International economics

Lindert and Kindleberger

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Preface

The fascinating turmoil in the world economy continues to shape the study of international economics. Japanese exports continue to invade new markets the world over, provoking renewed cries for protection. OPEC has delivered a second major oil shock, followed by a world recession and oil glut in 1980–81. The dollar has fallen and risen in ways that challenge established theory. International relations within North America are troubled by Canada's plans for the "Canadianisation" of industry and by the vexed question of immigration policy. We have taken on the task of suggesting what new analysis these events require, while at the same time showing how they are often easier to understand when one uses analytical tools already at hand. There are gains from trading between the study of events and the study of theory, and we have tried to show the comparative advantage of each side.

We have extensively revised our presentation of trade dynamics and trade policy. Chapter 5 offers an improved treatment of unbalanced growth, immiserizing growth, and the intriguing issue of when and why international technological leadership changes hands. Chapter 8 gives new perspectives on export subsidies, countervailing duties, dumping, and socialist trade. Chapter 9 now analyses the Common Agricultural Policy of the EC in the larger context of farm-program political economy. OPEC dominates the chapter on cartels (Chapter 10), just as it dominates the world macroeconomy. Chapter 11 takes a fresh and orderly look at the issues in the continuing North-South debate.

Our exploration of international finance and macroeconomics reflects the unmistakable march from the earlier focus on payments between nations toward a focus on exchange rates between currencies. The task of explaining exchange rates in the light of recent events and advances in theory occupies center stage in Part III, with Chapters 13 and 17 summarizing the core of what is now known (or believed) about why exchange rates rise and fall. The key policy issue of how to stabilize an open macroeconomy is weighed in a newly streamlined fashion in Chapters 19 and 20. A new chapter (Chapter 22) on the changing nature of world money now helps to explain the evolution of international money from the commodity (gold) standard to today's free flows of offshore Eurocurrencies.

We have also sought to improve and update the treatment of international factor movements in Part V. In particular, Chapter 23's essay on the policy stakes in international migration should help students judge this issue with care and sophistication.

In this task we had help. Our thanks are again due to the hosts of students, colleagues, and teachers on other campuses who volunteered suggestions for improving on earlier editions. We are particularly indebted to Don Chaffee of Golden Gate University, Betty Chu of California State University at San Jose, Robert A. Flammang of Louisiana State University, Thomas J. Grennes of North Carolina State University at Raleigh, Paul D. McNelis of Georgetown University, and Arvind Panagariya of the University of Maryland for their insightful suggestions.

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1 The study of international economics

The subject matter of this book will always require a separate body of analysis, distinct from the rest of economics. The mere existence of sovereign nations introduces complications requiring that we make changes in our ordinary tools of economic analysis before we can apply them to international economics. These complications are what makes the study of international economics fascinating and sometimes difficult. Future events are certain to keep reminding us of the problems that are special to international economics. To see why, let us look at four events since the early 1970s that have shaped the approach and subject matter of this book.

FOUR EVENTS

Floating the dollar

In a dramatic televised speech on August 15, 1971, President Nixon stunned both the nation and the world by announcing a new economic policy. On the domestic front he unveiled a freeze on wages and most prices, plus some tax changes, designed to check inflation overnight without adding to unemployment. On the international front he ended one era and began another with a few terse sentences announcing that the value of the U.S. dollar must be changed in terms of other nations' currencies and gold. He had his way on the international currency issue. Soon the exchange rates between the dollar and other currencies were drifting toward higher values for other currencies and lower values for the dollar. Suddenly international travelers, long accustomed to fixed exchange rates between dollars and other currencies, found that their dollars exchanged for fewer German marks, Japanese yen, and other currencies. The change also affected firms and individuals trading goods between countries. U.S. firms such as Boeing found it easier to sell their aircraft and other products abroad now that foreigners felt that they could afford more dollars and more U.S. goods priced in dollars. Foreign firms used to selling large amounts of goods to the United States felt a new kind of pressure. Volkswagen found that the same dollar prices for VWs in North America brought it fewer West German marks with which to pay West German workers and shareholders. It soon had to raise its car prices in dollars, losing some business to its U.S. and Canadian competitors.

The change brought a different kind of crisis headline to the newspapers. Before August 15, 1971, the system of keeping fixed rates of exchange between national currencies had been cracking, with increasingly frequent "balance-of-payments crises." Now the headlines began to shift, dropping the usual references to the balance of payments and replacing them with news of rising marks, falling dollars, and wavering pounds. Officials felt at least as much sense of crisis as before and hurriedly arranged meetings to deal with the new system. Meeting at the Smithsonian Institution in Washington on December 18, 1971, the governments and central banks of major countries announced an agreement to make the dollar worth less in gold and a few major currencies, and to try to hold fixed the new exchange rates between certain European currencies and the dollar. Yet the float more or less continued, with further changes in the ability of each currency to buy others, despite the Smithsonian agreement and a second round of unsuccessful attempts to make rates more fixed in early 1973. By July 1973 the U.S. dollar had sunk in its ability to buy other currencies by about 26 percent relative to the exchange rates of three years earlier.

