ECON 409

November 7, 2012

The World Economy after the 2nd World War

Robert Brenner (online read pp. 6-20)

- The World Economy after the second World War
  - High growth, high investment, high productivity and high wages
  - "Golden age of capitalism"
- Investment depends on expected profitability
- Brenner claims that the falling profitability contributed to the crisis in the 1970s
- How did it happen?

- Accumulation process (industrial countries)
  - The pressure on companies to cut costs as the condition for their survival (bigger market share by lowering prices)
  - Therefore they accumulate, in other words, they purchase more machinery and equipment to increase productivity.
  - However, they do it in unplanned manner. They have no interest in taking account of the overall effects of their actions ('anarchy of capitalism')
  - The outcome is redundant investment, (i.e. overinvestment and excess capacity)
  - The companies need to accept lower profit rates in the presence of lower prices or leave the market.

- Initially, US did not suffer damage from international competition due to their technological superiority and huge domestic market.
- US multinationals also benefited from the growth in other countries
- However, intensifying international competition led to lower profit rates starting in the late 1960s.
  - Beginning in the mid-1960s, manufacturers based in the later developing blocs – most especially in Japan, but also in Germany and in other parts of Western Europe – were thus able to combine relatively advanced techniques and relatively low wages to sharply reduce relative costs vis-à-vis those in the US.

- As an expression of declining manufacturing competitiveness, US trade and current account balances fell significantly(and German and Japanese trade and current account balances rose correspondingly).
- Along with military expenditures, this contributed to the abandonment of the gold-dollar system in 1971
  - Starting in the 1970s, major economies attained lower investment and productivity increases as a result of lower profitability in the manufacturing sector.

Manufacturing

	Net Profit Rate		*Output*		*Net Capital Stock*		*Gross Capital Stock*		*Labour Productivity*		*Real Wage*	
	1950–70	*1970–93*	*1950–73*	*1973–93*	*1950–73*	*1973–93*	*1950–73*	*1973–93*	*1950–73*	*1973–93*	*1950–73*	*1973–93*
US	24.35	14.5	4.3	1.9	3.8	2.25	–	–	3.0	2.4	2.6	0.5
Germany	23.1	10.9	5.1	0.9	5.7	0.9	6.4	1.7	4.8	1.7	5.7	2.4
Japan	40.4	20.4	14.1	5.0	14.5	5.0	14.7	5.0	10.2	5.1	6.1	2.7
G-7	26.2	15.7	5.5	2.1	–	–	4.8	3.7	3.9	3.1	–	–

G-7 net profit rate extends to 1990; German net capital stock covers 1955–93; Japanese net profit rates and net capital stock cover in manufacturing 1955–1991.

Private Business

	Net Profit Rate		*Output*		*Net Capital Stock*		*Gross Capital Stock*		*Labor productivity*		*Real Wage*		*Unemployment Rate*	
	1950–70	*1970–93*	*1950–73*	*1973–93*	*1950–73*	*1973–93*	*1950–73*	*1973–93*	*1950–73*	*1973–93*	*1950–73*	*1973–93*	*1950–73*	*1973–93*
US	12.9	9.9	4.2	2.6	3.8	3.0	–	–	2.7	1.1	2.7	0.2	4.2	6.7
Germany	23.2	13.8	4.5	2.2	6.0	2.6	5.1	3.0	4.6	2.2	5.7	1.9	2.3	5.7
Japan	21.6	17.2	9.1	4.1	–	–	9.35	7.1	5.6	3.1	6.3	2.7	1.6	2.1
G7	17.6	13.3	4.5	2.2	–	–	4.5	4.3	3.6	1.3	–	–	3.1	6.2

- Profit rates did not recover soon.
  - There was insufficient exit
    - Physical investment is irreversible. Most of the machinery and equipment have specific functions.
    - It was better to stay put and be satisfied with the existing low profit rates while trying to economize on other inputs (labor, raw material etc.)
    - Long-established relations with suppliers and costumers that could not be easily duplicated in other sectors
  - Too much entry
    - New low-cost competitors such as South Korea or Taiwan entered the international markets
    - Over-capacity was exacerbated

