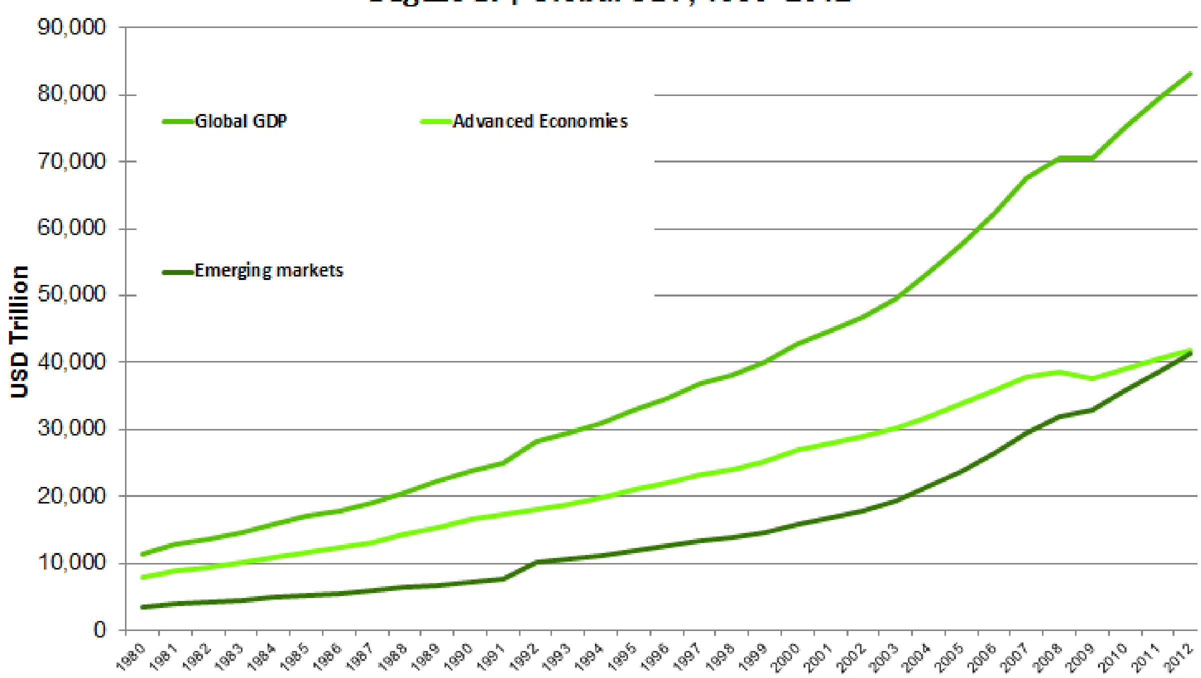
Global Economy: Looks Good from Afar But Is Far from Good

Mark Konold and Ralph Albus | December 30, 2013

Gross world product increased to just over $83 trillion in 2012, a 4.85 percent increase over 2011.[1] (See Figure 1.) On the surface, this metric supports the argument that the worst of the global recession is in the past—and it is. However, closer inspection shows that while there is at least tepid growth globally, growth rates like the ones experienced in the prior 20–25 years now seem to be taking place in emerging economies. In fact, the total gross domestic product (GDP) of emerging economies is now roughly equal to that of all the advanced economies.[2] Nominally, a growth rate just shy of 5 percent seems reasonable, but this rate of growth continues a pattern of slowing growth rates since 2010 and 2011, which were 6.35 and 5.67 percent, respectively.[3] Ironically, one trend that seems continuous since 1980 is that the percent change in global GDP varies widely. (See Figure 2.)

