LIBERERAL THEORY OF INTERNATIONAL POLITICAL ECONOMY

What is IPE?

This is the most basic aspect of the discipline. Those of you who study economics in the business school may be taught that there are no political influences on economics; however, in a Political Science class you will get a different perspective. From this perspective, politics has a great role in economic life and the study of IPE is the study of how politics influences economics relations within nations and between nations. When I say economic relations I mean the buying and selling of goods and services across borders, the flow of investment around the world, the wealth or poverty of regions and nations, and the ways in which economic power influences the political relationships among states (everything from alliances to war).

From the perspective of a political leader (imagine you are President or Prime Minister of a nation), you are concerned with two major issues:

1. What makes a nation wealthy? How can you design policies that make your nation wealthy or wealthier than it is now?
2. How can you design policies that spread that prosperity to your people? In theory you must do that to get reelected if you rule a democracy. Or if you rule in an authoritarian state you need to spread the wealth to prevent yourself from being overthrown. Then again, you may just be trying to enrich yourself. So you hoard your own nation's wealth, keep your own people poor and eventually face a potential backlash by millions of impoverished people when they discover how you have plundered the nations resources and the people's work to make yourself wealthy.

From the perspective of scholars and political leaders alike, the first step in answering the above question is to answer the following questions:

- What is the proper role of government in economic activity?
- How much of a role should government play?
- Is deep involvement of the government they key to economic growth or is it the one thing that is sure to doom economic growth?
- To make a nation wealthy doe the government lead or get out of the way or lead in some areas while letting others flow naturally?

The role of theory

Theories of international political economy provide different ways of answering the above questions. Theories show the different ways these questions have been answered by scholars and policy makers and also allows for an assessment of how well these theories work. Below I am going to describe four leading theories. They will provide a framework through which you can analyze everything you are reading.

We'll discuss three main bodies of theory: Economic Liberalism, Economic Nationalism, and Economic Structuralism. Economic Structuralism has two variants: Marxism and Dependency. Liberalism, Nationalism, and Dependency are capitalist theories. They all are based on the idea that creating wealth is the goal of economic activity. They differ on how that should be done. Marxism, however, is not a capitalist theory. Its argument is very different from the others: capitalism -- the creation of wealth and accumulation of profit -- is evil to Marxists.

One more thing about theory is important. Theories are models of how the world works. They are tools for analysis. You will find contradictions within the theories and aspects that don't make sense to you. That's good. The world is much more complex than any theory could ever illustrate, so be critical of theory and skeptical of theory.

Economic Liberalism (often called Laissez-faire liberalism, or internationalism, or globalism)

The theories of liberalism were stated best by Adam Smith in *The Wealth of Nations*, 1776. The key to national wealth and therefore national power is economic growth. The key to economic growth is free trade – the free flow of goods and services and investment across borders. Political leaders should allow trade between nations to expand and deepen and keep government intervention in that trade down to a minimum. This means that imports (products from other nations' companies that are sold in your nation) and exports (products from your nations' companies that you try to sell in other countries) should flourish with as little restriction as possible.

Liberals want the marketplace to make the economic decisions, not the government. This may not make sense yet, but it will further down the page. Just hold the thought for a moment.

Here's the problem as liberals see it. Governments have several tools they use to interfere or influence the flow of trade: tariffs, quotas, non-tariff barriers, and bans. Let's talk about tariffs first and explain their purpose. A tariff is a tax imposed by a government on a product as it crosses a border. So for instance a government might use a 10% tariff on all foreign shoes being sold in the US. This means that for the privilege of access to the US marketplace every foreign shoe company must pay the US government a 10% tariff. So if a pair of shoes cost $40, then $4 goes to the US government for every pair of shoes that enters the US. Generally, that means that a shoe that might have cost $40 without the tariff winds up costing you $44 when you try to buy it. Traditionally every government in the world places tariffs on every product that enters its marketplace. A 10% tariff is a low one.

