

International Political Economy.

- What is Political Economy?
 - Political Economy is analysis of politics that explicitly incorporates the interaction of economic and political spheres
- Political Economy has roots in Aristotle, Smith, Ricardo, Marx, Keynes, Galbraith, many modern analysts.



*From Kirel Yucilinda

International Political Economy

- The Study of the Politics of International Economic Relationships.
- The relationships between trading states
- Regimes on exchange and behavior established by states vis-à-vis one another
- Examples; Empire, Hegemonic (trade regimes), WTO, NAFTA

IPE

- Also studies the impact that economic relationships have on the ability of states to maintain freedom of policy.
- Certain protocols in the domain of trade and investment limit the scope of the state.
- Is sovereignty limited by globalization.

Main Paradigms of IPE

- Mercantilism
 - Realist-type philosophy.
 - State is dominant over economic policy and all economic spheres.
 - Goal of the state is to accumulate trade surplus, and cash reserves that accrue.
 - Power is seen result of currency or metals reserves.
 - Manifest in imperial style expansions to accrue raw materials and markets in carefully controlled environment.

Paradigms of IPE

- Liberal or Neo-Classical
 - Aligned with Neo-liberal and liberal IR perspectives.
 - Individual unit of interest
 - Goal of state to facilitate flow of goods, capital and labor.
 - Post-WWI role of state redefined: Provide stability to prevent great depression style crisis.
 - Hegemonic theory- lenders of last resort
 - Classical Political Economy reaction to violence and conflict of 18th century mercantilist economics and colonialisms.
 - Adam Smith, Ricardo early adopters

Paradigms of IPE

- World Systems/Dependency
 - Borrow from Marx's Analytical Methods
 - Units of interest are class actors within and between states, or interest groups.
 - Unit of analysis is flow and possession of productive resources
 - Recognize that patterns of production tend to reproduce themselves, groups protect their interests and the status quo.
 - Post-colonial and developing countries “peripheral” at the mercy of developed “center” states.

Mercantilism

- ❑ Classical Political Economy of Smith and Ricardo was a reaction to the Mercantilist policies of the time.
- ❑ Smith and Ricardo both HATED the Mercantilist system, seeing the role of Government as a coordinating body to provide information to lower classes.

Mercantilism

- ❑ Essential features of Mercantilism:
 - ❑ Regulation of international trade
 - ❑ State intervention in the economy
 - ❑ Corporatist/ state-private firms.
 - ❑ Licensed Monopoly
 - ❑ Protection of domestic manufacturers
 - ❑ Strong state government

Mercantilism cont'd

- ❑ Mercantilism is similar to economic nationalism for the purpose of building a wealthy and powerful state.
- ❑ Shares Realism's zero-sum world view. Old forms were for purposes of the crown and connected merchants/
- ❑ Gold=Power
- ❑ Term "mercantile system" coined by Smith to
- ❑ This system dominated western European economic thought and policies from the sixteenth to the late eighteenth century. Resurgent in the 19th century with national competition rationale from Friedrich List.

Mercantilism (conditions)

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- The most important Human technology for mercantilism in the sixteenth century was the consolidation of powerful center-states. Administrative capacity, hierarchical organization, rise of domestic merchant classes and royal competition with domestic land owners, use of specie (gold and silver currency-- standardized) over simple barter, establishment of banking, insurance etc...
- Other contributing factors were the establishment of colonies outside Europe, enabled the growth of European commerce and industry relative to agriculture.
 - Technological changes like the caravel. Compass. Chronometer, Sextant permitted more reliable navigation. Dropped transport costs.
- During the mercantilist period, military conflict between nation-states was both more frequent and more extensive than at any time in history.

Policy instruments of mercantilism

- ❑ Bullionism – strength of a nation measured by the amount of precious metal, gold, or silver it acquired.
 - ❑ This dictated favorable foreign trade balance.
- ❑ Each nation tried to achieve self-sufficiency (Autarky)
- ❑ Strong agriculture should be carefully encouraged –but not permit the old landed elites to re-emerge. Crown needed new lands to offset rising landlords.
- ❑ Regulation of commerce to create favorable balance of trade.
- ❑ Sea power needed to control access to foreign markets.
- ❑ Colonies provide captive markets.
- ❑ Large population needed to settle colonies.
- ❑ Avoid luxury items because they took money out of the economy.
- ❑ State action is needed to regulate and enforce the above policies.
- ❑ As it was driven by international competition and moderated by domestic competition among classes, mercantilism took different forms during different times and different countries.