Figure 1. | Global GDP, 1980–2012



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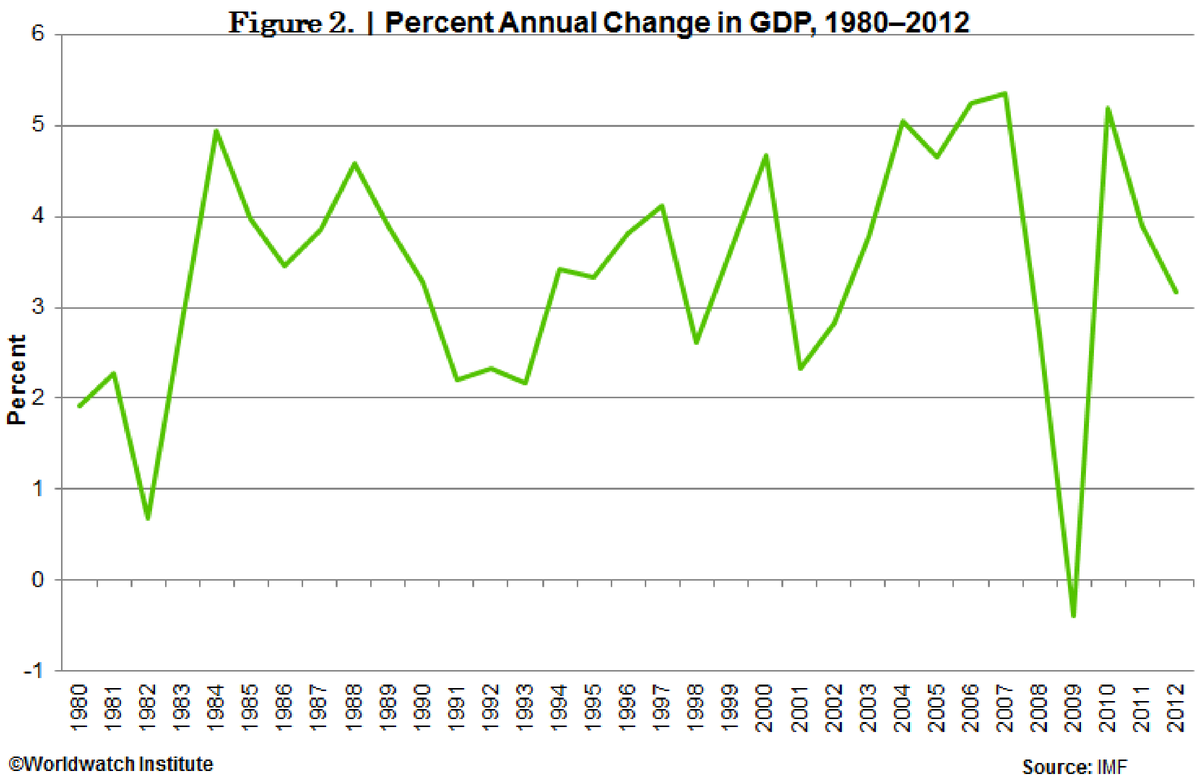
Source: IMF



The gross world product is the sum of the GDPs of all countries. This typically includes levels of consumption, investment, government spending, the cost of imports, and the proceeds from exports.[4] Because of various transaction costs, floating exchange rates, and barriers such as tariffs, a metric is applied to put purchasing power for countries on even footing. This factor, applied to the figures in this article, is called the purchasing power parity exchange rate.[5]

