WORLD ECONOMICS
LECTURE NOTES

1. MAINSTREAM AND POLITICAL ECONOMICS

In general, when we talk about mainstream economics, mostly we refer to neoclassical economics. Neoclassical economics is an approach to economics trough models and analytical techniques based on rich empirical data. Its methods and theories are accepted and utilized by most members of today's economics profession.

The main assumption of mainstream economics is the so-called rational choice theory, which suggests that actors of the economy have rational preferences and they make their choices according to these interests. A basic idea of neoclassical economics is that individuals and firms act independently, based on important information. The main goal of individuals is to maximize their utility, while firms work to maximize their profits.

In neoclassical economics, we regard the economies as closed systems and the theories indicate that they reach a balanced situation, an equilibrium. A good example of this is the assumption that markets clear in the economy: the demand for a good equals the supply of a good, there is no shortage or surplus. If there is, trade can solve the problem and everyone – except the factor owners and producers of the importing industry– benefits. But even the losers can be easily compensated by the growing welfare.

However, if we look around a bit, we can easily conclude that the economy does not always work as perfect as theories. Political economics suggests that theoretical insights, sociopolitical structures are essential ingredients of economics. They have a relevant impact on the different outcomes because actors are not fully rational.

Let us go back to the example of trading. As mentioned earlier according to mainstream economics trade is beneficial for the economy. Nevertheless, if we look at the topic from a political economic approach, we must ask the question: Always?

To answer this question we first need to look back at the mainstream aspects of the question. Let us take England and Portugal as a simplified example. Suppose that the two closed economies decide to trade. The subjects of trade are wine and clothing. In the beginning both countries produce both goods, however after they start to trade, they both specialize in the production of the good that they have a comparative advantage in. Therefore, England produces and exports clothing and Portugal specializes in producing wine.

If we stick to mainstream economics, we can state that generally, both economies benefit. If we look at the immediate results, this conclusion holds of course. However, let us take a look a the political economist interpretation of the events. For this, we need to observe what happened after establishing trade.

England specialized in the clothing industry, factories started to grow and more labour force was needed in cities, therefore urbanization got became very rapid, cities started to grow. As an effect, the clothing industry also grew and England drastically strengthened (in reality there were more reason for that of course).

In contradiction to England, in Portugal wine production did not enforce a rapid development or economic growth. Even if Portugal benefited from the trade, the difference between the strength of the two nation permanently grew. Portugal faced a problem when it became clear that England got so strong that it is in the position to force Portugal to trade and act in the stronger nation's favour. This is what eventually happened, a patriarchist relationship between England and Portugal has been established.

Political economics presumes that there are path dependences in the economy, which are disregarded by the economic models, even though they have a giant impact on the decisions made. Accepting the patriarchist relationship was neither utility nor profit maximizing for Portugal, still, there was no choice.

Another proof that economic actors don't always make rational decisions are financial markets. People want to make good deals and earn money with trading on the market. The fact that people fear, make assumptions, gossip, drastically influences current prices and market values. It is nearly impossible to make rational choices in this case, as it is known how the market will change in the upcoming seconds, minutes, hours.

For example, if stock prices suddenly fall, a lot of people immediately want to sell their securities. This creates extra supply on the market, and less demand of course, which makes the price fall even more radically. For the Czech market, this behaviour was a big threat, when investors started to sell off their Czech securities, just because they showed some similar characteristics to very risky investments in Asia.

To put it in a nutshell, mainstream economics looks at the economy as a closed system, in which most outcomes, happenings can be modelled with equations and analytical methods. The models are based on rich empirical data and possible outcomes can be precisely calculated.

However, in real life economics are often influences by political and sociological issues, people are not always rational decision makers. Therefore, according to political economics, models are not always perfectly reliable.

2. COMPETITION, GROWTH & SOCIAL INEQUALITIES

INTRODUCTION

Mainstream, economics has developed several models to economic growth in the long run. In fact, however, there are assumptions and consequences in mainstream models, which have important messages for the society, but they bear little interest for economists. These include one of the main problems of social sciences, inequalities. Because even such a positive sounding process like growth can have devastating effects on society in terms of inequalities. In the following we will deal with the social consequences of that said economic growth divided into 3 periods of time each with different levels of technology, which is in close relation with the effect on society

18TH/19TH CENTURY

At the time of the late 18th and early 19th technology did not allow mass production and the more important factor of production was labor. Let's consider through an example how this type of economy reacted to an external shock. Assume a shoemaker in the given era, whose dominant factor of production is labor, and is a price taker. In a simplified way we can write the cost of the shoes, which he is selling as

$P=C+\pi \rightarrow 20=17+3$

where P is the price, which the customers are paying, C is the total cost of the shoemaker and pi is the profit of the shoemaker. Now let's consider the effect of an external shock in this market which raises the market price of shoes to P=25. By common sense it would mean that, the price has increased, obviously the costs remain the same thus the profit of the shoemaker increases from 3 to π=8, so only the shoemakers win on this shock. Although this is not exactly the case, several other factors play a role. Firstly, because the cost is higher the shoemaker would like to produce more, thus he asks his employees to work more, which they agree to, but they ask more money for the extra hours. They are able to do it because of the scarcity of labor, meaning the shoemaker can't easily employ new people. This increase in wages increases total cost, thus lowering the profit: 25=22+3. This seems like the shoemaker didn't win anything, because his profit is still 3/unit, however we assumed that he increased production, thus his

total profit increased as well. Secondly, we also need to consider that the shoe industry in the 19th century is one with relatively easy entrance. This implies if there is suddenly an increased demand for shoes a lot of people will enroll in shoemaking, increasing the supply and eventually reducing the profits back to 3 from 8. These were only two examples out of many, the point is that several effects together will lead to a natural new equilibrium. And if we analyze that new equilibrium we can observe that the increase in the size of shoe industry increased the wages of the workers AND the profit of the shoemakers. This means that competition and the growth of that specific industry was beneficial for everyone, thus it increased social welfare and there are no "losers" of this external shock.

