Hough, Peter ORCID: https://orcid.org/0000-0002-1209-1654 (2010) International political economy I : theory & history. In: World politics : international relations and globalisation in the 21st Century. Haynes, Jeffrey, Hough, Peter ORCID: https://orcid.org/0000-0002-1209-1654, Malik, Shahin and Pettiford, Lloyd, eds. Pearson Longman, pp. 320-359. ISBN 9781408204924. [Book Section]

Chapter 16 INTERNATIONAL POLITICAL ECONOMY I: THEORY & HISTORY

Introduction

Introduction box Bra Wars

In 2005 a trade dispute between China and the European Union occurred when the Europeans began to block the import of certain forms of Chinese clothing after seeing their domestic industries undermined by a sudden influx of much cheaper-produced products from the Orient. The Chinese cried foul play at such politicized interference in commerce whilst European textile industries and Trades Unions defended the action, pointing out that they could hardly be expected to compete in price with clothes produced in the 'sweatshop' conditions of China.

A compromise solution ended the dispute but the incident highlighted how politics and economics are increasingly entwined in the contemporary world. That the world's leading Communist power could lecture the world's leading trading actor and epitome of Liberalism on free trade served to illustrate how economic globalization has produced political contradictions, uncertainties and dilemmas for governments in their dealings with the international economy and for students in understanding IPE.

In this chapter you will gain understanding of the following;

- What is meant by International Political Economy
- How the global economy has evolved over time
- Rival theoretical approaches to understanding International Political Economy
- How trade is regulated in the contemporary world
- The significance of increased transnational flows of money in relations between governments

What is IPE?

International Political Economy (IPE) is a sub-discipline of International Relations that arose in parallel with globalization. From the 1970s it came to be broadly accepted across the theoretical approaches to IR that globalization had blurred the distinctions between two traditional demarcations of the discipline; i, what is political and what is economic and ii, what is domestic and what is international. Hence *Political Economy* is the study of the intersection of politics and economics within a given country, whilst International Political Economy is the study of this at the international level.

As has been discussed in earlier chapters, globalization is a contested term and there is no consensus on when it started, what it precisely is and how significant it is for International Relations. Nobody, however, seriously disputes that the flow of people, ideas, goods and money across state borders has greatly intensified over recent decades with implications for our understanding of both politics and economics. The volume of goods traded today is over twenty-seven times what it was in the late 1940s (WTO 2007) and foreign investment from businesses has grown tenfold in just the last two decades (Global Policy Forum 2009). Whilst we have had periods of growth in the internationalization of economic activities before this current phase of globalization none have been to this extent. Hence the study of IPE in academic circles and appreciation of it in governmental circles came to emerge from the 1970s as a number of key realizations became apparent which challenged previous assumptions about how to compartmentalize issues into the subjects of 'Economics', 'Politics' and 'International Relations';

- *Economic events in one country can have economic implications for other countries*

For example, the global 'credit crunch' recession of 2008-9 originated in the collapse of the US housing market as numerous international banks began to either cease lending or collapse with implications for businesses and individual borrowers throughout most of the world.

- *Political events in one country can have economic implications for other countries*

For example, the reunification of Germany in 1990 was a key factor in the collapse of the UK pound in 1992. The Bundesbank had to raise German interest rates to pay for the absorption of their relatively poor neighbour causing financial fluctuations in the European markets unused to such extravagance from the Continent's traditionally prudent economic leader.

- *Economic events in one country can have political implications for another country*

It has long been observed that the political fortunes of a government are closely linked to the performance of the domestic economy. Increasingly, however, the performance of the domestic economy is as much dictated by international economic events as it is by how a government manages its fiscal (tax), monetary or industrial policy. Evidence for this can be found as far back as 1929 and the Wall Street Stock Market Crash in the US which precipitated the world's worst ever economic recession, which was then a contributory factor in the fall of many democratic governments and the rise of the ideologies of Fascism and Communism as alternative models of economic management.

- *Power in international relations can come from economic as well as military might*

(West) Germany and Japan rose again as world powers in the 1950s and 60s not by rearming and invading neighbouring countries, as they had done in the 1930s and 40s, but by building their economies and trading their way to wealth and influence. During the oil crises of the 1970s countries like Saudi Arabia, Iran and Iraq suddenly became much more influential players on the world stage because of their possession of the world's most important commodity.

- *International political structures reflect economics.*

Intergovernmental Organizations set up to regulate the international economy after World War Two, such as the International Monetary Fund and World Bank group, were from the start very much dominated in their decision-making by one country; the United States. The US in 1947 accounted for around half of all economic production in the world, a level of superiority never seen before and never since repeated. As a consequence these organizations, along with emergent trading rules established under the auspices of the General Agreement on Trade and Tariffs (GATT), were designed to further the US economic interest of promoting more trade opportunities and political interest of propping up the capitalist world against the threat of Communist expansion. Recognition of how international organizations and rules can both reflect and reinforce national economic power, rather than serve to diminish the importance of the state, gave new impetus to Realist thought in International Relations with the emergence of Neo-Realism (see Chapter 6)

A Short History of IPE

Although it may not have been a recognized academic discipline, there was, of course, an 'international political economy' well before the 1970s. International trade has linked countries together since Ancient times and, from the 15th and 16th centuries, it is possible to see such commercial exchanges as being clearly political as well as economic as the global market became more interlinked and more competitive in line with transportation advances and the idea of compartmentalizing people into states. Box 16.1 gives an overview of how it is possible to understand the evolution of the international economy in terms of political ideas on how governments orientate themselves towards the rest of the world and how, as a consequence, the intergovernmental system with regards to trade and money has operated.

