

# Today's menu

- I. The Nation in the international economy: Economic Nationalism
  - Assumptions:
  - Policies
  - Size and structure
  - Liberal Response and Econ. Nat. Retort
  - Economic nationalism and war
- III. business cycle
- IV. Great Depression
  - Prosperity,
  - Transition
  - Recession and Depression
  - war
- V. Could it happen again?

# Nations and war

- Nationalism as the ideology of Nations
- Great departure from the liberal ideal.....
  - Reason, rationality, human equality vs. emotion, uniqueness of the nation
  - Economic liberals believe in free trade and the idea that comparative advantage → specialization → trade → international interdependence → peace
  - Nationalism based on difference, often superiority, a permissive condition for war
  - War and the military unite the nation but distort the market, undermine democracy and liberal values

# **economic nationalism in the international economy**

- States are main actors
- They care about their national community and want it to grow
- They pursue power to protect the national community—even from markets
- They want influence over other states to make themselves richer
- No government over states
- States compete with each other to survive
- International trade is a PD game

# Anarchy prevents cooperation:

## Cooperation for Free Trade is a PD game

	Cooperate (free trade)	Defect (protectionism)
cooperate	<p>5, 5</p> <p>Comparative advantage</p> <p>Growth for all</p>	<p>0,3</p> <p>I keep my market open but you close yours; I lose an export opportunity but consumers benefit</p>
Defect (protectionism)	<p>3,0</p> <p>You keep your market open, I close mine, I win, you lose an export opportunity but consumers benefit</p>	<p>3,3</p> <p>We both close our markets; you close yours, I retaliate, you retaliate, and so on.....</p>

# Policies: Protection, Market Control, economic warfare

- Defensive policies: Protect the nation's economy from others in the market
  - Tariffs
  - Non-tariff barriers to trade
- Offensive policies: Market Control
  - Subsidies
  - Dumping
  - monopoly
- Aggressive policies: Economic Warfare
  - embargoes
- Retaliation

# What policy you pursue depends on how big you are

- Trade gives small states more benefits than large ones
- Trade enmeshment isn't good for any state's social stability, big or small
- Large states can easily close their markets, small states can't.
- Large states can use their markets to create political influence, leverage (embargos, threats of closure, etc.)
- They can also use their resources to create a liberal international economic system.
  - Can offer its open market, cheap exports, trade finance,
  - But then they're bound by the rules of membership in that system (WTO)

# The liberal response

**Rant!**




# The Economic Nationalist's Retort

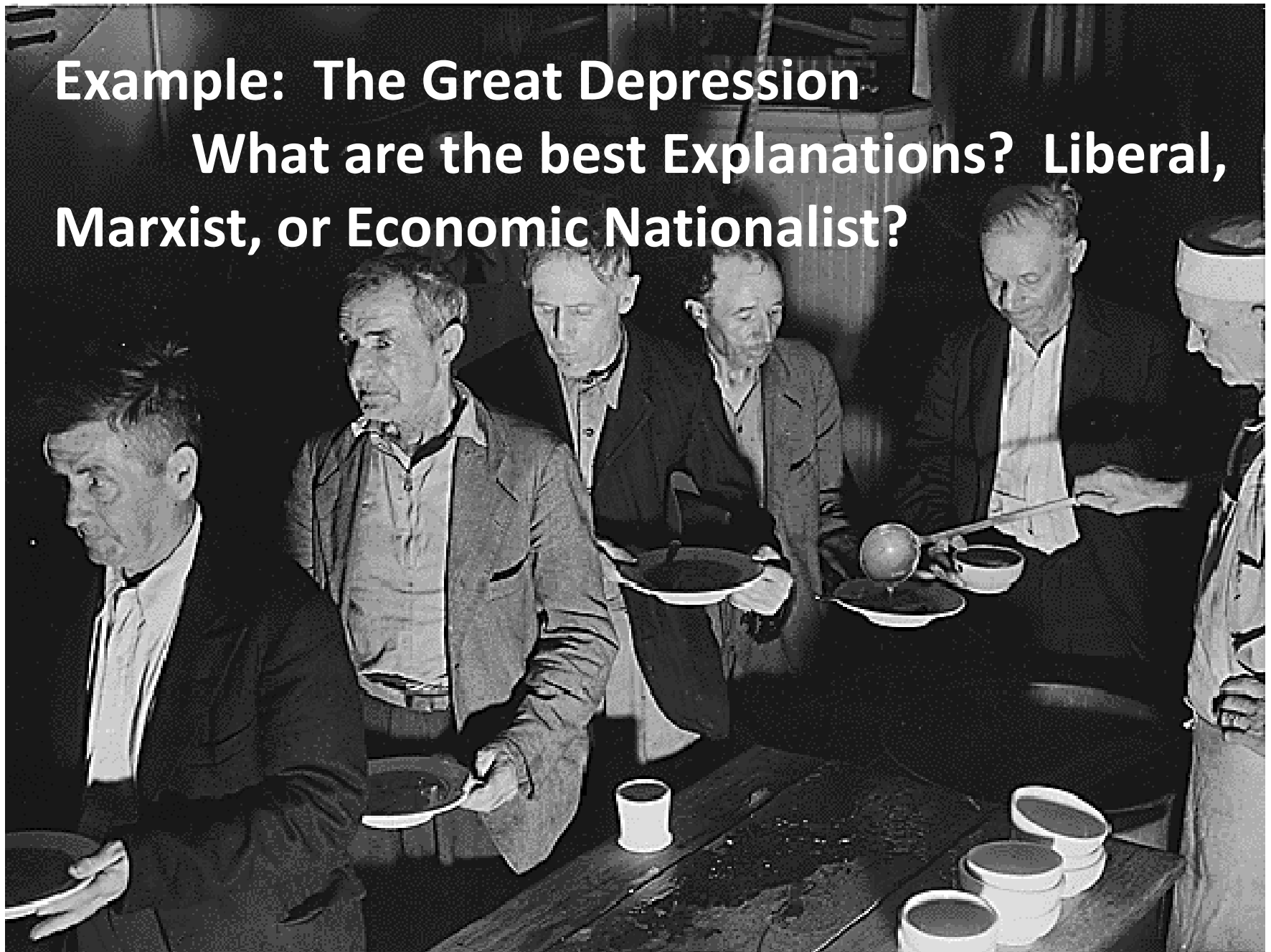
- What's good for the whole system (aggregate wealth) might not be good for the nation
- The nation must be protected
- The state must accumulate wealth to enhance the power to provide security.