20TH CENTURY

The 20th century is often referred to as the age of Fordism & low labor costs. The first part of that naturally refers to Henry Ford, who helped to accelerate industrialization, with his invention, the assembly line. Assembly line meant that products were no longer made by one craftsman they were rather moved around in a large conveyor belt and everyone did one sub-part of the assembly. This Fordist way of industry brought with itself the second part, low labor cost. Because in assembly lines every workers job was relatively simple, they didn't need to be skilled workers and, thus they were easily replaceable. This came down to the fact that labor was no longer a scarcity, everyone was able to work in these factories, however at the same time the gap between the level of knowledge of the management and the labor force started grow. Also, it is important to know that this type of industry was more heavily reliant on capital instead of labor. In this described world we should assume the previous status-quo: a shoemaker with same unit prices of 20=17+3 and an external shock, which increases the price of shoes to 25. As in the previous scenario the head of the shoemaker industry would like to produce more to supply the market. In the previous case he had 2 problems: scarcity of labor and easy entrance. We have already argued why the scarcity of labor is not a factor anymore since the industrialist can hire as much unskilled labor as he wants without having to increase their wages. Easy entrance is not holding profits back either, because a capital-heavy industry means one with high entrance cost, which is the exact deterrent for firms, which are considering producing shoes. So, the increased supply will not lower profits either. Therefore, the profit of the company increases, while wages remain the same. This creates a situation of inequality where the small group of industrialists can increase their welfare however the workers' welfare

remains the same. In comparison with the previous era where growth benefitted everyone, now it only benefits a sub-group of society, leading to growing inequalities.

21ST CENTURY

In the present of industrial development, assembly lines remained dominant, however there was an explosion-like growth of the IT sector. This rapid development enabled industrialists to heavily rely on the new technologies of IT to further increase their profitability. The most important new technology for the industrial sector was adaptive technology. In the past if an assembly line was constructed to produce a specific product it was expensive and time-consuming to rebuild it to a different product or to even just a different variation of the same product. This has changed in the 21st century, due to the heavy involvement of automated machinery and computers, producers could switch between several variations of the same product only by reprogramming some of the machines. This greatly reduced the cost and time of changing from one product to another, which lead to a much broader variety of products offered by suppliers. This wide range of products enabled producers to segment the market and apply so called market differentiation, it is the phenomenon of supplying specific demands, which in the past were impossible to supply with a profit. Now producer can create 100's of different versions of a product easily and sell them to the relevant market. A good example for this is when the shoe producer firm Nike started to sell special shoes for native Americans, among which flatfoot was a common phenomenon, they designed it to fit in their culture and to cater for the needs of flatfooted people. They could not have been able to do it without adaptive technologies. Due to this IT revolution the great market collapsed, it broke down it an infinite amount of sub-markets. The reason we say that the great market collapsed because in a market, products are competing, however the sub-markets are not in competition, they are there for a very specific demand, which another sub-market cannot satisfy. This was beneficial, since entry costs became lower you did not have to build a large factory to produce shoes, you could just cater for a small sub-market with lower entry costs. However, the IT revolution brought negative consequences as well, In the past producers with different numbers of clients were democratically distributed, most producers had medium number of clients, a few of them had a lot of clients, while a small portion had only a few. This occurred by simply the fact that people had to wait in queues in shops. With the introduction of Internet this has changed in a way that no on has to stand in queues anymore and people tend to buy from producers, which have the most clients, since a lot of people can't be all wrong. Its easily seen that this is beneficial for

already big producers, since they can grow even bigger, but it is negative for small ones, which have difficulties starting their business. All in all, we can say that it is extremely hard to judge how the newest technologies will affect competition, equality and growth but we can see that there are innovations, which are certainly positive while others, which have negative effects as well.

CONCLUSION

We have seen throughout different periods that even though in the long run growth is positive and it should be the goal of every economy, in the short run it can and will create inequalities between social groups. These inequalities are hard to avoid, and they come naturally with growth.

3. GROWTH AND TERRITORIAL INEQUALITY

The following article discusses the impact of growth on territorial inequality based on a comparison on the 19th and the 21st century and their typical economic behavior.

In the 19th century in the western world, typically there was territorial equality. In the USA, where development and economic growth was quite significant in those times, the building of the train system supported an evenly distributed development. The reason for that was that all kind different areas could join the process, and get integrated. The trains connected the cities, villages and development was sustainable trough transport. Therefore, the whole United States as a whole was growing and not just some very rich parts from it.

Territorial equality is not typical for the 21st century. Looking at the United States as an example it can be concluded that some parts are growing more steadily than other parts, some areas are simply richer, and welfare is higher.

Romania is also a good example for this situation. Bucharest, the capital city, is economically the most relevant city of Romania, and it has gained a lot of importance over the last decades. With the development of air traffic and airlines, it was possible for Bucharest to join the global network of production chain. However, in this case the air traffic does not work as the train system in the 19th century's United States. There are a few bigger, already more developed cities with airports. There is a connection between these cities through regular flights. Nevertheless, locations between the two airports remain unaffected. These little cities do not have the opportunity to join the economy and its growth. The cities grow steadily, but the other areas not, therefore there territorial inequality is growing between them.

According to Thomas Friedman's book, the "world is flat". This theory suggests that everybody can join the development, as opportunities are open to every region. However looking at the reality the conclusion is that this theory does not hold. On the contrary, usually the development and growth is concentrated in special areas, which were typically already better performing than others were.

Foreign Direct Investment increases the risk of territorial inequalities. According to mainstream economics, it is worth to invest in underdeveloped regions because they could provide more cash flow. In Europe for instance the best investment opportunities are already owned, therefore theoretically it would be beneficial to invest in poorer regions such as Africa. However apart from textbooks, this is not very likely to happen. The reason for this is that investing in Africa is simply too risky and investors choose to invest in other areas. This is phenomena is the so called perverted flow of capital.

There is a second failure with the model: In the reality, the human capital is not homogenous. If a society organizes itself more effectively, they become more productive. Therefore, they will simply be more attractive to the investors.

In the 19th century main resources of a city were materials, for example coal. Coal became the reason of growth in many cases. As the cities grew, the amount of the available resource got less and less. Eventually further growth was not sustainable based on coal; therefore, other ways had to be found.

