

Globalization – Principle and Practice

I. Globalization in Principle

- A. Liberalism
- B. Mercantilism

II. Globalization in Practice

- A. National Income
- B. Trade
- C. Monetary



I. Globalization in Principle

● **THREE QUESTIONS:**

- **How does the economy work?**

- **FUNCTION**

- **What is the economy for?**

- **PURPOSE**

- **What is the relationship between politics and economics?**

- **STATE-MARKET NEXUS**

A. Liberalism: Questions and Answers

● How does the economy work?

- Markets driven by supply and demand
- “Invisible Hand” (Adam Smith)

● What is the economy for?

- Increase private economic welfare through growth

● What is the relationship between politics and economics?

- State interference in markets reduces efficiency and growth
- “The state that governs least governs best”

A. Liberalism: Policy Implications

● DOMESTIC:

- Laissez-faire
- 'Creative Destruction' (Joseph Schumpeter)

● INTERNATIONAL:

- Free Trade through comparative advantage (make what you make best; trade for the rest)
- Capital Mobility

● OVERALL: Political interference hinders the functioning of markets, reducing growth

B. Mercantilism: Questions and Answers

- **How does the economy work?**
 - Capitalist markets optimal, but not neutral
 - Focus on *distribution of gains* from economic activity
- **What is the purpose of the economy?**
 - To increase national power
- **What is the relationship between politics and economics?**
 - Economics is subordinate to politics; a tool in international political struggles
 - States can and should use power to manipulate markets to their advantage

B. Mercantilism: Policy Implications

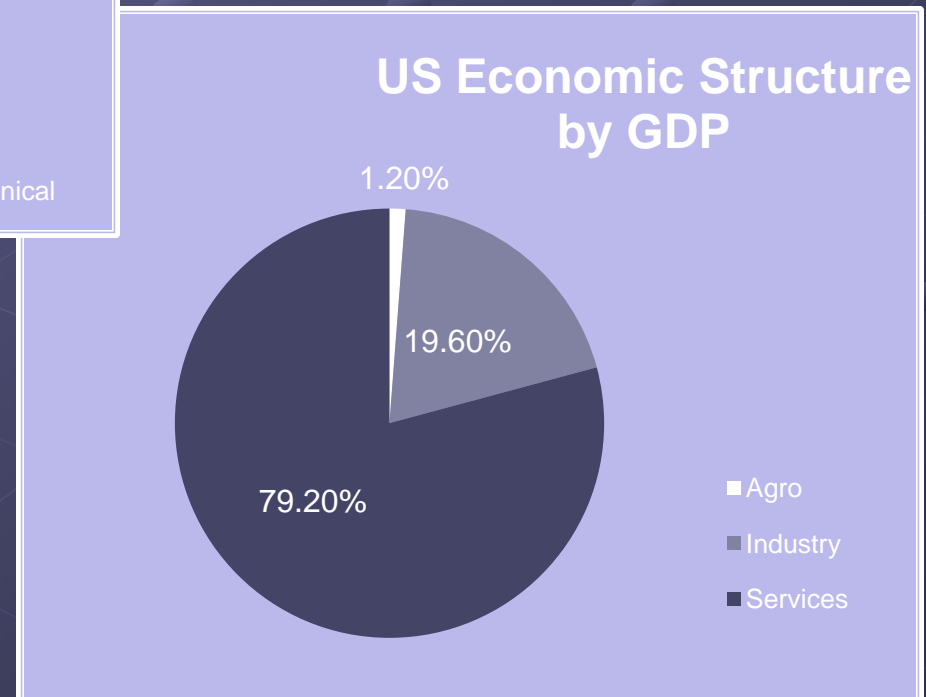
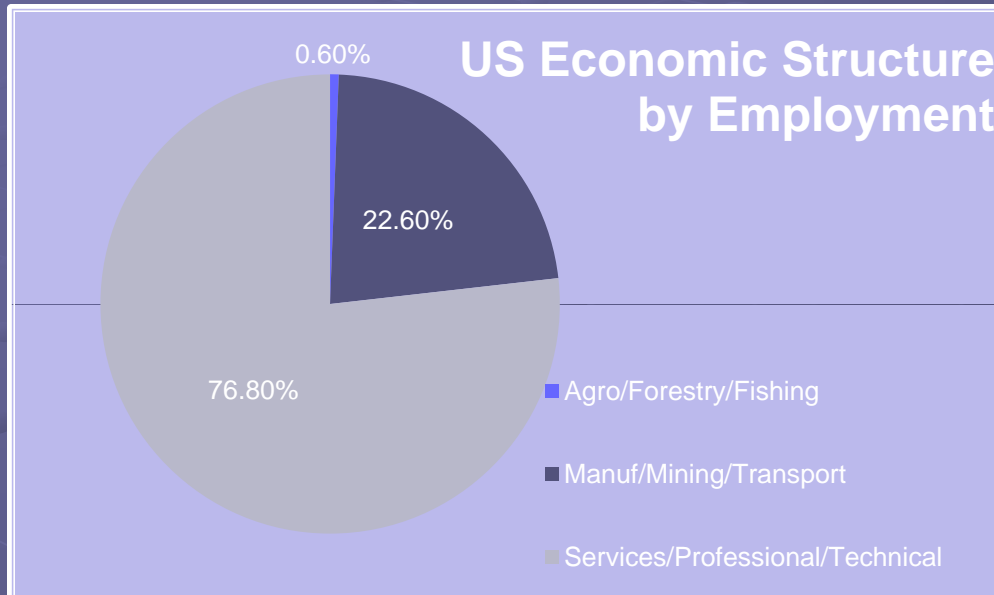
● **DOMESTIC:**

