International Political Economy

We live in a global economy. How many times have you heard or read that short sentence in the last month? If you watch the cable news networks or read the major newspapers, probably more than a couple of times. What does it mean? To paraphrase the famous British economist John Maynard Keynes, I think it means in part that, from my home in North Carolina, I can order an iPod designed by an American company, but manufactured by an East Asian company, order some polo shirts produced in Bangladesh, and buy and sell stocks in British and French companies all before I have finished my morning coffee (which, by the way, was grown in Sumatra). In part, therefore, living in a global economy means the products I regularly consume are as likely to come from a distant country as from the United States.

Living in a global economy also means that global economic forces play a large role in determining many of our career opportunities. Forty years ago, for example, people in my home state could find reasonably well-paying jobs in local textile mills. Today, most of these mills and the jobs they once provided are gone, and few young North Carolinians seek, much less find, employment in this industry. During the same period, however, high-technology firms moved to North Carolina. IBM, Lockheed, GlaxoSmithKline, and many other high-technology firms all operate within a few miles of my home. Charlotte, the state’s largest city, has emerged as one of the country’s largest financial centers, home to one of the nation’s largest banks, Bank of America. High-technology companies and financial institutions today provide thousands of jobs for North Carolinians. Thus, the opportunities available to the typical North Carolinian are far different today than they were only 30 years ago. I’m sure that the state you live in has seen similar changes. The global economy has played a central role in bringing about these changes, shaped by global, rather than national (much less local), economic forces.

International political economy (IPE) studies how politics shape developments in the global economy and how the global economy shapes politics. It focuses most heavily on the enduring political battle between the winners and losers from global economic exchange. Although all societies benefit from participation in the global economy, these gains are not

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distributed evenly among individuals. Global economic exchange raises the income of some people and lowers the income of others. The distributive consequences of global economic exchange generate political competition in national and international arenas. The winners seek deeper links with the global economy in order to extend and consolidate their gains, whereas the losers try to erect barriers between the global and national economies in order to minimize or even reverse their losses. International political economy studies how the enduring political battle between the winners and losers from global economic exchange shapes the evolution of the global economy.

This chapter introduces IPE as a field of study. It begins by providing a broad overview of the substantive issues that IPE examines and the kinds of questions scholars ask when studying these issues. The chapter then briefly surveys a few of the theoretical frameworks that scholars have developed in order to answer the questions they pose. The chapter concludes by looking at the emergence of a global economy in the late nineteenth century in order to provide a broader context for our subsequent focus on the contemporary global economy.

**WHAT IS INTERNATIONAL POLITICAL ECONOMY?**

International political economy studies the political battle between the winners and losers of global economic exchange. Consider, for example, the decision by the Bush administration to raise tariffs on imported steel in the spring of 2002. The decision to raise the steel tariff was prompted by lobbying by the owners of American steel firms and the United Steel Workers of America. The steel industry lobbying for higher tariffs because they were losing from trade. Imported steel was capturing a large share of the American market, resulting in a large number of plant closings and layoffs. Thirty-four American steel mills filed for bankruptcy between 1997 and 2002, forcing about 18,000 workers from their jobs. Steel producers and steel workers recognized that higher tariffs would protect them from this competition, thereby reducing the number of American steel mills in distress and slowing the rate at which steel workers were losing their jobs.

The higher steel tariff had negative consequences for other groups in society, however. The tariff hurt American industries that use steel to produce goods, such as auto manufacturers, because these firms had to pay more for steel. The tariff also harmed foreign steel producers, who could sell less steel in the American market than before the tariff was raised. Groups that suffered from the tariff turned to the political system to try to reverse the Bush administration’s decision. In the United States, the Consuming Industries Trade Action Coalition (or CITAC), a business association that represents firms that use steel (and other imported inputs) to produce other goods, pressured the Bush administration and Congress to lower the steel tariff. Foreign steel producers lobbied their governments to pressure the United States to reverse the decision. In response, the European Union and Japan threatened to retaliate by raising tariffs on goods that the United States exports to their markets and initiated an investigation within the World Trade Organization (WTO)—the
international organization with responsibility for such disputes. The story of
the steel tariff thus nicely illustrates the central focus of international political
economy as a field of study: how the political battle between the winners and
losers of global economic exchange shapes the economic policies that govern-
ments adopt.