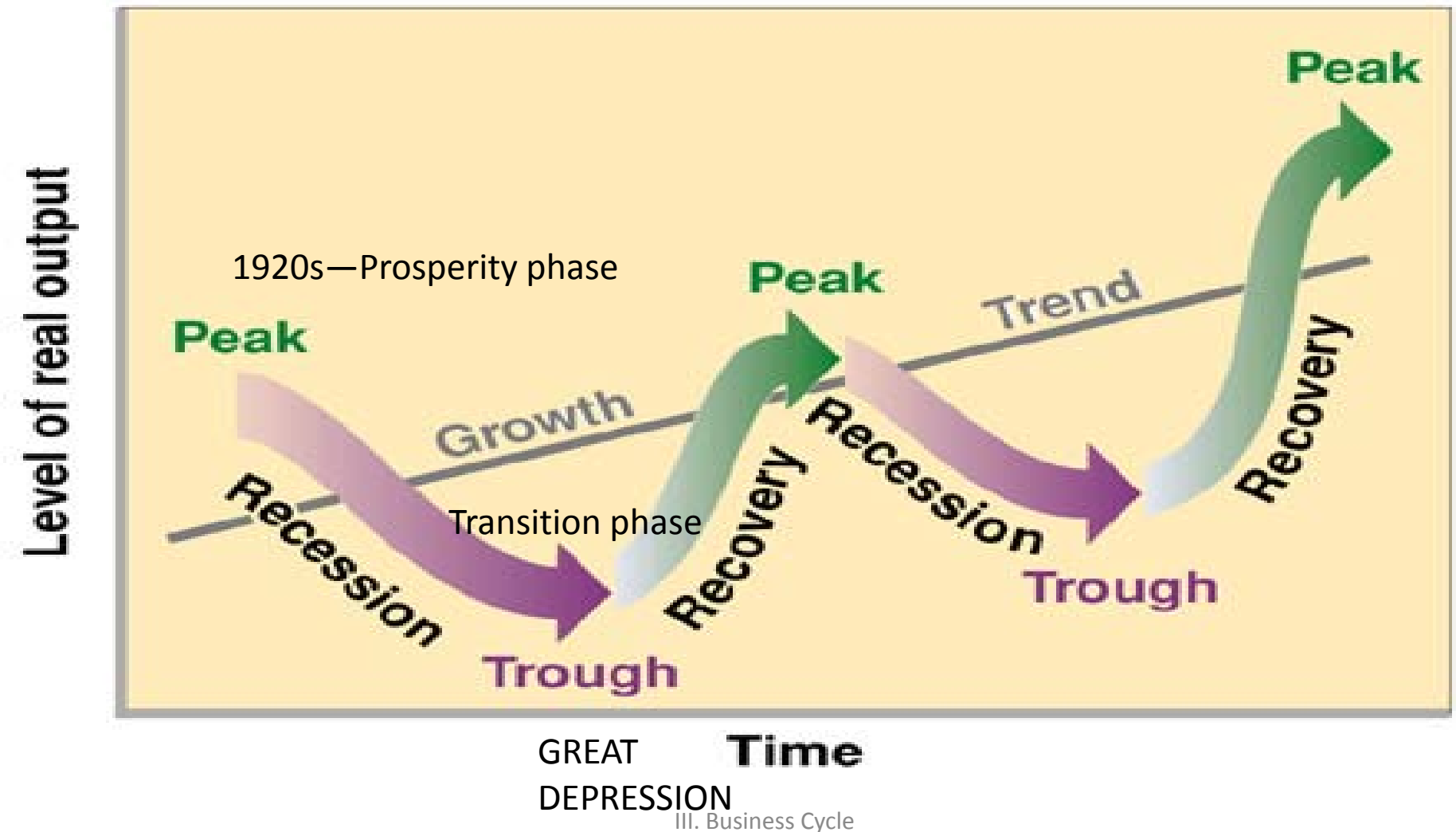
# Nation -states, nationalism, economic nationalism, and war