Box 16.1 Timeline of International Political Economy

1500 – 1780:	**Age of Mercantilism**
1780+:	**Industrial Revolution**
1815 – 1873:	**Age of Liberalism**
	1821 Great Britain adopts the gold standard 1834 Zollverein- *economic union between Germanic states which precipitated the creation of a unified Germany* 1846 Repeal of the Corn Laws- *landmark British act of Parliament which reduced protectionism* 1860 Cobden-Chevalier Treaty- *Franco-British agreement to free up bilateral trade.* 1866 Latin Monetary Union- *short-lived currency union based on the French Franc involving several south European countries* 1871 Germany adopts the gold standard
1873- 1945:	**Return of Mercantilism**
	1873-96 The Long Depression 1929 Great Depression 1930 Smoot-Hawley Act- *Highly protectionist law passed in the US* 1931 Collapse of the Gold Standard
1944:	**International Liberal Economic Order**
	1944 Bretton Woods Conference 1947 GATT launched 1971 Collapse of the Bretton Woods monetary system 1971-4 Oil Crisis 1995 World Trade Organization founded 1997-9 East Asian Financial Crisis 2008-10 Credit Crunch global Recession

In the early modern world of the 16th and 17th Centuries the economic policies of the great powers and the overall economic system are often referred to by the term 'Mercantilism'. Mercantilism is a term that can also be applied today to refer to certain government policies – as is explored later in the chapter- but, in the Age of Mercantilism, it was really the only approach that was in operation. During this phase of history international economic relations were very much carried out within the context of imperialism. A small number of states controlled most of the world both politically and economically. Hence these countries, such as Britain, France, Spain, Portugal, The Netherlands and Turkey, constructed their own international economic systems in which they imported what they needed from their colonies whilst also using those territories as markets for their own surplus exports. These imperial powers also traded with each other where it was necessary but, in general, saw other trading giants as commercial rivals rather than partners and looked to beat them to the acquisition of any remaining uncolonized territories whilst, at the same time, jealously guarding their own possessions from their covetous glances.

Mercantilism never disappeared, and persists today. However, from the time of the Industrial Revolution and age of Enlightenment, it faced for the first time a rival philosophy, Economic Liberalism. In the nineteenth century a significant precursor to contemporary globalization took place in which there was a huge growth in the volume of trade, due to a rise in both the economic capacity to and political willingness to engage in international commerce. A great leap in economic production occurred, due to the emergence of manufacturing industries, allied to an intellectual shift in favour of seeing other states more as partners than rivals in the international economy. In 1860, for example, that most bitter of regional and imperial great power rivalries, between Britain and France, entered a new era with the signing of a treaty, drafted by Liberal politicians on both sides of the Channel, which saw barriers to trade between the two countries significantly lowered. As a consequence of this a 200% increase in trade across the Channel occurred over the next two decades with, most notably, a huge growth in French wine heading Northwards and British textiles, from their booming newly-mechanized industry, heading south.

This period, in which Economic Liberalism began to flourish and challenge the logic of Mercantilism, was aided by the peace and diplomatic cooperation which marked the 19th Century **Concert of Europe** era and, hence, it started to unravel in line with the renewal of political conflicts on the Continent from the Franco-Prussian War of 1870-1. A growth in nationalist ideologies allied to an economic recession at the end of the 19th Century saw governments look more inwardly again and renew their traditional focus on acquiring resources for themselves, through force if necessary, rather than looking to enjoy the mutual spoils from encouraging global trade. An economic downturn invariably encourages governments to be more cautious about trading and focus instead on holding on to what they have got. This, added to a political reluctance to trade with countries deemed to be rivals, saw international trade slow down after this first era of globalization in the 19th Century.

Mercantilism thus came back to the fore in the early 20th Century in the context of the global military conflicts and extremist ideologies that emerged in that era. A revival of cordial international relations between the great powers and of liberal thought again occurred in the 1920s, in the wake of the horrors of the Great War, but a potential new era of economic and political globalization came to a crashing halt with the world's worst ever global economic recession, the Great Depression, which started in 1929. Illustrating the economic interconnectedness of the world well before the contemporary era of globalization, the effects of the 'Wall Street Crash' quickly reverberated around much of the world and saw a massive downturn in international trade. A sudden stock market collapse occurred due to the bursting of a 'speculative bubble' of stocks and shares that had become over-priced on the back of a domestic economic boom. This caused banks and businesses to collapse as the US economy shrunk by a third. This domestic crisis quickly internationalized as the US government responded in a Mercantilist manner. Loans given to European allies indebted by the Great War were recalled and measures were enacted to cut imports in order to protect weakened US industries from being undercut by foreign competition. Between 1929 and 1933 the value of world trade fell from $35 billion to just $12bilion as countries, such as many in Latin America, suddenly saw their main market for exports dry up and many European countries followed the US example and put up barriers to trade.

The world only came out of this depression as a consequence of the Second World War which prompted renewed industrial growth and international trade in order to support a burgeoning arms industry. Recognizing that relying on World Wars to ensure economic growth was not a viable long term strategy, leading capitalist governments at the close of the war sought to take international political steps to ensure that another Great Depression, as well as another world war, could not happen again. At a 1944 Conference, held at Bretton Woods in the US, the governments of the host country and the UK led discussions which created the institutional architecture of what would become known as the 'Bretton Woods System'. To support international capitalism both against Communism and another depression it was decided that Intergovernmental Organizations were needed to provide stability to the international economy and prevent governments lurching towards Mercantilism when the going got tough.

Hence, at the close of the Second World War, the present era of International Political Economy -the Liberal International Economic Order- was initiated, based upon the Bretton Woods System of two institutions created within the newly-established UN system and an international treaty:

- *The General Agreement on Trade and Tariffs (GATT)*- a Treaty establishing a regime intended to promote international trade and prevent governments resorting to Mercantilist measures.
- *The International Monetary Fund (IMF*)- an organization based in the US, which would provide a source of money for governments facing economic problems.
- *The International Bank for Reconstruction and Development (The World Bank)*- an organization also based in the US, which would lend to governments in order to develop their economies.

GATT is anayzed later in this chapter whilst the roles and impact of the IMF and World Bank are explored in the next chapter.

