EZY ECONOMICS

THE WEEKLY 5

15/03/19

Here are the five economic stories which have caught our eye this week:

Norway – Investing for the Future


Norway, a country famous for its mountainous landscapes, vibrant cultural life and high standard of living, has been in the news this week in regards to its vast investment into the oil and gas industry.

The Norwegian economy is the 46th largest in the world with a GDP value of $397bn. This is hardly surprising given the small land mass of the country and the fact that the Norwegian country has a population of just over 5 million people. However, GDP per capita (PPP) is the fourth highest in the world at $74,065. The country also inviably tops the charts when it comes to measuring income inequality (Gini Index) and economic development (HDI). How is Norway able to convert this small pool of resources into such attractive economic results?

The country is surrounded by deep coastal waters that are rich in natural energy resource deposits. This has provided the country with a natural extraction point for oil and gas exploration in the North Sea since the 1950s. Energy exploration activities have been facilitated by state ownership of major operators and refineries in the North Sea. The Norwegian government also grants exclusive licenses to some of these oil fields to ensure sustainable extraction levels over time.

The petroleum industry is now the largest industry in Norway and the country itself is the 5th largest producer of oil and the 3rd largest producer of gas. Export revenues from oil and gas exploration activities are significant with 50% of the country's exports relating to the petroleum industry. This contributes to 20% of the country's GDP.

The danger that Norway and other specific-sector driven economies have is the overreliance the country has on generating wealth from a single sector. To prevent this problem and support further economic diversification in the future, the Norwegian government set up a sovereign wealth fund (state-owned investments) called the "Government Pension Fund" in the 1990s. This would channel a fraction of the revenue made from the petroleum industry into global financial assets, stocks and bonds. It is estimated that this is now valued at just over $1tn and can be called upon to neutralise the volatility that stems from fluctuating oil prices.

The news this week is that the Norwegian government has tabled a plan to divest their $37bn holdings in some of the world's largest energy providers such as BP and Shell to protect itself against the expected downturn in oil in the decades to come.

With reference to an AD-AS diagram, assess the impact that a drop in oil prices is likely to have on the Norwegian economy.

Death of Capitalism?

Capitalism is a word you hear used regularly in the world of politics and finance, but what is its relevance in the 21st century? This is an interesting question posed by Raghuram Rajan, a former member of the Indian central bank, when appearing on some UK media outlets this week.

Capitalism is a hard term to pin down a clear definition for but it is traditionally seen as an economic system in which the country's trade, industrial and commercial interests are controlled by private firms rather than governments. The argument is that the private incentives that business owners have in making a profit drives individuals and businesses to be more efficient and productive. This ensures resources are allocated to the activities that garner the greatest value to an economic system.

However, Rajan this week warned that the system of capitalism breaks down when there are widening levels of inequality. In his words "capitalism is under serious threat because it's stopped providing for the many, and when that happens, the many revolt against capitalism". It is unclear from his comments whether he directly blamed a capitalist system on some of the wider and more entrenched inequality issues of society, but suggested the situation has taken a turn for the worse since the financial crisis.

The former central banker also warned that the next financial crisis may not be too far away as the same factors which caused the last crisis are more prominent than they were back in 2008. Government debt across the global economy is now 77% higher than it was ten years ago, with business debt 50% higher. High levels of indebtedness has for a long time been defined as a significant barrier towards economic growth, development and diversification.

Discuss what the term 'capitalism' means in practice.

To what extent do you agree with the view that governments are better positioned to allocate an economy's scarce resources compared to private sector firms.

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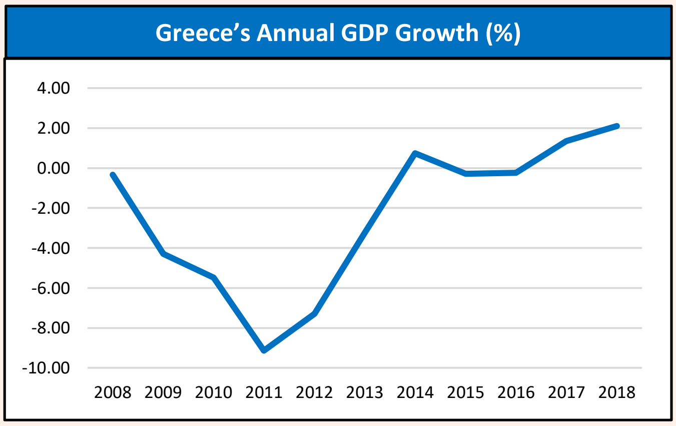
Road to Recovery for Greece?