So, let's analyze a fictitious market for chalk. Assume we live in State A. Now there's a company in Richmond (Richmond Chalk) that sells its chalk for $100 per box (great chalk!). There is also the Foreign Chalk Co. from State B – a foreign country) and it makes its chalk, ships it across the Pacific and into Richmond and sells it for $90 per box. The quality of the chalk is the same, but the price is different. Maybe Foreign Chalk Co. pays its workers less or has some new process technologies which make it cheaper to make chalk. Anyway, as a chalk consumer you will go down to Target or Wal-Mart and you will probably buy the $90 chalk from the Foreign Chalk Co. because you want to save $10. But there is a local congressman in Richmond. And he's worried that Richmond Chalk will go out of business because the Foreign Chalk Co. sells the same quality chalk for less money. He wants to protect that local business from the foreign competition. There are 3,000 Richmond Chalk jobs that will be lost if Richmond Chalk goes out of business. The congressman may be blamed for it. But if he can somehow protect the home company from foreign competition, he gets the credit and gets reelected. So he lobbies the leaders of the House of Representatives and he tries to make some deals. There's a big vote coming up. The President of the US wants to invade Iran and he asks for a congressional resolution in support of overthrowing the Iranian government. The Richmond congressman thinks it's a bad idea and is inclined to vote against it, but he then proposes a deal. He says: "Mr. President, I will support the resolution calling for the overthrow of the Iranian government if you impose a 20% tariff on foreign chalk." The President says, "Done!"

Now, when you go to Target or Wal-Mart to buy chalk here are the prices: Richmond Chalk $100 per box and Foreign Chalk Company $108 per box ($90 per box, plus the 20% tariff -- $18). Now which one will you buy? You'll buy Richmond Chalk and save $8 per box. Richmond jobs are saved. And they lived happily ever after.

Not according to liberals. Liberals see it differently. No one lives happily every after. Here's how liberals see it:

- You now pay $10 more for each box of chalk. Not only that, but Richmond Chalk may raise its prices to $105 a box and it will still be cheaper than the Foreign Chalk Co. chalk.
- Richmond Chalk has been rewarded for its inefficiency. It could not compete against the Foreign Chalk Co., but it is rewarded for that.
- The Foreign Chalk Co. is punished for being efficient. It was winning the competition, but it winds up getting punished through a political deal.
- Essentially, it's like this: Imagine a fast sprinter who wins every race. Someone decides it's unfair for him to win so many races because it makes the other sprinters sad, so we force that sprinter to wear ankle weights to slow him down. We make Michael Jordan

use only one hand; we tell Jerry Rice he's only allowed to score one touchdown per game. We make Roger Clemons pitch from a lower pitcher's mound.

This burns liberals up. Ultimately liberals argue this: Without competition and winners and losers, you will not have economic growth; you will not have innovation; you will not have progress. If Foreign Chalk Co. is punished because it is winning, then why should it or any other company try to win? If Richmond Chalk is rewarded for losing, then why not continue to lose; save the effort and it will still be rewarded.

Here's what liberals want to happen. Richmond Chalk and Foreign Chalk compete. Foreign sells at $90; Richmond sells at $100. So Richmond can do several things. It can quit the chalk business and maybe go into erasers, or it can change the way it does things. Maybe it automates and makes the same amount of chalk with 20% fewer workers and it can sell for $88 per box. Maybe it simply cuts salaries to make it to $88 per box and the employees are happy because a pay cut is better than a layoff. So maybe Foreign Chalk responds by going to $87 a box and then Richmond Chalk goes to $85, then Foreign Chalk goes to $83 and Richmond goes to $82. Then they can't cut prices anymore so they try another tack. Maybe Richmond uses research and development and comes up with dustless chalk and colored chalk and maybe dry erase markers and sells them for over $100 per box.

In this situation you can get innovation and excellence and a cut in prices. Competition creates new ideas and new things for consumers. And here the consumer is king. Getting better products for lower prices is the goal. It doesn't sound like a big deal, but imagine we're talking about building safer cars or developing new medicines or better engines that reduce pollution or save travel time. Then competition starts to benefit people in a big way. Think of it this way: would we have cell phones and computers and new Windows operating systems every few years if the companies in the telecommunications and computer industries didn't feel the need to compete with each other for our business? Probably not.

