



Core Concepts of Intl. Political Economy (IPE) and Intl. Governance of Trade

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POLI 150

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Today's Class

- Foundational concepts of IPE



Key Terms

- Globalization
- Comparative Advantage
- Absolute Advantage
- Heckscher-Ohlin Trade Theory
- Protectionism
- Tariffs
- WTO



Central Question

How does the economy matter for international relations?



Shift to IPE

- This second half of the class will shift focus away from political violence to discuss economic topics.
- **International Political Economy:** the study of how and when international economic integration occurs, and how this impacts domestic politics.
- Understanding the “political” in IPE means understanding the “economy” first!
- If any concepts are unclear, please ask questions!



Globalization Definition

IPE is fundamentally linked to the process of globalization.

- **Globalization:** international economic integration.
- This describes the increasing integration of national economies into international networks, as economic exchange spreads across borders. These components include:
 - Goods and services
 - Intellectual property
 - Money (“capital”)
 - People
- As a result, the economy of almost every state is now linked to a broader, global economic system.



The process of globalization has several implications:

- **Consequences for government sovereignty:** state economies are now influenced by actors other than the state.
- **Opportunities for growth:** states may be able to sell their goods and services to new buyers, potentially growing their economies.
- **Potential for crisis:** economic crashes rarely stay contained within a single state.
- Domestic and international politics **both** matter for economic policy.
- Globalization generates common and conflicting interests both within and across states.



Eras of Economic Globalization

- **British Gold standard:** the decades before WWI, and afterwards up to the 1929 economic crash.
- **Bretton Woods/US Gold Standard:** WWII until 1971.
- **(Hyper)globalization:** approximately 1970s until present.
- **Backlash:** 2010 to present?



Globalization over Time

- The spread of globalization can be measured empirically. The following slides show indicators from the **KOF Swiss Economic Institute**.
- These measure globalization both *de facto* and *de jure*: both real indicators of globalization as well as legal and regulatory indicators of it.

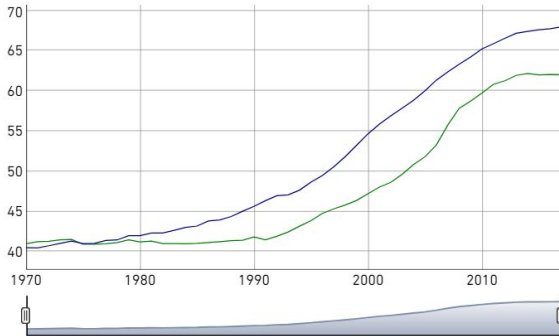


Dimensions of Globalization

- Social: cross-border contacts of all kinds.
 - De facto: international tourism, students, migration, information flows, cultural goods, etc.
 - De jure: telecommunications access, press freedom, spread of civil liberties and human rights, freedom to travel.
- Political: international institutions.
 - De facto: Embassies, UN peacekeeping, international NGOs.
 - De jure: international organizations and treaties, as well as diversity of states in them.
- Economic: economic exchanges.
 - De facto: trade in goods and services, FDI and capital flows, etc.
 - De jure: trade regulations, taxes, tariffs, investment and capital restrictions.



Social Globalization

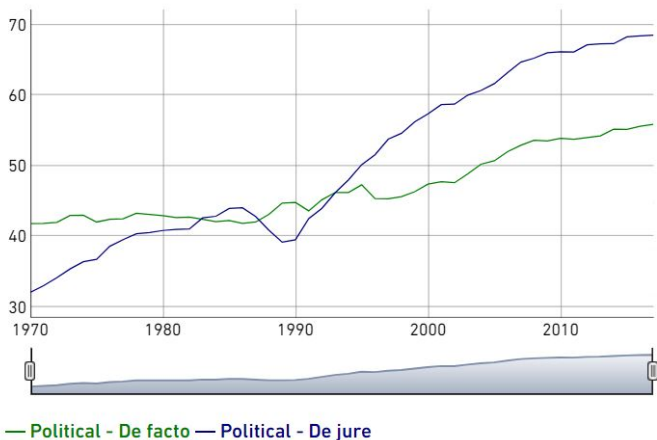


— Social - De facto — Social - De jure

World	▼	Social Globalisation	▼	De facto	▼
World	▼	Social Globalisation	▼	De jure	▼