- Protectionism threatens other nation-states
  - Market control threatens others
- 
- Nation-states seek to amass resources: imperialism → colonialism, invasion, war, occupation
  - Nation-states build militaries both to protect from aggression and to commit acts of aggression
  - Military-industrial complex and in liberal societies
    - Privatization of the military
    - Political “pork barrel” to create jobs shielded from the market
    - War profits
  - Nationalist ideology assists in this project


**Example: The Great Depression**  
**What are the best Explanations? Liberal,  
Marxist, or Economic Nationalist?**







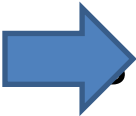
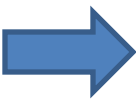
# Liberal Explanation: The Business Cycle



# Review: Prosperity Phase

- the economy is operating at or close to full capacity.
  - New jobs → full employment → union growth
- 
- Increased lending and spending → growth in aggregate demand.



# Transition phase.

- Growing demand for loans -→  interest rates above the expected return on some proposed investments.
- Wage demands exceed gains in productivity.
- **Production inputs become more expensive.** 
-  costs of doing business increase across the board, the profit margins of firms begin to fall.
- Some firms lay off workers, → unemployment growth
-  rate of investment business  firms sell off inventory  prices fall

# Recession or Depression Phase

- consumer borrowing and spending slow down → Firms postpone capital spending + lay off more workers → exports decline = deflation
- Pessimistic mood

# Moving back to the prosperity phase

- Decline in currency value →  exports →   
**Investment**
- Businesses start to buy more inputs and more labor.
- New jobs spur consumer optimism → increased spending.

# Prosperity

- <http://www.youtube.com/watch?v=iLnDPntfNFw&eurl=http://kassandraproject.wordpress.com/2008/10/10/economical-crisis-real-or-caused-stock-crash-and-market-crisis/>



# The Prosperity Phase in the 1920s: International Interdependence and the division of labor

- The Liberal Dream comes true!



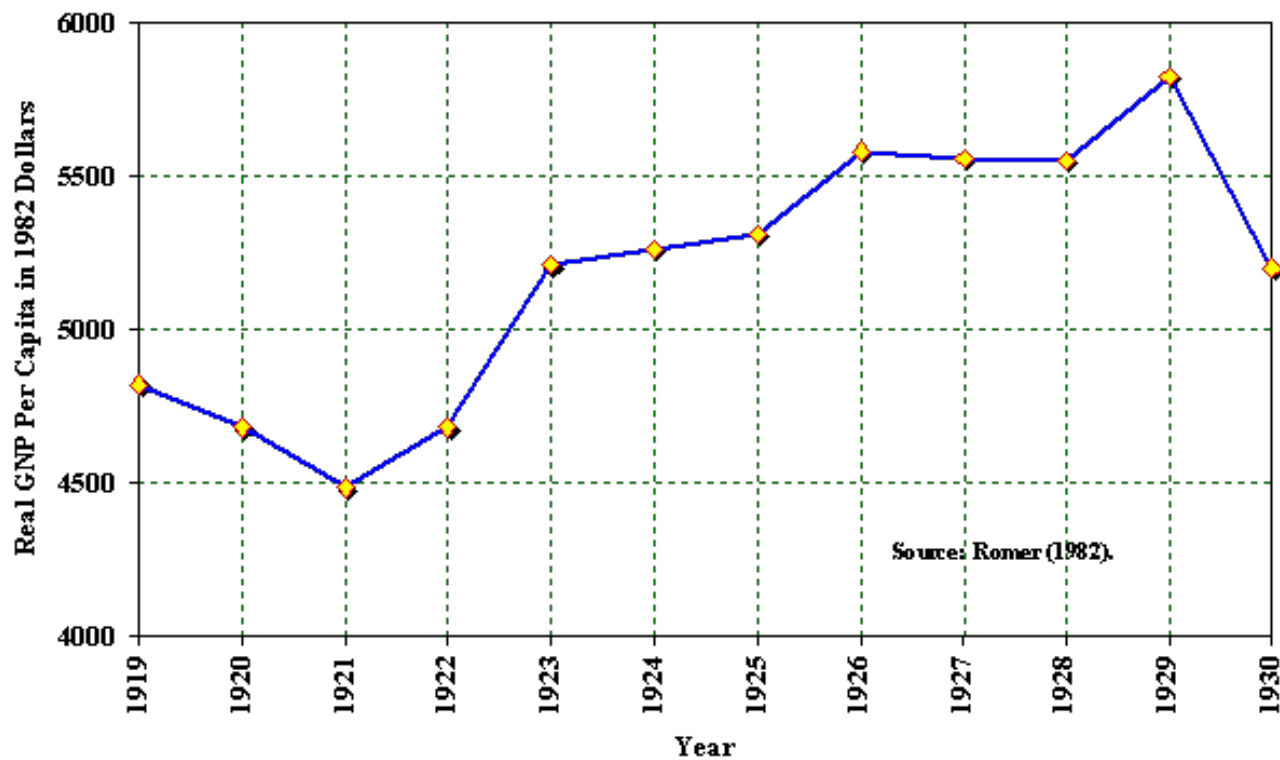
## Consumerism

## Advertising



# Economic Growth

**Figure 1: Real GNP Per Capita, 1919-1930**



# The gold standard led to more trade

- The Gold standard
- Freely exchangeable currency
- Gold Standard led to fluid exchanges in trade
- Multilateralism in Trade
- Comparative Advantage was working
- The beginning of consumer credit
- Growth of banking sector



