

Macroeconomics II

Lectures 20 and 21

Open economies, financialisation
Conclusion



Theoretical Lecture 20-21

Economic growth in an open economy, financial system and globalization

Some of the current debates in economics

Readings:

Louçã e Ash (2017), **Sombras**, chs 2 and 6

Beta 17: Core Project ch 17 (in your files)



So, let's recapitulate:

**we had a financial bubble even before
the current recession**

**globalisation and financialisation are
drivers of inequality**



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NEARLY HALF
THE WORLD'S POPULATION
(3.4 BILLION PEOPLE)

IS LIVING ON LESS THAN
\$5.50 A DAY²⁹



WHILE THERE ARE
MORE BILLIONAIRES THAN
EVER BEFORE (2,208)



THEIR WEALTH INCREASING BY
\$2.5 BN A DAY³⁰



Global stops and starts

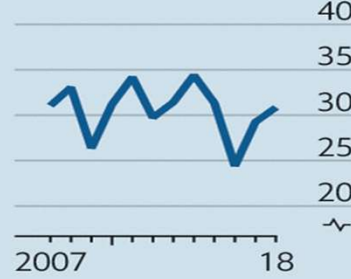
Trade in goods and services as % of GDP



Intermediate imports as % of GDP



Multinational profits as % of all listed firms' profits



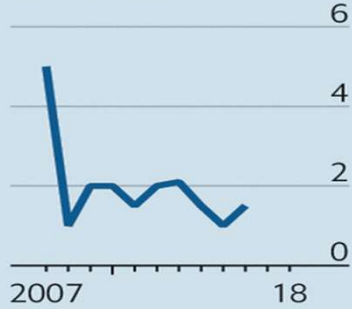
FDI flows as % of GDP



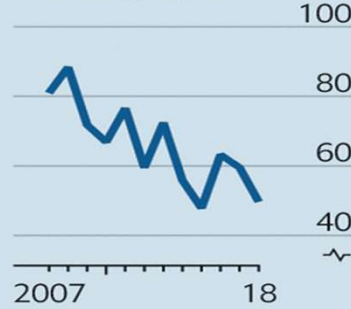
Stock of cross-border bank loans as % of GDP



Gross capital flows as % of GDP



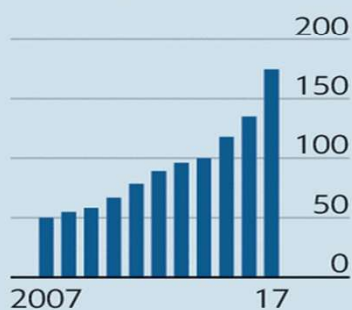
Share of countries catching up*, %



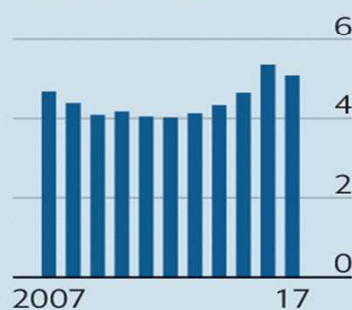
S&P 500 sales abroad, % of total



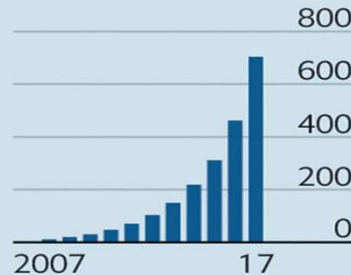
International parcel volume, m



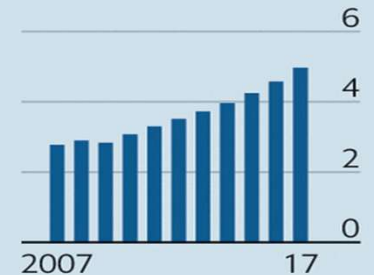
Permanent migrants to rich world, m



Cross-border bandwidth Terabits per second



International air travel, revenue passenger km, bn



Sources: IMF; UNCTAD; BIS; OECD; Bloomberg; IATA; UPU; McKinsey

*Compared with US GDP per person on a PPP basis



But a question:

which of the economies is more
open and more closed,
considering USA and Portugal?