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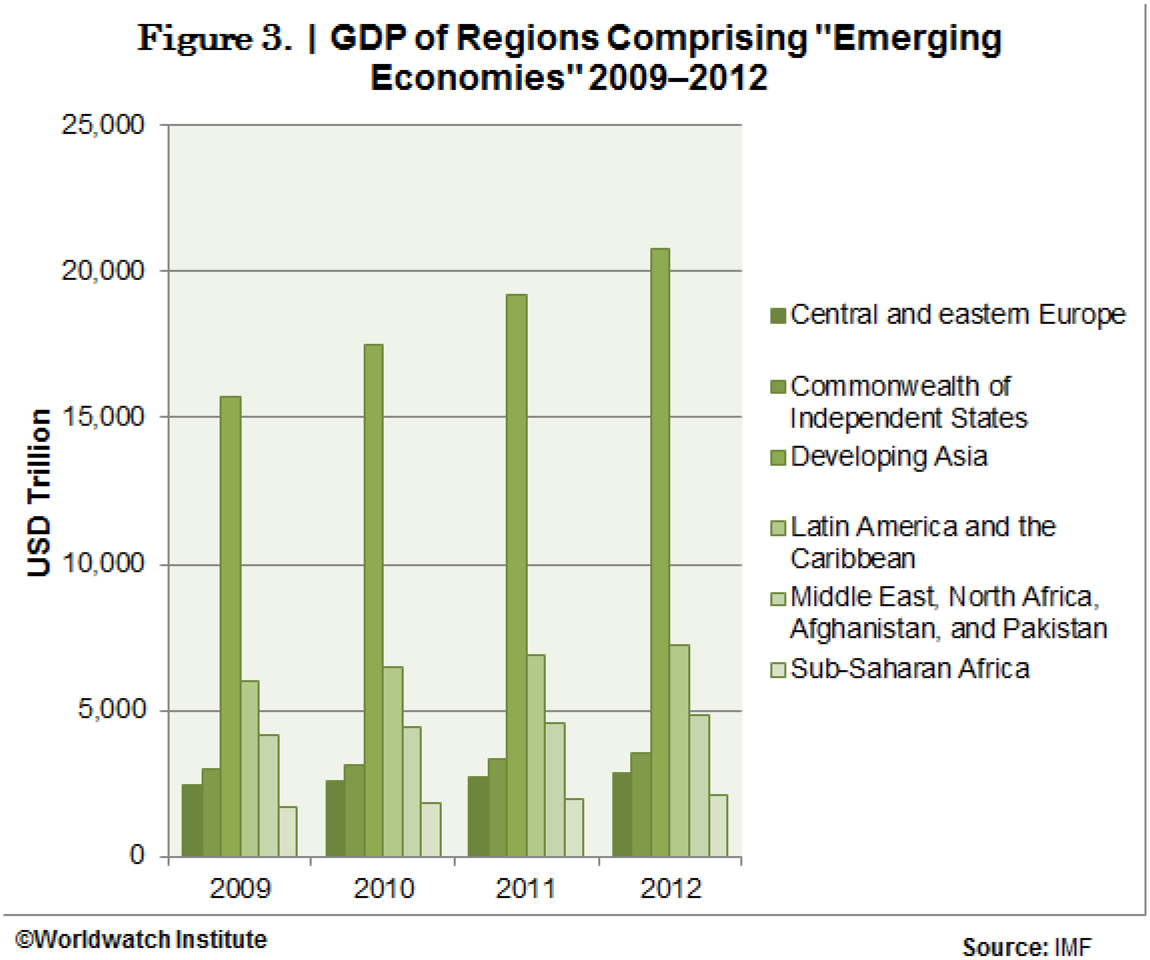
Economic activity continued to be a muddled picture in 2012, with some parts of the globe seeing relatively strong growth while others had tepid growth and some actually experienced some negative growth. In recent years, developing Asia has had by far the highest growth rate of any region.[6] (See Figure 3.)

Indeed, the strongest areas of growth continued to be developing and emerging economies due to policies that created favorable business and investment climates.[7] Countries that avoided overleveraging themselves while experiencing robust growth in recent years have had relatively healthier fiscal positions and therefore higher levels of foreign direct investment.[8] However, this growth was slightly hindered as advanced economies like the United States, Japan, and the members of the European Union (EU) dealt with headline-grabbing crises such as the "fiscal cliff" and the possible breakup of the EU. Despite successfully dealing with these challenges in 2012, there was little progress on long-term solutions, which may have kept growth modest.[9]

Other metrics show that that the global economy sputtered a bit in 2012.