# Britain as the world's creditor





**But while all are thriving.....Germany failed the test of the  
Market-Democracy Link: Hyperinflation!**



*Pundits like Thomas Frank deplore the role of interest-group lobbying, but aren't we all part of some interest group or other?*



Great Depression: Germany

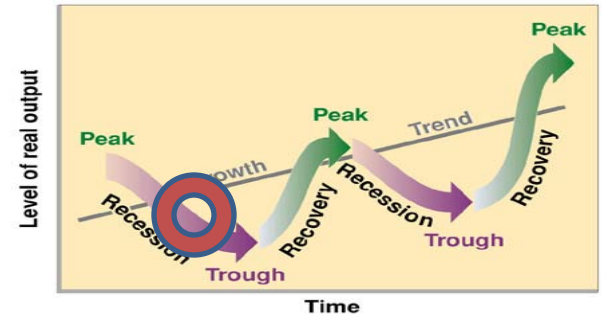
# And Germany is left out.....

The International Financial System  
Under the Dawes Plan and Young Plan  
1924-30

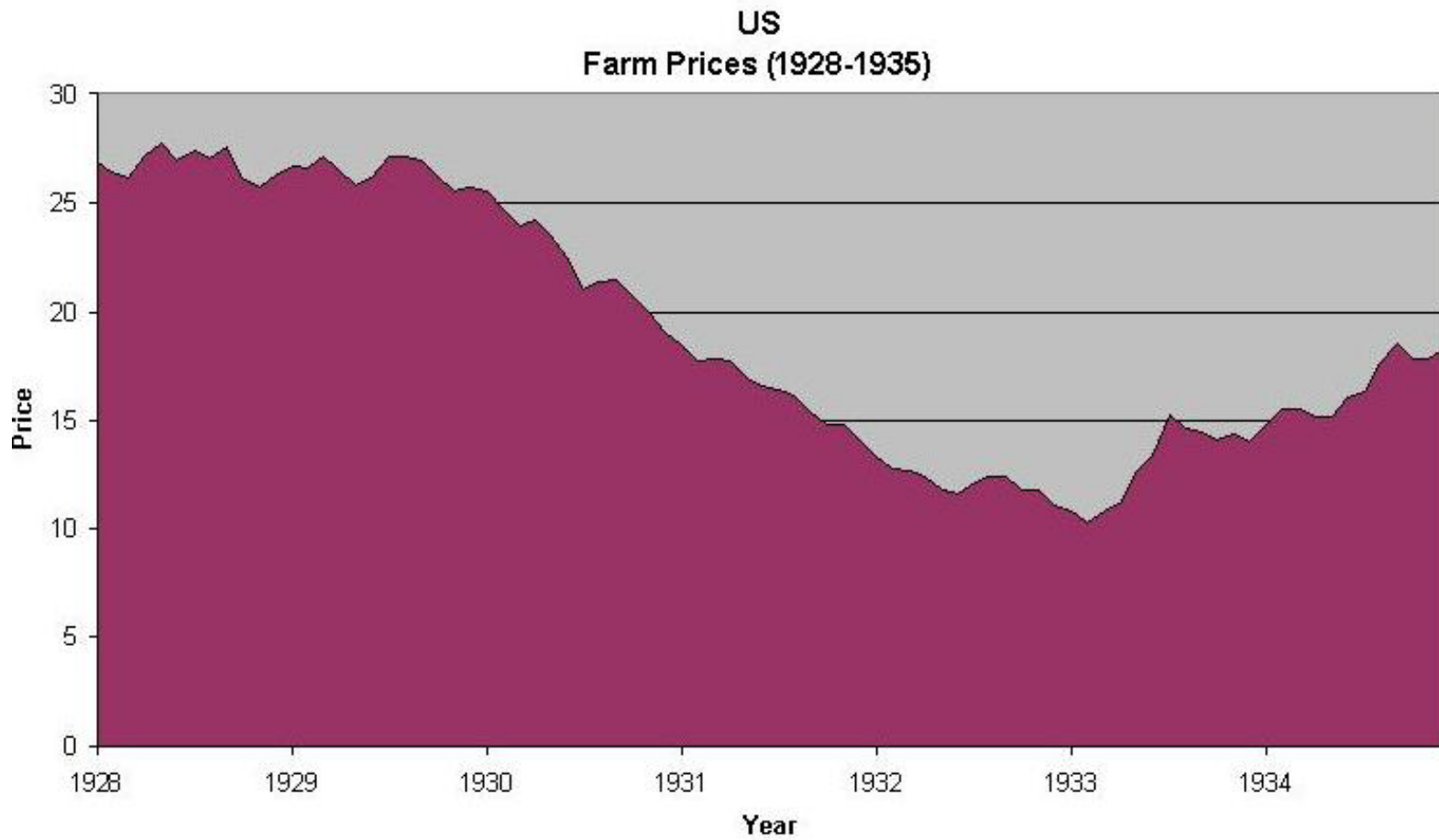


# And there were also hidden problems in the U.S. . . . (transition phase)

- Wages lagged behind profits
- Fewer purchases
- So prices fell
- Especially commodity prices: Farmers couldn't pay debts
- And couldn't purchase goods
- Manufacturing began to lose jobs and profits...



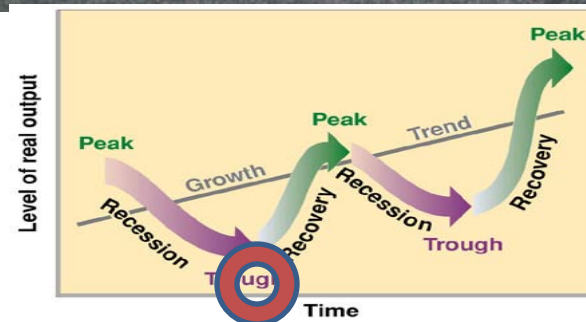
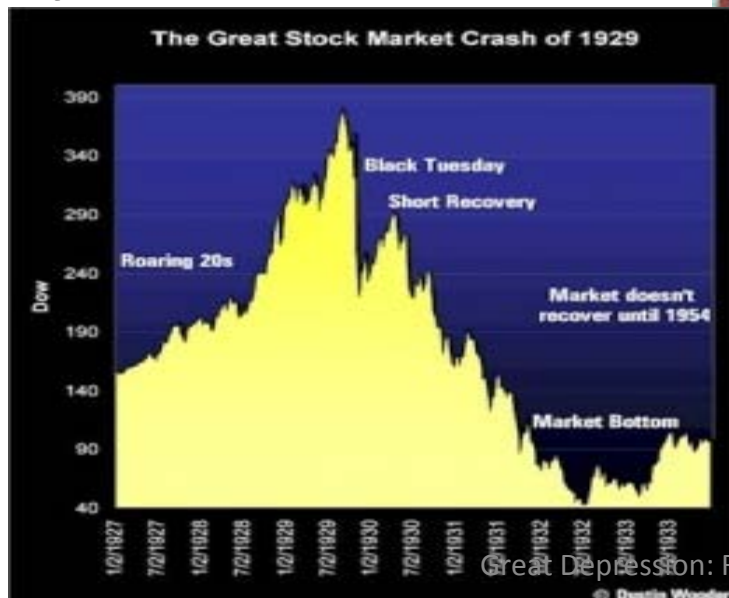
# Agricultural Decline and Depression





# The crash of 1929 and the spread of economic crisis

- World prices plunge
- World Trade falls
- Unemployment skyrockets



# clinging to the gold standard makes things worse....back to Polanyi



*The Silliest Show on Earth*

# Commodification of Money

## The Intl. Gold Standard

- Just like the commodification of labor, Polanyi argued that the gold standard wouldn't work.
- Global Market Place Without Global Government!
- *“Gold standard and constitutionalism were the instruments which made the voice of the City of London heard in many smaller countries which had adopted these symbols of adherence to the new international order”*

# What happens when you are in a balance of payments deficit and you are tied to the gold standard?

- What if a country's economy was declining and it began to import more than it exported. (balance of payments deficit)



# 1) Try to expand your exports (sell more so you can buy more)

- HOW? DECREASE YOUR CURRENCY VALUE BY LOWERING INTEREST RATES.....
