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International Political Economy

CSS CURRENT AFFAIRS

- Q. What are the causes and possible consequences of US-China trade war? Suggest measures for these countries to avoid trade war.
- Q. Economy and politics are two sides of the same coin. Discuss.
- Q. How do International Financial Institutions like IMF play their role in influencing the domestic decision-making of the loan-seeking countries? Explain with reference to Pakistan.
- Q. The rise of protectionism is seriously challenging the notion of international political economy. Discuss.

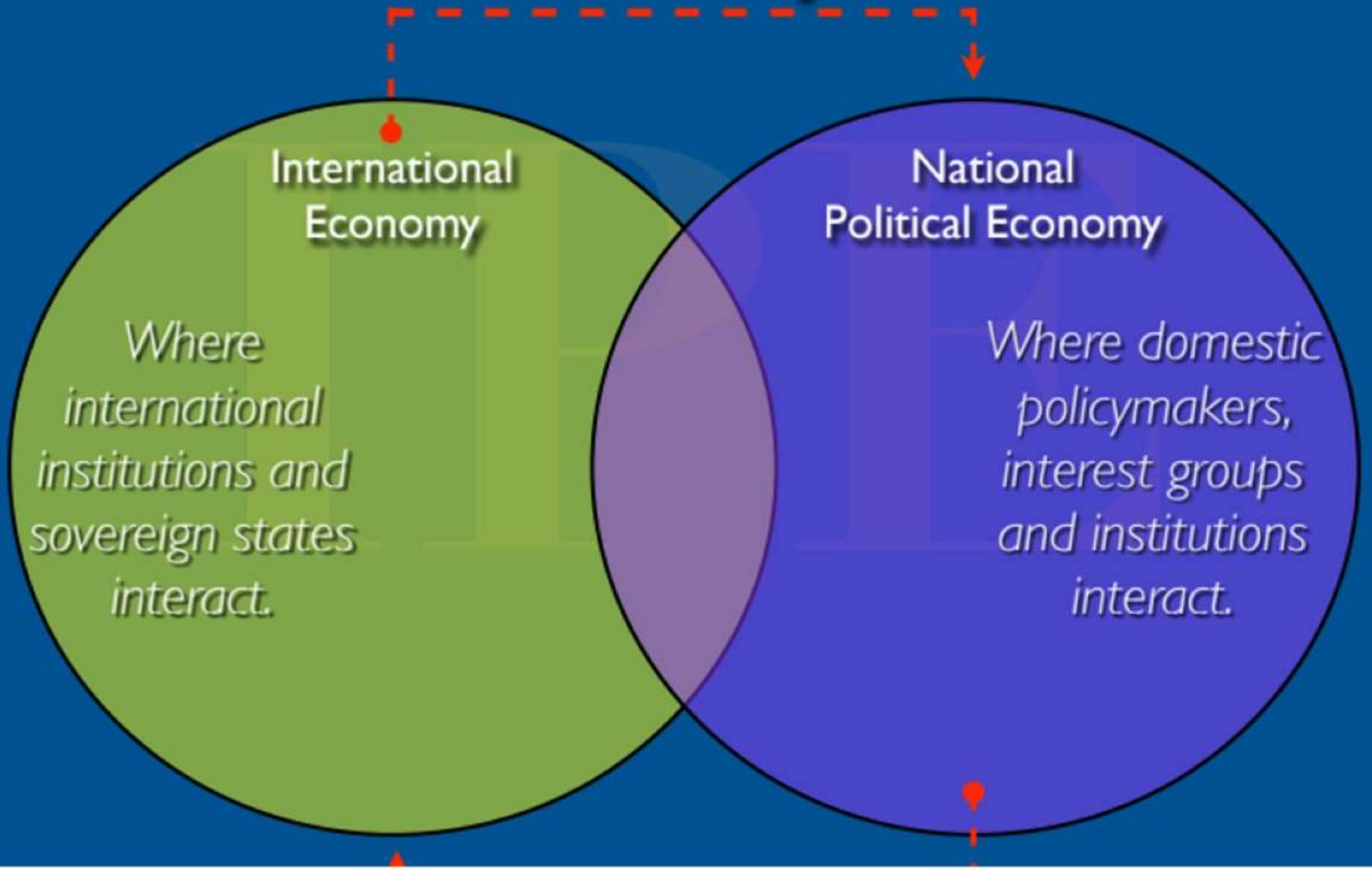
Introduction

- The Politics of Global Economic Relations.
