Seeking Prosperity

The Global Economy

CHAPTER 6

For Americans enjoying peace and prosperity, it has been all too easy to ignore the turmoil elsewhere. How can capitalism be in trouble when the Dow Jones Industrial average is higher than Sir Edmund Hillary? Americans look at other nations and see progress, even if it is slow and uneven. Can't you eat a Big Mac in Moscow, rent a video in Shanghai, and reach the Internet in Caracas?

—Economist Hernando de Soto, 2000[1]

The words of noted Peruvian economist Hernando de Soto at the turn of this century remain relevant today. The global economy affects the food we eat, the clothes we wear, the products we use, the cars we drive, the technology at our fingertips, the jobs we work, and the material wealth we can expect to attain. As de Soto suggests, it also generates very different sets of interests and perceptions regarding its successes and failures. States struggle to bring greater order to their financial markets, and companies weigh the merits of operating in relatively unfamiliar locations. Meanwhile, countless individuals cope with the uncertainty of a transforming job market or are in desperate search of their next meal.

As globalization has brought disparate parts of the world closer together, it has also compounded the difficulties of managing economic relationships. Since the early 1990s, a more privatized and deregulated global economy

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Though economic borders have grown increasingly porous, in places like Dharavi, one of the world's largest slums, in Mumbai, India (foreground), the gulf separating its inhabitants from the people living and working in the glittering high-rise buildings in the background is vast. This chapter explores the ways that the growth of global capitalism has both separated and joined world citizens.

has developed that clearly transcends state boundaries. The global market system has become highly integrated and interdependent. Private transnational commercial enterprises, whose activities often render political boundaries obsolete, have progressively expanded. Economic disasters that start in one locale can quickly reverberate to other parts of the globe. As states seek to promote and defend their interests, they may be inclined to act in ways that threaten to disrupt the flow of financial resources or commercial exchanges. Their willingness to empower regional or global organizations with the authority to impose uniform standards or behaviors is also limited.

Learning Objectives

After studying this chapter, you will be able to do the following:

- Define *capitalism* and identify its major features.
- Describe the historical development of the modern economic system, and explain the key concepts of liberalism, mercantilism, comparative advantage, and hegemon.
- Understand the Bretton Woods System and identify its major features.
- Understand the post-Bretton Woods economic system, and explain the role of neoliberalism within it.
- Define *dependency theory* and explain its role.
- Identify the group of postcommunist countries that are developing most rapidly and describe the factors contributing to their growth.
- Identify the key economic actors today and describe the trends they are affected by and that they themselves affect.

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A significant shift in the relative positioning of a number of pivotal players across the system adds to the uncertainty. The United States, the dominant force throughout much of the twentieth century, is struggling to maintain its global economic leadership. Meanwhile, China has enjoyed an extended period of substantial growth and is poised to emerge as the world's lead economy, even as it has expanded its stake in the United States and elsewhere through investments and debt financing. Poorer countries and those that have recently emerged from decades of isolating themselves from the forces of global **capitalism** are in highly uncertain times. Whereas some proponents view globalization as a way to catch up economically and to offer their people a way out of persistent poverty, detractors caution that they will continue to remain susceptible to forces beyond their control and be forced to adopt policies that undermine the prospects for sustainable development.

capitalism
a system of economic organization based on private property and free markets

As today's global transactions accelerate at an unprecedented speed, questions arise as to the world economy's underlying character. Is it poised to work toward the elimination of significant disparities between the rich and the poor? Can it avoid disruptions of trade stemming from the efforts of countries to protect domestic industries threatened by global completion? Is it capable of strengthening institutions that might foster better management of crises that arise? Can it provide a measure of financial stability that would promote sustained and sustainable growth? It is difficult to predict the direction of things to come.

This chapter looks inside the global economy and some of the key issues affecting its operation. It begins with a historical overview of global economic development and the emergence of contrasting economic ideas. It then proceeds to review some of the more critical events that have shaped the transformation of the system into what it is today.

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DEFINING ECONOMIC BORDERS: A VERY SHORT HISTORY

mercantilism
the economic approach that promotes the aggressive pursuit of export outlets and the simultaneous protection of domestic markets to acquire and expand national wealth and power

liberalism
the economic approach, commonly traced to the writings of Adam Smith, that emphasizes the role of the free market in promoting economic growth and prosperity

Historians trace the origins of the modern capitalist world economy to the sixteenth century, with the rise of European expansionism and the development of **mercantilism**. This, in turn, led to the emergence of economic **liberalism**, the principle that markets are the best path toward improvements in the quality of life. As the Arab-Muslim empire declined and the Ottoman Turks defeated Constantinople, Europeans began to step up their activities to expand the scope of their political, military, and financial influence. Portugal and Spain were particularly adept in their explorations of Africa and the Americas. They were soon eclipsed by Dutch, British, and French explorers, who benefited from the support of their respective monarchies and the active involvement of their growing merchant classes in developing new markets. Merchants were instrumental in

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shaping a new economic order that moved beyond feudal relationships to one in which capital fueled broader commercial ties.

The establishment of joint stock enterprises owned by their contributing investors, such as the Dutch East India Company in 1602, marked the emergence of private corporate actors in building overseas trading networks. The Dutch East India Company was the first trading company of its kind created to facilitate the spice trade and was the largest European trading company by 1620.[2] With the advent of the modern state in 1648 as a result of the Peace of Westphalia, trade in manufactured goods became a key factor in accumulating national wealth and power. Intense competition prompted states to aggressively pursue export outlets while restricting the access of foreigners to home markets. Such mercantilist policies promoted their interests and extended both the breadth and depth of their influence. But mercantilism was a risky strategy that invited retaliation and threatened to disrupt the flow of commercial activity. As both a trade policy and a more general way of thinking about the forces driving the world economy, it emphasizes intense competition for limited resources and vigilance in protecting national interests, regardless of international consequences. Mercantilism has remained popular, particularly during periods of economic contraction when competition is most intense.

By the late 1700s, Britain was becoming a dominant force within the system. As the birthplace and center of the Industrial Revolution, it had the resources and capability to extend its commercial reach. The development of new technologies provided the incentive to seek additional materials and new markets. Britain's overwhelming political and military power facilitated the development of a vast colonial empire that contributed greatly to its dominance during this period. Although other European nations sought to limit competition by restricting imports of British goods, Britain's exports continued to rise. The British Parliament's 1846 repeal of its Corn Laws, designed to protect national agriculture through tariffs and other measures,

IN THEIR OWN WORDS **Adam Smith**

> Every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it. By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good.[3]

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Depositors gather outside the shuttered doors of American Union Bank in New York City, 1931, during the Great Depression.

signaled an important move to freer trade and was met with similar initiatives by a number of Britain's European partners.

During this period, the drive for expansion and growth encouraged the adoption of progressive policies based upon the principles of economic liberalism. Eighteenth-century thinkers such as Adam Smith and David Ricardo advocated free and open markets as the best means to enhance the lives of people across the world. Adam Smith was a Scottish political economist and philosopher considered by many to be the father of modern economics. While acknowledging the market's often chaotic and uneven nature, his 1776 work, *The Wealth of Nations,* put forward the case for allowing its "invisible hand" to ensure the spread of its benefits.

Like Smith, the British political economist David Ricardo opposed protectionist trade policies. He argued that free trade would extend the availability of goods and services and promote efficiency by encouraging countries to specialize in producing and exporting those goods for which they had a **comparative advantage**. Liberal thinkers recommended importing a product when the relative cost of domestic production exceeded that of buying it elsewhere, taking into account the lost revenues resulting from the decreased production of other items. In short, these theorists saw an open economic system as the best option for producing the greatest good for the greatest number of people. These ideas were not universally accepted, however, particularly among people who did not have the political or economic capabilities to compete effectively in the marketplace.

comparative advantage
the idea that countries should produce and export those goods they can produce at a lower cost than others and import those items that others produce at lower cost

While British colonialism was indispensable to the expansion and integration of the global economy, it also contributed to a growing disparity in the levels of economic prosperity between the colonizers and the colonized. In addition to maintaining open markets and the free movement of goods across oceans, Britain gained considerable advantage by serving as the world's financial center and presiding over an international monetary system based on gold and supported by its national currency (the pound). Its colonial activities and role in opening China and Japan to trade also helped to bring disparate places into a unified system that was controlled by and structured to advance the interests of

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its more powerful members. The costs and burdens of that leadership, however, eventually took their toll.

By the latter part of the nineteenth century, Britain was losing is preeminent position. Industrial development was spreading rapidly across Europe and beyond. Japan was emerging as a major industrial power, due to strong government guidance and its large business conglomerates, and launched a series of military adventures to extend its imperial reach. The United States, for its part, was on a path to extend its overseas activities and interests beyond Latin America and would eventually emerge as a global power. Across Europe, economic rivalries intensified as political tensions led to the appearance of two competing alliances that were destined to collide. These conflicts resulted in the outbreak of war in 1914.

World War I was an important turning point in the evolution of the global economy. Beyond the financial and commercial disruptions, the war marked the beginning of the end of European colonial empires and Britain's dominant role in the world's financial and commercial systems. Heavy European war debts and German reparations requirements significantly slowed the pace of economic recovery. Meanwhile, the United States was enjoying a period of economic expansion marked by the growth of manufacturing and consumption. The values of many companies appreciated, fueled in part by speculative stock purchases with borrowed money. As the economy slowed and stock prices began to decline, the system began to unravel. The collapse of the US stock market in 1929 had immediate and profound international ramifications.

By this time, the United States had become a major economic player. The Great Depression following the stock market crash extended well beyond America's borders. To substantially increase the protection of US markets, in 1930 Congress passed the Smoot-Hawley Tariff Act, which reflected the considerable isolationist sentiment across the country and the desire to limit potential vulnerabilities to outside forces. This action produced comparable responses. Competing nations organized trade blocs, further fracturing preexisting relationships. One after another, countries began defaulting on their loans as they were unable to sustain economic activity. Meanwhile, declining markets in the leading industrial countries resulted in a significant drop in demand for raw materials and primary exports from the developing world.

The growing economic malaise was transforming economic and political life in these areas. In Latin America, a wave of military takeovers empowered repressive regimes that promoted economic nationalism. In Africa, organized resistance to colonial rule was mounting. Populist movements were also gaining momentum across Asia and the Middle East to challenge struggling colonial powers.

