



Chapter Three: International Political Economy

3.1. Meaning and Nature of IPE

- There is **no universal agreement on** how **IPE** should be defined.
 - Defining it is not as simple or straightforward as one might expect
- The term 'international' being used in IPE is one source of limitation in defining the concept.
 - In strict sense , the term “**international**” applies to **relations between and among sovereign states only** .
 - But that is not the case **in IPE** as the **involvement of non-state actors** in the economic activity in the world is a **practical reality**.
 - In fact, this is **making the definition of IPE even wider** and **changing the name** of the field **from IPE to GPE**

A **broader definition** is adopted in this chapter **for IPE** because a **market economy cannot exist and operate without political order.**

A question arises as to **what kind of political order is needed.**

Minimalist view: claims that the **best political order** is the one in which the **state only provides the legal institutional framework for enforcing contracts and protecting private** property (Neoclassical economists).

Hands-on view: calls for a **hands on approach by the state on the economic activity.**

It claims the **best political order** is one in which the **state plays an active and direct role in a much wider range of economic activity**

Hence a **broader definition is needed to capture these essences.**

IPE is a field of study that **studies the ever changing relationships between governments, businesses and social forces across history and in different geographical areas.**

Define this way, the field consists of two central dimensions:

Political dimension: accounts for the **use of power by a variety of actors**; and these **actors make decisions** about the **distribution of tangible things** like money and products; **or intangible things** like security and innovation

(these actors include: individuals, domestic groups, states (acting as single Units), international Organizations, NGOs and TNCs).

Politics involves the making of rules regarding 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 IPE

- There are **three major theoretical perspectives** in IPE
 - Mercantilism(Nationalism), Liberalism, and Marxism
- **Mercantilism** , is an economic system with a belief that a government can make a nation more prosperous by regulating trade and using tariffs and other protective measures to achieve a balance of exports over imports.
- It is the **oldest**- dates back to 16th c or even back. **Friedrich List**: intellectual father of mercantilist thought . It is a response to the classical economics of Adam Smith's liberal perspective.
- **Marxism** is the **youngest** of the three. Advanced by **Karl Marx**. Started as a critique to classical economics.
- Even though **Marxism as a doctrine has been discredited by many**, it is **still considered as an analytic tool and ideological critique of capitalism**
- Among the three, **currently, liberalism has experienced a relatively considerable growth in influence.**
- States are accepting liberal principles more
- EG: opening up economies to imports and foreign investment, minimize the role of the state in the economy; shifting to export led growth strategies.

A. Mercantilism (Nationalism)

- Defends a **strong and pervasive role of the state in the economy**
 - (the **state should play a strong role in both domestic and international trade, investment and finance**).
- Emphasizes the **importance of balance of payment surpluses** in trade with other countries
 - (**export must always be more than import**);
 - to this end, it **promotes** extreme policy of **autarky**
 - (**Autarky** is an **economic policy to have a closed economy and not allow any external trade/ minimal trade**)
- **Neo-mercantilism (21st C)**: is developed form of the old mercantilism; promotes a **more sophisticated and interventionist role of the state in the economy**.
 - EG: identifying and developing strategic and targeted industries through variety of means like tax policy, subsidization, banking regulation, labor control, interest rate management
- **Encourages the state to play a disciplinary role in the economy to ensure adequate levels of competition**
- A true mercantilist reflection in the contemporary world: Japan, South Korean, Taiwanese and Chinese national political economies.
 - Their governments applied the 'developmental state approach' (a less politically land term) to describe the nature of their mercantilist national political economic system.

B. Liberalism

- Defends the idea of **free market/trade** system.
 - **Free trade**: trade liberalization and free financial and Foreign Direct Investment(FDI) flows
- **Basic principle: Removing barriers to the free flow of goods and services among countries**
 - Assumes that free trade:
 - 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.
- **Free trade encourages states to specialize in producing certain goods; this will in turn contribute to the optimum utilization of resources (like land, labor, capital and entrepreneurial ability) worldwide**
- Free trade **helps countries to focus on what they do best: Comparative Advantage**

- **Economic globalization is making comparative advantage less attractive.**
 - Thus the **conventional theory of comparative advantage** has shifted to **Competitive Advantage**.
- Even though **liberalism** is gaining a **world wide acceptance compared to Marxism and Mercantilism**, **governments across the world** have **continued to engage in protectionism** despite going for the concept of free trade

C. Marxism

- Starts with the assumption that **problems like global and national inequality; exploitation of labor and the like are reflections of the global capitalist system** that has become highly reliant on financial speculation for profit making (capitalism/liberalism).

