

International political economy

- Studies the interaction of politics and economics, how politics influences and shapes economics and vice versa
- Interdisciplinary field that combines economics and politics
- Subfield of international relations
- Growing interest due to:
 - Increased nexus of security and economics in global politics
 - US-China rivalry and its impacts on global supply chain, particularly in the high-tech sector
 - Economic activities such as FDI and trade have become ideologically driven and weaponized
 - Can also be used as an analytical approach in understanding economic policy choices and behavior of states (ex. international negotiations)
 - Nations are engaged in some form of economic exchange
 - Study of the interaction of domestic and international factors as they affect economic policies and outcomes
 - Study of the winners and losers in international economic exchanges, domestic and foreign economic policies and capitalist global economy

Why does it matter?

- Government actions and decisions affect the market
- Bad economic performance is blamed on the incumbent
- Role of regulation - a contentious issue
- Financial and economic crises can lead to political instability

Political economy

- How politics shape societal decisions about the allocation of scarce resources
- Inseparability of politics and economics
- Comparative if two or more states are involved
- International if it regards international factors
- focuses on domestic economy

Logic of the market

- Seeks efficiency
- Not bound by borders, based on the concept of functional integration
- Allocation of resources based on market principles such as price, mechanism, demand and supply and production cost
- Market always prioritizes efficiency over equity

Logic of the state

- Seeks welfare and equity through intervention
- Based on the concept of territoriality, loyalty
- Allocation of resources is politically motivated such as alliance system, impacts on election, and general welfare

- The state seeks to promote public welfare and equity through intervention (ex. Cap on price of rice)

Politics

- Study of power, political processes, and the state
- Who gets what, when, and how
- Study of Influence and the influential

Economics

- Allocation of scarce resources
- Study of choices related to production, distribution, and consumption (in other words, economic activities)

Mercantalism

- First political economists
- Connected national power with economic activity
- accumulation of gold/silver/resources through trade export and import
- some goods are more profitable than others
- How nations can become rich

Trade is for survival because countries do not have everything

Export is needed to pay for the imports

Wealth of nations; ended economics

Institutions

- rules and organizations
- aggregate rule
- Rules has constraining and enabling effect on individuals

Political economy re-emerged in the 20th century

Public choice school

- Focus on the behavior of politicians and government officials
- Concept of rent seeking: intervention causes market “distortion”

Neoclassical institutionalism

- Importance of institutions
- -institutions have ‘constraining’ and ‘enabling’ behavior
- Institutions are formal and informal

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New political economy

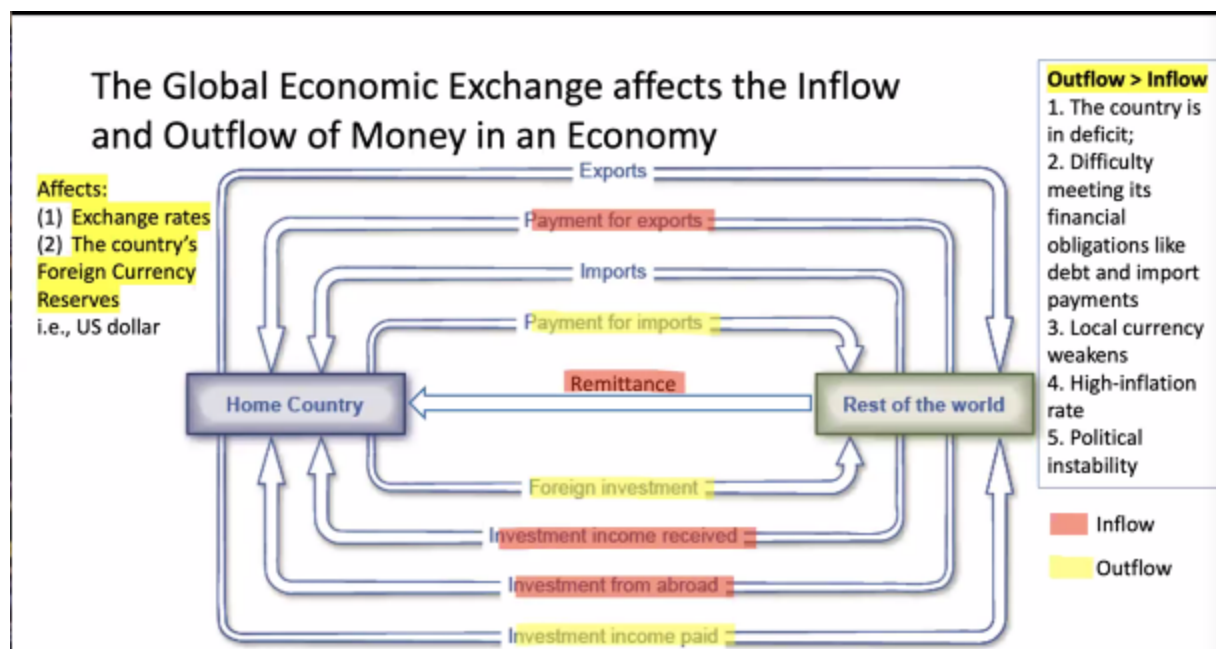
- Competition of groups over economic policies
- Public policies have distributive effects
- Whose interests are served or dominant

Neoclassical economics vs. political economy (Based on Robert Gilpin's distinction)

Areas	Neoclassical economics	Political economy
Unit of analysis	Market, equilibrium	Non-market/exogenous factors
Nature of actors/players	Rational, promote economic welfare (profit, gains)	Powerful actors compete with one another over economic policy
View of the economy	Collection of markets	Embedded in a larger socio-political system
Dynamics of the world economy	Economic factors are predominant causes	Political causes, other exogenous factors are equally relevant

Factors of production

- Land
- Labor
- Capital
- Entrepreneurship



What motivates nations to adopt the strategic economic policies that create winners and losers?

Address the imbalances in the economy

- These imbalances are reflected in the country's balance of payments
- Caused by trade and investments and mobility of capital
- Trade surplus vs deficit countries

Protect and promote the competitiveness of local manufacturers

- Create strategic advantages over other competitors in the global market
- America vs chinese vs european vs japanese manufacturers
- Due to intense competition and globalization

Alternative view of international political economy

- Study of IPE concerns the social, political and economic arrangements affecting the global systems of production, exchange and distribution and mix of values reflected therein
- Power is structural, not relational

Four structural powers

- Security
- Finance
- Production
- Knowledge

Structural power of production

- Ability to influence or shape what to/what not to produce and accessibility

Multinational corporations

- Have structural power of production

Structural power of finance

- Control over finance, credit, and determines who has/doesn't have access to credit

Structural power of security

- Protection, defense and hard power

What is the dominant international political economy approach?