- Focus on the structure of the economy
- **Industrial Policies:** Policies intended to support or promote specific industries

● **INTERNATIONAL:**

- Control international exchange to country's advantage
- **Terms of trade:** relative value of what you export compared to the relative value of what you import
- Protection/managed trade and investment controls

US Economic Structure



Source: CIA World Factbook

II. Globalization in Practice

NATIONAL INCOME:

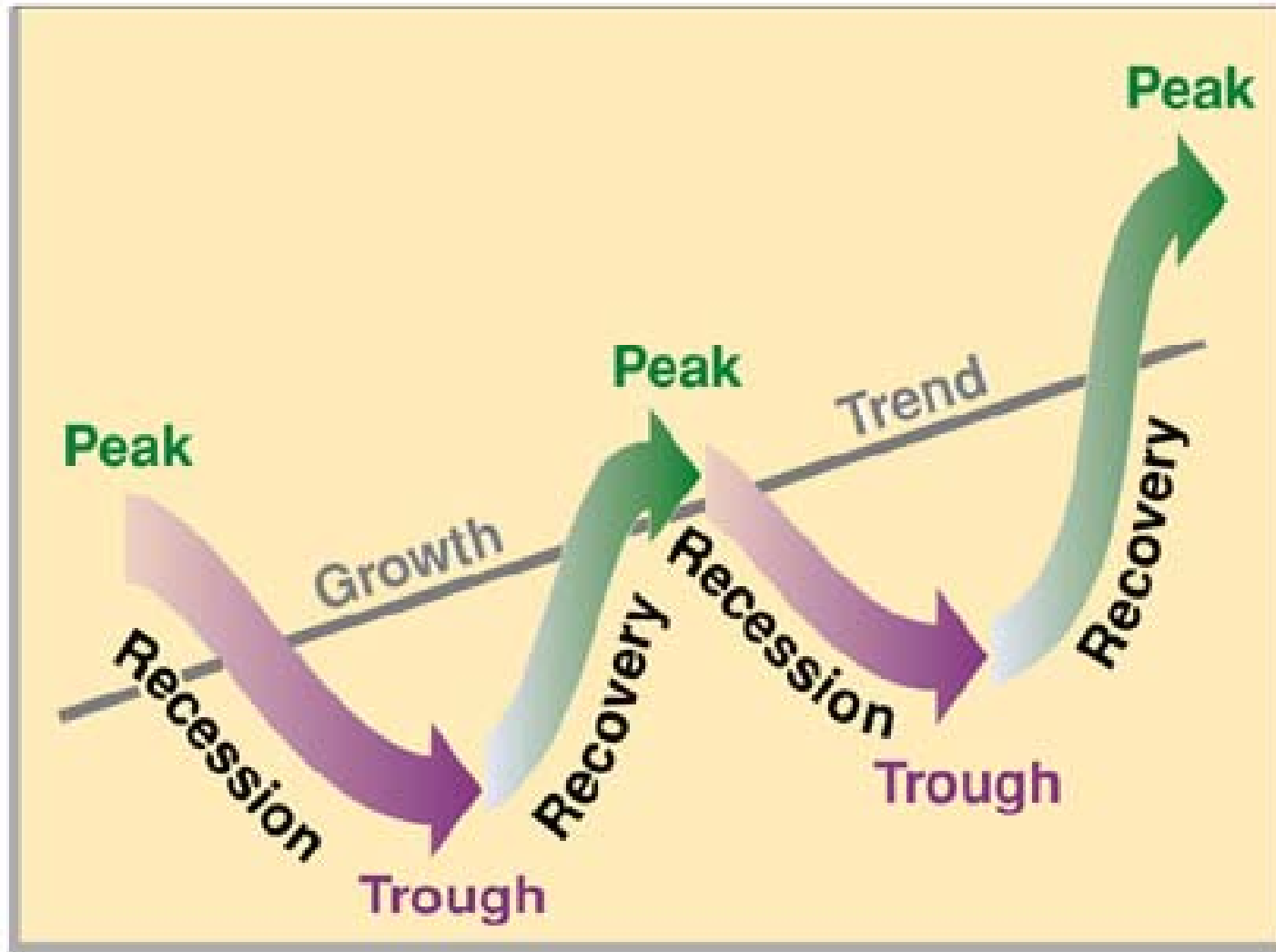
- **Gross Domestic Product:** an estimate of the total monetary value of all goods and services produced in a country in a given year.
- **Gross National Product:** Same as above, but takes into account foreign exchange (trade; foreign companies in the US; US companies producing abroad)
- **Per capita GDP:** Overall GDP divided by the population
- **Purchasing Power Parity:** makes adjustments for costs of living. (EX: *the Economist's* 'Big Mac Index')

