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Freeing the World from the Free Market Economy:
A Reexamination of Nation-State Based Capitalism

By

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A thesis submitted to the graduate faculty

in partial fulfillment of the requirements for the degree of

MASTER OF ARTS

Major: Political Science

Program of Study Committee:
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Ames, Iowa

2012

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These first six figures are located in chapter three and utilize the World Bank Development Indicators, which can be found at http://data.worldbank.org. The use and methodology behind these indicators is explained in chapter three. The following figures are found in chapter five. The first is an organizational chart depicting the structure and elements of the Regional Trade Network, the second, depicts an illustrative example utilizing the Ford Motor Company to illustrate firm production placement.

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Abstract

The economy is discussed as a unified whole, but the machine that is the economy is nothing more than the sum of its parts and like any machine sometimes the parts fail and need to be replaced. In examining the role of currency and trade in perpetuating economic crisis we find that four main concerns arise:
1. Currency valuation leads to speculation and market volatility.
2. Ideologies of free trade and trade liberalization are routinely flaunted by developed nations through the use of subsidization and bilateral trade agreements.
3. Economic competition is depleted through the loss of creative destruction and by export-oriented nations using developed nations as consumers of last resort.
4. The current problems create deflation tendencies in the market, which are lasting given the previous aspects.

Thus, this paper identifies the need to address four main points in fixing the economic system:
1. How to retain the ability for capital to be mobile and abundant, in order to continue the process of subsidization within and between nations, but avoid the volatility of a flexible exchange rate system.
2. How to incorporate practices of subsidization and bilateral trade into a new economic system which retains the advantages of traditional trade, but also addresses and corrects the trade imbalances which characterize the current system.
3. How to stimulate real market growth, namely through a process of creating sustainable consumer markets within developing nations and thus ending the 'consumer of last resort' dependence.
4. How to replace the idea of creative destruction with a system that replaces accumulation in developed nations and austerity in developing countries with market opportunities that stimulate innovation and market growth in a sustainable manner.

By addressing these concerns, raised from an examination of the nation-state upheld system of flexible exchange rates, we truly see a possibility for the realization of economic change that will promote real, sustainable, and beneficial growth.

General Introduction: Freeing the World from the Free Market Economy: A Reexamination of Nation-State Based Capitalism

The world today is rife with problems, limitations, and shortcomings. We face new and developing diseases, global climate change, growing disparity between the rich and poor nations, and a myriad of other problems all which represent pressing need, cross-border accountability, and a need for financial backing. The pressing need, cross-border conditions, and need of a large purse in order to attempt to levy any type of useful address to these global maladies lies beyond our current capacity. No single nation or contingent of nations can successfully lead humanity out of darkness, nor can any for-profit or non-profit firms or organization. What is needed, today, is to address the fundamental limitations of our current economic system in order for humanity as a whole to create a fundamental change in order to better our world and create our future.

Though global economic stability and growth can never by itself address the world's problems, economic stability and growth can be seen as a preeminent factor in creating the conditions that allow for benevolent human action to take place. War, restrictive policy applications, and xenophobia are all tied to economic stability. The psychology is applied directly from Maslow's Hierarchy of Needs, which depicts basic needs (food, shelter, etc.) as first level needs, in addition, second

level needs include security (namely the feeling that one can act without fear of immediate change). Economic stability crosses both of these levels, restricting, when it is not present, the willingness and ability for humankind to reach its full potential or self-actualization. For this reason, economic stability must be realized before we can hope to find solutions to the myriad of problems facing humanity. Its basis lies in the idea that we will seek to satisfy our own individual rational interests prior to addressing other concerns. Therefore, based on level of importance to an individual, economic stability is crucial to achieve.

Our current economic situation, throughout the world, represents a system that has been stretched to its limits and has begun to show signs of fatigue and collapse. The recent economic recession describes the most current example of a series of financial boom and bust periods. These include the South East Asian Crisis, the Dot-Com Bubble, among others. These events culminate in the housing and credit bubbles, which led to the recent economic peril. Though financial bubbles have been a standard affair with capitalism, their resulting turmoil has led to questions and reactions to capitalism after each period of collapse. The Great Depression led to an end of the Gold Standard and World War II led to the creation of the Bretton Woods Accord, an attempt to place limitations on the international economic system. The 1970s Oil Embargo led to another recession, which served to undo these controls and implement a return to unimpeded trade and flexible exchange rates. The decades since the end of the twentieth century have demonstrated a repeated attempt by nations to ride financial bubbles and use market speculation to attempt to gather imagined market growth, ultimately

resulting in the current economic recession and call for a return to financial controls by vocal popular movements, such as the Tea Party.

The current problem rests upon two main aspects: those of currency instability due to currency speculation and national subsidization and those of market overcapacity due to overproduction and economic deflationary tendencies. Currency instability takes up the need to address currency speculation and the variation within and between currencies, due to differences inherent to developed nations and developing nations. Market overcapacity refers to the overproduction of manufactured goods and the depleted market in which to sell these goods, due primarily to the deflationary tendencies. Despite returning rhetoric about the imagined potential of free trade and trade liberalization we can, today, clearly identify that the free trade doctrine is at best a cruel falsehood and at worst a tool for developed nations to exploit underdeveloped nations. These shortcomings within the market need to be further addressed, identified, and dealt with, in order to avoid further degradation within all nations' economic structures and in order to allow a greater possibility for real economic growth and innovation.

This article seeks to address the limitations of the current economic situation looking specifically at currency instabilities created by the flexible exchange rate system (Chapter 1), the misperceptions and misappropriation of free trade doctrine and trade liberalization in order to justify market deregulation (Chapter 2), and market overcapacity due to economic deflationary tendencies (Chapter 3). After reviewing these aspects of the current flexible exchange rate system a new dynamic system, rather than a series of quick fixes, is presented. Its purpose being to ensure

that economic growth and stability rather than a continued reliance on financial bubbles is achieved. This new system seeks to maintain the strength and flexibility of capitalism, but also seeks to place limits and boundaries upon it; limits and boundaries that create new advantages and opportunities, while addressing growing economic disparities within and across nations. With change we begin to see the possibilities for arriving at real solutions to the economic maladies of our world.

PART I:
THE FLEXIBLE EXCHANGE RATE SYSTEM:
CURRENT ECONOMIC SYSTEM FAILURE

Part I Introduction: The Flexible Exchange Rate System: Current Economic System Failure

When the current recession hit many asked what caused it, where did we go wrong, and how can we prevent this from reoccurring. Though we found blame in banking institutions, financial bubbles, and a myriad of other entities and individuals in all truth the economic system did not fail. Rather, it operated exactly as it is supposed to; providing a boom period based on a series of financial bubbles and ending in recession when these bubbles burst.

The current flexible exchange rate system, developed from the previous gold standard and Bretton Woods Accord discussed in chapter one, presents inherent limitations. Limitations which developed nations have attempted to offset through increased capital mobility (discussed in chapter one) and protectionism (discussed in chapter two), both of which have led to deflationary tendencies and a process of overproduction. The end result being a sustained process of accumulation in developed countries through the off-putting of creative destruction.

This unsustainable and volatile system creates inherent instability which particularly inhibits developing nations, but also possesses concerns for developing nations in the requirement of massive debt financing. The end result of such a system is difficult to determine. Two previous world wars sought to readjust economic imbalances, ending the hegemony of Great Britain and beginning the

hegemony of the United States. The question of the ability of developed nations to sustain their process of debt financed over-accumulation (discussed as over-production) results in the determination that this is the first of worsening recessions. In addition, the justification and morality for inhibiting the development of other nations also comes into question in chapters two and three.

Together, part I serves to identify the creation, inherent tendencies, and problems associated with the current flexible exchange rate system. Problems which lead to a firm conclusion to redress the viability of the flexible exchange rate system. Through the identification of currency instability and volatility, the circumvention of free trade and trade liberalization policies, and the continued process of debt financed overproduction the current flexible exchange rate system demonstrates inherent failure and limitations.

CHAPTER ONE: THE CHANGING FACE OF CURRENCY: FIXED AND UNFIXED CURRENCIES, CRISES, AND MANIPULATION

Introduction:

Currency, though we handle it every day in various forms, rarely do we realize its implications for economic growth and recession. At least until we are denied a loan, we lose our job, or go on a trip to another nation. Currency valuation and stability for the last 200 years has been based on three main systems, that of the Gold Standard, the Bretton Woods Accord, and the flexible exchange rate system. These systems have each attempted to address problems associated with how to balance factors inherent to currency, primarily, those of capital mobility, inflation, and stability. The balance of these factors becomes crucial when one realizes the importance of the valuation of ones currency in maintaining a national economy. As John Maynard Keynes wrote of the destructive inflationary practices in Germany after World War I, "There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency".[1]

Today, the international economic system functions on flexible exchange rates, which are set based on the market valuation of a nation's currency versus other nation's currency (usually the United States). It is flexible in that this valuation should take into

[1] Bonpasse, Morrison. *The Single Global Currency: Common Cents for the World*. Newcastle, ME: Single Global Currency Association, 2006.

account a nation's economic condition. This system resulted from the ending the Bretton Woods System that focused on a fixed exchange rate based with the United States Currency (which was based upon gold). This system had benefits, but it also had serious problems. These included restraining capital mobility and restraining the ability of nations to enact their own monetary policies to deal with internal economic problems, such as inflationary pressures (especially during the OPEC oil crisis). These problems led to its downfall. The question remains in the current literature whether the international economy was better under Bretton Woods or under the current system, as the current flexible exchange rate system possesses its own problems.

> "The quarter-century since the collapse of the Bretton Woods System brought frustrated ambitions and uncomfortable compromises. Many liked these circumstances not a bit. Developing economies with thin financial markets found it difficult to endure the effects of volatile exchange rate swings. Currency Speculations disrupted the efforts of European communities to forge an integrated European market. Even the United States, Germany, and Japan lost faith in the ability of the markets to drive their bilateral exchange rates to appropriate levels in the absence of foreign exchange market intervention. This dissatisfaction with freely floating exchange rates prompted a variety of partial measures to limit currency fluctuations; however, limited measures could not succeed in a world of unlimited capital mobility".[2]

The limited measures instigated included price controls based on subsidization of industries, the creation of bi-lateral and regional preferential trade agreements, and currency pegging practices. Subsidization and preferential trade agreements will be discussed in the following chapter, but it will suffice to say that these responses have created questions as to how free the market is to actually represent the real valuation of a nation's currency. Pegging practices will be discussed later in this chapter as we discuss the implications of the flexible exchange rate system. For now, it is important to see the progression of the currency systems, beginning with the Gold Standard.

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[2] Eichengreen, Barry. *Globalizing Capital: A History of the International Monetary System.* 2nd ed. Oxford: Princeton University Press, 2008.

The Gold Standard:

The traditional view of international economics argues that the true start of a global economy began with the 19th century gold standard. This refers to the placement of an eminent nation's currency onto direct exchange with gold, pegging the value of a nation's currency to the amount of gold a nation will exchange for its currency. England was the main nation that supported this standard and incurred much of the fluctuations of the international economy (fluctuations which it could spread across its vast empire). It served as the lender of last resort, but the standard was a requirement for any nation that wished to be viewed as a stable and competitive investment. The standard ended with World War I, as the amount of gold could not be maintained in order to repay war debts.[3]

> "The prewar gold standard was supported by a particular set of economic and political circumstances specific to that time and place. Sterling, which had provided a focal point for the harmonization of policies, no longer enjoyed a favored position in the world economy. Britain's industrial and commercial preeminence was past, the nation having been forced to sell off many of its foreign assets during World War I. Countries like Germany that had been international creditors were reduced to debtor status and became dependent on capital imports from the United States for maintenance of external balance".[4]

Beyond this, other important implications of the Gold Standard must be drawn out to understand the progression of the international economy.

The gold standard was the first attempt at presenting a means of control over the international economic market and served to control for national practices that caused fluctuation in the international economy. "According to the traditional view, the gold standard served to make states more accountable to markets. The gold standard is thus

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[3] The Gold Standard did not end everywhere and not all at once. Many countries retained elements of the Gold Standard and the Bretton Woods Accord used this factor in pegging foreign currencies to the U.S. Currency, which was tied to the U.S. Gold Supply.

[4] Eichengreen, Barry. *Globalizing Capital: A History of the International Monetary System*. 2nd ed. Oxford: Princeton University Press, 2008.

often presented as a liberal monetary regime that privileged market-led adjustments among national economies, and imposed significant constraints on the policies of states".[5] Two implications lie in the gold standard's creation and empowerment of monetary policy. It served as a national economic control measure and allowed flexible exchange rates in the periphery. "By progressively subjecting the management of fiduciary money to state control the institutions of the gold standard created a new monetary framework that opened the way for central banking. However, the commitments taken to this effect, such as provisions on the convertibility of banknotes, created new opportunities for speculation".[6] The gold standard placed restrictions on the ability for nations to adjust their currencies independently from other nations and required currencies to be based upon clear gold exchange rates. In process, however, the gold standard allowed the centralization of the banking process and for the creation of monetary policy. Currency could only be altered through national price devaluation of gold to currency, through the attainment of added gold resources to appreciate currency, or by the limiting of printed currency to control for inflation. Speculation was also added as a means for nations to affect the value of another nation's currency. Speculation refers to the process of one nation purchasing or selling bank notes of another nation in order to appreciate (buying) or depreciate (selling) the value of a nation's currency. The second implication, the importance of flexible exchange rates in the periphery nations, indicates

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[5] Knafo, Samuel. "The Gold Standard and the Origins of the Modern International Monetary System." *Review of International Political Economy* 13, no. 1 (Feb. 2006): 78-102, JSTOR.org.

[6] Knafo, Samuel. "The Gold Standard and the Origins of the Modern International Monetary System." *Review of International Political Economy* 13, no. 1 (Feb. 2006): 78-102, JSTOR.org. Both reference 2 and 3 are from the same article discussing both the intent of the gold standard and implications of the system on the international economy.

that it was the ability of flexible exchange rates that allowed for the stability of the gold standard.

> "For nearly a third of a century from the late 1870s, core sovereign nations managed to stick to a system of de facto fixed exchange rates, which not only prevented potentially destabilizing parity gyrations among the main international currencies, but also accommodated considerable differences in economic growth across nations and arguably helped foster world financial integration. These [flexible monetary regimes] translated into real exchange rate variations to which trade balances responded with an average elasticity of unity and in the direction of restoring external disequilibria. Some nominal exchange rate flexibility thus present in the pre-1914 system was instrumental to international payments adjustment".[7]

The flexibility to allow nations to fall off of the gold standard or to not adopt the standard allowed core nations to maintain stable currencies in order to balance the currencies of other nations against, while removing any large fluctuations to those nations which did not adopt the gold standard.

As noted previously, the Gold Standard ended with the advent of World War I and the inability for core nations to retain their fixed-exchange rate based on gold or sterling. The interwar period between World War I and World War II thus saw a short-lived system of uncoordinated flexible exchange rates based on currency transfers out of Germany and short-lived United States economic prosperity due to the use of their currency by Germany to pay its war debts. The Great Depression saw the end of this perceived economic prosperity, as a run on banks in the U.S. triggered a collapse of the circular currency exchange to repay German War debts. After World War Two, a new system was devised to produce currency stability and prevent a reoccurrence of the speculation of the interwar period that fueled Germany's ambition to go to war; this system would be called the Bretton Woods Agreement.

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[7] Catao, Luis and Solomos N. Solomou. "Effective Exchange Rates and the Classical Gold Standard Adjustment." *The American Economic Review* 95, no. 4 (Sep. 2005): 1259-1275, JSTOR.org.

The Bretton Woods Agreement:

As stated, the end of the gold standard came with the end of World War One and the interwar period created the economic imbalance, which if not the cause, was a contributing factor to the outbreak of World War Two. The Bretton Woods agreement was thus a proposed solution to not only address the need for stable reconstruction, but also to maintain the stability and growth of the international economy in order to prevent future conflict.

> "There has been a tendency in recent years to underestimate the importance of economic maladjustments as a cause of war – perhaps because so many economists in the past have claimed too much for economic factors; but there is growing recognition that, among the multiplicity of problems that must be solved if we are to "win the peace," economic problems will play an important role. Members [to the Bretton Woods agreement] would agree, further, to remove exchange restrictions and exchange discrimination as rapidly as possible and not to engage in competitive devaluation of the currency. Competitive depreciation of the currency is a game that all can play, and any temporary advantage is quickly nullified. Such economic warfare does not promote international good will; nor does it make for the steady growth of international trade, which, just as much as the steady growth of domestic trade, brings a high level of employment and prosperity."[8]

The Bretton Woods agreement revived the gold standard for the United States' currency and linked all other currencies to the currency of the United States, which was fixed to the price per troy ounce of gold; creating a relatively fixed rate of exchange. The intent being not only to regain the relatively stable international economy of the previous gold standard era, but also to address international development and trade. Insurance of transactions would lead to a more stable market and thus address the failings of the interwar period.

> "It has been widely held that international lending, while it should come as far as possible from private sources, will need some form of insurance. To have the insurance take an international form would have many advantages. Besides the fact that it is equitable that all countries should share in the risk, it opens up the possibility of developing, through

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[8] Newcomer, Mabel. "Bretton Woods and a Durable Peace." *Annals of the American Academy of Political and Social Science* 240 (Jul. 1945): 37-42, JSTOR.org.

> the collective action of borrowers and lenders, standards and procedures of sound investment which were badly lacking after the last war [World War One]".[9]

Though the Bretton Woods agreement served to reduce uncertainty and transaction costs, as well as, creates a number of international institutions (including the IMF and World Bank), the system produced a number of problems that led to the ending of the fixed-rate system for a flexible rate system.

The Bretton Woods Accord tied United States gold reserves to the value of the dollar and thus foreign nations could draw out gold in exchange for dollars, this system pegged the value of all currencies to a stable valued dollar. For the United States, however, the demand on gold reserves depleted the availability of capital. This combined with increasing imports and decreasing exports and sent the U.S. into a recession. To address this situation, President Nixon, under the Smithsonian Agreement, detached the repayment of gold for dollars from the Bretton Woods Accord, in an attempt to allow an appreciating U.S. currency to finance the increasing U.S. debt from its trade imbalance.

> "In 1971, President Richard Nixon declared that the U.S. government would no longer sell gold to foreign nations that had earned dollars and wanted to buy gold rather than purchase American-produced goods. In essence, the United States unilaterally withdrew from the Bretton Woods agreement. By 1971, the last vestiges of Keynes's enlightened international monetary approach, where the creditor nation accepts a large responsibility for correcting persistent trade imbalances, were forgotten".[10]

As the currency of the United States began to float on the market, other nations followed suit and the Bretton Woods agreement ended. In its place, flexible exchange rates would offer new opportunities, but the same problems that the

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[9] Williams, John H. "International Monetary Plans: After Bretton Woods." *Foreign Affairs* 23, no. 1 (Oct. 1944): 38-56, JSTOR.org.

[10] [10] Davidson, Paul, *The Keynes Solution: The Path To Global Economic Prosperity,* New York, NY: Palgrave Macmillan, 2009, 133.

Bretton Woods agreement attempted to prevent, namely currency volatility and unchecked capital mobility, would reappear.

The Flexible Exchange Rate System:

The resulting change to the flexible exchange rate system came primarily due to a realization by the United States that it could not support a growing demand for gold from foreign nations or deal with rising interest rates, due to U.S. capital accumulation by foreign nations. In addition to this U.S. based need, came a perception and an apparent need to allow for more flexibility in the exchange market (namely the ability for nations to devalue or appreciate their currencies to control for inflation) and an attempt to increase the movement of capital across boarders (to spur economic growth by allowing nation's with excess capital to invest in other nations). Nixon, thus unilaterally ended the Bretton Woods Agreement by declaring that the United States would no longer exchange gold for foreign U.S. dollars.

The flexible exchange rate system, as noted, is based on the market valuation of a nation's currency vis-à-vis another nation's currency (usually the United States). Nations under this system have three options for valuing their currency: they can peg their currency to either another currency (meaning their currency would be tied to the value of another nation's currency) or a commodity (gold primarily), they can float their currency (allow for market valuation based on economic variables and speculation), or they can attempt to permanently peg their currency to a specific value (stating a value assigned to their currency and exchanging based on this value). Each measure presented its own

detractions, thus presenting a choice and commitment in choosing the level of volatility your market could sustain.