In addition to the three foundational theories in IPE, we also have **additional theories:**

- Hegemonic Stability Theory
- Structuralism Theory
- Developmental State Theory

I. Hegemonic Stability Theory (HST)

This is a **hybrid theory** with elements of liberalism, Marxism and Mercantilism

Basic argument: the **root cause of economic troubles** that trouble Europe and the rest of the world **in the time of the Great Depression** (1920s and 30s) **was the absence of a 'Benevolent Hegemon'**

Benevolent hegemon: a **dominant state willing and able to take responsibility for the smooth operation of the international economic system as a whole**

During the Great Depression; there was **no benevolent hegemon** because **Great Britain had lost the capacity** to stabilize the international system; and the then new hegemon, **US, did not understand the need to take on the role.**

Hence, a global economic instability occurred.

HST has influenced the establishment of the Bretton Woods institutions (IMF and WB).

Both institutions are the products of American power and influence.

II. Structuralism

- A **variant of the Marxist perspective**
- Starts by claiming the **current world problems are structural problems of the international capitalism economic system.**
- The system has a **'Center- Periphery' (dependency) relationship between the Global South and the Global North** and this has **resulted in a permanently unequal trade and investment exchange.**
- Also known as **Prebisch-Singer thesis**. Originated in Latin America
- **Advocates for a new pattern of development based on industrialization via import substitution based on protectionist policies**
- Was famous in the 1950s.

III. Developmental State Approach

- **Started out after observing the failure of the neo-liberal development paradigm to solve the economic problems of the developing world.**
- **Is a variant of Mercantilism; advocates for the robust role of the state in the process of structural transformation**
- **Refers to a state that intervenes and guides the direction and pace of economic development**
- **What are the core features of DSA?**

3.3. Survey of the Most Influential IPE Systems in the World

3.3.1. The American System of Market Oriented Capitalism

American PE is founded based on the **premise: the primary purpose of economic activity is to benefit consumers while maximizing wealth creation; the distribution of that wealth is of a secondary importance.**

Individuals are assumed to **maximize their own private interests (utility); business corporations are expected to maximize profits**

Similar to the neoclassical model: markets are competitive;

Almost any economic activity is permitted unless explicitly forbidden;

the economy is assumed to be open for the outside world, unless specifically closed.

Compared with the German and Japanese model that focus on the social welfare impact of economic activities, the American system: **emphasis is given to consumerism and wealth creation**

Another prominent feature distinguishing the American PE from that of the German and the Japanese: **Industrial policy**

- **Industrial policy**: deliberate efforts by a government to determine the structure of the economy through financial subsidies, trade protection, or government procurement.

US used these kinds of industrial policies in just few areas:

- agriculture
- national defense.
- Research & Development.

But in 1980s US took a major step towards establishing a national industrial policy.

- The **only justification for an industrial policy considered legitimate** in the US is **to overcome a market failure.**

3.3.2. The Japanese System of Developmental Capitalism

MEJI seeks to empower, educate, and protect low income older adults and people with disabilities through administrative and policy advocacy, educational efforts, and collaboration with multi-disciplinary partners on the local, state, and national level.

After the end of WWII, Japan's Ministry of International Trade and Industry, and other agencies of the Japanese economic high command set their sight on making Japan in to the economic and technological equal and perhaps even the superior of the west.

this remained the driving force of Japanese society in the beginning of the 21st C.

For the Japanese, the economy is subordinate to the social and political objectives of society.

The goal of the economic system since the Meji restoration was to make the economy self sufficient and catching up with the west.

Pre WWII, this amounted to building a strong army and becoming an industrial power.

After the defeat in WWII, Japan abandoned militarism and has focused on:

- becoming a powerful industrial and technological nation,
- promoting internal social harmony among the Japanese people

After the WWII defeat, Japan's Liberal Democratic Party (LDP) had the goal of catching up with the west.

- Thus, **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 **people also supported this extensive interventionist role of the state.**

Japanese National economic policy: is based on **neo-mercantilism**

- Meaning: **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 arose from the experience of Japan as a late developer and its strong sense of economic and political vulnerability.

