

# Globalization and All That



**GLOBALIZATION IN CRISIS:  
THE US-CHINA TRADE WAR AND THE  
FUTURE OF GLOBAL GROWTH**

**SEPTEMBER 25, 2018**  
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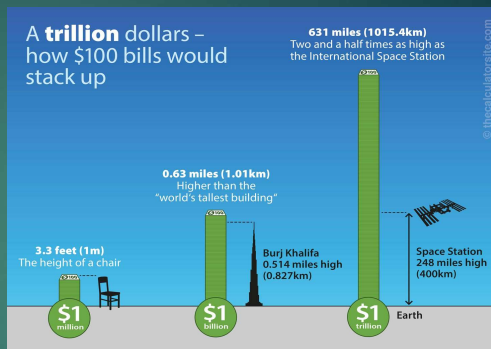


## Take Aways from Last Week

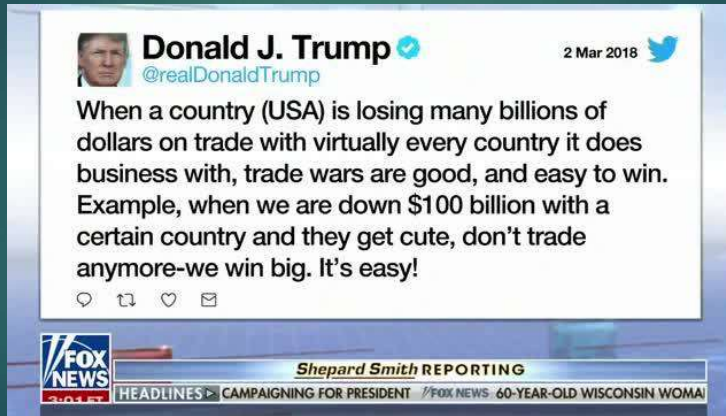
- ▶ 2008 Global Recession was catastrophic
- ▶ Size and scope of recession a function of the globalization of economic activity
- ▶ Was driven by the global financial sector (different from 1930s where global trade was the core issue)
- ▶ Immediate cause: US bad loans in housing market
- ▶ Real and deeper causes in:
  - ▶ US deregulation of banking and investment sector
  - ▶ Excessive risk taking by bankers and brokers
  - ▶ Low interest rates world wide leading to easy availability of cheap credit for governments, firms and individuals
  - ▶ Declining standards of living for majority of Americans using debt to compensate

## Take Aways from Last Week

- ▶ Global Economy is huge:
  - ▶ \$5+trillion in currency exchange
  - ▶ \$18 trillion in goods
  - ▶ \$5 trillion in services
  - ▶ A trillion is .....
  - ▶ US Debt about \$20T
- ▶ 260 million people are migrants
- ▶ Growth of trade in the last few decades driven in part by containerization, sophisticated supply changes and new economies
- ▶ Biggest growth in international financial sector, enabled by technology and computerization
- ▶ Massive increase in migration of peoples
- ▶ Framed by "neo-liberalism" since end of WW2

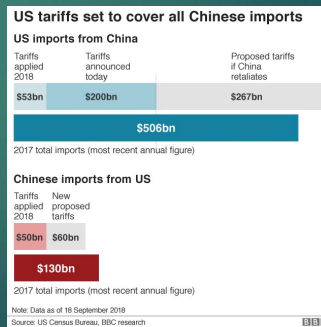
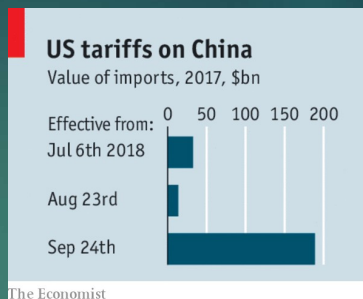


# Tariffs



## Tariffs and stuff..

- ▶ Protectionism
- ▶ Economic Nationalism
- ▶ Beggar thy Neighbor Policies
- ▶ Other tactics:
  - ▶ Import Quotas
  - ▶ Anti-dumping
  - ▶ Regulatory policies
  - ▶ Exchange Rate control
- ▶ Contrasts to Free Trade?



