Global Trends Chapter 3

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Chapter Three: International Political Economy (IPE) Introduction

3.1. Meaning and Nature of International Political Economy (IPE)

- Before defining the concept of International Political Economy, these things must be considered
  - ✓ there is no universal agreement on how IPE should be defined
  - ✓ definitions are important because it is the definitions that tell us what to include in our analysis and what to leave out
- The two key actors in the discussion of IPE are **states** and **markets** also the relationship between the two is often antagonistic
- Definitions must not miss these points
  - political society is not solely represented by the state in (especially today's) global/world politics
    - There are even more powerful (than states) non-state actors in global politics such as Transnational Corporations/Multinational Corporations (TNCs/MNCs)
- Two contending definitions of IPE
  - **State-centered** definition of IPE
  - **Marxist definition** of IPE
    - ✓ focuses on social class-based definition of IPE because the state for Marxists is an appendage (nothing more than the instrument of the dominant class) and hence it is not considered as relevant in the definition
- There is also other significant limitation in defining the concept of IPE which stems from the use of the term **International** in the concept
  - International applies only to relations between and among sovereign states
  - However, great deal of economic activity that occurs in the world today is conducted and sometimes controlled by non-state actors in ways that transcend national boundaries
    - Due to this trend in today's political economy, IPE's definition is getting ever widened and deepened in content and even the name of the field is changing from IPE to GPE (Global Political Economy)
- broader definition of IPE is adopted because a market economy cannot exist and

operate without some kind of political order (the state)

- there is a great deal of disagreement over exactly what kind of political order is needed
  - **minimalist view**
    - ✓ state only provides the legal-institutional framework for enforcing contracts and protecting private property
    - ✓ this is a view with which most neoclassical economists would agree
  - **Other views**
    - ✓ state plays an active and direct role in a much wider range of economic activity

International Political economy (IPE)

- It is a field of inquiry that studies the ever-changing relationships between governments, businesses, and social forces across history and in different geographical areas
- the field consists of two central dimensions
  - **political dimension**
    - ✓ accounts for the use of power by a variety of actors, including individuals, domestic groups, states, International organizations…
    - ✓ All these actors make decisions about the distribution of tangible things such as money and products or intangible things such as security and innovation
    - ✓ politics involves the making of rules pertaining to how states and societies achieve their goals.
  - **economic dimension**
    - ✓ deals with how scarce resources are distributed among individuals, groups, and nation-states

3.2. Theoretical perspectives of International Political Economy

There are <u>three major theoretical (often ideological) perspectives</u>

Foundational theories of International Political economy

1. **Mercantilism/nationalism**
   - defends a strong and pervasive role of the state in the economy – both in domestic and international trade, investment and finance
   - promotes an extreme policy of **autarky** to promote national economic self-sufficiency
   - defended even a much more sophisticated and **interventionist** role of the state in the economy-for example, the role of identifying and developing strategic and targeted industries
   - states should also play a disciplinary role in the economy to ensure adequate levels of competition
   - proof of the relevance of mercantilist thought in the contemporary international political economy is found in the recent experience of the

- ✓ Japanese ,South Korean, Taiwanese and Chinese
- ✓ these states used the term - **developmental state approach**

2. Liberalism

- it defends the idea of **free market system**
- the foundational value and principle of liberalism is: removing impediments (barriers) to the free flow of goods and services among countries
- advocate free trade, **free trade:**
  - ✓ reduces prices
  - ✓ raises the standard of living for more people
  - ✓ makes a wider variety of products available
  - ✓ contributes to improvements in the quality of goods and services
- by removing barriers to the free movement of goods and services among countries, as well as within them, countries would be encouraged to specialize in producing certain goods, thereby contributing to the **optimum utilization of resources**
  - **comparative advantage:**
    - If countries focused on what they do best and freely trade their goods with each other, all of them would benefit
- However, the theory of comparative advantage has been undermined by the current wave of economic globalization
  - ✓ These developments thus mark a shift from the conventional theory of comparative advantage to what is known as **competitive advantage:**
    - despite global acceptance of the concept of free trade, governments continue to engage in protectionism

