Last Class

- Britain becomes dominant political and Economic Power in 19th.c.
- Committed to classical economic liberalism
- Develops a liberal parliamentary democracy
- Advocates and structures a global economic system built on empire, free trade, comparative advantage and the free market
- Negative consequences of capitalism responded to by trade unions, liberal reformers and social activists
- Growth of financial sector and global financial markets – inevitable stage of capitalism? US after 1960s??
- In 20th. C. Problems of capitalism's tendency towards economic crisis leads to Keynes advocacy of government intervention – demand management

Reform Movements: Challenges and and Consequences

- Reformists call for greater government intervention – protecting worker's rights, regulation of monopoly, constraints on capital
- In the US – Progressive Era, some efforts at socialism
- In Europe – socialism……but takes two routes:
  - Socialist/Communism (revolution in Russia, later China etc.)
  - Social democracy in western Europe after 1945 and rise of Welfare State
- Increase in taxation? Costs to capital? Looking for cheaper labor and less taxes?

The 20th. Century

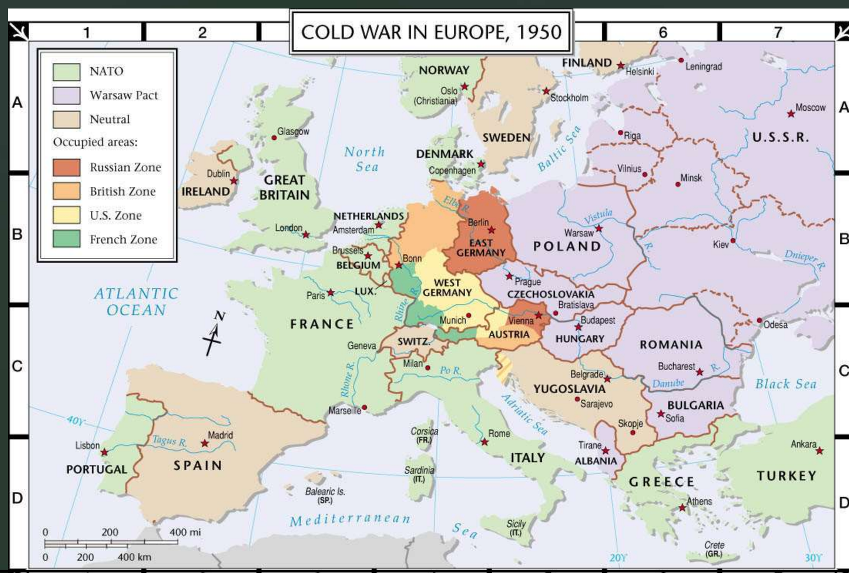
Broad changes:

- End of 19th. C. UK challenged by US, Germany, Japan, France etc. as capitalism takes off in these countries
- WW1 collapses European Great Power dominance
- 1920s and 1930s – Fascism, Great Depression
  - Nationalism
  - Economic Nationalism
  - Militarism
  - Collapse of world trade
  - Concern that capitalism always prone to crisis

World War Two and Post 1945

- War destroys Europe and Japan
- Soviet Union and Cold War
- US dominant economic power – assumes mantle of hegemon of global economic system under liberal free-trade regime
- Response to assumed causes of WW2:
  - Stabilize financial system
  - Reduce tariffs
  - Develop and promote liberal ideas and values
  - United Nations – collective security

Europe in 1950



Decolonization

Immediate Post War System

- Marshall Plan to rebuild Europe
- US controls system in West
- NATO and Cold War
- Emerging European Union – setting up free trade in the EEC
- Bretton Woods System to stabilize exchange rates and create liberal international institutions

Brief Digression on the Gold Standard and other instruments of policy

- Gold Standard – a countries currency in circulation cannot exceed the value of gold reserves set at some fixed value of gold e.g. after WW2 US Dollar set at $35 per ounce of gold

Gold Standard

Why fixed exchange rate to gold?

- Controls inflation – cannot print more currency than gold reserves and controls inflation
- Encourages exports – get gold for goods, adds to reserves, more money
- Automatic control of balance of payments problems
- **BUT**:
  - Makes economy only valued by amount of gold, not productivity
  - Cannot use interest rate changes to increase or decrease money supply
  - All countries need to be on gold standard
  - Limits economic growth because available capital has to be backed by gold

Economic Policy Instruments

Broadly there 2 ways a government can manage economic policy:

1. **Monetary**
   - Changes in the **central bank interest rate** - in US "discount rate" the interest rate Reserve Banks charge commercial banks for short-term loans.
   - **Reserve requirements** are the portions of deposits that banks must hold in cash, either in their vaults or on deposit at a Reserve Bank. A decrease in reserve requirements is expansionary because it increases the funds available in the banking system to lend to consumers and businesses.
   - **Open market operations**, the buying and selling of U.S. government securities "Printing" money e.g. borrowing against itself," quantitative easing"
   - **Interest on Reserves** is the newest and most frequently used tool given to the Fed by Congress after the Financial Crisis of 2007-2009. Interest on reserves is paid on excess reserves held at Reserve Banks.
2. **Fiscal**
   - (largely Keynesian) spending and tax policy by governments to influence aggregate demand by manipulating tax rates to encourage or discourage investing/borrowing and spending

Bretton Woods

Reaction to:

- Competitive devaluations of 1930s
- Economic protectionism and tariffs
- Cause of war?