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The debate among growth economists

autarky vs openness in models of economic growth

economic growth has been “explained” by economic models (**Harrod-Domar, Solow, AK model, Romer**, etc) assuming the the economy is closed; why? because the authors wanted to stress on the main mechanisms operating in the economy that would generate economic growth and thus ignored external factors

but actual economies are open

there is international trade (exports; imports)

there is international mobility of production factors (migration flows/labour; but mostly foreign capital; in some cases, technology)

measuring output in a open economy

GDP (national location of the production factors) -> GNP (national location of the owners of the production factors):

factors for openness of the modern economies

reduction of the transportation costs and improvement of quality and security of transportation (of merchandises and of passengers);

improvement of the quality of information technologies with reducing costs;

trade policies (less restrictions on international trade, like tariffs, quotas and other restrictions);

experiences of regional integration of the economies (in Europe, in South America, in Africa)

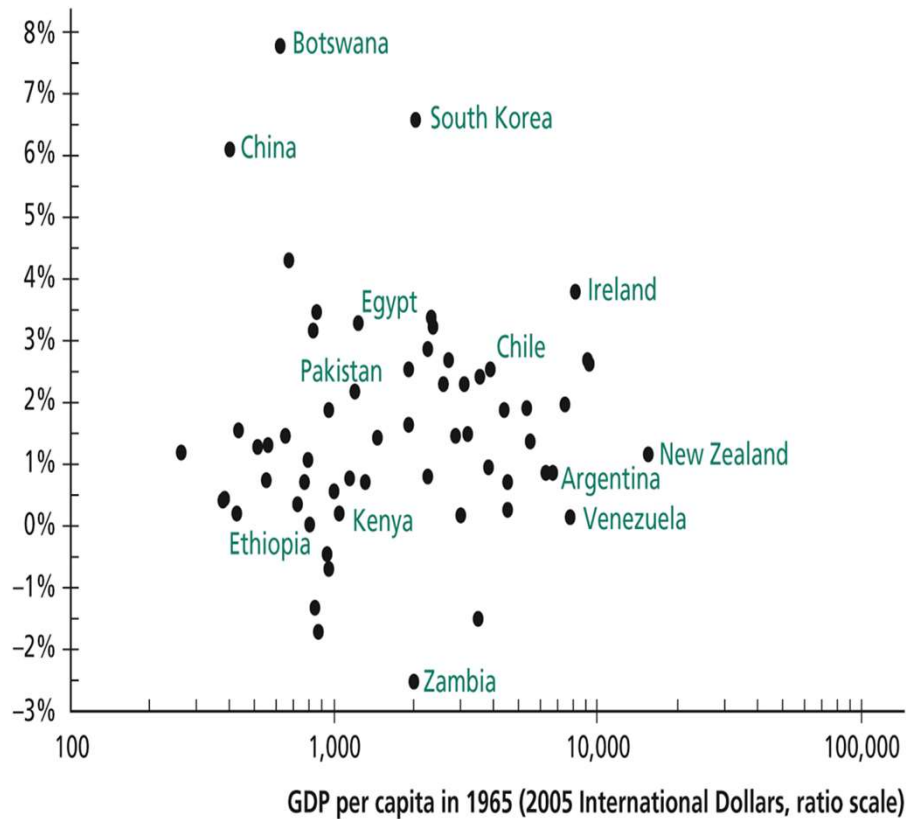
Financialisation

Global chains of value of Multinational firms



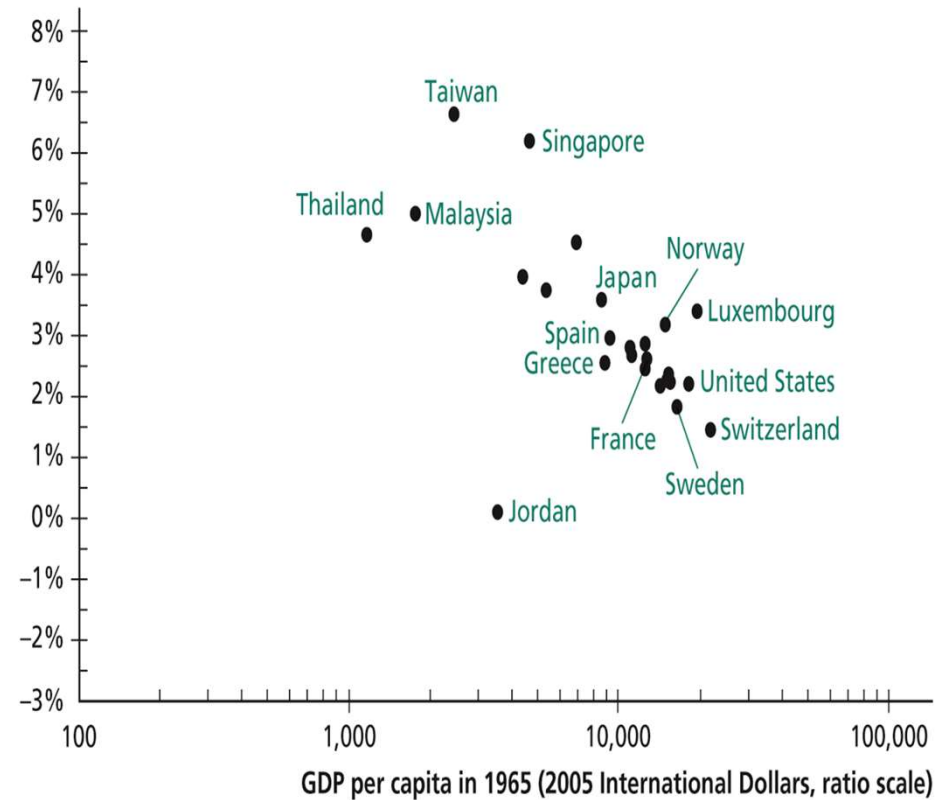
Growth in “Closed” Economies

Growth rate of GDP per capita, 1965–2000



Growth in “Open” Economies

Growth rate of GDP per capita, 1965–2000





The problem of offshoring

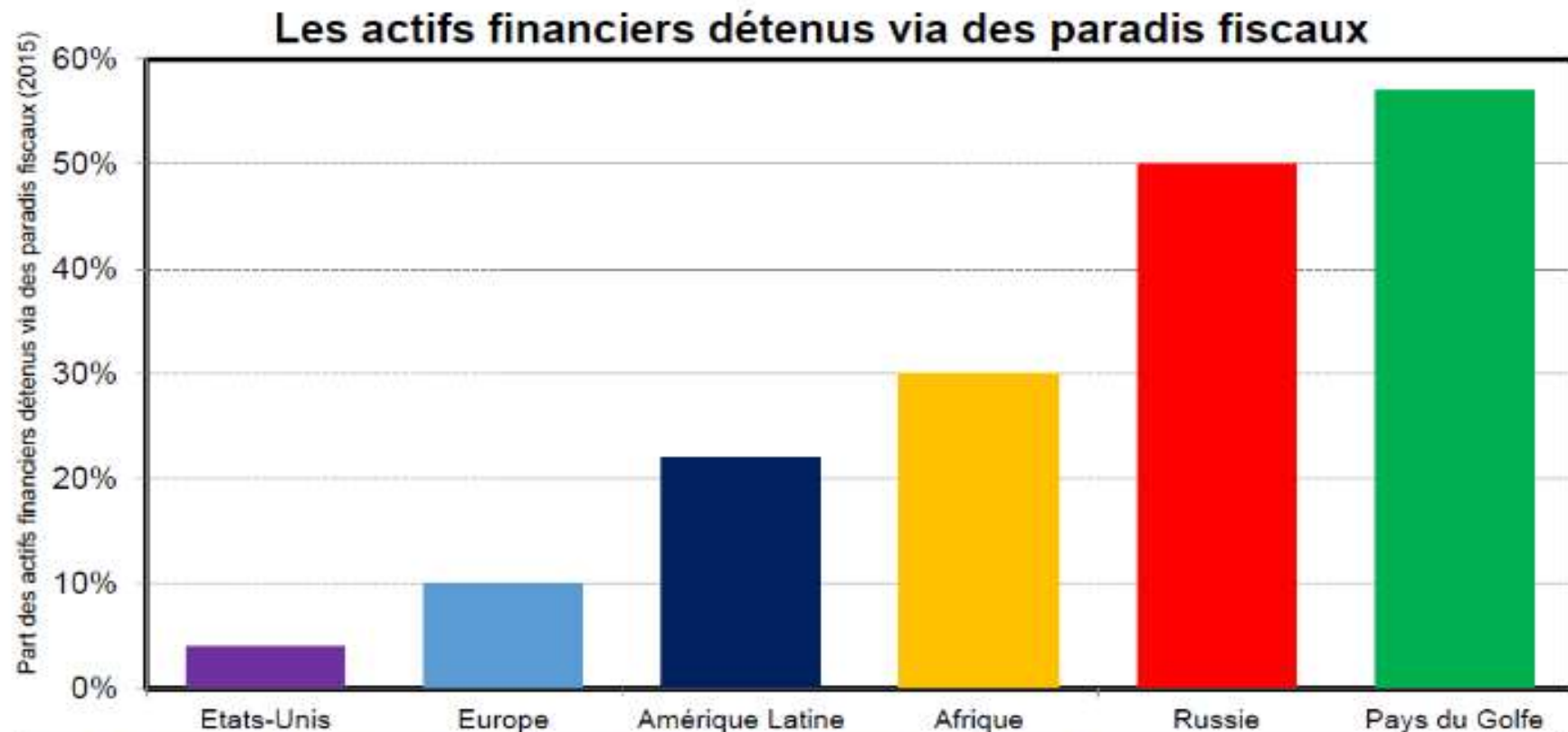
RICH PEOPLE ARE
HIDING WEALTH
OFFSHORE IN
THE REGION OF

\$7.6
TRILLION³⁹