With the British unable and the United States unwilling to take the lead, global economic conditions deteriorated. A weakened British pound undermined the stability of the world's monetary system, while trade barriers limited commercial interactions. The 1931 collapse of the German economy dealt a devastating blow. It fueled the rise of Adolf Hitler and his drive to restore

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German prosperity and pride through aggressive military and political expansion. Japan charted a similar course as it moved into China and other neighboring territories to establish the Greater East Asia Co-prosperity Sphere. Before long, much of the world was drawn into another encompassing and protracted conflict—World War II.

hegemon
the dominant power in the global economy

In part, the absence of leadership or direction had led to such disarray. Throughout its history, the modern world economy has often operated under the wings of its **hegemon**, or dominant power. The hegemon invests many of its resources to keep the system operating in an orderly and predictable fashion. As Yale historian Paul Kennedy has argued, however, hegemons tend to overestimate their capabilities in manipulating economic and political structures to preserve their advantage.[4] The relative decline of these great powers has ushered in periods of uncertainty marked by the absence of effective management. Eventually a new hegemon arises, and the cycle begins again. The events that led up to World War II followed from British hegemonic decline and the unwillingness of the United States to assume that role.

THE BRETTON WOODS SYSTEM

As the war was drawing to a close, the United States emerged as the world's lead economy. The physical and financial devastation of Europe stood in contrast to conditions in the United States, which had the resources to spearhead the drive to recovery. In 1944, Allied officials met in the New Hampshire resort town of Bretton Woods to discuss postwar reconstruction. They ultimately agreed on a broad set of arrangements for what would become known as the Bretton Woods system, which would guide the operation of the world economy from the end of World War II to the early 1970s. While based on liberal economic principles intended to promote a reopening of commercial and financial channels, the Bretton Woods system also relied heavily on the ability of the United States to shoulder much of the initial burden. Although weary from war, the United States did not have the luxury of turning its back to the emerging political and military challenge of the Soviet Union. To gain its Allies' support, the United States tolerated their efforts to protect their fragile economies from unfettered competition by agreeing to move more slowly in pushing for a more open trading system. All sides expected that once economic recovery had gained momentum, the responsibilities for managing and sustaining an open world economy would be shared more equally.

With this in mind, the United States proceeded on a number of fronts. The 1947 Marshall Plan, named for Secretary of State George Marshall, was especially noteworthy. It provided substantial funds to assist European countries in their recovery from the war and to promote the resumption of commercial

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activity. The United States contributed approximately $13 billion in aid to sixteen countries, and by 1951, industrial production in these countries was 37 percent higher than in 1947, and exports had risen at an annual rate of over 20 percent.[5] The Soviet Union refused to participate in the program, seeing it as a US mechanism to further American influence and interests. As it turned out, the Marshall Plan served as an important catalyst in rebuilding the economic strength of countries that proved critical to US efforts to contain Soviet political and military aspirations.

The Bretton Woods system revolved around the operation of a well-defined set of goals and institutions. Established in 1944, the International Monetary Fund (IMF) would oversee the world's financial system and function as its central bank, offering technical assistance and training and acquiring capital from member states to stabilize currency values. It also provided short-term loans for countries with immediate financial needs and particularly difficult economic circumstances. The US dollar stabilized the emerging financial order and came to be considered "as good as gold." This term reflected the long-term strength of the dollar, whose value was set and backed by this precious commodity deemed to have enduring value.

The International Bank for Reconstruction and Development (IBRD), more commonly known as the World Bank, was another key Bretton Woods institution. The architects of the agreement designed the World Bank initially to further hasten recovery from the war by lending funds for projects to promote longer-term economic development. Finally, the Bretton Woods participants formed the General Agreement on Tariffs and Trade (GATT) to foster greater cooperation in opening global markets by monitoring and promoting trade relationships.

They hoped to establish an International Trade Organization, a body with broad regulatory powers. Unable to forge the consensus necessary to launch the organization, the negotiating countries focused their attention on the series of arrangements they were developing under the umbrella of GATT to reduce tariffs. The GATT agreements were predicated on two basic principles to guide trade policies—**reciprocity** in the dismantling of trade barriers and **nondiscrimination** in the treatment of imported goods. The idea was to get countries to progressively eliminate preferences and protectionist inclinations by extending **most-favored nation (MFN)** status to all of their trading partners.

With these mechanisms in place, the post–World War II global economy began to take shape. It relied extensively on the United States for direction and leadership. The Bretton Woods system stimulated economic recovery and growth, especially in Western Europe and Japan, where the United States had a particularly large stake in assuring sustained economic progress. The success of Bretton Woods became increasingly tied to America's strategy in the developing Cold War, as the United States sought to enhance the Allies' political and economic capabilities to gain additional leverage in its struggle with the Soviet Union.

The effectiveness of the United States in managing these affairs actually eroded its dominant position. On the political and strategic front, the need to

reciprocity
the idea that countries would respond to actions taken by their trade partners to reduce trade barriers with similar reductions of their own

nondiscrimination
the idea that countries would extend preferential trade status to all their trade partners

most-favored nation (MFN)
a means to promote equality in trade relationships by guaranteeing that if one country is given better trade terms by another then all other trade partners must receive the same terms

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counter Soviet activities resulted in an array of commitments and actions across the world that were both costly and, at times, rather risky. Meanwhile, excessive US spending to meet its growing financial obligations began to take its toll. By the late 1960s, confidence in the strength and stability of the dollar had fallen, and many countries feared an impending adjustment that would lower the value of the dollar to address the mounting deficit. These developments prompted US President Richard Nixon to prohibit withdrawals of gold from the United States in exchange for dollars. He took this step—known as the "closing of the gold window"—to prevent a further outflow of gold, which would undermine the value of the dollar. This decision marked a fundamental shift in policy and reflected increasing US frustration with its closest partners.

Tensions had mounted as the world became a more dangerous place. The Cold War had heated up considerably during the 1960s, but America's allies did not universally share the US view of the Soviet threat. A number of them began to question US actions, raising concerns over their costs and potential impacts. US weapons development programs and deepening American involvement in Vietnam were particularly controversial and financially draining. For its part, the United States grew resentful of this lack of support and the unwillingness of its allies to assume an additional share of the burden. Furthermore, US efforts to convince the European Economic Community (EEC) and Japan to open their markets further to US products went largely unheeded. This was not surprising, as these countries had benefited considerably over the years from their relatively free access to the US market without having to reciprocate fully. The broad consensus that had propelled the Bretton Woods system was unraveling.

At the same time, political changes in other parts of the world were affecting the foundation of the global economy. The end of colonialism led to the creation of new countries across Africa and Asia with limited capabilities and considerable needs. The transition to independence was frequently violent and destructive and added further to the tasks at hand. Expectations were high and in stark contrast to the harsh realities of everyday life. Insufficient support from international agencies and more-developed countries raised serious questions as to the future path to development.

In response, less-developed countries (LDCs) from Africa, Asia, and Latin America joined forces in the United Nations (UN) to establish the Group of 77 (G-77), named for the number of states that joined. This organization was designed to air collective concerns and to engage industrial countries in continuing discussions on the need for economic restructuring on a global scale. These countries are often referred to today as the "Global South" to reflect the location of most in the world's Southern Hemisphere. (See Map 6.1.)

The G-77 critique saw the inequities of the Bretton Woods system as part of the historical evolution of a global capitalist economy that empowered and enriched a few core countries at the expense of a far greater number of peripheral ones. The unequal economic relationships between core and periphery, they argued, extended beyond the formal bonds of colonialism and perpetuated the

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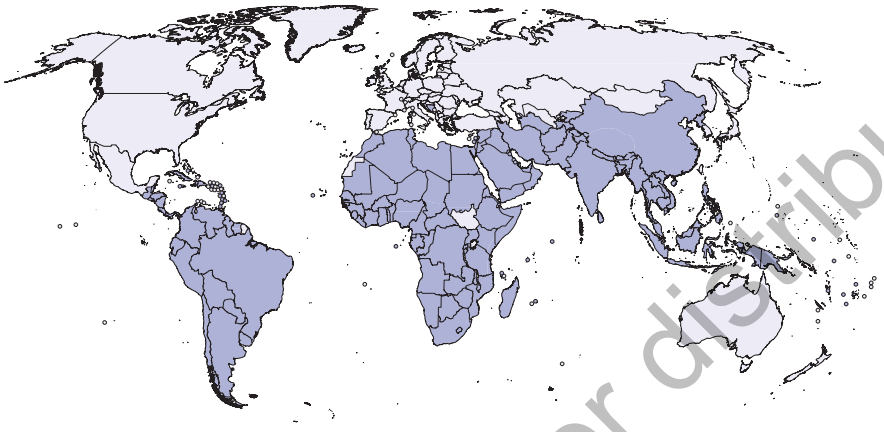
MAP 6.1

GROUP OF 77 COUNTRIES



gap in levels of economic development. Influenced by Marxist thought, sociologist Immanuel Wallerstein had been the first to propose this theory, which he called "modern world systems."[6]

Political economist Andre Gunder Frank, among others, further examined the difficulties of moving beyond the constraints of this system, focusing on the structures of dependence embodied in a global economy that continued to disadvantage the countries on the periphery.[7] He noted that LDCs were mostly relegated to the exchange of generally cheaper raw materials or food products, which were frequently subject to considerable price fluctuations, for more expensive manufactured goods. International investment and finance sectors, dominated by large and primarily American companies and banks, wielded their power and leverage to dictate the nature of their engagements with LDCs in need of their capital. In the late 1960s, **dependency theory** provided an intellectual framework for many G-77 members who did not see incremental change as the way to enhance their position. Citing the inability to break the cycle of poverty within established frameworks, in the 1970s they called for the creation of a New International Economic Order (NIEO), a reform program designed to comprehensively restructure global economic relationships. In his 1969 book *Latin America: Underdevelopment or Revolution,* Andre Gunder Frank explains the basic underpinnings of dependency theory.

dependency theory
the view that the development of countries in the Global South is limited by the unfavorable terms through which they have been integrated into the global capitalist economy

The G-77 envisioned the NIEO as a comprehensive program of fundamental reform to bolster the LDC economic performance and capacity. It included plans to provide preferred access to global markets, to enhance and stabilize the prices of food and raw materials, to offer financial and technical assistance at more favorable terms, to encourage local input in devising development projects, and

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> It is generally held that economic development occurs in a succession of capitalist stages and that today's underdeveloped countries are still in a stage of history, sometimes depicted as an original stage, through which the now developed countries passed long ago. It is also widely believed that the contemporary underdevelopment of a country can be understood as the product or reflection solely of its own economic, political, social, and cultural characteristics or structure. Yet historical research demonstrates that contemporary underdevelopment is in large part the historical product of past and continuing economic and other relations between the satellite underdeveloped and the now developed metropolitan countries. Furthermore, these relations are an essential part of the structure and development of the capitalist system on a world scale as a whole.[9]
>
> IN THEIR OWN WORDS **Andre G. Frank**

to monitor the business practices of large transnational corporations (TNCs). Most developed countries were not willing to make sweeping concessions or respond under pressure. Noting their continued confidence in a global economy based on the liberal principles of free and open exchange to address the needs of the LDCs, they moved forward with their economic agendas. Some critics of globalization today reflect the underlying concerns of the NIEO program, especially the pressures imposed on developing countries to adjust their policies to accommodate the interests of more powerful economic actors.[8] Despite its widespread support across the developing world, the NIEO program itself made only limited progress in influencing policy outcomes at the time.