- $\downarrow$  interest rates  $\rightarrow$   $\downarrow$  demand for currency  $\downarrow$  currency value  $\rightarrow$   $\downarrow$  price of goods sold abroad  $\rightarrow$   $\uparrow$  exports  $\rightarrow$   $\uparrow$  production +  $\uparrow$  jobs  $\rightarrow$   $\uparrow$  Y  $\rightarrow$  ability to pay for imports  $\rightarrow$   $\uparrow$  currency value
- But NO.....they couldn't do that. Why? **The currency value was fixed to the price of gold.**

## 2) Raise interest rates and deflate the economy even further.....

- Raise interest rates so that speculators wouldn't convert investments into gold.
- $\uparrow$  interest rates  $\rightarrow$   $\uparrow$  increase cost of borrowing  
 $\rightarrow$   $\downarrow$  access to credit  $\rightarrow$   $\downarrow$  production  $\rightarrow$   $\downarrow$  jobs  
 $\rightarrow Y \rightarrow$   $\downarrow$  demand for goods  $\rightarrow$  more  $\downarrow$  production  $\rightarrow$   $\downarrow$  jobs
- **This won't do either! Why?**

# Protest



# **The Gold Standard left governments immobilized**

- Why?
- What was the way out of immobilization while still clinging to the gold standard?
- Was the system really “self regulating?”
- Britain’s role



# **Depression took away Britain's ability to be the world's creditor**



# **Without credit, governments would be toppled if they clung to the gold standard**

- Their only choice was to deflate their economies and deflation was unacceptable....
- So they abandoned gold
- **And unmasked the unsustainability of the gold standard**

# **And unmasked the unsustainability of the gold standard**


- Just like the commodification of labor, Polanyi argued that the gold standard wouldn't work.
- Global Market Place Without Global Government!

