

Chapter three: International Political Economy

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

- ❑ IPE is the study of the relationships between governments and businesses
- ❑ the field thus consists of two central dimensions namely: **the political and economic dimension.**
 - A. **political dimension:** accounts for the use of power by a variety of actors, including individuals, domestic groups, states, IOs, NGOs, and TNCs.
 - ❖ All these actors make decisions about the distribution of tangible things such as money and products or intangible things such as security and innovation.
 - B. **The 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 three major theoretical (often ideological) perspectives regarding the nature and functioning of the International Political economy:

A. liberalism,

B. Marxism, and

C. nationalism (mercantilism).

❑ **Mercantilism** is the oldest of the three, dating back as early as the 16th C(perhaps even earlier).

❑ Marxism, by contrast, is the youngest of the three and is advanced by Karl Marx

- ❑ Since the mid-1980s, the relevance of the three perspectives has changed dramatically.
- ❑ With the end of communism, the relevance of Marxism greatly declined, and liberalism has experienced a relatively considerable growth in influence.
- ❑ many countries are accepting liberal principles these days
- ❑ they open their economies to imports and foreign investment, scale down the role of the state in the economy, and shift to export-led growth strategies.
- ❑ Marxism has been discredited but as an ideological critique of capitalism it survives and will continue to survive as long as those flaws of the capitalist system remain-e.g. the widening of gap between rich and poor

A. **Mercantilism/nationalism**: is a theoretical and ideological perspective which defends a strong and pervasive role of the state in the economy – both in domestic and international trade, investment and finance.

- ❑ In arena of international trade, mercantilism promotes an extreme policy of autarky to promote national economic self-sufficiency.
- ❑ According to mercantilism, state should play the role of identifying and developing industries through a variety of means, including tax policy, subsidization, banking regulation, and interest-rate management.

- ❑ The 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 national political economies whose states fulfilled the above stated roles almost perfectly.
- ❑ Instead of the term mercantilism, however, these states the East Asian economies (especially Japan, South Korea, and Taiwan) used the term ‘developmental state approach’ to describe the nature of their national political economy system

B. Liberalism:

- ❑ defends the idea of free market system (i.e free trade/trade liberalization and free financial and Foreign Direct Investment (FDI) flows).
- ❑ Accordingly, removing barriers to the free flow of goods and services among countries is the principle of liberalism.
- ❑ The consensus among advocates of free trade is that it reduces prices, raises the standard of living for more people, makes a wider variety of products available, and contributes to improvements in the quality of goods and services.

C. Marxism:

- ❑ the relevance of Marxism declined following the collapse of Soviet Union in the 1990's.
- ❑ but Marxist critique of capitalism has continued
- ❑ according to Marxism global and national income inequality remains extreme: the richest 20% of the world's population controlled 83% of the world's income, while the poorest 20 percent controlled just 1%; Exploitation of labor shows no sign of lessening

□ In addition to the above mentioned foundational theories of International Political economy, the following three contemporary theories of International political economy are also worth considering.

A. Hegemonic Stability Theory (HST): is a hybrid theory containing elements of mercantilism, liberalism, and even Marxism.

- ❑ Its closest association, however, is with mercantilism.
- ❑ The basic argument of HST is simple: the root cause of the economic troubles that bedeviled Europe and much of the world in the Great Depression of the 1920s and 1930s was the absence of a benevolent hegemon—that is, a dominant state willing and able to take responsibility (in the sense of acting as an international lender of last resort as well as a consumer of last resort) for the smooth operation of the International (economic) system as a whole.

B. Structuralism:

- ❑ is a variant of the Marxist perspective and starts analysis from a practical diagnosis of the specific structural problems of the international liberal capitalist economic system whose main feature is center-periphery (dependency) relationship between the North and the South which resulted in an “unequal (trade and investment) exchange.”
- ❑ it spread from Latin America to other countries in Asia and Africa in 1950's and advocates import substitution based on protectionist policies and the domestic promotion of manufacturing over agricultural and other types of primary production

C. Developmental State Approach

- ❑ Realizing the failure of neo-liberal development paradigm (in the 1980's) in solving economic problems in developing countries, various writers suggested the developmental state development paradigm as an alternative development paradigm.
- ❑ The concept of the developmental state is a variant of mercantilism and it advocates for the robust role of the state in the process of structural transformation.
- ❑ The term developmental state thus refers to a state that intervenes and guides the direction and pace of economic development.

Some of the core features of developmental state include;

- ❑ **Strong interventionism:** ability to use a set of instruments such as tax, credits, subsidies, import controls, export promotion, and targeted and direct financial and credit policies instruments 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
- ❑ Regime legitimacy built on development results that ensured the benefits of development are equitably shared

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

3.3.1. The American System of Market-Oriented Capitalism

- ❖ The American system of political economy is founded on the premise that the primary purpose of economic activity is to benefit consumers while maximizing wealth creation;
- ❖ the distribution of wealth is of secondary importance.
- ❖ the American economy does approach the neoclassical model of a competitive market economy in which individuals are assumed to maximize their own private interests (utility), and business corporations are expected to maximize profits.