- Identification of sources of economic interests
 - Analysis of competing interests
- How these interests are translated into the actual economic policies
 - Analysis of political institutions, national processes
- Consequences of these policies on global economy, relations with other states
 - Analysis of economic and foreign policies

Welfare consequences

- Decisions about resource allocation
- Determine level of societal well-being
- Study of the effect of foreign economic policies and if it improves the welfare of the people

Distributional consequences

- Examines the effect of economic policies on income

Major IPE themes

- Distribution of wealth and gains
 - Gains and losses from international economic exchanges
- National autonomy vs interdependence
 - Issues related to sovereignty and state control in a globalized economy, asymmetrical dependence

- Politics of international regimes
 - How states influence or shape the nature of international rules, principles
 - Issue of compliance
 - Theory of hegemonic stability and management of global economy

THEORIES IN IPE

Three sets of theories

- Mainstream perspectives (Ones that appeal to scholars the most)
 - Realism
 - Mercantilism (the 'realist' view in IPE)
 - Liberalism
- Critical perspectives
 - Classical and Neo-marxism
 - Dependency theory
 - World systems theory
- Focus on ideas, norms and identity
 - Constructivism
 - Post-structuralism
 - Post-modernism
 - Discourse analysis

Realism, Mercantilism, Liberalism

- Based on Rational choice (came from economics)
- actors are utility maximizers

Realism

- Primacy to state and political factors
- Prioritizes politics over economics
- International system is a self-help and anarchic system
- States are rational unitary actors (prioritizes power and security and pursuit of national interests)
- Hierarchy of issues, priority agenda: security and order
- International economic relation is zero-sum (states prefer relative gain)
- Distribution of power has major effects on international economic relations
- Globalization is seen as an economic process that does not affect the international political structure
- Economic interdependence is not mutual dependence but asymmetrical
- International organizations are arenas of acting out power relationships

- states/policy makers would sacrifice economic gain for political gain

Mercantilism

- Emphasizes the link between national power and wealth
 - national power is derived primarily from wealth
- national wealth could be acquired through trade
 - promote exports, discouraged imports
- some types of economic activities are more valuable than others
 - manufacturing is more profitable than agriculture
- states should play an active role in the allocation of resources
 - Favors intervention
- free trade is a policy for the strong
 - free trade is for states that have achieved industrial supremacy
 - international trade is conflictual
- protection of infant industries - A.Ham
- *"The united states must be self reliant and to be self reliant we must build a manufacturing industry"* - A.ham
- state that is not competitive is not ready to for free trade
- uninterested in domestic factors

Liberalism

- Primacy to market
- states are not unitary actors
- Laissez-faire, free enterprise, competition, and capitalism
 - international economic institutions = uphold the liberal economic principles
- international economic relations is a positive-sum game
 - theory of comparative advantage
- *"States are made wealthier by making products that they can produce at a relatively low cost at home and trading them for goods that can be produced at home only at a relatively high cost"* - adam smith
 - objective of trade = not to enhance state power rather to enrich individuals
- governments should avoid interfering/influencing economic transactions through policies
- government role : provision of public goods, enforce contracts, create infrastructure, provide market enhancing environment

Three strands of Liberalism

Orthodox

- Belief in the freedom of the market to function with minimal interference from states

Interventionist

- free market does not always produce equal gains/welfare

- government should promote equality and justice

Institutionalist

- favor strong international institutions (e.x WTO, IMF)

John maynard keynes (1883-1946)

- The general theory of employment, interest and money (1936)
- full employment requires government intervention
- use of fiscal policy; public spending/deficit spending
 - stimulate the economy, address unemployment
 - Policies of tax and spending
- government should intervene during economic crisis to revitalize the economy
- when a market is in a crisis it will not restore itself on its own
- government spending can stimulate the economy and generate employment
- Keynesian approach; Fiscal stimulus

ISSUES AND DEBATES BETWEEN LIBERALS AND REALISTS

1. Consequences of free market

- Classical thinkers : Interdependence or mutual dependence
- Adam Smith on the value of foreign trade, importation and when restriction on foreign trade can be justified
 - If its cheap to buy goods from other countries better to buy from other countries
 - buy it with surplus of our produce
- David Ricardo: On comparative advantage

2. Economic Crisis

- Critics of economic liberalization attribute the asian financial crisis to
 - Globalization (Out of control): Revival of Karl polanyl
 - Market fundamentalism
- Brink Lindsey's (Invisible hand vs Dead hand) contention
 - Market should not be blamed
 - Governments are simultaneously doing too much and too little
 - Monetary trilemma is to be blamed for partly the crisis
 - Government abuse of access to international capital market and pursuit of unsustainable monetary policies
 - Bad debts and loss-making government owned enterprises
 - Solution to state owned enterprise is privatization
 - State intervention
 - Failure of governments to provide reliable security for property and contract rights
 - Welfare policies

3. Free market and state sovereignty

- Globalization forces undermines state sovereignty (liberal argument)
- Globalization is still intact despite globalization forces (Realists)
- Sovereignty factors (Krasner)
 - Autonomy and independence
 - Principle of non-intervention
 - Control over trans-border movements
 - International personality to enter into international agreements

Marxism, dependency theory, world system theory

- Based on historical materialism and economic determinism
 - Critical perspective provide a historically sensitive analysis of IPE, structural analysis **historical**
 - System of production (Economic activities)
 - The notion that collective production of material necessities **materialism**
- “Social existence determines the consciousness of men” (**Economic determinism**)

Classical marxism

- Capitalism creates two rival social classes (capitalist and laborers)
- Each class promotes its own material interest
- Capitalism brutalizes the working class (through division of labor)
 - Marx argued that the value of manufactured goods should be based on the amount of labor used to produce them
- Division of labor was created to enhance profit
 - The capitalist does not fully pay the workers and keeps the profit to himself
 - More products to be produced, more profit, same sahod for the worker
- Labor becomes like a commodity