## Tariffs – why?

- ▶ Infant Industry Argument
- ▶ Protect critical economic sector – military?
- ▶ Project jobs/domestic industry
- ▶ Retaliation
- ▶ Political support in general
- ▶ Policy known as “**mercantilism**”



## Mercantilism

Economic theory that trade generates wealth and is stimulated by the accumulation of profitable balances, which a government should encourage by means of protectionism.

- ▶ Security the most important objective
- ▶ State and Market have to work for the maintenance of Security
- ▶ It is a theory, but a period in history as well, and a foreign policy for international economics
- ▶ Has undergone different forms over time: classical mercantilism; economic nationalism; and neo-mercantilism
- ▶ Linked to conservative thought and to feudalism?

## US Mercantilism?



## Theory underlying Mercantilism

- ▶ Create Wealth and Power to sustain security and independence for the state
- ▶ To create wealth and power states' promote exports and limit imports to create a trade surplus and add to wealth
- ▶ Security threats are seen broader than just military threats, including economic and social threats

## Mercantilism as a Historical Period

- ▶ Period of time in which nation-states started to develop (15<sup>th</sup>-18<sup>th</sup> Century)
- ▶ In that period the security of states was especially important
- ▶ Mercantilism meant dependency on other states was to be avoided
- ▶ Economics seen as zero-sum gain
- ▶ Colonialism accompanied economic policies and served growing wealth and was a form of protectionism

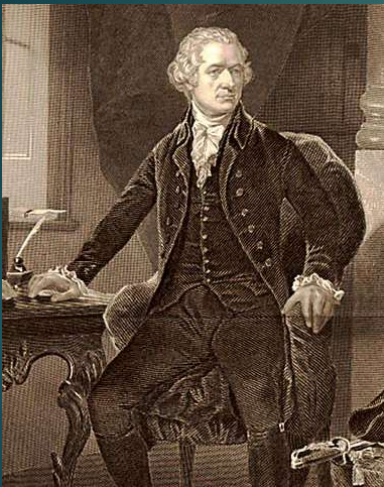
## Linking Politics to Economics: Realism

- ▶ Mercantilism is philosophically related to the political theory of realism
- ▶ State is primary actor, power the most important objective to create national security
- ▶ Realist see international politics as a zero-sum game
- ▶ Underlying philosophy for both is that human nature is prone to violence based on competition

## Economic Nationalism

- ▶ Where classical mercantilism was based on unequal trade, economic nationalism focuses on the domestic economy
- ▶ Grow the domestic economy to protect it from foreign competitors
- ▶ Avoid dependency on foreign markets by subsidizing your own producers
- ▶ Developing production through human skill will outlast the competition
- ▶ Grew rapidly during 1930s – part of cause of war in 1939?

## Alexander Hamilton Friedrich List



## Neo-Mercantilism – Trump??

- ▶ Mercantilism in a time of Free Trade
- ▶ States still try to protect their own economy
- ▶ They find Non-Tariff barriers to support their own producers
- ▶ Dependence on strategic resources seen as unacceptable security risk
- ▶ Minimizing dependency through developing alternatives or self-sufficiency
- ▶ Export subsidies used to promote domestic products abroad as well as quotas and Voluntary Export Agreements