- The study of a fundamental tension between and the dynamic interaction of two spheres of life, which we can variously call "politics and economics", or "states and markets".
- Any way you say it, political economy is about the lines that both connect and divide national interest from individual self interest.

▶Professor Susan Strange at the London School of Economics and Political Science has written that IPE

Concerns the social, political, and economic arrangements affecting the global systems of production, exchange and distribution and the mix of values reflected therein

Levels of Analysis in IPE



Compiled by sir Sajjad Haidar

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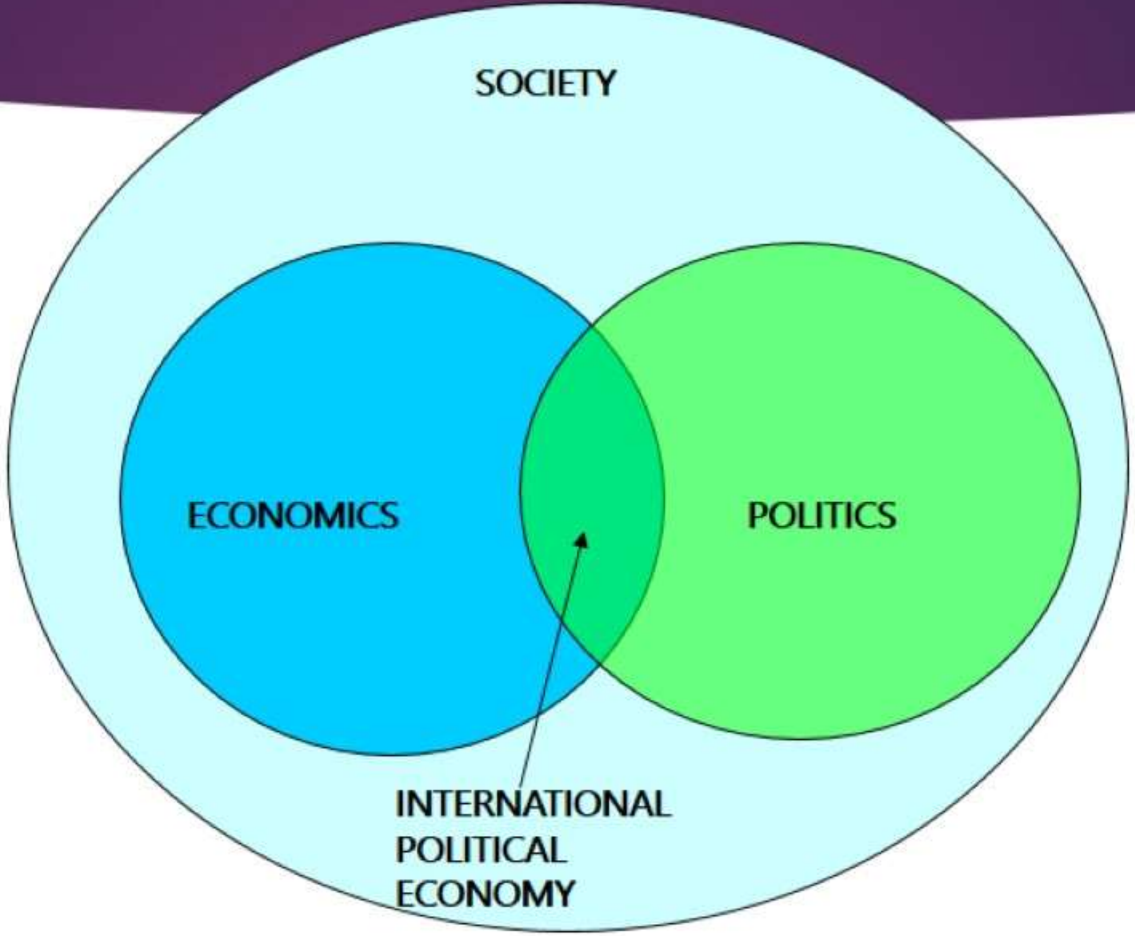
What is IPE?