The steel tariff also highlights the many distinct elements that interna-
tional political economy must incorporate to make sense of the global
economy. To fully understand the steel tariff, we need to know something
about the economic interests of the businesses and workers who produce and
consume steel. Understanding these interests requires us to know economic
theory. Moreover, we need to know something about how political processes
in the United States transform these economic interests into trade policy. This
requires knowledge of the American political system and the American trade
policy process. In addition, we need to know something about how a policy
decision made by the United States affects businesses and workers based in
other countries (more economic theory for this), and we need to know how
the governments in those countries are likely to respond to these consequences
(which requires knowledge about the political systems in the various coun-
tries). Finally, we need to know something about the role that international
economic organizations like the WTO play in regulating the foreign economic
policies that governments adopt. Thus, understanding developments in the
global economy requires us to draw on economic theory, explore domestic
politics, examine the dynamics of political interactions between governments,
and familiarize ourselves with international economic organizations. Even
though such an undertaking may seem daunting, this book introduces you to
each of these elements and teaches you how to use them to deepen your un-
derstanding of the global economy.

One way scholars simplify the study of the global economy is to divide
the substantive aspects of global economic activity into distinct issue areas.
Typically, the global economy is broken into four such issue areas: the
international trade system, the international monetary system, multinational
corporations (or MNCs), and economic development. Rather than studying
the global economy as a whole, scholars will focus on one issue area in relative
isolation from the others. Of course, it is somewhat misleading to study each
issue area independently. MNCs, for example, are important actors in the
international trade system. The international monetary system exists solely to
enable people living in different countries to engage in economic transactions
with each other. It has no purpose, therefore, outside consideration
of international trade and investment. Moreover, problems arising in
the international monetary system are intrinsically connected to developments
in international trade and investment. Trade, MNCs, and the international
monetary system in turn all play important roles in economic development.
Thus, each issue area is deeply connected to the others. In spite of these deep
connections, the central characteristics of each area are sufficiently distinctive
that one can study each in relative isolation from the others, as long as one
remains sensitive to the connections among them when necessary. We will
adopt the same approach here.
The international trade system is centered upon the WTO, to which some 153 countries belong and through which they have created a nondiscriminatory international trade system. In the international trade system, each country gains access to all other WTO members’ markets on equal terms. In addition, the WTO and its predecessor, the General Agreements on Tariffs and Trade (GATT), have enabled governments to progressively eliminate tariffs and other barriers to the cross-border flow of goods and services. As these barriers have been dismantled, world trade has grown steadily. Today, goods and services worth about $7.6 trillion flow across national borders each year. During the last 10 years, however, regional trading arrangements have arisen to pose a potential challenge to the WTO-centered trade system. These regional trade arrangements, such as the North American Free Trade Agreement (NAFTA), are trading blocs composed of small number of countries who offer each other preferential access to their markets. Scholars who study the international trade system investigate how the political battle between the winners and losers of global economic exchange shapes the creation, operation, and consequences of the WTO-centered system and the emerging regional trading frameworks.

The international monetary system enables people living in different countries to conduct economic transactions with each other. People living in the United States who want to buy goods produced in Japan must be able to price these Japanese goods in dollars. In addition, Americans earn dollars, but Japanese spend yen, so somehow dollars must be converted into yen for such purchases to occur. The international monetary system facilitates international exchange by performing these functions. When it performs these functions well, international economic exchange flourishes. When it doesn’t, the global economy can slow or even collapse. Scholars who study the international monetary system focus on how political battles between the winners and losers of global economic exchange shape the creation, operation, and consequences of this system.

