EZY ECONOMICS

THE WEEKLY 5

10/05/19

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

UN's Biodiversity Report

Report Summary:		
75% Natural land altered by human actions and activities	**300%** Increase in crop production since 1970	**55%** Ocean area covered by industrial fishing activities
45% Increase in timber production since 1970	**100%** Growth in urbanised areas since 1992	**72%** Natural indicators show a deteriorating trend
CONSEQUENCES		
1,000,000 Species threatened with extinction within decades	**33%** Marine fish stocks are being harvested unsustainably	**100%** Increase in carbon emissions since 1980

This week the United Nations (UN) released an incredibly powerful report that comprehensively examined and contextualised the damaging effects that human actions have had on the natural environment in the last century. The report suggests that the natural world is deteriorating at an unprecedented rate, and without transformative change, the effects on our ecosystems could be irreversible.

The report points to the fact that the global population has increased two-fold since the 1970s, whilst at the same time the global economy has quadrupled in size, unsustainable human activity is threatening and destroying the biodiversity of our planet.

As economics is a social science, this report raises some really interesting points. The first point is that Economics centres around the ability of a system to allocate a stock of finite scarce resources in the best possible way. If some of our actions continue to go unchecked, the disparity between the planet's natural resources and human desires is only going to grow wider. From the perspective of politicians and policy makers, this is going to increase the challenges that they face in enacting the right policy mix.

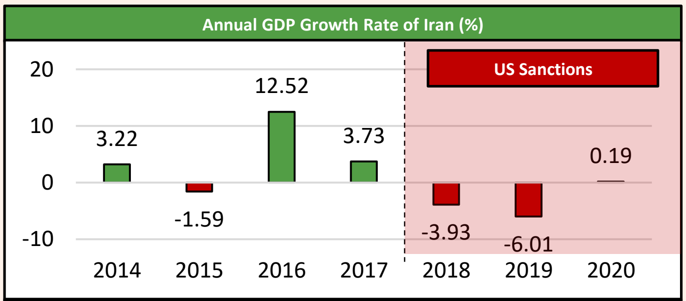
Another interesting point is whether growth and GDP numbers are all that matter when chasing higher living standards i.e. are some of the approaches taken to measure living standards and quality of life outdated? The rise in trade volumes, average incomes and GDP numbers are impressive and a reflection of hard work, fostered innovation and social progression. However, the associated costs with chasing those higher economic numbers could, in the long-term, wipe out those economic gains.

Discuss an alternative approach of your choice to measuring economic growth that holistically takes into account the damage that human activity has on the environment.

In reference to the Tragedy of the Commons, explain how the problem of overfishing emerges.

In light of the findings of the report, to what extent do you agree with the view that governments should end the provision of subsidies and wider supports programmes for the fishing and agricultural industry?

Iran Sanctions



* 2019 and 2020 provide growth estimates for Iran

In 2015, Iran and the rest of the international community ratified a legally-binding agreement that attempted to limit Iran's nuclear enrichment activities. In return, crippling economic sanctions imposed on the Iranian economy's most important economic sectors such as gas and oil, would be removed.

This landmark deal re-opened temporarily closed oil pipelines in the Iranian oil sector and restored Iran's daily production schedule to 4 million barrels a day. With the oil market awash with an injection of newly found Iranian oil, the world price of oil began to plummet and the dynamics of the global oil market are still being felt today. However, the removal of the sanctions re-energised the oil-rich nation and resulted in a bumper growth figure of 12.52% in the first full year immediately afterwards.

Since then, tensions between the US and Iran have risen considerably and the war of words between the two nations' leaders has grown sharp and ugly. In November 2018, the US decided to re-impose economic sanctions on Iran amidst rumours that the terms of the nuclear deal had been violated.. The US administration has claimed that the main incentive to impose the sanctions was to bring a shuddering halt to any exports of Iranian oil to the rest of the global economy.

So what have been the economic implications of this move by the US? Foreign investment has collapsed and the currency has fallen by 60% against the dollar to record lows. Iran's oil exports have also fallen by 60%, representing $10bn of lost revenue for the government. Inflation has quadrupled from 9% to 37% in the space of a year, resulting in unaffordable price rises for consumers and businesses.

The slowdown in the country's biggest and most influential sector has resulted in a sharp drop in economic growth by almost 4% in 2018, with IMF forecasts predicting that the crisis is likely to persist. Many commentators predict that the severity of the economic consequences will eventually force Iran back to the negotiating table to pave the way for a new Nuclear Accord.

With the help of a diagram showing the demand and supply of a currency, explain how a fall in foreign direct investment can contribute to a fall in the value of the currency of a country.

Discuss whether the members of OPEC should look to replace lost Iranian oil on the world marketto prevent rising oil prices.

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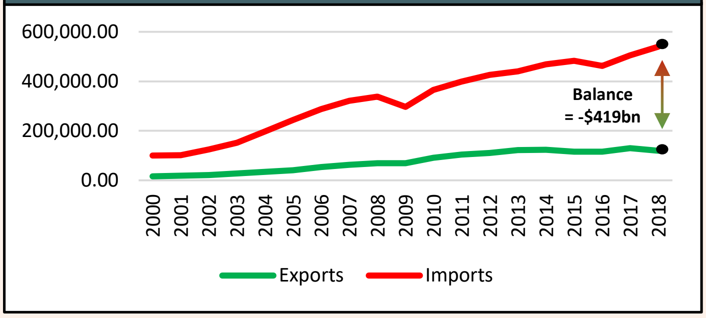
Trade War Rumbles On!