In contrast to this, the main resource of growth in the 21st century is human capital. If human capital is utilized, it eventually attracts more human capital. Therefore, the area, city is not running out of the resource of their growth.

The Silicon Valley is a good example for this. All big and relevant IT companies concentrate in the same area. Therefore, if a company, start-up wants to become more effective it moves to the area where all the big companies already have their headquarters. The reason for that is that area provides more skilled labor force. As an effect, talented programmers also move to the Silicon Valley, to fin proper, well-paying jobs. These results in steadily growing human capital in the area, which creates further territorial inequality as well.

Human Capital is a rather important in Foreign Direct Investment. The Hungarian city Kecskemét and the Romanian city Cluj Napoca were both campaigning for being able to establish the new Mercedes factory in Central-Eastern Europe. In the end, the decision favor Kecskemét. The final choice was based on the quality of human capital.

In modern times production changed as well. In order to survive companies need to follow different structures. In the 19th century, a company specialized on producing a kind of product, products. If there were resources needed for the production, these were bought from other subcontractor companies. For example, the shoemaker bought leather for the shoes.

In the 21st century, this pattern changed. There are complex connections, such as partnerships between companies. The production became more fluid, it is easier to alter it. The subcontractor has the opportunity to open up to buyers as well. This results the absurd situation that while the two companies are in a partnership, they still complete with each other in the same market. The Volkswagen Group for instance includes many different car brands and their production is combined. Many cars in the group have Audi engines for instance. However, with time Skoda became a market opponent for Volkswagen cars, despite the connection between the companies.

As result of on-growing territorial inequality, some cities became extremely important in today's world economy. Their position is unique. The cities New York, London and Hong Kong became giant, and have their own special dynamics. Many claim that despite the distance

the cities are closer to each other than their surroundings, the "hinterland". The expression NYLonKong symbolizes this special relationship, and suggests that the three cities are actually one big city, with three different parts on three different continents.

For the "Hinterland" it is impossible to catch up with the giant cities regarding development, and they are also less attractive for investors or human capital. Therefore, these areas have limited opportunities. Many smaller villages, towns face the problem that the young generations move away to the more developed regions, offering prosperity.

Politics is very important regarding this matter, because with regional investments and capitals, underdeveloped areas could be helped out. Typically, politics increases territorial inequality. Moreover, territorial inequality also creates political inequality. It is a very usual scenario that people living in the countryside have drastically other political opinions. From the politicians they demand completely different kind of solutions, programs.

To summarize it, we can conclude that in the 21st century economic growth remained concentrated in special areas. Territorial inequalities did not vanish; on the contrary, they are steadily growing. Extremely underdeveloped areas are too risky for investors. More developed regions attract more capital and more human capital.

4. GLOBALIZATION THEORIES

INTRODUCTION

Globalization is a word used widely by the economist and politicians of the 21st century. This extensive usage of globalization in many contexts made it hard to capture the essence of what it means and even harder to research it. In the following we will try to understand the concept by explaining four very distinct theories about globalization.

GLOBAL VILLAGE

The term global village was coined by the American researcher Marshall McLuhan, who was one of the very first to use the word 'globalization' in his research. His idea about globalization is arguably the most optimistic out of the four, which will be presented. The basis of the global village theory is that our world has become a great village through the connection of media, the possibility of travelling and cultural penetration (incorporation of another culture, language and customs in one's own). The inhabitants of the village are from different lands and from different cultures, but they are all in contact with each other, work together and trade with each other. According to this theory the borders we have today are non-existent and the whole world is one village, this also implies that the village cannot have war with itself. Naturally there are disputes and quarrels between villagers but according to McLuhan the close proximity of several cultures eliminates conflict. That is why it is referred to as optimistic, because it idealizes globalization as a process, which eliminates war between nations, essentially eliminating aggressive conflict from the world. On the other hand, this theory has received critiques as well, namely that the mixture of cultures can trigger tensions instead. Some extremist groups can exploit this tension to their own advantage as we have seen in the previous century. Also, it can be noted that due to the online opportunities (in theory) everyone can experience the same life and cultural products, however if they are not allowed to actually live that way it creates tension. The most straightforward example is people living in 3rd world countries, who can experience European culture through the Internet, but they are not allowed to enter the territory. This tension between the displayed world and the actual one creates conflict, just like the case of Turkey, which was not accepted to the EU and now it follows an anti-EU policy. In conclusion this theory is highly idealized and has several downfalls, however it has relevance with the point that through the media everyone is connected

JIHAD VS MCWORLD

This theory relates to the American author Benjamin R. Barber, who summarized his ideas in his book of the same name. His approach is far more pessimistic in tone than the previous. He argues that there are 2 ways for globalization to happen: McWorld and Jihad. McWorld symbolizes a concept where local "tastes" will be taken over by the multinational company "McDonalds", naturally it is not just about food, but local culture taken over by globalization. Barber argues that due to globalization, local communities disappear along with national ideas and according to him these localities make the world strong and most importantly free (democratic). Therefore, a heavy globalization tendency should not be described as a sign of democracy but a threat to democracy. The theory states that as globalization takes over, people have less and less choice and less and less of their culture with them, which causes a democratic deficit because eventually they will have no choice but to accept whatever globalization forces upon them. The other way he describes is the way of the Jihad. This way states that because globalization destroys democracy we should deny even the display of it. Democracy is only a 'Trojan Horse', which contains western interest. According to this worldview people will turn to the past and support a social hierarchy to avoid the satisfaction of Western interests. We can see that even though the two worldviews are very distinct, they both are extremely negative and neither of them describes globalization as a positive process.