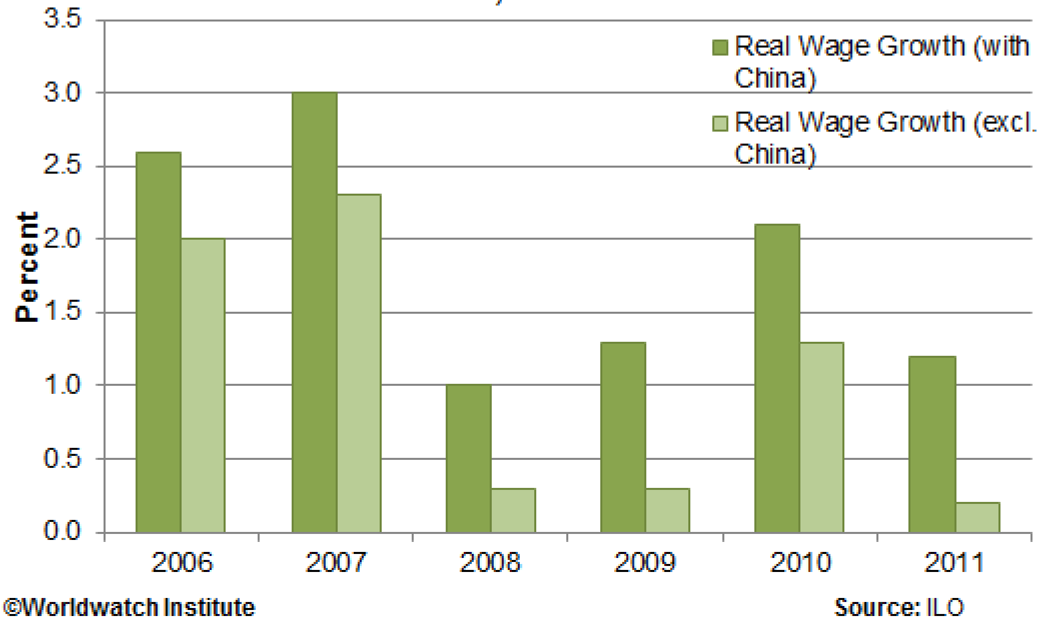


Trade flows, often a bellwether of economic health, continued to slow. As a result, current account balances, a collection of all transactions other than financial and capital, continued narrowing throughout the year, down from $355 billion in 2011 to $343 billion in 2012, a 3.4 percent drop.[10] Equally noteworthy was the downshift in commodity prices in 2012, which was significant enough to mark the end of a cycle that saw overly robust growth in the preceding 10 years.[11] Non-energy-related commodities were down by 7.5 percent, while oil prices stayed relatively flat throughout 2012.[12]

Unemployment levels also indicate that, despite continued growth, economic health is far from a rosy picture. According to the International Labor Organization (ILO), 200 million people around the world are unemployed—about 6 percent of the global workforce.[13]

In addition, the ILO notes that the labor share of national income has been steadily falling around the world for some time, with a larger share of the income going to capital because of the expansion of technological innovation, decreased labor union participation, globalized trade, and wider and more interconnected financial markets.[14] The ILO estimates that between 1999 and 2011 (the last year with complete data), labor productivity in advanced economies increased twice as much as average wages.[15] ILO data show how wage growth has sputtered in recent years. Excluding China, real wage growth has averaged less than 1 percent a year since the onset of the financial crisis.[16] (See Figure 4.) Low rates of wage growth may be contributing to slow economic growth, given the positive correlation between labor compensation and household consumption.[17]

Figure 4. | Annual Average Global Real Wage Growth,2006 – 2011



While global GDP gives a broad-stroke picture of economic health, it is incomplete. It makes no distinction between the money spent building a hospital, a school, or a prison. It does not differentiate between sales of gasoline, timber, or alcohol, nor is there any distinction between money spent on health care, education, or disaster cleanup. In addition, it does not consider things like home production, the value of time spent keeping up a home and rearing children, or the return on consumer durable goods.[18] According to one study, while the factors and calculations are complex, adding them to the measure of gross national product (GNP) would have resulted in a value 25 percent higher than actually recorded.[19] (GDP became the primary measure of growth in 1991, while prior to that GNP was the accepted metric. The former is a measure of total income produced domestically. The latter includes only income earned by nationals of a country. The study cited contained data prior to 1991 and therefore cited GNP throughout.)