> "Governments and central banks found the operation of pegged but adjustable exchange rates increasingly problematic. The merest hint that a country was considering a parity change could subject it to massive capital outflows, discouraging officials from even contemplating such a change. Defending the parity did not prevent the balance of payments pressures on pegged rates from continuing to mount, of course, or the markets from challenging pegs they suspected were unsustainable. The alternatives to pegged but adjustable rates were polar extremes: floating and attempting to peg once and for all. For smaller, more open economies, especially developing countries with thin financial markets, floating exchange rates were volatile and disruptive. They opted for the other alternative: attempting to establish a fixed currency peg. Developing countries maintained tight capital controls in an effort to support currency pegs against major trading partners".[11]

Nations like the United States opted for a floating currency based on the size and preeminence of their economy, most maintain a pegged currency. The EU incorporated two of these options by having a fixed currency peg within the EU and a floating currency against other nations outside of the EU.

The flexible exchange rate system allows for increased capital mobility and the ability for nations to have greater control over their currency via central bank controls (setting the interest rate, printing money, buying and selling foreign currency and your own national currency, and adjusting/setting which currency your nation's currency is pegged). However, increased volatility in short-term currency valuations due to speculation, or perceived economic maladies present continuing problems, especially for developing economies. In addition, the costs associated with monitoring and interacting in currency exchange have become extreme, forcing many countries to float their national currency.

> "The ongoing development of financial markets, powered by advances in telecommunications and information processing technologies, hampered efforts to contain international financial flows. Doing so was not only difficult but also increasingly costly: with the development of competing financial centers, countries

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[11] Eichengreen, Barry. *Globalizing Capital: A History of the International Monetary System*. 2nd ed. Oxford: Princeton University Press, 2008.

> imposing onerous controls risked losing their financial business to offshore markets. Developing countries that failed to liberalize risked being passed over by foreign investors. Liberalization, though inevitable, exacerbated the difficulty of pegging the exchange rate, leading to a growing number of developing countries to float".[12]

The volatility, especially for developing nations remains a concern with flexible exchange rates, a concern exacerbated by currency attacks (one nation or economic actor deliberately attempting to inflate or deflate the value of another nation's currency in order to achieve an economic advantage or promote financial fears about a nation's currency stability) and currency speculation. The flexible exchange rate system, more than any other turns currency itself into a tradable commodity (currency for goods is obvious; this is currency for other currency). The S.E. Asian Financial Crisis witnessed the devastation of currency speculation, when the fear of possible currency devaluation caused investors and nations to sell their currency holdings. Causing the currency to be substantially devalued (inflation) and thus for market depression to occur; this type of volatility leads to concerns over whether a flexible exchange rate can meet future economic demands or whether a different currency system is needed.

Overcoming Economic Problems:

Current discussion, due in part to the recent economic recession felt throughout the globe, has revitalized the idea of placing limitations and regulations on financial institutions and practices. As we have seen with the three prominent currency systems of the last 200 years, economic readjusts (recessions) rarely occur without policy reaction. The question asked by this paper is whether the policy reaction should be another piecemeal readjustment of a prior system, or whether it should be an encompassing

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[12] Eichengreen, Barry. *Globalizing Capital: A History of the International Monetary System.* 2nd ed. Oxford: Princeton University Press, 2008.

attempt to address all the serious problems with the current economic system; the problem lying, primarily, with the volatility of the flexible exchange rate system, due to currency speculation and attack. Any attempt to deal with currency should, however, address both the failings and benefits of the systems that came prior.

With the current flexible exchange rates countries are able to use their national monetary policies to control and adjust for inflation and appreciation. This independent national monetary policy, as well as, the ability to speculate on currencies creates the ability for nations to adjust for changes in their national economy. Enabling large movements of capital (capital mobility) across nations, while also allowing for nations to accumulate (mainly through debts) more capital while maintaining their currency's value. The previous Bretton Woods System placed all currencies on a fixed exchange rate, limiting the ability of nations to use their national monetary policies to adjust for economic changes, in addition to limiting the ability to move capital from one nation to another. Though, neither the Bretton Woods System nor flexible exchange rate system can solve the inherent problems in the international economic system they both illustrate benefits and problems that must be addressed in a successful international economic system.

Old Concerns about the Financial System:

The current question is whether the flexible exchange rates should be changed and if so, then by what. Should currency be fixed or unfixed, what controls and protections does a national currency have in relations to others affecting the valuation of currency, and how does adopting a different currency system increase our opportunities for growth?

The question, which should first be asked, is whether or not we want a multiple currency system or a single global currency.

John Stuart Mill in 1865 argued for a single world currency to overcome the economic and political costs associated with multiple currencies.

> "Let us suppose that all countries had the same currency, as in the progress of political improvement they one day will have…so much of barbarism, however, still remains in the transactions of the most civilized nations that almost all independent countries choose to assert their own inconvenience and that of their neighbors, a peculiar currency of their own"[13]

The international economic landscape has changed little in applied ideology, since John Stuart Mill first questioned the ability for the market to accurately and beneficially balance separate currencies. If we think of it in terms of America, we can get a clear picture of the institutional transaction hurdles created within a multiple currency regime.

> "Imagine the United States did not exist in its present form. Instead, imagine 50 sovereign nation states, each with its own national government. The people of each state speak different languages or variations of the same tongue. Each state has its own system of customs and tariffs. Each, its own tax structure. Each, its own currency and monetary authority, and each its own system of laws, criminal and civil. Given this condition, the standard of living of the citizens of these 50 nations would inevitably be much lower than at present. The people of the 50 nations would still transact business with each other, but with much greater difficulty. A significant portion of each nation's population would have to be pulled away from production of goods and services and channeled into the mere effort of exchange. Currency specialists, "money changers," would be required to assay the value of each nation's money so that businessmen could have the confidence in their transactions. As well as each nation would have an international wedge against commerce, with added paperwork and financial costs for every transaction across borders. Even worse, the mobility of each citizen of the 50 nations would be limited".[14]

The same aspects that create cost and volatility under the current flexible exchange rate system could be removed by removing multiple competing currencies. A new economic system, must therefore consider not only the benefits and disadvantages of prior currency systems, but must also consider how these can be uniquely affected by the move away from a multiple currency regime.

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[13] Mill, John Stuart. *Principles of Political Economy*, New York: Prometheus Books, 2004.

[14] Wanniski, Jude T. "Economic Policy and the Rise and Fall of Empires." *Financial Analysts Journal* 36, no. 1 (Jan. – Feb. 1980): 20-27, JSTOR.org.

Conclusion:

These questions continue and have continued over the extent of time. The changes in the last two centuries have led to financial changes in currency valuation. All aimed at increasing the flow of capital around the world and at providing nation-states more control over their internal economy. With these changes have come inherent problems and benefits to currency. Today, volatility due to speculation is paramount, but so too is capital mobility. Currency is the first area of concern in the global economy, but not all. The next chapter identifies the overall failure of free trade and trade liberalization doctrines to be fully realized due primarily to preferential trading and subsidization of certain economic markets, especially in developed nations. Currency is identified first; as it forms the basis on which modern trade is made possible, without currency there is only barter. In addition, the implications of the current flexible exchange rate system, in forcing nations to liberalize in order to retain foreign investors, are built upon in the next chapter, as are parallels between speculation and subsidization. The global economic system is one built in many ways upon defense and a predator mentality, with a backdrop of international façade.

Chapter Two: The Failure of Free Trade Doctrine and Economic Liberalization: The Curse Of Preferential Trade and Subsidization

Introduction:

Give a man a fish and you feed him for a day; teach a man to fish and you feed him for a lifetime. This old axiom is better applied today as: give a man a fish and you feed him for a day; allow a man to fish and you feed him for a lifetime. When discussing free trade and economic liberalization policy the main problem rests on the practices of subsidization, preferential trade agreements, and free trade zones to create strong biases toward developed nations. The practices of trade liberalization and free trade championed by the World Trade Organization and made conditional under the International Monetary Fund for loans presents obstacles rather than benefits to the global economic system.

International trade and international economy have long been studied and evaluated by mathematical calculations, philosophical theorization, and political deduction, still a growing importance in determining support for trade practices and policy has remained. Within this debate, Dick Thaler, a behaviorist, injected a focus upon individuals, their choices, attitudes, and perceptions, in determining market focus. An aspect that is glanced over and missed in classical explanations of economic activity that focused on nations rather than people.

> "When it came to the study of individuals and the decisions they make, this behaviorist updating of equations was an unalloyed success. Most economists and finance scholars had never disputed that people sometimes made weird choices. The issue was that finance professors couldn't see why it mattered. They studied prices, not people".[15]

Individual perceptions and understandings of the global trade and economy matter; they frame the support and ultimate success of trade policies and practices. "The recent controversies about "outsourcing" of jobs to foreign locales, arguments about the North American Free Trade Agreement (NAFTA) and other trade agreements, and protests and demonstrations that have disrupted meetings of the World Trade Organization have all revealed substantial political opposition to trade liberalization".[16] Though survey framing plays a large role in determining measured support or opposition to trade liberalization, media broadcasts, political addresses, and public demonstrations all indicate a growing concern over how trade liberalization and free trade practices will serve to affect national economic growth throughout the world.

> "Open trade and cross-national market integration help to allocate factors of production efficiently and to promote the welfare of countries and the world as a whole. Studies of the political economy of trade often attribute variations in trade preferences to the distributional implications of overseas commerce. Despite the economic benefits that a given country would accrue from open trade, some individuals suffer economic harm as a result. Recent research indicates that, in democratic countries, constituency opinion on trade plays a central role in influencing the policy positions of public officials".[17]

What effect do national economic policies have on free trade and trade liberalization? To determine this question we shall examine the extent to which

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[15] Fox, Justin. *The Myth of the Rational Market: A History of Risk, Reward, and Delusion on Wall Street.* New York: HarperCollins Publishers, 2009.
[16] Hiscox, Michael J., "Through a Glass and Darkly: Attitudes Toward International Trade and the Curious Effects of Issue Framing." *International Organization* 60, no. 3 (2006): 755-780, http://www.jstor.org/stable/3877826.
[17] Mansfield, Edward D. and Diana C. Mutz, "Support for Free Trade: Self Interest, Sociotropic Politics, and Out-Group Anxiety." *International Organization* 63 (2009): 425-457.

national policies of preferential trading, subsidization, and the creation of free trade zones serve to disrupt ideas of free trade and trade liberalization from being faithfully implemented and the role to which these national policies serve to exclude developing nations from economic growth and realization. To illustrate these implications we shall examine two case studies that of Africa and South America to determine the effects of national policies of certain developing countries on the subsequent failure of free trade and trade liberalization in a global economic system. Before delving into these aspects, however, we shall look at the ideas and implications behind Classical Trade and New Trade Theory, upon which the current economic system is built. These systems describe the beneficial aspects of free trade and trade liberalization. We shall see, however, that the benefits of these theories are not realized as outlined, due to the interruption of preferential trading practices and subsidization. In addition, these theories recognize overall benefits, while neglecting the suffering and loss of production felt by individuals due to the lack of a comparative advantage when confronted by trade with other nations.

Classical Trade and New Trade Theory

Since the fall of Communism, the main challenge to capitalism, a reinvigorated focus on free trade and liberalism has found ground in almost all international organizations and developed nations. Though a continuation from the time of empire and imperialism, this new wave of free trade and trade liberalism has been extended further and with more force than before and has become a required aspect of acceptance for any nation wishing to do business in the global economy.

> "The worldwide spread of economic and political liberalism was the defining feature of the late twentieth century. Free-market-oriented economic reforms – macroeconomic stabilization, liberalization of foreign economic policies, privatization, and deregulation – took root in many parts of the world. At more or less the same time, a "third wave" of democratization and liberal constitutionalism washed over the globe. Most economists believe the gains to developing countries from the liberalization of economic policies to be in the hundreds of billions of dollars. But they also acknowledge the instability and human insecurity sometimes left in liberalization's wake".[18]

Four distinct arguments prevail in explaining this adoption: the first is the ability of the United States to use its hegemonic power base and the Bretton Woods international organizations it helped to create to push its liberalization and free trade policies. The second is the decentralized process of technological innovation to promote global processes. The high cost of financial controls in currency trading, discussed in the previous chapter exemplifies this point. The sharp decline in the ability of nations to control cross-border trade indicates the third argument. The final argument rests on the emergence and congruence of influential ideologies on trade, namely free trade policy and economic liberalization. No matter its development, which is most likely due to a combination of previously made arguments, the important aspect is that free trade and economic liberalization depicts certain economic conditions, which result in certain economic difficulties.

Classical economics focused on the importance of free trade and trade liberalization in describing the absolute advantage of a nation to focus upon economic sectors to which they are inherently specialized and allowing other nations to provide the goods which are produced for less elsewhere. David Ricardo theorized this aspect of economics in his treatise, "On the Principles of Political Economy and Taxation."

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[18] Simmons, Beth A., Frank Dobbin, and Geoffrey Garrett, "Introduction: The International Diffusion of Liberalism." *International Organization* 60 (2006): 781-810.

> "The point of Ricardo's analysis: free trade makes it possible for households to consume more goods regardless of whether trading partners are more or less economically advanced. The point is exemplified in Ricardo's Corn Laws position: If the French farmers are willing to feed us for less than it would "cost" us to feed ourselves, let us eat French food and spend our time doing something else".[19]

Specialization occurs with aspects to which a nation has an absolute advantage in terms of the ability to produce a good or service at a lower rate than other nations. In addition to absolute advantage (having inherent benefits to producing a certain good, i.e. climate, raw materials, labor pool, etc.), there is also the notion of a comparative advantage.

> "Ricardo showed that every country (and every person) has a comparative advantage, a good or service that they can produce at a lower (opportunity) cost than any other country (or person). As a result, production is maximized when each country specializes in the good or service that they produce at lowest cost, that is the good in which they have a comparative advantage. Since specialization in comparative advantage maximizes production, trade can make every country better off".[20]

A comparative advantage in production of a good or service tends to come from an economy of scale; in addition, specialization of a good or service tends to lead to the centralization of the means of production thus further reducing costs.

> "In order to realize scale economies while minimizing transport costs, manufacturing firms tend to locate in the region with larger demand, but the location of demand itself depends on the distribution of manufacturing. Emergence of a core-periphery pattern depends on transportation costs, economies of scale, and the share of manufacturing in national income".[21]

The basis for specialization not only depends on economies of scale, but also on the movement of people and the speed of lowered transport costs. The economy of scale is used to describe how profits tend to converge in perfect competition. The Stopler-Samuelson theorem explains this aspect as it links commodity prices with

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[19] Buchholz, Todd G. *New Ideas From Dead Economists: An Introduction to Modern Economic Thought.* New York: Plume, 2007.
[20] Tabarrok, Alex, "What is New Trade Theory?," *Marginal Revolution,* http://marginalrevolution.com/marginalrevolution/2008/10/what-is-new-tra.html.
[21] Krugman, Paul, "Increasing Returns and Economic Geography." *The Journal of Political Economy* 99, no. 3 (1991): 483-499, http://links.jstor.org/.

factor prices presupposing that there is perfect competition implying that in the long run profits are zero in every industry.[22] Basically, when a nation opens its boarders to trade the interplay of factor and wages will bring a balance to profits. Firms with lower wages and lower factors of production (production costs) can produce goods at low costs. Firms with higher factor and wage costs raise prices and increase production, but the overall profit attainted between the two is the same. The idea being that specialization in production leads firms to maximize their comparative advantage whether in the form of creating centers of production to minimize transport and production costs or through the use of cheap and abundant labor. New Trade Theory, developed by Paul Krugman expands on these ideologies, by depicting how trade serves to provide increased options for consumers.

Paul Krugman's New Trade Theory made two important distinctions, one in recognizing the importance of trade liberalization in providing low cost variety to consumers and the other in recognizing the unimportance of the location of people and economies of scale. In New Trade Theory, trade liberalization is important in providing low cost goods through competition, but also in expanding the variety of low cost goods available to consumers:

> "In each country, consumers have a preference for variety but there is a tradeoff between variety and cost, consumers want variety but since economies there are economies of scale – a firm's unit costs fall as it produces more – more variety means higher prices. Preferences for a variety push in the direction of more variety, economies of scale push in the direction of less. So suppose that without trade country 1 produces varieties A, B, C and country 2 produces varieties X, Y, Z. In every other respect the countries are identical so there are no traditional comparative advantage reasons for trade. Nevertheless, if trade is possible it is welfare enhancing. With trade the scale of production can increase which reduces costs and prices. Notice, however, that something interesting happens. The number of world varieties will decrease even as the number of varieties available to each

[22] Iowa State Department of Economics, *Stopler-Samuelson Theorem*, http://www2.econ.iastate.edu/classes/econ355/choi/ho1.htm.

> consumer increases. That is, with trade production will concentrate in say A, B, X, Y so each consumer has increased choice even as world variety declines".[23]

In this way, the large amount of trade between seemingly identical nations can be explained as a way to increase variety and increase their specialization. The second aspect of New Trade Theory comes from the realization that contrary to the Heckscher-Ohlin-Samuelson model the location of the factors of production (capital and people) does not matter and is in many respects a matter of historical coincidence.

> "There are many economies of scale goods, everyone gets some of them; and the details, which may be largely a story of historical accident, aren't important. What matters, instead, is the overall pattern of trade: the broad pattern of what countries produce is determined by things like resources and climate, but there's a lot of additional specialization due to economies of scale, and there's much more to trade, especially between similar countries, than you would expect from a purely resource based theory. In the world of the old trade theory, "factor mobility" was a substitute for trade: if factories and industrial workers can move freely, they'll spread out to be close to the farmers, and neither food nor manufactured goods will be shipped long distances. But in the economies of scale world, the "centrifugal" effect of widely dispersed resources, which tends to push economic activity into spreading out, would be opposed by the "centripetal" pull of access to large markets, which tend to promote concentration of economic activity. If the centripetal forces are strong enough, you'll get a cumulative process: regions that for historical reason have a head start as centers of production will attract even more producers, becoming the economic "core" while other areas become the "periphery"".[24]

This insight describes how increased trade liberalization and free trade policies beyond offering increased specialization and market competitiveness to a nation, also provides a self-reinforcing aspect of continued viability to existing centers of production. What is also described in these two points is the realization that trade liberalization and free trade policies can increase competitiveness and production within a nation and can also serve to maintain and strengthen existing centers of production, while also allowing for new centers of production to develop. The

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[23] Tabarrok, Alex, "What is New Trade Theory?," *Marginal Revolution,* http://marginalrevolution.com/marginalrevolution/2008/10/what-is-new-tra.html.
[24] Krugman, Paul, "The Conscience of a Liberal," *The New York Times,* About The Work, http://krugman.blogs.nytimes.com/2008/10/15/about-the-work/.

problem rests on whether the benefits of these economic theories are realized in the global economic system.

We do see benefits to trade, the Latin American preference for trade explored by Andy Baker, in *Why is Trade Reform so popular in Latin America,* depicts that it is not that trade increases the potential earnings or economic welfare of individuals per say, but rather that the increase in cheap consumable goods produces the primary reason for the popularity of trade reform in Latin America and elsewhere.

> "In Latin America, the region where trade liberalization occurred most rapidly in the 1990s, the concerns of protestors appear to be well founded: free trade has a detrimental effect on employment opportunities and income equality. However, despite the protests and economic trends, evidence from various surveys indicates that trade liberalization is quite popular throughout Latin America. In developing countries emerging from decades of protectionism, citizens are more likely to assess trade policy based on highly visible impact on consumer options, not labor markets. Therefore, the impressive degree of support for trade liberalization in Latin America results from the wide spread appreciation of its beneficial outcome for the prices, quality, and variety of consumer goods".[25]

In the case study of Latin America we look at the opposite side of policy in an application of a state sponsored policy of economic growth, which did provide individual economic benefits, but restricted access to consumable goods from other nations. In addition to these applications of free trade and economic liberalization, we must consider the implications of bilateral/ preferential trade agreements and subsidization on whether these economic ideologies are truly implemented in the current economic system. If they are not fully realized then the perceived benefits and explanations of these ideologies may not indicate the actual operation in the global economic system. This would render the increase in cheap, consumable goods as the only argument to justify free trade policy and economic liberalization.

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[25] Baker, Andy, "Why is Trade Reform so Popular in Latin America? A Consumption-Based Theory of Trade Policy Preferences." *World Politics* 55 (2003): 423-55.

Bilateral Trade and Subsidization

The expansion of trade liberalization, the removal of policies against open trade, and free trade, the removal of trade restrictions and tariffs, are the cornerstone of modern trade. Though these policies have strong support from both the Bretton Woods Organizations developed after World War Two and the United States, other policies have arisen that undermine the application and thus the perceived benefits of these ideologies to the global economic system.

