

# **The New World Order**

## **The Political Economy of Globalisation**

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November 2006

HSBC 

# 1. Globalisation refers to the destruction of barriers

- Political
- Technological
- Cultural
- Institutional

## 2. Globalisation has microeconomic foundations

- City states
- Canal tolls
- Increased competition
- It's a story about the free flow of goods, services, labour and capital across borders, making those borders either increasingly porous or completely redundant.
- In other words, barriers to entry come down

# 3. The Roman Empire: information flows by sea



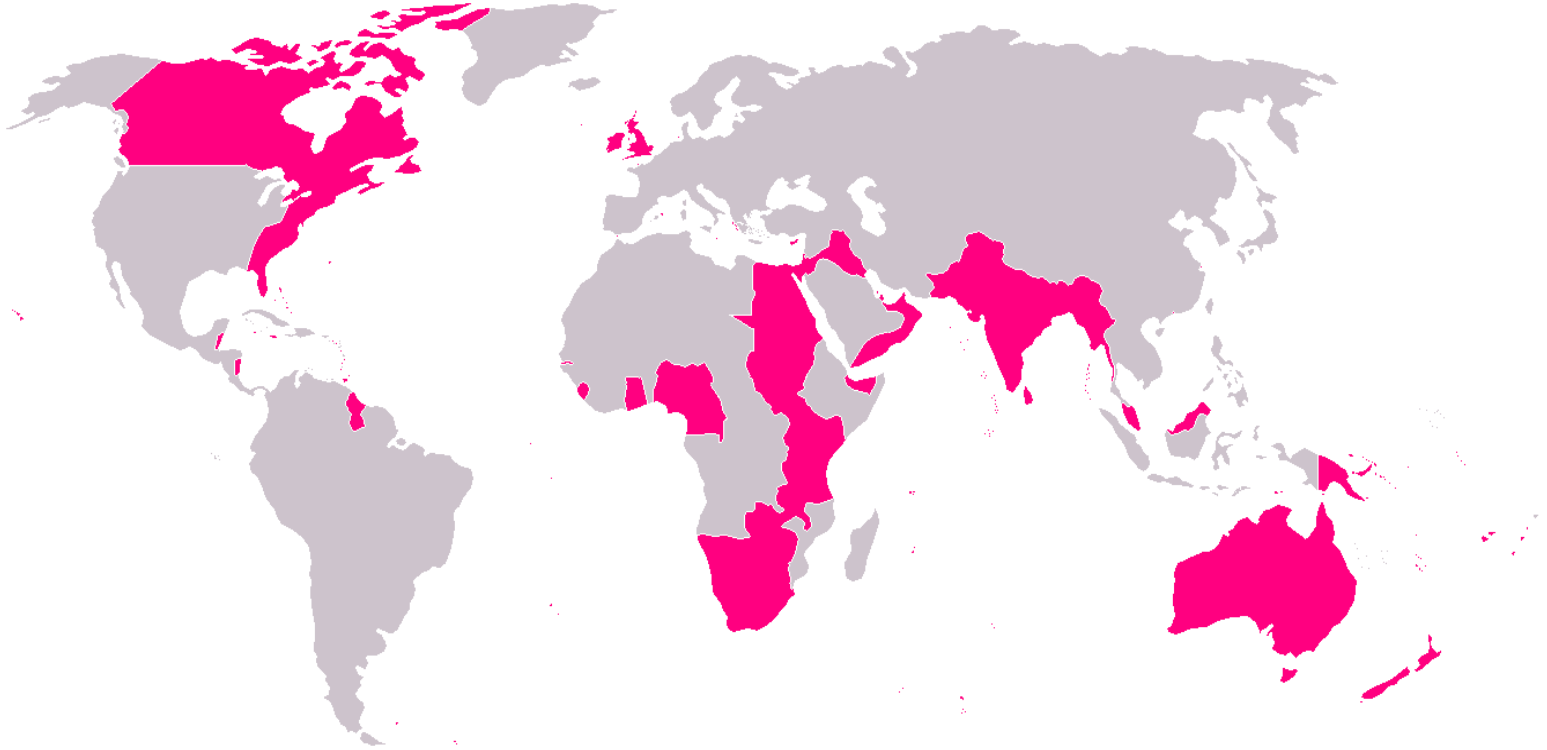
 Geographical Tour: A Tour of Empire

Source: WPS, Pearson Education





## 5. The British Empire: conquest, colonisation, property rights and democracy



Source: Wikimedia commons

## 6. Keynes on the height of globalisation

*“The inhabitant of London could order by telephone, sipping his morning tea in bed, the various products of the whole earth, in such quantity as he might see fit, and reasonably expect their early delivery upon his doorstep; he could at the same moment and by the same means adventure his wealth in the natural resources and new enterprises of any quarter of the world, and share, without exertion or even trouble, in their prospective fruits and advantages...The projects and politics of militarism and imperialism, of racial and cultural rivalries, of monopolies, restrictions, and exclusion...were little more than the amusements of his daily newspaper, and appeared to exercise almost no influence at all on the ordinary course of social and economic life, the internationalisation of which was nearly complete in practice.”*

## 7. Globalisation isn't guaranteed

- Economists focus on efficient resource allocation...
- ...but any PPE-ist knows that economics isn't everything
- Politics is just as important...
- ...particularly with regard to income and wealth distribution

## 8. The complacent westerner

- Until the late-1980s, western labour had monopoly access to global capital
- Rising labour incomes were seemingly guaranteed
- And the western model stood in stark contrast to poor economic performance in most other parts of the world
- The only challenge was from Asia – importantly excluding China and India
- Westerners lived in the modern day equivalent of the city state