- ❑ the American economy is characterized as a system of managerial capitalism.
- ❑ Put differently, the economy was profoundly transformed by the late 19th C emergence of huge corporations and the accompanying shift from a proprietary capitalism to one dominated by large, oligopolistic corporations
- ❑ Oligopoly implies small number of sellers controlling market
- ❑ with the New Deal of the 1930s, the power balance shifted away from big business and the neoclassical laissez-faire ideal was weakened by the notion that the federal government had a responsibility to promote economic equity and social welfare.

- ❑ The economic ideal of a self-regulating economy was further undermined by passage of the Full Employment Act of the idea that the federal government has a responsibility to maintain full employment
- ❑ Although the federal government retains responsibility for full employment and social welfare, a significant retreat from this commitment began with the 1980 election of Ronald Reagan as President of the United States and the achievement of a more conservative economic ideology emphasizing free and unregulated markets.
- ❑ Whereas consumer advocates want a strong role for the government in the economy to protect the consumer, American economists and many others strongly opposed this government intervention unless there is market failures.

3.3.2. The Japanese System of Developmental Capitalism

- ❑ At the end of WWII, Japan focused on making the economy self-sufficient and advancement of technology in order to catching up with the West
- ❑ In the pre-WW II years, this ambition meant building a strong army and becoming an industrial power.
- ❑ Since its disastrous defeat in World War II, however, Japan has abandoned militarism and has focused on becoming a powerful industrial and technological nation
- ❑ the national economic policy for Japan is characterized as neo-mercantilism; it involves state assistance, regulation, and protection of specific industrial sectors in order to increase their international competitiveness

- ❑ 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.
- ❑ Each of these labels connotes particularly important elements of the Japanese economic system, such as its overwhelming emphasis on economic development, the key role of large corporations in the organization of the economy and society, primacy of the producer over the consumer, and the close cooperation among government, business, and labor.
- ❑ Yet, the term “developmental state capitalism” best captures the essence of the system, because this characterization conveys the idea that the state must play a central role in national economic development and in the competition with the West

- ❑ the goal of catching up with the West was strongly worked on.
- ❑ To this end, the 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.
- ❑ The government bureaucracy and the private sector, with the former frequently taking the lead, have consistently worked together for the collective good of Japanese society.

- ❑ Industrial policy has been the most remarkable aspect of the Japanese system of political economy.
- ❑ In the early postwar decades, the Japanese provided government support for favored industries, especially for high-tech industries, through trade protection, generous subsidies, and other means.
- ❑ Through subsidies, provision of low-cost financing, and especially administrative guidance by bureaucrats, the Japanese state plays a major role in the economy.
- ❑ In this regard the Japanese state's extensive use of what is known as the “infant industry” protection system deserves special attention.

- ❑ Japanese industrial policy was most successful in the early postwar years when Japan was rebuilding its war-torn economy.
- ❑ However, 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 role in the continuing industrial evolution of the economy.

3.3.3. The German System of Social Market Capitalism

- ❑ The 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.
- ❑ On the one hand, Germany, like Japan, emphasizes exports and national savings and investment more than consumption.
- ❑ However, Germany permits the market to function with considerable freedom; indeed, most states in Western Europe are significantly less interventionist than Japan.

- ❑ The German system of political economy attempts to balance social concerns and market efficiency.
- ❑ The German state and the private sector provide a highly developed system of social welfare.
- ❑ The German national system of political economy is representative of the “corporatist” or “welfare state capitalism” in which capital, organized labor, and government cooperate in management of the economy.
- ❑ Although the continental economies differ from one another in many respects, in all of them the state plays a strategic role in the economy.

- ❑ To the success of economy state created a stable and favorable environment for private enterprise.
- ❑ Their laws and regulations have successfully encouraged a high savings rate, rapid capital accumulation, and economic growth.
- ❑ At the core of the German system of political economy is their central bank, or Bundesbank
- ❑ 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

- ❑ On the other hand, the role of the German state in the microeconomic aspects of the economy has been modest.
- ❑ The Germans, for example, have not had an activist industrial policy although, like other advanced industrial countries, the government has spent heavily on research and development. The 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 such as Lufthansa and the Bundespost (mail and telecommunications).
- ❑ On the whole, the German political economy system is thus closer to the American market-oriented system

3.3.4. Differences among National Political Economy Systems

- ❑ While national systems of political economy differ from one another in many important respects, differences in the following areas are worthy of particular attention:
 - (1) the primary purposes of the economic activity of the nation,
 - (2) the role of the state in the economy, and
 - (3) the structure of the corporate sector and private business practices.
- ❑ Although every modern economy must promote the welfare of its citizens, different societies vary in the emphasis given to particular objectives; those objectives, which range from promoting consumer welfare to pursuit of national power, strongly influence and are influenced by such other features of a national economy as the role of the state in the economy and the structure of that economy.