- One way to understand the basics of IPE is to pick apart its name.
- It is **INTERNATIONAL** meaning it deals with issues that cross national borders and with relations between and among nation states.
- It is **POLITICAL** in that it involves the use of state power to make decisions about who gets what, when and where in a society. The political process is complex and multi layered, involving nation states, bilateral relations among nation states and many international organizations, regional alliances, and global agreements.
- Lastly, IPE is about the **ECONOMY** or economics which means that it deals with how scarce resources are allocated to different uses and distributed among individuals through the decentralized market process.
- Economic analysis and Political analysis often look at the same questions but economic analysis focuses less on issues of power and national interest and more on issues of wealth and income and individual interest.
- Political economy, therefore, combines these two ways of looking at the world in order to grasp more fully society's fundamental nature.

The Geometry of IPE



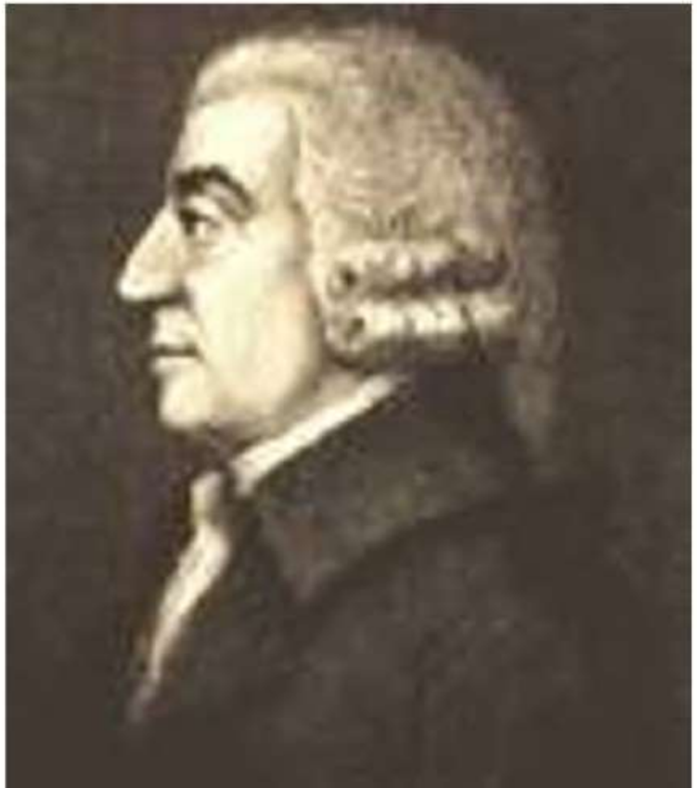
Concepts/Theories in IPE

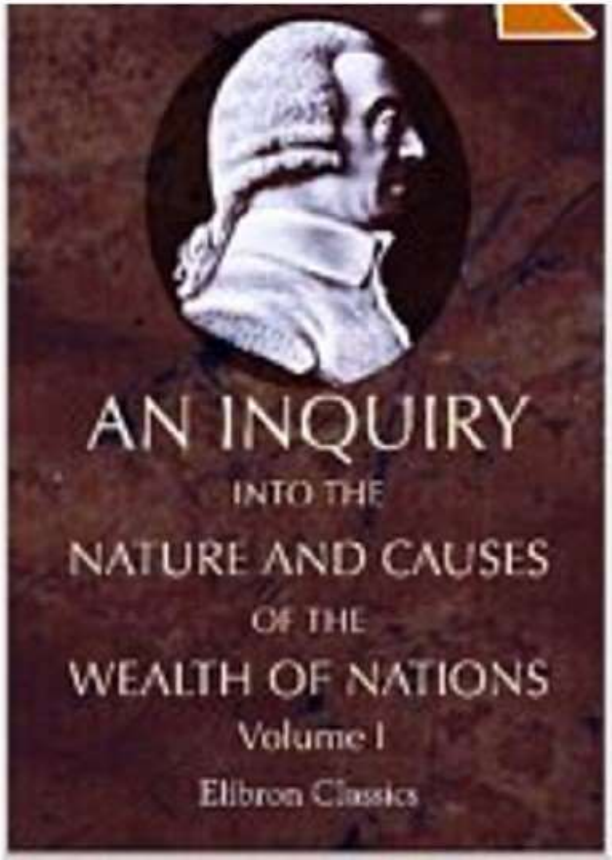
1. The first is *laissez-faire* liberalism (Economic liberalism), which advocates free trade and minimal state intervention in both the domestic and the international economy.
2. The second perspective is the Marxist theory which seeks to understand the workings of the global capitalist system in order to demonstrate its inherently exploitative nature. There are different versions of this general approach such as the Noe-Marxist approach, but all share a Marxist heritage. The best-known of these is world-system theory.
3. The third perspective is mercantilism. Sometimes referred to as economic nationalism, it is the oldest of the three perspectives. It was the dominant economic philosophy of European states from the 15th century to the late 17th century. Since that time, it has gone through a number of manifestations and continues to be an important economic alternative to both liberalism and Marxism.

- Economic Liberalism
- According to economic-(commercial) liberalism, humans can cooperate for shared benefits. They can engage in mutually beneficial exchanges.
- The early heroes of the liberal approach were Adam Smith and David Ricardo. Smith argued in favour of government's non-interference and the advantage of market exchanges guided by the 'invisible hand' of the price mechanism.

Liberalism

- Adam Smith (1723-90; Scotland)





Karl Polanyi