J. Hobson vs V.Lenin Marxist and non Marxist view of imperialism

Hobson Capitalism's contradictions	Lenin
Low wage and underconsumption by workers	Imperialism is an inevitable outcome of capitalism
Oversaving by capitalists	It is the highest state of capitalism
overproduction	It gave superprofits to capitalists and higher wages to workers
These gave rise to imperialism	It explains why Marx’s prediction regarding working class revolution did not occur
Creation of new markets in the colonies	Imperialism saved the capitalists

Theory of Dependency

- Came from Marxism and Latin American structuralism
- **LAS** = Structural obstacles to less developed countries’ development

- This perpetuates dependency
- Structural obstacle to LDCs:
 - International trade system (Focuses on Manufactured goods, not agricultural goods)
- Dependency theorists see the central problem as Foreign control/dominance over the means of the production
- Global capitalist economy is responsible for constraining the south's development
- Elites in the south form alliances with foreign capitalists in the north
- "Foreign-oriented development"
- Marxists = Opposes capitalism and private ownership of means of production, Dependency theorists = opposes foreign ownership/domination of foreign investors
- argues that global economy can be visualized through core-periphery structure in 2 classifications: countries/economy part of the periphery, countries/economy part of the core

Structure of dependence

- Dependence: "a situation in which the economy of certain country is conditioned by the development and expansion of another economy to which the former is subjected"
- Dependent states as peripheral states, core-countries where they depend
- Core = Developed countries, manufacturers and processing
- Periphery = LDCs, agricultural exports and takes processed/Manufactured imports
- Production in the periphery is determined by demands from the core

Three (3) Forms of dependence:

- Colonial dependence
 - Started during Colonialism era
 - Colonial masters implemented systems that made colonies dependent on the masters persisting after independence of colony
 - Trade monopoly of the colonial state (Dependent countries no control over trade)
 - Domination of the bi capital in the hegemonic state
- Financial-industrial dependence
 - Domination of big capital in the hegemonic center
- Technological-industrial dependence
 - Created by multinational corporations

World system theory

- Main proponent : Immanuel wallerstein
- Periphery is based on international division of labor
- Core certain tasks in production
- Semi-periphery = some tasks from the core, some from the periphery
- The unit of analysis is not the state, it is the world systems
- look at global economy as a single unit

Gramscian analysis

- Proponent : Antonio Gramscian, an italian marxist
- criticized marx =Marx was too economic, culture and ideology should be accounted for
- explains the persistence of capitalism
- Capitalism has been accepted and embedded into culture
- Capitalism created institutions and ideas that appeal to working class
- Capital class = hegemony
- Historic Bloc
 - State power, institutions and ideas that support capitalism
 - The belief that there is no alternative from capitalism
- Institutions/rules that support the capitalist class
- Rules that support the capitalist class
 - Free trade policy (capitalists are exposed to the international market) \
 - Free trade is essential to development (so you can't remove capitalism)
- CounterHegemony = Countering the dominance the capitalists, introduce new ideas and institutions that counter capitalism
- originally domestic, applied in the international economy by Robert Cox
- Transnational Historic bloc = IOs, MNCs
- THB explains the endurance of international capitalism
- Same thing with domestic approach, counterhegemony is needed

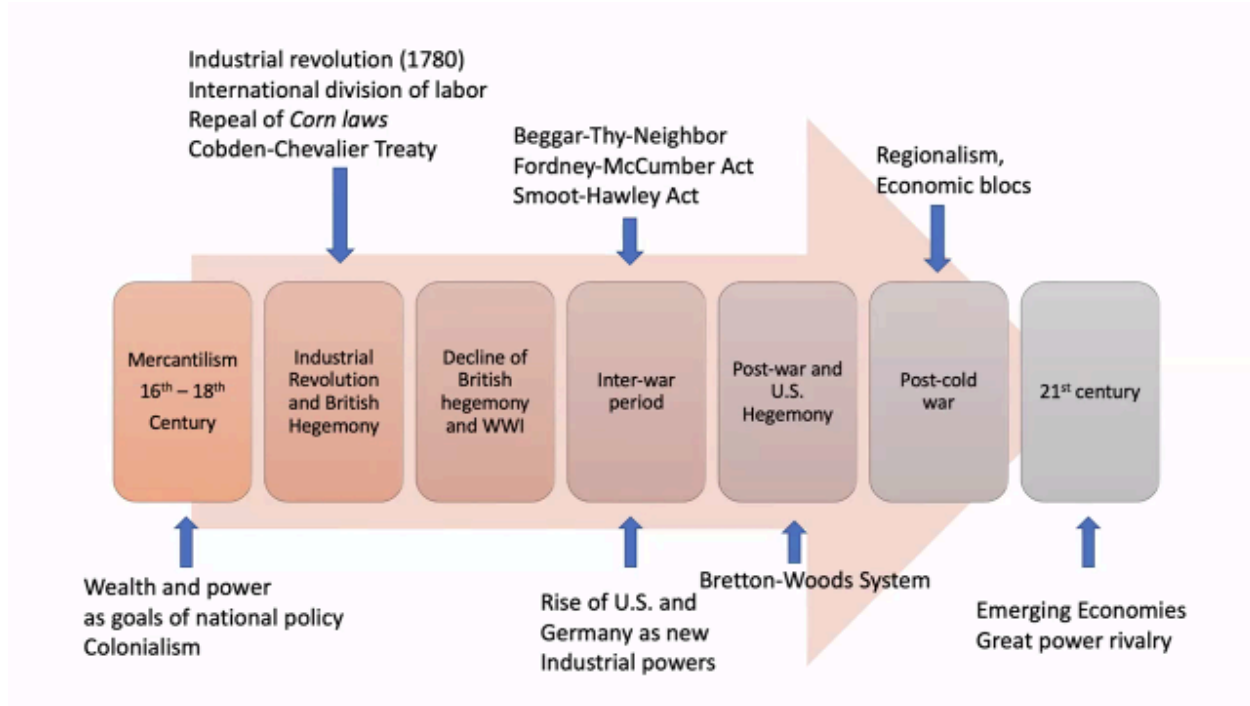
Constructivism

- Based on social construction
- everything can be relative
- Rejects rationality = Look at other factors (culture, traditions, norms, etc) that influence the decisions made by actors
- Epistemic community = professionals that share common ideas among themselves that influence decisions in their respective IO