## 9. The revolution

- The collapsing price of technology
- The political openness generated by, first, the adoption of outward looking policies by the Chinese under Deng Xiaoping in the early 1980s and, second, by the fall of the Berlin Wall in 1989.
- These are massive shocks that have rocked the competitive equilibrium of the world economy through both labour and capital flows.
- Since 1980, Chinese per capita incomes have started to rise faster than those in Europe: the first time in over 500 years

## 10. A three-country model

- A developed western country – call it the US
- A fast developing emerging market with lots of cheap labour – call it China
- A raw materials producer – call it the Middle East

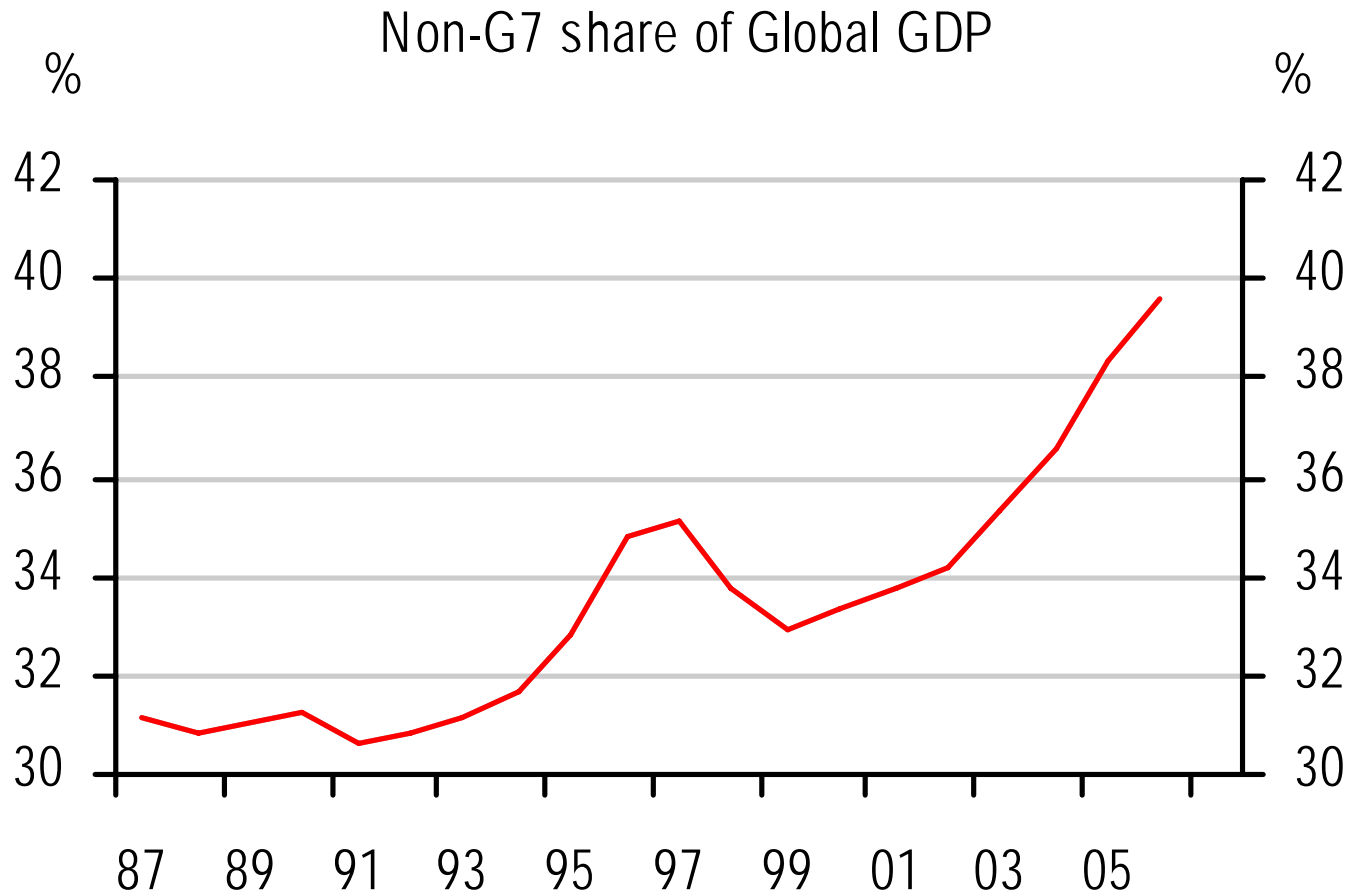
# 11. With free movement of labour and capital under globalisation, what should we see?

- Cheap Chinese labour should flow to the US
- US capital should flow to China
- Global growth should be stronger as factors of production are allocated more efficiently
- Raw materials prices should rise