Hegemony

A key means of understanding the progression of the global economy and illustrating the maxim that international political structures reflect economics comes from appreciating the importance of the role of a hegemon and the phenomenon of **hegemony** in IPE. A hegemon is a term used in IR to refer to a government with sufficient political power and motivation to dominate international affairs in ways that creates rules and institutions that serve to further its interests. To a large extent, the emergence of IPE as a distinct discipline was built upon an appreciation of the significance of this concept which transcended rival IR theories. Neo-Realists like Robert Gilpin saw this as a new more sophisticated way of understanding how states could exert power over others by using institutions and rules (Gilpin 1987). For Neo-Marxist or critical theories (particularly those known as 'Neo-Gramscian') hegemony provided a way of understanding how a dominant transnational economic class could exert power over a majority exploited global class of people (see Chapter 9). Some Liberal thought also embraced hegemony as a means of achieving the goal of free trade by getting over the **collective goods problem**. A dominant trading state is in a position to play an entrepreneurial role by creating and enforcing international rules which promote trade. Getting a group of equally powerful traders to set up such a system is more complicated since any one of them could break ranks for short-term gain and bring it down.

All three of these theoretical perspectives could see hegemony as a key explanation for the emergence of the Liberal International Economic Order. The United States' economic power at the close of the Second World War, allied to a desire to project it worldwide, allowed them to- from a Neo-Realist perspective- mould the structures of international politics and commerce to their liking and / or- from an Economic Liberal perspective- take the lead in promoting and freeing up international trade. A Government which enjoy a preponderant share of international trade will naturally be inclined to take steps to increase the overall volume of international trade since they will gain most from this. However, there will be short term costs incurred from taking the lead in terms of lowering restrictions on imports coming in to their country and funding international initiatives to get other countries to do the same. In the period of 19th Century liberalization Great Britain emerged as the world's leading economic power, on the back of going through the world's first industrial revolution and the fact that it had the largest Empire. In 1860 the British were responsible for 20% of all industrial production and 24% of international trade. Fourteen years earlier the British government had taken the landmark and controversial decision to initiate opening up their agricultural industry with the Repeal of the Corn Laws act. Additionally, the British took the lead in stablizing the international economy by devizing the Gold Standard, in which most of the world's many national currencies would agree to tie their value to the price of gold. Other countries followed the British lead and reduced measures protecting their economies, a more stable international economy emerged and international trade flourished to the benefit of Britain and many other states.

Towards the end of the nineteenth century British hegemony diminished, not through their decline but as a result of others, like Germany and the US, catching up and rivalling them. Under these conditions, allied to the political circumstances described earlier, it was harder to maintain the gold standard and prevent countries again resorting to Mercantilist policies and the liberalization of the mid nineteenth century unravelled. By the 1920s, with the European powers economically weakened by the Great War, the US was possibly strong enough to play the role of a new hegemon but, at this time, lacked the political will to lead the world. Becoming embroled in the essentially European struggle that was the First World War had reinforced in American culture a preference for a more isolationist foreign and economic policy. The response of the US government to the 1929 Wall Street Crash was to look inwardly rather than outwardly and in 1930 the Smoot-Hawley Act imposed the highest ever US tariffs (taxes on imports). Other major powers followed suit and international trade collapsed.

By 1945, however, the US was far more powerful than in 1929 (and more powerful than Britain had been in the mid 19th Century) and far more inclined to move away from its traditional isolationism and involve itself in international affairs. Hence the US bankrolled the Bretton Woods institutions and other international economic initiatives and took a strong lead in managing them in spite of the significant costs of doing so.

Box 16.2 Keynes and White

PHOTO

The UK and US were represented at the Bretton Woods conference by, respectively, the Treasury Deparment Official Harry Dexter White and the Liberal politician and economist John Maynard Keynes. The two men acted as co-chairs of the event, in line with the expectation that their two countries would be co-hegemons of the Liberal International Economic Order. The outcome of the conference very much favoured White's preferences for free trade and reducing government involvement in economics. This demonstrated that power in the world had shifted very quickly and that the US was to act much more unilaterally than had been anticipated during the Second World War when the planning for the international political and economic futures took place. Curiously, however, for the architects of modern capitalism, both men came to be associated with the political left of their respective countries. Keynes continues to be lauded by Social Democrats for his defence of using government expenditure to boost a flagging economy by creating jobs and demand for goods. White was, by US standards, a Liberal interventionist and even suffered persecution in the anti-Communist hysteria that swept the US in the late 1940s on the suspicion that he had spied for the Soviet Union during the Second World War

Approaches to IPE

Three broad theoretical approaches are generally used to characterize the politics of the international economy, both in terms of understanding government policies vis a vis the global system and the functioning of the overall system itself. The previous section introduced Mercantilism and Economic Liberalism as government approaches and these are further explained in this section in addition to outlining a third broad theory of IPE; Marxism.

Economic Liberalism

Economic Liberalism emerged in the era of industrialization and the enlightenment as a branch of the wider political and philosophical Liberal movement that swept through Western Europe and North America (see chapter 7). The approach is underpinned by the core Liberal tenet that people are naturally inclined to cooperate with each other and can be trusted by governments to control their own destiny without this producing disorder and problems in society. This logic applied to the economic sphere manifests itself in a belief in the following key principles;

- *free trade*

As already discussed, Economic Liberalism is at its fundament the belief in free trade. This is the minimization of government involvement in the affairs of international trade so that businesses are not restricted from exporting their goods and imports from other countries are not restricted by protectionist measures.

Box 16.3 Adam Smith

18th Century Scottish Philosopher turned Economist Adam Smith is widely revered as the father of Economic Liberalism and, possibly, of the discipline of Economics itself. Smith's landmark work *The Wealth of Nations* developed an economic rationale for why free trade was a good thing and, ultimately, to the advantage of all. He reasoned that markets free from government interference were not chaotic and more likely to achieve mutually beneficial cooperation through an efficient division of labour. A well known illustration used in the book concerns the manufacture of pins. Ten people making pins in which they cooperated by dividing up the tasks involved in the production between them and specializing in them will make more pins than 10 people making them independently. In the competitive and selfish arena of international commerce the less efficient method was operated to the detriment of everyone.