Post Modernism

- emphasizes the role of language in understanding reality
- Understanding of reality is based on the narrative
- The truth is the dominant narrative (but truth can be relative)

THE GLOBAL ECONOMY FROM A HISTORICAL PERSPECTIVE



Period of mercantilism

- Between 16-18th centuries
- State regulations were common
 - Trade, services, capital and people
- Accumulation of surplus was the chief objective of trade
- Trade protectionism
- Emphasis on export
- Colonialism and imperialism
- New markets
- The ultimate goal: enhance national power (Through wealth)

British hegemony

- Industrial revolution (1789s to 1830s)
- Free trade: repeal of corn laws (1846); liberalization of agriculture sector
 - Corn laws: prevented the importation of agricultural products into the British market
- Bilateral trade agreements with other European countries
 - Cobden-chevalier treaty with france (1860)
- 1870 peak of british hegemony
 - 1860: 37% of european industrial production
- Monetary and exchange rate system = gold standard
 - Requiring participating countries to have their currencies be convertible to gold
 - Determining the currency per ounce of gold
- Naval power: British command of the high seas

- London was the financial center of the world
- Contenders to British hegemony: Germany and the United States

Interwar period

- Decline of world trade from US\$35 billion (1929) to 12 billion (1933)
- Rise of Germany and United States as industrial powers
- US insistence that Britain and France repay all their war debts
- US protectionism
 - 1922 - Fordney-McCumber Act
 - 1929 - Stock market crash and economic depression
 - 1930 - Smoot-Hawley Act
- Reciprocal Trade Information Act (1934)
 - Tariff-setting authority transferred from the US Congress to the US President

Pre-WW2 Institutional framework to regulate commerce

- Central Commission for Navigation of the Rhine (1815)
- International Telegraph Union (1865) - agency for ICT
- Universal Postal Union (1874) - rules for international mail exchanges
- Bank for International Settlements (BIS) in 1930
- Gold Standard (development and formalization between 1696 and 1812)
 - UK adopted in 1821, abandoned it in 1931; US in 1933
- Use of international conferences to address trade and financial problems
 - 1922 conference in Genoa, Italy (on central banks and exchange rates)
 - 1936 conference involving the US, Britain and France (on international responsibility for exchange rates)
- Establishment of the League of Nations

Post-WW2 Period and US hegemony

- Early-postwar: U.S. economic and political leadership
- Bretton Woods Conference (1944)
 - 44 allied nations
- The U.S. encouraged open market and free trade
- Establishment of UN and Keystone International Economic Organizations (KIEOS)
 - International Monetary Fund (IMF)
 - International Bank for Reconstruction and Development (IBRD)
 - General Agreement on Tariffs and Trade (GATT) (1948)
 - System of exchange rate - fixed/pegged system
 - At 35 dollars per ounce of gold

Issues in postwar global economy

1950s-60s

- Cold War: Strong imperative for international cooperation under U.S. leadership
 - U.S. support for Western European and Japanese economic recovery

- U.S. hegemony helped establish principles and rules for trade, financial, and monetary relations
- Growing development disparity between the North and South; economic protectionism in the South
- The Global South: Discontent and Growing influence
 - Bandung Conference of 1955
 - 1961: Non-Aligned Movement (NAM)
 - Growing North-South gap (GDP per capita, HDI)
 - 1960: Organization of Petroleum Exporting Countries (OPEC)
 - 1964: Group of Seventy-Seven (G77*) now *134 countries
 - United Nations Conference on Trade and Development (UNCTAD)

1970s

- U.S. economic decline (Keohane and Nye, 1977)
- U.S. became less supportive of economic liberalism as its economic dominance declined
- Collapse of the Bretton-Wood's fixed rate system; shift to floating rate
- From US hegemonic to collective leadership
 - Group of Five (G5); Group of Seven (G7); Group of Ten (G10)
 - Organization for Economic Co-Operation and Development (OECD)
 - Excluded the South from decision-making process

1980s

- Debt Crisis of 1980s
 - Structural Adjustment policies as preconditions for debt relief and debt restructuring
 - Neoliberal policies (trade liberalization, privatization, deregulation) as aid conditionality
 - Start of Policy-based lending of the World Bank
 - IMF as crisis manager
- Rise of neoliberalism
 - Deregulation, privatization and liberalization policies of Reagan and Thatcher
- Developmental states or East Asian 'miracle' economies were getting international attention

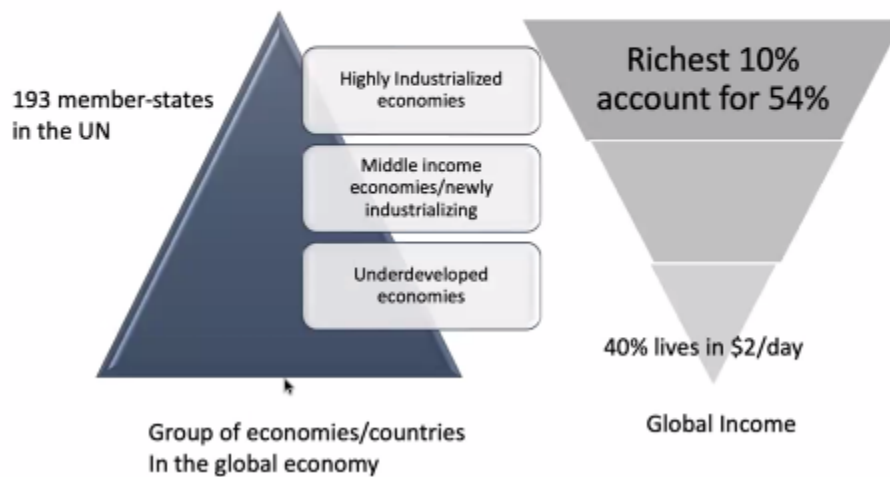
1990s

- Asian financial crisis of 1997
- IMF's new role as crisis manager
- Co-existence of regional and multilateral institutions
 - NAFTA in 1994
 - AFTA in 1992; ASEAN Community
 - Maastricht Treaty (Treaty on European Union) in 1993
- 1995: World Trade Organization (WTO); absorbed GATT
- Reintegration of former socialist states to world economy