US Trade in Goods with China ($m)



This week, a new development emerged in the escalating trade war between the world's two largest economies – the US and China. As of Friday, the US administration followed through with their latest trade threat by imposing additional import tariffs on $200bn worth of Chinese goods imported into the US.

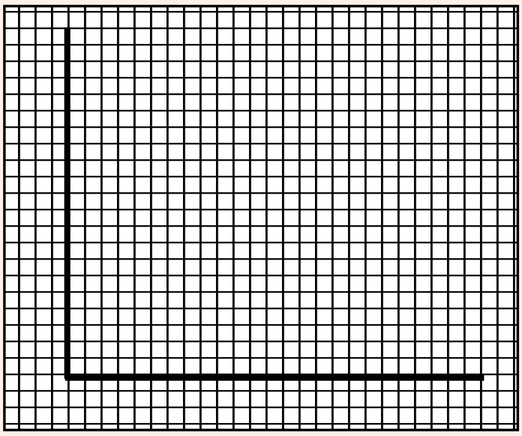
This whole episode stretches back to last year, when the US accused China of a series of unfair trade practices such as dumping, provision of state subsidies, currency manipulation and stealing intellectual property. It was suggested that this is the driving force behind the growing trade deficit between the countries. The US eventually imposed import tariffs of 10% on a range of different Chinese products valued at $200bn. In return, China responded in kind with import tariffs on $110bn worth of US products.

An import tariff is an example of an ad valorem tax, but instead of affecting the final price of domestic goods it affects the final price of imported goods. The tax is levied on individuals and businesses in the US that buy goods from China. The indirect nature of an ad volarem tax is such that when a business buys a product from China at a higher price, part, if not all, of the extra cost gets passed down to the consumer. This is where the effects of a trade war begin to be felt across the economy and within markets.

Economists have reacted with dismay at the latest series of events because a trade war is often seen, at best, as a zero-sum game. Any benefits that the local protection of domestic industries receives is offset by the fact that consumers and other businesses are hurt with dramatic price hikes for a range of goods.

Despite this economic rationale for free trade, Donald Trump has continued his pursuit of doing everything within his own power to shrink the trade gap between the two nations. That is why as of Friday morning, the US increased the tariff rate applied to those Chinese goods from 10% to 25%. You can bank on the Chinese response to be swift as both nations try to protect their own national interests, whilst recognising the importance of salvaging a new trade agreement.

Draw a demand and supply diagram below to show the effect of higher import tariffs placed on a specific range of Chinese goods for a US domestic market. You should highlight the welfare implications of the tariff.



Evaluate the impact of a persistent trade deficit on the macroeconomic performance of an economy.

1MDB Scandal

In 2015, the Malaysian government and Goldman Sachs came under intense scrutiny for its role in the management of funds in the country's sovereign wealth fund (state-owned investment fund), succinctly named the '1MDB'.

Most sovereign wealth funds are controlled by the country's finance minister or chancellor. The state invest in a series of different sectors to diversify their asset holdings. The returns that can be made on these assets can help provide the economy with the ammunition required to shore up any problems that the economy may have. In Malaysia's case the sovereign wealth fund was designed to mirror a development bank. The returns were used to fund development efforts and projects both within the country, as well as in countries abroad.

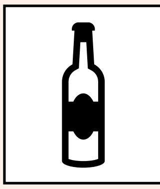
The development bank sought out the advice and experience of the US investment bank Goldman Sachs. The Investment bank helped advise the development bank on the right bonds and assets to purchase and in the process, helped raise $6bn for the development fund. Goldman Sachs were rewarded $600m in advisory fees for helping to raise this money.

However, later on it was discovered that almost $3bn was channelled from the 1MDB account to the personal bank account of the former Malaysian PM, Najib Razak. After an initial investigation had been opened, it was discovered that this money had been used by the former PM to pay for bribes to government officials and high-end luxury items.

Explain the functional differences between a commercial bank and an investment bank.

Explain how high levels of corruption can prevent economic growth translating into higher levels of economic development for a country.

Spin the Bottle



Bottle Deposit Rate	20p

Scotland has become the first UK region to sketch out the details of a deposit return scheme for single-use plastic bottles, glass bottles, containers and cans. It is designed to improve recycling rates.

Deposit return schemes operate on the basis that the deposit rate is applied to the final price of the product it relates to. However, if the customer returns the empty bottle, can or container to an officially recognised return venue, the government pledges to refund the customers deposit in full. The scheme is set up to provide individuals with the financial incentive to improve their own recycling efforts, without imposing forced financial penalties.

All retailers in Scotland will have to adhere to this scheme and apply the 20p deposit rate to the final price of the product sold. The scheme will apply to all related products within the 50ml to 3 litre size range. Currently the UK sells 13bn plastic bottles a year, whilst only 7.5bn of those bottles are recycled.

So is this likely to work? Germany introduced a deposit return scheme in 2003 and is widely successful. The recycling rate for single-use plastic bottles increased from 72% to 99%.

From a behavioural economics perspective, what conditions are necessary in order for these schemes to achieve the intended policy objectives?