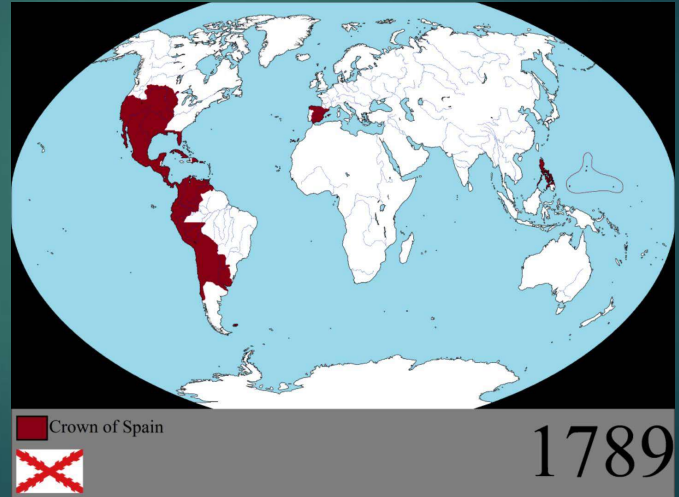
## What policy you pursue depends on how big you are

- ▶ Trade gives small states more benefits than large ones
- ▶ Trade enmeshment isn't good for any state's social stability, big or small
- ▶ Large states can easily close their markets, small states can't.
- ▶ Large states can use their markets to create political influence, leverage
- ▶ They can also use their resources to create a liberal international economic system. Can offer its open market, cheap exports, trade finance, etc.
- ▶ Britain in 19<sup>th</sup>. century, US after 1945

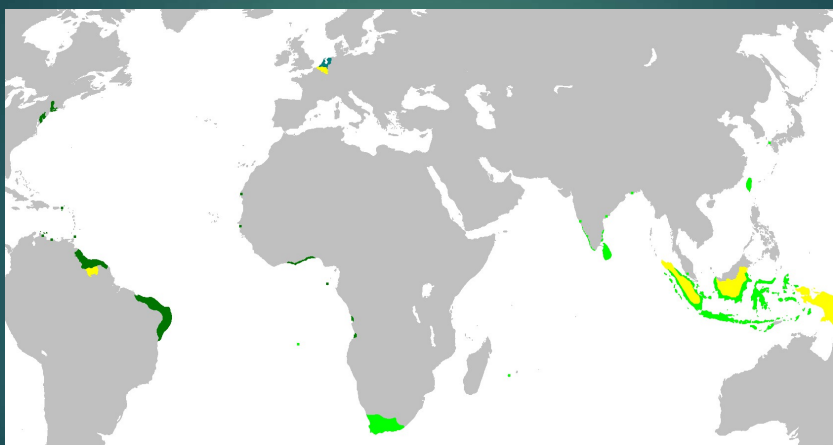


# Globalization is not new.....

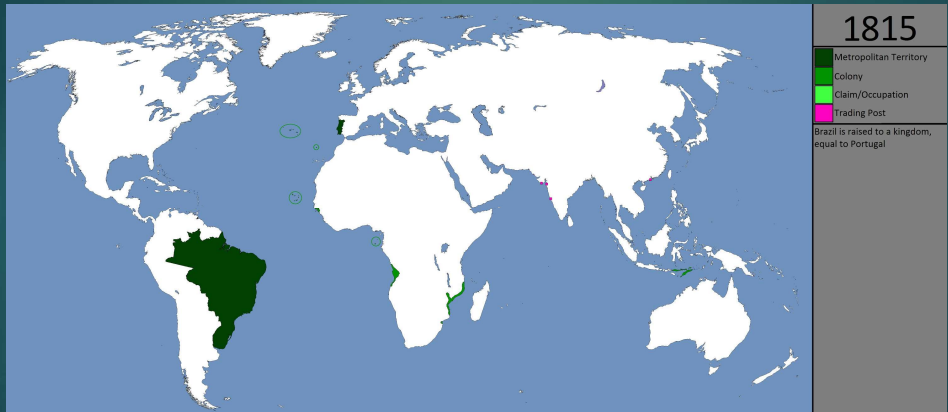
▶ Spanish Empire:



# Dutch Empire 17<sup>th</sup>. And 18<sup>th</sup>. century



# Portuguese



# Ottoman



And then came Great Britain:



The sun never set on the British  
Empire... because God didn't trust  
the English in the dark.

