

Fifth Lecture

Taming the Beast: Global Money and Finance

In what way is global money a “beast” and why does it need to be “tamed”?

The “Beast”: money and conflict

Money

- Means of exchange
- Store of value
- Unit of account
- Means of deferred payment

What makes money money?

- Non perishable
- Easily divisible
- Liquid

Acceptance

- Gold and labour time
- Symbolic money and the structure of authority and power

Public-Private tension

- Money = Quantity * Price
- Causality: from prices to money, from money to prices, or both?
- Money and prices: which is the “public,” which is the “private”?
- Capital and state

Global money

- More currencies, further complications
- State \leftrightarrow Private
- State \leftrightarrow State
- Domestic private \leftrightarrow Foreign states
- Money and GPE

Balance of payment

- Production and uses
- Current account and the internal balance
- Saving balance and budget balance
- Capital account
- The balance of payments

How does the balance of payment balance?

- Direct adjustment
- Indirect devaluation/revaluation

Monetary order:

- Who rules?
- How?
- Why?

Features:

- **Liquidity. Adjustment. Confidence.**
- **Monetary stability and sovereignty: an oxymoron?**

Monetary orders:

- **Automatic**
- **Supernational**
- **Hegemonic**
- **Negotiated**

Bretton Woods

- **Free trade**
- **Regulated capital account**
- **Stable exchange rates**

Adjustment: IMF and World Bank**Fundamentals: the Cold War**

- **Truman Doctrine**
- **Marshall Plan**
- **The “dollar shortage deal”: supply and demand sides**
- **Flooding the world with dollars**

The reckoning

- **Overvaluation**
- **Challenges to the US**

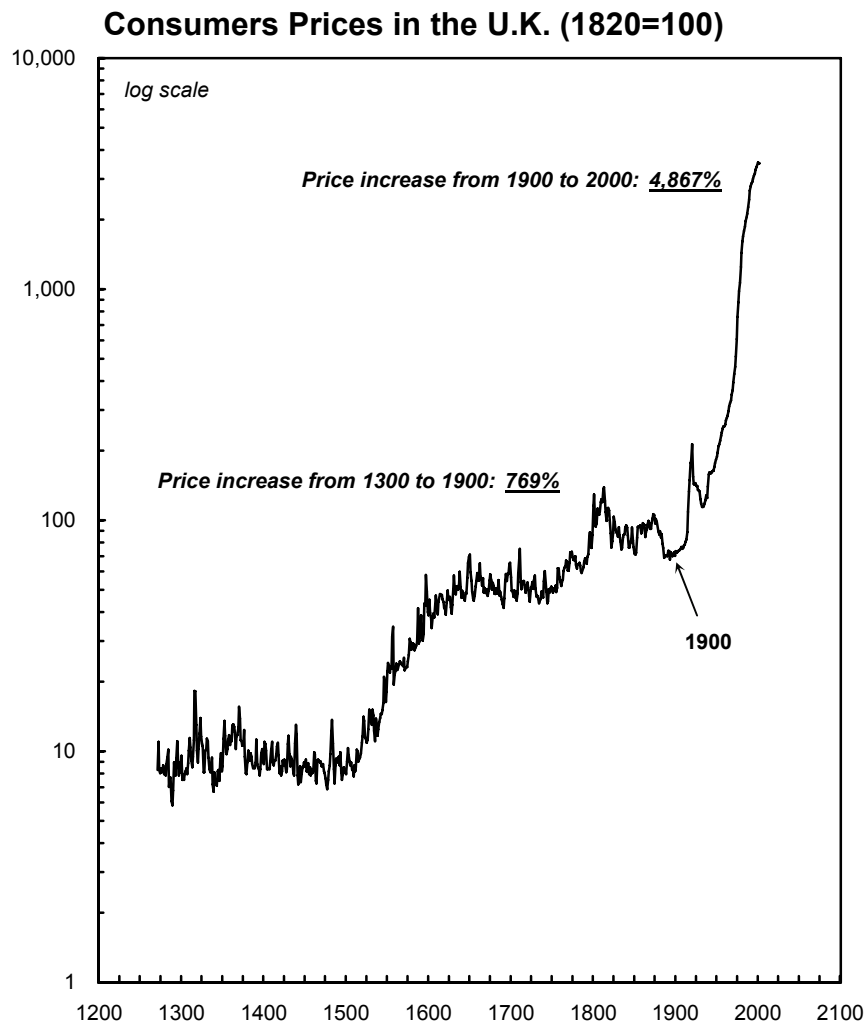
August 1971: The end of Bretton Woods

- **US domestic expansion**
- **Third world politics and global instability**
- **Conflict inflation**
- **Capital movement**

Bretton Woods: An aberration?