Neo-mercantilism

- ❑ Reasserted in late 19th century--Germany with List, followed by French, persistence of the U.S. protectionism, response to depression of 1870s.
- ❑ Trade protectionism
 - ❑ tariffs, and non-tariff barriers (quotas, health, environmental, standardization, exchange-rate)
- ❑ State subsidies for domestic producers
- ❑ Strategic trade policy, infant industry, Import-substitution industrialization.
- ❑ Deficit in industrialized economies are being mitigated by taxation and by flight of capital from developing countries.
- ❑ Tight state regulation of the economy.
- ❑ Fixed exchange rate, capital/investment controls.
- ❑ From dominant states, imposition of systemic changes to undermine rising powers, e.g. liberal great Britain 19th century, described, sometimes as current financial trade regime.
- ❑ Bi-lateralism

Neo-mercantilism vs. State led

- ❑ State-led policies can look like neo-mercantilist policies.
 - ❑ Strategic investments, tax-breaks, subsidies, or subsidized financing, can all foster investment.
- ❑ State policies to ease transitions, or transfer payments to “loser” groups.
- ❑ Stages of growth theory, with emphasis on state-led development, could be considered neo-mercantilist except...transitional outlook - potentially.

Mercantilism

- Dominant IPE ideology of 16-19th centuries.
- Modern forms also exist.
- Examples of state-led development
- Manipulation of tariff and non-tariff barriers
 - Non-tariff barrier examples
 - Exchange rate
 - Special licensing
 - Excessive Inspections
 - Market specific laws
 - Special tax rules
- Uses economic power to coerce behavior
- Uses position in system to maximize wealth for domestic actors (companies etc)

Theories of Trade

- Relaxation of assumptions still permits and even accentuates potential benefits of trade.
- Increasing returns, or technology differences increase benefits of trade.
- Even with Absolute Advantage in everything, as long as there is a comparative advantage trade increases productivity (or possibility for leisure/non-consumption.)

What's the Problem then.

- Getting from here to there is not costless.
- Specialization puts Portuguese Shepherds and British Vintners out of work, or at least makes them move and learn new skills.
- Dynamic theories include concepts of acquired comparative advantage

Assumptions Behind Pure Theories of Trade

- Costless Transactions
- Full Resource Employment
- Pareto distribution (side-payments to losers.)
- Similar Technology
- Constant Returns to Scale
- Similar tastes
- Costless Factor Movements (land labor capital.)

Comparative Advantage and Gains from Trade

- Absolute Advantage and comparative advantage.
- Gains from trade.

Theories of Trade

- ❑ Ricardo and Comparative advantage
 - ❑ Opportunity Costs of producing less efficient goods
 - ❑ Two Countries, Two commodities, No costs, constant returns to scale
 - ❑ Limited Productive Resources

Absolute Advantage: Units per Labor unit		
	Portugal	England
Wine	12	2
Cloth	6	4
Labor Available	1	1

Theories of Trade: Comparative Advantage

Autarky	Per unit of labor	
Production Schedule	Portugal	England
Either wine	12	2
or cloth	6	4
Opportunity Costs of producing cloth	2 bottles of wine	1/2 bottle of wine

Maximum Consumption if each produces both items is limited.

Autarky Consumption Possibility	Portugal	England
wine	6	1
cloth	3	2
Totals	9	3

England gives up 1/2 bottle of wine per yard of cloth.

