GLOBAL POLITICAL ECONOMY

THEORY AND PRACTICE

SECOND EDITION

THEODORE H. COHN

Global Political Economy: Theory and Practice

Second Edition

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To Shirley

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Preface

This book introduces undergraduate students and beginning graduate students to the complex and important issues of global political economy. I wrote the book because of a long-held conviction that it is only possible for students to understand the broader implications of international political economy (IPE) issues by examining them in a theoretical context. Without the organizing framework of theory, it is difficult to make sense of the growing body of IPE facts and statistics and to interpret events in the global political economy. Thus, the text takes a comprehensive approach to the study of IPE, focusing on both theory and practice. To help in drawing connections between the theory and the substantive issues, the book focuses on three major themes or challenges: globalization, North-North relations (among the developed countries), and North-South relations (among the developed countries of the North and the developing countries of the South). Considerable space is also devoted to the emerging centrally planned economies of the former Soviet bloc and Soviet Union, which are becoming increasingly integrated in the capitalist global political economy.

Although a major focus of the text is globalization, I do *not* claim that globalization is leading to some sort of a world society or world government. Indeed, considerable space is devoted to the increasing importance of regional blocs and organizations such as the European Union, the North American Free Trade Agreement, and Mercosur, and Chapter 9 is devoted to the subject of regionalism. Furthermore, there is discussion throughout the text of the interconnections between domestic and international issues both globally and regionally. These domestic-international interactions are generally more important in the study of IPE than in the study of security issues.

Changes in the Second Edition

The second edition of this book is revised and updated throughout. Some of the most important changes including the following:

- The second edition contains an assessment of the role of civil society groups, and there is some discussion of the theoretical approaches (such as Gramscian analysis) to civil society. The substantive chapters discuss the response of civil society groups to the management of international trade, foreign debt, international development, and foreign investment issues.

- Chapter 2 contains a more detailed discussion of global economic relations before World War II to provide the student with more historical background.
- Chapter 6 on international monetary relations includes a substantially expanded and updated discussion of European monetary relations, dollarization and the changing role of the U.S. dollar, and monetary uncertainty in East Asia.
- Chapter 7 on foreign debt discusses a number of newer developments and policies, such as the Heavily-Indebted Poor Countries Initiative, and provides more analysis of debt problems in Eastern Europe and the former Soviet Union countries.
- Chapter 8 on global trade relations provides considerable detail on the first seven years of experience with the World Trade Organization and on the negotiations leading to the accession of China to the World Trade Organization.
- Some of the most extensive revisions in the book are in Chapter 9 on regionalism and the global trade regime. The section on North America in the first edition has been expanded and is now entitled the "Western Hemisphere." This section discusses the North American Free Trade Agreement, the Mercosur (or Southern Common Market Treaty), and the negotiations to form a Free Trade Area of the Americas. The sections on Europe and Japan/China/East Asia are also substantially expanded and updated.
- Chapter 10 on multinational corporations has been extensively revised. The section on attempts to develop a regime for foreign direct investment contains expanded discussions of bilateral investment treaties and regional approaches, and an extensive discussion of the attempt by the Organization for Economic Cooperation and Development to form a multilateral agreement on investment. The chapter also introduces a new section on the interaction of business firms with nongovernmental organizations.
- As with Chapter 9, Chapter 11 on international development is one of the most extensively revised chapters. The discussion of development strategies is substantially updated to include a discussion of the World Bank's attempts to alter its approach to development since 1995. Updated discussions are also provided on development experiences in East Asia, sub-Saharan Africa, and Latin America.

In addition to changes in the substantive chapters, the book contains revised and updated discussions of theory and of the relationship of theory to practice.