BEYOND BRETTON WOODS: THE ROOTS OF CONTEMPORARY GLOBALIZATION

Any hope of resolving these outstanding issues cooperatively faded as the world economy came under enormous pressure during the 1970s. Most Arab members of the Organization of the Petroleum Exporting Countries (OPEC) imposed an embargo on oil shipments to countries supporting Israel during the 1973 Middle East war. OPEC was founded in 1960, and its original members were Iran, Iraq, Kuwait, Saudi Arabia, and Venezuela. By 1973, OPEC had expanded, and its members controlled 55.7 percent of the world's crude oil production. Their decision to restrict supply resulted in an unprecedented quadrupling of prices between 1973 and 1974.[10]

No one anticipated the crisis, and with so much of the world's economy dependent on the availability of inexpensive oil, its effects were widespread. Economic output contracted as money became tight and prices soared. Many

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companies were forced to curtail their operations and cut back their workforces. In the United States alone, economic output declined 6 percent between 1973 and 1975, and the unemployment rate surged to 9 percent.[11] The world was slipping into recession. Ironically, the OPEC countries emerged as the major sources of financing at this time, depositing the sizable earnings from oil sales in international banks. These banks, in turn, lent these **petrodollars** (US dollars acquired through the sale of petroleum) to countries so that they could purchase the oil they needed to keep their economies afloat.

petrodollars
US dollars earned through the sale of petroleum

These conditions made it difficult to sustain an open global economy, although its advocates felt some optimism when GATT member countries agreed to move forward with new international trade discussions. The Tokyo Round, the latest in a succession of negotiations under the auspices of GATT to combat trade protectionism, began in 1973. Previous rounds had succeeded in reducing or eliminating tariffs across a broad range of products. As a result, countries were now resorting to an array of other measures not covered by existing arrangements to limit access to their markets. The Tokyo Round developed new codes of conduct covering such barriers to free trade as subsidies of domestic producers, government purchasing practices favoring domestic producers, and excessive customs duties designed to undermine the competitiveness of imported goods. These agreements regarding nontariff barriers (NTBs) proved difficult for the GATT to monitor and enforce, and they provided only modest relief in offsetting the mercantilist trading tendencies that gained footing during these uncertain times.

Bill Ross/Corbis

Oil fields like the one shown here are part of a global industry that today produces many billions of barrels of oil annually. The production and sale of oil and gas spurs development worldwide but also leads to economic and political instability.

The gradual easing of oil prices also offered hope. The uncertainty of the global economy posed a unique dilemma for OPEC. Oil producers had a major stake in economic recovery due to their considerable loans and investments. By 1974, OPEC members had sent about one-third of their $60 billion surplus revenue to the United States, investing mainly in Treasury bills and other short-term holdings.[12] The 1979 outbreak of war between Iran and Iraq, two of the largest producers for OPEC, once again forced many countries to borrow heavily to secure necessary imports. Fearful of massive defaults on outstanding loans, large international banks extended payment schedules and offered additional financing opportunities in a very uncertain environment. Some of these institutions incurred significant costs for their uncharacteristically risky behavior. However, this patchwork did serve to prevent a global economic meltdown.

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By the mid-1980s, signs of recovery were emerging. Economic output was expanding, and financial markets were settling down. However, the global economic order was a far cry from that envisioned at Bretton Woods. Transnational connections between states and other actors were expanding, thereby contributing to the emergence of a system of "complex interdependence."[13] While the incentives for cooperation were significant, managing relationships was a more daunting task. This was certainly evident in the international monetary system, where the fixed exchange rate system of the Bretton Woods period had proven incapable of accommodating the shifts in economic conditions that affected the realistic values of the US dollar and other currencies. The values of currencies would now fluctuate or float on an ongoing basis to more accurately reflect daily ebbs and flows in economic conditions. Money markets had become far more fluid and speculative, with private financial institutions, TNCs, and even individuals buying and selling currencies.

The global economy had also become intensely competitive. The pressures were particularly acute for many American companies that had seen their positions erode over the previous decade. They found themselves increasingly forced to cut costs and aggressively pursue new markets to keep pace with European and Japanese businesses. LDCs also began to figure prominently in the community of globally minded companies. A number of "newly industrializing countries" (NICs) such as Taiwan, Singapore, and South Korea (then referred to as NICs and today as emerging markets) became more significant players by virtue of their ability to provide reduced labor costs or other financial enticements to companies in developed countries.

Keeping markets open remained a challenge. The rigors of what economist Lester Thurow labeled "head to head" competition made it difficult to offset the inclinations of many countries to protect their respective companies and interests.[14] In 1986, the GATT organized the Uruguay Round, its next series of multilateral trade discussions, to continue efforts to limit existing and emerging trade restraints. The United States pressed hard to incorporate into the deliberations an initiative to liberalize the fast-growing services sector (e.g., accounting, financial, insurance, legal) as it continued to enjoy a considerable advantage in this area and looked to ensure access to a broad range of markets. This did not sit well with other aspiring providers, however, who sought to maintain some level of protection that might enable them to emerge as viable competitors. Overall, this round of talks was difficult to sustain and would take nearly a decade to bring to closure.

Its most significant breakthrough was the agreement to create the World Trade Organization (WTO). Established in 1995, the WTO supplanted GATT as the body intended to preserve open markets by developing and overseeing the rules that guide global trade. It was designed to provide officials with enhanced capabilities to settle disputes and to enforce established rules. Both the mandate and the membership of the WTO expanded over the years, but the organization struggled to regulate international trade, since

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countries had considerable incentive to skirt existing requirements to gain competitive advantage.

Meanwhile, Japan and the United States had to deal with strains in their critical relationship. The economies of the two countries were closely linked by trade and investment activity, while the United States was committed to guard and fund a substantial portion of the military security of Japan as part of the arrangement derived at the close of World War II. Japan's meteoric rise as a global economic power was due, in large part, to its proactive business practices. With limited natural resources, Japan pursued a mercantilist development strategy to promote exports and protect its domestic market. This approach put the country at direct odds with the United States and other partners, who complained about currency manipulations and pricing practices designed to preserve low-cost advantages for Japanese products.

Japan's large industrial groups or *keiretsu,* such as Mitsubishi, had proven quite effective in penetrating the US market with high-quality products. Japan's direct commercial presence in the United States also expanded with the establishment of production facilities, the purchase of some prominent companies, and the acquisition of prime real estate in major American cities. By 1990, about 1,350 Japanese-owned manufacturers employed approximately 290,000 workers in the United States.[15]

Meanwhile, Japan continued to offer preferential treatment to its domestic companies. While the United States protested this policy, Japan countered by contending that the ineffectiveness of US export promotion policies and the ineptitude of American companies accounted for their limited success in the Japanese market. The widening and persistent trade gap, which was running between $40 and $50 billion at the time, was a particular source of friction.[16] Their growing stake in each other's economies did compel the two countries to address some of their more serious grievances through ongoing negotiations. The 1990 Structural Impediments Initiative (SII), with its emphasis on altering some long-standing Japanese market access restrictions, helped to avoid a potentially disastrous all-out trade war.

Concurrently, Western European countries discussed developing a framework for further European integration. In 1957, Italy, France, Belgium, Luxembourg, the Netherlands, and West Germany had created the EEC (or European Economic Community or Common Market) to promote closer economic ties and policy coordination among its members. Over time, the organization took a number of steps to extend its membership and its mandate. It was renamed the European Community (EC) in 1967 to reflect its commitment to broader cooperation and gained new momentum with the addition of the United Kingdom, Denmark, and Ireland in 1973. Membership grew to twelve members with the entry of Greece in 1981 and Portugal and Spain in 1986.[17]

This development did not come without challenges. Member countries with weaker economies strained EC resources, and adding them proved divisive. In particular, members argued over the EC comprehensive agricultural subsidy

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program financed by member taxes. Great Britain was particularly vexed by what it believed to be a disproportionate share of the cost it was expected to bear in funding the Common Agricultural Policy (CAP). Nevertheless, a broad sense of common interest prevailed. Through the leadership of Jacques Delors, the president of the European Commission, a plan was launched to move toward a fully integrated market and jointly managed monetary system.

The United States, Japan, and Europe were locked in an increasingly competitive struggle as they wrestled with the challenge of recovering from the disruptions of the 1970s. At the same time, some nations were committed to maintaining an open market system. US president Ronald Reagan and British prime minister Margaret Thatcher were at the forefront of this effort. They argued, among other things, for balanced budgets, a more limited government role in the economy, and policies that encouraged private sector initiatives. This renewed support for traditional liberal economic principles came to be known as **neoliberalism**. They put forward these ideas as a formula for domestic economic restructuring and for the promotion of a more open global economic environment.

neoliberalism
the economic principles that promote free market capitalism and closely reflect the ideals of contemporary globalization

Neoliberal practices caused considerable controversy, especially across the developing world, which immediately felt the effects. Freer trade undermined the ability of weaker companies to compete effectively, and large transnational companies gained considerable leverage in many countries, as they used their capital and superior technological capabilities to overwhelm smaller local firms seeking to maintain their market positions. By the mid-1980s, collective efforts to improve the position of these countries had brought only limited relief. As they struggled to enhance their indigenous capabilities and to tap into world markets, they now faced increasing demands for domestic reform along neoliberal lines. The global economy offered little opportunity for many LDCs to advance. They considered the further opening and deregulation of domestic markets to be yet another example of the undue leverage of the more industrial countries and their continuing ability to advantage themselves at the expense of the LDCs.

The IMF **conditionality** policy frustrated many LDCs. Major contributors determined the practices of international financing agencies. To qualify for IMF loans, countries were obliged to adhere to more "responsible" policy principles that often limited spending for programs intended to provide for the basic needs of the most vulnerable segments of their populations or to improve overall social welfare. Prospective borrowers generally had little choice but to accept these terms to secure necessary financing. It reinforced broader concerns among many of these countries regarding their disadvantaged position within the global economy and the continued demand of its wealthier and more powerful members to dictate terms of involvement.

conditionality
the requirements imposed on prospective borrowers by the IMF or other lending institutions that emphasize economic growth over welfare considerations

The world economy was becoming increasingly difficult to navigate, as countries sought to balance their domestic needs and international obligations. A consensus was emerging, at least among its more advantaged participants,

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around the need to work toward further integration of the market system through a set of fairly well-defined principles. However, the international institutions designed to develop rules and monitor compliance remained weak, and a number of bilateral and multilateral disputes emerged that threatened this fragile arrangement.