- Keynesian Policies
  - By increasing demand, deficit spending, and easy credit allowed many high-cost, low-profit manufacturers to stay in business
  - Most of the companies did not respond by increasing capacity; they preferred to pass along the rising demand to higher prices (inflation)
- High wages due to strong trade unions and social expenditures

- Stagflation (stagnation [low investment and high unemployment) + inflation] in the late 1970s

- Another problem was persistently high budget deficits

- Growth pattern of the developing countries (1945-1970s)
  - Import-substituting industrialization policies
    - Poverty and inequality was the major concern
    - One reason can be in terms of production structure
      - Mostly primary sector production (agriculture and raw material)
      - No profit from international trade (deterioration of the terms of trade, volatile international prices)
      - No technology spillovers and learning by doing

- How to change it?
  - Industrialization and capital formation was considered the major source of growth
    - rising productivity
    - backward-linkages
    - export diversification
  - How to acquire new machinery and equipment? (by saving foreign exchange)
    - Production of the previously imported goods (mostly consumer durable goods)
    - Protection of the domestic markets for consumption goods, but not for capital goods

- Main concerns during the ISI
  - How to go about the planning process?
    - It was not socialism, i.e. nationalization of all economic sectors
    - Allocation of investment among different sectors
    - Support by the international institutions such as the World Bank
  - How to protect markets?
    - Tariff and quota
    - Exchange rate policies
      - Overvaluation of domestic currency (cheaper imports)
      - BUT: imports can crowd out domestic private sector
      - How about exports?

- Problems:
  - Never passed the stage of consumption good production
    - There was neither cost efficiency nor innovation in protected markets
    - Most of the developing countries still depended on imported capital goods
    - Exports were harmed due to overvalued currency
  - Significant trade imbalances (lack of foreign savings)
  - Persistent unemployment (labor-saving technology embodied in the imported capital goods)
  - Underutilization of capital (lack of intermediate goods such as oil)
  - Strong trade unions and high wages

- Government failures
  - Presence of import licenses and investment permits created rents for private groups (rent-seeking)
    - It was more profitable for firms to use their resources in order to capture the rents
  - Price distortions
    - Undervalued currency (low revenue for exporters)
    - Low and even negative real interest rates curb domestic savings
      - Low nominal interest rates were expected to increase real investment spending
      - Real interest rate= nominal interest rate-inflation
- All these factors question the role of the government in managing the economy

Table 7
Historical Rates of Economic Growth by Major Regions during and after the Age of Imperialism (1820-1950)
(annual per capita GDP growth rate, %)

Regions	1820-70	1870-1913	1913-50	1950-73
Western Europe	0.95	1.32	0.76	4.08
Western Offshoots*	1.42	1.81	1.55	2.44
Japan	0.19	1.48	0.89	8.05
Asia excluding Japan	-0.11	0.38	-0.02	2.92
Latin America	0.10	1.81	1.42	2.52
Eastern Europe and the former USSR	0.64	1.15	1.50	3.49
Africa	0.12	0.64	1.02	2.07
World	0.53	1.30	0.91	2.93

Table 10
Per capita GDP Growth Rates of the Developing Countries, 1980-2000

	1980-90 (%)	1990-20 (%)	1980-2000 (%)
Developing Countries	**1.4**	**2.0**	**1.7**
East Asia and Pacific	6.4	6.0	6.2
Europe and Central Asia	1.5	-1.8	-0.2
Latin America and the Caribbean	-0.3	1.7	0.7
Middle East and North Africa	-1.1	1.2	-0.1
South Asia	3.5	3.7	3.6
Sub-Saharan Africa	-1.2	-0.2	-0.7
Developed Countries	**2.5**	**1.7**	**2.1**