Bankers Trust Company
Country Assessment
International Economics
280 Park Avenue, New York, N.Y. 10017 U.S.A.

THE GLOBAL POLITICAL ECONOMY

A COURSE OUTLINE

William H. Overholt
Vice President
Head, Political Assessment Group

PAG 61/1-D 10 August 1981

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The global political economy has four principal aspects: relations among the industrial democracies; relations between North and South; relations between East and West; and relations between oil producers and non-oil producers. The situation of the industrial democracies comprises both general stagflation of the domestic economies and trade problems. This review will neglect East-West trade issues, which have been covered elsewhere.

North-South Relationships

Following the OPEC oil crisis, and the dramatic subsequent rise in oil prices, relations between North and South took on far greater visibility as a central issue of world politics. There had long been concern in the North, expressed by aid and other measures, for the fate of the south. There had long been efforts to organize the south for effective political and economic action. But these efforts became much stronger after 1973.

The central demands of the South were expressed in the classic demand for a New International Economic Order:

Reading: United Nations General Assembly Resolutions 3201 (S-VI) and 3202 (S-VI), May 1, 1974

This document, and others sponsored by the Group of 77, demanded:

Higher commodity prices based on cartels;

A Common Fund for commodities;

Improved terms of trade and market access for developing nations;

Expanded Third World control of the shipping and insurance industries;

Reduction of the debt burden of Third World countries;

Transfer of modern technologies to developing countries;

measures to enhance Third World countries' control over their raw materials;

Other ways to reduce the roles and power of multinational corporations.

The Third World movement has also sought to promote universal access to the profits of seabed mining through the Law of the Seas conference, and enhanced Third World control of global information networks through a New International Information Order.

In general, these World demands focus on confronationist attitudes with the North; reduction of the roles of multinational corporation; demand priority for physical resource issues, such as raw material prices and cartel arrangements, rather than on human resources; emphasize Northern barriers to technology transfer rather than Southern absorptive capacities; and emphasize reduction of the debt burden of the South by the North rather than growing access to world capital markets and mutual needs for recycling. They press for independence rather than interdependence, a natural post-colonial reaction. In this and other ways their central demands are political even more than economic: power through cartels, power relative to multinational corporations; power over global information media; access to trade and monetary negotiations.

Most southern hopes have foundered:

The efforts to form cartels have virtually all failed, and it has become increasingly clear that even OPEC is a market leader rather than a successful cartel.

Efforts to create a Common Fund have converged on cosmetic versions.

The North has been unwilling to grant the South access to the major trade negotiations, on the grounds that those negotiations are already so unwieldy as to jeopardize the prospects of success.

Demands for a new information order have met strong resistance.

Demands for cancellation of debts have been rejected by the rich countries, aside from traditional gestures of charity to a few of the poorest countries, not only by the rich countries but also by the most powerful of the developing nations.

All the indicators of North-South interdependence continue to become stronger.

In virtually every major region of the world, the roles of the multinational corporations are expanding, and Third World countries are becoming less stringent in their control of multinational corporations even as they increasingly denounce them.

The principal reasons adduced by Third World spokesmen for these results are the tight-fistedness of the industrial democracies, and the enhancement of that tight-fistedness by difficult economic conditions throughout the OECD world. These arguments are basically true. Everywhere, parliaments composed of local regions' representatives, who have to explain to their constituents why local programs are being cut back, find it hard to vote for increased aid budgets, for reduced trade barriers which may raise unemployment, and for higher raw materials prices which may accelerate inflation.

However, there are also more fundamental reasons:

Extremely powerful market forces have destroyed cartels even where North and South collaborated to form the cartels. A frost in Brazil can send coffee prices shooting through an agreed ceiling, and overproduction of tea can destroy the possibility of creating an agreed floor. Even the central model for Third World cartels, OPEC, has developed feet of clay (see discussion of OPEC later).