> "The General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO) are credited with (or blamed for) regularizing a set of broadly agreed rules that have stimulated the growth of world trade. None of this has occurred without stress. The challenges today are subtler and are associated with forms of bilateralism. Increasingly, global consensus is being undermined by semi-consensual bilateral agreements that in some respects push well beyond multilaterally settled norms. These bilateral agreements pull multilateral norms a strand at a time toward the agenda of the most powerful negotiators, especially the United States and the European Union".[26]

Bilateral trade agreements represent the first policy, which hinders the application of free trade and trade liberalization in the global economic system; the other policy is that of subsidization. If these policies can be seen as a direct attempt by developed nations to undermine the ideologies of free trade and trade liberalization in order to secure their own market advantages, then the benefits of free trade and trade liberalization are defunct, as they are not fairly applied. They would thus be seen more as a tool for manipulating markets, and developing countries in particular, into opening their markets to developed firms, which are protected from open and equal competition (a prerequisite to free trade and trade liberalization) due to preferential trade and subsidization. Both bilateral/ preferential trade

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[26] Newman, Edward, Ramesh Thakur, and John Tirman, ed., *Multilateralism Under Challenge? Power; International Order; and Structural Change.* New York: United Nations University Press, 2006.

agreements and subsidization are discussed further to identify their implication on the global economic system.

These bilateral trade agreements include the creation of free trade agreements and preferential trade agreements between two or more nations. In any formulation, these agreements serve to provide a comparative advantage between the involved nations, protecting them from competition between other nations.

> "Free-trade agreements (FTAs), or free-trade areas, are outcomes of trade policy cooperation between countries. FTAs are often affected by both economic and political factors. In their study of the political economy of FTA formation, Grossman and Helpman (1995) find that FTAs are more likely to be formed when there are a sufficient number of potential exporters in each country to lobby for FTAs and when FTAs afford enhanced protection rather than reduced protection to most sectors. In addition, they show that FTAs that exclude some politically sensitive sectors are more likely to be achieved than those covering all sectors because governments can diffuse the opposition to FTAs".[27]

Free Trade Agreements are conditioned bilateral economic agreements to remove protective trade restrictions and tariffs between nations, within the agreement. Preferential trade agreements present a similar condition, but are usually more specific to a particular sector of economic activity and offer a nation special or unique access to another nation's economy, through preferential policies and preferential tariff arrangements.

> "Preferential Trading Agreements (PTAs) are a broad class of international commercial agreements that include common markets, customs unions, free trade areas, and economic unions, as well as other arrangements. All of these arrangements require members to adjust their trade policies towards one another (usually through domestic legislation), granting each member preferential access to others' markets".[28]

[27] Qiu, Larry D., "Lobbying, Multi-sector Trade, and Sustainability of Free-Trade Agreements." *The Canadian Journal of Economics* 37, no. 4 (2004): 1061-1083, http://www.jstor.org/stable/3696122.
[28] Mansfield, Edward D., Helen V. Milner, and Jon C. Prevehouse, "Vetoing Co-operation: The Impact of Veto Players on Preferential Trading Arrangements." *International Organization* 56 (2002): 477-514.

Bilateral trade agreements allow nations to use their economic power to condition international trade to favor their nation's economy, thus undermining ideas of trade liberalization and free trade.

The second policy of interest in determining the implementation of trade liberalization and free trade ideologies is that of subsidization. "Some firms would not be in business without the subsidy. Cost savings due to declining average costs are always greater than the losses incurred where price equals marginal cost".[29] National subsidization of industry or services directly conflicts with the idea of trade liberalization by making policies that remove any ability for other nations to compete fairly on an open market. Agricultural and manufacturing subsidies are among the largest portion of nationally subsidized sectors; these subsidies inflate market prices and render competition null and void.

> "The money for these subsidies comes from national economies, giving wealthy developed nations a large ability to protect their economic sectors to the detriment of their budgets and developing nation's ability to compete in a free trade economic setting. Interventions in pricing policies play a vital role in the performance of agriculture, but they have often had an unfavorable effect on economic development. In industrial countries the allocative inefficiency resulting from the pricing policies of agricultural protectionism puts the deadweight losses to a protectionist government somewhere between 0.5 percent and 3 percent of gross domestic product (GDP). Fiscal costs have also been high and are increasingly viewed as excessive by predominately urban electorates".[30]

Subsidies provide an important aspect for nations to protect their economic sectors from being out-performed by other nations.

> "Rodrik (1998) and others have argued that the economic insecurity induced by exposure to international markets demands greater levels of social welfare in the form of unemployment programs, retraining, and other social support for those

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[29] Gorter, Harry De, David R. Just, and Jaclyn D. Kropp, "Cross-Subsidization Due to Inframarginal Support in Agriculture: A General Theory and Empirical Evidence." *American Journal of Agricultural Economics* 90, no. 1 (2008): 42-54.

[30] Baffles, John and Jacob Meerman, "From Prices to Incomes: Agricultural Subsidization without Protection?" *The World Bank Research Observer* 13, no. 2 (1998): 191-211, http://www.jstor.org/stable/3986338.

> adversely affected by market liberalization. Employment insecurity has received considerable attention in the relatively large literature on the compensatory role of the welfare state in insuring workers against the volatility of world markets, and recent research associating insecurity with support for anti-establishment parties would give governments good cause for such social protection".[31]

This is a key aspect that is over-looked by ideologies of trade liberalization and free trade, that while a comparative advantage may exist eventually, in the meantime jobs are lost and people's livelihoods are ruined by cheaper competition from abroad.

> "The standard workhorse models of international trade have well defined implications for the distributive consequences of trade and hence for individual attitudes. Under the factor-endowments model, which assumes costless inter-sectoral mobility of productive factors, trade benefits individuals who own the factors with which the economy is relatively well endowed, and hurts the others. This is the well-known Stopler-Samuelson theorem. Under the specific-factors model, trade benefits individuals who are employed in the export-oriented sectors and hurts those who are employed in the import-competing sectors. To the extent that individuals are motivated by self-interest, these models provide important hints about an individual's likely attitude to trade depending on his/her factor type or sector of employment".[32]

Thus subsidies are used by nation's with the economic might to uphold them to protect jobs and vulnerable sectors of a nation's economy. The fact that they are denied by free trade and trade liberalization depicts a concern for nation's without the economic might to uphold them; economic might referring to the consumer base and political leverage a nation has in order to flout international demands to reduce or remove subsidies.

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[31] Kayser, Mark Andreas, "How Domestic Is Domestic Politics? Globalization and Elections." *Annual Review of Political Science* 10 (2007): 341-362.
[32] Mayda, Anna Maria and Dani Rodrik, "Why Are Some People (And Countries) More Protectionist Than Others?." *European Economic Review* 49 (2005): 1393-1430, http://www.elsevier.com/locate/econbase.

Case Studies: Difficulties of Developing Nations

The impact of trade liberalization and free trade policy can be seen as obstacles to developing nations when coupled with the prevalence of bilateral trade agreements and subsidization of economic sectors in developed nations. These implications matter when one considers both their impact on living standards and on our duties to individuals outside of our national boundaries. "Demanding political duties to help disadvantaged compatriots are said to be duties of fairness toward associates in economic interdependence; the principles that would shape duties toward disadvantaged compatriots in an economically self-contained political society have, thus, been spread worldwide by global commerce".[33] Though Richard Miller would argue against this cosmopolitan extension of the same duties we have to compatriots to individuals outside our political realm, he, and most other philosophers, would still argue that a lesser duty remains to still provide beneficial help and to abide by fairness and justice. Though politicians have to deal with representing their own constituents, they must realize and apply philosophical implications to determine the continuing viability and morality of their actions. These duties are specifically those that are routinely flaunted by developed nations who use their economic and military power to manipulate international economic conditions to their favor.

American dominance of international organizations, such as the World Bank, International Monetary Fund, and World Trade Organization, has led to some

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[33] Miller, Richard W. *Globalizing Justice: The Ethics of Poverty and Power.* "Chapter Two: Compatriots and Foreigners," Oxford: Oxford University Press, 2010.

rivalries and conflicts. The United States, having been a primary developer of the international system, retains a large amount of ability to influence these institutions.

> "The United States has used its threat influence to shape the virtually worldwide trade regime administered by the WTO, transforming patterns of ownership and ways of life in developing countries. The IMF and the World Bank have been at least as important as vehicles of American domineering influence. Although the possibility of U.S. veto helps to restrict the agenda of policymaking in both institutions, fears due to U.S. financial resources are more influential in most decision-making. The IMF relies on the United States to contribute additional dollars to IMF reserves as world liquidity requirements increase. The World Bank's access to U.S. capital markets is subject to U.S. approval. The most important vehicle and sign of U.S. influence is the routine role of U.S. policymaking elites in World Bank and IMF decision-making. The quasi-official rule that the Bank's President must be a U.S. citizen nominated by the U.S. government provides the most visible aspect of this involvement".[34]

The involvement of the United States in these international organizations is certainly not confined to the United States alone, but United States involvement is most prevalent.

Besides the influence of nation-states, developing nations also have to contend with a lessened status in dealing with international rule-making and decision-making process.

> "Developing countries made scant use of dispute settlement under the General Agreements on Tariffs and Trade (GATT). Most observers insist that the various GATT reforms that were intended to help developing countries failed to insulate them from the "power politics" of the system. Not surprisingly, many of these same observers predict that the greater "legalism" of the World Trade Organization (WTO), and the Dispute Settlement Understanding (DSU), in particular, will encourage more participation by developing countries. The rule of law system does not by itself guarantee efficient outcomes. For that, one also needs an adequate level of capacity and expertise to realize the full promise of such a system".[35]

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[34] Miller, Richard W. *Globalizing Justice: The Ethics of Poverty and Power.* "Chapter Five: Modern Empire," Oxford: Oxford University Press, 2010.

[35] Busch, Marc L. and Eric Reinhardt. "Developing Countries and General Agreement on Tariffs and Trade/World Trade Organization Dispute Settlement." *Journal of World Trade* 37, no. 4 (2003): 719-735.

Despite changes in the international system to better represent the interests of all nations, power relations are still pivotal in deciding economic disputes and in enforcing economic settlements.

> "Nevertheless, in spite of the more rules-oriented provisions, economists have conjectured that compliance with GATT/WTO rulings is still dependent on 'power' relationships, given that the agreements are self-enforcing and the threat of bilateral retaliation is the underlying means of compensation in dispute settlement negotiations. While the system may now be able to prevent countries from unilaterally impeding the initiation or legal progress of a particular dispute, there are still no fines, jails, or explicit retaliatory measures imposable by a party other than the plaintiff. Thus, economic theory suggests that if a plaintiff desires compensation for a defendant's refusal to abide by its GATT/WTO obligations, it must have the capacity to make its own bilateral retaliatory threats to obtain their compensation".[36]

Power relations, primarily in the form of economic and political capital, remain the primary drivers of successful national results in the international economy. As the WTO can initiate economic sanctions, but has no ability to compel nations, beyond the economic will of other nations to support economic sanctions against a nation. Developing nations must contend with this element and the national policies and restrictions, in order to achieve their development goals and to achieve an equal share of the global economy.

Case 1: Latin America

The Latin American area provides an excellent case study example of an attempt, by multiple nations, to deal with disruptive economic conditions both before and after the inaction of the Bretton Woods Agreement. Latin American countries utilized state-led industrialization, which quickly increased during the Great Depression and continued into the 1970s, nationalizing private businesses

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[36] Bown, Chad P. "Developing Countries as Plaintiffs and Defendants in GATT/WTO Trade Disputes." Oxford: Blackwell Publishing Ltd, 2004.

and subsidizing their operations. This process became known as Import-Substituting Industrialization (ISI), as the lack of a market for the export of goods from this region led to a crippling lack of foreign exchange for industrial imports. The state controlled enterprises differed from communist centralized planning in many important distinctions, namely, that there was no centralized planning.

> "Two aspects of state ownership in the region contradict popular stereotypes. For one thing, many of the important nationalizations – including the petroleum industries in Mexico and Venezuela, mining in Chile and Peru, and railroads in Argentina – involved companies that had been owned by multinational corporations, not local capitalists. Second, state-owned petroleum industries, railroads, and utilities provided private-sector industries with subsidized transportation, power, and other needed resources. Along with its ownership of many essential enterprises, the state also played a pivotal role in fomenting private sector growth. In Latin America's largest economies, the government initiated import-substituting industrialization (ISI) programs, which sought to replace imported consumer goods with products that were manufactured domestically".[37]

Though these programs initially created jobs, boosted industrialization, brought in foreign capital, and improved living conditions, the import-substituting industrialization programs also fostered a number of inefficiencies, which would lead to severe economic turmoil. Import-substituting development would be continued and expanded in Latin America until the 1970s when comparative disadvantages created by ISI would force Latin American countries into new economic problems.

Subsidization and the adoption of tariffs and trade barriers have been a long established method for nations to protect and promote vulnerable business sectors within their borders. For Latin American nations the initial growth of ISI created jobs, grew the economy, and improved the general welfare, however, ever-increasing expansion of this development scheme would have serious

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[37] Handelman, Howard, *The Challenge of Third World Development,* 3rd ed. Upper Saddle River, NJ: Pearson Education, Inc., 2003, 264-265.

repercussions. Import-substituting development created inherent flaws in competition and in currency valuation, which led to a dismembered, economy, incapable of interaction with other nations in trade without massive subsidization.

> "In order to protect embryonic domestic industries from foreign competition, consumer imports were generally subjected to protective quotas and tariffs. At the same time, however, planners also wanted to facilitate other types of imports, namely capital equipment and raw materials needed by domestic manufacturers. To reduce the cost of those imports, governments overvalued their own currencies. Eventually, most Latin American countries established multiple currency exchange rates, with differing rates for transactions tied to imports, exports, or other financial activities. Overvalued currencies and export taxes put traditional primary goods at a competitive disadvantage, thereby depriving the area of needed foreign exchange revenues. At the same time, because local consumer-goods manufacturers were allowed to import capital goods cheaply, the region never developed its own capital-goods industry and, instead, imported manufacturing technologies that were inappropriate to local needs. Subsidized imports of machinery and heavy equipment encouraged capital intensive production (using relatively advanced technologies and machinery while employing fewer workers) rather than the labor intensive manufacturing common to Asia".[38]

This process of relying on the import of cheap capital goods merely replaced dependence on consumer goods imports; little was done to expand exports or to ensure that subsidized companies were made competitive to other nations and regions. By the 1970s, the export-oriented industrialization of East Asia had begun to show the crippling competitive disadvantages of Latin America. Increasing foreign debt would eventually lead to a currency crisis and economic depression in the 1980s and a move toward export-oriented production as subsidization measures were removed due to International Monetary Fund free trade requirements.

The academic support for ISI comes from dependency theory which rejects the claim that Third World countries could follow the same path to development as

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[38] Handelman, Howard, *The Challenge of Third World Development,* 3rd ed. Upper Saddle River, NJ: Pearson Education, Inc., 2003, 274.

Western nations had because the first industrialized nations changed the landscape for those that followed them.

> "Third World countries have to borrow capital and purchase advanced technology from the developed world, thereby making them dependent on external economic forces beyond their control and weakening their development. In addition, dependency theorists argue that it was Western colonialism and economic imperialism that had turned Africa, Asia, and Latin America into sources of cheap food and raw materials for the colonial powers. Production of manufactured goods – the most profitable economic activities – were originally concentrated in the core, the industrialized West. Third World nations, in the periphery, were largely relegated to the production and export of food and raw materials".[39]

This theory continues to hold in describing why discrepancies exist between the core and periphery, but the application of this theory in terms of policy failed to deliver the commodity benefits which free trade later provided.

The inclusion of Mexico in the North American Free Trade Agreement (NAFTA) demonstrates this new orientation towards export-oriented industrialization. A plan utilized extensively to great effect by Asian nations. Export-oriented industrialization focuses on making industries more competitive in the face of foreign competition. This developmental shift in orientation has come at a huge human cost, as previously subsidized industries are forced to lay off employees and as wages and working conditions are driven down in order for firms to lower their cost of operation and thus make their products cheaper and therefore desirable. The Latin American case depicts how the current global economic system focuses on the aspects of free trade and trade liberalization to the detriment of human populations and regional stability. ISI programs produced real change and development, but when faced with an inability to remain solvent in the face of larger fiscal economies of developed nations, developing nation subsidization is slated to

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[39] Handelman, Howard, *The Challenge of Third World Development,* 3rd ed. Upper Saddle River, NJ: Pearson Education, Inc., 2003, 17-18.

eventually collapse. These nations lack the diversity of industrial sectors, infrastructural foundations, vast economic wealth, and economic clout of developed nations. Development for developing nations remains a process in which even state supported industrialization is hampered by the limits of the developing state and the pressures of developed nations in control of currency valuations, capital investments, and in possession of the newest/ advanced manufacturing capital. The clear benefits to the population under ISI were after the opening up of the market to other nations; benefits would have been sustainable if it were not for currency valuation and the dependence upon foreign capital for investment.

Case 2: Africa

The African case study expands on the previous by bringing renewed attention to the role developed nation's agricultural subsidies have on stifling growth and of the dangers of free trade shocks on fragile, dependent economies. Agricultural subsidies of developed nations are of primary concern and have been a key factor in the continuing Doha Round. Africa is an excellent region for understanding the effects of these growing trade restrictions, both because the region is heavily dependent upon primary commodity export (minerals and agricultural products) and because the nation receives a large amount of aid aimed at development. Thus, the region remains in the initial stages of development, due to its primary commodity dependence on exports and serves as a basis for understanding the role of aid versus trade importance in development.

Primary commodity dependence is critical to understanding the unsteady nature of the African region. "African exports are characterized by dependence on

primary commodities, and consequently, vulnerability to global economic shocks. Such commodities are also typified by a low-income elasticity of demand, volatility, and a secular decline in prices. In the context of trade liberalization in Africa, the overall result is deterioration in the balance of trade".[40] This deterioration in the balance of trade rests heavily upon the application of subsidies by developed nations to protect their agricultural and mining sectors from foreign competition.

> "It all comes down to politics. The net result is a protective world of trade restrictions and barriers thrown up around the West; to keep African (and other developing regions) produce out. But developed markets are crucial, in terms of both purchasing power and size, for African trade, which depends on such countries for much of its export revenue. The members of the Organization of Economic Cooperation and Development (OECD) spend almost US$300 billion on agricultural subsidies (based on 2005 estimates). This is almost three times the total aid from OECD countries to all developing nations. Estimates suggest that Africa loses around US$500 billion each year because of restrictive trade embargos – largely in the form of subsidies by Western governments to Western farmers".[41]

This loss, particularly in agricultural subsidies, due to developed nation's practice of subsidization and enactment of trade barriers is felt heavily in Africa, but also in all other developing nations.

This became a cornerstone issue in the Doha Round, as developing nations pressured developed nations to cap their level of subsidies to agricultural sectors in order to provide for fair trade.

> "Agriculture is the key to getting a deal in the current round of trade talks because previous negotiations failed to deliver significant reforms in this sector. The Uruguay Round created a more transparent framework for measuring and capping agricultural support, but it did little to lower the level of applied subsidies or trade barriers. Since the eight previous trade rounds reduced average tariffs on manufactured goods (other than textiles and apparel) to the low single digits in rich countries, agriculture is what remains as a market-access target, especially for key developing countries".[42]

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[40] K.S., Jomo and Jacques Baudot, ed., *Flat World, Big Gaps: Economic Liberalization, Globalization, Poverty, and Inequality.* New York: United Nations Publications, 2007, p. 300.
[41] Moyo, Dambisa, *Dead Aid: Why Aid is Not Working and How There Is a Better Way For Africa.* New York: Farrar, Straus, and Giroux, 2010, p. 115.
[42] Elliott, Kimberly Ann, *Delivering on Doha: Farm Trade and the Poor.* Washington, D.C.: Institute for International Economics and Center for Global Development, 2006.

The trade restrictions and trade barriers developed nations have placed at the foot of developing nations have not only stifled, but also produced an incredible amount of regional debt.