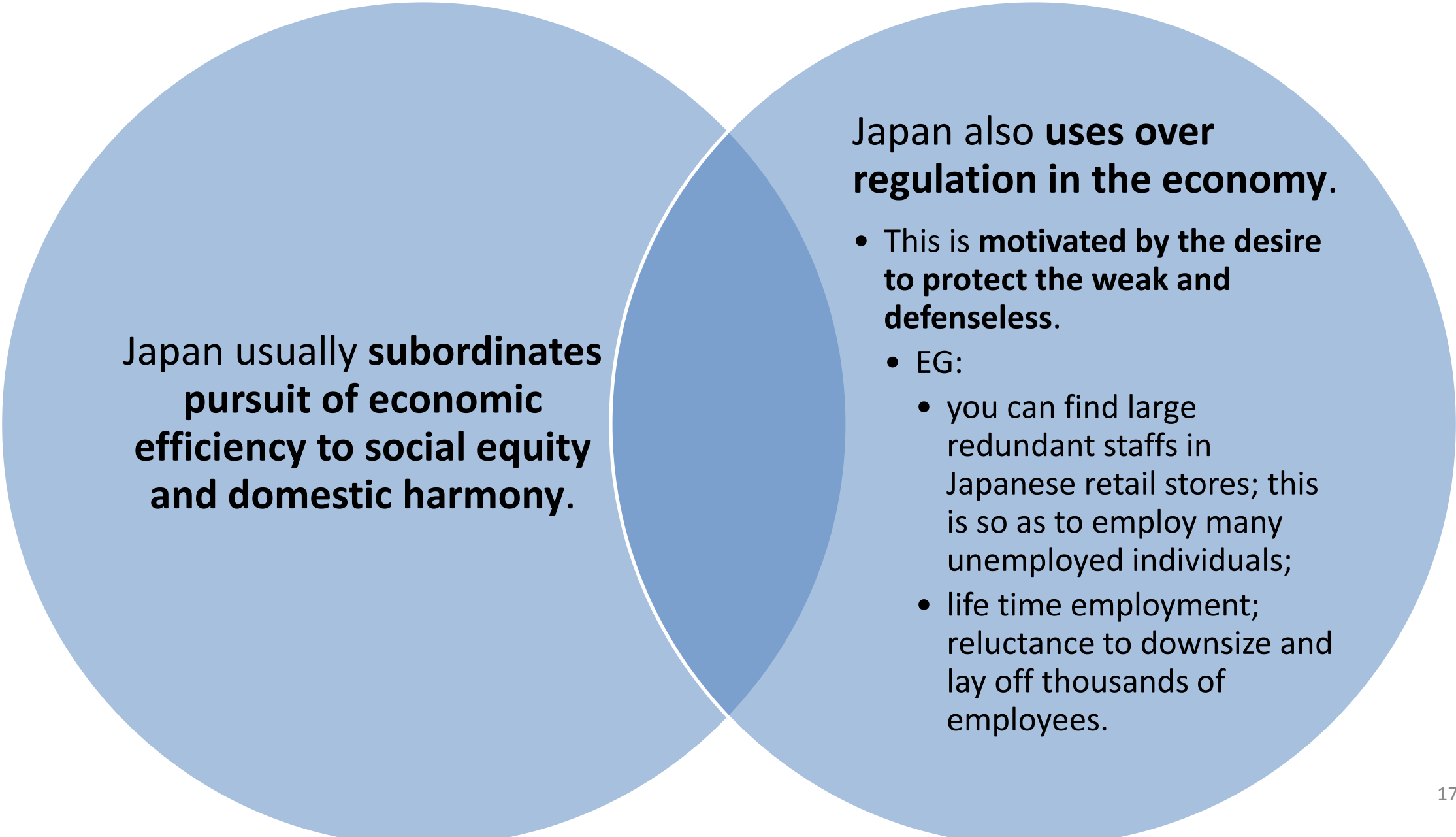
- Also the Japanese people's overwhelming belief in their uniqueness, in the superiority of their culture, and in their manifest destiny to become a great power.

Many terms are used to describe the Japanese economic system:

- developmental state capitalism, collective capitalism, welfare corporatism, competitive communism, network capitalism and strategic capitalism.