3. Marxism

- It is youngest of the three perspectives
- It is advanced by Karl Marx
- collapse of the Soviet Union in the 1990‘s and the apparent embrace of the free-market economy marks a clear failure and hence death of Marxism
  - ✓ more and more countries are accepting liberal principles as they open their economies to
    - imports and foreign investment
    - scale down the role of the state in the economy
    - shift to export-led growth strategies
- However, it is not necessarily true that all or even most of the Marxist critique of capitalism has been negated by any historical and contemporary realities.
- In fact, according to advocates of Marxism just the opposite is the case. Global and national income inequality, exploitation of labor shows no sign of lessening; the problem of child labor and even child slave labor has

become endemic and so on and so forth
    - all of these crises reflect the inherent **instability** and **volatility** of a global capitalist system that has become increasingly reliant on financial speculation for profit making

contemporary theories of International political economy

A. Hegemonic Stability Theory (HST)

- **hybrid theory** containing elements of mercantilism, liberalism, and even Marxism
    - ✓ **Its closest association is with mercantilism**
- basic argument of HST is: The root cause of the economic troubles (Great Depression) was the **absence of a benevolent hegemon** - that is, a dominant state willing and able to take responsibility for the smooth operation of the International (economic) system as a whole
    - what then happened during the Great depression period was the old hegemon, Great Britain, had lost the capacity to stabilize the international system, while the new (latent) hegemon, the United States, did not yet understand the need to take on that role
- HST has influenced the establishment of the **Bretton Woods institutions** (**IMF** and **WB**) - both being the products of American power and influence

B. Structuralism

- It is a **variant of the Marxist perspective**
- Analysis a practical diagnosis of the specific structural problems of the international liberal capitalist economic system whose main feature is
    - **Centre-periphery (dependency) relationship** between the Global North and the Global South which permanently resulted in an unequal (trade and investment) exchange
- The perspective is also known as - **Prebisch-Singer thesis**
- It advocates for a **new pattern of development** based on **industrialization** via **import substitution based on protectionist policies**

C. Developmental State Approach

- **variant of mercantilism**
- it advocates for the **robust role of the state** in the process of structural transformation
- **state intervenes and guides** the direction and pace of economic development
- features of developmental state:
    - ✓ **Strong interventionism**
        - State‘s willingness and ability to use a set of instruments such as tax credits, subsidies, import controls… that belong to the realm of industrial, trade, and financial policy
    - ✓ **Existence of bureaucratic apparatus** to efficiently and effectively

implement the planned process of development.

- ✓ **Existence of active participation and response of the private sector to state intervention**

3.3. Survey of the Most Influential National Political Economy systems in the world

3.3.1. The American System of Market-Oriented Capitalism

- primary purpose of economic activity is to **benefit consumers** while **maximizing wealth creation**
  - distribution of that wealth is of secondary importance
- **Emphasis on consumerism and wealth creation**
- American economy does approach:
  Neoclassical model of a competitive market economy
  - ✓ **individuals** are assumed to **maximize** their own **private interests** (utility)
  - ✓ **business** corporations are expected to **maximize profits**
- **markets are competitive** and that, where they are not competitive, competition should be promoted through antitrust and other policies
- Almost any economic activity is permitted unless explicitly forbidden
- economy is assumed to be open to the outside world unless specifically closed
- At the same time, however, the American economy is appropriately characterized as a system of **managerial capitalism**
  - ✓ the economy was profoundly transformed by the late nineteenth-century emergence of huge corporations and the accompanying shift from a proprietary capitalism to one dominated by large, **oligopolistic corporations**
  - ✓ Management was separated from ownership, and the corporate elite virtually became a law unto itself
- the neoclassical laissez-faire ideal was diluted by the notion that the federal government had a responsibility to promote economic equity and social welfare
  - acceptance of the **Keynesian idea** that the federal government has a responsibility to maintain full employment through use of macroeconomic (fiscal and monetary) policies
  - significant retreat from this commitment began with the 1980 election of Ronald Reagan as President of the United States and the triumph of a more conservative economic ideology emphasizing free and unregulated markets
  - **consumer advocates** want a **strong role for the government** in the economy to protect the consumer
  - American economists and many others react negatively to an activist government
    - They believe that **competition is the best protection for consumers** except when there are market failures
    - there has been **no persistent sense of business responsibility to**