> "The total external debt of Africa has increased nearly twenty-five fold from a relatively low level of US$14 billion in 1971, to more than US$300 billion in 2003. The major component is outstanding long-term debt, which is generally obtained on concessional terms. Overtime, International Monetary Fund (IMF) credits were also increasingly used, along with 'Structural Adjustment' and 'Enhanced Structural Adjustment' facilities until they also became a large component of debt. Although the share of African debt as a proportion of the total debt of developing countries is low, the relative debt burden born by Africa is extremely heavy compared to its capacity".[43]

Africa, as a developing region, thus deals with the harsh reality of the global economic system; free trade and trade liberalization apply only to those countries without the economic leverage to avoid such detrimental trade policies. When the basic footing on which a house is built cannot stand, the house crumbles. Likewise, no nation can hope to develop in the terms propagandized by advocates of free trade and trade liberalization, when the basic tenements of these policies are so virulently flaunted by developed nations.

Conclusion

The ideologies of trade liberalization and free trade do not render positive outcomes for those actually committed to these ideals. The only true benefit seen comes from trade in general between nations, in that a larger amount and variety of commodities are available to the consumer at a low price. Bilateral trade agreements and subsidization are impediments, which affect the application of free trade and trade liberalization, but they are a valued aspect of national economic

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[43] K.S., Jomo and Jacques Baudot, ed., *Flat World, Big Gaps: Economic Liberalization, Globalization, Poverty, and Inequality.* New York: United Nations Publications, 2007, p. 305.

control and protection. They provide the nation-state an ability to protect its citizens and respond to policy demands with regards to trade. The retention of these protectionist policies by the same nations, which argue for the importance of free trade and trade liberalization, should be enough to identify a logical problem in implementation. The devastating effects such contradictory activities have on developing nations cannot be ignored. What is then required is ignore the presumed benefits of free trade and economic liberalization, whose benefits are assumed under any depiction of trade between nations. Instead we should focus on the benefits of bilateral trade and subsidization, which are shown to actually benefit and protect workers and firms within a nation. In the next chapter we address further concerns to the current global economic system that also must be incorporated and addressed in producing an amiable economic system which benefits all nations; a model which allows each individual to fish to their fullest potential.

Chapter Three: Production Overcapacity and Capital Mobility: The Cause of Market Deflation

Introduction:

The previous chapters discuss the flexible exchange rate system and the myth of free trade doctrine and trade liberalization policies, as well as, their roles in destabilizing the global economic system. Of primary importance in each of these chapters were concerns about the role of the nation-state in trying to adapt to changes in the global economic system. The nation-state rather than being eroded by an increasing global economy has remained the main operator in setting rules, creating barriers, and maintaining their national economic hegemony.

> "Economic globalization is theorized, first, as a soft geo-politics, with which states use economic means to acquire international geo-hegemony. More importantly, globalization represents a strategy with which advanced capitalist states – along with members of their capitalist classes – shift the politics of accumulation away from domestic citizenries to gain increased control over their political-economies and greater insulation from intra-national contestation".[44]

It is this aspect of greater insulation and autonomy that poses problems within the current global economic system, as nation-states utilize their economic position to impose rules that provide increased control over their political economies. Examples from the previous chapters include the move to a flexible exchange rate that provided for greater capital mobility and capital accumulation, as well as, the

[44] Gritsch, Maria, "The Nation-State and Economic Globalization: Soft Geo-Politics and Increased State Autonomy?." *Review of International Political Economy* 12, no. 1 (Feb. 2005): 1-25, http://www.jstor.org/stable/25124006.

adoption of bilateral trade agreements and policies of subsidization to create market advantages and market protections, especially for developed nations.

The question thus occurs of how increased capital mobility, created by the adoption of the flexible exchange rate system, discussed in the first chapter, affects the global economic system, and how the interactions of nation-states contribute to its affect. In order to address this question we shall examine capital mobility more fully, assessing its contributions to the stability and instability of the current global economic system and the employment of Central Banking Systems by nation-states to attempt to regulate the flow of capital and labor into and out of nations. We shall also examine aspects production overcapacity in the manufacture of goods and the resulting economic implications. My hypothesis is that capital mobility and production overcapacity has led to a state of deflationary tendencies in the market. To assess this, we shall examine whether the flow of FDI, exports of goods and services, central government debt, inflation, unemployment, and subsidies expenditures by nations demonstrates deflation (overproduction of goods results in lowered prices but demand cannot meet production, manufacturers lay off employees to meet low prices, demand remains due to a reliance on credit rather than real wages and prices continue to drop).

Market deflation presents a real concern for nations as the only tool for fighting it rests in lowering interest rates to increase real economic growth, however, after the burst of the recent financial bubble most nations have already lowered their interest rates to feed the perceived economic prosperity (i.e. the credit bubble which relied on the availability of low interest credit to fuel

consumption). Perceived, because no real capital was created, there was no new production of goods or services, only the movement of credit between financial institutions. Thus, the effect of deflation would serve to worsen an already bad situation; a situation began and fueled with capital mobility.

Capital Mobility and Central Banking:

Capital mobility refers to the ease of ability to transfer capital from one individual, firm, or nation to another individual, firm, or nation. Capital mobility is was seen as a positive outcome of ending the Bretton Woods Agreement which placed strict limits on the amount of capital that could be removed from a state and invested elsewhere. Increases in capital mobility lead to an expansion of the economy (a real expansion is up for debate, as it usually fueled a financial bubble, i.e. the dot.com bubble and credit bubble) increasing both available credit and direct investment. Capital mobility began due to the concerted efforts of financial institutions and nations.

> "The expansion of credit is not a series of accidents but instead a systemic development that has continued for several hundred years as the participants in financial markets sought to reduce the costs both of transactions and of holding liquidity and money balances. The form each event takes may seem accidental – the substitution of bills of exchange for silver payments to China, or the development of deposits in the Eurocurrency market because ceilings prevented U.S. banks from increasing the interest rates that they could pay on deposits in New York, Chicago, and Los Angeles. Monetary expansion is systemic and endogenous rather than random and exogenous. During economic booms the amount of money defined as a means of payment has been used more efficiently to finance both increases in economic activity and the purchase of real estate and securities and commodities in search of capital gains".[45]

These economic booms have been, at least in the latter part of the twentieth century and early twenty-first century, financial bubbles that saw increased efficiency in the

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[45] Kindleberger, Charles P. and Robert Aliber, *Manias, Panics, and Crashes: A History of Financial Crises,* 5th ed. Hoboken, NJ: John Wiley and Sons, Inc., 2005, 66-67.

use and availability of capital for investments, purchases, and trading. The outcomes of this efficiency were an eventual collapse of a financial bubble and the search for a new area of investment.

The current period of capital mobility has come out of a concerted effort by nations, the United States in particular, to remove the Bretton Woods Accord, which pegged the world currencies to the United States Dollar. In exchange, the world's currencies would enter a period of flexible exchange rates set by the money exchange market and regulated by national central banks.

> "The post-World War II period was one of fixed exchange rates. Most Western countries, including France and Italy, had capital controls restricting the movement of currency in and out of their borders. The dollar was pegged to gold. But as global trade grew, fixed rates created frictions and inefficiencies and prevented capital from being put to its best use. Most Western countries removed controls during the 1970s and 1980s. The result: a vast and ever-growing supply of capital that could move freely from one place to the next. Along with freely floating money came another policy revolution: the spread of independent central banks and the taming of inflation".[46]

The central banks had the responsibility of safeguarding national currencies in light of speculation and the threat of vast currency transactions, which could disrupt economic activities. The use of central banks ensured that national economic policy would be maintained as national currency influxes and interest rates are controlled. These central bank control mechanisms allow nations to use national currency influxes to protect from currency withdrawals from a nation and use interest rates to either lower inflation by increasing interest rates or increase available credit by lowering interest rates.

Despite these controls, capital mobility does pose serious challenges to nations.

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[46] Zakaria, Fareed, *The Post American World,* New York, NY: W. W. Norton and Company, Inc., 2008, 23.

> "A disconcerting feature of contemporary capitalism is capital's current hypermobility. The bulk of capital in a capitalist society belongs to private individuals. Because it is theirs, they can do with it whatever they want. But this freedom, when coupled with recently enhanced technical transfer capabilities, gives capital a mobility that now generates economic and political insecurity around the globe. Financial markets now rule".[47]

This hypermobility of capital can serve to destabilize national policies, as increasing capital inflows heighten diversified sectors and non-diversified sectors decline due to capital outflows. The use of central banks and national policies can mitigate these destabilizing aspects, through subsidization, trade barriers, and increasing available credit. However, any exertion by central banking authorities or national policies will be increasingly restricted and become ever more of a destabilizing factor in national policies and coalitions.

> "While financial capital is extremely mobile across borders, other types of investment (especially in equities and sector-specific capital) are far less mobile. In this context, foreseeable levels of international capital mobility restrict but do not eliminate the possibility for national economic policies. In the developed world, financial integration favors capitalists with mobile or diversified assets and disfavors those with assets tied to specific locations and activities such as manufacturing or farming. International capital mobility tends to remake political coalitions by way of its impact on the effects of national policies. The political division between producers of tradable goods and producers of non-tradable goods and services is likely to become more important, as are distinctions between internationally diversified and undiversified investors".[48]

These challenges to the nation-state and to central banking institutions are enhanced when by economic deflation. When the economy fails to grow due to a lack of consumers to purchase all goods produced, then capital mobility presents a threat. As increased capital is available, but it does not get utilized to create new economic growth, but merely to maintain the current flow of goods and current

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[47] Schweickart, David, *After Capitalism,* 2nd ed. Plymouth, United Kingdom: Rowman and Littlefield Publisher, Inc., 2011, 46.
[48] Frieden, Jeffry A., "Invested Interests: The Politics of National Economic Policies in A World of Global Finance." *International Organization* 45, no. 4 (1991): 425-451.

established firms; pushing prices down below the return rate and sacrificing employment and capacity to maintain production.

Production Overcapacity:

Production overcapacity refers to the process in which more goods are produced within a market than can be consumed by individuals. This feature is usually handled in a capitalist market model of less efficient firms being edged out of the market more efficient firms which take over a market. Efficiency refers to the ability of a firm to produce goods more productively (better quality, better reliability, at a cheaper cost, or at a faster pace through reorganization, technological innovation, or some other factor). This process is referred to as creative destruction and is a cornerstone of the capitalist system, allowing for continued competition and growth through innovation and efficiency.

> "The opening up of new markets, foreign or domestic, and the organizational development from the craft shop and factory to such concerns as U.S. Steel illustrate the same process of industrial mutation that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one. This process of Creative Destruction is the essential fact about capitalism. It is what capitalism consists in and what every capitalist concern has got to live in. The fundamental impulse that sets and keeps the capitalist engine in motion comes from the new consumers' goods, the new methods of production or transportation, the new markets, the new forms of industrial organization that capitalist enterprise creates".[49]

Whether or not this component is realized in the current economic system is the main concern leading to economic deflationary tendencies. This essential component has been altered by three main factors, the focus of the United States as the 'consumer of last resort', under-consumption of produced goods, and deficit financed over production.

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[49] Schumpeter, Joseph A., *Capitalism, Socialism, and Democracy,* New York, NY: HarperCollins Publishers, 2008, 82-83.

> "Since then [the end of the Bretton Woods agreement], the United States has tended to run unfavorable trade balances as other nations pursued an economic growth policy based on continual expansion of export sales to the United States – the largest market for consumer goods in the world. Export industries were the backbone propping up the economies of many nations, especially those in Asia. As long as Americans were willing to buy more imports from foreigners than what they exported to foreigners, the United States stimulated growth in these export oriented nations".[50]

By focusing on export to developed nations, rather than the expansion of markets within their own nations the export oriented nature of these emerging foreign nations have pressed firms to compete for decreasing market shares and a smaller consumer markets, leading to under-consumption.

Under-consumption, describes a lack of effective demand that creates a condition where more goods are produced than can be consumed, causing prices to decrease and market shares to become more competitive.

> "It is now well understood that consumer sentiment and consumer confidence in the more affluent societies are not only keys to endless capital accumulation but are more and more the fulcrum upon which the survival of capitalism depends. What is called a crisis of under consumption, results when there is not enough effective demand to absorb the commodities produced. Workers spending their wages are one source of effective demand. But worker demand, though an important base can obviously never solve the problem of realization of profits".[51]

The reliance on affluent nations for consumer demand comes when more and more nations began to industrialize and produce goods while also suppressing wages to increase their comparative advantage. This process of reliance on developing nations, especially the United States, for the consumption of manufactured goods demonstrates in itself the myth of creative destruction in the global economic system. Any exorbitant trade imbalance, such as that which has existed and

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[50] Davidson, Paul, *The Keynes Solution: The Path To Global Economic Prosperity,* New York, NY: Palgrave Macmillan, 2009, 133.
[51] Harvey, David, *The Enigma of Capital and the Crises of Capitalism,* New York, NY: Oxford University Press, 2010, 107-108.

expanded in the United States since just prior to the 1970s, should have been re-adjusted under normal market conditions. However, manufacturing nations have provided the capital to the United States in order to maintain this imbalance.

> "All else equal, worsening US external balances could have been expected to self-adjust by generating a decline in the exchange value of the greenback and corresponding improvement in US competitiveness. But, to prevent this rebalancing, East Asian governments, especially Japan and later China made even larger purchases of dollar denominated assets so as to fund US external deficits at artificially low rates of interest rate, which they generally financed by printing ever-greater amounts of domestic money. Their aim was to hold down their own exchange rates vis-à-vis the dollar and repress US interest rates, so as to subsidize US borrowing and consumption, in order to sustain their own export-dependent manufacturing growth machines. The US economy, with its elevated currency and reduced cost of borrowing, enjoyed cheap imports, declining inflation, subsidized over-consumption, and a pumped-up non-traded goods sector – featuring booms in construction, retail trade, and land development."[52]

This creates a situation where more goods are produced than can be consumed, and where developing nations do not develop their own consumer base for fears of losing their comparative advantage to more efficient firms in developed nations; thus over-production is created. Though real benefits are accrued by the United States due to this arrangement, its impact in leading to the current recession cannot be ignored. Without real market growth, no sustainable economic activity can take place and yield real profits and thus real wage growth to increase consumption of goods. Some may raise questions of how under-consumption can exist when one considers the environmental unsustainability of US consumerism, but that underlines a concern for the global economy. If the current consumerism is environmentally unsustainable and it is short of market requirements, then how sustainable is the global economy?

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[52] Brenner, Robert, "What Is Good for Goldman Sachs Is Good For America: The Origins of the Current Crisis." *Center for Social Theory and Comparative History UCLA* (Apr. 2009): 1-73.

The answer lies in over production being maintained by deficit spending and subsidization. Overproduction in the global economic system has been maintained by use of credit and public finance to maintain profits. Falling profits and labor reductions in firms throughout the developed world, as well as, the maintaining of low labor wages in developing nations mark the global economy.

> "The decreasing vitality of the advanced capitalist economies has been rooted in a major decline, and stubborn failure to revive, of the rate of profit, finding its fundamental (though not its only) source in a persistent tendency towards over-capacity in the global manufacturing sector, which originated with the intensification of international competition between the mid-1960s and mid-1970s. Manufacturing over-capacity emerged, was reproduced, and has been further deepened by way of an extended process of uneven development, in which a succession of newly emerging manufacturing powers has been able, thanks to systematic state intervention and highly organized forms of capitalism, to realize the potential advantages of coming late, especially by combining ever increasing technological sophistication with relatively cheap labor and orienting production to exports for the world market. Overcapacity has meanwhile been exacerbated and rendered chronic as a consequence of the reluctance of the great corporations at the core of the world economy to cede market share to their rivals even in the face of falling rates of return – their proclivity to fight to hold on to their established positions by cutting costs rather than switch to new unfamiliar lines, especially by falling back on their proprietary capital, above all their capacity to innovate".[53]

These three factors, the focus of the United States as the 'consumer of last resort', under-consumption of produced goods, and deficit financed over production have undermined the process of creative destruction. As a result, nations are using public funds, credit, and financial manipulation to maintain existing economic structures while failing to create any real growth in the economy. As this process continues to squeeze available profits, labor wages will become lower and deficit spending will increase. This process describes an ailing economic system, which uses the increased availability of capital and credit available to maintain existing consumerism and economic conditions. In the end, disrupting capitalism into an

[53] Brenner, Robert, "What Is Good for Goldman Sachs Is Good For America: The Origins of the Current Crisis." *Center for Social Theory and Comparative History UCLA* (Apr. 2009): 1-73.

altogether unrecognizable and untamable beast, which may still have some bite in store for the global economic system.

Deflationary Tendencies:

The stability of the global economic system is of critical importance when one considers the unique characteristics, which bind all nations together in economic prosperity and in times of economic decline. The stability of the economy has always served to also reflect the stability of the times. The current question is whether the current economic conditions point to a troubling aspect of deflation. Deflation is unique from stagnation, which occurred in the 1970s and brought about the end of the Bretton Woods Accord; stagnation refers to a stagnant economy and rising interest rates.

> "The term stagnation refers to an economic condition of both continuing inflation and stagnant business activity, together with an increasing unemployment rate. Inflation seemed to feed on itself. People began to expect continuous increases in the price of goods, so they bought more. This increased demand pushed up prices, leading to demands for higher wages, which pushed prices higher in a continuing upward spiral".[54]

Stagnation ended only after the Federal Reserve board increased interest rates and starved the economy of the credit demanded to purchase goods and continue the inflationary cycle.

Deflation depicts a different problem altogether as demand for goods decreases pushing down prices, lowering employment, and further deflating the economy. The difficult aspect of combating deflation is that the normal Central Bank control measures do not apply, as they are focused more on combating inflation.

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[54] About.Com, "Stagflation in the 1970s." *U.S. Department of State, http://economics.about.com/od/useconomichistory/a/stagflation.htm*

> "That nightmare scenario of deflation might seem remote considering the recent rebound in growth, and the Federal Reserve would almost certainly try to head it off, probably well before prices started to fall. But some investors and economists say the risk is real. Inflation is expected to more than halve over the next year as a spike in prices for goods like oil and grains unwinds. Unemployment, meanwhile, will likely hold at nearly double its pre-recession level into next year, keeping incomes under pressure. To counter inflation, central banks can always raise interest rates. But the Fed's normal tool kit for countering falling prices [lowering the interest rate] is limited since it has already cut short-term borrowing costs nearly to zero".[55]

So, the question should be asked as to what other signs of deflationary tendencies are present, besides general indications consistent with an economy in the grips of financial recession. A. Gary Schilling discusses these signs in a Forbes Magazine article.

> "The first is deflation in financial assets. With the collapse in the subprime residential mortgage market in 2007, we have seen a swoon in stocks and bonds from investment grade to junk and municipal bonds. Virtually all-financial assets have declined. Massive monetary and fiscal stimuli revived them in 2009, but financial assets are shrinking again. Financial-asset deflation is also in Europe. Sovereign debt prices have been hit hard by the euro zone crisis and rating downgrades. My second deflation type involves price declines in tangible assets. For this, Exhibit A is housing. The S&P Case Schiller Home Price Index is down 4.1% from a year ago and 31% from its July 2006 peak. Moody's/REAL Commercial Property Price Index has dropped 43% from its October 2007 top. Third deflationary symptom? Commodity prices. Copper measures global industrial activity since it's used in almost all manufactured products. It's down nearly 30% from its February Top. Cotton is off 58% since March. Even Gold is down from its peak. With the weak U.S. labor market, the wage side of the wage/price deflationary spiral is firmly established. This is my fourth type of deflation. Currency deflation is the fifth type. With financial and tangible asset, commodity, wage, and currency deflation in place, goods and services deflation can't be far behind. As global deleveraging persists, all these prices will be marked down".[56]

With these signs of deflationary tendencies already persistent, nations are faced with little reactive measures and a highly unstable global economic system. The concern is that little can be done in small measure to correct for deflationary tendencies and that the intervening period could be marked with an unstable political spectrum, as nations are left for themselves, as the world waits.

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[55] Lange, Jason, "Nightmare Scenario: U.S. Deflation Risks Rising," *Thomas Reuters,* October 26, 2011, www.reutersprints.com.

[56] Schilling, A. Gary, "Deflation Has Arrived," *Forbes.com*, October 24, 2011, www.forbes.com.

We can add increasing pressures on immigration control as a measure to inflame an already volatile situation.

