Quiz #3

• Trade barriers usually reflect domestic concerns (T/F)

• The Stolper-Samuelson theorem says that:  a.) protection benefits the scarce factor of production b.) protection benefits the abundant factor of production, c.) protection benefits the rich, d.) protection is a net drag on the world economy.

• What does GATT stand for?:  a.) Grande Administration of Taxes and Tariffs, b.) Great Advance in Terms and Transfers, c.) General Agreement on Tariffs and Trade, d.) Get Another Tax system Today
International Political Economy

Trade, Money, & Power

Erik Gartzke

UCSD

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Fundamentals of IPE

- Basic Issues of IPE
- Three Traditional Perspectives of IPE
  - Realist Perspective (Mercantilism)
  - Liberal Perspective
  - Historical Structuralist Perspective (Marxism)
- Comparative Advantage
- Two (Ricardian) Models of Comparative Advantage
- Extensions of Comparative Advantage
- Summary
Basic Issues of IPE
What is to be explained?

• International Political Economy (IPE) is the nexus of politics and economics in the setting of international relations

• Politics involves competition
  Issues become “political” when some will benefit and others lose, or when benefits only possible through collective action

• Economics is fundamentally about cooperation
  Exchanges occur when 2 or more actors bargain over goods/services/conditions that can be owned, denied, and traded

  Markets imply that both parties in an exchange are made better off by engaging in the exchange

  • Else, why participate in the exchange?
  • Assumes no coercion
  • May be less applicable in some contexts
Basic Issues of IPE

Basic logic of the market metaphor
IPE involves accounting for violations of basic logic of the market metaphor

• Markets often fail to materialize for certain goods
  Role of states in the provision of public goods
  Prominence of public goods in politics
    • Environment
    • Peace/stability
• States intervene to obstruct international markets
  Aggregate social welfare ≠ “national interest”
  Political objectives may trump economic goals
• Trend has been toward less gov. intervention
  At the same time that economics is becoming more important to international relations, politics is arguably becoming less important
  Shift in relative power of states and markets has important implications for future of IR
Three Traditional Perspectives of IPE

The Realist Perspective (Mercantilism)

- Role of state power in obtaining advantageous trading arrangements
- Argues that states seek relative gains through exports/monetary policy, minimize imports.
- Overview of realist perspective:
  Also called Mercantilism
  First important IPE perspective
  Developed with rise of nation-states in Europe
  - Further developed in response to liberal or structuralist challenges (neomercantilism)
  - Name of historical period when European powers colonized much of “New World”

Mercantilism argues that states seek, or that they should seek, economic surpluses

Politics uses markets for resources to compete

- Intellectual Roots
  Alexander Hamilton, commissioned by first US Congress to make a “Report of Manufactures.”
Three Traditional Perspectives of IPE

“It is well known... that certain nations grant bounties on the exportation of particular commodities, to enable their own workmen to undersell and supplant all competitors in the countries to which those commodities are sent. Hence the undertakers of a new manufacture have to contend not only with the natural disadvantages of a new undertaking, but with the gratuities and remunerations which other governments bestow. To be enabled to contend with success, it is evident that the interference and aid of their own government are indispensable.”

Alexander Hamilton

“Infant industry hypothesis”

- States with new industries must subsidize them so that they can compete globally

Realist IPE refers to Nationalism, patriotism

- focuses on conflictual side of human nature

Economic power involves manufactures

- Seek gain from goods with value added
Three Traditional Perspectives of IPE

- History of Mercantilism (16th to 18th centuries)
  
  Rise of nation-state system [monopoly on use of force, sovereignty, anarchic interstate system]

  Commerce as vehicle to enrich state coffers

  Decline of mercantilist period coincides with
  
  - English hegemony
  
  - Industrial revolution
  
  - Weakening of absolute power of monarchs.

  Economic Nationalism (buy American)

  Neomercantilism
  
  - Competing economic/political objectives of cold war. (Trading with the enemy.)

- Realism

  Competition: Zero sum – leads states to be concerned with relative gains

  Preeminence of the state

  International anarchy
Three Traditional Perspectives of IPE

The Liberal Perspective

- Emphasizes the role of markets in maximizing aggregate social welfare

- Argues that surpluses do not exist over time

  Seeking surpluses interferes with efficient production/consumption, stifling welfare.

- Overview of liberal perspective:

  “Liberal” refers to 19th century English political movement favoring “Laissez-Faire” economics like Libertarians, some Republicans in US today

  “Laissez-Faire” means “let do”

  - Refers to belief that government should not “interfere” in the market.

Associated with classical economic theory (Smith, Ricardo, John Maynard Keynes, etc.)

Adam Smith regarded as father of liberal theory

- *The Wealth of Nations* (1776) widely read

- Notion of “invisible hand” serving to self-regulate markets is drawn from Smith.
Three Traditional Perspectives of IPE

Classical liberals were not fond of the state.