Sought to:

- Promote economic growth under liberal trade regime
- Create international reserve currency – the $
- Stabilize exchange rates – fixed exchange rates
- Prevent or alleviate balance of payments problems (or current account deficits

Bretton Woods

Set Up:

- **International Monetary Fund (IMF)** help developed countries with B of P problems – lend them money
- **World Bank**, comprised of:
  • The International Development Association (IDA)
  • The International Finance Corporation (IFC)
  • The Multilateral Investment Guarantee Agency (MIGA)
  • The International Centre for Settlement of Investment Disputes (ICSID)

General Agreement on Tariffs and Trade (GATT)

- A 1947 legal agreement between many countries, whose overall purpose was to promote international trade by reducing or eliminating trade barriers such as tariffs and quotas.
- It was first discussed during the UN Conference on Trade and Employment and was the outcome of the failure of negotiating governments to create the International Trade Organization (ITO).
- established the World Trade Organization (WTO) in 1995. The WTO is a successor to GATT, and the original GATT text (GATT 1947) is still in effect under the WTO framework

Balance of Payments and Current Account

- **What is the 'Current Account'**
  - The current account records a nation's transactions with the rest of the world – specifically its net trade in goods and services, its net earnings on cross-border investments, and its net transfer payments – over a defined period of time, such as a year or a quarter.
  - The current account is one half of the balance of payments, the other half being the capital or financial account.
  - While the capital account measures cross-border investments in financial instruments and changes in central bank reserves, the current account measures imports and exports of goods and services; payments to foreign holders of a country's investments and payments received from investments abroad; and transfers such as foreign aid and remittances.

A Bit More History

Entwined Politico-Strategic and Economic Developments 1945-1971

- US economic dominance under Bretton Woods
- Cold War
- Re-emergence of Western Europe - the EEC – EC – EU, and Japan
- Decolonization – third world, Cold War competition
- Rise of the Multinational Corporation (MNC)
- Emerging Economies
- Liberal reform and social democracy in Europe
- Vietnam War and inflation

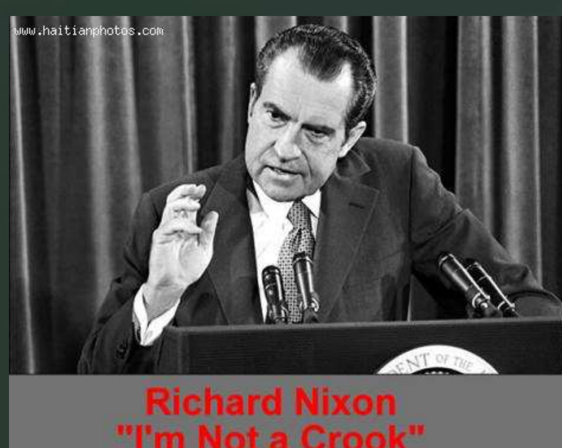
Fashion?

1970s: Worse than just Disco!

1970s usher in big changes and challenges:

- Arab/Israeli Conflict, OPEC and global economic crisis
- Inflation “stagflation”
- Crisis in Europe – Cold War and Eurocommunism
- Expansion of US and now other MNCs
- Shift from manufacturing to service economies in West
- Changes in political power bases domestically in US
- Thatcher/Reagan and neo-liberalism

Nixon Ends Bretton Woods



End of Bretton Woods

- 1971 Nixon ends Bretton Woods - “New Economic Policy”
- Under the Bretton Woods system, the external values of foreign currencies were fixed in relation to the U.S. dollar, whose value was in turn expressed in gold at the congressionally-set price of $35 per ounce. By the 1960s, a surplus of U.S. dollars caused by foreign aid, military spending, and foreign investment threatened this system, as the United States did not have enough gold to cover the volume of dollars in worldwide circulation at the rate of $35 per ounce; as a result, the dollar was overvalued.

End of Bretton Woods

- Nixon sets tax cuts and a 90-day freeze on prices and wages
- Suspends the dollar’s convertibility into gold
- 10 percent tariff be levied on all dutiable imports
- Effective end of fixed exchange rates

Post Bretton Woods

- After the collapse of the Bretton Woods system, the major powers authorized the IMF to widen the trading bands so that changes in currency values could more easily reflect the supply and demand of currencies.
- The oil shocks of the 1970s helped preserve the dollar's status as top currency, as OPEC demanded ever-greater quantities of dollars to purchase OPEC oil.
- OPEC nations placed many of these "petrodollars" in Western banks.
- Petrodollars were loaned out to developing countries, which substantially increased their debt.

Post Bretton Woods – Setting the Stage for next Phase of Globalization

- Stagflation (concurrent inflation and slow economic growth) during the 1970s prompted the U.S. to raise interest rates to combat domestic inflation, which contributed to global recession.
- This economic downturn motivated a turn away from Keynesian orthodoxy in favor of a return to classical liberal "laissez-faire" ideology under Thatcher in the UK, and Reagan in the U.S.
- Concerned about the growth of communism in Latin and South America, the IMF and World Bank under U.S. pressure provided opportunities for developing countries to reschedule their debts (accrued during the petrodollar boom) in exchange for agreeing to structural adjustment policies (SAPS).
- By 1985, the U.S. had become the world's biggest debtor nation, causing many to argue that the U.S. dollar was overvalued.