2000s and beyond

- Economic rise of China
- 1999 onwards: Growing significance of the Group of Twenty (G20)
 - Towards a more participatory management of the global economy
- Evolving role of non-state actors
 - World Economic Forum, 1987 (Initially, European Management Forum in 1971)
 - NGOs, Civil Society
 - Formation of transnational advocacy networks
- Global financial crisis of 2007-09
- BRICS (Brazil, Russia, India, China and South Africa, first summit in 2009)
 - Growing bargaining power in international negotiations
- US protectionist stance under President Trump
- The global pandemic, lockdowns, global economic slowdown

Recurring Issue: Global Economic Disparity



International development

- Trade policy: protectionism vs free trade
- Economic disparity between north and south and within southern states
- Challenges of globalization

International regimes

- International cooperation
- Discord (delays in doha round)
- US hegemonic decline and US isolationism and protectionism

Representation

- Reform of the UN
- IMF and world bank
- International decision making

Power

- US leadership; collective leadership
- Rise of new powerful players like the BRICS countries

HEGEMONY, INTERNATIONAL REGIMES AND COMPLIANCE PROBLEM

Liberal international economy

- There is no alternative
 - "Better to have a liberal international economy than a closed international one"
- International anarchy
- Global governance without a world government

International economic order

- Hegemony
 - International political leadership
 - Dominance, power, stabilizer
 -
- International regimes
- International institutions
- cooperation/compliance of states

Hegemonic stability Theory : Realist version

- Idea that an international political leader is required to create and manage a liberal international economy
 - International system is anarchic
- State-centric
 - Hegemon is a state
 - In establishing a liberal international economy, it promotes its own interests
- Hegemony is based on international cooperation, not coercion
- Hegemon must be committed to liberal economic principles
- Hegemon is necessary in the provision of international public goods
- That hegemony is a necessary for cooperation is both empirically and theoretically weak; validity is exaggerated

Kindleberger's liberal Hegemony

- "Stabilizer" of the global economy rather than a hegemon
 - "A single country that assumes responsibility for the international economic system"

- Great depression occurred due to absence of an effective leadership stabilizer in the global economy
 - Brit: Willing but unable to lead
 - US: Not willing to lead
- Five functions of a stabilizer
 - Maintaining a market for distress goods = goods that do not have a market (products cannot be sold in int'l market)
 - Countercyclical lending = hegemonic state providing credit to members of the int'l system
 - Stable exchange rates = HS should provide stable exchange rate system
 - Coordination of macroeconomics policies =
 - Lender of last resort

Two models of hegemony (keohane)

Basic force model

- Hegemony as a preponderance for material resources
 - Raw materials
 - source of capital
 - control over markets
 - competitive advantage in the production of highly valued goods = expensive goods
- Emphasizes material capability
- Military power and hegemony
 - "Hegemonic power need not be militarily dominant world wide"
 - A hegemonic state must "possess enough military power to be able to protect the IPE that it dominates from incursions by hostile adversaries"

Force activation model

- There is not link between power and leadership in the global economy
- Decisions to exercise leadership are necessary to activate the posited relationship between power capabilities and outcomes

Gilpin on hegemony

- Hegemon is a necessary but not sufficient condition for establishment of liberal international economy
- essential for the creation of international regimes and solution for compliance problem
 - Address free riding
 - repeated use of "rewards for compliance" and "sanction for non-compliance"
- founded on international cooperation
- "Without a hegemon, international cooperation in trade, monetary and most other matters in international affairs becomes exceptionally difficult, if not impossible, to achieve"

Two effective hegemony

British

- Gold standard
- promotion of free trade through bilateral agreement

US

- Promotion of free market through multilateral institutions
- bretton woods institutions
- fixed exchange rate system
- collective leadership

British hegemony VS US Hegemony

	British hegemony	US hegemony
International political structure	Reliance on colonial system	Multilateral trade
International economic structures	Reliance on market dominance	Dominance of international trade
International political process	Reliance on international market power: Less reliance on institutions Leadership provided political linkages	Use of positive and negative sanctions : Realize on institutions and regimes; one side of political power divide
International economic process	Promoted inter-trade” More portfolio investment	Promoted intra-trade More direct investment

Is international cooperation without a hegemon possible?

- Yes accor. keohane
- Sustained cooperation is possible because of
 - Common interests of leading capitalist states
 - existence of international regimes

International cooperation and hegemony

- Did American hegemonic decline undermine international cooperation?

1967-77 US hegemonic decline

International cooperation	Before 1967	Changes ‘67-77
Trade regime	Protectionism; disagreements	More trade rules
Monetary regime	Deficits; fixed rate system	Shift to floating rate system in

		1970s
Petroleum regime	Nationalization* of oil industry by OPEC countries *Govt taking over the industry	Effective transfer of power from MNCs to OPEC member countries

- Keohane concluded US hegemonic decline did not undermine international cooperation

Gilpin	Keohane	Kindleberger
<ul style="list-style-type: none"> - State-centric concept of hegemony - A liberal international economy requires a hegemon committed to liberal economic principles, - A hegemon is a necessary but not sufficient condition for the establishment of liberal international economy, - A hegemon need not be an imperialistic power, - Facilitates international cooperation and prevents defection from international rules through the use of sanctions and other means, - Provides international public goods 	<ul style="list-style-type: none"> - Validity of the theory of hegemonic stability is often exaggerated, - Hegemony may contribute to world order but is not a sufficient condition and not necessary, - Hegemony fosters cooperation, - "Basic force model of hegemony defines hegemony as preponderance of material resources or control over <ul style="list-style-type: none"> - Raw materials - Sources of capital - Markets - Competitive advantages in the production of highly valued goods - Hegemonic power need not be militarily dominant world-wide. The military conditions for economic hegemony are met if the economically preponderant country has sufficient military capabilities to prevent incursions by others that would deny it access to major areas 	<ul style="list-style-type: none"> - The hegemon is a stabilizer, - Neoclassical view of hegemony or one that promotes free market, - Five functions of an economic hegemon: <ul style="list-style-type: none"> - Maintaining market for distress goods, - Provide countercyclical or long-term lending, - Maintain stable exchange rates, - Coordinate macroeconomic policies, - Lender of last resort. - The absence of an effective hegemon led to the 1929 great depression, - The US is the only country that can provide economic leadership. The EU and Japan must cooperate. - A situation where the three vie for leadership or dominance could

	of its economic activity.	cause instability in the world economy.
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International regimes and regime theory