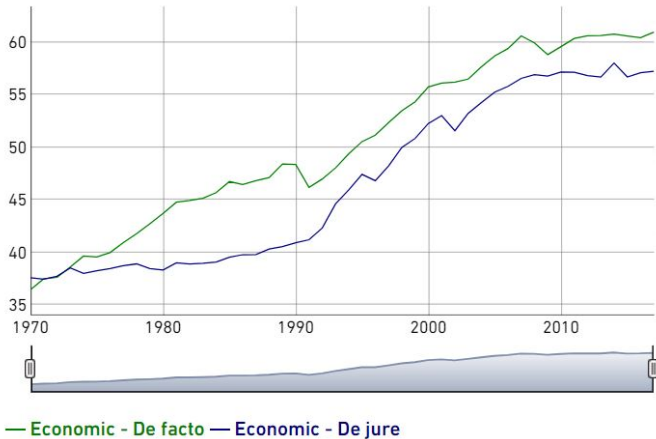


Political Globalization





Economic Globalization





Comparative and Absolute Advantage

- So, what determines what products and services firms and states send out into this global economy?
- Answering this means first defining **comparative advantage** and **absolute advantage**.
- Extended example: mowing one's lawn.



Comparative and Absolute Advantage

- Imagine a UNC alum and her neighbor, a Duke alum, both of whom live in identical houses with identical-sized lawns.
- Suppose the UNC alum in question is both brilliant and a fabulous athlete.
- This UNC alum can mow her lawn faster than anyone else, **but should she?**



Comparative and Absolute Advantage

- The UNC alum can mow her lawn in 2 hours.
- The Duke alum could mow the UNC alum's lawn in 4 hours.
- The UNC alum thus has an **absolute advantage** in mowing lawns.
- **Absolute advantage:** the ability of a producer to generate a greater number of goods than other producers using the same starting amount of resources.



Comparative and Absolute Advantage

- Suppose that those same 2 hours, the UNC alum's next best alternative work would be to make \$1000 as a consultant.
 - Thus, UNC alum's **opportunity cost** for mowing the lawn is \$1000.
- Suppose also that the Duke alum's next best alternative to mowing a lawn is serving drinks at a local bar for \$8 per hour.
 - Thus, Duke alum's **opportunity cost** for mowing the lawn is \$32, as it would take them 4 hours to mow the lawn.



Comparative and Absolute Advantage

- Our UNC alum has an absolute advantage in mowing lawns because they can do the same amount of work in less time.
- But our Duke alum has a **comparative advantage** in mowing lawns because he has the lower opportunity cost ($\$32 < \1000).
- **Comparative advantage:** the ability of a producer to generate a good more efficiently than other goods it could create, so that its most efficient use of resources is to make that specific good/service.
- Another way to say this is that an actor has a comparative advantage if they can produce a good/service at a lower opportunity cost than other actors.



Comparative and Absolute Advantage

- What does this imply?
- Rather than mowing her lawn, our UNC alum should work as a consultant and hire our Duke alum to mow the lawn.
- As long as the UNC alum pays the Duke alum more than \$32 and less than \$1,000, **both of them are better off than they would be otherwise.**
- **All actors have a comparative advantage in producing something, even if they have an absolute advantage in nothing.**
- Now, scale this up to the level of international economics...



Comparative and Absolute Advantage

- States also have comparative advantages in producing goods and services.
- Economics, going all the way back to Adam Smith's *Wealth of Nations* (1776), has recognized the benefits of specializing production.
- Assuming prerequisites are met (including a large enough market to sell all those goods that are produced by specialized producers, and a free market), **production according to comparative advantage will result in more goods being available at the cheapest possible price.**



Comparative and Absolute Advantage

- This implies that free trade, where all producers can specialize by producing the goods for which they have a comparative advantage, can be mutually beneficial. This still holds even if one state has an absolute advantage in producing all goods.



