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Continued from last time...

III. Pros and Cons of Free Capital Movements

Pro: Efficiency gains because capital can move to where it is most productive (in some LDCs productivity of capital is higher than in DCs).

Con: Vulnerability to crises, because capital can move out of countries very quickly. FDI is very illiquid so it is difficult to pull out suddenly, but financial capital is very liquid and very mobile.

IV. Debt Problem of the 1980s (mostly Latin America)

LDC borrowing at high levels at high interest rates.

Why high interest rates?

1. high productivity (high returns to capital)

2. High risk

LDC governments get involved in borrowing, they actually do a lot of borrowing and also guarantee some loans that private sector took out.

Role of Oil: Oil prices rose in the 1970s and OPEC nations made a lot of money. They lent a lot of this money to DCs, and then DCs lent this money to LDCs ("recycling Petro dollars"). LDC debt rose and servicing the debt became increasingly difficult in the 1980s. Also, there was a US recession in 1980-81, causing the US to import less and thus causing LDC exports to fall, thus making it more difficult to service their debt. There was also an appreciation in the US dollar, and since LDCs had borrowed in dollars, this also increased LDC debt (in terms of their own currency). LDC inflation was also a problem, as was overvaluation of their currencies.

Results: DCs accepted smaller payments on their debt (rescheduling the debt), and the world was then not willing to lend as much throughout the 1980s (The "Lost Decade").

V. The Asian Crisis of 1997

Thailand, Philippines, Malaysia, Indonesia, S. Korea. All had Pegged Exchange rates. A sudden and inexplicable loss of confidence occurred, speculators tried to pull their money out and this forced devaluations.

"Contagion": spreading crisis to other countries through expectations. This contagion caused the crisis in other countries (not some problem, just the expectation of a problem).

GLOBALIZATION

I. Symptoms of Globalization

A thru C:

- Trade has grown faster than GDP
- Trade in services has grown faster than trade in goods
- FDI has grown faster than the above

An increasing share of world production is being done by MNEs (Multi-national Enterprises). There is a global market for capital (more integration of capital markets) and also more of a global market for labor:

- Employers can move from place to place, with workers in those different places therefore competing for jobs internationally.

D. Fragmentation

The splitting of production processes, in order to produce in different places (maybe different countries). Fragmentation has been increasing and has been facilitated by improvements in communication and transportation.

Continued in next lecture...