COCA-COLONIZATION

The expression 'Coca-colonization' refers to the globalization of American culture pushed through popular American products such as the extremely popular soft drink Coca-Cola. The term itself only describes a process, however over the years it become a word to liken globalization to westernization, bearing a negative meaning. This negative tone is because according to this theory, globalization is not a process where companies from all over the world, which have advantage in a product have a chance to expand, rather that only American (Western) companies can expand and they are forcing their products on every market of the world. They argue that globalization is not a balanced mechanism it is nearly only the privilege of Western companies. It is very well described through the Coca-Cola company, which sells to all except 2 countries of the world, Cuba and North-Korea. Coca-Cola become the synonym of coke because it is the top seller of soft drinks in nearly every country. There are a few exceptions though, which shows that even global branding can't overcome local tastes

sometimes. The first is the Peruvian Inca cola, which was established more than 100 years ago. It was preserved partly by nationalist protective measures but mostly because people are accustomed to the taste of it and by the time Coca-Cola got to Peru they were not willing to change to it; therefore, Coca-Cola couldn't fully overcome the Peruvian market (it does own part of Inca-Cola though). The other example is the Slovakian Kofola, which was a karaoke product of the communistic regime of Slovakia. Karaoke means that it was a copy of the original Coca-Cola, which they couldn't sell in a communistic country due to its association with Western values. Therefore, the Slovakian government introduced the Kofola, which became increasingly popular in Slovakia and even though the company went bankrupt once, it was able to recover, and it still is a beloved product of Slovakia.

GLOCALIZATION

Lastly, the theory of glocalization agrees with the traditional globalization theory on the fact that big cities and corporations approach each other, on the other hand it argues that the hinterland stays behind not approaching anything. This theory is sort of a grey mixture, which acknowledges the damage, which globalization causes on the other hand it states that the process is not 100% negative because it has indirect positive effect. A famous example of the theory in practice is the story of the beer market. Because of globalization many national beer companies were bought up by big beer producers, leading to the fact that in most of western countries the same commercial beers were available. On the other hand, because global info on beermaking was now available for everyone small companies started to open with their own unique beers, leading to the now-popular craft beer segment of the market. Even though the national beer market was bought up, it was not entirely taken over by global companies because it jumpstarted a new segment, therefore globalization had both negative and positive effects.

CONCLUSION

There are many ways to approach globalization, however there is not single theory, which can overcome the others. All of them have valid points but all of them have just as much critiques and downfalls as well. It is important not to analyze globalization according to just one theory because you might end up with a biased conclusion, but rather take into consideration all of the negative and all of the positive factors and try to balance them out.

5. TECHNOLOGICAL DEVELOPMENT AND STARTUPS

The enormous technological development drastically changed production over the last century. Old frameworks have changed and the mass production began. These technological changes have also affected the society. The attitude towards working and the way of working changed as well.

The Ford T model was the first mass-produced car in history, and it marks the beginning of a new era of production. In factories, assembly lines were set into practice. The biggest advantage of the new, modern system was that each worker by the assembly line was only responsible for a particular sub-process. These did not require outstanding skills or knowledge. Therefore, labour drastically became cheaper, as workers were easily replaceable. This breakthrough enabled cheap mass production. This is the so-called Fordism. With time, most of the biggest factories had begun to practice this production pattern as well.

At the end of the 20th century and in the 21st century, technological progress became even more rapid. Nowadays we speak of the so-called Post-Fordism. One of the most relevant issues is product differentiating. This process highlights the differences and unique qualities between competing products and makes the one product more attractive than other products. If product differentiation is successful, it the producer can have a competitive advantage in producing the particular good.

Probably the biggest development took place in the IT sector. There numerous adaptive technologies, therefore factories can change their products and way of the production quite easily. Additionally, if producers want to enter the market with a new or a differentiated the extra cost are relatively low.

In the 21st century, startups have become a very popular form of launching a new business. Many of them, such as the Airbnb has grown to well-operating firms. Theoretically, the door is open to anybody: everybody can launch a startup. However becoming successful is by far not as easy as many would think. We speak of the so-called lottery capitalism, which indicates that those who want success should take a risk and “play the game”. They might win a lot, but actually, most people lose.

The first step by launching a new business is to have a promising idea and a proper team. Then the startups need venture capital, therefore the team needs to convince investors that from all the start-ups theirs will be the best and most profitable. This is hard because most start-up teams have no market valuation, just a bunch of ideas. However many investors are ready to invest in

very risky new concepts because if the projects eventually become a success they can make huge profits. Investors who help the newly launched start-ups to survive often are called "Business Angels". Nevertheless, most investors before investors do require something from the new business that is actually working, the minimal viable product.

There are many new start-ups and new ideas each year, therefore it is not easy to find a Business Angel. Because investors have limited time, it is essential for the start-up team to make a very convincing pitch presentation, a very short, understandable summary of the new ideas. The presentation of the ideas is often nicknamed as "elevator speech" because most startups do not get the chance to properly present their concepts, but meet the investors in an elevator and have only 2-3 minutes to make them interested.

The main critical point regarding this system is that investors immediately wish for the exponential growth of the company. However, this implies no market rivals, therefore a monopolistic or an oligopolistic structure. Therefore, most startups show an optimistic, but rather aggressive behaviour on the market.

For instance, Airbnb has a kind of monopoly in renting out flats for short time. Airbnb is so dominant and well known that it is extremely hard to survive next to it.

A great aim of investors is a successful exit. The so-called exit strategy implies that you let the company grow until it experiences an exponential growth. Then at the peak sell the company to for more money to bigger investors or giants. For example, Google or Facebook eventually buys most successful IT- startups.

This system also has a social effect. The norm nowadays is that you do not need to be dedicated to an idea, or profession in your entire life, you can always quit. "If you had enough, just sell what you created and be happy with the money." There are exceptions of course. The owners of Snapchat drew user's attention by refusing to sell their company to Facebook.

However, start-ups and technological development are not always positive only. Even if some start-ups promote making life efficient, some technological development even hurts common people. In the United States, there are numerous little shops, so-called Bodegas, which sell cigarettes and drinks. Latino people typically own these Bodegas. However, a new startup set a goal to replace the Bodegas with machines and make them cheaper, more effective. There is a big discussion about it because the set-up of these machines would mean that a lot of people lose their only job.

With the rapid development and all the new inventions also a new trend was born. The so-called techno-pessimism states that the technological development of the 21st century is different as it was a hundred years ago. The newest inventions do not improve our life or make our work more

effective anymore. Peter Thiel, one of the original investors of Facebook claims, that the newest inventions, such as messenger apps, smileys even worsen our efficiency because they negatively affect our leisure time. Social media also created a new discussion: is it ethic that these companies hold people's personal data and use them for business purposes? The Cambridge analytical scandal rose awareness to that recently. This topic is often referred to as the Industry 4.0, meaning today's technologically highly developed production patterns, versus Freiheit 4.0, the movement to protect the personal data.