Developmental state capitalism is the widely used one:

- **the state must play a central role in national economic development and in the competition with the west**
- Represents:
 - 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, and
 - the close cooperation among government, business and labor.



Japan usually **subordinates pursuit of economic efficiency to social equity and domestic harmony.**

Japan also **uses over regulation in the economy.**

- This is **motivated by the desire to protect the weak and defenseless.**
 - EG:
 - you can find large redundant staffs in Japanese retail stores; this is so as to employ many unemployed individuals;
 - life time employment; reluctance to downsize and lay off thousands of employees.

Japanese Industrial policy:

- **government support for favored industries** (especially for high-tech industries)
 - Methods used: trade protection, generous subsidies and other means
- **government supported the declining industries**
 - Methods used: creation of cartels to help and eliminating excessive competition;
- **government followed infant industry protection** through different means

After Japan closed the technology gap with the west, the Industrial policy became considerably less significant in the development of the economy.

- But the government and the people **continued to believe that the state should play a central role** at least an important supportive role in the continuing industrial evolution of the economy.

- **3.3.3. The German System of Social Market Capitalism**

3.3.3. The German System of Social Market Capitalism

- **Shares some characteristics similar to the American and some to the Japanese** systems of PE
 - **Like Japan:** emphasizes exports and national savings and investment more than consumption.
 - Unlike Japan: allows the market to function with considerable freedom
- German **tries to balance social concerns and market efficiency.**
 - The state and the private sector provide highly developed system of social welfare.
- The **German PE** is representative of the “**corporatist**”/ “**welfare state capitalism**” of continental Europe:
 - This is a type of capitalism **where capital, organized labor and government cooperate in management of the economy**
 - Corporatist capitalism is characterized by **greater representation of labor and the larger society in the governance of the corporate governance.**
- In Germany, **labor has an important role in corporate governance.**
 - German has “**a law of co-determination**” which **orders for the equal representation of employees and management on supervisory boards**

Most important **contribution of the German state to the economic success of their economy has been indirect**

- **After WWII**, the federal and state governments **created a stable and favorable environment for private enterprise.**
 - The laws and regulations have successfully encouraged a high savings rate, rapid capital accumulation and economic growth.

***Bundesbank* (central bank)** plays a **key role** in the German PE.

- It **created a stable macro-economic environment and low interest rates** which **provided support for the German industries post WWII** to make them competitive in the world.

Role of the state in the micro economic aspects of the economy has been modest.

German did not have an active industrial policy

- Government **invested heavily on R&D.**
- Government **only gave subsidies and protection to dying industries** like the *Coal and Shipbuilding Industries* and government owned businesslike *Lufthansa* and *Bundespost*;
- other than this it **did not interfere in the economy**

Generally, the **German PE system is more closer to the American market-oriented system than to the Japanese.**

Differences among National Political Economy System

- **The differences of national political economies seen in terms of:**
 - the primary purpose 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
- **Objectives of National PE might range from:**
- promoting consumer welfare to pursuit of national power
- ⑩ **Role of the state in the economy:**
 - ⑩ Market economies follow Laissez-faire= USA, Japanese state follows central role in the overall management of the economy
- ⑩ **Mechanisms of corporate governance and private business:**
 - ⑩ USA: relatively fragmented business structure
 - ⑩ Japanese: highly integrated industrial groupings

The purpose of economic activity in a particular country largely determines the role of the state in that economy:

- **Liberal societies:**

- **role of the state** tends to be **minimal** as the **welfare of the consumer and the autonomy of the market are emphasized.**
- The **main responsibility of the state** is to **correct market failures and provide public goods**

- **Societies where communal/collective purposes prevail:**

- **role of the state is more intrusive and interventionist in the economy.**
- The **states' role can vary** from providing **administrative guidance (like Japan)** to a **command economy (like former USSR)**

Different state systems have different ways of organizing their economic activities of production marketing etc.

- USA:
 - **shareholders/stockholders** have an **important role** in the **governance** of America.
 - The **largest firms usually invest and produce abroad**
- Japan:
 - **firms prefer to invest and produce at home.**
- Japan and Germany:
 - **Business, banks** have **played a more important role**

Additional factors that bring difference in the NPEs of states: policies of each government

- These can be **regulatory, industrial and other policies;**

national differences in corporate structure and business practices have also been shaped by the economic and technological forces of the state.