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## Rise of Global Capitalism

- ▶ Transition from Feudalism to Capitalism

- ▶ Feudalism:

The dominant social system in medieval Europe. Nobility is given land by Monarch in exchange for military service and allegiance. vassals are tenants of the nobles. The peasants (villeins or serfs) were obliged to live on their lord's land and give him homage, labor, and a share of the produce, notionally in exchange for military protection.

- ▶ No real market economy, essentially agricultural based
- ▶ Empires built on trade of raw products, gold, spices etc.
- ▶ Traders accumulate wealth from exploitation and slavery

## Monty Python's View of feudalism...

- ▶ <https://www.youtube.com/watch?v=t2c-X8HiBng>

## Capitalism...

- ▶ an economic and social system in which investment in and ownership of the means of production, distribution, and exchange of wealth is made and maintained chiefly by private individuals or corporations, especially as contrasted to cooperatively or state-owned means of wealth. Also known as a "free-market economy"
- ▶ Begins first in England as the Industrial Revolution
- ▶ Mix of technology, labor, capital to create factory system
- ▶ Unprecedented ability to make stuff...
- ▶ Britain becomes "workshop of the world"

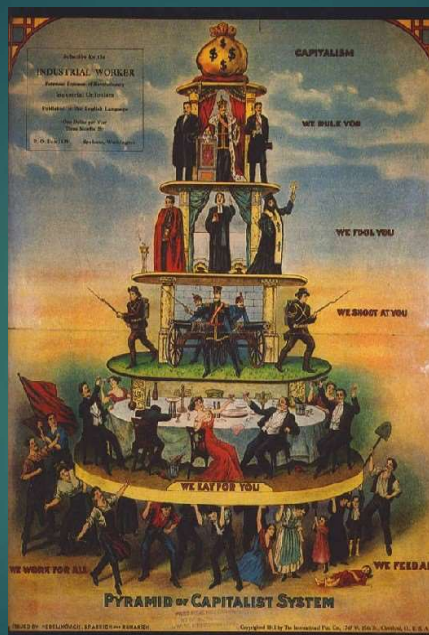
## How did it happen in Britain?

- ▶ Starts in mid 18<sup>th</sup>. Century – mechanized spinning and textiles, water power (later steam), people moving from rural areas into new factory towns. Population increases.
- ▶ Reaches full development by mid 19<sup>th</sup>. C. by which time British Empire is full blown and controls over 1/3 of land mass of globe.
- ▶ "Capitalists" own factories, workers and working class formed
- ▶ Aristocracy/monarchy still in place
- ▶ Capital/labor/technology linked together
- ▶ Why UK? Why then?

## Britain in 1800s.....

...becomes fully capitalist.

- ▶ Factory system incredibly successful at producing goods – textiles, later steel, machinery, chemicals, etc. See: Lowell
- ▶ Has coal and iron ore but finds resources around the world – cotton (US, India), sugar and fruits in the Caribbean to feed growing population – must import food
- ▶ Manchester Liberals develop ideas of **free trade** and comparative advantage. Commits to free trade after Repeal of Corn Laws and remains committed through present day.
- ▶ Enormous amounts of capital created, invests around world (largely FDI)
- ▶ By end of 19<sup>th</sup>. Century US and Germany outproducing UK in coal, steel and chemicals
- ▶ Growth of financial capital



## Capitalism needed an economic and political system and theory...

- ▶ At start of Industrial Revolution capitalist in UK had lots of wealth but limited political power
- ▶ Age of manufacturing and role of government and representation clash
- ▶ New forces and classes emerging in 18<sup>th</sup>, 19<sup>th</sup>. And 20<sup>th</sup>. Centuries:
- ▶ Aristocracy, Capitalists, Workers and, later, a middle class

All this required the development of new political and economic theory.....