Many believe that net neutrality would be a solution for that, claiming that the internet should be nationalized. Nevertheless, this creates even more discussions whether that would prevent illegal use of personal data.

In his book, „Where are the boys", Peter Zimbardo discusses the effect of video games on primary school boys. Previously schoolboys used to play outside on the streets, but nowadays most of them spend their spare time with gaming. This is a good way for them to escape reality and hide in a virtual world. There is a growing tendency of social loneliness Zimbardo states a correlation between the decadence of primary school-aged boys and the increasing time spent with video games.

To summarize the topic, we can state that technological development has drastically changed production and business performance. These changes have had an impact on social patterns as well. Whether the effects are positive is highly debated.

6. TRADE WAR BETWEEN THE U.S. AND CHINA

INTRODUCTION

The United States of America was undoubtedly the biggest economic actor of the world for nearly a century, however in the previous decades China showed incredibly rapid development, emerging as the second (in some aspects THE) biggest economic power in the world. It is straightforward that the two largest economic actors are trade partners, in fact they are the biggest bilateral economic relationship and with the countries as significant as these, this means a great portion of world trade. We would think that this trade benefits both countries by neoclassical economic rules, therefore they would try to keep up this heavy trade with each other. The current status-quo is quite the opposite, the 2 countries are engaging in a trade war with each other, which seems economically inefficient for the economist observer. This paper aims to uncover the reasons why can a trade-war happen between 2 great nations despite the obvious downfalls of engaging in such an activity.

HISTORY OF CHINA

In order to understand the relationship of these two nations we must focus our vision on the past of China first. The period before the 1970's is not included since China did not start the rapid growth, which it showed later, and it was a heavily communist country so it it bears little to no relevance to the topic we are analyzing. During the 70's the communist pressure started to loosen and there were signs of the two nations approaching each other, such as Kissinger's trip to China or the so called 'ping-pong diplomacy', these were small steps, but they were one of the first instances of the two nations cooperation. This political opening towards the United States was sped up by the death of chairman Mao and more importantly the common enemy, the Soviet Union. China and the U.S were not allying but the common enemy proved to be a great way for uniting the two nations. Despite the mutual convergence towards each other the collapse of the Soviet Union, the 2008 financial crisis and several diplomatic affairs worsened the relationship, it is often referred to as a 'mixed bag of relations'. There were affairs on which they agreed on but there were other occasions where they considered the other an enemy. This political insight is important because for China and the US trading with each other was not as straightforward, as for example for nations of the European Union. The first step of trade is always diplomacy and until a good diplomatic relation is not achieved countries

will not trade with each other, despite the economic efficiency. In conclusion after the first few years the diplomatic relations enabled the two countries to start trading and this trade went on undisturbed.

THE TRADE WAR

in order to analyze the why of engaging in a trade war we will take two routes, on the first one it is assumed that the United States as a nation, as an economic actor engages in the trade war (this is route is more focused on economics and not on political economy), with the second one, however we assume that it's president Trump's rhetoric (which is focusing more on politics). These simple assumptions help us to focus our view.

For the United States as a nation imposing barriers on trade (import) could be beneficial for several reasons. Firstly, according to neoclassical economics a large open economy (which the US can be considered as) can increase its welfare by imposing tariffs, because it has market power on world prices. However, it only works to an extent and the current status-quo has gone well beyond this level. It is also argued that even though tariffs on trade create welfare loss, but they create tax revenue for the state, which can be redistributed, although its hard to monitor how that money is used. Secondly the US is currently in 335 billion $ trade deficit to China, that is it imports more by 335 billion than it exports. This means that the country may want to decrease this 'dependency', however more often than this is not about economic efficiency, it's rather a political argument.

Another approach to this topic is that United States as a decision maker body is not taking part in this trade war so heavily, rather its president Donald Trumps' political direction. As president Donald Trump has considerable power, if not actual legislative but diplomatic power, which is sometimes more important than actual legislation. If we assume that the trade war is the president's political rhetoric, we are seeking the question: why would he want a trade war? It's certainly not the growth of the country or macroeconomic indicators because we are aware that trade barriers will have a negative effect on those. The main reason found for this political direction is satisfying current and acquiring voters or stakeholders. As it is known the last presidential campaign was heavily focused on themes of nationalism and anti-globalism and engaging in a trade war with a great competitor of the country fits in those rhetorics very well. President Trump has to realize some of his promises of anti-globalism, which he made in the election period, because the competition was quite fierce, and one or two states of electors could turn the tide for the next, following election. Therefore, it is an option that Donald Trump

uses this opportunity to satisfy his stakeholders who expect him to follow the nationalist political direction and to acquire more voters for the upcoming election by stepping up against globalism and mostly China. In summary if we assume that the trade war is happening because of the president's political views, it's possible that it was started to satisfy his voters and to ultimately be a strong point of argument for the next election. Although, its important to note that this is political economics, and most of these are assumptions, one can never be sure of the intentions of political steps.

THE ACTUAL STATE OF THE TRADE WAR

The current state of trade barriers can be represented by the nominal amount of tariffs imposed. The US imposes 250 billion $ tariff exclusively on Chinese products and the Peoples Republic of China imposes 110 billion $ tariff on products of the United States. These numbers are relatively high if we compare them to the US deficit towards china in trade (335 billion $) on the other hand they are relatively small if we compare it somewhat like the import of the annual import of the united states (2.4 trillion $). These tariffs however were not imposed in once, they were introduced step by step since the October of 2017, among which the one with the greatest importance was the tariff imposed in July 2018 on ALL imported products from China. We can conclude that the tariffs are growing in number and as said above they are already a considerable portion.