- **Capital movement**
- **Trade**
- **TNCs**
- **State vs capital**

A new crisis?



SOURCE: WEFA-DRI; Global Financial Data [back data based on David Hackett Fischer (1996) *The Great Wave. Price Revolution and the Rhythm of History*. New York and Oxford: Oxford University Press].

THE BALANCE OF PAYMENT AND THE DOMESTIC ECONOMY

Production

- (1) ... Gross Domestic Product = Consumption + Investment + Government + (Export–Import)
 $GDP = C + I + G + (X - M)$

Uses

- (2) ... Gross Domestic Product = Consumption + Saving + Taxes
 $GDP = C + S + T$

Combining production and uses

- (3) ... $C + I + G + (X - M) = GDP = C + S + T$
 (4) ... $I + G + (X - M) = S + T$

Current account and the internal balance

- (5) ... $(X - M) = (S - I) + (T - G)$
 Current Account = Saving Balance + Budget Balance
 $CA = SB + BB$

Current account under barter

- (6) ... Current account = 0
 $X - M = 0$

Current account under a monetary system

- (7) ... Current account = Change in Reserves
 $X - M = \Delta Res$

Current account under a credit system (+ve/-ve values denote fx inflow/outflow)

- (8) ... Current Account + Capital Account = Change in Reserves
 $(X - M) + CF = \Delta Res$

- Ex. 1 $\$100 \text{ bn} + (-\$120 \text{ bn}) = \Delta Res$ $\square\square\square\square \Rightarrow \Delta Res = -\20 bn
 Ex. 2 $\$200 \text{ bn} + CF = -\10 bn $\square\square\square\square \Rightarrow CF = -\210 bn
 Ex. 3 $(X - M) + \$80 \text{ bn} = (-30 \text{ bn})$ $\square\square\square\square \Rightarrow (X - M) = -\110 bn

Policy implications

In equation 8, substitute $(SB + BB)$ for $(X - M)$:

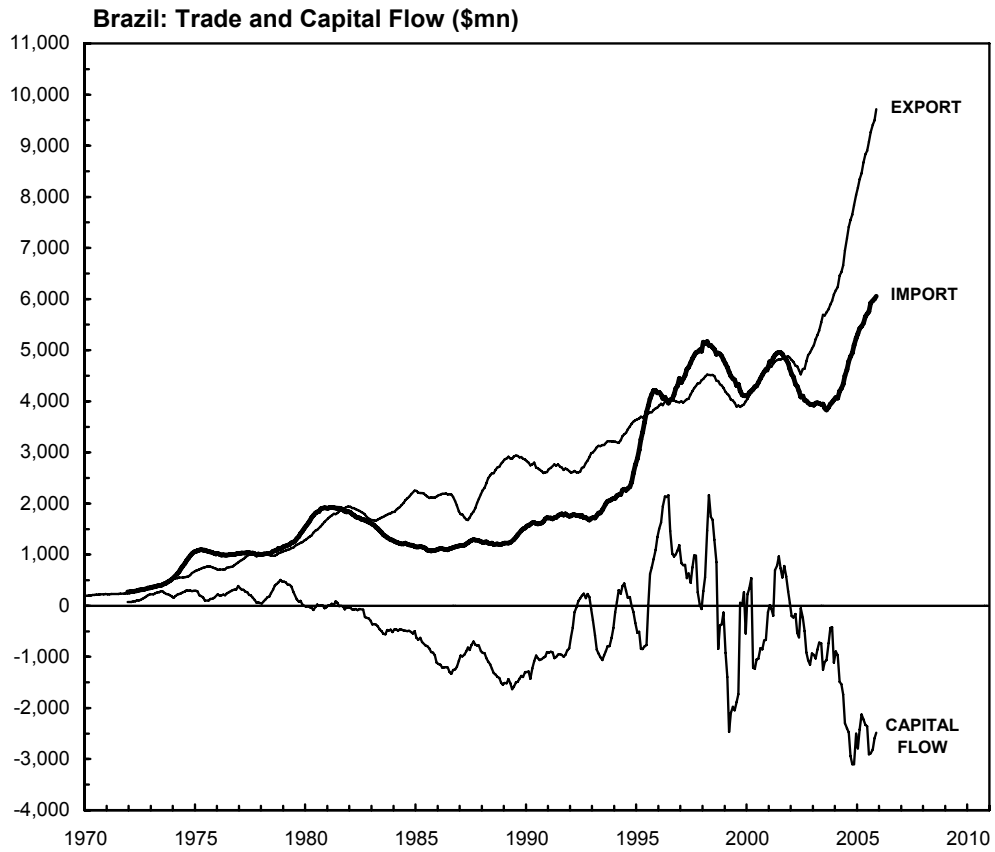
- (9) ... $(SB + BB) + CF = \Delta Res$
 (10) ... $(SB + BB) - \Delta Res = -CF$