- set of implicit/explicit principles, norms rules and decision making procedures around which actors' expectation converge in a given area of international relation (Krasner)
- Regimes govern and regulate state/transnational relations with specific areas
- they reduce uncertainty, minimize transaction costs, prevent market failures
 - regime studies:
 - origin = negotiated, imposed
 - content = Distributive consequences
 - compliance = theories of international cooperation (iterative games and neoinstitutionalism)
- "an effective international regime takes on a life of its own"

Susan Strange four structures of power

- Relation power (conventional notion) vs Structural power
- they shape the international political economy
- Hegemony is based on relational power
- **security structure**
 - provisions of security
 - based on BOP
- **Production of structure**
 - Arrangement to determine what to produce by whom, by what method, by what terms
 - mode of production is the basis of class power
- **financial structure**
 - provisions/creation of credit
- **knowledge structure**
 - control of information/ideas
 - access of which can be denied or granted

The international trade system

Major issue in international trade

- Gains.

Two major benefits of international trade

- Comparative advantage
 - Can change
 - absolute advantage (accor. to classical thinkers)
 -
- Economy of scale

- Average cost of a product falls when production increases
- Cannot be obtained without international trade

Opportunity cost

- forgone opportunity of making another thing
- Used to define the comparative advantage of a country
- If there is low opportunity cost, high comparative advantage

Heksher&Ohlin trade theory

- Countries with abundant capital will have an advantage over developing countries with limited capital

INCREASE OF GLOBAL TRADE DUE TO LIBERALIZATION

Multilateral trade agreements

WHy liberalize? Why protect?

Liberalization	Protection
Creates national specialization and optimum use of scarce resources	To avoid income redistribution, wage inequality
Maximize consumer choice; increased product variety	Protect local employment
Leads to competitive prices and increased competition in domestic markets	To achieve political objectives
encourage s innovation, spread of technology and know-how	Free trade is a policy for the strong
Increases the prospects for world peace	Dependence is vulnerability
Promotes interdependence	Protect infant industries

Free trade and Developed countries

- Free trade is “Fair trade”
- US trade deficit due to “unfair trade practices”
- Free trade yields income inequality and job insecurity
- Cause of low economic deterioration
- Agriculture is the least competitive sector
- Increased competition in high-tech sector

Free trade and developing countries

- Suffer from unfavorable terms of trade in the long run
 - Not as highly differentiated as manufactured goods
 - Products from developing countries have low price elasticity of demand (change in quantity demanded/change in price)
- Free trade policy undermines local manufacturers
- Trade dependence
- WTO/GATT = favorable to trade in manufactured goods

HOW DOES FREE TRADE MAKE SOCIETIES BETTER OFF? Gains of open trade system

Comparative Advantage

- A country could not produce everything Factor of production is finite (Land, labor, capital)
- There is always a tradeoff (opportunity cost)
- To produce more shirts, the economy must produce less of other things, say computer (vice versa)
- Production Possibility Frontier (PPF): combination of goods that an economy will produce
- Consumption indifference curves: specific combination of goods that consumers will purchase

Gains from trade are made

- By specializing in the production of goods with low opportunity cost and exchange them with goods which requires high opportunity cost if produced
- Efficient use of scarce resources
-

Politics of trade

- trade policies of states

Heckscher-Ohlin model

- international trade is driven by differences in countries' factor endowments
 - Also called factor-proportions theory
 - products that country specialize in depend on the factors of production
- There is a trade off in the production of goods
- The choice producers make is based on the relative costs of the inputs used to produce goods
 - Some countries have abundant capital, while others have abundant labor
 - countries rich in capital must produce capital-intensive goods, while countries with abundant labor must produce labor-intensive goods
- Countries thus gain from trade

- By specializing in the production of goods that use factor of production which that country holds in abundance and exchange them with goods that make use of the factors of production that are scarce in its economy
- Specialization yields to: Decline in average cost as output expands (increasing returns to scale)
- Free trade and factors of production: Stolper-samuelson theorem
 - Free trade benefits the country's abundant resources/factor and damages the country's scarce resources/factor
 - leads to factor price equalization
 - price of factors will become equal
 - Land vs labor vs capital
 - theorem explains the basis of domestic coalition in a given country when it is exposed to free trade

Why is free, open international trade controversial??

Effects on national welfare

- employment and wages (distributive effects)
- factor-price equalization theorem

Winners and losers in every sector of the economy

- effects on consumers
- effects on producers
- effects on labor/workers, labor standards

Limit of conventional trade theory

- H-O model and S-S theorem
- produces and very rigid specialization in the production of certain products
- an economy produces multiple products at the same time
- it predicts inter-trade transactions
 - H-O predicts trade between countries with dissimilar factors endowments
- large volume of goods that are traded today are similar products

What explains global trade patterns

Conventional trade theory

- Comparative advantage and the H-O model predict an inter-trade pattern

Human capital

- Influence of education, training and know-how
- Leontief paradox (the US having comparative advantage in labor intensive goods)

Economies of scale and product differentiation

- scale of production affects the cost per unit

- high-tech sector: cell phones, computers and automobiles
- enables countries to trade similar but highly differentiated goods

Managed trade

- trade between or among MNCS
- Caused by FDI and the rise of MNCS

Theory of competitive advantage

- Over time some firms acquire an advantage over the production of certain products
 - Firms achieve economies of scale and experience
- role of technological innovation in trade
- role of state policies and intervention
- influence of internal characteristics of a national economy to the firms' competitiveness in international market
- Knowledge capital as a factor in competitiveness

New trade theory/strategic trade theory

- States are engaged in strategic trade (specifically in high-tech sector)
 - To help their national firms gain advantage over their competitors
- Competition is imperfect (oligopoly)
 - First-mover advantage
- knowledge capital
- technological superiority
- established firms can use dumping and preemption to retain oligopolistic control of the market
 - Dumping = Selling below cost to drive out competitors
 - Preemption = huge investment in productive capacity to deter competitors
- government policies can assist national firms to generate technological spillovers and to shift profits from foreign to national firms
- Competitiveness in the production of certain goods can be acquired over time by firms
- role of state here is deemed important

