

WORKSHOP 6

Business Cycle Characteristics and Transmission of Crises in a Globalized Economy:

The Case of MENA and Europe

directed by

Serdar Sayan (Bilkent University, Ankara)

and

Ayhan Kose (International Monetary Fund, Washington, DC and Brandeis University)

Workshop Abstract

The globalization of the world economy has proved to facilitate not only the spillover effects of growth in one country/region, but also spread of economic crises from one region to another. The Asian crisis, in particular, has taught to the world that there is a strong need to have a better understanding of the sources of macroeconomic fluctuations and financial crises in different parts of the world, so as to be able to answer the following questions:

- ? What are the common/differing characteristics of the fluctuations leading to crises in the countries within a certain region or across regions?
- ? What are the sources of/the causes underlying these fluctuations? In particular, are the fluctuations driven by some external shocks, or are they mainly resulting from misguided macroeconomic policies?
- ? What are the channels through which recessions and crises in a country may spread to others?
- ? What measures can countries take to avoid economic crises?
- ? How should a country try to cope with sometimes devastating economic and social consequences of economic crises in the form of output reductions and increased unemployment and poverty?

The purpose of the proposed workshop is to create a forum where answers to these questions can be sought within the context of MENA region and Europe; new and related questions can be posed; the relevance and validity of proposed answers can be discussed in detail, and experiences of different countries can be shared by a group of researchers/ practitioners from different parts of the world. The workshop is expected to lead to significant contributions to the existing literature where there is a severe lack of studies on the MENA economies in general, and the effects of MENA-Europe interaction on the transmission of crises, in particular.

Workshop Description

Why Such a Workshop?

The globalization of the world economy at an accelerated pace has proved to facilitate not only the circulation of goods and factors of production (particularly capital), and spillover effects of growth in one country/region, but also spreading of crises from one region to another. The Asian crisis, in particular, has taught to the economics profession as well as the

general public that there is a strong need to have a better understanding of the sources of macroeconomic fluctuations and financial crises in different parts of the world.¹ Within this context, the following questions have become especially important to answer:

- ? What are the common and differing characteristics of the fluctuations leading to crises in the countries within a certain region or across regions?
 - ? What are the sources of/the causes underlying these macroeconomic fluctuations? In particular, are the fluctuations driven by some external shocks, or are they largely induced by some misguided macroeconomic policies?
 - ? What are the channels, if any, through which recessions and crises in a country spread to others?
 - ? What policy measures can countries take to avoid economic crises?
- and last, but not least
- ? How should a country try to cope with negative and sometimes devastating economic and social consequences of economic crises in the form of output reductions and increased unemployment and poverty?

The same questions remained relevant during the Russian and Mexican crises, and more recently, the crises in Turkey and Argentina.

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This will be a very useful exercise, since the design and implementation of stabilization policies to deal with crises require first and foremost the identification of the sources of these cycles and fluctuations, and there is a severe lack of studies addressing these questions within the context of MENA region. The proposed workshop intends to contribute to the filling of this gap by bringing together researchers from different parts of the world to investigate the sources and characteristics of macroeconomic fluctuations in the MENA region; to compare them to those of the fluctuations in Europe, and to identify the channels through which fluctuations in Europe can be transmitted to the MENA countries. Even though Europe has always been one of the major destinations for exports as well as migrant workers from MENA countries, this question is perhaps more important to address now than ever: Economic linkages between Europe and the MENA region became much stronger during the past decade, due to the significant expansion in the volume of international trade and capital flows between the two regions. As a result, macroeconomic fluctuations in the MENA region have become increasingly driven by economic conditions in Europe. Thus, developments in European economies have a bearing on the growth prospects in the MENA region, and important implications for the design of economic policies. These implications need to be spelled out after extensive discussion, and the proposed workshop will provide an excellent forum for that purpose.

Potential Contributions to the Literature

Despite a voluminous literature of empirical studies that have analyzed stylized facts of business cycles and characteristics of macroeconomic fluctuations in various countries and compared them across a number of countries, relatively few papers have focused on the business cycles in individual countries in the MENA region (Metin-Ozcan, Voyvoda and Yeldan, 2001; Turhan-Sayan and Sayan, 2001; Alper, 2000), and some papers on African countries happened to include some of the MENA countries in their country samples (such as

¹ The Asian crisis was particularly instructive, as it has shown the entire world how rapidly a financial crisis in a relatively small country (Thailand) could spread to the other emerging market economies and how the extent of a crisis could quickly become magnified.

Kose and Riezman, 1998 and 2001; Deaton and Miller, 1996; Hoffmaister, Roldos, and Wickham, 1998).²

By comparison, the literature made up of the studies on sources of the spectacular growth performance of the Asia-Pacific region before the Asian crisis, and the studies focusing on the crisis itself is vast. Given that even this literature has failed to identify the entire set of reasons behind the Asian Crisis,³ the need for more studies is perhaps more severe for the MENA region than any other in the world.