Question 1:

The country has \$100 bn in reserves, the saving balance (SB) is -80 \$bn, the budget balance (BB) is -20 \$bn, and there is no capital flow ($CF = 0$). Can this situation continue indefinitely?

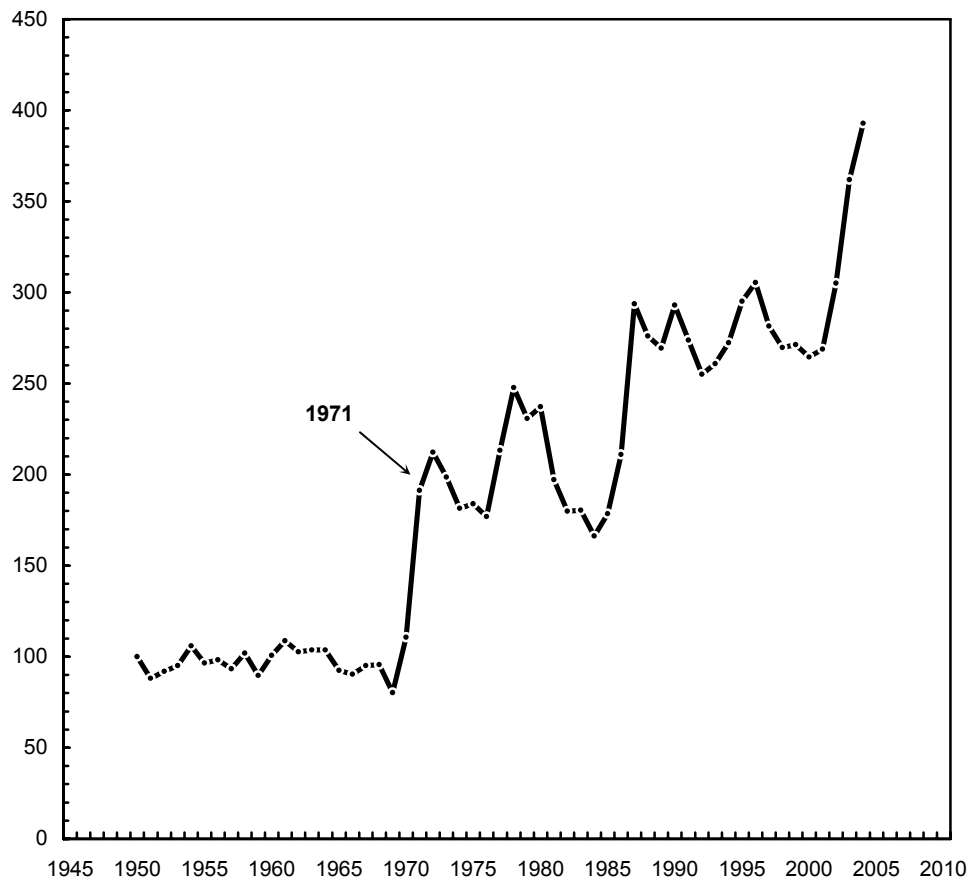
Question 2:

The current account is -100 \$bn ($SB + BB = -100$ \$bn), the capital account is an inflow of 100 \$bn (so $-CF = -100$ \$bn), and the country has no reserves. If capital inflow falls to 80 \$bn, what must happen to SB , BB or the currency?