society or to individual citizens

- The role of the American government in the economy is also determined by fundamental features of the American political system
  - ✓ Authority over the economy is divided among the executive, legislative, and judicial branches of the federal government and between the federal government and the fifty states
  - ✓ financial system, in the United States this responsibility is shared by the Treasury, the Federal Reserve, and several other powerful and independent federal agencies
- **Industrial policy** represents another great difference between the United States and other economies
  - ✓ Industrial policy: deliberate efforts by a government to determine the structure of the economy through such devices as financial subsidies, trade protection, or government procurement
  - ✓ Industrial policy may take the form either of
    - ➢ **sectoral policies**: benefit to particular industrial or economic sectors
    - ➢ **macroeconomic and general policies:** designed to improve the overall performance of the economy
      - United States has employed sectoral policies in just a few areas, notably in agriculture and national defense
  - ✓ The rationale or justification for industrial policy and associated interventionist activities is that some industrial sectors are more important than others for the overall economy
    - In general, however, the only justification for an industrial policy considered legitimate in the United States is **to overcome a market failure**
    - In practice, most American economists, public officials, and business leaders are **strongly opposed to industrial policy**
    - American economists argue that the structure and distribution of industries in the United States should be left entirely to the market
    - despite the arguments against having an industrial policy in America, such policies have developed in the areas of agriculture, national security, and research and development

3.3.2. The Japanese System of Developmental Capitalism

- At the end of World War II Japanese Ministry of International Trade and Industry (MITI) and other agencies of the Japanese economic high command set their sights on making vanquished Japan into the economic and technological equal, and perhaps even the superior, of the West.
  - At the opening of the twenty-first century, this objective has remained the driving force of Japanese society.
  - Japan has abandoned militarism and has focused on becoming a powerful

industrial and technological nation, while also promoting internal social harmony among the Japanese people

- the economy is subordinate to the **social and political objectives of society**
- Japan's overriding goals have been making the economy self-sufficient and catching up with the West
- There has been a concerted effort by the Japanese state to guide the evolution and functioning of their economy in order to pursue these sociopolitical objectives.
  - these political goals have resulted in a national economic policy for Japan best characterized as **neo-mercantilism**
    - it involves state assistance, regulation, and protection of specific industrial sectors in order to increase their international competitiveness and attain the commanding heights of the global economy
- This economic objective of achieving industrial and technological equality with other countries arose from
  - ✓ Japan's experience as a late developer and also from its strong sense of economic and political vulnerability
  - ✓ The Japanese people's overwhelming belief in their uniqueness, in the superiority of their culture, and in their manifest destiny to become a great power
- Many terms have been used to characterize the distinctive nature of the Japanese system of political economy
  - developmental state capitalism
  - collective capitalism
  - welfare corporatism
  - competitive communism
  - network capitalism and strategic capitalism
- **particularly important elements of the Japanese economic system**
  - ✓ its overwhelming emphasis on economic development
  - ✓ the **key role of large corporations** in the organization of the economy and society
  - ✓ **subordination** of the individual to the group
  - ✓ primacy of the **producer over the consumer**
  - ✓ the close cooperation among government, business, and labor
- the Japanese frequently subordinate pursuit of economic efficiency to social equity and domestic harmony.
  - over-regulation of the Japanese economy is motivated in part by a desire to **protect the weak and defenseless:**

    Example: the large redundant staffs in Japanese retail stores
    - This situation is also a major reason for the low level of productivity in non-manufacturing sectors