- ❑ As for the role of the state in the economy, market economies include the generally laissez-faire, noninterventionist stance of the United States as well as the Japanese state's central role in the overall management of the economy.
- ❑ And the mechanisms of corporate governance and private business practices also differ; the relatively fragmented American business structure and the Japanese system of tightly integrated industrial groupings contrast dramatically with one another.

- ❑ The purpose of economic activity in a particular country largely determines the role of the state in that economy.
- ❑ In those liberal societies where the welfare of the consumer and the autonomy of the market are emphasized, the role of the state tends to be minimal.
- ❑ On the other hand, in those societies where more communal or collective purposes prevail, the role of the state is interventionist in the economy.
- ❑ The system of corporate governance and private business practices constitutes another important component of a national political economy.

- ❑ American, German, and Japanese corporations have differing systems of corporate governance, and they organize their economic activities (production, marketing, etc.) in varying ways.
- ❑ For example, whereas shareholders have an important role in the governance of American business, banks have played a more important role in both Japan and Germany.
- ❑ In addition, whereas the largest American firms frequently invest and produce abroad, Japanese firms prefer to invest and produce at home.
- ❑ The policies of each government have also shaped the nature of business enterprise through regulatory, industrial, and other policies

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

3.4.1. International Trade and the WTO

- ❑ trade involves the exchange of money for goods and services.
- ❑ This type of trade can take place entirely within a domestic economy or internationally.
- ❑ But there are a number of critical distinctions between domestic and cross-border trade.
 - ❑ cross-border trade the exchange of goods and services is mediated by at least two different national governments

- ❑ To the liberal economists, cross-border trade is beneficial, both for individual national economies and for the world as a whole.
- ❑ But 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.
- ❑ But, there is unfair trade relationship between developed and developing countries.
- ❑ As a result, it is common to observe in the world disputes and frequently serious tensions over trade.

How is international trade governed?

- ❑ institutions like World Trade Organization (WTO) and North American Free Trade Agreement (NAFTA) or similar other organizations regulate international trade
- ❑ How does this work? In the case of NAFTA- a trade agreement among the U.S., Canada, and Mexico- for example, “free trade” was initially meant a lesser degree of governmental constraints in cross-border trade, but not an elimination of government action.
- ❑ the notion of free trade in NAFTA had and still have significant element of protectionist /mercantilist policies such as a tax on specific imported goods (tariff), prohibiting their importation (import ban), or imposing a quantitative restriction (import quota).

- ❑ The World Trade Organization (WTO) is an international organization which sets the rules for global trade.
- ❑ This organization was set up in 1995 as the successor to the General Agreement on Trade and Tariffs (GATT) created after the Second World War.
- ❑ It has about 150 members.
- ❑ All decisions are taken unanimously but the 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.
- ❑ The developing countries often complain of non-transparent procedures and being pushed around by big powers.

3.4.2. International Investment and the WB

- ❑ The World Bank was created immediately after the Second World War in 1945.
- ❑ Its activities are focused on the developing countries.
- ❑ It works for human development (education, health), agriculture and rural development (irrigation, rural services), environmental protection infrastructure and governance (anti-corruption, development of legal institutions).
- ❑ It provides loans and grants to the member-countries
- ❑ It is often criticized for setting the economic agenda of the poorer nations, attaching strict conditions to its loans and forcing free market reforms

3.4.3. International Finance and the IMF

- ❑ The International Monetary Fund (IMF) is 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.
- ❑ The top ten countries have 55% of the votes. They are the G-8 members (the US, Japan, Germany, France, the UK, Italy, Canada and Russia), Saudi Arabia and China.
- ❑ The US alone has 17.4% voting rights.

- ❑ The global financial system is divided into two: **a monetary system and a credit system.**
- ❑ The international monetary system can be defined as the relationship between and among national currencies.
- ❑ More concretely, it revolves around the question of how the exchange rate among different national currencies is determined.
- ❑ The credit system, on the other hand, 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.
- ❑ for a deeper understanding, let us separately discuss the main components of the monetary and credit systems.

3.5. Exchange Rates and the Exchange-Rate System

- ❑ An exchange rate is the price of one national currency in terms of another.
- ❑ For example, according to July 2013 rate, one U.S. dollar (\$1) was worth 98.1 Japanese yen (¥), while one British pound (£) was worth 1.54 U.S. dollars.
- ❑ Yet, in August 1998, one U.S. dollar was worth 145.8 yen. 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”.
- ❑ There are two main exchange rate systems in the world namely: fixed exchange rate and floating exchange rate.

- ❑ In a pure floating-rate system, the value of a currency is determined solely by money supply and money demand.
- ❑ In other words, this system exists only when there is absolutely no intervention by governments or other actors capable of influencing exchange-rate values through nonmarket means.
- ❑ A pure fixed-rate system, on the other hand, is one in which the value of a particular currency is fixed against the value of another single currency or against a basket of currencies.

- ❑ The question thus remains: How is the global financial system governed? The creation of IMF provided the answer for this question.
- ❑ The IMF, which was set up as an supposedly neutral international financial institution, was designed to clearly represent U.S. interests and the interests of the other major developed countries while governing the global financial 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.