> "With unemployment rates remaining persistently high in the wake of the global economic crisis, ongoing turbulence in financial markets, and new austerity in public spending, anxious publics and governments trained their attention on immigration and immigrants during 2011. Among the results: more restrictionist immigration policies, a rise in anti-immigrant sentiment, and the increasing popularity of radical-right parties. The latter have capitalized on fears of diluted cultural identity and the perceived failures of multiculturalism for short-term political gains".[57]

As more nations become like Spain, Greece, and Italy, dependent on deficit funding and assistance loans to maintain their economic place, more nations will face the problems these nations now face. Economic deflationary tendencies have forced firms to contract their labor pool and increase production just to capture ever-decreasing profits, and governments have attempted to stimulate or prevent economic collapse through public spending, yet cannot motivate the economy. Continual lowering of prices and lowering inflation will be seen alongside increasing national debt and lowered economic gains. These indicators shall be examined more closely by using World Bank indicators to measure some of these disturbing trends.

Method:

Measuring deflationary tendencies on a world scale is accomplished using the World Development Indicators provided by the World Bank. "The primary World Bank collection of development indicators, compiled from officially-recognized international sources. It presents the most current and accurate global

[57] Migration Policy Institute, "Issue #2: Economic Malaise Makes Immigrants a Target for Restrictive Legislation, Public Backlash," *Migration Information Source,* December 1, 2011, www.migrationinformation.org.

development data available, and includes national, regional and global estimates".[58] Using this dataset I identified six variables to assess in order to identify whether or not deflation is present in the global economic system. This process and variables were identified in my hypothesis where I depicted that we shall examine whether the flow of FDI, exports of goods and services, central government debt, inflation, unemployment, and subsidies expenditures by nations demonstrates deflationary tendencies (overproduction of goods results in lowered prices but demand cannot meet production, manufacturers lay off employees to meet low prices, demand remains but prices continue to drop, market stagnates). These indicators exhibiting the processes identified in the section on deflationary tendencies would identify: a stagnant market (exports of goods and FDI) with increasing unemployment, increasing government deficits and spending (central government debt and subsidies), and a decrease in consumer prices (inflation). If these factors are indicated then it can be reasonably inferred that deflationary tendencies are present in the global economic system.

Data and Results:

The first variable utilized is the measure of Foreign Direct Investment, Foreign direct investment, net inflows (BoP, current US$); it is labeled as Figure 1.

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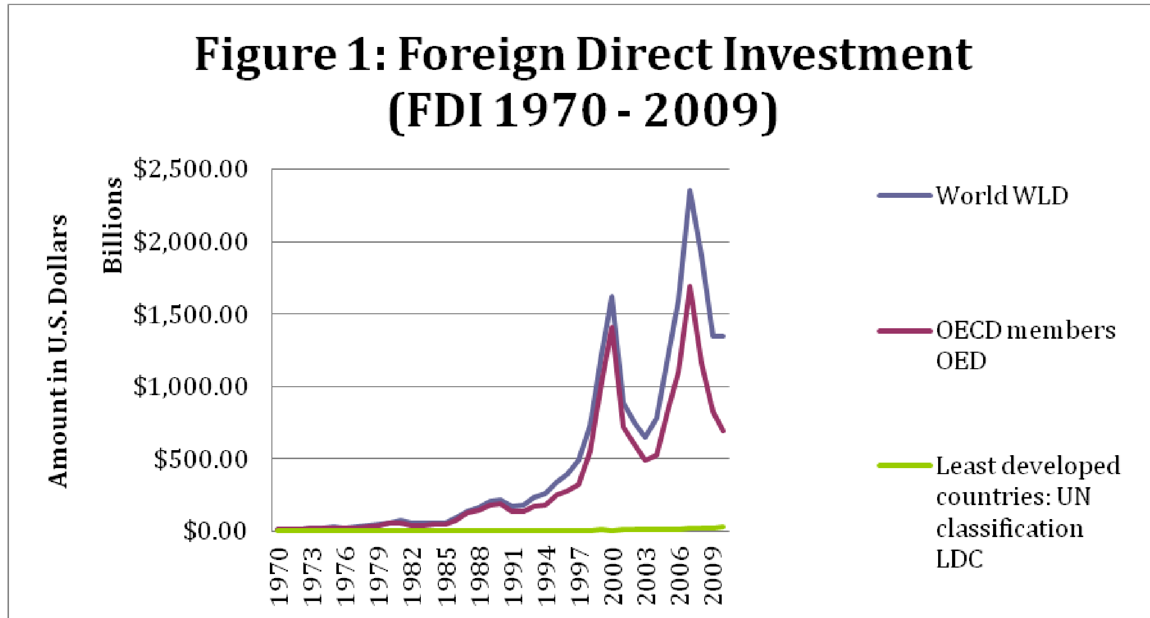
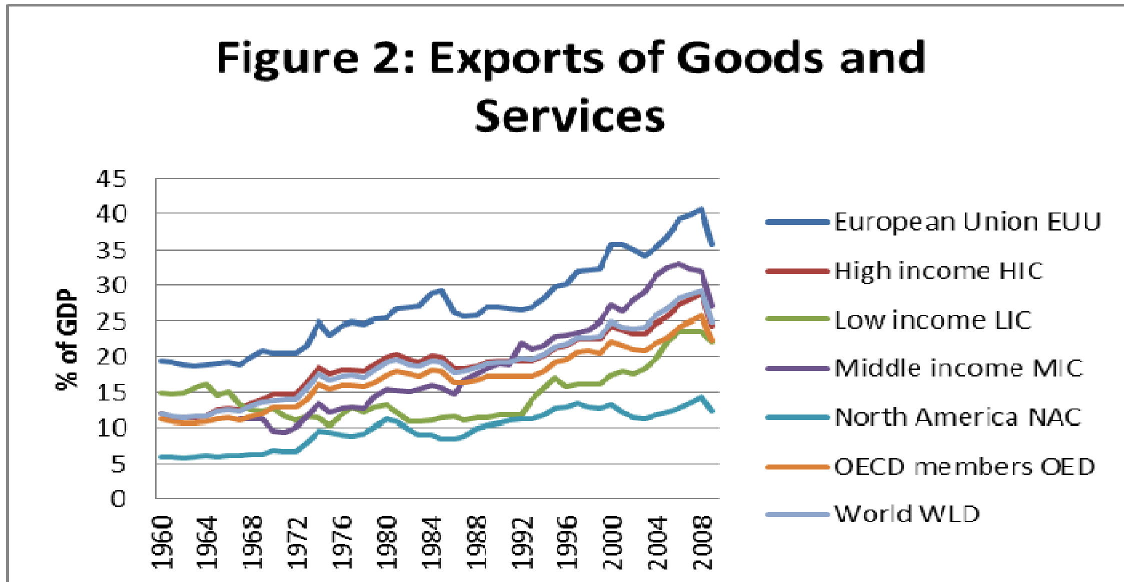
[58] The World Bank, "World Development Indicators," *Data Catalog,* December 1, 2011, http://data.worldbank.org/data-catalog.
[The method for generating the data present and organized in the data catalog is gathered from surveys, census data, and estimations. They follow strict methodological practices that are articulated in the World Development Indicators publication, which can be viewed online at: http://data.worldbank.org/data-catalog. Therefore, reliability and validity of the measurements can be confirmed and we can be assured of using the best indicators present to identify deflationary aspects.]

"Foreign direct investments are the net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments. This series shows net inflows (new investment inflows less disinvestment) in the reporting economy from foreign investors. Data are in current U.S. dollars".[59]



The graph of figure 1 illustrates the rapid decline of foreign investment rates in the world and OECD member countries, as well as, the consistently low foreign investment of the Least Developed Countries (these are classified by the United Nations). The decline of foreign direct investment rates are a key indication of a stagnate economy, as these serve to demonstrate that either the profits are falling in firms and firms cannot invest or that firms are unwilling to invest given economic conditions. Either way, this is an indication of negative growth in the global economic system.

[59] The World Bank, "World Development Indicators," *Data*, December 1, 2011, http://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD



The second variable utilized is the measure of the exports of goods and services (% of GDP); it is labeled as Figure 2.

> "Exports of goods and services represent the value of all goods and other market services provided to the rest of the world. They include the value of merchandise, freight, insurance, transport, travel, royalties, license fees, and other services, such as communication, construction, financial, information, business, personal, and government services. They exclude compensation of employees and investment income (formerly called factor services) and transfer payments".[60]

The graph of figure 2 illustrates the recent drop in return price from the export of goods and services, in all country income levels (determined by United Nations coding), OECD members, the E.U., North America, and the World. The similarity of the graphed data indicates two important points: 1. The decline of export prices is shared globally, and 2. The decline of export prices is not due to any national or regional protective measure or failure of any particular market. These conclusions point to a shared failure of the overall global economic system, where prices are being deflated.

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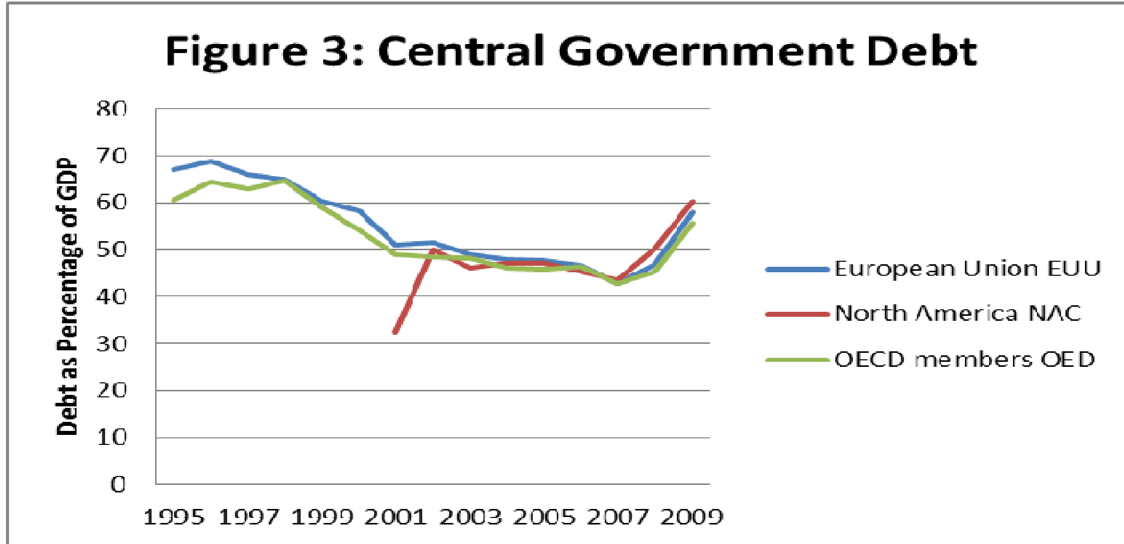
[60] The World Bank, "World Development Indicators," *Data*, December 1, 2011, http://data.worldbank.org/indicator/NE.EXP.GNFS.ZS.

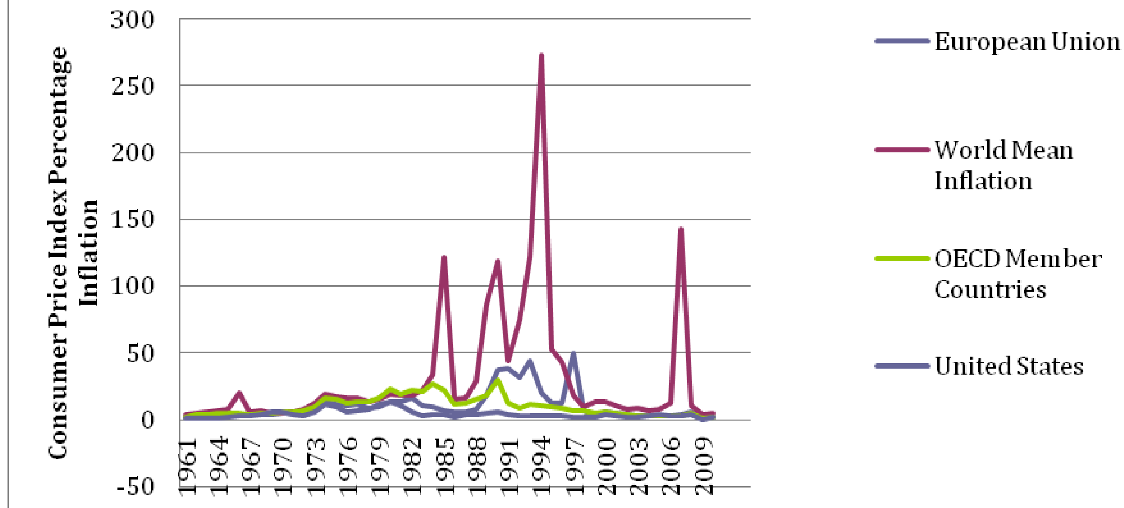


The third variable utilized is the measure of Central government debt, total (% of GDP); it is labeled as Figure 3.

> "Debt is the entire stock of direct government fixed-term contractual obligations to others outstanding on a particular date. It includes domestic and foreign liabilities such as currency and money deposits, securities other than shares, and loans. It is the gross amount of government liabilities reduced by the amount of equity and financial derivatives held by the government. Because debt is a stock rather than a flow, it is measured as of a given date, usually the last day of the fiscal year".[61]

The graph of figure 3 illustrates the increasing levels of debt of nations in the EU, North American Region, and OECD members. The graphed data clearly demonstrates that the wealthiest nations, which are able to afford massive deficit spending, are increasing their spending at the same time as economic indicators (FDI and exports of goods and services) show lowered returns. This dataset points to an attempt by governments to revitalize a stagnant economy by maintaining their economic margins through public finance.

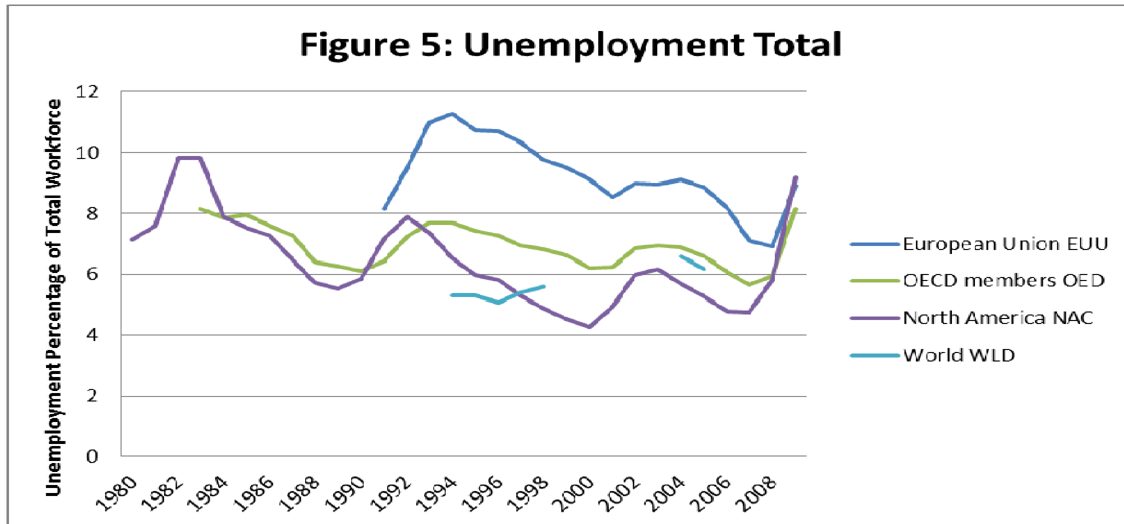
[61] The World Bank, "World Development Indicators," *Data*, December 1, 2011, http://data.worldbank.org/indicator/GC.DOD.TOTL.GD.ZS/countries.



The fourth variable utilized is the measure of Inflation, consumer prices (annual %); it is labeled as figure 4. "Inflation as measured by the consumer price index reflects the annual percentage change in the cost to the average consumer of acquiring a basket of goods and services that may be fixed or changed at specified intervals, such as yearly".[62] The graph of figure 4 illustrates the steady, low interest rates of the United States, European Union, and OECD countries. The World Mean Inflation takes all countries into account and therefore presents a more dynamic fluctuation over time, but still depicts the current trend of near zero interest rates. These inflation trends are consist of an attempt by many nations to fuel credit bubbles through the use of increased capital/credit by adjusting the interest rate downward. With such record low interest rates and the resulting availability of credit this period should be one of economic expansion. The fact that it is a recession displays the concerns associated with deflationary tendencies, that the main economic tool for spurring growth is already engaged. This means that prices

[62] The World Bank, "World Development Indicators," *Data*, December 1, 2011, http://data.worldbank.org/indicator/FP.CPI.TOTL.ZG.

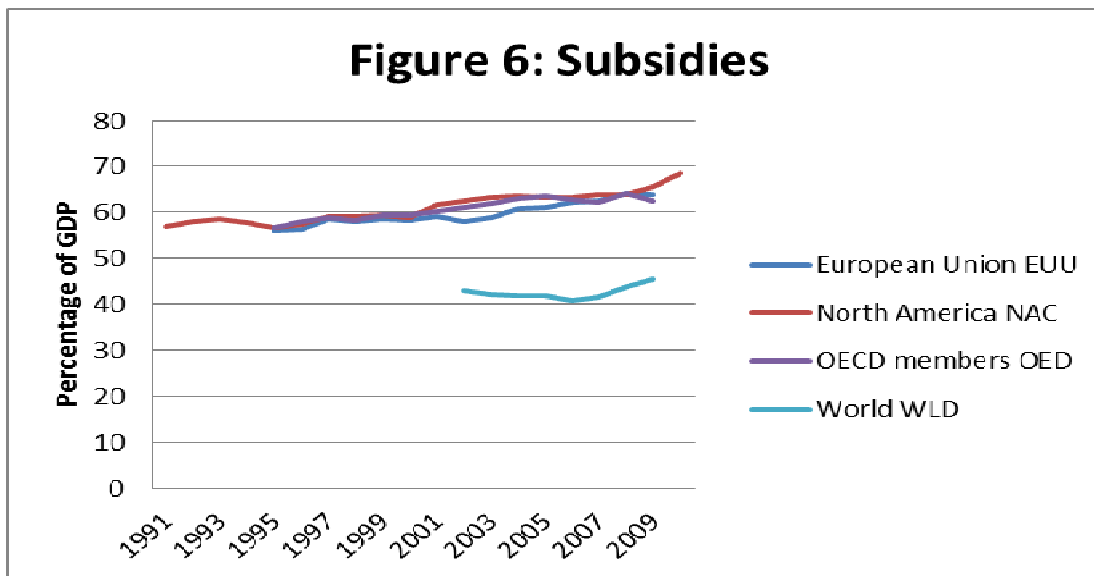
have fallen and continue to fall and thus returns (profits) for firms are also in decline leading to employee redactions and conservative cost-cutting measures.



The fifth variable utilized is the measure of Unemployment, total (% of total labor force); it is labeled as figure 5. "Unemployment refers to the share of the labor force that is without work but available for and seeking employment. Definitions of labor force and unemployment differ by country".[63] The graph of figure 5 illustrates the rapid increase in unemployment after the 2006/2007 bursting of the housing/credit bubble in the European Union, OECD member nations, and in North America. Some world measures are indicated, but many nations do not adequately track unemployment or do so for only a specific segment of the population, thus the three aforementioned measures are the most reliable and accurate. The rapid rise in unemployment clearly demonstrates the attempt by firms to maintain profits in the wake of falling prices, it is worth noting that in North America and OECD member nations these are some of the worst unemployment numbers on record and

[63] The World Bank, "World Development Indicators," *Data*, December 1, 2011, http://data.worldbank.org/indicator/SL.UEM.TOTL.ZS.

the trend continues upward and shows little sign of improvement. Unemployment is a concern for a myriad of reasons, but in particular it is troublesome for the fact that it parallels earlier unemployment trends during the 1970s-1980s inflation crisis; Representing similar structural problems in the economic system which were never resolved, but simply overshadowed by financial bubbles from the late 1980s to the collapse of the most recent bubble.



The last variable utilized is the measure of Subsidies and other transfers (% of expense); it is labeled as figure 6.

> "Subsidies, grants, and other social benefits include all unrequited, non-repayable transfers on current account to private and public enterprises; grants to foreign governments, international organizations, and other government units; and social security, social assistance benefits, and employer social benefits in cash and in kind".[64]

The graph of figure 6 illustrates the expenditure on subsidies by nations in the European Union, the North American region, OECD members, and the world average. Though North America and the world average both indicate a clear rapid

[64] The World Bank, "World Development Indicators," *Data*, December 1, 2011, http://data.worldbank.org/indicator/GC.XPN.TRFT.ZS.

increase, in an already increasing trend, the European Union and OECD members both show a slight downward trend in an overall increasing trend. This difference may be an indication of the availability of debt to finance continued subsidies, remember that the United States did not experience the same inflationary curve that other OECD members and the European Union experienced. Overall, however, we can conclude that the world at large is attempting to use public finance to maintain their economic margin and to cover increasing cost of unemployment. It is also important to note that the % of GDP spent on subsidies and debt equal more than 100, indicating that all nations included in these two datasets are relying on debt financing to cover their own economic short-comings.