In addition to the empirical studies investigating salient features of business cycles of various countries by relying solely on structural econometric methods such as VAR analysis, a rapidly growing research program has in recent years studied the sources of macroeconomic fluctuations by examining the business cycle characteristics within the framework of stochastic dynamic general equilibrium business cycle theory.⁴ With overwhelming majority of the studies focusing on the cross-country differences and similarities of business cycle characteristics of major developed economies, this research program has largely overlooked business cycle characteristics in developing countries.⁵ While a limited number of studies consider developing countries, there exists no comparative study that examines the sources of macroeconomic fluctuations and business cycle characteristics in the MENA region using the methods of the stochastic dynamic general equilibrium business cycle theory.⁶

Furthermore, there is a severe lack of descriptive studies on the experiences of MENA economies with crises in terms of their social and economic costs. Likewise, the evolution of economic linkages (through trade, migration and capital flows) between MENA region and Europe over time is not sufficiently well-documented.

² Kose and Riezman (1998, 2001) study the sources of economic fluctuations in a number of non-oil exporting African countries including Egypt, Morocco and Tunisia. They use a dynamic business cycle model to establish a link between external shocks and the highly volatile macroeconomic fluctuations in these economies. They find that trade shocks play a much more important role than financial shocks, despite the fact that these countries are typically heavily indebted. Deaton and Miller (1996) employ a vector autoregression (VAR) model to examine the importance of commodity price shocks in African countries. Hoffmaister, Roldos, and Wickham (1998) estimate a structural VAR model, where identifying restrictions are derived from a long-run small open economy model, to study the role of terms of trade and world real interest rate shocks in several African countries.

³ The former literature examines the long-term growth trends. See Crafts (1998) for a survey of this literature. There has been also a rapidly growing research program studying the causes of the Asian Crisis. Corsetti, Pesenti and Roubini (1999a, 1999b), and Radelet and Sachs (1999) provide extensive information about the causes of the Asian Crisis.

⁴ See Baxter (1995) for a survey on the stochastic dynamic general equilibrium business cycle models of open economies.

⁵ Backus and Kehoe (1992) examine the characteristics of business cycles in 10 OECD countries, Christodoulakis, Dimelis and Kollintzas (1995) study the business cycles in the EU. These studies find that business cycles in major industrialized economies are quite similar. In a recent study, Kose, Otrok, and Whiteman (2000) investigate the common dynamic properties of business cycle fluctuations across countries, regions and the world using a comprehensive data set. Kose and Yi (2001) study the role of trade linkages in transmitting business cycle fluctuations across developed countries in a multi country business cycle model.

⁶ Mendoza (1995) compares business cycle characteristics of a group of developed economies with those developing countries. Kose (2001) investigates the regularities observed in several small open developing countries. Kim, Kose and Plummer (2000, 2001) provide an extensive analysis of the similarities and differences across the business cycle characteristics of the countries in the Asia-Pacific region.

There is therefore a great need for publications to address these issues. The workshop directors do intend to put out one (or two) edited volume(s) to make the contributions to be made in the proposed workshop available to researchers around the world through a well-known publisher. Considering the time that such volumes typically take to be published, however, putting out a special issue of an existing journal is thought to have the potential to speed up the dissemination of information gathered through the proposed workshop considerably. So, serious attempts in the directions of both an edited volume and a journal issue are planned, pending approval of the proposed workshop for inclusion in the program of the *Fourth Mediterranean Social and Political Research Meeting* --with late 2003/early 2004 seeming feasible for the journal issue and late 2004 for the edited volume(s).

Such studies, if published, are believed to make potentially significant contributions to extending the limited scope of the current research program studying the dynamics of economic activity in MENA countries by taking into account major structural characteristics of the economies in the region.⁷

Topics for Potential Contributors

Contributions addressing the following questions/issues will be particularly welcome, even though topics are certainly not limited to those:

? (Statistical/econometric or descriptive) Studies aiming to identify characteristics and stylized facts of business cycles in a MENA country; comparative studies on the common and differing characteristics in a number of MENA countries, or across a number of MENA and European countries.

? Studies on the sources of/the causes underlying these cycles in MENA countries, particularly those seeking an answer to whether the fluctuations are driven by some external (Europe or region-based) shocks, or they are largely induced by some misguided domestic policies.

Concerning misguided domestic policies, there is a large and expanding literature suggesting that a highly unstable domestic macroeconomic environment is one of the primary reasons for the slow growth performance in developing economies,⁸ and contributions considering where MENA countries stand in this context will be welcome additions to this literature.

External shocks to be considered, on the other hand, may include changes in relative prices (of main export and import items); in the amount of capital flows or transfers such as the remittances that guest workers in Europe send to their home countries in the MENA region, and changes in the world real interest rate --which, for small open economies of the MENA region, are exogenously given and hence, act as the main channels for the transmission of the effects of developments in the rest of the world onto these economies (Kenc and Sayan, 2001).