Whether the new system of fluctuating exchange rates was better or worse than the system it replaced is a very complex issue that will be pursued in Parts III and IV of this book. Yet it is clear that this issue is unique to the international sphere in economics. Exchange rates do not change between Kansas and Missouri, or between Alberta and British Columbia. The usual tools that economics applies to domestic issues have to be modified and extended if we are to make sense of what changes in exchange rates mean to ordinary people.

The American import invasion and protectionism

Since the early 1970s the United States has debated another kind of policy move that is unique to the international side of economics:

measures to clamp down on the import of foreign goods into the United States. The pressure to do so had been building for some time, as one U.S. manufacturing industry after another felt the competition of rising imports. The United States was importing larger and larger shares of its clothing, steel, automobiles, motorcycles, radios, TV sets, ships, and other products. A CBS documentary at the start of the 70s, entitled "Made in Japan," scared viewers by arguing that more and more of them would lose their jobs to foreign competition that was unpatriotically backed by U.S.-based multinational firms ("You can be sure if it's Westinghouse—it's made in Japan"). Even the Stars and Stripes were being imported from the Far East. The U.S. trade surplus dwindled, and in 1971 and 1972, for the first time since World War II, the United States imported a greater value of goods and services than it exported.

The rising fear of losing jobs and profits to import competition caused many congressmen to switch to favoring import restrictions, such as higher tariffs (import duties) and tougher quotas (quantitative limits on imports). A protectionist (import-cutting) bill was passed by the U.S. House of Representatives and by a Senate committee late in 1970, but it narrowly missed passage.

The pressure continued largely because the largest organized labor group, the AFL–CIO, was vehemently determined to push for protection against imports. From late 1971 through mid-1973, Congress debated the historic Burke-Hartke Bill, which would have slashed imports into the United States and put new limits on the ability of U.S. firms to set up manufacturing subsidiaries abroad, in order to defend U.S. jobs. The bill ultimately failed to pass and even yielded to a moderately trade-liberalizing law at the very end of 1974.

The battle over U.S. import protection remains heated. Some threatened industries have won minor help from Washington. In 1977 the beleaguered and stagnating steel industry won import-limiting quotas, "anti-dumping" tariffs and minimum-price rules that checked some of the industry's relative decline. Partial protection against the import invasion was also given to U.S. suppliers of beef, sugar, footwear, and industrial fasteners. Other industries were less lucky in their lobbying efforts. The U.S. shoe industry was given almost no assistance, to the benefit of U.S. shoe buyers. Meanwhile in electronics, no protection was given, and jobs were lost as plants like the Zenith assembly plant in Sioux City were shut down in favor of new plants in Mexico and Taiwan.

The U.S. auto industry has become the main arena for the trade wars. The early warnings were sounded when Volkswagen "bugs" began to creep across North America in the late 1950s. By 1980 imports accounted for about a quarter of U.S. new car sales, with Japan

Steel workers protest unfair import competition in 1978.

American Iron and Steel Institute

alone taking a fifth of the market. The invasion of cheap and efficient cars has been an undeniable boon for most households. It has been a disaster in eastern Michigan and other auto-dependent regions. There the unemployed stand in long relief lines, General Motors has at times become a nonprofit institution, and Chrysler has been pushed to the brink of extinction despite government emergency loans. Detroit's giant auto firms and the United Auto Workers, long champions of free trade, are clamoring for protection against auto imports.

The issue of protection against imports requires a specifically international analysis. Within nations, such protection is illegal except in subtle and slight forms. California is not allowed to put up, say, a 50 percent tax on all goods and services imported into that state from the rest of the United States. The argument that doing so would protect the jobs of Californians against "unfair" Eastern competition would receive the retort that protecting California jobs in this way would

Angry members of the United Auto Workers protest unrestricted auto imports in March 1981 by smashing a Toyota car near the Ford Motor Company stamping plant in Chicago Heights, Illinois.

Courtesy United Auto Workers, Local 588.

destroy jobs in the companies elsewhere that counted on being able to sell to California. The interests of the rest of the nation cannot be ignored and are explicitly defended against intranational trade barriers by the U.S. Constitution. Yet foreign interests can be more easily ignored, and any analysis of the likely effects of protectionist laws must explicitly distinguish between effects within the nation and effects of foreigners. Such analysis is offered in Parts I and II of this book.

The victory of OPEC

A chain of events in late 1973 revolutionized the world oil economy. In a few months' time, the 13 members of the Organization of Petroleum Exporting Countries (OPEC) effectively quadrupled the dollar price of crude oil, from $2.59 to $11.65 a barrel.[1] Oil-exporting

[1] OPEC was created by a treaty among five countries—Iran, Iraq, Kuwait, Saudi Arabia, and Venezuela—in Baghdad in September 1960. Since then the following countries have joined: Qatar, January 1961; Indonesia, June 1962; Libya, June 1962; Abu Dhabi, November 1967; Algeria, July 1969; Nigeria, July 1971; Ecuador, 1973; Gabon, associate member by 1973, full member in 1975.