Many of the Third World's demands are not in the best interests of those countries which would be most affected by successful implementation of Group of 77 demands. Most notably, those countries which hold most of the Third World's debt (Brazil, Mexico, South Korea, several other Asian countries) have enormously successful economic growth programs which are based on continued access to commercial banking systems. They borrow money to purchase technology, use the technology to raise productivity, then use the enhanced productivity to repay the loans and raise living standards. These countries are intensely aware of this growth-creating cycle and do not, under any circumstances, want it disrupted by debt cancellation programs which would reduce their access to international financial markets. Hence the largest and most successful Third World economies, which hold perhaps three quarters of total Third World debt, oppose the Group of 77 program.

Reading: "The Global Political Economy," by William H. Overholt, sections on, North-South issues.

Despite the failure of the major NIEO programs, the Third World has enjoyed substantial economic successes in the last decade. Third World growth rates have been substantially higher than the historic growth rates of the countries which led the world's industrialization, Britain and the U.S., and these historically high growth rates have affected a geographic area and a population (about two billion people) unprecedented in world history. The basket cases, namely large parts of South Asia and Africa, which have remained at subsistence levels domestically and on the verge of bankruptcy internationally, are the exception not the rule.

One group of countries, which has come to be labelled the New Industrial Countries or NICs, has been particularly successful. These countries have generally been more export oriented and more market guided than their neighbors, although there are wide differences among their policies. They have played an increasing role in development theory, a central role in American foreign policy, and a blocking role in the NIEO negotiations.

Readings: Anne O. Krueger, "The Newly Industrializing Countries; Lessons and Experience," prepared for the Congressional Research Service, "An International Economic Agenda; Major Issues for the 97th Congress," November 1980.

Young W. Kihl, "Trade Expansion by the ADCs (Advanced Developing Countries) or the NICs (Newly Industrializing Countries): Problems and Prospects," prepared for panel on "Comparative Trade Policies and Politics" at the 22nd Annual Convention of the International Studies Association, Benjamin Franklin Hotel, Philadelphia, March 17-20, 1981.

For a series of reasons, while the long run success of the NICs' overall approach to development appears assured, they have as a group faced political-economic difficulties of unusual magnitude as they entered the 1980's. (See Overholt,"Global-Political Economy.")

The most successful group of countries, the Pacific Asian Group from South Korea to Indonesia, has grown at an average rate in excess of seven percent per year. Of these fast-growing countries, those with strong domestic political regimes and commitment to economic development priorities rather than patronage politics (South Korea, Taiwan, and Singapore) have outperformed the industrial democracies and all other groups of Third World countries not only in economic growth but also in income distribution, rapid indigenous acquisition of control over increasingly sophisticated technologies, ability to respond to crises like the oil shock, and ability to chart their own economic future.

Reading: William H. Overholt, "The Rise of the Pacific Basin," Pacific Community, July 1974

Bela Belassa, "The Newly Industrializing Countries After the Oil Crises," World Bank Staff Working Paper No. 437. (This should be skimmed rather than read in detail. The central point is that the more outward-looking, market oriented countries adapt more easily.)

The success of these countries has created a model of outward-oriented, market-oriented growth which is increasingly emulated even by countries whose ideological predispositions are quite different: Sri Lanka, Bangladesh, Zimbabwe, and even, more slowly, Andean Pact countries.

Discussions of North-South Issues have tended to polarize discussion between Northern interests and Southern interests. As a result, the Northern banks and multinational corporations have been treated as peas in a pod. However, a close analysis of North-South economic relations reveals that highly nationalistic countries have often used the banks as the central tool in an effort to keep the multinational corporations at arms' length. In particular, they avoid reliance on multinational corporations by borrowing money from commerical banks to fund state firms; thus capitalist banks have financed the takeover of broad sectors of many Third World economies by Third World governments, shifting ownership from multinational corporations and from the indigenous private sector into the hands of government.

Reading: Jeff Frieden, "Third World Indebted Industrialization: International Finance and State Capitalism in Mexico, Brazil, Algeria, and South Korea," International Organization Volume 35, Number 3 (Summer 1981)

Those countries which have oil to offset their debts have sometimes used this strategy with some success. South Korea, which has pursued a balanced strategy, has ended up dependent on neither multinational corporations nor banks to an extent that seriously compromises its policy autonomy. Brazil, on the other hand, has ended up with an unexpectedly large state sector which has proved difficult for the government to control, and with foreign debt which will total about $70 billion by the end of 1981.