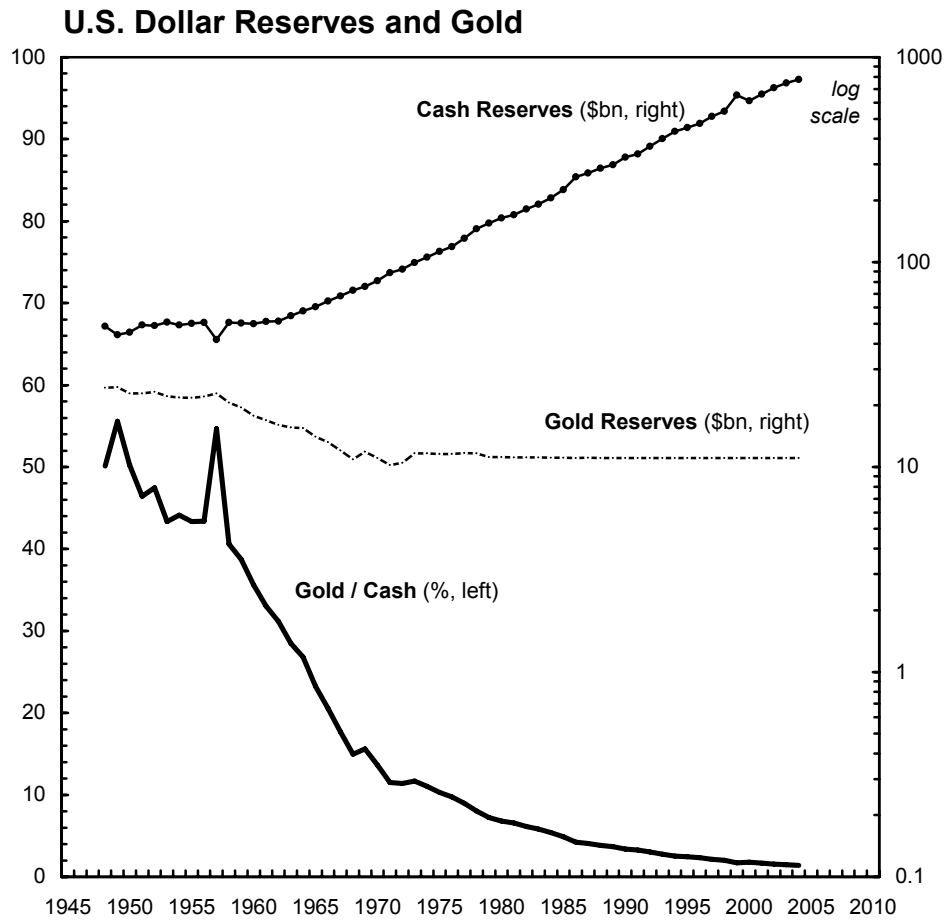
NOTE: Monthly data expressed as 12-month moving averages.
 SOURCE: IMF *International Financial Statistics*, through Data Insight.