- state assumed central role in the economy and specifically the elite pursued rapid industrialization through a strategy employing trade protection, export-led growth, and other policies
  - ✓ The Japanese people have also supported this extensive interventionist role of the state and believe that the state has a legitimate and important economic function in promoting economic growth and international competitiveness.
- **Industrial policy** has been the most remarkable aspect of the Japanese system of political economy
  - ✓ Japanese provided government support for favored industries, especially for **high-tech industries**, through trade protection, generous subsidies, and other means.
  - ✓ government also supported creation of cartels to help declining industries and to eliminate excessive competition
- the Japanese state's extensively use of what is known as the **"infant industry" protection system**
  Among the policies Japan has used to promote its infant industries include the followings
  - policies that encouraged extraordinarily high savings and investment rates.
  - policies that kept consumer prices high, corporate earnings up, and discouraged consumption, especially of foreign goods
  - policies and import restrictions that protected infant Japanese industries against both imported goods and establishment of subsidiaries of foreign firms
- As Japan closed the technology gap with the West and its firms became more powerful in their own right, Japan's industrial policy became considerably less significant in the development of the economy
  - ✓ Yet the population and the government continued to believe that the state should play a central or at least an important supportive role in the continuing industrial evolution of the economy

3.3.3. The German System of Social Market Capitalism

- German economy has some characteristics similar to the American and some to the Japanese systems of political economy, but it is quite different from both in other ways
  - Germany, like Japan, **emphasizes exports and national savings** and investment more than consumption
  - However, Germany permits the **market** to function with **considerable freedom**
- Except for the medium-sized business sector (Mittelstand),

- ✓ the nongovernmental sector of the German economy is **highly oligopolistic** and is dominated by alliances between major corporations and large private banks

- German system of political economy attempts to balance social concerns and market efficiency
- German national system of political economy is representative of
  - the **"corporatist"** or **"welfare state capitalism"** of continental Europe in which
    - ✓ capital, organized labor, and government cooperate in management of the economy
- state plays a strategic role in the economy. It is significant, especially in Germany, that major banks are vital to the provision of capital to industry
- in Germany **labor** has a particularly important role in corporate governance
  - ✓ the **"law of co-determination"** mandates equal representation of employees and management on supervisory boards
- At the core of the German system of political economy is their central bank, or **Bundesbank**
  - Movement towards the European Economic and Monetary Union has further increased the powerful impact of the Bundesbank
  - its actual independence and pervasive influence over the German economy have rested on the belief of the German public that the Bundesbank is the "defender of the mark" (euro) and the staunch opponent of dreaded inflation
  - Indeed, the Bundesbank did create the stable macroeconomic environment and low interest rates that have provided vital support to the postwar competitive success of German industry.
- the role of the German state in the microeconomic aspects of the economy has been modest.
  - ✓ Germans **have not had an activist industrial policy** although, like other advanced industrial countries, the government has spent heavily on research and development
- German government **has not also intervened significantly in the economy** to shape its structure except in the support it has given through subsidies and protection to such dying industries as coal and shipbuilding and the state-owned businesses
- On the whole, the German political economy system is thus **closer to the American market-oriented system** than to the Japanese system of collective capitalism

3.3.4. Differences among National Political Economy Systems

- national systems of political economy differ from one another important in the following areas

- ✓ the **primary purposes** of the economic activity of the nation
- ✓ the **role of the state** in the economy
- ✓ the **structure of the corporate sector and private business practices**