Rules and principles that underpin the international trade regime

WTO can be

- Established in 1995
- at the center of the international trade system
- embodiment of all the regulations
- facilitates multilateral trade negotiations to lower/remove tariffs between countries
- **has 3 components:**
 - Is a set of rules/principles
 - Market liberalism (elimination of tariff/non-tariff barriers)

- Non discrimination (treat everybody as equal partners in INTL trade)
 - MFN/Most favored nation principle (A country must treat all of its partners as favored trade partners)
 - exceptions are RTAs and GSP
 - General tu
 - National treatment (when a foreign product enters the domestic market, the product must be treated like a domestic product)
- intergovernmental bargaining process

- Negotiating agreements to eliminate tariff and non-tariff barriers to trade
- WTO ministerial conferences sets the agenda, target date for conclusion
- Issues covered
 - Initially, tariff reductions/elimination
 - extended to non-tariff barriers
 - protection of intellectual property
 - trade in services
 - trade-related investment and MNCs
 - Use of safety standards to regulate national product market
- **challenges:**
 - diverse interests: difficulty in reaching agreements
 - growing power of developing countries and NGOs in WTO
 - Consider the case of DOHA round
 - Proliferation of regional trade agreements
 - enforcement/compliance problems and international cooperation
- provides a mechanism for settling disputes
 - ensures compliance with rules
 - dispute settlement mechanism
 - independent quasi-judicial tribunal
 - Dispute settlement body forms a panel to:
 - investigate and submit report
 - in case of an appeal, an appellate body is constituted
 - A government found in violation of rules is required to alter the offending party or compensate the country or countries that are harmed

Enforcement-cooperation issue

- Enforcement problem in international trade
- iterated prisoner's dilemma
- Role of hegemony and collective leadership
- Hegemons are expected to provide international public goods
- US hegemonic decline and international trade
- Rise of BRICS (powerful bloc within the WTO)
- Regional trade arrangement
 - Free trade area and customs unions
 - Poses the greatest challenges to multilateralism

Region trade agreement and Free trade area

RTA and FTA

They can be,

- Can be building blocks to world trade (enables members to open their markets to each other)
- Can be a stumbling block (Members of a RTA discriminate nonmembers)

Terms

Free trade agreement

- Two or more states agree to lower or eliminate tariffs on each other
- Multilateral, regional or bilateral

Regional free trade agreement

- A set of countries that belong to a certain region or regions agree to lower or eliminate tariffs on products and services

Preferential trade arrangements

- Unilateral trade preferences
- includes generalized system of preferences schemes (under which developed countries grant preferential tariffs to imports from developing countries), as well as other non reciprocal preferential scheme granted a waiver by the general council

Regional free trade area

- geographical coverage of the free trade agreement

Regionalization vs regionalism

Regionalization

- Growth of economic interdependence (increased intra-regional trade and investment)

Regionalism

- formal process of inter-governmental collaboration between two or more states

RTAs are inherently discriminatory

- violation of most favored nation principle
- contrary to the principle of multilateralism

LEGAL BASIS OF RTA/FTA

ARTICLE XXIV of GATT (general agreement of tariff and trade)

Conditions:

1. on custom union and FTAs: *Duties imposed on non members "shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union or the adoption of such interim agreement"*
 - If an fta will be established the tariffs (duties) to non members will not be higher/more restrictive than before the establishment of the fta
2. Reasonable length of time for plan and schedule for the formation of such customs union or FTA (usually not to exceed 10 years)

ARTICLE V of GATS/general agreement on trade and services (regardin economic intergration)

- provision that allows countries from creating a fta
- *"This agreement (GATS) shall not prevent any of its members from being a party to or entering into an agreement liberalizing trade in services between or among the parties to such an agreement "*

conditions:

1. such agreement must have "substantial sectorial coverage"
 - Should not only cover few sectoral coverage in the agreement
2. must provide for the "absence or elimination of substantially all discrimination between or among parties"

Enabling clause/ "Decision on differential and more faboranble treatment, reciprocity and fuller participation of developing countries"

- Adopted under GATT in 1979
- Enables developed member-countries to give differential and more favorable treatment to developing countries
- This is the legal basis for Generalized System of Preferences (GSP)
- Under GSP, developed countries offer non-reciprocal preferential treatment to products originating from developing countries
 - such as zero or low duties on imports

Nature and types of FTA

- Membership composition
 - Geographically contiguous
 - Not so geographically contiguous
- Scope
 - Bilateral
 - Minilateral
 - Multilateral/global
 - Transregional

Why do nations join RTAs?

- as a response to declining provisions of international public goods
- shortcomings of multilateral institutions/agreements are too slow to foster, rules are more difficult to enforce
- extract concessions from non-members
- RTA is a signal for strong commitments to economic reform;to maintain open markets

Motivations in the formation of RTAs

- Political motivations
 - confidence building
 - addressing new security agenda
 - as a bargaining tool
 - to lock in reforms by enhancing credibility of domestic reforms
 - satisfy domestic political constituencies
 - ease negotiating and implementing agreements

- Economic motivations
 - protection of certain sectors that would not survive in global competition
 - opportunities for deeper integration
 - larger markets and increased foreign investment

Why have RTAs proliferated

- growing economic interdependence
- change of US attitude towards FTAs
- willingness of nations to cooperate at regional level (states would prefer to open their markets to countries that belong to the same region, easier to negotiate to negotiate trade liberalization between regional than multilateral)

DO RTAs complement or challenge the WTO system?