- See states as a meddlesome entity
- Of course, this was the mercantilist state

Movement to liberalize national, regional, world economy after collapse of Soviet bloc lead some to argue liberalism is predominant philosophy

- others point to its shortcomings

Intellectual Roots

Focuses on cooperative side of human nature

Central idea of liberalism

- Individuals, left to their own devices, tend to arrive at best solutions to their problems

“He generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it. By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its own produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote the end which was no part of his intention”

Adam Smith
Three Traditional Perspectives of IPE

Liberal view of International Relations

- Emphasize chance for cooperative, peaceful, constructive interaction
- Trade is seen as mutually beneficial
- Ex: David Ricardo (Corn Laws):

"Under a system of perfectly free commerce, each country naturally devotes its capital and labor to such employments as are most beneficial to each. The pursuit of individual advantage is admirably connected with the universal good of the whole. By stimulating industry, by rewarding ingenuity, and by using most efficaciously the peculiar powers bestowed by nature, it distributes labor most effectively and most economically: while, by increasing the general mass of productions, it diffuses general benefit, and binds together, by one common tie of interest and intercourse, the universal society of nations throughout the civilized world" — David Ricardo

- Liberalism

Cooperation: Non-zero sum – absolute gains
Joint market/state, market increasingly important
International hierarchy (hegemon, norm/regimes)
Three Traditional Perspectives of IPE

The Historical Structuralist Perspective

- Emphasizes inequality among states and between economic classes within states
- Structuralists argue that markets perpetuate status quo by advantaging holders of capital
- Overview of structuralist perspective:
  
  Also referred to as Radicalism, Dependency Theory, Dependencia
  
  Heterogeneous body of theory united by ideas of class struggle, exploitation, imperialism, and effects of unequal technological change
  
  Underlying ideas (2)
  
  - The economic structure of things (IPE) conditions outcomes (determinism)
  - Contradictions in structure of things induces a struggle and conflict (dialectic)

- Intellectual Roots

  Originates in the writings of Karl Marx, though most of his ideas focused within the state

  Hobson, then V.I. Lenin expand Marxism to address the role of late 19th century imperialism
Three Traditional Perspectives of IPE

Work during post-WWII period focuses on legacy, residuals, of imperialism

- Dependency theory interested in relative stagnancy of third world economies

Post cold war work attempts to reconcile collapse of Soviet system, resurrect theory to address/remedy global inequality

Structuralist theories offer a means of recourse for groups and states that have failed to benefit from structure of the international economy

Structuralists identify shortcomings that mercantilist/liberalist perspectives ignore

- Structuralism

Class competition: Zero sum – relative gains

Class predominates, but elites use market to acquire/maintain power, subjugate proletariat

International hierarchy (north vs. south)
Comparative Advantage

Comparative advantage is the most important concept in the PE of trade

Rests on the idea of “gains from trade”

• As long as 2 states differ in relative productivity of at least 2 goods within their economies…

  It makes sense for states to specialize and trade

  Comparative advantage also tells us in which good each state should specialize

• Simple Ricardian model illustrates concept of comparative advantage

• Must first define a couple of terms…

  Efficient Production when it is impossible to increase production of a good without reducing output of some other good.

  Opportunity Cost amount of some other good that is lost in order to obtain unit of given good
Comparative Advantage

Marginal Rate of Transformation (MRT) amount of one good not produced to produce a given amount of another good

Relative Prices the price of a good in terms of other goods (the barter price)

Comparative Advantage A country is said to have the comparative advantage in the good for which it has a lower relative price (lower opportunity cost or MRT).

Implication: countries are better off specializing in the production of the good for which they have comparative advantage and then trading for the “basket” of goods they consume
## Two (Ricardian) Models of Comparative Advantage

### Example 1: The Ricardian Model

**Ricardian Model: Labor Required in Each Country to Produce One Unit of Each Good**

<table>
<thead>
<tr>
<th></th>
<th>Cuckoo Clocks</th>
<th>Kuala Bears (stuffed toys)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>Austria</td>
<td>1</td>
<td>1</td>
</tr>
</tbody>
</table>

**Autarky no international trade.**

Australia: 800 units of labor
Austria: 400 units of labor

**Ricardian Model: AUTARCHY (50/50)**

<table>
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<tbody>
<tr>
<td>Australia</td>
<td>100</td>
<td>200</td>
</tr>
<tr>
<td>Austria</td>
<td>200</td>
<td>200</td>
</tr>
<tr>
<td>World</td>
<td>300</td>
<td>400</td>
</tr>
</tbody>
</table>
Two (Ricardian) Models of Comparative Advantage

Example 1: The Ricardian Model, continued…

Ricardian Model: FREE TRADE (100)