Multinational corporations occupy a prominent and often controversial role in the global economy. A multinational corporation is a firm that controls production facilities in at least two countries. The largest of these firms are familiar names such as Ford Motor Company, General Electric, and General Motors. The United Nations estimates that there are more than 82,000 MNCs operating in the contemporary global economy. These firms collectively control about 810,000 production plants and employ about 77 million people across the globe. Together, they account for about one-quarter of the world’s economic production and about one-third of the world’s trade. MNCs shape politics because they extend managerial control across national borders. Corporate managers based in the United States, for example, make decisions that affect economic conditions in Mexico and other Latin American countries, in Western Europe, and in Asia. Scholars who study MNCs focus on a variety of economic issues, such as why these large firms exist and what economic impact they have on the countries that host their operations. Scholars also study how the political battle between the winners and losers of MNC activity shapes government efforts to attract and regulate MNC activities.
Finally, a large body of literature studies economic development. Throughout the postwar period, developing country governments have adopted explicit development strategies that they believed would raise incomes by promoting industrialization. The success of these strategies has varied. Some countries, such as the Newly Industrializing Countries (NICs) of East Asia (Taiwan, South Korea, Singapore, and Hong Kong) have been so successful in promoting industrialization and raising per capita incomes that they no longer can be considered developing countries. Other countries, particularly in sub-Saharan Africa and in parts of Latin America, have been less successful. Governments in these countries adopted different development strategies than the NICs throughout much of the postwar period and realized much smaller increases in per capita incomes. Students of the politics of economic development focus on the specific strategies that developing countries’ governments adopt and attempt to explain why different governments adopt different strategies. In addition, these students are concerned about which development strategies have been relatively more successful than others (and why) and about whether participation in the international economy facilitates or frustrates development. In trying to make sense of these aspects of development, IPE scholars emphasize how the political battle generated by the distributive consequences of the global economy shapes the development strategies that governments adopt.

Those who study the global economy through the lens of IPE are typically interested in doing more than simply describing government policies and contemporary developments in these four issue areas. Most scholars aspire to make more general statements about how politics shape the policies that governments adopt in each of these issue areas. Moreover, most scholars want to draw more general conclusions about the consequences of these policies. As a result, two abstract and considerably broader questions typically shape IPE scholarship. First, how exactly does politics shape the decisions that societies make about how to use the resources that are available to them? Second, what are the consequences of these decisions? Because these two overarching questions are central to what we cover in this book, it is worth taking a closer look at each of them now.

How does politics shape societal decisions about how to allocate available resources? For example, how does a society decide whether to use available labor and capital to produce semiconductors or clothing? Although this question might appear quite remote from the issue areas just discussed, the connections are actually quite close. The foreign economic policies that a government adopts—its trade policies, its exchange rate policies, and its policies toward MNCs—affect how that society’s resources are used. A decision to raise tariffs, for example, will encourage business owners to invest and workers to seek employment in the industry that is protected by the tariff. A decision to lower tariffs will encourage business owners and workers currently employed in the newly liberalized industry to seek employment in other industries. Decisions about tariffs, therefore, affect how society’s resources are used. Foreign economic policies are, in turn, a product of politics, the process through which societies make collective decisions. Thus, the study
of international political economy is in many respects the study of how the political battle between the winners and losers of global economic exchange shapes the decisions that societies make about how to allocate the resources they have available to them.

These decisions are complicated by two considerations. On the one hand, all resources are finite. As a result, choices about how to allocate resources will always be made against a backdrop of scarcity. Any choice in favor of one use therefore necessarily implies a choice to forgo another possible use. On the other hand, in every society, groups will disagree about how available resources should be used. Some groups will want to use the available resources to produce cars and semiconductors, for example, whereas others will prefer to use these resources to produce clothing and agricultural products. Societies consequently will always confront competing demands for finite resources. One of the important goals of IPE as a field of study is to investigate how such competing demands are aggregated, reconciled, and transformed into foreign economic policies.