- As for the role of the state in the economy, market economies include
  - the generally **laissez-faire**
  - **noninterventionist** stance of the United States
  - Japanese **state's central role** in the overall management of the economy
- Regarding mechanisms of corporate governance and private business practices
  - relatively **fragmented** American business structure
  - Japanese system of **tightly integrated** industrial groupings (**the keiretsu**)
- The purpose of economic activity in a particular country largely determines the role of the state in that economy
  - ➢ **In those liberal societies**
    - ✓ **welfare of the consumer** and the **autonomy of the market** are emphasized
    - ✓ role of the state tends to be **minimal**
    - ✓ predominant responsibility of the state in these societies is to correct market failures and provide public goods
  - ➢ **in those societies where more communal or collective purposes prevail**
    - ✓ role of the state is much **more intrusive and interventionist** in the economy
    - ✓ role of such states can range from providing what the Japanese call **"administrative guidance"** to maintaining a **command economy** like that of the former Soviet Union
- regarding the system of corporate governance and private business practices
  - ☞ **shareholders (stockholders)** have an important role in the **governance of American business**
  - ☞ **banks** have played a more **important role in both Japan and Germany**
    - regarding business practices
      - **largest American firms** frequently invest and produce abroad
      - **Japanese firms** prefer to invest and produce at home

3.4. Core Issues, Governing institutions and Governance of International Political Economy

3.4.1. International Trade and the WTO

WTO (World Trade Organization)

- is an international organization which sets the **rules** for **global trade**
- set up in 1995 as the successor to the General Agreement on Trade and Tariffs (GATT)
- major economic powers such as the US, EU and Japan have managed to use the WTO to frame rules of trade to advance their own interests

- ✓ developing countries often complain of **non-transparent procedures and being pushed around by big powers**

What is International Trade?

- **barter trade:** the exchange of a good or service for another
- In the contemporary period, however, the great preponderance of trade involves the **exchange of money** for goods and services

Domestic and cross-border trade

- **in cross-border trade**
  - ✓ the exchange of goods and services is mediated by at least two different national governments
  - ✓ each of which exercises (sovereign) authority and control over its national borders (In practice, this means that even the "free trade is never entirely free")
    - **standard definition of free trade**: the unrestricted purchase and sale of goods and services between countries without the imposition of constraints such as tariffs, duties and quotas
- the scope and scale of cross-border trade is, today, immensely greater than at any other time in human history. **Why**
  - ☞ To the liberal economists
    - cross border trade is **beneficial**, both for individual national economies and for the world as a whole
    - even in the general public (especially in wealthy capitalist economies)
      - ✓ most people acknowledge that the antithesis of trade - namely, **autarky** (i.e., a policy premised on complete economic independence or self-sufficiency) - is essentially impossible and self-defeating in the industrial and post-industrial eras

how is international/global trade governed?

- The answer is: Global/Regional Free Trade Agreements govern it
- institutions like World Trade Organization (WTO) and North American Free Trade Agreement (NAFTA) or similar other organizations

How does this work?

- **In the case of NAFTA** (a trade agreement among the U.S., Canada, and Mexico)
  - ✓ **"Free trade"** was initially meant a lesser degree of governmental constraints in cross-border trade, but **not an elimination of government action**
  - ✓ tariffs were eliminated by mutual agreement in 2008
  - ✓ import-sensitive sectors could be protected with emergency safeguard measures
  - ✓ notion of free trade in NAFTA had and still have significant element of **protectionist /mercantilist** policies such as

- tax on specific imported goods (**tariff**)
- prohibiting their importation (**import ban**)
- imposing a quantitative restriction (**import quota**)
    - The latter two policies are examples of nontariff barriers, or NTBs. Other types of NTBs include
        - domestic health, safety, and environmental regulations
        - technical standards
        - inspection requirements; and the like

- political and theoretical debate on international trade will continue to mount high as the trade itself grows more and more
    - ✓ **liberals** argument would continue to center on the principle of **comparative advantage**
    - ✓ while **mercantilists and Marxists** expound upon **power differentials** between national economies, or on **class inequality and exploitation**

3.4.2. International Investment and the WB

WB (World Bank)

- created immediately after the Second World War in 1945
- Its activities are focused on the **developing countries**. It works for
    - human development
    - agriculture and rural development
    - environmental protection
    - infrastructure
    - governance (anti-corruption, development of legal institutions)
- It **provides loans and grants** to the member-countries.
    - ✓ In this way, it exercises enormous influence on the economic policies of developing countries
    - ✓ It is often **criticized for**
        - setting the economic agenda of the poorer nations
        - attaching stringent conditions to its loans and forcing free market reforms