Free Trade vs. Mercantilism

- Smith, and other economists of his era like David Ricardo (1772-1823), thus clashed with the **mercantilist** thinking of their era.
- Recall that mercantilism explicitly prevented free trade, restricting trade within an empire via **trade barriers**: state restrictions on the international flow of goods and services.
- Eventually, free trade and globalization won out, leading to the eras of globalization from prior slides.



Grand Theories of IPE

This theoretical struggle is also captured by the grand theories of IPE:

- **Liberalism:** government should be separated from markets (also sometimes referred to as free trade or capitalism.)
- **Mercantilism:** governments direct and restrict the economy (also sometimes called economic nationalism).
- **Marxism:** the structure of economy determines politics, necessitating the importance of collective ownership of the means of production by workers.



Grand Theories

Table 1.1 Three Traditional Schools of International Political Economy

	Mercantilism	Liberalism	Marxism
Most Important Actor	The State	Individuals	Classes, Particularly the Capitalist Class
Role of the State	Intervene in the economy to allocate resources	Establish and enforce property rights to facilitate market-based exchange	Instrument of the capitalist class uses state power to sustain capitalist system
Image of the International Economic System	<i>Conflictual:</i> Countries compete for desirable industries and engage in trade conflicts as a result of this competition.	<i>Harmonious:</i> The international economy offers benefits to all countries. The challenge is to create a political framework that enables countries to realize these benefits.	<i>Exploitative:</i> Capitalists exploit labor within countries; rich countries exploit poor countries in the international economy.
Proper Objective of Economic Policy	Enhance power of the nation-state in international state system	Enhance aggregate social welfare	Promote an equitable distribution of wealth and income



Heckscher-Ohlin Trade Theory

- States (their industries) tend to have a comparative advantage in producing *something*, but how do we determine what that thing is?
- **Heckscher-Ohlin trade theory** is one attempt to answer this, and was highly influential on following economic theory.
- This theory starts by classifying a state's **factors of production**:
 - 1 Land: farming or natural resource extraction.
 - 2 Labor: generally unskilled labor.
 - 3 Capital: financial capital and equipment.
 - 4 Human capital: skilled labor (sometimes combined with Capital).

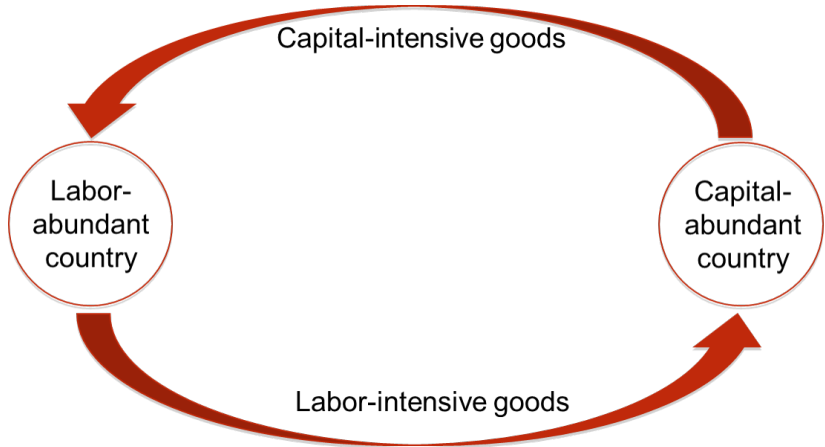


Heckscher-Ohlin Trade Theory

- HO trade theory predicts that the relative amounts of these factors within a state determine its comparative advantage in production.
- **States with an abundance of a given factor will have a comparative advantage in producing goods that use that factor, and so will export goods based on that factor.** The inverse is also true:
- States will import goods that require factors which are scarce in the state, as they will not have a comparative advantage in producing them.