## 12. Income and wealth distribution implications

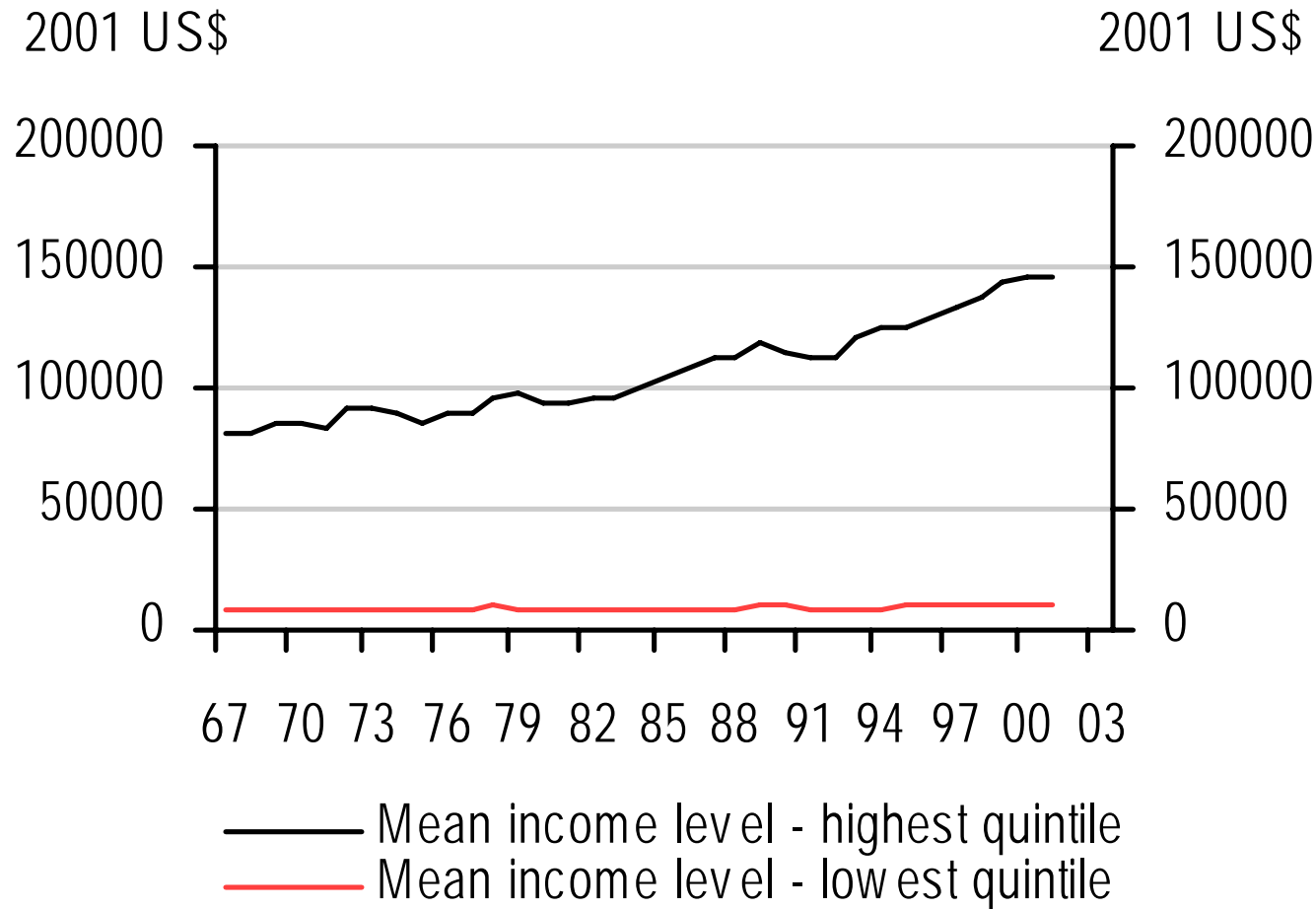
- Western capital wins relative to western labour (profit shares rise as access to cheaper labour increases)
- Emerging labour wins relative to western labour (because emerging labour can now get better access to global capital)
- Raw materials producers win relative to raw materials consumers (because stronger global growth changes the terms of trade between raw materials producers and consumers) – most of these are in emerging markets
- Consumers win because goods and services are produced more efficiently.