Quotas do the same thing in a bit different way. Let's say that in the US there are 1 million boxes of chalk sold annually (I'm just making a number up; I have no idea how much chalk is sold in the US). The US government might decide that of those 1million, only 100,000 can be boxes of chalk made outside the US. This saves Richmond Chalk's market share another way. Non-Tariff barriers are ways of keeping out foreign products through other means. For example, the US government could declare that foreign chalk has carcinogens in it or does not meet some new US-government standard imposed just to keep out foreign chalk. There are also outright bans – simply saying that a foreign product cannot be sold in the US.

Nations around the world do all of these things and liberals generally hate them because they impede economic growth; they discourage excellence and innovation; they make consumers pay more for inferior products.

What liberals want is this: all economic decisions should be made by the marketplace – the free market. Get the government out of foreign trade (and the domestic economy) as much as you can. Then winners and losers in the economy are not decided by the government, but by the market – the aggregate decisions of consumers, sometimes called the "invisible hand." What does this mean? People like Coke better than Pepsi. Who knows why, but they do. That's the market decided. The sum of all the decisions made by consumers is the marketplace, the invisible hand. In this case the marketplace has decided that that it will buy more Coke than Pepsi. In 1985 Coke tried to change its formula – New Coke. The invisible hand slapped the company around. People wanted the old formula. Coke had to choose – go out of business or change back to the old formula. Coke changed back. Consumers won the argument. People don't buy plaid cars; people don't wear hats anymore to work; few people listen to jazz. Why? Who knows? The important thing here is that it is the decision of the consumers when you add up all their choices and that is the market and a free market creates growth and wealth. It creates growth and wealth because it gives the people what they want and forces companies to compete to find new ways of satisfying the needs of the people.

Liberals argue that along with innovation you get a division of labor. Everyone finds a niche to make a living. If you lose one competition, you move on to compete in a new arena. You specialize. So the US, with its huge amount of land and great soil, has the largest food companies in the world. Saudi Arabia has oil, so its companies produce oil. Japanese and South Korean companies go into shipbuilding. Chinese companies make inexpensive, labor intensive products because China has an abundance of people. This is called comparative advantage. You find your niche – what you can excel in --- and you do it.

Multi-National Corporations (MNCs, sometimes called Transnational Corporations – TNCs)

The world now has a global marketplace. Much of what you will read is based on that idea. Within this global marketplace are MNCs – large corporations that operate all around the world. They are present everywhere. For example, you can buy a Coke in just about every place in the world. And little slimy McDonald's burgers infest just about every nation in the world. Exxon is everywhere. So are Toyota, Honda, British Petroleum, and General Motors. About 90% of the taxis in Shanghai, China are Volkswagens because VW has a plant there. The majority of taxis in Beijing, China are Hyundai's because Hyundai has a plant there. Hyundai is South Korean; VW is German. Also, this is not new. Shell Oil is not an American company; it's

Dutch. Nestlé's is Swiss; Siemens is German. Bayer is German. And these companies have been in the US so long they are as American as French Fries!

More recently, there is something besides MNCs that runs the world economy. Products are losing their nationalities. Something you buy on a shelf or a showroom may have been made by five, ten, fifteen different companies based in five, ten, fifteen different nations. Companies from all over the world work together to produce a product. They don't care about where the company is based; they care about skills, quality, and cost. Look around your house or apartment and see where things were made. Call up Dell customer service and you are likely to be talking to someone in India. Much of the medical transcription business – the business of taking medical records dictated by a doctor and typing them up – is based in the Philippines. The doctor's office e-mails the audio file to the Philippines at the end of the work day. Overnight a Filipino company types them up and they are e-mailed back to the US for the start of the next business day.

Liberals think this is a good thing.   MNCs spread wealth and technology and jobs around the world.