Published in 1776 *The Wealth of Nations* influenced British policy and also the founding fathers of the United States of America which declared its independence that same year.

- *invisible hand*

Adam Smith illustrated his thesis that freeing up international trade benefited all with the metaphor of the 'invisible hand'. The invisible hand refers to what is more commonly today known as 'market forces', meaning the way business and trade operates in the absence of governmental interference. In a direct riposte to Conservative (and Mercantilist) fears that an unregulated economy leads to anarchy and exploitation as greedy individuals enrich themselves without regard to the suffering this may inflict on others, the invisible hand posits that society would be better off without government interference because it is this that distorts the natural inclination of people to work together, exchange goods and make money. Governmental interference in the economy, rather than protecting its citizens, actually serves to impoverish them by stifling their potential to enrich themselves and their fellow citizens. Cautious governments reluctant to allow imports into their country, for fear of exposing their domestic industries to cheaper competition and preferring to strive for self-sufficiency, serve to reduce the overall volume of international trade. As a consequence of this, citizens are left to pay more than they otherwise would for goods that were traded on the open world market and suffer from the overall amount of money that could be generated from commerce being artificially restricted. In an example of what is known as the **collective goods problem** self-serving governments, in the name of protecting their own citizens, actually disadvantage them with their caution (another example of the collective goods problem is the polluter's dilemma outlined in Chapter 23).

- *comparative advantage*

The English protégé of Adam Smith David Ricardo built on his work by developing a further rebuttal to the Mercantilist approaches which had up until now dominated the policy of Britain and other great powers, commonly known as the theory of comparative advantage. The theory lends support to the notion of the invisible hand by offering an economic rationale for why free trade produces more trade and more wealth for all nations. For reasons of climate, terrain and the abundance of natural resources it stands to reason that some countries have an advantage over others in the growth of particular crops or production of particular goods. This advantage can be to the benefit of all if allowed to flourish and not stifled by government interference in commerce. In a system of unrestricted international trade states can concentrate on what they are good at producing rather than trying to do a bit of everything since they can freely import goods that are produced more efficiently elsewhere. More particularly, comparative advantage ensures that even the relatively disadvantaged countries gain from specialization. For example, in a situation in which the economies' of two countries are based on the production of cars and corn but State A produces both more cheaply than State B, State B can, nonetheless, still prosper because the *relative* costs of producing the two goods will differ and give an incentive to trade. If State B , although less efficient in the production of both corn and cars than State A, produces cars more efficiently than it produces corn this will make it advantageous for both states to trade. Even though it appears cheaper for State A to produce its own corn and cars it is cheaper still to produce more cars instead and trade for State B's corn. Ricardo's work was a major influence on the British government's decision to pass the Repeal of the Corn Laws Act and trade with countries producing goods cheaper than they were and so usher in an era of much freer trade.

- *trade brings peace*

In addition to the economic rationale for free trade, Economic Liberalism, in line with Liberal political thought, sees that there are political gains to be had from throwing off the shackles of government protectionism. Though it tends to be best known for its advocacy of democracy, the notion of Kantian peace also advocated tying states together through commerce and so giving an economic incentive for peace (see Chapter 25). A motivation for the British and French politicians who designed the 1860 Cobden-Chevalier Treaty, in addition to the opportunities for increased trade revenues, was to bind these two traditional political rivals together with mutually beneficial economic ties. Concerns had begun to rise of the possibility of another in a long line of wars between them due to rival interests in Italy. In more recent times World War Two was the catalyst for the binding together of Western European states into the economic bloc that has now evolved to the European Union.

Mercantilism

Mercantilism refers to the traditional, and still significant, approach to International Political Economy to which Economic Liberalism emerged as a challenge. Although it reached its height in the late Middle Ages, as for a back as Ancient Greece Plato advocated a self-serving strategy of favouring exports over imports so that wealth could be accumulated. Since then the Romans and other Empires have tried to put systems in place ensuring such an imbalanced pattern of trade which, of course, cannot be pursued by all states.

- *the government should involve itself in international trade*

In direct contrast to Economic Liberals, Mercantilists advocate that governments should involve themselves in matters of international commerce in order to protect the interests of the state and their citizens. Mercantilism in IPE shares the same Conservative logic as Realism that the world is anarchic and states are, by necessity, self-serving and inward looking entities. If this mindset is adopted, you cannot trust other states to fulfil their part of the comparative advantage bargain since they could easily switch their trade to another country or take an opportunity to plunder your resources if it suited them. A states' economic resources are a key source of its power and should not be subjected to the vagaries of the international marketplace. A government should look to secure as many resources as it can and protect them. Hence Mercantilism advocates limiting imports to those absolutely necessary (important goods you cannot produce yourself) whilst exporting what you can in order to profit from it.

- *international economics is competitive not cooperative*

Mercantilists reject the notion of comparative advantage due to their more pessimistic take on human nature and the behaviour of governments. In the fiercely competitive arena that is the international political system 'collective goods' will never be acquired and there will be losers as well as winners. Governments thus should 'beggar thy neighbour' and just concentrate on ensuring that they are not one of the losers. Whilst the logic that free trade leads to more trade and more goods can scarcely be denied, it is far from certain that all participants in the global economy will gain from this increase. Some states risk seeing their domestic industries decimated by being undercut by cheaper imports, as in the 'bra wars' dispute highlighted at the start of the chapter. Weak states could be weakened further by not being able to compete with the 'big boys', the big boys themselves could be weakened by finding themselves unable to compete with lower priced goods from poorer states with lower wages and slacker working conditions. This sort of gamble is one that many governments will be unwilling to take. Telling recently laid-off steelworkers that importing cheaper steel from the other side of the world is better for the country and the world in the long run is unlikely to be a wise political move for a democratic government seeking re-election in the short term.

