative price elasticity of export (import) volumes with respect to a change in the relative price of exports (imports). Exports and imports refer to goods plus services at constant prices.

Source: OECD calculations.
POLICY CHOICES TO REDUCE SPILLOVER RISKS AND ENHANCE OPPORTUNITIES TO BENEFIT FROM MULTILATERAL CO-OPERATION
Countries need to continue to strengthen domestic resilience, especially in the financial sector.

Selected EMEs include: Argentina, Brazil, China, Colombia, Hungary, India, Indonesia, Malaysia, Mexico, Poland, Russia, South Africa and Turkey.

Currency-based measures include regulations to lower the risks of currency mismatch in bank balance sheets.

Source: OECD calculations.

**Note**: The easing or the removal of a financial policy is coded as -1; the tightening or introduction of a financial regulation is coded as +1.
Reforms are needed to help people and displaced workers adapt to shocks and find new opportunities.

Take-up of reforms
% share of Going for Growth recommendations

- Fully implemented or in process of implementation
- No action taken in 2017

Improving targeting and coverage of social benefits
Strengthening active labour market policies
Expanding vocational education and training
Labour tax reforms to improve job opportunities
Housing policies to enhance labour mobility

Note: Refers to reform priorities identified in Going for Growth in 2017 for the 46 economies covered.
Source: OECD Going for Growth 2018
Collective and more effective global policy co-ordination is needed to tackle common challenges

International macro co-ordination, notably in crisis conditions

- Collective action faced with a common shock (e.g. fiscal expansion in 2009).
- Strengthening global and regional financial safety nets.

Ensuring an effective global rules-based system to enhance domestic resilience and lower risks of adverse policy spillovers

- OECD BEPS: common standards and improved transparency to tackle tax avoidance strategies that exploit gaps and mismatches in tax rules.
- OECD Code of Liberalisation of Capital Movements: facilitates transparent dialogue and co-operation on capital flow issues and policies.

Regulatory co-operation and continued multilateral dialogue are essential.
Complex supply chains raise the gains from safeguarding and expanding the rules-based global trade system

Exports to Japan via third markets
% of value-added

Note: How to read this chart: for example, in 2014 35% of total value-added manufacturing exports from France to Japan passed through one or more third markets on the way to Japan.

Source: OECD TiVA database; and OECD calculations.
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