A. National Income

- **Business Cycle:** Regular up and down fluctuations of capitalist economies.
- **Inflation:** a sustained *rise* in the general price level over time.
- **Deflation:** a sustained *fall* in the general price level over time.
- **Productivity:** value of output (production) per units of input (materials; capital equipment; labor, etc.).

The Business Cycle

Level of real output



Time

US Balance of Payments

Table 9-1

U.S. Balance of Payments, 2006 (in billions of dollars)

Goods and services			Capital account		
Exports	1,127.4		Net capital transfers	-4.0	
Imports	-1,886.0		U.S.-owned assets abroad	-1,057.0	
(Subtotal)		-758.6	Foreign-owned assets in the United States	1,859.0	
			Net financial derivatives	28.7	
			Capital account balance		826.7
Income on investments					
Income	650.5		Reserve account	2.0	
Payments	-613.8		Statistical discrepancy	-17.2	
(Subtotal)		36.7	(Subtotal)		-15.2
Government transfers		-89.6			
Current account balance		-811.5	Capital account balance + reserves + statistical discrepancy		811.5
Balance of payments (current account balance + capital account balance + reserve account + statistical discrepancy)					0

CURRENT ACCOUNT:

Exports = Credit; Imports = Debit

CAPITAL ACCOUNT:

Exports = Debit; Imports = Credit

C. Monetary Policy -- Domestic

- **Fiscal Policy:** Taxation and spending
- **Monetary policy:** money supply and interest rates
- **Interest Rate:** the cost of borrowing money
- **Federal Reserve controls money supply via:**
 - Discount Rate (Interest rate charged to banks)
 - Reserve Requirements
 - Open Market Operations (buy/sell Treasury bonds)
- **IF want to EXPAND economy → Lower Interest Rates**
- **IF want to CONTRACT economy (to fight inflation) → Raise Interest Rates**

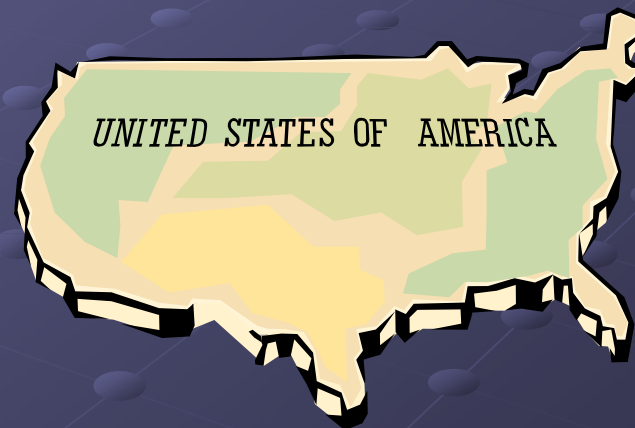
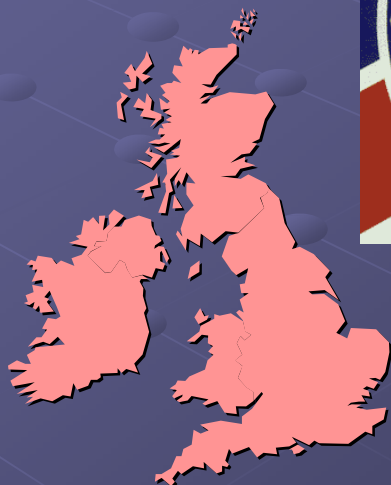
IV. Monetary Policy – International

- **Exchange Rates:** Price of a currency valued in another currency
- Change in exchange rates change the price of imported/exported goods
- Exchange rates and investment
- Portfolio Investment v. Foreign Direct Investment (FDI)
- No ‘Giant Sucking Sound’!

Changes in Exchange Rates and Trade

DAY 1: £ 1 (UK) = \$1 (US)

- Bass Ale in UK costs £ 1
- Budweiser in US Costs \$1
- Budweiser in UK Costs £ 1
- Bass Ale in US costs \$1



DAY 2: £ 1 (UK) = \$2 (US)

FALL in \$; RISE in £

- Bass Ale in UK costs £ 1
- Budweiser in US Costs \$1
- Budweiser in UK Costs 50p
- Bass Ale in US costs \$2

