

**1. (30%) Short Descriptions:**

*Answer 10 of 12 (3% each) In two to three articulate sentences each, explain each of the following, along with their importance, context, or relevance. Clearly mark which two you are dropping. If you answer all 12, I will drop the last two.*

- a) *Chaebol: Large conglomerate firms in South Korea, including Hyundai, Samsung, and LG, that came to dominate manufacturing and exports, due in large part to government policy and supported lending.*
- b) *East Asian Miracle: The term given to the rapid growth of four dragons and other NICs since the 1960s, which resulted from high savings and investment, a pro-market attitude (though not necessarily a laissez faire policy) by government, and an outward orientation that included export promotion.*
- c) *European Union: Established in 1993 with 12 members (now more), this combines economic integration policies (no internal tariffs on goods, a common external tariff, the common agricultural policy, fixed exchange rates, and free flows of labor and capital) with political integration and supranational institutions. Most members also chose to join the European Monetary Union.*
- d) *Freiburg School of Neoliberalism: German philosophy of Professor Alfred Müller-Armack of the University of Freiburg, which attempted to combine the concept of the Sozialstaat, an interventionist philosophy of justice between groups and a balance of power, with the Sozialer Rechtsstaat, a more laissez faire system of individual rights and equality before the law.*
- e) *Iron Triangle: The term for the close relationship between Japan's Liberal Democratic Party, the leaders of big business (the Zaikai), and the technocrats in government agencies like MITI and the Ministry of Finance, which helped to direct state support, trade policy and bank lending towards the largest firms in the Keiretsu.*
- f) *Maastricht Treaty: A treaty setting the stage for creation of the European Union and the European Monetary Union. It had three pillars of cooperation and integration, including economic, foreign policy and national security, and justice and home affairs, plus a fourth pillar of social cooperation that was not applied to UK.*
- g) *Marshall Plan: An American policy after World War II that provided food, financial aid, and advice for reconstruction. Primarily targeted towards Europe, it was an effort to reduce the popularity of communism and move away from the punitive policies of the Treaty of Versailles.*
- h) *Meiji Restoration: The 1868 overthrow of the Tokugawa shogunate which gave power back to the Meiji Emperor, who then set about on a dramatic plan to modernize and industrialize Japan.*
- i) *Ni-Ni Policy: An agreement between France's President Mitterrand and Prime Minister Chirac to neither nationalize nor privatize firms further. In essence, this was an agreement not to do anything because of political deadlock.*
- j) *Social Market Economy: The economic system designed for the Federal Republic of Germany and influenced by the Freiburg School, which combined government intervention in the labor and product markets, welfare programs, and subsidized savings programs with noninterventionist monetary and fiscal policies, minimal state planning, and minimal state ownership.*
- k) *Weimar Hyperinflation: Because the Treaty of Versailles forced Germany to pay reparations it could not afford, the German Weimar government covered its budget deficit by printing new money. Between 1921 and 1923, the money supply rose 7.5 million times, prices rose 88 billion times, savings were wiped out and the economy was devastated.*
- l) *Zaibatsu: Financial cliques that developed in Japan after the Meiji Restoration formed with interdependent suppliers, banks, and trading companies with interlinked family ownership. By 1945, the four major Zaibatsu controlled 40% of equity.*

## Short Essays:

2. (10%) Why did Giersch argue that “Eurosclerosis” created higher unemployment? Compare this to the efficiency wage argument and to the argument that unemployment is essentially voluntary.

*Herbert Giersch argued that excessive regulation made it difficult for private business in France, Germany, and elsewhere to hire, fire, expand and contract, and the increase in labor costs led to a disincentive to hire workers. The result would not only be higher unemployment but also slower growth. In essence, he was making a Schumpeterian argument that entrepreneurship is key to growth. On the other hand, the efficiency wage hypothesis argues that because employers often pay workers more than the market-clearing wage rate to motivate them to be more productive, the result is higher wages and more unemployment. When there is a generous unemployment program, employees are less threatened by unemployment, and employers must pay them even more, resulting in even more unemployment. This contrasts with the argument that generous unemployment benefits lead workers to choose to be unemployed, because with the efficiency wage hypothesis unemployment is the involuntary result of the lack of motivation of the employed. In sum, do we lay the blame for unemployment on the government, on the unemployed, or on the employed?*

3. (15%) How did the French system of indicative planning work, how did it change over time, and how did it perform?