The North-South Political Agenda

The burden of the above arguments is that the South has failed in most of its central economic programs, and has succeeded in its central political thrusts (access to trade negotiations, new information order, Law of the Seas) only where its interests overlapped those of the North. Nonetheless, the economic progress of the South has been remarkable, outside key areas of South Asia and Africa.

The South has, however, achieved other political and ideological successes. In those international forums, largely created at the initiative of the United States after World War II, where numbers of votes are decisive in the decision-making processes, the South has triumphed. The United Nations and its subsidiary organizations are the leading examples. These organizations have been transformed from effective instruments of the U.S. and its allies into instruments of pressure on the U.S. and its allies.

In addition, the South has achieved a degree of moral and ideological unity, and has convinced significant parts of Northern elites, based on theories that the ills of the South are largely the consequences of dependence on the North and its institutions. Poverty, inequality and technological backwardness in particular are laid at the feet of the multinational corporations. Examples like Taiwan and South Korea show that high growth, income distributions more egalitarian than Sweden, and extraordinary technological progress, along with domestic owndership of most of the economy are consistent with, and indeed enhanced by close cooperation with the North and with multinational corporations, so long as the indigenous political elite and government institutions are devoted to these goals and willing to take tough measures to ensure their own integrity. Close inspection of the consequences of following NIEO policies reveals resultant difficulties running all the way from the development failures of states like Zambia to the social failures of Mexico, whose huge unemployment and gaping social inequality result from protectionism that prevents the income-equalizing, employment-raising entrance of labor-intensive foreign firms that occurred in South Korea, Taiwan and Singapore.

An alternative explanation of the social inequality that has occurred in Brazil and other Latin American countries is that local elites, including businessmen and labor elites, have used nationalist arguments to protect inefficient industries, thereby limiting both output and employment at the cost of massive unemployment, and to ensure the continued pursuit of capital-intensive development strategies which create very high incomes for an elite (Brazilian firms pay top executives twice what American firms pay, as does much of the public sector) at the expense of the majority of the population, who are often left at subsistence levels. This is the central difference between the Northeast Asian model of development, which informs the work of a high proportion of economists at international institutions, and the Latin American model of development, which informs almost all _dependencia_ theorists.

There is a third main source of multinational-host country relationships. Countries which possess great raw material wealth, weak political institutions, and weak educational and organizational institutions have a characteristic pattern of development. They focus on natural resource development, which is capital intensive, at the expense of agriculture and light manufacturing. Their corruption and inefficiency deter light manufacturing, which is labor intensive, but do not deter capital-intensive mining investments. Therefore they end up with an enclave economy of great inequality and technological dependence.

Readings on southern goals and their political achievements: Stephen D. Krasner, "Transforming International Regimes: What the Third World Wants and Why," _International Studies Quarterly_, Volume 25, Number 1 (March 1981)

Reading on the Northeast Asian model: William H. Overholt, "The Politics of Korean Development," from Korea case study folder, chapter 2, especially sections on income distribution, 2-57ff.

The Political Economy of OPEC

The success of OPEC as a cartel was the greatest boost to the morale of the NIEO movement in its history. On the other hand, nothing has done greater damage to the Third World's economic prospects than the rising prices of imported oil. Particularly hard hit have been Brazil, India, South Korea, Taiwan, Thailand, and the Philippines.

Reading: Lawrence J. Brainard, "Oil and the OPEC Surplus: New Patterns of Growth and Adjustment in the World Economy," Bankers Trust

Now it is firmly established that OPEC is not a cartel in the strict sense, but a market leader which took advanatage of the emerging imbalance of demand over supply to raise prices in 1973, then suffered declining real prices (i.e., nominal prices minus inflation) until the Iranian revolution once again created a shortage of supply. Now there is a prospect for long-term equilibrium between supply and demand, unless something such as a a revolution in Saudi Arabia or an interdiction of supply lines once again creates an imbalance.

Reading: Herbert Goodman, President of Gulf Trading and Transportation Company, "Energy Outlook - The Global Context," presentation to Asia Society, 28 May 1981.