- In his book *The Great Transformation*, Karl Polanyi puts forward the argument that economic activity is embedded within a social and economic context.

- "This is one of Polanyi's central concepts," explains Ben, "the idea of the double movement that characterises the market society. On the one hand, you've got the forces of economic liberalism seeking to spread and expand the role of market forces — freeing up labour markets, for example — but on the other hand, you have a sort of backlash from society, as society is subjected to ever more dislocation; there's a call for social protection and the setting up of welfare state institutions for example to protect vulnerable citizens."

- **Mercantilism**
- Mercantilism (Economic nationalism) was the common practice of many governments before the emergence of Economic liberalism. Mercantilism is the economic dimension of realism.

- Essentially, mercantilism is an economic philosophy that believes that economic management should be part of the state's pursuit of its national interests defined in terms of wealth, power, and prestige. Francis Bacon, an early defender of this philosophy, wrote that there was a direct line 'from shipping to Indies, from Indies to treasure, and from treasure to greatness.' Consequently, mercantilists are not interested in improving the quality of life of humanity or of fostering mutual cooperation among states in the international system. Their primary goal is the maximisation of power, and they see economic activity as a vehicle for achieving this end. Message of mercantilism can be summarized in following points:

Basics of Mercantilism

1. Mercantilism's goal is to build economic wealth to build the power of the state.
2. Mercantilists see inter-state relations as a zero-sum game.
3. State should cooperate in economic realm only when they themselves get the benefits.
4. Jean-Baptiste Colbert (1617-83) argued that states should accumulate gold and silver, as well as build a strong central government.
5. Alexander Hamilton (1757-1804) made similar arguments in the United States.
6. The pre-liberal era of international political economy was the era of mercantilism.
7. Protectionism is a policy of mercantilism where states try to put higher tariffs on imports in order to lend advantage to their local economies.
8. China, due to its export capacity, is the beneficiary of the current free-trade system and USA is on the receiving end. Chinese economy is growing with a far greater speed than the US economy.
9. The protectionist policies of Donald Trump's America can be understood in this larger context.

What do Mercantilist States do?