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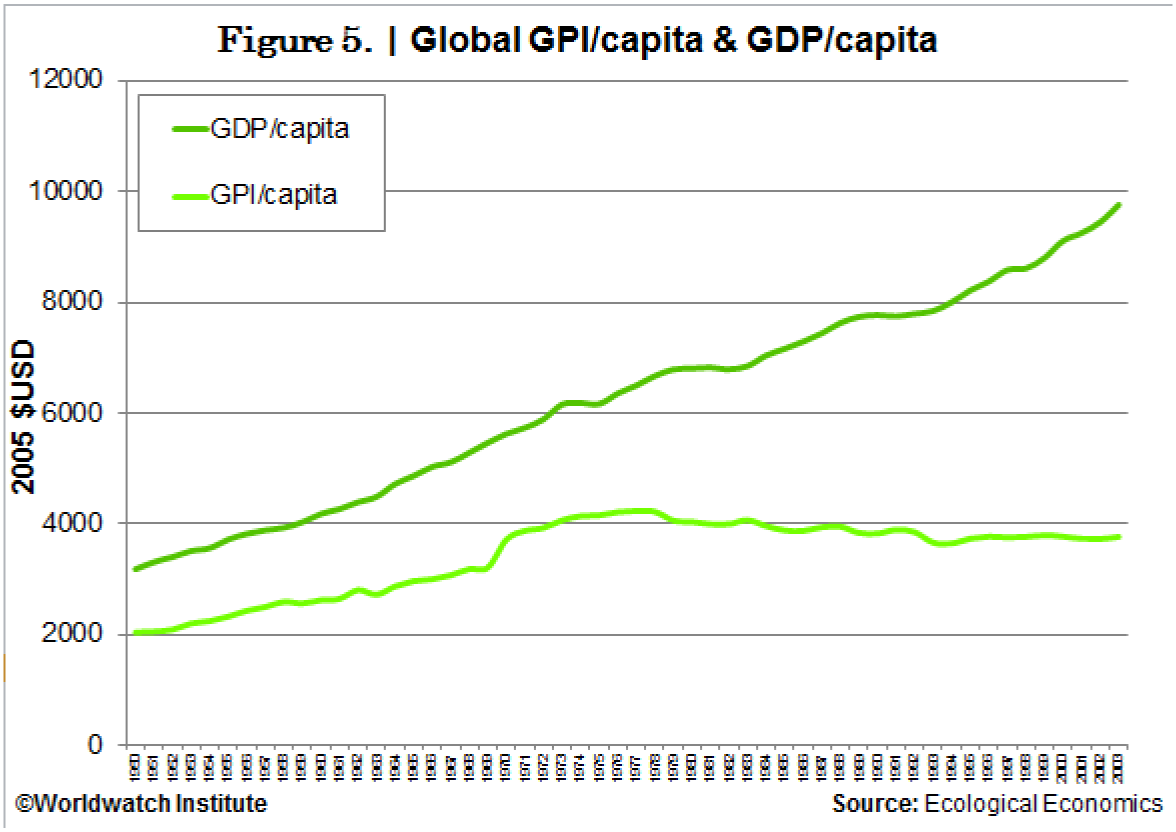
Conventional economics regards economic growth as an unalloyed good, necessary to improve human well-being. But it is only a nominal indicator. It lacks the many intricacies and more subjective goods that are essential to a more encompassing, holistic, meaningful metric. Given the disparity of the benefits, it is clear that in and of itself, growth is far from an effective measuring stick.

In light of this, new metrics have been developed that seek to paint a more comprehensive and accurate picture of humanity's overall welfare. An enhanced and widely cited metric is the Genuine Progress Indicator (GPI),



which includes the economic cost of expenditures that diminish "community capital."[20] Though GPI has critics for what it includes and excludes, it is more comprehensive than GDP and thus gives a more adequate picture of well-being. However, some critics argue that it is still rooted in a consumption-based model and ignores the important issue of sustainability or preservation of resources.

Still, the study of GPI has yielded some interesting results. For example, a 2012 study looked at a group of countries that contain more than half of global population and for which data were either tracked or could be reasonably estimated.[21] It showed that after the mid-1970s, per capita figures for GDP and GPI, which had shown a strong correlation up to that point, began to diverge. While GDP per capita continued to rise, broader economic well-being leveled off and has even declined.[22] (See Figure 5.)