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I am grateful for the comments, advice, and support of a number of individuals in writing and revising this book. First, I want to thank Mark Zacher of the University of British Columbia and Michael Webb of the University of Victoria for providing helpful advice and comments on numerous occasions with regard to the organization and content of the first edition of the text. I would also like to thank Benjamin Cohen of the

University of California, Santa Barbara, for his advice on monetary issues for the second edition. I want to recognize the contribution the late Harold K. Jacobson of the University of Michigan has made to my studies. The emphasis of this IPE text on international institutions and governance owes a great deal to the interest I developed in the subject years ago when Professor Jacobson was my Ph.D. supervisor. I am indebted to the following external reviewers for providing useful comments that were extremely helpful in making revisions. Some of these reviewers provided comments for the first edition, and others for the second edition: Sherry L. Bennett, Rice University; Vicki Birchfield, Georgia Institute of Technology; Kurt Burch, University of Delaware; Jeffrey Cason, Middlebury College; Vincent Ferraro, Mount Holyoke College; David N. Gibbs, University of Arizona; Vicki L. Golich, California State University, San Marcos; Robert Griffiths, University of North Carolina at Greensboro; Beverly G. Hawk, University of Alabama at Birmingham; Michael J. Hiscox, University of California, San Diego; Matthias Kaelberer, University of Northern Iowa; Quan Li, Florida State University; Thomas Oatley, University of North Carolina at Chapel Hill; Howard Richards, Earlham College; David E. Spiro, University of Arizona; and Kenneth P. Thomas, University of Missouri, St. Louis. In addition, thanks are due to several colleagues at Simon Fraser University with whom I discussed various aspects of the text, including Stephen McBride, Michael Howlett, Tsuyoshi Kawasaki, James Busumtwi-Sam, and Anil Hira.

The competent editorial staff at Longman Publishers has given active support to this book. For the first edition, I especially want to thank Jennie Errickson and Ellen MacElree for the time and effort they put into the project. For the second edition, I greatly appreciate the careful attention Anita Castro and Jeff Stiles (of Shepherd, Inc.) have given to ensure that the revisions were included in a timely and careful manner. I also appreciate the assistance of others at Longman, and would especially like to thank Eric Stano and Megan Galvin-Fak. Finally, I would like to thank the copy editors for the careful work they did for both editions of the text.

My acknowledgments would not be complete without mentioning the important role my students have played over the years in asking insightful questions, raising important issues, and giving me feedback as to what aspects of IPE they found clear or confusing. My sons Daniel and Frank also gave me assistance in a variety of areas, and I want to thank them for their patience with my extended working hours. Finally, I am dedicating this book to my wife Shirley, for her caring advice, support, and encouragement.

Contents

PART I

Introduction and Overview

The field of international relations traditionally focused primarily on the study of security issues and largely ignored economic issues, but it has become increasingly evident that the political, economic, and social aspects of international relations are closely intertwined. As a result, *international political economy* (IPE) has emerged as an important area of study in international relations. Chapter 1 provides answers to some basic questions such as "What is IPE?" and "Why is IPE a relatively new area of study?" It then discusses the basic themes of this book and introduces the main theoretical perspectives in the field. Chapter 2 begins with a brief historical discussion of the development of the international economy from the fifteenth century to World War II. Most of the chapter then provides a general overview of the world economy since World War II, with particular emphasis on the institutions developed to manage international economic relations.

CHAPTER 1

Introduction

In July 1944, while World War II was still raging in Europe and the Pacific, delegates from 44 countries held a conference in the small resort town of Bretton Woods, New Hampshire, to reach a broad-ranging agreement for economic cooperation. The **Bretton Woods system** that emerged from the conference helped to shape international economic relations in the postwar era. After World War II, however, the emergence of the Cold War between the United States and the Soviet Union became the central concern of Western policymakers, and international economic issues often seemed to be of lesser priority. Thus, postwar international relations scholars placed primary emphasis in their research on security issues related to the Cold War, or "high politics." International economic issues, by contrast, were considered to be relatively nonpolitical and were relegated to the area of "low politics." As this book will discuss, by the late 1960s and early 1970s it became increasingly evident to both policymakers and academics that they had underestimated the political importance of international economic issues. Indeed, some of the most contentious international issues in the 1970s were both economic and political by nature. It was at about this time that IPE, which examines the interaction among the political, economic, and social aspects of international relations, emerged as an important field of study. A few examples of major issues and events clearly demonstrate how international politics and economics are often closely intertwined.