- *Self sufficiency*

The pessimistic assumptions of human nature and state behaviour that underpin Mercantilism also mean that they advocate governments hording what they have and trying to reduce reliance on other states. An extreme manifestation of self-sufficiency is the policy known as **autarky** which is the pursuit of total self-reliance. This would, of course, be straightforward for governments of countries blessed with all the natural resources they could want but, in practise, this has never been achieved. Attempts at achieving autarky have thus tended to be associated with states driven by ultra-nationalist ideologies. On the one hand this can take the form of simply stealing resources from others. Hence Imperial conquests, the rise of Fascism and Nazism and, Iraqi expansionist ambitions in the 1980s and '90s, which sought to enhance national power through the acquisition of other countries' resources, can be seen in this context. On the other hand, autarky has occasionally been pursued by states through isolationist strategies in order to jealously guard their own resources. Burma and Albania in the second half of the twentieth century pursued such a strategy and North Korea have continued to do so, in the guise of their state ideology of *Juche* (which seeks development as a communist country but without reliance on external support). The poverty that accompanied such strategies in these three states, however, is indicative of the poverty of such a strategy in the modern world. Hence, Mercantilist strategies today tend not to be as purist as autarky and aim, instead, for the accumulation of resources allied to the implementation of measures to protect domestic industries.

- *Protectionism*

The most prominent form of Mercantilism in the contemporary world is protectionism, which refers to a variety of economic policies employed by governments to insulate their domestic industries from foreign competition. The most common of such strategies are outlined in box 16. 4.

Box 16.4 Forms of Protectionism

- *Tariffs*- the taxing of imports
- *currency devaluations*- changing the value of your currency so as to make exports cheaper and imports dearer.
- *Quotas*- allowing in imports only up to a certain number. (e.g. the EU stance which prompted the 'bra wars' with China)
- *export subsidies*- giving government support to exporters to help them sell abroad.
- *government subsidizing of industry*- giving handouts to struggling domestic industries so that they can be supported against foreign competition.
- *Red tape*- using domestic laws to unofficially restrict foreign competition by insisting on particular product standards more likely to be achieved by domestic goods.

The progression of the Liberal International Economic Order has been marked by political efforts to reduce or outlaw government recourse to these various measures, and is explored in the next section.

Marxist approaches

Given the fall of the Soviet empire and the fact that Communist states which have persisted since the end of the Cold War, like China and Vietnam, have embraced capitalism in their international policies one might be given to conclude that Marxism was on the wane as an approach to International Political Economy. However, whilst very few states take a Marxist or Maoist approach in their dealings with other countries, structuralist perspectives on the global economy as a whole have actually become more prominent in academia as the sorts of exploitative working conditions Marx wrote about in regards to industrialized countries have become more apparent at the global level. Concerns over sweat shop labour in the urban slums of 19th Century Europe mirror the anxieties many express today about sweat shop labour in the industrializing world.

Marxist approaches to International Relations, explored in more depth in Chapter 8, assume that global economic structures are the chief determinants of international political behaviour and events and, hence, see IPE as being synonymous with IR, rather than a mere subset of the discipline. Marxists agree with Mercantilists that capitalist economics is a zero-sum game of losers and winners rather than the Liberal's sum-sum game of comparative advantage. Hence Dependency Theorists have advocated that governments of the 'zero' (i.e. loser) countries adopt protectionist measures to save themselves from exploitation. However, as Neo-Marxist approaches have evolved and economic globlalization has intensified, the emphasis has shifted to seeing the competition in the global economy as not being between states but between transnational classes of 'haves' and 'have-nots'. Neo-Marxists see IPE as based on a global bourgeoisie systematically exploiting a global proletariat. Some of that bourgeoisie is composed of small elites in poorer states who operate in 'enclave economies' profiting from the proceeds of exporting their country's resources to the richer states. Some of the exploited transnational class reside in the richer states as underpaid workers or unemployed beggars also short-changed by the global system.

The Contemporary Trading System

In an illustration of the difficulties inherent in steering governments away from Mercantilism, even with the scale of hegemony that the US enjoyed in 1944 what was intended to be the third institution of Bretton Woods, the International Trade Organization, failed to get off the ground owing to the number of governments who sought special exceptions to far-reaching plans to eradicate protectionist measures. In place of the International Trade Organization a lesser non-institutional arrangement was agreed based on the 1947 General Agreement on Trade and Tariffs (GATT) Treaty.

Central to GATT was the resurrection of an old idea for facilitating trade which the British had used in their nineteenth century hegemony and had periodically been employed between

European powers as far back as the fifteenth century, the **Most Favoured Nation principle**. The Most Favoured Nation principle is an undertaking between two governments that, in granting trade concessions to each other (e.g. mutually reducing tariffs on certain goods), they also agree not to grant even greater concessions to another country. Hence if State A and State B have a Most Favoured Nation agreement they are both committed not to then conclude a new deal with even greater concessions to States C or D, no matter how mutually beneficial it may be. The point of this principle is to give some order and openness to international trade and avoid the otherwise likely endless series of undercutting deals and ensuing rows. Also, in terms of liberalising trade, if Most Favoured Nation agreements multiply between states, this will see tariffs start to be cut on a multi-lateral basis. Hence the early 'Rounds' of GATT- periodic phases of negotiation amongst parties to the Treaty over new initiatives- were dominated by the extension of Most Favoured Nation agreements before then moving on to get agreement on the phase out of tariffs and other forms of government protectionism. The key features of the nine GATT Rounds are summarized in box 16.5

Box 16.5 GATT / WTO Rounds

Round	**Number of states**	**Key agreements**
1947 Geneva	23	Extension of the use of Most Favoured Nation Agreements between parties. Tariff cuts between some parties.
1949 Annecy	13	
1951 Torquay	38	
1956 Geneva	26	
1960-1 Dillon	26	
1964-7 Kennedy	62	35% average cut in industrial tariffs.
1973-9 Tokyo	102	25% average cut in industrial tariffs. Principle of exempting Less Developed Countries from Most Favoured Nation obligations established. Rules on Non-Tariff Barriers introduced for the first time (on government subsidies).
1986-93 Uruguay	123	40% average cut in industrial tariffs. Some (limited) measures to reduce agricultural protectionism introduced for the first time. Creation of the WTO.
1999- Doha	153	Impasse over liberalization of agricultural trade.