"Real Liquidity" Index for the Industrialised Countries

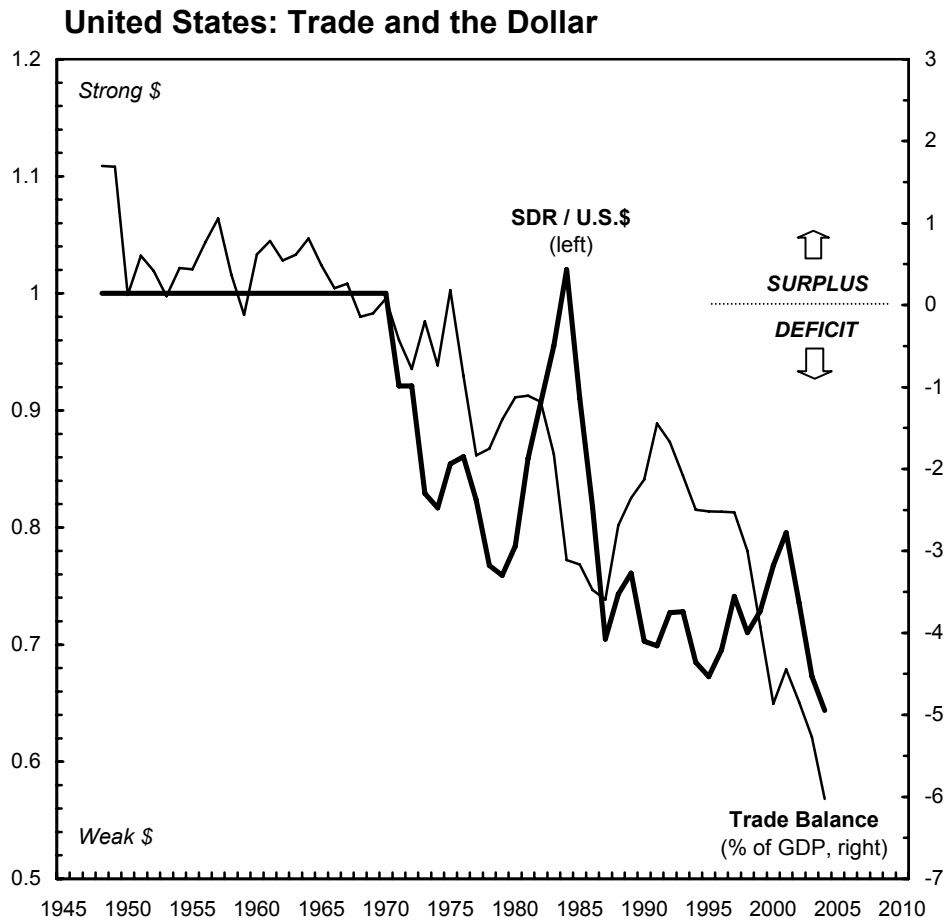


* Computed as a ratio of "real" reserves to industrial production. "Real" reserves are given by foreign reserves minus gold expressed in SDRs, converted to US\$ and deflated by the US CPI.

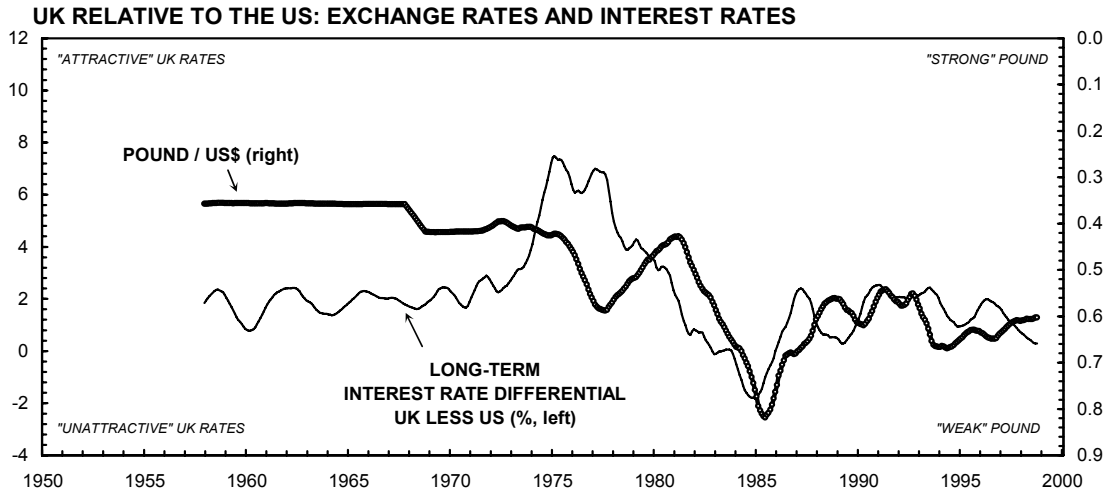
SOURCE: IMF, *International Financial Statistics* through WEFA-DRI