Oddly enough, a series of extraordinary and mostly unanticipated events outside the global capitalist orbit helped to shape and define its direction. The decades of Cold War had severely weakened the economies of the Soviet Union and its satellite countries across Eastern Europe. In the late 1980s, mounting resistance led to the fall of Soviet-backed regimes in such places as Albania, Czechoslovakia, Poland, Romania, Yugoslavia, and East Germany. The dismantling of the Berlin Wall symbolized the end of the Cold War era. The Soviet Union itself did not survive. These developments offered both monumental challenges and opportunities, unleashing a set of forces that shaped the global economic system as we know it today.

EMERGING ECONOMIC CENTERS

The experiences of the countries transitioning from communist rule provide a good snapshot of the changes in the structure of today's global economy. Early efforts to implement political and economic reforms were uneven. In Russia (and a number of former Soviet republics), the introduction of market reforms did not bring about an expected improvement in overall living standards. Instead, a relatively small group of investors with access to government officials gained considerable wealth and influence over the direction of the economy. These new elites, commonly referred to as the *oligarchs,* took advantage of their position to challenge the government's control over economic policy until their activity was eventually curtailed by Russian president Vladimir Putin (2000–2008 and 2012–present).

Russia's economy expanded considerably under Putin, owing largely to its flourishing energy industry and rising prices for oil and natural gas on world markets. Rates of economic growth remained relatively healthy and steady—expanding an average 7.3 percent between 2004 and 2007. Although it experienced some drop-off to 5.2 percent growth in 2008, the overall state of the Russian economy remained strong until the downturn in global economic conditions took their toll. As Putin handed off political control to his handpicked successor, Dmitri Medvedev, economic output fell a considerable 7.8 percent in 2009. Yet Russia recovered as the global financial crisis eased, posting gains of 4.5 percent in 2010 and 4.3 percent in 2011. Although still plagued by a fair share of corruption and inefficiency, Russia's economy was in relatively good

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shape when Putin reacquired the presidency for another term in 2012. Its more modest growth rates of 3.4 percent in 2012 and 1.3 percent in 2013 were more reflective of the overall sluggishness of the global economy.[18] In 2014, Russia demonstrated its resiliency by concluding a long-term, multibillion dollar deal to sell natural gas to China. This was designed, in part, to offset US and European economic sanctions imposed following its contentious takeover of Crimea.

China's emergence has been steadier. China has become one of the world's leading economies, with an average annual growth rate that has generally exceeded 10 percent and gross domestic product (GDP) of more than $7 trillion. Not even China remained immune from the effects of the global recession, as its annual rate of growth slowed to 9.6 percent in 2008 and 9.2 percent in 2009 after accelerating a full 14.2 percent in 2007. With growth rates of 10.4 percent and 9.3 percent in 2010 and 2011, China's economic dynamism appeared to remain relatively intact. With its heavily export-oriented focus, however, China did begin to experience some deceleration. With slackening demand in Europe and the United States due to lingering effects of the global recession, China's output increased at a rate of only 7.7 percent in both 2012 and 2013.[19] Even so, China still seems poised to surpass Japan and perhaps even the United States as the world's largest economy before the end of the twenty-first century.

China is deeply enmeshed within the global economy and has become especially linked to the United States through expanding trade ties and the financing of significant amounts of US debt. At the same time, its ruling Communist Party has resisted US pressure to enact political reforms that would undermine its authority. China applies its own unique vision in the pursuit of its broad economic and political agenda. This dates back to the 1970s, when China's leader, Deng Xiaoping, enacted major reforms designed to introduce market principles to the country's socialist economy. This model of "socialism with Chinese characteristics" has endured. It is reflected in the development of special administrative regions in Macao and Hong Kong, where there are different sets of rules and regulations to facilitate the coexistence of socialist and capitalist principles. Encouraged by the government, developers have made the island of Macao the world's casino capital, exceeding Las Vegas in revenues from its gambling operations. A leading global financial center, Hong Kong is an important economic asset to China and critical to its future economic planning.

China's success may be traced, in part, to its advantages as a producer of lower cost goods and its vast market potential. International companies have flocked to China to capitalize on its huge and inexpensive workforce. For its part, China has welcomed foreign investment to fuel its ambitious modernization agenda. In 2013, foreign direct investment (FDI) reached a record $117.6 billion. While the rate of growth has slowed over the past few years, China ranks among the leading destinations for foreign investment across the world.[20]

China has amassed additional wealth by parlaying its role as a leading manufacturing center into an aggressive export strategy. In 2013, China's foreign trade exceeded $4 trillion, resulting in a significant $260 billion surplus. Its lopsided

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trade relationship with the United States—which led to a surplus of $315 billion in 2012 and another $318 billion in 2013—remains a particularly sore point between the two countries.

The United States, for its part, has accused China of keeping its currency (the yuan) undervalued to enhance the pricing advantages of Chinese products. China has denied this claim, suggesting instead that US firms need to become more efficient to compete more effectively.[21] Nevertheless, in June 2010, China did bend to increasing pressures by agreeing in principle to allow for more exchange rate flexibility.

In return for the capital and technology provided by outside investment, China provides consumers elsewhere with an array of inexpensive goods. Meanwhile, China's more than 1.3 billion people are especially attractive to retailers. Chinese consumers may shop at Walmart after dropping by a McDonald's or KFC, whose menus have been tweaked to reflect local tastes. The economic indicators in Table 6.1 reflect China's growth.

TABLE 6.1 MEASURING CHINA'S GROWTH*

	2009	*2010*	*2011*	*2012*	*2013*
Gross domestic product (GDP)	4990.5	5930.4	7321.9	8229.4	9181.4
Real GDP growth	9.2	10.4	9.3	7.7	7.7
Foreign exchange reserves	2,452.9	2,913.7	3,254.7	3,387.5	3,820.0
Exports	1,201.6	1,577.9	1,898.6	2,048.9	2210.0
Percentage change	-16.0	31.3	20.3	7.9	7.9
Imports	1,005.6	1,394.8	1,743.5	1,817.8	1,950.3
Percentage change	-11.2	38.7	24.9	4.3	7.3
World trade balance	196.0	183.1	155.1	231.1	259.7
With United States	226.9	273.0	295.4	315.1	318.4
Inward foreign direct investment (FDI)	90.0	105.7	116.0	111.7	117.6
Percentage change	-2.6	17.4	9.7	–3.7	5.3

Sources: Ministry of Commerce, People's Republic of China, http://english.mofcom.gov.cn; World Economic Outlook Database, International Monetary Fund, April 2014, www.imf.org/external/pubs/ft/weo/2014/01/weodata/index/aspx; The World Bank, http://data.worldbank.org/indicator/FI.RES.TOTL.CD; www.trading economics.com/china/foreign-exchange-reserves.

*Numbers shown are in billions of US dollars.

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In many ways, China's expanding influence speaks to the fundamental transformation of the global economy. Despite the continuing dominance of its Communist Party and differences with the West on many strategic issues, China has embraced core capitalist economic precepts and has become both a critical partner and formidable competitor. As an outlet for investment and a source of finance, China has considerable leverage and latitude to pursue its economic and political interests. Its aggressive policies often provoke tensions with the United States, Japan, and other key partner-competitors. China's labor practices, including the use of prison and child labor and the alleged manipulation of its currency, are especially contentious yet effective ways to undercut trade competition. China's trading partners are also concerned about its expanding demand on global energy resources. The growing stake these partners have in each other's economies provides them an incentive to negotiate solutions to emerging political and economic disputes.

India's emergence as an important player in the twenty-first century also reflects shifting roles in the global economy. With its long-standing democracy and strong educational system, India has experienced significant growth and has attracted the interest of foreign businesses and investors seeking to engage the country's economic and human resources. Although it is one of the world's most populous countries, many of its more than 1 billion people endure conditions of extreme poverty even as a vibrant English-speaking middle class has developed. Continuing religious tensions between Hindus and Muslims, and other differences that surface in India's multiethnic society, periodically result in bombings and other acts of violence. Modern office parks house some of the world's most sophisticated software firms in areas surrounded by shantytowns that lack any modern conveniences. Although it is a country of paradoxes, India has become one of the world's most dynamic economies and has secured an important niche in the rapidly developing information technology (IT) sector.

outsource or offshore
often used interchangeably, these terms refer to the displacement of work activity. Outsourcing involves the transfer of certain specific functions performed within a company to an outside provider. Offshoring entails the relocation of an entire business operation to another country.

HOW DO YOU CONNECT?

CALLING INDIA

Have you ever had an encounter with a call center located in India?

a. yes
b. no
c. I have connected to a call center located in another country.

Were your questions or concerns addressed effectively?

a. yes
b. no
c. to some extent

In what areas do you think call centers excel?

a. familiarity with the issue
b. technical expertise in terms of devising a solution
c. clarity of communication

India has had considerable success in the global marketplace. Its top IT companies are among the world's leaders, while six of its cities rank among the top eight outsourcing destinations. TCS (Tata Consultancy Services) has over 285,000 employees worldwide and is the largest IT services firm in Asia, and Infosys Technologies, with its 160,000 workers and revenues exceeding $8 billion, ranks among the leading IT service

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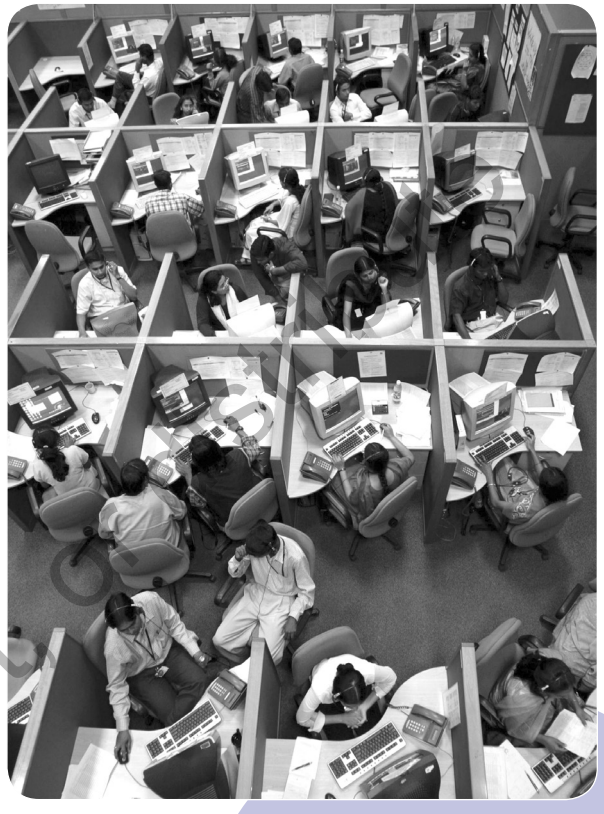
providers globally. In addition, India's Tata Motors is poised to become an important global player in the industry. It purchased Jaguar and Land Rover from Ford for $2.3 billion in early 2008 and is working to bring automobile ownership within the reach of millions of Indian families through the production and sale of its Nano model for approximately $2,500.[22]

Meanwhile, wealthy Indian entrepreneurs are being courted by foreign firms eager to secure contracts for services previously performed in house. Anyone in the English-speaking world in need of assistance with a malfunctioning computer or booking reservations for an upcoming airline flight has a good chance of connecting to a call center in India. These facilities are staffed by young, highly educated Indian workers pursuing modern lifestyles that stand in stark contrast to traditional Indian values.