# Leaving the Gold Standard Standard

DECEMBER 24, 1913-SIXTEEN PAGES-PRICE TWO CENTS

## PRESIDENT'S SIGNATURE ENACTS CURRENCY LAW

Wilson Declares It the First of Series of  
Constructive Acts to Aid Business.



**WILSON SEES DAWN OF  
NEW ERA IN BUSINESS**

Aims to Make Prosperity Free to  
Have Unimpeded Momentum.

**Makes Speech to Group of  
Democratic Leaders.**

Conference Report Adopted in  
Senate by Vote of 43 to 26.

Banks All Over the Country Hasten to  
Enter Federal Reserve System.

Gov-Elect Walsh Calls Passage of Bill  
A Fine Christmas Present.

**HOME VIEWS OF FOUR PENS USED  
CURRENCY ACT BY PRESIDENT**

# Currency values plunged.....



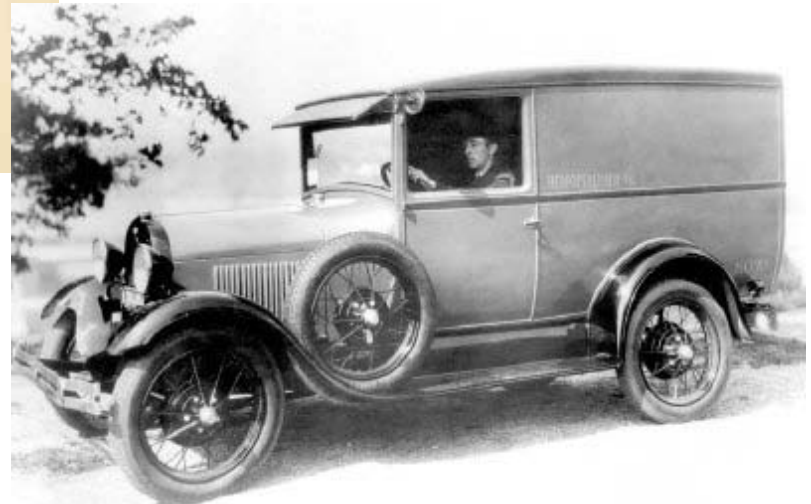
# Protectionism: Tariffs, quotas, and other trade barriers enacted



# The world responds with economic nationalism



# Trade stops, US economy declines even more





# **The Tendency toward Economic Nationalism**

- **The Logic of Protectionism**
  - **Contradictions between needs of the domestic political economy and the International economy**
  - **Markets require national economies to be open for free trade to flourish**
  - **But markets fluctuate and can have negative effects on society**