The Persian Gulf War In August 1990, Iraq invaded its much smaller neighbor Kuwait and was in a position to control about one-fifth of the oil production of the Organization of Petroleum Exporting Countries (OPEC). The Western industrial states and Japan were concerned not only about the strategic implications of the Iraqi invasion, but also about the possible economic effects in view of their high degree of dependence on Middle East oil imports. When Iraq failed to withdraw from Kuwait by a specified date, the United Nations Security Council endorsed the use of force by a U.S.-led military coalition against Iraq. Because one Communist regime after another in Eastern Europe had disintegrated in 1989 and the Soviet Union itself was on the verge of dissolution, the United States was able to engage in military actions against Iraq without concerns about any counteraction from the Soviets. Nevertheless, the American *economic* position was no longer as predominant as it had been in the 1950s and 1960s. The United States therefore insisted that Japan, Germany, Saudi Arabia, and Kuwait provide a substantial amount of funding to help finance the Gulf War effort (Japan and Germany did not participate in the military operations). A close relationship exists between economic "wealth" and political "power" internationally, and the cost-sharing plan agreed to in the Gulf War could serve as a model for some future U.S.-led military operations.

European Integration In 1951, six Western European countries (France, West Germany, Italy, Belgium, the Netherlands, and Luxembourg) joined together to form the European Coal and Steel Community (ECSC), which was designed to coordinate the policies of member states and reduce their trade barriers in coal and steel. Although the ECSC was designed to promote *economic* integration of the member countries' coal and steel resources, the reasons for its formation in 1951 were primarily *political.* The French foreign minister, Robert Schuman, had two major purposes in developing the plan for the ECSC: first, to meet U.S. demands that West Germany be rebuilt to help deter any aggression by the Soviet Union, and second, to allay French domestic fears of renewed aggression by a rearmed Germany. Over the centuries, Germany and France had repeatedly fought over access to coal and steel resources in border areas such as Alsace-Lorraine. It was therefore felt that a sharing of coal and steel resources in the ECSC would help rebuild Germany and also make future wars between France and Germany virtually impossible. Thus, the preamble to the ECSC treaty states that the member countries wish "to create, by establishing an economic community, the basis for a broader and deeper community among peoples long divided by bloody conflicts."[1]

The ECSC was successful in integrating the coal and steel resources of the six member states, and the members agreed to extend it to a full-scale regional integration agreement with the formation of the European Economic Community (EC) in 1957. Today, this community—which is now called the **European Union (EU)**—has 15 full members and a large number of associate member states. One of the original purposes of economic integration in Europe—to end armed hostilities and war between France and Germany—has certainly been achieved.

World Bank Loans to Third World Countries This book will show that politics and economics often are inextricably linked in the decision making of the major international economic organizations. Such linkages are evident in the lending activities of the *World Bank,* which is the largest source of **multilateral** development finance for Third World countries (also called economically less developed countries or LDCs). The *Articles of Agreement* of the World Bank state that the bank "shall not interfere in the political affairs of any member" and that "only economic considerations shall be relevant" to its lending decisions.[2] Many analysts argue, however, that the bank's loans are inevitably based on political as well as economic considerations. For example, the World Bank has had a clear preference for lending to countries that emphasize private enterprise, and this preference became far more pronounced after the Third World foreign debt crisis in the 1980s (the debt crisis is discussed in Chapter 7). Although bank officials argue that those countries with a private market orientation are more likely to be economically efficient, the bank's preference for private enterprise is also based on the political and ideological leanings of its most powerful members—the advanced industrial states. In the 1950s to 1970s, the bank gave some support to a Third