On the face of it GATT has been hugely successful in liberalizing international trade. In 1947 the average tariff its members were imposing on industrial imports was 38% but, by the end of the Uruguay Round, it was only 4% and covering most countries in the world. During this period international trade grew twenty-fold. By 1995 globalization and the end of the Cold War prompted the International Trade Organization idea, abandoned half a century earlier, to be revived in the guise of the World Trade Organization (WTO). The WTO absorbed the 1947 Treaty and regime and added to it measures committing its members not to violate the rules and mechanisms to enforce decisions lacking under the GATT regime. Hence the WTO became widely referred to as 'GATT with teeth'. The ambition of the new institution was evident from the words of its first leader in a speech to United Nations Conference on Trade and Development after the close of the Uruguay Round.

> *"(the WTO) is no longer writing the rules of interaction among separate national economies. We are writing the constitution of a single global economy"*
> (Renato Ruggiero1996)

However, despite unprecedented international political efforts to liberalize international trade, the contemporary global system is far from being entirely free and government recourse to Mercantilist measures is still regularly seen. Whilst progress on reducing industrial tariffs may be impressive the liberalization of the trade in food and textiles is far more limited. In striking contrast to the figures for industrial protection, the tariffs imposed on agricultural imports are at an average of 30% in the European Union and nearly 33% in Japan (Josling & Hathaway 2004). Steps were taken to tackle agricultural protectionism in the Uruguay Round with the Europeans agreeing to cut export subsidies (unpopular in the rest of the world for artificially reducing high EU prices so that their surpluses could be 'dumped' on the international market). Further liberalization concessions could not be won, due to the political sensitivity attached to protecting farmers in some EU states and particularly France, but the subject was now on the table and the principle of more significantly freeing up this area of commerce was agreed to for the next Round. The Doha Round has, however, proved more intractable than any of its predecessors and agricultural trade remains largely as unfree as it ever was, with particular implications for Less Developed Countries whose economies tend to be based on food rather than industrial exports.

In addition to the issue of agricultural protectionism, over the course of the GATT/WTO era there have emerged so many exceptions to the Most Favoured Nation principle that some posit that industrial trade is not as free as the tariff reduction figures would suggest. It was agreed upon in the 1947 Treaty that members forming Trade blocs which freed up trade between them could be exempted from the Most Favoured Nation principle (ie, they could give greater concessions to their trade bloc partners than to their 'Most Favoured Nation's). At the time this was not all that significant, since there were very few trade blocs, but the proliferation of these arrangements is such that today all WTO members bar Mongolia are in a regional free trade area and most are simultaneously members of several. Whether this phenomenon is good or bad for the cause of freeing up international trade is hotly disputed. Some see trade blocs as a positive development for liberalization since they are, after all, freeing up trade and so can be seen as stepping stones towards global free trade. Others, however, voice concern that Trade Blocs are detrimental to global free trade since they produce ‘trade diversion’ by increasing trade amongst their own members but at the expense of trading with the rest of the world. The European Union, for example, has greatly facilitated flows of trade amongst its members but this has been accompanied by those states’ trading less with countries outside of the EU. Hence, although it is indisputable that there is more trade then ever in the world some contend that this is misleading since the logic of the invisible hand and comparative advantage are only really being applied at the regional rather than global level.

A further exception to the Most Favoured Nation principle was established in the Tokyo Round by allowing Less Developed Countries preferential access to developed country markets. The intention of this was to help their infant economies grow by giving them some protection from competition with stronger economies but has also sometimes proved controversial. During the ‘banana wars’ of the 1990s, for example, the US government complained that the EU was using this principle as a means of capturing the fruit exports of Caribbean ex-colonies.

An additional complication in regards to freeing up international trade is that there is more to protectionism than tariff-cutting but these ‘Non-Tariff Barriers’ are for more difficult to legislate for. Quotas and subsidies have come to be restricted by GATT but such measures tend to be harder to implement than tariffs since they are less explicit and more easily disguised than a tax. Protectionism through creating red tape is harder still and governments have taken to ingenious measures to seek to protect domestic industries in this way. In the 1990s Japan’s government defended unique national standards for the construction of skis on the basis that Japanese snow was different than that found in the rest of the world. Hence we see the central dilemma of achieving free international trade. Strong domestic pressures will often be exerted on governments to bail out or protect domestic jobs and industries from foreign imports, whilst the realization of global collective goods is rarely prominent in the demands made by the public of the officials who represent them.

The Contemporary International Monetary System

Political involvement in economic affairs centres on enacting measures to regulate the money supply, as well as the flow of trade. Money, essentially, was created to facilitate trade. It allowed people to buy goods rather than just exchange them by coming to a mutual agreement on the respective worth of those goods every time they are swapped (bartering). With the progress of international trade this also came to apply to international commerce with many imports coming to be paid for in money rather than ‘in kind’. Crucially, then, the value of money has to be agreed upon by the participants in a commercial transaction. Domestically this comes from the existence of a national currency as legal tender. The state, via its Central Bank, issues coins and notes and authorizes other kind of monetary exchanges to an amount considered appropriate to maintain the value of the currency and facilitate business. This monetary policy amounts to expanding the national money supply (to boost businesses or create jobs) or contracting it to prevent inflation (the problem of an excess of money undermining the value of goods). Traditionally government monetary policy focuses on the raising or lowering of Central Bank interest rates or by the raising or lowering of taxes (fiscal policy). Lowering the tax rate gives people more money in their income whilst lowering the interest rate makes it easier for them to borrow money from banks. Raising either rate contracts the money supply by doing the reverse.