Portugal gives up 2 bottles of wine per yard of cloth

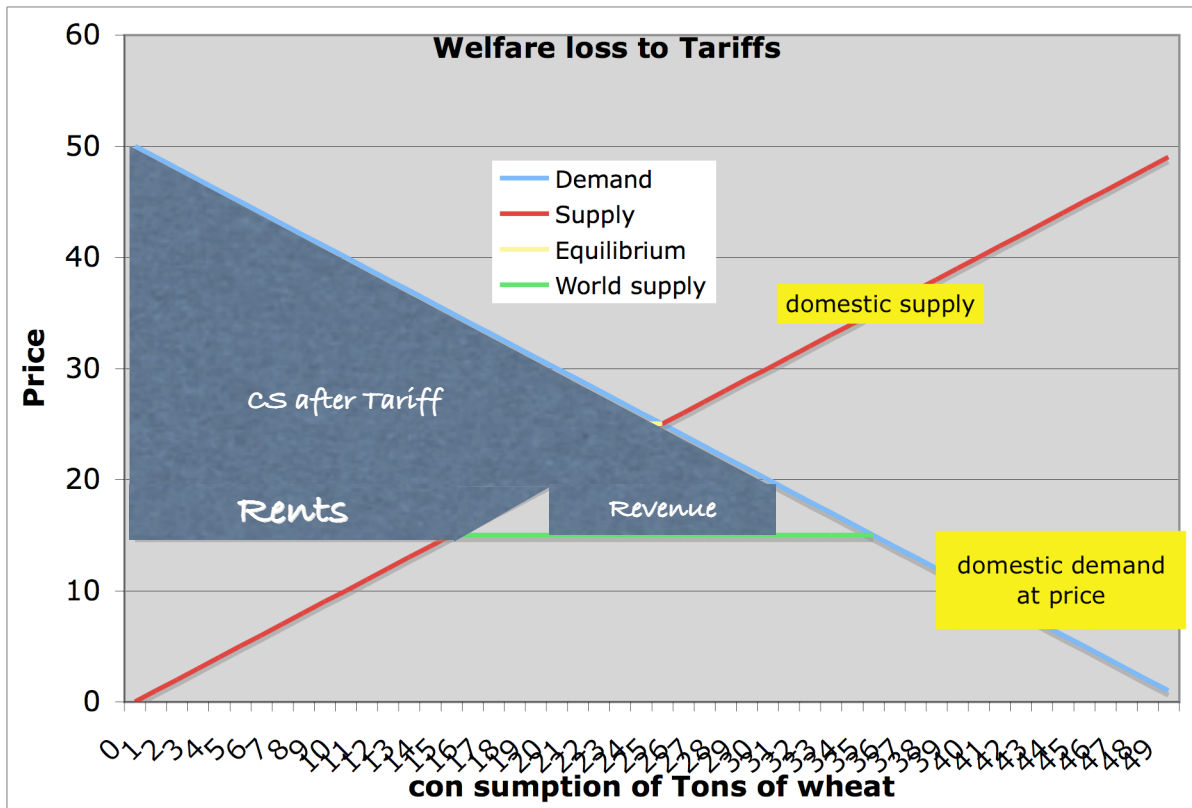
Gains from Trade

Specialized Production	Portugal	England	
Wine	12	0	
Cloth	0	4	
Production	12	4	16
After Trade	Portugal	England	
Wine	6	6	
Cloth	2	2	
Consumption	8	8	16

Alternative Exchange Rates

Consumption with Minimum	Portugal	England	
Wine	6(9)	3(0)	9
Cloth	3(1)	2(4)	5
	9	5	14

Losses From Rent-seeking



Marginalists: rent=lost consumer surplus

Ricardo & Smith & Marx:
Rent= lost reproduction of labour + Lost profit/investment

Ricardo & Smith:
Rent = Starvation of workers.

Marx: Rent = competition among Capitalists, lost investment + greater separation of labor power and labor value.

Pareto Optimality

- Pareto Optimality is the condition that maximizes social benefits. Any move that makes someone better-off with making anyone worse off is said to be towards Pareto optimality.
- Trade can be Pareto optimizing if friction is removed through side-payments or other mechanisms. (Taxes often used for this.)

Side-payments to even out structural adjustments

- Gains from trade or resource mobility are not Pareto optimal.
- Some winners and losers by economic sector or social class.
- Side-Payments offset losses, increase efficiency
 - Trade Adjustment Assistance (TAA).
 - Nafta-Taa
 - Social-security, unem etc...
- Paying for side-payments
 - Taxes taxes taxes

Selecting Side-payment regimes

- Political problems
- Transitional period to implementation
 - All member countries of trade or investment agreement.
 - Domestic players within each
- Sectoral subsidies or supports
 - All member countries
 - Domestic players within each
- Domestic tax and benefit structure
 - Decided by political structure
 - Policy capture by special interests

Externalities: Race to the Bottom

- Artificial comparative advantage
- Comp advantage and Pure theory of trade assume equivalency in tech, and products.
- Gained through differences in social technology or preferences,
 - different power relationships within countries
- Externalization means:
 - Concentration of private benefits, distribution of social costs.
 - Prices are supposed to reflect costs.
 - Social costs in some products not included or delayed for market entree or capture.
- Costs to environment, labor etc transmitted both physically and economically.

Dependency & World Systems

- Dependency Tends to use a Marxian analysis
 - World divided into classes. Capitalist, small capitalists (petit bourgeoisie), proletariat (worker), peasant (rural workers.)
 - First World capitalists extract raw materials from developing countries using help of local classes.
 - Relationship reinforces political economy that favors local client capitalists (compradore) at the expense of the rest of the country.
 - Role of states is to enforce interests of capitalist classes.

Dependency & World Systems

- World System Theory
 - Similar to dependency, but..
- World Divided into Center, Semi-Periphery and Periphery Countries.
- Center Countries
 - Industrialized developed possess most global capital
- Periphery
 - Produce primary goods, configured to limit development, role of government unimportant.
 - Semi-periphery produces basic industrial goods.