- In order to achieve 'greatness' through 'treasure', mercantilist states typically do two things. First, they orient their domestic economy so as to produce a favourable balance of trade.
- Their goal is to produce goods for export while, at the same time, keeping imports low. Second, they will gear their industries to producing value-added products from cheap imported raw material. Thus, mercantilist states tend to discourage agricultural production in favour of manufacturing, to impose high import duties on foreign-made products, and to offer subsidies to domestic industries. They are also notorious for pursuing beggar-thy-neighbour policies. Mercantilist states, then, are highly interventionist.
- **Beggar-thy-neighbor** policy, an economic policy that benefits the country that adopts it but harms that country's neighbors or trading partners.

Role of the International Economic Institutions

Economic liberalism Woods institutions: the World Bank, the International Monetary Fund (IMF), and to a lesser extend the General Agreement on Tariffs and Trade (GATT) — now the World Trade Organization (WTO).

1. **The World Bank — Stimulating Economies**

- The World Bank was designed initially to facilitate reconstruction in the post-World War II Europe.
- In the 1950s, the Bank shifted its emphasis from reconstruction to development. It generates capital funds from member-states' contributions and from borrowing in financial markets.
- A high proportion of the World Bank funding has been used for infrastructure development.

1. **The International Monetary Fund (IMF) — Stabilizing Economies**

- The task of the International Monetary Fund (IMF) was to stabilize exchange rates.
- Originally, the Fund established a system of fixed exchange rates
- In 1972, this system collapsed when the United States announced that it would no longer guarantee the system.
- In 1976, the Fund formalized the system of floating exchange rates which is currently in use.

- **GATT and the WTO — Managing Trade**
- The General Agreement on Tariffs and Trade (GATT) enshrined important liberal principles:
- Support of trade liberalization
- Non-discrimination in trade
- Exclusive use of tariffs for protecting home markets
- Preferential access in developed markets to products from the South
- Support concept of “national treatment” of foreign enterprises
- The GATT established a continual process of multilateral negotiations among those countries sharing major interests in the issue at hand; the agreements reached were then expanded to all GATT participants.
- Most of the work was carried out over the course of eight negotiating rounds — each round progressively cutting tariffs and addressing new problems, such as intellectual property rights.

Challenges to the Working Apparatus of IPE

More generally, there is a problem with the very institutions of global governance in how they settle a trade-off between their democratic accountability and effective economic policymaking.

- **1. World Trade Organization (WTO)**
- In the case of the World Trade Organization (WTO), the implementation of trade rules is not easily reconciled with the demands articulated by international non-governmental organisations such as Greenpeace. These frequently hold the view that the management of international organisations has been captured by a few powerful countries, undermining their role as honest brokers, mediators and enforcers of joint policies.

2. International Monetary Fund (IMF)

- From the angle of democratic accountability, things look even more problematic in other global economic institutions. Most notably, the International Monetary Fund (IMF), which is charged with the task of ensuring economic stability around the world.
- The International Monetary Fund allocates voting rights proportional to the size of financial contributions made by its member states. At grass-roots level, critical voices view this as fundamentally contradicting the organisation's goal of global policy change and economic reform.
- They see a desperate need for new social mass movements to address the failings of deregulated capitalism, build working arrangements for global governance and arrive eventually at a fairer world.

3. 'International' or 'Global' Political Economy

- Many scholars now prefer to use the term 'global political economy' (GPE) over the more traditional term 'international political economy' (IPE).
- Although both terms are often used interchangeably, using the word 'global' is important as it indicates a wider scope in political economy that reaches beyond relations between states.

Absolute Gains and Relative Gains

- The "**absolute gain**" theory measures the total effect, comprising power, security, economic, and cultural effects of an action. ... In contrast, the realist "**relative gain**" theory is single-minded in weighing the effects of an action towards power balances.

- Neoliberals are indifferent to relative gains. Referring to a non-zero-sum game, they suggest that all states can benefit peacefully and simultaneously by virtue of comparative advantages.