# 13. Emerging market success as Europe and Japan lose their way



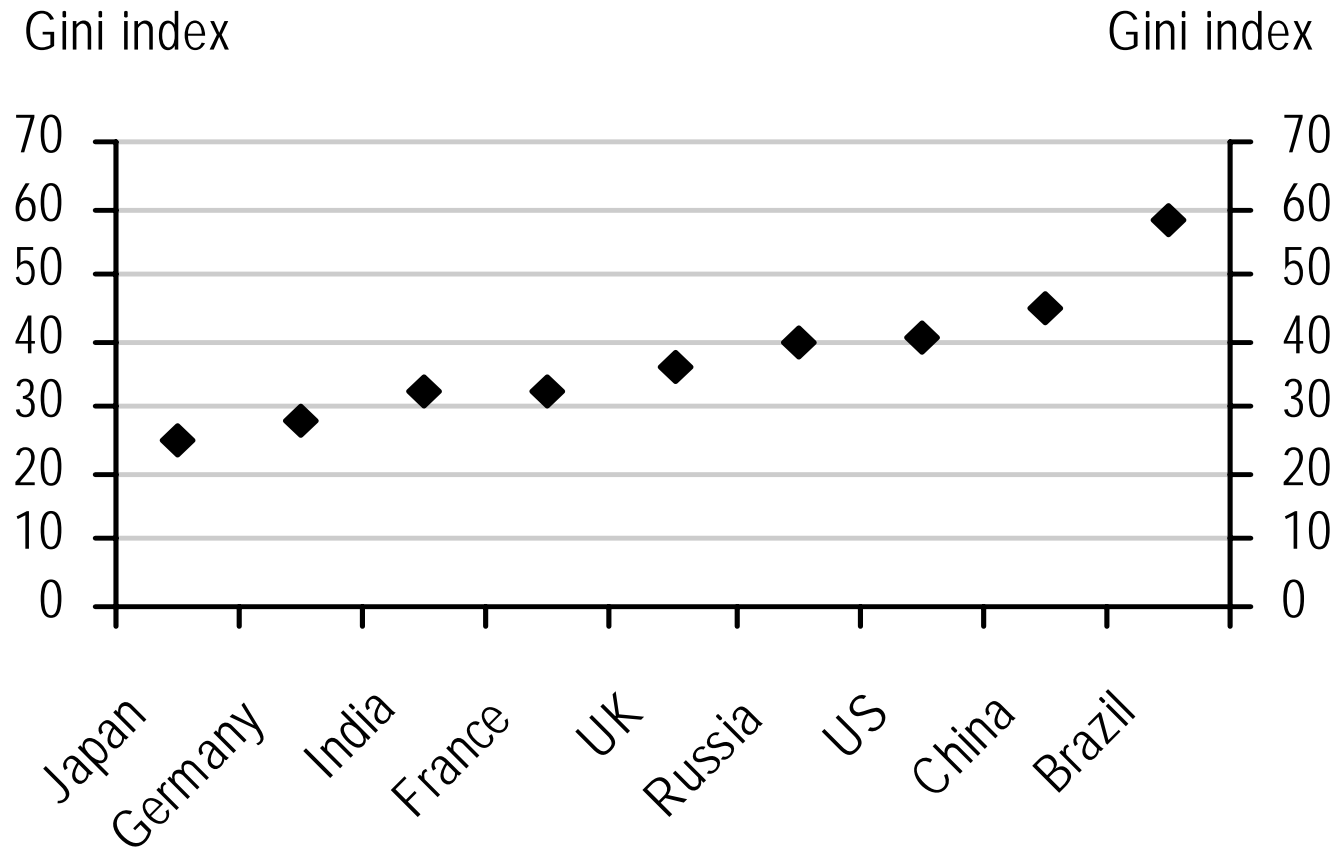
Source: Thomson Financial Datastream

# 14. In US, gap between rich and poor has widened



Source: US Census Bureau

# 15. China has greater income inequality than the US



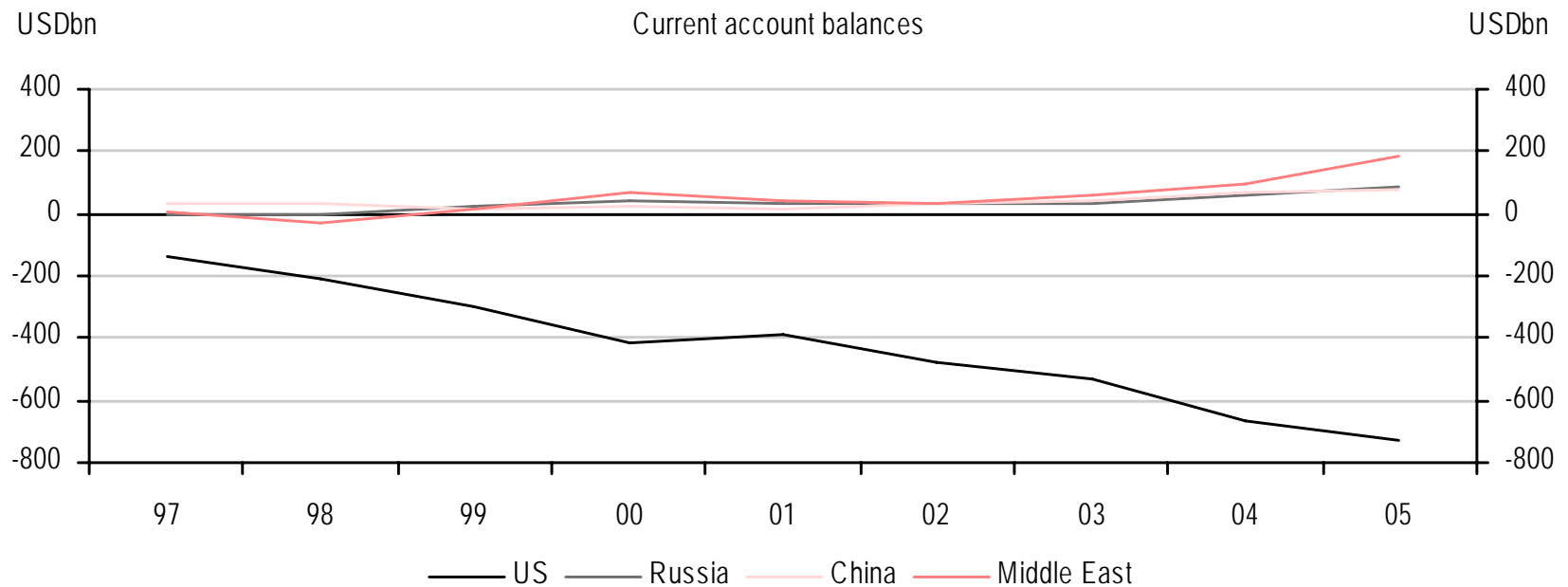
Source: World Bank

The Gini index is often used to measure income inequality. Here, 0 corresponds to perfect income equality (i.e. everyone has the same income) and 1 corresponds to perfect income inequality (i.e. one person has all the income, while everyone else has zero income).

## 16. Implications for the balance of payments

- The Middle East should run an increasing current account surplus with the US and China as commodity prices rise
- Exports of capital from the US to China should leave China with a current account deficit (it's borrowing both from the Middle East and the US)
- The US current account position may be in either surplus or deficit, but the deficit will not be as big as China's