# The imperatives of the market vs. needs of the national community

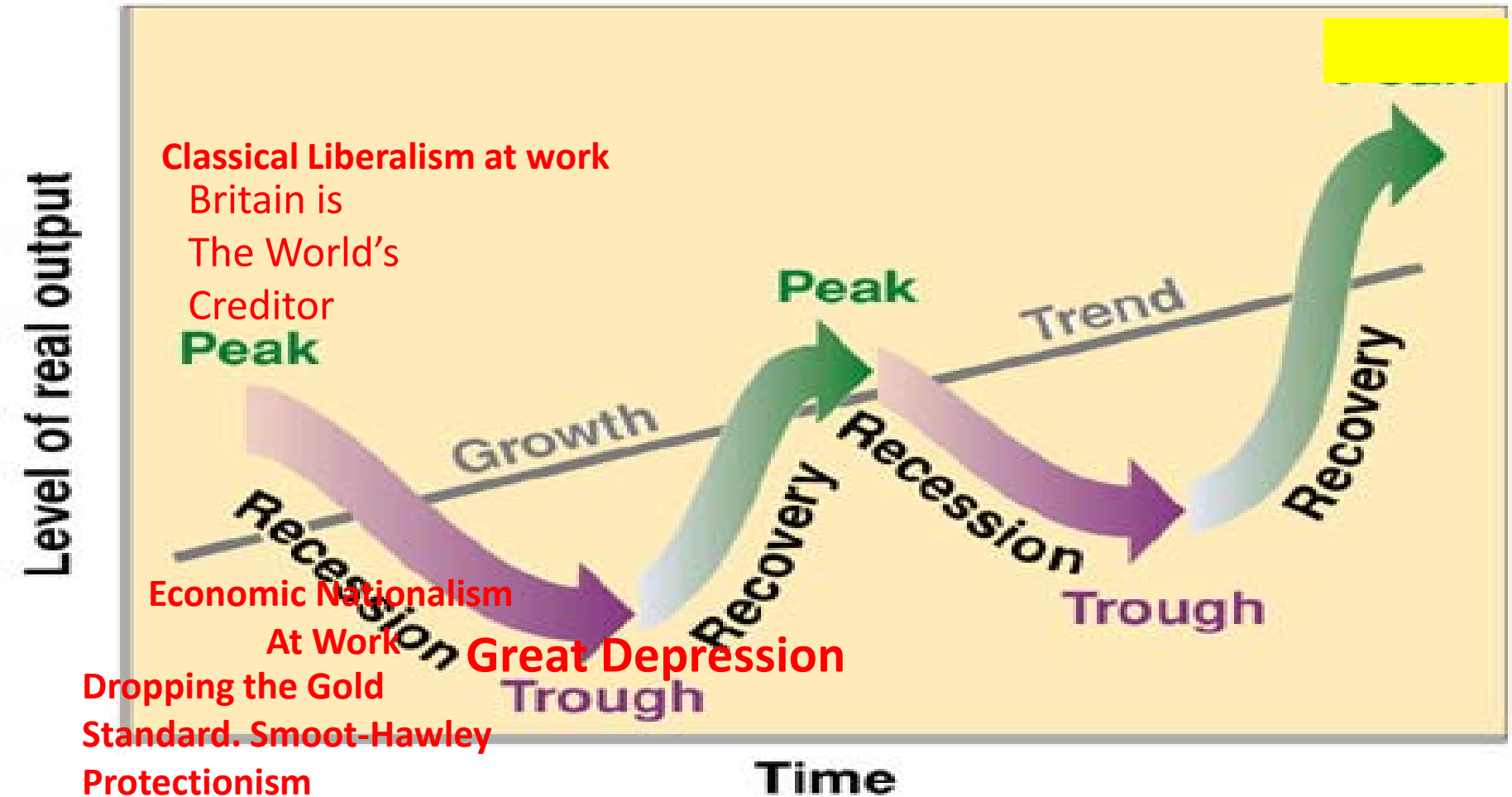
- Market imperatives
  - The business cycle
  - Free Trade creates losers and requires “adjustment”
    - Losers are free to fail
- Political Imperatives
  - Nations and states need political and social stability—losers are must have a safety net because they are citizens of the “nation”
  - The political need for stability and the requirements of the market are contradictory under the above conditions
- Governments must intervene in markets
  - to protect the “nation”
  - They can topple when society is unstable

# Tendency toward economic nationalism: explaining protectionism as a PD Game

	Cooperate (free trade)	Defect (protectionism)
cooperate	5, 5 Comparative advantage Growth for all, I keep my market open even with BOP deficits because I know things will get better	0,3 I keep my market open but you close yours; I lose so eventually I will retaliate
Defect (protectionism)	3,0 You keep your market open, I close mine, I win, you lose and eventually you retaliate	1,1 We both close our markets; you close yours, I retaliate, you retaliate, and so on.....no more free trade

**Contradictions between needs of the domestic political economy and the International economy**

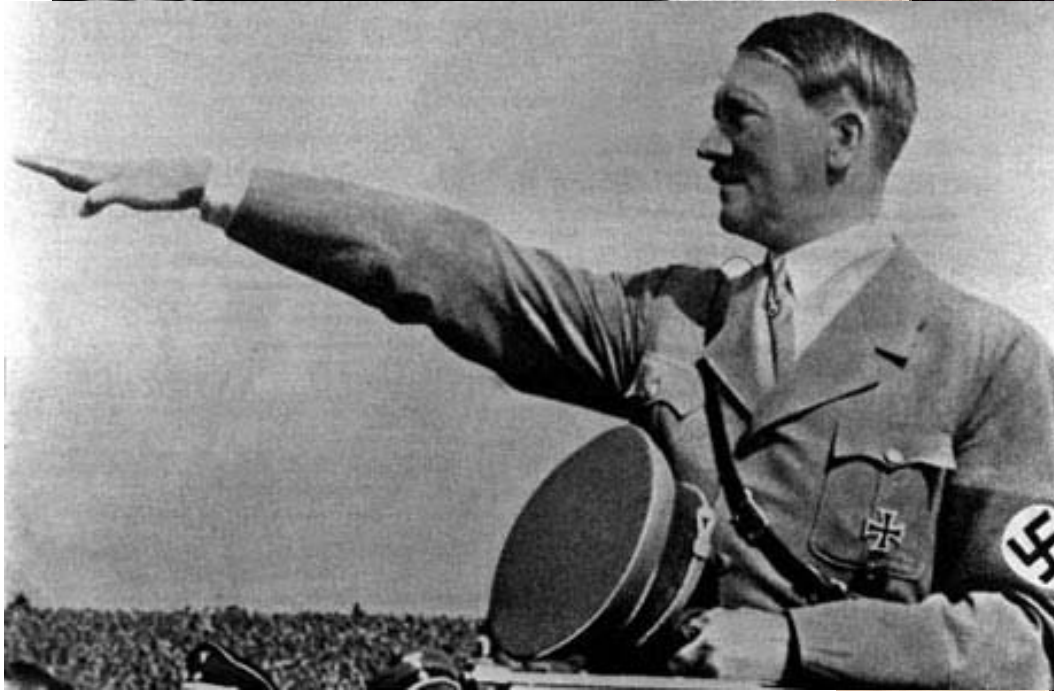
# Sure enough....the world moved from Liberalism to Economic Nationalism