? Theoretical or empirical studies aiming to identify the relative significance of each of the channels through which recessions and crises in Europe or one or more of the regional

⁷ These structural characteristics magnify the role of external shocks in shaping short-run economic fluctuations in the MENA region. The exports of these countries are typically concentrated in a relatively limited number of commodities, and the main import items are intermediate inputs and capital goods. The export revenues are highly unstable due to recurrent and sharp fluctuations in the prices of major exports, particularly the major oil exporters, although it applies even to Turkey, the country with the most diversified exports (Kotan and Sayan, 2001). Furthermore, most of the MENA countries are heavily indebted, and a significant fraction of their export revenues are used to meet their debt service obligations. These factors make the countries in the region extremely vulnerable to sudden changes in the world interest rate and the movements in the terms of trade.

⁸ Sachs and Warner (1996) and Rodrik (1998) use a variety of growth regressions to study the determinants of economic performance, and conclude that macroeconomic stability is an important factor for the long-run growth in Africa. Ramey and Ramey (1995) find, using data on both developing and developed economies, that countries with highly volatile macroeconomic environments have relatively lower growth.

economies spread to others; papers discussing the propagation mechanisms of these shocks by placing special emphasis on the analysis of the link between trade liberalization in the MENA region and changing nature of macroeconomic fluctuations in the countries under consideration.

? Papers discussing the measures countries in the region can take to avoid economic crises; empirical studies that pay special attention to the evaluation of the implications of findings for policy formation in the region.

? Papers addressing how MENA countries should try to cope with negative and sometimes devastating economic and social consequences of economic crises in the form of output reductions and increased unemployment and poverty. Papers proposing and evaluating social assistance schemes for displaced workers in the time of crises will be particularly welcome.

Potential Contributors

The workshop is expected to bring together scholars from economics, political science, international relations and sociology from MENA countries, Europe and the US, as well as practicing economists from such international organizations as IMF, OECD and the World Bank.

Abstracts of Directors' Individual Papers

Guest Workers' Remittances and Output Fluctuations in Host and Home Countries: The Case of Remittances from Turkish Workers in Germany and the EU

Serdar Sayan

Over the past decades, MENA countries such as Jordan, Morocco, Tunisia and Turkey have sent considerable numbers of workers to Europe, generating significant amounts of foreign exchange receipts through the remittances these guest workers send back home. While these remittances have been a major source of income, significantly relaxing hard currency constraints facing the home countries of workers, the sizable share of remittances in foreign exchange receipts has often been a cause for concern. Such high shares imply serious effects on macroeconomic balances, due to potential current account problems which might follow sudden drops or jumps in remittances. Despite the importance of implications of the volatility of remittance receipts, the current literature severely lacks thorough investigations into the sources of this volatility.

A particularly interesting question within this context is whether there are any empirical regularities between fluctuations in remittances and business cycle characteristics in either the countries hosting guest workers or the countries sending them. Yet, both the voluminous literature on business cycles and the literature studying remittances and their effects have surprisingly overlooked this important question.

This paper aims to help fill this gap in the literature by documenting some key business cycle properties of workers' remittances received by Turkish economy. More specifically, the paper investigates whether there is a relationship between the amount of remittances sent to Turkey by the large number of Turkish workers living and working in various parts of Europe (particularly Germany), and growth and crisis cycles in Turkish and host country economies. For this purpose, regularities between fluctuations in the national outputs of respective economies and remittance flows to Turkey are analysed by using time series data, and implications of results for Turkish economy as well as other MENA economies are discussed.

Key words: Business cycles, Worker's remittances, Turkey, Germany.

Understanding the Transmission of Business Cycles from Europe to the MENA Region **Ayhan Kose**

Economic linkages between Europe and the MENA region have become much stronger during the past decade as the volume of international trade and capital flows between the two regions has significantly expanded. These changes have important implications for the design of economic policies in the MENA region since macroeconomic fluctuations in the region have increasingly driven by economic conditions in Europe. The objective of this paper is to examine the channels of business cycle transmission from Europe to the MENA region.

In particular, we address the following questions:

- (1) What are the major features of business cycles in Europe and the MENA region?
- (2) What are the major channels transmitting business cycles from Europe to the MENA region?

We first study the characteristics of business cycles in these two regions by documenting the stylized features associated with economic fluctuations in the main macroeconomic aggregates. We analyze whether business cycle fluctuations in these regions move together and how recent changes have affected the degree of synchronization of regional cycles. Next, we quantify the dynamic interdependencies between the regions by analyzing the extent of trade and financial linkages. We then construct a multi country stochastic dynamic business cycle model to study the transmission mechanisms of business cycles across these two regions. The model captures the relevant structural features of these regions and reflects the major economic linkages associated with international trade and capital flows. Using this model, we determine the relative importance of fiscal policy shocks, monetary policy shocks, productivity shocks, and global shocks in transmitting business cycles from Europe to the countries in the MENA region. Our results suggest that global shocks play an important role in transmitting business cycles. We also find that while positive productivity shocks in Europe generate prolonged expansions in the MENA region, contractionary fiscal policy shocks induce short-lived recessions.

Key Words: Transmission of business cycles; Regions; Shocks; Stochastic dynamic model.

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