# 17. Spending in the rich US is being funded by savings from poor emerging markets

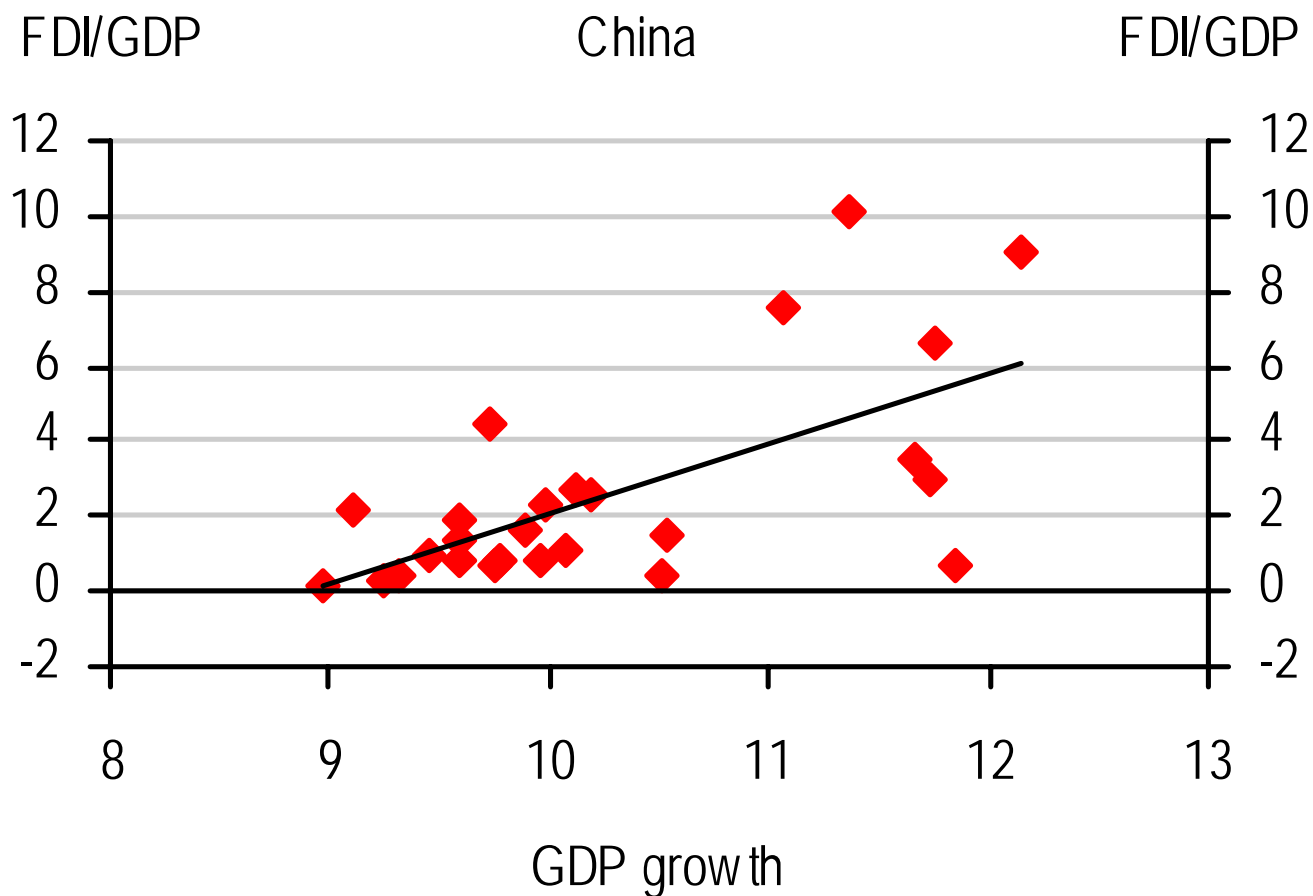


Source: IMF World Economic Outlook, September 2006

## 18. A comparative advantage model

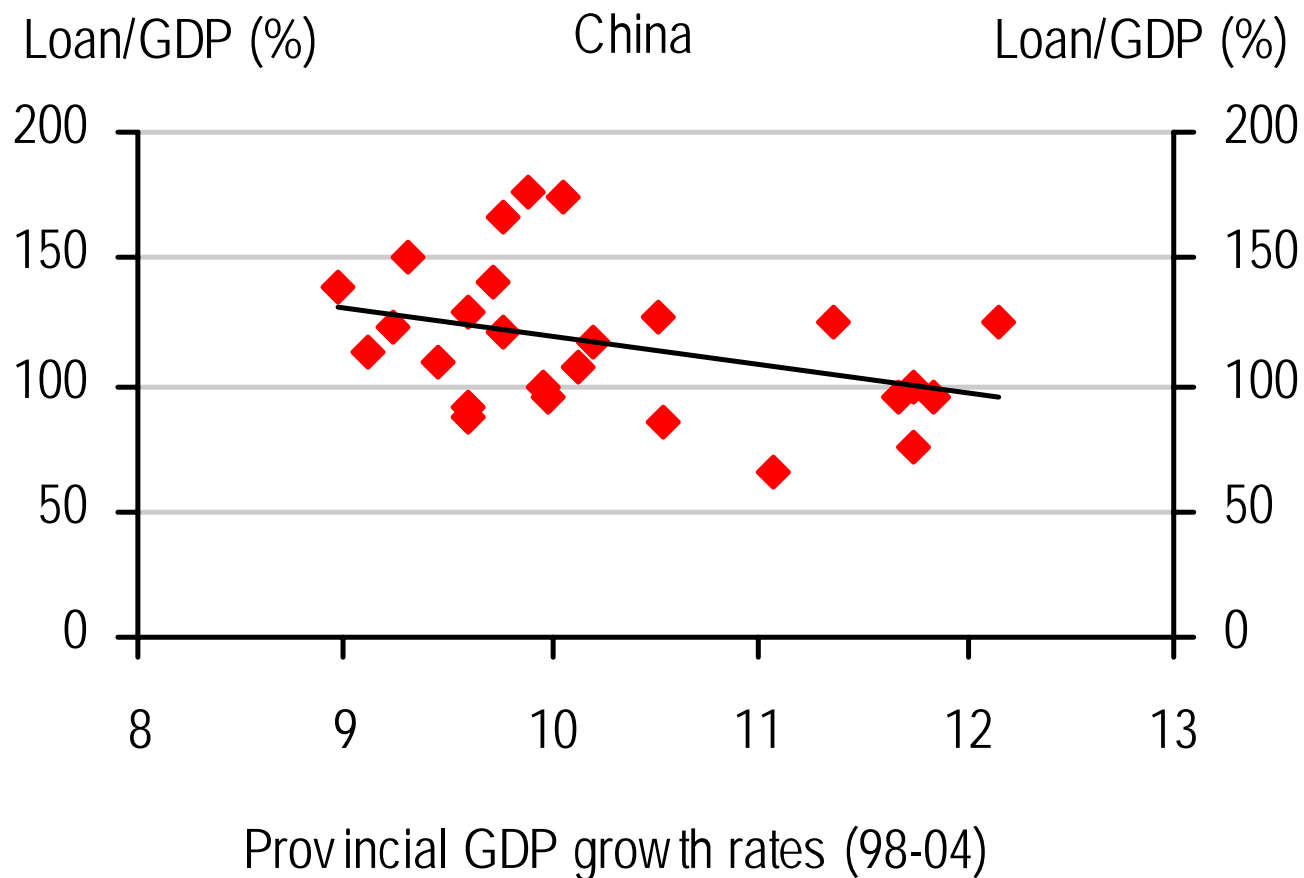
- As China grows, so does its absolute level of savings relative to the US
- The rise in Chinese savings cannot be absorbed in China given poorly functioning domestic capital markets. China therefore runs a growing current account surplus
- China buys low risk foreign assets to diversify away from high risk domestic assets
- The US acts as China's bank, taking a percentage of China's savings for consumption and reinvesting the rest in both the US and China.
- China's growth is higher because of the combination of cheap Chinese labour with US capital allocation skills