Sherwin Crasto/Reuters/Corbis

Employees at a busy call center in Bangalore, India, provide customer support for callers worldwide. These jobs provide new opportunities for a rising Indian middle class but raise criticism in other countries that jobs are being outsourced.

India's engagement with the global economy has raised questions regarding its impact. Soaring economic growth has done little to lessen the gap between India's modern and traditional sectors. The draw of the country's relatively inexpensive, technologically savvy workforce has proven unsettling in other parts of the world. Companies based in the United States and other high-wage countries have transferred millions of white-collar jobs to India. It is far more profitable to them to **outsource** particular jobs to other companies and **offshore** complete business operations to other locales. As of 2012, around 2.8 million people were employed in the business processing outsourcing (BPO) sector across India. In 2013, moreover, a total of more than 2.6 million US jobs were transferred to workers in India and other low-wage countries.[23]

Within a global economy that has had difficulties sustaining growth over recent years, economic output across the developing world has remained relatively healthy. At the height of the global financial crisis in 2009 when global output shrank 2.4 percent, for example, developing countries actually grew 2.4 percent. This could be traced to the fact that the crisis originated in the developed world and that, in a number of developing countries, governments enacted financial stimulus measures to reinforce domestic demand and trade linkages. This pattern has continued over recent years. With the global economy recovering modestly and tenuously (4 percent growth in 2010, 2.8 percent in 2011, 2.3 percent in 2012, and 2.2 percent in 2013), developing countries have expanded at a higher rate (7.5 percent in 2010, 5.9 percent in 2011, 4.7 percent in 2012, and 4.6 percent in 2013). This has far outpaced the

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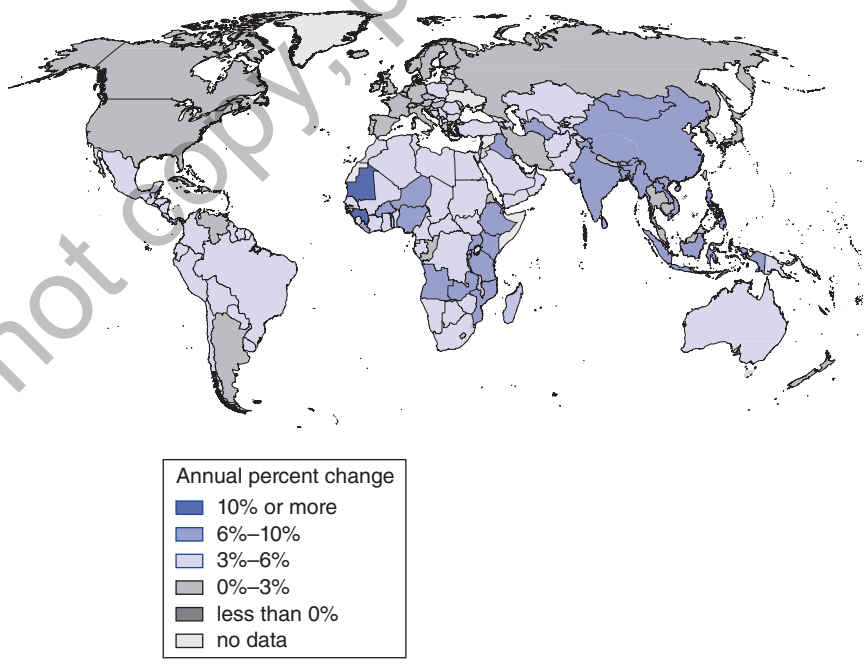
performance of the more developed economies, which have continued to struggle with high levels of debt, unemployment, government austerity measures, and a host of other economic difficulties (see Map 6.2).[24]

These figures contribute to the notion that the world economy has become "upside down," as developing countries have come to account for more of the world's capital investment, trade, and consumption of resources.[25] In 1999, the Group of Seven industrial countries (popularly known as the G-7) accounted for about 50 percent of world output; a decade later its share had declined to around 41 percent. The IMF expects this figure to fall to approximately 37 percent by 2015, as countries such as China, India, Brazil, and Mexico—among others—continue to expand their economies.[26]

While these numbers may suggest a leveling of the global economic playing field, there are considerable disparities. The more dynamic economies in the Global South contribute most significantly to this aggregate picture, but many others have continued to lag seriously behind due to failures to successfully address economic or political challenges. In East Africa, for example, severe drought has devastated crops in Eritrea, Ethiopia, and elsewhere and has resulted in widespread famine. In Somalia, the ability to deal with this situation

MAP 6.2 **REAL GROSS DOMESTIC PRODUCT GROWTH, 2014**



Source: International Monetary Fund, IMA Data Mapper, "Real GDP Growth," http://www.imf.org/external/datamapper/index.php.

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has been compromised further by a protracted civil war and dysfunctional government. The unsettled nature of the global economy, moreover, has hit developing countries hard. Uncertain employment and income prospects have hampered governmental and nongovernmental efforts to improve living conditions. While the overall rate has declined, there are still over 1.2 billion people across the world living in extreme poverty (less than $1.25 a day). Sub-Saharan Africa and South Asia are the most seriously impacted, with nearly 49 percent and 30 percent of their respective populations enduring these conditions.[27]

The difficulty of maintaining steady worldwide demand for commodities in the aftermath of the 2009 recession contributes heavily to the challenges many countries face across the Global South. Lower prices have debilitating effects on the ability to generate funds that might be used to support efforts to reduce

UNDERSTANDING CROSS-BORDER CONFLICT: HOW CAN INTERNATIONAL STUDIES HELP?

Tragedy in Bangladesh*

On April 23, 2013, the multistory Rana Plaza building in an industrial suburb of Dhaka, the capital of Bangladesh, collapsed (see Map 6.3). More than 1,100 people were killed and another 2,500 escaped the wreckage, many with significant injuries. This was just the latest (albeit deadliest) in a series of disasters affecting garment factories in the country.

Bangladesh has more than 5,000 of these factories as it has emerged as one of the world's leading clothing exporters, second only to China. The textile industry is critical to the country's economic health, accounting for 17 percent of GDP and more than 75 percent of total exports. The Rana Plaza building itself contained five separate garment shops under contract with some twenty-nine global brands, including such trendy retailers as Canada's Joe Fresh, the United Kingdom's Primark, and Italy's Benetton. With its substandard construction, cracks developed and an inspection conducted the day prior to the collapse deemed the structure unsafe. Factory supervisors discounted the findings and ordered workers back into the building the next morning. Tragedy struck when the large and heavy power generators previously placed on the upper floors to compensate for regular power failures were turned on.

This disaster highlighted the circumstances faced by workers (overwhelmingly female), who have come to occupy critical roles in industries deeply impacted by the demands and pressures of globalization. In addition to their low wages, they often endure harsh and unsafe working conditions as employers seek to locate production facilities in the Global South to minimize costs in a highly competitive global market where consumers expect quality and inexpensive goods. In this instance, the toll was considerable. While a $40 million fund under the auspices of the International Labour Organization (ILO) was established to compensate victims and their families, only about half of the brands associated with the building have contributed. Bangladesh enacted a series of new oversight measures, but the lack of sufficient numbers of inspectors and the resistance of influential factory owners to enhanced regulation have limited their impact.

* http://www.cnn.com/2013/10/24/opinion/bangladesh-garment-workers

http://www.cbsnews.com/news/the-bangladesh-factory-collapse-one-year-later

http://www.forbes.com/sites/clareoconnor/2014/04/24/report-a-year-after-bangladesh-disaster-retailers-fail-to-address-biggest-factory-risks

What is the role of crossing borders in addressing this issue? How can the cross-disciplinary focus of international studies help?

(Continued)

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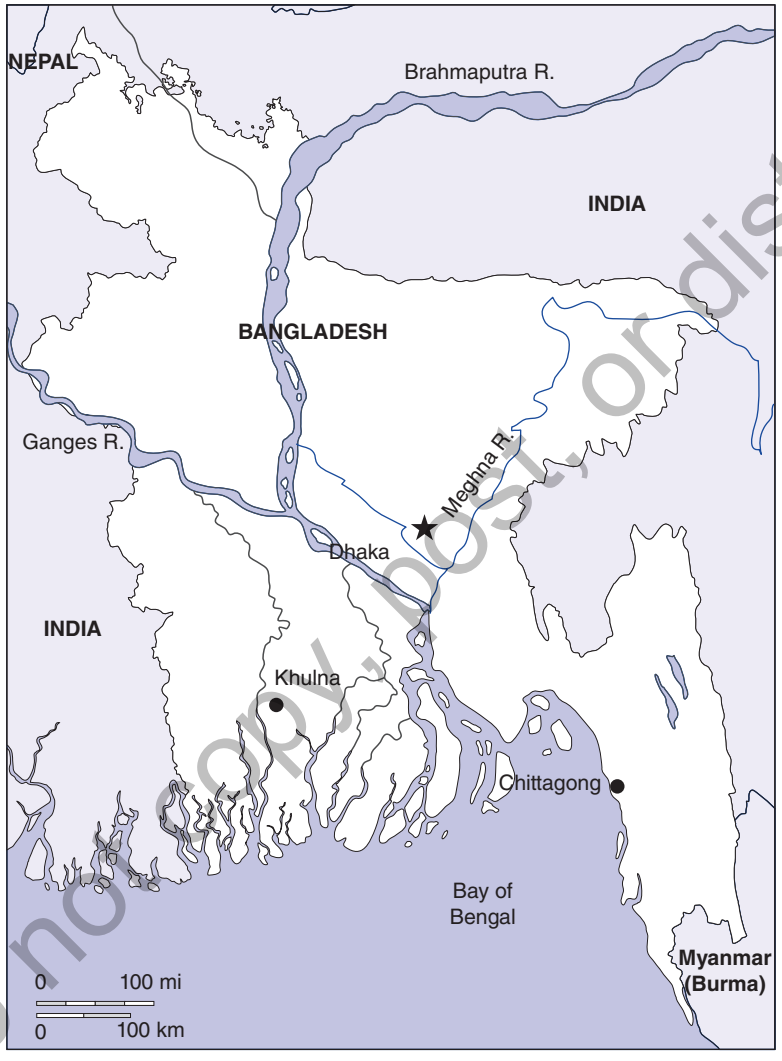
(Continued)

MAP 6.3

DHAKA, BANGLADESH



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Questions

- What is the role of geography in this situation?
- What are the political motivations of the countries and companies involved?
- What are the economic implications for the Bangladesh and the global garment industry?
- What role do social and cultural factors play in contributing to these types of conditions?
- Can the international community offer any solution?