<table>
<thead>
<tr>
<th></th>
<th>Cuckoo Clocks</th>
<th>Kuala Bears (stuffed toys)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Australia</strong></td>
<td>150</td>
<td>200(400)</td>
</tr>
<tr>
<td><strong>Austria</strong></td>
<td>250(400)</td>
<td>200</td>
</tr>
<tr>
<td><strong>World</strong></td>
<td>400</td>
<td>400</td>
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Ricardian Model: Gains from Trade

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<tbody>
<tr>
<td><strong>Australia</strong></td>
<td>-1</td>
<td>+2</td>
</tr>
<tr>
<td><strong>Austria</strong></td>
<td>+2</td>
<td>-2</td>
</tr>
<tr>
<td><strong>World</strong></td>
<td>+1</td>
<td>+0</td>
</tr>
</tbody>
</table>
Two (Ricardian) Models of Comparative Advantage

Example 2: The Ricardian Model

Ricardian Model: Units of Good Each Country Produces with One Unit of Labor

<table>
<thead>
<tr>
<th></th>
<th>Airplanes</th>
<th>Automobiles</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>2</td>
<td>6</td>
</tr>
<tr>
<td>United States</td>
<td>1</td>
<td>2</td>
</tr>
</tbody>
</table>

Each country has 200 workers

Ricardian Model: AUTARCHY (50%/50%)

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</thead>
<tbody>
<tr>
<td>Japan (100, 100)</td>
<td>200</td>
<td>600</td>
</tr>
<tr>
<td>U.S. (100, 100)</td>
<td>100</td>
<td>200</td>
</tr>
<tr>
<td>World</td>
<td>300</td>
<td>800</td>
</tr>
</tbody>
</table>
Two (Ricardian) Models of Comparative Advantage

Production Possibilities for the United States
Two (Ricardian) Models of Comparative Advantage

Production Possibilities for Japan

```
p = 3
```

```
Autos

1200

0

Japan
```

```
Airplanes

400

20
```
## Two (Ricardian) Models of Comparative Advantage

### Example 2: The Ricardian Model, continued…

### Ricardian Model: FREE TRADE

<table>
<thead>
<tr>
<th></th>
<th>Airplanes</th>
<th>Automobiles</th>
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</thead>
<tbody>
<tr>
<td>Japan (50, 150)</td>
<td>100</td>
<td>900</td>
</tr>
<tr>
<td>U.S. (200, 0)</td>
<td>200</td>
<td>0</td>
</tr>
<tr>
<td>World</td>
<td>300</td>
<td>900</td>
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### Ricardian Model: Gains from Trade

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<td>600 (900)</td>
</tr>
<tr>
<td>U.S. (200, 0)</td>
<td>100 (200)</td>
<td>300 (0) [+100]</td>
</tr>
<tr>
<td>World</td>
<td>300</td>
<td>900</td>
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Extensions of Comparative Advantage

Heckscher-Ohlin A country has a comparative advantage in the good that is relatively intensive in the use of the country’s relatively abundant factor.

Factor-Price Equalization Theorem Free trade between two countries will tend to cause factor prices in countries to equalize.

Stolper-Samuelson Theorem Free trade tends to raise wages in the labor abundant country (and lower the rent on capital) while lowering wages in the labor scarce country (and raising the rent on capital).

- Economic Implication: The scarce factor is made worse off under free trade.
- Political Implication: The scarce factor should seek barriers to free trade.
Extensions of Comparative Advantage

So, if there are at least two factors (inputs)
And if the factors are held by different people in a country
Then comparative advantage:
  • While it benefits the society as a whole
  • Does so by benefiting holders of the abundant factor at the expense of the minority factor.

Have a situation in which domestic political forces can explain state behavior that differs from predictions of comparative advantage
  • Holders of scarce factors seek protection

Need explanation for how economic incentives to seek protection are realized as political acts
  • This brings in domestic politics
Extensions of Comparative Advantage

• **Terms of Trade**: Relationship between prices of state’s imports and exports

  Nations face declining terms of trade when import prices rise faster than export prices

  Rising terms of trade occur when relative export prices grow faster

• **Trade Policy**: Intent behind regulations/laws of a state toward international trade

  Trade policy is a function of government ability to dictate terms on which goods and services are permitted to cross border (either direction)

  Can include factors like tariffs, quotas, export subsidies, environmental regulations, free trade agreements, favored nation status, etc.

The motives for protection

• States may seek to use trade policy to alter the terms of trade

• Yet, as we shall see, liberalism claims that no long-term shift in the terms of trade is possible

  States cannot raise the price of exports without ultimately altering exchange rate of currencies
Summary

Three traditional perspectives on IPE

- Realism (mercantilism)
- Liberalism
- Structuralism (Marxism)

Three traditional perspectives parallel discussion of structural approaches in the Bueno de Mesquita textbook

Comparative advantage in fundamental insight about IPE

- Emphasizes the role of different relative costs in promoting trade
  - State with absolute disadvantage in no good has comparative advantage in some good

Presence of comparative advantage does not preclude incentives to block free trade – engage in protection

Stolper-Samuelson says that scarce factors prefer to seek protection