## 19. Chinese regions with strong FDI grow quickly...



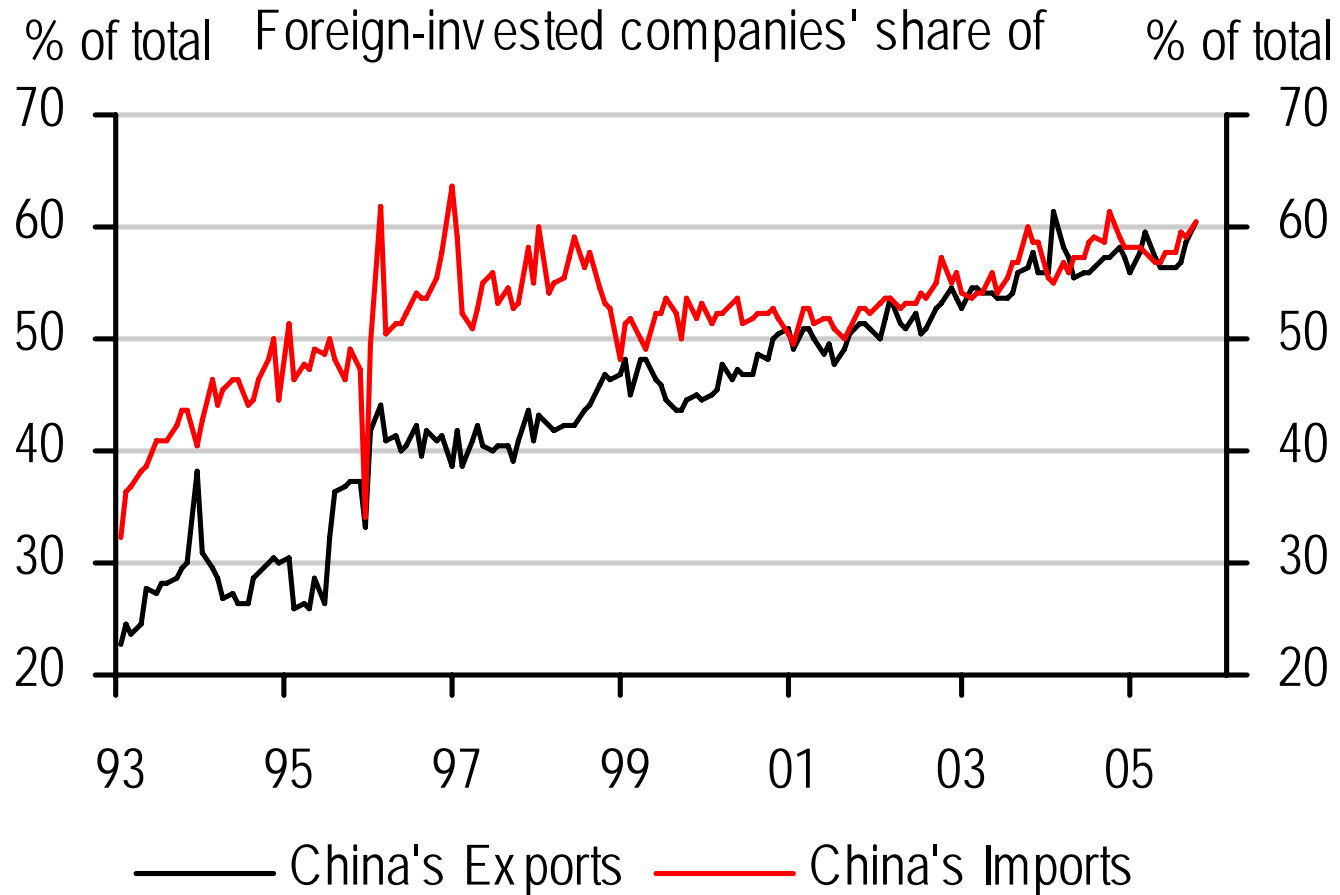
Source: Thomson Financial Datastream

## 20. ...and Chinese regions with dependency on domestic bank lending grow slowly



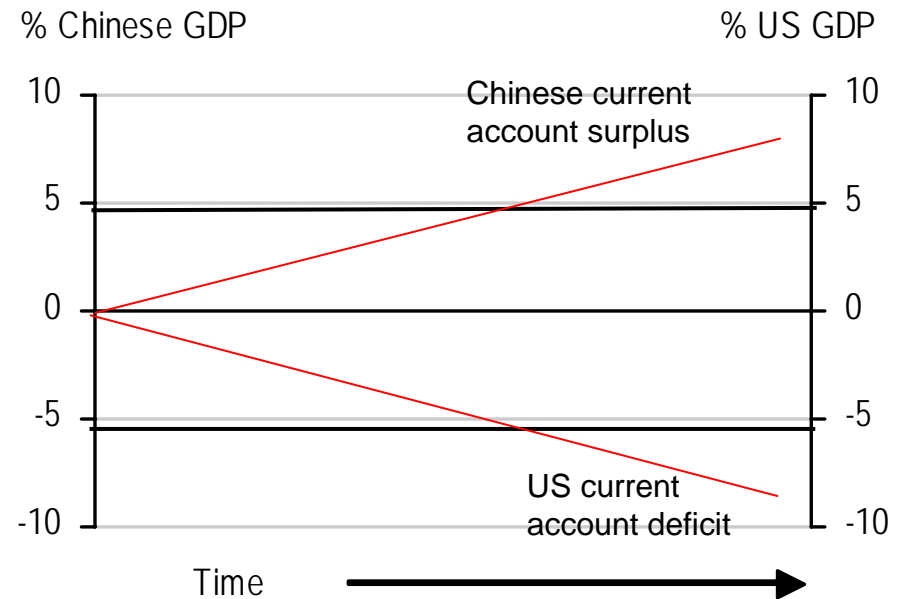
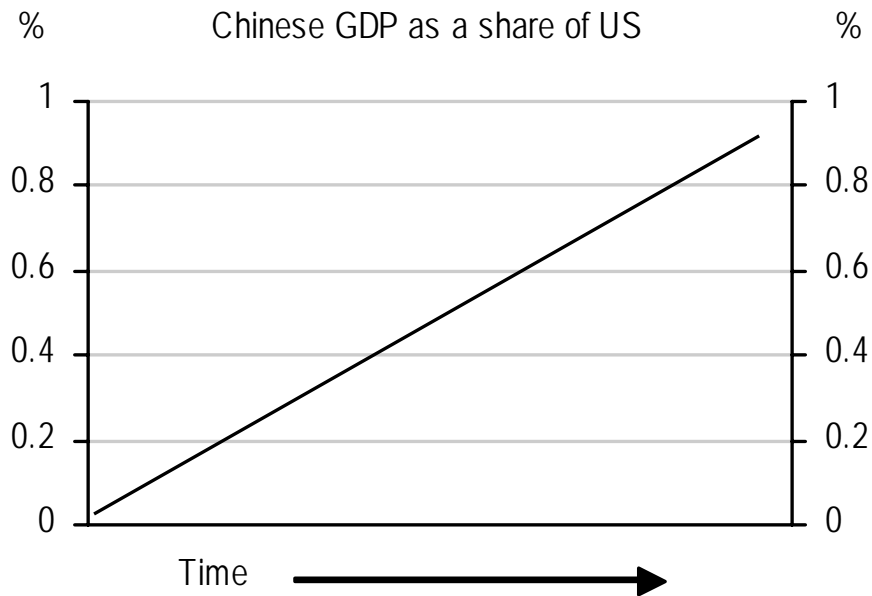
Source: Thomson Financial Datastream

