Benjamin Fenster
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Notes – Topic 15

Topic 15: Globalization

I. The Bretton Woods System
  a. After WWII, the US encouraged non-communist nations toward more globalization.
  b. Economists gathered in New Hampshire at the Bretton Woods resort in 19544 to setup institutions governing trade.
  c. The US dollar was set as the official international reserve currency.
  d. All other currencies were fixed to the dollar and the dollar was fixed to gold.
  e. This gave the US certain powers, which were eventually resented by the other nations.
  f. In addition to those powers, it saddled the US with certain responsibilities
  g. Eventually the system collapsed in 1971.
  h. It also setup three very important organizations
    i. IMF
      1. International Monetary Fund
      2. Lender of last resort on an emergency basis to nations in danger of defaulting on international financial obligations
      3. Has bailed out Mexico and SouthEast Asian countries.
      4. South Korea needed $60 billion in 1997 from the IMF
      5. Loans come with strings attached
        a. "Structural Adjustment Policies"
        b. Programs compelling receiving nations to improve their financial institutions
        c. Reductions of government deficits
        d. Reform of central banking
        e. Interest rate increases.
        f. Designed to reassure international investors, not necessarily help the receiving nation.
      6. Most powerful monetary organization.
      7. Been the target of protest from those sticking up for developing nations.
    ii. World Bank
      1. "International Bank for Reconstruction and Development"
      2. Created to serve one purpose: Help with the financial reconstruction of Western Europe after WWII.
      3. By the 1960s, Europe had recovered and the World Bank decided to continue existing.
      4. It now issues loans to developing nations.
      5. Doesn't give *aid*, it just gives *loans*.
      6. Hasn't been especially successful.
      7. It's gotten a reputation for funding prestige projects like big hydroelectric dams and new international airports that aren't too helpful economically.
      8. Successful developing nations got most of their money from private investors.
      9. World Bank has been focusing on more economically valuable projects now.
      10. Many believe the World Bank need not exist; that private funding will fill its purpose.
    iii. GATT
      1. General Agreement on Tariffs and Trade
      2. Became the World Trade Organization (WTO).

            3. Bretton Woods wanted to form an International Trade Organization to settle international disputes.
            4. ITO proved impossible because of political obstacles; instead the GATT was created.
            5. Not an organization, though it functioned as such until it became the WTO.
            6. Did not have any power to set rules governing trade.
        iv. WTO
            1. All WTO members simultaneously participate in talks (most wealthy nations plus many developing ones).
            2. Organizations have been gradually opening the world markets to trade.
            3. Fundamental principle is "Most-Favored-Nation Trade Status"
                a. All WTO members are obligated to treat all other members equally.
                b. Cannot discriminate in treatment of imported goods.
                c. Cannot charge 5% tariff on coffee from Costa Rico and 10% on coffee from Brazil.
                d. Exceptions: Trade within specified "Trade Blocks" (NAFTA, EU are the biggest) can be treated differently than trade outside those blocks.
            4. Unlike GATT it does have a conflict resolution mechanism, but still has no way to enforce it.
                a. If a nation feels it's being treated unfairly it can complain to the WTO.
                b. WTO will decide whether the complaint is justified or not.
                c. If the ruling is in favor of the complaining nation, the WTO will request that the offending nation change its policy.
                d. There's always a possibility that the offending nation will neglect to make the change.
                e. The complaining nation will then be authorized to impose retaliatory restrictions on its own imports.

II. Aspects of Globalization
    a. Globalization
        i. Term used very often with different meanings.
        ii. Used here to mean the "Trend toward greater integration of national markets for goods, services, and most importantly capital."
    b. Has been stimulated by technological progress in communication, transportation and information technology.
    c. First Aspect: International Trade.
        i. Increased imports.
        ii. Very important, but already discussed in great detail earlier.
    d. Second Aspect: Foreign Direct Investment.
        i. Investors from one nation purchase real assets in another nation.
        ii. Real estate, productive capital, etc.
        iii. Firm from one nation sets up operations in another.
        iv. Massive increase in recent years.
        v. Two reasons to invest
            1. Get access to cheap labor in developing nations. Low-skilled operations only.
            2. Access to foreign markets.
                a. This works in both less developed nations and in other wealthy nations.
                b. Circumvents export costs by actually being in the nation.
        vi. Strong trend away from exporting and toward actually setting up operations there.