Dependency & World Systems

- Dependent position of small states
 - Undiversified economies
 - Producers of raw materials commodities
 - Small economy size prevents scale advantages for production
 - Small economy size limits capital base
 - Single, or limited range of efficient production means many goods imported, sensitivity to swings in commodity prices (terms of trade).
- Local Production of manufactured goods often uses imported technology and capital, local subsidiaries.
 - Stumps development of economic integration into society, production by the rich for the rich, solving using technology and products for richer countries.

Dependency & World Systems

- Economic Penetration Puts Smaller States on Agenda of Bigger States
 - Foreign owned firms, access to resources (strategic resources in particular), or global competition between larger center states both gives latitude and constrains smaller states
- Resisting Foreign Penetration through state ownership concentrates resources in hands of political elites.
 - Common feature of many left and right-wing coups is state assertion over economy. Right-wings tend to be corporatist coercive, left-wing more state owned.
 - Concentration of economy in hands of government brings prospect of patronage politics.
- Some balance in between
 - Dependent Development, the Brazilian Model.

Game-Theoretics- Symmetrical

- Nash equilibrium in Bold, Pareto Optimal in italics
- Prisoner's Dilemma: Models free-riding temptation
 - $DC > CC > \mathbf{DD} > CD$
- Stag Hunt (Multi-player possible) Assurance, Uncertainty
 - $\mathbf{CC} > DC > \mathbf{DD} > CD$
- Chicken
 - $\mathbf{DC} > CC > \mathbf{CD} > DD$
- Deadlock
 - $DC > \mathbf{DD} > CC > CD$
- Coordination Game Battle of Sexes
 - From Husband's perspective $CC > DD > CD = DC$
- Harmony $CC > CD > DC > DD$

Game-Theoretics: Asymmetrical Payoffs

❑ Called Bluff

❑ (Alpha) Powerful Country plays Prisoner's Dilemma.

❑ (Beta) Weaker Country plays chicken

❑ Powerful country has dominant defect strategy because Beta better off with sucker's payoff than with defect-defect outcome. Could model bilateral trade between small and large countries. This is a World-systems like trade model.

	Beta	
Alpha a	3,3	1,4
	4,2	2,1

❑ Suasion-- Could model multi-lateral trade regime led by large power willing to bear costs. Hegemonic Stability, or dominated trade bloc.

❑ Alpha plays Harmony (cc>cd>dc>dd) with a dominant cooperate strategy

❑ Beta has a chicken payoff leading to a preference for defection.

❑ Gains of cooperation are always better than defection for Alpha.

	Beta	
Alpha a	4,3	3,4
	2,2	1,1

	Mercantilism/ Realism	Liberalism	Marxism	Dependency II	World Systems
Unit of analysis	State	Individual	International Social class	State	State-systems
Purpose of econ. Activity	Maximize state interests	Maximize individuals' welfare	Maximize social class interests	Maximize state/social class interests	Maximize national/class interests
Nature of economic activity	Conflictual & zero- sum	Harmonious & non-zero-sum	Conflictual & zero- sum	Conflictual non- zero-sum	Conflictual & zero- sum
Primacy of politics versus Economics	Politics	Should be economics	Dialectic	Economics/ Depends	Economics
Nature of change	Conflictual	Harmonious	Conflictual	Conflictual	Conflictual

***From Birol Yesilada**

Currency Regimes and Politics

- Currency Regime Types
 - Fixed
 - Pegged
 - Float/ dirty float
- Winners and Losers from Ex-Rate Regimes

		Preferred Level	
		High	Low
Degree of float	Low	International Traders and Investors	Export-competing producers
	High	Non-tradable goods producers	Import-competing producers

Financial Crisis- Why it matters

- A financial crisis is a powerful dislocator of resources.
- Can trigger inflation, recession or both.
- Result in either massive unemployment, or powerful reduction in real wages- or both.
- Can- and often do trigger a change in government. Proximal triggers for both democratic and authoritarian transitions.
- Almost always cause change in democratic states.

Mundellian Impossible Trinity

- Only can achieve two of the three following objectives
 - Fixed currency
 - Free Trade/ Investment
 - Monetary Policy Autonomy
- Less important to very large economies
- Investment flows put pressure on currency reserves, reserves maintained by changing interest rates, issuing or buying back debt or devaluing money.