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

3.4.1. International Trade and the WTO

International Trade

- **Trade** is the **exchange of money for goods and services**;
 - this could happen domestically or internationally
- **Distinction between domestic and cross-border trade**:
 - **Cross border trade**: at least two different national governments with their own sets of interests and concerns, exercising sovereign authority and control over their national borders engage in the trading activity

Scope and scale of cross border trade is now greater than any other time in human history

How is international/global trade governed?

- **Why** is this?
 - **To Liberal economists**, this is because cross border trade is **beneficial for the national economies of the individual states and for the world as a whole**.
 - liberals believe that **autarky is impossible and self defeating** in the industrial and post industrial eras

- Via **Global/Regional Free Trade Agreements (FTAs)** like WTO, NaFTA etc.
 - However, even these FTAs are not 100% going for a free trade; some times they follow protectionist/mercantilist policies like tariffs, and nontariff barriers (import ban, import quota) to protect 'import sensitive sectors'

The world trade organization (WTO):

Set\$ the rule\$ for global trade;

Set up in 1995 \$ucceeding GATT which was created at the end of WWII;

Has around **150 member\$;**

All decision\$ are taken unanimously; but **major economic power\$ use WTO to frame rule\$ of trade to advance their own interest\$;**

Developing state\$ complain of non-transparent procedure\$ and being pushed around by big powers

3.4.2. International Investment and the WB

- **Created in 1945** after WWII;
 - primarily designed **for the disbursement of Marshall Plan money to reconstruct war torn Europe.**
 - It achieved a financially, economically, politically more stable and stronger Europe
- **Later the bank focused its influence on Asia, Africa and Latin America.**
 - Its activities are now focused on the developing countries
- Works for achieving: human development, agriculture and rural development, environmental protection, infrastructure and governance.
- **Provides loans and grants to member states.**
 - as a result it **has a high degree of influence on the economic policies of developing states.**
 - **criticized for setting the economic agenda of the poor nations, attaching stringent conditions to its loans and forcing free market reforms**

Investments and development processes in developed states are primarily governed by the interactions of multinational companies;

however, **investments and development process in developing countries are directly or indirectly governed by the WB.**

FDI is the major element of the international or global political economy.

This is because:

1. There is a drastic increase in transport and communications costs, and this makes transnational production much more economically efficient.

2. Rise of efficiency seeking aid worldwide.

3. Developments of new and better technologies and improvements in global finance

Impact of the WB on the development of developing states is mostly controversial (sometimes even negative) because the WB uses 'one size fits all' kind of policy prescription for development.

WB uses tough aid/loan conditionality in order to influence the policies of the developing states.

hence, the relationship b/n WB and developing states' governments who want to defend their policy freedom is not smooth.

3.4.3. International Finance and the IMF

- **IMF** is an **International Organization that oversees those financial institutions and regulations that act at the international level**
- IMF has **184 members**; but not all members have equal say in it.
 - top 10 countries (the G8) have 55% of the votes. USA alone has 17.4% of the vote.
- The **global system is divided into two separate, but highly inter-related systems**:
- **The International Monetary System:**
 - Concerned with the relationship between and among national currencies; deals with how the exchange rate among different national currencies is determined
- **The Credit System:**
 - is the framework of rules, agreements, institutions, and practices that facilitate the transnational flow of financial capital for the purpose of investment and trade financing

3.5. Exchange Rates and the Exchange-Rate System

- Exchange rate: the price of one national currency in terms of another.
- There are two main exchange rate systems in the world:
 - **Fixed Exchange Rate:** in a pure fixed rate, the value of a particular currency is fixed against the value of another single currency or a basket of currencies
 - **Floating Exchange Rate:** in pure floating rate, the value of a currency is determined solely by money supply and money demand. This system exist only when there is absolutely no intervention by governments or other actors
- How is the global financial system governed? Creation IMF provides answer for this question.
- IMF was set up as an ostensibly neutral international financial institution. It was designed to clearly represent US interest and power primarily and the interest of other major capitalist countries secondarily while governing the global financial system.
- Decision making power in IMF: voting power is determined by quota (the amount of money that member country pays to IMF). The more a country pays, the more say it has in IMF decision making. US is at the top of the quota list.

Thank you!

Next on CH-4