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poverty and to invest in infrastructure to promote more sustainable production. These countries also remain dependent on continuing public and private capital flows from more developed countries facing their own sets of financial constraints. Economic uncertainties have dampened the enthusiasm for globalization across many parts of the region, where support has resurged for populist leaders who promised to reassert national control over resources and economic policy, such as Venezuela's Hugo Chavez and his successor Nicolas Maduro. Support for populist leaders suggests citizens' heightened desire for more leverage over the terms of participation in the global economy but by no means signals a desire to retreat from that engagement.

HOW DO YOU CONNECT?

OUTSOURCED!

Do you know someone who has lost a job due to outsourcing?

a. yes
b. no

If you do, was he or she able to find another job locally at comparable pay?

a. yes
b. no
c. was able to find a job at comparable pay but had to move elsewhere
d. was able to find a job but at considerably lower pay

Has your community had an entire business relocate offshore?

a. yes
b. no

If so, what happened to the facility?

a. A new business moved in.
b. It remains vacant.
c. The facility was torn down and the space is now used for other purposes.

KEY PLAYERS IN TRANSITION

Uncertainties in the global economy affect people around the world. The realignment of some of the more pivotal players in the post–World War II period has added to this dynamic. Countries that played a major role in fueling growth during the latter half of the twentieth century are now attempting to retain their vibrancy in the face of increasing competition and demands for greater sharing of resources from those that are now more prominently positioned to shape the direction of the twenty-first century.

Japan, which enjoyed extraordinary economic performance in the 1970s and 1980s, has floundered in a prolonged recession that calls into question its basic economic orientation and strategy. Japan built its expansion on a fragile foundation of overvalued land and ephemeral stock market prices. The collapse of that financial bubble in the early 1990s sent Japan's economy into a persistent tailspin.

To make matters worse, Japan's political environment, which has been prone to considerable instability, discourages significant restructuring. The governing *iron triangle* of politicians, bureaucrats, and big business that oversaw the economic boom continues to dominate the system but has

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reconsidered its approach to sustain the country's global competitiveness. Under the leadership of Junichiro Koizumi, elected prime minister in 2001, Japan enacted reforms that included privatizing inefficient government agencies, forcing banks to write off bad loans, and limiting any tax increases in an effort to increase corporate and individual spending. These were seen as critical to the resumption of economic growth. His youthful successor, Shinzo Abe, who was elected prime minister in 2006 on a platform of further reform to restore Japan's economic luster, quickly lost this office, as his tenure was punctuated by a number of political and financial scandals. Japan's political uncertainties have shown few signs of abating. Five prime ministers followed Abe in rapid succession until he regained his position in late 2012. None was able to avoid the infighting and improprieties that stymie the political process and limit the ability of the country to navigate through turbulent economic times.

From every indication, Japan's economic recovery will be a slow process. Annual growth rates from 2004 to 2007 hovered in the modest 2 percent range, owing largely to relatively limited capital investment and consumer spending. With a severe reduction in global demand for automobiles, IT, and other exports, Japan's economy contracted 1.1 percent in 2008 and a more significant 5.5 percent in 2009. As the global financial system came back from the crisis of that time, Japan continued to struggle. While its economy rebounded with 4.4 percent growth in 2010, it retracted again (just under 1 percent) in 2011 and posted very modest gains of 1.4 and 1.5 percent in 2012 and 2013.[28] The extensive damage and lingering disruption stemming from the massive earthquake and tsunami in March 2011 have contributed to this weakness.

Even such enduring symbols of Japan's global economic prowess as Honda, Sony, and Mitsubishi have fallen on hard times. Meanwhile, Toyota, long known for its quality control and assurance, suffered a dramatic decline in sales as production practices became shoddy and effective managerial oversight and responsibility failed. To adjust to slumping sales and preserve their competitive posture, many Japanese companies have had to rethink such traditional business practices as lifetime employment guarantees, strategic partnerships with non-Japanese companies, and the offshoring of production facilities. For example, in 2012, in order to comply with legislation that mandated the use of domestic components, 80 percent of the parts that went into the Accords manufactured by Honda came from the United States or Canada.[29] As a result of this legislation, Honda and other manufacturers have established American affiliates of many of their suppliers.

Europe, for its part, has proceeded with a broad-based integration strategy. The 1992 Treaty of Maastricht resulted in a set of agreements to promote broader and deeper cooperation. In recognition of this effort, the EC was renamed the European Union (EU). The building of this union of twenty-seven countries proceeded through the creation of a single European market

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and a jointly managed monetary system. Through delicate maneuverings and compromises they worked together to strengthen the EU governing institutions. However, breakthroughs have not come easily.

In 1999, the EU took a landmark step with the introduction of a single currency, the euro. Initially, eleven of the fifteen EU members at the time adopted it, and Greece followed shortly thereafter. (Denmark, Sweden, and the United Kingdom chose to continue using national currencies.) Participants are required to meet targets relating to inflation, interest rates, and debt. They are also subjected to rules and policies of the European Central Bank, a body that limits the sovereign authority of individual governments and seeks to ensure that the euro works to broaden EU trade and investment goals. There are currently eighteen states in the *eurozone*. These are members of the EU that use the euro as their official currency and have moved toward even greater economic coordination and political management.

Support for extending the EU coverage is, in part, a response to the challenges many of its members (and aspiring ones) face in coping with new economic realities. Broader integration promotes levels of cooperation and efficiency required to compete effectively in global markets, although it is sometimes difficult to reconcile divergent interests and perspectives. However, the debt crisis that engulfed a number of European economies in 2010 and 2011 dampened enthusiasm for this strategy considerably.

PRO/CON

Should the European Union Control Member States' Budgets?

Pro	Con
Markus Ferber German Member of the European Parliament and Member, Economic and Monetary Affairs Committee. Written for CQ Global Researcher, April 2012	**Nikolaos Chountis** Greek Member of the European Parliament and Member, Economic and Monetary Affairs Committee. Written for CQ Global Researcher, April 2012
Recent debt problems in the eurozone have shown the need for more central European Union (EU) control and influence over national budgets. Eurozone countries cannot continue to pile up deficits and then launch desperate rescue attempts. EU member states that violate the EU's debt criteria have to be punished more quickly than in the past—and with tougher penalties. The recently adopted fiscal pact provides national debt brakes and automatic sanctions. This means a tightening of fiscal controls in the eurozone.	With the outbreak of the debt crisis in the eurozone, the dominant political forces (the social democrats and the conservatives) decided to minimize public spending and impose austerity policies all over Europe. To more closely coordinate fiscal policies and control national budgets, the EU recently adopted an "Austerity Treaty" [known as the fiscal treaty], called for European Commission control of national budgets and strengthened the Stability and Growth Pact through penalties to member states.
(Continued on next page)	*(Continued on next page)*

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PRO/CON (Continued)
Should the European Union Control Member States' Budgets?

Pro

Since the establishment in 1997 of the Stability and Growth Pact, the European Commission has monitored the development of the budgetary situation in eurozone countries. Under the pact, each EU member state must submit an updated stability program annually to the commission, providing information on medium-term budget planning. The commission must also be notified twice per year of the projected deficit and the expected total debt. The Stability and Growth Pact clearly says that member states must limit the amount of their annual budget deficit to 3 percent of their gross domestic product (GDP) and their overall public debt to 60 percent of GDP.

Even before the current financial and economic crisis hit Europe, the institutional weaknesses of the pact became clear. Even major economies such as Germany and France did not adhere to its criteria, which led to the weakening of the pact.

The new "six-pack" is a legislative package that includes six reports that toughen European borrowing and debt-reduction rules. In the negotiations, the European Parliament fought for a hard line on the measure. Until now, sanctions against an EU member violating Stability and Growth Pact rules had to be decided by a majority of EU member states. Under the six-pack, the sanction process starts automatically and can only be stopped by a majority of EU finance ministers. Thus, in the medium term EU members are forced to keep to a balanced budget, without resorting to new borrowing.

As a next step, the European Parliament is working on the so-called two-pack, which would further improve the control and coordination of national budgets. Euro countries should adopt far-reaching domestic and economic reforms only after the EU Commission and the remaining members of the eurozone have been consulted.

Recent history has clearly taught us that allowing member states to go it alone in setting budgetary policy is not sustainable once you have a monetary union.

Con

Fiscal policy is a very important tool for the implementation of economic and development policy. Especially, after the introduction of the eurozone, fiscal policy is the only macroeconomic instrument that member states have.

The suffocative coordination of fiscal policies under this austerity policy eliminates the capability and the flexibility of EU member states to pursue an effective and countercyclical stabilization policy, geared toward redistribution of wealth, sustainable development and maintaining adequate public services and infrastructure.

Tighter fiscal discipline and closer coordination of fiscal policies along the lines of dominant economic policies will not help member states recover from this crisis or prevent a future one. Instead, this kind of coordination exacerbates the effects of a crisis, increases social inequalities, poverty and unemployment and eventually leads to the impoverishment of Europe.

Unfortunately, the EU has decided practically to cancel the role of national parliaments, which are elected by the people, in order to give superpowers to bureaucratic institutions, such as the European Commission and the European Central Bank.

The tightening of the Stability Pact, the institutionalization of austerity and the limitation of democracy and national sovereignty are the new components of the EU. The results of this change and of EU control of national budgets are more than obvious in Greece. The economic program to be implemented by Greece has nothing to do with the vision of a united Europe. It is incompatible with the European social model, with the ideas of solidarity and economic and social convergence of member states with the values—of democracy and social justice.

The experiment conducted in Greece is not confined to Greece. On the contrary, what we live today in my country, Greece, is the future of Europe and the euro.

Source: Brian Beary, "Future of the EU," *CQ Global Researcher 6* (2012): 181–204.

Some of the more stable and established members of the EU, such as Germany and France, have found it increasingly difficult to bail out members

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WHERE Do You Stand?