This week, the International Monetary Fund (IMF) released a report putting the Greek economy under the microscope. The report series titled 'IMF Country Focus' provides regular assessment checks on the bill of health of economies around the world. The report provides an important collection of statistics and figures, as well key recommendations for the policy framework of that country. If you want to build up your knowledge of the economic profile of countries around the world this is a really good report series to keep tabs on.

Greece experienced a severe economic deterioration in 2008 due to its heavy borrowing and dubious government accounting procedures. In 2009, the country's debt levels went over the €300bn mark, bond yields soared (borrowing costs), the economy tanked and adult and youth unemployment rose to unprecedented levels. The financial and policy restrictions imposed on the country from being locked into the Euro's single currency meant the country had to call upon financial assistance from institutions such as the ECB and the IMF.

In total the country required three bailout loans in 2010, 2012 and 2015, as its debt-to GDP level soared to 180%. The country had to implement severe austerity measures in return to receive this financial assistance such as privatisation, pension reforms and tax clampdowns. Despite appearing harsh at the time, the country has stabilised its debt position to some degree and growth has recovered. In 2018, the GDP growth rate stood at 2.1%, with youth unemployment coming down from 50% to 40% (still extremely high!).

In the report, the IMF identify three main policy areas that can improve the situation for the country. For each, discuss the types of policies that can be implemented in those areas and assess the effects of implementing those policies ceteris paribus.

Policies to improve labour market flexibility	Policies to re-structure bank loans and commercial lending	Policies to re-form the country's tax and benefits structure

FCA's "Financial War Room"

This week the UK's main financial watchdog, the FCA (Financial Conduct Authority) has announced the measures that it will take if there is a disorderly Brexit on the horizon.

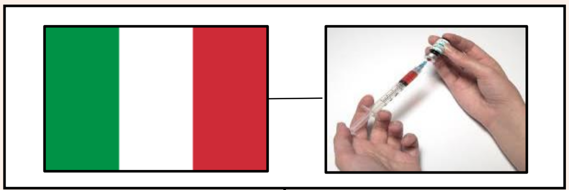
The regulator has announced plans to set up a "financial war room" in the case things take a sudden turn for the worse. All sounds very dramatic doesn't it? The reality is that this will work as a surveillance hub for the FCA to keep a close watch on the activities of firms operating in the financial sector post-Brexit.

The FCA will be monitoring the efficiency of the web of IT systems that are used to conduct financial transactions across financial markets. There have been some high profile examples of banks and financial institutions that have experienced serious technical breakdowns in their systems creating huge social and economic disruption across the economy. The FCA will keen to avoid this on a national scale as a result of Brexit.

Research and discuss the role that the Financial Conduct Authority (FCA) plays in maintaining the stability of the financial system.

In relation to the term 'systemic risk' and the example above, discuss the implications of problems that arise in the financial sector for the real economy.

"No Vaccination, No School"



We end this week's edition with an interesting story that is developing in Italy. The populist coalition government has just passed a new piece of legislation that enforces certain medical vaccinations on children under six years old to avoid health outbreaks of measles, polio and chickenpox.

The country has recently been battling an outbreak in measles across the country with government officials blaming the country's falling vaccination rates for this health epidemic. The World Health Organisation (WHO) suggest that countries should aim to maintain vaccination rates of at least 95% to prevent outbreaks, but Italy has a declining vaccination rate of just 80%.

If a child is sent to school from this point onwards without the mandatory vaccinations, the parents risk a fine of 500 euros and the children risk being sent home until proof of vaccination has been given.

The relevance of this within economics is that medical vaccinations such as these are often defined as representing a merit good. The vaccination of any given child protects that child but also reduces the risk to others via an epidemic.

Define the term merit good.

With reference to a diagram, explain why the level of vaccinations lie below that of the WHO's target.

Discuss some of the alternative proposals that could be used by a government of a country to improve immunisation rates.