The Recession:

Though these six variables serve to confirm my hypothesis that deflationary economic tendencies do apply to the current global economic system, it does not spell the death toll for the economy. The economy is going to recovery from the current recession, for no other reason than it has to in order for the needs and wants of individuals to be satisfied. The question posed by ascribing the detractions of over-production, under-consumption, and capital mobility to the creation of the current deflationary tendencies and resulting recession is where to go from here. After each recession, a new monetary arrangement will be maintained with the intention of dealing with the provision of credit and the accumulation of debts. As Philip Coggan articulates in *Paper Promises:*

> "As each cycle develops we learn to use new monetary tools, expand the supply of money, begin to believe that we are smarter or better equipped at managing the risks – only to over-reach, suffer new painful crises, and start anew. With each

> consecutive cycle, the fundamental conflict between money's two functions [Borrower's argue that money is a 'means of exchange' that lubricates the wheels of daily commerce and therefore requires abundance, whereas creditors argue that money is a 'store of value' that encourages savings, requiring a degree of scarcity.] is resolved in favor of abundance, to the detriment of creditors. Along the way, money became increasingly reliant on the value of a promise written on a piece of paper. Today, your money is someone else's debt and your debt is someone else's money-like asset. Today we cannot possibly expect all these promises to be honored in full. As we slowly come to accept this as inevitable, economics and politics for the next decade and beyond will be dominated by this issue, as social classes and countries debate where the brunt of the pain will fall".[65]

The question remains as to whether the current strategy for over-coming the recession will succeed or whether it will place increased demands on paper promises that will continue to undermine the economy through continued deflationary tendencies.

> "According to the IMF, the on-going recovery is entirely due to policy responses: Diving the global rebound was the extraordinary amount of policy stimulus. Monetary policy has been highly expansionary, with interest rates down to record low levels in most advanced and many emerging countries, while central bank balance sheets expanded to unprecedented levels in key advanced economies. Fiscal policy has also provided major stimulus in response to deep downturn. At the same time, there are still few indicators that autonomous (not-policy-induced) private demand is taking hold, at least in advanced economies. [Simon Evenett goes on to comment on this statement] The significance of this macroeconomic and financial market intervention for commercial and policymaking is that the wide range of tools available to policymakers over the past year has diminished the resort to protectionism during the crisis. If this logic holds true in 2010 then certain recent developments bode ill for the near term. Those developments include statements by leading central bankers to begin unwinding their support for the financial sector in the coming year and the growing pressure on governments from central banks, the bond markets, and in some nations elements of the electorate, to cut budget deficits, including limiting spending on bailouts and other subsidies".[66]

If the deflationary tendencies argument holds true then no lasting recovery can occur until a measure is found to address the underlying cause of the current market tendencies. Causes that inherently bring forth problems that are antithetical to traditional market theory due to the isolation of creative destruction brought

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[65] Lane, Allen. "Book Review: Paper Promises: Money, Debt, and the New World Order by Philip Coggan." blogs.Ise.ac.uk, January 15, 2012, http://blogs.Ise.ac.uk/politicsandpolicy/2012/01/15/book-review-paper-promises-by-philip-coggan/.

[66] Evenett, Simon J. "The Global Overview: Has Stabilization Affected the Landscape of Crisis-Era Protectionism?" *The 4th GTA Report, University of St. Gallen and CEPR* (2010): 17-27.

about through capital mobility's finance of debt based consumerism and a retained focus on exports rather than on the expansion of internal markets in developing countries.

Conclusion:

The tale told of the beginning of this century shall be the same told of the beginning of the last; short-term gains led to long-term loss. What is left to question is how bad that loss will be and what can be done to avoid the tolling bell. The current recession depicts market deflationary tendencies, however, these deflationary tendencies are marked by un-paralleled manipulation of the traditional methods of market self-adjustment namely that of creative destruction. By maintaining the notion of subsidized consumerism by export-oriented nations we serve to maintain the very element that creates the current recession. At the same time, however, due to vast subsidization policies within developed nations (seen in the last chapter) we cannot simply apply fictional policies of free trade or trade liberalization. Thus, any new economic system must be devised to address three main concerns: 1. How to retain the ability for capital to be mobile and abundant, in order to continue the process of subsidization within and between nations, but avoid the volatility of a flexible exchange rate system. 2. How to incorporate practices of subsidization and bilateral trade into a new economic system which retains the advantages of traditional trade, but also addresses and corrects the trade imbalances which characterize the current system. 3. How to stimulate real market growth, namely through a process of creating sustainable consumer markets within developing nations and thus ending the 'consumer of last resort' dependence; in

addition to growth, how to replace the idea of creative destruction with a system that ensures limited market opportunities without innovation or market growth. Part II responds to these concerns produced by an examination of the current economic system and proposes an adoption of a new global economic system.

PART II:
THE NEW ECONOMIC MODEL: THE SINGLE CURRENCY REGIONAL TRADE SYSTEM

Part II Introduction: The New Economic Model: The Single Currency Regional Trade System

To ignore the past is to build an imperfect future. These words have always held true to me in all considerations. These same words must be applied to any system that seeks to replace the current flexible exchange rate system. Indeed, John Maynard Keynes noted the past in describing how an unregulated market, even with the best intentions is doomed to failure.

> "Keynes' work was the direct outcome of having observed the economies of the western world in action. Indeed the feature of openness does not take away from the Keynesian theory of the determination of income or from the demonstration of income or from the demonstration that an unregulated market economy may be dragged downward by the ebbing tide of a shrinking aggregate demand even as it may be populated by super-rational and resourceful firms".[67]

Keynes noted that an unregulated market is predisposed to the kind of gerrymandering behavior of currency speculation and crisis due to market volatility and described how states as rational actors would seek to make adjustments to protect their own markets. We explored these aspects of subsidization, bilateral trade, and deficit spending in the previous chapters. Any new system must take the history of the international economy in its entirety and not make suppositions that time or changes in the international landscape would alter the findings of the past. Beyond this, any economic system must work to integrate all of humanity. Only in integrating all nations in a system of mutual

[67] Balakrishnan, Pulapre. "Globalization and Keynesian Reach." *Economic and Political Weekly* 37, no. 33 (Aug. 2002): 3412-3413, JSTOR.org.

interdependence, rather than dependence will we ensure an economic system with the stability to withstand changes and demands over time.

> "The tragic character of our age is revealed in the world-wide insecurity which is the fate of modern man. Technical achievements, which a previous generation had believed capable of solving every ill to which the human flesh is heir, have created, or at least accentuated, our insecurity. For the growth of technics has given the perennial problems of our common life a more complex form and a scope that has grown to be worldwide. Our problem is that technics have established a rudimentary world community but have not integrated it organically, morally, or politically. They have created a community of mutual dependence, but not one of mutual trust and respect. Without this higher integration, advancing technics tend to sharpen economic rivalries within a general framework of economic interdependence".[68]

The current character of the global economy is in many ways one of dependence on the market, on rational actors, and on the ability to control for currency influxes and speculation. It is a system that lends itself to the benefits of capital accumulation and national economic policy, but fails in offering the stability and growth wanted from a global economic system.

The current flexible exchange rate system depicts a series of advantages and disadvantages, which shape and limit our economic possibilities. The advantages of the flexible exchange rate system lie in its ability to increase the flow of capital between various markets and lie in the ability for nations to administer their own monetary controls. The disadvantages, which have been discussed thus far, depict how the current flexible exchange rate system in combination with international economic entities (the WTO and IMF) have allowed for vast economic disparities to develop in concert with a continual series of financial bubbles which feed economic deflation. These limitations or failings of the flexible exchange rate system depict real limitations in creating real economic growth on a global scale. Rather, the

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[68] Niebuhr, Reinhold. "The Illusion of World Government." *Foreign Affairs* 27, no. 3 (Apr. 1949): 379-388, JSTOR.org.

system has and continues to produce shifting movements of capital based on comparative advantage (namely cheap labor) in developing countries and a continuous series of financial bubbles in developed countries; the result of which can be seen with the recent and continuing economic recession.

Though this process is depicted as global in character, the benefits and shortcomings of the flexible exchange rate system are far from global in application. Though this ability to isolate the economic downturn of a few nations from spreading to others is seen as a benefit in times of recession, as some nations do not feel the full weight of collapse as others, it still represents a global loss of benefit from economic activity. The proposal that follows challenges this flexible exchange rate system through by proposing the creation of a regionally administered global trading system based on a single global currency.

Though the argument can always be made that nations will not give up their sovereignty or that this process cannot be quantitatively analyzed it is important to note: that the European Union has shown that, when sufficient benefits are available, nations are willing to give up sovereignty, in addition, it is important to remember that numbers can identify patterns, but only a dedicated action reveals the true effectiveness of an idea. Thus, as the saying goes, actions will speak louder than words in judging the actual abilities of such an idea and how easily they can be applied. Even though the single currency region system represents a major change in international economics, when one looks at the past economic systems it can be understood that it is only an extension to what has come before.

The idea at the heart of the regional trade system is that a market system based on a volatile currency base can no longer address the concerns and needs of an expanded human population. It can no longer address the needs of 6+ billion people who wish to live in the same luxury as those in America, it cannot deal with the 200 years of industrial pollution threating our world, and it cannot yield the same promises of humanity that it once held. The market system is still needed to maintain the flow of goods and services, but should it depict the value of currency? What is needed at the global level is a new system, not contingent on taxes or exchange of some hard currency, but a system which is based on utilizing the abilities, resources, and determination at hand in new and creative ways.

The regional trade system makes this possible by maintaining the market system within and between regions, but allowing an overarching system, which separates world expenditures and resource use from those of a regional expenditure and resource use, thereby, creating two levels of the economy; the intra-regional level and the inter-regional level. By incorporating this feature the World Central Bank would have an unlimited budget to obtain services, resources, and capital needed and would instead focus on utilizing and reutilizing these services and goods in a sustainable systemic manner to maintain a stable base economy within each region and to address the needs of the world. The object we have to get pass in thinking is that paper currency has to be exchangeable for a hard currency in order to have value. Currency can have value if everyone agrees it has value and if it can retain that value over time. A piece of art, a document, or a book has no value beyond the cost of the paper and ink, but value is given to it by a

universal acceptance and understanding of its value. Likewise, governments have no power without the people to give them such power. What follows is a depiction of the system (including its benefits and failings) and an explanation of how this system depicts a radical change from the current failures of the flexible exchange rate system, while retaining most of the benefits and providing new benefits and possibilities for future economic stability and real growth for both developed and developing countries.

CHAPTER 4: ADDRESSING CURRENCY: THE NEED FOR A SINGLE GLOBAL CURRENCY

Introduction:

As stated in the introduction, the first step to realizing a new economic system is to realize that though money has traditionally, at least up though the Bretton Woods Agreement, has been tied to the price of some valued commodity (usually gold or silver) except for a brief period prior to World War II and today. Though both periods have seen the collapse of financially driven systems due to currency volatility a single global currency would not have such instability. The main reason for this lack of instability being that it is global in nature and thus backed by all nations' economies rather than any single economy and that it would have a fixed rate of exchange set by a central bank of a world monetary union. Still, it is important to ask why the current flexible exchange rate system has failed, and a first step is to evaluate the role of money under this system.

> "What is money, anyway? The standard answer from economists is that money is a medium of exchange, a store of value, and a unit of account. Medium of Exchange: Money moves value from one person to another, unless one person uses a different currency, in which case the money is essentially bartered in the foreign exchange markets. As the value of money across boarders fluctuates, its effectiveness as a medium of exchange is impaired. Store of Value: People should be able to leave foreign money on a bureau and it should retain that value over time. However, such value can be diminished or enhanced by fluctuating exchange rates, or if the money is involved in a currency crisis. Unit of Account: Money enables the value of an object or service to be measured and then perhaps compared with something else. This function, too, is subject to fluctuations by foreign exchange rates. Thus, in our multicurrency foreign exchange world, money fails in all three of its primary functions due to fluctuations in exchange rates".[69]

These failures of the flexible exchange rate system lead to the argument for integrating all the nations of the world under a single global currency and a single monetary union.

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[69] Bonpasse, Morrison. *The Single Global Currency: Common Cents for the World.* Newcastle, ME: Single Global Currency Association, 2006.

> "The twin phenomena of erratic changes in foreign exchange rates and massive international flows of funds have been important elements in the instability of the world economy since the breakdown of the Bretton Woods system. James Tobin recognizes that a world currency with supporting institutions would be preferable. A global currency not only offers a solution to the current impasses but also is a necessary component in the shaping of a global democracy, which will restore scope for diversity to the world's constituent parts".[70]

These advancements by James Tobin come from review of the previous stability of both the gold standard period and the Bretton Woods period in relation to currency fluctuation. Obviously, both periods had inherent problems (i.e. the Gold Standard required a nation to have a large enough gold supply and similarly the limited gold supply of the United States forced interest rates to raise as currency appreciated in value), however, both systems presented a stable medium of transaction of currency from one nation to another. Money, under these systems, did fulfill the requirements of being a medium of exchange, a store of value, and a unit of account. The current obstacles and benefits of the flexible exchange rate system must also be fully addressed to assert that a single currency monetary system is truly needed in the international economy.

Obstacles and Benefits to Apply:

The current system has replaced currency stability with flexible exchange rates so as to allow greater ability for national monetary policy to react to market changes and for greater capital mobility. Though these benefits have led to certain nations experiencing greater economic rewards through a flexible system, it has not lead to that benefit being shared across the globe.

> "Partisans of this political agenda [free trade and free markets] argue, based on the theory of comparative advantage, that overwhelmingly favorable outcomes can be expected to result from the opening of a country's markets to free trade: income differentials between countries are expected to diminish. The United Nation's Development Program's

[70] Frankman, Myron. "Beyond the Tobin Tax: Global Democracy and a Global Currency." *Annals of the American Academy of Political and Social Science* 581 (May 2002): 62-73, JSTOR.org.

> (UNDP's) Human Development Report 1999 reported that the ratio of the income share of one-fifth of the world's people living in the richest countries to that of one-fifth living in the world's poorest countries has gone from 30:1 in 1960, to 61:1 in 1991, to 86:1 by the late 1990s and that the assets of the world's three richest individuals exceeded the combined GNP of the 600 million people living in the world's poorest countries".[71]

The current system does offer one important component to the success of any international economic system, that of the flexibility to use competition to increase or further the market reflection of trade and monetary surpluses, increasing the exchange and acquisition of capital between nations.

> "The capitalist world economy is fragmented into politically discrete jurisdictions: states. Competition for capital between states is necessary for the system to reproduce itself but so is the need for order. It is scholars like Leopold von Ranke, Otto Hintze, and Max Weber who first drew attention to the relationship between capitalism and the modern interstate system. Max Weber added the interstate system to his list of necessary structural conditions for the emergence and reproduction of modern capitalism".[72]

The ability to compete with other nations allows for market variation to be offset by natural market flows from areas of abundant capital to areas with a large amount of cheap labor but little capital with which to develop an economic base.

This competition of the market is the main driver behind the collapse of any closed economy; even North Korea has embarked on means to address this failing of closed economic systems.

> "On July 1, 2002, Pyongyang established a series of far-reaching economic reforms that were intended to improve economic conditions in North Korea. These measures, which have impacted the daily lives of all North Koreans, can be categorized into three separate but converging trends: monetization, decentralization, and foreign capital acquisition. The first two trends, which are domestic in nature, have been mainly intended to increase the country's official food supply, regain state control over sectors of the economy being encroached upon by the black market, and reduce the state's subsidization burden. The final trend has been geared toward looking abroad to obtain the large amount of capital

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[71] Frankman, Myron. "Beyond the Tobin Tax: Global Democracy and a Global Currency." *Annals of the American Academy of Political and Social Science* 581 (May 2002): 62-73, JSTOR.org. Reference 14 and 15 are from the same article which discusses the benefits behind a global currency and monetary policy in overcoming the growing economic distance between the rich and poor nations of the world.

[72] Ray, Krishnendu. "Crises, Crashes, and Speculation: Hegemonic Cycles of Capitalist World-Economy and International Financial System." *Economic and Political Weekly* 29, no. 31 (Jul. 1994): PE86-PE104, JSTOR.org.

> needed to kick-start the industrial sector, thereby leading to the increase in productivity necessary to achieve Pyongyang's goals".[73]

If even closed economic systems are forced to compete on the market in order to receive real economic benefits then it is of upmost important to realize that though the current system has failed in many respects it will always be the system to contend with because the market is always a factor. A single global currency, itself, does not impede this aspect of economic competition, but does remove competition based on currency valuation in the market. This does not impair economic competition in any sector other than the financial sector, which buys and sells currencies on the open market.

Speculation, Transaction Costs, and Purchasing Parity:

The savings from adopting a single Global Currency are twofold: first, billions will be saved due to the inherent cost required in exchanging one currency for another; second, countries will not suffer economic collapse or recession due to fluctuations in their currency. Currency speculation, the process of buying or selling another currency to artificially inflate or deflate its value, does not occur for two reasons: one, a single currency does not offer another currency to speculate against; two, the only value change in currency which can occur is in purchasing power parity, however, this is a feature more of market valuations of goods and services within a given area (i.e. housing values, land values) and not on differing valuations of a currency. A single currency reduces transaction costs because no exchange of currency occurs. Transaction costs are those incurred as one exchanges one currency for another and the annual cost to individuals (think ATM withdrawals), corporations, and nations is large.

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[73] Hale, Christopher D. "Real Reform in North Korea? The Aftermath of the July 2002 Economic Measures." *Asian Survey* 45, no. 6 (Nov. – Dec. 2005): 823-842, JSTOR.org.

> "Since the European Commission studies were done, the automation of the currency markets has continued and the per transaction costs of trading have dropped in the fifteen years since 1990. To be conservative about the current transaction costs, we assume an average transaction cost of .062 percent (.00062) of the value of the transactions, and thus one fifth of the .3 percent previously determined in the 1990 European Commission study. This estimate includes the initial foreign exchange trading costs, as well as, all the charges to customers at various levels, and its applied only to the total for "traditional" foreign exchange transactions, and does not include the dollar volume for derivatives or over-the-counter transactions. At the .062 percent rate, the annual worldwide transaction costs for foreign exchange trading are $403 billion. (.00062 X $2.5 trillion (amount daily traded) X 260 working days)".[74]

Rather than incur transaction costs, the value of currency is the same across nations with a single global currency; it is rather the purchasing power that changes.

This change would be automatically reflected by the market in the amount of goods one can purchase with a single unit of currency. This aspect is crucial in understanding how a single global currency can be equitable applied across nations with extreme opposites in the level of development and average income. Purchasing parity would allow for variation in the price of commodities across nations, but would still retain the same value of the currency. This idea is most easily understood when one compares living in New York City with living in a rural town in Iowa. Just off the bat, commodities such as housing, food, and travel are going to be more expensive because they are in higher demand in New York City than in rural Iowa, simply due to population. Due to this, average household incomes also vary with incomes being higher (on average) in New York City then in rural Iowa, even if the standard of living is similar between individuals. Thus, this aspect provides an important tool for understanding how a single global currency can be applied to disparate nations.

The final important characteristic of a single currency is that it allows a single central bank to adjust the value of the currency without affecting other currencies

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[74] Bonpasse, Morrison. *The Single Global Currency: Common Cents for the World.* Newcastle, ME: Single Global Currency Association, 2006.

(because there are no others), as happens with interactions of central banks under the current flexible exchange rate system. Under a single global currency the flexibility of the central bank in adjusting to inflation and appreciation, which was one of the key factors in leaving behind the Bretton Woods Agreement, is retained. The central bank can inflate or deflate the interest rate, can print more currency, or it can buy up/withhold currency.

Solutions to Past Problems:

By combining the positive attributes of both systems with a single global currency many, if not all, of the shortcomings of the current international economic system would be addressed. A single global currency would remove the problem of speculation, while the purchasing parity would continue to allow for competition between capital rich and resource rich (regions with large workforces or natural resources) nations. This combination would breach the concerns of both the Bretton Wood Agreement, a concern of high speculation and negative competition (competition which results in radical economic shifts) in an unregulated market, and the current flexible exchange rate system which raised a concern for nations to be able to adjust and control their monetary policy so as to reduce the effects of economic shifts. A single global currency offers a fixed rate of 1:1 exchange between all nations, backed by the economies of all nations combined under the single monetary union. A union operated by a central bank, whose duties could be assumed by the World Bank and International Monetary Fund. Though the benefits of a single global currency are made clear a question of why nations would want to give up their own currencies and control over their national monetary policy remains.