- RTAs liberalize trade (trade creation)
- "Regional arrangements are compatible with the multilateral order and may constitute path toward deeper integration"
- RTAs institutionalize discrimination (Trade diversion)
- They are impediments to global free trade

Views on the formation of RTAs/FTAs

- Policy driven vs Market driven
- EU integration = policy driven
- Asian regionalism = market driven

Why do countries seek to harmonize their economic policies? Theories of integration

- Neo functionalism
 - expansion of scope due to 'spillover' effect (ernst haas)
 - cooperation in one area produces pressure for cooperation in another area

- Intergovernmentalism
 - Integration is the outcome of member-governments that were responding in a rational way to domestic interests
 - Countries harmonize their economic policies because of domestic pressure

Stages of intergration

Political Union	Common foreign security policy
Fiscal Union	Harmonization of tax rates; COmmon level of spending and borrowing
Monetary Union	Single currency and common monetary policy
Common Market	<ul style="list-style-type: none">- Free movement of goods, service and capital- Common market and common trade policy on non-members (Economic union)
Customs Union	Removal of tariffs and external tariffs on nonmembers
Free trade Area	Elimination of tariffs on All goods
Preferential Trade Area	Elimination of tariffs on certain goods
Independent economy	

RTAs in east asian

- 'spaghetti/noodle bowl effect'
- different/conflicting tariff rates and rules of origin
- ROOs = criteria needed to deetermine te national source of a product to qualify for RTAs/FTAs

Importance of ROOs

- rules of origin can be exploited by non-memebers by using a member as a base for their products and export good from there to other members

Basis of ROOs

1. Value added criterion
2. A change of tariff heading criterion
 - change of tariff heading should be a result of local processing/manufacturing
3. A specific processing criterion
 - Particular stages in production must occur in a member
4. A specific components criterion
 - particular parts of the finished goods must have been manufactured locally

TRADE POLITICS AND DEVELOPMENT

Trade politics = interests and preferences

- What determines the specific trade objectives that governments pursue
- when bargaining within WTO when negotiating regional trade arrangements
- when making unilateral trade policy decisions

Society-centered approach

- Assumes societal groups play an important role in determining trade policies in a state

State-centered approach

- assumes states are autonomous
- **Two models**
 - Factor model
 - when an economy is exposed to free trade the abundant factor will benefit by free trade, scarce factor will suffer by it
 - Sector model

What makes a strong state

- State autonomy
 - Degree to which national policymakers are insulated from domestic interest group pressures
- Highly needed in designing and implementing industrial policy
- Centralized VS Federal government

Industrial Policy

- Use of broad assortment of instruments in order to channel resources to industries that the state wishes to promote
- Necessary in high tech industries
- Why it's important in high-tech industries
 - Interferes with oligopolistic competition
 - Economies of scale and experience
 - Government intervention enhances welfare

CAN TRADE CONTRIBUTE TO DEVELOPMENT?

Two schools of thoughts

Structuralism and Development economics

- Yes, if state succeeds in shift of resources from agriculture to manufacturing
 - Dependency theory = Impossible, third world countries are trapped in circle of poverty
- GATT was not favorable to primary commodity exporters
- Address 2 coordination problems related to investment decisions
 - Complementary demand = needing another industry to expand before expanding itself

- Pecuniary external economies = conditions of the market in general

NeoLiberalism

- Yes, through specialization
- Free trade leads to economic efficiency, efficient allocation of resources

Trade and development policy among developing countries

- Development policy is an outcome of the competition between: Rural based agriculture and Urban-based manufacturing sector
- Import-competing sector and export oriented sector
- Labor and capital

Two development strategies

Import substitution industrialization

- Industrialization by substituting domestically produced goods for manufactured items previously imported
- **Two stages** :
 - Easy ISI (First stage)
 - Development of domestic manufacturing of consumer goods
 - Secondary ISI (second state)
 - Shift from simple consumer goods to consumer durables (technology required)
 - Local content requirement = manufacturers are required to secure components locally
 - Promote the development of backward linkages = production of one good increases demand for components/parts
- Producing for domestic market
- Strategy of choice by LatAm and some asian countries in 1950s-60s

Governments that employed ISI

- Establishment of industries
 - Creation of state owned enterprises
 - Partnership with private sector
- Foreign exchange intervention
- Protection of infant industries by limiting importation and restricting foreign direct investments
- Redistribution of income from export-oriented producers to the import-competing sector

Challenges and Problems with ISI

- Difficulty of economic reform
- ISI generated rents through protectionist policies
- Governments sustained ISI by borrowing abroad
- Imbalances:

- (1) Persistent budget deficit
 - State investments either through partnership or creation of state-owned enterprises
 - SOEs never became profitable
 - Subsidies were provided to hide true cost and price charged
- (2) Persistent current account deficit
 - ISI generated more imports, particularly intermediate goods but reduced ability to export
 - Small markets of developing countries did not allow economies of scale
 - Local manufacturers are not competitive
 - Overvalued exchange rate
 - Decline of agriculture sector (heavy tax burden on farmers)

Export oriented industrialization

- Industrialization by producing manufactured goods that can be sold in international markets
- Based on east asian model of development
- Well-designed government industrial policies
- Investment in education to raise skills level
- **Three stages:**
 - Development of light manufacturing (textiles)
 - Production of simple, durable goods
 - Production of heavy and chemical industries
- Promotion of exports
 - Industrial policy
 - Undervalued exchange rate
 - Allowed imported intermediate goods = goods that produce another product
- Producing for External markets

What explains East Asian economic success?

- Development of an export-oriented industry-2 explanations
 - Market-friendly strategies (WB) and state-led industrial policy (Amsden, Johnson, Wade)
- Selective import liberalization
- Maintained stable macroeconomic condition
 - Low inflation, conservative fiscal policy, appropriate exchange rate
- Implementation of policies that encouraged exports
 - Credit access and industrial targeting
 - Incentives (like low-interest investment funds) based on export performance
 - Infant industry protection
 - Undervalued exchange rate
- Investments in upgrading skills and knowledge
- Investments in scientific infrastructure and research and development

Effect of ISI: The shift from structuralism to neoliberalism

- Imbalances in countries that adopted ISI (mainly, Latin America)
- Successes of East Asian economies (Japan, Taiwan, Korea)
 - Creation of export-oriented industries
- Debt Crisis, structural adjustment and Reform
 - Protectionist economy
 - Too much external borrowing
 - Rise of oil imports
 - Falling prices of commodity products

Structural Adjustment Program (1983-95)

- Promoted by the IMF/World Bank and creditor countries
- Based on the Washington Consensus
- Created stable macroeconomic conditions
 - Tight fiscal policy
 - Devalue exchange rates
- During this period, developing countries liberalized trade
 - 1980: 41.6% average tariff 1990: 13.7 (Latin America)
- Privatized state-owned enterprises
 - 2000+ publicly owned firms were privatized between 1985 and 1992

Washington consensus: "stabilize, liberalize, privatize"

- Mixed outcomes
- Redistribution of income
- Large job losses
- Those were short-run adjustment costs
- Oatley: Countries that have reformed the most experienced large improvements in growth, while countries that have reformed less experienced small (in some cases, negative) growth gains