## Liberalism....

A "Liberal" ....goes to all the weddings of his/her gay friends, buys groceries at Whole Foods, listens to NPR, carries a NY Review of Books Book Bag, drives a Prius, gives generously to the Sierra Club and is constantly checking their carbon footprint....



## This has little to do with what we mean by liberalism

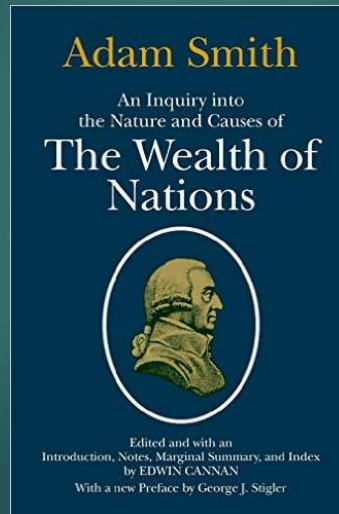
- ▶ Two connected strands develop in the UK in 1700s-1800s
  - ▶ Economic Liberalism
  - ▶ Political Liberalism
- ▶ Both emerge as a means of explaining and justifying the development of the capitalist system and the political and social system it created.
- ▶ They began to challenge conservative thought as justification for the feudal system

These are merged as the basis for what we call Liberal-Democratic Capitalist States e.g., US, UK, Germany, Sweden, Italy, etc.

## Capitalism and Liberalism

- ▶ A free market is one element of the liberal view, which sees individuals as best equipped to make social choices.
- ▶ Liberals focus on the range of human activities that reveal their cooperative side.
- ▶ The best interest of society is served by (rational) individual choices, that when observed from afar appear as an "invisible hand" that guides the economy and promotes the common good.
- ▶ Adam Smith's liberalism was part of a broader intellectual movement that was intensely political. For political theorists, liberalism is based on the principle of freedom of the individual.
- ▶ Liberal political philosophy holds that people need to have negative rights (freedom from state interference, such as freedom from unlawful imprisonment), positive rights (freedom to do certain basic things, such as freedom of speech), and a participatory democratic form of government to guarantee the positive and negative rights.
- ▶ A free-market is the best way to guarantee all this





## Free Market

- ▶ The market model consists of a demand model representing the consumers (buyers) and a supply model representing the producers (sellers).
- ▶ As the price of a commodity falls, consumers will substitute more of that commodity for other goods which now cost relatively more. This inverse relationship between price and quantity demanded reflects the law of demand.
- ▶ The direct relationship between price and quantity supplied reflects the law of supply. When the price increases, a supplier will want to produce more to maximize its profits.
- ▶ Resources will be reallocated depending on changing consumer tastes and preferences.
- ▶ Production efficiency concerns how well resources are used in a particular use. In particular, is the resource being used at the least cost?

## John Stuart Mills

- ▶ Wrote during 19<sup>th</sup> century and Industrialization
- ▶ It did not look that the market worked to the self-interest of the factory worker
- ▶ State therefore needed to provide corrective action to supplement the market
- ▶ Selective action by the state to promote education and social welfare when individual could not provide

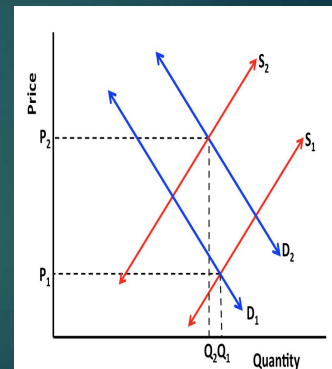
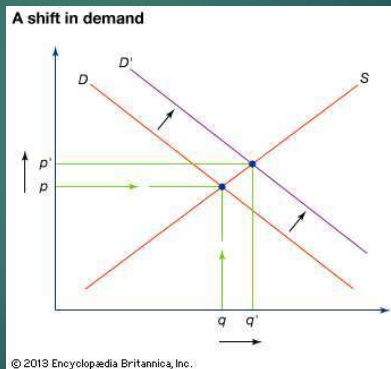
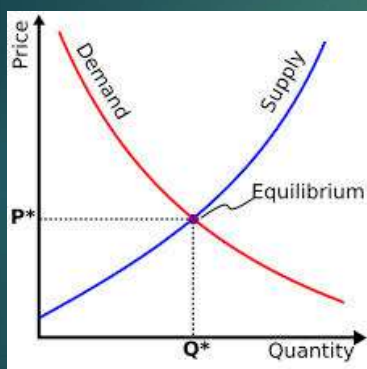
## David Ricardo