CONCLUSION

The ongoing trade war can be approached by several sides, it can be argued that the US economy is profiting from the tariffs as a form of growing independency and tariff revenue. Or it can be said that president Trump's political direction and stakeholder satisfaction is the one, which dictates this trade-war. Regardless of the assumption taken the trade war has escalated to be a noticeable phenomenon both in nominal value and in effect of current politics. It is important to keep note of the following events since both the midterm elections and the Trump-Xi meeting is coming up, which can both effect the current status-quo. In the end it is hard to make assumptions about the future of this trade war since it's a social science after all however, improvement over the current situation is possible and it would be beneficial for both states.

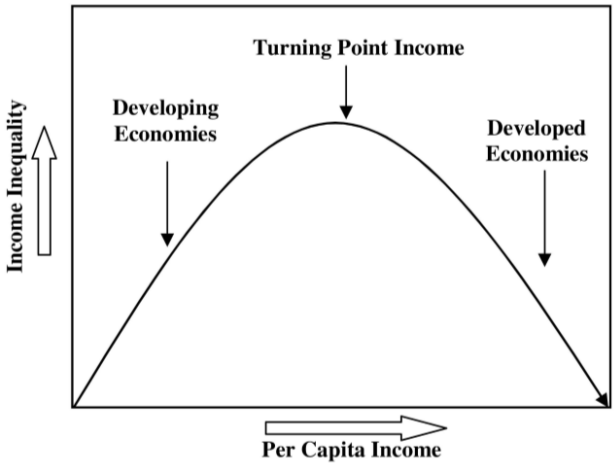
7. TERRITORIAL INEQUALITIES & IMAGINATIVE GEOGRAPHY

TERRITORIAL INEQUALITIES

We have discussed thoroughly how economic growth can cause social inequalities, but we have yet to touch on the subject of territorial (in)equalities. Territorial inequalities were well discussed by mainstream economics and were widely debated by politics in the previous century. It is all in all a well-known phenomenon, therefore we are able to introduce several models built to explain it.

At first we move a step back and look at a function describing the relations between social inequalities and economic growth and later we will argue how this function can be applied to the territorial inequality problem. The function, which we mentioned is the Kuznets curve, it is a function that relates the level of development to social inequalities.

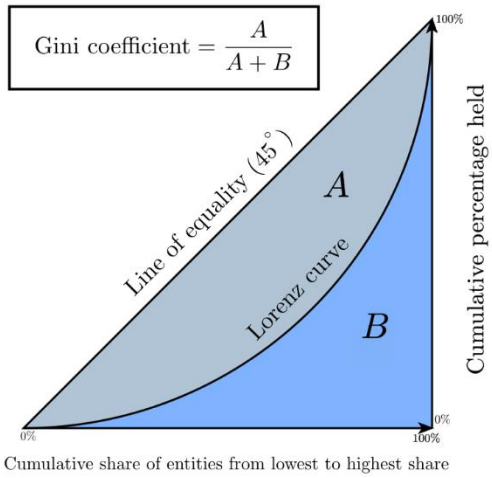
As we can see as the per capita income increases, (the economy experiences growth) it



creates inequality between social layers, however there is a turning point in the function, from which further increases in per capita income rather decreases social inequalities. In reality it means that if a country exhibits growth, there will be social layers, which exhibit faster or more effective growth than others. This happens for example if growth occurs in the industrial sector then the stakeholders of that sector will experience more rapid growth than someone who is not a stakeholder such as a farmer, thus one social layer will be ahead of the other. The turning point in the function is explained as: after a certain level of development is reached, resources are focused to solve social/income inequality problems. The conclusion of the model is that in the short run growth creates inequalities, which it solves in the long run by focusing money on the problem.

The Williamson-curve is exactly the same with the exception that it extends the model to territorial inequalities. It arrives to the same conclusion that at first growth causes territorial inequalities, which decline as a country grows further. To imagine it, assume a capital city, which experiences rapid growth, naturally this causes the inhabitants of that area and (and only them) to be in a favorable position compared to other territories. However after some time the capital city will focus its resources to improve the countryside since they are dependent on each other, therefore it's the interest of the more advanced territory to trigger growth in the less advanced. This theory was proved to be true by empirical data in the 1970's, however nowadays studies fail to prove the correlation, which the Williamson-curve suggests. The reason for this is unknown but it can be theorized that modern development doesn't have the same effect as it did 50 years ago therefore it can't be described with the same curve and perhaps todays development doesn't cause or doesn't solve inequality at all.

Now we will look at two another measures of inequality, the Gini coefficient and the Lorenz curve. These can be represented on a graph:



The Lorenz curve is the graphical representation of the distribution of wealth. The curve is showing the proportion of wealth belonging to lowest X% of the people in a cumulative way. In a more practical way, you can read off for example that the 'lower 20% of households hold 10% of the total income' or 'how much wealth belongs to the poorest 10% of society'. In a perfectly equal society the lowest 10% of households would hold 10% of the wealth, the lowest 20% would hold 20% etc. thus forming a perfectly linear correlation between the percentage of wealth held and the proportion of people in that layer. However as we can see the Lorenz curve deviates from this line of equality and the Gini-coefficient captures exactly this deviation. The Gini-coefficient is by the definition is the territory between the line of equality and the Lorenz curve divided by the territory of the whole triangle. In a more practical way the Gini-coefficient

tells us how far are we from perfect equality. The Gini-coefficient can take up any number between 0 and 1. If it is close to 0 it means that the Lorenz-curve is actually very close to the line of equality therefore the situation is close to perfect equality, similarly if it is close to 1 the situation is close to perfect inequality. The Gini-coefficient is a powerful tool to analyze the state of social equality in a country, however it is important to note that due to the differences in the structure of countries it is not really useful to compare the Gini-coefficients of several countries, it is rather used to compare several time periods of the same country to see how the situation of equality changed over time.