Other attempts to gauge human progress have emerged recently. In 2011, taking a cue from Bhutan, which began tracking something called Gross National Happiness in the 1970s, the United Nations General Assembly passed a resolution stating that all countries should begin measuring happiness.[23] And in 2013, the second World Happiness Report, sponsored by the Sustainable Development Solutions Network, was released to provide some insight for discussions about a global policy for sustainable development.[24]

The new report tracks and analyses such factors as social support, freedom to make life choices, perception of corruption, and healthy life expectancy at birth.[25] It demonstrates that despite the financial crisis in 2007–08, overall happiness has been on the rise.[26] However, this trend has not been universal. Increases in happiness have mostly been recorded in sub-Saharan Africa, East Asia, the Commonwealth of Independent States, Latin America, and the Caribbean.[27] Larger western economies, particularly the United States and the countries affected by the euro crisis, have seen happiness drop.[28] There have also been declines in the Middle East, North Africa, and South Asia.[29]

Similarly, the U.N. Development Programme prepares a Human Development Index as an indicator of well-being that relies primarily on health (life expectancy at birth), education (mean and expected years of schooling), and living standards (gross national income per capita on a logarithmic scale.)[30] Regardless of the approach or specific metrics involved, all studies seem to conclude that sole reliance on GDP growth as the measuring stick for prosperity and well-being is woefully inadequate and probably has been for some time. Higher human development can only begin to be seriously measured when the impact of expenditures is evaluated and when more-qualitative elements are examined as part of a much larger and more complex mechanism to decipher human development.

But even when these more qualitative factors are considered, most approaches to global economic health ignore the planet's capacity to provide the resources necessary to sustain it. The resources of the natural environment are finite, while human consumption has reached such a point that humanity consumes a year's worth of resources in less than 365 days. Groups like the Global Footprint Network strive to accurately account for resource use by measuring humanity's impact on the ecosystem compared with the ecosystem's ability to replenish itself.[31] The organization tries to determine the rate at which humanity's use of natural resources exceeds the resources Earth can sustain. In fact, the group widely publicizes its annual Overshoot Day. The first time the event was noted was in 1987, on December 21st. By 2012, Overshoot Day had crept back to August 22nd.[32] Current studies note that civilization is above Earth's capacity to replenish itself by about 50 percent.[33]

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Notes

1 International Monetary Fund (IMF), *World Economic Outlook 2013* (Washington, DC: 2013).
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4 Paul Krugman and Maurice Obstfeld, *International Economics: Theory & Policy* (New York: Addison-Wesley, 2009).
5 Tim Callen, "PPP vs. the Market: Which Weight Matters," *Finance and Development,* March 2007; Krugman and Obstfeld, op. cit. note 4.
6 IMF, op. cit. note 1.
7 Ibid.
8 Ibid.
9 Ibid.

[10] IMF, op. cit. note 3.
[11] Mark Konold, "Commodities Supercycle Slows Down in 2012," *Vital Signs Online,* Worldwatch Institute, 27 September 2013.
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[13] International Labor Organization (ILO), *Global Wage Report 2012/13* (Geneva: 2013).
[14] Ibid.
[15] Ibid.
[16] Ibid.
[17] Ibid.
[18] Benjamin Bridgman et al., "Accounting for Household Production in the National Accounts, 1965–2010," *Survey of Current Business*, May 2012.
[19] Ibid.
[20] Ida Kubiszewski et al., "Beyond GDP: Measuring and Achieving Global Genuine Progress," *Ecological Economics*, vol. 93 (2013), pp. 57–68.
[21] Ibid.
[22] Ibid.
[23] John Helliwell, Richard Layard, and Jeffrey Sachs, eds., *World Happiness Report 2013* (New York: Sustainable Development Solutions Network et al., 2013), p. 3.
[24] Ibid.
[25] Ibid.
[26] Ibid.
[27] Ibid.
[28] Ibid.
[29] Ibid.
[30] U.N. Development Programme, *Human Development Report* (New York: various years).
[31] Jennie Moore and William E Rees, "Getting to One-Planet Living," in Worldwatch Institute, *State of the World 2013* (Washington, DC: Island Press, 2013), pp. 39–50.
[32] Global Footprint Network, "Earth Overshoot Day," at www.footprintnetwork.org/en/index.php/GFN/page/earth_overshoot_day.
[33] Moore and Rees, op. cit. 31.