## 21. China's trade is driven by foreign companies



Source: Thomson Financial Datastream

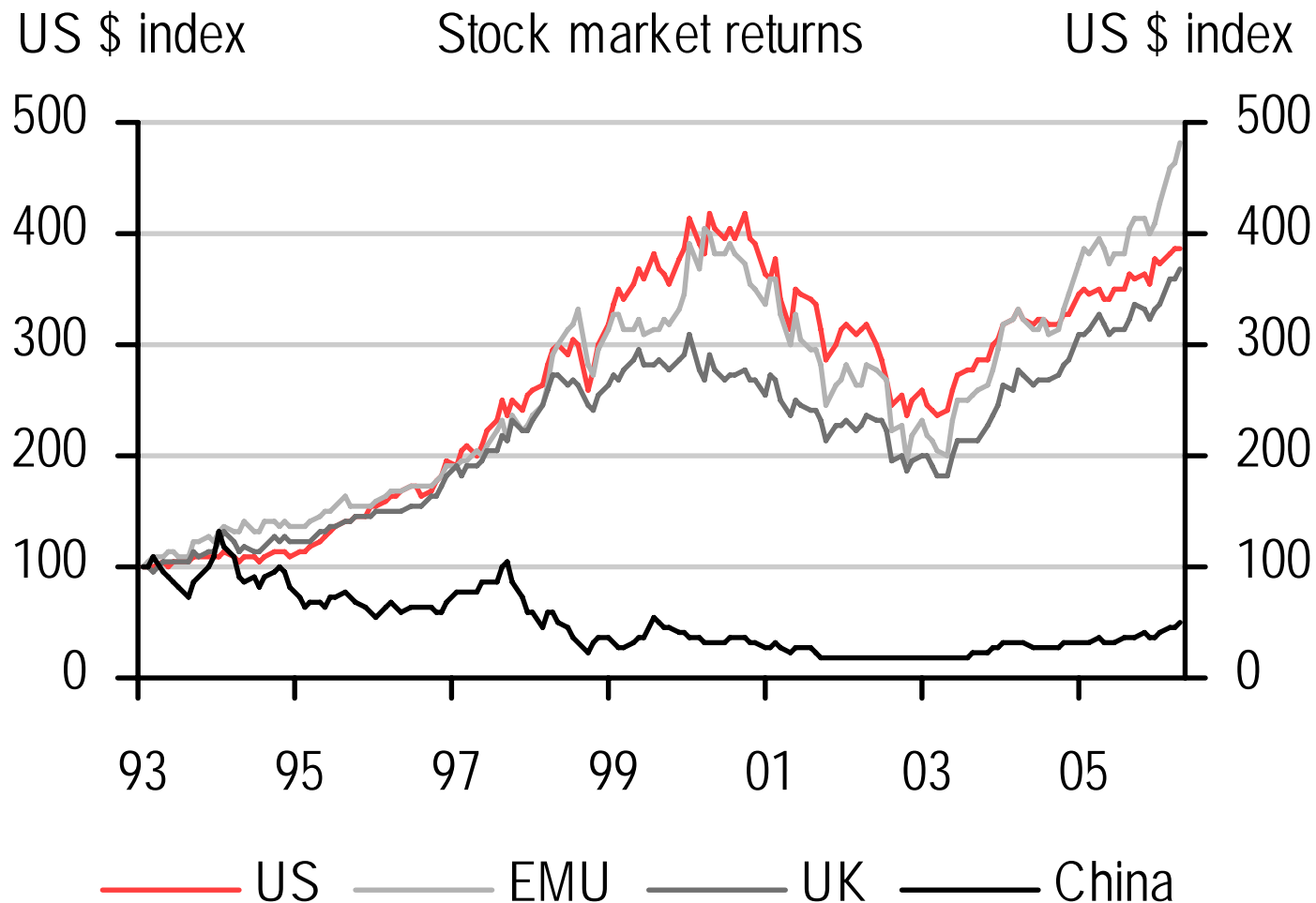
## 22. The possibility model in action



— Current account as a share of Chinese GDP (LHS)

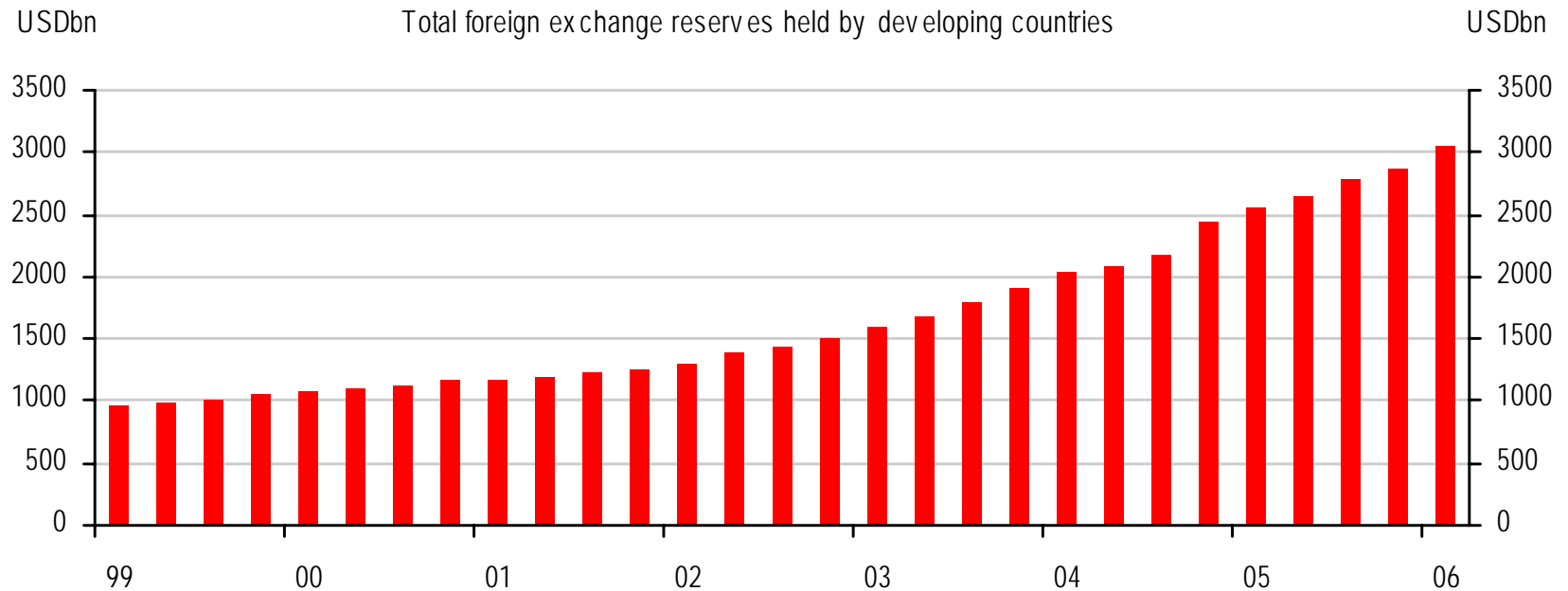
— Current account as a share of US GDP (RHS)

## 23. The best way to invest in China has been to avoid the Chinese stock market



Source: Thomson Financial Datastream

## 24. Emerging markets have huge potential command over US output



Note: Total foreign exchange reserves is defined as the sum of both allocated and unallocated reserves. Source: COFER database, IMF Statistics Department

## 25. Spanish eyes

- 16th century Spain had control of the reserve currency of the time...
- ...and used reserve currency status to fund a widening current account deficit...
- ...leading to lots of consumption....
- ...but the loss of economic skills to the Dutch and English...
- ...paving the way to economic and military decline

## 26. The politics of imbalances: back to 16<sup>th</sup> Century Spain

- For Spain, the long term rivals were England and Holland
- For the US, the long term rivals are China and India

## 27. The politics of imbalances: ownership of capital

- As emerging markets run bigger surpluses...
- ...their buying power over western assets will improve...
- ...allowing them to diversify out of pieces of paper valued in dollars...
- ...into real assets or other currencies

## 28. The politics of imbalances: why the dollar has to fall

- Should the US and Europe resist the latest version of globalisation...
- ...placing limits on the assets that can be sold to emerging market regimes...
- ...the emerging markets will increasingly regard the dollar in a less favourable light...
- ...and will diversify into other currencies and countries, pointing to sustained dollar weakness.
- No one cares about the balance of payments position between London and Manchester...
- ...but borders matter – it's politics, not economics, that makes global imbalances difficult to deal with.

## 29. The politics of globalisation

- Globalisation is not just a story about resource efficiency
- By breaking down barriers, it threatens vested interests...
- ...and may raise income and wealth inequality within countries.
- The next phase of globalisation may be associated with currency abuse...
- ...and politically-unwelcome shifts in ownership...
- ...which suggest that, once again, globalisation will go into reverse.

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