
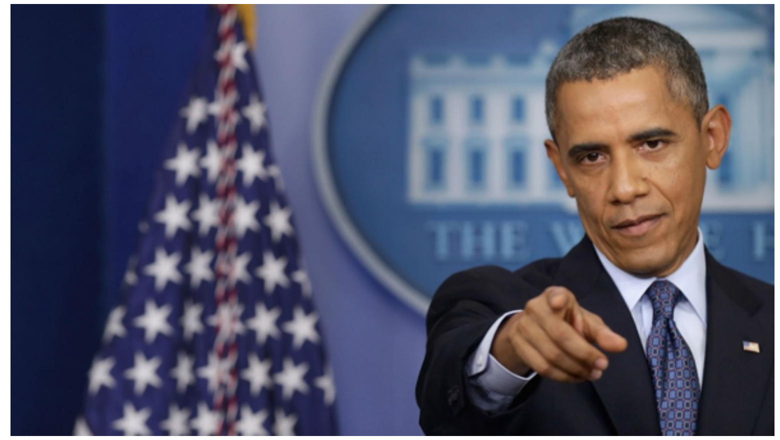

POLI 142A: United States Foreign Policy




The World Political Economy

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POLI 142, Lecture 7b

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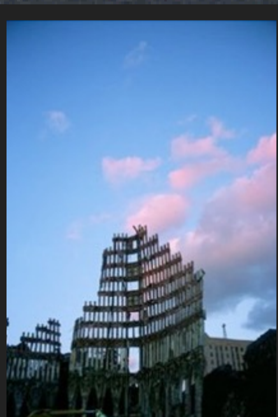



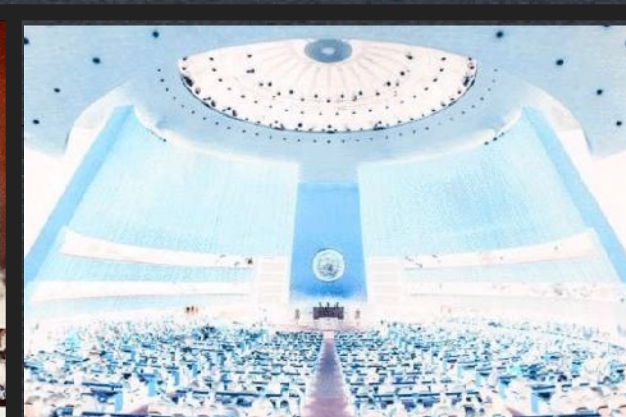
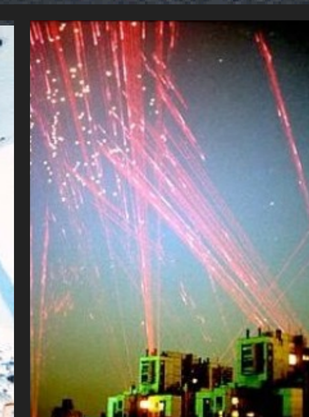

Who gets what?

- Increasingly, the world is divided up
  - Not by who has the most guns
  - But by who can produce the most
- States compete for economic power
  - But they also must cooperate for economic gain
  - Wealth that cannot be taken must be earned

Problems

- Great Depression
  - Beggar-thy-neighbor policies
  - Loss of currency reserves (national banks)
- World War II
  - Widespread destruction.

Two themes

- Cooperation
  - Wealth is increasingly function of cooperation
  - Surplus from trade (comparative advantage)
- Conflict
  - Still opportunity to compete over which state gets the lion's share of the surplus
  - Conflict is contained by mutual incentives to cooperate

Cooperation

- Bretton Woods System
  - International Bank for Reconstruction and Development (IBRD)
  - General Agreement on Tariffs and Trade (GATT)
  - International Monetary System (IMF)

Cooperation

- International Bank for Reconstruction and Development (IBRD)
  - Development bank ... for Europe
    - US cannot prosper without European markets for its goods
    - Also "bulwark against communism"
    - Marshall Plan
  - Later moves on to ROW (rest of world).

Cooperation

- General Agreement on Tariffs and Trade (GATT)
  - Most Favored Nation (MFN) - reciprocity
  - Iterative (rounds of agreements, Uruguay, Tokyo, etc).
  - Eventually spawns the World Trade Organization (WTO).
  - May also help to explain the EU.

Cooperation

- International Monetary Fund (IMF)
  - The reserve bank for reserve banks
  - Originally planned to hold Sterling
  - Special Drawing Rights (SDRs).
  - Dollars. The liquidity problem.

Conflict

- Bretton Woods System is victim of its success
  - Dual role of money (store of value, medium of exchange)
  - Seignorage
  - Nixon 1973 - takes the dollar off the gold standard.

Conflict

- The same forces needed to develop a supply of $ abroad challenge the strength of currency
    - US exports dollars to serve as world reserve
    - Greater supply reduces value of US currency
    - More $ needed as value declines
    - World economy gets bigger
    - More $ needed
    - Value of $ declines further
- Store of value is function of confidence
    - Declines in supply of currency
- Medium of exchange is function of availability
    - Increases in supply of currency

Conflict

- The gold exchange standard may, but does not necessarily, help in relieving a shortage of world monetary reserves. It does so only to the extent that the key currency countries are willing to let their net reserve position decline through increases in the short-term monetary liabilities unmatched by corresponding increases in their own gross reserves. If they allow this to happen, however, and to continue indefinitely they tend to bring about a collapse of the system itself through the gradual weakening of foreigners' confidence in the key currencies. - H.D. White (US Rep. at Bretton Woods)

- As dollars held abroad rose relative to U.S. gold reserves

- Confidence in the convertibility of dollars into gold weakened

Conflict

- Seignorage
  - U.S. policies shift domestic U.S. inflation on to foreign economies
  - Sanctions and use of economic institutions for political objectives