The Nation State vs. Regions:

In order to answer this question we need to understand the role of the nation-state in upholding the policy of multiple currencies in a flexible exchange rate system. Capitalism, itself, is a creature of the nation-state system requiring a unified whole to uphold property rights, patent rights, and provide security in the form of military (both physical and through threat power) and economic barriers (tariffs, currency, and investment through a national banking system). The nation state as a rational actor seeks to maintain power and control for itself, as long as it is in its own interest to do so; the question posed in this paper is whether the nation-state based model is still a viable or the best model to support a global economy. This question is examined in part I, in which the previous chapters identified aspects of the nation-state based model, and identified the failure or shortcomings therein. The results of these evaluations of the global economic system depict the need to reexamine the basic theories upholding this system and the need for a better way forward. If it is the best interest of nations to turn over their currency and economic autonomy in order to achieve higher economic returns and currency stability then they will do so under a rational model.

The following chapter utilizes the single global currency in a unique region based format and focuses on applying new institutional mechanisms to replace the old ideologies associated with free trade and trade liberalization. This model seeks to supplant the role currently held by the nation-state with that of a regional based system which utilizes a single global currency, but in addition to a central banking authority also

utilizes regional authorities to better capture the economic needs within a given region. Together, these two elements produce a wholly new paradigm, which addresses not only the currency concerns presented in chapter one, but also the structural concerns of chapters two and three. Though adoption of this system we not only find the realization to correct mistakes of the past, but also to realize the possibilities of the future.

CHAPTER 5: ADDRESSING OVER-PRODUCTION AND CAPITAL MOBILITY: THE REGIONAL TRADE NETWORK

Introduction:

True globalization takes place with the end to the treaty of Westphalia. An end to the political limitations and boundaries placed upon men and women. The boundaries with which we hide our morality, courage, and humanity behind must end. The ways to deal with the main problems facing the world economy are: 1. To address speculation by moving to a single world currency; 2. To address over capacity in the market by institutionalizing over capacity in forming separate semi- closed regional economies - this also serves to address 3. The imbalance of global trade and injustice of developed nations exploiting developing nations; 4. To address job loss to other nations and foreign competition by limiting competition to like nations at similar developmental levels within a protected regional trade zone; 5. By maintaining the benefits of globalized trade by allowing for just trade between nations and maintaining and enhancing the entrepreneurship of capitalism, exchange of goods, and trade benefits. The Regional Trade Network seeks to address these problems by using the initial benefits of capitalism in a new hybridized regional application, which allows for the fulfillment of capitalism throughout the world.

Regional Trade Agencies and Central Trade Agency:

In order to process the demands and ensure the continuation of the regional trade network a central body and supporting regional bodies must be created. These bodies shall have three main responsibilities: one, to ensure that the regional trade networks are respected, maintained, and enhanced (reciprocating trade values, policing respective enterprises, and helping to establish new commercial and industrial entities when appropriate); two, to regulate the monetary markets within each regional trade zone and as a whole (this will replace national monetary unions and reserve boards which control interest rates and perform other market regulating functions; these entities shall also set restrictions on trade policy to ensure that regional commercial and industrial entities are protected and shall protect from market inflation, appreciation, and stagnation); three, it shall set commercial and industrial standards both practice/business standards and environmental standards within each regional trade zone and shall enforce these standards (these shall include, but are not limited to product safety standards, workplace safety standards, workplace age and wage standards, environmental remediation and prevention standards, and weights and measurements standards).

Within each regional trade network a regional agency would be created, charged with fulfilling mentioned responsibilities within their respective region. In addition, a central agency would be created to coordinate the activities of each region toward mutually beneficial agreements and be responsible for all trade interaction between regions. These activities would be concentrated on the extracting of tariffs and the payment of remittances based upon trade activities between regions; also, the setting of world standards (standards not set by the central agency would be the prerogative of the respective

regional trade agency). A regional trade network shall be made up of nations with similar levels of economic development, which are in close proximity to one another, and which share common business practices.

> "The best known criterion for evaluating the suitability of an area for monetary union comes from Robert Mundell's 1961 "Theory of Optimum Currency Areas". He wrote that the optimum currency is the region, and the region is defined by the similarity of three factors among nations considering monetary union: the mobility of labor and capital, the extent of trade, and the congruence of economic cycles".[75]

The reason for selecting nations with similar levels of economic development comes out of the three factors Mundell offers and the realization of purchasing parity within a region. The mobility of capital and labor, the extent of trade, and the congruence of economic cycles all fall equally when like nations are compared. Though nations may trade more with a developing nation, this represents an aspect of maintaining a trade imbalance and as a goal of establishing a regional market base within each region is of primary concern, the prevalence of trade imbalances would indicate a disqualifying factor in assigning a nation to a particular region. In addition, most similar nations are chosen, because the depiction of specialization is shown to be false in chapter two. Modern mass production methods can be reproduced with similar levels of success across nations.

> "In mass production industries differences in production costs are less likely to reflect differences due to a nation's climatic or mineral endowment, as the same technology is used in production of any specific product in any nation. Keynes recognized this possibility when he wrote: A considerable degree of international specialization is necessary in a rational world in all cases indicated by wide differences in climate and natural resources…but over an increasingly wide range of industrial products…I become doubtful whether the economic costs of self-sufficiency are great enough to outweigh the other

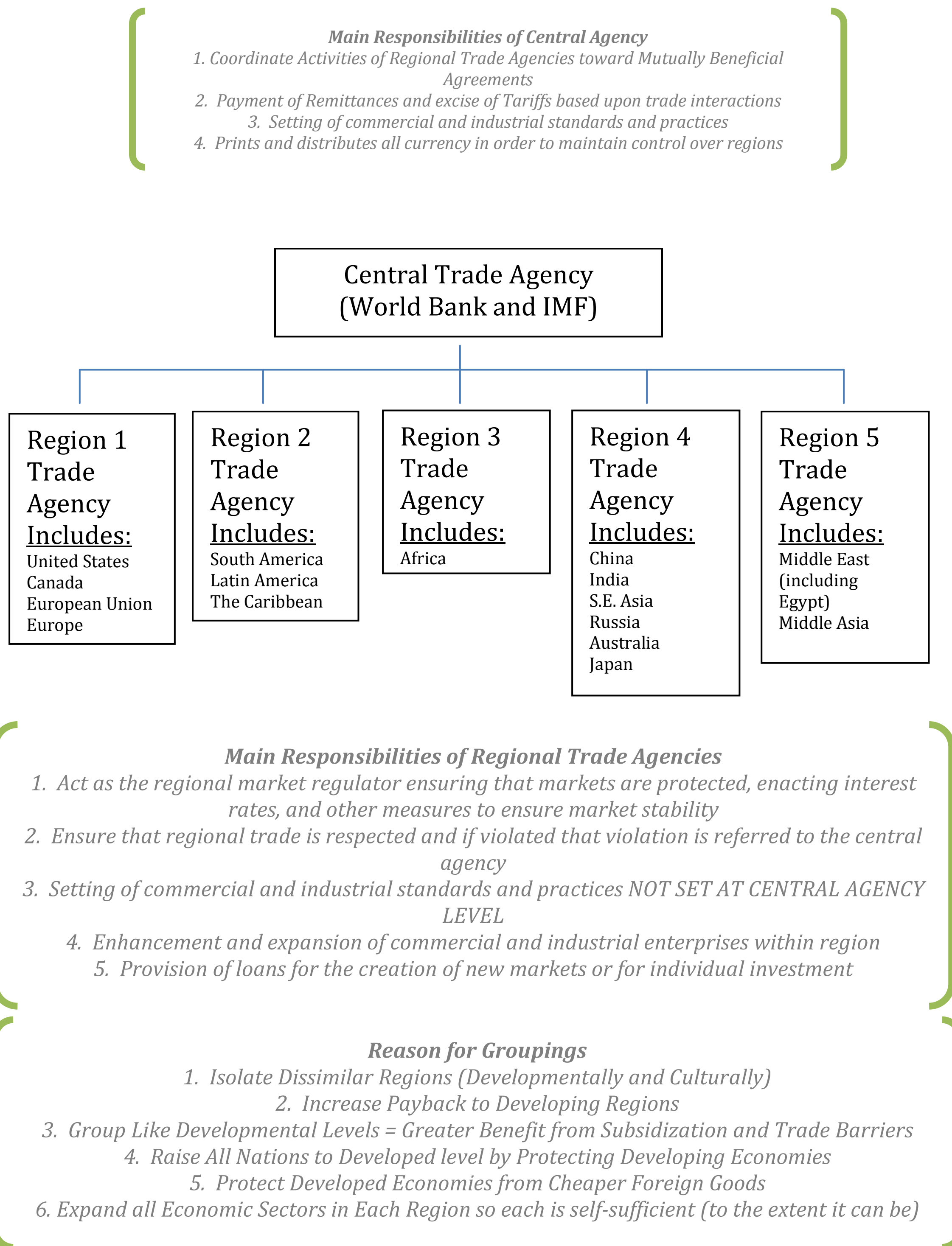
[75] Bonpasse, Morrison. *The Single Global Currency: Common Cents for the World.* Newcastle, ME: Single Global Currency Association, 2006.

> advantage of gradually bringing the producer and the consumer within the ambit of the same national economic and financial organizations; to ensure full employment. Experience accumulates to prove that in most modern mass production processes can be performed in most countries and climates with equal efficiency".[76]

For those products that cannot be produced within a region and for excess production within a region, inter-regional trade is available. All intra-regional trade occurs across nations within a given region just as they currently do, except that no currency transactions occur or bilateral trade occurs. Since subsidization can occur, this is yet another reason to include similar economies/nations together within a region. Other benefits occur by placing similar nation's with similar developmental levels together within a region. In particular, this allows developing regions to face fair levels of competition and provides an economic incentive to branch beyond export-oriented structures of mass industrial production. For developed nations, it protects vulnerable industries that face competition from other nations due to cheap labor, ensuring that these individuals are employed and compensated at a level consistent with regional need and purchasing parity. By allowing for these economic incentives, the regional trade system creates an appeal and benefit for both developed and developing nations. The chart below depicts the Regional Trade Network and its responsibilities, following this we discuss the system more fully beyond its structure and responsibilities, to identify how such a system would function and the benefits from such a system.

[76] Davidson, Paul. *The Keynes Solution: The Path to Global Economic Prosperity.* New York: Palgrave Macmillian, 2009.

Figure 7:



Regional Trade Network Actions

The six following points discuss the main actions taken by the regional trade network that serve to identify how this system would function intra-regionally. Inter-regional trade is discussed under good crossing borders. Though these six points in combination with previous discussion serve only to layout the basics of this global economic system, they serve to identify the main goals of addressing the current needs of the global economy, while redressing the failures of the past, and implementing current benefits.

1. Each economic zone shall function as its own market reflecting the purchasing power of the single global currency within each region. The purchase prices of goods within each region are to be set by the regional market (i.e. the existing financial institutions which buy and sell commodities). Thus the actual price of a good will vary from one region to the next, which reflects the aspect of purchasing parity discussed previously. All goods traded within a region will be priced based on the regional market valuation, individual nations within a region can continue to subsidize the price of goods or can utilize the regional trade agency to set a region wide subsidized price to ensure adequate production of agricultural products or to ensure that prices remain artificially low to allow for purchase by poor families. Goods traded between regions are adjusted to meet a global trading price (an average of all regions purchase price of a commodity); this process is discussed under goods crossing borders.

2. Individuals who travel between regions need not exchange their currency (as the same currency is utilized globally) but are subject to a tariff tax if they purchase certain

commodities from a regional zone with a lower purchasing parity (i.e. region where their prices are set lower than an individual's home region). These commodities include the purchase of removable goods that are above a certain quantity (to be set by the central bank) or labeled as a luxury item (item above a certain price and which can be purchased within their home region, again set by central bank), otherwise they shall be charged by the tariff rate (of their regional zone (zone in which they have a permanent residence). The idea is to protect against individuals trying to side step the inter-regional trade process discussed in goods crossing borders. The quantity and amount should be high enough to ensure that only individuals who are attempting to buy cheap goods to resell within their home region are subject to this tariff. Any individual can purchase any commodity for sale in another region, so long as it remains within the purchased region, without being subject to a tariff.

3. Regions are groups or divisions of nations with similar purchasing parity and economic development into a single region; allowing developed nations to protect their manufacturing ability and for developing nations to not have to compete with developed nations. This was discussed previously, but is restated here, because it is a basic tenet of attraction and application of the regional trade network. The focus of the regional trade agency should reflect the nations, which it supports; it should work to increase development, ensure maximum employment, and establish sustainable economic growth within all the nations it represents. It is the role of the central trade agency to ensure that regional trade agencies to not impinge on one another's economic activities in a non-beneficial manner and to settle trade disputes. Regional trade agencies should rather focus on representing and meeting the needs of the nation's within their region, though they are

required to fulfill their duties and obligations assigned by the central trade agency if they wish to receive funding. Regional trade agencies can receive funding by nations, though it is not required, in order to fulfill national requests that the central trade agency will not fund. The central trade agency in this event cannot use the power of the purse to punish a region through removal of more funding, restricting of future funding, or by adding another region in order to punish; the central bank can increase funds to other regions to offset nationally funded measures that directly injure another region's economic prosperity.

4. Since currency competition is removed due to a single global currency and purchasing parity is isolated within a region, the central trade agency is able to print and use whatever amount of funds is deemed appropriate because currency competition is removed, thus, any influx of currency would not serve to thus upset the value of currency. Since purchasing parity is intentionally isolated to within a region and each region uses the same currency each region could receive influxes of capital without affecting other regions. The single global economy presented would thus be more capable of dealing with economic shocks due to its separation, but would also be integrated by a single currency and ability to trade across regions (given the correct circumstances discussed in goods crossing borders). The single currency regional trade network allows thus for a unique ability to allow for huge capital accumulation, without affecting the value of currency or the price of commodities. This critical aspect allows for the central bank to print money and thus increase the amount of available capital without directly affecting the value of currency or the price of commodities; obviously with more capital more commodities may be purchased thus increasing demand and thus increasing cost (inflation), but regional trade agencies can use monetary policy or subsidization to control for inflation.

5. Nations can subsidize prices internally either at the manufacturing or consumer level, but any price subsidization by the regional trade agencies to which they are a member negates the ability of a nation to further subsidize the same commodity. A nation can still subsidize a commodity further if only manufacturing or only consumers are subsidized; nations may subsidize the other. Internal price subsidization can be placed by regional trade agencies or nations, but if placed by regional trade agency then it is funded by the central bank (Central Trade Agency), which must approve the funds and can remove them at their discretion, in order to ensure that no erroneous subsidization occurs. Private ownership and funding of firms is, however, to be promoted. If a firm is nationalized or subsidized, the price at which it is allowed to sell its good cannot be below the lowest market price of a competing private enterprise (protects private firms from nationalized firms using their resources to undercut a market and protects taxpayers from non-profitable enterprises unable to compete equally).

6. Comparative advantage is eliminated across regions; this is why like economies are placed within the same region. Comparative advantage remains within regions and is strengthened due to direct competition with like economies. By isolating comparative advantage within a region we remove the incentive for nations to focus solely on export-oriented manufacturing and selling to foreign markets. Each region would be required to build their own consumer, service, commercial, and manufacturing structures. Not to say that firms are restricted from acting amongst and between multiple regions, they are actually encouraged to do this because of the advantages outlined previously, but, rather, an economic base must exist within each nation in order to control supply and demand (limited population and space to consume goods = creative destruction) and to eliminate

dependence on a consumer of last resort. By creating this regional base, innovation is also empowered, as firms can no longer rely on cheap labor or cheap outside goods but are rather required to license or create new products or production methods in order to develop a comparative advantage.

Goods Crossing Boarders:

As the primary function of the regional trade network is to address overproduction and bilateral trade, which were found to be main contributors to current failings, restrictions on goods crossing regional boarders (inter-regional trade) are placed. These restrictions serve to create a real need to build industrial, service, and consumer infrastructure within each region. By creating semi-self-sustaining economies within each region we create a process of creative destruction, by limiting the number of goods that can be consumed. In addition, the restrictions place an added incentive for firms to innovate and also to focus on new avenues (besides production) in building and expanding their economies. The restrictions are outlined below and are followed by another restriction, which coincides with goods crossing boarders that of production of goods by a firm to be located within the region it intends to sell the goods. These two processes reinforce one another and serve to reinforce the notion of creating and expanding all economic sectors within a region, making that region semi-self-sufficient and increasing employment, opportunity, and competition in the process.

Restrictions:

Goods and services can only cross borders of zones if a shortage of supply exists, a lack of capacity exists, a lack of diversity in products/ suppliers exists (monopoly busting), or no equivalent product/services exist. These goods are sold at market price but the central

trade agency makes up difference in purchasing parity between two regions through subsidization or tariffs. Supplier and sellers also must follow regional trade restriction - Wal-Mart can buy from china to sell in United States but the price will be the same to Wal-Mart as if it bought from the United States. Objects/services do not loose or gain value when crossing between regions.

- Objects/services moving from cheaper to expensive region = price added by central regional agency by use of a tariff to equal if purchased at market value in expensive region; the central agency would retain the profits
- Objects moving from expensive to cheaper = subsidized price to producers (sell at a loss – this is used to encourage enterprises to develop new infrastructure in other regions in order to make a profit); this applies when objects do not follow trade restrictions noted above. Subsidized price applies in approved transactions, in these cases the central regional zone will subsidize the price so the producer makes a profit based on their regional zone's purchasing power and the consumer will pay price based on their regional zone's purchasing power; central regional agency covers the price difference.
- Corporations can transfer internal monetary funds from one region to another without tariff or subsidization, but cannot transfer internal goods or services without being assessed a tariff, no subsidization will occur.
- Would not affect intellectual exchange of goods – magazines, books, TV, movies, etc. Intellectual goods based can be based in one location and are traded based upon no tariff trade and would be subsidized into other regions by the central regional trade agency. This would be done to facilitate the exchange of information, growth of

ideas, and exchange of culture. However, this only applies to new/unique works that are protected by copy right, not to mass printed or reproduced works (these articles would fall under normal trade restrictions).

- The Internet shall not be based upon regional trade restrictions except in the case of physical goods being purchased and transferred across regional trade zones.

Producing Goods:

All goods must be produced/manufactured/serviced in economic region; companies can cross boarders but can only remove up to 75% of profit (in zone purchasing power). Profit = amount after employees paid and taxes and other externalities covered. Any terminated employees will reduce the amount of profit that can be removed from one zone to another. The central regional agency is to set wage minimum in each economic region. All employees must have permanent residency within the economic region of their employment. Those employed only at headquarters must still be paid by where their residency is located and enterprises must make up salary (if an individual in one economic region works in another they must be paid by the division within the region they work, not the region in which they reside = very large salary which decreases profits which can be removed to a central headquarters = incentive to have individuals set up permanent working staff in a region).

Figure 8: Ex. (Ford Company Setup in order to sell goods)

Region 1	Region 2, 3, etc.
• Ford Headquarters	• Ford Manufacturing
• Ford Manufacturing	• Ford Service
• Ford Service	• Ford Dealer
• Ford Dealer	

- All manufacturing and service industries (Ford Service and Dealer) must be replicated in the second region in order for an enterprise to **not** violate the trade restrictions of the regional trade zones. These items do not have to be directly operated by the corporation in question but can be licensed for others to provide the manufacturing and service for the corporation in question. Products and services cannot be transferred internally within a corporation or externally from one zone to another without tariffs or subsidization, but capital (only in the form of money and specialized equipment) can be moved internally once these restrictions are meet.

Benefits:

- Real economic wages would increase as the threat power of firms to outsource production would be removed, firms would be required to use the labor within a region to produce goods to be sold in that region increasing the negotiating power of unions and labor in general.
- No buying and selling (speculation) on currency due to one currency which no one would want to diminish in a rational model because it would diminish their individual assets.
- Ability to control trade barriers without costs due to single currency transactions and without preferential trade agreements, which affect other nations or limit economic development.