IMAGINATIVE GEOGRAPHY

Imaginative geography is a term originating from Edward Said. In this context the word imaginative does not mean that it is 'made-up' or 'fictional', it rather means that it is "perceived" differently. Imagined geographies means that we perceive a region and the inhabitants of that region according to our impressions, to our prior knowledge or cultural heritage etc. but this 'imagined' picture is different for everybody. The concept is similar to stereotypes but as stereotypes are well-known and nation wide imagined geographies is different for every individual (although it sometimes correlates with stereotypes). These preconceptions can have real economic effect in consumers and eventually in producers choices. It is best described through real life examples. A famous case of imaginative geographies was the car brand of Dacia. Dacia cars were generally poor quality after the second world war, and they originated from Romania (towards which Hungarians were hostile at the time), therefore Hungarian people got the general perception that Dacia cars were bad and not worth the money. Since then the car brand was modernized and it was objectively tested to make good quality cars, thus the past claims that of inferior quality was proved to be wrong. Even though it was objectively no longer true, Hungarians were still not willing to buy them in the same market price as other cars, because the "perception" that Dacia is poor quality was still present in many Hungarians. Therefore Dacia has to underprice its cars in Hungary for a reason, which is strictly imaginative. On the contrary in Africa, Dacia is a relatively widely used car brand, because this concept of 'Dacia = bad quality' was never present there.

8. CENTRAL-EASTERN EUROPEAN REGIONAL CORPORATIONS

Regional Corporations play an important role in today's politics and economics. Cross-border cooperation can be very beneficial, especially when the countries are not as strong on their own. However, if it is in their interest, together they can have joint lobby positions and gain favourable positions.

Over the last decade the bond between four Central-Eastern European countries, Poland, the Czech Republic, Slovakia and Hungary has become rather strong. All four countries are a member of the European Union and of the NATO as well. However, they form a regional cooperation, the so-called the V4, the Visegrád countries. The name of the group has a historical background. In 1335, the Polish, Bohemian (Czech) and Hungarian rulers met in the Hungarian city Visegrád. Their main purpose was to agree on creating new commercial routes that do not go through Vienna in order to make European markets more accessible. This corporation was revivified in 1991, after the collapse of the Soviet Union. In 1993, Czechoslovakia was officially split into the Czech Republic and Slovakia, therefore the cooperation now has now four members.

To understand why this regional corporation was established, we need to understand the socio-economic differences between the Western and the Eastern regions of the European Union. Therefore, we need to take a closer look at social indicators.

First of all, there are differences in Educational Attainment. According to research, the V4 countries spend the same percentage of their budget on education. This percentage is a little bit below the European Union average.

There are other similarities between the four states. The average household size and the household income very similar. The percentages spent on the Health Care Sector are approximately the same as well.

In the case of mobility, research states that in the Visegrad countries train traffic is more frequent than in other countries of the European Union. Train traffic will be the main target of development in the European Union's future project.

An additional factor that is common in the four central-eastern European countries is that typically the capital cities and the surrounding regions are more developed than other regions. Many parts are rural areas and their development level is far below the European average.

The European Union puts emphasis on eliminating regional disparities. About one-third of the European Budget is dedicated to structural and cohesion funds to help underdeveloped regions.

The European Regional Development (ERDF) is a strategic investment tool that focuses on developing cities. This fund is like a solidarity tool between the more developed Western Europe and the Eastern part. The fund supports research and innovation. The focus is typically on education and on developing transport systems, as well as on supporting medium size local businesses. In the last decade information and communication technology, development gained importance as well.

The European Social Fund, ESF's main purpose is job creation. Each year ten million euros are spent on investing in human capital. The main target of the ESF is the southern part of Europe, Portugal, Italy, and Spain.

The European Agricultural Fund for Rural Development, EAFRD is working out strategic plans to provide investment for rural areas in the European Union.

The Cohesion Funds aim is to reduce regional disparities and the emphasis is on developing transportation, build new train routes, motorways etc. Money is also spent on the maintenance of their good condition.

There is a Solidarity Fund as well. This fund acts as a response in case of major natural disasters such as floods or earthquakes. Recently it aided regions in Spain and Italy, where there have been serious flooding.

The Visegrad countries do benefit from most of the above-mentioned funds. About two-thirds of the Czech Republic is less developed than the Eu average. Around 17 per cent of the ERDF fund is allocated to the Czech regions. Additionally, eight per cent of the social fund and about 15,5 per cent of the cohesion fund is dedicated to the Czech Republic.

Hungary apart from the capital city and the surrounding central region is below the European average in case of development. Therefore, it also benefits from the different kind of European Union funds. Around 15 per cent of the ERDF is allocated to Hungary. Similarly, to reduce disparities 15 per cent of the Cohesion Fund is dedicated to the poorer regions. Additionally, Hungary gets 18 per cent of the social fund budget each year.

Poland is the biggest and most populated of the Visegrad countries. The Warsaw and Krakow areas are more developed than the rest of the country. Because of its size, the biggest ratio of the above-mentioned European Union funds is dedicated to Poland. More than the half, 57 per cent of the ERDF, 53 per cent of the social fund and almost percentage of 59 of the Cohesion fund are allocated to Poland in order to aim development.

Slovakia shows similar statistics as the rest of the V4 countries. Only Bratislava and the areas surrounding it are more developed, the rest of the country's development is below the European average. From all the above-mentioned funds, 10-10 per cent is dedicated to Slovakia.

Since 2011, the European Union has a macro-regional strategy for the Danube region as well, the EUSDR. There are several targets. First of all to improve mobility and intermodality of inland waterways and to rail, road and air traffic. Secondly, to encourage more sustainable energy, to restore and maintain the quality of waters, preserve biodiversity, landscapes and the quality of air and soils. Thirdly, to improve culture and tourism in the region. Additional priorities include management of environmental risks, to support the competitiveness of enterprises. One goal of the EUSDR is to invest in people and their skills and develop the Knowledge Society for research and education. Furthermore, countries in the area should work together to defeat organized crime.

To coordinate cooperation and integrate all the policies, the Danube Transnational Program was launched. Its additional purpose it to control the different kinds of funds.

9. THE ROLE OF INSTITUTIONS IN ECONOMIC DEVELOPMENT (THE CASE OF WESTERN BALKANS)

According to the Washington consensus, former communist or authoritarian states adopting capitalism would catch up to the rest of the world. This has clearly not happened until now, therefore the question might arise: Why are the less developed regions, mainly the Balkan not catching up to Europe and the West? We hypothesize that economic institutions had and do have an impact on economic performance and this correlation might answer the lack of growth in the Balkan. We will unfold the correlation between the well-being of the economic institution and general economic performance indicated by GDP.