1. Does the need to balance European budgets take priority over the need for government spending on programs to stimulate growth and employment?
2. Given its financial uncertainties, does the EU have the right to impose more stringent requirements on countries failing to reduce their deficits?

facing severe capital shortages, such as Greece and Italy, while continuing to attend to the pressures of preserving traditional entitlements and social welfare policies at home. The relatively weaker economies that are either unwilling or unable to curtail their expenditures have placed an additional strain on the euro and undermined its value. Surging government debts resulted, in large measure, from spending surges intended to stimulate recovery from the global recession. Following annual increases in 2006 and 2007 of around 3.5 percent, EU output stalled in 2008 and dropped 4.4 percent in 2009. While recovering somewhat in 2010 (2 percent) and 2011 (1.7 percent), EU economies remained flat (–0.3 percent growth in 2012 and 0.2 percent in 2013). Europe continues to face severe challenges, as it copes with financial uncertainty that threatens the stability of the euro and an unemployment rate hovering around 10 percent.[30] These economic difficulties have also taken their toll politically. The 2014 elections to the European parliament resulted in victories for parties skeptical of deeper integration in a number of key countries. The debate in the "Pro/Con" box beginning on page 171 suggests the complexity of reconciling regional and national interests that will confront the EU in the years ahead.

The United States remains the world's largest economy, although its growth has slowed over recent years. While expanding modestly before contracting 2.8 percent in 2009, its recovery has been rather sluggish and deliberate (2.5 percent in 2010, 1.8 percent in 2011, 2.8 percent in 2012, and 1.9 percent in 2013).[31] The United States continues to advance free market principles and policies in both regional and global forums, although many citizens have come to question this approach. They are particularly concerned about the loss of US jobs. The closing of factories and their relocation to lower-wage countries, such as Mexico, the Dominican Republic, Indonesia, and China, has hit the US manufacturing sector hard. Other sectors have also suffered, as advances in IT and telecommunications make it easier and easier for companies to turn to India and other countries for cheap labor. Highly trained and relatively inexpensive workforces in these places are now engaged in a wide array of increasingly complex tasks previously performed in the United States. The considerable decline in other employment opportunities only magnifies the impact of these job losses.

The cost of maintaining America's economy is also a source of contention among politicians and citizens as it involves questions regarding the advisability

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current account
the equivalent of a country's checkbook, reflecting the combined balances on trade in goods, services, income, and net transfers

of increasing budget deficits and debt. The US **current account** deficit, which reflects a net outflow of money from the country, was $379.3 billion in 2013.[32] Although moderating rather significantly over recent years, the country is still saddled with an annual government budget deficit of around $680 billion (down from $1.1 trillion in 2012). With an outstanding national debt of close to $18 trillion, the country remains hard pressed to sustain itself financially.[33] Once the world's leading creditor country, the United States now faces a more vulnerable economic future as it has come to rely on China and other foreign sources of financing. By the end of 2013, foreigners owned approximately $5.8 trillion of the US national debt held publicly, with a full $1.3 trillion held by China.[34]

The US economic downturn that surfaced in 2008 and reverberated across the global economy magnified uncertainties about the future. An extended period of risky and ill-advised mortgage lending practices precipitated the collapse of the housing market and set in motion a series of events that undermined financial markets at home and abroad. As unemployment grew to nearly 9 percent and consumer confidence declined against a backdrop of business failures and personal bankruptcies, the US government implemented a massive economic stimulus package designed to prevent further fallout.[35] While this infusion of money resulted in additional debt, the government hoped that it would invigorate credit markets and promote the resumption of sufficient levels of investment and financing activity to restore economic confidence.

As the impact of the American financial meltdown spread across the globe, the volatility of oil prices compounded economic uncertainty for many countries. Oil drives economic activity across the world, and its ready availability at a reasonable cost is critical to stable markets. This is not easy to guarantee. To begin with, demand for oil has escalated. Figure 6.1 suggests, moreover, that the members of OPEC account for an overwhelming 81.2 percent of proven reserves and are in a position to control production decisions. In the United States and numerous other consumer countries, enthusiasm for conservation or the pursuit of alternative energy sources waned after the crises of the 1970s and generally resurfaced only during periods of rising prices.

At the same time, the thirst for oil in China, India, and other emerging economies has rapidly expanded with industrial development. Although tempered a bit by the global recession of 2008–2009, the demand for oil increased as the recovery proceeded. This resurgence contributed to the price hikes noted in Figure 6.2. Since oil is purchased around the world with US dollars, the fluctuating value of the currency has added to the pressure on prices. So has the heightened involvement of speculators looking to reap significant financial gain from the flourishing oil market. These speculators, anticipating a rise in prices, sign contracts for future deliveries at the current price. Their purchases are often considerable, thereby impacting available supply and market prices. As noted in

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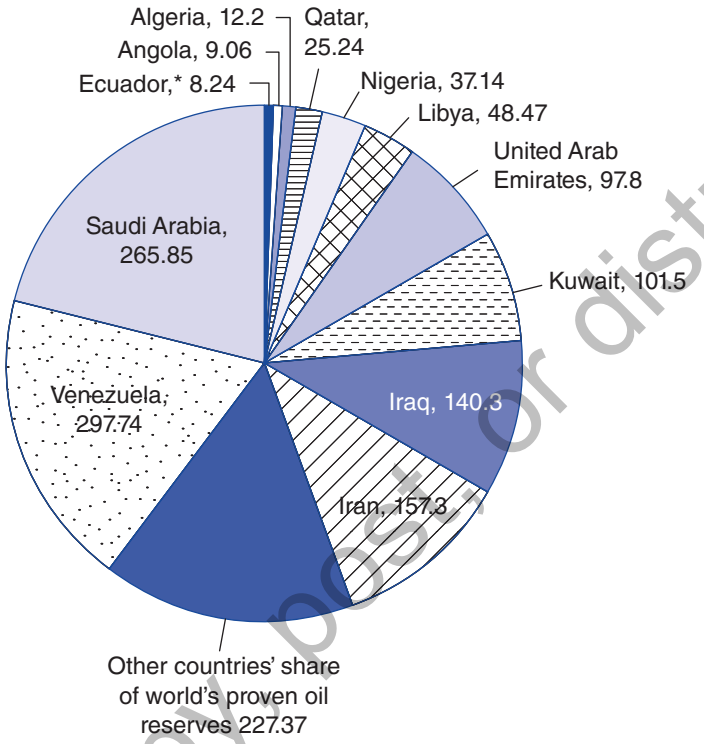
FIGURE 6.1 **ORGANIZATION OF THE PETROLEUM EXPORTING COUNTRIES MEMBERS: PROVEN CRUDE OIL RESERVES 2012 (BILLIONS OF BARRELS)**



Source: OPEC, *Annual Statistical Bulletin,* 2013 edition, www.opec.org.

*Ecuador suspended its membership in 1992 and reactivated it in 2007.

**This represents 81.2 percent of the world's proven oil reserves.

Figure 6.3, for example, prices remained at the $90- to $100-per-barrel level throughout most of 2013.[36]

Political instability in the Middle East and other major supply areas continues to affect oil markets. In Saudi Arabia and other Persian Gulf oil-producing countries, internal opposition threatens the future of long-standing monarchies. Ongoing political tensions in Iraq, Iran, Nigeria, and Venezuela add to these uncertainties and threaten to interrupt production or otherwise disrupt the flow of oil to its intended destinations. With supplies so vulnerable to shifting political winds, oil markets remain jittery and are often subject to unanticipated spikes. Rising prices may offer windfall profits to oil companies and producer countries; however, they disrupt economic activity and create severe hardships for dependent consumers.

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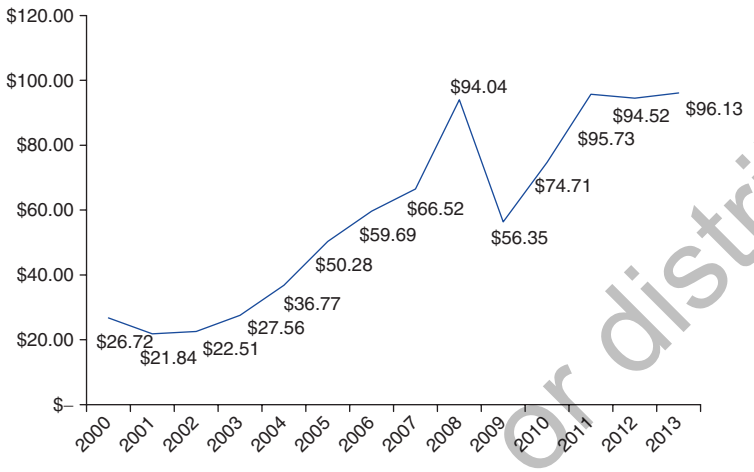
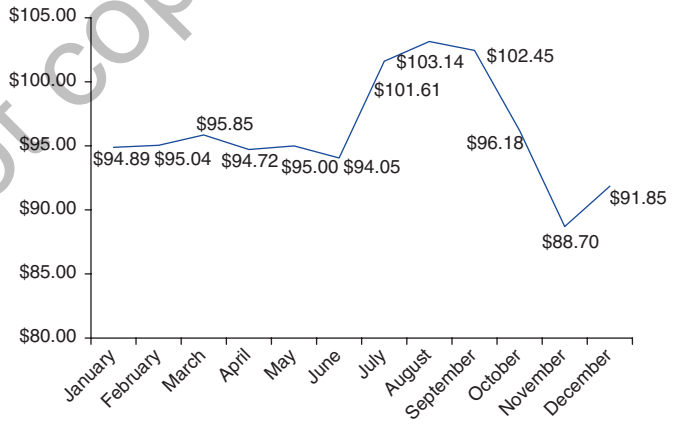
FIGURE 6.2 AVERAGE WORLD CRUDE OIL PRICES (US DOLLARS PER BARREL), 2000–2013*



Source: Energy Information Administration, US Department of Energy: *Monthly Energy Review,* April 2014, www.eia.gov/totalenergy/data/monthly/pdf/mer.pdf.

*Domestic first purchase price, annual average.

FIGURE 6.3 WORLD CRUDE OIL PRICES (US DOLLARS PER BARREL), 2013*



Source: US Energy Information Administration, US Department of Energy, *Monthly Energy Review,* April 2014, www.eia.gov/totalenergy/data/monthly/pdf/mer.pdf.

*Prices as of last week of each month.

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CONCLUSION: THE EVOLUTION OF THE WORLD ECONOMY

The world economy is constantly evolving. On the one hand, the spread of globalization has benefited people previously outside the mainstream, who have become deeply engaged and productive participants. In China and other emerging economies, for example, eager governments and bold entrepreneurs have parlayed local advantages into impressive growth and development. A good case in point is Jian Shuo Wang, one of a growing number of young Chinese innovators seeking to capitalize on the country's growing market opportunities. After working for Microsoft, he launched Kijiji—eBay's classified advertising business in China. While enjoying considerable success in expanding these listings to more than 300 cities, he then spun off Baixing.com, an online community with listings for houses, jobs, and second-hand goods.[37]

At the same time, the extension of the free market has destabilized the lives of many others who continue to operate on the periphery without sufficient tools to compete. This has certainly been true for Neah, a young woman from the Philippines whose encounter with globalization brought her into the web of human trafficking—a growing segment of today's global economy that involves recruiting and transporting persons through force or coercion. This sector generates around $150 billion in profits annually and impacts almost 21 million people.[38] Although promised a job as a waitress in Germany, she found herself transported to Nigeria and then to Togo, where she was confined to working in brothels under harsh supervision and with insufficient means to alter her situation. She made her way to another brothel in Cyprus and eventually succeeded in earning enough money to buy a ticket home.[39]

This contrast between Jian and Neah epitomizes the complex and often contradictory nature of today's global economy. It affects the fates and fortunes of countries and their people in very different ways. The challenge is magnified by the shifting boundaries of economic activity and the absence of broad consensus as to the policies that are most useful and desirable in tackling issues such as stabilizing financial markets, managing debt, and alleviating poverty that are pivotal to the economic well-being of people across the world.