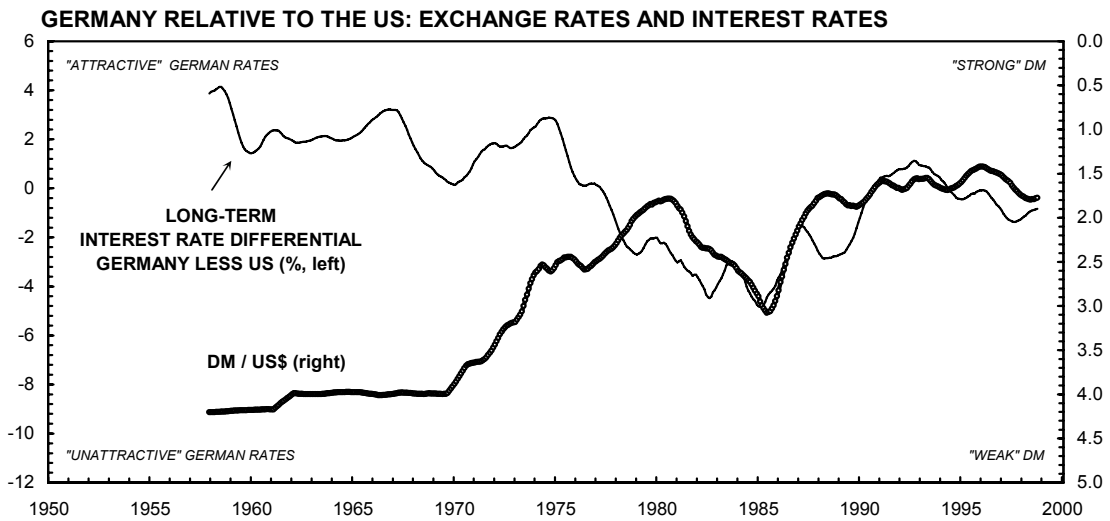
SOURCE: IMF, *International Financial Statistics* through WEFA-DRI



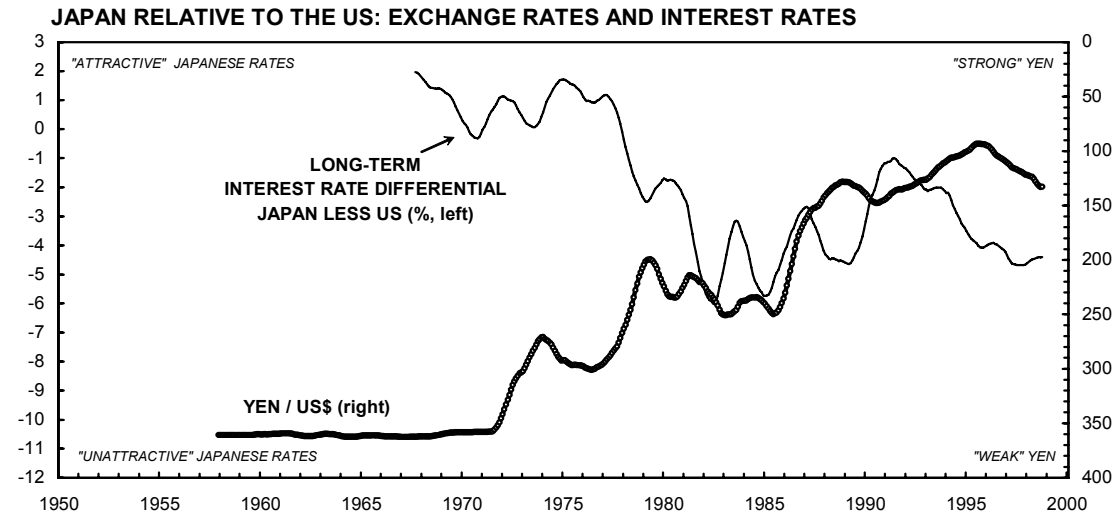
SOURCE: IMF, *International Financial Statistics* through WEFA-DRI