Tax heavens and offshore money



Lecture. En exploitant les anomalies dans les statistiques financières internationales et les décompositions par pays de résidence publiées par la Banque des règlements internationaux et la Banque nationale suisse, on peut estimer que la part des actifs financiers détenus via des paradis fiscaux atteint 4% aux Etats-Unis, 10% en Europe et 50% en Russie. Ces estimations excluent les actifs non financiers (immobilier, etc.) et doivent être considérées comme des estimations minimales. **Sources et séries:** voir piketty.pse.ens.fr/ideologie (graphique 12.5).

effects of economic openness on economic growth

there are two main groups of effects of openness on economic growth:

1. international trade

effect on productivity: trade is like a form of technology: potential gains from trade arise whenever a country has a comparative advantage in producing some good;

effect on technological progress: countries that are have a strong position in trade are more able to import existing technologies (through direct investment and transfer of technology);
creation of new technologies: countries invest more in R&D if there are greater prospects of higher profits resulting from a new invention and able to export its new products;

it may have a positive effects on the efficiency, if weakening the monopoly power of domestic firms (therefore, a matter of conflict)



effects of economic openness on economic growth

2. external savings

effect on external savings and, then, reducing the financial constraints that may be originated from the limited amount of domestic savings

in a closed economy, the macroeconomic equilibrium is $I = S_{\text{domestic}}$