The second abstract question asks what are the consequences of the choices that societies make about resource allocation? These decisions have two very different consequences. Decisions about resource allocation have welfare consequences—that is, they determine the level of societal well-being. Some choices will maximize social welfare—that is, they will make society as a whole as well-off as possible given existing resources. Other choices will cause social welfare to fall below its potential, in which case different choices about how to use resources would make society better off. Decisions about resource allocation also have distributional consequences—that is, they influence how income is distributed between groups within countries and between nations in the international system.

Welfare and distributional consequences are both evident in the American steel tariff. Because the tariff makes it more profitable to produce steel in the United States than it would be otherwise, some investment capital and workers, who might otherwise be employed in highly efficient American industries such as information technology or biotechnology, will be used in the less efficient American steel industry. The tariff thus causes the United States to use too many of its resources in economic activities that it does less well and too few resources in activities that it does better. As a consequence, the United States is poorer with a high tariff on steel than it would be without it.

The steel tariff also redistributes income. Because the tariff raises the price of steel in the United States, it redistributes income from the consumers of steel, such as American firms that use steel in the products they manufacture and the American consumers who purchase goods made out of steel, to the steel producers. In addition, because the tariff makes it more difficult for foreign steel firms to sell in the American market, it redistributes income from foreign steel producers to American steel producers. The steel tariff, like many economic policies, affects both the level and the distribution of income within a society.

These two abstract questions give rise to two very different research traditions within IPE. One tradition focuses on explanation, and the second focuses on evaluation. Explanatory studies, which relate most closely to our first
abstract question, are oriented toward explaining the foreign economic policy choices that governments make. Such studies most often attempt to answer "why" questions. For example, why does one government choose to lower tariffs and open its economy to trade, whereas another government continues to protect the domestic market from imports? Why did governments create the WTO? Why do some governments maintain fixed exchange rates whereas others allow their currencies to float? Why do some governments allow MNCs to operate in their economies with few restrictions, whereas other governments attempt to regulate MNC activity? Each of these questions asks us to explain a specific economic policy choice made by a government or to explain a pattern of choices within a group of governments. In answering such questions, we are most concerned with explaining the policy choices that governments make and pay less attention to the welfare consequences of these policy choices.

**Evaluative studies**, which are related most closely to our second abstract question, are oriented toward assessing policy outcomes, making judgments about them, and proposing alternatives when the judgment made about a particular policy is a negative one. A welfare evaluation is interested primarily in whether a particular policy choice raises or lowers social welfare. For example, does a decision to liberalize trade raise or lower national economic welfare? Does a decision to turn to the International Monetary Fund (IMF) and accept a package of economic reforms promote or retard economic growth? More broadly, do current policies encourage society to use available resources in ways that maximize economic welfare, or would alternative policies that encouraged a different allocation result in higher economic welfare? Because such evaluations are concerned with the economic welfare consequences of policy outcomes, they are typically based on economic criteria and rely heavily upon economic theories.

Scholars also sometimes evaluate outcomes in terms that extend beyond narrow considerations of economic welfare. In some instances, scholars evaluate outcomes in terms of their distributional consequences. For example, many nongovernmental organizations are highly critical of international trade because they believe that workers lose and business gains from trade liberalization. Implicit in this criticism is an evaluation of how global trade distributes income across groups within countries. Evaluations may also extend the frame of reference within which outcomes are evaluated beyond purely economic efficiency. For example, even those who agree that international trade raises world economic welfare might remain critical of globalization because they believe that it degrades the environment, disrupts traditional methods of production, or has other negative social consequences that outweigh the economic gains. Explanation and evaluation both play an important role in international political economy. This book, however, focuses primarily upon explanation and, secondarily, upon evaluating the welfare consequences of government policies.

**STUDYING INTERNATIONAL POLITICAL ECONOMY**

Scholars working within the field of IPE have developed a large number of theories to answer the two questions posed earlier. Three traditional schools of political economy—the mercantilist school, the liberal school, and the