Relative and Absolute Gains

- The "absolute gain" theory measures the total effect, comprising power, security, economic, and cultural effects of an action. Neoliberals are indifferent to relative gains. Referring to a non-zero-sum game, they suggest that all states can benefit peacefully and simultaneously by virtue of comparative advantages.
- In contrast, the realist "relative gain" theory is single-minded in weighing the effects of an action towards power balances. Since it is a zero-sum game, states have to compete with each other to increase their own benefits.
- Obviously, both "absolute gain" and "relative gain" theories are derived from the context of ***international anarchy***, in which states have incentive to cheat and fear being cheated.
- They both agree with the importance and necessity of international cooperation. However, realists are pessimistic and argue that it is much harder to achieve and maintain cooperation than alleged

- The differences between absolute and relative gains in IR theory indicate the major differences between neoliberalism and neorealism. Though in agreement with the anarchic context of international relations, neoliberals move away from the realists' state-centric framework and advocate a ***mixed-actor model*** that includes international organizations, NGOs, multinational corporations, and other non-state players.
- They believe that the international affairs agenda has been greatly expanded in the twentieth century, especially since the end of the Cold War. Thus, comprehensive concerns beyond military and diplomatic dimensions should be taken into account. Consequently, they concentrate on the pursuit of "absolute" rather than "relative" gains in international interactions.

Neo-realism vs. Neo-liberalism

- It is interesting that both neoliberals and neorealists criticize each other for oversimplifying the complexities of the real world. The highly power-focused neorealism is blamed for ignoring the multiple sources that shape the dynamics of international relations, such as non-state actors, institutions, processes, rules, and norms. Thus, it is out of date in dealing with contemporary IR issues (Evans and Newnham).
- On the other hand, neorealists fight back and accuse neoliberals of being naive in discounting the threat of conflicts and war. As is widely recognized, states have neither permanent friends nor permanent enemies, ***only permanent interests in international relations.***

Neo-realism vs. Neo-liberalism

- It is true, in reality, that states always keep an eye on each other, even during the honeymoon period of bilateral relations. Therefore, realists emphasize that states should be cautious of their collaborators and keep track of relative gains.
- Present allies, strengthened by greater relative gains, might turn out to be enemies in the future. The worries of aiding potential foes through cooperation constitute another fundamental barrier to cooperation. In line with this logic, regardless of the absolute gains, a smaller relative gain can be regarded as a loss for states.

Problems with Relative Gains

- Furthermore, stressing relative gains may cause other problems. Mastanduno indicates that "relative gains calculations can be destructive, to the extent that they lead to or reinforce the twin evils of protectionism and nationalism".
- Both put states at the risk of losing opportunities in the globalizing world, as more often than not, there will be substitutes willing to cooperate.

Critical Analysis

- The real world is too complicated to be explained by absolute or relative gains alone. Both theories treat states as rational and unitary actors.
- However, interest groups play significant roles in politics. Due to the diversity of interests, it is not easy to define a unitary national interest in some issues. Consequently, gains *per se* sometimes cannot be clearly stated.
- In addition, states are not always rational. Historical, cultural, and religious factors can make states adopt emotional actions from time to time. For instance, retaliatory trade policies are not unusual in international news.

Critical Analysis

- In a word, the problem is not scarcity, but inequality. States therefore, need to weigh the pros and cons of relative and absolute gains when making decisions.
- Reactions will vary according to the involvement of allies or adversaries; the relational arena in question, such as economic, cultural, or military; initial conditions, such as national strength, technology, and economic size.
- In the real world, relative gains are more important in some conditions and less in the others.

Conclusion

- In sum, absolute gains and relative gains go hand in hand in the real world.
- It is a tough task to make proper calculations separately, given the complex international context.
- In general, if the possibility and costs of war and conflicts are low, prospects for cooperation are bleak, in accord with relative gains.
- On the other hand, if the fighting cost is high enough to prevent potential conflicts, cooperation is feasible, in line with absolute gains.
- Globalization and international integration are processes that push the real world towards the latter path.
- Hence, calculations of absolute gain are becoming increasingly significant in contemporary international relations.