aggregate demand
income

$$Y = C + I$$

$$Y = C + S_{\text{domestic}}$$

$$C + I = C + S_{\text{domestic}}$$

$$I = S_{\text{domestic}}$$

in a **open economy**, the macroeconomic equilibrium in neoclassical models is **I=S** but

aggregate demand

$$Y = C + I + X - M$$

income

$$Y = C + S \text{ domestic}$$

$$C + I + X - M = C + S \text{ domestic}$$

$$I + (X - M) = S \text{ domestic}$$

$$I = S \text{ domestic} + (M - X)$$

$$I = S \text{ domestic} + S \text{ external}$$

financial sources for financing investment
(domestic; external)

if $(M - X) = S \text{ external} > 0$, the **country is using external savings to finance the economic activity**

the use of external savings to finance investment

it can be made by different forms:

foreign investment

it is both use of external savings and investment (decided abroad);
it is not “free of charge”: it “costs” further transfer of profits abroad;
it can originate external dependence and other vulnerabilities

external credit

it finances investment decided domestically;
it is not “free of charge”: it creates external debt and financial costs (interests);
it may have negative effects on the external accounts;

external public donations and loans (e.g. EU structural funds)

But also privatization of domestic assets



external savings and the domestic constraints for savings

there are domestic constraints for raising savings (to save means not to consume);

$$Y = C + I + (X - M)$$

$$Y/Y = C/Y + I/Y + (X - M)/Y$$

$$1 = c + s + m$$

this means that:

we may rise s without decreasing c , if m decreases;
to decrease m means to make more use of external savings (if $m < 0$) or to finance less the Rest of the World (if $m > 0$)