Introduction

HS405

We live in a Globalized World

- Can connect instantly with any corner of the world by cellular phone, instant messaging, teleconferencing, travelling.
- Converging tastes.
- Globalization of services.
- Increased migration.
- Globalization of finance.

Phases of Globalization

- World has experienced three periods of rapid globalization – 1870-1914, 1945-1980, and 1980 to present.
- 1870-1914 - resulted from Industrial Revolution in Europe and opening up of new resource rich but sparsely populated lands of North America (United States and Canada), South America (Argentina, Chile and Uruguay), Australia, New Zealand and South Africa. Came to an end with the break out of World War I in 1914.
- 1945-1980 – started with the end of World War II – characterized by rapid increase in international trade as a result of dismantling of heavy protection that has been put in place during the Great Depression that started in United States in 1929 and during the World War II.
- Since 1980 – tremendous improvements in telecommunications, transportation, massive international capital flows.

2 sides of Globalization

- Globalization is associated with both advantages and disadvantages.
- Labor migration from underdeveloped nations leads to more efficient utilization of labor but job loses and lower wages for less skilled labor in advanced nations. Also “brain drain” from migrating nations.
- Unrestricted capital flows also leads to more efficient utilization of capital, provides opportunities for higher returns and risk diversification for individuals and corporations, but leads to international financial crises.
- Globalization also held responsible for depletion of natural resources.
- Disadvantages of globalization has led to rethinking of the age old belief in free trade and to anti-globalization movement.
- Globalization is important because it increases efficiency in production of material things, but it needs to be sustainable and ‘fair’ – a challenge facing us today.

Reasons and Consequences of Interdependencies

- Not all countries can produce all products efficiently.
- For developing nations, exports provide employment opportunities and earnings to pay for many products that they cannot produce.
- Interdependencies or openness is measured by the ratio of total trade (exports+imports) to GDP. Smaller industrial and developing nations have higher trade GDP ratio than countries such as United States, UK and Japan.
- If countries are interdependent, economic events and policies in one nation significantly affects other nations and vice versa. As for example policies for stimulating the economy through increase in money supply, policy for reducing the interest rates etc.

Indicators of Economic Integration or Interdependencies or Globalization

(1) Flow of goods and services.

(2) Flow of labor and capital.

International Flow of Goods and Services: The Gravity Model

- In general, we can expect nations to trade more with larger nations, with geographically closer nations, with nations with more open economic systems, with nations with similar languages and cultural background.
- The gravity model postulates that bilateral trade between two countries is proportional to or at least positively related to the product of the two countries’ GDP and to be smaller the greater the distance between two countries. That is larger and closer the two countries are, the larger the volume of trade between them is expected to be.

International Flow of Factors of Production

- International flow of people (migration) and capital is another indicator of economic integration and globalization.
- People migrate primarily for economic reasons (for better standard of living, to provide more opportunities to children etc.) and also in order to escape from political and religious oppression.
- Flow of labor across country boundaries is more restricted than the flow of capital.
- Financial or portfolio capital (bank loans and bonds) generally flow to markets and nations where interest rates are higher.
- Foreign direct investments in plants and firms flow to nations where expected profits are higher.
- Financial markets are globalized like never before; consequence – when a financial crisis starts in one country, it quickly spreads to other countries.

What is International Economics?

International economics deals with:

- International trade theory – analyzes the basis for and gains from trade.
- International trade policy – examines the reasons for and effects of trade restrictions.
- Balance of payments – measures a nation's total receipts from and total payments to the rest of the world.
- Foreign exchange markets – the institutional framework for the exchange of one national currency for others.
- Open economy macroeconomics – mechanisms of adjustment in balance of payments disequilibria.

Micro and Macro aspects of International Economics

- International trade theory and policies represent microeconomic aspects of international economics because they deal with individual nations treated as a single units and with the relative price of individual commodities.
- Balance of payments represent macroeconomic aspects of international economics because it deals with total receipts and payments, as well as with adjustments and other economic policies that affect the level of national income and general price level of the nation as a whole.

Importance of Trade in Development

- Optimistic views – trade is believed to increase the welfare levels of the participating countries.
- Skeptical views – differences in economic structure between countries bias the gains from trade in favor of developed, industrialized economies and against the underdeveloped, non-industrialized economies.

Optimistic views

- **Trade provides an outlet for the countries surplus commodities which would otherwise go unsold (wastage of resources) -** trade provides an outlet for an underdeveloped country with huge amount of unemployed natural resources and abundant unemployed or semi-employed labor to be utilized gainfully to produce an output over and above the domestic requirements which can then be exchanged for other scarce goods. Trade thus has a role in increasing the level of employment, income, savings and investment in the economy.
- **Extension of market improves the process of production –** catering for a large market results in more extensive division of labor, greater use of machines and inventions. This leads to improvement in production process, thereby overcoming the diseconomies of being a small nation.
- **Opening up of trade in a backward country gives its citizens exposure to new commodities and tempting them by easier acquisition of things which they had previously thought not attainable.**
- **Through interaction with the developed countries, the underdeveloped countries can accumulate knowledge to propel economic development.**
- **Trade stimulates and facilitates the international flow of capital from developed to developing nations.**
- **Expansion of export sector determines the pace of industrialization in a country.**
- **Trade is an excellent anti-monopoly weapon because it stimulates greater efficiency by domestic producers to meet foreign competition.**

Skeptics

- Easy availability of substitute for the primary commodities exported by the developing nations, hinders the process of their economic development.
- Prebisch-Singer hypothesis
- Immiserizing growth: If growth is heavily export biased it might lead to a fall in the terms of trade of the exporting country. This fall in the terms of trade may be so large as to outweigh the gains from growth.