- Allows similar markets to be protected from jobs moving to lower wage earning nations and protects poor undeveloped nations from dealing with a developed economic market and subsidization by those developed nations.
- The central trade agency would process and enforce copy right laws of all regions so that any copy righted item/ idea/ work would be enforced in all other regions. This will be enforced in all other regions preventing copying or illegal reproduction of an item/ idea/ work. Any region, however, could legally reproduce the work in order to be sold or utilized by another region, in order to ensure the spread of knowledge, production methods, and competition. The central trade agency would ensure that the owner of a copyright received a portion of the sale price in each reproduction or distribution; the central trade agency would set the percentage and application terms (whether a copy right applies – is it an original creation - or whether it does, but restricts competition through enforcement – in which case the central bank will pay for the copy right, but will allow other regions and firms access to it).
- Has benefit of encouraging small producers and manufacturing and small business by encouraging more and smaller enterprises across regional economic zones. Insulates and protects regions from threat of corporate moving locations or retiring employees by requiring these aspects in order to sell goods within a region

Though this system would work best with all nations participating, it has the ability to operate with any one region agreeing to form under the outlined guidelines. Beyond the economic advantages this system provides, it has the ability to coerce nations to join in a reverse manner of collapse to the collapse of the Soviet System. As the Soviet system found itself unable to compete and maintain its debt-financed structure, so too would other

nations whom failed to join this system. An added benefit could come from the forgiving/repayment of a nation's debt once they joined this economic system. This is possible due to a unique characteristic of the system of an unlimited central/world budget.

Unlimited Budget at World Level:

The formulation of an unlimited budget at the world level presses forth new possibilities for addressing the concerns of our age: global climate change, resource depletion, costs of education, famine, and the rising cost of healthcare to name a few. It also raises new concerns, opening a potential Pandora's Box in terms of the ability to provide unlimited capital towards frivolous, depleting, or fraudulent investments. Thus, new forms of analyzing benefits must be aligned to represent the removal of capital from the equation and new philosophical ideals must be formulated, as what is good for everyone may not be good for the system or planet as a whole. Nevertheless, the great potential to deal with pressing economic collapse and national debt may serve to focus the realization that even the modest of compassionate and egalitarian methods may be too extreme if they are to be sustainable. What is truly needed, however, are new ideas on how to deal with the problems at hand while not serving to cause new problems or buy time for current ones.

CHAPTER 6: THE LITERATURE, THE QUESTION, AND THE FUTURE: CONVINCING NATIONS TO CHANGE

Introduction:

Accepting and applying the single currency regional trade network is a tall order. From the outset the simplest response would be that it can't be done, that it is fantasy concocted as a hopeful utopian ideal to mask the true problems and solutions at hand. In many ways this is true. It is now a fantasy, it is hopeful, and it provides benefits, which would seem from the outset to be utopian pandering. Yet, this is true of all endeavors, ideas, and imaginings until they are acted upon. Landing on the moon, breaking the sound barrier, crossing the Atlantic, even the current economic system, at one point were all fantasy. Fantasy depicted from hopeful ideals which upon action and human ingenuity, passion, and commitment became reality, became everyday objects. To say something can't be done or that it is simply fantasy is to ignore the plain truth that humanity can accomplish anything and can instill any ideal, so long as conviction and passion can replace ignorance and fear. To these ends, this chapter addresses the foundation of the current proposal in existing literature and provides an initial grounding of how to convince nations to accept and implement a new ideal.

By identifying the drive in current literature towards a new path, in terms of economic activity and by addressing how to convince developed and developing nations to accept a new economic paradigm brings us closer to reality. In the final analysis, what is to be decided and implemented today will impact the future, yet the future will come.

Tomorrows always come and with them a choice appears before us to continue on a path of over accumulation based on debt financing that will eventually result in economic realignment in the form of a massive destruction of capital or to attempt to reach for the impossible. What history has taught us is that the rewards of reaching beyond what is thought possible are great and wondrous. True they can be coopted for mischievous ends, but never would we trade the opportunities provided, even given the cost.

Literature:

As discussed throughout this paper, the aspects of discussion are not new; even Keynes proposed a regional based system to regulate economic competition between competing nation-states. As such, this paper can be seen to clearly fit within the large amount of work that has emerged in reference to the global recession and in identifying problems associated with it. What is unique within this paper is the attempt to offer a new solution to end a continuing cycle of economic boom and bust that is central to the current nation-state market system.

This process can be seen throughout current foreign policy literature. Even the identification of what new ideology will serve to guide the post-recession period is examined. Francis Fukuyama makes the following point in articulating an ideology of the future:

> "It would have to have at least two components, political and economic. Politically, the new ideology would need to assert the supremacy of democratic politics over economics and legitimate a new government as an expression of the public interest… It would have to argue forthrightly for more redistribution and present a realistic route to ending interest groups' denomination of politics. Economically, the ideology could not begin with a denunciation of capitalism as such, as if old-fashioned socialism were still a viable alternative… The new ideology would not see markets as an end in themselves; instead, it would value global trade and investment to the extent that they contributed to a flourishing middle class, not just to the aggregate national wealth… The dangers inherent in such a movement are obvious: a

> pullback by the United States, in particular, from its advocacy of a more open global system could set off protectionist responses elsewhere".[77]

The single currency regional trade system attempts a response to this new ideology, in providing a new system and framework based on the market, but providing a method of using the vast potential of capitalism in a new way to benefit all nations. The need to address redistribution and economic equality across nations has grown, even despite the recession. Even more central, to the argument for changing the current economic system is the inability for developed nations to respond to growing electorate demands for services, policies, and economic growth. The current literature depicts a rising concern for western nations in failing to respond to rising demands of their electorate, as a problem emanating from current economic cycles and globalization.

> "A crisis of governability has engulfed the world's most advanced democracies. It is no accident that the United States, Europe, and Japan are simultaneously experiencing political breakdown; globalization is producing a widening gap between what electorates are asking of their governments and what those governments are able to deliver… Globalization was supposed to have played to the advantage of liberal societies, which were presumably best suited to capitalize on the fast and fluid nature of the global marketplace. But instead, mass publics in the advanced democracies of North America, Europe, and East Asia have been hit particularly hard – precisely because their countries' economies are both mature and open to the world… Deindustrialization and outsourcing, global trade and fiscal imbalances, excess capital and credit and asset bubbles – these consequences of globalization are imposing hardships and insecurity not experienced for generations".[78]

The security of regionalized economies provides a real benefit to the overall wellbeing of populations, in no longer being sacrificed to ever-changing aspects of globalization and economic fluctuation.

The problems associated with currency are also prevalent in current literature. A need to address concerns about the strength and continued vitality of the dollar and the

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[77] Fukuyama, Francis. "The Future of History: Can Liberal Democracy Survive the Decline of the Middle Class?" *Foreign Affairs* 91 no. 1 (Jan. 2012): 53-61.
[78] Kupchan, Charles A. "The Democratic Malaise: Globalization and the Threat to the West." *Foreign Affairs* 91 no. 1 (Jan. 2012): 62-67.

euro impresses an important aspect in identifying possible acceptance of a new single global currency as a reserve unit to bolster the international financial system.

> "Central banks and investors are likely to conclude that neither a diversification into smaller currencies nor an embrace of the Yuan can substitute for their reliance on the Dollar and the Euro. Might they instead push to create a new global reserve unit, as their predecessors did in establishing SDRs in the late 1960s and early 1970s? A United Nations commission on reforming the international monetary and financial systems chaired by the Nobel Prize-winning economist Joseph Stiglitz similarly argued in 2009 for an expanded role for an international reserve unit, such as SDRs… This is not the first time that a synthetic unit, like SDRs, has been proposed as the basis for the international monetary system. The idea goes back to the Bretton Woods negotiations in 1944, when John Maynard Keynes argued for something along those lines. SDRs have existed for more than four decades, and yet they still account for barely three percent of national reserves. A fundamental reason is the difficult of agreeing on how SDRs should be allocated".[79]

SDRs are clearly not a feasible solution in the current economic arrangement, as firms and investors would not want to face the expense of converting SDRs into local currencies. These issues present in the current literature, presented here and throughout this paper represent the foundational grounding upon which the single currency regional trade zone rests. Its task of meeting the current economic maladies has been articulated, but what remains is to address how and why nations would want to accept such a new and different system.

Convincing Nation-States:

Two initial plans develop from the regional trade system in convincing nations to join this new economic system. The first is what I will call the developed nation plan and the second is what I will call the developing nation plan. These two plans revolve around whom the system would come to see as the central agency actors and as the main architects in determining regional formations and applications for membership. The two plans differ mainly on providing the key benefits of initial application to those who join

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[79] Eichengreen, Barry. "When Currencies Collapse: Will We Replay the 1930s or the 1970s?" *Foreign Affairs* 91 no. 1 (Jan. 2012): 117-134.

first, though neither plan works to deny benefits central to the operations described in chapter five. The offering of central agency control can be seen as critical when one realizes that the money and authority to regulate the printing of currency and its distribution would provide any initial nations with a powerful tool to leverage against other nations for economic compliance or political ends.

The Developed Nation Plan

The developed nation plan rests on the recognition of concerns about the vitality of the dollar and the euro, as well as, the rise of other consumer economies in China and elsewhere which threatens the support of export-oriented nations in financing national debt. Developed nations would be able to capitalize on admission by removing their economic debt in order to balance all entry nations into a unified monetary system. The nations, which entered the regional trade arrangement first, would also be able to decide the arrangement of the central bank; whether the members of the central bank will be chosen by appointments, popular elections, or outside commission. In addition, these nations would be able to describe the formal arrangement, whether a council, a representative body, or a single administrator and whether developed nations would have a special veto privilege as they do on the security council of the United Nations. These benefits are similar to those established under the Bretton Woods Accords and, today, allow developed nations to enact rules and procedures that benefit their economies and ensure their continued economic dominance. Though the single currency regional system would inhibit overt rules which disrupted basic functioning, thus ensuring economic equality to all nations involved, it would provide the ability for developed nations to tie policy and legal adoption to acceptance into the new economic system.

The Developing Nation Plan

The developing nation plan focuses on the advantages in creating internal economies and subsidization practices that would boost internal economic development. As we saw in chapter 2, the main problem in currently implementing these strategies stems from the lack of inflows of capital; Inflows, which do not occur without massive depreciation of a nation's capital and wage rates. The single currency regional system would resolve capital and wage limitations, seeking to both spur investment in internal economies, realization of regional independence, and raising the wage rates in order to spur internal consumption. These ideals would spur an internal economy, which could still benefit from trade and interdependence globally, but would allow for greater economic isolation from market shocks and subsidization/competition from nations outside of the home region. In addition, developing nations taking the lead could ensure that these nations can finally address trade and capital imbalances that have been of historical benefit in maintaining developed nations' economic hegemony.

These two plans would serve to evoke other nations to join once the initial group joined by the nature of powerful economic incentives of capital control and creation, internalization of economic growth within regions, and by the decreased dependence upon other nations' currency, capital, and goods for economic growth and stability. The single currency regional system is one that has strong advantages for developed nations in institutionalizing subsidization and other economic policies to protect against outsourcing/ off-shoring, wage restrictions/ suppression, and serves to provide new opportunities for financing the welfare state besides relying on foreign nations to purchase bonds. For developing nations the advantages are equally strong; the ability to attract foreign capital

or investment will no longer limit the ability to institute economic growth. In addition, developing nations will no longer have to compete 1:1 with developed nations, meaning that low-cost labor will not be a primary economic advantage, allowing workers to increase their wages without loss of comparative advantage. Finally, developing countries will no longer be dependent on purchase of their goods by extra-regional nations; internal economization of developing nations will provide new jobs, new specializations, and fair markets. Together, the benefits to both developing and developed nations identifies a third aspect of central agency control, one which focuses on democratic recognition and fair, balanced application of all economic benefits.

The Central Trade Agency Institution

The central trade agency can be institutionalized to apply the best intentions of advantages to all nations and can put forth a solid democratic foundation which represents the interests of the concerns of the global citizenry. As such the make up the central trade agency and regional trade agencies should be administered as follows:

The regional trade agency shall consist of a council consisting of two elected members from each nation within a region and one elected member from the region as a whole who will administer the council and have a deciding vote in deadlocks. Each national council member shall have one vote, so that each nation will receive two votes to cast on the council when voting upon actions and policies that the regional trade agency shall enact. The election of each of these council members shall be open to all legal residents (within a nation for national members and within the region as a whole for the council administrator) and shall be based on a single member district approach.

The central trade agency shall consist of a similar council consisting of two elected members from each region and one elected central agency administrator. These individuals will have the same voting and election conditions that are present within the regional trade agency, one vote for each regional council member and the ability for the central administrator to cast a vote in the event of a deadlock and administer the council. The members will be popularly elected from the region as a whole for council members and will be elected from all regions for the central administrator. The re-election for all representatives should be set at every four years, with the ability to initiate a recall election. Also, an independent judicial organization should be set up to monitor the actions of regional trade agencies and the central trade agencies in order to provide clear jurisdictional application for misconduct, failure to perform duties, or criminal activity and prosecute such activity. The ICC could fill this role, if the United Nations were to expand its authority and limit its role to the monitoring and prosecuting regional trade agency members and central trade agency members. In order that nations do not have to accept the ICC mandate in order to be a part of the single currency regional system.

In getting nations to join, a large carrot can be depicted in their economic benefits in joining the system and in their ability to shape the initial system, its institutions, its precedents, and its policy. Though this is half of the political question regarding whether the single currency regional system can be made a viable alternative to convince nations that the rewards outweigh the loss of sovereignty, it is not the whole question. The politics of accepting the single currency regional trade system lie in convincing the masses and, possibly to a greater extent, convincing key economic and political actors to recognize the benefits as outweighing any fabricated or real threat to their personal stake.

The Politics

The political question at the heart of this paper is why any nation or individual would wish to move away from the current nation-state based market system, which is controlled and regulated by nation-states. It is by far the most the most impressive and adaptable economic system in our history and has won its rightful position as the sole economic system, beating out socialism, communism, and other systems in the twentieth century and rendering huge gains for the world as a whole. The answer in many ways lies not in questioning market based capitalism, but in questioning whether the nation-state is the best source of regulation in a global system.

The current system, in many ways, depicts a sort of lottery where your potential economic wellbeing is decided by where you are born. "It's the luck of where you're born, according to the late Nobel Prize-winning economist Herbert Simon, who estimated that the benefits of living in a well-functioning economy probably account for 90 percent of individual income".[80] In such a system stability and rules apply to a select group of developed nations who control international financial institutions and are allowed to offset over-accumulation by forcing austerity on developing nations. The difference in economic wellbeing between nations and within nations has set off an ideological battle, though one shaped on policy rather than principle.

> "We are living, so we are told, through an ideological crisis. The United States is trapped in political deadlock and dysfunction, Europe is broke and breaking, authoritarian China is on the rise. Protestors take to the streets across the advanced industrial democracies; the high and mighty meet in Davos to search for "new models" as sober commentators ponder who and what will shape the future. In historical perspective, however, the true narrative of the era is actually the reverse – not ideological upheaval but stability. Today's troubles are real enough, but they relate more to policies than to principles. The major battles about how to

[80] Kenny, Charles. "The Optimist: We're All the 1%." *Foreign Policy* (Mar. 2012): 24.

> structure modern politics and economics were fought in the first half of the last century, and they ended with the emergence of the most successful system the world has ever seen".[81]

Though this system offers great rewards for those few lucky enough to receive them, it does not distribute even rewards throughout the globe and does not ensure that present rewards will remain in the future. For these reasons, a growing political and economic concern has grown over the need to address inequalities in distribution and in the need for an economic and political system that can work to ensure benefits to all, rather than a few.

> "The present generation is rightly concerned and concerned far more deeply than its immediate forbears ever were, in the ending or mending of the monstrous economic and social inequalities and iniquities which permit and even foster the distress we see about us in the midst of plenty. In sharp contrast with the older notions of an inevitable progressive development that had best be let alone, or even the recent naïve belief that depressions were a thing of the past, there is a determination among men of the present day, particularly the younger ones, to do something about this; and some would even go so far as to threaten the very existence of plenty itself, in their hatred of the glaring unevenness of distribution… One thing is clear enough: the world in its present mood will never put up with a mere "muddling through" as an answer. The preservation of the status quo is a solution that can satisfy none but the contented; and just now most men are not contented".[82]

The political acceptance of this system by financiers, political-elites, and the extremely wealthy is less of a concern than the acceptance of the majority of citizens in every nation throughout the world. It is these individuals who will benefit the most from the single currency regional system and it is for them that the nation-state truly exists to benefit. So in answering the political question we must ask whether citizens will commit to a new system which protects their economic vitality and provides protections from outside competition, while working to improve their wages, their nation's economy, and their personal livelihood.

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[81] Rose, Gideon. "Making Modernity Work: The Reconciliation of Capitalism and Democracy." *Foreign Policy* 91 no. 1 (Jan. 2012): 3-6.
[82] McIlwain, C.H. "The Reconstruction of Liberalism." *Foreign Affairs* 91 no. 1 (Jan. 2012): 34-35.

Conclusion

Perhaps this paper does not address all the political and economic concerns that are presented by its argument; perhaps it even serves to raise new concerns. Yet, this is the story of progress and human evolution, even when we are presented with a solution we continue to question it, refine it, destroy, and re-create. The concerns and problems of implementation will only pass after implementation, but even after implementation and acceptance of a policy questions remain, new solutions are derived, and new policies implemented. It is the role of humanity to never linger or accept what is, but to look towards what can be and strive towards it. For if anything we are explorers, innately curious, destructive, and persistent we hold few truly noble qualities except our ambitions, our hopes, and dreams.

General Conclusions: Freeing the World from the Free Market Economy: A Reexamination of Nation-State Based Capitalism

A growing structure of interconnectedness based upon a need to address the shortcomings of the nation-state system has been developed. These developments take the form of the UN, NGOs, IGOs, and international institutions, which meet to discuss concerns including human rights, environmental concerns, monetary exchange, economic concerns, and conflict resolution among many other items. All of which cannot be solved or enforced by any single nation-state, but which require the agreement of many states for any chance of meaningful action or engagement. When we consider the failures of the nation-state in actions of genocide, environmental degradation, and economic crisis we must consider the future of humanity and determine the course that would best serve all of humanity. It is time to remove ourselves from our common baser aggressions and passions of prejudice and greed and look to a new path. That new path begins with the adoption of the single currency regional trade system.

It is the only system that demonstrates the ability to address four main concerns:

1. How to retain the ability for capital to be mobile and abundant, in order to continue the process of subsidization within and between nations, but avoid the

volatility of a flexible exchange rate system. Through a single global currency in combination with a regional trade network capital continues to be mobile. Its abundance is enhanced through the unlimited budget paradigm, and volatility is removed as currency competition and valuation is removed from currency.

2. How to incorporate practices of subsidization and bilateral trade into a new economic system which retains the advantages of traditional trade, but also addresses and corrects the trade imbalances which characterize the current system. The restrictions placed on inter-regional trade serve to directly address imbalances in development and trade, while enhancing the ability for nations to utilize protective measures to ensure maximum employment.

3. How to stimulate real market growth, namely through a process of creating sustainable consumer markets within developing nations and thus ending the 'consumer of last resort' dependence.

4. How to replace the idea of creative destruction with a system that ensures limited market opportunities without the loss of innovation or market growth. The Single Regional Trade System's focus on creating semi-self-sustainable economies in all economic regions depicts an incorporation of competition into the regional system, but at the same time addresses the problems of overproduction and dependence by reinstituting creative destruction as a legitimate economic aspect. By addressing these concerns, raised from an examination of the nation-state upheld system of flexible exchange rates, we truly see a possibility for the realization of economic change that will promote real, sustainable, and beneficial

growth. The only question that remains is whether action will be taken or if, as the past depicts, small changes are made to restart the heart of a system which has been on the brink of failure since its first inception.

The title of this essay, a re-examination of nation-state based capitalism, is not a condemnation of the nation-states' role in creating and perpetuating an inherently volatile system, rather, it is a realization that nation-states are rational actors. As such they serve their own interest, but unlike individuals who exhibit altruism a nation-state can only seek its own glory and power. What is to be realized then is that this is not about who is deserving of power or glory. This is not about land or conquest. This is higher than these mortal bounds. What we discuss here is the preview of the future, of humanity's promise and beneficence. This is about our ability to overcome the evils of ignorance, prejudice, and nationality. To build a better world we must have courage, patience, humility, and above all faith. Faith that though the path of good is filled with great trepidation and trial, that the few good men and women in each and every country of this world can overcome the inhibitions of the evil in each and every country - to build something new, with great potential and promise.

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