vii. Large percentage of international trade is now foreign direct investment related.
    1. Nike used to produce in the US and export its goods. Now it's more likely to setup new operations.
    2. If Nike produces in China, it must export a lot from the US in order to import its product, so US exports rise too.

viii. More optimistic View: Foreign Direct Investment is so widespread, firms' nationalities become more ambiguous.
    1. Headquarters of Ford is in the US, but Europeans who drive Ford cars don't think of them as US cars. They're produced in Europe.
    2. Despite that trend it's still more typical for the firm to keep high value-added operations at home.

e. Third Aspect: Foreign Portfolio Aspect
    i. Buying stocks and bonds in a foreign country.
    ii. Assets with maturities of one year or less are called "hot money"
        1. Liquid investments can be rapidly withdrawn if investors lose confidence.
        2. Suppose a developing nation issues short-term bonds and sells them internationally.
            a. Nation refinances that debt as soon as it matures by borrowing more from other lenders.
            b. Works very well as long as the total amounts are modest and the performance of the economy meets investors' expectations.
            c. If investors start to lose confidence, there's a problem – can't pay off the bonds.

III. Globalization Pros
    a. Already discussed pros/cons of trade.
    b. Main selling point: Capital becomes free to go wherever the return is highest
    c. Should work to the benefit of both savers and investors.
    d. If Taiwanese securities are paying higher interest than US securities, everyone benefits if US savings flows to Taiwan.
    e. Investors get a higher return and firms get more capital for production.

IV. Globalization Pros
    a. Effects on Labor
        i. The friendlier the economy is for capital, the worse it is for labor.
        ii. Income can only go to those who work or to those who own capital.
        iii. The more of a nation's output that goes to capital, the less goes to labor. Marx was roughly right.
        iv. Globalization is seen by many to be moving wealth from labor to capital.
        v. US firms that move their operations overseas can pay lower wages and more of the profit will go to the owners of the capital.
        vi. Argument assumes there's a fixed amount of wealth (a fixed "pie") to be had. That's not true. The faster capital can be put to use, the faster the "pie" grows.
        vii. Some even argue that capital owners aren't even taking a bigger share.
        viii. Distinction between "capital" and "labor" is also becoming more blurred. A lot of US workers will collect some income from capital as well as their labor (ex. Pension Funds)
        ix. Flow of capital will raise wages in poorer countries.
    b. Effects on Policy
        i. Reduces the ability of governments to set policies in their nations' best interest.
        ii. International capital likes some policies and dislikes others. Capital will tend to flow to nations with "good" policies.
        iii. What Investors Like

            1. Monetary policy oriented toward fighting inflation and preserving the currency.
            2. Low taxes and minimal national barriers.
            3. Privately owned industries. (State-owned industries are ‘bad’.)
            4. Balanced budgets, indicating fiscal irresponsibility.
            5. Lightly regulated economies.
            6. This set of policies is called the “Washington Consensus.”
        iv. Many policies in the Washington Consensus are highly unpopular since they supposedly shift wealth to international financiers.
        v. These affect poor and wealthy nations.
        vi. Critics opposed think the world would eventually turn into a sweatshop.

V. International Crises and the “Contagion Effect”
    a. Every few years since global investment picked up, a crisis has developed.
    b. Local financial problems in developing nations spread to the world.
    c. When capital moved very slowly, local crises tended to remain local.
    d. With fast-moving capital, it spreads quickly.
    e. The Process
        i. During a period of financial stability, capital flows into the nation seeking higher returns. Hot money.
        ii. Some developing nation faces a financial squeeze.
            1. Maybe the government squandered its previous income instead of putting it to productive use.
            2. Maybe it was just bad luck – poor prices for exports, for example.
        iii. International investors start worrying about losing their money.
        iv. Investors rush to withdraw money from the troubled nation and invest it in safer places.
        v. Often investors rush to withdraw money from other, vaguely similar nations – perhaps all other developing nations.
        vi. This sudden reversal of flow out of nations that depend on it means there really is a problem – investors’ concerns are a self-fulfilling prophecy.
        vii. IMF usually steps in with an emergency loan to prevent actual default. IMF policies are usually the opposite of what would encourage investment.
    f. Appears that reforms will eventually be necessary.
    g. Seems that for the most part, in the long run, Globalization does help developing nations.