Heckscher-Ohlin Trade Theory





HO and Competing Theories

- Heckscher-Ohlin is not the only theory of comparative advantage for a state's economy, but it influenced subsequent theories (like Ricardo-Viner trade theory).
- Equally importantly, it establishes a way to broadly classify elements of the state's economy.
- This topic will come up in the next lecture.



Trade Barriers and Protectionism

- Despite the economic consensus that production according to comparative advantage in a system of free trade will maximize available goods and minimize prices, states routinely create **trade barriers**: government limits on the international exchange of goods.
- Usually these barriers are synonymous with **protectionism**: state-imposed barriers to imports.



Protectionism can take several forms:

- **Tariff:** tax on an import, raising the domestic price of that imported good. Tariffs are paid by the importer.
- **Quota:** restriction on how much of a foreign good can be imported.
- **Nontariff barriers:** rules often related to quality of imports that naturally restrict quantity.

Practically every state in the international system engages in protectionism, most commonly via tariffs, but tariff rates have fallen over time.

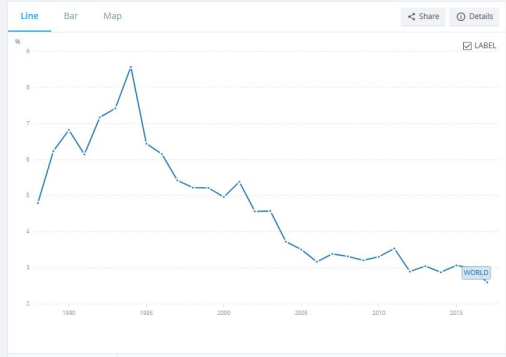


Tariff Rates Over Time

Tariff rate, applied, weighted mean, all products (%)

World Bank staff estimates using the World Integrated Trade Solution system, based on data from United Nations Conference on Trade and Development's Trade Analysis and Information System (TRAINS) database and the World Trade Organization's (WTO) Integrated Data Base (IDB) and Consolidated Tariff Schedules (CTS) database.

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International Institutions and Trade

This decline in tariffs, and accompanying increase in free trade, has its roots in post-WWII rebuilding.

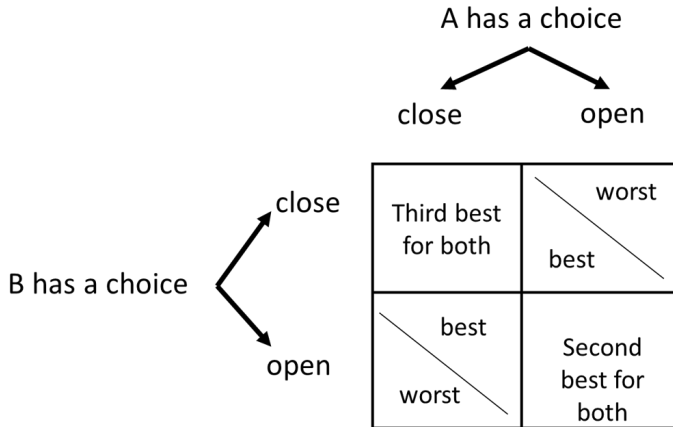
- In the postwar era, Western leaders tried to create institutions to prevent future conflict.
- While the UN was part of this, they were also motivated by the belief that economic integration would make war recurrence less likely.
- This led to the creation of the Bretton Woods institutions, of which the relevant one for trade is the World Trade Organization (originally called the GATT when it was formed in 1947, with formal change to WTO in 1995).
- **The WTO's goal is to encourage multilateral reduction of trade barriers, and also provide a dispute resolution mechanism.**



- Why is the WTO necessary in the first place?
- The choice between free trade and protectionism is effectively a Prisoner's Dilemma...