Anatomy of a crisis

- Triggering shocks can come from anywhere in the financial system.
 - Contagion- other similar countries had crisis, investors nervous.
 - Inflation shock- rise in oil or critical imports prices.
 - Real estate bubble
 - Banking sector crisis- a bank collapse reveals fraud and NPL's
 - Business sector collapse, a major corporation collapses- bringing investors and asset base with it.

What do crisis have in common?

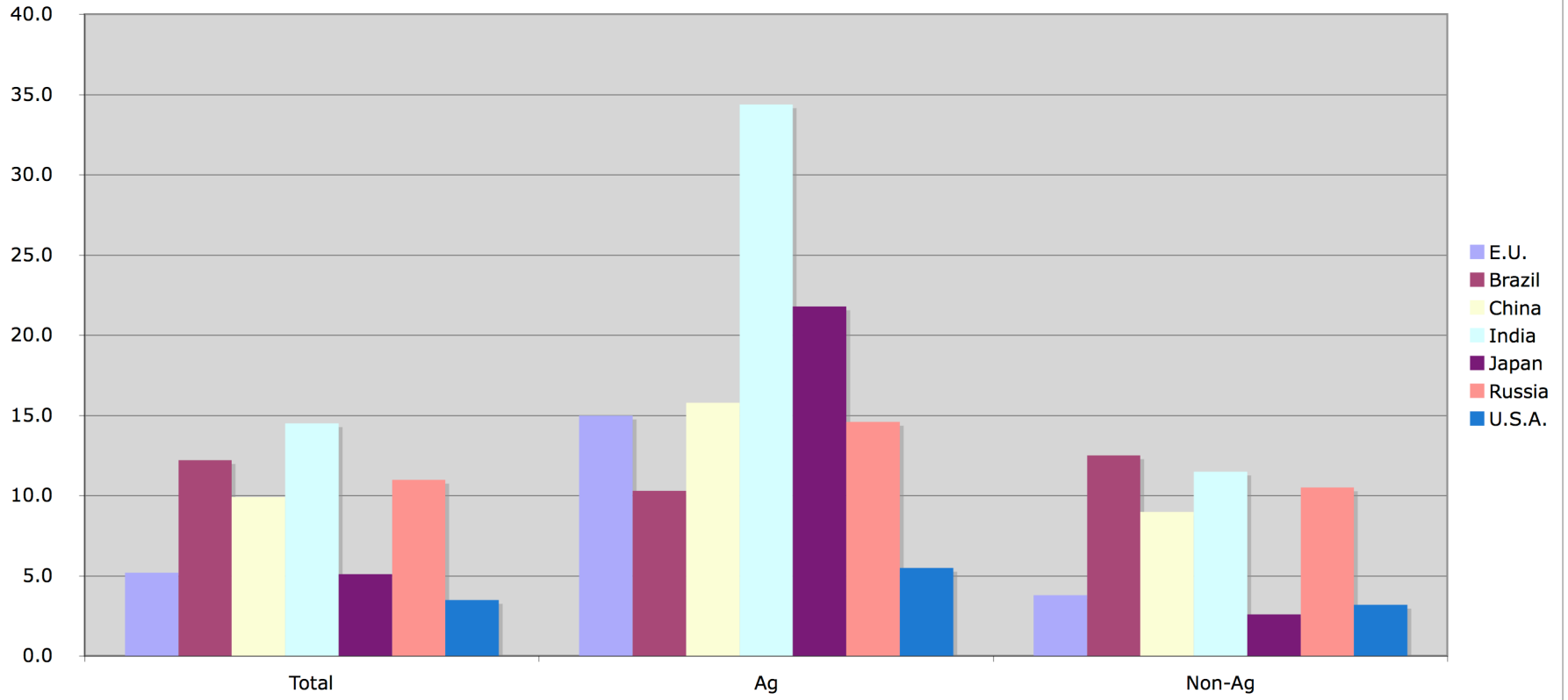
Most crisis have a number of common features.

1. High government borrowing requirement
2. Fairly high existing debt burden.
3. Sovereign debt owed in Foreign Currency
 - Or very high interest domestic currency debt.
4. Often manipulation of exchange rates. High reserves for banks required- but not maintained.
5. Poor regulation or deregulation of finance and business sectors.

Symptoms of Crisis

- Lending Boom: Domestic consumer and real estate loans increase. Decline in productivity not matched by decline in consumption.
- Domestic investment shifting from flattening stocks to real estate. Bank assets in stocks and real estate.
- Gov't borrowing keeps currency demand high, high currency shifts consumption to imports.
- High imports puts pressure on currency, creating risk for investors who lend to government or banks-demand higher interest rates.

Average Tariffs by Grouping



Average Tariffs for Groups by Country