International/Transnational/global production (in short global FDI)

- A type of production in which **different parts of the overall production process for a particular product take place across different national territories**
- it is one major element of the international or global political economy
- today transnational production networks are immensely more complex and larger in scale and scope than at any other time in history

  major factors are
    - ☞ drastic decrease in transport and communications costs which made transnational production much more economically efficient
    - ☞ developments of new and better technologies and improvements in global finance have also made it easier and more profitable to build integrated

production systems across borders

- investment and the development process in general **in the developed countries** is predominantly **governed by the interactions of multinational companies, investment**
- development process **in the developing countries**, on the other hand, are **directly or indirectly governed by the WB** (sometimes more powerfully than the governments of sovereign states).
  - ✓ The WB which was primarily designed as a vehicle for the disbursement of Marshall Plan money set up to aid the (immediate) reconstruction of Europe
  - ✓ Later on, the bank expanded its influence to all developing countries in Asia, Africa, and Latin America
- Unlike in the case of Europe, the impact of the WB on the development of developing countries has been at best **controversial and at worst negative**
  - ☞ This has largely to do with the **"one size fits all" types of excessive and hard to implement policy prescriptions** (mostly of the neo-liberal versions) of the bank to developing countries and the tough aid/loan conditionality it often puts for policy conformance

3.4.3. International Finance and the IMF

IMF (International Monetary Fund)

- an international organization that oversees those financial institutions and regulations that act at the international level
- The IMF has 184 member countries, but **they do not enjoy an equal say**.
  - ✓ top ten countries (G-8 members, Saudi Arabia and China) have 55 per cent of the votes

The global financial system is divided into two **separate, but tightly inter-related systems**

- **The international monetary system**
  - ✓ It can be defined as the relationship between and among national currencies
  - ✓ it revolves around the question of **how the exchange rate among different national currencies is determined**
- **The credit system**
  - ✓ refers to the **framework of rules, agreements, institutions, and practices** that facilitate the **transnational flow of financial capital** for the purposes of **investment and trade financing**

3.5. Exchange Rates and the Exchange-Rate System

An exchange rate

- **An exchange rate** is the price of one national currency in terms of another
- For example
  - ☞ July 2013 rate, one U.S. dollar ($1) was worth 98.1 Japanese yen (¥)

- ☞ Yet, in August 1998, one U.S. dollar was worth 145.8 yen
  What does this show?
  - ✓ Compared to the rate in July 2013, the difference is then almost 50 percent. This implies that in August 1998, the yen was substantially "weaker"
  - ✓ Note: a weak currency is not necessarily a disadvantage

  What does this mean in concrete terms??
  - ✓ In 2013, if you had traveled to Japan and exchanged dollar, you would have a lot less Japanese yen to spend compared to 1998

The two main exchange rate systems in the world

- **floating exchange rate**
  - ✓ value of a currency is **determined solely by money supply and money demand**
  - ✓ this system **exists only** when there is absolutely no intervention by governments or other actors capable of influencing exchange-rate values through nonmarket means
- **fixed exchange rate**
  - ✓ the value of a particular currency is **fixed against the value of another single currency** or against a basket of currencies

How is the global financial system governed?

- The IMF, which was set up as an ostensibly neutral international financial institution, was designed to clearly represent U.S. interests and power **first and foremost**, and the interests of the other major capitalist countries (the developed economies) **secondarily** while governing the global finical system
- This can be seen, more concretely, from the way **decision-making power within the IMF** was designed-i.e.
  - ✓ voting power is determined by what the IMF calls a **quota**.
  - ✓ **A quota (or capital subscription)** is the amount of money that a member country pays to the IMF. Accordingly, the **more a country pays, the more say it has in IMF decision makings**. And it is the US that tops up in this regard.