Barring such contingencies as those mentioned above, the world economy is more than half way through the restructuring necessary to adjust to higher prices and to ensure a long-run supply-demand equilibrium. The mechanisms of adjustment have been financial recycling, acceptance of high prices to stimulate supply and reduce demand, matching of new Middle East demand for imports to Western and LDC capacities for export, and energy diversification. Long term adjustment and equilibrium can be achieved at an early date only if these policies continue to be pursued.

Reading: Hollis B. Chenery, Restructuring the World Economy: Round II," Foreign Affairs, July 1981

West-West I: Stagflation and Political Immobilism

Since the late 1970s, the Western nations have been beset by slow growth, high inflation, and political weakness. These are aspects of a common malaise.

Stagflation has resulted from a combination of convergent trends:

End of the recovery from World War II;

Declining population growth;

Declining military demand in the late 1970s;

Reduced investment caused by inflation;

Diminishing returns to education;

Diminishing returns on the shift from agriculture to industry;

High energy prices;

High environmental protection costs;

A shift of values from growth to health, safety, equity, stability;

Political immobilism.

Simultaneously, the West has been through a period of weak executives (presidents and prime ministers), weak political parties, narrow electoral margins, policy indecision, intellectual exhaustion, factionalism, and inability to implement policies which would exact significant prices from any major social group. More broadly, the political characteristics of the period have been:

Weak government;

Broad social consensus on moderate policies (unlike the last period of political-economic weakness, the 1930s);

Blocking by the moderate consensus and by strong pressure groups of all innovative policies that would be costly to any major group;

A reaction against immobilism and a yearning for strong leadership, with innovative policies, which would attack the political-economic establishment and break the political-economic logjam. This has led to the election of anti-establishment outsiders of both the right and left: Carter, Reagan, Thatcher, Mitterand

<u>Reading:</u> West-West sections of William H. Overholt, "The Global Political Economy"

Western Trade Issues

Among the constants in any nation's political-economic life is the pressure that will come from particular economic interest groups for protection. These demands increase during a time, like the present, when growth has slowed down and when new competitors are shouldering into the economic game. This much is widely understood.

Current forces promoting protectionism go still deeper, however. The key problems are:

1. The different structure of Japan's society, which makes it difficult to structure joint measures which affect all the OECD countries equally.
2. The rapidity of growth and technological change created by the dynamism of the Pacific Basin, which forces countries to run fast if they are to stay in place.
3. The painful changes required by increased energy prices.
4. Today's political immobilism, which makes these adjustments far more difficult than they would have been in earlier years.

A thorough review of these issues would require months, and a thorough case study would be a major discrete exercise. But a good start can be made by reviewing briefly current thought about "structural adjustment" and by looking at Japanese-American trade relations in general and at the automobile case in particular.

The major themes of Japanese-American economic relations are:

1. Japan has taken a long-range view, swimming with the tides of Pacific Basin development, which means for instance knowing when to deliberately phase out of cheap textiles and consumer electronics, while the U.S. has tried to hold back the tide,

protecting obsolescent textile firms and not investing enough to keep up with the pace of technological change and worker retraining.

2. The U.S. has also been slow to adapt to international economic realities. In particular, by holding down domestic energy prices for seven years, the U.S. made it comfortable for Americans to own large cars. Americans therefore insisted on large cars, and American companies were forced to produce them. When U.S. prices finally rose to world levels, American companies, in this area and others, faced a seven-year lag.

3. Similarly, the U.S. has typically been such a large domestic market that U.S. firms focused on that market, exporting a surplus which was not the center of their designing and marketing concern. They have been slow to adapt to a world where exporting can be a life or death issue -- a world Europe and Japan have lived in for a long time.

<u>Readings</u>. Irving Leveson and Jimmy W. Wheeler, <u>Western Economies in Transition</u> (Westview Press, 1980) Chapters One and Two by Robert Hormats and by Wheeler and Leveson.

James Abbeglen, "U.S.-Japan Trade Competition in the 1980s: Changing Context and New Issues," mimeo

Yoshitaka Sajima, "Promotion of U.S. Exports: A Trading Company's Experience," mimeo