Tariffs and Free Trade





Trade as Prisoner's Dilemma

- Best outcome: you don't lower your trade barriers (close) and the other country lowers theirs (open).
- Second-best outcome: both countries lower/remove trade barriers (known as trade liberalization).
- Worst outcome: you lower your trade barriers and the other country does not.
- The incentive structure of the situation gives both countries an incentive to defect by engaging in protectionism.



- The WTO helps to foster cooperation by creating rules for members.
- The most important is **Most Favored Nation** status: all members of the WTO must treat all other members the same as their most favored trading partners (that is, those partners with whom they have the fewest trade barriers).
- WTO also provides a way to resolve trade disputes via the **Dispute Settlement Body**.
- If a state is found to be in violation of WTO rules, the WTO permits the other state to impose trade protection of equal value.
- WTO rules are “self-enforcing” – they work by letting states punish other states “legally.”



WTO Over Time

- The GATT/WTO has evolved and expanded since WWII over several rounds of negotiations, which have generally involved reducing remaining barriers to free trade.
- Negotiations stalled after the start of the Doha Round (2001), and by 2015 it was clear that the WTO had lost organizational momentum.
- This led to the rise of...

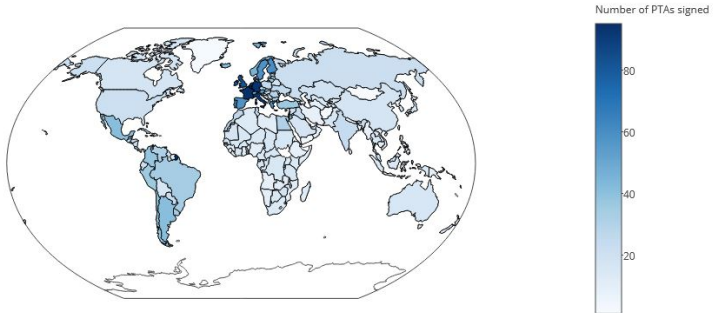


Preferential Trade Agreements

- **Preferential trade agreements** (PTAs) (also called Regional Trade Agreements) have proliferated since the WTO has stalled.
- These can be regional (ex: NAFTA) or bilateral, but are never global like the WTO is.
- They serve the same monitoring and dispute resolution functions, but are easier to negotiate due to fewer members.
- Have grown increasingly complex (including ties to human rights).



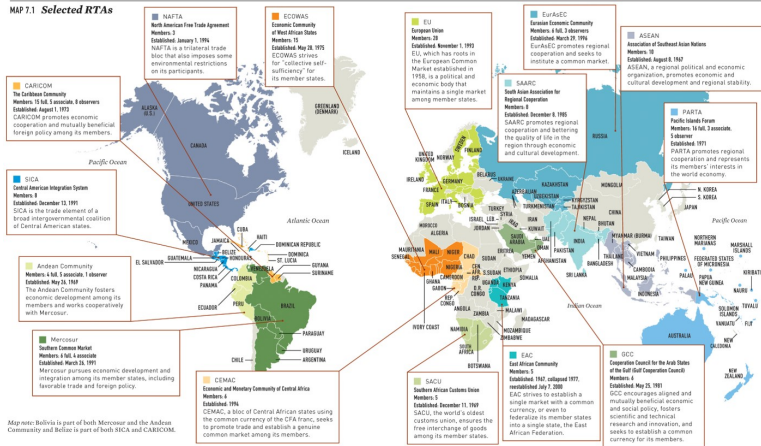
PTAs Worldwide





Selected PTAs Worldwide

MAP 7.1 Selected RTAs





WTO Shortcomings

- WTO has been criticized as especially responsive to rich developed states (most of whom used protectionism while becoming rich and developed) and neglecting the interests of poorer states.
- Many poorer states with primarily agricultural economies view the WTO as stacked against their interests for insisting on lowering trade barriers while allowing rich states like the US to keep agricultural subsidies in place.
- WTO has also been criticized for prioritizing economic liberalization over environmental protection.



Closing Questions

Do the benefits of free trade accrue equally to all citizens? Does this have any relation to the persistence of protectionism?