World development strategy that combined state action with private entrepreneurship, and it provided finance for some **infrastructure** projects such as roads, railways, airports, water systems, and public utilities that involved state-owned corporations. Even in these early years, however, the bank showed a definite preference for private enterprise, and one noted observer of the global political economy has written that Eugene Black, World Bank president from 1949 to 1962, was "inclined to talk as if there were some kind of exclusive relationship between political freedom and private enterprise, and as if he believed that his main task is therefore to defend the only true economic faith throughout the world."[3]

In the 1980s the bank followed such national leaders as British Prime Minister Margaret Thatcher and U.S. President Ronald Reagan in a shift to the Right, and was far more inclined to view governments and public enterprise as hindrances to growth. Thus, World Bank structural adjustment loans (SALs) to indebted Third World countries in the 1980s and 1990s have been linked with the agreement of these countries to institute policies promoting privatization, deregulation, and trade liberalization. In sum, international politics and international economics have been so intertwined in the area of Third World development policy that the World Bank has been both unwilling and unable to fully follow the directive of its Articles of Agreements that its loans should be based solely on economic considerations.

The Boeing Company's Merger with McDonnell Douglas Corporation This book demonstrates that the economic activities of private actors such as international banks and multinational corporations often have major political implications. A prime example of such political-economic linkages is evident in the decision of two American aircraft companies—Boeing and McDonnell Douglas—to merge their operations in early 1997. When the merger proposal was first announced, the EU swiftly raised objections and threatened to retaliate against Boeing, which was based in Seattle, Washington (a decision was later made to move Boeing headquarters to Chicago, Illinois). The EU's concerns stemmed largely from the fact that Boeing had a much larger market share for commercial aircraft than Europe's Airbus Consortium. The Europeans feared that spillovers as a result of the McDonnell Douglas Corporation's experience with defense production, and an increase in defense-related public funding for research and development would enable Boeing to increase its domination of the civil aircraft business. Furthermore, the Europeans objected to the 20-year contracts with exclusive-supplier provisions that Boeing signed with three U.S. airlines—Delta, American, and Continental. Although the merger was approved by the U.S. Federal Trade Commission and supported by the White House, Boeing had to be concerned about European retaliation. The Europeans could not block a merger between two U.S. companies, but they threatened to impose fines for violations of their competition rules that would make it difficult for Boeing to operate in Europe. They also threatened to withdraw from the 1992 U.S.-EU bilateral civil aircraft agreement, which was aimed at limiting direct and indirect subsidies in the aircraft sector. To avoid these actions, Boeing eventually agreed not to enforce the exclusive-supplier provisions of its agreements with the three U.S. airlines, to supply information to the EU about the indirect subsidies it gained from government-sponsored research, and to provide some benefits to European companies.

The United States has initiated similar clashes with Europe over civil airlines issues. Indeed, after years of bitter disputes over European government subsidies to Airbus, which contributed to its growing sales vis-à-vis Boeing, the United States pressured the Europeans to sign an agreement in 1992 limiting the Airbus subsidies. Almost 10 years later in 2001, the United States was expressing strong concerns about Airbus's increasing market share and about financing by EU governments for a new Airbus superjumbo jet that would compete directly with Boeing's 747. The civil airline industry has been described as being "the most politicized in the world—apart from the defense industry," with which it is closely tied.[4] However, as global competition increases in a wide range of economic areas, disputes such as those involving Boeing and Airbus will become more frequent. Because governments often feel a stake in the welfare of their domestically based multinational corporations (MNCs), disputes over economic market share often become highly politicized.