As the world's economies have been brought closer together, new entrepreneurship opportunities have materialized to address outstanding problems. A particularly creative approach is that of Piece & Co,, a for-profit enterprise that seeks to establish new forms of collaboration in the global marketplace. The company connects major brands such as Crate and Barrel, Reef, and Nordstrom with female artisans in developing countries who craft an array of fashionable products. In addition to providing sustainable employment outlets for these women, the partner companies benefit by selling high-quality and desirable items. Under the leadership of its founder, Kathleen Wright, Piece & Co. has brought more than 4,000 artisans in over forty-five countries into its network.[40]

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Important questions remain as to the future resiliency of the world economy and the extent to which it will be poised to meet the basic and sometimes divergent needs of its varied participants. Trade, investment, and finance are three critical areas that will require considerable attention. Chapter 7 looks at the challenges of addressing these issues.

KEY Concepts

capitalism
comparative advantage
conditionality
current account
dependency theory
hegemon
liberalism
mercantilism
most-favored nation (MFN)
neoliberalism
nondiscrimination
outsource or offshore
petrodollars
reciprocity

TO LEARN More

Books and Other Print Media

Jeffrey A. Frieden, *Global Capitalism: Its Fall and Rise in the Twentieth Century* (New York: W. W. Norton, 2006).

This book is a good review of the earlier wave of globalization in the early twentieth century and how it collapsed with the outbreak of World War I in 1914. It is very helpful in understanding contemporary globalization and the idea that it is necessarily inevitable and irreversible.

Bruce C. Greenwald and Judd Kahn, *Globalization: The Irrational Fear That Someone in China Will Take Your Job* (Hoboken, NJ: John Wiley & Sons, 2009).

Greenwald and Kahn look at the impact of globalization on people's lives.

Paul Kennedy, *The Rise and Fall of the Great Powers* (New York: Random House, 1987).

Kennedy's classic and comprehensive history of the development of the global economy focuses on how great powers arise and eventually lose their preeminent status.

Michael Mandelbaum, *The Road to Global Prosperity* (New York: Simon & Schuster, 2014).

While acknowledging the concerns stemming from the fallout from the financial meltdown in 2008, this book puts forth an optimistic view of the future of globalization and its capacity for spreading wealth across the world.

Thomas Piketty, *Capital in the Twenty-First Century* (Boston: Belknap Press, 2014).

This widely discussed and rather controversial book analyzes data from twenty countries and argues that the inequalities of wealth generated by contemporary capitalism threaten democratic values.

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Joseph P. Quinlan, *The Last Economic Superpower: The Retreat of Globalization, The End of American Dominance, and What We Can Do about It* (New York: McGraw-Hill, 2011).

This book is an intriguing look at the reconfiguring of the global economy following the 2008 financial crisis, with special emphasis on the rise of China and other emerging market economies.

Dani Rodrik, *The Globalization Paradox: Democracy and the Future of the World Economy* (New York: W. W. Norton, 2011).

In this book, Rodrik offers a historical and contemporary analysis of the tension between economic globalization and the spread of democracy.

Michael Taillard, *101 Things Everyone Needs to Know about the Global Economy: The Guide to Understanding International Finance, World Markets, and How They Can Affect Your Financial Future* (Avon, MA: Adams Media, 2013).

As advertised, this book features brief definitions and descriptions of 101 commonly referenced concepts, terms, and phenomena. It is a useful companion.

Websites

Europa (the European Union [EU]), http://europa.eu

This official website of the EU contains a wealth of information on the organization and its member states.

The Group of 77 (G-77), www.g77.org

This organization represents the interests of developing countries within the UN and beyond.

International Labour Organization (ILO), www.ilo.org

The official website for this UN specialized agency contains information about the ILO along with publications, research, labor standards, and a statistical database.

Organisation for Economic Co-operation and Development (OECD), www.oecd.org

This organization's website houses its storehouse of data and statistics and provides access to publications and reports.

Organization of the Petroleum Exporting Countries (OPEC), www.opec.org

OPEC is an intergovernmental organization (IGO) representing the major oil-producing states, primarily those in the Middle East. The official website hosts information about the organization, including data, publications, and other media.

US-China Business Council (USCBC), www.uschina.org

The USCBC is a private, nonprofit organization of US companies that do business with China.

Videos

1–800-India (2006)

Examines the human and cultural impact, especially on women, of the emergence of India as a leader for outsourced white-collar jobs.

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Capitalism: A Love Story (2009)

This film by humorist and social critic Michael Moore offers a highly critical look into the dynamics of modern capitalism, focusing on the corporate dominance of everyday life. Both highly acclaimed and heavily criticized (depending on one's political perspective), the film is quite useful in generating discussion and debate.

Cappuccino Trail: The Global Economy in a Cup (2004)

This documentary addresses issues of equity and profit in international trade by following the trail of two coffee beans grown in Peru—one that takes the route of the open market and the other that becomes part of a gourmet coffee introduced by a British company committed to paying fair prices to farmers.

Commanding Heights: The Battle for the World Economy (2003)

A three-part series tracing the transformation of the global economy from the beginning of the twentieth century to the 1990s, this is an excellent source for understanding the conflicting views on the relationship between governments and markets. The contrasting ideas of economists John Maynard Keynes and Friedrich von Hayek are noted throughout as a means for understanding current disagreements over economic policy. There is also a comprehensive website with many special features hosted by the Public Broadcasting System (PBS).

Fashion Victims (2013)

This Australian documentary looks at the tragic collapse of the Rana Plaza building in Bangladesh.

The First Red Multinational (2007)

This documentary presents a case study of China's first multinational corporation, TCL—the parent company of Thomson Color TV.

The Globalization Trilogy (2011)

This collection of three videos explores different levels of today's global production and consumption chain. It includes *Store Wars: When Wal-Mart Comes to Town* (2001), which examines US consumerist culture; *China Blue* (2005), which uncovers labor conditions in Chinese sweatshops; and, *Bitter Seeds* (2011), which focuses on farmers in India growing cotton for export to China's garment factories.

Keynesianism: It's All About Spending (2010) and *Fight of the Century* (2011)

These are lighthearted and entertaining yet informative reviews of the how the ideas of Hayek and Keynes informed the debates over how to respond to the financial crisis of 2008.

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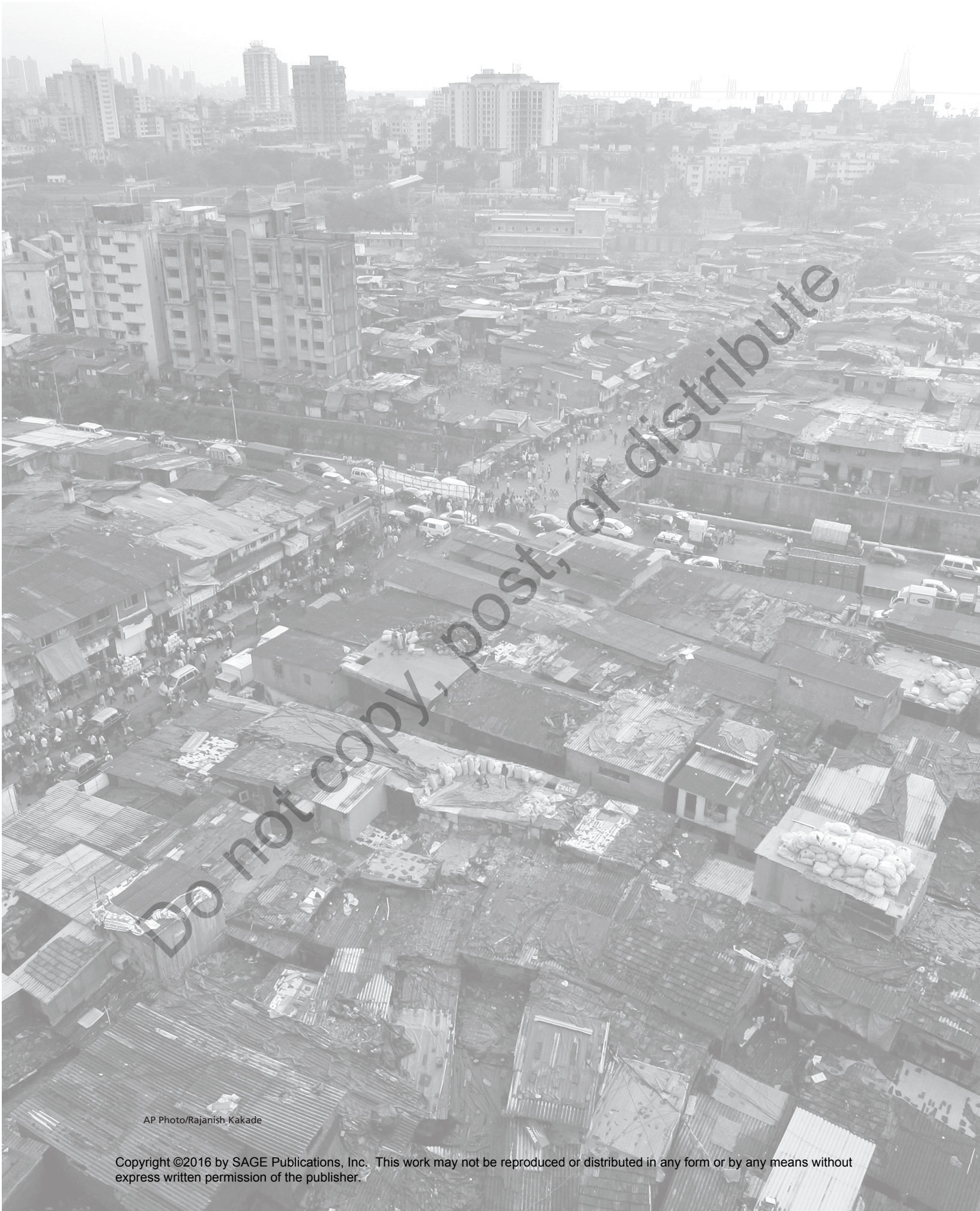

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