# Capitalism in Crisis: The Great Depression and backlash against liberalism



**The Great Depression showed that the classical liberal response was too risky for governments**







Hitler auf seinem Deutschlandflug bei der Zwischenlandung in Danzig

# Deutschland erwacht!

In allen Ecken der deutschen Nation ruft  
Adolf Hitler das erwachende Volk zum  
Befreiungskampfe auf.



Hitler beim Verlassen  
einer neuerrichteten  
nationalsozialist.  
Geschäftsstelle.



Oben:  
Hitler schreitet die  
Front der S.A. ab.

Nebenstehend:  
Die Jugend begrüßt  
den Führer des  
kommenden  
Deutschlands.

Unten:  
Hitler spricht mit  
mecklenburgischen  
Landarbeitern.

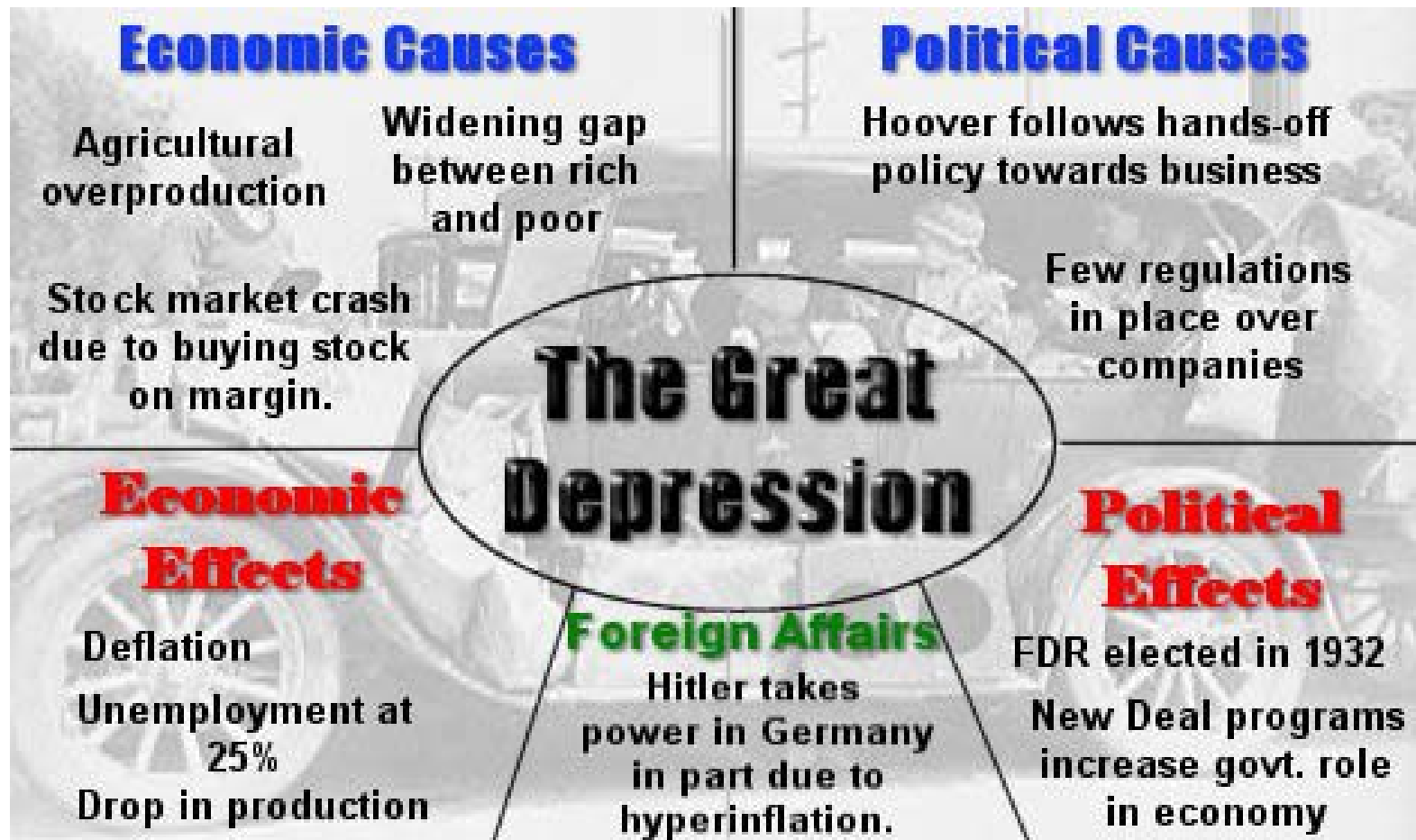


# War and Genocide





# Overview: Cause and Effects



**Could it happen again?**