*The French system of indicative planning was established in 1946. There was a Planning Commissariat with a small bureaucracy, and most of the work was done in “modernization commissions” that brought business leaders, government officials, and labor unions together, but were dominated by the alumni of the Grandes Ecoles. The five-year-plan targets were voluntary, not coercive or directive, and the process was supposed to be as important as the plan. The goal was to provide information, coordinate investment and build a consensus.*

*The first plan was the Monnet Plan from 1947-53, and it focused on recovery and modernization in six strategic sectors. This was followed by the harmonizing plans, which expanded the plan to other sectors. During this time, the plans were “relatively accurate,” and national champions were chosen in each sector for special attention and investment. By 1970s, however, the plans began to include social objectives and the expansion of the welfare state, and targets became less credible. French planning became more of a forecasting process in the late 1970s, though for a while Mitterrand attempted to revive it and make it more enforceable. As far as how the plan may have affected the performance of the French economy, growth during the planning era was much higher than it had been before the war, but it was high in other capitalist countries too. Thus planning may or may not have contributed to France’s growth, but it appears not to have hindered it.*

4. (15%) What is unusual about Swedish labor markets? What role has government policy played, and what effects have these policies had?

*Beginning with the Saltsjobaden Basic Agreement of 1938, Sweden’s government has brought firms and unions together through their national organizations – the SAF and the LO – for regular negotiation of a framework agreement, which could then be more easily implemented at the local levels. In addition to having strong unions, Sweden has one of the most generous welfare systems in the world, and the unemployment replacement ratio has been quite high. But Sweden also has an Active Labor Market policy, with the National Labor Market Board centralizing job information and providing subsidies for recruitment, retraining and relocation, as well as making other efforts to maintain high employment (e.g., public works, a micro fiscal policy, and a reserve fund system to stabilize investment).*

*The system of centralized collective bargaining led to less leapfrogging and a reduction of conflict. Wage share bargaining in particular led unions to support new technologies that improved worker productivity. Following the so-called Rehn-Meidner policies and the EFO Model, unions focus on improving international competitiveness, and the policy of Wage Solidarity led to small wage differentials between workers and greater equality though it also led to a disincentive for Swedes to go on to higher education. With a few exceptions, Sweden has been able to maintain a high employment rate and a low rate of unemployment, in spite of the generous welfare system, but Swedes call in sick a lot and high taxes have created a brain drain.*

5. (15%) How did the Japanese *keiretsu*, or "main bank" system affect Japan's postwar economic growth? What was the bubble economy, what caused it, and what has led Japanese growth to slow so dramatically in the last decade? What role was played by the government and the banks?

*The Keiretsu were descended from the old Zaibatsu monopolies, but were more in number and more loosely grouped around a trading company and a city bank. This main bank system provided a "convoy" system of firms that shared risk, bought each others products, and had intertwined ownership. The main banks provided loans based on their relationship at low interest rates, and consumer credit was unavailable. The result was high savings and investment rates, a greater willingness to take risks, and rapid growth. The government was heavily involved through support provided by the Ministry of Finance and the Ministry of International Trade and Industry.*

*Financial liberalization eventually gave banks more choices over lending decisions, but regulators were unable to adequately monitor this lending. Poor incentives combined with low interest rates and excessive optimism helped to create a tremendous bubble in asset prices in the late 1980s, and when the Bank of Japan finally intervened to halt it, asset prices plunged and the Bank of Japan failed to back off of their tight money policy even as the Ministry of Finance allowed banks to cover up their bad lending in order to prevent bankruptcy. This created a moral hazard and the banking crisis grew worse throughout the 1990s as good money was thrown after bad. The Bank of Japan failed to prevent price deflation, and this continued to dampen investment and consumption.*

6. (15%) What was the Asian Financial Crisis? What were the four different underlying crises? Which countries were most affected by which crisis?

*The Asian Financial Crisis happened in 1997, and was a surprising end to the Asian Economic Miracle. In 1996, growth in Asia slowed, then FDI slowed down and Japanese banks started lending less internationally. In the Summer of 1997, the Bank of Thailand unexpectedly devalued their currency after repeated assurances that their foreign exchange reserves were adequate, and this set off a panic that spread to Korea, Indonesia, and much of Southeast Asia as well as to South America. Eventually the IMF lent Korea \$55 billion to cover their short-term debt, and most economies in the region suffered severe recessions.*

*There were really four inter-related crises. First was a banking crisis caused by poorly regulated banks making loans that depended on fast growth for repayment. Second was a crisis caused by rising use of short-term foreign debt denominated in dollars, which was lent back out in domestic currency. The value of debt was thus dependent on the exchange rate. Third was a speculative bubble in financial markets and real estate, which could be explained by lack of transparency and the biggest fool theory, and this led to even more lending. Last was a balance of payments crisis caused by central banks maintaining fixed exchange rates without adequate Forex reserves.*

*Thailand, South Korea, and Indonesia were hit by all four crises, but Taiwan had stronger banking, while Hong Kong and Singapore had adequate Forex reserves (Hong Kong used a Dollar-based currency board) and no short-term debt problem. China did not allow free flows of capital, so did not suffer the balance of payments crises that exacerbated the other crises.*

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