- ▶ Smith saw States acting as Individuals on the Int' l level
- ▶ David Ricardo worked the international aspects further out
- ▶ Free trade makes states efficient, stimulated industry, encourages innovation, and creates a “greater benefit”
- ▶ International trade a positive-sum game: everybody benefits

# Comparative Advantage

- ▶ The Effectiveness of the Market through International Trade leads to specialization
- ▶ States produce what they are the most efficient in producing in a competitive market place
- ▶ Effectiveness based on the amount of labor inserted into production
- ▶ Comparative advantage promotes trade and specialization

# Supply and Demand



## Invisible Hand

- ▶ The Market best served by rational individual choices
- ▶ The Market looks to be steered by an invisible hand because of the rationality of the individual choices
- ▶ The “invisible hand” would thus be collective individual rationality
- ▶ Rationality is based on competition and self-interest
- ▶ Interplay between self-interest and competition takes the sharp edges off self-interest

## Capitalism and Liberalism

- ▶ Many countries have experienced an economic, political, and social transformation from an agricultural-based economy to one characterized as industrial or service-based.
- ▶ Self-interest motivates economic activity as if lead by an “invisible hand” that distributes resources, enhancing society as a whole.
- ▶ Private property creates strong incentives to use resources efficiently.
- ▶ Competition regulates economic activity by disciplining the pursuit of self-interest.
- ▶ Markets help coordinate society's economic activity by allocating resources given the tastes and preferences of individual consumers.
- ▶ Economic freedom consists of freedom of job choice and enterprise, and consumer sovereignty to dictate how resources will be allocated.
- ▶ Laissez-faire is the idea that suggests that a capitalist economic system functions best when there is no intervention by the state.

## Role of the State

- ▶ State to perform some limited tasks the individual cannot perform by themselves
- ▶ State provides institutional framework within individuals can operate
- ▶ National defense and legal framework would be part of the functions of the state
- ▶ The State needs to keep the market functioning
- ▶ Directly linked to political liberalism as Rousseau, Locke and Jefferson pleaded for at the same time

## Keynes

- ▶ Great Depression viewed as an example of serious flaws in the market, especially during periods of risk, uncertainty, and ignorance.
- ▶ Keynes favored state action to shore up market failures and an activist macroeconomic policy (note that this differs in degree only from statism).
- ▶ The Paradox of Thrift illustrates Keynes's view that rational individual actions can produce irrational collective outcomes. When all individuals rationally save, they collectively become poorer as economic activity slows. Government can compensate for the invisible hand's failure by spending when individuals do not.
- ▶ Keynes participated in the birth of the Bretton Woods system that established several institutions that organized much of the international political economy following World War II.
- ▶ While Bretton Woods sought to create a liberal system of *international* economic relations among Western member states, individual nations would be allowed to support domestic markets and insulate them from depressions and other economic dislocations.
- ▶ The "Keynesian compromise" between stronger markets (international) and stronger state (domestic) roles also reflected the idea of embedded liberalism, whereby states would gradually decrease protection and allow market forces to shape domestic and international political-economic policies.

## John Maynard Keynes

- ▶ The invisible hand could fail, self-interest could be rational for the individual and at the same time collectively be irrational
- ▶ For example: Paradox of Thrift  
When faced with unemployment one would start spending less to save for hard times, but if everybody would do so → less would be bought → downturn in production → more unemployment → recession
- ▶ State should offset collective irrationality through spending