We already noted that the traditional neoclassical theory of economics doesn't explain the situation well. According to it if a country opens itself up to trade -which the Balkan states did- it would trigger rapid growth, meanwhile the Balkan hardly experienced growth despite its relatively big trade volume. Some other theories try to explain this lack of growth, although with limited success. The Neo-Marxian theory claims that growth will only happen in the 'rich' center, while the peripheries will remain poor. Or according to economic geography, the geographical location of a country can be the core and curse of a country, in our case it would mean that the inferior geographical location negates the effect of free trade. However, these do no provide a full explanation on the topic, since the Balkans geography can hardly be called inferior, it has access to the sea and its sub-Mediterranean climate is optimal for both agricultural and touristic purposes. We can look to another country for clues, which went through a rapid growth period the same time the Balkan should have, namely China. China shifted from a relatively poor country to one of the leading economic powers of the world nearly in an instant. It did so partly because of good decision-making processes or so to call good institutional performance. Now we arrived to our hypothesis that if good institutional performance contributed to the rapid growth of China it is possible that inferior institutions (wrong decisions) are the reason why the Balkan is not growing.

To formulate the above-mentioned suspicion in to a hypothesis we state that Central Eastern European countries with higher quality of institutional indicators WILL have higher levels of economic performance. To prove this hypothesis we are going to use a model in, which the dependent variable is the economic performance (in our case GDP or per capita GDP) and the independent variables are the indicators of the quality of institutions. However as in all

social sciences the meaning 'quality of institutions' depends on the definition. Furthermore with the already developed definition we must also have a system in, which we can distinguish the better institutions from the worse, since the basis of our hypothesis is that the better the institutions are the better the economic performance is. We will introduce 6 indices with, which we can evaluate the well-being of economic institutions in many areas. These are following:

Political Stability Index measures the potential for political destabilization, government overthrowing and the risk of terrorism

Political Accountability Index captures the level of political participation and government accountability. It is correlated with the rule of law index.

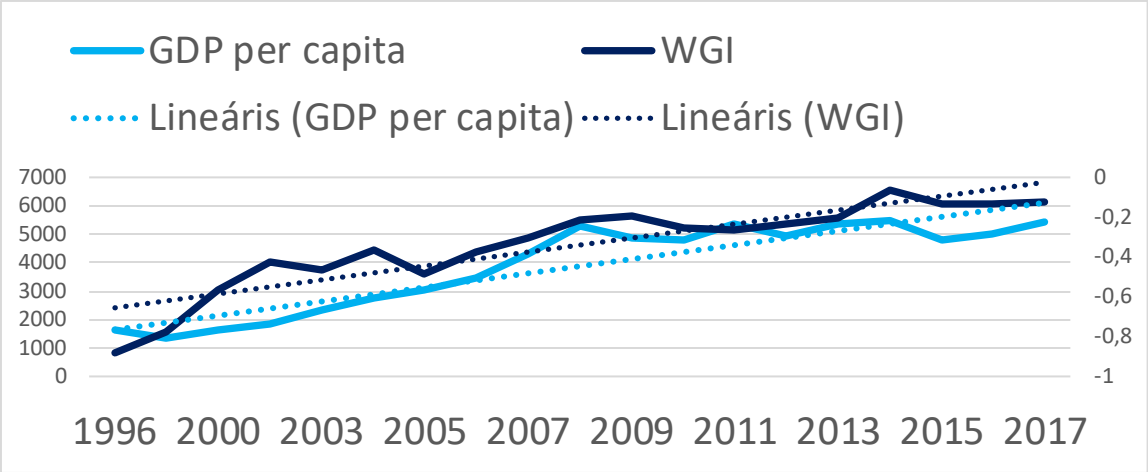
Government Effectiveness Index maps the quality and effectiveness of civil service and the independence and competence of that civil service. It also captures the credibility and transparency of government policy-making processes.

Regulatory Quality Index measures improvements in the business environments' perception about the government (how do firms view the government) and procedures for industrial policy.

Corruption Control Index, as its name suggests measures the prevalence of corruption in the society

Rule of Law Index captures the level of enforceability of contracts, predictability of judicial system, implementation of judicial decision and control of corruption.

We defined all the variables necessary to build a simple causality model (regression) in which the dependent (explained) variable will be the GDP per capita and the independent variables will be the above-mentioned indices. In simple terms we wish to see how an improvement in one or more of the indices increases or decreases GDP per capita. Also note that in this case the independent variables together (all the 6 indices) are referred to as WGI, which stands for world governance indicators.



As we can see by the graphical representation of our model the growth in government indicators is correlated with the growth in GDP per capita, meaning that the model shows that some variability in the GDP per capita can be explained by the well-being of economic institutions. If further divide the model we can see that an increase in each individual index has a positive effect on the GDP per capita as well, concluding that these indices alone and together as well explain some part of the GDP growth.

These findings however do not provide a hundred percent causality between WGI and gross domestic product, we should also look at which part of the model was confirmed by empirical studies. Therefore here we present an incomplete lists of findings, which were proved to be true by studies. It has been proven that institution limit expropriation risk and stability. It was also found in 2015 that institutions are more important than geography and most importantly trade for economic performance. Another recent finding is that institutions explain domestic and foreign direct investment. Some studies, which are more than a decade old (therefore they may not be relevant in todays economies) found that institutions affect per capita income and convergence (just what our model found) and that WGI explains higher productivity levels.

So far we have been able to find some important correlations between institutional devlopment and economic performance but here it is important to point out some of the limitations of our thought process. Firstly, there may very well be some correlation between the independent variables itself and there may be other variables, which are important but we did not take into consideration. Furthermore there can be problems with measurement since there is always an error margin in data surveys and it can also happen that the number of observations was also not enough.

In conclusion, even though it did not become clear-cut at this point of the study what had caused the lack of growth in the Balkans several factors were identified. We were able to define a relevant process to evaluate the state of economic institutions and we used the formulated indices to develop a simple causality model between gross domestic product and institutional quality. This model yielded a positive correlation between the institutional quality of a country and its gross domestic product. These findings were partly confirmed by previous and current economic researches, however to get a comprehensive understanding of the situation further research is needed.