The "Nixon Economic Shocks" This book shows that economics and politics are closely intertwined in foreign policymaking. On August 15, 1971, President Richard Nixon responded to growing U.S. balance of payments deficits by suspending the convertibility of the U.S. dollar into gold, and imposing a ten percent surcharge on all dutiable imports. These "Nixon shocks" will be explained fully later in this book, in the chapters on monetary and trade relations. What is of interest here is the reaction of Henry Kissinger, who was President Nixon's national security adviser (and later secretary of state), to the crisis with Europe and Japan surrounding the "Nixon shocks." Kissinger later wrote in his memoirs:

> My own participation in the economic deliberations during this period was peripheral. From the start I had not expected to play a major role in international economics, which—to put it mildly—had not been a central field of study for me. Only later did I learn that the key economic policy decisions are not technical but political. At first I thought that I had enough on my hands keeping watch on the State and Defense Departments and the Central Intelligence Agency without also taking on Treasury, Commerce, and Agriculture. I took a crash "tutorial" from Professor Richard N. Cooper of Yale University to learn the rudiments of the subject. I appointed the brilliant economists Fred Bergsten and Robert Hormats to my staff.[5]

The foregoing examples demonstrate that politics and economics are often inextricably linked in the real world of international relations. Before discussing the purposes and themes of this book, we need to address two important questions: What is IPE? And why is IPE a relatively new area of study?

What Is International Political Economy?

As a field of study that bridges the disciplines of politics and economics, IPE is concerned with the interaction between "the state" and "the market." The state and the market, in turn, are associated with the (political) pursuit of power and the (economic) pursuit of wealth. As the political component of IPE, a *state* is a sovereign territorial unit with a government and a population. As the economic component, the **market** is "the co-ordinating mechanism where the forces of supply and demand in an economy determine prices, output and methods of production via the automatic adjustment of price movements."[6]

An inherent tension often exists between the state and the market. The state is concerned with preserving national sovereignty and unity while the market is associated with economic openness and the breaking down of state barriers.[7] For example, the 1988 Canada-U.S. Free Trade Agreement (CUSFTA) extended the "geographic space" to include an open market between the two countries, but many Canadians feared that this expanded market posed a threat to Canadian sovereignty in some areas such as energy, foreign investment, and cultural industries. When CUSFTA was extended to form the **North American Free Trade Agreement (NAFTA)** in 1994, many Mexicans were concerned that NAFTA might encroach on their sovereignty in areas such as energy and agriculture. Although the United States is a much larger economy than its two North American neighbors, many Americans feared that NAFTA would lead to a loss of national control over such issues as employment and the environment.

Despite the inherent tensions between states and markets, they also often have a complementary and even symbiotic relationship. Domestically, states establish rules to protect private property rights and to provide infrastructure such as transportation and communications facilities required for market transactions. Internationally, states join in agreements and form organizations to promote economic openness and stability. Furthermore, there is often a close relationship between a state's wealth and market size on the one hand and its military and political power on the other. As interdependence has increased, states have been drawn more closely into the competitive forces of the world economy. Thus, states today are sometimes called *competition states* because they are closely involved in supporting research and development in high-technology sectors, in restructuring industry, and in deregulating financial markets.[8] The impressive economic growth rates of some states seem to be closely related to their success in fostering a symbiotic relationship with the competitive marketplace. As we will discuss, Japan and the newly industrializing economies (NIEs) of East Asia (Hong Kong, Singapore, South Korea, and Taiwan) were especially successful in fostering such state-market relationships from the 1960s to the 1980s.

Although state-market interactions continue to be the core issue in the study of IPE, we are also concerned with other types of organizational relationships. Primary among these is the interaction between states and MNCs—also referred to as transnational corporations. The MNC is the main nonstate actor with which the state must contend today. Indeed, the 600 largest MNCs now each benefit from worldwide sales of more than $1 billion, and together they produce more than 25 percent of world gross domestic product; the 350 largest corporations account for about 40 percent of world trade. As is the case with states and markets, there is an inherent tension between the state and the MNC, but they can also have a complementary and cooperative relationship.

The traditional view of the MNC is that it is closely linked with the "home" state where its headquarters are located. Although the MNC opens foreign branch plants in "host" countries, its main financial, and research and development activities remain firmly planted in the home country. The directors and shareholders in the home country also retain primary responsibility for management of the MNC's foreign operations. From this perspective, the home state is in a more powerful position than its