This crucial dimension of political economy has functioned within states since ancient times and control of the money supply is, alongside control of the use of force, the basis of sovereignty. With the rise of international trade, however, a problem emerged with monetary exchanges in that there was no international currency and the world's myriad national currencies had very different and fluctuating values. The 'Exchange Rate' between any two currencies is likely to vary on a regular basis and create uncertainties for traders. Hence the idea of the Gold Standard emerged with a value in gold, chosen as the amount of it in the world was broadly known, given to national currencies of states partaking in international trade. The world's leading trading states agreed to have their currencies given a set value in reference to gold and so avoid competitive devaluations. The gold standard was a key feature of the trading system of the nineteenth century, upheld by Britain as hegemon, but this system collapsed as Mercantilism resurged in the twentieth century.

As with measures introduced to liberalize international trade at the Bretton Woods Conference, the method used to give order to the international monetary system revived a scheme from the nineteenth century but strengthened it through the creation of an intergovernmental organization to uphold the new rules. The International Monetary Fund (IMF) would, on the one hand, provide an international pot of money from which countries could borrow in times of hardship and, on the other hand, be the centre of a new system of managed currencies. A significant variation on the Gold Standard was created however, clearly reflecting the extent of US hegemony in the 1940s. The US dollar was made the unofficial currency of the capitalist world (not, of course for the Soviet Union and their allies) by establishing a monetary system in which other countries promised to keep the values of their currencies tied to the value of American money. Gold was still pivotal to the system, however, since the US dollar was tied to the price of that precious metal (at $35 per ounce). Hence Washington became the world's lender whilst not having to worry about exchange rates or balancing its own books. Hence the US was able to run a trade surplus (export more than import) and so act in a Mercantilist manner whilst propping up a liberalizing international economy.

The US economy, and the global economy, thrived under this monetary system through the 1950s and '60s but it all came unstuck in the 1970s. This era of US hegemony came to an abrupt halt amidst the global economic recession of 1971-4. The sudden rise in oil prices instigated by the Organization of Petroleum Exporting Countries, taking advantage of having secured political control of this crucial commodity from MNCs, allied to the spiralling costs of the Vietnam War, led to the US budget deficit (amount of debt acquired through borrowing) getting so large that bondholders and other governments began to lose faith in the dollar holding its value in relation to gold. Importantly, the revival of European economies and emergence of Japan as a major player in the international economy meant that the US's hegemony was not what it had been and other currencies were emerging to rival the US dollar. Whilst political factors undoubtedly hastened the collapse of the Bretton Woods monetary system, many have come to concur with the views of the Belgian economist Robert Triffin that any international monetary system based on any one country is doomed to fail regardless of political circumstances. (see box 16.6)

Box 16.6 The Triffin Dilemma

The ‘Triffin dilemma’ posits that it is unsustainable for one country to act as the world’s banker since, in time, it will eventually come to pass that more of that country’s currency will be held outside of its own borders than within. History and common sense dictates that lending more than you own is a recipe for disaster. This is precisely what happened with the US dollar and, hence, in 1971 President Nixon pulled the plug on the Bretton Woods monetary system by revaluing the dollar and abandoning its conversion rate to gold.

Attempts were made to revive the Bretton Woods monetary regime through the early 1970s but, eventually, a system of fixed exchange rates was abandoned and the capitalist world instead entered a new era of floating exchange rates (i.e. unregulated at the global level), which persists to this day. The present monetary system is not a return to financial anarchy, however. Not all states do ‘float’ their currencies. Some continue to peg their currencies to the dollar and some to other powerful currencies. Ecuador and El Salvador have gone further and actually adopted the US dollar as their national currency in 2000 and 2001 respectively. Most European Union members have now adopted a new, joint currency, the Euro to give them strength through unity in the global financial system. A number of states, including the US and UK, do float their currencies and have come to accept the consequent fluctuations in their exchange rates in the confidence that their standing in the financial world will keep their currencies and economies strong. A huge growth in the flow of money across the borders of countries has led to a situation in which governments have come to have less control over their money supplies and be more vulnerable to market forces. Around a third of the world’s paper money is now held outside of the country where it is legal tender (Cohen 2003). Several Asian countries suffered a significant economic downturn between 1997 and 1999 when rapid financial outflows from Thailand occurred when the government decided to float the *baht* rather than peg it to US dollar. The effects quickly spread to Japan and other states but the North American and European economies remained relatively unaffected and the fashion for floating currencies and liberalizing capital markets (relaxing government rules on financial firms) persisted. After a decade of economic growth in Europe and North America, however, another sudden- and this time global- economic recession caused by financial turbulence threatened the remaining Bretton Woods edifice.

Case Study box The credit crunch recession

From 2008 a financial crisis spread through the world triggered by the collapse of the US housing market. Banks had been granting loans to people to buy houses much more easily than in the past and then selling on the money based on this debt to other financial companies to fund investments. These financial companies assumed these loans were 'secure' because mortgages have traditionally been viewed in this way (because the sum is seen as guaranteed by the fact that the banks have people's homes as collateral) and credit rating agencies in the city assured them that they were. House prices had been rising for several years, allowing this sort of lending to appear viable, but when this financial bubble inevitably burst it became apparent that it was not. The loans were not traditional mortgages and were not secure because the banks had been increasingly lending to; a) poor people unlikely to be able to make the re-payments and b) rich people who had bought property purely for investment purposes. Hence, when the poor borrowers started to default on repayments and rich borrowers responded to a fall in prices by simply handing back the house keys, the mortgage lenders were left owning property nowhere near the value of the sums of money they had lent. When it became obvious that banks had been lending sums far in excess of what they owned businesses lost confidence in them and the whole financial system was plunged into chaos. Many major international banks collapsed, many others had to be bailed out with $multi-trillion injections of government (i.e. taxpayers) money, and a slump in production occurred as businesses became starved of bank loans, creating a huge growth in unemployment. Across the world around $4 trillion was lost (to put this in context global GDP or 'all the money in the world' is around $60trillion) in the worst economic recession since the Great Depression of the 1930s.