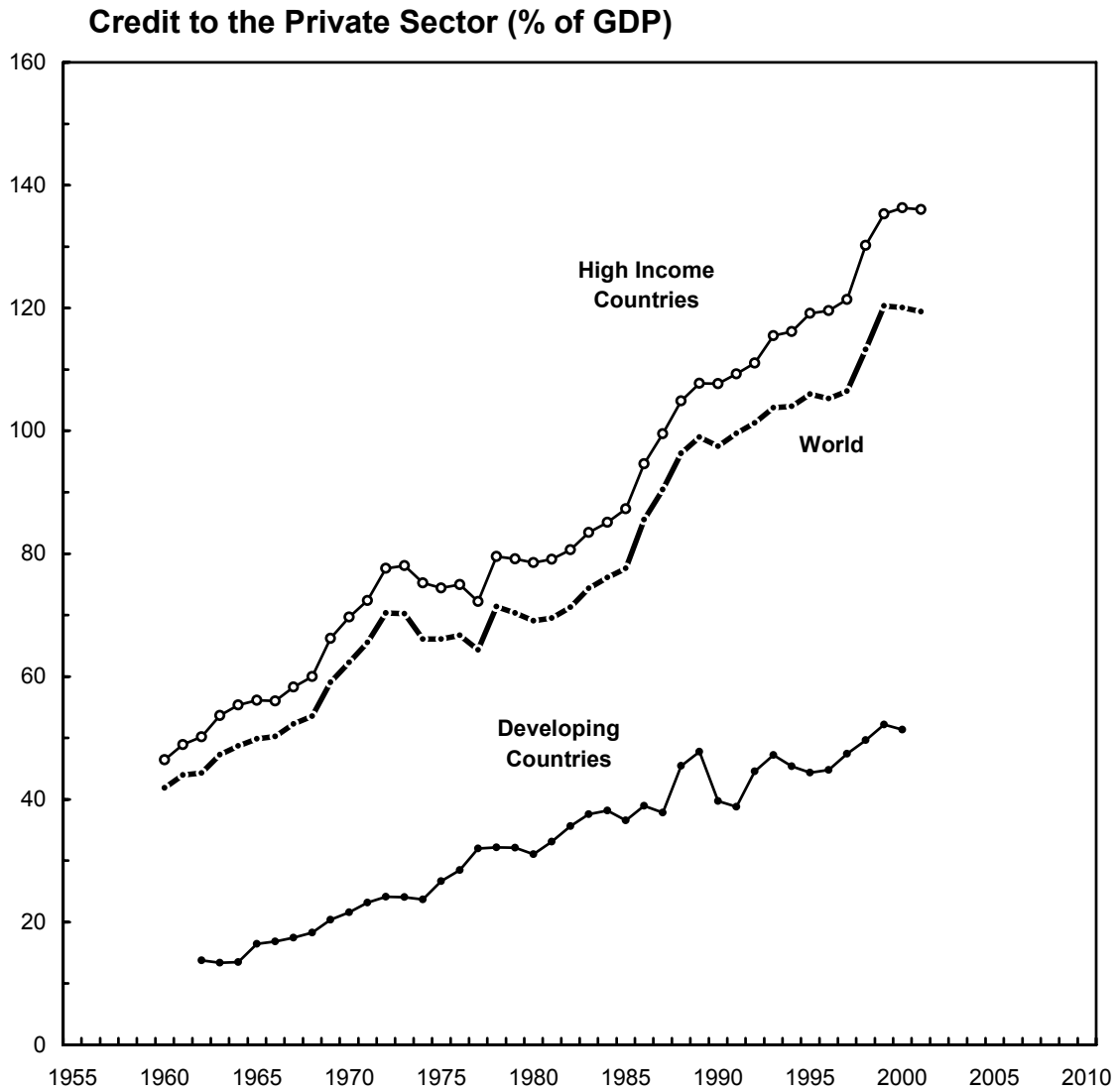
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SOURCE: *World Development Indicators*