From the perspective of the three positions on globalization outlined in Chapter 2 this recession can variably be viewed in the following ways;

- For *Globalists* this is a temporary set back; the bursting of another economic bubble after which the market will correct itself and allow the normal pattern of economic growth- which has dominated the past sixty years- to resume.
- For *Alter-globalists* the recession represents a political failing; the failure of certain governments to properly control banks and the financial markets. By learning from this and putting reforms in place the global economy can be resurrected in a better, more regulated, form.
- For *Anti-globalists* the scale of the downturn provides damning evidence that capitalism is simply unsustainable as a global economic system.

Unlike the 1930s, however, the overall response governments has not been to 'beggar thy neighbour' and turn inwards but to look to cooperative international solutions to preserve the global economic system but reform the way its institutions operate. This is explored in the next chapter.

STOP AND THINK REFLECTION- who do you think was to blame, if anyone, for the Credit Crunch Recession?

Conclusions

Economic globalization has brought the states of the world closer together than ever before into a single economic system. Those states, however, are still prone to act unilaterally in economic policy and where international cooperation has thrived it has tended to be at the regional rather than global level. Mercantilism, in the form of economic protectionist strategies, persists in the Liberal International Economic Order and remains a popular recourse for governments at times when the global economy does not appear to be delivering collective goods. Although beset by periodic downturns, the persistence of the Bretton Woods system and its apparent success in delivering unprecedented levels of global trade and economic growth and in avoiding a repetition of the great Depression seemed to vindicate the international political architecture fashioned by the US in 1944. The spectre of that 1930s economic catastrophe that loomed again with the financial crash of 2008, however, has challenged many assumptions and prompted a re-appraisal of the nature of International Political Economy.

Prescriptions for the global economic system from the rival perspective of International Relations and the states that inhabit it have come to be broadly the same as for the other core aspirations of the discipline; peace and human rights. Realists, as always, put their faith in the state and advocate that governments should 'look after number one' and follow a Mercantilist agenda to ensure that they are not the losers in a competitive, anarchic marketplace. Marxists see the persistence of perennial poverty in the Global South and of the periodic poverty of economic boom and bust in the Global North as evidence of the need for systematic change rather than mere reform.

IR Liberals in this regard are not synonymous with Economic Liberals in that they propose greater political intervention rather than pure market solutions, through the promotion of global governance. In this view a single economic system needs to be regulated accordingly. 176 currencies not fixed to the amount of gold or any other fixed variable whilst financial flows cross borders at ever greater amounts and speeds could be said to be a recipe for economic disorder and, even, serve to undermine the meaning of money. Money was invented to facilitate trade but, to some extent, has become a commodity in its own right with the rise of financial speculators earning their living by betting on and encouraging currency and share collapses. In light of this, some Liberals have come to advocate the most far reaching of all economic reforms in terms of its implications for state sovereignty; the creation of a single global currency. As radical a proposal as this might be it is far from new. John Maynard Keynes at Bretton Woods advocated an 'international clearing union' in which state currencies would be fixed to a hard currency (i.e. not for public use) held by a global central bank. All states would have what approximates to a bank account with the international clearing union and be charged for running an excessive trade surplus or deficit with the value of their currency automatically recalculated accordingly. In this way Keynes believed that global economic stability could be guaranteed through all governments having to balance their books and currency speculation coming to an end.

Radical solutions, calling for a complete overhaul or overthrow of the Liberal International Economic Order, have emerged from the margins of the IPE debate due to the shock to the system presented by the 2008 downturn. The future of IPE is far from certain with very different predictions and prescriptions about how the role of the state will be affected by globalization and the unprecedented complexities and dilemmas that it continues to produce for governments.

QUESTIONS

- How free is world trade today?
- Contrast Liberal and Mercantilist theories of international political economy and consider which approach is most apparent in the contemporary world.
- Is a hegemon an essential pre-requisite for the construction of a liberal world economy?

RECOMMENDED READING

O'Brien & Williams, (2004) *Global Political Economy: Evolution and Dynamics*

A thorough yet accessible overview of IPE, particularly strong in terms of an historical overview but also covering rival theories and key contemporary issues. Helpful, concise case studies and data are presented throughout.

Ravenhill, J (2008) *Global Political Economy*

A well-presented textbook which is particularly strong in presenting the theoretical approaches to IPE and in defining key concepts.

USEFUL WEBSITES

Global Policy Forum 'Globalization of the Economy'

http://www.globalpolicy.org/globalization/globalization-of-the-economy-2-1.html

An authoritative and well-set out website (good for IR in general) providing overviews and data for all of the key themes in IPE as well as links to analytical essays.

BIBLIOGRAPHY

Cohen, B. (2003) *The Future of Money* Princeton: Princeton University Press

Gilpin, R. (1987) *The Political Economy of International Relations* Princeton: Princeton University Press.

Global Policy Forum 'Globalization of the Economy' http://www.globalpolicy.org/globalization/globalization-of-the-economy-2-1.html

IMF (2009) *Global Financial Stability Report. Respoding to the Financial Crisis and Measuring Systemic Risks.* Washington: IMF

Josling & Hathaway (2004) 'This Far and No Farther? Nudging Agricultural Reform Forward' *International Economics Policy Briefs,* Policy Brief 04-1 Peterson Institute for International Economics March.

O'Brien & Williams (2004) *Global Political Economy: Evolution and Dynamics* (Basingstoke UK, New York; Palgrave).

Ricardo, D (1992) *The Principles of Political Economy and Taxation* first published 1817, (London: Everyman's Library

Rugiero, R (1996) speech to United Nations Conference on Trade on Development, October 8.

Smith, A (1983) *The Wealth of Nations* first published 1776 (New York: Penguin).

World Trade Organization (2007) *World Trade Report 2007* (WTO: Geneva)